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November 23, 1998

VIA HAND-DELIVERY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: Comments of GTE
CC Docket Nos. 96-61, 98-183

Ms. Salas:

Please find enclosed for filing in the above-referenced matter an original and five copies of Comments of GTE in the above-captioned docket. Please date stamp the enclosed extra copy of this filing and return it with the messenger. Thank you for your attention to this matter.

Sincerely,

April G. Dawson

Enclosures

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

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In the Matter of	)	
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Policy and Rules Concerning the Interstate, Interexchange Marketplace	)	CC Docket No. 96-61
	)	
Implementation of Section 254(g) of the Communications Act of 1934, as amended	)	
	)	
1998 Biennial Regulatory Review -- Review of Customer Premises Equipment and Enhanced Services Unbundling Rules in the Interexchange, Exchange Access and Local Exchange Markets	)	CC Docket No. 98-183

COMMENTS OF GTE

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COMMENTS OF GTE

GTE Service Corporation and its below-listed affiliates[1] (collectively, "GTE") respectfully submit their comments concerning the Further Notice of Proposed Rulemaking ("FNPRM") in this docket.[2] As discussed below, GTE urges the Commission to eliminate the restriction on bundling regulated services and unregulated services and equipment for all providers. Doing so will allow the market, rather than the particular regulatory regime imposed upon each provider, to determine the optimum

[1] GTE Alaska, Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., GTE West Coast Incorporated, and Contel of the South, Inc., GTE Communications Corporation, GTE Wireless Incorporated.

[2] FCC 98-258 (released October 9, 1998).

deployment of service/equipment bundles.

I. INTRODUCTION AND SUMMARY

The Commission's unbundling policy, adopted two decades ago in the *Computer II* proceeding, is a prime example of regulation that has become detrimental to consumer welfare with the passage of time.[3] The telecommunications industry today bears little resemblance to the industry of twenty years ago. Most notably, when the original unbundling policy was adopted, the Bell System controlled virtually all long distance service, 80 percent of local service, and the world's largest manufacturer of customer premises equipment. Today, in contrast, competition has come to nearly every corner of the telecommunications services market, and there are thousands of CPE manufacturers and enhanced service providers that face virtually no barriers to entry. The original unbundling policy conceivably performed a purpose consistent with the Commission's regulatory regime in a monopoly environment. Now, however, that policy must be eliminated to keep pace with today's marketplace and enable consumers "to take advantage of innovative and attractive packages of telecommunications equipment, enhanced services, and telecommunications services" and to "foster increased competition."[4]

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[3] *See Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 48 (1983); *see also* FNPRM, ¶ 5 ("we seek to eliminate any existing regulatory requirement that no longer makes sense in light of current technological, market, and legal conditions.").

[4] FNPRM, ¶ 5.

Accordingly, GTE agrees with the Commission that the unbundling policy should be discontinued. To maximize consumer benefits and assure fair competition, however, the Commission also must do away with the policy on a symmetric basis for all service providers. The proposal to permit only non-dominant interexchange carriers (IXCs) to bundle would place incumbent local exchange carriers (ILECs) at a serious competitive disadvantage in the face of increasing consumer demand for packaged offerings. Marketplace realities and technological convergence are making it essential for competitors to offer the full range of products and services sought by customers, both individually and in combination. Preventing one class of carriers from responding to this market demand would amount to a regulatory determination of winners and losers and undermine the pro-competitive, deregulatory imperatives of the Telecommunications Act of 1996.

More importantly, retaining the original unbundling policy for ILECs is unnecessary to promote consumer choice and protect against anticompetitive conduct. ILECs already operate under a multitude of constraints – including federal and state price/rate regulation, Section 251(c)(3) unbundling obligations, Section 251(c)(4) discounted resale requirements, and detailed cost allocation rules – that assure that unbundled basic services will remain available at just and reasonable rates. Consequently, there is no risk that permitting ILECs to bundle local services with long distance, CPE, and enhanced services would restrain consumer choice or impede competition. Rather, exactly the opposite is true: it is only by allowing all carriers, including ILECs and their affiliates, to bundle that the Commission can maximize service options for customers and stimulate vigorous competition.

Finally, the Commission must clarify the relationship between bundled service offerings and eligibility for universal service support. In accordance with Section 214(e) of the Act, eligible telecommunications carriers (ELTELs) should be eligible to receive support for serving customers that purchase bundles of supported services along with CPE and/or toll usage in high-cost areas. Nonetheless, for universal service to be meaningful, there must be an obligation for each eligible telecommunications carrier to offer at least one set of services that meets or exceeds the list of supported services and is available at a price no greater than the maximum affordable rate determined by the state commission. Without such a requirement, a carrier could receive universal service support but limit its offerings to an expensive bundle that would be attractive only to the highest income customers in an area, turning the idea of affordable universal service on its head.

II. THE BUNDLING OF CPE AND ENHANCED SERVICES WITH TELECOMMUNICATIONS SERVICES IS IN THE PUBLIC INTEREST.

A. Bundling Will Produce Significant Consumer Benefits.

As the FNPRM recognizes, the fundamental inquiry in this proceeding is whether removal of the bundling restriction would benefit consumers.[5] GTE respectfully submits that the answer indisputably is affirmative.[6] These benefits flow from several sources.

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[5] FNPRM, ¶ 2.

[6] *See generally* Affidavit of Dr. Gregory M. Duncan (Attachment 1 hereto) at 5-8 ("Duncan Aff.").

First, as noted in the FNPRM, the current restrictions on bundling "prohibit carriers from offering 'package discounts,' which enable 'customers [to] purchase an array of products in a package at a lower price than the individual products could be purchased separately.'"[7] Likewise, the Commission notes that it "has previously found that bundling may be used as an 'efficient distribution mechanism' and an 'efficient promotional device' that may allow consumers to obtain goods and services 'more economically than if it were prohibited.'"[8] The existing bundling policy therefore needlessly raises costs for consumers.

Second, bundling enhances the flexibility enjoyed by service providers, enabling them to mitigate risks associated with introducing new services and products. For example, bundling can allow carriers to package specialized, costly, and not widely available CPE with telecommunications services at reduced cost, even in the face of uncertain demand.[9] Bundling therefore directly promotes innovation.

Similarly, through bundling, providers can offer promotional packages that can spur consumer interest in new goods and services.[10] In this regard, the Commission explained in the *Cellular Bundling Order* that "bundling . . . reduces barriers to new

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[7] FNPRM, ¶ 1.

[8] FNPRM, ¶ 14 (citing *Cellular Bundling Order*).

[9] *See generally* R. Blair and D. Kaserman, "Uncertainty and the Incentive for Vertical Integration," 45 Southern Economic J. 266 (July 1978); R. Blair and D. Kaserman, "Tying Arrangements and Uncertainty," Research in Finance, Supplement 1, *Management Under Government Intervention: A View From Mount Scopus*, 1984.

[10] *See* M. Handler "Changing Trends In Antitrust Doctrines: An Unprecedented Supreme Court Term - 1977," 77 Columbia Law Review 979 (1977)

customers" and spreads "the fixed cost of providing cellular service . . . over a large population of users, achieving economies of scale and lowering the cost of providing service to each subscriber."[11] The Commission also found persuasive the judgment of the FTC staff that, "because a decision to how to distribute one's product may have a significant impact on the type of service or the quality of the product provided, 'interference in these relationships should be approached with caution.'"[12]

Finally, bundling enables carriers more fully to realize economies of joint sales. For example, if a digital switch already includes the functionality to deliver enhanced services, permitting the bundling of basic local exchange and enhanced services may yield greater sales and lower overall rates for consumers. Prohibiting bundling, in contrast, prevents carriers and consumers from enjoying these efficiencies.

In sum, the ability to bundle CPE and enhanced services with interstate, domestic, interexchange services and local exchange services will enable carriers to offer consumers many attractive and affordable combinations of services and products. These bundles would not only simplify the billing process, but they would enable customers to purchase service packages less expensively than buying the products separately. Clearly, bundling would advance the public interest.

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[11] *Bundling of Cellular Customer Premise Equipment and Cellular Service*, CC Docket No. 91-34, FCC 92-207 (rel. June 10, 1992), at ¶¶ 19, 20

[12] Id. at ¶ 21. *See also* Duncan Aff. at 8 ("[F]irms only compete when there is an opportunity for profit. Furthermore, one of the most important ways they compete is by differentiating their product offerings, which is what bundling allows.").

B. Elimination of the Bundling Prohibition Would Comport With Marketplace Realities.

The ever increasing demand for service and equipment packages is evidenced by a multitude of surveys and reports. In the *Bell Atlantic/NYNEX Order*, for example, the Commission noted that the evidence presented in that docket "demonstrated that many [telecommunications] customers would like to purchase both local and long distance telecommunications services as part of a single bundled service."[13] The Commission also noted that, "according to one recent research report, nearly 80% of American households would like to receive telecommunications and information services (local telephone, long distance, cable television, cellular, paging, and Internet access) from a single provider if the overall cost remained the same."[14]

In addition, GTE has performed its own internal research regarding customer demand for bundled service offerings. This research shows that 64 percent of GTE's customers are interested in purchasing bundled packages of services from GTE. These and other studies show that many telecommunications customers would prefer one bill, rendered by one provider, for local, long distance, wireless, Internet and the associated CPE equipment required to receive those services.[15]

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[13] *Bell Atlantic/NYNEX Order,* ¶ 114

[14] *Id.* ¶ 111 n.221

[15] *See, e.g.*, The Yankee Group 1997 Technologically Advanced Family Report (Dec. 1997); K. Clemmer, "Consumers & Technographics: Do Consumers Want Bundling?," (Forrester Research, Aug. 1998); T. Rhinelander & C. Mines, "The Forrester Brief: People & Technology Strategies," (Forrester Research, Inc., June 25, 1998); Consumer Communications Report, "Bundling: Cuddling the Communications Consumer" (Vol.

(Continued...)

Fueled by this consumer demand, as well as powerful new technologies and the market-opening policies put in place by the 1996 Act, numerous service providers from all segments of the communications industry have announced business alliances and new products aimed at providing bundled packages of services on a national and global basis. Examples of current or planned integration of services include:

- AT&T and TCI have said that, following their merger, they will upgrade TCI's cable infrastructure to accommodate two-way communication and begin providing digital video services, digital telephony, and high-speed data to consumers by the end of 1999.[16]

- Sprint is deploying an integrated on-demand (ION) network, which, "[b]y using ATM technology coupled with [Dense Wave Division Multiplexing] and its synchronous optical ring architecture ... has the ability to push its network intelligence into customer premises" and give "access to information services ... phone calls, Internet, [and] videoconferencing." According to Sprint, the new network will "give continuous access ... for voice, video, data, faxes, and other services" to both large businesses and, within 18 months, to consumers.[17]

- Cox, MediaOne, and other large cable operators are offering integrated voice and high-speed Internet access along with multichannel video

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(...Continued)
15, No. 12, June 1998); B. Azuma, "Market Analysis: Bundling or Bungling" (Gartner Group, Oct. 20, 1997).

[16] Joint Release of AT&T and Tele-Communications, Inc., available at <http://www.att.com/press/0698/980624.cha.html>; *see also* Jared Sandberg and Thomas E. Weber, *A High Tech Vision Faces Big Hurdles*, Washington Post, June 25, 1998, at B1 (quoting AT&T Chairman C. Michael Armstrong as stating that "We can become a provider of broadband services that encompass telephony [and] entertainment").

[17] "Sprint Challenges Rivals With New Network, Seeks New Regulatory Treatment," *Communications Daily*, June 3, 1998, at 2-4. AT&T apparently plans to deploy a similar network. *See* "AT&T to launch high-speed network service," *Washington Times*, Sept. 10, 1998, at 1B.

programming.[18] Indeed, as the recent FCC Office of Planning and Policy report regarding Internet over Cable notes, "[t]he cable industry is in the midst of a transformation ... to two-way, interactive broadband systems ... which enable the industry to deliver a wide range of telecommunications and information services – including Internet access, telephony, and digital television."[19] Cox has further announced the launching of digital telephone service via cable in San Diego, providing voice, video, and data over a single network.

- Wireless service providers offer economical local and long distance telephony, CPE and other enhanced telecommunications services in package format.

- Direct Broadcast Satellite providers, with millions of customers, are offering video and Internet access. For example, Hughes DirecPC/DirecTV offers high-speed Internet access, called Turbo Internet Software, at speeds ranging from 200 to 400 kbps.[20]

- Incumbent local exchange carriers such as GTE, BellSouth, and Ameritech are offering video and Internet access through affiliates, which also may resell voice service where permitted by state regulators.

- LMDS providers are offering local and long distance telephony, Internet access, and video. For example, WinStar is deploying network equipment that will support "enhanced voice, video conferencing, native LAN-LAN interconnections, MPEG-2 video and high-speed Internet access on a single fully integrated local metropolitan area ATM transport network."[21]

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[18] *See Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Fourth Annual Report*, 13 FCC Rcd 1034, 1063-69 (1998)

[19] B. Esbin, "Internet Over Cable: Defining the Future in Terms of the Past, OPP Working Paper #30 (August 1998), at 75 ("Internet Over Cable"). This Report goes on to describe the wide range of Internet services being offered over cable. *See id.* at 77-80.

[20] *See* <http://www.future-furnishings.com/DirectDuo/DirecDuof.html>; <http://www.direcpc.com/about/a36f.html>.

[21] *See* "WinStar and Hughes Network Systems Enter Strategic Relationship for Nationwide Deployment of Point-to-Multipoint Broadband Fixed Wireless Networks," <http://www.winstar.com/index/New.htm>.

For its part, GTE has attempted to satisfy consumer demand for new and different services in several ways. GTE Communications Corporation (GTE-CC), for example, offers customers a wide range of local and long distance telecommunications and other services and products, consistent with the Commission's existing rules.[22] However, GTE's efforts have been hindered by a maze of state and federal regulations that restrict these activities.

Before all carriers can fully respond to consumer demand, therefore, current restrictions on any carriers' ability to bundle must be eliminated. As Dr. Duncan explains:

> Regulation ... still inhibits carriers from offering the full range of service options demanded by consumers. It is time for regulation to catch up with technology and to accommodate the needs and wants of consumers. The prohibition against the bundling of telecommunications services with enhanced services and CPE needs to be removed, which, in turn, will allow the market to function properly."[23]

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[22] GTE urges the Commission not to take any action in this docket to restrict the ability of companies (like GTE-CC) that share a common corporate parent with an ILEC to meet consumer demand in the same manner as competing providers. *See* FNPRM, ¶ 25 (tentatively concluding that "to the extent the BOCs and their section 272 affiliates, as well as independent LECs and their affiliates, are classified as nondominant in the provision of interstate, domestic, interexchange services, these carriers may bundle CPE with such services to the same extent as other nondominant interexchange carriers."). Imposing asymmetric limitations on affiliates of ILECs would grossly distort competition and harm consumers while serving no legitimate countervailing purpose.

[23] Duncan Aff. at 9.

III. TO MAXIMIZE CONSUMER BENEFITS AND ASSURE FAIR COMPETITION, THE BUNDLING RESTRICTION SHOULD BE ELIMINATED FOR ALL SERVICE PROVIDERS.

The FNPRM seeks comment on whether non-dominant interexchange carriers should be permitted to bundle long distance services, CPE,[24] local services,[25] and enhanced services.[26] In addition, the Commission asks whether "there are carriers in the local exchange or exchange access markets that would similarly not raise anticompetitive concerns if allowed to bundle CPE with local exchange and exchange access services" and urges parties to "address what role market power should play in the analysis" and whether "lifting the CPE bundling restrictions on only certain categories of [LECs] would promote competition ...."[27] GTE respectfully submits that predicating a decision to retain the bundling restriction solely on perceptions of local exchange market power is misguided. As discussed below, there is no rational basis for maintaining an asymmetrical bundling prohibition applicable only to ILECs, and doing so would distort competition and deprive consumers of the broadest possible array of marketplace choices.[28]

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[24] FNPRM, ¶ 13.

[25] *Id.*, ¶ 26.

[26] *Id.*, ¶ 35.

[27] *Id.*, ¶ 29; *see also id.*, ¶ 40 (enhanced services).

[28] *See* Duncan Aff. at 10 ("In order for competitors to be given accurate and efficient price signals, they must compete with firms on as symmetric a basis as possible. By adopting this approach, entrants are given accurate market signals that lead to entry in those instances where their economic costs of providing services are less than or equal to the incumbent's economic costs – not unneeded regulatory constraints.").

A. Retaining the Bundling Restriction for ILECs Is Unnecessary To Assure Consumer Choice and Protect Competition.

In determining whether to eliminate the bundling policy, the Commission should focus on whether the policy remains necessary to achieve the goals underlying its adoption. Specifically, the bundling prohibition should be discontinued if it no longer is needed to avoid "restricting consumer choice and retarding the development of a competitive CPE market."[29] Upon analysis, it is clear that retaining the unbundling policy with respect to ILECs is unwarranted and (as discussed in section III.B below) would actually harm consumers.

In considering the most appropriate action, the Commission should recognize that "bundling" can mean different things.[30] As explained in the attached Declaration of Dr. Gregory Duncan, bundling can be pure or mixed.[31] "Pure" bundling (which is often referred to as "tying") refers to a requirement that a customer purchase multiple goods or services in order to obtain any of the component services. By contrast, "mixed" bundling – which is what the Commission appears to be proposing in this proceeding – means the ability to market services together, possibly at a single price, without restricting consumers from obtaining the components of the bundle separately. Mixed bundling raises no concerns regardless of market power – properly defined by the

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[29] FNPRM, ¶ 11, *citing Computer II Final Decision*, 77 F.C.C.2d 384, 443 n.52 (1980).

[30] The FNPRM (at ¶1) similarly defines bundling as "selling different goods and/or services together in a single package."

[31] Duncan Aff. at 5.

Commission as the ability to sustain prices above competitive levels[32] – because existing regulation of ILECs assures that they will not be able to restrain customer choice or impede competition.[33]

In this regard, it is dispositive that ILECs are required to provide local exchange and exchange access services on a standalone basis (just as IXCs continue to sell unbundled interstate, interexchange services).[34] The FCC and state commissions assure that rates for retail and wholesale telecommunications services are just, reasonable, and non-discriminatory, and these services must be tariffed in every jurisdiction. In addition, ILECs are required to allow competing telecommunications service providers to access unbundled network elements at any technically feasible

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[32] *See FNPRM*, ¶ 24.

[33] *See* Duncan Aff. at 13-14. Notably, even pure bundling raises antitrust issues only if it "substantially lessen[s] competition or tend[s] to create a monopoly in any line of commerce." *See* 15 U.S.C. §§ 15, 18. As the Commission has recognized, tying presents no problem where the markets for component services are "workably competitive." FNPRM, ¶ 11, *citing Computer II Final Decision*, 77 F.C.C.2d at 443 n.52. Indeed, there is disagreement among economists whether tying raises competitive concerns even where a firm has market power over one of the components. *Compare* Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 Am. Econ. Rev. 837 (1990) (concluding that, if a firm is a monopolist in one market where it faces rivals, allowing bundling may lead to higher prices and fewer firms in the market where there is competition) ***with*** Patrick DeGraba, *Why Lever into a Zero-Profit Market: Tying, Foreclosure, and Exclusion*, 5 J. Econ. & Mgmt. 33 (1996) (concluding that, if a firm with market power in one market is bundling its product with a separate product in a market where no firm has market power, then prices will be lower and welfare higher due to bundling).

[34] As. Dr. Duncan notes, this requirement "prevent[s] *any* possibility of anticompetitive tying." Duncan Aff. at 13 (emphasis in original).

point at cost-based rates.[35] ILECs also must offer unbundled retail telecommunications services to competing carriers at a wholesale discount, enabling them to resell those services either individually or as part of their own equipment/service bundles. Since any ILEC bundle could be replicated by consumers or competitors, permitting ILECs to bundle plainly will not diminish customer choice or restrain competition. Rather, such bundling indisputably would increase the range of choices (since pre-existing services will remain separately available) and promote more vigorous competition (since other carriers will be motivated to respond to ILEC bundled service offerings).[36]

Additionally, no inordinate concerns are raised when CPE or enhanced services are added to the bundles offered by ILECs. The customer (and competing service providers) can always purchase the components of those bundles separately. Moreover, the ILEC has no inherent advantage in purchasing CPE in a competitive market. No ILEC, to GTE's knowledge, currently is engaged in equipment manufacturing. Rather, GTE and other companies with ILEC affiliates purchase CPE directly from manufacturers on the same basis as any other telecommunications service provider.[37] Similarly, both CPE and enhanced services are available on an unbundled

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[35] *See* 47 U.S.C. § 251(c)(3).

[36] *See* Duncan Aff. at 14 ("A mixed bundling requirement ... promotes consumer welfare by allowing consumers to choose the product in the combination they wish.").

[37] While larger LECs may be able to obtain greater volume discounts in purchasing CPE than smaller LECs would, this is not a factor related to incumbency and certainly is not a valid reason to prohibit bundling. Indeed, no ILEC, of whatever size, is likely to be able to gain better terms in purchasing CPE than AT&T, MCI WorldCom, or Sprint.

basis from thousands of providers, so there is no risk that ILECs could lever any market power they possess in the provision of local service into other markets.[38]

In short, the continued availability of (1) local exchange and exchange access offerings at regulated rates, (2) the unbundling obligation, and (3) the discounted resale service requirement render moot the consumer choice and competitive concerns that underlie the current bundling policy. No ILEC can exercise market power in the local exchange market (assuming *arguendo* that it retains such power with respect to certain services), because no ILEC can sustain prices above competitive levels in the face of this regulation.[39] This is true regardless of whether the ILECs are permitted to bundle. Accordingly, permitting the ILECs to bundle will advance competition and consumer choice. In contrast, as discussed below, retaining the bundling prohibition for ILECs alone would favor individual competitors rather than competition and deprive consumers of valuable service options.

B. Asymmetric Imposition of a Bundling Prohibition on ILECs Would Distort Competition, Impair Consumer Choice, and Be Fundamentally Inequitable.

As the FNPRM indicates, the Commission is considering whether to retain the bundling restriction for ILECs while permitting all other competitors to package local,

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[38] In the *Cellular Bundling Order* (at ¶¶ 13, 14), the Commission dismissed concerns that cellular carrier could impede competition in the CPE market, noting that "most cellular carriers do not manufacture CPE" and the CPE market is characterized by "a robust level of competition."

[39] Of course, with the rapid emergence of competition, any residual market power is likely to dissipate rapidly even in the absence of close regulation.

long distance, and enhanced services and CPE without constraint.[40] Imposing such an asymmetric bundling restriction on ILECs would amount to the Commission's picking winners and losers in the market – a role that plainly is inappropriate for a regulator to perform, as the Commission has recently emphasized.[41] The marketplace, not regulatory fiat, must determine which companies succeed and which fail.

As GTE established in section II above, any company that wishes to compete in today's telecommunications marketplace must be able to offer bundled service and equipment packages if other providers are allowed to do so. This ability will become increasingly important over the next few years, as technological convergence permits entities from previously discrete industry segments to offer a full range of services (including local and long distance telephony, multichannel video programming, and high-speed Internet) using any of several disparate technologies (including copper, fiber, coax, hybrid fiber/coax, terrestrial wireless, and satellites). IXCs, cable companies, LMDS operators, satellite service providers, CLECs, and electric utilities all will be able to bundle services. Indeed, leading companies from each of these industry sectors are working to bundle services as seamlessly and affordably to consumers as possible.

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[40] FNPRM ¶¶ 27-29.

[41] *See Deployment of Wireline Services Offering Advanced Telecommunications Capability, Memorandum Opinion and Order and Notice of Proposed Rulemaking*, CC Docket No. 98-147, FCC 98-188 (rel. Aug. 7, 1998), at ¶ 2 ("The role of the Commission is not to pick winners or losers, or select the 'best' technology to meet consumer demand, but rather to ensure that the marketplace is conducive to investment, innovation, and meeting the needs of consumers.").

If the Commission extends the same flexibility to ILECs, consumers can only benefit from the added competition. Under any reasonable competitive analysis, ILECs bring a lot to the table. Their strength in customer service and product innovation should enable them to develop highly attractive and affordably priced packages. In turn, other competitors in the market will be driven to assemble their own offerings. As rivalry among competitors escalates, customers will benefit from lower prices and more responsive service.

In contrast, an asymmetric bundling policy would add yet another obstacle to the ILECs' ability to compete on par with large, well-financed competitors like AT&T/TCI and MCI WorldCom, reduce consumer welfare,[42] and inefficiently allocate producer welfare. As GTE detailed in its comments in Docket Nos. 98-146 and 98-147, ILECs already are forced to operate under regulatory constraints that none of their competitors face, including the very largest telecommunications companies in the world.[43] Those same companies undoubtedly will urge the perpetuation and expansion of those disabilities in this proceeding, claiming without substantiation that permitting ILECs to bundle inevitably would lead in some unspecified fashion to ILEC domination of the enhanced service, CPE, and interexchange markets. As the foregoing discussion

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[42] *See* Duncan Aff. at 11 ("Given that customers want to use the ILEC and that bundling is welfare enhancing ... then a loss of welfare results if customers are prevented from selecting their preferred choice of provider.").

[43] *See* Comments of GTE, CC Docket No. 98-146 (filed September 14, 1998); Reply Comments of GTE, CC Docket No. 98-146 (filed October 8, 1998); Comments of GTE, CC Docket No. 98-147 (filed September 25, 1998); Reply Comments of GTE, CC Docket No. 98-147 (filed November 13, 1998).

concerning continued regulatory constraints and the individual availability of the component parts of any bundle establishes, such claims are utterly without foundation. Moreover, placing a regulatory thumb on the competitive scale in this manner would short-change consumers and improperly protect individual competitors at the expense of competition.[44] Finally, depriving only ILECs of the ability to bundle will render them second-class competitors and undermine their capacity to pursue new market opportunities.

IV. THE COMMISSION SHOULD CLARIFY THE ELIGIBILITY OF CARRIERS OFFERING BUNDLED SERVICES TO RECEIVE HIGH COST SUPPORT.

A tangential, but nonetheless important, consideration that confronts the Commission in deciding whether to permit bundling of all types of telecommunications and enhanced services with local exchange service is the relationship to the Commission's proposed universal service mechanism. For example, suppose an ELTEL offers only one bundle of services, and the bundle contains supported local exchange services as well as CPE and interexchange toll usage. In this scenario, GTE believes the ELTEL should receive federal universal service support for serving customers who purchase the bundle.[45]

The fundamental question, however, is whether an ELTEL has any obligation to

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[44] *See Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962).

[45] The plain requirements of Section 214(e) are satisfied if the ELTEL has been designated by the state commission as offering the service and advertising it using media of general distribution.

offer universal service at an "affordable" rate.[46] For universal service to be meaningful, there must be such an obligation. However, if the aforementioned bundle of local, toll, and CPE is priced attractively to the consumer at $75, bundling essentially becomes a means of using the universal service mechanism to selectively target only high-value consumers. Since the $75 bundle is the ELTEL's only offer in the marketplace, it never has to serve anyone who spends less than $75.[47] Universal service funding in this example becomes a premium for targeting only those customers that would be the most desirable to serve. Furthermore, since only ILECs would have an obligation to offer universal service at an affordable tariffed rate under state regulatory requirements, a serious concern arises as to whether the universal service funding that is calculated to be sufficient for an area on average would be sufficient and sustainable if such bundling led to selective demand loss of only the most attractive customers.

A simple solution would be to require every ELTEL that chooses to provide service bundles to offer at least one set of services that meets (or exceeds) the list of supported services, but is available at a price no greater than the maximum affordable rate determined by the state commission. The proposed solution would be consistent with the requirements of Section 214(e)[48] and would eliminate the potential asymmetry

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[46] *See* 47 U.S.C. §254(b)(1) ("Quality services should be available at just, reasonable, and affordable rates.").

[47] This example raises the issue of whether the plain requirements of Section 214(e) permit the Commission to establish two classes of ELTELs: those that have an obligation to offer universal service ubiquitously by virtue of their incumbency and those that do not but receive the same support payment.

[48] Section 214(e) states that ELTELs are eligible to receive support in accordance with

(Continued...)

and selective demand loss noted above. GTE therefore urges the Commission to act consistent with this recommendation.

V. CONCLUSION

GTE urges the Commission to remove the CPE and enhanced services bundling restriction for all telecommunications providers, regardless of their classification. Doing so would allow providers to offer consumers innovative and affordable packages, foster competition, and provide all carriers with a full and fair opportunity to compete. Existing regulatory safeguards and antitrust laws will ensure that customers will continue to have a choice of goods and services, and will also prevent any carrier with market power in one market from retarding competition in other markets. The Commission also should require every ELTEL that chooses to provide service bundles to offer at least one service bundle that meets (or exceeds) the list of supported services but is available at

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(...Continued)
Section 254, which clearly permits states to establish additional rules and regulations that are consistent with fostering universal service support that is sufficient, explicit, specific, and sustainable. *See* 47 U.S.C. §254(f). Alternatively, the Commission simply could read the definition of universal service as implicitly requiring affordability.

a price no greater than the maximum affordable rate determined by the state commission.

Respectfully submitted,

GTE SERVICE CORPORATION and its affiliate domestic communications companies

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Its Attorneys

November 23, 1998

ATTACHMENT 1

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

In the Matter of	)	
	)	
Policy and Rules Concerning the Interstate Interexchange Marketplace	)	CC Docket No. 96-61
	)	
Implementation of Section 254(g) of the Communications Act of 1934, as amended	)	
	)	
1998 Biennial Regulatory Review -- Review of Customer Premises Equipment and Enhanced Services Unbundling Rules in the Interexchange, Exchange Access and Local Exchange Markets	)	CC Docket No. 98-183

AFFIDAVIT OF
GREGORY M. DUNCAN

I, Gregory M. Duncan, being duly sworn, say:

1. My name is Gregory M. Duncan. I am a Vice President at National Economics Research Associates, Inc. ("NERA"). Established in 1961, NERA is an international firm of consulting economists recognized for its work in antitrust matters, telecommunications, energy, securities litigation, employment and discrimination, intellectual property, environment, health, transportation, international trade and sports.
2. I received a Master's degree in Statistics in 1974 and a Ph.D. in Economics in 1976, both from the University of California, Berkeley.
3. Beginning in 1975, I taught in the Economics Department and Statistics Program at Northwestern University in Evanston, Illinois, where I was an Assistant Professor of

Economics and of Statistics. There, my teaching included demand, cost and production theory, econometrics, and statistics. I also conducted research on demand and cost and production that appeared in refereed journals. I left Northwestern in 1979 to join the faculty at Washington State University. There, I served as Professor of Economics and of Statistics. My research continued in demand, production, cost theory, and applications, as well as in other topics. During that period, I was one of the first Associate Editors of the academic journal *Econometric Theory*. My last position before joining NERA was with GTE Laboratories, Inc.'s Department of Economics and Statistics as a Staff Scientist, a position reserved for a small number of independent researchers with responsibility for developing, proposing, and conducting research, as well as supervising the research of other economists and statisticians.

4. I have published many refereed papers in cost, production, and demand analysis, including the results of the research that supported other testimony before a number of regulatory commissions. My particular expertise includes the area referred to as applied microeconomics. As a consequence, I was asked to teach and have taught many graduate level courses that covered directly and indirectly all aspects of microeconomics, including welfare analysis. My papers in this area appear in the *International Economic Review, Proceedings of the National Academy of Sciences, Econometrica*, and the *Journal of Risk and Uncertainty*. Under my supervision, a number of Ph.D. students at Northwestern University, Washington State University, and Boston University wrote dissertations that utilized modern demand methods. In addition, I have directed studies that

determined the economic benefits of bundling telecommunications services and service features. In particular, I developed a set of procedures to determine the willingness to pay for bundled features.

5. I have been asked by GTE to evaluate whether the public interest would be served by changes to the unbundling rules associated with Customer Premise Equipment ("CPE"), enhanced services, and interstate interexchange, local exchange, and exchange access services. In particular, should service providers in the local exchange and exchange access markets be allowed to bundle enhanced services and CPE with their local and long distance telecommunications services.

Introduction

6. In its Further Notice of Proposed Rulemaking ("FNPRM"),[1] the Commission seeks comment on many issues related to the bundling of telecommunications (or "basic") services with "enhanced" (or information) services and/or CPE. The Commission has three goals: ensuring carriers are unable to act anticompetitively to harm consumers; fostering competition in all three markets; and the elimination of unnecessary regulation. Issues vital to the Incumbent Local Exchange Carriers ("ILECs") ability to compete are: should the Commission continue to regulate the local exchange and exchange access markets differently from other markets (*i.e.*, interstate interexchange) in regards to bundling; and should it continue to regulate "dominant" carriers differently from nondominant carriers.

[1] FCC 98-258 (released October 9, 1998).

7. The Commission correctly recognizes that the CPE and enhanced services markets are very competitive. It also recognizes, again correctly, that the interstate interexchange marketplace is "substantially" competitive on a retail basis. Based on this recognition, there is no reason for the Commission to continue to prohibit the bundling of CPE and/or enhanced services with interstate interexchange service. Since all three markets are competitive, no regulation is required. Economic regulation should be a substitute for, not a complement of, competition. When the market is competitive, as these markets are, regulation is not needed and can be harmful. The quandary then remains what to do with the local exchange and exchange access markets, where competition is not yet as vigorous as in the interexchange market, and should nondominant carriers operating in these markets be treated differently than dominant carriers.

8. From an economic standpoint, elimination of the unbundling prohibition will benefit consumers. This prohibition should be eliminated for all competitors, not just nondominant carriers. Asymmetric regulation is generally bad or ineffective because it withholds the potential benefits of competition from consumers by constraining an entire class of competitors (*i.e.*, ILECs). In addition, regardless of the degree of competition that exists in the local exchange, asymmetric regulation of ILECs is not required to ensure that market power is controlled. Existing regulatory requirements in the local exchange (*e.g.*, tariffed rates and resale requirements) prevent the exercise of market power, and these regulatory restraints are unaffected by the bundling prohibition. Further, the availability of

individually unbundled elements of the bundled service prevents using bundling to exercise market power.

Bundling Benefits Consumers

8. There is a long tradition in the economics literature on the practice of commodity bundling.[2] The three modes of bundling strategies are pure bundling (tying), mixed bundling, and component selling (or pure unbundling). In pure bundling, consumers must purchase the entire bundle or nothing at all. Mixed bundling allows the consumer to select either the bundle or individual components. Pure unbundling requires consumers to construct their own bundles by purchasing individual components. Sometimes consumers who choose to purchase the bundle will pay less than if they purchase individual components. In almost all cases, the availability of bundled offerings enhances convenience. Also, most often bundling reduces customer transactions costs associated with putting the bundle together (*e.g.*, one stop shopping). Further, it is intuitively obvious that mixed bundling is the superior option from a customer's perspective. A mixed bundling strategy enhances welfare by allowing both high and low-demand users to satisfy their preferences by joining the appropriate consumption groups. Mixed

[2] *See* G.J. Stigler, "*United States v. Loew's Inc.*:A note on block booking," *Supreme Court Review*, 152-7 (1963); W.J. Adams and J.L. Yellen, "Commodity Bundling and the Burden of Monopoly," *Quarterly Journal of Economics* 90:475-98 (1976); R. Schmalensee, "Gaussian Demand and Commodity Bundling," *Journal of Business* 57, No. 1, pt. 2:S211-30 (1982); R.P. McAfee, J. McMillan and M.D.Whinston, "Multiproduct Monopoly, Commodity Bundling, and Correlation of Values," *Quarterly Journal of Economics* 104:371-83 (1989).

bundling provides consumers with a choice, which is something that consumers both want and need.

9. Market research surveys on the economic benefits of bundling repeatedly have indicated the value consumers attach to bundling related products. While the studies I directed did not specifically include the possibility of CPE bundling, the principles are clear: a substantial number of customers are willing to pay a non-trivial amount to avoid putting a bundle of related services together themselves.

10. The only pervasive option available to telecommunications consumers today (other than the limited exception of CMRS/CPE combinations) is a pure unbundled option. Consumers want the right to purchase telecommunications services and products on an integrated basis from one provider. Telecommunications consumers, especially businesses, need solutions to all their telecommunications needs, which includes packages or bundled services. Recent information indicates that 85 percent of mid-size firms are interested in bundled services from one provider and 50 percent most definitely would purchase bundled services. Further, of the firms definitely interested, 42 percent want local, long distance, wireless, Internet, and enhanced data services included in the bundle—a complete solution.[3]

11. Service quality, customer service, and convenience are of prime importance to consumers. These factors are so important to businesses that 47 percent report better service as the reason for switching to a single provider.[4] This has two very

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[3] *See* Global Information, Inc, *Business Branding & Bundling: Telecommunications Services 1998*, http://www.gii.co.gp/english/sg3102_brandingbundling.html.

[4] *Id.*

important implications. First, consumers are willing to switch providers, which indicates that the market is competitive. Second, the quality of telecommunications service will improve as consumers make it more and more of an issue. Thus, carriers wanting to improve their market share simply will have to provide better service. In a competitive market, telecommunications carriers will be forced to design bundles that satisfy the demands of increasingly sophisticated customers that want value, defined in terms of convenience and better services, at a reasonable price.[5] This is definitely a consumer benefit.

12. Moreover, residential customers also want the convenience of bundles. Another survey of all telecom customers revealed that the two top priorities in a communications package are consolidated bills and a reliable brand provider. Further, market studies reveal that more than half of the consumers prefer certain cross-service family offerings and most prefer single-source, traditional companies for bundled services.[6] All consumers want the right to purchase bundled services and products from whatever carrier they choose, including their local carrier, and the Commission should not thwart the consumer in an effort to artificially promote competition. Regulation should interfere in the marketplace only when it is necessary to ensure just and reasonable and nondiscriminatory rates.

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[5] *See* Arthur D. Little, Inc, *The Bundling Game: From Ground Zero to 21st Century Leadership*, http://www.adlittle.com/ industry/time/bundling1, at 3.

[6] *See* Arthur D. Little, Inc, *The Bundling Game: Bundling: The Hard Part*, http://www/adlittle.com/industry/time/bundling2, at 3.

Intervention, when not necessary, leads to inefficient entry and distorts the marketplace.

13. The Commission must recognize that firms only compete when there is an opportunity for profit. Furthermore, one of the most important ways they compete is by differentiating their product offerings, which is what bundling allows. Competition should be a natural outcome of companies seeking to obtain a competitive return on their shareholders' investment. Satisfying customers' demands provides economic rewards which, in turn, stimulates competition. Rather than stimulating competition, regulation serves to protect inefficient competitors.

Regulation Remains the Only Reason for Product Separation

14. Consumer preference for bundled services is fueled by technological development. In the past, technology and historical regulatory boundaries drove the definition of telecommunications products and services. Today, however, technological advances are rapidly changing the telecommunications business, blurring the distinction between products and services on the one hand and the rules that define them on the other. Traditional products and services can be intermingled so that they are individually indistinguishable. Innovations once thought to be in the distant future are happening today. Wireless services have become nearly ubiquitous in business operations, with over 60 percent of businesses currently subscribing to cellular/PCS service. Consumers can have a phone that works at home and on the road and with the same telephone number. In addition, they can have e-mail, paging, Internet access, voice mail connections, and other features

and functions. Further, the distinction between services will become increasingly blurred with time. Consider a future where there are no local or long distance charges, but a few cents a minute to call anywhere, anytime. Although this seems very different from today's environment, it is happening today. Thus, technology change is erasing the historic regulatory definitions of local v. long distance, basic v. enhanced, and wireline v. wireless.

15. Regulation, however, still inhibits carriers from offering the full range of service options demanded by consumers. It is time for regulation to catch up with technology and to accommodate the needs and wants of consumers. The prohibition against the bundling of telecommunications services with enhanced services and CPE needs to be removed, which, in turn, will allow the market to function properly.

The Bundling Restrictions Should Be Lifted for All Competitors in the Local Exchange and Exchange Access Markets

16. The Commission seeks comment on whether market conditions in the local exchange and exchange access markets warrant continuing the bundling restrictions. The answer is definitely not. A principal goal of regulatory policy in introducing and promoting competition should be to reduce, to the greatest extent possible, unnecessary asymmetric obligations on the incumbent provider. Pursuing such a policy ensures that a provider's efficiencies and relative abilities to supply customer demands determine success in the market—not regulatory distortions. Therefore, regulation must not only prevent the exercise of market power by the incumbent but must simultaneously regulate the incumbent and

entrants as symmetrically as possible in all other dimensions. Regulation should protect consumer welfare by eliminating unnecessary regulatory constraints that do not reward efficiency and prevent the least-cost supplier from providing the service. This should occur when the market is first opened to competitors so that entrants and incumbents will make efficient entry and exit decisions, some of which entail large investments and sunk costs. In order for competitors to be given accurate and efficient price signals, they must compete with firms on as symmetric a basis as possible. By adopting this approach, entrants are given accurate market signals that lead to entry in those instances where their economic costs of providing the service are less than or equal to the incumbent's economic costs—net unneeded regulatory constraints. This ensures that the firm, which is capable of producing the service at the lowest economic cost, provides it—thus ensuring productive efficiency. Accordingly, it also promotes consumer welfare. Occasionally, competition may prevent the minimization of total production costs. Nevertheless, it may improve social welfare if the gains in consumer surplus from enhanced price competition outweigh the higher production costs that result from suboptimal production. The key word is price competition. Consumer welfare will only be better off if price competition is allowed.

17. The Commission should not provide the ILECs' competitors an additional advantage by allowing them to bundle products and services while prohibiting the ILECs. If the consumer surveys are correct, and there is no reason to believe they are not, consumers want the ILECs to have the ability to provide

telecommunications solutions. The Commission should recognize this and afford this very limited flexibility to the ILECs.

18. A prior FCC Chief Economist recognized the pitfalls associated with unnecessary asymmetric regulation. It is very "important that the playing field should be leveled upwards, not downwards" because "rules that forbid a firm from exploiting efficiencies, just because its rivals cannot do likewise" do nothing but harm, rather than improve, consumer welfare.[7] Given that customers want to use the ILEC and that bundling is welfare enhancing (which it is), then a loss of welfare results if customers are prevented from selecting their preferred choice of provider. As mentioned above, these costs may be indirect costs such as the transaction costs of finding a new trustworthy provider who can bundle all the services reliably. This cost could be avoided by consumers but would not be if dominant players were prohibited from bundling when nondominant can bundle.

19. If the Commission establishes impartial rules that allow the ILECs, as well as new entrants, an equal opportunity to compete, it can rely on market incentives to produce competitive outcomes. "If private branch exchanges (PBXs) compete directly against LEC-supplied Centrex service, then it makes no sense to order the unbundling of either. Suppliers of both PBXs and Centrex will bundle or unbundle as customers demand, or will quickly lose ground to more responsive competitors."[8] This theme holds true for other services as well. An interest in

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[7] Joseph Farrell, *Creating Local Competition*, 49 Fed. Comm. L.J. 201, 212 (1996).

[8] Peter W. Huber, *Competition and Open Access in the Telecommunications Markets of California* (Feb. 8, 1994).

consumer welfare must take precedence over the retention of artificial distinctions such as dominant and nondominant, which no longer are valid in either the exchange access or local exchange markets. These markets have Competitive Local Exchange Carriers, Alternative Local Exchange Carriers, cellular carriers, PCS providers, electric companies, cable companies all joining in the fray to provide services and products.[9]

20. The Commission must establish a regulatory climate that permits the development of efficient and fair competition. This means that market forces should be allowed to determine which firms provide service. Granting the ILECs the flexibility to offer bundles, combined with adequate safeguards, must not wait until the local exchange and exchanges access markets are very competitive. Such an approach increases the likelihood of inefficient entry due to uneconomic opportunities afforded by regulation. Adequate regulatory flexibility must be permitted at the advent of competition, which will assure that the most efficient providers prevail.

21. Regulatory policy should enable the development of competition without mandating it directly or promoting it artificially (*i.e.*, entry barriers should be removed, but new entrants should not be afforded undue long-term advantages). Also, regulation should facilitate production by low-cost providers, which means it should be nondistortionary and competitively neutral. In other words, in competitive markets,

[9] An example of cross-service offerings, which are infiltrating the local exchange, is Conectiv (formerly Delmarva Power and Atlantic Energy) which offers home security, communications, and power services.

the incumbents' burdens (*e.g.*, cross subsidization, rate averaging, carrier of last resort, universal service) become industry burdens. Otherwise, high-cost producers will continue to survive in the marketplace when they should not. Lastly, if designed properly, regulatory plans should go away when competition has progressed sufficiently.

Anticompetitive Conduct Would Not Result from Removal of the Bundling Prohibition

22. While eliminating unnecessary regulatory constraints and granting regulatory flexibility are sound economic policy, the Commission does have a responsibility to guard against anticompetitive conduct. In this case, existing regulations are sufficient to provide the proper safeguards against possible exercises of market power by the ILECs if allowed to bundle their telecommunications services with CPE and enhanced services. First, no ILECs manufacture CPE anymore. This means that they must buy CPE on the same basis as any other purchaser, which gives them no incentive to sell it below cost, even if they lawfully could. Second, ILECs are required to file retail tariffs with state commissions for any bundled offering, restricting any ability to uneconomically lower prices. Further, the resale provisions of the Telecommunications Act of 1996 would require the ILECs to provide these unbundled retail offerings to their competitors, at the retail rate less avoided costs. These factors adequately restrict the ILECs' ability and incentive to engage in any type of anticompetitive conduct.

23. In addition, the Commission can prevent *any* possibility of anticompetitive tying simply by maintaining the requirement that the individual components of bundles

be offered separately. The very way in which tying causes a problem is whenthe consumer is required to buy the whole package or nothing at all. A mixed bundle requirement effectively prevents this behavior and, simultaneously, promotes consumer welfare by allowing consumers to choose the product in the combination they wish.

I hereby swear, under penalty of perjury, that the foregoing is true and correct.

Gregory M. Duncan

Subscribed and sworn to before me this 21st day of November 1998.

TOBY K. ANDERSON
Commission Expires
NOTARY
PUBLIC
MAR. 1, 2001
STATE OF WASHINGTON

Toby K Anderson
Notary Public

My Commission expires: March 1, 2001

CERTIFICATE OF SERVICE

I, Ruth S. Massie, hereby certify that on this 23rd day of November, 1998, I caused copies of the foregoing "Comments of GTE" to be sent via hand-delivery or via first-class mail, postage pre-paid to the following:

International Transcription Service, Inc.
1231 20th Street, NW
Washington, DC 20036

Ruth Massie

Ruth S. Massie