Communications Workers of America
AFL-CIO, CLC

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ORIGINAL

February 11, 1998

Ms. Blanca Bayo, Director
Division of Records and Reporting
Room 110, Easley Building
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

Re: Docket No. 971604-TP — Request for approval of transfer of control of MCI Communications Corporation (parent corporation of MCI Metro Access Transmission Services, Inc., holder of AAV/ALEC Certificate 2986, and MCI Telecommunications Corporation, holder of IXC Certificate 61, PATS Certificate 3080, and AAV/ALEC Certificate 3996) to TC Investments Corp., a wholly-owned subsidiary to WorldCom, Inc. d/b/a/ LDDS Worldcom.

Dear Ms. Bayo:

The Communications Workers of America (CWA) petitions to intervene and to request a formal proceeding in the above-mentioned Docket No. 971604-TP. Enclosed is an original and 15 copies of our comments filed in this docket.

CWA represents 20,000 workers in the state of Florida, the majority of whom are employed in the telecommunications industry. The proposed WorldCom-MCI merger will impact our members as workers and as consumers of telecommunications services.

We request that you place CWA on the service list, listed as follows:

ACK
AFA
APP
CAF
CMU Williams
CTR
EAG
LEG 1
LIN 5
OPC
RCH
SEC 1
WAS
OTH All

George Kohl
Debbie Goldman
Communications Workers of America
501 Third St. N.W.
Washington, D.C. 20001

Sincerely,

George Kohl

George Kohl
Senior Executive Director
Research and Development
Communications Workers of America

DOCUMENT NUMBER-DATE
02154 FEB 12 8
FPSC-RECORDS/REPORTING

Before the
Public Service Commission
of the State of Florida
Tallahassee, Florida

In the Matter of Request for approval of transfer of control of MCI Communications Corporation (parent corporation of MCI Metro Access Transmission Services, Inc., holder of AAV/ALEC Certificate 2986, and MCI Telecommunications Corporation, holder of IXC Certificate 61, PATS Certificate 3080, and AAV/ALEC Certificate 3996) to TC Investments Corp., a wholly-owned subsidiary of WorldCom, Inc. d/b/a/ LDDS WorldCom	)	Docket No. 971604-TP

Petition to Intervene and Protest of Proposed Agency Action of the Communications Workers of America

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Dated: February 12, 1998

I. Introduction

Pursuant to Rules 25-22.029 and 25-22.036 of the Florida Administrative Code, the Communications Workers of America (CWA) petitions to intervene and submits this Protest of the Commission's Proposed Agency Action in Docket No. 971604-TP, the request for approval of transfer of control of MCI Communications Corporation to TC Investments Corp., a wholly-owned subsidiary to WorldCom, Inc. d/b/a/ LDDS Worldcom.

CWA represents more than 630,000 workers nationally, including 20,000 workers in Florida, the majority of whom work in telecommunications. CWA members are also consumers of telecommunications services.

The Commission should hold formal proceedings on the impact of the Applicants' request for transfer of control of licenses from MCI Communications Corporation to WorldCom, Inc. The proposed merger raises important public interest concerns that the Commission should carefully consider in the context of formal proceedings. On the merits, the Applicants fail to demonstrate the proposed merger between MCI and WorldCom, Inc. would benefit Florida consumers, for numerous reasons, including the following:

(1) The proposed merger would adversely affect the development of competition in the local exchange residential and small business market. The merged entity's business plans indicate that it plans to reduce national spending in the local loop by a total of $5.3 billion over the next four years, compared to pre-merger planned local loop investments by MCI and WorldCom.

(2) The proposed merger would harm the provision of quality service at affordable rates over the public switched telephone network in Florida. Thus, it would not serve to maintain nor to improve the quality of service available to consumers in Florida, particularly those in high-cost areas. Rather, the merged entity's focus on serving business customers in urban areas will shift significant revenues from the public switched network to the private MCI-WorldCom network. It will increase access charge bypass by high-value business customers. In response to the sharp reduction in revenues in the local exchange, there will be increased pressure to raise local residential rates, to reduce investment in the public switched network, or both.

(3) Although the Application does not disclose or even discuss the question, the merged entity would control about *63 percent* of the United States Internet backbone market. Thus, the proposed merger would adversely affect competition in the Internet access market. The proposed merger will have the anti-competitive effect of significantly increasing the merged entity's market power to set prices for and access to the Internet, particularly in high-cost rural areas in Florida.

(4) The proposed merger would not benefit state and local economies, local communities, and would result in job loss and reduced living standards for telecommunications workers. The merged entity's planned reduction in network investment and sales and marketing expenses will result in significant loss of telecommunications jobs in the state of Florida.

II. The Proposed Merger Will Delay Development of Competition in the Local Exchange Residential and Small Business Market.

A. MCI Before the Proposed Merger with WorldCom Was the Most Aggressive Potential "Precluded" Competitor in the Local Exchange Residential and Small Business Market

The proposed merger would have an anti-competitive impact in the local exchange residential and small business market. First, it would reduce investment in facilities in the local exchange. Second, as explained in detail below, it would eliminate MCI as an aggressive potential competitor to break the local bottleneck in the residential and small business local exchange market.

Before merger plans were announced, MCI had been the most aggressive among long distance carriers in its plans to build facilities to compete for residential and small business customers in the local exchange. The company announced plans to spend $2 billion to build local facilities, with plans to enter residential and small business markets in 31 cities in 1997 and 75 cities in 1998.[1] "We plan to serve residential customers with our local networks," MCI President and Chief Operating Officer Timothy F. Price announced.[2] Analysts noted that among the long distance companies, "only MCI was interested in spending real money on local wires and switches."[3] MCI

[1] Standard & Poors, *Telecommunications: Wireline*, Sept. 25, 1997, p. 13.

[2] "One Year After Telecom Act: MCI Aggressively Expands Local Service; Brings Local Networks to Six New Cities, Plans Local Service for Residential Customers in More States; MCI Committed to Serving Local Customers Nationwide," Feb. 6, 1997 (http://www.mci.com/mcisearch/about...rests/publicpol/press/970206.html).

[3] Robert Crandall, "MCI Played the Regulation Game and Lost," *The Wall Street Journal*, Nov. 27, 1997.

continued to maintain its commitment to the residential and small business local exchange market, even after July 1997 when it announced lower than anticipated revenues from the local loop.[4]

B. The Merged Entity's Planned Reductions in the Local Exchange over the Next Four Years Would Delay the Development of Facilities-Based Competition in the Local Exchange Residential and Small Business Market

However, on October 3, 1997, two days after MCI and WorldCom announced their proposed merger, WorldCom's Vice-Chairman and Chief Operating Officer John Sidgmore announced in a press interview that the merged company planned to retreat from the consumer market by transferring MCI's current long distance residential customers to another firm. "[We are] not in the consumer business," Mr. Sidgmore said.[5] "It's very difficult for us to find a way to make economic sense out of the advertising budgets, the customer service budgets, etc. required to be in the consumer business."[6] While the merged company might continue to earn high-margin revenues by carrying consumer traffic on its network, Mr. Signore said, the low-margin work of providing customer service, operator services, and billing would be transferred to another carrier.[7]

Mr. Signore's statement provoked a firestorm of negative reaction. And so, the next day, on October 4, 1997, Mr. Signore tried to soften his original statement. The plan to transfer

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[4] "MCI Remains Committed to Its Local Service Strategy," *Communications Today*, July 7, 1997

[5] Mike Mills, "WorldCom Would Shift MCI's Focus; Bidder Plans to Shed Residential Service," *Washington Post*, Oct. 3, 1997.

[6] *Id.*

[7] *Id.*

residential customers, he said, was only a "possibility" or something "we would consider." But he repeated that the merged company would show little interest in the residential market. "Our religious focus is on the business customer," he said.[8] "It is a jihad."[9] (See "Attachments".)

Based on these public statements, the future of the merged entity's long distance residential and small business customers is unclear. But analysis of financial documents filed by WorldCom with the Securities and Exchange Commission (SEC) indicates that the merged company plans to abandon MCI's previous plan to build out its network in order to serve residential and small business customers.

Indeed, the merged entity plans to reduce their nationwide spending in the local exchange by $5.3 billion over the next four years compared to pre-merger planned local loop spending plans.[10] (See Table 1 below.)

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[8] Mike Mills, "WorldCom Clarifies MCI Plans; Bidder Pledges It 'Will Not Abandon' Residential Customers," *Washington Post*, October 4, 1997.

[9] *Id.*

[10] WorldCom, Inc. Form 8-K Exhibit 99.3.

Table 1. Post-Merger Planned Reductions in Spending in Local Residential and Small Business Market					
	1999	**2000**	**2001**	**2002**	**Total**
Operating Costs	$500 million	$700 million	$900 million	$1.2 billion	$3.3 billion
Capital Expenditures	$700 million	$575 million	$450 million	$300 million	$2 billion
Total	$1.2 billion	$1.2 billion	$1.4 billion	$1.5 billion	$5.3 billion
Source: WorldCom Form 8-K, Exhibit 99.3, "MCI and WorldCom Analysts Presentation Given on Nov. 10, 1997."					

MCI and WorldCom describe these reduced local loop investments as "synergy" savings, savings to be realized as a result of the merger. MCI and WorldCom break these "synergy" savings into two broad categories: operating cost savings and capital expenditure savings.[11]

Operating Cost Savings. MCI and WorldCom identify a line item among operating cost savings called "MCI local savings." The merged entity anticipates MCI local operating cost savings of $500 million in 1999, rising to $1.2 billion in 2002.[12]

In their public announcements and SEC filings, MCI and WorldCom do not identify anticipated MCI local operating cost savings in 2000 and 2001. However, interpolating from the 1999 and 2002 figures that are provided in the financial documents, one might conservatively estimate planned savings in the range of $700 million in 2000 and $900 million in 2001. Based on this

[11] *Id.*

[12] *Id.*

estimate, the merged entity plans a total reduction of $3.3 billion in MCI local operating costs in the four years after the merger.

A small portion of these savings may come from merger-related efficiencies. But operating cost savings in the magnitude of $3.3 billion over four years can only be realized by a shift in business focus, away from the high costs of marketing, provisioning, billing, and providing customer service to a mass market.

Local Capital Expenditure Cost Savings. MCI and WorldCom also identify $700 million in reduced capital expenditures in the local loop in 1999 and $300 million in reduced local loop capital expenditures in 2001.[13] Interpolating from these figures, one might estimate reductions in planned local loop investment of $575 million in 2000 and $450 million in 2001, for a total planned reduction in the local loop of about $2 billion. This is the same amount that MCI earlier announced it planned to invest to "invade the local telephone market."[14]

In sum, over the next four years, the merged entity plans to reduce local spending by a total of $5.3 billion compared to what MCI planned to spend in the local exchange absent a merger with WorldCom. The overwhelming portion of the $5.3 billion in savings will be realized from the

[13] *Id.*

[14] "One Year After Telecom Act: MCI Aggressively Expands Local Service; Brings Local Networks to Six New Cities, Plans Local Service for Residential Customers in More States; MCI Committed to Serving Local Customers Nationwide," *supra.*

shift in MCI's business strategy away from the residential and small business local exchange market.[15]

There is strong evidence that prior to the announcement of its planned merger with WorldCom, MCI planned to enter the local exchange residential and small business market with an aggressive local build-out and marketing commitment.[16] These plans will be scrapped over the next four years by the merged entity with its "religious focus" on the medium- and large-sized business customer.

Thus, the merger will eliminate the strongest potential precluded competitor for facilities-based competition in the residential and small business local exchange market. In addition, it reduces the number of competitors in the local exchanges in Florida's metropolitan centers. Today, MCI-Metro and WorldCom (through its MFS subsidiary) provide local exchange services in Miami, Orlando, and Tampa. The merger will reduce the number of competitors in these local business markets.

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[15] There are other financial signs that the merged entity would reduce MCI's pre-merger planned investment in local facilities. The merged entity will have a significant debt overhang as a result of borrowing $7 billion to purchase British Telecom's MCI stock, reducing cash flows that might have otherwise been available for expansion.

[16] "One Year After Telecom Act: MCI Aggressively Expands Local Service; Brings Local Networks to Six New Cities, Plans Local Service for Residential Customers in More States; MCI Committed to Serving Local Customers Nationwide," *supra*.

In both these ways--the reduction of the number of current competitors in the local exchange, and the elimination of the most aggressive potential competitor in the residential and small business local market--the merger adversely affects competition and is not in the public interest.

III. The Proposed Merger Will Significantly Harm the Provision of Quality Service at Affordable Rates on the Public Switched Telephone Network.

A. The Merged Entity's Vertical Integration of Exchange Access, Long Distance, and Internet Access Markets in Urban Centers Would Result in a Significant Shift of Revenues from the Public Switched Network to the Private MCI-WorldCom Network

WorldCom, through its recent acquisitions of MFS and Brooks Fiber, is the largest competitive access carrier in the nation, providing exchange access to business customers in 86 metropolitan centers. Nationally, WorldCom's long distance network customer base consists of 80 percent business customers; the remaining 20 percent are residential customers who purchase through a wholesale arrangement.[17] Less than five percent of WorldCom's revenues derive from the retail segment and fully 20 percent of WorldCom's revenue comes from its private line business.[18] WorldCom, and the firms that it has acquired, have pursued a targeted business strategy, ignoring residential customers and mass markets, while pulling high-revenue medium- and large-sized business customers off the public switched network.

[17] Morgan Stanley Dean Winter, "WorldCom: The I's Have It; International and Internet Fuel a Great Growth Story," June 2, 1997, p. 8.

[18] *Id.*, pp. 4 and 8.

A merger of MCI and WorldCom would result in a vertically integrated company ideally positioned to arbitrage business opportunities opened by a competitive, deregulatory policy. The merged entity would own fiber ringing the business districts in Florida's urban centers; a long-distance network with significant market share (25 percent nationwide); and 63 percent of the Internet backbone network and the largest Internet service providers.[19]

In their application, MCI and WorldCom state that the proposed merger will accelerate competition--especially in local markets. But in reality the merged entity will not be a competitor *in all markets* served by incumbent local exchange carriers. Rather, the merged entity's business plans build upon WorldCom's past business strategy--to achieve high margins by targeting lucrative medium- and large-sized business customers. Through vertical integration, the merged entity will be able to attract high revenue business customers by providing a bundled package of exchange access, long distance, and Internet access provided entirely on its own network. The result will be a diversion of revenue off the public switched network and accelerated bypass access charges.

[19] "MCI WorldCom — A New Era Communications Company," (http://www.mci.com/about us/company/news/wcom/fact.html).

B. The Increase in Access Charge Bypass by the Merged Entity Will Undermine Provision of Quality Service at Affordable Rates

A merger between MCI and WorldCom would undermine the provision of quality, affordable service on the public switched telephone network in two ways. First, as discussed above, the merged entity's vertically integrated network in the major urban centers would enable it to bundle exchange access, long distance, and Internet access to business customers and shift a substantial portion of revenues off the public switched network. Incumbent local exchange carriers are currently unable to provide similar packages due to a variety of regulatory and legal barriers, including regulated access prices and restrictions under the Telecommunications Act of 1996 Section 271 against providing long distance service.[20]

Second, the merged entity's vertically integrated network would accelerate access charge bypass. Nationwide, MCI and WorldCom estimate "synergy" savings in "domestic line costs" of $1.5 billion in 1999 and $1.2 billion in 2002.[21] While MCI and WorldCom do not explain the source of these "domestic line cost" savings, it is most likely that the savings derive from access charge bypass. Assuming savings in 2000 and 2001 of $1.3 billion and $1.4 billion, respectively, we estimate the total access charge savings nationally over the four years comes to $5.4 billion. A substantial portion of those savings will be realized in Florida.

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[20] Section 271 prohibitions on Bell Operating Company entry into long distance are uncertain, pending appeal of recent court decisions.

[21] WorldCom, Inc. Form 8-K submitted to the Securities and Exchange Commission, Nov. 9, 1997, Exhibit 99.3, Analysts Presentation Given on November 10, 1997, pp. 25-26 (hereinafter WorldCom Form 8-K, Exhibit 99.3).

The combination of these two factors--the accelerated migration of lucrative business traffic off the public switched network and the increase in access charge bypass--would lead to significant revenue loss by incumbent local exchange carriers who continue to have carrier-of-last-resort obligations. The resulting loss in revenue is likely to result in pressure by incumbent LECs to raise residential rates, particularly in high-cost areas, decisions to reduce network investment, or both.

The result would undermine the provision of quality service at just, reasonable and affordable rates to residents in all areas of the state, especially those in rural, high cost areas. The result would also reduce revenue available to invest in upgrading networks, delaying progress toward bringing access to advanced telecommunications and information services in all regions of the state.

For this reason, the MCI-WorldCom merger is not in the public interest of Florida consumers.

IV. The Proposed Merger Would Adversely Affect Competition in the Internet Access Market.

A. The Merged Entity Would Dominate the Internet Backbone Market

The evidence demonstrates that the merger would adversely affect competition in the Internet access market by combining two of the three largest Internet backbone providers.

The Internet is composed of two distinct markets: 1) Internet service providers (ISPs) that connect end users (customers) to the Internet primarily through dial-up or dedicated connections; and 2) Internet backbone providers that inter-connect with the ISPs to pass traffic across the country and around the globe. (See "Conceptual Overview of the Internet," Attachments.)

While today there are about 4,500 ISPs nationwide, there are only a small number of *national* backbone providers. A *national* Internet backbone provider is defined as one that maintains a packet-switched national data network with DS-3 (45 Mbps) or higher speeds, peers (interconnects) with other networks on both coasts, and is able to carry data traffic from the originating to the terminating user without having to purchase Internet access from any other company.

Today, a handful of companies dominate the Internet backbone market. The only publicly available market share data on the Internet backbone market is that collected by *Boardwatch* magazine.

The data in Table 2 on the next page presents two measures for market share: the percent of Internet service providers (ISPs) that connect to each national backbone and the percent of ISP connections that each national backbone network has. (The numbers differ slightly since some ISPs have multiple connections.)

The data demonstrates that today there are three dominant firms in the Internet backbone market. Based on the percent of ISPs connected to its network, MCI has 40.7 percent of the market, Sprint has 30.5 percent, and WorldCom (which owns UUNET, ANS, and Compuserve) has 23 percent. BBN and AGIS trail with single-digit market share; all other Internet backbone providers have very small market share.[22] This market share data is consistent with market share information that has been published in the press and investment analyst reports.[23]

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[22] Jack Rickard, "The Big, The Confused, and the Nasty: UUNet Resigns from the Internet--US West Expresses Clueless Greed and Confusion, the FCC Rules on Access Charges," *Boardwatch*, June 1997, http://www.boardwatch.com/mag/97/June/bwm1.htm (hereinafter *Boardwatch*). An updated fall 1997 *Boardwatch* survey reports that the merged company would own at least 48.43 percent of all Internet connections (29.43 percent for MCI and 19 percent for WorldCom/UUNET; no figures given for ANS or CNS). This updated survey reports that MCI would have 38.79 percent of ISPs connected to it, but does not report similar figures for WorldCom's backbone networks. *See* Boardwatch, *Internet Service Providers: Quarterly Directory*, Fall 1997.

[23] Other sources that cite market share data include: Thomas E. Weber and Rebecca Quick, "Would WorldCom-MCI Deal Lift Tolls on Net?," *The Wall Street Journal*, Oct. 2, 1997, p. B-1; "The New World Order," *Business Week*, Oct. 13, 1997, p. 30; Kenneth Pukier, "MCI-WorldCom Faces Internet Probe," *Communications Week International*, Nov. 24, 1997; "Net Charges Loom as WorldCom Grabs for 60% of Backbone," *Computerize, Inc.*, Dec. 5, 1997; Bhawani Shanker, "WorldCom, MCI, and the Internet," *UMI*, Dec. 1, 1997; Morgan Stanley Dean Winter, "WorldCom: The I's Have It; International and Internet Fuel a Great Growth Story," June 2, 1997, p. 22; "GTE's MCI Bid Impacts AT&T's Net Position," *Internet Week*, Oct. 20, 1997.

Table 2. Internet Backbone Providers			
Backbone	**Connections**	**% of ISPs**	**% of total connections**
MCI	**1569**	**40.73%**	**35.22%**
Sprint IP Svcs	1176	30.53%	26.30%
UUNET (WorldCom)	**811**	**21.05%**	**18.20%**
AGIS	303	7.87%	6.80%
BBN	189	4.90%	4.24%
ANS (WorldCom)	**69**	**1.79%**	**1.55%**
Digex	61	1.58%	1.37%
DataXchange	53	1.37%	1.19%
CWIX	45	1.17%	1.01%
Goodnet	45	1.17%	1.01%
PSI	31	.80%	.70%
NAPNet	23	.60%	.52%
GridNet	21	.55%	.47%
ATMnet	17	.44%	.38%
IBM	13	.34%	.29%
CAIS	10	.26%	.22%
NetCom	9	.23%	.20%
Savvis	5	.13%	.11%
CompuServe (WorldCom)	**5**	**.13%**	**.11%**

Source: *Boardwatch*, June 1997.
Bold indicates that this Internet service provider would be owned by the merged WorldCom-MCI.
% of ISPs = % of all ISPs interconnecting with this backbone provider
% of total connections = % of total ISP connections with this backbone provider.
This table also includes Internet backbone providers which do not meet the definition of national backbone providers because they must purchase some Internet access from other providers.

Should the WorldCom-MCI merger occur, the merged entity would have 63 percent of all ISPs connected to the network and 55 percent of all ISP connections.[24] (See Table 3 below.) The merged WorldCom-MCI would have twice the market share of Sprint, the next largest backbone provider, with all others trailing far behind.

Table 3. Internet Backbone Providers			
Backbone	**Connections**	**% of ISPs**	**% of total connections**
WorldCom	**2,454**	**63.7%**	**55.08%**
Sprint IP Svcs	1176	30.53%	26.30%
AGIS	303	7.87%	6.80%
BBN	189	4.90%	4.24%
Source: *Boardwatch*, June 1997. Totals add up to more than 100% because some ISPs are connected to more than one backbone.			

Thus, the proposed merger would reduce competition in the Internet backbone provider market among the most significant market participants in three ways. First, it would eliminate MCI which is WorldCom's largest major competitor. Second, it would create a market dominated by one powerful provider, with almost two-thirds of the market share. Third, it would leave the market with only two significant market participants. This would adversely affect competition by creating one backbone provider with the ability through unilateral or concerted action to exercise market power to control prices, reduce access, or both.

[24] *Id.*

Evaluating market share using ISP connection data is a relevant starting point for merger analysis. The key issue in evaluating Internet dominance relates to the issue of interconnection. Since privatization of the Internet backbone in the early 1990s, there has been no regulatory requirement that networks interconnect with each other on the Internet. Rather, private network providers have agreed to interconnect with each other through negotiated "peering arrangements." These peering arrangements allow Internet service providers and backbone providers to exchange traffic across regional and national networks.

When the Internet backbone industry was small and fragmented, there was free peering among the many backbones and ISPs. The voluntary peering arrangements worked well, sparking tremendous growth and innovation on the Internet. The number of Internet users doubles every four to six months, growing from 9 million customers in 1995 to 30-35 million today. Analysts predict that there will be half a billion Internet users worldwide in the year 2000, with revenue growing from one billion dollars in 1995 to $23 billion in the year 2000. Many expect that the Internet's packet-switched data network will replace the public switched telephone network as the predominant communications infrastructure for voice, data, and video.[25]

As the Internet market matures and concentrates, the large backbone providers convert former "peers" into "customers" who pay for interconnection. In May 1997, WorldCom broke ranks and began charging smaller ISPs and backbone networks not only for Internet transit but also for

[25] Kevin Swerback, *Digital Tornado: The Internet and Telecommunications Policy*, FCC Office of Plans and Policy Working Paper Series, No. 29, March 1997, p. 12.

access to its customer routes.[26] Smaller backbones and ISPs had little choice but to agree or go out of business, since refusal meant that their customers could not reach WorldCom's customers. Once WorldCom instituted this new policy, the other large backbone providers, including MCI, Sprint, and BBN, followed suit.[27]

It is important to stress that it is interconnection, not transport capacity, that is the key issue to consider regarding ease of or barriers to entry in the Internet access market. As long as no one firm dominates the Internet backbone, it is in the interest of all the national backbone providers to agree to interconnect with each other on reciprocal terms. However, should one firm grow so large, the dominant firm will be able to set the terms of interconnection.

Post-merger, there would be two large Internet backbone providers: the dominant WorldCom-MCI network and number two Sprint. The merged entity's dominant control over the Internet backbone market, absent regulatory constraint, would allow it to exercise its market power to control prices and access to the Internet backbone through unilateral or concerted action.

The merged entity could use its market power to further consolidate Internet access by refusing interconnection to smaller backbone providers and ISPs; adopting discriminatory pricing in favor

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[26] Bell Atlantic Petition to Deny the Applications of WorldCom or, in the Alternative, to Impose Conditions, *In the Matter of Applications of WorldCom, Inc. for Transfers of Control of MCI Communications Corporation*, CC Docket No. 97-211, Jan. 5, 1998, p. 8. *See also* UUNet Details Pay 'Peering' Policy for Smaller ISPs, *TR Daily*, May 12, 1997; R. Barrett, "UUNet Sets Official Peering Requirements," *Interactive Week Online*, May 13, 1997 at http://www.zdnet.com/zdnn/content/inwo/o513/inwo0001.html.

[27] *Id.*

of its own ISPs (MCI and WorldCom's UUNET, ANS and CNS are both backbone providers and among the largest ISPs); charging monopoly prices; or providing poor service to interconnecting providers (delaying capacity upgrades, for example), with the result that competitors' customers will switch carriers.[28]

Regulators have long recognized the unique economic structure of networks; the value of any one network increases as more customers and content providers connect to it. Because a merged WorldCom-MCI Internet backbone network would connect the vast majority of customers and content providers to its backbone, other providers will find connecting to the WorldCom-MCI network is vastly more valuable to them than their networks are to WorldCom-MCI. Thus, post-merger, other backbone providers and ISPs would have to accept the dominant WorldCom-MCI's terms for interconnection to ensure that their customers can reach all destinations on the Internet.

In short, in a post-merger environment, new entrants to the Internet access market, including many large telecommunications firms that employ CWA members, would face barriers to entry imposed by the dominant backbone provider through its control of interconnection. This would

[28] Bell Atlantic, in its comments in CC Docket No. 97-211 before the FCC,, notes that even in the short run there are many technical obstacles to easy switching by ISPs should their backbone provider raise its prices or reduce service. Ninety percent of ISPs lease address space. For these ISPs, switching backbones would entail assigning its customers new IP addresses, which would require renumbering many hardware, operating system, network software, and other applications, a process which could take up to a year. (Bell Atlantic Petition, pp. 10-11.)

be true regardless of whether new entrants possess superior technology or provide higher quality service.

The merged entity would in essence have bottleneck control over access to its dominant backbone network. As noted earlier, in addition to its 63 percent ownership of the Internet backbone network, the merged entity would also own some of the largest ISP networks, including UUNet (the largest), MCI (the second largest), ANS (7th largest), and Compuserve.[29] The merged entity would be able to use this bottleneck control in a discriminatory fashion, adopting pricing policies that favor interconnection with its own ISPs through cross-subsidies, predatory pricing, or other practices.

In the near future, the Internet backbone will become the major communications infrastructure as packet-switched data becomes the dominant traffic. Since the Internet is not regulated, the only policy tool the Commission has at its disposal to ensure that competition continues to drive innovation on the Internet and to prevent bottleneck control of Internet access is to ensure that no one firm gains dominance over the Internet backbone. The threat of market domination over the Internet backbone that would result from this merger, particularly given the Internet's importance to the Florida economy, is sufficient cause for the Commission to deny the Applicants' merger request.

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[29] Daniel Lyons, "Internet Service Providers — Revenue Booms, But Strain on Profits Prompts New Emphasis on Value-Added Services," *Computer Reseller News*, June 2, 1997.

Since the Internet is not regulated, post-merger the Commission will have no regulatory tools to ensure that the merger benefits Internet consumers. Therefore, to protect consumers from the anti-competitive impact of the merger on the Internet market, the Commission should reject the Applicants' request.

B. Quantitative Analysis of Concentration

The U.S. Department of Justice (DOJ) uses the Herfindahl-Hirschman Index (HHI) to conduct a quantitative analysis that calculates changes in market concentration due to a merger. The HHI analysis is typically used as a "screen" to identify cases in which a merger significantly aggravates or creates highly concentrated markets. The results of the HHI quantitative analysis supplement, but do not substitute for, our more detailed examination of competitive concerns.

The HHI is calculated by summing the squares of the firms' percentage of the market. According to the DOJ's *1992 Horizontal Merger Guidelines*, a market with an HHI above 1800 is considered "highly concentrated."[30] In a market with an HHI above 1800, the DOJ generally regards mergers that increase the HHI by more than 100 points as "likely to create or enhance market power or facilitate its exercise."[31]

[30] United States Department of Justice & Federal Trade Commission, *1992 Horizontal Merger Guidelines*, 57 Fed. Reg. 41558, § 1.51 (1992).

[31] *Id.*

Based on pre-merger market shares of 40.7 percent for MCI and 22.9 percent for the WorldCom group (UUNet, ANS, and Compuserve), this produces: 40.7 x 40.7 = 1,656; 22.9 x 22.9 = 524. The pre-merger HHI for the two firms would be at least 1656 + 524, or 2,180. In the post-merger market, however, the merged entity's market share would produce an HHI of 63.6 x 63.6, or 4,045. Accordingly, the merger would result in a change of 4,045 - 2,180 = 1,865.

This is well above the threshold of the DOJ's *1992 Horizontal Merger Guidelines* for identifying a merger "likely to create or enhance market power or facilitate its exercise." Our analysis finds that a merger between MCI and WorldCom would result in a highly concentrated Internet backbone market.

V. The Proposed Merger Will Reduce Employment Growth in Florida.

The reduced spending that will result from the merged entity's planned reduction in capital and operating expenses will result in significant job loss in Florida. For this reason, too, the proposed merger is not in the public interest.

We have used a conservative methodology to estimate the nationwide employment impact of the merged entity's planned reduction in capital and operating expenses in the year 2002. A significant portion of that job loss would be in Florida.

We estimate that the reduced network build-out in the local and long distance markets, combined with the reduction in customer service in the local exchange market, translates into the loss of 75,000 telecommunications jobs nationwide that would have been created by the year 2002, absent the merger. We describe the methodology below.

Capital Expenditures. In 2002, the merged entity plans to cut $1.6 billion in capital expenditures ($1.3 billion in long distance/international/Internet and $.3 billion in local).[32] This translates into the loss of 35,000 jobs. We derive this figure based on the following methodology. First, we estimate average annual compensation, including wages and benefits, for non-union telecommunications craft work at $45,000. Second, we divide the $1.6 billion cut in capital expenditures by this average annual compensation of $45,000. Rounding down, we arrive at 35,000 jobs lost due to the merger-related cuts in capital expenditures.

Operating Costs. In 2002, the merged entity plans to save $2.5 billion in job-related operating expenses ($1.2 billion in MCI local savings and $1.3 billion in core sales, general, and administrative expenses).[33] We generously estimate that half these savings are non-personnel related: real estate, advertising budgets, etc. This leaves us with an estimate of $1.25 billion in personnel-related SG&A savings by 2002. We estimate average annual compensation for non-union sales, marketing, customer service, and clerical occupations at $30,000. We divide the

---

[32] *Id.*

[33] *Id.*

$1.25 billion cut in personnel-related SG&A expense by this average annual compensation of $30,000. Rounding down, we arrive at 40,000 jobs lost due to merger-related cuts in SG&A.

Total Telecommunications Job Loss. Thus, we estimate that the total merger-related job loss in telecommunications due to reduced network investment and operating costs is 75,000 jobs in the year 2002.

Within weeks after the merger announcement, MCI announced 1,500 lay-offs. It also announced that it would take pretax charges of more than $200 million for restructuring and job cuts.[34] In this area, too, the proposed merger is not in the public interest. These are reductions from *current* employment levels. At the same time that MCI announced the $200 million charge for jobs cuts, it also announced a $300 million charge to be used to retain top executives. According to the merger agreement, upon successful completion of the merger, MCI's top five executives will get $78.1 million.

Clearly, merger-related "synergies" and "efficiencies" that result in job loss are not in the public interest.

[34] Bloomberg Business News, "Corporate-MCI to Feel Big Bite of Pretax Charges," *The Commercial Appeal.*

VI. Conclusion

The Commission must carefully evaluate a proposed merger on a case-by-case basis. Some mergers may strengthen competition by ensuring that the merged firm has the resources necessary to compete; on the other hand, mergers that result in dominant market power are not in the public interest.

On the merits, this merger is not in the public interest for four reasons.

First, the proposed merger will transform the current vibrant Internet access market into one in which the merged entity would have market power to set the price of and the rules for Internet access. It may not be an exaggeration to say that the future of the Internet, which is critical to Florida's economic future, could well be determined by the Commission's decisions on this merger.

Second, the merger would delay the development of facilities-based competition in the market for residential and small business customers in the local exchange.

Third, it will harm the provision of affordable, quality universal service, particulary in high-cost and underserved communities.

Fourth, it would result in job loss in the telecommunications industry.

The Commission should conduct a formal proceeding on the proposed merger. In hearings, interested parties including CWA would have the opportunity to present facts regarding the matters raised in this Protest, as well as other matters regarding the impact of the proposed merger on the public interest.

Respectfully submitted,

George Kohl
Senior Executive Director
Research and Development

Communications Workers of America

Dated: February 12, 1998

Attachments

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

Date of Report (Date of earliest event reported): November 9, 1997

WORLDCOM, INC.
(Exact Name of Registrant as Specified in its Charter)

Georgia	0-11258	58-1521612
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification Number)

515 East Amite Street
Jackson, Mississippi 39201-2702
(Address of Principal Executive Office)

Registrant's telephone number, including area code: (601) 360-8600

Exhibit No. 99.3

Operating Cost Savings

<TABLE>
<CAPTION>

	Anticipated Annual Savings ($ in billions)			
	1999		2002	
	Previous	Revised	Previous	Revised
<S>	<C>	<C>	<C>	<C>
Core SG&A	$1.0	$1.0	$1.3	$1.3
MCI Local Savings	$0.7	$0.5	$1.5	$1.2
Domestic Line Costs	$0.6	$0.6	$1.3	$1.8
International Line Costs	$0.1	$0.4	$0.3	$1.3
Total	$2.4	$2.5	$4.4	$5.6

</TABLE>

Presentation contains forward-looking statements.
Actual results may vary.

Capital Expenditure Savings

TABLE>
CAPTION>

	Anticipated Annual Savings ($ in billions)			
	1999		2002	
	Previous	Revised	Previous	Revised
S>	<C>	<C>	<C>	<C>
.D./Int'l/Internet	$0.8	$0.9	$1.2	$1.3
ocal	$0.7	$0.7	$0.3	$0.3
T	--	$0.4	--	$0.4
Total	$1.5	$2.0	$1.5	$2.0

TABLE>

Merrill Lynch

In-depth Report

United States
Telecommunications/Services - Long Distance

4 February 1998

Daniel P. Reingold, CFA
First Vice President
(1) 212 449-3031
daniel_p_reingold@ml.com
Mark Kastan, CFA
Vice President
(1) 212 449-3241
mark_kastan@ml.com

WorldCom Inc.

Ind. Consolidation+Core Growth+Synergies = Compelling GARP Stock ACCUMULATE*

Reason for Report: Resuming Coverage

Long Term
BUY

Price: $35 3/4

12 Month Price Objective: $45

Estimates (Dec)	1996A	1997E	1998E
EPS:	$1.42	$0.38	$0.85
P/E:	25.2x	94.1x	42.1x
EPS Change (YoY):		-42.7%	123.7%
Consensus EPS:		$0.39	$0.87
(First Call: 16-Jan-98)			
Q4 EPS (Dec):	NA	$0.14	
Cash Flow/Share:	$1.36	$2.12	$1.92
Price/Cash Flow:	26.3x	16.9x	18.6x
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$[illegible] / 1000
Book Value/Share (Dec-96):	$13.70
Price/Book Ratio:	2.6x
ROE 1997E Average:	NA
LT Liability % of Capital:	25.5%
Est. 5 Year EPS Growth:	37.0%

Stock Data

52-Week Range:	$39 7/8-$21 1/4
Symbol / Exchange:	WCOM / OTC
Options:	Pacific
Institutional Ownership-Spectrum:	54.6%
Brokers Covering (First Call):	29

ML Industry Weightings & Ratings**

Strategy; Weighting Rel. to Mkt.:

Income:	Overweight	(07-Mar-95)
Growth:	Overweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	In Line	(25-Jul-95)
Market Analysis; Technical Rating:	Above Average	(24-Nov-97)

*Intermediate term opinion last changed on 01-Oct-97.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

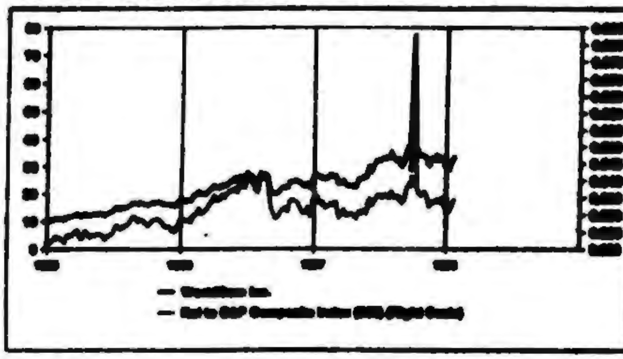
Investment Highlights:

- Resuming coverage of WCOM with an Int. term Accumulate & LT Buy ratings (D-2-1-9).
- Stock selling at what we view as attractive multiples of '99E: 17.9x reported EPS, [illegible] EPS, and 7.3x EBITDA. Relative to [illegible] EPS growth (off '99), WCOM [illegible] "growth at a reasonable price" (GARP) with a P/E relative to S&P 500 of [illegible] with 6 yr growth [illegible] that of S&P 500 ([illegible]% vs. 26% for WCOM).
- WCOM's investment case is strengthened by the MCI merger which adds 26% to pre-merger '99E EPS, due to hard synergies accounting for 1/2 of EPS growth, continuing growth of Internet profits, inherent low exposure to RBOC entry & potential cash from asset sales.
- 12 month price objective of $45 based on a 22.5x target multiple on our '99 EPS est. of $2.

Fundamental Highlights:

- Brooks acq. on 1/29 marks end of phase 1 of WCOM's industry consolidation strategy while accelerating local network deployment [illegible] yrs.
- Merger with MCI (phase 2) remains on track for 3Q98 close. Hard (cost) synergy estimates of $[illegible] in '99 growing to over $5B within 5 yrs. remain unchanged. Soft (revenue) synergies are upside to our estimates.

Stock Performance



Merrill Lynch & Co.
Global Securities Research & Economics Group
Global Fundamental Equity Research Department

[illegible]

BC980105703

Resuming Coverage Of WorldCom With A 2-1 Opinion; $45 Price Objective Over The Next 12 Months

8 Key Reasons We See WorldCom As A Key Large Cap Stock Holding

Our recommendation of WorldCom is based on 8 key reasons which we think uniquely positions the stock as a key large cap stock:

- **"Growth At A Reasonable Price"**

#1 "Growth At a Reasonable Price" Attractive Valuation Relative To S&P 500 And Other Long Distance Companies

WorldCom's current valuation stacks up quite attractively on a number of different metrics including P/E (both on a reported basis as well as cash earnings), P/E to growth, EBITDA and EBITDA to growth as detailed in table 6 below. In addition, WorldCom currently trades at a P/E discount to the S&P 500 (based on '99E), a valuation disparity that is especially striking when one considers the wide disparity — over four fold — in 5 year forecasted growth rates (6% for the S&P vs. 25% for WorldCom).

- **MCI Merger Will Bring 2 Benefits: Significant Cost Savings & Reduced Intra-Industry Competition:**

#2. Merger With MCI Should Yield 2 Key Benefits — Cost Synergies & Reduced Competition

A) **Potential Cost Savings:** We continue to estimate that $2.5 billion in total cost synergies (see table 1 below) will be realized in the first full year ('99) following the merger with MCI, increasing to over $5 billion annually by 2002. The bulk of these synergies are to be provided via network cost savings, overhead/SG&A savings as well as a significant cut back in the aggressive local market entry plans at MCIMetro which are now be redundant to existing and planned MFS and Brooks CLEC assets and activities. The net impact on '99 earnings is forecasted at a 25% accretion to EPS ($2.00 vs. WorldCom "stand alone" forecast of $1.60).

Table 1: Est. EBITDA Savings - MCI Merger Only

($ in millions)	1999E	2000E	2001E	2002E
Line Cost Savings				
MCI Local	500	725	875	1,200
Domestic LD	600	1,000	1,400	1,800
International	400	700	1,000	1,300
SG&A	1,000	1,150	1,250	1,300
Total EBITDA Synergies	2,500	3,625	4,575	5,600

Source: Merrill Lynch estimates

B) **Reduced Intra-Industry Competition:** Mergers with MCI and Brooks will reduce, on the margin, the level of intra-industry competition in both the US LD and local markets via the reduction in the number of major competitors. In the LD sector, we hope for a slightly more rational approach to residential marketing expenditures and pricing with a new focus on profitability, rather than a single minded pursuit of pure market share.

On the local side, completion of these two mergers would mean that MCI's Metro unit, Brooks and WorldCom's MFS unit would no longer compete with each other. We therefore expect that local pricing will feel slightly less pressure and that significant overlapping expenditures (both capital and marketing) will be eliminated.

- **Wide Investor Appeal:**

#3. Wide Investor Appeal: Attractive P/E Valuation Brings In Traditional Growth Investors

WorldCom's addressable investor base was vastly expanded to once again include traditional growth investors, many of whom were unable to invest in WorldCom due to current P/Es in excess of 40x.

CITIES WITH WORLDCOM AND MCI FACILITIES
$5 BILLION IN "EFFICIENCIES" = LOSS OF ONE COMPETITOR

<u>California</u>

- San Francisco
- Los Angeles
- San Diego

<u>New York</u>

- New York City

<u>Florida</u>

- Orlando
- Tampa
- Miami

<u>Ohio</u>

- Cleveland

<u>Minnesota</u>

- Minneapolis

<u>Colorado</u>

- Denver

<u>Pennsylvania</u>

- Philadelphia
- Pittsburgh

<u>Massachusetts</u>

- Boston

<u>New Jersey</u>

- Newark

<u>Michigan</u>

- Detroit

<u>Illinois</u>

- Chicago

<u>Washington</u>

- Seattle

<u>Arizona</u>

- Phoenix

<u>Oregon</u>

- Portland

<u>Georgia</u>

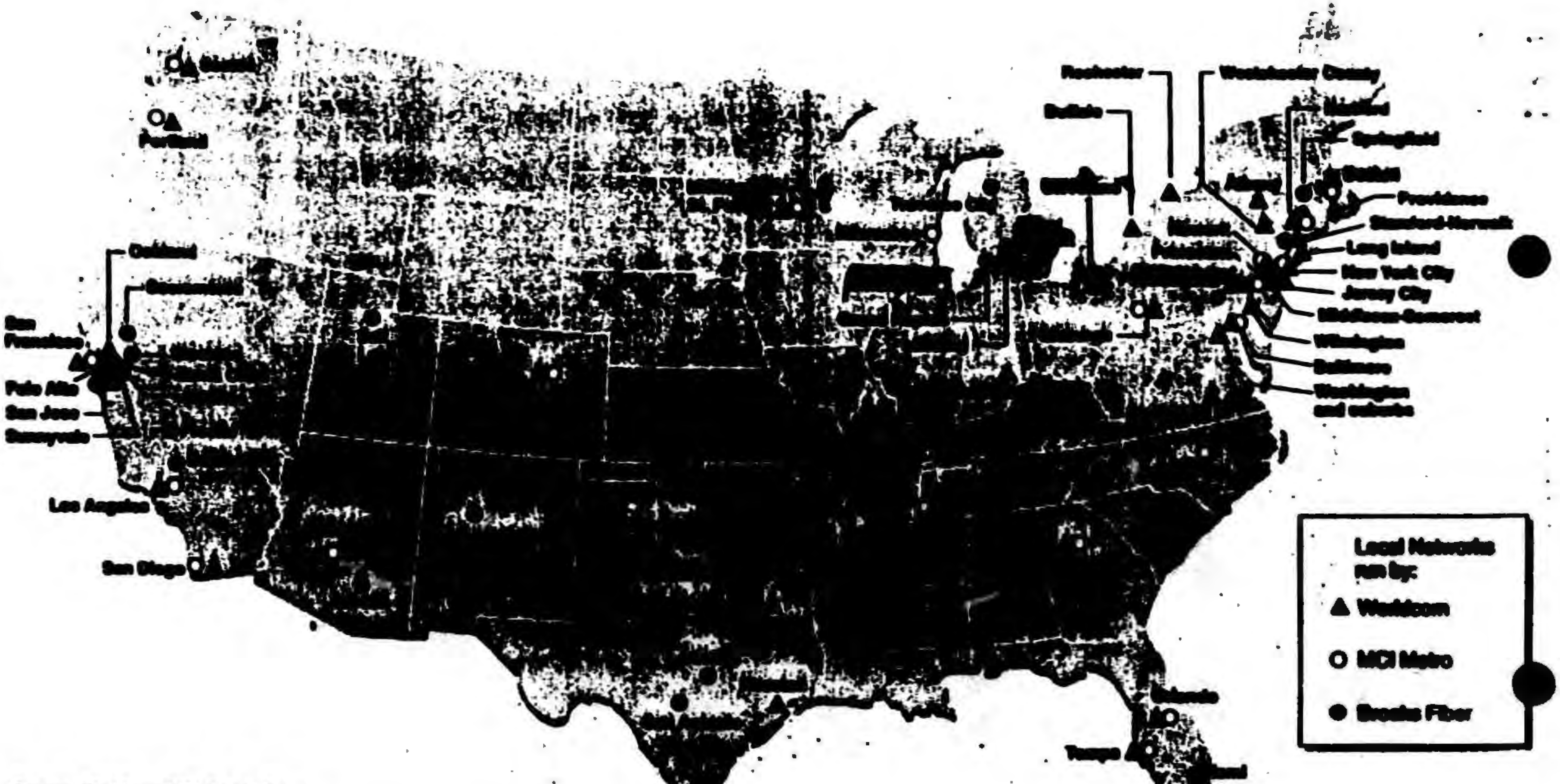
- Atlanta

<u>Maryland</u>

- Baltimore

<u>Connecticut</u>

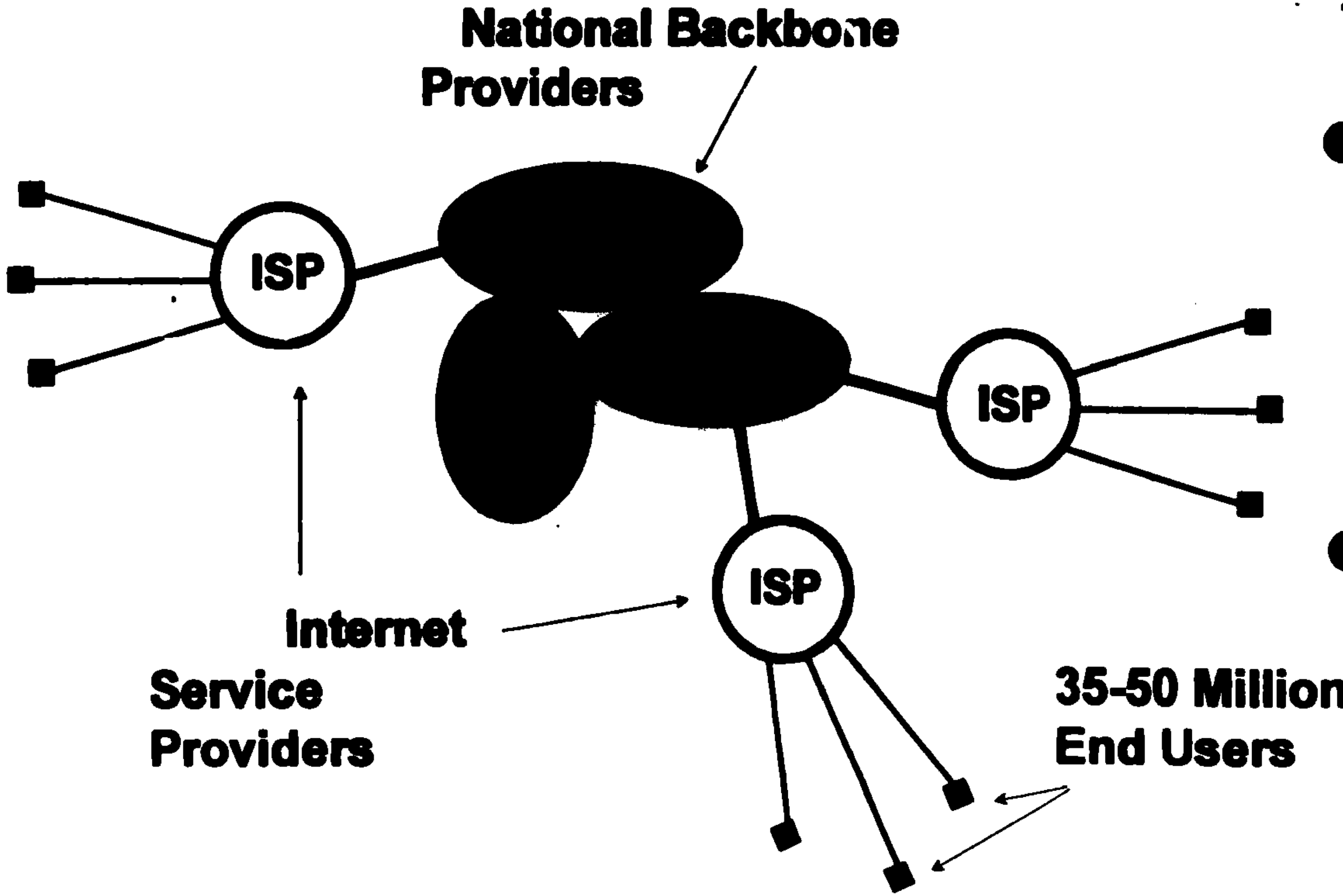
- Hartford



Sources: Worldcom; MCI; Brooks Fiber

The New York Times

Conceptual Overview Of The Internet



THE WALL STREET JOURNAL

(c)

MARKETPLACE

THURSDAY, OCTOBER 2, 1997

Would WorldCom-MCI Deal Lift Tolls on Net?

By Thomas E. Weber
And Rebecca Quick
Staff Reporters of The Wall Street Journal

Is the Internet about to become a toll highway?

For the first time, a single company is within reach of dominating the innards of the Internet. If WorldCom Inc. succeeds in its surprise bid to acquire MCI Communications Corp., the combined company [redacted] would control more than 60% of all U.S. traffic on the global computer network and a hefty share of the traffic world-wide, according to some estimates.

That kind of market dominance would give WorldCom an unprecedented level of clout and, potentially, pricing power over the Internet. For years, the members of the Internet have functioned like the high-tech equivalent of a funky commune, with service providers freely exchanging e-mail messages and Web pages with each other's members at no charge.

But WorldCom has already made it clear it has an entirely different view of the Internet's economic model — a straightforward capitalist one. Earlier this year, it began charging small Internet-access providers for the right to link up to its network.

"It's important that we have at least some minimal charge," says John Sidgmore, vice chairman of WorldCom. He says it costs WorldCom money to maintain its network and link up with other providers, and it isn't right for little players to piggyback onto the network for free.

If the old commune model turns into a free marketplace dominated by a single player, any new charges are likely to find their way back to consumers. Ultimately, that could signal the demise of those ubiquitous $19.95-a-month unlimited-access plans.

"Flat-rate pricing isn't likely to last under this model," says Don Heath, president of the Internet Society, a Reston, Va., nonprofit group that advises on Internet policy. An MCI merger, he says, "could ultimately yield too much control" for WorldCom.

Indeed, the Justice Department will examine whether the proposed merger would violate antitrust laws. WorldCom, meanwhile, says it is confident the deal will pass muster by early next year.

Mr. Sidgmore has long been an outspoken critic of the industry's flat-rate pricing, which doesn't discourage users from overloading the already clogged Internet. But he said yesterday he has no plans to raise the prices he charges for access to WorldCom's network.

Yet many expect the industry's consolidation to ultimately change its pricing schemes. Users could find themselves paying based on how long they stay on-line, how much data they send and receive, or even how quickly the data are beamed over the Internet.

The smaller Internet service providers who link up to WorldCom's network are anxious about what will happen. "I'd say it's a whole new game," says Kent Eng-

Please Turn to Page B24, Column 5

WorldCom started out buying small phone companies... ...Then moved into taking over Internet providers... ...Now its proposed MCI takeover could give it Internet dominance... ...Which some fear would lead to higher Internet prices

Would Tolls Increase On Net if WorldCom Made Deal With MCI?

Continued From Page B1

land, vice president of technology at GeoNet Communications Inc., a midsize Internet access provider in Redwood City, Calif. "At this point, maybe [WorldCom executives] can throw their weight around."

Having one company hold such power would be a first for the Internet. Though the network started off as a bomb-proof communications system for the U.S. military, its growth has been driven by the thousands of computer networks, large and small, that have hooked up to it in recent years under a loose confederation. It is often remarked — and at times, even lamented — that no one really governs the Internet.

The proposed deal could spur a drastic realignment because of the Internet's structure. Most consumers reach the Internet through an on-line service or an Internet service provider. These companies range in size from giant America Online Inc. to thousands of local providers with just a few hundred customers each.

But like the side streets of a city, all of these providers eventually connect to a main highway — in this case, the giant Internet pipelines called backbones. The companies that operate these backbones — which essentially are the Internet — provide the crucial link for on-line services and [illegible]. They also charge corporate customers to hook up directly to these pipelines.

By long tradition, the Internet's various networks have agreed to pass along each other's traffic. Everyone was considered a "peer," and the peer agreements required that no single link on the network would charge a special toll for traffic to pass through its system.

But lately, as large network operators have [illegible] backbones [illegible] increasingly [illegible] of [illegible] players [illegible]. WorldCom [illegible] Internet service providers [illegible] it would [illegible] "peering" agreements [illegible] start charging small [illegible] for access to its backbones.

Indeed, WorldCom says it has [illegible] a few of its [illegible]. But the company says [illegible] the fees it charges insignificant, sometimes as low as $1,000 a month for backbone access.

WorldCom has clout because over the past year it has been buying up these main highways. Late last year, it paid $14.4 billion for phone company MFS Communications Corp., which owned Internet-backbone operator UUNet Technologies.

Last month, WorldCom entered into a complex transaction to purchase CompuServe Corp.'s network and an Internet backbone owned by America Online called ANS Communications.

Acquiring MCI and its substantial Internet-backbone business would mark the biggest step yet in an expensive buying spree. But whether WorldCom's increased power over the Internet's backbones would violate antitrust laws is a matter for the Justice Department to decide. People close to the matter say the department is already exploring similar issues in WorldCom's [illegible] purchase of the networks of CompuServe and AOL.

A key question [illegible]: If [illegible] customers seek an alternate [illegible]? Moreover, regulators aren't likely to be concerned if they conclude that new competitors could easily enter the market. They also must decide whether the Internet backbone [illegible] [illegible] telecommunications market, which includes many other players.

"There're an awful lot of backbone providers out there," says Gary Miller, chief executive of Aragon Consulting Group in St. Louis, which works for several Baby Bells and other carriers. "I think the regulators are going to be hard-pressed to think of any reason why this thing shouldn't go through."

Muddying the issue is the fact that few agree on how to measure control of the backbones, and operators have been loath to reveal data about their traffic volume for competitive reasons. WorldCom's Mr. [illegible] yesterday [illegible] industry [illegible] WorldCom-MCI [illegible] be about [illegible] "I don't know what the right numbers are." MCI has been reported to have 30% to 40% of domestic Internet traffic, and WorldCom's UUNet has boasted that its Internet business is even bigger than MCI's.

Still, most agree that a WorldCom purchase of MCI would mark the biggest step yet in the industry's consolidation. At the bottom, small Internet service providers unable to afford "peering" fees could find themselves out of business. At the top, there will be one fewer backbone operator.

—Bryan Gruley contributed to this article.

3

MCI- WorldCom faces Internet probe...
CUKIER, KENNETH
CommunicationsWeek International Nov 24, 1997 p. 1

U.S. regulators are poised to take the unprecedented step of investigating the impact a combined MCI-WorldCom would have on the Internet before it approves the deal.

If the merger goes through, the new company may control up to half of all U.S. domestic Internet traffic.

As a result, the merger is concentrating U.S. regulators' minds on the Internet's commercial structure and what might happen if a single company achieves a dominant position. "It's not just the long distance network, but the implications for the Internet backbone," said a wellplaced official at the Federal Communications Commission, who asked to remain anonymous. "The Commission will have to think very directly on what the implications will be."

Other FCC officials confirmed that the Commission will examine the matter, but say it is too early to know if it might reject the deal or place conditions on the new company. Either way, it will mark the first time the FCC has formally examined "the merger's effect on competition on the backbone," said an FCC official.

A Department of Justice investigation, customary for mergers of this magnitude, is already under way, and officials have said they will scrutinize the Internet dimension.

In recent investigations, such as those into the Bell Atlantic-Nynex union, and the aborted BT-MCI affair, the FCC placed conditions on the companies--characterized by the Commission as "pro-competitive"-for the deal to pass.

The FCC has long maintained that the Internet sector should remain unregulated, yet with four new commissioners appointed this autumn, doubts have arisen over whether this approach can continue in what marks the commissioners' first key policy test.

Consolidation of the Internet backbone represents the industry's most fractious debate, as the Net transforms from its academic origins into a commercial entity. The fear among network engineers, industry executives and regulators is that such connectivity concentrated in a single player's hand may lead to market abuse, as the dominant player may seek tough interconnect concessions from other Internet service providers--both small and large-that need to reach the global Internet.

4

"If one company had a large enough share of the market," noted Gerald Brock, an interconnection expert at George Washington University in Washington DC, "then it could use its dominant position to either take over the market or extract payments from the smaller companies."

If the merger is approved by U.S. regulators, 50-55% of backbone Internet traffic will pass over facilities owned by Jackson, Mississippi-based WorldCom Inc., estimated Michael Kleeman, a consultant at the San Francisco office of the Boston Consulting Group.

During the past year, peering agreements among ISPs have been severely shaken up, while the number of backbone ISPs has plunged due to acquisitions, notably by UUNet Technologies Inc., the Fairfax, Virginia-based ISP subsidiary of WorldCom (CWI, 5 May and 22 September).

As a result of the consolidations and subsequent tough peering policies, the prices for Net access could jump. "The power of many is OK-I'm worried about the power of one," said the lead network engineer of a tier-one U.S. backbone ISP.

Smaller ISPs still cautious

The more vulnerable mid-sized ISPs remain cautious. Walter Prue, technical manager of the Los Angeles, California-based ISP Los Nettos, which buys upstream transit from MCI, said the force of the combined companies "could lead to higher prices in the future."

And the pace of consolidation is quickening. GTE Corp., of Stamford, Connecticut, this month acquired the San Francisco-based backbone Genuity Inc. from the privately held Bechtel organization. The terms of the deal--which gives GTE seven Web hosting centers--were not announced. In May, GTE acquired the fourth-largest U.S. ISP, BBN Corp.

In an apparent attempt to preempt regulators, WorldCom downplayed the Internet dominance of the combined companies when it made its bid for MCI in October. "It's still a small amount of Internet traffic on a worldwide basis," said John Sidgmore, chief operations officer of WorldCom and president of UUNet.

Doubts over Sidgmore's claims However, industry executives doubt Sidgmore's claim. "We all know that the majority of the traffic is in the United States, and it is also clear that UUNet has a significant presence in Europe and MCI has a lot of international connections," said Frode Greisen, the general manager of the pan-European backbone, Ebone, in Copenhagen. "It could well be half of the backbone traffic internationally."

In similar examinations, the FCC has typically lumped all data communications business under a single umbrella. In this case, industry executives note, the Commission will need to decide whether the Internet sector must be treated as a separate entity.

Despite the expected FCC investigation, regulators and policy makers in the United States say they are committed to a hands-off regulatory approach.

5

Billy Tauzin, the Republican representative from Louisiana and chairman of the House subcommittee on telecommunications, said before a congressional hearing in October that even if the combined company controls 60% of U.S. Internet traffic, there is healthy competition, since many rivals exist or are forming.

Washington against Net control A bill was introduced into Congress this year to prohibit the FCC from regulating the Internet. Although it has no bearing on an FCC review of the merger, it is indicative of Washington's reluctance to wield a regulatory stick.

The FCC has a swath of complex regulations for basic telephony service, yet maintains a laissez-faire attitude for so-called "enhanced services," of which the Internet is one. Yet the FCC has experience regulating data communications: in 1995 it treated frame relay and X.25 networks as a basic service, and placed filing requirements on interconnection agreements among providers.

The Internet is trickier. As a network of networks based on a model of trust, nothing mandates a particular provider to interconnect with another. When private backbones first appeared in the early 1990s, the U.S. National Science Foundation, which funded Internet development, required networks hosting government-funded research institutions to interconnect with other backbones.

Now, as the private sector dominates Internet backbone provision, the lack of interconnection requirements risks breaking up the Net, say engineers, since nothing prevents a dominant ISP from refusing to interconnect unless a settlement is paid for exchanging traffic.

The issue becomes further complex when considered internationally. ISPs outside the United States are understandably less worried about peering but more concerned with the settlement fees they currently pay and the fact that they must bear the full price of circuits to the United States. The protests, lead by Australian carrier Telstra Corp., has led the Organization of Economic Development to considering tackling the matter (CWI, 3 November).

6

HD WHY BERNIE EBBERS WANTS TO BE THE INTERNET'S MR. BIG
* THE MCI-WORLDCOM DEAL ILLUSTRATES WHY DATA MEAN EVERYTHING TO THE TELECOMMUNICATIONS INDUSTRY.

BY ANDREW KUPFER

PD * 12/08/97

SN Fortune Magazine

CY (Copyright 1997)

LP * Bernie Ebbers' audacious gambit to buy MCI, a company three times * the size of his WorldCom, is about more than Jonah trying to swallow the whale. This deal, along with others it has overshadowed, shows how much the telecom industry has been swallowed by the Internet. Control of the pipes that carry data is the name of the game--perhaps to the point where customers are left on the sidelines.

* Even before MCI accepted WorldCom's offer, a clear sign of an about-face in the telecom business had come--not from a merger but from a split, as U.S. West announced it would sell its cable-TV operations. That move forever kills the idea that cable companies are natural allies of local telephone companies. Not long ago, communications executives were betting that the telephone and cable industries would converge, each type of network evolving to look more like the other. That never happened; the convergence proved too costly.

TD Then came the Net, and telecom executives changed their focus. Shelving plans to invade each other's markets, telephone and cable companies are racing to offer high-speed data services. Phone companies are introducing a new technology called ADSL (asynchronous digital subscriber line) that permits fast Internet access over ordinary copper phone lines. In Phoenix this fall, US West introduced the first commercial service. Cable companies are investing in special modems that do the same over cable systems.

But the boldest data play belongs to Ebbers, who, you can argue, is trying to buy the pipes that run the Internet. If he succeeds, the cozy collegial atmosphere that exists among Internet service providers will be gone. As of now, any ISP can send traffic onto the Net without a fee at a variety of public entry points. But so many little providers are using these gangways that they have become chokepoints. To avoid them, the dozen biggest Internet companies have so-called private peering agreements to carry one another's traffic over their own data networks for free.

These arrangements assume that Internet companies will hand off traffic to one another in roughly equal volumes. But the WorldCom deal means that three of the biggest data networks--MCI's, WorldCom subsidiary UUNet's, and a network WorldCom recently bought from America Online--will all be under Ebbers' control, giving him an estimated 40% of the Internet backbone, the high-speed network that carries data around the country. Ebbers will be able to rely less on the others, while the others will need him more, which may mean more money for him.

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Ebbers argues that worrying about the peering agreements is absurd. "We think that people who use the Net ought to pay at least a little bit for it," he says. MCI-WorldCom's Internet presence is sure to draw Justice Department scrutiny, but regulators may decide that Ebbers doesn't have crushing market power. After all, other companies, notably GTE, are building high-speed data networks. Willkie Farr & Gallagher attorney Philip Verveer, who helped prosecute the AT&T antitrust case, says WorldCom wouldn't have a lock on the Internet transport business since the factors of production (routers, fiber) are readily available.

Ebbers doesn't want to stop at the border. WorldCom is building a high-speed data network in Europe, and, with Britain's Cable & Wireless, it is laying its own trans-Atlantic fiber-optic cable, which will let the company carry traffic to Europe without leasing circuits from anyone else. That could make WorldCom the low-cost international data carrier. "If you buy off on the models of the consulting gurus, the Internet is growing so fast that data traffic will dwarf voice traffic," Ebbers says. "There's going to be a tremendous demand for bandwidth."

So Ebbers wants to own as many of the pipes as he can. But will he be able to fill them? He may have hurt himself by backpedaling from Concert, the joint venture between British Telecom and MCI that sells worldwide telecom services to multi-national customers. (The MCI-WorldCom deal will allow BT to buy back MCI's stake in the venture.) This service has enormous appeal to business customers and is MCI's only differentiation from AT&T and Sprint, argues telecom analyst David Goodtree of Forrester Research. "MCI WorldCom will lose multinational customers, kit and kaboodle," he says. MCI says it will still distribute Concert services, but BT may sell them through other telecom companies.

For now, Ebbers' main worry is keeping WorldCom's stock price from falling any lower. It has sunk 25% from its recent high, to around $30--close to the minimum price at which its offer for MCI will be worth $51 a share. For every dollar WorldCom falls below $29?, the value of its bid for MCI declines by $1.75 a share. A few more dollars, and it will be within range of GTE's cash offer, said to be $45 to $46 a share. Says GTE Chairman Chuck Lee: "For GTE shareholders, $51 per share is too much, but we certainly haven't precluded other options."

Quote: EBBERS' MAIN WORRY IS KEEPING WORLDCOM'S STOCK PRICE FROM FALLING ANY LOWER.

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WorldCom, MCI and the Internet
Bhawani Shankar
12/01/97

LONDON - If the bid by WorldCom for MCI is endorsed by shareholders and regulators, the merged company would obtain enormous influence over the development of the Internet. The Net began as a disorganised, decentralised network of networks. There is no owner, no central guiding force, just a collection of standards and some voluntary bodies to administer them. But recently a handful of big companies have built up powerful roles in providing access to the Internet and carrying its data.

WorldCom owns UUNet, the biggest and most international of the Internet service providers (ISPs), which link users to the net. Recently, it agreed to buy the network infrastructure of America Online and CompuServe, two proprietary on-line systems which also act as ISPs. Similarly, MCI provides the most heavily used of the fibre-optic backbones for the system in the US.

But the Internet industry is far from mature - more fibreoptic backbone capacity is being added daily, worldwide. With the many thousands of small ISPs and other big Internet players, such as Sprint, AT&T, Unisource and Global One, it may still be too early to say that a merger between WorldCom and MCI would produce an undesirable concentration of power. Nonetheless, there is a risk that the consolidation of the industry will transform the way the Internet works.

From the outset, Internet players have carried each others' data across their networks for free. It is this arrangement that gave the system its low cost and global reach. As individual participants get bigger, there is a growing temptation for the larger to discriminate against the smaller, charging them for access or refusing connections altogether. So far, the shift to charging has not destroyed the Internet ethos; it may, indeed, be a desirable step towards maturity and financial stability.

The proposed merger unites two of the biggest US-based companies in the emerging Internet industry, together handling around 60 per cent of domestic backbone traffic. For the US regulator, the Federal Communications Commission, it provides an ideal opportunity for an examination of the competition issues.

The ramifications of the deal for regulators in Europe keen on streamlining the Internet are still unclear. Through its ownership of MFS, WorldCom owns considerable amounts of fibre in the UK, Germany and France. It also has interconnects in various other European countries as well as in Hong Kong and the Far East. The federal authorities should rise to this challenge. This means that a combined UUNet-CompuServe-America Online Internet services company would not only be the largest ISP in the world, but would also be the only one to have free access to the most extensive backbone infrastructure.

But analysts point out that the three ISP members of the WorldCom family are all very different players. UUNet has sold itself on the basis of its so-called "industrial strength Internet access," while the other two are content-based information providers. But the fact remains that each of the three ISPs will now have the best global reach among all present and potential competitors. - BS

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WP 10/3/97

WorldCom Clarifies MCI Plans

Bidder Pledges It 'Will Not Abandon' Residential Customers

By Mike Mills
Washington Post Staff Writer

WorldCom Inc. yesterday said its plans to continue serving all of MCI Communications Corp.'s 20 million residential long-distance customers, should it succeed in its unsolicited bid to buy MCI for $30 billion.

The statement came in response to an article in yesterday's Washington Post that quoted WorldCom Vice Chairman John Sidgmore about the potential benefits of moving MCI out of the consumer long-distance business, if the merger goes through, to focus exclusively on business customers.

A WorldCom statement yesterday said: "WorldCom will not abandon MCI's residential long-distance customers." But it did not elaborate on its plans for the residential business.

Under a possible strategy outlined by Sidgmore in the article, WorldCom would turn MCI's residential customers over to other long-distance companies, which would handle billing and customer service. These companies would purchase wholesale long-distance capacity from WorldCom and MCI but serve former MCI customers under their own brand names.

In an interview upon which the article was based, Sidgmore talked about that course as a "possibility" or something that "we would consider." The first sentence in The Post's article said that MCI "would jettison" the residential customers if the acquisition goes through. Business section Assistant Managing Editor David Ignatius said yesterday that the wording was stronger than Sidgmore's remarks warranted.

At the same time, Sidgmore talked in detail about the benefits WorldCom and MCI would enjoy by getting out of the residential long-distance business, which generally is a low-profit business. [illegible]

Analysts said that WorldCom's shareholders would support the company's moving away from residential business, in which growth has been slowing amid intense competition in the past year.

But such a move would not be at all popular with MCI management—which still is evaluating the buyout offer—or with employees, or customers, analysts said.

Some industry analysts also were critical of any such strategy. "Breaking it up so you can keep business customers, and farming out the residential customers, serves WorldCom's purpose, I guess. But it's just unsettling," said telecom analyst Jeffrey Kagan of Kagan Associates in Atlanta.

"If it was any other company than MCI, it would make perfect sense," said Kagan. "But you're dealing with an MCI, which is the number two long-distance company. It's near and dear to the hearts of their customers and to America."

"MCI broke up Ma Bell," he said, referring to the court battle that helped bring about the dismantling of the AT&T monopoly phone system in 1984.

Such a change for MCI likely would capture the attention of regulators, who would have to approve any WorldCom-MCI merger. [illegible]

Meanwhile, WorldCom moved in other forward on the legal front, asking a Delaware court to strike down a provision in MCI's pending merger agreement with British Telecommunications PLC that would protect it from hostile takeovers from other companies. WorldCom also asked the court to allow MCI to escape paying BT a $450 million breakup fee if MCI pulls out of that deal.

WorldCom shares closed yesterday at [illegible], up [illegible] cents. MCI finished trading at [illegible], down [illegible] cents.

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WorldCom Would Shift MCI's Focus; Bidder Plans ...

DOCUMENT 3 OF 7
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A Section
* WorldCom Would Shift MCI's Focus; Bidder Plans to Shed Residential Service
Mike Mills
Washington Post Staff Writer
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MCI Communications Corp. would jettison its approximately 20 million residential long-distance customers and focus solely on more profitable business customers if a proposed $30 billion buyout of MCI goes through, according to a top official of the company that would make the purchase.

* John Sidgmore, vice chairman of WorldCom Inc., said in a telephone interview that the residential customers likely would be transferred to other long-distance companies, potentially including the regional Bell companies.

For example, he said, "an MCI customer would become a Bell Atlantic customer."

* Under this scenario, calls would still be carried by WorldCom and MCI wires. But the job of setting rates, providing operators and billing the customers would belong to the other companies. The customer would never hear the MCI name or deal with the company.

* WorldCom would "sell" MCI customers to other long-distance companies, who would pay for rights to serve established accounts. Because customers are legally guaranteed the right to choose their long-distance provider, they would not have to stay with the company they were moved to.

Precisely when and how all this would occur is unclear: Even
* under the speediest scenario, WorldCom would have to wait until next year to buy MCI. "We're not saying [the end of residential service] is definitely going to happen on day one," Sidgmore said. Initially "we're going to market to consumers just like MCI does. On the other hand, our strategy is not in the consumer business."

"It's very difficult for us to find a way to make economic sense out of the advertising budgets, the customer service budgets, etc., required to be in the consumer business. We might be willing to

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Source: Washington Post, October 3, 1997

let somebody else do the retail marketing of that consumer business," he said.

WorldCom has long seen its specialty as "wholesaling" of telecommunications capacity. It operates high-capacity fiber-optic lines that it leases to more than 50 other long-distance companies, which use the lines to carry their calls. It sells long-distance service under its own name primarily to business customers.

Such a move would be a remarkable shift for MCI, which built much of its early business with a blitz of TV ads aimed at Americans fed up with the rates of AT&T Corp. In recent years, it has taken on millions of customers through its "Friends and Family" discount program. Just three weeks ago, it offered American customers phone calls on Sunday for a nickel a minute within the United States.

The shift would roil the nation's annual $38 billion residential long-distance market by removing one of its largest players. At present the market is dominated by AT&T, MCI and Sprint Corp.

MCI today controls roughly 16 percent of it, generating revenue that outside analysts estimate at $6 billion. But its growth in the consumer market has slowed over the past year as price competition from smaller long-distance companies has shrunk MCI's profit margins.

In the long-distance business, profits from residential customers can be low or nonexistent. Many homes spend just a few dollars a month, but must still be billed and tended to. Plus, companies must compete with others with such tactics as $80 checks to win customers who often just stay a few months before moving on to another company offering a check.

According to Brian Adamik of the Yankee Group, a Massachusetts market research firm, about three-quarters of MCI's residential customers switch to a different company each year.

Residential competition will grow even more fierce once the regional Bell companies win permission from regulators to offer long-distance to their local customers, industry analysts say. Even before the WorldCom offer, MCI was growing tired of the fight and had cut back on money spent on checks.

Business customers, in contrast, are more stable. Employees talk long, secure in the knowledge that the company is paying the bill.

Shifts like those WorldCom is planning are "going to be increasingly prevalent in the telecommunications industry," said Dwight Allen, a telecommunications analyst for Deloitte & Touche Consulting Group in the District. "Until now it's been all about providing basic phone service universally. But it's becoming increasingly possible for companies to focus on particular market segments . . . There will be others who will see the residential

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Source: Washington Post, October 3, 1997

marketplace as being their specialty."

Adamik said that with MCI, WorldCom is seeking the best of both worlds. It would retain the high profits that MCI's business customers generate, plus the guaranteed flow of payments from other long-distance companies that used MCI's wires to carry residential calls.

On Wednesday, WorldCom made an unsolicited offer for MCI, throwing into turmoil year-old plans by British Telecommunications PLC to buy the Washington-based long-distance giant. WorldCom is offering roughly $9 billion more than BT's last offer.

MCI officials, who were meeting yesterday to plan a reaction to WorldCom's offer, declined to comment on Sidgmore's remarks.

By acquiring MCI, WorldCom would get the nation's second-largest long-distance carrier, with $18.5 billion in annual revenue. WorldCom also is interested in MCI's Internet fiber-optics network and its $1.4 billion computer systems business.

http://www.washingtonpost.com

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Source: Washington Post, October 3, 1997

CERTIFICATE OF SERVICE

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