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June 28, 2001

VIA HAND DELIVERY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
Room Number TWB-204
445 12th Street, S.W.
Washington, DC, 20554

RECEIVED

JUN 28 2001

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: GTE Corp. and Bell Atlantic Corp., CC Docket No. 98-184

Dear Ms. Salas:

On behalf of AT&T Corp., the attached letter addressed to Dorothy Attwood and David Solomon was hand-delivered to all addressees today. AT&T plans to separately file a confidential version of this letter under seal that will address aspects of the audit report that were redacted by Verizon.

Respectfully submitted,



Joan Marsh

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June 28, 2001

VIA HAND DELIVERY

Dorothy Attwood
Chief, Common Carrier Bureau
Federal Communications Commission
445 12th Street, S.W.
Washington, DC, 20554

RECEIVED

JUN 28 2001

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

David Solomon
Chief, Enforcement Bureau
Federal Communications Commission
445 12th Street, S.W.
Washington, DC, 20554

Re: GTE Corp. and Bell Atlantic Corp., CC Docket No. 98-184

Dear Ms. Attwood and Mr. Solomon:

The Auditor's Report¹ and Management's Report² on Verizon's and Genuity's compliance with the Genuity-related merger conditions, submitted on June 1, 2001 pursuant to the *BA/GTE Merger Order*,³ document numerous instances of "material"

¹ June 1, 2001 Independent Accountant's Report ("Auditor's Report") prepared by Mitchell & Titus LLP.

² The Report of Management on Compliance with the Genuity Conditions Set Forth in FCC Order Approving the GTE/Bell Atlantic Merger ("Management Report").

³ Memorandum Op. and Order, *Application of GTE Corp. and Bell Atlantic Corp. for Consent to Transfer Control of Domestic and International Section 214 and*

(footnote continued on following page)

violations of that order. The Auditor's Report further documents Verizon's and Genuity's refusal to provide the auditor with information required by the *BA/GTE Merger Order* that may well have led to the discovery of additional violations. In other words, Verizon has once again, upon the closing of a merger, decided to simply ignore the merger conditions it agreed to in order to gain the Commission's approval of Verizon's merger.⁴ Moreover, as shown below, each of the reported violations further reflect Verizon's continuing "control" over Genuity and the reality that Verizon is "providing," through Genuity, in-region interLATA services in violation of Section 271 of the Communications Act, 47 U.S.C. § 271.

In these circumstances, the Commission should both order that the audit be redone (and that Verizon and Genuity should cooperate fully with the auditor as required by the *BA/GTE Merger Order*) and impose sanctions for Verizon's and Genuity's violation of their merger obligations and Verizon's violation of Section 271.

(footnote continued from previous page)

310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License, CC Docket No. 98-184, ¶¶ 336-342 (June 16, 2000) ("*BA/GTE Merger Order*").

⁴ The prior instance relates to the conditions agreed to in the *Applications of NYNEX Corp. and Bell Atlantic Corp. for Consent to Transfer Control of NYNEX Corp.*, 12 FCC Rcd. 19985 (1997). AT&T and MCI were forced to file complaints with the Commission to obtain Bell Atlantic's compliance with the merger conditions which Bell Atlantic, after the merger, declared to be a "dead letter." Opening Brief of Bell Atlantic Corp., File No. E-98-05, at 4 (FCC March 13, 1998).

I. The Auditor’s Report and Management’s Report Identify “Material” Violations of the *BA/GTE Merger Order* that Demonstrate Verizon’s Continuing Control Over Genuity.

The critical issue in the *BA/GTE Merger* proceeding addressed by the Genuity-related conditions was whether the Genuity spin-off, as proposed by Bell Atlantic and GTE, would be sufficient to avoid a violation of Section 271. More specifically, the issue came down to whether Verizon would maintain *de facto* control over Genuity after that spin-off.

In resolving the issue of *de facto* control, the Commission looked at, *inter alia*, “Genuity’s financing arrangements [and] the contractual relationship between the entities following the spin-off.”⁵ The Commission concluded, based on the material presented to it at the time by Bell Atlantic and GTE, “that the merged firm will not have the power to dominate Genuity’s corporate affairs and, therefore, is not in actual control of Genuity.”⁶ But the Commission admonished the merging parties:

Should the actual relationship between Bell Atlantic/GTE and Genuity deviate from or extend beyond those representations, the Commission would be compelled to reevaluate its assessment of whether the merged firm controls Genuity. In the event that the Commission finds that, in light of the changed circumstances, the merged firm does, indeed, control Genuity, we will take appropriate enforcement action which may include issuing a standstill order.⁷

As shown below, Bell Atlantic/GTE (i.e., Verizon) and Genuity have breached representations which they made to the Commission with respect to both financing arrangements and contractual relationships.

⁵ *BA/GTE Merger Order* ¶ 76.

⁶ *Id.*

⁷ *Id.*

A. Genuity's Financing Arrangements with Verizon Demonstrate Verizon's Control over Genuity.

The Auditor's Report, the Management's Report, and other publicly available information demonstrate that Verizon has provided Genuity with loans in excess of the permitted 25 percent of *the total outstanding debt* of Genuity.⁸ Indeed, Genuity's 10Q indicates that almost 100% of Genuity's outstanding indebtedness is to Verizon.

While the Auditor's Report simply identifies Verizon's credit arrangements with Genuity as one of the "Agreements . . . not provided to the FCC,"⁹ Genuity's 10Q¹⁰ and other published reports¹¹ indicate that: (a) Genuity had a \$500 million (later increased to \$900 million and the maturity date extended) interim line of credit facility with Verizon Investments Inc., a wholly-owned subsidiary of Verizon, and, as of March 31, 2001, Genuity borrowed \$200 million under this line of credit; (b) Verizon also agreed to provide Genuity with additional credit enhancements such that the aggregate amount of interim funding and credit enhancements provided by Verizon is \$2 billion; and, (c) Genuity received an additional \$2 billion bank line of credit, but, as of March 31, 2001, there were no outstanding credit advances to Genuity from this

⁸ *BA/GTE Merger Order* ¶ 86 (emphasis added).

⁹ Auditor's Report, Attachment 1, p. 3.

¹⁰ Genuity's Form 10Q for the Quarterly Period ended March 31, 2001 ("Genuity's 10Q"), *Liquidity and Capital*, pp. 21-22. <http://www.sec.gov/Archives/edgar/data/11110794/000092701601501014/d10q.txt>.

¹¹ *See*, Peter Camp, Morgan Stanley Dean Witter (May 4, 2001); Thomas W. Watts, Merrill Lynch (May 4, 2001); Linda Meltzer, UBS Warburg ("We view the agreement as positive, solidifying GENU's relationship with VZ as long-term strategic asset"); *see also*, Review of First Quarter Earnings, May 3, 2001 and 1st Quarter Analyst Meeting, May 22, 2001, Financial Overview Power Point presentation by Dan O'Brien, Chief Financial Officer. http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=genu&script=1200.

line of credit. Thus, while the *BA/GTE Merger Order* states that Verizon may not lend Genuity “more that 25 percent of *the total outstanding debt* of Genuity,”¹² Verizon in fact lent Genuity almost 100 percent of Genuity’s total outstanding debt,¹³ and the financing available to Genuity from Verizon represents almost 50% of the total financing available to Genuity.¹⁴

Verizon, in an apparent concession that it has exceeded the *outstanding debt* threshold, asserts in the Management’s Report that the debt limit (in terms of funds lent by Verizon to Genuity) is “25% if the aggregate debt financing that *Genuity is permitted to incur*,”¹⁵ which amount Verizon elsewhere identifies as \$2.75 billion.¹⁶ Not only is Verizon’s assertion contrary to the Commission’s Order, it is utterly without content – a company is “permitted to incur” as much debt as the market will bear. In an effort to give this meaningless phrase some content, Verizon has apparently tied it to Verizon’s right as a minority shareholder to consent to any debt that Genuity seeks to incur in excess of \$11 billion. But Verizon’s minority shareholder right is irrelevant to the issue of whether it controls Genuity by virtue of controlling all or most of Genuity’s debt. Verizon’s proposed standard would allow it to own and control 100 percent of Genuity’ outstanding debt of up to \$2.75 billion even though that amount almost equals (and indeed in the past has exceeded)

¹² *BA/GTE Merger Order* ¶ 86 (emphasis added).

¹³ In addition to the \$200 million owed to Verizon, Genuity also has capital leases and convertible subordinated debt in the sum of \$81.4 million.

¹⁴ \$2 billion out of approximately \$4 billion.

¹⁵ Management’s Report ¶ 7.

¹⁶ See notes 10 and 11 *supra*.

Genuity's entire market capitalization.¹⁷ There is no doubt that in controlling so much of Genuity's debt, Verizon has enormous leverage and control over Genuity.¹⁸

B. Genuity's Commercial Arrangements with Verizon Also Demonstrate Verizon's Control over Genuity.

In its effort to obtain Commission approval of the proposed spin-off of Genuity, Verizon committed that "[a]ll commercial interactions" between it and Genuity "will be pursuant to commercially reasonable contracts."¹⁹ Verizon proposed this condition to assure the Commission that Verizon would not be able to exercise *de facto* control over Genuity. Indeed, as explained by Verizon, this commitment was "consistent with the fact that DataCo and Bell Atlantic/GTE will each be independent public corporations whose directors and officers will owe duties of care and loyalty to their respective shareholders."²⁰ However, the Auditor's Report and Management's Report demonstrate that Verizon breached its commitment to enter into commercially reasonable contracts with Genuity by: (a) improperly agreeing to charge Genuity non-arm's-length, affiliate rates; and, (b) improperly failing to collect amounts which

¹⁷ Genuity's market capitalization at the time the Verizon loan facility was made public was approximately \$2.25 billion; it is now slightly over \$3 billion. *See*, <http://biz.yahoo.com/p/g/genu.html>.

¹⁸ Changes in the debt structure of an entity can also result in changes in the ownership interests of that entity. Because Verizon's ownership interest in Genuity was, at the time of the spin-off, only slightly under the limitation prescribed by Section 271, Verizon's ongoing significant financing of Genuity may also be sufficient to incrementally increase Verizon's ownership position to an unlawful percentage under Section 3(1) of the Telecommunications Act. *See Implementation of Cable Television Consumer Protection and Competition Act of 1992*, CS Docket No. 98-82 (Oct. 20, 1999).

¹⁹ *BA/GTE Merger Order* ¶ 36.

²⁰ Supplemental Filing of Bell Atlantic and GTE in the Bell Atlantic/GTE Merger Proceeding, filed on January 27, 2000 at 33.

Genuity owed Verizon with respect to over 25% of those contracts.²¹ In both situations, it is apparent that Verizon is treating Genuity as an affiliate within the meaning of Sections 3(1) and 271 of the Communications Act.

1. Verizon is Not Charging Genuity Commercially Reasonable Rates.

The Management's Report states that Verizon is not charging "commercially reasonable rates . . . where rates may have been established by agreement of the parties before the Genuity spinoff under affiliate transaction rules."²² If Genuity is an affiliate, then the spin-off is a sham and Verizon is violating Section 271 of the Communications Act. If, on the other hand, Genuity is not an affiliate, then these transactions violate the *BA/GTE Merger Order's* "commercial reasonableness" mandate. The identified transactions also appear to violate the Commission's ruling in the *BA/GTE Merger Order*, rejecting Verizon's request for a waiver of the affiliate transaction rule.²³

After obtaining approval of its spin-off by persuading the Commission that Genuity was not an affiliate under Sections 3(1) and 271 of the Communications Act, Verizon now argues that it may adopt pricing arrangements that treat Genuity as if it were indeed an affiliate. Moreover, to the extent that any rates were established by the parties prior to Genuity's spin-off, those rates had to be renegotiated to reflect the new "arm's-length" status of Verizon and Genuity. Their failure to do so violates both the

²¹ Verizon also failed to submit bills in a timely manner with respect to 17% of the contracts tested.

²² Report of Management ¶¶ 7(d), 9(c), and 13(b).

²³ *BA/GTE Merger Order* ¶¶ 94-95.

BA/GTE Merger Order and Section 271 of the Communications Act.

2. The Auditor Explicitly Found That Verizon Breached The Merger Order By Not Billing and/or Collecting on Outstanding Debts From Genuity.

The Auditor's Report concludes that there was "material non-compliance" with Verizon's and Genuity's obligation under the Merger Order to engage in only commercially reasonable interactions. The auditor's conclusion was based on its finding that in over 25% of the agreements reviewed, Verizon did not collect payments within a reasonable time frame.²⁴ This finding is additional evidence that Verizon is improperly treating Genuity as an affiliate.²⁵

II. The Auditor's Report Identifies Instances Where Verizon and Genuity Refused to Cooperate, Frustrating the Auditor's Ability To Investigate The Existence of Additional Violations.

The Auditor's Report documents various instances where Verizon and Genuity breached the *BA/GTE Merger Order* by failing to produce specified information, frustrating the auditor's ability to identify whether additional violations exist.

²⁴ Auditor's Report at 3, further noting that with respect to 17% of the contracts reviewed, Verizon did not bill "in accordance with the periodic billing terms stated in the agreements" and that neither violation was disclosed in the 2000 Compliance Report, submitted to the FCC on March 15, 2001.

²⁵ Perhaps in an effort to preclude third parties from assessing the materiality of this violation, Verizon redacted from the Auditor's Report the gross volume of revenues involved, Auditor's Report, Attachment 1 at p. 3, even though the disclosure of this data alone obviously does not, and could not, improperly disclose confidential financial details associated with Verizon's or Genuity's operations as claimed by Verizon. Letter from Susan C. Browning, Executive Director – Regulatory Compliance, Verizon, dated June 21, 2001. Of course, there is no de minimis exception to violations of Section 271 of the Communications Act.

A. Verizon's Failure to Cooperate

1. Verizon Improperly Refused to Produce Agreements.

The auditor reported that Verizon refused to provide ten agreements which the auditor wanted to test for commercial reasonableness.²⁶ The *BA/GTE Merger Order*, however, requires Verizon to provide the auditor with all agreements necessary to examine “the full relationship between Bell Atlantic/GTE and Genuity, so that if the merged entity engages in any prohibited or questionable transactions, . . . [the Commission] can expect disclosure of the pertinent facts and potential enforcement action.”²⁷

It is apparent from the titles of the agreements withheld that some, if not all, should have been reviewed by the auditor. For example, the auditor should have had the opportunity to review the joint marketing arrangement²⁸ to verify that Verizon is not providing or jointly marketing in a state where it has not obtained 271 authority, any Genuity service that is, or includes as a bundled component, an interLATA

²⁶ These includes: (a) three agreements between GTE Labs as provider and Genuity as recipient for TIPS Support and Maintenance, Advanced Services for Wireless Support, and Web Content Transformation Technology Evaluation Services; (b) an Amendment/Addendum to a Capacity Agreement between GTE California as provider and Genuity; (c) three Master Agreements all Internet related, for Billing Services for wholesale e-mail, wholesale ISP-DSI Services and dial access services; (d) two Global Service Agreement (“GSP”) related agreements, one for Billing Services and one for PVC remapping, (e) a “Brand, Technology and Co-Marketing Agreement between TELUS Corporation, an affiliate of Verizon, and Genuity.” Auditor’s Report at 2.

²⁷ *BA/GTE Merger Order* ¶ 340, n. 791.

²⁸ The “Brand, Technology and Co-Marketing Agreement between TELUS Corporation, an affiliate of Verizon, and Genuity”

service.²⁹ The auditor similarly should have had the opportunity to review the two Global Service Provider (“GSP”)-related agreements to verify that: (a) in “remapping” the “PVC” (which AT&T understands to mean a Permanent Virtual Circuit) the GSP is not directing the in-region interLATA traffic to Verizon’s out-of-region router, or (b) in billing for the GSP, Verizon is not improperly using its brand.³⁰

2. Verizon Refused to Provide the Auditor with a Requested Assertion Regarding High-Speed Special Access and Regular Special Access Services and the Auditor Failed To Audit The Commission’s Specified Measurements For Those Services.

The Auditor’s Report also concluded that “Verizon’s management did not provide . . . an assertion regarding Verizon’s discrimination in favor of Genuity in the provision of high-speed access and regular special access services.” According to Verizon’s management, however, no assertion was required by the *BA/GTE Merger Order*.³¹

In fact, the *BA/GTE Merger Order* required much more. That Order provided that, with respect to its provision of high-speed special access and regular special

²⁹ *BA/GTE Merger Order* ¶ 88. See also, *AT&T Corp. v. Ameritech Corp.*, File No. E-98-41, Memorandum Opinion and Order, 13 FCC Rcd 14508 (1998).

³⁰ Cf. Memorandum Op. and Order, *Qwest Communications International Inc. and US West, Inc. Applications for Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, 15 FCC Rcd 11909, ¶¶ 14 (use of Qwest brand with bills for in-region interLATA traffic would violate Section 271) and 38 (requiring GSP to hand in-region interLATA traffic to Qwest’s out of region routers would violate Section 271) (June 26, 2000).

³¹ Auditor’s Report at 2.

access services, Verizon was required to report five different measurements³² on a monthly basis to the independent auditor so that it could ascertain whether Verizon was discriminating, or attempting to discriminate, in favor of Genuity in the provision of these services.³³ Reporting this data to the auditor was critical because, “the knowledge that discrimination would be detected either by the independent auditor or in subsequent section 271 proceedings, and possibly deprive the BOC of its ability to exercise the conversion right, reduces the likelihood that the merged entity will engage in such behavior.”³⁴

The auditor apparently sought to implement its obligation to audit the five measurements by asking Verizon for an assertion that it was not discriminating in favor of Genuity when providing high-speed access and regular special access services. Verizon’s refusal to provide the requested assertion only underlies its failure to comply with the data reporting requirements mandated by the *BA/GTE Merger Order*, frustrating the very mechanism the Commission relied upon to assure non-discrimination. In all events, even if Verizon failed to provide the requested assertion, the auditor failed to comply with the merger order’s requirement that there be an independent audit of the five specified measurements.

B. Genuity’s Refusal to Cooperate with the Auditor.

Finally, the auditor reported that Genuity refused to provide it with information

³² Percent of commitments met; the average interval (in days); the average delay days due to lack of facilities; the average interval to repair service (in hours) and the trouble report rate.

³³ *BA/GTE Merger Order*, ¶ 72 (emphasis added).

³⁴ *Id.* ¶ 75, *see also*, ¶ 74.

when requested to do so. This refusal arose in two contexts. First, the auditor was “unable to obtain sufficient evidence from Genuity’s management to test for commercial reasonableness [two agreements that govern Genuity’s provision of information technology transition services to Verizon].”³⁵ Second, Genuity similarly refused to disclose sufficient information for the auditor to determine “whether the commercial interactions [between Genuity and Verizon] were pursuant to commercial [sic] reasonable contracts.”³⁶

The Auditor’s Report does not attribute to Genuity any alleged justification for refusing to disclose the requested information. Nor can there be one. The *BA/GTE Merger Order* imposed an auditing obligation on both Verizon *and* Genuity. Indeed, the *BA/GTE Merger Order* provides that “*Bell Atlantic and GTE* will retain an independent auditor to conduct an annual audit to provide a thorough and systematic evaluation of *Bell Atlantic/ GTE’s* compliance with the conditions.”³⁷ Similarly, the Commission clearly stated in its Order that whenever it used the phrase “Bell Atlantic and GTE” (or “the Applicants”), it meant the pre-merger entities,³⁸ which included the GTE-Internetworking assets that became Genuity.³⁹ Any other reading of the *BA/GTE Merger Order* that would exclude Genuity would encourage strategic

³⁵ Auditor’s Report at 2.

³⁶ *Id.* at 3. Genuity similarly did not provide “written representations acknowledging responsibility for its compliance with” the *BA/GTE Merger Order* requirements regarding incentive compensation, and the election process and conduct of the Board of Directors.

³⁷ *BA/GTE Merger Order* ¶ 336; see also ¶ 38 (speaking in terms of the “Applicants”).

³⁸ *Id.*, ¶ 1, n. 1. These provisions define the scope of Condition XVIII, ¶ 480.

³⁹ *Id.*, ¶ 8.

avoidance of the Commission's auditing obligations – as already happened here.

* * *

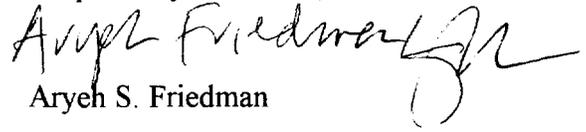
In summary, in light of the clear evidence that Verizon and Genuity violated the conditions of the *BA/GTE Merger Order* and Section 271, AT&T respectfully submits that the Commission should: (1) require Verizon and Genuity to provide the auditor with any information necessary to allow the auditor to conduct a complete audit as mandated by the *BA/GTE Merger Order*, including a full audit of the financial arrangements between the two parties and Genuity's current indebtedness; (2) mandate the re-issuance of an audit report that fully complies with the *BA/GTE Merger Order*; (3) levy a fine against Verizon and Genuity for violating the merger conditions, and (4) sanction Verizon for violating Section 271 of the Communications Act, by issuing, at the very least, the standstill order that is referred to in the Commission's order.⁴⁰

Please note that Verizon has provided me access to the information redacted from the Auditor's Report pursuant to the Protective Order in this proceeding. I am separately filing a confidential version of this letter that includes my analysis of, and comments on, the redacted information.

⁴⁰ *BA/GTE Merger Order* ¶ 76.

Thank you for your attention to this matter. You may direct any questions to the undersigned.

Respectfully submitted,

Aryeh S. Friedman

cc: Carol Matthey
Anthony Dale
Radhika Karmarkar
Richard Welch
Brad Berry