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

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

FURTHER COMMENTS OF THE
COMPETITION POLICY INSTITUTE

Of Counsel:
James L. Casserly
MINTZ LEVIN COHN FERRIS
GLOVSKY & POPEO, P.C.
701 Pennsylvania Ave., NW
Washington, D.C. 20004
Phone: 202/661-8749
Fax: 202/434-7400

Ronald J. Binz, President
Debra R. Berlyn, Executive Director

1156 15th St. NW Suite 520
Washington, D.C. 20005
Phone: 202/835-0202
Fax: 202/835-1132

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SUMMARY

Nothing of consequence has changed since CPI filed its reply comments in February. The Communications Act still bars Bell Atlantic and GTE from merging so long as GTE provides interLATA services in those Bell Atlantic in-region states for which Bell Atlantic has not yet obtained authority under section 271. Bell Atlantic and GTE still insist on continuing the interLATA operations of GTE Internetworking (now known as Genuity), post merger, in Bell Atlantic's in-region states, without obtaining authority under section 271. As before, the parties seek to shed the appearance, but not the reality, of owning and controlling Genuity. The Commission cannot properly approve such a proposal.

Section 271 occupies a special status in the Communications Act. No other section wields such power to induce the Bell companies to meet their market-opening requirements and thereby enable consumers to enjoy the myriad benefits of competition. No other section (and only one other subsection) is walled off from the Commission's exercise of its forbearance authority. No other section has been more carefully and faithfully followed by the Commission.

Bell Atlantic and GTE have modified their "DataCo" proposal on at least two occasions since CPI filed its reply comments. Although these changes are modest steps in the right direction, they are far from adequate to address the fundamental flaw that has been common to all of Bell Atlantic's and GTE's proposals over the past several months. The plain truth is that, despite GTE's proposed transfer of its interLATA Internet backbone operations to a new company, Bell Atlantic and GTE plan to retain both equity interests and control sufficient to make that new company an "affiliate" and therefore subject to section 271. So long as these parties insist on preserving their ownership and control of GTE's interLATA operations, the Commission must continue to withhold its consent.

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The Competition Policy Institute ("CPI")[1] hereby responds to the latest proposal by Bell Atlantic and GTE (collectively, "the merger parties" or "BA/GTE") to address the section 271 issues presented by GTE's ownership of GTE Internetworking (now known as Genuity), which provides interLATA telecommunications services in Bell Atlantic's in-region states.[2]

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[1] The Competition Policy Institute is a non-profit organization that advocates state and federal policies to bring competition to telecommunications and energy markets in ways that benefit consumers.

[2] Letter from William P. Barr, GTE Corporation, to Magalie Roman Salas, FCC, CC Docket No. 98-184 (Apr. 28, 2000)("BA/GTE 4/28 Proposal"). See Public Notice, "Commission Seeks Comment on Additional Filings Submitted by Bell Atlantic Corporation and GTE Corporation," CC Docket No. 98-184 (Apr. 28, 2000).

I. INTRODUCTION

Although the merger parties have made some changes that move their proposal a few steps in the right direction, the current proposal still suffers fatal infirmities. Bell Atlantic and GTE still seek to maintain impermissible ownership of an interLATA carrier; they still seek to maintain impermissible control of that carrier; and section 271 still prohibits a Bell company from having such ownership or control of a carrier that provides interLATA services in its in-region states. As a consequence, the proposed merger remains unlawful.

Even if the law allowed the Commission greater discretion, policy considerations likewise compel a negative determination regarding the latest BA/GTE proposal. The strongest incentive for Bell companies to open their local markets to competition is the prospect of being authorized to enter the market for interLATA services. Congress was quite clear about the appropriate sequencing of local market opening and interLATA market entry: only *after* the competitive checklist is fully implemented (and certain other requirements are met) may the Bell companies or their affiliates provide interLATA services. If and to the extent that the Commission allows departures from that approach, the incentive structure will be undermined and the dismantling of local market monopolies will be delayed.

CPI filed detailed reply comments on an earlier proposal by Bell Atlantic and GTE that had essentially the same purpose and effect as the latest proposal.[3] In those comments, CPI argued that the proposed terms of the BA/GTE merger were unlawful under section 271 of the Communications Act, as amended by the Telecommunications Act of 1996. CPI explained that the prohibition on the provision of interLATA services applies not only to the Bell companies but also to their affiliates, and would apply with full force to a company formed by the merger of Bell Atlantic and GTE just as it now does to Bell Atlantic alone. CPI also noted that this prohibition applies to the provision of all interLATA telecommunications services, including Internet backbone services and point-to-point private lines, as well as traditional long distance service.

[3] Reply Comments of Competition Policy Institute, CC Docket No. 98-184 (Feb. 22, 2000).

CPI further observed that, although the merger parties have taken a variety of different positions concerning the application of section 271 to their proposed transaction, all of their diverse proposals shared a common theme of enabling the merged entity to continue certain interLATA operations in Bell Atlantic's "in-region" states, without meeting the statutory requirements established by section 271. So, too, with the latest proposal. BA/GTE have made some changes in their earlier proposal, but the fundamental character of the proposal is unchanged. It would reserve for BA/GTE impermissible ownership and control of Genuity (denominated "DataCo" in the proposal) and therefore violate section 271.[4] It would also undermine the market-opening incentives carefully crafted by Congress and pave the way for possibly even greater violations of the statutory framework.[5]

II. THE BA/GTE PROPOSAL WOULD PERMIT THE MERGED ENTITIES TO RETAIN UNLAWFUL EQUITY OWNERSHIP OF AN INTERLATA CARRIER.

Neither Bell Atlantic nor any affiliate thereof may provide interLATA telecommunications services in Bell Atlantic's in-region states until section 271 approval has been obtained for each of those states. 47 U.S.C. § 271(a). Genuity provides interLATA telecommunications services throughout Bell Atlantic's territory. The issue, then, is whether BA/GTE's proposed new structure for ownership of Genuity takes it out from under the statutory prohibition.

On the issue of ownership, the main point to bear in mind about the statute is that Congress defined the term "affiliate" quite broadly. For purposes of that term, any equity interest

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[4] Curiously, the merger parties seem to recognize the impermissibility of proposing similar arrangements for all of their other interLATA services. See Letter from Alan F. Ciamporcero, GTE, to Magalie R. Salas, FCC, CC Docket No. 98-184 (Apr. 17, 2000)(detailing termination of various services by GTE Communications Corporation and GTE.net and divestiture of facilities by GTE Data Services Inc., GTE Telecommunications Services, Inc., and GTE Network Services).

[5] In deciding that the arrangements proposed here entail impermissible ownership and control, the Commission need not assume the burden of completely delineating every form of permissible and impermissible ownership and control. See U S West Communication, Inc. v. FCC, 177 F.3d 1057, 1061 (D.C. Cir. 1999)(subsequent history omitted)(same point made regarding "demarcation of the border between permitted marketing and forbidden provision").

exceeding 10 percent constitutes ownership. 47 U.S.C. § 153(1). Ownership is found whether that interest is exercised "directly or indirectly." Id. And, by encompassing not just an equity interest of more than 10 percent but also "the equivalent thereof," id., Congress made it clear that the Commission must focus the economic realities of the business relationship, and not just the form.[6]

The economic reality of the latest BA/GTE proposal -- like the versions that preceded it -- is that GTE will never relinquish 90 percent, or even the majority, of its equity interest in Genuity. To be sure, public shareholders will purchase Class A common stock that carries 90.5% of the voting rights and the right to receive 90.5% of any dividends or other distributions,[7] but the inescapable truth is that the public shareholders will never acquire 90.5% of the equity, or anything close.

Indeed, earlier in this proceeding, the merger parties admitted that "DataCo stock will trade based upon [BA/GTE's] expected level of ownership *assuming conversion of B shares into A shares*."[8] (In the latest proposal, that would be: "conversion of B shares into C shares.") In other words, the market will value the publicly available DataCo stock -- from the time of issuance -- on the "expected level" of public ownership that will exist *after* conversion. GTE has now confirmed this in Genuity's filing with the Securities and Exchange Commission.[9]

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[6] Cf. Alarm Industry Communications Committee v. FCC, 131 F.3d 1066 (D.C. Cir. 1997) (subsequent history omitted) (questioning reasonableness of agency focusing on form rather than substance of transaction).

[7] BA/GTE 4/28 Proposal, Exhibit A, at 1. It is unclear whether the parties mean to imply that there is in fact any serious prospect of "dividends or other distributions" to Class A stockholders. There isn't. Genuity "ha[s] a history of significant operating losses and expect[s] those losses to continue for at least the next several years." Form S-1 Registration Statement of Genuity Inc., at 7 (as filed with the Securities and Exchange Commission Apr. 7, 2000)("Genuity S-1").

[8] Letter from Patricia E. Koch, Bell Atlantic, to Magalie Roman Salas, FCC, CC Docket No. 98-184 (Dec. 21, 1999), Attachment at 2 (emphasis supplied).

[9] Genuity S-1 at 17 ("We expect that, upon completion of this [initial public] offering, the trading price of the Class A stock will reflect the dilution that will result from th[e] future conversion of Class B common stock").

Thus, the public shareholders will likely pay, in the aggregate, about 20 percent of the value of Genuity for the entire issue of Class A stock. Conversely, the value of the equity interests that will *not* be sold to the public, but retained by GTE/Bell Atlantic (the Class B stock), would be approximately 80% (not 10%). Thus, the parties' claim that they will not own more than a 10% equity interest, or equivalent thereof, of Genuity is not credible and is, in fact, misleading.

Several other aspects of the proposed arrangements are equally telling. When BA/GTE exercises its right of "conversion," the amount it will pay for the privilege of formalizing its 80% ownership of Genuity is zero. It will pay nothing, and the putative 90.5% owners will receive nothing. BA/GTE will not "buy back" its equity interest in Genuity because it never sold it off in the first place (other than the 20% that is the true economic stake that is being sold through the initial public offering). Moreover, if the value of Genuity appreciates during the time before conversion, BA/GTE's intention is that BA/GTE -- not the "public shareholders" who purportedly own 90.5% of the company -- will capture 80% of that appreciation.

The merger parties seem to think that they have materially improved their proposal by introducing the element of "risk" that their conversion right cannot be exercised unless section 271 approval is secured for 50% of Bell Atlantic lines.[10] In other words, if they do not secure Section 271 approval for 50% of Bell Atlantic's lines, they will be left with only their 10% interest. But this is no genuine contingency -- and certainly not enough of one to justify devaluing the present equity value of the "contingent" interest to zero.

As the Commission demonstrated in its New York 271 order, when the Commission believes that a Bell company has fulfilled its market-opening obligations, approval to offer interLATA services quickly follows.[11] If Bell Atlantic is unsure of its ability to obtain authority to

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[10] BA/GTE 4/28 Proposal, Exhibit A, at 3-4.

[11] Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York, CC Docket No. 99-295, FCC 99-404 (rel. Dec. 22, 1999) (subsequent history omitted).

offer interLATA services within five years, that is another way of saying that it is doubtful that it will have complied with section *251* within five years. Given that the Telecommunications Act became law four years ago, and that the merger parties are seeking up to five additional years, any claim of “risk” or “contingency” is tantamount to admitting that they may not have fully implemented their duties under the law until more than nine years after its enactment. And they also seem to be underestimating the Commission’s determination to use its enforcement powers to compel compliance, where the incentive of section 271 is not sufficient.

To reduce the contingency even further, under the BA/GTE proposal, the conversion privileges vest when Bell Atlantic has obtained section 271 approvals covering only 50% of its lines.[12] Bell Atlantic has already obtained section 271 authority for New York, which represents close to a quarter of Bell Atlantic’s lines, and approvals for any other two large states (New Jersey and Massachusetts, for example) would carry it over the 50% mark. Again, given the Commission’s oft-stated and recently demonstrated commitment to awarding 271 authority to Bell companies that fully implement their market-opening requirements, there is just no reasonable doubt that such approvals will have been earned in two more states by the year 2005.

III. THE BA/GTE PROPOSAL WOULD LEAVE THE MERGED ENTITIES WITH IMPERMISSIBLE CONTROL OF AN INTERLATA CARRIER.

The notion of what constitutes “control” may in some instances be elusive, but on the facts presented here it is clear that BA/GTE would maintain control of Genuity. In fairness, BA/GTE has given ground since the proposal on which CPI previously commented; it has eliminated or

[12] The latest proposal also provides for variations in BA/GTE’s conversion rights depending on whether BA/GTE has obtained Section 271 approvals for over 50%, over 90%, or over 95% of its lines, but these differences do not alter the analysis. Once the 50% threshold is reached, BA/GTE will at a minimum have a vested right to “all of the proceeds attributable to a 10% equity interest” *plus* whatever amount BA/GTE “would have received if it had taken the amount of its initial investment above its 10% interest and invested it, at the time of closing, in the S&P 500 Index.” BA/GTE 4/28 Proposal, Exhibit A, at 5. That sum will inevitably constitute, in the words of the statute, “an equity interest (or equivalent thereof) of more than 10 percent.”

modified some of the most egregious limitations on the rights of the public shareholders who would supposedly own 90% of the company to run it as they see fit. But a closer look reveals that BA/GTE will retain a degree of influence that necessarily must be deemed to constitute control.

The dominant instrument of control is the "once and future" nature of BA/GTE's overt ownership. Even by the narrow definition of ownership that the merger parties favor, GTE owns Genuity right now, and (assuming the merger were approved) BA/GTE will own 80 percent of it in the future. Every director, every manager, and every employee of Genuity will understand this, and they will act accordingly. The incentives of the directors, managers, and employees to conduct the business in the manner that they know to be desired by BA/GTE will not be altered by the fact that DataCo is temporarily being held in a form of parking arrangement. To imagine otherwise is to ignore human nature.

But BA/GTE are not relying solely on human nature to maintain the control of DataCo. Genuity is a going concern. It is incapable of functioning without the ongoing support of GTE. Indeed, as Genuity has elsewhere acknowledged, Genuity will rely on GTE for a host of services: accounting and cash processing services (including payroll, asset accounting, and accounts payable), billing and collection processing services, human resources services and benefits administration, real estate support services (including project management and environmental and safety services), software support services, hardware support services (including help desk support for personal computers), systems support centers for critical services, and local area network support.[13] In addition, Genuity will provide wide area network support to GTE, and GTE will provide wide area network support to Genuity in areas outside Bell Atlantic's in-region states.[14] Genuity's dependence on GTE also extends to "computer programming and technical

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[13] Genuity S-1 at 66. It also bears emphasis that BA and GTE are suppliers of essential inputs used by Genuity, and by Genuity's competitors. As a result, opportunities abound for discrimination and cost-shifting.

[14] Id.

services, including the development of software interfaces and modifications and enhancements to existing systems."[15] While these arrangements may as a matter of form purport to be "terminable at any time by DataCo [Genuity] without penalty,"[16] there is no reason to believe that Genuity will in fact terminate them or that Genuity has any incentive to deny BA/GTE the "control" that is inherent in Genuity's dependence.[17]

And this is not all. One might reasonably assume that shareholders who nominally own 90.5 percent of a company would be able to exercise substantial discretion in what they do with it. Yet BA/GTE propose that Genuity's shareholders be required to obtain the consent of BA/GTE to make any one of a variety of business decisions, including whether to merge, whether to sell assets, whether to issue additional stock, whether to change the nature or scope of DataCo's business, whether to make certain acquisitions or dispositions, or whether to incur debt beyond predetermined (by BA/GTE) levels. These "Mother-may-I" constraints go well beyond the usual requirements for protection of minority stockholders. And, especially in the context of a going concern that is only temporarily being housed in a new shell, they demonstrate BA/GTE's ongoing control.

Perhaps even more remarkable is the proposed limitation on aggregations of voting interests by anyone other than BA/GTE. Under the revised proposal, no single holder or group may vote more than 20% of the Class A stock.[18] Thus, if every single "public shareholder" agrees on a particular matter and conveys a proxy to a single entity to vote on that matter, those votes will automatically be discounted; they will register as a vote of 20 percent, not 90 percent. By

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[15] Id.

[16] BA/GTE 4/28 Proposal, Exhibit A, at 3.

[17] GTE's continuing control of Genuity was forcefully demonstrated recently, when a new capital expenditure plan of $11-13 billion for Genuity to accelerate its network buildout was announced by GTE Chairman and CEO Charles R. Lee. GTE News Releases, "Statement from GTE on Genuity" (Apr. 10, 2000), available at <www.gte.com/AboutGTE/NewsCenter/News/Releases/genuitystatement.html> (visited May 4, 2000). Coincidentally (or not), the plan covers the next five years. Id.

[18] BA/GTE 4/28 Proposal, Exhibit C.

impairing the ability of any other entity to exercise influence through the solicitation of proxies, the merger parties are further reinforcing their own control.

IV. THE COMMISSION SHOULD PRESERVE THE INCENTIVE REGIME ESTABLISHED BY CONGRESS.

As shown above, CPI believes that BA/GTE are proposing a scheme to evade section 271 through arrangements that obscure their continuing direct and indirect ownership (in excess of a 10 percent equity interest, or the equivalent thereof) and control of Genuity. A hard look at what the parties are proposing (or even a not-so-hard look) reveals that they are manipulating form without altering substance. To approve such a scheme would be a departure from past practices of the Commission and establish a dangerous precedent for the future.

As the Commission knows well, the prospect of section 271 "relief" is the principal incentive -- other than the threat of enforcement actions -- to obtain Bell company compliance with the market-opening obligations established in section 251(c). If Bell Atlantic can, in effect, "buy" a major interLATA business now, before it has satisfied the competitive checklist (and other requirements of section 271), its cooperation with market-opening measures will inevitably diminish. If Bell Atlantic and GTE are permitted to circumvent section 271, it is inevitable that other Bell companies will insist that they be granted the same privilege. It is also inevitable that the next attempt, if this one is successful, will push the envelope still further, creating even greater jeopardy for the statutory framework.

When BA/GTE presented their first DataCo proposal a few months ago, there was an outpouring of opposition from many of the entities with the strongest interest in opening local telephone markets to competition. Wired and wireless, local and long distance, resale and facilities-based -- competitive entities representing all these industry sectors filed comments or reply comments in opposition. Perhaps the attritive effects of BA/GTE's regulatory strategy -- with proposal after proposal after proposal, each one little different from the last -- will diminish the number of opposing commenters this time; if so, the cause will be fatigue and resource constraints, not BA/GTE's' satisfaction of legitimate concerns. But the Commission must maintain its resolve.

The Commission has not hesitated to deny unmeritorious section 271 applications in the past.[19] It has steadfastly refused proposals to create large data-only LATAs or to forbear from applying section 271 to advanced telecommunications services.[20] It required SNET to divest its long distance operations in SBC's states,[21] and it did the same with Qwest's interLATA telecommunications operations in the U S West states.[22] This is not the time to change course, or to weaken the incentives of the Bell companies to fulfill their market-opening duties.[23]

Indeed, thanks in large part to the Commission's rigor in enforcing section 271, the potential of the Telecommunications Act is much closer to being realized than ever before. Most of the statutory litigation (much of it intended primarily to delay competition) has at last been resolved. Considerable market-opening progress has been made in many states. The first successful 271 application has been granted,[24] and many more presumably will be granted over the next few years. As local markets have opened, competitors have seized the opportunities

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19 E.g., Application of BellSouth Corp. Pursuant to Section 271 to Provide In-Region, InterLATA Services in South Carolina, 13 FCC Rcd. 539 (1997).

20 Deployment of Wireline Services Offering Advanced Telecommunications Capability, 13 FCC Rcd. 24,011, 24,044-50 (1998) (subsequent history omitted).

21 Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Southern New England Telecommunications Corporation, Transferor to SBC Communications, Inc., Transferee, 13 FCC Rcd. 21292, 21309-10, 21318 (1998) ("in order to comply with section 271, SNET and its subsidiaries must cease originating long distance traffic in SBC's current seven-state region if the merger is approved").

22 Qwest Communications International Inc. and U S 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, CC Docket No. 99-272, FCC 00-91 (rel. Mar. 10, 2000).

23 The Commission has made it clear that even narrowly tailored requests for section 271 relief will not be granted where the effect would be to weaken the incentives of the Bell company to comply with its market-opening responsibilities. Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147, FCC 00-26 (rel. Feb. 11, 2000).

24 See supra note 11.

available to them. As a result, consumers are enjoying the benefits of lower prices, better service, a wider array of pricing plans, and all the other benefits of competition.

It is for this reason -- and also because a careful statutory analysis compels it -- that the Commission should reject BA/GTE's latest proposal and disapprove their pending merger.

CONCLUSION

The Commission should reject Bell Atlantic's and GTE's latest proposal to circumvent section 271. To approve this proposal would violate the letter of the law and establish a dangerous precedent. It would also inevitably undermine the incentive mechanism Congress established, delay local competition, and deny consumers the full benefits of the Telecommunications Act.

Respectfully submitted,

Ronald J. Binz, President
Debra R. Berlyn, Executive Director
COMPETITION POLICY INSTITUTE
1156 15TH St. NW Suite 520
Washington, DC 20005
Phone: 202/835-0202
Fax: 202/835-1132

Of Counsel
James L. Casserly
MINTZ LEVIN COHN FERRIS GLOVSKY & POPEO, P.C.
701 Pennsylvania Ave., NW
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