

costs. ARPM is just the right way to analyze the price-cost margin. The resulting margin is so low that the proper conclusion is that the market is highly competitive.

c) *Mix effects*

A mix effect would distort average revenue per minute if the composition of long-distance sales shifted toward products that are cheaper to produce, such as calls at night. The mix effects that Professor MacAvoy fears are tiny in comparison to the error made by using list prices in place of actual prices. Today, the prices of long distance do not depend on the length of the call at all and are insensitive to distance—AT&T's discounted evening rate from California to New York is 10.4 cents per minute and to Minnesota is 9.8 cents per minute, for example. The only mix effect that could possibly matter would be between day and night calls. In order to explain the dramatic decline in revenue per minute as a mix effect, there would have had to have been a tremendous shift from daytime to nighttime calls. There is no evidence that this has happened. Rather revenue per minute has fallen so much in relation to list prices because discounts are much larger and more widespread. 1996 data show that nearly 80 percent of MCI's residential consumers subscribe to a discount plan. And, as I mentioned earlier, the omission of discounts from the Consumer Price Index is in the process of correction by the Bureau of Labor Statistics.

5. Studies by Professors Douglas Bernheim and Robert Willig

Professor MacAvoy's *Affidavit* criticizes material presented by Professors Bernheim and Willig in their December 1994 affidavit. Incredibly, he does not mention any of the replies they made to earlier, similar criticisms in their affidavit in August 1995.¹² Pages 112 through 159 of their reply affidavit dispose of all of MacAvoy's criticism, yet he pretends that they never replied at all.

In their earlier critique of MacAvoy's analysis of price-cost margins, Professors Bernheim and Willig pointed out that strict marginal-cost pricing is an irrelevant standard for judging long distance, because marginal cost falls short of average cost, so if price is at marginal cost, firms are incurring losses. They pointed out that the appropriate standard is average cost. They mentioned that the theory of contestable markets provides a better way to

¹² *Reply Affidavit of B. Douglas Bernheim and Robert D. Willig*, August 27, 1995, Civil Action No. 82-0192.

consider the state of competition when there are fixed costs. MacAvoy disputes the contestability of long distance.¹³ He notes that two criteria for a perfectly contestable market are the absence of sunk costs and the ability to attract customers before rivals can adjust their prices. He denies that either of these conditions hold.

As I have pointed out earlier, both conditions hold as reasonable approximations. Long-distance carriers do not need to sink large costs which are unrecoverable upon exit. Entry can occur on the basis of leased facilities or by reselling. Even an entrant who builds facilities but later decides that the market is too competitive to sustain a profit can sell or lease the facilities to another carrier, so the facilities costs are not sunk.

Long-distance carriers cannot keep their basic list prices secret from their rivals. But discounts are another story. Rivals can be taken by surprise by discount promotions. And smaller carriers can offer terms that will not draw strategic responses from their larger rivals even though the terms are widely known. Hence, though long distance is hardly more perfectly contestable than it is perfectly competitive, the market delivers benefits to customers that are close to the ideal of a contestable market.

MacAvoy also chides Bernheim and Willig for assigning an important role to resellers in ensuring that the long-distance market is competitive.¹⁴ He claims that the non-competitive pricing of bulk long distance precludes arbitrage from bulk to retail. But this claim is refuted by Professor Hausman's observation that "... the price of bulk long distance has decreased markedly over the past few years so that it can now be purchased for less than 1.5 cents per minute (cpm) ..."¹⁵

Professor MacAvoy argues that resellers should have gained market share if they are able to purchase bulk capacity on competitive terms. Here, he is assuming his conclusion that the retail long-distance market is non-competitive. A competitive long-distance market offers no significant profit opportunities for resellers, so the finding that resellers are not expanding despite the continuing decline in the price of bulk long-distance service is a strong piece of evidence in favor of the conclusion that the long-distance market is substantially competitive.

¹³ *Affidavit*, p. 18.

¹⁴ *Affidavit*, p. 19.

¹⁵ *Hausman Declaration*, p. 3.

6. Crandall and Waverman's analysis of long-distance margins

Robert Crandall and Leonard Waverman have calculated price-cost margins in a number of ways.¹⁶ They conclude that AT&T price-cost margin may be at essentially competitive levels or at levels indicating moderate excess of price over marginal cost. They also make calculations based on marginal costs as low as 1 or 2 cents per minute, "as MacAvoy and others allege."¹⁷ They point out that MacAvoy's low figure is inconsistent with AT&T's reported costs. They conclude, "What is needed (and unavailable in the interstate market and other jurisdictions) is a complete model of the cost of service, including NTS costs and traffic-sensitive costs" (p. 144). It is unreasonable for MacAvoy to cite this balanced appraisal, in which his very low marginal cost figure is included only because he has alleged it, as support for the figure! Rather, the study favors non-access costs around 5 cents per minute. My results below suggest that the average revenue per minute of the three largest carriers in 1994, net of access charges, was 6.4 cents per minute (4.3 cents in 1985 dollars). This looks like strong competition to me.

D. Professor MacAvoy's conclusion that MCI believes it controls market output

In his book, Professor MacAvoy uses the framework of conjectural variations to examine the relation between the market shares of AT&T, MCI and Sprint and their price-cost margins.¹⁸ This framework, though well known, is not considered by specialists in industrial organization to be a completely satisfactory way to capture the strategic interaction of oligopolists. Although the approach has some practical value, the theory of conjectural variations cannot be rationalized in terms of formal game theory, which provides the basis for most modern analysis of oligopoly. In any case, Professor MacAvoy's findings in the framework are nothing short of absurd. They only demonstrate the defects in the data and say nothing about the interactions among sellers in the long-distance market.

The basic idea of the analysis is that the relation between a firm's market share and its price-cost margin reveals information about how the firm interacts with the other sellers in

¹⁶ Robert W. Crandall and Leonard Waverman, *Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications*. Washington, DC: The Brookings Institution, 1995.

¹⁷ *Op. cit.* p. 145

¹⁸ *Failure*, Chapter 5, pp. 156-164.

the industry. In a purely competitive market, all margins are zero and there is no relation. Each firm believes that any decrease in its own quantity sold will result in a fully offsetting increase in sales by other firms, and price will not change. In a market where firms cooperate and share monopoly profits, each firm believes that other firms will cut their sales if this firm cuts its sales. Then price-cost margins are positively related to market shares. In the standard intermediate case—the Cournot model—one firm believes that other firms do not change their sales if this firm cuts its sales. Then price-cost margins are somewhat positively related to market shares.

Professor MacAvoy finds that MCI and Sprint fall into the category of firms that believe they control other firms' output. Their market shares have grown since 1984, and, according to Professor MacAvoy's data, their price-cost margins have risen as well. On the other hand, AT&T is found to be on the competitive side of Cournot—the firm sees the rest of the sellers as responding competitively by increased sales if AT&T decreases sales. This finding is the result of the decline in AT&T's market share during a time when Professor MacAvoy's measure of the price-cost margin rose.

Remarkably, then, Professor MacAvoy sees AT&T as behaving as if other firms respond competitively to its initiatives. AT&T does not dare to raise prices, according to Professor MacAvoy's analysis, because MCI, Sprint, and all the other sellers would sell aggressively given the opportunity that AT&T's overpricing would generate. But MCI and Sprint have a completely different view. They see AT&T as following willingly in their footsteps if they initiate a price increase and sales decrease. Although the rest of *Failure* describes the industry in the thralls of AT&T's price leadership, with MCI and Sprint following AT&T obediently, the econometric results state just the opposite should be occurring.

In one of the most incredible statements of his entire study, Professor MacAvoy asserts the following: "MCI's conjectural variation indicates that if it were to decrease its sales level, it could anticipate that AT&T and Sprint would decrease their combined sales by 1.53 times that level, resulting in a commensurately higher market price than could be achieved by single firm restriction."¹⁹ Any economist would find this statement absurd. Because Professor MacAvoy believes that the market elasticity of demand is only 0.75, the statement means that there is no upper limit perceived by MCI to the price it could set.

¹⁹ *Failure*, p. 164

Every dollar it adds to the price of a minute of service only further adds to MCI's profits. Remarkably, then, MCI continues to sell long-distance service for 10 or 15 cents per minute when, according to Professor MacAvoy, it believes it could charge \$10 or \$10 million per minute and make more profit.

Professor MacAvoy's ridiculous findings are nothing more than the result of the price and cost measurement problems I have detailed earlier. A proper measure of the price-cost margin shows that it has declined over the past decade. MCI and Sprint, according to a proper statistical analysis, see the market as highly competitive. They do not indulge themselves in the fantasy that their rivals would hold back if they overpriced their products. Rather, they are keenly aware that only by delivering reliable, high-quality service at competitive prices will they be able to stay in the market

VI. An Analysis of Competition in Long-Distance

I have carried out a study of competition in the long-distance market using standard economic analysis. My analysis finds the long-distance industry not only to be substantially competitive, but to deliver steady improvements in service at continually declining prices. The industry's performance has been exceptional since divestiture in 1984.

The long-distance market in the United States comprises four larger carriers—AT&T, LDDS, MCI, and Sprint—together with numerous others who offer services on partial national networks, facilities leased from other owners, or who resell services purchased in bulk from other carriers. Contrary to Professor MacAvoy's analysis, in my opinion, the evidence shows strongly that these carriers compete rather than collude. The result of this competition has been benefits to the consumer in the form of substantial reductions in the price of long-distance service as well as numerous technical improvements and the development of new services.

A. Structural analysis of the long-distance market

There are a substantial number of smaller carriers that play a significant competitive role in the market even though the four largest carriers—AT&T, LDDS, MCI and Sprint—together account for a large fraction of all long-distance traffic. These smaller carriers could expand rapidly if competition among the larger carriers were inadequate and left

prices above competitive levels. Further, the smaller carriers are increasing competition in the market through consolidations which result in a number of highly successful entities such as Frontier Communications.

As I stressed earlier, AT&T's market share of just over half does not necessarily indicate a serious deficiency in competition. In any industry, but particularly in an industry where one seller has had an historical head start, one must examine a broader set of information than market share to reach conclusions about the state of competition in a market. In particular, such an examination should consider barriers to entry and the prospective profits of a new entrant.

In a non-competitive industry with high barriers to entry, a new firm would make abnormal profits if it could overcome the barriers. In long distance, regulation created an absolute barrier to entry until the 1970s. Consequently, prospective new entrants knew they could make substantial profits if they were allowed to compete with AT&T.

Today, the barriers to entry are relatively low, so actual and prospective entry keep the long-distance industry competitive. One form of entry would call for a completely new network of transmission facilities at the national level. This form would cost billions of dollars and would likely be unprofitable. However, other more viable forms of entry exist and include creating a national network from a combination of investment and leasing of existing fiber capacity—as LDDS and Allnet have done—as well as entry at a smaller scale by constructing a smaller network and by reselling the services of other carriers.

If existing long-distance carriers were charging prices that generated excessive profits and were providing substandard service, the profits of a prospective entrant would be enough to induce the necessary investment for full-scale entry because there are no artificial barriers to entry in the long-distance market. Even if prevailing prices generated only moderate excess profits, a different form of entry at the national level, or entry on a regional level, could still occur. Today, more than a decade after regulatory barriers to entry were removed, the entry about a hundred of carriers of different sizes has exhausted the profits from entry. As a result, the long-distance market is substantially competitive, and the ease of entry ensures that the market will remain competitive in the future.

Finally, a striking piece of evidence of healthy competition in the long-distance industry is that the regional Bells have chosen not to pursue opportunities in the industry so far.

Under current law, a BOC could enter the business by spinning off a separate long-distance entity not under the BOC's subsequent control or ownership. Spin-offs are not a novel concept in this or other industries. Because no BOC has chosen to enter the business through either type of spin-off, it is reasonable to conclude that BOC managements agree with the market in general that there are no extra profits to be made in today's long-distance market. Investments in long distance pay for depreciation and the financial cost of capital, but do not earn more. The BOCs' own behavior confirms that competition in long distance has erased the abnormal profits that would come with market power.

Accordingly, the structure of the industry suggests adequate competition with large consumer benefits even though AT&T still has a large share of the U.S. long-distance market. The long-distance market is not perfectly competitive in the textbook sense. However, the long-distance market is just as workably competitive as most industries in the United States. There are neither natural nor legal barriers to entry in the market. If competition were inadequate, new firms would enter and those currently in the periphery would move into the core.

B. Performance of the Long-Distance Industry

Increasing competition in the long-distance industry has delivered important benefits to the American economy. Traditionally, long-distance service was available only from AT&T. Regulation prevented other companies from offering long-distance service. During the 1970s, MCI waged an uphill battle to obtain the right to offer service in competition with AT&T, but there was still little rivalry in the industry by the early 1980s.

The divestiture of long distance from local telephone companies came as a result of the settlement of the U.S. government's antitrust case against AT&T, effective at the beginning of 1984. Divestiture started the transition to competition in long distance. The new policy eliminated the economic incentive for the local telephone company to favor the long-distance carrier owned by the company's parent. Divestiture brought equal access, under which telephone subscribers have a symmetric choice among all long-distance carriers. Subscribers use the same convenient method to dial long-distance calls for all carriers. The FCC has made other contributions to creating a favorable environment for competition by expanding equal access to independent local telephone companies, by requiring portability of 800 numbers, and controlling some anti-competitive practices.

The mid-1980s saw an explosion of service by long-distance carriers other than AT&T. During this time, MCI and Sprint built nationwide networks and gained acceptance as alternatives to AT&T. Divestiture was successful at stimulating major new investments with corresponding increases in market shares by new entrants to the long-distance market.

C. The Role of Declining Access Charges in Lowering Long-Distance Prices

Long-distance carriers pay local telephone companies access charges for carrying long-distance calls from the caller's business or home to the point where the long-distance carrier picks up the call. They pay a second access fee to a local telephone company to deliver the call to its ultimate destination. During the 1980s, the FCC imposed important changes on the structure of access fees—early in the decade, most of the fee was imposed as a per-minute charge on long-distance calls, whereas by the end of the decade, part of the fee had been shifted to a fixed monthly charge per telephone line.²⁰

The table below shows gross revenue per minute for the three largest carriers on the top line; stated here as 1985 dollars per minute. The graph also shows the industry average access charge per minute of call, again in 1985 dollars per minute²¹. The average access charge fell from 15.3 cents per minute of conversation in 1985 to 5.7 cents in 1994 (adjusted for inflation). Finally, average revenue per minute after subtracting access cost fell from 15.1 cents per minute in 1985 to 4.2 cents in 1994 (adjusted for inflation), a decline of 72 percent. Claims that the only reason for the decline in long-distance prices is the declining cost of access are incorrect.

²⁰Long-distance carriers still pay more than 40 percent of their revenues to local telephone companies as access charges.

²¹This calculation is based on the assumption that there are two minutes of access per minute of call (approximately one minute on the originating end and one minute on the terminating end). It also adjusts for call setup time and for access by means other than the local switched network.

Year	Revenue per minute, 1985 dollars	Access charge per minute, 1985 dollars	Revenue per minute net of access charges, 1985 dollars
1985	0.304	0.153	0.151
1986	0.243	0.140	0.104
1987	0.193	0.116	0.077
1988	0.177	0.102	0.075
1989	0.157	0.089	0.068
1990	0.130	0.074	0.057
1991	0.115	0.065	0.051
1992	0.111	0.060	0.051
1993	0.104	0.058	0.046
1994	0.099	0.057	0.042

The table shows that the fall in the price of long-distance service net of access charges occurred in both the period immediately following divestiture and in more recent years. Although falling access charges were an important factor in the substantial decline in the price of long distance over the period, other factors were also significant, reflecting the successful performance of the competitive long-distance industry in the United States.

D. Technical Improvement and New Services since Divestiture

Even the occasional user of long distance in the United States is aware of tremendous improvement in the quality of service in the past decade. Background noise, cross-talk, echoes, and dropped calls have essentially disappeared from long-distance calls. The usefulness of one minute of telephone conversation has risen over the period at the same time that the cost of that minute has fallen dramatically. Fiber optics account for much of the improvement. State of the art fiber has advanced from under a trillion bits per second in 1986 (capacity for 10,000 simultaneous phone calls) to 2.4 trillion bits per second in synchronous optical networks today. In addition, the new dispersion-shifted fiber technology requires half as many regenerators per mile in the network. These advances in long-distance technology have lowered costs and improved reliability. The carriers

brought into being as the AT&T monopoly was broken up—MCI chief among them—have been leaders in advanced fiber technology.

E. Benefits of Competition in Long Distance

Divestiture and the opening of the long-distance market to competition have produced a vibrant, successful long-distance industry in the United States. Since competition was introduced to the long-distance market, there has been a large and continuing flow of technological innovations. The performance of the industry in the past decade has been a clear success, with substantial declines in prices relative to other products and the rapid development and dissemination of advanced technologies by the competitive long-distance carriers.

VII. Benefits and Hazards of Entry of Local Carriers into the Long-Distance Market

Professors Hausman and Professor MacAvoy argue that entry of local carriers into the long-distance market will increase competition in the industry and will reduce the market power of the incumbent carriers. I believe they seriously overstate the benefits from BOC entry and ignores the hazards that would flow from vertical integration.

A. Benefits

Contrary to Professors Hausman and MacAvoy's conclusion, standard economic analysis concludes that the entry of the BOCs would not increase the number of long-distance carriers in the long run. Entry is driven by potential profit, and industry equilibrium occurs at the point where there are sufficiently many sellers so that the incremental profit to one more seller is zero. Therefore, BOC entry would displace the entry or expansion of other carriers.

Further, given the absence of barriers to entry and the absence of abnormal profit in the industry, there simply is no substantial market power left for the BOC to compete away. Since divestiture, the entry of numerous sellers has competed away the profit opportunities that previously existed.

A full analysis of the effects of BOC entry depends on the level of access charges the BOCs are allowed to impose on long-distance carriers and on the state of competition in local markets for access services. The Telecommunications Act of 1996 has provisions intended to hasten the development of local competition. It is well accepted that current access charges exceed cost by a wide margin. As a result, the BOCs have an incentive to expand their long-distance operations that is the artificial consequence of overpriced access and is not matched by any incentive available to independent long-distance carriers

A BOC has no special incentive to take long-distance business away from an independent carrier who is an access customer of the BOC, because the foregone access charge becomes an opportunity cost. But the BOC does have a special incentive to take business away from a long-distance carrier who is using non-BOC access, whenever the BOC's actual access cost is less than the price of access set by the non-BOC access provider. As local competition develops, this factor may lead to more rapid expansion of the BOCs' long-distance affiliates than one would expect for an entrant lacking this artificial incentive. The corresponding effect on independent long-distance carriers would be larger—more of them would be driven out of the market or would fail to enter. With BOC entry, there would be more concentration in the long-distance market than without BOC entry.

B. Hazards

Professors Hausman and MacAvoy show little concern for the hazards of vertical integration of local carriers into long-distance service. In effect, they deny the basic premise of the reorganization of telecommunications mandated in 1982, that the Bell system's long-distance arm needed to be independent of the regional BOCs in order to permit active competition in long distance. The premise remains in the Telecommunications Act of 1996, which requires that local competition reach a threshold level before vertical integration is permitted. The complete integration of the Bell system before divestiture created enormous practical obstacles to competition in long distance.

Vertical integration of the BOCs into long distance will have an important chilling effect on local telephone competition. We may safely assume that the BOCs' long-distance operations will rely entirely upon the BOCs for access. Hence the shift of an important share of long-distance traffic from independent carriers to the BOCs will reduce the

potential business available to an independent local carrier. Because local service has important increasing returns to scale, the reduced size of the local market will lower the incentive perceived by the potential entrant to the local market and cut the number of local competitors.

In addition, integrated long-distance operations will give the BOCs a potent strategic tool for depriving potential local entrants of much of their anticipated profits from the provision of access. Where the BOC is not a long-distance carrier, local carriers can capture access business whenever their cost is below the high level of regulated switched access charges. The BOC cannot lower the switched access charge opportunistically to retain the access business. But when the BOC bundles access and long-distance, as it would under any program of vertical integration, the BOC would have the freedom, in effect, to lower its implicit access charge so as to deter entry and retain its access customers.

I conclude that vertical integration of the BOCs into long distance will inhibit the development of local competition by depriving potential entrants to local markets of much of the profit otherwise available from the access business. This adverse effect of vertical integration could be avoided by bringing the price of regulated access down to the level of cost.

A second critical adverse effect of vertical integration of the BOCs into long distance is the breakdown in cooperation between the BOCs and the independent long-distance carriers that will occur. Absent vertical integration, upstream firms cooperate with their downstream customers. On the other hand, horizontal rivals in the same market do not usually cooperate with each other; cooperation is the antithesis of competition. Once an upstream supplier integrates vertically into the downstream market, it becomes the rival of its downstream customers. Accordingly, it is unrealistic to expect the upstream firm to cooperate with its rivals in the downstream market. Yet cooperation between upstream and downstream firms is essential for consumer welfare.

The strain between cooperation and rivalry is greater the larger the role of the vertically integrated firm in the upstream market. When the upstream market is perfectly competitive, and no seller has a significant market share, failure of cooperation of a vertically integrated firm is innocuous—the downstream purchaser can find an alternative

upstream supplier who will cooperate if the vertically integrated supplier is uncooperative. Further, competitive markets can find the socially optimal degree of vertical integration. If there are efficiencies of integration, then competitive markets take the form of competition among many vertically integrated firms.

On the other hand, when the upstream seller has a significant share of the upstream market, the breakdown of cooperation with downstream customers upon vertical integration of the upstream seller becomes important. Unless cooperative upstream sellers can completely displace the sales of the less cooperative vertically integrated firm, the tension between cooperation and rivalry will arise; the customers who remain with the uncooperative vertically integrated firm in the downstream market will suffer from the lack of cooperation.

Here, access is the upstream market upon which long-distance carriers are dependent. Notwithstanding some alternative suppliers of access, the traditional local phone companies are the sole providers of access at a reasonable cost to the overwhelming majority of telephone customers. This domination of the access market means that the lack of cooperation with the BOCs' long-distance rivals, should vertical integration be permitted, will severely harm long-distance competition. A BOC would have a duty to its shareholders to inhibit the success of its long-distance rivals if it operated its own long-distance carrier. It would have a strong incentive to withdraw cooperation from the independent long-distance carriers, an incentive made much stronger by the continuing regulation of almost all local service. Most telephone customers would have no efficient alternative to the BOC for access to their long-distance carrier. Although there are some areas of growing competition in the access market, they are restricted to large customers, and cannot be relied upon to discipline the incentive to withdraw cooperation. Accordingly, standard economic analysis teaches that BOC entry into the long-distance market through vertical integration will actually decrease competition in the market, with a corresponding loss of benefit to the consumer.

The failure of the BOCs to pursue their ability to enter long distance by spin-off coupled with their persistent requests to be permitted to sell long-distance services strongly suggest that only the special advantages of coupling local exchange and long distance propel BOC entry into long distance. Further, I am not aware of any efficiencies that the

BOCs bring to the long-distance market. Thus the BOCs' desire for vertical integration is most likely the anticompetitive benefit that joint operation enjoys.

The local carrier has an incentive to favor its own long-distance carrier over its rivals. Lack of cooperation between the local carrier and a rival long-distance carrier may mean delayed installation of access lines, more costly forms of interconnection, degradation of technology, and other subtle inconveniences. A local carrier may also be able to make it more difficult for a rival long-distance carrier to recruit its customers. Although regulators are aware of the inefficiency of such practices and strive to suppress them, lack of cooperation is difficult to detect, and enforcing cooperation is nearly impossible.

To summarize, I can find no benefit from BOC entry into the long-distance market through vertical integration other than to the BOCs themselves. The BOCs will be able to obtain substantial market shares in their long-distance markets both because of their artificial advantage in access and because of the ability to hobble their long-distance rivals. The result will be a reduction in competition in long distance and higher prices to the long-distance consumer. Further, BOC presence in long distance would lower incentives for entry of independent local carriers and inhibit the development of local competition. Local telephone prices would be higher as a result.

VIII. Alternatives to BOC Entry into the Long-Distance Market through Vertical Integration

As I have shown, entry by the BOCs into the long-distance market will decrease competition in both the long-distance and local markets. The ultimate standard for judging the performance of the telephone system is the economic welfare of telephone customers. BOC entry through vertical integration, in my opinion, will only reduce this economic welfare.

BOC entry would have a less harmful effect on the long-distance market if the local service market became sufficiently competitive. Distortions caused by the overpricing of access would disappear in that case. Further, when the upstream market is perfectly competitive, failure of a vertically integrated firm to cooperate is innocuous—the downstream purchaser can find an alternative upstream supplier who will cooperate if the

vertically integrated supplier is uncooperative. In this setting, competitive markets can find the socially optimal degree of vertical integration.

Absent a substantial increase in competition in the local-service market, BOC entry into the long-distance market would not harm competition if it took the form of a spin off of a separate long-distance entity not under the BOC's subsequent control or ownership. All of the distortions I have discussed are the result of vertical integration, not the presence of a new entity in the long-distance market.

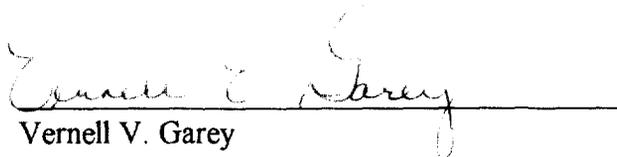
IX. Conclusions

The indictment of the competitive long-distance market in the United States offered by Professors Hausman and MacAvoy on behalf of BellSouth does not withstand scrutiny guided by standard economic principles. All the evidence refutes the claim that long-distance is a comfortable three-firm oligopoly whose members forbear to take business from each other by cutting prices. As in the competitive model, the force preventing further reductions in price is cost. In every part of the long-distance market, smaller sellers are ready and able to take business from their larger rivals if even a small gap between price and cost opens up

Professors Hausman and MacAvoy conclude that entry of the BOCs into long distance would favor the interests of the consumer. They are wrong for three reasons. First, the entry of the BOCs into their own long-distance markets would lower competition in those markets. Second, BOC entry into long-distance markets would inhibit local competition, which otherwise promises important benefits to consumers. Third, until the development of vibrant competition throughout the local telephone market, it is desirable that the local telephone companies who are the sole source of access to long distance carriers not be their rivals. The interests of the consumer are best served if local carriers cooperate with long-distance carriers, not compete with them.

CERTIFICATE OF SERVICE

I, Vernell V. Garey, do hereby certify that a true copy of the foregoing "Reply Comments" in CC Docket No. 96-61 was served on May 24, 1996 by first class mail, postage prepaid, upon the following:


Vernell V. Garey

***HAND-DELIVERED**

ITS*
1919 M Street, N.W.
Room 214
Washington, D.C. 20054

Charles P. Featherstun
David G. Richards
1133 21st Street, N.W.
Washington, D.C. 20036

Gary L. Phillips
Counsel for Ameritech
1401 H Street, N.W., Suite 1020
Washington, D.C. 20005

Campbell L. Ayling
Donald C. Rowe
The NYNEX Telephone Companies
1111 Westchester Avenue
White Plains, NY 10604

Edward Shakin
Attorney for Bell Atlantic Telephone
Companies
1320 North Court House Road
Eighth Floor
Arlington, VA 22201

Marlin D. Ard
John W. Bogy
Pacific Telesis Group
140 New Montgomery Street
Room 1530A
San Francisco, CA 94105

John F. Beasley
William B. Barfield
Jim O'Llewellyn
1155 Peachtree Street, N.E., Suite 1800
Atlanta, GA 30309-2641

Margaret E. Garber
Pacific Telesis Group
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

James D. Ellis
Robert M. Lynch
David F. Brown
SBC Communications Inc.
175 E. Houston
Room 1254
San Antonio, TX 78205

S. Joseph Dorr
Vice President
American Computer
and Electronics Corporation
209 Perry Parkway
Gaithersburg, MD 20877

Eileen Seidowitz
President
Audits Unlimited, Inc.
139-15 83rd Avenue
Briarwood, NY 11435

Stuart Zimmerman, General Manager
Fone Saver, LLC
733 Summer Street, Suite 306
Stamford, CT 06901-1019

Dr. Robert Self
Market Dynamics
4641 Montgomery Avenue, Suite 515
Bethesda, MD 20814-3488

Michael Greenspan
MBG
370 Lexington Avenue
New York, NY 10017

Robert L. Boxer, Vice President
Corporate Counsel
MOSCOM Corporation
3750 Monroe Avenue
Pittsford, NY 14534

John Abernathy, Director
Network Analysis Center, Inc.
45 Executive Drive, Suite GL3
Plainview, NY 11803

William B. Goddard, President
Telecommunications Information Services
4613 West Chester Pike
Newtown Square, PA 19073

Cheryl A. Tritt
Joan E. Neal
MORRISON & FOERSTER LLP
2000 Pennsylvania Avenue, N.W.
Suite 5500
Washington, D.C. 20006
Counsel for Telecommunications
Management Information Systems
Coalition

William H. Welling, Chairman, CEO
XIOX Corporation
577 Airport Boulevard, Suite 700
Burlingame, CA 94010

Bradley Stillman
1424 16th Street, N.W., Suite 604
Washington, D.C. 20036
Counsel for Consumer Federation of
America

Aliceann Vohlbruck
 Executive Director
 National Association of Development
 Organizations
 444 North Capitol Street, N.W.
 Suite 630
 Washington, D.C. 20001

John Crump
 Executive Director
 National Bar Association
 1225 11th Street, N.W.
 Washington, D.C. 20001-4217

Samuel A. Simon
 Counsel
 Telecommunications Research and Action
 Center
 901 15th Street, N.W., Suite 230
 Washington, D.C. 20005

Albert H. Kramer
 Robert F. Aldrich
 Dickstein, Shapiro & Morin, L.L.P.
 2101 L Street, N.W.
 Washington, D.C. 20037-1526
 Attorneys for American Public
 Communications Council

Jeffrey A. Campbell
 Manager
 Federal Government Affairs
 Compaq Computer Corporation
 1300 I Street, N.W., Suite 490E
 Washington, D.C. 20005

Robert A. Mazer
 Albert Shuldiner
 Vinson & Elkins
 1455 Pennsylvania Avenue, N.W.
 Washington, D.C. 20004-1008

John W. Pettit
 Sue W. Bladek
 Richard J. Arsenault
 DRINKER BIDDLE & REATH
 901 Fifteenth Street, N.W.
 Washington, D.C. 20005
 Counsel for the Consumer Electronics
 Retailers Coalition

Herbert H. Marks
 Jonathan Jacob Nadler
 Squire, Sanders & Dempsey
 1201 Pennsylvania Avenue, N.W.
 Washington, D.C. 20044
 Counsel for the Independent Data
 Communications Manufacturers

Emily C. Hewitt, General Counsel
 Vincent L. Crivella
 General Services Administration
 18th & F Streets, N.W., Room 4002
 Washington, D.C. 20405

Carl Wayne Smith
 Chief Regulatory Counsel,
 Telecommunications, DoD
 Defense Information Systems Agency
 701 S. Courthouse Road
 Arlington, VA 22204

Charles H. Helein
 General Counsel
 Helein & Associates, P.C.
 8180 Greensboro Drive, Suite 700
 McLean, VA 22102

Glenn S. Richards
 Stephen J. Berman
 Fisher Wayland Cooper
 Leader & Zaragoza L.L.P.
 2001 Pennsylvania Avenue, N.W.
 Suite 400
 Washington, D.C. 20006

Lon C. Levin
 Vice President and Regulatory Counsel
 AMSC Subsidiary Corporation
 10802 Park Ridge Boulevard
 Reston, VA 22091

Mark C. Rosenblum
 Roy E. Hoffinger
 AT&T Corp.
 295 North Maple Avenue
 Room 3244J1
 Basking Ridge, NJ 07920

Cheryl Lynn Schneider
 Joan M. Griffin
 BT North America Inc.
 601 Pennsylvania Avenue, N.W.
 Suite 725, North Building
 Washington, D.C. 20004

Mark P. Sievers
 William B. Wilhelm, Jr.
 Swidler & Berlin, Chtd.
 3000 K Street, N.W., Suite 300
 Washington, D.C. 20007

Ann P. Morton
 Cable & Wireless, Inc.
 8219 Leesburg Pike
 Vienna, VA 22182

Danny E. Adams
 Edward A. Yorkgitis, Jr.
 Kelley Drye & Warren
 1200 19th Street, N.W.
 Washington, D.C. 20036
 Attorneys for Cable & Wireless, Inc.

Natalie Marine-Street
 Telco Communications Group, Inc.
 Long Distance Wholesale Club
 4219 Lafayette Center Drive
 Chantilly, VA 22021

Michael G. Hoffman, Esq.
 Vartec Telecom, Inc.
 3200 W. Pleasant Run Road
 Lancaster, TX 75146

Genevieve Morelli
 Vice President and General Counsel
 Competitive Telecommunications
 Association
 1140 Connecticut Avenue, N.W.
 Suite 220
 Washington, D.C. 20036

Dana Frix
 Morton J. Posner
 Swidler & Berlin, Chtd.
 3000 K Street, N.W., Suite 300
 Washington, D.C. 20007
 Counsel for Eastern Telephone Systems

Thomas K. Crowe
 Michael B. Adams, Jr.
 Law Offices of Thomas K. Crowe, P.C.
 2300 M Street, N.W., Suite 800
 Washington, D.C. 20037
 Counsel for Excel Telecommunications, Inc.

Michael J. Shortley, III
 Senior Attorney
 Frontier Corporation
 180 South Clinton Avenue
 Rochester, NY 14646-0700

Kathy L. Shobert
 Director, Federal Affairs
 General Communications, Inc.
 901 15th St., N.W., Suite 900
 Washington, D.C. 20005

Robert J. Aamoth
 Jonathan E. Canis
 Reed Smith Shaw & McClay
 1301 K Street, N.W.
 Suite 1100-East Tower
 Washington, D.C. 20005
 Counsel for LCI International
 Telecom Corp.

Lee M. Weiner
 Douglas W. Kinkoph
 LCI International Telecom Corp.
 8180 Greensboro Drive, Suite 800
 McLean, VA 22102

Catherine R. Sloan
 Richard L. Fruchterman
 Richard S. Whitt
 WORLDCOM, INC.
 d/b/a LDDS WorldCom
 1120 Connecticut Avenue, N.W., Suite 400
 Washington, D.C. 20036
 Attorneys for LDDS Worldcom

Andrew D. Lipman
 Erin M. Reilly
 SWIDLER & BERLN, Chtd.
 3000 K Street, N.W., Suite 300
 Washington, D.C. 20007
 Attorneys for MFS Communications
 Company, Inc.

Susan Drombetta
 Manager - Rates and Tariffs
 Scherers Communications Group, Inc.
 575 Scherers Court
 Worthington, OH 43085

Leon M. Kestenbaum
 Jay C. Keithley
 Sprint Corporation
 1850 M Street, N.W., 11th Floor
 Washington, D.C. 20036

Charles C. Hunter
 HUNTER & MOW, P.C.
 1620 I Street, N.W., Suite 701
 Washington, D.C. 20006
 Attorney for Telecommunications Resellers
 Association

Helen E. Disenhaus
 Kathy L. Cooper
 SWIDLER & BERLIN, Chtd.
 3000 K Street, N.W.
 Suite 300
 Washington, D.C. 20007
 Attorneys for Ursus Telecom Corp.
 and WinStar Communications, Inc.

Wayne V. Black
 C. Douglas Jarrett
 Susan M. Hafeli
 Keller and Heckman
 1001 G Street, N.W., Suite 500 West
 Washington, D.C. 20001

Charlene Vanlier
 Capital Cities/ABC, Inc.
 21 Dupont Circle, 6th Floor
 Washington, D.C. 20036

Howard Monderer
 National Broadcasting Company, Inc.
 1299 Pennsylvania Avenue, N.W.
 11th Floor
 Washington, D.C. 20004

Mary McDermott
 Linda Kent
 Charles D. Cosson
 United States Telephone Association
 1401 H Street, N.W., Suite 600
 Washington, D.C. 20005

Wayne Leighton, Ph.D.
 James Gattuso
 Vice President For Policy Development
 Citizens For a Sound Economy Foundation
 1250 H Street, N.W., Suite 700
 Washington, D.C. 20005

William H. Smith, Jr., Chief
 Bureau of Rate and Safety Evaluation
 Iowa Utilities Board
 Lucas State Office Building
 Des Moines, IA 50319

Gail L. Polivy
 GTE Service Corporation
 1850 M Street, N.W., Suite 1200
 Washington, D.C. 20036

Lawrence C. St. Blanc
 Louisiana Public Service Commission
 P.O. Box 91154
 Baton Rouge, LA 70821-9154

Eric Witte
 Missouri Public Service Commission
 P.O. Box 360
 Jefferson City, MO 65102

Paul Rodgers
 General Counsel
 National Association of Regulatory
 1102 ICC Building
 Post Office Box 684
 Washington, D.C. 20044

Robert S. Tongren
 Consumers' Counsel
 The Office of the Ohio Consumers' Counsel
 77 South High Street, 15th Floor
 Columbus, OH 43266-0550

Philip F. McClelland
 Assistant Consumer Advocate
 Office of Attorney General
 Office of Consumer Advocate
 1425 Strawberry Square
 Harrisburg, PA 17120

Alan Kohler
 Assistant Counsel
 Counsel for Pennsylvania Public
 Utility Commission
 P.O. Box 3265
 Harrisburg, PA 17105-3265

Betty Montgomery
 Attorney General of Ohio
 The Public Utilities Commission of Ohio
 180 East Broad Street
 Columbus, OH 43215-3793

John W. Katz, Esquire
 Special Counsel to the Governor
 Director, State-Federal Relations
 Office of the State of Alaska
 444 North Capitol Street, N.W.
 Suite 336
 Washington, D.C. 20001

Rodney L. Joyce
 Ginsburg, Feldman and Bress
 1250 Connecticut Avenue, N.W.
 Washington, D.C. 20036
 Attorneys for Ad Hoc Coalition of
 Corporate Telecommunications Managers

Ellen G. Block
 James S. Blaszk
 Henry D. Levine
 Levine, Blaszk, Block & Boothby
 1300 Connecticut Avenue, N.W.
 Suite 500
 Washington, D.C. 20036

Betty Gardner, President
 The Association For The Study of Afro-
 American Life and History, Inc.
 1407 Fourteenth Street, N.W.
 Washington, D.C. 20005-3704

Winston R. Pittman
 President
 Chrysler Minority Dealer Association
 27777 Franklin Road
 Southfield, MI 48034

Joseph P. Markoski
Marc Berejka
Squire, Sanders & Dempsey
1201 Pennsylvania Avenue, N.W.
P.O. Box 407
Washington, D.C. 20044
Attorneys for Information Technology
Association of America

Earl Pace
Founder & Chair, Legislative Committee
Black Data Processing Association
1250 Connecticut Avenue, N.W., Suite 600
Washington, D.C. 20036

Jeffrey L. Sheldon, General Counsel
Sean A. Stokes, Senior Staff Attorney
UTC
1140 Connecticut Avenue, N.W., Suite 1140
Washington, D.C. 20036