

June 3, 1998

Magalie Roman Salas, Secretary
Federal Communications Commission
1919 M Street NW, Room 222
Washington, DC 20554

Re: CC Docket No. 97-211
WorldCom, Inc. and MCI Communications Corporation

Dear Secretary Salas:

The staff of the Common Carrier Bureau has requested that MCI file further information on the proposed divestiture of MCI's Internet backbone business to Cable & Wireless. In response to the staff's request, a description of the proposed transaction is set forth in the attachment to this letter, along with an explanation of how the divestiture resolves any issues concerning the impact of the MCI-WorldCom merger on the Internet.

Should there be any questions concerning this matter, please contact the undersigned.

Sincerely,

Mary L. Brown

cc: Michelle M. Carey
Michael Pryor

Divestiture of MCI Internet Backbone Business

This statement supplements the record concerning the Internet aspects of the merger of MCI Communications Corporation (“MCI”) and WorldCom, Inc. (“WorldCom”). As the industry and the Commission know, MCI recently announced that it will divest its Internet backbone business to Cable & Wireless plc (“C&W”), a competing provider of Internet and telecommunications services, in order to obtain prompt approval of the merger by U.S. regulators and the European Commission (“EC”). This letter explains the terms of the divestiture and why it resolves the specific issues that regulators and commenters in this proceeding have raised about the effect on Internet competition of the merger of WorldCom and MCI. The divestiture should therefore clear the way for the Commission to approve the WorldCom-MCI merger with the same streamlined review and on the same expeditious schedule that it has used for other mergers of non-dominant carriers.

BACKGROUND

In the course of the intense scrutiny that the merger has received over the last seven months, including the parties’ discussions with the U.S. Department of Justice (“DOJ”) and the EC, it has become apparent that the overriding competitive issue involves the Internet backbone business. The key Internet-related concern expressed by both regulators and private third parties is that consolidation of the MCI and WorldCom backbones will give the merged company power in an alleged “Internet backbone” market consisting of the provision of Internet backbone services to Internet Service Providers (“ISPs”).

For example, GTE complains, “The merger will destroy the critical competitive balance that exists on the Internet today by creating a dominant provider of Internet

backbone service. . . . By concentrating under common control the two largest Internet backbone networks to create one dominant national network, the merger will give MCI-WorldCom a stranglehold over the burgeoning Internet and the incentive and ability to stifle competition from all other rival Internet backbone operators, including GTE.”

Complaint, ¶ 2.a, GTE Corp. v. WorldCom, Inc. and MCI Communications Corp., Case No. 1:98CV01155-TPJ (D.D.C. filed May 7, 1998); Petition to Deny of GTE Services Corporation, at 46, CC Docket No. 97-211 (Jan. 5, 1998). Similarly, Sprint alleges that “[a] combined WorldCom/MCI entity will create a powerful new Internet entity that will be able to exercise substantial dominance in the core Internet backbone market.” Comments of Sprint Corporation, at ii, CC Docket No. 97-211 (March 13, 1998). Accord Petition to Deny and Request for Hearing of Simply Internet, Inc., at 2, CC Docket No. 97-211 (Jan. 5, 1998) (“Grant of the above-referenced applications will lead to the merger of the largest and third largest Internet backbone provider companies in the United States, thereby creating an excessive degree of market concentration in the national Internet backbone services market . . .”); Comments of the Communications Workers of America, at 13, CC Docket No. 97-211 (Jan. 5, 1998) (“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 coordinated action.”); Petition for Conditional Approval by BellSouth Corporation, at 19, CC Docket No. 97-211 (Jan. 5, 1998) (“THE PROPOSED ACQUISITION THREATENS ANTICOMPETITIVE HARM IN THE PROVISION OF INTERNET TRANSPORT.”).

Parties opposing the merger have gone out of their way to emphasize that the merger will not directly reduce competition in the market for retail Internet services. See Comments of Sprint Corporation, at 3, CC Docket No. 97-211 (March 13, 1998) (“Although the provision of Internet services will be adversely affected by the proposed merger, the direct threat to competition here involves only the transmission of the services, not the services themselves.”); Petition to Deny and Request for Hearing of Simply Internet, Inc., at 4, CC Docket No. 97-211 (Jan. 5, 1998) (“While the ISP market is highly competitive, the Internet backbone market is not.”). After all, literally thousands of ISPs compete to provide retail service to the millions of business and residential consumers of Internet services, and in several rounds of comments, no party contended that MCI’s and WorldCom’s combined share of the retail business raises any competitive concerns. Any alleged threat to retail competition among ISPs results from a claimed reduction in competition among the Internet backbone providers on which retailing ISPs purportedly rely.

WorldCom and MCI strongly dispute both the premise that a separate market for Internet backbone services exists and the conclusion that their merger will give them market power in this market. But it became clear to WorldCom and MCI that it would take several months to obtain a favorable decision on the merits from each of the governmental bodies reviewing the merger. The parties concluded that this delay would be unacceptable because continuing uncertainty would adversely affect their customers, employees, and

shareholders and because continuing delay would postpone realization of the procompetitive efficiencies in local and long distance services that drive the merger.

Accordingly, despite the conviction that the merger does not raise any legitimate concern about Internet — or local or (domestic or international) long distance — competition, MCI decided to divest its Internet backbone business and end the protracted delay in the regulatory process. Both MCI and WorldCom operate an Internet backbone business — the collection of switches, routers, transmission capacity, peering arrangements, and other assets used to transport Internet traffic. Divestiture of MCI's backbone business would mean that the merged company would have no greater share of the alleged backbone market than WorldCom does premerger and that the merger would not produce any increase in concentration in this alleged market.

After general discussions with both DOJ and the EC about the terms of a possible divestiture, MCI sought offers from prospective buyers that satisfied three criteria. First, the buyer would need unquestionable ability to operate the backbone, retain and attract customers, and continue the business as a healthy, growing enterprise. This criterion met a stated requirement of DOJ and the EC, and it protected both MCI's existing customers and the merged company, which would be a substantial purchaser of backbone services from the buyer. Second, the buyer would not create any new regulatory issues that could delay approval and thereby defeat the primary goal of the divestiture. In particular, DOJ indicated that a sale to certain major facilities-based providers of Internet backbone services would raise significant concentration questions and delay, if not defeat, the

approval process. Third, the buyer had to be financially viable and had to meet the financial requirements of purchasing such a business. DOJ and the EC made clear that any sale in which MCI became an investor in the buyer or could otherwise exercise control would not be acceptable.

THE DIVESTITURE

After discussions with several potential purchasers, MCI selected C&W based on several factors, including that it made the highest offer. This transaction will enable C&W, a global carrier with substantial world-wide Internet expertise, to expand its Internet business in the United States and around the world. C&W's global telecommunications revenues were \$12 billion in its last fiscal year, and it has 17 million customers in over 70 countries. C&W has substantial experience and expertise in providing Internet services, not only in the Pacific, the Caribbean, and Europe, but also in the United States where it operates a national backbone network providing transit, peering, and other services. In addition, C&W operates a national facilities-based long distance network that it uses to provide telecommunications services in the United States. C&W's U.S. operations generate over \$1 billion in annual revenues, employ 2,300 workers, and serve over 100,000 business customers in all 50 states.

The terms of the divestiture to C&W are clean and straightforward. The attached schematic diagrams illustrate in simple terms the basic structure and effect of the transaction.

First, MCI will transfer all of the physical assets that comprise its Internet backbone: 22 nodes (or hubs); over 15,000 interconnection ports; and all the routers, switches, and other equipment dedicated to the backbone. MCI will also transfer: (1) the right to use the transmission capacity that C&W needs to operate the network, including projected growth requirements; (2) the right to use all associated dedicated software and operations support systems; (3) assignment of Internet addresses; (4) collocation rights that permit C&W to maintain equipment in MCI facilities; and (5) 50 engineering, sales, and administrative employees necessary to assist the personnel in C&W's existing Internet organization in operating the backbone business. MCI will lease transmission capacity to C&W on competitive commercial terms for a minimum of two years, with an option for C&W to extend the term for an additional three years. C&W is completely free to use transmission capacity and other services from sources other than MCI, and to use any facilities or equipment in any location to operate its backbone. MCI has agreed to fund negotiated incentives to facilitate the transfer and retention of the employees that support the backbone business.

Second, MCI will transfer to C&W all of the more than 40 peering agreements to which MCI is a party. Where the agreement requires the peer's consent to an assignment, MCI will encourage the peer to transfer to C&W. After C&W acquires the backbone, it will be free to peer with any ISP on whatever terms it chooses. In addition, MCI has agreed to extend its current peering agreement with C&W on a long-term basis.

Third, MCI will transfer to C&W MCI's contracts with ISPs. C&W will replace MCI as the provider of backbone services to more than 1,300 domestic and international ISP customers that now obtain Internet access from MCI. This transaction should be operationally transparent to these ISPs. Approximately \$200 million in revenues are associated with these contracts, which constitute approximately two-thirds of MCI's anticipated Internet revenues for 1998. For international ISP customers, C&W will acquire not only the domestic portion of the backbone service but also (pursuant to a favorable two-year lease from MCI) the international circuits and domestic backhaul facilities used to connect foreign ISPs to nodes on the U.S. backbone. The agreement protects C&W from competition by MCI WorldCom by precluding MCI WorldCom from contracting with any of these ISPs to provide Internet services for a period of two years; under a limited exception to this non-compete provision, MCI WorldCom is permitted to continue to compete for the business of any ISP customer that currently purchases Internet access from WorldCom

Fourth, MCI will purchase backbone capacity from C&W to serve current and anticipated demand of retail commercial and residential customers for a period of two years, plus a gradual phase-out over an additional year. The forecasts are based on the projected demand for MCI's retail business (for example, approximately \$110 million in 1998). As depicted in the attached diagrams, MCI will continue to contract with these retail customers as a reseller, but C&W will become the provider of the underlying backbone service. In other words, MCI will become a wholesale customer of C&W's

backbone services, like the ISPs currently served by MCI's backbone, and MCI will continue to compete in the retail business to provide Internet and value-added services (including Intranet and web-hosting services) utilizing the C&W backbone. MCI has given guarantees for both traffic and revenue based on MCI's current and anticipated retail business, including an increase in these guarantees over the next two years. On its part, C&W has committed to meet service and quality commitments to ensure that retail customers served by C&W's backbone will experience no decline in the quality of their service. C&W has agreed not to contract for retail Internet services with MCI's current commercial Internet customers for a period of two years or the term of the customer's existing contract with MCI, whichever is shorter; C&W is free to compete to provide other services to these customers at any time.

Fifth, C&W will pay MCI a purchase price of \$625 million in cash at the time of closing. That price is generally consistent with (1) the reported prices paid by purchasers of other Internet providers during the last three years, ranging from two to six times annual revenues, (2) the offers made to MCI by other potential purchasers of the backbone, and (3) an independent valuation of MCI's Internet business that MCI obtained before agreeing to merge with WorldCom. MCI believes that the purchase price reflects the long-term, strategic value of the Internet backbone and ISP business to C&W.

The transaction is subject to only two conditions. The first relates to the closing of the MCI WorldCom merger: if that merger does not proceed, MCI is not obligated to move forward with this transaction. The second is receipt of all necessary regulatory approvals

of the divestiture from DOJ and the EC. FCC approval is not required for this divestiture because the services provided over MCI's Internet backbone are unregulated and no transfer of any FCC licenses is involved — just as no FCC approval would be required if WorldCom and MCI were merging only their Internet businesses.

ANALYSIS

The divestiture wholly eliminates any competitive overlap between MCI's and WorldCom's backbone businesses and therefore completely resolves the concerns that third parties identified in comments filed earlier in this proceeding. After the divestiture, MCI WorldCom will have only those backbone assets that WorldCom currently owns. The merger will not produce any increase in WorldCom's backbone services or backbone capacity. With this divestiture, the same number of independent backbones will exist after the merger that exist before the merger. The difference is that C&W instead of MCI will own and operate one of them. To the extent that MCI WorldCom is able to increase its business after the merger in this rapidly growing marketplace, it will be because MCI WorldCom competes successfully on the merits with C&W and other ISPs.

The divested Internet backbone business will be as viable under C&W's management as it is under MCI's. In the extensive coverage following the announcement of the divestiture, no commenter questioned C&W's ability to operate an Internet backbone or the complementary strategic fit between MCI's backbone and C&W's domestic and international Internet and telecommunications business. C&W will be better off in at least two respects than MCI is in the current competitive backbone business: C&W will enjoy

substantial traffic and revenue guarantees that a competitive market does not provide to MCI; and C&W will be protected from competition by MCI WorldCom during the period of the non-compete agreement. As illustrated in the attached schematic diagrams, MCI will become an ISP customer of C&W, and MCI has contracted to purchase more backbone services over a longer term than most of C&W's other ISP customers. MCI will continue to compete at the retail level with C&W and thousands of other ISPs, by reselling backbone services purchased from C&W. MCI will be dependent on C&W as a backbone provider in the same way, and to the same extent, as third parties opposing the merger claim other ISPs are dependent on suppliers of backbone services. C&W will purchase transmission capacity from MCI after the divestiture, but that will make it no different from many other backbone operators (such as GTE) that lease transmission capacity used in their backbones from competing telecommunications companies. As stated above, C&W is free to obtain transmission capacity from other sources, including its own network.

The backbone will be as full of traffic as it would be if MCI continued to own and operate it: C&W will carry on its backbone the traffic from MCI's existing ISP customers, the traffic associated with MCI's existing peering agreements, and the traffic that MCI's retail customers are expected to generate over the next two years. Nevertheless, although C&W will obtain from MCI existing ISP contracts and projected traffic from retail customers, C&W will not be dependent on MCI or MCI WorldCom for the traffic that will fill its backbone. In addition to the traffic generated by MCI's current ISP and retail

customers, C&W will undoubtedly capture new business from both ISP and retail customers, building on its own existing base of domestic and international customers.

Given the full divestiture of MCI's backbone business to Cable & Wireless, it is time to move forward with speedy regulatory approval of the MCI-WorldCom merger by the Commission. MCI and WorldCom expect expeditious review of the proposed divestiture of MCI's Internet backbone by DOJ and the EC, and anticipate that approval of that transaction and their merger will be obtained promptly. Divestiture of MCI's backbone business eliminates the need for a detailed analysis by the Commission of whether the alleged Internet backbone market exists, what MCI and WorldCom's combined share may be, and whether combining MCI's and WorldCom's backbones would reduce competition. Regardless of the FCC's proper role in reviewing otherwise non-reviewable mergers of the Internet businesses of companies that are also merging regulated telecommunications businesses, it is clear that this complete divestiture of MCI's backbone business resolves any substantive issue relating to the effect of the merger on the Internet.

Swift approval of the merger will enable WorldCom and MCI to combine their complementary strengths in local markets and help them to compete more effectively and efficiently against the incumbent local telephone monopolies that still control over 98% of the local telephone markets. MCI and WorldCom have brought the benefits of competition to long distance (and Internet) customers, and just as WorldCom and a host of other carriers followed MCI into the long distance market once MCI showed the way, successful

entry by MCI WorldCom as the path breaker into local markets will generate more entry by more competitors and achieve the basic goal of the Telecommunications Act of 1996.

CONCLUSION

For these reasons, and the reasons stated in WorldCom's and MCI's earlier submissions, we respectfully request that the Commission promptly approve the pending applications for transfer of control.