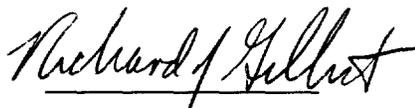


competition in local service, reducing the level of sunk investment needed for effective competition. This Commission should therefore reject the attempts by the commenters to expand the public interest test into a covert metric test in order to deny U.S. consumers the benefits of Ameritech's *de novo* entry in the provision of interLATA service.

81. Finally, we have shown that the evidence and experience to date suggest that approval of Ameritech's application is likely to increase the welfare of interLATA consumers and not decrease the welfare of Michigan local service consumers. We consequently conclude that approval of Ameritech's application would be in the public interest.

District of Columbia, ss:

We hereby swear, under penalty of perjury, that the foregoing is true and correct, to the best of our knowledge and belief.

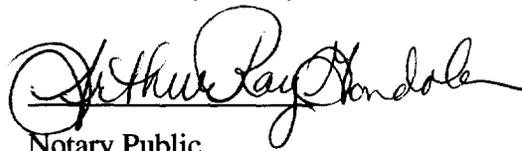


Richard J. Gilbert



John C. Panzar

Subscribed and sworn before me this 2nd day of July, 1997.


Notary Public

Arthur Ray Gondola
Notary Public, District of Columbia
My Commission Expires June 30, 2001



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APPENDIX

**A Numerical Analysis of Discrimination Incentives
Upstream Monopolist with Downstream Separate Subsidiary, Independent Decision-Making**

Following the equation on page 4 of the Appendix of the Economides-Mayo Affidavit, we compute the predicted break-even level of discrimination using "plausible parameters" put forth by commenters in this proceeding. The break-even level of discrimination measures the smallest cost penalty that the upstream monopolist must selectively impose on the competitors to its downstream affiliate to increase its overall profits with respect to the alternative hypothesis of no discrimination.

| Description & Symbol | | Plausible Parameters | | Formulas |
|---|------------------|---------------------------|-----------------------------|--|
| | | Baseman & Warren-Boulton* | Hubbard & Lehr [‡] | |
| <u>Parameters</u> | | | | |
| Access Charge (both ends, ¢/min.) | w | 10.0 | 6.5 | |
| Marginal Cost of Access (¢/min.) | c | 0.0 | 0.5 | |
| Marginal Cost of Long Distance (¢/min.) | s | 10.0 | 3.5 | |
| Number of Competitors (Existing and BOC Affiliate) | n | 6.0 | 6.0 | |
| Long-Distance Point Demand Elasticity | ε | (1.0) | (0.8) ^a | |
| [price where elasticity measured (¢/min.)] | P _{ref} | 15.0 | 11.0 ^a | |
| Implicit Intercept Parameter (Linear Demand) | a | 30.0 | 24.8 | $a = P_{ref} * (1 - 1/\epsilon)$ |
| <u>Discrimination Required to Break-even</u> | | | | |
| Selective cost penalty on unaffiliated competitors | | | | |
| Expressed in ¢/min. | 2r* | 10.0 | 2.5 | $r^* = [2s + (n+3)w - 2a - (n+1)c] / [2(n-1)]^{\dagger}$ |
| Expressed as proportion of underlying marginal cost | x | 100% | 71% | $x = 2r^*/s$ |

[†] Source: Affidavit of Nicholas S. Economides and John W. Mayo on behalf of AT&T Corp., FCC Docket CC No. 97-137, June 5, 1997

* Source: Affidavit of Kenneth C. Baseman and Frederick R. Warren-Boulton on behalf of MCI Corp., FCC Docket CC No. 97-137, June 9, 1997, p. 26, Note 21

[‡] Source: Affidavit of R. Glenn Hubbard and William H. Lehr on behalf of AT&T Corp., FCC Docket CC No. 97-137, June 2, 1997, p. 71, Note 97, Figures 1,7

^a Authors' assumption as value not offered by commenters, based on literature, e.g., Taylor, *Telecommunications Demand Modeling*, Kluwer, 1994.

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JUL - 7 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)

Application of Ameritech)
Michigan Pursuant to Section)
271 of the Telecommunications)
Act of 1996 to Provide In-)
Region, InterLATA Services in)
Michigan)

CC Docket No. 97-137

Joint Reply Affidavit of Robert G. Harris and David J. Teece
on Behalf of Ameritech Michigan

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I. INTRODUCTION

1. The comments and affidavits filed in response to Ameritech's § 271 application discuss a number of matters that relate to our initial affidavit. These opponent's arguments suffer from a number of common defects, including a reliance on pure "metric tests" to determine the openness of the local exchange, and a failure to appreciate the competitive discipline imposed by competitors providing service using resale and unbundled network elements ("UNEs"). Most important, the opponents ignore the facts – set forth in our initial affidavit and updated here – demonstrating the current level of actual competition in Michigan and the rapid growth of Ameritech's competitors. In light of these facts, there can be no doubt that the local exchange in Michigan is fully open to competition. Accordingly, the time is ripe to allow Ameritech to compete in the interLATA business.

2. Indeed, allowing Ameritech to offer interLATA services in Michigan will surely accelerate the growth of competition in Michigan, because, we are convinced, only then will AT&T, MCI and Sprint be properly incented to compete in local exchange services. Our reading of the evidence indicates clearly that, so long as the interexchange carriers (IXCs) believe that they can prevent Ameritech from gaining interLATA authority by delaying their full-fledged entry into local service, they will continue to do so. That same evidence demonstrates conclusively just how large are the benefits of allowing Ameritech to compete with the IXCs, both in long distance per se, and in the packaged offering of local and long distance services.

3. In the main, opponents argue that Ameritech Michigan should not be allowed to enter the interLATA market because, in their view: (1) there is not yet “enough” competition in the local exchange in Michigan;^{1/} (2) there would be few net benefits from Ameritech Michigan entering into the interLATA business;^{2/} and (3) there could be harmful effects in both the local exchange and interLATA services businesses from allowing Ameritech to enter the interLATA business.^{3/} This affidavit addresses both the facts pertaining to and the economic relevance of the opponents’ assertions regarding a lack of local competition. First, we demonstrate as we did in our initial affidavit that the local exchange business is open to competition and that competition is growing rapidly and is unlikely to abate. In the less than three months since we filed our initial affidavit, competition has advanced still further. In just the past few days, Ameritech’s resale service center has successfully processed thousands of service orders. Second, we review the comments made by the opponents and demonstrate that they do not apply appropriate economic analysis to the data representing the state of competition in the local service business in Michigan. Third, we show that entering the interLATA business through contract rather than vertical integration would not produce nearly the same level of benefits to society.

^{1/} AT&T Brief (“AT&T”), p. 41; MCI Brief (“MCI”), p. 48; Sprint Brief (“Sprint”), pp. 36-37.

^{2/} AT&T, pp. 46-50; MCI, p. 48; Sprint, pp. 47-48.

^{3/} AT&T, pp. 43-45; MCI, pp. 40-46; Sprint, pp. 39-45.

II. LOCAL EXCHANGE BUSINESS IN MICHIGAN IS FULLY OPEN TO COMPETITION

A. *Local competition is advancing rapidly*

4. Our initial affidavit discussed the state of local competition in Michigan by reviewing such key measures as the number of unbundled loops purchased, the number of resold lines, the number of interconnection trunks purchased, numbers disconnected, and numbers ported. Since the time of filing our initial affidavit, competition has continued to advance in Michigan, and rates of growth remain stupendous. Tables II.2 and II.3 reflect the latest available information on the state of competition. As can be seen from these data, which do not include on-net lines,^{4/} competitors have added 4,891 loops, 5,685 EOI trunks, and 34,008 resold local service lines, and have disconnected or ported over 7,000 lines in the past three months. Table II.2, which reflects the current array of facilities-based providers in the state shows three new entrants have gained authority offer local exchange service and four more have certifications pending. Each of the authorized competitors might enter the local exchange business at any time.

5. Perhaps even more astounding than the aggregate growth in the number of resold local service lines is the widespread geographic distribution of resold service. The

^{4/} Opponents take issue with the formula we used to calculate the number of on-net lines that are provisioned by CLECs. We readily admit that the formula does not produce perfect estimates. However, we would not have to estimate at all if the data was made available to us by the CLECs. The fact is that a very significant number of lines are provisioned on-net and that these numbers do not show up in our data on unbundled loops and resold lines, thus downplaying the true presence of competitors. Our estimate of 79,200 CLEC lines compares to AT&T's estimate of 76,269 lines and MCI's estimate of 67,000 lines. Department of Justice Evaluation, p. B-3.

map depicted in Figure 1 shows graphically that virtually every wire center in Ameritech's service area has been penetrated on a resale basis. Through the use of different sized circles, the other map in Figure 2, shows the relative distribution of these resold lines. From that depiction it is obvious that the spread of CLEC service is not confined to a few large urban centers. It is dispersed throughout the Ameritech serving areas across the state. Viewed in the context of the short time that this form of local service competition has been in existence, these inroads are remarkable.

TABLE II.1
MACRO INDICATORS OF ACTIVE FACILITIES-BASED COMPETITION
- MICHIGAN -

| | Unbundled Loops | Numbers Disconn. | Numbers Ported | EOI Trunks | Resale Lines |
|---------------|----------------------------|----------------------------|----------------------------|----------------------------|-----------------------------|
| Sep-95 | 918 | | 2,699 | | |
| Oct-95 | 1,284 | | 3,033 | | |
| Nov-95 | 1,795 | | 4,875 | | |
| Dec-95 | 2,919 | 7,822 | 5,854 | | |
| Jan-96 | 3,765 | 8,612 | 6,494 | | |
| Feb-96 | 4,558 | 9,402 | 7,110 | | |
| Mar-96 | 5,178 | 9,933 | 7,464 | | |
| Apr-96 | 5,750 | 10,928 | 8,137 | | |
| May-96 | 6,898 | 11,652 | 8,545 | 5,524 | |
| Jun-96 | 7,708 | 12,273 | 9,063 | 5,908 | |
| Jul-96 | 9,000 | 18,056 | 14,636 | 5,956 | |
| Aug-96 | 10,539 | 18,813 | 15,057 | 6,388 | |
| Sep-96 | 11,774 | 19,572 | 15,571 | 6,874 | |
| Oct-96 | 13,151 | 20,530 | 16,221 | 7,426 | |
| Nov-96 | 15,162 | 23,843 | 19,093 | 8,550 | |
| Dec-96 | 16,861 | 25,112 | 19,856 | 9,250 | 96 |
| Jan-97 | 18,869 | 26,180 | 20,903 | 10,210 | 852 |
| Feb-97 | 20,211 | 27,268 | 21,849 | 11,148 | 1,938 |
| Mar-97 | 21,321 | 28,910 | 23,212 | 14,096 | 4,313 |
| Apr-97 | 22,510 | 30,374 | 24,354 | 14,454 | 8,279 |
| May-97 | 24,467 | 31,574 | 25,487 | 17,982 | 25,570 |
| Jun-97 | 26,212 | 32,965 | 26,760 | 19,781 | 38,321 |
| % increase | 23% (Mar 97- Jun 97) | 14% (Mar 97- Jun 97) | 15% (Mar 97- Jun 97) | 40% (Mar 97- Jun 97) | 788% (Mar 97- Jun 97) |

Source: Ameritech Information Industry Services

* Excluding Centrex

TABLE II.2

SUMMARY STATUS OF COMPETITIVE ENTRANTS

| Service Provider | Summary Description of Services | Available to Bus | Res | Expected Offer Date | Data Source and Comments |
|-------------------------|---|------------------|-----|-------------------------|--|
| AT&T | "Everything you can imagine." (Fac-based local, LD, Internet, data, specialized business services, wireless (PCS), video (DBS)). Statewide. | Y | Y | Now | Offering via resale and possibly using Brooks' facilities. |
| ARC Networks | Resale to Bus and Res | Y | Y | — | Certification approved 4/4/97. |
| Brooks Fiber | Local & LD, business services (data, high-speed, access, vertical etc.); Grand Rapids, Traverse City, Ann Arbor & Lansing. | Y | Y | Now | Brooks news releases. |
| Building Communic. | Centrex telemanagement reseller (MDUs, business). Licensed for exchange service in Detroit, Ann Arbor, Southfield, and other areas. | Y | N | Now | AIS data; Certification. |
| Climax | Exchange service; expanding into Kalamazoo, Battle Creek, and surrounding area. | Y | Y | Now | Press accounts; Certification. |
| Comcast | Exchange and Broadband services resold and over own network in SE Michigan. | Y | Y | — | Certification Application. |
| Continental Cablevision | Detroit, Lansing, Ann Arbor, Southfield. HFC "ring-ring," ATT 5 ESS in Plymouth (1997E); SS7; Internet access. | Y | Y | — | AIS data; Certification Application. |
| Coast-to-Coast | Centrex telemanagement reseller (MDUs, business, commercial) mostly in Detroit area and lower Penn. Internet. | Y | Y | Now | AIS data; Certification. |
| Cypress Telecom | "Price-competitive" exchange service in Detroit, Ann Arbor, Southfield, and other areas. Resale and facilities-based. | Y | Y | — | Certification. |
| Image Paging of MI | Fac-based and resale to Bus & Res | Y | Y | Pending | Certification pending. |
| LCI | Local & LD to residential and business via resale. Grand Rapids. | Y | Y | Now | Certification. |
| MCI/MCImetro | Business communications services on-net. Local, LD, data, Internet, CO services, wireless (Nova-resale), and DBS in 1997 or 1998. | Y | — | Now | MCI brochures; Certification Application |
| MFS/Worldcom | Local, LD, data, Internet, CO svc over own networks. Statewide. | Y | Y | Now | Based on company brochures and proposals. |
| MI Independent Network | Fac-based and resale to Bus & Res | Y | Y | — | Certification approved 5/22/97. |
| Microwave Services | Fac-based and resale to Bus & Res | Y | Y | Pending | Certification pending. |
| Millennium Group | Resale to Bus & Res | Y | Y | — | Certification approved 5/07/97. |
| Polycom America | Resale to Bus & Res | Y | Y | Pending | Certification pending. |
| Sprint | Initially a reseller in Detroit, Grand Rapids, Lansing, and other areas. | Y | Y | — | Certification Application. |
| TCG | Multi-line access, analog & digital PBX, A/D DID, Centrex, payphone. Also switched access for interexchange carriers. Detroit area. Wireless transport through BizTel subsidiary. | Y | Y | Now | Certification Application. |
| Tele-Phone | Detroit LATA; Resale to business and residence in the Chaldean and Arab communities. | Y | Y | — | Certification Application. |
| Tele-Save Inc. | Fac-based and resale to Bus & Res | Y | Y | Pending | Certification pending. |
| US Network | Local, LD, data, Internet, CO svc by resale in Detroit metro, Ann Arbor, Ypsilanti, Auburn Hills, Southfield, and others. | Y | Y | Now | Certification Application, ads, Tariff Filing. |
| WinStar | Primarily transport (microwave) and wireless local loop. LD reseller. | Y | Y | Now, to other carriers. | Press releases, analyst reports. |

Sources: Data sources primarily are the companies' applications for certification before the MPSC, but other data sources include company advertisements, brochures, Ameritech IIS provisioning data, trade press, and investment analyst reports.

Figure 1

Resold Lines In Ameritech Michigan's Service Area

Red Shading Indicates Reseller Presence

White Wirecenters have no Resold Lines

Green Area is Michigan Territory not Served by Ameritech



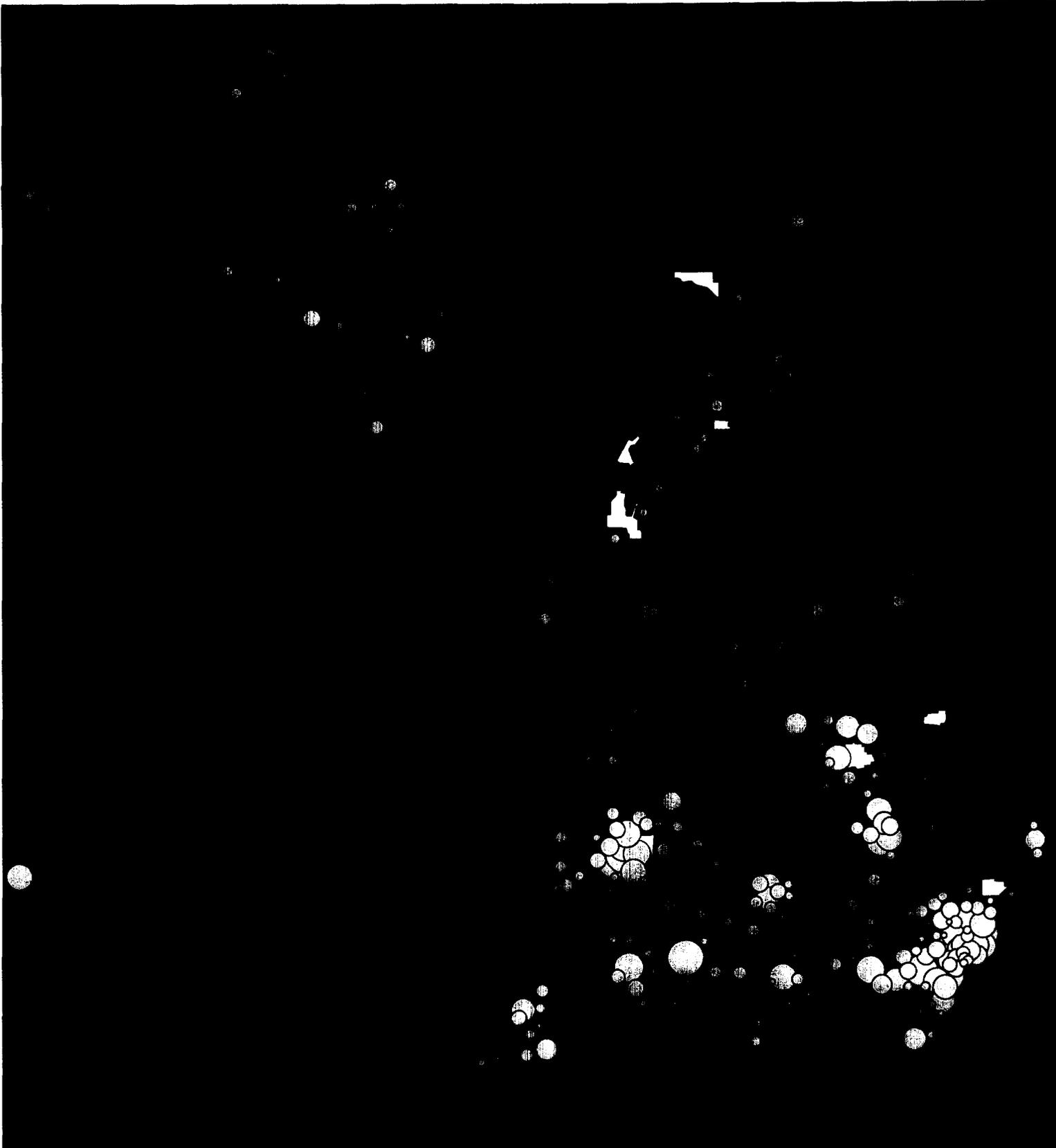
Figure 2

Resold Lines In Ameritech Michigan's Service Area

Red Shading Indicates Reseller Presence

White Wirecenters have no Resold Lines

Green Area is Michigan Territory not Served by Ameritech



B. *Opponents' assorted claims regarding our competitive analysis are baseless*

6. Some opponents have criticized our analysis of competitors' use of self-supplied infrastructure and interconnection, unbundled elements and resale as evidence of the openness of the local exchange business. These criticisms are based on incorrect facts, flawed economics, or both. We address each allegation in turn.

1. CLECs' rapid expansion

7. The growth rates for unbundled loops, resold service and minutes of use are readily observable from the data we obtained from Ameritech. Opponents took exception to our description of the local exchange competitors as rapidly growing, characterizing our growth rates as exaggerated because of the small initial bases.^{5/} They further state that the growth rates are unsustainable as the base of installed facilities grows.^{6/} Their comments, however, attempt to view the data through a rear view mirror. A forward looking interpretation of the data would recognize the short time that competitors have been actively deploying facilities in Michigan. Seen in that context, the penetration already accomplished is remarkable. With respect to CLECs' abilities to sustain those growth rates over time, it can be said that, for the foreseeable future, the penetration growth rates indeed are quite probably sustainable.

^{5/} Affidavit of Carl Shapiro on Behalf of Sprint ("Shapiro Aff."), p. 14; Affidavit of Michael Starkey on Behalf of AT&T ("Starkey Aff."), pp. 11-15; Affidavit of Kenneth C. Baseman and Frederick R. Warren-Boulton on Behalf of MCI ("Baseman/Warren-Boulton Aff."), pp. 53-54.

^{6/} Starkey Aff., pp. 13-14; Baseman/Warren-Boulton Aff., p. 54.

8. Opponents also claim that competitors' growth is small compared to the actual growth of Ameritech's own network.^{7/} Contrary to these assertions, the levels and growth of unbundled loops, resold local service and mutual compensation minutes of use are the relevant measures to consider, not their comparison with Ameritech Michigan's levels of these same variables. The level of activity by local competitors demonstrates that competitors are making rapid inroads into the marketplace co-occupied by Ameritech Michigan. These facts are clear indicia of the openness of that marketplace to entry and the growth of new entrants.

2. The addressable market

9. Our initial affidavit (pp. 31-42) described the ability of CLECs to serve a substantial percentage of Ameritech's Michigan access lines and revenues through (i) their equipment collocated in Ameritech offices, and (ii) expansion of their fiber rings through readily-available technologies. As we explained, this "addressable" market – a concept routinely used in the telecommunications industry – is an appropriate measure of the state of competition.

10. As we described in detail in our initial affidavit, competitors have collocated facilities in Ameritech Michigan central offices that serve 42% of Ameritech Michigan's business lines and 29% of its residence access lines (p. 35). This represents 34% of Ameritech Michigan's business line revenue, 30% of its residence line revenue, and 36% of its carrier access revenue (p. 35). Clearly, the offices in which Ameritech's local service competitors are collocated are those that have the biggest "bang for the buck."

^{7/} Starkey Aff., pp. 12-13.

This penetration, and the ready access it provides to a significant portion of telephone customers in Ameritech Michigan's service territory, has been achieved in a relatively short period of time. It should not be underestimated. Competitors are "wired to compete," whenever they should choose to do so. Looking at the existing market shares of competitors masks these much more significant facts and therefore contributes to erroneous conclusions.

11. It is important to recognize that the competitive capabilities of firms is better assessed, particularly in the context of an industry undergoing change, by the capabilities of firms, and not the particular products and services offered at any one point in time. That firms ought to be assessed in this way is ridiculed by some respondents,^{8/} but it has a long tradition in economics going back at least to Edith Penrose's Theory of the Growth of the Firm (1959).^{9/} The idea is now an accepted mainstream view in the strategic management literature and animates "resource based" analyses of firms and their competitors undertaken by firms everyday.^{10/} The key question is not what services are firms supplying right now, but what are they positioned to supply if an opportunity for profit arises. The actuality of entry is to be expected only if there are profit opportunities. Ameritech's cost structure and pricing is lower than other RBOCs; the lack of actual entry

^{8/} AT&T, p. 41.

^{9/} Edith Tilton Penrose, The Theory of the Growth of the Firm, New York: Wiley, 1959.

^{10/} See R. Rumelt, D. Schendel, and D. Teece, Fundamental Issues in Strategy, Boston: Harvard Business School Press, 1994; and B. Wernerfelt, "A Resource-Based View of the Firm", *Strategic Management Journal*, 5 (2), 1984; and D. Teece, "Towards an Economic Theory of the Multiproduct Firm," *Journal of Economic Behavior and Organization*, No. 3 (March), 1982.

should not in this context be viewed as evidence of a poorly functioning and noncompetitive market. Just the opposite is the case. Respondents are committing an inverted “cellophane fallacy”^{11/} by using the lower rate of entry into residential service as evidence of lack of competition, when it simply reflects Ameritech’s low pricing of basic residential service and the correspondingly lower profit margins in the residential segment.

12. Opponents have attempted to minimize the evidence of significant competition by alleging that the facilities of the competitors are in limited geographic areas^{12/} and that it is difficult, expensive or impossible to extend their reach to customers located near these networks.^{13/} They also assert that there is insufficient space in Ameritech’s central offices to accommodate expansion by competitors.^{14/}

13. MCI, for example, claims that Ameritech may lack the space in its offices for firms to serve customers via collocation. However, the upgrades that were identified in our collocation analysis considered the replacement of OC-3 electronics with OC-12 or higher on the same fiber. Replacing OC-3 electronics with OC-12 electronics quadruples capacity. These changes, which permit access to more customers with no addition of fiber, will not cause space problems, unless MCI envisions some other architecture. In

^{11/} D. Cameron, M. Glick, and D. Mangum, “Importing the Merger Guidelines Market Test in Section 2 Cases: Potential Benefits and Limitations,” *Antitrust Bulletin*, No. 1, Vol. 42 (March, 1997).

^{12/} Starkey Aff., p. 10; Shapiro Aff., pp. 14-15.

^{13/} Baseman/Warren-Boulton Aff., p. 55; Starkey Aff., pp. 35-38.

^{14/} MCI, p. 26.

addition, virtual collocation can be used by competitors which overcomes any space limitation that might be encountered.

14. The purported difficulties of reaching new potential customers from existing CLEC fiber rings also has been offered as a reason why competitors can not expand their market presence.^{15/} In our initial affidavit we showed how the existing fiber networks of competitors can increase their coverage, both in terms of Ameritech Michigan's access lines that can be supplanted and the percentage of the population that can be reached (pp. 36-42). But opponents argue that the proximity of these networks to a significant portion of the market does not mean they can actually serve nearby customers.^{16/} This argument is incorrect: fiber networks can be spliced into and electronics added, especially where excess capacity lies dormant awaiting potential usage. Furthermore, the costs of extending fiber networks via wireless connections are not necessarily high, and, in some instances, can be price competitive with wireline interconnection. For example, WinStar markets 38 GHz wireless T-1 and T-3 connectivity between "off net" buildings and competitors' SONET facilities. TCG's Biztel acquisition offers the same service. So does Advanced Radio Telecommunications. We therefore conclude that the argument that it is "difficult or impossible" to extend their reach is false, and one that investors certainly do not believe.

^{15/} Baseman/Warren-Boulton Aff., p. 55; Starkey Aff., pp. 35-38.

^{16/} Starkey Aff., pp. 35-38.

3. Switching capacity of CLECs

15. In a similar argument, opponents characterize the installed base of switches in Michigan as incapable of supporting viable competition.^{17/} Commentors cite the existence of six switches now in use in Michigan as evidence of minimal switching availability. It should be noted that these switches can serve between 30,000 and 80,000 lines apiece depending on traffic patterns, or a combined total of 180,000 to 480,000 lines. Because these switches cost in the neighborhood of \$3 million each, it would be irrational and uneconomic if the carriers did not have expectations of using the switches to their economic capacity. Opponents so egregiously underestimate the switching capacity of competitors in Ameritech Michigan's region that, according to Mr. Starkey's estimates,^{18/} MCI, MFS, TCG, and Brooks would together serve only 21% of Ameritech Michigan's customer base even if each company relocated all of their local switches to Michigan.

^{17/} Starkey Aff., pp. 19-21; Sprint, p. 33.

^{18/} Starkey concludes that, because Ameritech serves 5,124,000 customers and employs 434 end office switches, competitors could only serve 1.4% of Ameritech's existing customer base if they utilized "the capacity of their switches in a manner comparable to that of Ameritech (approximately 11,806 access lines per switch)," Starkey Aff., p. 19-20. Brooks had 21 switches installed in March, 1997. "Brooks Fiber Properties Reports Record First Quarter Revenues," Press Release, April 28, 1997. TCG had 25 switches installed by year end 1996. Blake Bath, et. al., Lehman Brothers, March 26, 1997, p. 16. MFS had 19 switches as of December, 1996. S.P. Conrad, "Emerging Competition in Local Telecommunications," Deutsche Morgan Grenfell, December 20, 1996, p. 61. MCI expected to have 24 switches in operation by the end of the first quarter 1997. Linda B. Meltzer, "MCI Communications," UBS Securities, January 23, 1997.

16. These numbers are absurd, greatly understating the amount of CLEC switching capacity already in place, and fail to acknowledge the ease of adding switching capacity. Brooks has added three class 5 switches in the past year in Michigan alone. Nationally, Brooks installed 18 switches in year ending March 31, 1997^{19/} and expects to add another 23 by the year end 1997.^{20/} WinStar has installed four new switches in just the past 90 days.^{21/} TCG expects to add 11 switches in 1997^{22/} and MFS plans to add over 60 switches in the next four years.^{23/} Some of these switches will be available to handle multistate traffic, traffic from high revenue/low cost customers that they specifically target in the overall market. Opponents also fail to account for the availability of inexpensive transport, which enables CLECs to serve far more customers with fewer switches. In fact, competitors could feasibly serve the Michigan marketplace with switches located outside the state, as they already do in other states. As Bear Stearns analyst James Henry points out:

“It is worth noting that TCG can serve multiple markets with a single switch by virtue of its extensive fiber network, which enables it to back-haul traffic from multiple markets to a central location. This ability enables the company to deploy its capital on a more timely basis, dedicating a switch to a single market only when traffic volumes make it worthwhile.”^{24/}

^{19/} “Brooks Fiber Properties Reports Record First Quarter Revenues,” Press Release, April 28, 1997.

^{20/} James H. Henry, “Competitive Local Exchange Services,” Bear Stearns, June, 1997, p. 62.

^{21/} “WinStar Launches CLEC Service in San Diego,” *Telecom A.M.*, June 26, 1997.

^{22/} Blake Bath, et. al., Lehman Brothers, March 26, 1997, p. 16.

^{23/} S.P. Conrad, “Emerging Competition in Local Telecommunications,” Deutsche Morgan Grenfell, December 20, 1996, p. 61.

^{24/} James H. Henry, “Competitive Local Exchange Services,” Bear Stearns, June, 1997, p. 122.

4. Geographic area served by CLECs

17. The commentators also contend that CLECs must be providing service throughout the state before finding that local competition exists.^{25/} As we explain later, this argument has no business or economic foundation, and is just another attempt to delay Ameritech's entry into the interLATA business indefinitely by crafting a "public interest" test that effectively enables the IXCs to raise an interLATA entry barrier against Ameritech.

18. First, the notion of "widespread geographical coverage" as a condition of competitive entry is devoid of economic sense. Population is not uniformly dispersed across Michigan; nor is economic activity. It just does not stand to reason that new entrants, who have never been burdened with an obligation to serve everyone, would deploy assets far and wide instead of concentrating them where they have the greatest opportunity to earn a profit. Indeed, the ability of CLECs to focus their investment in the most profitable geographic areas is a source of significant competitive advantage over Ameritech, which has an obligation to serve many remote areas, whether profitable or not. This competitive advantage, in fact, is widely recognized by Wall Street. For example, a recent Bear Stearns analyst report recognizes,

"What is clear to us is that the [local] market is readily addressable by facilities-based telecommunications providers, by virtue of the fact that much of the local market's traffic and revenues are concentrated in densely populated metropolitan centers... With such a large percentage of traffic being generated by such a small

^{25/} MCI, p. 38; Sprint, pp. 37-38; Baseman/Warren-Boulton Aff., pp. 42-43.

percentage of geographic areas, we believe that the business case for building competitive local networks in metropolitan areas is quite compelling.”^{26/}

The notion that wide geographical coverage by facilities-based CLECs is necessary to establish the viability of competition has no economic basis and should have no weight in the Commission’s decision. The only issue is whether CLECs can enter any geographic market they choose; the answer is that they can.

19. Second, facilities-based entry has occurred in the largest metropolitan areas in Michigan, primarily Detroit and Grand Rapids, and in several smaller cities as well (e.g., Lansing, Traverse City). That, of course, is consistent with the expected entry strategy of CLECs, investing in their own facilities in areas that can generate the greatest revenues and highest profit margins in the shortest amount of time. There are no business reasons to expect new entrants to target their facilities in the lower density markets, especially when they buy Ameritech network elements or resale Ameritech services in those areas.

20. The notion that the presence of a full range of CLEC offerings across the entire state is an indicator of competition is flawed from an economic standpoint. It has long been recognized that full range suppliers are often vulnerable to “niche players.” The Japanese auto manufacturers, for example, devastated the U.S. auto industry by starting as “niche players”: while GM, Ford and Chrysler were producing a wide product line, Toyota, Nissan and Honda focused on the “low” end of the market. Because of many similar experiences – effective entry by niche players – students and practitioners of competitive strategy now recognize that there are many ways to compete effectively, and

^{26/} James H. Henry, “Competitive Local Exchange Services,” Bear Stearns, June, 1997, p. 20.

that a marketplace populated by a variety of firms pursuing rather different strategies will be even more highly competitive. While Ameritech's competitive advantage may lie in providing a broad range of services across a wide geographic area, new entrants may seek and gain competitive advantage by focusing their facilities, services, and marketing efforts at particular product and market segments.

21. Competitors will serve only those customers that they choose to serve, and they will market their services selectively. They will target those customers that are most profitable, all demand and supply side considerations taken into account. It is clear that new entrants have identified business customers as their primary target. Revenues per customer and profitability per customer tends to be higher with business customers than with residential customers. As AT&T's CEO, Robert Allen, said, "It's logical that bees follow honey and banks are robbed because that's where the money is. And our focus will be on concentrated markets in major cities with concentrations of business customers."^{27/} This is not to say that some residence customers will not be attractive to some entrants. Such customers generally will be targeted by new entrants, but generally only after more profitable alternatives are exhausted.

22. With respect to opponents' assertions^{28/} that there is little or no competitive residential service, Brooks is, in fact, using its own facilities to provide residential service. Our initial affidavit cited this fact. MCI acknowledges providing residential service on a resale basis (and business customers on a facilities basis). AT&T provides

^{27/} Roy Neel, "Static on the Line," *Chicago Tribune*, December 11, 1996.

^{28/} MCI, p. 48; Sprint, p. 33.