course, does not equate debt and equity and, in fact, neither do Professors Miller and Modigliani. The Irrelevance Propositions were intended as an extreme null hypothesis, much of the last 40 years of financial economics scholarship having been devoted to demonstrating why the Irrelevancy Propositions are incorrect.[4] For example, Miller and Modigliani did not take the governance characteristics of debt and equity into account, precisely the characteristics of greatest interest to the FCC. Indeed, if it is finance with which we are concerned, equity is valued by quite different methods than options. Variants of the capital asset pricing model or arbitrage pricing model are typically invoked for the pricing of equity. The Black-Scholes option pricing model is typically invoked to price options and option-like instruments such as warrants and conversion rights.

NewCo's Receipt of Its Opportunity Cost in the Event of Sale Does Not Result in NewCo Improperly Receiving Pre-Approval Appreciation in DataCo's InterLATA Data Business

11. AT&T appears to argue that the terms of DataCo's option will nevertheless result in a violation of Section 271 because the option allows NewCo to profit from pre-exercise appreciation in the value of DataCo: through receipt, in the event of a sale of Class B shares, by NewCo of its opportunity cost with respect to Section 271 compliance greater than 50 percent but less than 95 percent. AT&T's analysis, however, confuses payment of what NewCo would have earned had it *not* invested in DataCo, with a payment based on DataCo's performance.

12. Under the DataCo option, if NewCo eliminates applicable section 271 restrictions on at least 50% but less than 95% of Bell Atlantic in-region lines, its Class B

[4] The Irrelevancy Propositions are developed in accessible fashion in Jesse Choper, John C. Coffee, Jr., and Ronald J. Gilson, Cases and Materials on Corporations ch. 3 (5th ed. 2000).

shares will be convertible into 80 percent of DataCo's shares (assuming no dilution), but NewCo can retain only those convertible shares that would be convertible into 10 percent of DataCo's outstanding shares. In addition, NewCo cannot retain all the proceeds from any sale of the shares convertible above 10% that it must sell; it can retain only the value of NewCo's initial investment in the shares sold plus the amount NewCo would have earned had it placed the remainder of its initial investment in an *S & P 500 Index fund* instead of the DataCo option - that is, NewCo's "opportunity cost." AT&T argues that Section 271 approval grants NewCo the right to earn profits from long distance services after approval but not before; return of NewCo's opportunity cost, the argument runs, therefore gives it an improper pre-approval profit from long distance services.

13. This argument simply ignores the fact that NewCo's opportunity cost is measured, properly, by what NewCo would have earned in another investment, which, as Professor Coffee correctly points out, is best approximated by the S & P 500 Index used in the Revised Proposal. For NewCo to participate in profits from *DataCo's* pre-approval provision of long distance service, the payment would have to be keyed to *DataCo's* performance, not NewCo's performance measured by the S & P 500 Index. DataCo is an Internet backbone firm, whose stock performance can be expected to track an Internet index, not the S & P 500 Index.[5] Thus, payment measured by NewCo's

---

[5] The relevant determinant of DataCo's performance is the risk and return of its business, not its initial public offering. Professor Coffee accurately describes studies that, lumping all types of initial public offerings together, show average underperformance over a sustained period, Third Declaration of Professor John C. Coffee, Jr. ¶8 ("Coffee Third Declaration"). However, Professor Coffee neglects to mention the results of more recent studies that differentiate between the types of issuers in initial public offerings. These studies show that the sustained underperformance to which Professor Coffee refers is a phenomenon of small-firm IPOs; large-firm IPOs - like that contemplated for DataCo - do not experience this pattern. Indeed, recent studies show that this underperformance is not an IPO phenomenon at all. Rather, small firms underperform the market regardless of the existence of a recent IPO.

opportunity cost rather than DataCo's performance is not a payment of profits from the provision of long distance services.

14. AT&T also argues that the fact that the exercise price of NewCo's option is fixed alone constitutes a violation of Section 271 because, unless this price fluctuates with DataCo's appreciation, NewCo receives the benefit of DataCo's pre-exercise performance. In AT&T's analysis, a Bell Operating Company ("BOC") can only buy a long distance carrier at market price so that it obtains no benefit from appreciation in value resulting from the long distance carrier's prior performance. AT&T May 5th Opposition ¶3. The argument clearly proves too much. To take AT&T's example, suppose a BOC, believing it has satisfied Section 271, enters into an executory agreement calling for the acquisition of a long distance carrier at a price negotiated at the time of execution. There follows a lengthy approval process – perhaps prolonged by objections from AT&T – that results in Section 271 approval two years later. In the interim, the value of the long distance carrier appreciates. AT&T's analysis suggests that the BOC in this case would be prohibited from completing the transaction under the negotiated terms because, if the BOC were to purchase the carrier at the negotiated price, *it* would profit by the difference between the negotiated and then-current market price. As a result, every fixed-price acquisition agreement that is closed after some delay potentially violates Section 271 if, during that delay, the long distance carrier's stock appreciates. There is simply no basis for this bizarre result.

15. Indeed, AT&T's argument appears to invalidate its own acquisition of MediaOne. That acquisition agreement was signed over a year ago, during which time the market value of MediaOne has undoubtedly appreciated. Presumably, AT&T is prevented from profiting as a result of pre-approval MediaOne performance. However,

AT&T does not represent in its opposition that it intends to increase the consideration it has agreed to pay for MediaOne.

NewCo Will Not Control DataCo By Virtue of Its Option

16. Finally, AT&T argues again that even if NewCo's option is not tautologically an equity interest under Section 3(1), the option and the associated pre-conversion consent rights result in NewCo exercising actual control of DataCo and therefore renders DataCo a NewCo affiliate under Section 3(1). For the purpose of this inquiry, the FCC must confront the policy of the statute and the practicalities of transactional practice. As I showed in my initial Declaration, the FCC's treatment of an equivalent transactional structure – the option held by the acquiring company in connection with a regulated acquisition during the post-execution/pre-FCC approval and closing period – plainly reflects this reality. After execution, the acquiring company holds an option to purchase the target company at the price specified in the acquisition agreement, with exercise of the option conditioned on FCC approval. During the period prior to FCC approval and closing, the acquiring company has the right to all appreciation in the value of the target company. Also during this period, the acquiring company typically has the benefit of a set of covenants, just like the consent requirements associated with NewCo's option, that restrict the target's behavior without acquiring-company consent. Similarly, the incentives that AT&T ascribes to DataCo management during the pre-conversion period are equally applicable to target management during the post-execution/pre-FCC approval and closing period.

17. Thus, if AT&T's argument is to be taken seriously, any acquisition that takes the standard form will violate FCC approval rights because, as a result of the inherent option, the target will be controlled by the acquiring company and will therefore

be the acquiring company's affiliate under Section 3(1). For example, AT&T has been in this position for a full year with respect to its MediaOne acquisition.

18. What is apparent is that the FCC has thoughtfully exercised its discretion to develop a practical approach to control under Section 3(1), one that allows the construction of transactional structures bridging the period pending Commission approval so long as the structure does not implicate the matters of concern under the relevant statutory structure. The NewCo/DataCo option structure does not allow NewCo to get the benefit of service bundling without FCC approval. Accordingly, the NewCo/DataCo option structure should be treated the same as functionally equivalent option structures, including AT&T/Media One's option structure. In the end, the FCC is presiding over the restructuring and consolidation of the U.S. telecommunications industry. Managing that process effectively requires the thoughtful review of new transactional structures that preserve FCC approval over those matters of substance under Section 271.

I declare under penalty of perjury that the foregoing is true and correct.

Date. May 10, 2000

Ronald J. Gilson

B

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
GTE CORPORATION,	)	
	)	
Transferor,	)	
	)	
and	)	CC Docket No. 98-184
	)	
BELL ATLANTIC CORPORATION,	)	
	)	
Transferee,	)	
	)	
For Consent to Transfer Control.	)	
	)	

THIRD SUPPLEMENTAL DECLARATION OF PROFESSOR RONALD J. GILSON

1. This Third Supplemental Declaration responds to AT&T Corp.'s May 5, 2000 opposition ("May 5th Opposition") to the April 28, 2000 revised proposal ("April 28th Proposal") of Bell Atlantic Corp. ("Bell Atlantic") and GTE Corp. ("GTE") regarding GTE's interLATA data operations, which have been referred to post-merger as DataCo in my prior declarations. Since the April 7, 2000 meeting with the staff, Bell Atlantic and GTE have made significant revisions to their original proposal. AT&T, however, has simply escalated its rhetoric and now refers to "transparent stock parking arrangements," and "non-option option" and "non-risk risk." In the remainder of this declaration, I will try to frame the issues the Commission must confront and the economic substance associated with each. As I have emphasized in each of my prior Declarations, an option is simply not an equity interest under Section 3(1). An option becomes an equity interest only on its exercise. Other statutory schemes, like the Federal Securities law, reach a

different conclusion because they are different and have different purposes. Where, as here, it is only the *exercise* of the option that implicates the statutory purpose, the option itself is not treated as the equivalent of an equity interest.

The Current Structure of NewCo's Option

2. Under the arrangement set out in the April 28th Proposal and modified by the revision filed today (the "Revised Proposal"), NewCo will receive Class B DataCo stock representing a 9.5 percent current equity interest in DataCo with an option in the form of a conversion right exercisable as follows. If NewCo eliminates Section 271 restrictions with respect to 50 percent or more of its lines, then its Class B shares will be convertible into 80 percent of DataCo's shares (as that figure may be diluted by DataCo issuance of new shares). But unless 271 restrictions are eliminated, NewCo must dispose of a sufficient number of these convertible shares such that its remaining shares would be convertible into no more than 10 percent of DataCo's equity, and the proceeds from any sale would be given to the United States Treasury to the extent that they exceed the amount NewCo would have if it had taken the amount of its initial investment in the shares sold and instead invested it in the S&P 500 Index. NewCo could exercise its conversion rights so as to own and operate DataCo only after eliminating all applicable Section 271 restrictions. NewCo can thus receive no appreciation related to DataCo's unique business, and certainly no value associated with bundling long distance and local service, without first securing full Section 271 approval.

An Option Is Not an Equity Interest
for Purposes of Sections 3(1) and 271

3. AT&T continues to argue, ever more expansively, that all options, including NewCo's DataCo option, are tautologically equity interests for purposes of

Section 3(1) and Section 271. Throughout this extended exchange of opinions – both between AT&T and Bell Atlantic/GTE on the one hand, and between my colleague Professor Coffee and me on the other – reference has been made both to regulatory schemes in which the *acquisition* of an option is treated as the jurisdictional trigger and to regulatory schemes in which *exercise* of an option triggers jurisdiction. There is only one principled basis for deciding which regulatory scheme is relevant here: the purpose of Section 271 of the Federal Communications Act.

4. As I have urged throughout this exchange, whether an option should be treated as the equivalent of a current equity interest (and acquiring the option therefore treated as the jurisdictional trigger) or whether the exercise of the option should trigger jurisdiction, *depends on the purpose of the particular statute.* Where the statutory purpose is implicated by the acquisition of an option, having the option is treated as the triggering event. Where the statutory purpose is implicated only by the exercise of the option, then it is only the exercise that triggers jurisdiction.

5. The Federal Securities laws, referred to repeatedly by AT&T and Professor Coffee, and the Hart-Scott-Rodino Pre-Merger Notification Act, referred to by Bell Atlantic/GTE and me, illustrate the dichotomy. As I described in my Supplemental Declaration, the portions of the Federal Securities law relied upon by AT&T all involve statutory purposes that necessitate treating the acquisition of options as a jurisdictional trigger. In the case of insider trading and disclosure under the tender offer rules, options pose the same problem as do the underlying securities; the statutory purpose thus dictates treating the purchase or sale of an option as the transfer of an equity interest. In contrast, the Hart-Scott-Rodino Pre-Merger Notification Act is concerned with the exercise of control that requires acquisition of formal corporate participation rights. Accordingly,

acquisition of an option does not trigger reporting under Hart-Scott-Rodino; only *exercise* of an option subjects the transaction to the Act's reporting requirements.

6. This discussion places AT&T's repeated, but inaccurate, references to "stock parking" in their proper context. The term grows out of an unlawful practice that sought to avoid the disclosure requirements of Section 13d of the Securities Exchange Act of 1934 (the "Exchange Act"). Section 13d requires that shareholders who acquire more than 5 percent of the outstanding shares of any class of securities registered under the Exchange Act disclose both the amount of their holdings and their plans with respect to the company. Because disclosure under Section 13d typically results in an increase in the market price of the shares, acquirers who would like to acquire more shares have an incentive to avoid disclosure, and thereby avoid the price increase. This can be accomplished by having someone else acquire – i.e., "park"– in their name the shares that would trigger disclosure if acquired in the name of the real acquiring shareholder. As indicated in Paragraph 4, a disclosure statute like Section 13d treats options as a jurisdictional trigger because their acquisition implicates the statutory purpose – broad disclosure. Despite AT&T's hyperbole, NewCo's DataCo option has nothing to do with stock parking. The purpose of Section 271, unlike that of Section 13d, is not implicated until the option is exercised.

7. For purposes of Section 271 of the Federal Communications Act, then, an option adds nothing to a party's capacity to participate through ownership of an equity interest in the provision of long distance services. Only the exercise of that option – the transformation of a future equity interest into a *current* equity interest – conveys the equity attributes necessary to implicate Section 271 concerns. As with Hart-Scott-

Rodino, exercise of the option – but not the option's acquisition – independently triggers the application of the regulatory scheme.

8. In its May 5th Opposition, AT&T raises yet another scheme that it asserts exposes an option as an equity interest. This time AT&T points to the definitions of the terms "equity interest" and "equity security" contained in Sections 1.19 and 1.20 of the American Law Institute's Principles of Corporate Governance,[1] of which both Professor Coffee and I were reporters. Section 1.19 defines an "equity interest" as including an "equity security," and Section 1.20 defines an "equity security" as "a security convertible ... into a [share in a corporation]." On this basis, AT&T asserts that the ALI Principles treat a stand-alone option as an equity interest. Here, however, AT&T misstates the application of the ALI Principles.

(i) Convertible common stock, like other stock, is an equity interest. NewCo's Class B convertible common stock, for example, represents a 9.5 percent equity interest in DataCo. But as I made clear in my initial declaration, as a matter of economic substance a convertible security is composed of two elements: a current equity interest in the form of stock carrying voting and distribution rights, and an option – a future equity interest that becomes a current equity interest only when exercised. What is at stake in this matter is whether the *option* component is an *additional* equity interest, and therefore must be separately counted in determining whether NewCo owns more than 10 percent of

---

[1] While AT&T refers to the ALI Principles as a "'restatement' of corporate law," the American Law Institute was at some pains to distinguish the project from a Restatement. From the inception of the project, whether to characterize the ALI Principles as a "restatement" has been controversial. The difference is that a Restatement is directed at court made law, while significant elements of the ALI Principles would require implementation by the legislature. Chief Reporter's Foreword, I American Law Institute, Principles of Corporate Governance: Analysis and Recommendations XXV-XXVI. While the ALI Principles do not directly address whether Sections 1.19 and 1.20 are of Restatement character, since Section 1.19 is described as "new," and Section 1.20 states that its source is statutory, the two sections would not appear to be "restatement-like."

DataCo for purposes of section 3(1). On this issue, the ALI Principles explicitly disclaim the position that a stand-alone option is an equity interest.

(ii) Under Section 7.02(a) of the ALI Principles, the holder of an "equity security" has standing to bring a derivative suit. If AT&T is correct that under the ALI Principles a stand-alone option is an equity security (and therefore also an equity interest), then, tautologically, the holder of a stand-alone option must have standing to bring a derivative suit. In fact, the ALI Principles disclaim precisely this result. Paragraph c of the comment to section 7.02 states that "Section 7.02(a) takes no position on whether the holder of a warrant or right issued by the corporation and not attached to some other security should have standing to bring a derivative action." On this issue, state corporate law is clear – an option holder lacks an equity interest and therefore does not have standing to bring a derivative suit, and the ALI Principles decline to take a contrary position. Until exercised, NewCo's option adds no additional equity interest to NewCo's initial 9.5 percent interest in DataCo.

9. The American Law Institute's reluctance to treat stand-alone options as an equity interest, and thereby confer standing to bring a derivative suit on its holder, is consistent with the general structure of corporate law: only exercise of an option confers equity rights on its holder. Corporate fiduciary principles provide a compelling illustration. Directors owe equity holders a fiduciary duty. *Directors do not owe option holders a fiduciary duty.* [2] And that proposition brings us full circle, to the argument in

---

[2] *See Glinert v. Wickes Cos.*, 1990 WL 34703, at *9 (Del.Ch. Mar. 27, 1990)("Under our law, the option feature of these instruments does not qualify for the protections that flow from a fiduciary duty."); *Powers v. British Vita, P.L.C.*, 969 F. Supp. 4, 6 (S.D.N.Y. 1997)("Clearly, any attempt to analogize options to stocks in order to suggest a fiduciary duty are to no avail."); *Simons v. Cogan*, 549 A.2d 300, 303 (Del. 1988)("[A] mere expectancy does not create a fiduciary duty."); *Starkman v. Warner Communications, Inc.*, 671 F. Supp. 297, 304 ("The [option] instrument stands alone, claiming no equity in the corporation, entitled to no vote, and with no fiduciary obligation of the management to the option holder's interest.").

my Initial Declaration: "[F]or corporate law purposes the boundary between an equity security and an option is quite explicit and sharp. Only the exercise of the option transmutes the holder's interest into an equity interest with corporate participation rights." Initial Declaration ¶16. And that proposition brings us full circle, to the argument in my Initial Declaration: "[F]or corporate law purposes the boundary between an equity security and an option is quite explicit and sharp. Only the exercise of the option transmutes the holder's interest into an equity interest with corporate participation rights." Initial Declaration ¶16.

10. Also in its May 5th Opposition, AT&T advances what appears to be a new argument for why an option is really an equity interest. Citing the article for which Merton Miller and Franco Modigliani were awarded the Nobel Prize in Economic Science,[3] AT&T asserts that "financial theory teaches that a firm's capital is in the form of either equity or debt." May 5th Opposition ¶ 2, p.21. The point, I suppose, is that an option must be one or the other; not being debt, it must be equity. While I am aware of no basis for AT&T's proposition that the issuance of an option or a warrant must be either debt or equity, Professors Miller's and Modigliani's seminal article certainly provides no support for it (or, indeed, even bears on the claim). That article advanced, what are called in financial economics, the "Irrelevancy Propositions" – in effect, that a firm's cost of capital is not affected by the mix of debt and equity in its capital structure and that the value of the firm is unaffected by whether the firm finances an investment with retained earnings or instead pays a dividend and finances the investment with debt. In other words, debt and equity are equivalent for valuation purposes. The FCC, of

[3] Merton Miller and Franco Modigliani, The Cost of Capital, Corporation Finance and the Theory of Investment, 48 Am. Econ. Rev. 261 (1958).

course, does not equate debt and equity and, in fact, neither do Professors Miller and Modigliani. The Irrelevance Propositions were intended as an extreme null hypothesis, much of the last 40 years of financial economics scholarship having been devoted to demonstrating why the Irrelevancy Propositions are incorrect.[4] For example, Miller and Modigliani did not take the governance characteristics of debt and equity into account, precisely the characteristics of greatest interest to the FCC. Indeed, if it is finance with which we are concerned, equity is valued by quite different methods than options. Variants of the capital asset pricing model or arbitrage pricing model are typically invoked for the pricing of equity. The Black-Scholes option pricing model is typically invoked to price options and option-like instruments such as warrants and conversion rights.

NewCo's Receipt of Its Opportunity Cost in the Event of Sale Does Not Result in NewCo Improperly Receiving Pre-Approval Appreciation in DataCo's InterLATA Data Business

11. AT&T appears to argue that the terms of DataCo's option will nevertheless result in a violation of Section 271 because the option allows NewCo to profit from pre-exercise appreciation in the value of DataCo: through receipt, in the event of a sale of Class B shares, by NewCo of its opportunity cost with respect to Section 271 compliance greater than 50 percent but less than 95 percent. AT&T's analysis, however, confuses payment of what NewCo would have earned had it *not* invested in DataCo, with a payment based on DataCo's performance.

12. Under the DataCo option, if NewCo eliminates applicable section 271 restrictions on at least 50% but less than 95% of Bell Atlantic in-region lines, its Class B

[4] The Irrelevancy Propositions are developed in accessible fashion in Jesse Choper, John C. Coffee, Jr., and Ronald J. Gilson, Cases and Materials on Corporations ch. 3 (5th ed. 2000).

shares will be convertible into 80 percent of DataCo's shares (assuming no dilution), but NewCo can retain only those convertible shares that would be convertible into 10 percent of DataCo's outstanding shares. In addition, NewCo cannot retain all the proceeds from any sale of the shares convertible above 10% that it must sell; it can retain only the value of NewCo's initial investment in the shares sold plus the amount NewCo would have earned had it placed the remainder of its initial investment in an *S & P 500 Index fund* instead of the DataCo option – that is, NewCo's "opportunity cost." AT&T argues that Section 271 approval grants NewCo the right to earn profits from long distance services after approval but not before; return of NewCo's opportunity cost, the argument runs, therefore gives it an improper pre-approval profit from long distance services.

13. This argument simply ignores the fact that NewCo's opportunity cost is measured, properly, by what NewCo would have earned in another investment, which, as Professor Coffee correctly points out, is best approximated by the S & P 500 Index used in the Revised Proposal. For NewCo to participate in profits from *DataCo*'s pre-approval provision of long distance service, the payment would have to be keyed to *DataCo*'s performance, not NewCo's performance measured by the S & P 500 Index. DataCo is an Internet backbone firm, whose stock performance can be expected to track an Internet index, not the S & P 500 Index.[5] Thus, payment measured by NewCo's

[5] The relevant determinant of DataCo's performance is the risk and return of its business, not its initial public offering. Professor Coffee accurately describes studies that, lumping all types of initial public offerings together, show average underperformance over a sustained period, Third Declaration of Professor John C. Coffee, Jr. ¶8 ("Coffee Third Declaration"). However, Professor Coffee neglects to mention the results of more recent studies that differentiate between the types of issuers in initial public offerings. These studies show that the sustained underperformance to which Professor Coffee refers is a phenomenon of small-firm IPOs; large-firm IPOs – like that contemplated for DataCo – do not experience this pattern. Indeed, recent studies show that this underperformance is not an IPO phenomenon at all. Rather, small firms underperform the market regardless of the existence of a recent IPO.

opportunity cost rather than DataCo's performance is not a payment of profits from the provision of long distance services.

14. AT&T also argues that the fact that the exercise price of NewCo's option is fixed alone constitutes a violation of Section 271 because, unless this price fluctuates with DataCo's appreciation, NewCo receives the benefit of DataCo's pre-exercise performance. In AT&T's analysis, a Bell Operating Company ("BOC") can only buy a long distance carrier at market price so that it obtains no benefit from appreciation in value resulting from the long distance carrier's prior performance. AT&T May 5th Opposition ¶3. The argument clearly proves too much. To take AT&T's example, suppose a BOC, believing it has satisfied Section 271, enters into an executory agreement calling for the acquisition of a long distance carrier at a price negotiated at the time of execution. There follows a lengthy approval process – perhaps prolonged by objections from AT&T – that results in Section 271 approval two years later. In the interim, the value of the long distance carrier appreciates. AT&T's analysis suggests that the BOC in this case would be prohibited from completing the transaction under the negotiated terms because, if the BOC were to purchase the carrier at the negotiated price, *it* would profit by the difference between the negotiated and then-current market price. As a result, every fixed-price acquisition agreement that is closed after some delay potentially violates Section 271 if, during that delay, the long distance carrier's stock appreciates. There is simply no basis for this bizarre result.

15. Indeed, AT&T's argument appears to invalidate its own acquisition of MediaOne. That acquisition agreement was signed over a year ago, during which time the market value of MediaOne has undoubtedly appreciated. Presumably, AT&T is prevented from profiting as a result of pre-approval MediaOne performance. However,

AT&T does not represent in its opposition that it intends to increase the consideration it has agreed to pay for MediaOne.

NewCo Will Not Control DataCo By Virtue of Its Option

16. Finally, AT&T argues again that even if NewCo's option is not tautologically an equity interest under Section 3(1), the option and the associated pre-conversion consent rights result in NewCo exercising actual control of DataCo and therefore renders DataCo a NewCo affiliate under Section 3(1). For the purpose of this inquiry, the FCC must confront the policy of the statute and the practicalities of transactional practice. As I showed in my initial Declaration, the FCC's treatment of an equivalent transactional structure – the option held by the acquiring company in connection with a regulated acquisition during the post-execution/pre-FCC approval and closing period – plainly reflects this reality. After execution, the acquiring company holds an option to purchase the target company at the price specified in the acquisition agreement, with exercise of the option conditioned on FCC approval. During the period prior to FCC approval and closing, the acquiring company has the right to all appreciation in the value of the target company. Also during this period, the acquiring company typically has the benefit of a set of covenants, just like the consent requirements associated with NewCo's option, that restrict the target's behavior without acquiring-company consent. Similarly, the incentives that AT&T ascribes to DataCo management during the pre-conversion period are equally applicable to target management during the post-execution/pre-FCC approval and closing period.

17. Thus, if AT&T's argument is to be taken seriously, any acquisition that takes the standard form will violate FCC approval rights because, as a result of the inherent option, the target will be controlled by the acquiring company and will therefore

be the acquiring company's affiliate under Section 3(1). For example, AT&T has been in this position for a full year with respect to its MediaOne acquisition.

18. What is apparent is that the FCC has thoughtfully exercised its discretion to develop a practical approach to control under Section 3(1), one that allows the construction of transactional structures bridging the period pending Commission approval so long as the structure does not implicate the matters of concern under the relevant statutory structure. The NewCo/DataCo option structure does not allow NewCo to get the benefit of service bundling without FCC approval. Accordingly, the NewCo/DataCo option structure should be treated the same as functionally equivalent option structures, including AT&T/Media One's option structure. In the end, the FCC is presiding over the restructuring and consolidation of the U.S. telecommunications industry. Managing that process effectively requires the thoughtful review of new transactional structures that preserve FCC approval over those matters of substance under Section 271.

I declare under penalty of perjury that the foregoing is true and correct.

Date. May 10, 2000

Ronald J. Gilson

C