

residential service on a resale basis as well but clearly their main focus is on business customers as basic economics would dictate. Apparently, opponents do not wish to accept these facts regarding residential competition.

5. Viability of CLECs

23. Opponents argue that, “[t]here are no facilities-based providers, resellers, competitive access providers, or wireless providers capable of constraining Ameritech’s ability or incentive to engage in anticompetitive behavior.”^{29/} A moment’s reflection on Ameritech Michigan’s competitors shows that this assertion is ludicrous.

- MCI is a multi-national corporation, one of the largest telecommunications firms on earth. MCI has invested heavily in Detroit and is currently taking customers away from Ameritech.
- MFS is part of Worldcom, the fourth largest IXC in the US. Worldcom has a large presence in local, long distance, data and Internet services and is considered the “phone company for the next millennium” by Salomon Brothers analyst Jack Grubman.^{30/} In fact, TCG and MFS combined have about the same market capitalization as US West’s telephone operations.
- Brooks has financing behind it inasmuch as it is a preferred provider for both MCI and AT&T. MCI, in fact, has a 3% equity stake in the company.
- AT&T itself has become one of the largest resellers in Michigan in only a few months.

To say that none of these firms has the ability to exert a significant constraining influence on Ameritech just can not be taken seriously.

24. Investors clearly think highly of the CLECs and their market potential in Michigan and other places. One way of assessing the way in which investors view CLECs

^{29/} AT&T, p. 41.

^{30/} Jack Grubman, “MFS Worldcom – The First Phone Company for the New Millenium,” Salomon Brothers, January 2, 1997.

is to consider a commonly used financial measure known as Tobin's q. It can be approximated by calculating the ratio of a firm's value in the marketplace to the book value of its gross assets.^{31/} Table III.3 shows these ratios for four groups of firms; ILECs, Wireless carriers, IXC's and CLECs. One integrated firm, Worldcom, is also shown. These data are very revealing. ILECs, including Ameritech, have the lowest q-ratio at 1.118. In contrast, the IXC's as a group have a q of 1.682, about 30% greater than the ILECs. The most telling numbers, however, are for the CLECs. Although there is more variation for that group than the others, the notable fact is that the lowest of the CLECs has a higher value than the highest of the ILECs. For CLECs, investors believe that every dollar invested in CLEC plant will produce about \$5.75 of firm value, a substantial expectation. In our view, investors' expectations are the best indicator of CLECs' prospects, and are certainly far superior to the advocacy statements put forward by parties deeply vested in the outcome of this proceeding. These facts are clearly at odds with the admonitions of advocates who suggest that there is little or no competition and that the local market is not yet even open to competition.

^{31/} Strictly defined, q is the market value divided by the replacement cost of the asset. Replacement cost can be roughly approximated by the book value.

TABLE II.3

FIRM CAPITAL TO GROSS FIXED ASSETS AS AN INDICATOR OF RELATIVE VALUE

	Price \$/share	Mkt Cap (\$millions)	LT Liab. (\$millions)	LT Capital (\$millions)	Gross Fixed Assets (\$millions)	Capital-to-Gr Assets (times)
ILECs						
Ameritech	67 5/8	\$ 37,161	\$ 9,038	\$ 46,199	\$ 32,589	1.418
Bell Atlantic	75 15/16	\$ 32,367	\$ 11,660	\$ 44,028	\$ 35,462	1.242
BellSouth	46 3/4	\$ 46,361	\$ 12,736	\$ 59,097	\$ 50,727	1.165
Nynex	56 7/16	\$ 24,849	\$ 13,384	\$ 38,233	\$ 37,744	1.013
SBC	60 13/16	\$ 55,475	\$ 19,625	\$ 75,100	\$ 62,707	1.198
USWest	37 15/16	\$ 18,288	\$ 9,424	\$ 27,712	\$ 32,766	0.846
GTE	44 5/16	\$ 42,316	\$ 21,305	\$ 63,621	\$ 53,709	1.185
SNET	39 3/8	\$ 2,591	\$ 1,541	\$ 4,132	\$ 4,707	0.878
Total/Average		\$ 259,407	\$ 98,714	\$ 358,121	\$ 310,411	1.118
Weighted Avg						1.181
Wireless						
Airtouch	28 7/16	\$ 14,307	\$ 2,434	\$ 16,740	\$ 3,696	4.529
360 Commun.	17 1/16	\$ 2,104	\$ 1,922	\$ 4,026	\$ 1,519	2.650
Rogers Cantel	6 1/2	\$ 1,156	na	na	na	na
Total/Average		\$ 17,567	\$ 4,355	\$ 20,766	\$ 5,216	3.589
Weighted Avg						4.165
IXCs						
AT&T	35 3/16	\$ 57,172	\$ 19,133	\$ 76,305	\$ 39,595	1.927
MCI	39 9/16	\$ 21,802	\$ 6,953	\$ 28,755	\$ 19,417	1.481
Sprint	51	\$ 17,561	\$ 5,076	\$ 22,638	\$ 21,870	1.035
Total/Average		\$ 96,535	\$ 31,162	\$ 127,697	\$ 80,882	1.481
Weighted Avg						1.682
CLECs						
ACSI	6 7/8	\$ 179	\$ 226	\$ 405	\$ 186	2.177
Advanced Radio	9 3/8	\$ 183	\$ 140	\$ 323	\$ 20	15.984
Brooks Fiber	32 3/4	\$ 1,243	\$ 592	\$ 1,835	\$ 406	4.518
GST	10 3/16	\$ 263	\$ 289	\$ 552	\$ 258	2.138
ICG	18 13/16	\$ 601	\$ 883	\$ 1,484	\$ 523	2.837
Intermedia	31 1/16	\$ 507	\$ 358	\$ 865	\$ 242	3.580
McLeod	29 3/16	\$ 1,080	\$ 313	\$ 1,393	\$ 124	11.274
TCG	33 27/32	\$ 5,580	\$ 1,080	\$ 6,659	\$ 1,439	4.627
WinStar	14 1/8	\$ 466	\$ 284	\$ 750	\$ 68	10.981
Total/Average		\$ 9,636	\$ 3,880	\$ 13,516	\$ 3,198	5.892
Weighted Avg						5.740
Integrated						
Worldcom	31 5/8	\$ 28,236	\$ 4,792	\$ 33,028	\$ 4,742	6.965

Firm Capital = Market equity capitalization + long term debt + other long term liabilities

25. In terms of analysts' expectations regarding CLECs' abilities to sustain themselves in the marketplace, one need only look at a few projections. Over the next seven years capital spending by the CLECs is anticipated to be very high. In aggregate, expectations regarding the ten CLECs depicted in Table II.3 is that they will spend about \$2.7 to \$2.9 billion per year. When AT&T's and MCI's spending on local service provisioning are included, this total rises to about \$4.6 to \$5.6 billion per year over the 1997-2005 period. Clearly, this represents a huge investment on the part of the new local service competitors in new local service facilities. Even if any one of the CLECs should run into financial distress, this infrastructure will not disappear. The assets could be sold to another competitor and thereby provide additional competitive pressure in the marketplace.

26. Table II.4 shows revenue projections for CLECs as forecasted by analysts. Their forecasts show that CLEC revenues are expected to increase from an aggregate level of \$1.9 billion in 1996 to \$9.5 billion in 2000 and \$28.3 billion in 2005. In other words, revenues are projected to increase by about 35 percent per year during the 1996-2000 period, and by an average of 49 percent per year during the 1996-2000 period, and by an average of 24 percent per year during the 2000-2005 period.

27. When viewing forecasts such as these, it is easy to see why Everen Todd Scott calls the CLECs "the MCIs of tomorrow."^{32/} These are not entities with an inability to get in and stay in the local exchange marketplace in Michigan. On the contrary, they

are able to finance their local forays and achieve their rapid growth in the local service marketplace.

TABLE II.4
AVERAGE VIEW OF EXPECTED CLEC CAPITAL SPENDING (\$ MILLIONS)

	1995	1996	1997	1998	1999	2000	2005
ACSI	33	108	175	141	80	60	50
Advanced Radio		7	27	43	48	56	105
Brooks Fiber	45	182	277	216	175	177	187
GST Telecom	175	124	192	85	67	53	66
ICG Comm.	86	228	259	259	239	212	152
Intermedia Comm.	33	103	136	142	130	128	137
McLeodUSA	10	43	105	115	127	126	177
MFS	524	688	1013	1110	1247	1374	1500
TCG Inc	290	391	478	494	483	500	475
WinStar		60	230	149	130	125	130
"New" CLECs		1932	2892	2753	2726	2811	2978
AT&T - Local		277	1033	1544	1933	2362	1946
MCImetro	265	390	700	400	400	400	400
TOTAL CLEC		2599	4625	4697	5059	5573	5324
Average ILEC	2288	2463	2488				

CLEC spending is computed as an average of available analyst estimates. ILEC (RBOC and GTE) spending is based on an estimate by Deutsche Morgan Grenfell. AT&T spending is based on an estimate by Morgan Stanley. MCImetro capital expenditures for 1995-96 is from the MCI 10K. The 1997 estimate for MCImetro is Linda Meltzer, UBS. The 1998 through 2005 is based on statements by the company (See "MCI Deal Reverberates," New York Times, 11/4/96).

^{32/} Todd Scott, "Competitive Local Exchange Carriers: The MCIs of Tomorrow," Everen Securities, October 25, 1996, p. 1.

TABLE II.5

ANALYSTS' AVERAGE EQUITY VALUATION STATISTICS

Firm	WACC	Revenue (\$000s)				Revenue Growth			EBITDA Margin		
		1995(A)	1996(A)	2000(F)	2005(F)	1995-96	1996-00	2000-05	2000	2005	Term Mult.
ACSI	16.5%	1,369	9,416	316,530	1,385,034	588%	141%	34%	8%	29%	10.7
ART	15.7%	6	2,908	123,196	587,542	50097%	155%	37%	21%	43%	10.0
Brooks	15.3%	14,160	45,574	538,793	1,657,822	222%	85%	25%	20%	34%	10.8
GST	16.3%	22,900	58,000	394,746	1,134,754	153%	61%	23%	9%	31%	10.3
ICG	15.8%	111,610	169,094	885,238	2,159,057	52%	51%	19%	14%	33%	10.2
Intermedia	16.0%	38,631	103,397	577,682	1,347,352	168%	53%	17%	17%	31%	10.0
McLeod	14.2%	28,998	81,323	680,247	1,901,560	180%	70%	22%	12%	29%	10.5
MFS	14.4%	583,200	1,115,000	3,971,210	11,354,699	91%	36%	23%	17%	28%	12.4
TCG	13.5%	184,852	281,522	1,360,715	4,940,456	52%	49%	26%	24%	36%	11.0
WinStar	15.8%	33,000	68,000	657,326	1,792,046	106%	78%	22%	19%	34%	10.5
TOTAL CLEC	15.3%	1,018,726	1,934,234	9,505,683	28,260,321	90%	49%	24%	16%	33%	10.6

NOTE: WACC = Weighted average cost of capital (after tax). Data sources: Average of available individual analyst reports.

28. It is important to note that while these tables vividly demonstrate analysts' high expectations of CLECs, they underestimate the competitive clout of CLECs as a whole. First there are a number of significant CLECs that are not represented in these tables, either because they are not public or are not actively tracked by analysts. Second, in today's market for telecommunications, firms are creating an intricate web of interests and relationships, both among themselves and with other industries, to reach different market segments and better respond to customer needs. In sum, Tables II.3 and II.4 do not reflect the whole of CLECs' potential to compete in the local exchange.

29. CLECs are not going it alone in the local exchange. In today's marketplace, CLECs are integrating their capabilities with that of other telecommunications suppliers, as well as looking outside the industry for alliances and partners. MCI, for example, is partnering with a utility cooperative in Iowa to "infiltrate the local market there for integrated services," and plans to strike deals "with various area power, cable and telephone companies as well as with private businesses, universities and municipalities."^{33/} To give an example of the local exchange entry/expansion opportunities available to CLECs today, consider a few of the strategies that Brooks is pursuing:

- Brooks is planning a 50/50 joint venture with Century Telephone "to develop full-service competitive local exchange networks in additional markets throughout Michigan"^{34/}

^{33/} "MCI Teams with Iowa Utility for Local Service," *Telecom A.M.*, March 21, 1997.

^{34/} Gail Lawyer, "Brooks Buys Century's CLEC Business for \$89 Million, Plans Joint Venture," *Local Competition Report*, April 14, 1997, p. 1.

- Brooks is the “provider of choice” for MCI for local access service in 17 markets, a relationship that is cemented by MCI’s equity stake in the company^{35/}
- Brooks is building a network from scratch in Minneapolis/St. Paul and Long Island because “it has existing operating agreements with long-distance carriers in those markets”^{36/}
- Brooks has agreements with CLECs ARC Networks and Inter-Tel NetSolutions that allows these companies to resell Brooks’ local services under their respective brands^{37/}

Clearly, the local exchange marketplace in Michigan and elsewhere is loaded with actual and potential suppliers, partners and competitors. No market share metric (or for that matter, table of investment analyst projections) can fully capture the rapidly changing vibrancy and dynamics of this expanding industry.

* * *

30. In short, the local exchange is open to competition and, despite opponents’ contrived claims, competition is growing rapidly every day. First, the barriers to entry have been removed. Legal barriers do not exist, as evidenced by the large number of approved competitors. Second, entry can occur easily and is, in fact, occurring through resale and through self-provisioned and partially leased facilities, spurred on by the ready access to unbundled loops and other elements. Entry has occurred at a rapid clip by carriers large and (relatively) small. Third, there is a significant amount of actual and

^{35/} “MCIMetro Make Additional Investment in Brooks Fiber,” PR Newswire, July 9, 1996.

^{36/} “Brooks Plans Networks in Minn., N.Y.,” *Local Competition Report*, March 5, 1997.

^{37/} “Inter-Tel to Resell Brooks’ Services,” *Local Competition Report*, April 28, 1997, p. 15; “Brooks Fiber Chosen to Provide ARC Networks with Local Resale Services,” PR Newswire, November 18, 1996.

potential competition in the marketplace today, and those that have entered are growing rapidly. The success of Brooks, TCG and MFS totally contradict the claims of AT&T and MCI that they are somehow unable to operate in the market. The market is more than contestable. There is, in fact, competition. These facts make a strong case for "sufficient competition."

31. From a competitive standpoint, the only disappointing outcome, to date, is that the very large potential players namely, AT&T, MCI and Sprint, have not followed the lead of the much smaller CLECs. They have kept a low profile in the local service marketplace, choosing only to serve some customers on a limited or resale basis.

32. We believe this lack of energetic entry by these major, deep-pocketed firms is attributable primarily to one factor: their incentive to forestall entry by Ameritech into their interLATA long distance marketplace by holding back from full-fledged entry into the local service market, including residential service. We elaborate further on this phenomenon later but the fact seems inescapable when one considers that the IXC's have more to gain by delaying entry into their interLATA market than they do by entering the local service business. This set of circumstances will change completely once Ameritech is freed to enter the IXC's' interLATA turf.

33. Thus, it is not surprising that the incentive "carrot" not discussed by IXC's' advocates is the IXC's' own full-fledged entry into the local service marketplace.^{38/} Once Ameritech is allowed to enter the interLATA market, the carrot of entering the local

^{38/} Sprint, of course, being the exception, since it already had millions of local exchange customers as an ILEC. Even so, Sprint has the same interLATA entry-

service business suddenly will begin to look much more attractive when they (AT&T, MCI, and Sprint) have nothing to gain by refusing to pursue that business in a more substantial way.^{39/} At that point, competition can really flourish in both the local and long distance markets.

III. THE COMMENTERS' PROPOSED "PUBLIC INTEREST" TESTS BASED ON THE AMOUNT OF COMPETITION ARE IRRELEVANT TO THE OPENNESS OF THE LOCAL EXCHANGE AND DESIGNED TO DELAY COMPETITION

A. *Opponents' misplaced reliance on metric tests*

34. Several affiants supporting the positions of opponents assert that there is little competition in the local exchange business in Michigan.^{40/} They state that the market share held by competitors is small and that their geographic scope is limited.^{41/} Furthermore, they state that there is only a small amount of competitive residential service available.^{42/} Finally, they assert that local competition will develop slowly in

blocking incentive as AT&T and MCI in entering local service markets where it is not the ILEC.

^{39/} Right now, it is bitter sweet, as competition here helps secure authorization for Ameritech, and causes competition in the IXCs' core markets.

^{40/} Baseman/Warren-Boulton Aff., p. 51; Starkey Aff., pp. 3-4; Affidavit of William J. Baumol on Behalf of AT&T ("Baumol Aff."), p. 12; Affidavit of R. Glenn Hubbard and William H. Lehr on Behalf of AT&T ("Hubbard/Lehr Aff."), p. 28; Affidavit of B. Douglas Bernheim, Janusz A. Ordover and Robert D. Willig on Behalf of AT&T ("Bernheim/Ordover/Willig Aff."), p. 13; Shapiro Aff., p. 14.

^{41/} Starkey Aff., pp. 9-10; Shapiro Aff., pp. 14-15

^{42/} Shapiro Aff., p. 15.

Michigan.^{43/} For all of these reasons, they conclude that entry by Ameritech Michigan into the interLATA market is, at this time, premature.

35. In attempting to demonstrate a lack of competition, opponents erroneously rely upon traditional structural measurements, such as market share, to compare the levels of various measures (e.g., number of loops or switches) to those of Ameritech Michigan.^{44/} Opponents argue that there must be an erosion of Ameritech's market share by various measures or, on the other side of the same coin, that there must be a large scale incursion of competitors offering local exchange services in Michigan.^{45/} Such comparisons completely miss the point both of TA96 and of appropriate economic analysis. As we explained earlier (¶¶ 7-11), market share tests do not reflect the degree to which the local exchange services marketplace is open to competition, and are rejected as proxies by TA96. As we demonstrated in our initial affidavit (pp. 3-4), any purported measure of market share, i.e., metric tests, have little or no meaning in the rapidly changing telecommunications industry.

36. Market share analysis, applied in the way opponents have applied it, is in any case meaningless in the new telecommunications market wherein "intraLATA" versus "interLATA" distinctions will disappear under the industrial structure envisioned in the Act.^{46/} Market share analysis based on an industry structure only recently changed

^{43/} Baseman/Warren-Boulton Aff., p. 53; Hubbard/Lehr Aff., pp. 57-59; Starkey Aff., p. 11.

^{44/} AT&T, p. 41; MCI, pp. 2-3; Sprint, pp. 32-34.

^{45/} AT&T, p. 41.

^{46/} In contrast to the industrial structure mandated by the MFJ with telcom providers assigned regulatorily mandated missions, the Telcom Act creates the opportunity

necessarily will reflect the outcomes under the old regime. They reflect the past, not the present.

37. Rather than market share comparisons, the type of analysis that is relevant is a demonstration that the barriers to entry into local exchange services are down, that entry has begun and is occurring at a significant level, that competitors are growing rapidly, and that a large share of the customer base is "addressable." This approach is fully consistent with economic theory and TA96 which does not suggest that one has to show that there are no costs of entry. Clearly, there are many highly competitive markets (e.g., consumer electronics) where there are entry costs of one kind or another. The data submitted in our initial affidavit along with other information filed in support of the application emphatically demonstrate that Ameritech meets all of the conditions which sensible and sound economic principles would require.

B. Opponents err in claiming that local markets must be self-regulating

38. Opponents of Ameritech Michigan's entry into the interLATA market assert that the local exchange business must be sufficiently competitive to curb Ameritech's market power to a degree that the market is "self regulating."^{47/} Opponents misstate what we understand the law requires in order for Ameritech to gain the opportunity to

for vertically integrated firms competing along the entire waterfront of telcom services. Measures that address only the local services or any one part of the telcom market are misleading.

^{47/} Affidavit of Robert Hall on Behalf of MCI ("Hall Aff."), p. 16; Baumol Aff., pp. 12, 17-18.

compete in the interLATA marketplace, and what economic analysis would suggest is necessary in order to make it appropriate for such entry to be permitted.

39. The most important point is that the test for competitiveness of the local exchange marketplace that is proposed by opponents is not a test for determining whether entry should be allowed into the interLATA business but is, in truth, a test as to whether the local exchange marketplace is sufficiently competitive to be totally deregulated.^{48/} It appears to us that the proposed tests reflect thinly veiled political strategies geared to delay the delivery of benefits to consumers. Consider, for example, MCI's position. It advances the view that there will not be sufficient competition to allow BOC entry until: (1) access charges decline, (2) purported monopoly profits decline and (3) most customers have a choice of carrier – not potentially but actually.^{49/} This would serve pretty well as an indicator for total deregulation, which is not a proposal under consideration. Among other things, this standard contemplates multiple providers along the entire front of all telcom services, including access.

40. If the market were deemed sufficiently competitive under standards defined the MCI way, there would be either no need for any regulation or, to the extent any regulation would remain, there certainly should be no asymmetric regulation i.e., exactly the same regulation should be applied to Ameritech Michigan and the CLECs alike. At this point there would be no need for ILECs to be compelled to lease UNEs or resell

^{48/} Robert Bork's affidavit is a case in point. So long as there is a monopoly element somewhere that needs to be regulated, Bork would appear to disfavor authorization. This view is contrary to sound economics and TA96.

^{49/} MCI, p. 48.

services at a discount. In fact, all of the safeguards set forth in TA96 would be unnecessary. We do not believe that this standard of competitiveness is what Congress intended as a hurdle for an RBOC's entry into the interLATA market, nor do we think it is consistent with accepted economic principles. Whether or not it is intended as such, MCI's proposal would simply serve to "raise the bar" and delay Ameritech's entry into interLATA service as long as possible. If allowed to be determined by those who stand to profit from keeping the RBOCs out of the interLATA market, competition would never be considered "sufficient".

41. Other opponents define sufficient competition as when competition is geographically widespread, covering a wide variety of services, a variety of customers, provided in a variety of ways.^{50/} We have already discussed the irrelevance, from an economic perspective, of geographic coverage. Regarding service variety, Appendix A of our initial affidavit showed example after example of local voice services, high speed data services, vertical services, 800 services, billing options, Internet services, video services, security services and wireless services offered to business and residence customers. Regarding variety of customers, we demonstrated in our initial affidavit that services are being sold in commercial quantities to both business and residence customers (certainly Brooks is making a commercial go of it). And, finally, we demonstrated that services are being provided using self-provisioned networks, UNEs, and resale.

^{50/} MCI, p. 38.

42. Clearly, any assessment of when “sufficient competition” exists in a market must go beyond a mere comparison of market shares of competitors or some amorphous test for when regulation is no longer necessary and must look at the host of surrounding factors that we have discussed in some detail in our initial affidavit and here. These various considerations include the conditions of entry barriers and the extent of the addressable market of existing competitors, as well as other indicators of competitive activity such as the statements of competitors before their regulators, the investment community, and their various publics regarding their plans. Again, the evidence of a competitive local exchange marketplace in Michigan is substantial.

C. The DOJ test for “fully and irreversibly open to competition”

43. The DOJ has endeavored to clarify its position on § 271 authorization by advancing what it calls its competitive standard of “fully and irreversibly open to competition.” We agree that the local exchange marketplace should be open to competition, and are convinced that the local exchange market in Michigan is fully and irreversibly open to competition. The department points out that “this standard seeks to ensure that the barriers to competition that Congress sought to eliminate in the 1996 Act have in fact been fully eliminated and that there are objective criteria to ensure that barriers are not imposed after BOC entry into in-region interLATA services.”^{51/} The DOJ states that its standard looks to “the extent of actual local competition as evidence that local markets are open, and whether such entry is sufficiently broad to support a

^{51/} Department of Justice Evaluation, pp. 29-30.

presumption of openness.”^{52/} Second, if there has not been “broad-based commercial entry involving all three entry paths” that would justify a presumption of openness, the DOJ will “examine competitive conditions more carefully, and consider whether significant barriers continue to impede the growth of competition, focusing particularly on the history of actual commercial entry.”^{53/} In other words, the DOJ wants to be sure that the local exchange business is currently open to competitors and, as a result of performance benchmarks and other safeguards (e.g., the accounting and non-accounting safeguards established by the Commission) will remain open.

44. Clearly, one would not declare that a market is sufficiently open if entry barriers would likely be erected, once authorization was granted. However, one cannot determine if a market is open by looking merely at entry rates. Slow entry, or its absence, may be due to a variety of factors, ranging from the lack of a profit opportunity, incompetence, lack of entrepreneurship, or cognitive and informational challenges. Managers may not be aware of opportunities, or they may not have developed a business model appropriate for the opportunity at hand. Regulation may itself be the barrier. Moreover, some companies (e.g., IXC) may simply see better opportunities elsewhere, may simply be burdened by organizational inertia, or may have political/regulatory reasons to eschew profit opportunities. As we explained earlier, the IXCs have every reason to stay out of the local exchange if their very presence could accelerate new entry (via triggering authorizations) into their core long distance markets.

^{52/} Id., p. 30.

^{53/} Id.

45. How the DOJ might operationalize this concept is outlined in the affidavit of Marius Schwartz, a DOJ consultant. We agree with much of what he has to say. Schwartz is clear that the concept does not require “evidence of local competition of all forms and in all regions of a state sufficient to substantially discipline BOC market behavior.”^{54/}

46. As we show in this affidavit, Michigan clearly meets the test as operationalized by the DOJ’s own consultant Marius Schwartz. We can demonstrate modest scale local entry. We cannot demonstrate local competition of all forms and in all regions; but the DOJ’s own standard does not require it. The DOJ’s conclusions suggest that Ameritech has met the requirements regarding the lowering of barriers to entry except for a few specific areas in which they raise concerns.^{55/} It is clear to us that DOJ thinks there is no need of further economic analysis. The only remaining issues, in their mind, are some of a very practical nature.

D. Opponents’ concept of “irreversible” competition

47. The DOJ and their consultant Schwartz use the phrase irreversibly open to competition, which from an economic standpoint does not appear unreasonable. We support the notion that markets should be open to competition. However, opponents use

^{54/} Affidavit of Marius Schwartz, Competitive Implications of Bell Operating Company Entry into Long-Distance Telecommunications Services, Submitted on behalf of the Department of Justice (“Schwartz Aff.”), *In the Matter of Application of SBC Communications Inc. to Provide In-Region Inter-LATA Services in Oklahoma*, CC Docket No. 97-121, May 16, 1997, p. 7.

^{55/} These concerns are summarized at Department of Justice Evaluation, pp. iv-v. Ameritech’s reply to the DOJ’s findings is set forth in affidavits by the Ameritech employees and consultants who deal with these network and service issues.

a different phrase, irreversible competition to which they attach significant additional requirements. The concept as they define it has no basis in economics and might well establish a hurdle too high for any company to surmount. Opponents have twisted and carried their concept beyond its proper boundaries. We note that Dr. Shapiro on behalf of Sprint wishes to redefine the DOJ concept to mean:^{56/}

- (1) The presence of expenditures on significant such investments by LECs (these supposedly represent a vote of confidence that competition is feasible). Such investments must be devalued in significance if they are shared facilities yielding economies of scope.
- (2) The (low) height of entry barriers – height must be calibrated to see if potential competition is truly feasible.
- (3) Assessing barriers to growth in by which Shapiro means “market conditions that impede the ability of market participants to compete effectively and add new customers or services.”^{57/}

These criteria do not mirror the DOJ/Schwartz view as presently articulated and are not rooted in accepted antitrust economics; indeed they are contrary to established principles of competition policy. We also note that as a practical matter, a firm might encounter growth restraints for a variety of reasons having nothing to do with the behavior of an input supplier. Indeed, if one were to accept Sprint’s formulation, it would impose a standard riddled with additional ambiguities, and offering no obvious additional advantages.

48. The concept of “irreversible competition,” as implied by opponents would seem to require competitors to be not only present in the marketplace, but that they would

^{56/} Shapiro Aff., p. 18.

^{57/} Shapiro erroneously claims that barriers to growth are sometimes referred to in the literature as “barriers to mobility.” This is not so. Mobility barriers are the barriers which a firm encounters in moving from one strategic group to another in an industry. This has nothing per se to do with growth.

be so committed through sunk costs that exit could not occur so there would be, as Sprint termed it, “irreversible entry.” In what market in the U.S. economy, except perhaps in some highly regulated ones, is this the case? Firms exit from virtually every market when they are unable to succeed and remain when they do succeed. Success and failure are the hallmarks of a free enterprise economy. Except for legal prohibitions on exit, this process can not be made to be “irreversible” in the sense suggested by Sprint.

49. Putting aside the notion of “irreversible” competition in the sense of lack of exit, we now consider some of the arguments put forth by opponents pertaining to the level of commitment by competitors that would signal that competition was “irreversible.” We consider these arguments in the context of evaluating the economic significance and implications of the substantial investments in the local exchange marketplace in Michigan. The relevance of this information is, as we discussed earlier, a clear signal that entry not only can occur but, indeed, has and is continuing to occur.

E. Opponents’ erroneous claims regarding competition

1. Substantial sunk costs are not required

50. Opponents argue that for “irreversible” competition to exist, substantial sunk investments must have been made by local competitors other than Ameritech Michigan.^{58/} Opponents further raise the bar by arguing that the most expensive investment and hence, the most significant way to incur sunk costs, is investing in the local loop,^{59/} which they

^{58/} Sprint, p. 9; Baumol Aff., p. 13; Shapiro Aff., p. 13; Hall Aff., pp. 16, 59.

^{59/} Hall Aff., p. 15-16.

contend is a natural monopoly.^{60/} They argue that there will only be one loop and that substantial economies of scale exist in its provision.^{61/} In light of the fact that Ameritech Michigan already has local loops extended to most customers and, therefore, enjoys these economies of scale, they thus would have an advantage over any entrant. When this set of assertions is joined with the fact that Ameritech Michigan is under a requirement to unbundle its local loop and make it available to any would-be competitor (at very favorable cost-based prices, we would hasten to add), there is almost no incentive for new entrants to invest in local loop plant; therefore, significant limits on the amount of sunk investment exist. Opponents would place one further ridiculous restriction upon the form that sunk investments must take, namely, they can not be used for any purpose other than local exchange service.^{62/} Finally, opponents argue that unbundled local loops should not count in determining whether a competitor is facilities-based,^{63/} an issue we will address below.

51. The above collection of assertions and unfounded requirements paints a grim picture for Ameritech Michigan's chances of ever being granted permission to enter the interLATA business. In fact, it establishes a scenario where entry simply can not be allowed. It defies reason to think this is what Congress had in mind. Nor, as we establish below, does it make any economic sense.

^{60/} Baumol Aff., p. 13; Hall Aff., p. 15

^{61/} Hall Aff., p. 15.

^{62/} Shapiro Aff., p. 17

^{63/} MCI, p. 7; AT&T, pp. 34-36; Sprint, pp. 6-12.

52. First, the notion that any sunk costs must be totally specific to local exchange service and must be useful for no other purpose is readily debunked as the leitmotif of competition. This is a standard to which no other industry in the world would be held. Service specific assets, although they can exist,^{64/} are the exception not the rule. More often, assets either are used for multiple purposes or have alternative uses in case their use in the existing application is no longer necessary. One of us has written on this at length in the academic literature.^{65/} To suggest applying such an absurdly restrictive requirement in order to ascertain the extent of investment in the local service marketplace is simply a transparent attempt to disqualify virtually all of the existing and forthcoming investments that CLECs have and will make.

53. Having disposed of this erroneous proposal to determine qualifying investments, it is abundantly clear that significant sunk costs already have been made by competitors in Ameritech Michigan's territory. As we suggested earlier, one sign of irreversibility is the inflow of capital into the infrastructure by competitors. The lengthy discussion of competitor facilities in our initial affidavit clearly indicates that there are millions of dollars invested in facilities by CLECs that can and are being used to provide

^{64/} For example, loops that travel to only one customer and no other through a remote area may not have any other use and thus could become stranded plant if a competitor builds a substitute facility to the customer and, in turn, captures that customer's business from the existing provider. In this case, it is obviously more efficient and, therefore, beneficial to society for a new loop not to be built but for the competitor to buy or lease that of the original provider.

^{65/} David J. Teece, "Towards an Economic Theory of the Multiproduct Firm," *Journal of Economic Behavior and Organization*, 3 (1982), pp. 39-63.

local service. The fiber networks, switches and collocation facilities represent a sizable and growing investment in sunk costs.

54. Moreover, the inflow has occurred despite the unbundling requirements which serve to reduce the inflow of new competitive capital needed to be a competitor (as do the TELRIC-based prices at which the elements are to be leased). And as discussed previously, the CLECs who have entered the Michigan local service marketplace are huge national telecommunications firms who have not only made statements to the investment community and their stockholders of their intentions, but have put their money where their mouths are and have rolled out their local service offerings. Most firms, especially ones with national operations, are loathe to abandon their customers, sell their assets and run, especially since many of those customers are home based elsewhere, with only branch locations in Michigan. Given the substantial investment to date and future investment commitments made by these well-capitalized carriers, competition in Michigan is here to stay.

2. Barriers to growth have been removed

55. Opponents state that, in addition to there being existing competition, there must not be barriers that would inhibit competitors' growth after entry.^{66/} We agree that for the local exchange service marketplace in Michigan to be open to competition, the possibility for existing competitors to expand their customer bases must exist. The evidence, both empirical and otherwise, proves that such an opportunity is present.

^{66/} Shapiro Aff., p. 18.

56. All of the information we presented in our initial affidavit and updated here convincingly show that competitors have not only found it possible to enter the Ameritech Michigan service territory, but that they have been growing at very high rates.

3. Opponents' claims regarding unbundled network elements are specious

57. Opponents argue that unbundled network elements, especially loops, although they may count for satisfaction of the competitive checklist requirements,^{67/} should not count for satisfaction of the public interest test because they are not evidence of effective, irreversible competition.^{68/} How they can justify this distinction eludes us, especially in light of the FCC's universal service fund order that defined the unbundled network element as part of facilities-based competition and that, therefore, opponents must somehow try to salvage the argument by drawing a meaningless distinction between unbundled elements and self-supplied facilities.

58. We re-emphasize the importance of the discussion in our initial affidavit concerning the use of unbundled elements by CLECs in their provision of local service. Whether CLECs elect to build their own loops, either at the outset or eventually, is an economic and strategic decision that the CLEC must make on a case-by-case basis.^{69/} In

^{67/} MCI, pp. 7-8; AT&T, pp. 34-36.; Sprint, pp. 6-12.

^{68/} Sprint, pp. 35-36; Shapiro Aff., p. 11.

^{69/} AT&T witnesses Robert Willig and William Baumol recognize this fundamental economic concept as it applies to freight transportation. "CSXT's witnesses Willig and Baumol explain that, post-merger, Railroad A still has every economic incentive to route traffic over the most efficient of the two alternatives between Point Y and Point Z. CSXT, as a profit-maximizing firm producing a service (freight transportation to and from south Florida), has a choice of producing the

some instances CLECs may never elect to build a loop to serve a particular customer. It may just not be in their economic best interest to do so. How many of those cases might exist depends upon the economics of the specific situations, with a significant factor being the cost to the CLEC of leasing unbundled loops. Depending upon the ultimate costing and pricing that is adopted for unbundled loops, the marketplace may be continually biased toward use of the ILEC's unbundled loops. Public policy determinations regarding RBOC entry into interLATA service simply cannot be based on whether or not the economics of unbundled loop use swings toward self-supply or toward the use of leased facilities from an ILEC.

59. In addition to the fact that many unbundled loops may be used for a long time to come by CLECs, we would again emphasize that relying on an ILEC for unbundled elements does not result in a reduction of competition. For example, no one has suggested that CLECs have or will hold back on their competitive thrusts for fear of retaliation by their ILEC loop suppliers. Quite the opposite is true. ILECs have been vigorous in their pursuit of competitive activities. The other highly significant fact is that the law requires that loops be provided to CLECs at cost-based rates. See 47 U.S.C. § 252 (d). Possible reliance of a CLEC on Ameritech for unbundled network elements, including local loops, is not a concern as opponents believe. In fact, such reliance on

complete service itself (i.e., using its single-line route traversing Florida) or outsourcing part of the service (i.e., using FEC between Jacksonville and Miami). Similar in-house-versus-outsourcing choices are made by firms throughout the economy." Decision, *Merger of Seaboard Air Line Railroad Company and Atlantic Cost Line Railroad Company*, Interstate Commerce Commission, Finance Docket No. 21215 (Sub-No. 5), March 13, 1995, p. 13.

competitors for essential components of their business is not uncommon. This aspect of cooperative behavior is important enough that we elaborate on this point below.

60. In fact, the availability of unbundled network elements from Ameritech reduces the amount of sunk costs that new entrants must make to enter the market and, therefore, further reduces the barriers to entry into local service. As opponents admit, the lack of necessity for long-term commitments to unbundled loops both makes the risk of entry lower and makes it easier for competitors to move to fully owned loops whenever they choose to do so. All of these characteristics of unbundled loop purchase facilitate entry and, by reducing the costs of entry, make the sunk cost requirement for new entrants less than it otherwise would be. These facts pertaining to the use of unbundled elements, and in particular unbundled loops, serves to heighten the need for the distinction between irreversibly open to competition and "irreversible competition."

61. For all of the above reasons, unbundled loops must necessarily be included in any consideration of what is relevant in assessing actual competition. Indeed, if what some opponents^{70/} intimate were true and that local loop provision might be a natural monopoly, it would be expected that there would only be one local loop provider, whoever that turned out to be, and that all competitors would rely upon this single entity for many or most of their loops. If such an outcome were the reality, which we seriously question, surely this would not prevent the owner of the loops in a particular area from ever being allowed to provide interLATA telephone service.

^{70/} Baumol Aff., p. 13; Hall Aff., p. 15.