proceeds blind to Ameritech's and the other LECs' regulatory obligations will generate market share numbers that are irrelevant and will inevitably lead to wrong conclusions.

To summarize, regulators should adopt measures of competition that respond to the question of whether the incumbent LEC can raise price above competitive levels or restrict output below competitive levels in the specific market being examined. High concentration levels in a market may justify further inquiry, but in no case are they determinative of market power. In addition to current competition, an incumbent's ability and incentive to raise price or restrict output is tied directly to its vulnerability to competitive incursions, a point on which market share reveals very little. At best, market share informs the regulator about the historical capabilities of current marketplace participants. Only a forward looking assessment of competition can adequately assist regulators in determining whether streamlining is warranted.

III. There are a number of factors which should be incorporated into a sound assessment of local telecommunications competition.

The assessment of competitive conditions is important for policy analysis in the telecommunications industry, and I fully support the FCC's emphasis in this regard. However, the various methodologies expounded by the commenters are, at best, poor indicators of competitive conditions as they illuminate only a portion of actual and completely neglect potential competition. Nor do they suggest sensitivity to important qualitative factors which are critical to the assessment of competition. In short, relying on (static) market share statistics or a predefined checklist, while neglecting information which is difficult to gather and assess but which is nevertheless central to the assessment of competitive conditions, will, perhaps inadvertently, support a historical assessment of competition that distorts the new reality. Competition in local telecommunications is fluid and dynamic and cannot be assessed by employing the conceptually flawed, biased and mechanical measurement vehicles offered by the commenters.

A. The necessary first step is to define the relevant product and geographic markets.

A relevant product market in telecommunications should represent a set of offerings in a geographic area for which a hypothetical monopoly supplier of those products would be able to profitably raise price by a small but significant amount. Put more simply, the relevant product market includes those services that are viable substitutes in production or consumption.

The relevant geographic market should be designed to include all suppliers that compete, or could compete (should prices rise), for the business of the same group of customers. Ameritech proposes that the geographic market be defined so as to encompass those contiguous wire centers that, if combined, meet the competitive conditions spelled out in Ameritech's competitive checklist. While this exercise will not, in every case, lead to a precise geographic market definition, it does, in combination with the checklist conditions, provide a framework for the FCC to render economically sound decisions concerning regulatory streamlining. Furthermore, its ease of administration, and the resulting savings, more than offset any additional advantages that a more thorough, but more time-consuming and costly, methodology could deliver.

Any analysis of local competition should only occur after the relevant product and geographic markets have been defined.[26] The importance of market definition cannot be overemphasized. If improperly defined, the entire framework used for regulatory review will be distorted and will accordingly lead to results that fail to promote economic efficiency. Though AT&T and other commenters agree that market definition and the concomitant assessment of market power are a critical first step in reviewing local competition, they do not follow accepted approaches to makret definition and wish to exclude potential competition from the framework.[27]

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[26] AT&T and other commenters echo the importance of relevant market definition. AT&T states that "The need for properly defined geographic markets is crucial ..." (AT&T Comments at p. 12.)

[27] *See, e.g.*, AT&T's Comments at page 14: "... the substitution factor argues strongly for narrow geographic boundaries defined solely by the pervasiveness competition in the proposed market."

Under AT&T's paradigm, the calibration of local competition in Chicago would entirely ignore AT&T's own capacity and quite ambitious plans to compete head to head with Ameritech. Yet the intentions and capabilities of a major industry player such as AT&T is clearly information to which the Commission should assign considerable weight when evaluating local competition. The obvious capabilities of AT&T are an important discipline on the market even before AT&T's tangible presence. Standard antitrust analysis as developed by the Department of Justice and the FTC requires that this be taken into account.

B. Evaluating demand elasticities.

In spite of the commenters' rather strenuous efforts to enshrine market shares of improperly defined markets as the dominant metric, the FCC by this time no doubt recognizes that the measure is fundamentally flawed. Indeed, the Commission has stated:

> "... market share alone is not necessarily a reliable measure of competition, particularly in markets with high supply and demand elasticities."[28]

The true concern of the Commission is market power, that is the ability to raise prices above competitive levels or lower output:

> "... a high market share does not necessarily confer market power. A company that enjoys a high market share will be constrained from raising its prices above cost if the market is characterized by high supply and demand elasticities. We believe that an analysis of the level of competition for LEC services based solely on the LEC's market share at a given point in time would be too static and one-dimensional."[29]

In defining markets and assessing competition, the Commission should commit significant attention to studying buyer options and buyer power. If large customers such as the big three

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[28] FCC Report and order in CC Docket No. 90-132, September 16, 1991 at ¶51.

[29] Second FNPRM at ¶143.

IXCs or the Fortune 500 companies can switch access suppliers, they can wield a tremendous amount of influence in negotiating rates and terms with the LECs. The fact that they don't necessarily elect to move their business to an alternative provider does not indicate that the LEC has market power. It is enough that the LEC stands to lose a substantial chunk of business if it fails to offer attractive terms. In other words, the mere existence of viable alternative suppliers, and buyers' willingness to move business from the LEC, serves to police the conduct of incumbents.

An analysis of buyer power should not confine itself to customers' ability to move traffic to alternative suppliers currently serving the marketplace. The Commission should also recognize that a large customer can sponsor the entry of a CAP if existing alternative providers do not provide acceptable options to LEC services. Under the commenters' approach to evaluating competition, regulatory relief can come only after the LEC loses a number of its large accounts. The irony in this is that the customers opting for service alternatives have not fully benefited from the competitive process, as they were denied the price and service options that the LEC could provide but for the artificial and needless restraints of regulation. In other words, the LEC's lack of flexibility prevented it from responding to competition with potentially more favorable terms. If the conditions for streamlining were oriented toward the future state of competition, this loss of competitive benefits would be avoided.

As is becoming increasingly apparent, the largest LEC customers, namely the IXCs, are positioning themselves as providers of local services. MCI Metro is expected to have fiber optic facilities deployed and functioning in 20 major cities representing 40% of the business access market by the end of 1995. MCI had plans to spend $500 million in 1995 on MCI Metro, with "significant additional investments ... over the next several years."[30] For its part, AT&T plans to

[30] MCI 1994 Annual Report at pp. 3 and 6.

launch a "full-scale attack on all seven of its Bell offspring simultaneously."[31] Not only will the resulting networks provide the IXCs with immediate means to bypass the LECs, but any unused capacity can be sold to other third parties.

C. Evaluating supply elasticities.

One concept for assessing competition is "addressability," which speaks directly to the LEC's ability to raise price or lower output to particular customers, the ultimate concern of regulators. Addressability is a valuable concept because it simultaneously considers the aggregation of customer revenues within a given area and the capacity of competitors to serve those customers. An incumbent faces increasing competitive pressure the greater a competitor's capacity, and the more tightly concentrated are revenues. Price increases or a degradation in service quality can be swiftly exploited by competitors if those competitors possess the wherewithal to immediately serve the disaffected customers.

The addressability concept is similar to that of the "uncommitted entrant" in the 1992 DOJ/FTC Horizontal Merger Guidelines. As explained above, an uncommitted entrant is a firm that is not an actual supplier in a relevant market, but has capacity in place that can be used to serve demand in that market with little additional sunk expenditures. The Guidelines treat an uncommitted entrant as if it were an actual supplier in the estimation of market shares. For purposes of evaluating streamlining requests, the Commission should likewise actively consider the competitive pressure brought to bear by those entities able to address a meaningful portion of the LEC's revenue base.

It is universally accepted that entry conditions are critical to the state of competition and to the assessment of market concentration. If entry barriers are low, new entry, or merely the expectation thereof, will force the incumbent to continuously seek out efficiency enhancing

[31] Wall Street Journal, December 5, 1995 at p. A3.

improvements and to undertake the development and introduction of new products and services. In order to develop a comprehensive evaluation of local competition, it is critical that regulators assess entry conditions and the corresponding effects on competitive activity.

Ameritech's Customers First Plan, and its provisions for unbundling, interconnection and reciprocal compensation, dramatically lower, if not eliminate, barriers to entry into the local exchange and enables would-be competitors to take advantage of Ameritech's economies of scale and scope. Similar activities are now being undertaken in other states and regions, including New York and California. A methodology focusing exclusively on actual marketplace rivals and facilities-based provision of services cannot possibly capture the competitive effects of unbundling.[32] The fact that firms can enter the local exchange with little investment and target the most lucrative segments of telecommunications buyers clearly indicates a highly competitive local telecommunications marketplace. Put differently, the historical focus of a quantitative assessment of actual competition will reveal very little about evolving competition. With unbundling in place, market concentration means nothing as entry barriers virtually disappear.

When reviewing entry conditions, the Commission should also be prepared to address the panoply of emerging technologies that provide existing and potential competitors with novel ways to compete for local exchange business. The digitization of switching and transmission, the deployment of satellite and terrestrial wireless networks and fiber optic cable systems, the use of high-powered computers for network management control, and many other technological advances greatly reduce the importance of incumbents' existing capital stock, since new entrants can employ the optimal technology available at the time of their entry. Once again, a snapshot of technology deployment is obsolete before it can ever be considered and incorporated into the policymaking process. In order to fully appreciate the importance of various technologies, the

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[32] *See, e.g.*, the Comments of Time Warner Communications Holding, Inc. at p. 26.

Commission must be forward thinking and consider the structural ramifications of emerging modes of service delivery.

The number and type of potential entrants is another factor that regulators should spend considerable time and effort evaluating. In the view of the commenters, such inquiries are too speculative to benefit the investigation of local competition, but in reality, an evaluation of local competition that ignores potential entry does not begin to provide a reliable basis upon which to make decisions concerning regulatory relaxation. To understand the enormity of the distortion created by the omission of potential entry, one need only consider the recent AT&T announcement of its intention to "...wage a broad-based battle to connect directly to local phone customers and offer local, long-distance and wireless services."[33] AT&T reportedly has more than 100 local switches already handling some traffic, and "[p]eople inside AT&T say the company plans a massive first strike against the Bells, hoping to penetrate all 50 states with a special bundle of services."[34]

The preceding passage on AT&T's plans is suggestive in a couple of respects. Because AT&T's plans are, by definition, prospective, the commenters' proposed tests would miss it altogether. Furthermore, even if the Commission were to acknowledge AT&T's plans to enter as a local exchange competitor, there is nothing in the commenters' proposed methodologies that takes account of the breadth of products that AT&T hopes to offer. Because AT&T is likely to enter as an integrated provider of local, long-distance and wireless services, the company has the ability to offer an entire portfolio of unique service and pricing combinations that appeal to select consumer groups.[35]

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[33] "AT&T Vows Battle to Offer Local Service," Wall Street Journal, October 27, 1995 at p. A3.

[34] "AT&T Eagerly Plots A Strategy to Gobble Local Phone Business," Wall Street Journal, August 21, 1995.

[35] MCI points out the advantages of being an integrated provider in its Comments. "Without the ability to provide the full range of services offered by the LEC -- local service, intrastate access, and interstate access -- new entrants will be less likely to achieve the scale and scope economies to compete against the LECs." (MCI Comments at p. (footnote continued)

Telecommunications services are characterized by concentrated pockets of demand, an attribute which lends itself to the self-supply of services. Self suppliers deploying private networks offer significant competition to the LEC both through bypassing the public switched network and making spare capacity on their private networks available to other third parties. According to a European Commission estimate, there are more than 700,000 privately owned telecommunications networks in the United States.[36]

Satellite-based transactions processing systems using Very Small Aperture Terminal (VSAT) technology represent one important form of private network competition. Unocal Corp. and Chevron Corp. are using VSAT networks for communications among retail stations and credit card authorization, while Toyota Motor Sales USA uses VSAT for communications among offices and dealers around the country.[37] The number of VSAT systems has increased markedly in recent years, and ongoing innovations in satellite technology will continue to drive costs down.[38] In most cases, VSAT users are able to forego subscribing with the LEC for additional access lines and instead opt to employ satellite technology to meet their transactions processing needs.

Gas and electric utilities offer yet another source of bypass, as they have thousands of miles of fiber optic cable already in place to meet their own communications needs. Many of

(footnote continued)

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22) Of course, Ameritech and the other LECs are still not permitted to offer long-distance service, and any IXC or other entrant wishing to achieve economies of scale and scope similar to the LEC can take advantage of the unbundling and resale provisions available in the Illinois, Michigan and other states.

[36] "Survey of Telecommunications: The Death of Distance," *The Economist*, October 6, 1995, p. 8.

[37] "Local Oil Companies Gaze Skyward to Boost Corporate Communications," *Los Angeles Business Journal*, August 15, 1994.

[38] The digitization of satellite communications will generate huge increases in transmission capacity and large decreases in costs and prices. Data compression technologies will further reduce the effective cost of satellite communications. The miniaturization of electronic components and improvements in signaling processing capabilities are enabling users to employ much smaller satellite dishes.

these companies are now leasing conduit and excess fiber capacity to CAPs and IXCs.[39] Utility companies are experimenting with methods to use their fiber backbones in combination with existing cable operators such as TCI or new wireless distribution networks to provide Advanced Energy Management Systems (AEMS) to electricity customers.[40]

The existence and growing deployment of private networks highlight a couple of important points. First, the implications for supply elasticity are clear, as the greater availability of private networks, both for the owners' own use and for the leasing of spare capacity to third parties, places pressure on the incumbent LEC to keep service quality and prices at competitive levels. Second, private networks are not subject to reporting requirements and there exists no straightforward method for incorporating their pervasiveness into an analysis of local competition. This is perhaps not of grave concern unless one of the market share tests being advocated by the commenters in this proceeding is adopted. The mere existence of private networks guarantees that the incumbent LEC's share will be overstated, which means that regulatory oversight will be maintained even though market conditions warrant relaxation.

D. In the end, streamlining decisions must be made on a case-by-case basis.

Even though there are factors that regulators should consider regardless of the product and geographic markets under study, there exists no formula or set of guidelines that can accurately depict the state of local competition across all circumstances. On this point, AT&T has previously stated that "... different access components face different levels of competition at different times and in different places."[41] As AT&T correctly recognizes, local competition is

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[39] "Check Out These Potentially Lucrative Utility Fiber Plans," *Fiber Optics News*, April 4, 1994.

[40] "SOCAL Ed to test interactive TV Link to Let Customers Manage Energy Use," *Electric Utility Week's Demand-Side Report*, February 2, 1995.

[41] Comments of AT&T Corp. in the Second FNPRM, at p. 10.

driven by a number of factors that are necessarily individual to a market and that cannot be fairly captured with unconditional analyses.

The Commission should adopt a methodology for evaluating local competition which recognizes that demand and supply conditions are necessarily specific to relevant product and geographic markets. While competitive checklists and other predefined conditions are not rendered useless under such an approach, their role, as Ameritech clearly recognizes, should be viewed as an indicator, and not as a determinant, of the state of competition. A checklist can serve as a safe harbor and an easily administered method for ruling on streamlining requests, but the Commission should remain open to incumbents presenting additional qualitative factors that bear directly on the evaluation of local competition.

IV. Conclusion

When weighing a LEC's request for streamlined regulatory treatment, the Commission should conduct an assessment of local competition that is forward looking and reflects the dynamic and ever evolving nature of the telecommunications industry. Just as a corridor snapshot of a highway right after an earthquake reveals nothing about the speed, direction or ultimate destination of traffic and drivers on the ramps, a snapshot of local telecommunications competition does little to inform the regulator about future competitive developments that sharply impact the conduct and incentives of today's competitors. Policymakers need to widen the aperture of their analytical frameworks to take account of the organizational arrangements and developing technologies that are now shaping competition. Commenters' near obsession with static approaches such as market share tests are ill-suited for calibrating local competition and fashioning economically efficient decisions regarding the relaxation of regulatory constraints. If adopted, such approaches will slow the competitive evolution of the market and will unnecessarily tax consumers with no recognizable offsetting benefits whatsoever. Likewise, competitive

checklists that are so onerous as to preclude the flexibility to authorize streamlining when competitive conditions are sufficient only serve to stymie competitive developments and the concomitant consumer benefits that would materialize in the face of unfettered competition.

CERTIFICATE OF SERVICE

I, Deborah L. Simmons do hereby certify that a copy of the foregoing Reply Comments of Ameritech has been served on the parties listed on the attached service list, by first class mail, postage prepaid, on this 11th day of January 1996.

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