

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,
Plaintiff,
v.
WESTERN ELECTRIC COMPANY, et al.,
Defendants.

Civil Action No. 82-0192

FILED

AUG 7 - 1986

JAMES F. DAVEY, Clerk

MEMORANDUM

The issue before the Court^{1/} is whether NYNEX's purchase of a conditional right to acquire 100% of the stock of Tel-Optik, Ltd., would constitute entry into a line of business, requiring Court approval under section VIII(C) of the decree.

I

Tel-Optik is a Delaware corporation whose principal asset is FCC authorization to land two transatlantic fiber-optic cables linking the United States with the United Kingdom. It is undisputed that Tel-Optik's operation of these fiber-optic cables

^{1/} The issue was brought to the Court by a Report from the Department of Justice. In response to that Report, a number of entities filed briefs supporting or opposing the NYNEX acquisition.

would constitute the provision of interexchange service, an activity barred to the Regional Holding Companies, including NYNEX, absent a section VIII(C) waiver. It is also undisputed that NYNEX is not proposing, at this juncture, acquisition of an equity interest in Tel-Optik. Instead, NYNEX will pay \$10 million to Tel-Optik for the right to acquire all of Tel-Optik's stock on or before July 1, 1988,^{2/} if certain conditions, including NYNEX's assumption of Tel-Optik's outstanding debts, are satisfied.

The Department of Justice, relying on the language of section II(D) which states that "no BOC shall, directly or through any affiliated enterprise . . . provide interexchange telecommunications services," argues that no waiver is required because Tel-Optik will not become an enterprise "affiliated" with NYNEX merely because of NYNEX's conditional interest. The Department, and NYNEX, interpret the decree as requiring that a Regional Holding Company have an equity interest in an enterprise before it can be said to be affiliated with that enterprise.^{3/}

^{2/} That deadline may be extended for 60 days under certain conditions. Conditional Purchase Agreement, Article XIII (filed June 20, 1986 as Appendix 2 to Report of the United States to the Court Concerning Proposed Purchase).

^{3/} The Department finds the principal attributes of an equity interest to be participation in the operating or capital profits and losses of the investment, voting rights, and the right to transfer the interest. The Department contends that none of those attributes is present here.

Opponents of the NYNEX acquisition argue that purchase of a conditional interest, particularly a large interest, in prohibited markets, cannot be accomplished without a waiver.

The issue is thus clear: what, in this context, constitutes an "affiliated enterprise"? That term is not defined in the decree; hence the Court must necessarily look to the purposes of the decree^{4/} to determine the meaning of affiliation under section II(D).

Section II(D) was designed to ensure that the newly created Operating Companies,^{5/} with their monopoly of exchange service, will not use their monopoly revenues or their control of bottleneck facilities to disadvantage persons or entities doing business in competitive markets, including the interexchange market. As the Department of Justice has properly noted in another context, "manipulations of form should not obscure the real economic incentives underlying . . . [a particular business] relationship."^{6/} Thus, it would be wholly unreasonable to hold that the decree does not require a waiver proceeding pursuant to

^{4/} See United States v. ITT Continental Baking Co., 420 U.S. 223, 238 (1975) ("circumstances surrounding formation of the consent order" are an aid to its construction); United States v. Western Electric Co., 592 F. Supp. 846, 856-57 (D.D.C. 1984); United States v. Am. Tel. & Tel., 552 F. Supp. 131, 217 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001, (1983).

^{5/} Or their alter egos, the Regional Holding Companies.

^{6/} Response of the United States to Ameritech's Motion for Clarification and Waiver at 16 (filed June 29, 1984).

section VIII(C) in a situation where acquisition of a conditional interest provides a Regional Holding Company with a substantial incentive and ability unfairly to impede competition by use of its monopoly position in the market it is thus entering. In that situation, the Court would be unlikely to grant a waiver, or at least it would condition a waiver upon the giving of appropriate assurances. On the other hand, NYNEX and the other Regional Holding Companies that have filed comments are quite correct when they state that not every expenditure made in pursuit of an acquisition target requires a waiver.

It is in this context that it becomes the Court's obligation (1) to decide the substantive issue raised by the Department of Justice Report and (2) to establish a procedure for defining more generally the permissible boundaries of Regional Holding Company conditional interest investments, having due regard for the purposes of the decree and the need for fairly rapid decision-making.^{7/} It is convenient to discuss these two issues in inverse order.

II

The problem raised by the Department's Report -- as of other issues which have come before the Court in this case -- requires

^{7/} The establishment of such a procedure will further advance the predictability of the process and the decisions made pursuant thereto and, as discussed infra, it will reduce the need for involvement of the Court.

consideration and resolution of what may be conflicting goals. On the one hand, the Court must of course protect the decree and its predominant purposes, and on the other it must consider the practicalities of business life. In the context of the proposed acquisition by a Regional Holding Company of a conditional interest in an entity engaged in a line of business prohibited by section II(D), the following procedure shall be followed.

Prior to acquiring a conditional interest in a prohibited line of business, a Regional Holding Company shall secure the approval of the Department of Justice. The Department shall approve the acquisition of such an interest if it concludes that the transaction is not inconsistent with the goals and purposes of the decree, in particular section II(D). The Department may reach such a conclusion upon a showing tending to establish (1) that the investment is relatively minor; (2) that occurrence of the contingency is genuinely in question; and (3) that the Regional Holding Company clearly lacks the ability, the incentive, or both, to disadvantage the target company's competitors. Upon approving such an acquisition, the Department shall inform the requesting Regional Holding Company and file with the Court for the record both the request and the approval.^{8/}

^{8/} The Department may of course forward copies to other interested parties and otherwise follow whatever procedure it deems appropriate.

In order to avoid unnecessary delay and undue interference with business decisions, the approval of the Court shall not be required. However, as discussed below, the actual acquisition by a Regional Holding Company of an equity interest in an entity engaged in activities prohibited by the decree may not occur without a waiver granted by the Court pursuant to section VIII(C) of the decree.

III

In light of the delay NYNEX has already encountered, and to provide guidance to the Department of Justice and the parties in future cases, the Court will, in this case, itself approve the Tel-Optik transaction and give its reasons for the approval.

In the view of the Court, the Tel-Optik transaction presents a close case.

First. For a company with over \$2 billion in revenues, a \$10 million investment may be deemed to fall just within the category of investments that the Court is prepared to regard as "minor."

Second. NYNEX's exercise of its option to purchase Tel-Optik stock will depend upon the future value of Tel-Optik stock, the future size of Tel-Optik's debt burden, the progress of the cable installation, and regulatory and judicial approvals. For these reasons, the Court is persuaded that the occurrence of

contingencies permitting NYNEX to enhance its interest in Tel-Optik is genuinely in question.

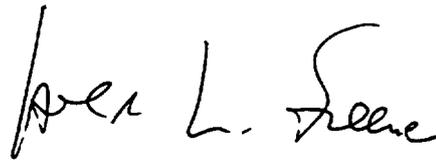
Third. The most difficult issue is whether NYNEX will clearly lack the ability or incentive to disadvantage Tel-Optik's competitors. MCI argues persuasively that NYNEX, which controls bottleneck exchange facilities in its region, could deprive Tel-Optik's competitors in the transatlantic market of equal access in order to strengthen Tel-Optik's position. The ability to disadvantage competitors, however, will not render the conditional interest infirm if the incentive to act anticompetitively is absent. That is the case here.

Despite the obvious economic incentive NYNEX has to enhance the value of Tel-Optik stock and the success of Tel-Optik facilities, the legal obstacles to anticompetitive conduct are decisive. NYNEX correctly states that it could not exercise its option without first securing a waiver from this Court. Were NYNEX to attempt to use its monopoly position to the detriment of Tel-Optik competitors, that attempt would almost certainly be made known to the Court during any subsequent waiver proceedings. This Court can be depended upon to enforce the decree and to deny a waiver request if it concluded that NYNEX

had abused its interest in Tel-Optik to disadvantage competitors.^{9/}

Accordingly, the Court finds that NYNEX's proposed conditional interest does not require a waiver.

August 7, 1986



HAROLD H. GREENE
United States District Judge

^{9/} MCI's charges that NYNEX has already abused its position, because Tel-Optik has employed the NYNEX name in its marketing effort, see MCI's Supplemental Opposition at 2 (filed July 25, 1986), may properly be raised if and when NYNEX requests a waiver. The Court expresses no position, at this juncture, on the propriety or significance of these activities.

FILED

JAN 31 1992

**Clerk, U.S. District Court
District of Columbia**

**UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA**

UNITED STATES OF AMERICA,

Plaintiff,

v.

**WESTERN ELECTRIC COMPANY,
INC., et al.,**

Defendants.

**Civil Action No. 82-0192
(HHG)**

MEMORANDUM

The Department of Justice has moved the Court for a declaratory ruling that the decree allows Regional Companies to enter into funding-royalty agreements with independent manufacturers if the particular Regional Company does not have more than a five percent equity interest in and does not exercise substantial control over such independent manufacturers. The Department argues that under such agreements, a Regional Company would not be engaging in prohibited activity "directly or through any affiliated enterprise" within the meaning of section II(D)(2) of the decree. The motion is denied.

I

Section II(d)(2) of the decree provides that no Regional Company shall "directly or through any affiliated enterprise . . . manufacture or provide telecommunications products or customer premises equipment" A Regional Company may apply for a waiver to allow it to engage in the prohibited activities, but no such waiver is required where the prohibited services are not provided directly or through an affiliated enterprise.

Ameritech made application for a waiver through the Department of Justice to enable it to fund design and development by an equipment manufacturer, David Systems, in exchange for royalty payments. Rather than seeking a waiver from the Court, however, the Department of Justice has taken the position that no waiver is required, on the theory that Ameritech's proposal does not involve manufacturing either "directly or through an affiliated enterprise" as prohibited by section II(D)(2). The Department contends that David Systems is not an affiliated enterprise since Ameritech has no equity interest in the company and no substantial control over it. Accordingly, the Department seeks a declaratory ruling that this is the operative definition of an affiliated enterprise. Thus, its request sweeps more broadly than the manufacturing restrictions and would apply to other prohibited lines of business.

The Justice Department argues that according to the "usual or customary meaning of the term 'affiliated,'" an "affiliated enterprise" means only entities in which a Regional Company has more than a de minimis equity interest (five percent or more) or exercises operational control. Department of Justice Motion at 9. The Department also argues that its definition would provide clear and certain guidance to Regional Companies and independent equipment manufacturers as to what contractual relationships they may enter into with each other. *Id.* at 5.

The Department of Justice position is contrary to a substantial number of prior Court rulings.¹ For example, this Court has previously considered and rejected the Department's contention that "affiliated enterprise" be narrowly construed to apply only to those enterprise in which a Regional Company has an equity interest. United States v. Western Electric Co., Inc., Civil Action No. 82-0192 (D.D.C. August 7, 1986). In so ruling, the Court rejected the Department's argument that no waiver or Department approval was required prior to a Regional Company acquiring a conditional interest in a prohibited line of

¹ The Department acknowledges the existence of only one of the numerous Court rulings, waving it aside as offering little guidance, and suggesting that the Court's approach in that case constituted legal error. Motion of the United States at 14.

business (but the Court granted a waiver in that instance). The Court noted that a waiver under the decree was required in those situations in which a Regional Company would have "a substantial incentive and ability unfairly to impede competition by use of its monopoly position in the market it is . . . entering." Id. at 4. See also, United States v. Western Electric Co., Inc., 578 F.Supp. 653, 655 (D.D.C. 1983) (division of revenue arrangements between AT&T and the Regional Companies would violate decree without waiver because it would permit continued "Operating Company participation in interexchange telecommunications prohibited by section II(D)(1) of the decree . . ."). It is curious, to say the least, that the Department neither followed these prior rulings nor even acknowledged their existence. This does not foster a sense of confidence in the Department's actions.

Beyond that, the Department of Justice's narrow and mechanical definition of "affiliated enterprise" would not alleviate the incentive and ability of the Regional Companies to engage in anticompetitive conduct. The royalty arrangements here at issue provide an apt example of this problem. Under the Department's definition, all such arrangements would be permissible since they would not involve an equity interest or operational control. The Department would not place any restrictions on the amount

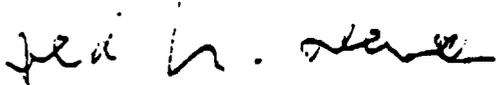
invested by the Regional Company or the size of the royalties received. Whether these royalty arrangements provide for the investment of \$5 million dollars or \$50 million, and whether they provide for royalties of five percent of the profits or fifty percent of the profits, they would not be within the reach of the decree, according to the Department. Again curiously, the Department interpreted the then proposed section II(D)(1) restriction of the decree prior to divestiture as extending to any arrangement, including one based on division of revenues, between a Regional Company and an interexchange carrier that gives the Regional Company a direct financial stake in the success or failure of the carrier. Response of the United States, p. 4 (November 10, 1983).

It is beyond dispute, however, that a Regional Company that funds in large part the activities of a small manufacturer, and that has the option of funding its activities in the future, exercises a great deal of influence over the decisions of that company regardless of whether or not it has an equity interest in the company. Nor can it be doubted that a company that stands to earn substantial royalties on the sale of a product has an incentive to discriminate in favor of the product. There is the risk a company would cross-subsidize the price of the product and pass on artificially high prices to its

ratepayers. There is therefore no rational basis under the decree for distinguishing the risks posed by such a royalty arrangement from those posed by an equity investment in a manufacturer. In fact, in some cases, a royalty arrangement would be more dangerous than ownership of a relatively small interest in a manufacturer. In sum, the Department's proposed definition of "affiliated enterprise" would undercut the purposes of the manufacturing restrictions.²

Accordingly, it is this 31st day of January, 1992,

ORDERED that the Department of Justice Motion for a Declaratory Ruling Regarding the Receipt of Royalties on Third-Party Sales of Telecommunications Products be and it is hereby denied.



HAROLD H. GREENE

United States District Judge

² Other Department of Justice justifications for its definition of "affiliated enterprise" are equally unpersuasive. For example, the Department argues the term "affiliated enterprise" is too vague and its proposed definition would bring welcome certainty. First, the Department's suggested standard of "operational influence" by a Regional Company over a manufacturer is hardly a clear-cut term. Second, any perceived difficulty of resolving issues under the decree is not a basis for ignoring decree restrictions. See United States v. Western Electric Co., Inc., 675 F. Supp. 655, 658 (D.D.C. 1987).

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
 Plaintiff,)
)
 v.) Civil Action No. 82-0192
)
WESTERN ELECTRIC COMPANY,)
INC., AND AMERICAN TELEPHONE)
AND TELEGRAPH COMPANY,)
)
 Defendants.)

REPORT OF THE UNITED STATES TO THE COURT
CONCERNING PROPOSED PURCHASE BY NYNEX CORPORATION
OF CONDITIONAL INTEREST IN TEL-OPTIK, LTD.

The Department of Justice ("Department"), on behalf of the United States, submits this report to inform the Court of the plans of NYNEX Development Company, a subsidiary of NYNEX Corporation ("NYNEX"), to acquire a conditional interest in Tel-Optik, Ltd. ("Tel-Optik"), and to notify the Court of the Department's view that NYNEX need not obtain a waiver of any provision of the Modification of Final Judgment ("MFJ" or "decree") prior to acquiring the conditional interest. NYNEX, however, would have to obtain a waiver of the decree prior to acquiring any beneficial interest in Tel-Optik.

I. INTRODUCTION AND SUMMARY

NYNEX proposes to acquire all of the issued and outstanding stock of Tel-Optik, a Delaware corporation. Tel-Optik and Cable and Wireless, PLC, a public limited company organized under the laws of England ("C&W"), have formed a joint venture,

Market Link, to construct, manage and operate a private fiber optic cable system between the east coast of the United States and the United Kingdom. In May 1985, Tel-Optik received authorization from the Federal Communications Commission ("FCC") to land two private fiber optic cables in the United States. 1/ The joint venture plans to operate two separate cable systems, PTAT-1 and PTAT-2, which would be placed in service in mid-1989, and 1992, respectively.

The proposed transaction would take place under a two-step procedure. In the first step, NYNEX will purchase for \$10 million the conditional right to acquire the issued and outstanding shares of Tel-Optik. In exchange, subject to FCC approval, the Tel-Optik shareholders will place their stock in a trust to be administered by three of Tel-Optik's shareholders. The Tel-Optik shareholders will be the sole beneficiaries of the trust. During the trust period, NYNEX will not be involved directly or indirectly in any of the operations of the joint venture nor will it possess any beneficial interest in Tel-Optik or the transatlantic fiber system.

1/ See In the Matter of Tel-Optik, Limited, F.C.C. 85-99, 50 Rad. Reg. 72, April 15, 1985. (Copy attached as Appendix 1.) C&W has been authorized by the British government to land and operate transatlantic cables in Britain.

In the second step of the transaction, NYNEX proposes to purchase the Tel-Optik stock from the trustees by discharging the debt incurred by Tel-Optik in connection with the construction of the fiber optic cable system. NYNEX's right to acquire the Tel-Optik shares from the trustee under the second step is subject to various conditions, including that it obtain an appropriate waiver of section II(D) of the MFJ from the Court by July 1, 1988. 2/

In the Department's view, the contemplated transatlantic fiber optic system will constitute a prohibited "interexchange telecommunications service" under section II(D). As a consequence, NYNEX must obtain a waiver of the interexchange services prohibition in order to acquire Tel-Optik, which owns a 50 percent interest in the proposed system. After a thorough evaluation of the proposed transaction and the language and purpose of section II(D), however, we do not believe that NYNEX must obtain a waiver prior to obtaining the proposed contingent interest. As recognized by NYNEX, a waiver would be necessary before it could acquire a beneficial interest in the cable

2/ The two-stage trust form of the transaction is attributable to the fact that Tel-Optik's shareholders are unwilling to make the sale of their stock to NYNEX contingent on NYNEX's ability to obtain the necessary approvals from the FCC and this Court. We are told that as a consequence NYNEX, to preserve what it views as a favorable business opportunity, had to structure the deal in a manner that imposed all the risk of failure to obtain the Court's approval on itself rather than the sellers.

venture. In our view, neither the language nor purpose of the section II(D) prohibition on interexchange services require prior Court approval to allow NYNEX to acquire such a contingent interest in Tel-Optik. NYNEX will hold no cognizable equity interest in Tel-Optik during the pendency of the waiver request nor will it exercise any operational influence or control during that period.

II. BACKGROUND

A. The Parties

Tel-Optik is a Delaware corporation organized for the purpose of participating in a joint venture to construct and operate a private fiber optic cable system between the United States and the United Kingdom. Tel-Optik's principal assets are two FCC licenses to land the fiber optic cables in this country and a 50 percent interest in a joint venture with C&W to finance, construct and operate the proposed fiber optic cable system beginning in mid-1989.

C&W is a public limited company, organized under the laws of the United Kingdom. C&W provides telecommunications services in numerous countries, including the United States. C&W owns a 50 percent interest in the Market Link joint venture. Its subsidiary, Mercury Communications Limited ("Mercury"), is licensed to land and operate the private fiber optic system in the United Kingdom. Mercury operates an existing communications network in the United Kingdom.

B. The Transaction

NYNEX proposes to purchase all of the stock of Tel-Optik under a two-step procedure. The parties propose to enter into a Conditional Purchase Agreement ("CPA"), Stock Purchase and Trust Agreement ("SPTA"), Joint Ownership Construction, Operation and Maintenance Agreement, Letter Agreement between C&W and Tel-Optik, Cable Venture Agreement, and Letter Agreement between Messrs. Coleman and McGillan of Tel-Optik and NYNEX. (Copies of these agreements are attached as Appendix 2.) Execution of these agreements is scheduled to take place five days after the filing of this Report to the Court. Under the SPTA, upon FCC approval, Tel-Optik's shareholders will place their stock in a trust. The trustees will be Ronald D. Coleman, President of Tel-Optik, James J. McGillan, Treasurer of Tel-Optik, and the E.F. Hutton Group, Inc. Upon execution of these agreements, NYNEX will pay \$3 million to the Tel-Optik shareholders. After FCC approval, NYNEX will pay Tel-Optik's shareholders another \$7 million. The combined total of \$10 million will secure NYNEX's right to purchase the Tel-Optik stock subject to FCC approval and grant of a waiver from the line of business restrictions in the MFJ by July 1, 1988.

C&W will construct the fiber optic cable at a cost estimated at between \$300 and \$400 million dollars. C&W intends to advance its own funds or to arrange for third party loans necessary to complete the installation of the fiber optic cable and will advance Tel-Optik's 50 percent share of the

construction and operating costs. Should the Court approve NYNEX's waiver application by July 1, 1988, NYNEX will acquire the Tel-Optik stock by discharging the debt incurred by Tel-Optik in connection with the construction of the fiber optic cable system. If NYNEX's waiver request is denied or not approved by July 1, 1988, the agreements will terminate and the trustees will be authorized to transfer the stock to any third party at terms and conditions determined solely by the trustees. In these circumstances, NYNEX will have no right to any distributions, dividends or appreciation in the value of the Tel-Optik stock when transferred by the trustees to any third party. NYNEX will lose its \$10 million investment, but it will not be liable for any debts incurred by Tel-Optik in the event that NYNEX's waiver request ultimately is denied.

During the trust period, NYNEX will have no beneficial interest in the Tel-Optik stock; NYNEX will play no role in the operation or management of Tel-Optik or the Market Link joint venture; and NYNEX will not communicate or influence directly or indirectly the trustees regarding the management and operation of Tel-Optik or the joint venture, Market Link. 3/

3/ The FCC licenses held by Tel-Optik designate a landing site in New Jersey. It is possible that a new landing site for the two fiber optic cables will be selected on Long Island. Should that occur, NYNEX may offer exchange or exchange access service to the venture within the New York LATA.

C. The Proposed Transatlantic Fiber Optic System

The Market Link joint venture proposes to construct and operate a sophisticated private transatlantic fiber optic cable system between North America and the United Kingdom. Each cable will consist of three working optical fiber pairs and associated supervisory circuits. Capacity on the private fiber optic system will be sold or leased by Market Link in bulk on a non-common carrier basis to individual customers with large communications needs. 4/ Potential customers include large private network users and common carriers that require capacity for the transmission of voice, data, video or facsimile services between the two countries.

III. THE ACQUISITION OF A CONDITIONAL RIGHT TO PURCHASE TEL-OPTIK'S STOCK DOES NOT REQUIRE A WAIVER UNDER SECTION II(D)

The Market Link joint venture will provide interexchange telecommunications services, as defined under section IV(K) of the MFJ, between the United States and international points. 5/ NYNEX acknowledges that a waiver of the

4/ The Joint venture itself will not offer voice, data, video or facsimile services, such as International Message Telephone Service, that are typically provided by common carriers.

5/ Section IV(K) of the MFJ defines "interexchange telecommunications" as "telecommunications between a point or points located in one or more other exchange areas or a point outside an exchange area" (emphasis added). International telecommunications services clearly fall within the ambit of the section IV(K) definition of interexchange telecommunications services and are prohibited, in the absence of a waiver, by section II(D) of the decree.

interexchange prohibition contained in section II(D) of the MFJ is necessary for NYNEX to acquire Tel-Optik's stock and to participate in the Market Link joint venture. Nevertheless, NYNEX argues, and we agree, that a waiver of section II(D) of the decree is not necessary for NYNEX to preserve the right to purchase the Tel-Optik stock upon FCC approval and grant of a waiver application by the Court. After lengthy and careful consideration of this matter, we have concluded that NYNEX's purchase of a conditional right to acquire Tel-Optik's stock does not make Tel-Optik an "affiliated enterprise" for purposes of the section II(D) line-of-business restrictions.

Section II(D) of the MFJ prohibits a BOC "directly or through any affiliated enterprise" from providing "interexchange telecommunications services" in the absence of a waiver pursuant to section VIII(C). 6/ A "BOC" is defined under section IV(C) as including those companies specifically

6/ The meaning of "directly" providing a prohibited service under section II(D) is not at issue in this situation. The direct provision of a particular product or service arises where a BOC provides products or services to an entity in which the BOC has a direct financial stake in the success of the enterprise. The Department has taken the position that any "economic integration" of a BOC with an entity providing a product or service prohibited by section II(D) would require a waiver by the Court. See Department Response to Comments on the MFJ 47 Fed. Reg. 23,339, 23,347 (MFJ does not prohibit BOCs from leasing excess switching capacity to an information service supplier so long as "such arrangements do not result in an economic integration with these providers...").

referenced in Appendix A of the decree and "any entity directly or indirectly owned or controlled by a BOC or affiliated through substantial common ownership." The term "affiliated enterprise" is not defined in the decree, but unless that term is viewed as redundant, i.e., encompassing only those entities included in the definition of a "BOC," the logical inference is that an "affiliated enterprise" is an entity related to a BOC by less than "substantial common ownership." 7/ The language contained in sections II and IV of the decree defines entities related to a BOC in terms of ownership interests, i.e., equity interests, that a BOC may hold in an organization. Thus, where a BOC contributes capital in return for equity to an entity that provides products or services prohibited under section II(D), the entity may become a "BOC" or an "affiliated enterprise" for purposes of applying the decree's line of business restrictions, depending upon the precise equity

7/ Section IV(A) of the decree defines the term "affiliate" to include those entities "under direct or indirect common ownership with or control by AT&T" or "owned or controlled by another affiliate." The terms "ownership" or "owned" are defined only for purposes of section IV(A) as a "direct or indirect equity interest (or equivalent thereof) of more than fifty (50) percent of an entity." Section IV(A) also defines a "subsidiary" as any entity in which AT&T owns stock, whether or not controlled by AT&T. This section was designed to distinguish between those corporations that AT&T controlled and those corporations, such as Cincinnati Bell and Southern New England Telephone, in which AT&T held only a minority interest, and, by the terms of section IV(A), the meaning of the terms used therein are not controlling with respect to section II(D)'s restrictions on BOC activities.

ownership interest maintained by the BOC in the entity. 8/ In such circumstances, a BOC would have to obtain a waiver of section II(D) of the MFJ prior to acquiring an equity interest in a entity providing a prohibited service.

Applying these criteria, the proposed trust arrangement does not make Tel-Optik an affiliated enterprise of NYNEX. During the interim period, NYNEX would not have any kind of equity interest in Tel-Optik. The principal attributes of an equity interest are: 1) an economic interest, i.e., the right to participate in the profits or losses of the organization during the investment and realization of any gain or loss upon sale of the investment; 2) voting rights and 3) the right to dispose of the interest. 9/

8/ Although not directly at issue here, it is the Department's position that de minimis equity interests, e.g., of less than 5 percent of the stock of any company, are not encompassed within the meaning of "affiliated enterprise" or "BOC", as used in the MFJ. The Department believes that in those cases where a BOC owns less than a 5 percent equity interest in a related entity engaged in a prohibited activity, section II(D) should not be construed to bar the BOC from obtaining such an interest because of the minimal risk that a BOC would engage in anticompetitive behavior to favor the related enterprise.

9/ See, e.g. 11 W. Fletcher, Cyclopedia of the Law of Private Corporations 5083; Statement of Basis and Purpose for Rules Promulgated Under Hart-Scott-Rodino Antitrust Improvements Act of 1976, 43 Fed. Reg. 33458 (July 31, 1978) (where "beneficial ownership" is defined to include right to obtain benefit of increase in value or dividend, risk of loss, right to vote or determine who may vote, and investment discretion, including power to dispose).

NYNEX will have no economic interest in the Tel-Optik stock during the pendency of the waiver request other than the conditional right to obtain the Tel-Optik stock upon approval by the Court and the FCC. During this period, NYNEX will receive no dividends, will make no capital contributions and will suffer no liability for Tel-Optik's debts. Further, NYNEX will not participate in any gains or losses resulting from disposition of the stock to a third party in the event that its waiver application is denied. Additionally, NYNEX will have no voting rights while the stock is in the trust. The trustees will hold the exclusive rights to vote the stock without any communications or influence from NYNEX, will select the officers and directors, and will manage and operate Tel-Optik. Finally, NYNEX has no power to direct the transfer of the Tel-Optik stock. The trustees are solely responsible for selecting a substitute buyer if NYNEX's waiver application is denied; if no buyer is found, then the Tel-Optik stock will be redistributed to its previous owners and the trust will be dissolved.

The Department believes that the MFJ cannot be construed to restrict a BOC from obtaining a contingent interest of the type here at issue, pending waiver approval, in an organization engaged in an activity otherwise prohibited by section II(D). To construe the section II(D) language to encompass NYNEX's proposed conditional interest would be contrary to elementary principles of decree interpretation. The relevant provisions

of the MFJ extend to equity ownership interests that a BOC may possess in a related entity. The conditional interest to be secured by NYNEX does not constitute an "equity interest" as that term is normally used. Moreover, acquisition of a conditional right to purchase Tel-Optik's stock would not increase NYNEX's ability and incentives to engage in anticompetitive behavior. 10/

In sum, in view of the considerable degree of insulation between the trustees and NYNEX, and the fact that NYNEX will not own an equity interest in Tel-Optik during the trust period, 11/ we have advised NYNEX that, in our opinion, it does

10/ It might be argued that NYNEX's anticipation of a future interest in Tel-Optik may increase its incentive to discriminate against existing or potential competitors in providing access to the local exchange during the interim period. Such behavior, however, is unlikely to occur in view of the fact that the Department and interested parties will be reviewing NYNEX's waiver application during the very period when any such discriminatory activity would occur. Any anticompetitive behavior on the part of NYNEX during the pendency of its waiver application would be contrary to NYNEX's interest in that it would jeopardize its efforts to secure the Court's approval of the waiver application. Moreover, even if there were some merit to the argument, the fact that the decree does not admit a reading that would prohibit NYNEX's acquisition of the conditional right is controlling.

11/ The Department's position is consistent with the Court's approval of a temporary waiver permitting a voting trust created by Pacific Telesis Group ("Pacific") to operate Communications Industries, Inc.'s ("CI's") equipment manufacturing and telephone answering businesses within a one year period pending divestiture in connection with Pacific's acquisition of CI. See February 26, 1986 decision, Civil Action No. 82-0192. In that situation, a temporary waiver was necessary because Pacific proposed to own a beneficial interest in the stock included in the trust. In contrast, NYNEX will hold no beneficial interest in the Tel-Optik trust.

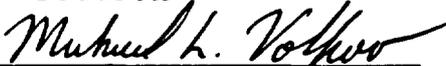
not need to obtain a waiver from the Court in order to complete the first step of the proposed transaction. We have also reminded NYNEX, however, that it is the Court, not the Department, that ultimately must resolve questions of decree interpretation.

The Department wishes to emphasize to the Court that it intends to review carefully NYNEX's waiver request and any associated public comments. The Department has informed the parties to the transaction that the first-step transfer will not influence in any manner the Department's assessment of NYNEX's waiver request. We have also informed the parties that NYNEX's initial \$10 million payment securing its conditional right to obtain Tel-Optik's stock is being made at NYNEX's own risk pending the outcome of the waiver proceeding. NYNEX has indicated an understanding that its \$10 million investment should not influence the Court's ultimate waiver decision, and that its investment is, in these circumstances, a reasonable business risk decision for a company of NYNEX's resources.

Respectfully submitted,


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