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EX PARTE OR LATE FILED

November 23, 1999

BY HAND

Magalie R. Salas, Esq.
Secretary
Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
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Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: *CC Docket No. 98-184; Ex Parte Filing*

Dear Ms. Salas:

Enclosed are two copies of a written *ex parte* to be filed on the public record in the above-referenced docket. By copy of this letter, I am hand delivering this document to Dorothy T. Attwood of Chairman Kennard's office and Christopher J. Wright, General Counsel.

If you have any questions, please contact me.

Very truly yours,

Steven G. Bradbury

Steven G. Bradbury

SGB:pd

cc (w/encl.): Dorothy T. Attwood
Christopher J. Wright, Esq.

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Alternative Arrangements That
Eliminate Any InterLATA Issues Relating to
GTE Internetworking

This paper outlines two possible arrangements that would eliminate any interLATA issues in the GTE/Bell Atlantic merger proceeding that pertain to the Internet backbone and related services provided by GTE Internetworking ("GTE-I," formerly BBN).

Background. GTE-I provides Internet backbone and related data services that the FCC has concluded fall within the scope of Section 271 of the Communications Act. If the combined Bell Atlantic/GTE were to retain ownership or control of GTE-I after the merger, GTE-I would become an affiliate of Bell Atlantic's local telephone companies ("BOCs"). The Act defines an "affiliate" as an entity that is under common "ownership" or "control," where ownership is defined as an "equity interest (or the equivalent thereof) of more than 10 percent." 47 U.S.C. § 153(1).

Alternative Arrangements. Either of the following two alternatives would avoid having Bell Atlantic/GTE take ownership or control of GTE-I so that GTE-I would not be a BOC "affiliate" subject to Section 271.

a. Sale/Contingent Purchase. Bell Atlantic/GTE could sell to an unrelated third party purchaser 90 to 100% of the stock in GTE-I, keeping at most only the 10% equity interest it is permitted by the Act to hold without making GTE-I an affiliate. 47 U.S.C. § 153(1). The right to vote the 90+% of shares sold likewise would be transferred to another independent third party, and GTE-I would have an independent board and management. Bell Atlantic/GTE would repurchase GTE-I from the acquirer should Bell Atlantic/GTE receive sufficient 271 approvals or other appropriate relief to operate the GTE-I business before the expiration of five years. Bell Atlantic/GTE's interest in GTE-I would be a contingent future interest only. Because Bell Atlantic/GTE could never acquire and retain any part of the GTE-I business that did not conform with the restrictions of Section 271, Bell Atlantic/GTE's ability to repurchase the full business would, in fact, be contingent on satisfying Section 271 or otherwise obtaining interLATA relief within such five-year period. In the event Bell Atlantic/GTE does not obtain appropriate relief within the five year period, Bell Atlantic/GTE will either reacquire those GTE-I assets that do not require additional relief (or otherwise bring GTE-I into compliance with Section 271), assign its entire repurchase right/obligation to an independent third party, or reacquire GTE-I solely for purposes of disposition.

b. Tracking Stock. Alternatively, we are still examining the possibility of a tracking stock structure for addressing the 271 issue. For any tracking stock proposal, we will need to obtain a favorable opinion from tax counsel and will also require guidance from the SEC concerning the impact on pooling accounting of the merger. At the present time, we are considering the following structure:

At the time of the merger, Bell Atlantic/GTE could distribute a new class of common stock that tracks the economic performance of GTE-I (the "Tracking Stock") to all of the shareholders of the combined company. The Tracking Stock and the Bell Atlantic/GTE common stock would trade independently in the public market.

At the same time that the Tracking Stock is distributed, an independent board of directors would be established for GTE-I. The independent board would have control over GTE-I, except for approved FCC minority investor safeguards, and day-to-day management of GTE-I would be exercised by a management team that is separate and independent from Bell Atlantic/GTE. The current value of any profits and losses realized by GTE-I would accrue to the benefit of the holders of the tracking stock. Bell Atlantic/GTE will commit to adopt a binding policy statement providing that any dividends declared from GTE-I's earnings will be passed through to the holders of the GTE-I Tracking Stock. If Bell Atlantic/GTE chose to redeem the Tracking Stock once it received sufficient 271 approvals or other relief, any such subsequent buy back of the Tracking Stock would be at fair market value, thus giving the holders of the Tracking Stock the full benefit of any appreciation in the value of the business. If, after a fixed period of five years, all necessary regulatory approvals have not been achieved, any assets that cannot be operated by Bell Atlantic/GTE consistent with the requirements of Section 271 will be disposed of and the proceeds distributed to the holders of the Tracking Stock.

We are continuing to explore the Tracking Stock structure. From a tax and accounting standpoint, certain adjustments, including the possibility of giving the voting rights to a proxy holder, may be required.

<u>Each of the Alternative Arrangements Eliminates Any InterLATA Issue</u>

The sale/contingent interest transaction eliminates any interLATA issue because ownership and control would be transferred to unrelated third parties. Similarly, the use of the Tracking Stock in combination with an independent board would insulate ownership and control of GTE-I from Bell Atlantic/GTE. Under the first structure, Bell Atlantic/GTE would obtain only a contingent right to repurchase GTE-I in the future if the combined company receives the regulatory relief needed to take possession of GTE-I. Under the second structure, Bell Atlantic/GTE could reacquire the economic interest in GTE-I by redeeming the Tracking Stock only after receiving 271 relief.

<u>Bell Atlantic/GTE Would Not Own GTE-I</u>. Under the terms of the Act, ownership is defined in terms of an equity interest (or its equivalent), not in terms of pure legal title. Equity interests typically are viewed as a bundle of rights – in particular, participation in the economic profits and losses of an investment, voting rights, and the right to transfer the interest. The alternatives described above effectively shift equity ownership away from Bell Atlantic/GTE for purposes of Sections 153(1) and 271.

First, the sale/contingent interest transaction would divest entirely Bell Atlantic/GTE of ownership of GTE-I through the outright sale of 90+%. It would also divest Bell Atlantic/GTE of any current right or ability to participate in the economic gains and losses of GTE-I and would transfer voting rights to an independent third party. Bell Atlantic/GTE's only remaining right – to repurchase and retain GTE-I – would only arise if Bell Atlantic/GTE receives necessary regulatory approvals within five years.

Second, under the Tracking Stock proposal, the holders of the Tracking Stock would receive the economic benefits of GTE-I's profits and losses and any appreciation in the value of GTE-I during the pendency of the 271 process. If Bell Atlantic/GTE chose to redeem the Tracking Stock once it received sufficient 271 approvals or other relief, any such buy back of the Tracking Stock would be at fair market value, thus giving the holders of the Tracking Stock the full benefit of any appreciation in the value of the business. In addition, by combining the Tracking Stock with an independent board, the governance and control of GTE-I would be exercised by the independent board, which would have the ultimate authority to operate GTE-I and oversee the decisions of its independent management team.

The fact that Bell Atlantic/GTE would obtain a contingent right to purchase GTE-I would not make GTE-I an affiliate. Because contingent interests do not have the normal indicia of ownership, the FCC does not treat contingent interests as ownership interests prior to their exercise. *See, e.g., BBC License Subsidiary L.P.*, 10 FCC Rcd 10968, 10973 n.12 (1995) ("future interests, such as options and convertible rights, are not relevant to our alien ownership determinations until converted"); *Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite* Services, CC Docket No. 92-297, FCC 98-15, ¶ 76 (rel. Feb. 11, 1998) (Third Order on Reconsideration) (contingent interests non-attributable).

Contingent interests held by a BOC in a prohibited long distance company have been approved by the FCC and are a common feature in prior transactions. For example, the FCC approved NYNEX's application to buy fixed-price options for Tel-Optik, a company operating transatlantic fiber optic cables which landed in the New York City area, while NYNEX sought the long distance authority necessary for it to assume ownership and control of Tel-Optik. *See Tel-Optik Limited*, 1 FCC Rcd 742 (CCB 1986), *aff'd* 2 FCC Rcd 2276 (1987). The FCC also recently approved Bell Atlantic's application for a landing license for FLAG, an international cable in which Bell Atlantic holds a contingent interest that, if exercised, would give Bell Atlantic an ownership interest in excess of 10 percent. Likewise, the Department of Justice and Judge Harold Greene, who were responsible for approving applications for long distance relief prior to the 1996 Act, permitted BOCs to hold fixed-price contingent interests in prohibited assets. *See, e.g.,* Report of the United States Concerning Proposed Purchase by NYNEX Corporation of a Conditional Interest in Tel-Optik, Ltd. (July 1986); Report of the United States to the Court Concerning Procedures for Approval of Contingent Interests and

Ameritech's Acquisition of a Conditional Interest in Corporation X (Sept. 19, 1986); Report of the United States to the Court Concerning Ameritech's Acquisition of a Contingent Interest (Jul. 15, 1987); *United States v. Western Elect. Co.*, No. 82-0192 (D.D.C. July 11, 1986), rev'd on other grounds, *United States v. Western Elec. Co.*, 894 F.2d 430 (D.C. Cir. 1990).

Bell Atlantic/GTE Would Not Control GTE-I. Under either structure, Bell Atlantic/GTE would not exercise control over GTE-I. The Act itself does not contain a definition of the term "control," but the FCC has a long line of precedent outlining the factors for determining control in analogous circumstances. *See Intermountain Microwave*, 24 Rad. Reg. (P & F) 983, 984 (1963). Applying the FCC's standard analysis here makes it clear that Bell Atlantic/GTE would not control the operations of GTE-I. Day-to-day management of GTE-I would rest in the hands of an independent management team. GTE-I's independent management would determine how to maintain and expand its network, make employment decisions, create positions on public policy matters, develop marketing and sales strategies, and allocate investment dollars. Any GTE-I dividends or other distributions would be passed through to the holders of the Tracking Stock. Finally, there would be no interlocking officers or directors with Bell Atlantic/GTE, and voting control would rest with an independent third party under the sale/contingent interest structure or in the hands of an independent board under the Tracking Stock structure. GTE/Bell Atlantic will retain only those minority safeguards permitted to a 10% non-affiliated equity holder, consistent with 47 U.S.C. § 153(1). In light of the totality of these circumstances, it is clear under standard FCC analysis that Bell Atlantic/GTE would have no control over GTE-I.

The Transactions Would Fully Maintain Incentives Under Section 271

Both of the proposed structures would fully preserve – and indeed strengthen – Bell Atlantic/GTE's incentives to satisfy the requirements of Section 271. First, under either option, Bell Atlantic/GTE would still have all of the same baseline 271 incentives that all other BOCs have. Bell Atlantic would retain the same overwhelming incentive to enter the traditional voice long distance business, which represents $100 billion in annual revenue nationwide, compared to only about $6 billion for the Internet backbone-related markets in which GTE-I is a relatively small competitor.

Second, having a contingent future interest in GTE-I would in no way relieve any of the 271 pressures on Bell Atlantic/GTE, but would in fact add immediate new incentives to satisfy 271. Shifting Bell Atlantic/GTE's interests in GTE-I into one of these two contingent structures would create a powerful new "stick" to induce Section 271 compliance. If Bell Atlantic/GTE resists complying with the 271 checklist or otherwise does anything else to delay or jeopardize the receipt of 271 approvals prior to the expiration of the five year period, Bell Atlantic/GTE would risk losing its ability to bring GTE-I back into the merged company. These structures would also create a further "carrot" to ensure compliance with 271, since Bell Atlantic/GTE could only achieve the immediate benefits of joint marketing of GTE-I's Internet-related services in those Bell Atlantic states where 271 approval has been obtained. Finally, Bell Atlantic/GTE will have a compelling need to achieve 271 relief in order to integrate the GTE-I data business into the merged company on a national basis as quickly as possible. As fully described in our public interest filings, GTE-I is pivotal to the success of the Applicants' business objective of offering nationwide, bundled services in competition with the Big Three long distance carriers.

Precisely because these structures give Bell Atlantic/GTE incentives to accelerate its 271 applications, they are the opposite of the U S WEST/Qwest arrangements that the FCC rejected. There, the FCC was concerned that the marketing arrangements at issue would give U S WEST the ability to provide a package of local and long distance services to its customers in advance of getting long distance relief. Here, in those states where the combined company is subject to Section 271, Bell Atlantic/GTE would be able to offer a package of services that include the interLATA long distance services provided by GTE-I only after achieving 271 relief.

Neither structure would create a significant risk that Bell Atlantic/GTE either could, or would have an incentive to, discriminate in favor of GTE-I. First, as an Internet company that caters primarily to large business customers and ISPs, GTE-I's interactions with Bell Atlantic's BOCs are almost entirely limited to the purchase of DS-1 and DS-3 point-to-point circuits. In many cases, these circuits are provided on a competitive basis, and in most cases are supplied under a published tariff. GTE-I's purchase of traditional local loops from the BOCs is limited to its provision of wholesale DSL service to ISPs, a business that accounts for less than one percent of GTE-I's revenues.

Second, these limited forms of customer/supplier interactions are readily policeable. As to price and other terms, they either are currently, or will be post-merger, all provided pursuant to a public, nondiscriminatory tariff. As to the timing of circuit provisioning or repair, inputs supplied by the Bell Atlantic BOCs to GTE-I could easily be monitored or audited to minimize any possible concerns about discrimination. Bell Atlantic/GTE, for example, would commit to the following guiding principles:

- All transactions between GTE-I and BA/GTE will be on tariffed rates or on terms readily available to other similarly situated companies.

- All transactions will be on an arms-length basis and fully documented.

- Bell Atlantic/GTE will not discriminate in favor of GTE-I in any manner, including provisioning time and standards of service, subject to regular audits.

- Joint marketing (*e.g.*, agency and reseller agreements) will be limited by 271 restrictions in Bell Atlantic states.

Third, to the extent the services at issue fall within the scope of the Section 271 checklist, any hypothetical discrimination in GTE-I's favor by Bell Atlantic/GTE would only jeopardize Bell Atlantic/GTE's ability to get GTE-I back, since such discrimination would certainly be scrutinized by the states and FCC as part of the 271 process. Fourth, similar and even greater hypothesized incentives exist for Bell Atlantic to discriminate in favor of its existing Internet and wireless assets, yet Bell Atlantic plainly has not done so. FCC and antitrust oversight has been effective. Finally, any hypothetical incentive to favor GTE-I that might be imagined would plainly be no greater (and in fact, if anything, it would be significantly less) than the acceptable levels of incentive any BOC would have to favor its own 272 affiliate after achieving 271 approval.

* * *

On a broader policy level, both of the proposed mechanisms for separating GTE-I from Bell Atlantic/GTE are especially appropriate in the context of a merger relating primarily to non-interLATA businesses. GTE-I constitutes only an ancillary part of the proposed merger, amounting to less than two percent of the companies' combined revenues.

They are also particularly well-suited to the fundamental design of Section 271. The 271 interLATA restrictions are temporary in nature – in other words, under the terms of the Communications Act, these restrictions are designed to go away once Bell Atlantic satisfies the checklist requirements in its in-region states. This context is very different from the situation where the prohibition at issue, such as a horizontal ownership prohibition, is permanent or incapable of being fixed. Thus, it is appropriate in the 271 context to rely on structures that separate ownership and control of a business pending completion of the regulatory review and compliance process. Both the Tracking Stock and sale/contingent interest proposals described above would operate in the same way to break the chain of ownership and control of GTE-I pending 271 compliance and would give Bell Atlantic/GTE only a contingent future ability to acquire and retain GTE-I once the 271 requirements are satisfied.

Approval of these proposals would not open the floodgates to other BOCs seeking similar arrangements. The relief sought by Bell Atlantic and GTE is narrow and results from unique factual circumstances. Preserving the ability of GTE/Bell Atlantic to purchase GTE-I in the long run will help keep GTE-I as a competitive Internet backbone provider in an already concentrated and rapidly consolidating market.