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THE MCI WORLDCOM/SPRINT MERGER: A COMPETITION REVIEW

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

ON

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A BILL TO REFORM THE HART-SCOTT-RODINO ANTITRUST IMPROVEMENTS ACT OF 1976

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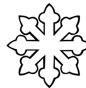

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THE MCI WORLDCOM/SPRINT MERGER: A COMPETITION REVIEW

WEDNESDAY, NOVEMBER 4, 1999

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 11:14 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee) presiding.

Also present: Senators Thurmond, DeWine, Ashcroft, Leahy, and Kohl.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

The CHAIRMAN. The committee will come to order. Good morning, and welcome to today's hearing examining the proposed merger of MCI WorldCom and Sprint. I first would like to thank all of our witnesses today for their time and cooperation, and I would ask all witnesses to come forward. We are going to merge both panels, if we can, in the interest of time. I understand some of you have to catch planes and I want to accomplish that if I can.

Last month, MCI WorldCom and Sprint announced their intention to merge in a deal valued at nearly $130 billion. This is the largest merger in history, although given how the merger wave has been going, I don't know how long it will last being the largest. The resulting company, the Washington Post reported, "would be broad by any measure, able to sell, local, long-distance and wireless service, along with high-speed Internet access. The merger would cement MCI WorldCom's position among the handful of large players * * * expected to dominate global communications in the future by offering a full array of services in a 'bundle' to businesses and consumers.

Our hearing today will focus on the possible effects this merger will have on competition and consumer choice in the telecommunications industry. Let me also point out that without commenting on the merits of this particular merger, mergers of this type that affect a significant portion of the economy is what the premerger notification requirement under our antitrust laws were intended to cover.

That is why today I will be introducing sensible bipartisan legislation, cosponsored by Senators DeWine and Kohl, that is designed to update the Hart-Scott-Rodino transaction thresholds to more accurately reflect today's economy. This will provide significant finan-

cial and regulatory relief for small businesses all across the country.

In our examination of the competitive effects of this merger, I would hope to hear from our witnesses on the effects on the ever-changing landscape of the telecommunications markets in general, and on several specific markets in particular. These specific markets are, the market for consumer long-distance telephone services; the provision of broadband Internet services to consumers and businesses; and the market for the reportedly concentrated Internet backbone, which is the underlying network used to transmit Internet traffic.

We are fortunate to have before us today two distinguished panels of witnesses, which we are going to merge in order to assist our examination. The witnesses are Mr. Bernard J. Ebbers, the president and chief executive officer of MCI WorldCom. We are happy to have you here, Mr. Ebbers.

Mr. William T. Esrey, the chairman and chief executive officer of Sprint Corporation. We are certainly delighted to have you here as well.

Mr. James F. Rill, we are always glad to get you back, Jim, with the great job when you served as former Assistant Attorney General in charge of the Antitrust Division. And, of course, Jim is currently a partner in Collier, Shannon, Rill and Scott.

Mr. Gene Kimmelman, a respected former member of the Judiciary Committee staff, and currently Co-Director of the Consumers Union. It is good to see you back, too.

And Tod A. Jacobs, Senior Research Analyst for Telecommunications at Sanford C. Bernstein and Company.

Again, I want to thank all of our witnesses for appearing today, and I look forward to hearing from you.

Let me now just turn to Senator Kohl, who will represent the minority, and then I will also turn to Senator DeWine. Senator DeWine is the chairman of the Antitrust Subcommittee, and Senator Kohl is the ranking member.

So we will turn to the Democrat side first, to Senator Kohl, and then to Senate DeWine for any remarks they care to make.

Senator KOHL. Thank you, Mr. Chairman. Today's hearing is important not only because we are examining the largest merger in history, worth nearly $130 billion, but also because it would combine two of the most important competitors in the long-distance telephone market and two key providers of Internet services. Indeed, Mr. Chairman, if there is a merger that "reaches out and touches" the "friends and family" of every American, this one is it.

We certainly recognize the strength of both MCI WorldCom and Sprint, and the business acumen of you, Mr. Ebbers, and you, Mr. Esrey. You have built your respective companies from scrappy upstarts to become vigorous competitors to AT&T. Your companies have been real American success stories, offering inexpensive and reliable long-distance telephone services and, through dynamic competition, leading the way to reduced prices and improved quality in a manner that has, without doubt, greatly benefited consumers over the last two decades.

But it is exactly for these reasons that many of us have serious concerns about this merger. With respect to long-distance, three

major companies currently control over 80 percent of the market. One need not be a rocket scientist—or even an antitrust lawyer—to be highly suspicious of a merger which reduces the number of rivals in an industry from three to two. Such mergers raise the dangerous possibilities of collusion, price coordination, cartel pricing, and reduction in quality of service.

In fact, Mr. Esrey, you might even agree. In written testimony last year, you told our subcommittee, “Fewer larger telephone companies make innovation less likely and make it more difficult for regulators and customers to compare relative performance.”

Mr. Chairman, protecting robust competition in long-distance telephone service is all the more important because it has been one of the brightest spots in the telecommunications industry, and a stark contrast to the lack of competition at the local level.

Despite the promise of the 1996 Telecommunications Act, residential consumers have seen few benefits. Are we now about to end the fierce competitive battle which has prevailed in long-distance? Will the long-distance market unhappily come to resemble the less competitive local markets?

This merger, of course, is about much more than about long-distance telephone competition. Both MCI WorldCom and Sprint play crucial roles with respect to Internet access, and both companies view this merger as strengthening their ability to offer broadband. But with the ever-growing importance of the Internet to the national economy, regulators will need to scrutinize this deal closely to determine whether the combined entity will control too much Internet infrastructure.

In fairness to our witnesses, let me make just a few more points. First, in an era of converging technologies, many argue that the old paradigm of long-distance and local no longer applies. Second, in the last few years regulators have permitted a series of horizontal mergers among the companies that have been most resistant to opening their markets, which has created giant conglomerates against which you must compete.

On that basis, it is not surprising that your two companies would want to merge. But that doesn’t make the deal necessarily a good one. Given the strength and size of your combined entity and the strong competition now existing between your two companies, the burden of proof is squarely on you, Mr. Ebbers, and you, Mr. Esrey, to show that your merger will benefit consumers rather than create obstacles to competition. We hope that you can convince us of that, and we look forward to hearing your testimony today.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

We will turn to Senator DeWine now.

Senator DEWINE. Thank you very much, Mr. Chairman. The full Judiciary Committee, as well as our Subcommittee on Antitrust, Business Rights, and Competition, has been working hard to promote competition in the telecommunications industry ever since the passage of the Telecommunications Act of 1996. And while many of us are disappointed with the level of local competition the Telecom Act has produced, I think it is fair to say that competition has been booming in the market for long-distance service.

In the years since AT&T was broken up, MCI and Sprint have become strong competitors to AT&T. Consumers have benefited from the battles among these three companies. Quality has improved, new services have been introduced and, most importantly, prices for long-distance service have dropped dramatically.

Now, however, Mr. Chairman, MCI and Sprint have announced that they will merge. The proposed deal between MCI and Sprint is valued at approximately $130 billion and, if approved, it will dramatically alter the landscape of long-distance service. The long-distance market will move from three primary competitors to two, known in antitrust lingo as a duopoly. Most economists agree that duopolies do not provide the same level of service and price competition as will be found in markets including three competitors.

In this instance, Mr. Chairman, economic theory may well be correct. Certainly, long-distance, with three major competitors, has been a very competitive market. Sprint and MCI have been very aggressive in competing with AT&T, and I think that as consumers we have all benefited from the competition, even if we sometimes get annoyed by those dinner time telephone calls.

So I am concerned, Mr. Chairman, about the impact of this proposed merger. If MCI WorldCom and Sprint are allowed to merge, consumers will only have two major choices for long-distance service. Mr. Chairman, I am not convinced that any of the smaller long-distance providers currently have the name recognition or reach to compete strongly with the major players. Further, it is unclear exactly when the regional Bell operating companies will be granted the legal authority under section 271 of the Telecommunications Act to compete for long-distance customers within their own regions. Until these smaller companies grow into brandname competitors and the Bell companies are allowed to provide long-distance competition throughout the Nation, AT&T and the merged parties will dominate the long-distance market.

It is possible that broadband service can ultimately fill the void. As a growing number of telecommunications companies are able to provide bundled services, customers will have greater and greater choice in the broadband market. But even though the broadband market is growing, and it appears to be the way of the future, it is not here yet today. Most consumers still pay separate bills for separate services, and one of those services is simple, old-fashioned long-distance telephone service. In that very important market, this merger will dramatically decrease competition.

This merger does offer some significant benefits to consumers. For example, it will allow the companies to combine their strengths to better compete in the market for bundled services, and provide better local and wireless service to customers. Further, there may be ways to fix the problems of this deal, possibly by divesting certain properties. However, my primary concern, Mr. Chairman, is the effect this deal will have in the long-distance market. So the burden is on you, Mr. Ebbers and Mr. Esrey, to show me that long-distance customers will benefit from this deal.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

We are going to turn to Senator Thurmond now, who has about a minute-and-a-half statement, and then I will turn to Senator Ashcroft, since Sprint is your State, as I understand it.

Senator THURMOND. Mr. Chairman, I am pleased that we are holding this hearing today regarding the proposed merger between MCI WorldCom and Sprint. The goal must always be to promote strong competition in the telecom industry because that is the key to keeping rates down for consumers.

I have to leave for another engagement. However, I would like to place some questions into the record for the witnesses to answer in writing.

Mr. Chairman, thank you very much.

The CHAIRMAN. Thank you, Senator Thurmond.

We will turn to Senator Ashcroft.

Senator ASHCROFT. Thank you, Mr. Chairman. I thank you for holding the hearing today. Obviously, this is a matter of great interest to me and my constituents in Missouri. As you know, Sprint is a very large employer in my State—approximately 6,800 Sprinters in the State of Missouri, and they are people who are highly talented and very, very committed to providing the best in communications.

Sprint connected its first call about 100 years ago in Abilene, KS, as the Brown Telephone Company. Today, the company employs a total of 78,000 employees; 16,000 are located in the Kansas City area. The rest of the country appreciated, I think, the plummeting long-distance rates created when Sprint entered the market. Missourians not only benefited from lower rates, but from the job growth that was created when this kind of capacity and integrity and competition entered. That ever-recognizable pin drop of Sprint, representing quality, provided the entire State and community with a sense of pride.

Now, as we discuss the larger merger in history, I understand that there are members of the committee who have concerns about the impact that this will have on the competitive nature of the telecommunications industry, and I am also concerned and interested in hearing the testimony of the witnesses on this subject.

While competitive implications should be fully examined, of course, my largest concern is for the jobs of the hard-working and talented people in the State of Missouri. Based on the conversations I have had with Bernie Ebbers, of MCI WorldCom, I believe that the job growth potential of the combined companies will bring additional workers to Kansas City and the State of Missouri. It is those Missouri and Kansas technicians, engineers and scientists that have brought such innovative products to the telecommunications market to help build the company into what it is today. In fact, it is their effort that makes Sprint such an attractive company to MCI WorldCom.

I looked at some of the other mergers with this in mind. When the former LDS took WillTel, the Tulsa Corporation that survived from the Williams Brothers transmission of energy services at one time, just 3 years after being purchased by WorldCom, WillTel's employment grew from 2,000 to 4,500 employees in Tulsa.

I think the proposed merger fills gaps in both companies' service offerings, and the combined company would offer one-stop shopping

for consumers. I think they should create efficiencies, and those efficiencies should continue to drive down prices for telecommunications services, local access, long-distance, wireless, and Internet.

I just from my own perspective note that virtually everyday I get mail that suggests to me that I can have cheaper and cheaper long-distance service, and it is in addition to the television advertising I see from MCI and Sprint comparing the virtues of Michael Jordan with other individuals in recommending service to me.

I noted an AP story just a month or so ago, "Little-known service provider IDT is escalating the long-distance rate price war, undercutting the industry's giants with charges as low as 3.5 cents per minute." I think the telecommunications framework which requires the options and opportunities for resellers and others in the marketplace appears to be providing a basis for people to continue to drive down costs, and drive down costs to consumers.

I must say at this point I am strongly inclined to support the proposed merger. It promises, I think, to be a win/win situation, winning for Missouri with more jobs and opportunity, and winning for consumers. But I will reserve my final decision in order to examine other issues, including the effects on competition, including long-distance and other telecommunications services.

I am delighted that these two leaders of American industry and the industry in which America leads the world have decided to come and be with us today, and I thank the chairman for this opportunity to make comments.

The CHAIRMAN. Well, thank you, Senator Ashcroft.

We are going to begin with Mr. Ebbers. We will go to Mr. Esrey, then we will go to Mr. Rill, then Mr. Kimmelman, and we will wind up with you, Mr. Jacobs. We are delighted to welcome all of you here. We look forward to your testimony. And we understand there is a time constraint here, so we will try and move this as quickly as we can. We hope you can limit yourselves to 5 minutes. It is a big deal to be limiting yourselves to 5 minutes, but I have found people of your caliber can do that.

So we will turn to you, Mr. Ebbers.

PANEL CONSISTING OF BERNARD J. EBBERS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MCI WORLDCOM, CLINTON, MI; WILLIAM T. ESREY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, SPRINT CORPORATION, WESTWOOD, KS; JAMES F. RILL, COLLIER, SHANNON, RILL AND SCOTT, WASHINGTON, DC; GENE KIMMELMAN, CO-DIRECTOR, CONSUMERS UNION, WASHINGTON, DC; AND TOD A. JACOBS, SENIOR TELECOMMUNICATIONS ANALYST, SANFORD C. BERNSTEIN AND COMPANY, INC., NEW YORK, NY

STATEMENT OF BERNARD J. EBBERS

Mr. EBBERS. Thank you, Mr. Chairman and members of the committee. I appreciate the opportunity to come and speak to you today.

In the changing world of the telecommunications marketplace, the question facing us is simple: Can competitive long-distance providers survive to fight against the Bell and cable monopolies? The

MCI WorldCom/Sprint merger is the answer to that question, and that answer is yes.

Consider what the recent months have brought. First, a dramatic decrease in the price of traditional long-distance service; second, the explosive growth of wireless telephony that has eliminated the artificial distinction between local and long-distance calling. There is no such thing anymore as pure long-distance. Third, the mega-Bells are edging closer to entry into what has been known as the long-distance market. Fourth, we see a growing demand for broadband capacity from both residential and business customers.

Our conclusion is that the separate market for long-distance created by the divestiture of AT&T is eroding, that successful competitors like ourselves need to be able to fulfill all of a customer's needs for wireless and wireline, and that strong competitors must be able to effectively bring broadband Internet access and services all the way to the customer's home or business.

In other words, the telecommunications industry of the future requires that a company be able to provide a comprehensive suite of services, broadband capabilities, and to the maximum extent possible to reach the customer directly. The broadband battle is basically about the last mile, and in the world of the last mile two titans are emerging. One is an old titan reborn through local cable facilities, AT&T. The other, ironically, is the offspring of that company, the Bell operating companies, or the now mega-Bells.

The new mega-Bells have maintained their hold over local markets, are already major wireless providers, and have moved swiftly to leverage those local assets toward becoming providers of the full range of voice and data services, and they are not even in long-distance yet. AT&T, meanwhile, has chosen to buy up the other last mile, cable, and is seeking to dominate the provision of high-speed Internet access and bundle it with its own wireless local and long-distance services.

Faced with these trends, MCI WorldCom had a tough choice to make. We could have left residential customers to the Bells and big cable, but that would have been bad for those customers and bad for us. We could have merged with a Bell in order to gain the advantage of controlling the critical last mile of copper wire into every home. Or we could get stronger and even more competitive. You know the choice that we made.

MCI WorldCom and Sprint decided to join forces as the single best hope for a strong and effective alternative to the mega-Bells and the emerging AT&T cable monopoly. We know how to do this. Both MCI WorldCom and Sprint were born outside of the Bell system and share an entrepreneurial spirit that has contributed to rapid growth and success. Dedicated to opening markets to competition, both our companies have focused on delivering benefits to customers, lower prices, innovation, and higher-quality services.

And we will be able to do all of this more efficiently. Over the next 5 years, the merged company will realize cost savings of $9.7 billion in operating costs and $5.2 billion in capital expenditures. These cost savings not only allow for the new company to compete aggressively in both the business and consumer markets, but also will enable us to aggressively invest in new technologies such as broadband access and next-generation wireless. And as you have

observed, since our merger with MCI the bulk of that savings has been passed through to consumers.

And that world, as we know it, is becoming smaller. Our competitors overseas, spurred by mounting competition on their home turf, are making acquisitions, joint ventures, and aggressive international investments in key markets around the world, ours included. The combined complementary strengths of MCI WorldCom and Sprint will make us uniquely equipped to develop and market the communications products and services customers need and want most—data, Internet, wireless, local, long-distance, distance-insensitive, and international.

Together, we will have the capital, proven marketing strength, and end-to-end state-of-the-art networks to compete more effectively against the internationally incumbent carriers. Our self-reliant, facilities-based global strategy positions us well to fully serve the rapidly growing global telecom market, a market valued at $1 trillion by the year 2002.

Our new company will have the people and the technology required to bring innovative services and the benefits of competition to residential and business consumers across America and around the world. Here in the United States, we can already see hints that this combination will accelerate broadband deployment in competition with Bell, DSL, and AT&T cable modems.

MCI WorldCom is breaking through in local markets in New York State, already providing over 200,000 residential customers there with two things they have never had before—choice and low, flat-rate service. Sprint is going forward with the introduction of its Integrated On-demand Network, ION, in Kansas City, Seattle, Denver, and eventually in local markets across the country. MCI WorldCom will be colocated in 1,500 central offices for DSL by the end of this year, and 2,000 by next year.

We have both invested heavily in a fixed wireless technology known as MMDS that will allow us to get to customers who are beyond the reach of DSL, usually in predominantly rural areas. With these MMDS and DSL assets, combined with Sprint ION networks and local facilities, we are in a very strong position to bring consumers, both urban and rural, the broadband they need and most definitely want.

Some regulators have reacted to the news of an MCI WorldCom/Sprint merger by raising a yellow flag of caution. That is their job. We look forward to demonstrating, and we will, that this merger is procompetitive in all markets, including what has historically been known as long-distance. That debate will benefit everybody because it will help government officials and consumers alike to understand the best way to advance the cause of telecommunications competition in the next century.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Ebbers.

Mr. Esrey.

STATEMENT OF WILLIAM T. ESREY

Mr. ESREY. Thank you, Mr. Chairman. I welcome this opportunity to offer you Sprint's perspective on our merger with WorldCom. We believe that with Sprint's human talents and the

physical assets combined with WorldCom's, we will break the local telephone monopoly that has frustrated public policymakers throughout the 20th century. We will bring to local customers advanced technologies and lower prices, just like we did in long-distance.

In the early days of long-distance competition, Sprint and MCI WorldCom successfully challenged the established players and offered the public new and innovative services. Now that long-distance competition has matured, our combined capabilities are uniquely suited to meet the new competitive challenges that have arisen. We will build on our competitive heritage to help open monopoly local markets to competition, to provide the next generation of broadband services, and to offer packages of voice and data wireless and wireline services that consumers are increasingly demanding both domestically and worldwide.

The telecommunications industry is undergoing massive change. One or more Bell operating companies appear on the verge of getting approval to offer in-region long-distance service, a market they were barred from in 1984 because of their local bottlenecks. Simultaneously, AT&T, the former parent of the Bell companies, is getting back into the local service business through its acquisitions of TCI and MediaOne.

At the same time, policymakers have made two critical decisions that will further strengthen the local monopolies. The first was to allow cable companies to close off access to their broadband systems, thus depriving competitors of access to the cable line to the house for services such as high-speed Internet. The second was to permit the first of two mega-BOC mergers that creates a single telephone company that controls a third of the Nation's telephone lines.

As these policy choices were made, it became clear to us at Sprint that our future should no longer hinge on a plan that depended upon cable companies or Bell companies to reach our customers. We looked at alternative strategies as a stand-alone company. We also explored alternatives to associate our human resources and the state-of-the-art assets with other resources and assets in ways that would complement our own and fill in our own missing pieces. WorldCom offered us the best opportunity to meet both shareholder and customer needs. Together, we will marshall the necessary talents and capabilities to meet the new, larger-scale challenges and new, larger competitors.

And let me be specific. While Sprint's local telephone companies serve principally residential users in rural and suburban communities throughout 18 States, we need access to local customers throughout the remainder of the country. Our breakthrough initiative announced last year, Sprint ION, can offer customers exciting and innovative means of communicating, but only if we can reach those customers in their homes and offices nationwide. WorldCom's local facilities covering more than 100 urban centers go a long way toward addressing this problem.

To deliver Sprint ION, we also need bandwidth to the home. At Sprint, we believe that bandwidth is the next great leap in telecommunications services for both businesses and residential users. Sprint's broadband wireless assets, MMDS, which is multichannel,

multipoint distribution services, when combined with WorldCom's, create a true local broadband alternative to the RBOC's and to AT&T.

Moreover, there is a substantial and an increasing demand by consumers for a full range of services from their traditional providers. Many of the telecommunications mergers announced recently echo this view, including those which have been the subject of hearings before this very committee.

The new WorldCom will be able to provide the full range of products that consumers demand, including local, long-distance, international, Internet access, and mobile services. By supplying the missing pieces in each other's portfolios, the merger better positions our companies to compete in the bundled services marketplace.

Sprint and MCI WorldCom have each grown and achieved success by innovating and offering choices, as compared to the traditional, established companies. In so doing, each company has individually acquired distinctive capabilities and assets. By combining these unique capabilities in local access and in ION and wireless and MMDS and international infrastructure, the new WorldCom can be a distinctive telecommunications company that has the potential to, one, achieve the objective of the 1996 Telecommunications Act by breaking open the local monopolies, and, two, by bringing a distinctive competitor to the worldwide communications marketplace.

Thank you.

The CHAIRMAN. Thank you.

Now, we will go to you, Mr. Rill.

STATEMENT OF JAMES F. RILL

Mr. RILL. Thank you, Mr. Chairman, members of the committee. I think as the competition review of this transaction unfolds, it will become apparent that it can only be perceived as a broader-scale, aggrandized version of the WorldCom/MCI merger which was challenged last year in some respects by enforcement agencies here and elsewhere in the world.

I have a prepared statement which I would like to summarize, Mr. Chairman.

The CHAIRMAN. We will put all prepared statements in the record as though fully delivered.

Mr. RILL. I would like to focus on three main points. First, in the Internet backbone market this merger will create substantial harm to competition which is not curable by the sort of partial divestiture that was effected last year, in 1998, in the case of the WorldCom/MCI merger.

Second, in the long-distance market this merger creates and entrenches a very, very substantial duopoly. Third, the dynamics of this merger underscores a necessary but not sufficient step, the need for lifting of the Telecom Act 271 restrictions on long-distance entry by the RBOC's so as to further stimulate competition as envisioned under the 1996 Telecom Act in the long-distance market, as well as other markets.

I would like to cover each of these points. First, with respect to the Internet backbone market, we have essentially the same issues

as last year. This fact has been acknowledged by Sprint, although not in its prepared testimony. Here we have the number one and two firms in the Internet backbone market merging, and as a result the bargaining power with competitors who are also customers will be irrevocably skewed in the direction of the merging parties and give them the opportunity to degrade the Internet connection of rivals, which will cause their customers in turn to abandon them and entrench the Internet backbone monopoly of these parties.

The remedy that was imposed in 1998, I respectfully submit, by the European Commission, and accepted by the U.S. Department of Justice, was not fully adequate. It left critical facilities, especially the Internet backbone pipeline, in the hands of the merging parties, thus creating the capacity for anticompetitive strategies, such as the degradation of connection, with the competitors who are also customers.

Certain problems arose. There was no consent decree that was entered by the Department of Justice, therefore no mechanism of review, no opportunity for the purchaser Cable and Wireless to negotiate modifications of the transaction that would have made it a more effective competitor. And as I understand it, there is a Cable and Wireless lawsuit pending now challenging whether or not WorldCom MCI has adequately even lived up to the bargain that was presented to Cable and Wireless at the time of that partial divestiture. The point is, Mr. Chairman, it was not the divestiture of a going business; it was the divestiture of some partial, inadequate assets.

In the long-distance market, market shares created by this merger blast through the 1992 DOJ–FTC merger guideline levels at which anticompetitive results are presumed. As indicated by subcommittee chairman Senator DeWine, we have a situation here where the combined share is approximately 80 percent of the relevant long-distance market, with the next competing firm having approximately 2 percent of the market.

The Herfindahl Index, the DOJ–FTC index which gauges concentration levels and attempts to use concentration as an initial litmus for antitrust review, presumes competitive harm when the threshold of 1,800 and an upward change of 100 are surpassed. In this transaction, just for example, in the consumer retail market, the post-merger Herfindahl Index would be 4164, with a change of concentration more than twice the 100-level of a change that the Department and the FTC view as likely to create anticompetitive concerns, and other markets are similarly affected.

No wonder Chairman Kennard has observed, "Competition has produced a price war in the long-distance market. This merger," referring to the one in front of us now, "appears to be a surrender. How good can this be for consumers?"

There are other factors in merger review than concentration. Entry is the most important, but under the merger guidelines entry must be timely, likely, and sufficient to deter the anticompetitive effect of a merger transaction. Mr. Chairman, "edging closer" is not an antitrust standard under the 1992 merger guidelines.

Section 271 has greatly impeded RBOC entry. It has taken 2 years to obtain PSC review in New York, and that is only one State. Under 271, state-by-state approval is necessary, and it is

highly improbable that approval be forthcoming in other States within the time frames set by the parties for the conclusion of this merger. Finally, approval in one State—that is, New York—should it be forthcoming under the "edging closer" standard, is not going to do anything for consumers in Utah or Vermont or Ohio or Wisconsin or Missouri.

In fact, the likelihood is, with the entrenched monopoly in those States, profits in those States will be used to subsidize what competition arises in the one State where 271 relief has been granted. Nevertheless, 271 relief is necessary as a first step toward ensuring the reinvigoration of competition in the long-distance market.

There have been several interpretations of 271 by the FCC, and applications and advice by the Department of Justice that we submit have not fully realized for Congress the goals of the 1996 Telecom Act. And those restrictions and those interpretations should be removed to facilitate competition. Mr. Chairman, section 251 of the 1996 Act is working. There has been realistic entry into the market. The availability of entry is there. 271, if it had a purpose, has been served and needs to be relieved as a first step.

One word, if I may, about the MMDS argument—really, two words. It is not clear that this is driving the merger or that the merger is necessary to achieve the scale of MMDS. And even if it is so, it doesn't seem right under antitrust standards to justify anticompetitive results now in two important markets for the hope of facilitating greater entry into another market which is not yet fully established. It is not true under the case law, it is not true as a matter of good public policy.

I have run over time. Thank you very much for your patience, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Rill.

[The prepared statement of Mr. Rill follows:]

PREPARED STATEMENT OF JAMES F. RILL

I appreciate the opportunity to offer my views on the merger under scrutiny by this Committee today, and I thank Chairman Hatch, Senator Leahy and the other members of the Committee for inviting me to appear.

The proposed merger of MCI WorldCom and Sprint is an aggravated version of last year's merger of MCI and WorldCom. The merger of MCI and WorldCom presented serious antitrust issues in two product markets: It would have resulted in undue concentration in the Internet backbone market, and antitrust authorities therefore required MCI to divest its Internet backbone operations. And it barely survived competitive review in the long-sea —distance market, where it reduced the number of significant players from four to three. Apparently hoping that the antitrust authorities are asleep at the switch, MCI WorldCorn now seeks to consummate a merger that would again result in undue concentration in the Internet backbone market and that would create a duopoly in the long-distance market.

My testimony will address four basic points:

1. The proposed merger of MCI WorldCom and Sprint would significantly harm competition in the Internet backbone market, for the very same reasons antitrust enforcers required MCI last year to sell off its Internet backbone operations before merging with WorldCom.
2. The merger would create a damaging duopoly in the long-distance market, with AT&T and the new MCI WorldCom-Sprint controlling more than 80 percent of the market. Indeed, even the agreement to merge is almost certain to suppress—in the immediate future, even before closing—any further price competition of the sort that MCI WorldCom and Sprint have been engaged in.
3. In the event that MCI WorldCom and Sprint were required to divest either of their pre-existing Internet backbone operations, their consolidation of their long-dis-

tance facilities would mean that any acquirer of the Internet backbone operations would fail to obtain the supporting facilities infrastructure needed to remain viable. Just as with Cable & Wireless's acquisition last year of MCI's Internet operations, MCI WorldCom's real game appears to be to consolidate its and Sprint's long-distance operations in order to entrench its dominance in the Internet backbone market.

4. An essential step toward promoting competition in all markets—local, long-distance, and Internet backbone—is to abolish the section 271 restrictions on Regional Bell Operating Company ("RBOC") provision of long-distance services.

1. THE INTERNET BACKBONE MARKET

The effects of an MCI WorldCom-Sprint merger on the Internet backbone market would be profoundly negative. Indeed, this merger is nothing more than a replay of last year's merger between MCI and WorldCom, which would have combined the largest Internet backbone with one of its few competitors. Fortunately, antitrust enforcers recognized that competitive parity among backbone providers is essential to the continued success of the Internet, and they therefore required that MCI divest its Internet backbone operations before merging with WorldCom.

It is worth noting that Sprint was among the most vocal opponents of MCI's and WorldCom's attempt to consolidate their Internet backbone operations. Sprint pointed out that if WorldCom were able to add MCI's Internet backbone to the backbone networks that WorldCom had already amassed through its acquisitions of UUNet, ANS, and Compuserve, WorldCom would become "the overwhelmingly dominant provider of core Internet backbone services."[1] Espousing the very points embraced by the antitrust agencies, Sprint explained that the disparity in size between the combined MCI WorldCom and the few other Internet backbone providers would "lead[] to asymmetries in the bargaining power of the merged WorldCom/MCI visá-vis its core backbone rivals."[2] MCI WorldCom would then have the incentive and ability to degrade interconnection with these backbone rivals, which would in turn induce customers of those rivals to switch and become customers of MCI WorldCom, which would further entrench MCI WorldCom's dominance, which would then enable MCI WorldCom to extract monopoly prices for Internet interconnection from Internet service providers.[3] Once MCI WorldCom established such dominance in the Internet backbone market, it would then be able to leverage that dominance throughout adjacent Internet service markets.

Having been thwarted last year in its attempt to establish dominance in the Internet backbone market, MCI WorldCom now seeks to achieve the same goal by acquiring Sprint's Internet backbone. For the reasons so well articulated by Sprint last year, such a combination would be profoundly anticompetitive and should not be permitted.

2. THE LONG-DISTANCE MARKET

By any measure—including the joint Department of Justice-FTC horizontal merger guidelines—the long-distance market is already highly concentrated. The Big Three—AT&T, MCI WorldCom, and Sprint—have the only significant brand names and control more than 80 percent of the market, widle none of the remaining small players accounts for more than 2 percent or so. As FCC Chairman William Kennard warned last year in discussing the merger of then-Number 2 player MCI with then-Number 4 player WorldCom:

> Once this merger is consummated, the industry will again be poised just a merger away from undue concentration. I daresay that any subsequent merger—of this or similar magnitude—between long distance firms in the near future should be judged quite differently than the merger before us today.[4]

Of course, the proposed merger of MCI WorldCom and Sprint is not merely of "similar magnitude" to last year's merger of MCI and WorldCom. It is far larger. Sprint has a much greater presence in long distance—especially in the retail market segments—than did WorldCom before last year's merger. And the combined MCI-

[1] Comments of Sprint Corporation, *In the Matter of Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications to WorldCom, Inc.,* CC Docket No. 97–211, at iii (FCC filed March 13, 1998).

[2] Id. at 14–15.

[3] Id. at 15–16.

[4] Press Statement of FCC Chairman William E. Kennard On Merger Of WorldCom And MCI, Sept. 14, 1998.

WorldCom is, of course, larger than MCI was. It is no wonder, then, that Chairman Kennard reacted as he did to this merger proposal:

> Competition has produced a price war in the long distance market. This merger appears to be a surrender. How can this be good for consumers?[5]

The clear answer to Chairman Kennard's question—how can this merger be good for consumers?—is that it certainly would not be. On the contrary, the merger would result in a duopoly in the already highly concentrated long-distance market. Such concentration levels create a presumption that anticompetitive effects would result from the merger. Prices would rise. The quality of customer service would fall. And AT&T and WorldCom would extract monopoly rents from American consumers. As the lessons of a century of antitrust economics teach us, this duopolistic market structure would invite tacit, and difficult-to-detect, collusion rather than vibrant competition.

Not surprisingly, by any accepted measure of industry concentration, this merger would be profoundly anticompetitive. For example, the standard measure of market concentration is the Herfindahl-Hirshman Index, or HHI, which is calculated by summing the squares of the individual market shares of all the participants. Under the joint Department of Justice and FTC horizontal merger guidelines, markets with HHI's above 1800 are regarded as highly concentrated, and a merger that produces an increase in the HHI of more than 100 points is presumed to enhance market power.

This merger would produce HHI numbers that are off the chart. To begin with, the pre-merger HHI for the consumer long-distance market (see Exhibit 1, attached) is 3945—which reflects an extraordinarily high level of concentration. Worse, the merger would push the HHI some 219 points higher—again, an increase well above the level that presents a threat to competition.

The effect on each of the other long-distance market segments (see Exhibits 2–6, attached)—including the business long-distance market and the wholesale long-distance market—is similarly problematic. In each of these other segments, the merger would take a market that is already well above the 1800 HHI threshold and push the HHI higher by some 400 to 1000 points.

Moreover, anticompetitive effects from the MCI WorldCom/Sprint merger are likely to be experienced almost immediately, even before the merger is projected to close. MCI WorldCom and Sprint have led the recent price declines in the long-distance market. But now that they have agreed to merge, they no longer have the incentive to continue to translate a portion of their ongoing cost reductions into price cuts. In other words, long-distance prices would continue to fall but for the agreement to merge. This makes it all the more important that antitrust authorities sound the death knell of this deal sooner rather than later.

I understand that MCI WorldCom and Sprint may claim that the potential entry of the RBOCs into the long-distance market is somehow sufficient to dispel any concerns over the long-distance duopoly that would result from their merger. I fully agree that actual and pervasive entry into the long-distance market by the RBOCs would be the single most important factor in ensuring the long-term competitiveness of the long-distance industry. But the suggestion that entry would be sufficiently widespread, likely and imminent to counteract the manifestly anticompetitive effects of this merger cannot survive the slightest scrutiny.

In the first place, nearly four years after the enactment into law of section 271, all of the RBOCs remain barred by section 271 of the Communications Act from providing general long-distance services in any of their in-region States. This bar will continue indefinitely in each State until FCC approval of a section 271 application is obtained for that State. As of now, the FCC has not approved a single section 271 application. The only section 271 application currently pending before the FCC is Bell Atlantic's application for New York, where a cumbersome, exhaustive process involving more than 400 different performance measures took well over two years to run through the New York commission. And while industry observers expect Bell Atlantic's New York application to be granted by the end of this year, it is worth noting that MCI WorldCom and Sprint have obstructed and delayed approval, and both have filed oppositions to Bell Atlantic's 271 application.

Second, it is farfetched to believe that section 271 approvals will have been obtained for many, much less most or all, States by the time MCI WorldCom and Sprint intend to close their merger. Indeed, apart from Bell Atlantic, it is highly doubtful that any RBOC will have made marked progress towards obtaining wide-

[5] Statement of FCC Chairman William E. Kennard On Proposed Merger of MCI WorldCom, Inc. And Sprint Corp., Oct. 5, 1999.

spread section 271 approvals by the end of 2000. For a large number of States, 271 approval could easily be 3 to 5 years into the future—perhaps even more.

Third, even when section 271 approval has been obtained for a particular State, such approval will not significantly alter the competitive landscape in the national long-distance market. For starters, such approval, of course, does nothing for those States where section 271 approval has not been obtained. The citizens of Utah or Vermont, for example, would not receive any protection from the AT&T-WorldCom duopoly by virtue of Bell Atlantic 271 approval in New York. Indeed, it is far more likely that AT&T and WorldCom would further exploit their duopoly in Utah in order to subsidize their competition against Bell Atlantic in New York. Moreover, even as to the State for which section 271 approval has been obtained, the RBOC will remain handicapped in certain long-distance market segments. For example, even once Bell Atlantic obtains section 271 approval for New York, Bell Atlantic will be at a competitive disadvantage in the large business market because it will still have to develop the more complicated systems that large business customers require and because (until such time as it has obtained section 271 approvals for its other in-region States) it will be unable to offer a full package of services to a New York-based business that has branch offices in, say, Boston or Washington, D.C, or Philadelphia.

In sum, there is no reason to believe that RBOC entry into the long-distance market would be so timely, likely and sufficient as to discipline the duopolistic conduct of AT&T and the combined MCI WorldCom-Sprint in the foreseeable future. For this reason, unless and until some other solution permits massive, widespread, and immediate entry by the RBOCs into the long-distance market, MCI WorldCom and Sprint should not be permitted to consummate their merger.

3. REMEDIAL PROBLEMS

Short of blocking MCI WorldCom from acquiring Sprint's long-distance operations, it is not clear that there is any divestiture remedy that would adequately address the problems that the merger would create in the long-distance market.

Because Sprint's Internet backbone business shares network facilities with its long-distance business, divestiture is also a highly dubious remedy for the undue Internet backbone concentration that the merger would create. In particular, the experience of the MCI-WorldComn merger counsels caution in accepting divestiture of Sprint's Internet backbone business, severed from many of the underlying facilities, as a workable remedy for this problem. In order to close its merger with WorldCom, MCI last year sold its Internet business to Cable & Wireless. Antitrust authorities permitted this supposed remedy notwithstanding warnings from Sprint and others that Cable & Wireless was not acquiring the facilities infrastructure that it needed in order to maintain itself as a viable competitor but would instead be critically dependent on MCI WorldCom, which would then have the incentive and ability to exploit Cable & Wireless's vulnerability. And, indeed, these warnings appear to have been prophetic. According to market analysts, Cable and Wireless's market share has fallen precipitously into the mid-single digits. In addition, Cable & Wireless has sued MCI WorldCom for noncompliance with the terms of the divestiture agreement.

In this regard, MCI WorldCom's and Sprint's proposed consolidation of their long-distance facilities—which in turn are integrated with their current Internet backbone operations—should be regarded not only as leading to a duopoly in the long-distance market but also as a ploy to entrench their dominance in the Internet backbone market. For if this consolidation were to proceed, any company to whom Sprint divested its Internet backbone operations would, like Cable & Wireless, soon discover that it lacked the facilities infrastructure that it needed to maintain its status as a major Internet backbone provider.

4. ABOLITION OF SECTION 271 RESTRICTIONS

A necessary step toward ensuring vigorous competition in the local, long-distance, and Internet backbone markets lies squarely within Congress's power: abolish the section 271 restrictions on the RBOCs' provision of long-distance services.

Such abolition is manifestly in the public interest. It would stimulate a competitive free-for-all in both long-distance and local markets that would lead to lower prices and higher-quality services for all Americans, and it would ensure competitive parity in the critical Internet backbone market. It would especially benefit those Americans—in more rural areas, for example—who have so far not directly benefitted from the competition directed at business and high-value customers, since their local providers would immediately be able to provide them an attractive and competitive alternative for long-distance and Internet services.

It is time for Congress to recognize that the section 271 process has gotten badly off track in at least three respects. First, the section 271 restrictions have been deemed to apply to Internet (and other packet-switched) traffic, even though the LATA architecture underlying section 271 has no sensible application to the Internet. Because of their existing customer base and brand name, the RBOCs are the only companies well-positioned to restore vibrant competition to the Internet backbone market. The lamentable, but predictable, effect of locking out the RBOCs from the Internet backbone market has been to lock up the market for the Big Three long-distance companies.

Second, the section 271 process has focused too narrowly on competitors using an RBOC's own network elements to compete against it, and has given virtually no attention to the actual development of true facilities-based alternatives to the RBOC's network. This misfocus has required the incredibly costly and time-consuming development and implementation of extremely complicated laboratory tests measuring an RBOC's performance in providing network elements.

Third, as a result of the FCC's approach to the section 271 approval process, which affords undue weight to entry by the Big Three long-distance carriers (rather than carriers generally) into the local markets, AT&T, MCI and Sprint have been able to game the system. In order to protect their long-distance market shares for as long as possible, AT&T, MCI, and Sprint have made the tactical decision to delay entering local markets, all the while diverting attention by complaining that their entry is being impeded.

Bell Atlantic's recent experience with MCI WorldCom in New York is instructive. Even though smaller players with fewer resources had already entered the residential local market, MCI WorldCom did not seriously undertake to compete for residential local customers until after it had become clear that Bell Atlantic was well on the path to section 271 approval. Specifically, in the months immediately preceding Bell Atlantic's filing of its 271 application, MCI WorldCom began serving 160,000 local lines, the vast majority of which are to residential customers. See also P. Elstrom, AT&T's Wireless Path to Local Service, Bus. Week, Dec. 28, 1998, at 53 ("AT&T executives are seriously considering launching the commercial trial (of AT&T's fixed wireless approach, Project Angel) in New York. * * * The reason is strategic: Bell Atlantic is likely to get approval in 1999 to provide long distance service to New York residents.").

Moreover, section 271 no longer serves any useful purpose. Genuine facilities-based competition is occurring, and, in any event, the market-opening requirements imposed on all incumbent local exchange carriers under section 251 fully ensure that the RBOCs would not be able to leverage any local market power into the long-distance market.

The lesson is clear: Abolish section 271 and competition will flourish in the local, long-distance, and Internet backbone markets.

The Consumer Long-Distance Market Is Highly Concentrated and the Merger Will Significantly Enhance Market Power

U.S. Residential Long Distance Market Shares, 1998

Carrier	*1998 (Percent)*	**1998 HHIs (Pre-Merger)**	**1998 HHIs (Post-Merger)**	*Δ HHI*
AT&T	59.91	3589	3589	
MCI WorldCom	16.99	289	549	
Sprint	6.44	41		
Frontier	0.64	0	0	
Qwest/LCI	1.53	2	2	
Cable & Wireless USA	0.05	0	0	
Excel/Teleglobe	3.74	14	14	
Other IXCs*	7.90	7	7	
LECs*	2.81	2	2	
Total	**100**	**3945**	**4164**	**219**

Source: Dataquest, Public Telecommunications Services North America Market Share and Forecast, 1999

Note: * It is assumed that no carrier in that category has a market share greater than one percent.

EXHIBIT 1

The Business Long-Distance Market Is Highly Concentrated and the Merger Will Significantly Enhance Market Power

U.S. Business Long Distance Market Shares, 1998

Carrier	*1998 (Percent)*	1998 HHIs (Pre-Merger)	1998 HHIs (Post-Merger)	Δ *HHI*
AT&T	39.43	1555	1555	
MCI WorldCom	27.56	760	1500	
Sprint	11.17	125		
Frontier	1.56	2	2	
Qwest/LCI	2.09	4	4	
Cable & Wireless USA	1.56	2	2	
Excel/Teleglobe	0.54	0	0	
Other IXCs*	15.18	15	15	
LECs*	0.90	1	1	
Total	**100**	**2464**	**3080**	**616**

Source: Dataquest, Public Telecommunications Services North America Market Share and Forecast, 1999

EXHIBIT 2

The Wholesale Long-Distance Market Is Highly Concentrated and the Merger Will Significantly Enhance Market Power

U.S. Wholesale Long Distance Market Shares, 1998

Carrier	*1998 (Percent)*	1998 HHIs (Pre-Merger)	1998 HHIs (Post-Merger)	Δ *HHI*
AT&T	18.71	350	350	
MCI WorldCom	37.41	1400	2585	
Sprint	13.43	180		
Frontier	6.14	38	38	
Qwest/LCI	4.70	22	22	
Cable & Wireless USA	4.32	19	19	
Excel/Teleglobe	1.10	1	1	
Other IXCs*	13.91	13	13	
LECs*	0.29	0	0	
Total	**100**	**2023**	**3028**	**1005**

Source: Dataquest, Public Telecommunications Services North America Market Share and Forecast, 1999

EXHIBIT 3

The 800 Service Long-Distance Market Is Highly Concentrated and the Merger Will Significantly Enhance Market Power

U.S. 800 Service Shares by Revenue, 1998

Carrier	*1998 (Percent)*	1998 HHIs (Pre-Merger)	1998 HHIs (Post-Merger)	Δ *HHI*
AT&T	49.24	2425	2425	
MCI WorldCom	27.13	736	1409	
Sprint	10.40	108		
Frontier	1.01	1	1	
Qwest/LCI	1.07	1	1	
Cable & Wireless USA	1.46	2	2	
Excel/Teleglobe	0.10	0	0	
Other IXCs*	9.36	9	9	
LECs*	0.22	0	0	
Total	**100**	**3282**	**3846**	**564**

Source: Dataquest, Public Telecommunications Services North America Market Share and Forecast, 1999

EXHIBIT 4

The Outbound WATS Long-Distance Market Is Highly Concentrated and the Merger Will Significantly Enhance Market Power

U.S. Outbound Long Distance Toll Shares by Revenue, 1998

Carrier	1998 (Percent)	1998 HHIs (Pre-Merger)	1998 HHIs (Post-Merger)	Δ HHI
AT&T	45.43	2064	2064	
MCI WorldCom	22.57	509	953	
Sprint	8.30	69		
Frontier	2.12	4	4	
Qwest/LCI	2.34	5	5	
Cable & Wireless USA	1.07	1	1	
Excel/Teleglobe	2.53	6	6	
Other IXCs*	13.48	13	13	
LECs*	2.17	2	2	
Total	**100**	**2675**	**3049**	**375**

Source: Dataquest, Public Telecommunications Services North America Market Share and Forecast, 1999

EXHIBIT 5

The Private Line Long-Distance Market Is Highly Concentrated and the Merger Will Significantly Enhance Market Power

U.S. Private Line Long Distance Toll Shares by Revenue, 1998

Carrier	*1998 (Percent)*	1998 HHIs (Pre-Merger)	1998 HHIs (Post-Merger)	Δ *HHI*
AT&T	46.22	2136	2136	
MCI WorldCom	26.24	689	1202	
Sprint	8.43	71		
Frontier	0.70	0	0	
Qwest/LCI	3.35	11	11	
Cable & Wireless USA	2.70	7	7	
Excel/Teleglobe	0.38	0	0	
Other IXCs*	11.78	11	11	
LECs*	0.19	0	0	
Total	**100**	**2926**	**3368**	**442**

Source: Dataquest, Public Telecommunications Services North America Market Share and Forecast, 1999

EXHIBIT 6

The CHAIRMAN. We will turn to you, Mr. Kimmelman.

STATEMENT OF GENE KIMMELMAN

Mr. KIMMELMAN. Thank you, Mr. Chairman. On behalf of Consumers Union, publisher of *Consumer Reports,* we appreciate the opportunity to testify, and I personally appreciate the opportunity to come back to my alma mater.

Let me start off by saying I totally agree with Mr. Rill's antitrust analysis related to this merger regarding Internet backbone and the long-distance market. There are enormous concerns for consumers in this transaction. I would like to focus on one piece of that because while everyone is totally correct in applauding the decline in long-distance pricing that we have experienced over the past 20 years, there is a hidden side to this that is often not visible to the public and to policymakers. I daresay most of the people in this room have not reflected on this because it doesn't reflect their usage. They are not the typical consumer long-distance user.

Five cents a minute, seven cents a minute, sounds great. When you look at the plans, there is often more to it than that—$1.95, $5.00 minimum, $5.95. Sprint and MCI have that. It is not just Sprint and MCI; it is AT&T. We have gone back to look at what the typical consumer uses in long-distance to figure out what is really happening in this market.

Five cents a minute, seven cents a minute, often translates into as much as effectively 20 to 35 cents a minute when you add in all of these fees. The FCC's own data show that people who make less than 30 minutes of interstate long-distance calls a month are today paying three times as much as they did 2 years ago.

Going to higher levels of usage, half of the country is paying about $2 billion a year more than at the time you passed the Telecommunications Act, effectively for the same long-distance usage. And as far as we can tell, you need to go up to 70, 80-percent level before you start to see full break-even or coming out ahead. A nickel, seven cents is good for some people, but there are a lot of people who are not getting the benefits of long-distance competition today. And for those people, going from three carriers to two as the dominant players is a significant concern that needs to be addressed.

However, having said that, I want to agree with quite a bit of what Mr. Ebbers and Mr. Esrey have said. They have outlined in great detail the problem they face. We have too much concentration of ownership in the local telephone companies, with expanding local telephone monopolies. We have allowed what looks like the first cross-sector entry, AT&T into cable, to expand into broader cable horizontal concentration, dominating that wire. And they face an enormous problem. It is understandable. The question is whether this transaction solves the problem or adds to it.

I am fearful we are at a point where merger mania has just gone too far for consumers, not just this transaction, but the ones that preceded it. And what you heard this morning, stated quite eloquently, boils down to this. This committee has done more to oversee these transactions than any other, and I commend you, Mr. Chairman, and Senator DeWine and Senator Kohl, for sitting through hours of hearings on this.

First, we had Bell Atlantic and NYNEX saying it is not a problem to join together; we were not potential competitors; we really weren't going to compete against each other. Then you have, after SBC buys Pacific Telesis, a purchase of Ameritech, and it is "don't look at our concentration, look at the fact that we want to go into local phone service elsewhere." Then AT&T: don't look at our concentration in cable, look at the fact that we want to go and provide local telephone service and broadband somewhere else.

And now we have today's proposal. It is more of the same. Effectively, this boils down to concentration today. You justify today's merger by yesterday's merger, which sets the stage for tomorrow's merger—concentration, more concentration, higher prices for cable, higher prices for some in the long-distance area, and promises of benefits, just promises. Mr. Chairman, I don't think that is fair for consumers. I don't think that is enough.

We want to put an end to this merger mania. We urge you to go back and review the Telecom Act. From Consumers Union's perspective, we think the administration has done an abysmal job of implementing this, both on the antitrust and the regulatory front, and we have a mess. I think it is time to review the law to ensure that with these consolidations, we do not end up in a world where prices keep going up, the choice that was promised doesn't appear, and we end up with either a digital divide, with the majority of consumers not benefiting, or the need to come in and regulate once again because competition just did not thrive.

Thank you.

The CHAIRMAN. Thank you, Mr. Kimmelman.

[The prepared statement of Mr. Kimmelman follows:]

PREPARED STATEMENT OF GENE KIMMELMAN

Consumers Union[1] is concerned that an avalanche of mergers in the telecommunications and cable industries is threatening to undermine the development of broad-based competition for local telephone, long distance, television and high-speed broadband Internet services. The Clinton Administration—including its antitrust and regulatory enforcers—and the Congress appear frozen in place as today's mergers are justified on the basis of yesterday's mergers, and then used to justify even further consolidation in the future. This merger-mania is already so out of hand that the most popular services most consumers want and need may be available from only one or two players in the market.

The proposed merger between the second and third largest long distance companies, MCI WorldCom and Sprint, illustrate this pattern. In defending its proposed merger MCI WorldCom-Sprint argue that:

> * * * the Bell operating companies have consolidated their local operations through a series of mergers and are moving toward becoming full-service providers of voice, wireless and data services. AT&T, meanwhile, will dominate the provision of broadband services over cable while operating its own nationwide wireless network. MCI WorldCom's merger with Sprint would offer consumers a strong and effective alternative-especially

[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about good, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports,* its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

in local markets, where neither company can compete as effectively alone against entrenched monopolies.[2]

In other words, MCI WorldCom-Sprint claim that consumers have nothing to fear from a merger that dramatically concentrates control of the residential long distance market (in apparent violation of the Justice Department's merger guidelines) between AT&T (58 percent market share) and MCI-Sprint (24 percent combined market share[3]), and consolidates substantial Internet backbone capacity, because the merger will improve chances for these combined companies to compete in the local telephone and broadband Internet markets. Will this competition materialize? Here is an example of what the merging companies said about the likelihood of anyone being able to compete against the consolidated Bell companies:

> The pending mergers of Bell Atlantic and GTE, and SBC and Ameritech, are over the line and must be blocked. The mergers would create two mega Bells owning and controlling two-thirds of the local telephone access lines in this country. The situation is now critical and Federal policymakers must stop the local telephone industry from transforming itself into basically a Bell West and a Bell East monopoly.
>
> * * * * *
>
> The conduct of these companies in the two-and-a-half years since the Telecom Act became law has been to fight competition in both local central office and the courts, which causes us to believe that the purpose of these mergers is to fortify against competition and not to embrace it. The result is that local telephone consumers on an even wider scale will continue to be denied the benefits of choice, price, products, quality and service.[4]

While we agree with Mr. Esrey's assessment of these Bell mergers,[5] and have raised similar concerns about AT&T's even more enormous consolidation of cable companies serving almost 60 percent of cable consumers,[6] it is hard to understand how a merger of MCI WorldCom with Sprint will undo the harm caused by the mergers that have preceded it. The logic appears to be two wrongs—Bell mergers and AT&T/cable mergers—justify a third wrong!

Just consider where this wave of consolidation leaves American consumers. At the time Congress passed the 1996 Telecommunications Act,[7] there were eight large local telephone monopolies (seven Bell companies and GTE); three large long distance companies and a handful of small-but-growing competitors; a comparable number of large cable monopolies; four satellite ventures, and electric companies and independent wireless firms were beginning to show interest in expanding more broadly into telecommunications. With markets and technology converging, the Telecommunications Act's goal of promoting broad-based competition could have yielded industry combinations (e.g., local phone/long distance/satellite, cable/long distance) that would have offered consumers a dozen national firms, with as many as half of them attempting to offer a full package of telecom and television services in each local market.

Instead, merger-mania is shrinking the competitive field: SBC and Bell Atlantic have each gobbled up two other regional companies to control about two-thirds of local phone lines, and are partnering with mid-size long distance companies and one of the two remaining satellite firms.[8] AT&T purchased TCI and is in the process of merging with MediaOne (which has a substantial stake in Time Warner's cable systems,) giving AT&T an ownership stake in cable wires reaching about 60 percent of consumers, plus arrangements to provide local telephone services through other

[2] John Sidgmore, "More Choices for Telecom Consumers," letter to editor, *Washington Post,* October 20, 1999.

[3] Trends in Telephone Service, Federal Communications Commission, September 1999, p. 11–11.

[4] Statement of William T. Esrey, CEO Sprint before the Antitrust, Business Rights, and Competition Subcommittee of the U.S. Senate Committee on the Judiciary, September 15, 1998.

[5] Testimony of Gene Kimmelman on behalf of Consumers Union, before the Antitrust, Business Rights, and Competition Subcommittee of the U.S. Senate Committee on the Judiciary, September 15, 1998.

[6] Comments of Consumers Union, Consumer Federation of America, and Media Access Project Before the Federal Communications Commission In the Matter of *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal Ownership Limits,* MM Docket No. 92–264 and in the Matter of *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Review of the Commission's Cable Attribution Rules,* CS Docket No. 98–82, August 17, 1999.

[7] Public Law 104–104.

[8] Testimony of Gene Kimmelman op. cit.

cable companies.[9] Once this degree of horizontal power is established in these entrenched monopoly markets, it becomes more difficult for the few remaining players to challenge the dominant local phone and cable players, increasing incentives for further consolidation and partnership.

And even these two giant consolidated groups are not well positioned to take each other on in most local markets with a full package of services. For example, AT&T's cable empire has not wired businesses, but can offer consumers a high-speed TV-quality Internet service that local phone companies cannot technically compete against.[10] Unless the price of satellite TV hookups and equipment keep falling and local broadcast channels become readily available from satellite TV providers, the Bell companies will not be able to compete against AT&T and other cable companies. As a result, two giants may not be enough to ensure consumer choice for local phone, cable or TV-quality high-speed Internet services. And the "silent majority" of consumers who are modest users of these services are likely to find themselves on the wrong side of a "digital divide" with rising monthly bills.[11]

Of course the consolidating companies have proposed a host of promises designed to alleviate antitrust and competitive concerns about their mergers. SBC and Bell Atlantic promise to invade other territories, AT&T promises to make its cable systems into local telephone competitors, and now MCI WorldCom-Sprint promises to take a hodge-podge of wireless licenses (MMDS which has significant capacity and line-of-sight limitations)[12] added to limited local wireline infrastructure and become "a third" full service provider into the home. Will these promises be kept? Unfortunately, there is no way of knowing, and probably no way of mandating competitive behaviors that would be sustainable in unknown, future market conditions. So the tradeoff is simple: allow enormous within-sector consolidation of local telephone companies, then cable companies, and then long distance companies, in the hope that they will-then cross sectors and challenge each other for a full package of telecom, Internet and television services.

The dangers of allowing entrenched monopolies (local phone and cable) to expand their core markets, or actual competitors (MCI WorldCom and Sprint) to merge are obvious. With cable rates continuing to rise about three-times faster than inflation (23 percent rate increases since passage of the Telecom Act)[13] and local phone rates restrained only by regulation, the fact that little competition is emerging casts significant doubt about recent consolidation in these markets. And long distance competition is not nearly as robust as advertisements for new calling plans would lead you to believe.

A careful analysis of consumers' long distance bills reveals that since passage of the Act, the majority of consumers are paying a net increase of about $2 billion a year on their long distance bills. This results from new monthly fees and line-item charges (e.g., federal access, universal service, monthly minimum charges, monthly service charge) added to the lower per-minute rates.[14] These net price hikes are most alarming because they come during a period when the Federal Communications Commission (FCC) reduced the cost of connecting long distance calls by more than $4 billion a year. Apparently, even as costs decline and usage increases, the long distance companies do not feel competitive pressure to pass along savings to a large segment of the consumer market:

> How did the telecom companies maintain their profit margins? The secret is that many consumers are paying monthly fees of about $4.95 in return for the lowest rates. AT&T officials on Monday said revenue per minute has actually increased in part because of these monthly fees. Also, people are talking more because they think their long-distance costs are lower.
>
> One other significant but little noticed factor is that the long-distance companies are now paying less to the regional Bell operating companies to originate and terminate calls.[15]

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[9] Comments of Consumers Union, op. cit.

[10] David Lieberman, "On the Wrong Side of The Wires," *USA Today,* October 11, 1999.

[11] Cooper, Mark and Gene Kimmelman, *The Digital Divide Confronts the Telecommunications Act of 1996: Economic Reality vs. Public Policy,* Consumer Federation of America and Consumers Union, February 1999.

[12] Lieberman, op. cit.

[13] Bureau of Labor Statistic cable and "all items" consumer price indexes.

[14] Comments of Consumer Federation of America, Consumers Union, and The Texas Office of Public Utility Counsel, Before the Federal Communications Commission, in the Matter of *Low-Volume Long-Distance Users,* CC Docket No. 99–249, September 22, 1999.

[15] Rebecca Blumenstein, "MCI's Revenue, Operating Profit Surges," *Wall Street Journal,* October 29, 1999.

With inadequate competitive pressure in today's market to hold down long distance prices for the majority of consumers who are modest users of long distance services, it is difficult to understand how a merger of the number two and number three companies will benefit consumers. Speculation that some day, the few remaining Bell companies will open their local networks to competition, in compliance with the 1996 Act, and offer long distance service nationwide, is not enough to justify reduced competition for today's long distance consumers.

CONCLUSION

It is time for policymakers to put an end to the telecommunications and cable consolidation that is threatening the growth of broad-based competition. We offer excerpts from a recent "Essay" by William Safire as a wake-up call to reverse course on telecommunications policy:

> Why are we going from four giants in telecommunications down to two? Because, the voice with the corporate-government smile tells us, that will *help* competition. Now each giant will be able to hedge its bets in cable, phone line and wireless, not knowing which form will win out. The merger-manic mantra: In conglomeration there is strength.
>
> That's what they said a long generation ago when business empire-builders boosted their egos by boosting their stock to buy the earnings of unrelated companies. A good manager could manage anything, they said, achieving vast economies of scale. As stockholders discovered to their loss, that turned out to be baloney.
>
> Ah, but now, say the biggest-is-best philosophers, we're merging within the field we know best. And if we don't combine quickly, the Europeans and Asians will, stealing world business domination from us. The urgency of "globalization," say today's merger-maniacs, destroys all notions of diverse competition, and only the huge, heavily capitalized multinational can survive.

* * * * *

Here are two startling, counterintuitive thoughts: *The fewer companies there are to compete, the less competition there is. And as competition shrinks, prices go up and service declines for the consumer.* (Say these reactionary words at the annual World Economic Forum in Davos, and listen to the global wheeler-dealers guffaw.)

Who is supposed to protect business and the consumer from the power of trusts? Republican Teddy Roosevelt believed it to be the Federal Government, but the antitrust division of Janet Reno's Justice Department is so transfixed by its cases against Microsoft and overseas vitamin companies that it has little time to enforce antitrust law in dozens of other combinations that restrain free trade.

Our other great protector of the public interest in diverse sources is supposed to be the F.C.C. When MCI merged with WorldCom last year, the chairman appointed by President Clinton, William Kennard, took no action but direly warned that the industry was "just a merger away from undue concentration." Now that is happening.

Why will the F.C.C. after asking for some minor divestiture, ultimately welcome a two-giant waltz? For the same reason that the broadcasters' lobby was able to steal tens of billions in the public's bandwidth assets over the past few years: Mr. Clinton wants no part of a communication consumer's "bill of rights."

Candidates Bradley, Bush and Gore look shyly away lest trust-luster contributions dry up * * *[16]

The CHAIRMAN. Mr. Jacobs, we will take your testimony now.

STATEMENT OF TOD A. JACOBS

Mr. JACOBS. Mr. Chairman, members of the committee, thank you for inviting me here to discuss the proposed merger of MCI WorldCom and Sprint. My name is Tod Jacobs and I am the senior telecom analyst at Sanford Bernstein and Company.

My job is to forecast the growth and earnings and stock performance of the telecom industry, as well as the largest local, long-distance, and wireless companies that make up that industry. Our firm is somewhat unique in that we don't do investment banking;

[16] William Safire "Clinton's Consumer Rip-Off," Essay, *New York Times* October 11, 1999.

that is to say, we don't work for the companies that we follow. I only have one set of clients and that is institutional investors, and I only have one mandate and that is to try to be right. Therefore, we don't live with fear of repercussions when we say things that the companies don't like, and we avoid conflicts of interest.

For the record, I am currently recommending the stocks of some large long-distance companies, including WorldCom and Sprint, as well as AT&T, and am currently neutral on the baby Bells.

I would like to cover three topics today: No. 1, why stories of telecom mergers appear on the cover of the Wall Street Journal more frequently than taxes, healthcare, or Hillary Clinton's new-found love of the Yankees combined; No. 2, where this merger fits into the changing Internet landscape; and, No. 3, where this merger fits into the changing long-distance landscape.

Now, first, on mergers, we have attached as an exhibit a piece that we released in October on industry consolidation that argues the following thesis. First off, telecom is a very high-fixed cost business, and like all high fixed-cost businesses, the way to compete successfully is to have lots of customers and lots of traffic so that your average cost per unit will fall.

Low-cost positions are critical, since exploding national and global competition are pushing prices down rapidly in telecom, especially in wireless and in long-distance, if not yet in local. So in each category, there is a mad rush to get big as fast as you can. Our Exhibit 1 with our testimony shows several examples of such scale-driven mergers.

Second, telecom companies are also attempting to get broad, that is to assemble the assets that will enable a carrier to offer the full slate of products and services to all the major customer segments. And once anybody can offer multiple products across a single network and a single sales force, then essentially everybody will have to create the same capability. Why? Because the more products you offer to a given customer, the more you can discount the products and still make money.

Thus, anyone who remains a single-product risks seeing their product become someone else's loss leader. And since no single telecom company was born with all the necessary limbs, and growing new ones either takes too long or indeed isn't possible, merger and acquisition is the only real solution. Exhibit 2 shows several examples of such scope-driven mergers. The proposed MCI/Sprint merger fits squarely into this category and is primarily driven by MCI's need for wireless. We have an attached research report from this past May that proposed this very merger as a way for WorldCom to solve its wireless dilemma. Consumers should delight in this because this is how they are going to continue to get lower prices in long-distance and wireless, and eventually in local service.

On the Interest, for starters let me tell you what I have already told my clients. Rightly or wrongly, Sprint will almost certainly have to divest itself of its Internet backbone business prior to this merger, just as MCI had to sell its business prior to merging with WorldCom, and I believe the companies know it and I believe they are prepared for it.

Despite complaints to the contrary, I would point out that Cable and Wireless, which bought MCI's Internet business prior to that

merger, is a healthy Internet player despite the huge turnover that they experienced in the very senior management that effected that deal right after the deal was closed. So, clearly, it is a viable option, and there will be numerous interested buyers when Sprint Internet goes on the block.

As to current competition in the Internet, as Exhibit 3 shows with our testimony, we believe that the current domestic Internet backbone market is about $8 billion. Here, MCI WorldCom leads the pack, with more than $3 billion in revenue. GTE, AT&T, Sprint and Cable and Wireless are numbers 2 through 5, respectively. So, clearly market share has more to do with investment and marketing than with how big your overall company is.

Competition has caused MCI WorldCom to lose about 11 percent of its market share in Internet since 1997. By 2003, we believe they will have lost at least a quarter of that market share, especially given the entry of the baby Bells and numerous aggressive new competitors into that space.

Point three is we have been asked to discuss the so-called peering situation, and we have portrayed that in schematic in Exhibit 4. Now, if you will follow that schematic, suppose I am Hillary and my Internet provider is Al's ISP. Al, in turn, rents access to WorldCom's global Internet backbone. However, I, Hillary, want to access the ACLU Web site that is sitting on Cable and Wireless' backbone.

Now, peering allows for unfettered flow of traffic onto each other's backbone networks, which makes all Internet service possible. Without peering, MCI WorldCom would be out of the Internet business, and it should be noting that peering arrangements at MCI, which currently number 72, have been rising and not falling. Put shortly, the sale of the Internet business will address all the relevant Internet concerns.

Finally, in long-distance, this merger would create a company that, in consumer long-distance, is something more than half the size of AT&T, as Exhibit 5 shows. While both Sprint and MCI have done a good job competing against AT&T in consumer long-distance, the reality is that neither has the size nor the scale to compete with what is otherwise becoming a two-horse race between AT&T and the baby Bells to offer a full bundle of products to consumers.

Indeed, either stand-alone company would have been highly imprudent to enter that most expensive race without substantial existing market share to justify it. Thus, this is a clear case where the creation of larger scale in consumer long-distance will actually motivate further investment and competition. And given the companies' recent complementary investments in a new wireless technology called MMDS as a high-speed data solution, we actually now expect the development of a third broadband pipe to the home. And we note that we expect the RBOC's to take about a quarter, at least, of the long-distance market and consumers within a few years of entry.

As to business long-distance, the short story is that on a combined basis, the company will be about the size of AT&T. And when you consider that the amount of new capacity being activated by new carriers over the next 12 months is approximately two times

greater than the entire capacity of the big three players, it should give you some sense of why business pricing is already low and getter lower, and why this company will be very lucky indeed to make our long-term share forecast. To the contrary, if the MCI merger is a guide, the cost savings generated by the merger will in large measure be given back to customers in the form of lower prices.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Jacobs.

[The prepared statement of Mr. Jacobs follows:]

Presentation to the Committee on the Judiciary
Re: Merger of MCI WorldCom & Sprint

by
Tod A. Jacobs
Senior Telecommunications Analyst
Sanford C. Bernstein & Company, Inc.
(212) 756-4607
tjacobs@bernstein.com

Mr. Chairman...Members of the Committee. Thank you for inviting me here to discuss the proposed merger of MCI WorldCom and Sprint. My name is Tod Jacobs, and I'm senior telecommunications analyst at Sanford C. Bernstein & Company. My job is to forecast the growth and earnings and stock performance of the telecom industry as well as its largest local, long distance and wireless companies. Our firm is somewhat unique among brokerage firms in that we do not engage in investment banking; that is, we don't work for any of the companies we cover as analysts. We therefore avoid conflicts of interest, and have the ability to speak our minds without fear of repercussion. My only clients are institutional investors, and my only mandate is to be right. And for the record, I'm currently favoring long distance companies such as WorldCom, Sprint and AT&T, and have neutral ratings on the baby bells.

I'd like to cover three areas today:

1. Why stories of telecom mergers appear on the cover of the Wall St. Journal more frequently than taxes, health care or Hillary Clinton's newfound love of the Yankees combined
2. Where this merger fits into the changing Internet landscape
3. Where this merger fits into the changing long distance landscape

First, On Mergers...

We've attached as an exhibit a piece we released in October on industry consolidation that argues the following thesis: first off, telecom is a high fixed cost business. And like all high fixed cost businesses, the way to compete successfully is to have lots of customers and traffic, so that average cost per unit will fall. Low-cost positions are critical since exploding national and global competition is pushing prices down rapidly, especially in long distance and wireless, if not yet local. So in each category, there's a mad rush to get big fast. Exhibit 1 shows examples of scale-driven mergers.

Exhibit 1. Scale-Related Telecom Mergers

- SBC-Pacific Telesis-Ameritech-SNET
- Bell Atlantic-NYNEX-GTE
- MCI-WorldCom
- Qwest-LCI
- Global Crossing-Frontier
- Voicestream-Omnipoint-Aerial

Second, telecom companies are also attempting to get *broad*. That is, to assemble the assets that will enable a carrier to offer a full slate of products and services to all the major customer segments. And once anybody can offer multiple products across a single network and a single salesforce, then *everybody* will have to create the same capability. Why? Because the more products you offer to a given customer, the more you can discount the products and still make money. Thus anyone who remains a single-product company risks seeing their product become someone else's loss leader. And since no single telecom company was born with all the necessary limbs -- and growing them takes too long -- mergers and acquisitions are the only real solution, as Exhibit 2 shows. The proposed MCI - Sprint merger fits squarely into this category, and is driven by MCI's need for wireless. (see our attached research report from May proposing this very merger as the WorldCom wireless solution).

Exhibit 2. Scope-Related Telecom Mergers

- AT&T-TCI-MediaOne-Teleport
- WorldCom-MFS-Brooks Fiber
- GTE-BBN
- Cincinnati Bell-IXC
- Global Crossing-RACAL
- WorldCom-Sprint

Consumers will delight, because this is how they're going to continue to get lower prices in long distance and wireless and eventually local service.

Second, on the Internet...
For starters, let me tell you what I've already told my clients. Rightly or wrongly, Sprint will almost certainly have to divest itself of its Internet backbone business prior to the merger, just as MCI had to sell its business prior to merging with WorldCom. And I believe the companies know it and are prepared for it. Second, despite complaints to the contrary, I'd point out that Cable & Wireless, which bought MCI's Internet business, is a healthy Internet player despite huge turnover in the very senior management that effected the deal shortly after the deal closed. So clearly it's a viable option, and there will be numerous interested buyers when Sprint internet goes on the block.

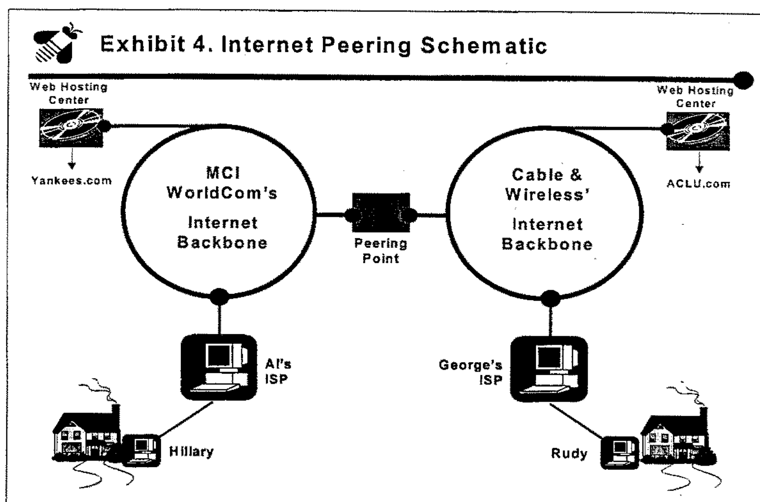
As to current competition: as Exhibit 3 shows, we believe the domestic Internet backbone market is about $8 billion. Here, MCI WorldCom leads the pack, with more than $3 billion in revenue. GTE, AT&T, Sprint and Cable & Wireless are numbers 2-5, respectively, so clearly market share has more to do with investment and marketing than with how big your overall company is. Competition has caused MCI WorldCom to lose about 11% of its share since 1997; by 2003 it will have lost at least a quarter– especially given the entry of the baby bells and numerous new carriers into the space.

Exhibit 3.
Internet Backbone Revenue and Share Forecast

		Estimates			Avg. Annual Growth	
	1997	**1999**	**2001**	**2003**	**97-99E**	**99E-03E**
Revenue ($, Mil.)						
MCI WorldCom	1,151	3,090	5,379	7,051	64%	23%
GTE-BBN	346	1,207	2,375	3,860	87%	34%
AT&T	322	924	2,206	4,120	69%	45%
Sprint	325	728	1,148	1,660	50%	23%
C&W	233	459	869	1,257	40%	29%
All Other	287	1,677	3,326	4,186	142%	26%
Total	2,663	8,085	15,303	22,135	74%	29%
Market Share						
MCI WorldCom	43%	38%	35%	32%		
GTE-BBN	13%	15%	16%	17%		
AT&T	12%	11%	14%	19%		
Sprint	12%	9%	8%	8%		
C&W	9%	6%	6%	6%		
All Other	11%	21%	22%	19%		
Total	100%	100%	100%	100%		

Source: Bernstein Estimates

Point three, we've been asked to discuss so-called peering, which we've portrayed in Exhibit 4. Following the schematic, suppose I'm Hillary, and my Internet service provider is Al's ISP. Al in turn rents access to WorldCom's global Internet backbone. However, I, Hillary, want to access the ACLU website that is sitting on the Cable & Wireless backbone. Peering allows for unfettered flow of traffic onto each other's backbone networks that makes all Internet service possible. Without peering, WorldCom would be out of the Internet business. And it should be noted that peering arrangements at MCI, which currently number 72, have been rising, not falling.



Put shortly, the sale of the Sprint business will address all relevant Internet concerns.

Finally, in Long Distance...

The merger would create a company that in consumer long distance is a bit more than half the size of AT&T, as Exhibit 5 shows. While both Sprint and MCI have done a good job competing against AT&T in consumer long distance, the reality is that neither has the size and scale to compete with what is otherwise becoming a two-horse race between AT&T and the baby bells to offer a full bundle of products to consumers. Indeed, either standalone company would be highly imprudent to enter that most expensive race without substantial existing market share to justify it. Thus a clear case where the creation of larger scale in consumer long distance will actually motivate further investment and competition. And given the companies' recent complementary investments in a new wireless

technology called MMDS as a high-speed data solution, we now expect the development of a third broadband pipe to the home.

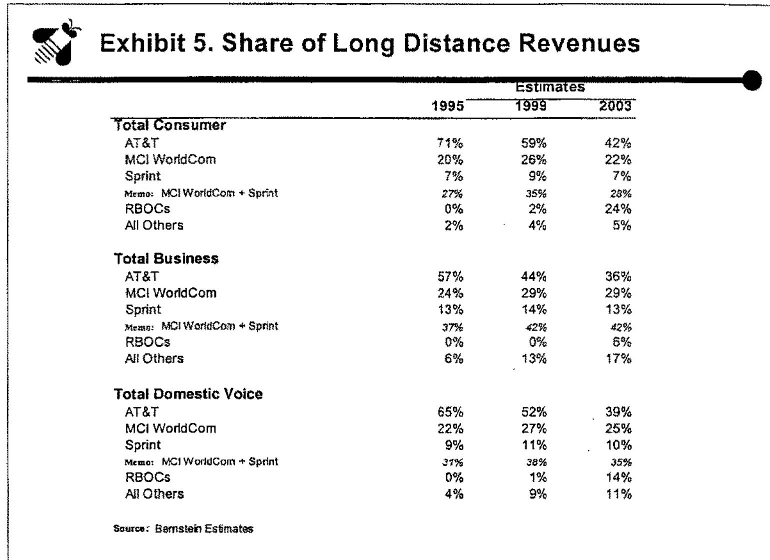


Exhibit 5. Share of Long Distance Revenues

	1995	Estimates 1999	Estimates 2003
Total Consumer			
AT&T	71%	59%	42%
MCI WorldCom	20%	26%	22%
Sprint	7%	9%	7%
Memo: MCI WorldCom + Sprint	27%	35%	28%
RBOCs	0%	2%	24%
All Others	2%	4%	5%
Total Business			
AT&T	57%	44%	36%
MCI WorldCom	24%	29%	29%
Sprint	13%	14%	13%
Memo: MCI WorldCom + Sprint	37%	42%	42%
RBOCs	0%	0%	6%
All Others	6%	13%	17%
Total Domestic Voice			
AT&T	65%	52%	39%
MCI WorldCom	22%	27%	25%
Sprint	9%	11%	10%
Memo: MCI WorldCom + Sprint	31%	38%	35%
RBOCs	0%	1%	14%
All Others	4%	9%	11%

Source: Bernstein Estimates

As to business long distance, the short story is that on a combined basis the company will be about the size of AT&T. And when you consider that the amount of new capacity being activated by new carriers over the next 12 months is at nearly 2x greater than the entire capacity of the big three players, it should give you some sense for why business pricing is already low and getting lower and why the company will be very lucky indeed to make our long-term share forecast. To the contrary, if the MCI merger is a guide, the cost savings generated by the merger will in large measure be given back to customers in the form of lower prices.

Thank you for your time.

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October 18, 1999

			EPS**			P/E		Rel P/E		FV/EBITDA*		99 REL	
STOCK	RATIN	PRICE	1998	1999E	2000E	1999E	2000E	1999E	2000E	1999E	2000E	STK PF	YLD
T	O	$43.2	$2.33	$2.18	$2.13	19.8	20.3	78%	85%	8.3	7.6	-16%	2.0%
FON	O	$64.0	$1.72	$1.73	$2.01	37.0	31.8	145%	134%	12.3	11.5	51%	0.8%
WCOM	O	$72.5	$0.63	$1.96	$2.85	37.0	25.4	145%	107%	13.7	11.0	0%	0.0%
SBC	M	$48.7	$2.08	$2.37	$2.60	20.5	18.7	81%	79%	7.9	7.2	-11%	2.0%
USW	M	$57.0	$3.01	$3.20	$3.40	17.8	16.8	70%	71%	6.9	6.5	-13%	3.8%
PCS	M	$70.0	($4.42)	($5.10)	($3.60)	nm	nm	nm	nm	nm	nm	201%	0.0%
PTEL	O	$66.8	($10.01)	($9.80)	($6.90)	nm	nm	nm	nm	nm	nm	391%	0.0%
S&P500		$1,247.4	$44.00	$49.00	$52.50	25.5	23.8						1.3%

** ADJUSTED FOR HIDDEN ASSETS; ENTERPRISE VALUE = MARKET CAP + NET ** EXCLUDES 1-TIME ITEMS, CONTINUING*

***AT&T 2000 pro forma for UMG; WCOM 1999PF for MCI

O – Outperform, M – Marketperform, U – Underperform

HIGHLIGHTS:

1. Telecom merger fury will continue unabated, driven by a pressing quest for vertical and horizontal scale: key drivers are what you've got and what you lack (the substance of this report)
2. We foresee four obvious consolidated survivors: WCOM and AT&T are ahead and now have all the pieces; BEL and SBC are close, and are likely to see near-term links with DT or FT (and perhaps Global One)
3. Numbers five and six less obvious and more likely to see someone's shareholders getting diluted: fifth likely to be BLS-QWST-USW-KPN with continuing need for national wireless; sixth is some version of GBLX with links to a DT (and continued need for national wireless) or a large BOC (also solves wireless) or both
4. CLECs/DLECs clear candidates as are few standalone Internet players and national wireless companies; but most will race against the toll that competition will ultimately take on standalone players as the large-scale-multi-service carriers apply increasing pressure across business lines

INVESTMENT CONCLUSION:

WCOM, T and FON remain outperform. SBC and USW are rated marketperform. In wireless, Powertel is outperform and PCS is marketperform. Investment strategy on a broader scale is addressed below.

DETAILS

1. Overview

Recently at a meeting in Amsterdam, a portfolio manager asked us to try to make sense of what was happening in telecom – the blur of mergers and ventures, the endless press releases, the rumors, the volatile stock prices. Just what is the point and why, and how could a non-specialist in the area attempt to get a view of the forest, even as the trees are in motion. In the process of trying to explain how the pieces fit, we began drawing a grid of company capabilities across a white board. Over the course of the next few meetings, the grid was refined, ultimately becoming the focal point of the entire European trip. The concept is pretty simple: no telecom company on the globe was born with all the necessary limbs. Now they're trying to get them: through grafting, growing, planting, replanting and partnering – you name it. Moreover, our basic thesis holds

The information set forth has been obtained from sources we believe to be reliable but is not guaranteed by us and may be incomplete. Such information and any views or opinions expressed herein are not to be considered as representations by us or as a prospectus or offer to buy or sell any security. Investment information supporting a recommendation of a specific security or materials upon which a projection or prediction are based are available upon request. Sanford C. Bernstein & Co., Inc. (the "Corporation") or one or more of its clients, officers, directors, stockholders, affiliates or employees may at any time hold, increase or decrease positions in securities of any company mentioned herein. The Corporation may provide investment management or other services for such companies or employees of such companies or their pension or profit sharing plans. Detailed information about the conduct of the business of the Corporation is set forth in its Investment Management Services and Policies Manual, which is available on request.

that once *anybody* has everything – and WorldCom and AT&T are coming awfully close – then *everybody* needs everything.

The reason? Because scale works in several important ways. First, high fixed-cost businesses like telecom provide natural advantages for large players if they can operate efficiently (i.e. being large doesn't imply scale advantage if the company can't capture it – like pre-Armstrong AT&T, whose SG&A was out of control; but *only* large companies can be scale-advantaged players). The long distance industry's woes in 3Q99 demonstrated this fairly well. While all companies saw either company- or analyst-driven revenue downdrafts (i.e. growth rates for 2H were lowered), 2H earnings expectations at the small guys got crushed (IXC, Teleglobe, Frontier, Star); earnings expectations at the largest of the small (Sprint) got tarnished; and the large (T and WCOM) remained intact. Why? Because the large guys have the ability to take out costs faster. Perhaps more to the point: the fact that the large guys have been taking out costs for a while now (2 years at T; 1 year at WCOM) has in a sense created the pressure on the rest of the industry as part of the cost savings is being continually channeled back into lower prices, even as margins rise. And given that roughly 80% of long distance costs are either relatively fixed (e.g. part of network cost, most of SG&A) or scale-driven (e.g. access costs, which are a function of network breadth and depth and volume), the operating leverage works lethally against the small guys as pricing drops. Especially as historic pricing provided a comfortable umbrella.

The phenomenon is multiplied as carriers gain the ability to offer multiple services over ever-more-integrated pipes, thus taking greater advantage of network and marketing scale, and creating the possibility of multi-product discounting. Thus the lead increases. And while successful integration is not a forgone conclusion (that is, execution is most definitely an issue), how many players can risk the outcome if even one of the scale players is successful?

Predictably, the result is a mad rush to gains customers and capabilities. Some, like the AT&T and the BOCs (especially SBC and BEL, whose nationalizing and globalizing strategies are under way) will rely on massive customer bases and huge balance sheets to smooth the way to otherwise inherently dilutive acquisitions of higher-valued companies; others will make use of their expensive currencies (QWST, GBLX); while still others will make use of both (WCOM). Either way the trend toward massive consolidation is irreversible, and will likely be completed long before investors have a chance to catch their breath: we'd say within 18 months for the most significant mating.

What follows is, we hope, a guide toward the inevitable. Sort of a how-to-fill-your-holes-if-logic-prevails way of looking at the world. On the latter point: logic *doesn't* always prevail. Managements have ways of either panicking or doing less-than-shareholder-friendly deals in order to maintain their own control and to avoid being left out (especially professional non-owner managements). Those are a bit harder to forecast. But clearly the more you're missing, the more likely orderly and non-hugely-dilutive (let alone accretive) deals will prove elusive.

With that, then, we present our "Telecom Guide for the Perplexed" – a.k.a. "How can I get a semblance of a notion of what's going on without having to raise my hand and ask questions in public?"

2. The categories

While arguments will obviously be made relative to the categories we've chosen as well as to our system of grading within categories -- zero stars (no positioning) to 4 stars (best positioning) -- this is our best attempt to capture the primary issues (see Exhibit 1: the grid).

- "Incumbent local" assets (shown as % of US households served): i.e. are you an RBOC or GTE or a smaller ILEC, such as Sprint, still enjoying roughly 99% market share in consumer local and nearly 95% market share in business local – and the monopoly margins that accompany it.
- "National competitive local," – that is, do you have a CLEC strategy in place for business and for consumer customers. This category is relevant to all non-ILECs on a nationwide basis, and for ILECs as it relates to out-of-region capabilities.

Exhibit 1

Telecom Capability & Strategy Grid											
	North American Telecom										
Traditional Segment	Company	Incumbent Local[7]	Nat'l Competitive Local		Hi-Speed Cons. Data[7]	LD Network	LD Scale	Internet Backbone	Wireless		Global
			Business	Residential					Regional	National	
LD	AT&T[1]		***	****	****	****	****	**	****	****	***
	WCOM[2]		****	*	**	****	****	****			****
	FON[3]	5%	**	*	**	****	***	****	****	****	*
	WCOM+FON	5%	****	***	***	****	****	****	****	****	****
	QWST-USW-KPN	11%	*		11%	****	**	**	**		**
	GBLX-FRO	*				****	**	**			**
	Level3[9]		*	*	*	**					*
	Williams, Enron, etc.					**					
Local	BEL-GTE[4]	37%			37%	****		****	****	****	*
	SBC-AIT[5]	32%	*		32%				****	*** (nat'l with GSM)	**
	BLS	16%			16%				****		*
	CLECs/DLECs[6]		****	*	*	**		**			
Wireless	GSM Companies[8]								****	*** (nat'l with SBC)	
	Nextel								****	****	
Internet	PSINet							***			
	Sprint Internet							****			
	Cable & Wireless					**		****			**
Foreign	BT										***
	DT										**
	FT										**
	Small PTTs										

Notes:
1- AT&T: Business Local through Teleport; Residential local over cable, UNE-P, wireless
2- MCI WorldCom: Business Local through MFS/BFPT; Residential Local over MMDS, UNE-P
3- Sprint: Business & Residential Local over ION-MMDS-DSL
4- National Wireless with Vodafone
5- SBC-AIT: LD over Williams Network (partial ownership; partial control); national wireless roaming likely with GSM players
& International holdings: Bell Canada, Telmex, Belgacom, TeleDanmark, Matav, Cegetel, Relationship with Teleglobe
6- Residential CLECs: RCN, McLeod
7-ILECs shown as % of US primary lines (proxy for homes)
8-Voicestream-Omnipoint-Aerial, Powertel, Western Wireless
9-Level3 holds portion of RCN for residential

- "Hi-speed consumer data," which does not necessarily accompany a CLEC strategy (though all ILECs have such strategies in-region). That is, if your consumer local strategy relies primarily on resale of RBOC local service (e.g. WCOM in NY), that doesn't imply hi-speed data capabilities. Hi-speed requires a cable model, DSL or MMDS strategy of some kind.
- "LD Network" is a simple run at whether you own a nationwide fiber network (or are trying to build one).
- "LD Scale" gets at the question of customers, capabilities and possibility or realization of a low-cost-provider position. In addition, and somewhat imperfectly, we've included in this category the standard LD data products (ATM, frame, LD private line). Imperfection lies in the fact that there are non-traditional LD players with real data businesses (USW out-of-region in frame relay, Intermedia, Equant and others).
- "Internet Backbone" rates players as national backbone players, with both wholesale and retail capabilities and customers (Qwest has lots of capacity, some products and an aggressive strategy; WorldCom has a huge existing customer base and global scale and capabilities; AT&T enters late, but is building a strategy and leveraging its existing LD and data customer base and extensive network assets).
- "Regional Wireless": how are you positioned at least within the region that you serve?
- "National Wireless": self explanatory.

- "Global": do you have capabilities (e.g. WCOM) or at least a well-defined and developing strategy (e.g. T & BT) for providing end-to-end service for multinationals, at least throughout NA and across Europe?

3. The Company Descriptions

"Long Distance Companies"

- AT&T

Haves: The company is one of two in the industry (along with WCOM-FON) that has assembled strategies and/or assets in all the major product sets. In national competitive local, the company serves business customers through Teleport, the number 2 CLEC. In residential, the company has invested heavily in cable as the preferred long-term means of serving customers; however, the fact that cable will only begin rolling commercially in a meaningful way across 2000 and into 2001 means that the company will use UNE-P and UNE-L (both low-cost resale strategies of RBOC local voice services); the company also hopes to fill in with fixed wireless as the economics become attractive. Hi-speed consumer data will come wherever cable or fixed wireless is deployed; UNE-P consumer has no obvious associated data product. Relative to LD, the company is one of the true 2 scale players. Internet assets are in place, but the company is coming from behind relative to products and customers; so acquisitions aren't out of the question. The company is national in wireless, though some PCS markets are still in start-up phase. And global is being developed on a wireline and wireless basis with BT.

Have-nots: mostly a question of successful execution and integration of stated strategies.

In short, no requirement for major acquisition.

- MCI WorldCom

Haves: The other true scale player, MCI WorldCom has lined up the pre-eminent set of global wireline assets, especially regarding Internet, business competitive local and global, where the company's ability to provide on-net services across NA and into Europe and to a much lesser extent Asia is unparalleled, and will remain so for some time.

Have-nots: Weaknesses are two: the company is half pregnant in consumer local, where it has invested modestly in both UNE-P (as it has become available in NY and to a lesser extent, TX – though recent FCC action have mandated ultimate ubiquity of residential UNE-P), and, more recently, MMDS, a fixed hi-speed wireless solution for data and possibly voice (though Sprint appears to be further ahead on utilizing MMDS for voice services through its ION effort). The other obvious large hole lies in wireless, where the company effectively has nothing other than some very weak resale sales that came along with MCI.

With Sprint, the deals are done. Longer term the company will need an out-of-North-American wireless strategy – perhaps through a Vodafone merger.

- Sprint

Haves: The company was early in data and Internet and has built from scratch a premier nationwide wireless business. In addition, the company controls incumbent local exchange service to about 5% of US homes.

Have-nots: In competitive local the company takes a clear backseat to both T and WCOM; indeed the ION local services for business and residential are only seeing the earliest stages of rollout (large business runs on rented fiber rings; small business and residential will utilize MMDS and DSL as transport). The company has a long distance network, but lacks scale relative to the big guys (as evidenced by higher access and SG&A costs). In many ways we view Sprint as the largest of the small rather than the smallest of the large; thought to be sure it's the number three player (and well ahead of numbers 4-800) relative to large business services. Global is at best a disaster, with Global One virtually dysfunctional for the past few years, primarily for management and political reasons (mis-aligned partners since the beginning).

WCOM fills the major lacks.

- WCOM+FON

This is where the action is: WorldCom offsets Sprint's weaknesses relative to LD scale, business competitive local and global. Sprint brings WCOM wireless. And, combined, the company can provide a distant third place spot to the RBOCs and T in consumer bundled services.

- Qwest-USW-KPN

Haves: USW brings ILEC service to about 11% of the nation's homes and businesses, including a high-speed data strategy and an out-region frame-relay business in concert with Intermedia. The company has a new premier network, but has not yet attained to scale relative to customer counts, traffic and network buildout; same with Internet (though the company is moving fastest among all the new carriers with respect to both).

Have-Nots: The company has precious little so far in competitive out-of-region local, though QWST is in the process of building, buying and swapping for local fiber rings. Wireless is a gaping hole; and global is just taking shape with the KPN venture in Europe.

Company needs to get taken out or make further acquisitions, especially in wireless and possibly in competitive local.

- Global Crossing-Frontier

Haves: Frontier brings with it a small ILEC base in Rochester. The company has LD network assets in place in NA and from NA to numerous points abroad, and to a lesser extent in Europe (though the recent Racal acquisition will add capabilities in the UK; and the company has begun developing interesting strategies in Japan along with several partners).

Have-nots: GBLX is by no means yet a scale player in LD or Internet backbone (though Frontier has a premier Web hosting business). The company has almost nothing in competitive local for both business and consumer. Wireless is non-existent outside of upstate NY.

Needs are similar to Qwest, just more so.

- Level3

The company has ample capital and is building furiously across both the US and Europe – both backbone and local connectivity -- but cannot yet really be put into the category of a functional player (though much like Qwest we expect Level3 to move up in a hurry when the assets are in place. Even when the network goes live, buildout is likely to be relatively piecemeal. Consumer retail appears not to be part of the strategy (though the company owns about 29% pro forma of consumer CLEC RCN). Wireless is non-existent.

- Williams, Enron, etc.

Of the smaller, in-build-process players, Williams has a shot of attaining scale relatively quickly given its position as premier LD provider to SBC (once it enters the business), which owns a small piece of the newly public company and has an agreement under which it will help to develop the network and products. Meanwhile, Williams is moving into position as a carrier's carrier as the network comes on line. Enron is also producing a carrier's carrier business on its new and developing network. We'd also include IXC-Cincinnati Bell in this group: a new LD network trying to develop a customer base, but in this case married up with a small, regional ILEC.

"Local Companies"

- BEL-GTE

Haves: Of all the local companies, BEL-GTE is closest to holding a complete North American set of assets: 37% of the nation's incumbent local assets; an LD network (GTE), albeit one without scale and much demonstrated capability, particularly regarding business customers; a premier Internet business (GTE/BBN) and a national single technology (CDMA) wireless business in concert with Vodafone/Airtouch.

Have-nots: Out-of-region local is extremely sparse, though we expect the company to have to commit to some type of out-region attack strategy similar to SBC's. Global is fairly weak (some interesting stand-alone investments, but not a seamless strategy), and likely in need of a large European partner.

Company may deem it necessary to continue to invest in CLEC assets (as it did recently with Metromedia Fiber Network); but largest holes would be filled by joining forces with DT or FT, perhaps with Global One thrown in.

- SBC-AIT

Haves: The company controls about 32% of the country's ILEC assets. Wireless is more complex: the company is approaching a national strategy, but lacks NY and lacks a single-technology digital roaming capability (California is GSM; rest of country is TDMA; most of AIT's CDMA businesses were sold to GTE on the merger close). Most likely scenario, in our view, would be a strong roaming agreement (similar to BEL-ATI of old) with the now-consolidating GSM companies, who need SBC's California capability in exchange for NY; merger is clearly not necessary. As to global, the company towers above the other RBOCs, with strong, partial-control investments in Canada, Mexico, Denmark, Belgium, Hungary and South Africa (with incumbents) and further investments and/or arrangements with numerous smaller providers in Europe and Asia. In addition, a relationship with Teleglobe put AIT into the business of international LD resale. And while the numerous international assets haven't yet been knitted into a seamless capability relative to serving multinationals, the toe-holds are pretty strong and the company clearly has a base to move in that direction.

Have-nots: As to the rest of the country, SBC has announced its "national-local" strategy, but it's less than clear exactly what the scale is likely to look like and whether it will be all build/lease, or some buy. While the company doesn't own an LD network, it does have a small investment and some development control in the new Williams network. Like the other BOCs SBC-AIT already has some LD capabilities in-region (they've effectively connected the dots in advance of LD entry, allowing for a so-far undetermined level of capability). The company clearly lacks LD scale since Williams itself lack it; nor is there a significant Internet capability.

Like BEL, SBC would provide a suitable marriage partner for DT or FT, also potentially in concert (no pun intended) with Global One.

- BLS

Haves: The company has a strong and growing region in the form of the SE United States, both with respect to wireless and wireline (including data and some video).

Have-nots: BLS's historically provincial strategy (other than in Latin America) strongly disadvantages the company in the race for national --let alone global -- scale and capabilities. That is, outside of its region BLS has precious little to show: no LD (aside from a relatively ill-defined benefit from its 10%-going-to-3%-pro-forma Qwest investment), no Internet, no wireless.

Long term, BLS has relatively few options (though it can grow earnings for a time by continuing a SE focus). Logic would perhaps dictate getting taken out by Qwest post USW (that way the high-multiple company takes out the low; synergies are possible by the USW part of the merger); however, a desire for control will likely work any deal the opposite direction. Post an LD-related merger the company will still need wireless and perhaps CLECs. Thus should BLS desire control, it's got at least two large and expensive mergers ahead of it.

- CLECs-DLECs

These small companies benefit from RBOC foot-dragging (e.g. in rolling out DSL) and RBOC pricing (subsidy laden business prices; even DSL for business will be priced high to protect the T1 business). Business mix includes some LD voice (mostly resale) and data in addition to local voice and data services. Management talent is all over the lot; but the assets have proven and will prove strategic for numerous other players. The DLECs may have a standalone strategy as front-men for a host of ISPs and LD players in the DSL space; the CLECs largely exist to be bought.

"Wireless Companies"

- Nextel:

It's got national business-focused wireless, though capacity and migration to 3G will become ever more important issues. Nothing else relative to North American assets. A clear take-out by a Qwest or GBLX most likely; could bind itself together with a group of CLECs and DLECs, but who'll get the premium and who'll get control?

- GSM Companies:

With the merger of Voicestream, Aerial and Omnipoint, the long-awaited GSM consolidation is well under way. Powertel would help round the SE footprint. But the group needs California. Luckily, SBC needs NY. Thus a self-interested roaming alliance seems obvious. The company will likely be taken out by whichever LD upstart doesn't take out Nextel.

"Internet Companies"

- PSINet

One of the few pure plays, the question is when more than if. For any of the Internet players buyers would included just about everyone with the exception of MCI WorldCom and perhaps BEL (post GTE).

- Cable & Wireless

The old MCI Internet business, C&W's North American Internet business is part of what appears to be the company's global focus on and narrowing towards data and Internet assets. We expect the company to have a brighter future as part of a behemoth than as a stand-alone.

- Sprint Internet

Everybody will want it; but management probably won't offer it to anyone considered dangerous (e.g. AT&T).

"Foreign Companies"

- BT, DT, FT

Only BT at this point has a well defined global strategy (with AT&T in both wireline, building on the existing Concert venture, and wireless) that includes North America. DT and FT are nowhere, especially with Sprint's imminent departure from Global One. In our opinion, If they're smart, they'll find a way to merge or at least knit themselves together with SBC and BEL. The sexy, but more dilutive and far less logical strategy would see acquisitions of GBLX or QWST in tandem with or followed either by a wireless (Nextel, GSM) acquisition. The other way would see a GBLX takeout and then a link-up with BEL or SBC to avoid having to make an expensive wireless deal.

- Smaller PTTs (Telefonica, Telecom Italia, etc.)

Cannon fodder for the big guys.

4. Who Needs Who?

Exhibit 2 summarizes the needs and wants of the major players by category as well as offering up a view of the available supply. In short, an awful lot of players need an awful lot of capabilities, and most of the lists of how to get them are short. Hence, we expect the pace to be frenzied for some time.

--more--

Exhibit 2

Who Needs What and From Whom

Who Needs Local?	Who Needs Wireless?	Who Needs LD?	Who Needs Internet?	Who Needs Global?
QWST-USW	QWST-USW		QWST-USW (more scale)	QWST-USW-KPN (more scale, wireless)
GBLX-FRO	GBLX-FRO		GBLX-FRO (more scale)	GBLX-FRO (more scale, wireless)
Williams, Enron, etc.	Williams, Enron, etc.			
			AT&T (more scale)	
				WCOM-FON (wireless)
Level3	Level3		Level3	Level3 (more scale, wireless)
BEL-GTE (out of region)				BEL-GTE
SBC-AIT (out of region)	SBC-AIT (NY primarily)	SBC-AIT	SBC-AIT	SBC-AIT (connect dots; wireless)
BLS (out of region)	BLS (out of region)	BLS	BLS	BLS
Cable & Wirless	Cable & Wirless	Cable & Wirless		Cable & Wirless
PSINet	PSINet	PSINet		PSINet
GSM Companies		GSM Companies	GSM Companies	GSM Companies
Nextel		Nextel	Nextel	Nextel
	CLECs/DLECs	CLECs/DLECs	CLECs/DLECs	
BT	BT	BT	BT	
DT	DT	DT	DT	DT
FT	FT	FT	FT	FT
Supply	**Supply**	**Supply**	**Supply**	**Supply**
CLECs	GSM Companies	Williams	PSINet	Cable & Wireless (data, internet)
DLECs	Nextel	Global Crossing-FRO	Sprint Internet Assets	DT, FT, Global One?, Smaller PTTs
Cable MSOs		Qwest	C&W?	Vodafone
		Cincinatti Bell-IXC		Mannesman
		Level Three		Equant, Colt, GTS, Viatel, etc.

5. What Will It look Like?

When all is said and done, we expect that there will emerge maximally 6 players in the North American theater (Exhibit 3); perhaps just 4-5 should QWST or Global Crossing get consolidated in some fashion (e.g. by merging with each other or with SBC or BEL – though GBLX will be easier given the difficulty of another horizontal merger at either BEL or SBC going forward) – a highly logical endgame. At least the first 4 are relatively easy:

- AT&T in a consortium with BT, the North American Cable industry, and eventually, probably NTT (which may view AT&T as friendlier than a by-then attacking WCOM).
- MCI-WCOM-FON, perhaps with Telefonica given an existing and friendly relationship. Ultimately the company may have to consider merger with Vodafone relative to global wireless.
- BEL-GTE-Vodafone North America. Company will likely wind up with DT or FT and perhaps Global One. Fill-in acquisitions will include CLECs and small data players. Wildcard is whether company will need more LD firepower (e.g.. GBLX) as time-to-market quickly becomes an issue.
- SBC-AIT-Williams-GSM Roaming. Company claims that it doesn't need to own LD, but control may well become an issue, especially as the company moves up from consumers and small business into large business and multinationals. Whichever of DT and FT doesn't get together with BEL will wind up here, again possibly with Global One. Fill-ins may prove numerous: CLECs for out-region, an Internet player.
- Qwest-USW-KPN-BLS?-NXTL or GSM? Entering the realm of the less obvious, the most likely consolidation involves BLS and then NXTL or the GSM companies. As we noted above, Qwest should be the buyer; BLS probably will be.

- Global Crossing-FRO-Racal-NXTL or GSM? Even less clear is the fate of GBLX. Company is occasionally rumored as take-out by DT, which could of course then merge into or join with BEL or SBC. Otherwise, a wireless takeout will be necessary.

Exhibit 3

The Shape of the Future Behemoths

	Complete or Likely	Wildcards	Additional
1	AT&T-BT-North American Cable Industry-Japan Telecom	NTT?	
2	MCI-WCOM-FON	Telefonica?	
3	BEL-GTE-VodafoneNorthAmerica	DT? FT? Global One? GBLX? Smaller PTTs?	CLECs/DLECs
4	SBC-AIT-Williams?-GSM Roaming?	DT? FT? Global One? GBLX? Smaller PTTs?	CLECs/DLECs
5	Qwest-USW-KPN-BLS?-NXTL or GSM?	DT? FT? Global One?	CLECs/DLECs
6	Global Crossing-FRO-Racal-NXTL or GSM?	DT? FT? Global One?	CLECs/DLECs

6. Investment Strategy: What do I do in the Meanwhile?

For the nimble and non-faint-of-heart, playing the take-outs is a fine strategy, though not one that will allow for much market cap: PSINet in the Internet space, a basket of CLECs and DLECs, the wireless guys. The risk is that the takeouts don't happen quickly enough and competition takes a toll first. Such was the risk with Sprint, which was already beginning to feel the stress on earnings of its lack of scale and need to invest. Such was the case with USW as well, where the pursuit of revenue growth was taking a hard toll on earnings and the stock (especially given the historic EPS and dividend focused shareholder base). GBLX and QWST obviously come to mind as well, but LD pricing, should it step down again, could have significant impact on expected revenue growth.

The beauty of the large LD players – AT&T and WCOM – is that the deals are nearly done (at least they've already been announced); the companies are now focusing on execution and integration. WCOM is the core holding; T is the cheap one, but has a far rockier road to hoe over the next two years, especially given pending RBOC entry. Both are rated outperform.

In the near term the RBOCs have more catalysts than the LD companies (where pricing problems have not gone away despite the fact that the street is at least temporarily ignoring them) relative to LD entry and DSL rollouts. The most logical are BEL and SBC given the maturity of their strategies and lesser need for highly dilutive further investments. Risk in both is that the core voice business is just now coming under attack (though BEL is further along in the process than SBC). With expected slowing, the vast majority of revenue growth will be driven by new businesses, with far less certain margins. Our investment rating on SBC remains marketperform pending clarity (which we should receive today) of the impact on earnings of the new local data strategy.

Potential dilutors: BLS, DT, FT – though we have offered ideas for how each could evade expensive acquisitions and add to shareholder value in the near term.

Telecommunications Services

FAX Problems Only: 212-756-4263

WorldCom and the Wireless Question II: A Sprint Combination Could Work and Would Involve Lower Network and Technology Risk

Tod Jacobs 212-756-4607 & Carl Walker 212-756-4379 & Jeff Halpern 212-407-5958

May 4, 1999

			EPS**			P/E		Rel P/E		FV/EBITDA*		99 REL	
STOCK	RATIN	PRICE	1998	1999E	2000E	1999E	2000E	1999E	2000E	1999E	2000E	STK PF	YLD
FON	O	$104.4	$3.43	$3.80	$4.25	27.5	24.6	97%	92%	9.9	9.1	14%	0.5%
WCOM	O	$84.1	$0.63	$1.96	$2.82	42.9	29.8	152%	112%	15.6	12.6	8%	0.0%
PCS	M	$45.0	($4.40)	($5.10)	($3.60)	nm	nm	nm	nm	nm	nm	128%	0.0%
S&P500		$1,354.6	$44.00	$48.00	$50.75	28.2	26.7						1.2%

** ADJUSTED FOR HIDDEN ASSETS; ENTERPRISE VALUE = MARKET CAP + NET ** EXCLUDES 1-TIME ITEMS, CONTINUING*
***AT&T 1999 pro forma for TCI and includes $0.34 goodwill addback; WCOM 1999PF for MCI

O – Outperform, M – Marketperform, U – Underperform

Highlights

1. A WorldCom-Sprint (FON and PCS) combination could be a very attractive alternative to a WCOM-NXTL merger and would, we believe, meet WorldCom's expressed dilution guidelines of less than 10% dilutive in year one and accretive by year three with much lower network and technology risk, even assuming a higher takeout premium (20% for Sprint versus 15% for Nextel)
2. Following are the strategic rational and financial assumptions underpinning a potential WorldCom-Sprint deal

Investment Conclusion: We continue to rate MCI WorldCom outperform. It continues to offer the best mix of wireline services and growth in our universe. But, we expect that the stock may hold in its current $83-$93 range until the company puts up or shuts down the speculation on wireless. Once done, and assuming that the targets for dilution/accretion fall as expected, we would expect a rapid recovery in the stock as the market appreciates what would likely be a sounder long-term operating structure (the last hole filled) and an improved long-term growth rate.

Details

Strategic Rational

As we indicated in our previous piece, *WorldCom and the Wireless Question* – issued April 30, 1999, we believe that WorldCom would benefit long-term from having a facilities-based wireless solution that could support voice and high-speed data services in a bundled offer. And while that piece focused on the strategic implications of a Nextel merger, we believe that a WorldCom-Sprint merger could work as well and would, in fact, result in a more powerful combination. WorldCom would be getting Sprint's substantial wireline business – required, if the company is going to do a pooling (probably the only way that the deal could get done, given the potential dilution otherwise) and a ready source of positive earnings and synergies for the combined company – in addition to Sprint PCS which we believe has lower network/technology risk than Nextel. This is primarily because Sprint's network is based on the industry standard CDMA technology which enjoys widespread vendor support (for handsets and network equipment) and has a better evolution path towards the higher speed (e.g., greater that 28.8 kbps) and third generation (3G) data services that we think will

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be important to business customers and in corporate RFPs over time. Moreover, Sprint PCS has close to 30 MHz of spectrum, on average, across the country – and therefore, much less capacity risk going forward -- and a great distribution network (via Radio Shack and other retailers) already established. So, we think that WorldCom would be able to deploy advanced bundled services off the Sprint platform with much lower network/technology risk and less management overhead than with Nextel. That said, regulatory and cultural issues could hamper the deal. Specifically, WorldCom would be buying Sprint's wireline business, and this would increase concentration in the wireline LD market. However, we maintain that this is already a very competitive business -- and about to get more so with RBOC entry starting later this year -- and that the FCC and the Department of Justice (and consumers) would be better served by WorldCom becoming more competitive with AT&T in the broader market for bundled services. Beyond that, cultural issues could be a problem, with the aggressive WorldCom buying the more staid and conservative Sprint, but we believe that the companies could get past this. WorldCom, after all, is a master at acquiring and then integrating new businesses.

Financial Issues

Assuming a pooling (as indicated above) and a mid-2000 closing date (reasonable, given the complexity and regulatory challenges of the deal), we believe that a Sprint acquisition would dilute WorldCom's 2000E earnings by 15%, or about $0.45, based on a 20% premium to yesterday's closing price (Exhibits 1 and 2). After backing out the losses from Sprint's CLEC and Global One businesses (assumed to be discontinued operations after the deal), dilution would be about 14%, or $0.40. And after operating synergies – including cuts in overhead and reduction of Sprint's wireline network and sales/distribution expense from leveraging WorldCom's core operations ($0.14/share) and the D&A and interest rate synergies related to the lowering of the combined company's total CAPEX budget ($0.02) – dilution could be 8-9%, or about $0.25 a share. This is below the 10% dilution target set by the company and represents much less of a stretch than with Nextel's "reach" NOLs. Beyond 2000, we believe that earnings dilution could decline to 4% by 2001E and be about 1% accretive by 2003E. At the same time, WorldCom's long-term (2001E-03E) revenue growth -- prior to any expected revenue synergies, which we haven't counted – would be reduced by about a point, to 10%, but the company's EBITDA growth rate would increase by about a point, to 12%. Incremental revenue synergies (e.g., from bundling) could add even more to the deal.

Exhibit 1

Inc. Shares & Exchange Ratio	FON	PCS	Total
Stock Price	104.4	45.0	
Expected Premium	20%	20%	
Acquisition Price	125.3	54.0	
Fully Diluted Shares	432	504	
Acquisition Value	54,103	27,213	81,316
Less: Cash on conv. of opts		732	732
Purchase Price	54,103	26,481	80,584
WCOM Share Price	84.1	84.1	84.1
WCOM Shares Required	644	315	959
Exchange Ratio (WCOM/Sprint shrs)	1.491	0.625	

-- more --

Exhibit 2

Combined Shares	2000E	2001E	2002E	2003E
WCOM Shares	1,963	1,983	2,003	2,023
Extra WCOM Shares	959	959	959	959
PF WCOM Shares	2,922	2,941	2,961	2,981
Combined Net Income and EPS	**Only 6 mo. Of Sprint**			
Worldcom NI, standalone	5,528	7,169	8,860	10,232
memo: WCOM EPS, standalone	2.82	3.62	4.42	5.06
FON Net Income, standalone	939	2,204	2,550	2,815
PCS Net Income, standalone	(846)	(905)	(281)	57
Combined NI, before disccontinued operations and synergies	5,621	8,469	11,129	13,105
memo: EPS, before disc. ops and synergies	2.39	2.88	3.76	4.40
memo: Dilution re: Bernstein	-15%	-20%	-15%	-13%
Less: CLEC	(122)	(122)	0	122
Less: Global One	(13)	(5)	8	9
Combined NI, before synergies	5,756	8,595	11,121	12,974
memo: EPS, before synergies	2.43	2.92	3.76	4.35
memo: Dilution re: Bernstein	-14%	-19%	-15%	-14%
Synergies, after-tax				
Cash Op Syn w/FON LD, after-tax	196	682	822	1,006
memo: % to FON LD Cash Exp	8%	13%	15%	18%
Cash Op Syn, overheads, after-tax	154	448	593	747
memo: % to Sprint Corp Cash Exp including FON and PCS	3%	4%	5%	6%
Total Cash Op Synergies, after-tax	350	1,130	1,416	1,753
memo: % to Sprint Cash Exp	7%	10%	12%	14%
D&A Synergies, after-tax	9	42	90	140
memo: % to Sprint D&A	1%	2%	4%	6%
Interest Exp Synergies, after-tax	41	93	152	209
Combined NI, after synergies	6,156	9,861	12,779	15,076
memo: EPS, after synergies	2.57	3.35	4.32	5.06
memo: Dilution re: Bernstein	-9%	-7%	-2%	0%
memo: est. dilution in NXTL merger	-9%	-7%	0%	0%

Valuation

We used our standard discounted free cash flow construct to value Sprint PCS's 2000E equity value at about $22.8 billion or $45 per share (Exhibit 3). Essentially, we forecast the pre-tax, unlevered free cash flows available to the firm through 2007, applied a 15x FCF (11x EBITDA) multiple to account for long-term growth and discounted back to the end of 1999, using a 12.5% discount rate to give us total enterprise value. We then backed out net debt, including option conversions, and

divided by fully diluted shares to reach our estimate of fair value. Applying a 20% premium in a takeout situation would value PCS at $27 billion, or $54 per share, somewhat above our 2001E estimate of fair value.

A proforma income statement for the combined company is attached in Exhibit 4

-- more --

Exhibit 3

Sprint PCS FCF Valuation							
Discount Rate, pre-tax	12.5%						
Terminal Growth Rate	6.0%						
Terminal Multiple (x 2007 FCF)	15						
memo: Terminal Multiple (x 2007 EBITDA)	11			Estimates			
		1999	2000	2001	2002	2003	2007
Operating Profits ($, mil.)		(3,102)	(1,802)	(435)	591	1,119	2,752
-Taxes		(1,939)	(1,126)	(272)	369	699	1,720
memo: effective tax rate		37.5%	37.5%	37.5%	37.5%	37.5%	37.5%
=Operating Profits, after tax		(1,163)	(676)	(163)	222	420	1,032
+Depreciation		1,435	1,607	1,713	1,730	1,869	2,360
-CAPEX		3,031	1,427	1,229	1,190	1,156	1,073
=Free Cash Flow (FCF)		(2,759)	(496)	320	762	1,133	2,319
FCF, pre-tax, unlevered		(4,414)	(794)	512	1,219	1,813	3,711
Terminal Multiple		-	-	-	-	-	57,091
Total Cash Flow		(4,414)	(794)	512	1,219	1,813	60,802
NPV ($, mil.)		29,580	34,072	37,818	41,327	44,680	
- Net Debt from balance sheet		10,422	12,049	12,865	13,164	12,944	6,329
+ Cash from options & warrents		732	732	732	732	732	
= Equity Value		19,890	22,754	25,685	28,895	32,468	
Equity Value per Share		39	45	51	57	64	
Fully Diluted Shares		504	504	504	504	504	

Exhibit 4

WorldCom/Sprint Combined Proforma Inc Statement ($, mil.)	1999E	Only 6 mo. of Sprint 2000E	2001E	2002E	2003E	CAGR 01E-03E	memo: CAGR 99E-03E
WorldCom		38,909	44,072	49,217	54,276	11.0%	
Sprint, ex CLEC		8,872	18,628	19,339	19,778	3.0%	
Sprint PCS		2,303	6,672	8,168	9,306	18.1%	
Revenue		50,084	69,373	76,723	83,360	9.6%	
WorldCom		14,140	16,566	18,758	20,285	10.7%	
Sprint, ex CLEC		2,909	6,172	6,565	6,809	5.0%	
Sprint PCS		(97)	1,278	2,322	2,988		
EBITDA		16,952	24,016	27,644	30,083	11.9%	
WorldCom		10,113	12,252	14,123	15,182	11.3%	
Sprint, ex CLEC		1,825	3,855	4,092	4,179	4.1%	
Sprint PCS		(901)	(435)	591	1,119		
Op Profit		11,037	15,672	18,806	20,480	14.3%	
WorldCom	3,817	5,528	7,169	8,860	10,232	19.5%	
Sprint, ex CLEC, GlobalOne		1,074	2,331	2,542	2,685	7.3%	
Sprint PCS		(846)	(905)	(281)	57		
Net Income, pre-synergies	3,817	5,756	8,595	11,121	12,974	22.9%	35.8%
After-tax synergies		449	1,483	1,886	2,214		
Net Income, post-synergies	3,817	6,205	10,078	13,007	15,188		
EPS ($)	1.96	2.61	3.48	4.47	5.18		
memo: Dilution re: Bernstein	0%	-7%	-4%	1%	2%		
Weighted Avg. Shares (mil)	1,944	2,381	2,892	2,912	2,932		

BERNSTEIN RESEARCH CALL

Telecommunications Services

FAX Problems Only: 212-756-4263

WCOM-FON? Still Strikes Us as Powerful Combination

Tod Jacobs 212-756-4607 & Carl Walker 212-756-4379 & Jeff Halpern 212-407-5958

September 27, 1999

			EPS**			P/E		Rel P/E		FV/EBITDA*		99 REL	
STOCK	RATIN	PRICE	1998	1999E	2000E	1999E	2000E	1999E	2000E	1999E	2000E	STK PF	YLD
FON	O	$54.0	$1.72	$1.73	$2.01	31.2	26.9	120%	110%	10.5	9.4	24%	0.9%
WCOM	O	$76.1	$0.63	$1.96	$2.85	38.8	26.7	149%	110%	14.3	11.8	2%	0.0%
S&P500		$1,277.4	$44.00	$49.00	$52.50	26.1	24.3						1.3%

** ADJUSTED FOR HIDDEN ASSETS; ENTERPRISE VALUE = MARKET CAP + NET ** EXCLUDES 1-TIME ITEMS, CONTINUING*
***AT&T 2000 pro forma for UMG; WCOM 1999PF for MCI

O – Outperform, M – Marketperform, U – Underperform

Highlights

1. Continue to believe that WCOM-FON combination is the right one to solve WorldCom's wireless question; would also be a boon to Sprint relative to its need for cohesive strategies in both international and domestic local
2. Assuming purchase accounting, creation of a tracker for PCS assets could hold dilution to less than 10% year1, and under 5% year3; conservative revenue synergy assumptions could make breakeven year3
3. Assuming pooling (and the tracker) which we think would be possible, deal immediately accretive by 1-2%, moving up to about 3% year2
4. Deal could probably withstand regulatory scrutiny other than in internet space; forced divestiture of Sprint Internet wouldn't poison pooling, but could create taxable event and thus modestly higher price to WCOM

Investment Conclusion: We continue to rate WCOM and FON outperform

Details

A. Overview

In May of this year, as the market expectations were growing in relation to a WCOM-NXTL deal to solve the WorldCom wireless "problem," we issued a piece suggesting that the more sensible merger was with Sprint, in part because the addition of the wireline part of Sprint would also bring substantial synergy and access to a large customer base in both business and consumer markets, and in part because the PCS wireless assets have an easier migration path into the future (3G, capacity; see below) than do the Nextel assets. Current talk of a merger, though unconfirmed, nonetheless still strikes us as reasonable and possible. In the piece we wrote, which we've appended here for those interested in pursuing the wireless angle in more detail, we made several assumptions that need to be updated. First off, the numbers have changed: FON has had a stock split, and PCS stock has risen substantially from its then-$45 level. Second, we modeled a consolidated entity; talk today was for a tracker on the PCS business, which would radically reduce dilution. Third, we modeled a pooling, and talk in the recent articles was of a purchase, though for reasons we don't understand (though the company may wish to preserve the right to sell off Sprint's ILEC business). While we believe the chief regulatory risk of such a combination is the overlap in internet assets, any Government-forced divestiture, even if it triggered a taxable event for FON shareholders (which it presumably would; thus potentially raising the price to WCOM by the amount of the tax liability), wouldn't poison a pooling according to what we know. On the other hand, if WCOM had in mind to divest FON's ILEC assets (the tradeoff being a steady, if slightly less than sexy (not only based in Kansas City, but an *ILEC* too!), cash generator for a more consistently growth-honed (Jackson-based) company.

B. Logic

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In our view there are four chief benefits to the concept of a WCOM-FON combination:

1. **WCOM's wireless problem gets solved** with a first-resort solution. Unlike Nextel, for example, PCS enjoys a single frequency, single technology, capacity unconstrained, multi-vendor-supported wireless technology which also comes complete with a path to 3G. The consumer friendliness of the PCS product also allows for greater customer-base penetration. The issue with business customers for WCOM comes down the road, in our opinion, when business customers begin to demand integrated wireless products from their vendors (e.g., for wireless remote access, etc). And while wireless would not have been a prudent investment for WCOM to make to support its consumer business alone, there's no question that having it would greatly strengthen the company's rather anemic consumer bundle (vis-à-vis T and RBOCs), as well as offer the company a vehicle to recapture consumer LD minutes that are migrating to wireless. Moreover, the addition of wireless would end a persistant overhang on WorldCom: namely, how long can you go without wireless? At once, that negative would become a positive in the sense that the company would now be exposed to every growth segment in telecom. As exhibit 1 shows, by 2003E, voice revenue would drop from 44% of the total corporate revenue mix on a stand-alone basis to about 38% pro forma, with wireless making up 12% of the total.

Exhibit 1

WCOM 2003E Revenue Mix		
	Standalone	Combined
Voice	44%	38%
Data/Internet	43%	33%
Wireless		12%
International	12%	8%
I-LEC/Other (FON only)		9%
Total (ex elim)	100%	100%

2. **FON's international problem gets solved**. That is, the company could extract itself from Global One in favor of WCOM's existing and cohesive strategy. The fate of G1 would be very much up in the air. According to our understanding of the G1 agreement, upon a change of control in Sprint, board and voting control would move to FT/DT. Sprint then has the right to offer its shares to FT/DT at a price to be determined by a third party appraiser. If FT/DT refuse the price the voting control is restored to prior levels (prior to further fighting). For WCOM, FON's extraction simply becomes a source of synergy, if not a source of cash from a sale.

3. **FON's local connectivity problem gets solved**, and WCOM/FON get scale in MMDS. FON is currently subjecting itself and its shareholders to $0.30 a year dilution from ION and an additional $0.18 from MMDS – all in an attempt to build what in essence is a CLEC for both consumer and business customers. Joining with WCOM would shorten the timetable dramatically for FON given WCOM's large CLEC presence, thus helping to reduce customer churn through bundling of more services. And both companies have recently embraced MMDS as a local hi-speed access strategy; thus scale would come faster and for lower combined R&D and deployment costs.

4. **The combination would allow for significant cost and capital savings,** much as the MCI merger did and does, as we discuss below.

C. Synergies and Earnings Impact

We essentially modeled four scenarios to assess potential dilution and earnings impact from a Worldcom-Sprint deal: a purchase transaction with PCS spun out as a tracking stock (our base case scenario), a pooling transaction with PCS spun out as a tracker, a purchase transaction without a tracker, and a pooling without a tracker (our original, May 4th scenario). These are discussed below.

Exhibit 2 lays out our base case scenario, a Worldcom purchase of Sprint (FON and PCS) with PCS spun off as a tracking stock, and highlights the incremental goodwill and shares required.

Exhibit 2

Deal Structure for Purchase Transaction with Wireless Tracking Stock	FON	PCS	Combined Purchase
Stock Price	51.1	74.5	
Expected Premium	20%	20%	
Acquisition Price	61.4	89.4	
Fully Diluted Shares	888	528	
Acquisition Value	54,465	47,225	101,690
Less: Cash on conv. of opts		732	732
Purchase Price	54,465	46,493	100,958
Book Value of Equity	11,507	367	11,874
Goodwill	42,958	46,126	89,084
Amort. Period	40	40	40
Incremental Amort. Per year	1,074	1,153	2,227
Purchase Price, net of tracking stock consideration	54,465	7,871	62,336
WCOM Share Price	76.1	76.1	76.1
WCOM Shares Required	715	103	819
Exchange Ratio (WCOM/Sprint shrs)	0.806	0.196	

Assuming a 20% premium to the September 23rd closing price for both FON and PCS, current owners of FON would get 0.806 shares of WCOM for each FON share and current owners of PCS would get one share of the new wireless tracker and 0.196 shares of WCOM. In total, WCOM would have to issue 819mm new shares -- 715mm to FON shareholders and 103mm to PCS shareholders (= value of premium to closing PCS stock price; PCS shareholders would also get the new wireless tracking stock). The transaction would create $43b of incremental goodwill in the wireline stock and $46b of incremental goodwill in the wireless tracker, and we've assumed a 40-year amortization. Based on a year-end 2000 close, we believe that first year dilution in the wireline stock (WCOM plus FON wireline operations) could be less than 10% after expense and capital synergies (Exhibit 3).

Exhibit 3

WCOM-Sprint: Summary Dilution Purchase Accounting			
EPS	2001E	2002E	2003E
WCOM, standalone	3.59	4.39	5.04
Combined, pre-synergy	2.99	3.71	4.27
memo: % dilution re: Bernstein	*-17%*	*-16%*	*-15%*
+ expense & capital synergies	0.27	0.43	0.54
= New EPS, pre-revenue synergies	3.25	4.14	4.80
memo: % dilution re: Bernstein	*-9.4%*	*-5.7%*	*-4.6%*
Revenue synergies req. to BE in '03 (assuming avg. WCOM operating margin)			3,852
memo: % to total LD/data revenue			*5.7%*

Base case synergies include a 5-15% reduction in FON LD cash expense to reflect combined operations with WCOM, a 3-5% reduction in overheads at FON and lower D&A and interest expense to reflect lower capital expenditures on the LD and data networks and IT and in Sprint's C-LEC operations. More specifically, we are

assuming that the combined company would keep ION (especially given its MMDS bias), but could nonetheless reasonably cut the ION CAPEX in half by reducing the co-location and facilities costs by leveraging WCOM's broadly deployed local C-LEC assets, while continuing development costs and incremental (success-based) network capital and associated software. All told, we believe that these synergies could be worth nearly $0.30 per share in 2001, rising to $0.43 in 2002, and reaching nearly $0.54 in 2003.

Out year (2003) dilution for the purchase transaction (assuming the PCS tracker) would be less than 5% after synergies. Moreover, WCOM could make the deal neutral to EPS by 2003, if it could capture 5-6% incremental revenue from bundled services and other offers (we think this could be attainable, give the combined company's marketing might). If the purchase premium were 30% on both FON and PCS, first year dilution would be 14% and third year dilution would be 9%, with 11% incremental revenue required for break-even in 2003.

Divestiture of Sprint's internet assets could add modestly to this dilution, given the high growth rate of revenue and what we think would be an increasing profit impact on the business, though to be sure this would be at least partially offset by returns driven on the the cash received on sale of the assets.

Exhibit 4

WCOM-Sprint: Summary Dilution Pooling Accounting			
EPS	2001E	2002E	2003E
WCOM, standalone	3.59	4.39	5.04
Combined, pre-synergy	3.37	4.09	4.65
memo: % dilution re: Bernstein	*-6%*	*-7%*	*-8%*
+ expense & capital synergies	0.27	0.43	0.54
= New EPS, pre-revenue synergies	3.64	4.52	5.18
memo: % dilution re: Bernstein	*1.2%*	*3.0%*	*2.9%*

Exhibit 4 shows WCOM dilution for the deal under pooling accounting (still assuming a PCS tracker). This would limit the firm's flexibility for further asset sales (e.g., the FON ILEC business) but could cut out year dilution (pre-synergy) in half, to 7-8%, and make the deal accretive from year one post synergy, without assuming any revenue synergies. And, as Exhibit 5 shows, on a cash EPS basis (= EPS + D&A), the deal looks even better (Exhibit 5), with out year dilution 1% before synergies and accretion 6-7%, after.

Exhibit 5

WCOM-Sprint: Summary Dilution Cash EPS			
EPS	2001E	2002E	2003E
WCOM, standalone	5.77	6.72	7.58
Combined, pre-synergy	5.82	6.75	7.54
memo: % dilution re: Bernstein	*1%*	*1%*	*-1%*
+ expense & capital synergies	0.27	0.43	0.54
= New EPS, pre-revenue synergies	6.08	7.19	8.07
memo: % dilution re: Bernstein	*5.5%*	*7.0%*	*6.5%*

A straight purchase transaction, without a tracker, is a non-starter with first year dilution of more than 40% and out year dilution of over 20%, while a straight pooling transaction without a tracker (our May 4th scenario) is somewhat better (see Exhibit 6): 21% dilutive in year one and 9% dilutive in year three, but still about 10 points higher than we forecast in May on the higher assumed PCS purchase price.

Exhibit 6

WCOM-Sprint: Summary Dilution Pooling Accounting No Tracker			
EPS	2001E	2002E	2003E
WCOM, standalone	3.59	4.39	5.04
Combined, pre-synergy	2.60	3.45	4.08
memo: % dilution re: Bernstein	*-27%*	*-21%*	*-18%*
+ expense & capital synergies	0.23	0.38	0.49
= New EPS, pre-revenue synergies	2.83	3.83	4.57
memo: % dilution re: Bernstein	*-21.1%*	*-12.7%*	*-9.3%*

D. Risks

There are several risks to the deal, the most obvious being regulatory. On that front, we've talked to several attorneys over the past several months; most hold the opinion that the deal could pass muster, largely in light of exploding LD capacity (here the pricing problems of recent months would be helpful), imminent RBOC entry and general consolidation trends globally. The stickiest point revolves around internet, where MCI was forced to divest prior to the WCOM merger; that would likely happen here as well (though some attorneys believe that the entry of T and QWST and soon BEL into the internet space may make it possible to retain the assets). Sale of the business would likely be a taxable event, and thus would generate a tax liability that WCOM would have to cover. In our May piece we also noted culture as a risk; though we expect that WCOMs desire to own PCS could outweigh its desire to only buy high-fliers. And of course, as with all deals, this would bring execution risk, though we expect that the MCI experience has well prepared WCOM to digest a company this size with this much overlap.

Following is an appended copy of our May 1999 note of a possible WCOM-FON combination:

WorldCom and the Wireless Question II: A Sprint Combination Could Work; Lower Technology and Network Risk; Tougher Regulatory & Cultural Go

Tod Jacobs 212-756-4607 & Carl Walker 212-756-4379 & Jeff Halpern 212-407-5958 May 4, 1999

			EPS**			P/E		Rel P/E		FV/EBITDA*		99 REL	
STOCK	RATIN	PRICE	1998	1999E	2000E	1999E	2000E	1999E	2000E	1999E	2000E	STK PF	YLD
FON	O	$104.4	$3.43	$3.80	$4.25	27.5	24.6	97%	92%	9.9	9.1	14%	0.5%
WCOM	O	$84.1	$0.63	$1.96	$2.82	42.9	29.8	152%	112%	15.6	12.6	8%	0.0%
PCS	M	$45.0	($4.40)	($5.10)	($3.60)	nm	nm	nm	nm	nm	nm	128%	0.0%
S&P500		$1,354.6	$44.00	$48.00	$50.75	28.2	26.7						1.2%

** ADJUSTED FOR HIDDEN ASSETS; ENTERPRISE VALUE = MARKET CAP + NET ** EXCLUDES 1-TIME ITEMS, CONTINUING*
***AT&T 1999 pro forma for TCI and includes $0.34 goodwill addback; WCOM 1999PF for MCI

O – Outperform, M – Marketperform, U – Underperform

Highlights

1. A WorldCom-Sprint (including both FON and PCS to avoid prohibitive tax and GAAP earnings consequences) combination could provide viable alternative to a WCOM-NXTL merger and would likely meet company's expressed dilution guidelines of less than 10% dilutive in year one; neutral by year three
2. Combination would create lower network and technology risk; however much tougher sell regulatorily (we think it would fly after a fight) and culturally
3. Timing is everything: most ugly dilution would be avoided by effecting 2H-2000 close – beyond peak PCS dilution period; cost savings trace primarily to long distance side, CLEC, Global One and general overhead
4. Continue to believe company not compelled to act relative to business trends for next couple of years; nor is Nextel – which may be a viable choice – the *only* choice

Investment Conclusion: We continue to rate MCI WorldCom outperform. Better levered than any large-cap telecom company to the growth areas of data, internet, international and competitive local, WCOM should outgrow both its major competitors and the market by a substantial and sustainable measure. However, now that wireless lightening has struck at least twice (first Airtouch, upon which cold water was thrown after 4 days of speculation, and now Nextel, where the hot water continues to flow), we expect that the stock may hold in its current volatile trading range until the company puts up or shuts down the speculation. Once done, and assuming that the targets for dilution/accretion fall as expected, we would expect a rapid recovery in the stock as the market appreciates what would likely be a sounder long-term operating structure (the last hole filled) and an improved long-term growth rate. Sprint retains an outperform rating for the strategic value of its wireless and wireline assets to a host of others and for its continued double digit earnings growth and reasonable valation. PCS is rated market perform on valuation.

Details

Strategic Rationale

As we indicated in a piece last week titled, *WorldCom and the Wireless Question* (April 30, 1999), we believe that MCI WorldCom would benefit long-term from having a facilities-based wireless solution that could support voice and high-speed data services in a bundled offer. And while that piece

focused on the strategic implications of a Nextel merger, we believe that a WorldCom-Sprint merger could provide a perfectly viable combination. Key to the merger would be the acquisition of both parts of Sprint: wireline (FON) and wireless (PCS). That's the only way to avoid prohibitive tax consequences (relative to PCS; they don't go away prior to November 2000 in a stand-alone purchase) and prohibitive GAAP earnings consequences (ie the only way to effect a pooling and avoid goodwill). It's also the only way to mask the otherwise substantial PCS dilution through application of cost synergies derived from a combination with the wireline company.

Beyond financial impact, we believe that Sprint PCS carries lower network and technology risk than Nextel. This is primarily because Sprint's network is based on the industry standard CDMA technology which already enjoys widespread vendor support (for handsets and network equipment) and which sports a more elegant evolution path towards the higher speed (e.g., greater that 28.8 kbps) and third generation (3G) data services that we expect to grow in importance to business customers over time. Moreover, Sprint PCS has close to 30 MHz of spectrum, on average, across the country – and therefore, much less capacity risk going forward -- and a great and largely established distribution network (via Radio Shack and other retailers) to boot. MCI WorldCom could thus deploy advanced bundled services off the Sprint platform with much lower network/technology risk and less management overhead than with Nextel.

That said, regulatory and cultural issues could hamper the deal. Specifically, the long distance marketshare concentration engendered in a combined WCOM-FON company would likely draw fire from competitors and regulators alike. However, having spoken with several regulatory experts, we believe that the following facts would combine to push the merger through:

- pending RBOC LD entry (especially given unanimous analyst estimates of a fast march into the consumer LD market (we think 25% by 2003) and a robust entry into the business LD market (estimated 8% by 2003 – effectively 15% of the small-medium business market and about 0% of multinational, which will require the assistance of full-service networks, which they don't have and can't build that quickly from scratch)
- growing CLEC (new entrant) market share
- exploding long-haul bandwidth (domestic and intercontinental), and
- relative ease of market entry by other would-be competitors
- consumer competition would actually increase as MCI WorldCom – which on a standalone basis has little incentive to invest in the consumer space (see our March research report for in-depth treatment) – would have a higher stake in consumer, with a foothold in LD and wireless. The company would thus be far more likely to enter the local market to complete the bundle.

The second issue is culture: MCI WorldCom seems to find an affinity with high-flyers and upstarts, like Craig McCaw, the MFS guys, the UUNet guys, the Brooks Fiber guys. Not that they're squares or anything like that out in Kansas City; but the Sprint Local Division (not to mention product distribution and directory publishing segment) might not walk the WCOM walk (though there's very little strong and consistent cash flow can't cure with time). And while it's somewhat difficult to imagine Art Krause and Scott Sullivan or Bernie and Bill doing a lot of joint meetings on the roadshow, we expect that in a take-out the most senior brass at Sprint could be persuaded to spend more time with their families. At the end of the day, WCOM has a way of incenting and keeping the folks they need and allowing for graceful departures for the typically cashed-out folks they don't.

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Financial Issues

Assuming a pooling (as indicated above) and a mid-2000 closing date (reasonable, given the complexity and regulatory challenges of the deal, and important given the higher dilution inherent in PCS' losses that would be caused by an earlier close), we believe that a Sprint acquisition would dilute WorldCom's 2000E earnings by 15%, or about $0.45, based on a 20% premium to yesterday's closing price (Exhibits 1 and 2). Backing out the losses from Sprint's CLEC and Global One businesses (assumed to be discontinued operations after the deal; even if WCOM wants to keep the development of ION going, it doesn't need the hard assets; and WCOM's international division obviates the need for G1), shaves about another point off dilution. And operating synergies – including cuts in overhead and reduction of Sprint's wireline network and sales/distribution expense from leveraging WorldCom's core operations ($0.14/share) and the D&A and interest rate synergies related to the lowering of the combined company's total CAPEX budget ($0.02) – dilution could drop to about 9%, or about $0.25 a share. This falls within the "single digit" dilution target oft repeated by the company and represents much less of a stretch than with Nextel's "reach" NOLs that we described in our piece last week. Beyond 2000, we believe that earnings dilution could decline to 7% by 2001E and to about 2% by 2002E. At the same time, WorldCom's 2000E-2003E revenue growth would drop on the inclusion of the slower growing FON revenue (which includes far slower growing local, product distribution and directory publishing revenue and which excludes, according to our expectation, the CLEC) – prior to any expected revenue synergies, which we haven't counted (Exhibit 3). However, the company's EBITDA growth rate would increase by about a point, to 12%, and operating profit growth would increase by 300bp. The promise of bundling would add the juice to the dilution and growth rate numbers.

Exhibit 1

Inc. Shares & Exchange Ratio	FON	PCS	Total
Stock Price	104.4	45.0	
Expected Premium	20%	20%	
Acquisition Price	125.3	54.0	
Fully Diluted Shares	432	504	
Acquisition Value	54,103	27,213	81,316
Less: Cash on conv. of opts		732	732
Purchase Price	54,103	26,481	80,584
WCOM Share Price	84.1	84.1	84.1
WCOM Shares Required	644	315	959
Exchange Ratio (WCOM/Sprint shrs)	1.491	0.625	

==more==

Exhibit 2

Combined Shares	2000E	2001E	2002E	2003E
WCOM Shares	1,963	1,983	2,003	2,023
Extra WCOM Shares	959	959	959	959
PF WCOM Shares	2,922	2,941	2,961	2,981
Combined Net Income and EPS	**Only 6 mo. Of Sprint**			
Worldcom NI, standalone	5,528	7,169	8,860	10,232
memo: WCOM EPS, standalone	2.82	3.62	4.42	5.06
FON Net Income, standalone	939	2,204	2,550	2,815
PCS Net Income, standalone	(846)	(905)	(281)	57
Combined NI, before disccontinued operations and synergies	5,621	8,469	11,129	13,105
memo: EPS, before disc. ops and synergies	2.39	2.88	3.76	4.40
memo: Dilution re: Bernstein	-15%	-20%	-15%	-13%
Less: CLEC	(122)	(122)	0	122
Less: Global One	(13)	(5)	8	9
Combined NI, before synergies	5,756	8,595	11,121	12,974
memo: EPS, before synergies	2.43	2.92	3.76	4.35
memo: Dilution re: Bernstein	-14%	-19%	-15%	-14%
Synergies, after-tax				
Cash Op Syn w/FON LD, after-tax	196	682	822	1,006
memo: % to FON LD Cash Exp	8%	13%	15%	18%
Cash Op Syn, overheads, after-tax	154	448	593	747
memo: % to Sprint Corp Cash Exp including FON and PCS	3%	4%	5%	6%
Total Cash Op Synergies, after-tax	350	1,130	1,416	1,753
memo: % to Sprint Cash Exp	7%	10%	12%	14%
D&A Synergies, after-tax	9	42	90	140
memo: % to Sprint D&A	1%	2%	4%	6%
Interest Exp Synergies, after-tax	41	93	152	209
Combined NI, after synergies	6,156	9,861	12,779	15,076
memo: EPS, after synergies	2.57	3.35	4.32	5.06
memo: Dilution re: Bernstein	-9%	-7%	-2%	0%
memo: est. dilution in NXTL merger	-9%	-7%	0%	0%

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Exhibit 3

WorldCom/Sprint Combined Proforma Inc Statement ($, mil.)	1999E	Only 6 mo. of Sprint 2000E	2001E	2002E	2003E	CAGR 01E-03E	memo: CAGR 99E-03E
WorldCom		38,909	44,072	49,217	54,276	11.0%	
Sprint, ex CLEC		8,872	18,628	19,339	19,778	3.0%	
Sprint PCS		2,303	6,672	8,168	9,306	18.1%	
Revenue		50,084	69,373	76,723	83,360	9.6%	
WorldCom		14,140	16,566	18,758	20,285	10.7%	
Sprint, ex CLEC		2,909	6,172	6,565	6,809	5.0%	
Sprint PCS		(97)	1,278	2,322	2,988		
EBITDA		16,952	24,016	27,644	30,083	11.9%	
WorldCom		10,113	12,252	14,123	15,182	11.3%	
Sprint, ex CLEC		1,825	3,855	4,092	4,179	4.1%	
Sprint PCS		(901)	(435)	591	1,119		
Op Profit		11,037	15,672	18,806	20,480	14.3%	
WorldCom	3,817	5,528	7,169	8,860	10,232	19.5%	
Sprint, ex CLEC, GlobalOne		1,074	2,331	2,542	2,685	7.3%	
Sprint PCS		(846)	(905)	(281)	57		
Net Income, pre-synergies	3,817	5,756	8,595	11,121	12,974	22.9%	35.8%
After-tax synergies		400	1,265	1,658	2,102		
Net Income, post-synergies	3,817	6,165	9,861	12,779	15,076		
EPS ($)	1.96	2.57	3.35	4.32	5.06		
memo: Dilution re: Bernstein	0%	-9%	-7%	-2%	0%		
Weighted Avg. Shares (mil)	1,944	2,381	2,892	2,912	2,932		

BERNSTEIN RESEARCH CALL

Telecommunications Services

FAX Problems Only: 212-756-4263

WCOM-FON: Expensive but Worth It; Both Rated Outperform

Tod Jacobs 212-756-4607 & Carl Walker 212-756-4379 & Jeff Halpern 212-407-5958

October 5th, 1999

			EPS**			P/E		Rel P/E		FV/EBITDA*		99 REL	
STOCK	RATIN	PRICE	1998	1999E	2000E	1999E	2000E	1999E	2000E	1999E	2000E	STK PF	YLD
FON	O	$58.9	$1.72	$1.73	$2.01	34.0	29.3	128%	118%	11.3	10.7	34%	0.8%
WCOM	O	$67.9	$0.63	$1.96	$2.85	34.7	23.8	131%	96%	12.9	10.4	-11%	0.0%
PCS	M	$74.0	($4.42)	($5.10)	($3.60)	nm	nm	nm	nm	nm	nm	234%	0.0%
S&P500		$1,301.5	$44.00	$49.00	$52.50	26.6	24.8						1.3%

** ADJUSTED FOR HIDDEN ASSETS; ENTERPRISE VALUE = MARKET CAP + NET ** EXCLUDES 1-TIME ITEMS, CONTINUING*

***AT&T 2000 pro forma for UMG; WCOM 1999PF for MCI

O – Outperform, M – Marketperform, U – Underperform

HIGHLIGHTS:

1. WCOM-FON deal expensive but worth doing; company would have premium assets in all growth areas of telecom; all the complaints over assets, scale and capabilities for both sides are ended
2. At current share price, cash EPS dilution believed to fall around 8%; number gets cut to 3% if WCOM nears $81 (upper collar) and nears 11% at lower end of collar ($62)
3. Primary changes relative to our published expectations: higher synergies (credible) and shorter amortization schedule for goodwill (doubles the amortization and increases GAAP dilution)
4. Goodwill choice a smart one: investors will be forced to look at cash EPS (EPS+GW) as only viable way to measure company's value and earnings power
5. Regulatory will provide an overhang on the consumer-benefits issue; but we expect the combined company's consumer-small-business broadband strategy (MMDS and DSL) to provide the appropriate cover

INVESTMENT CONCLUSION: While WCOM has clearly paid top dollar for Sprint, we believe that the deal's strategic sense is powerful, and represents – as we've believed all along – by far the most propitious solution to the wireless issue. Even if the deal closes with WCOM at its current level (and thus dilution runs 8% on cash earnings) the stock would be trading at about 17x 2001 estimates despite strong double digit earnings growth and the most powerful set of global assets in telecom – a situation we find untenable and very likely to unwind in WCOM's favor. The times that investors have made significant money with WorldCom have always come on deal-related (post MFS and MCI announcements; probably here as well) or sentiment/fear-related issues (the great LD scare of '99). We continue to rate both WCOM and FON (which will likely prove a cheap way to buy WCOM) outperform.

DETAILS

1. Changes from our piece last week:

Primary changes are the price of the deal assumed (though structure is exactly as we'd discussed, with premium paid for both FON and PCS pieces), the size of the synergies (both cost and capital) and the amortization period relating to the goodwill. First on deal structure, Exhibit 1 lays out the basics: a $76 price per share of FON within the collar, which is set at $62.15/WCOM share at the low end and $80.85 at the upper end. The exchange ratio thus floats from a low of 0.94 WCOM shares per FON share to 1.228 at the high end. Goodwill of $56b on the wireline side will be amortized over

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20 years rather than the 40 we'd assumed, and for two reasons: 1) it will play better with the SEC; 2) it will force most investors to disregard GAAP earnings by effectively rendering them meaningless as a gauge of company value and cash generating power.

Exhibit 1

WCOM-FON Basic Deal Financials	Lower Collar	Current	Upper Collar
= Guaranteed Price/FON Share Within Collar ($)	$76	$76	$76
X Total FON Shares (mil)	888	888	888
= Total Deal Equity Value ($ mil)	$67,470	$67,473	$67,472
/ WCOM Share Price	$62.15	$67.94	$80.85
= WCOM Shares/FON Share	1.2228	1.0760	0.9400
WCOM Shares/ PCS Share as Premium	0.1547	0.1547	0.1547
Value to PCS Holder ($)	9.61	10.51	12.51
WCOM Shares Required for FON (mm)	1,086	993	835
+ WCOM Shares Required for PCS	82	82	82
= Total WCOM Shares Required	1,167	1,075	916
memo: as % WCOM 2001E shares	58%	54%	46%
	FON	PCS	Total
Goodwill Created ($mm)	55,999	43,543	99,543
Amortization Period - years	20	20	20
Annual Amtzn ($mm)	2,800	2,177	4,977
per related share ($)	0.91	4.63	

Exhibit 2 lays out the company's expected pro forma earnings on a cash EPS basis. With $1.35 in pro forma goodwill, the new company at current WCOM stock price levels would produce about 8% in cash EPS dilution. At the upper end of the collar ($80.85 share price), dilution on our estimates drops to about 3%, while dilution at the lower end of the collar ($62.15) rises to about 11%. Relative to GAAP EPS, the 20-year amortization schedule creates huge dilution (29% going to 23% by year 3 at current share price levels; 3-4 points better and worse at the collar ends.

Exhibit 2

WCOM-Sprint: Summary Dilution Cash EPS (EPS + GW Amtzn)	2001E	2002E	2003E
WCOM, standalone	4.22	5.02	5.66
y/y growth	22%	19%	13%
New Cash EPS at current WCOM share price	3.88	4.62	5.19
y/y growth	*36%*	*19%*	*13%*
memo: % dilution re: Bernstein	*-8.1%*	*-8.0%*	*-8.2%*
Cash EPS at Upper Collar	4.09	4.86	5.47
y/y growth	*36%*	*19%*	*12%*
memo: % dilution re: Bernstein	*-3.1%*	*-3.1%*	*-3.3%*
Cash EPS at Lower Collar	3.77	4.48	5.04
y/y growth	*36%*	*19%*	*13%*
memo: % dilution re: Bernstein	*-10.8%*	*-10.7%*	*-10.8%*

Exhibit 3 lays out the company's expectations for synergies. Relative to our initial attempts, the company added a $100mm a year cost synergy at ION (lower cost of switching and transport by using WCOM facilities rather than RBOCs), and, in our way of thinking about it, added about 2 points of overhead reduction (as % to total FON cash cost) and about 4 points of LD cash cost reductions in year one, and grew the numbers to a very similar level to our initial forecast for the latter years (2003). The company also has identified larger capex synergies than we'd assumed, coming in at about $1.3b versus (nearly double our attempt), and in turn driving higher depreciation and interest expense savings. On a pro forma basis, synergies thus are expected at about $0.41 in 2001 and $0.57 by 2003 – numbers that we expect analysts will believe credible given the company's successful experience in the MCI transaction in its first year.

Exhibit 3

WCOM-Sprint: Synergies ($mm)	2001E	2002E	2003E
ION Reduction, pre tax	100	100	100
after tax	*60*	*61*	*61*
Long Distance-Related, pre tax	1,090	1,317	1,530
after tax	*654*	*802*	*936*
memo: % to FON LD Cash Exp	*12%*	*14%*	*16%*
Overhead Synergies, pre tax	677	683	696
after tax	*406*	*416*	*426*
memo: % to FON Cash Exp	*5%*	*5%*	*5%*
Total Cash Op Synergies, pre tax	1,866	2,100	2,326
after tax	*1,120*	*1,278*	*1,423*
memo: % to FON Cash Exp	*14%*	*15%*	*17%*
D&A Synergies	96	193	289
after tax	*58*	*117*	*177*
memo: % to Sprint D&A	*3%*	*5%*	*8%*
memo: CAPEX Synergies	*1,300*	*1,300*	*1,300*
memo: % to FON LD/ION CAPEX	*55%*	*52%*	*50%*
Interest Expense Synergies	92	159	225
after tax	*55*	*97*	*138*
Total Synergies, pre tax	2,055	2,451	2,840
after tax	*1,233*	*1,492*	*1,738*
per share	*0.41*	*0.49*	*0.57*

2. Shape of the New Company

Exhibit 4 lays out the 2003E revenue expected revenue mix for various WCOM permutations relative to both the wireline company (WCOM + FON) as well as the consolidated company (including PCS) – both with and without Sprint's internet business, which we expect will have to be sold. The reason consolidated needs to be tracked is that starting in November 2001, WCOM will have the option (as FON does now) to buy out PCS at a 10% premium. On a consolidated basis, voice drops from an expected 44% to either 39% or 38% depending upon inclusion or exclusion of FON internet. On a wireline basis, voice stays virtually the same as WCOM standalone. Thus the deal is clearly neutral to positive to business mix however you count it.

Exhibit 5 traces our forecast for the company's revenue growth rates under the various scenarios. Our current WCOM standalone forecast calls for 12% compound growth from 2000-03. The combined wireline company would see that growth come at about 9.5% given the much slower growth of FON's non long-distance operations, with less than half a point in growth dilution if FON internet is excluded. On a combined basis, with PCS, growth appears to be about 11.5%. And clearly if the company later divests the local business (and directory publishing), the growth rate would accelerate further.

Exhibit 4

WCOM 2003E Revenue Mix			
		WCOM - Combined	
2003E Revenue Mix - Consolidated	WCOM Standalone	FON Combined	ex FON Internet
Voice	44%	38%	39%
Data/Internet	43%	32%	31%
Wireless		12%	13%
International	12%	8%	8%
I-LEC/Other (FON only)		9%	9%
Total (ex elim)	100%	100%	100%
memo: Revenue	53,932	87,342	85,682
2003E Revenue Mix - Wireline Co.			
Voice	44%	44%	45%
Data/Internet	43%	37%	36%
International	12%	9%	9%
I-LEC/Other (FON only)	0%	11%	11%
Total (ex elim)	100%	100%	100%
memo: Revenue	53,932	76,442	74,782

Exhibit 5

WCOM-Sprint Revenue Growth	2000E	2001E	2002E	2003E	cagr
WCOM Standalone	38,524	43,783	48,906	53,932	11.9%
y/y % change		13.7%	11.7%	10.3%	
WCOM-FON Wireline	58,207	64,763	70,709	76,442	9.5%
y/y % change		11.3%	9.2%	8.1%	
ex FON Internet	57,312	63,615	69,303	74,782	9.3%
y/y % change		11.0%	8.9%	7.9%	
Consolidated WCOM-FON	63,098	71,967	79,868	87,342	11.4%
y/y % change		14.1%	11.0%	9.4%	
ex FON Internet	62,203	70,819	78,462	85,682	11.3%
y/y % change		13.9%	10.8%	9.2%	
memo: FON Internet	895	1,148	1,406	1,660	22.9%
y/y % change		28.2%	22.5%	18.1%	

3. Regulatory

The clear issues here are internet concentration and consumer benefit. On the former, we expect the company to divest the Sprint internet business (which we believe would be neutral to accretive to eps given what we believe is that business's currently not-too-profitable picture). On the latter issue, we expect the company to make a big deal about the fact that it will be the third broad-band pipe into the home and small business (T has cable; BOCs have DSL) given the company's combined 55%-of-US-homes footprint in MMDS (which we expect to actually get larger given the simultaneous xDSL-related ION strategy). Ultimately we expect the deal to pass muster, with closing anticipated in about a year (company says 2H'00; Ebbers says 3Q'00).

The CHAIRMAN. Let's have a few questions, and let me ask this to Mr. Esrey and Mr. Ebbers. There are a lot of people concerned about the merger's effect on prices for long-distance. That has been raised here. Should we be concerned about that, or how do you answer those worries?

Mr. EBBERS. Mr. Chairman, as Mr. Jacobs stated, the increased capacity and the new players that are coming on board that will continue to drive down long-distance rates, if you look at them as long-distance rates, will continue. If you look at the difference in pricing between at the time we announced the MCI merger and the pricing today, you see a significant decrease in long-distance rates, and so I would certainly expect that to continue.

But let me add for just a moment something that I think is very fundamental to the telecom industry as a whole going forward in what Mr. Jacobs tried to demonstrate, and that is the concept of long-distance was created at the time of divestiture of AT&T in order to separate two businesses, to agree to have two businesses continue.

In the deregulation of the telecommunications market in Europe, in Canada, and in Mexico, there is not a separation of local and long-distance. In this country, as a result of the Telecommunications Act, where companies like Sprint and MCI are now allowed to compete in local service, where we were not before, the definition of a call that we have commonly called long-distance is evaporating very rapidly.

We do not charge anymore based on distance; our rates are distance-insensitive. And so it is very critical for a company to be able to touch the customer at the access end with local service, and that is the way the industry is headed.

I know it has been important to talk about long-distance rates going forward, but what is going to be the prevailing concern of consumers going forward from this point on is not going to be the separate nature of local versus long-distance. It is going to be how those two are integrated and how the customer buys that as one product.

The CHAIRMAN. I see. Mr. Esrey, do you have any comment?

Mr. ESREY. I would just agree, but then I would go on to add that there are 600 companies today in the United States offering long-distance. There are 28 of these that currently have revenue in excess of $100 million; there are 7 in excess of $1 billion. There is a lot of competition out there. WorldCom itself was a rather small company a few years ago that entered the market as a competitor, as we have these hundreds of companies today all providing competition.

I would like to add when the regional Bells get into long-distance—Mr. Kimmelman said that entering in New York won't help Utah or other States, and that is contrary because the FCC rules require long-distance pricing to be equivalent around the country. So the pricing competition in New York will immediately spread around the country, so you have these giants about to enter long-distance.

I think people can be very comfortable with the fact that the competition and continuing price competition will be in long-dis-

tance, although the real battle ground, as Mr. Ebbers said, will be in the bundled services and getting more efficient too the customer.

The CHAIRMAN. Thank you.

Our ranking member is here and he would like to deliver a set of remarks, and then I have a couple more questions.

Senator LEAHY. Mr. Chairman, I appreciate that. I will put my full statement in the record, in the interest of time.

[The prepared statement of Senator Leahy follows:]

PREPARED STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

I am pleased we are having this hearing today. Preserving competition in the communications industry is an issue of crucial importance to consumers and to America's economic future. The proposed merger between MCI WorldCom and Sprint raises once again questions concerning the effectiveness of the Telecommunications Act of 1996 in promoting competition rather than consolidation.

One of the major reasons I voted against the Telecommunications Act of 1996 was my concern that its promise of real competition was illusory, and that consumers would end up paying higher prices. We have all enjoyed the benefits of extensive price competition in the long distance industry, as the three major carriers, led by fierce competition between MCI WorldCom and Sprint, reduced their long-distance rates to the lowest point in history. None of us want to see a merger between two of these three carriers put an end to this welcome competition, as well as the benefits that long distance consumers have derived from it. This merger is certainly the largest horizontal merger we have seen in the telecommunications industry, and it therefore raises questions that mergers such as the SBC-Ameritech and GTE-Bell Atlantic mergers have not. When two large and direct competitors in such an important industry merge, it is a cause for concern. That being said, I am grateful for the opportunity to hear the thoughts of today's witnesses on this topic, and I plan to keep an open mind on this issue.

I do, however, continue to fear that concentration of ownership in the telecommunications industry is proceeding faster than the growth of competition. Fewer than 20 years after AT&T's monopoly on long distance was broken up, we are now faced with the prospect of a long distance duopoly consisting of AT&T and WorldCom. Meanwhile, the regional Bell operating companies continue to consolidate. I am more than ever reminded of a 1998 editorial in the *Rutland Daily Herald* that observed: "It might even seem as if Ma Bell's corpse is coming back to life."

This rash of consolidation was something I feared and expressed in my floor statement on the day that the 1996 Act passed:

> Mega-mergers between telecommunications giants, such as the rumored merger between NYNEX and Bell Atlantic, or the gigantic network mergers now underway, raise obvious. concerns about concentrating control in a few gigantic companies of both the content and means of distributing the information and entertainment American consumers receive. Competition, not concentration, is the surest way to assure lower prices and greater choices for consumers. Rigorous oversight and enforcement by our antitrust agencies is more important than ever to ensure that such mega-mergers do not harm consumers.

The NYNEX-Bell Atlantic merger has been followed by numerous other mega-mergers, and the 12 largest long distance and local providers that existed in 1996 will be pared to six if this merger receives approval. I do not believe that bigness by itself is bad, and I understand that mergers can produce economies of scale that benefit consumers and shareholders alike. I also take note of the fact that the six surviving companies offer more services today than they did when the Act was passed, in part due to an explosion of the Internet that few predicted three short years ago.

But mergers in this vital area of the economy still demand strict scrutiny from regulators and from this Congress. I have a few particular concerns about this merger that I would like to see addressed in this hearing.

First, I am concerned about the impact of this merger on long distance consumers. FCC Chairman Kennard has pointed out in his discussions of this merger that Americans currently pay lower long distance rates than at any time in history. If this merger is approved, AT&T and WorldCom will control more than 80 percent of the long distance market, with its nearest competitor, Qwest, controlling less

than 2 percent. I understand that hundreds of companies sell long distance services, but I also know that many of those companies are simply resellers who rely on MCI to sell them bundles of long distance minutes. I am interested in hearing from the witnesses whether AT&T and WorldCom will have sufficient incentives to compete on price in the short term, instead of taking advantage of the inevitable period of time it will take for a major, competitor to arise to maximize short-term profits at competitors' expense. (While some advocates of this merger have argued that dominance of the long distance industry will quickly become irrelevant due to the rising power of the Internet and cellular and digital phones, that theory might also lead to the conclusion that AT&T and WorldCom have an incentive to maximize long distance profits while they still can.)

I am also concerned about the effects of this merger on business long distance users. Forrester Research has reported that corporate users will suffer as a result of the merger, since MCI is already a market leader in that area, and since there may be no practical third options for business users at this time.

Second, questions have been raised about the effects of this merger on the expense of Internet access. FCC Chairman Kennard recently pointed out that Americans currently pay the world's lowest Internet rates. But MCI WorldCom and Sprint are the two largest Internet backbone providers—in other words, they run the two largest networks that carry Internet traffic. The two companies currently control about two-thirds of the long-haul Internet market. I understand that the parties have signaled a willingness to divest themselves of some portion of their Internet backbone business, which I believe would probably be necessary to avoid antitrust consequences, especially given the increasing importance of the Internet in our economy. But even so, consumers and businesses that rely on the Internet on a daily basis will want assurance that disruptions would not result from the divestiture itself.

Third, I am concerned whether this merger will produce broader anti-competitive effects. It now seems highly likely that our communications industry will consist of a smaller number of companies offering a wider range of services, from long distance to wireless to Internet access to cable. If that is true, our economy might be better off if our existing communications companies—some of which already offer almost all of those services—remained in existence and developed competing services in each of those areas. I understand that one of MCI's major motivations in entering into this merger was its desire to acquire Sprint's wireless services. I am interested in hearing from the witnesses whether the American and global economies might not be better served if MCI developed its own wireless services so that consumer choices would broaden, instead of remaining stagnant or decreasing.

In conclusion, I would like to thank our witnesses for coming here today to offer their thoughts, and I look forward to this discussion of these issues.

Senator LEAHY. I have expressed concern about some of these mergers, as you know, and one of the reasons I voted against the Telecommunications Act was I was afraid it might go too far. On the other hand, I have seen a number of things that have actually helped us.

I did have a couple of questions. I wasn't quite sure—maybe this was cleared up before I came in. Mr. Rill, are you here representing GTE? I know that is one of your clients.

Mr. RILL. I am here representing GTE, Senator Leahy. The views I express are, in addition, my own.

Senator LEAHY. I appreciate that. I didn't have it in my notes and I just wanted to clear that up.

Mr. RILL. That is correct.

Senator LEAHY. Mr. Ebbers has said that the merger is necessary for MCI WorldCom to keep pace with AT&T and the regional Bells in the broadband battle. Do you agree with that?

Mr. RILL. I think that would be a heavy load to carry, Senator Leahy. I think what we have heard here is estimates and suggestions that may somewhere down the road be right as to the dynamics of this marketplace. I don't think antitrust enforcement authorities, antitrust analysis, can be comfortable with that kind of prediction as to what may occur in the future, and therefore permit

the going forward of a merger that creates an 80-percent market share in an existing market, a merger between direct competitors to occur based on those hopes and expectations for the future that may never be realized.

I would like to just comment briefly on the notion that long-distance prices have gone down. Of course, there is a hearing today being conducted by the Federal Trade Commission and the FCC as to what really long-distance prices are. But the fact is that, absent mergers of this sort which increase concentration and raise antitrust concerns in the long-distance market, prices might even go down further if the markets were fully competitive.

Senator LEAHY. Mr. Ebbers, did you want to respond?

Mr. EBBERS. Well, there wasn't much substance there, but the fact of the matter is, you know, the idea of long-distance is going away. And I know I keep saying that, and antitrust officials are required to look out 2 years to see what the marketplace is. And certainly with the mega-Bells now, most of the calling that they have is not even out-of-region anymore; it is in-region because they have expanded so much. But the concept of long-distance as a standalone business is just not a correct way to look at the industry.

What is occurring in our industry is that we need to provide broadband access to users that are going to use it for a lot of different things. I would say that in the not too distant future, we are not going to know whether a call is long-distance or local, or whether it is a call to an Internet provider. It is bits, as you well know, Senator, and the world is changing out there.

The fact of the matter is that if there is going to be more than two competitors for the local end of the service, which is a necessary end because you have to touch your customers, then this merger is a very good step in the right direction to provide more than two alternatives for local service.

Senator LEAHY. Thank you. Mr. Chairman, I will submit other questions for the record, and I appreciate you and Senator Kohl and Senator DeWine having this hearing.

The CHAIRMAN. Thank you, Senator.

If I could just ask one or two more, then I am going to turn to Senator Kohl and then Senator DeWine to finish up.

MCI WorldCom and Sprint both own substantial portions of the Internet, "backbone," the systems that carry Internet data. It is reported that an MCI WorldCom/Sprint merger would give the new WorldCom some, "choke-holds," on Internet access points. According to some media reports, more than three-quarters of all Internet traffic from Europe to the United States comes through the MCI WorldCom network access point here in Washington, DC. Is that right? Is that pretty close?

Mr. EBBERS. I don't know.

Mr. ESREY. I am not sure about international.

The CHAIRMAN. OK; that is according to some media reports, with much of the remaining Internet traffic coming through a network access point controlled by Sprint. At least that is what they report. First, it would be helpful to some of us and many who may be watching if you could explain to us what the Internet, "backbone," is and how it relates to the Internet access that is purchased by consumers. And then please explain what the likely effects of

this merger will be on the Internet backbone and on consumers, and if any of the rest of you would care to comment, I would be happy. We will start with Mr. Ebbers first, Mr. Esrey, and then whoever else wants to comment.

Mr. EBBERS. Bill, I am over my head technically here, so I don't know. I will say this, Mr. Chairman, that the allegation that the transaction with Cable and Wireless did not work well is not sustainable by fact. Because Cable and Wireless has filed a lawsuit against us doesn't have anything to do with the success. They are growing their Internet business, as Mr. Jacobs demonstrates in his graphs, at 29 percent. They are publicly stating that this has been a very, very successful transaction for them, whereas the remaining part of the company of ours is growing only 23 percent. So they are outgrowing us at this point in time, and that is a successful transaction.

The backbone is the fiber over which the traffic is carried, and there are a substantial number of players that participate in that. Bill, do you want to help me with that?

Mr. ESREY. Well, sure. We could spend more time than you want in describing the Internet and I am not sure how good a job we would do. But, basically, if you start from the consumer side, they need a way to get onto the Internet, so they have an Internet access provider. And there are literally thousands of those people that provide access to the backbone of the Internet, if you will. They service the customer and they bill the customer.

The CHAIRMAN. But by backbone, you actually mean the fiber, the transmission?

Mr. ESREY. Right, the interstate highway system, if you will.

The CHAIRMAN. Right.

Mr. ESREY. And the Internet access providers provide all the byways and the local access to the Internet, but we are talking about the backbone traffic that goes over there, and it is because of a number of things. It is because MCI WorldCom and Sprint's backbone is very data-efficient and can handle this traffic very, very effectively and very, very efficiently. And so the traffic is handed from somebody else's customer to our backbone networks, where we route it to wherever the customer wants to go, some computer or some server somewhere, and hand it off.

The CHAIRMAN. OK, thank you. Does anybody else care to comment?

Mr. RILL. Yes, I would just very briefly, Mr. Chairman. I think the notion of a superhighway metaphor for the backbone is a good one, and if the superhighway is controlled by a dominant firm, it is going to be able to control the entry and exit ramps. If it controls the entry and exit ramps, it can discriminate through access derogation to its competitors, who are also its customers, and as a result develop a monopoly which will produce network tipping effects to entrench that monopoly for the foreseeable future.

I don't know what the market share numbers are. I think as the antitrust investigation unfolds, we will see what the market share numbers look like. But I think that this merger would give the superhighway-dominant firm the opportunity to derogate the connections of its competitors customers and severely and long term injure competition.

Mr. EBBERS. Mr. Chairman, could I respond to that just real quick?

The CHAIRMAN. Yes.

Mr. EBBERS. Let me say that those same allegations were made by the company that Mr. Rill represents in the transaction with MCI. At that point in time, GTE was one of our largest customers, has grown to be an even larger customer, and they can make no claim that there was any degradation in service or controlling of entry points or any of the things that he is suggesting.

Mr. JACOBS. Can I make a comment, Mr. Chairman?

The CHAIRMAN. Sure.

Mr. JACOBS. The point of the Internet is that everybody has access to everybody else's network. That is the only reason that it works. That is the only reason that it has grown as quickly as it has over the last few years in terms of how you have seen the explosion in the industry.

The CHAIRMAN. So you are saying this backbone is not controlled by any one company?

Mr. JACOBS. There are approximately 72 companies at this point, or more, who either own or lease their own backbone Internet networks. They all have to be able to interconnect with each other because no one would be able to serve their customer if their customer was going to be denied access to anybody else's network. The reality is if there are 72 backbone networks, some of those backbone networks hold Yahoo's Web site information, some hold Lycos' Web site information, some hold the hundreds of thousands of other Web sites that are out there that people access.

The way that you get big in the Internet business is simply by providing a good highway system and efficient connections with the other networks, and that is the whole game. If WorldCom attempted for a minute to limit the ability of their customers, for instance, to access what was on the Cable and Wireless network, WorldCom would be out of business because every customer would simply go to another backbone provider. The schematic that we drew in Exhibit 4 tried to capture that in very, very simple terms.

The CHAIRMAN. You are saying, unlike Microsoft which basically controls the underlying operating system—that has been the big gripe there, and their ability to force people to cooperate with them—there is no way that MCI WorldCom could force people to cooperate with them with regard to access to the backbone or to the Internet or to the worldwide superhighway or whatever you want to call it?

Mr. JACOBS. That is absolutely true, and if you look particularly at the aggressiveness of the new carriers who are coming on with brand new fiber which has basically no traffic on it yet, no variable costs, which is to say the cost of building the network is done so all they have got to do is pour more traffic on those networks—if WorldCom tried to deny anybody access anywhere, there are numerous other competitors who have ample capacity to provide that entranceway onto the Internet to any customer who wants it, and the rules are pretty clearly stated.

The CHAIRMAN. Mr. Rill, you seem to disagree with that.

Mr. RILL. Substantially, and I think not only do I disagree with it, so did the Department of the Justice and the Competition Direc-

torate of the European Commission when these same arguments were raised when WorldCom acquired MCI.

While I don't know what the market share numbers are, I am sure the antitrust agencies and the Federal Communications Commission will, and I predict that they will find that the Internet backbone is close to 50-percent controlled, or more, by the merging parties. When they get that level of control, they will have a dominant position over the pipeline and over the entry and access points to those pipelines, which will permit them to go ahead and derogate the customers who are also their competitors based on established antitrust analysis that presents that kind of dominant opportunity where there are network and tipping effect considerations to be taken into account. This is what the antitrust agencies need to look at, not the speculative notions that we have heard from the analysts here.

Mr. KIMMELMAN. Mr. Chairman, could I just add this is the sine qua non problem of telecommunications we have had throughout history of a bottleneck problem. Some of them have a long history with a litany of abuses that I think MCI WorldCom probably was best at characterizing earlier in the old AT&T monopoly. The same concerns have been raised about AT&T's dominance over a broadband cable wire. This is not the national superhighway; this is the local choke point and these concerns here.

Some of them are more future-oriented, and I think Mr. Rill has described that appropriately, and they are significant concerns. The other ones, based on our experience, became very real as profit motive led to favoritism, where there was inadequate competition, and I think that is the appropriate role for antitrust oversight here to ensure that that appropriate entrepreneurial zeal doesn't go over the line.

Mr. RILL. Just one sentence. I think last year—if one wants to look at what Sprint said last year about the MCI/WorldCom merger and its effect on the Internet backbone market, that would give you a good basis for a starting point of analysis of that market.

The CHAIRMAN. Well, I have other questions that I will submit in writing to you.

Let me turn to Senator Kohl. I have taken enough time.

Senator KOHL. Thank you, Mr. Chairman.

Mr. Ebbers, if your merger is completed, there will only be one major competitor for AT&T in long-distance telephone services. We are not just talking about the abstract here. We had a member our staff call AT&T, MCI WorldCom, and Sprint, and ask about various long-distance plans. She is one of your typical customers, a 25-year-old single woman. She called twice, once to ask for a plan best suited for a person with above average long-distance calling, and another time to ask for a plan best for a person with below average calling.

You will be pleased to know that each time, both of your companies beat AT&T, but one of you did not consistently beat the other one. Each of you offered differing plans with differing features that would be advantageous for differing types of consumers. So, gentlemen, what do you tell a consumer like this staffer from my office that this deal will result in more rather than fewer choices, either one, Mr. Esrey, Mr. Ebbers?

Mr. EBBERS. I would just suggest, Senator, that there are not only, if this merger is complete, two competitors for long-distance. In areas where the Bell operating companies and GTE has been able to compete in long-distance, they have taken up to 30 percent of the market.

What we are facing in this transaction is our ability to compete with the companies that are allowed to provide or are capable of providing local service, in addition to long-distance. Those calling plans in the companies that Mr. Rill represents are very effective long-distance competitors in the markets that they choose to compete in and in the markets that the Bell operating companies will soon be in.

Mr. ESREY. I would like to make just a couple of comments. One, your staff representative could have called many other long-distance companies and gotten more choices, I think, that are available out there in the market today. But let's back up and look at what we are really talking about factually here in terms of the consumer marketplace.

If you add Sprint and MCI WorldCom on access lines, our combined market share, it is 18 percent, compared to 67 percent for AT&T. If you prefer to take revenue and you add our combined revenue, it is about 24 percent, compared to close to 60 percent for AT&T. That is what is happening today.

Now, let's look at what is going to happen when the RBOC's, which are going to get into long-distance, whether it is imminent or a few months or whatever—look at Southern New England Telephone Company. Within 2 years, in their local areas, they got 35-percent market share, substantially more than the combined of Sprint and AT&T. So this marketplace is obviously changing very rapidly, and when the regional Bells get in—when Bell Atlantic filed, they said that they would expect to get 25 percent market share almost immediately. That is in excess of our combined market share in the consumer marketplace. So I think there are plenty of choices that are going to continue to be out there.

Senator KOHL. But is it true that in the long-distance market today your combined share is 80 percent?

Mr. ESREY. No, no.

Mr. JACOBS. With AT&T added in.

Mr. EBBERS. That is including AT&T.

Senator KOHL. The three of you, yes. Yes, I understand. So if you just merge, you two, then along with AT&T, we have 2 companies controlling 80 percent of the long-distance market. And you said, well, there will be plenty of competition, but when you go down from three to two, doesn't that reduce enormously the level of competition?

There is a fact here, isn't there, that when you go from three to two and the two now control 80 percent, there is a reduction of competition enormously, a reduction of consumer choice enormously? Now, you may cite other benefits and other things, but that is almost uncontestable, isn't it?

Mr. EBBERS. That fact, if that were a stand-alone fact, I think could give you legitimate concern. But the fact of the matter is we are not going from three to two; we are going from three to nine,

with the Bell operating companies getting in, in addition to all of the other competitors that are out there.

Let's be honest about it. In the long-distance marketplace, we saw a rate come out yesterday with a small company that is coming out with a 3.5-cent rate for long-distance service. Customers can change service providers very, very easily, and they certainly will take market share away from us if we don't meet those types of price points.

Senator KOHL. I think this particular person on my staff would say that not having Sprint and WorldCom is a reduction in her choice. I mean, you might have other things you would want to say to her, but I think she would regard that pretty clearly as a reduction in her ability to choose. You wouldn't disagree with that too strongly, would you?

Mr. EBBERS. I wouldn't disagree if those are the only calls she made for choices, but there are 600 other calls she could have made to get a long-distance service provider.

Senator KOHL. Mr. Kimmelman.

Mr. KIMMELMAN. Yes; Senator Kohl, it is correct that there are hundreds of very small companies offering some long-distance service. It is hard to figure out who they are and what their rates are, whereas Spring, MCI WorldCom and AT&T deluge us with advertising. Now, maybe that is good or bad. I don't know.

Mr. Jacobs made a comment about the scale effect of combining MCI WorldCom and Sprint to be able to challenge AT&T better. I guess that is more advertising, or more outreach to the public. These small companies are not in a position to do that. I think most consumers are not aware of how to reach them.

And then there is a speculation. Mr. Ebbers, I wish there were seven Bells left, but there are not. There are fewer; two dominant ones, it appears. When they enter, if they enter, that may help. They are certainly large enough. They have the capital base to go out and do mass-market advertising. They are not there yet. Bell Atlantic may be getting very close in one State. We have a way to go before we get that more choice from other big players.

Senator KOHL. Well, let me ask this question, Mr. Rill and Mr. Kimmelman. If the RBOC's were already in long-distance, wouldn't this be an easier call for you?

Mr. RILL. Entry under the antitrust guidelines is certainly a very important factor to undercut market concentration. When we designed the 1992 modifications to the horizontal merger guidelines, we looked at entry and we said entry, in order to trump an anticompetitive merger, which this one certainly is at 80 percent of the market being controlled by two firms, the next largest having 2 or less—entry has to be timely, likely, and sufficient to overcome the anticompetitive effects of the merger.

Entry, as Mr. Ebbers said, with a Bell edging toward entry in one market, one State, is not under any analytical standard likely to be timely, likely, or sufficient to overcome the anticompetitive effects of this transaction. If the parties are so convinced that entry is going to happen in that magnitude, with that expedition, then why don't they defer the merger until the entry takes place?

Mr. KIMMELMAN. Senator Kohl, Mr. Rill is absolutely correct. However, I fully understand the predict that Mr. Ebbers and Mr.

Esrey are in because that is an absolutely correct analysis for the long-distance market. However, they face an entrenched monopolist in the local market being the "about to be, edging closer" entrant. And until we have fully resolved how these long-distance companies can fully come in and fairly compete in the local market, we are in a pickle.

Senator KOHL. So you would say, Mr. Ebbers and Mr. Esrey, you simply want to try and stay ahead of what you see as the inevitable curve?

Mr. EBBERS. Yes; I would suggest that the Bell operating companies could have been in long-distance a long time ago had they chosen to be. The checklist is a very valid list of criteria for them to make. They choose at which speed they meet that compliance requirement, and choose at which speed they get it. Obviously, if they could argue that if they don't get in long-distance and we have to wait until they get in long-distance, they will never get in long-distance.

Mr. RILL. Let me just the point. I am not in the management business, but as a lawyer one would even look at the Justice Department comments just made on the 271 application of Bell Atlantic, in New York, and indicate that there has been utterly no negative comment on the good faith of Bell Atlantic to undertake to comply with the provisions of the statute, and indicating further that it is a very complex question, one that presents difficulties. I am not representing Bell Atlantic, but I think that the notion that the Bells could flip a coin and get in at any time is absolutely untrue under the conditions set forth in the Act.

Senator KOHL. One other question for all of the members of the panel. Gentlemen, what is the biggest problem facing markets today? Is it this deal or is it the failure of the RBOC's to open their markets, or is it both?

Mr. Jacobs, would you like to make a comment?

Mr. JACOBS. We are now approximately approaching, what, 4 years past the—I think next February we will be 4 years past the passage of the Telecom Act of 1996. The local monopolies, the RBOC's and GTE combined, have lost approximately one point of market share in the residential markets, and they have lost approximately five to seven points of market share in the business markets.

It is hard to count because it is a complex calculation to put together because the data is not so forthcoming from numerous companies. But that is about our best guess, and we have published that many times and no one has ever told us it is incorrect.

The regional Bell companies basically made a decision sometime around the end of 1996 that they didn't like the way the Telecom Act was being implemented by the FCC. The FCC had some up with a plan essentially to force a very low-priced resale of the local service to the competitors. And had the RBOC's gone along with that, they would have gotten into long-distance. That was basically the way the FCC tried to implement the Telecom Act.

The RBOC's took it to court and that whole situation was tied up for a period for 2½ years or so, and essentially that was why the RBOC's didn't lose share and that is why the RBOC's are not

in long-distance right now. Had they decided that that bet was worth it, they would be in long-distance at this moment.

Why didn't they decide long-distance was worth it? Well, a couple of reasons. The local market is a $100 billion market. It has 40-percent operating cash flow margins. It has 25-percent operating margins. And it is growing and there is no competition, and you can grow your earnings 10, 12 percent a year, as the RBOC's have done every single year, without getting into long-distance and without having to worry about it.

The long-distance market is about a $60 billion, $60 to $70 billion market, with about half the margin structure of the other market. So if the RBOC's were going to get into long-distance and lose local, it was not, in their view, a fair trade because it was much less profitable and much smaller, the business being offered as a carrot than the business they were going to be losing share in.

The RBOC behavior didn't change until AT&T bought TCI. That was the beginning of the entire change because at that moment the RBOC's realized that their loss of market share was no longer in their own hands. AT&T has bet at this point over $100 billion on the concept of coming into local, building out their own facilities across the cable plant, and offering local service in competition.

If you look at the behavior of the RBOC's in relation to that merger, it was only after that merger and the subsequent AT&T attempt to merge with MediaOne that the RBOC's began to truly ramp up their desire to get into the long-distance markets, as well as to build out, by the way, broadband capabilities, known as ADSL, in terms of their technology.

So I have to agree with Mr. Ebbers that the choice of getting into long-distance and the timing of getting into long-distance has largely been in the RBOC's hands. If you look at the competitive framework of the market, they still control certainly as a monopoly point of view the local markets. The long-distance markets are very competitive at this point. Every single long-distance company saw projections for revenue growth lowered in the third quarter because of the fact that pricing simply sort of went out of bounds beyond what anybody was expecting. It has to do with new competition in long-distance. So I think that should more or less sum up the situation.

Senator KOHL. Mr. Esrey.

Mr. ESREY. The single policy issue, I believe, in this country and what the Telecom Act of 1996 was designed to do is break open the local markets to competition, and that offers a huge engine of promise for the consumer, for business, for our economy, and for our social fabric to give competition, give choice, and let our great system work by giving choice, which will give better value, lower prices, and so forth.

This merger is a lot about that issue because the capabilities that have been assembled by MCI WorldCom in terms of local access capability, what they have done with MMDS, what we have done with ION and MMDS, put together, make a force that we believe can go and break open that local monopoly, but do it in a way that offers the consumers a whole different choice than they have had before.

Rather than just local service, we give them multiple lines, high-speed Internet access. I won't go into all the capabilities, but it is

a new choice. This is what competition does—better things, lower prices. That is what this is about. Each one of us alone would have difficulty doing that, especially due to the size of the regional Bells and AT&T's monopoly position in cable.

We look at the size of this merger and we say, gosh, this is huge. If you look at what AT&T paid for TCI and MediaOne together, it is $110 billion, to position themselves to get into the local market. Our combined capabilities offer that same type of promise of what we can do for the consumer.

Mr. RILL. If I may just for one moment, first, the purpose of the Telecom Act is to open up all markets, including the long-distance market. Second, I think the statements made by Mr. Jacobs are essentially a diversion. What is before this committee and what is going to be before the enforcement agencies is whether or not it is necessary to have strong anticompetitive effects in two present, current, relevant markets, long-distance and the Internet backbone, in order for the allegations, the hopes, of more competition in a third market might be realized. I don't think the antitrust analysis as it unfolds is going to justify those kinds of assertions and that kind of damage to consumers in the long-distance and Internet backbone markets.

Mr. KIMMELMAN. Senator Kohl, I think Mr. Rill is absolutely right. The Telecom Act appeared to be about breaking open all markets to competition, open entry everywhere. I think our problem is we have had enormous within-sector consolidation. We have gone from a few dozen companies from different sectors of telecommunications that could have combined somewhat, but left us with a dozen or more national players, many going into the local market, offering the bundles that Mr. Ebbers and Mr. Esrey described.

We don't have that today. We have fewer local phone companies consolidating their control. With AT&T, we have fewer cable companies consolidating their control. And I fear this merger could be fewer players in long-distance. Tomorrow's market may be very different. Today's market is a danger of price increases for consumers, and we have an enormous problem here. The Act is way off course.

The CHAIRMAN. Let me interrupt. We are running out of time, but let me make the point that Senator Feingold has submitted a statement for the record.

[The prepared statement of Senator Feingold follows:]

PREPARED STATEMENT OF HON. RUSSELL D. FEINGOLD, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Mr. Chairman, first let me thank you and the Ranking Member for convening this important hearing. I have my own feelings about this proposed mega-merger, but I look forward to hearing from this panel of experts to see if, in fact, the Sprint/MCI WorldCom merger would enhance competition in the long-distance telephone market.

I won't mince words, Mr. Chairman, I am disheartened by this proposed merger, to say the least. Should this merger pass muster with the Federal Communications Commission and the Justice Department, about 90 percent of the long-distance telephone market would be controlled by just two companies. According to the FCC, the next largest companies possess just percent of the market each. I fail to see a benefit to consumers from combining the second and third largest long-distance companies in an already concentrated market.

Mr. Chairman, many people will be surprised to learn that according to Consumers Union, the Consumer Federation of America, and the Texas Office of Public Util-

ity Counsel, the majority of residential long distance consumers are actually paying more today for long distance calling than they did before the passage of the Telecommunications Act of 1996. What with nickel nights to 5 cents every day to 7 cent "one rates," long-distance rates have seemed to fall precipitously in the recent past—unfortunately, those gains for consumers on per-minute rates have been more than offset by a host of new charges and fees. Now, these two behemoths want to consolidate and thereby strangle some of the competition that has led at least to falling long-distance rates. And again, consumers inevitably will take it on the chin. Mr. Chairman, this is a step backward, not progress toward competition.

As I have discussed, there also is evidence that the benefits of competition in the long-distance market are not all it's cracked up to be. The long-distance companies have more than made up for falling long-distance rates with monthly minimum usage charges, the presubscribed interexchange carrier charge, and the universal service fund charge, which hit low-income, low-volume callers disproportionately.

Some of the witnesses before us today may argue that this proposed merger will increase competition in the long-distance telephone market, but I am skeptical, given what has happened so far. Analysis by the organizations I mentioned found that 71 percent of poor households; 64 percent of lower-middle income households; 58 percent of middle income households; 50 percent of upper-middle income households; and 43 percent of wealthy households now pay more in their long distance bills than they did before the 1996 Telecom Act. Since the Act passed, about 70 million households are paying $2.3 billion more per year in their long-distance bills. One-half to two-thirds of all residential consumers are paying more expensive telephone bills. This is occurring while 60 percent of the wealthiest Americans are paying less. If this is the effective competition we were promised, I won't lose any sleep over my vote against the Telecom Act.

Mr. Chairman, the fact that we're even considering this merger shows, once again, that the 1996 Telecommunications Act has not led to the vaunted growth in competition that it promised and has failed to deliver significant benefits to consumers. In fact, just the opposite has happened.

I was one of just five senators to vote against the Telecom Act. In fact, I strongly opposed the provisions that supporters contended would lead to greater competition and lower rates for consumers. Those few of us in the Congress who voted against the Telecom Act did so because it did not seem likely to lead to true competition and benefits to consumers. We have been hoping to be proved wrong, but it doesn't seem to be working out that way. In fact, it is now clear that competition is dwindling before our eyes, and certainly not growing.

Mr. Chairman, I favor increased competition and deregulation of telecommunications markets because true competition benefits consumers by providing them with more choices, lower prices and improved service. The spate of recent mergers, including the proposed union of Sprint and MCI/WorldCom that we are discussing today, has led and will continue to lead to fewer choices. I would wager that higher prices and diminished service will follow hard on the heels of that merger.

Over the past few years, the biggest news in the telecommunications industry has been the tremendous consolidation of all its facets, from local and long distance phone service, to cable television to the Internet. The latest merger rage has highlighted the willingness of companies that traditionally have operated in one realm to buy their way into other realms, but the only problem with that trend is that it brings consolidation—the enemy of competition.

The most obvious example is AT&T. Over the past year and a half, AT&T has committed $112 billion to the acquisition of cable television companies. Last year, AT&T agreed to acquire Tele-Communications, Inc. (TCI) from Time/Warner. TCI was the nation's second-largest cable company. Earlier this year, AT&T reached an agreement to acquire MediaOne, the nation's fourth-largest cable company. Aside from becoming the nation's largest cable company, AT&T also is aligned with the nation's other two largest cable companies.

The AT&T/MediaOne deal extends AT&T's reach into cable television and continues AT&T's move to provide consumers with a bundled, full range of telecommunications services. The merger could allow AT&T to provide competition against Baby Bells in local phone markets through cable connections.

Not to be outdone, the Baby Bells, have saddled up in a move toward regional monopolies. The 1984 breakup of Ma Bell spawned seven Baby Bells that could offer local phone service only. The 1996 Telecommunications Act allowed the Baby Bells to provide long-distance service should they meet conditions that open their local service to competition. There are now four remaining regional Bell operating companies. They control 98 percent of all local telephone service. I fail to see how a few vast regional monopolies are any better than a single vast national monopoly.

So, the statistics presented by a recent American Antitrust Institute report are striking. This study cataloged 4,728 reportable mergers in 1998, compared to 3,087 in 1996, and 1,529 in 1991. The total value of U.S. mergers completed in 1998 was $1.2 trillion in an economy with a gross domestic product of $8.4 trillion. Mergers are the big story in American economic life today, and as the report shows in stark terms, funding for the agencies on which we rely to police those mergers has not nearly kept up.

Mr. Chairman, we now have four companies controlling 98 percent of the local telephone market; six companies controlling more than 80 percent of the cable television market; seven firms controlling nearly 75 percent of cable channels and programming; and four companies accounting for nearly a third of the radio industry's annual revenue.

The speed of these mergers can make your head spin just to keep up with the name changes. But they have real life consequences for consumers.

I look forward to hearing the testimony of the witnesses. And I look forward to their answers to some of my concerns.

The CHAIRMAN. Senator DeWine, who has agreed to Chair these hearings because I have to leave, has agreed to allow Senator Ashcroft to ask his questions before Senator DeWine finishes up.

So we will turn to you.

Senator ASHCROFT. Mr. Chairman, I thank you, and I thank the Senator from Ohio for his courtesy and his kindness to me.

Mr. Jacobs, there seems to be an implicit understanding or assumption or suspicion on the part of some members of the panel that if this merger goes through that somehow the emerging entity would raise prices for long-distance. What would be the business consequence to the surviving organization if it were to raise prices for long-distance after a merger like this?

Mr. JACOBS. They would immediately lose market share, and most of the analysts would downgrade their stocks from "out-perform" to "under-perform," point one. Point two is I think there is a certain point that is being missed here altogether. Once you have the RBOC's coming into long-distance and once AT&T goes into local—and those are foregone conclusions, those two things are happening—the whole concept of long-distance is going to go away.

AT&T has already talked about what its pricing plan is going to be. Its pricing plan is going to be a flat rate, you know, monthly fee for all you can eat once they pull this thing together, all the local you can eat, all the long-distance you can eat, all the high-speed data you can eat.

The RBOC's, when they come into long-distance, are going to do the exact same thing, and it is only sensible because costs do not act on a per-minute basis. Costs are fixed, and therefore what you do is you create fixed revenue streams and you give the customer more and more and more. That is the way telecom is going to look. Two companies are headed for that strategy, you know, irrevocably, irretrievably, and the issue is are we only going to have two—and by the way, two is infinitely better than one, which is what we currently have—or do you have the chance of getting a third. And I think what is going to happen is we are going to get a third and this concept of per-minute long-distance is going to be a relic in another 2 years.

Senator ASHCROFT. That is not the structure of long-distance now?

Mr. JACOBS. Correct.

Senator ASHCROFT. Let me sort of recite this carefully and see if I can say this properly. The long-distance provider, before the call is delivered to the consumer, has to pay a local provider.

Mr. JACOBS. Correct.

Senator ASHCROFT. That is sort of a barrier, a toll booth there, and AT&T's merging with the cable companies is to get them around the toll booth so that they won't have to pay that extra charge.

Mr. JACOBS. Correct.

Senator ASHCROFT. Now, what percentage of a long-distance call is that access charge now?

Mr. JACOBS. The access charge, on average—if you take all-in on a domestic minute of long-distance, the average revenue in the industry is about 10 percent. That is, by the way, if you take the monthly fee and you also figure that in over the number of minutes on average, around 10, 11 cents. Depending on where you are, the average all-in access fee that is paid to the RBOC is somewhere on the order of magnitude of about 4 cents, something like that.

Senator ASHCROFT. So it is 40 percent of the cost of a long-distance phone call.

Mr. JACOBS. Forty percent to revenue. It is actually half of the cash cost, half of the cash cost. It is the most significant.

Senator ASHCROFT. I just want to see if I can carry this. And what they are proposing is a means of getting around this toll booth, which is 40 percent. Now, there must be some costs to getting around the toll booth.

Mr. JACOBS. $100 billion in AT&T's case.

Senator ASHCROFT. And what would that result in, though, on a per-call basis? Can they do it cheaper, is what I am saying. Can they provide access cheaper by going around the toll booth than by going through the toll booth?

Mr. JACOBS. It is a simple question to answer because it is very expensive to get that new highway. It is actually the last mile we are talking about, you know, out to the customer—very, very expensive, $100 billion for AT&T, and I think that the assets of the RBOC's are something like $100 billion as well. But once you are there, access charges paid to the RBOC's have very little to do with actual cost. They are filled with subsidies, they are filled with overhead, they are filled with all sorts of——

Senator ASHCROFT. Are you saying, then, that the long-distance rates—there would be every reason on a cost basis for long-distance rates to go down?

Mr. JACOBS. Correct. The expensive thing is to create the connection with the customer. The cheap thing is to then pour the service over that, and that is why what I tried to say in my testimony is once you get to a point where you have bundling companies who have numerous products to put over a single pipe sold by a single sales force, there is every reason in the world to discount very, very heavily, and each side will discount the other guy's product.

Senator ASHCROFT. Let's go quickly to something else. I think I have heard it said that there are 600 long-distance companies.

Mr. JACOBS. I think there are actually closer to 800, but yes.

Senator ASHCROFT. And these guys don't all own superhighways. There are, what did you say, 70-some superhighways?

Mr. JACOBS. Well, you have to be careful about superhighways. There is the Internet superhighway, and since MCI has 72 different companies that they so-called peer with who are allowed free access—and by the way, those companies meet a certain criterion in terms of having lots of traffic—there are 72 companies of stature on the Internet.

Senator ASHCROFT. I want to go back to this. How do we have 600 companies if it is so impossible to do this unless you own this big infrastructure?

Mr. JACOBS. You can always get access to long-distance backbone fiber by renting it because the reality is that in—we have to be clear on one thing. There are local facilities, the last mile, of which there is right now only one into the house offering telephone service. And then there is the connecting point for the whole country, which is the long-distance backbone or the Internet backbone. At this point, there is, in theory, almost an infinite amount of capacity in that backbone. There is ample excess capacity.

Senator ASHCROFT. So these 600 or 800 guys——

Mr. JACOBS. You can rent it for nothing, basically.

Senator ASHCROFT [continuing]. Go and rent it very cheaply.

Mr. JACOBS. Correct.

Senator ASHCROFT. And is if someone were to try and elevate the costs of long-distance——

Mr. JACOBS. It would be suicide.

Senator ASHCROFT [continuing]. These rent-for-nothing people would be able to deliver to my door mimeographed flyers and things that said you can go around these high costs by just dialing 10–10-blank-blank-blank or what have you and get 5 cents a minute. I mean, at my house I get these flyers everyday.

Mr. Kimmelman, I think there is a certain responsibility on the part of a consumer to be able to read, and I get this stuff everyday and they are not big companies, but they tell me I can have 5 cents a minute with no monthly charges. I do have to dial seven extra digits, which a 1999 phone can program once and for all, if you want. I don't want to tell people how to avoid using Sprint and MCI and paying the extra value to Michael Jordan and the other advertisers.

So what you are saying is the potential for price reduction is always there from the other 6 or 800?

Mr. JACOBS. I would defy anyone on this panel to show me a single price in telecom that has ever gone up in the last 10 years. Costs are falling and competition is increasing, and you cannot find a price for anything in telecom that is falling. The only single thing I can think of is that at one point some of the long-distance carriers with some of the large pipes of data before some of the new guys had brought their pipes on the marketplace were very capacity-constrained. That is about the only thing I can think of in 10 years.

Senator ASHCROFT. You would probably confess that if a person was going to make one 5-minute call a month and opted for a service that required a $4.95 a month charge that that price to that consumer—that is Mr. Kimmelman's point, I think.

Mr. KIMMELMAN. It is one of my points, Senator Ashcroft. I have got to tell you there is no way we want to condone stupidity on the part of consumers, but today the Federal Trade Commission and

the FCC are holding a hearing to admonish this very industry for distorting its information it is providing in those flyers, not all of them, but some of them because it is totally—the consumer can't understand it.

It is described as 5 cents a minute, but it is 99 cents for the first minute, the second minute, all the way up to 20 minutes. We get this all the time, and I can show you probably a dozen AT&T basic schedule rate increases in the last decade. I mean, there are rate increases all over the place, almost every one of which were followed by an MCI rate increase and a Sprint rate increase, a follow-the-leader rate increase. There are enormous segments of this market that are not competitive. It is just totally factually inaccurate what you are saying.

Senator ASHCROFT. Well, let me just say this. I think there are places where you get this deal that says 99 cents for up to 20 minutes, and I guess if you have 20 seconds, you pay 99 cents, too. And I think that is an enforcement problem; that is an FTC problem, but that is not a merger problem, that is not a structure of the industry problem. That is an advertising problem of having truth in advertising in communications.

But we need to look at structure here and we are asking ourselves whether a combined structure of these two companies is likely to have an increase in cost or a decrease in cost for long-distance. That has been an expressed concern, and the only thing I have been able to hear so far, and the only thing I can figure out, is that, they want to avoid the toll booth by getting all the way to the consumer which would at least provide a decrease in cost, and you seem to be nodding your head that they would do so. And the other is that if they tried to increase their cost, they would just incredibly savage and hemorrhage in terms of market share.

And the last point is that the current landscape is not the landscape to be considered. It is a landscape where it is anticipated that there will be another competitor in virtually every setting that will enter the market with a 25-percent share, which is more than either of these two individual companies now have, and will obviously avoid the toll booth because they own the toll booth.

It seems to me that when we are talking about structure, we ought to at least try and figure that out. And I am very pleased to hear from you, Mr. Rill, because so far if you have got a point to make, it is not coming across to me.

Mr. RILL. Well, the point is one that is really hornbook antitrust analysis and established in the merger guidelines enforced by the Federal Trade Commission and the Department of Justice, and that is in a given industry when a market structure reaches two firms with 80-percent control and the next firm in that market with no more than 2 percent of the market, the presumption is that that is going to be anticompetitive market. Now, I would grant you that——

Senator ASHCROFT. Well, wait. Let's make it clear that when we are talking about 80 percent of the market, we are not talking about the surviving entity here. You are talking about——

Mr. RILL. Two firms.

Senator ASHCROFT. You are talking about 80 percent of the market being——

Mr. RILL. Controlled by two firms.

Senator ASHCROFT. But if these each had 2 percent and AT&T had 76 percent, you would have the same problem.

Mr. RILL. Then we would have a separate problem with the 76-percent firm, but that is not what we have here. We don't have that. We have a firm with approximately 48 percent, 50 percent, another firm with approximately 30, 32 percent. I think that is a given. You can strip away a percent or two, but that is a given. Under the merger guidelines, there is a presumption in that market that there is an anticompetitive effect.

Now, if there is entry such that that is either not a market or that any anticompetitive price increase or failure, by the way, to reduce prices to reflect declining costs—declining prices are not necessarily good enough; prices should decline at a level dictated by competition. The entry story that we have heard today is entirely speculative. It is not there. Mr. Ebbers set up an antitrust standard that I haven't heard before that if I were defending a merger I would like to use, and that is the "edging toward entry" standard.

Unless entry is timely, likely, or sufficient—and this is under the DOJ–FTC merger guidelines—to deflect, undercut an anticompetitive price increase, it will not cut the mustard. And as the antitrust agencies look at this merger, I predict they will find that entry is not timely, within a merger guideline timeframe, or sufficient to permit this high level of duopoly to go forward.

Mr. KIMMELMAN. Senator Ashcroft, I was aggressively nodding in agreement with you because I want to make it clear that on your point of avoiding the toll booth, there is no one who wants to get that toll booth out of the way any more than the consumer. I think that 4 cents a minute, that 40 percent, is a bloated, vastly inflated number. It is keeping prices way too high for connecting long-distance calls. My concern is I don't see enough about this merger that allows MCI WorldCom and Sprint to truly avoid that toll booth.

I heard a description of use of some wireless equipment for broadband that may work, may not work. It has been a problem. Wireless cable has not worked well because of capacity and line-of-sight problems for offering an alternative to cable. Maybe it is better here. I didn't hear much about local phone service, which is what that toll booth is the problem in.

And most of what I heard about was a continuation of leasing lines from Bell companies and GTE, and it is hard for me to understand how the consumer is better off whether it is just MCI WorldCom/Sprint leasing those lines or the two of them separately leasing those lines.

Senator ASHCROFT. Well, the two of them, plus another 6 or 800. And I don't know who the next giant is, but they grow quickly and the kinds of things they do in competition force the big guys to change.

LCI International, I don't know how long ago, decided they weren't going to play the round-up game or round-off game, or whatever it is, with time. They said we are only going to charge you for the amount of time you are on the phone. They are infinitesimal in the market, but they have an impact in the market.

I think what we have to look at as policymakers—and I thank the chairman for his indulgence and I will quit with this—we have to look not at hornbooks. Frankly, as policymakers, we are in charge of developing a hornbook that will make the system work, not in respecting a hornbook that may protect the kind of industry that might have existed or market structure that might have existed. We need to make the system work.

We need to look when we are looking at things to find ways so that we can have competitors in the United States that stand well among world competitors so that we can have consumers that are served well and efficiently. And I think this Telecom Act which we put in place provides tremendous opportunity. We have had a proliferation of companies that, with their offers of competition and the like, have just helped this industry explode.

So I am pleased that all of you came. I think the debate has been very productive, but I think we ought to try and find a way to do things that results in better service and lower rates and greater competitiveness for our players on the international scene.

I thank you, Mr. Chairman, and am grateful for this opportunity to be with you.

Senator DEWINE [presiding]. Thank you, Senator Ashcroft, very much.

Gentlemen, I think this has been a productive 2 hours. Let me see if I can summarize a little bit, and also maybe get you to engage a little more. Frankly, none of you are shy and retiring, but I sort of feel like we are talking around each other today for the last couple of hours and let me see if I can summarize and maybe spark a little more direct debate here.

Mr. Kimmelman and Mr. Rill, basically what you are saying is, look, we are going from three companies to two companies who are now going to have 80 percent of the market. Under classic analysis, this is a problem. The lights ought to go off. The burden of proof ought to be on the company that wants to do it.

Mr. Ebbers and Mr. Esrey, and I guess Mr. Jacobs as well, you seem to be saying, no, no, no, you guys are all wrong, you don't get it. You can't apply the normal standards, and the reason you can't apply the normal standards is this is a moving target. It is not static. You can't just look at it from a point of view of long-distance, even though long-distance is still what people think about. What they are saying is that is wrong. Mr. Kimmelman and Mr. Rill, you just don't get it.

You get into the 21st century and long-distance is over with, it is dead. That is not how we do business anymore. It is just a different world, and what is going to happen is that AT&T is going to get into local, the RBOC's are going to get into long-distance, and this whole business changes. And, in fact, it is changing and, in fact, therefore it is a moving target. And you guys want to take a snapshot and look at it and freeze it, and really that is just not the way the world is working today.

Now, is that a fair summary of what I have heard over the last 2 hours?

Mr. RILL. I certainly would never suggest it is not a fair summary.

Senator DEWINE. Well, you just tell me what is wrong about it, then. You tell me what I am hearing that is——

Mr. RILL. I think I could put it somewhat a different way, and I will start out with your statement that long-distance is what people think about today. And the reason they think about it today is it is a relevant market today.

Senator DEWINE. But they are saying, yes, it may be relevant today, but it is really not going to be relevant tomorrow.

Mr. RILL. That is speculative, Mr. Chairman. They are trading off injury to long-distance consumers and injury to customers and competitors on the Internet backbone, which will be a fact by this merger of two direct competitors in those markets with overwhelming market shares, against speculation that somewhere down the road maybe there will be more competition. And maybe there will, but the merger analysis must show with a clear confidence that that entry will be timely, likely and sufficient now to dissipate the anticompetitive effects that this merger will have in two markets that today, to put it in your terms, is what people really think about.

Senator DEWINE. Mr. Ebbers, Mr. Esrey, let me just ask it this way, and I want you to have the opportunity to respond. They are basically saying you are speculative; you are talking about someplace out in the future. And that may or may not be true, but today the analysis has to be of what the market is today, and today you guys are going to end up with 80 percent of the long-distance market.

Now, am I right in saying that what you are really telling this committee is that is the wrong premise to start with, that is the wrong place to start with? It seems to me where we start, whatever our basic assumption is, is where we end up. On one analysis, it is very tough for you to climb that hill and show us or show the American people that having two companies having 80 percent of the market is not a bad thing, when there is a lot of competition out there now with three, plus.

I mean, is that correct? You are just saying that we shouldn't take that as the initial analysis? That shouldn't be our premise, that shouldn't be our starting place?

Mr. ESREY. Well, I agree with your basic statement and I don't think it is speculative.

Senator DEWINE. Which one?

Mr. ESREY. Pardon?

Senator DEWINE. Which one?

Mr. ESREY. Well, your synopsis of what was said here in the last couple hours.

Senator DEWINE. All right.

Mr. ESREY. But I think the issue is it is not speculation. AT&T spent $110 billion to position themselves to enter the local market. You know, it is quite clear what they are going to do.

Senator DEWINE. When?

Mr. ESREY. Pardon?

Senator DEWINE. I guess the question is when?

Mr. ESREY. They are rolling it out now. As we speak, they are rolling it out. It doesn't happen overnight, obviously, but they have already started to roll it out to offer that type of service.

Senator DEWINE. Well, should the public policy analysis be where we are now or where we will be in 5 years or 10 years as far as what should be allowed now? Isn't that the question?

Mr. ESREY. It is not 5 years or 10 years.

Senator DEWINE. OK. How many years is it?

Mr. ESREY. It is months, it is months that you see this happening. It is going on right now and, of course, it is somewhat evolutionary. You don't wake up one morning and switch.

Senator DEWINE. I understand.

Mr. ESREY. But it is going on right now. You can see by Bell Atlantic's own statement that they expect to get 25 percent of the market when they get in. People are investing enormous sums of money because the industry landscape is clearly changing.

And talking about speculation, I think Mr. Rill says injury to consumers. What injury to consumers? That is where the speculation is. I think as Mr. Jacobs says, and it is quite clear to us, if we sat and attempted to raise long-distance prices, there would be injury, but it wouldn't be to consumers. It would be to our companies.

Senator DEWINE. Mr. Kimmelman.

Mr. KIMMELMAN. I think your synopsis is correct, with a little footnote, and that is that some of the mergers that Mr. Ebbers and Mr. Esrey are describing as somewhat motivational or that they have responded to are not completed. The Antitrust Division is still reviewing the AT&T/MediaOne transaction.

Now, the Chairman of the FCC has stated very clearly that he thinks getting AT&T to expand off-cable plant and hopefully—again, another promise, speculation—offering local phone service and broadband is worth them owning all that cable plant. The Antitrust Division has not ruled on that. If that transaction does not go forward as it was proposed, that changes the landscape.

What Mr. Jacobs described as this inexorable movement, that there will be a Bell doing all of this and AT&T with its cable plant doing all of this, is not anywhere near as real as what people are paying today and receiving today for cable, local phone service, and long-distance. I don't dismiss it as a possibility, but it is not real.

Senator DEWINE. Mr. Ebbers, you wanted to say something.

Mr. EBBERS. Yes; I would just be real factual, if I could, about this. The company that Mr. Rill represents, which is in the process of merging with Bell Atlantic, determines when they want to get in the long-distance business. He says it is not imminent or it is not soon or it is not for sure. Why are they doing this merger, then? They stated publicly that the reason for this merger is they want to be part of an RBOC that has access lines that is going to be a significant competitor in long-distance. I don't blame them. I think it is the right way to go.

But, you know, it is kind of foolish for us to sit here and listen to him say that the timing isn't imminent. The applications are forthcoming. The PSC in Texas is supposed to vote this week and is expected to approve the application of SBC to be in long-distance in Texas. It only takes 4 States to have 24 percent of the market competitive when they enter.

Senator DEWINE. Mr. Rill?

Mr. RILL. Mr. Chairman, there is not one State yet in which these applications have been approved. Certainly, it is an intention of all firms in this business to compete and succeed in being competitive. The fact of the matter, under the antitrust analysis that is going to be required of the agencies, is whether or not that entry will be of such magnitude, speed, and likelihood to offset what is clearly under the merger guidelines presumptively an illegal merger in two markets.

Senator DEWINE. Anyone else?

Mr. KIMMELMAN. Senator DeWine, just one more point here.

Senator DEWINE. Mr. Kimmelman.

Mr. KIMMELMAN. $110 billion is a lot of money that AT&T has spent, and just to conclude that they are absolutely right or know what they are doing, I think, is going a little overboard. The relevant analysis is how do they make the most money once they have spent that, and how do the Bells once they have spent it in their merger, and the entrepreneurs here at the table.

And what is troubling from the consumer perspective if we constantly see people entrenching and staying more in their core market and finding they can make more money there—and Mr. Jacobs reflected on that before—than aggressively challenging others in new markets. That is what is of greatest concern to us.

Senator DEWINE. Mr. Kimmelman, on the one hand you have said that once horizontal power is established, it is difficult for the remaining players to compete. But on the other hand, you have said that two wrongs don't make a right and we shouldn't let these competitors merge. Now, I have already expressed my concern about the impact of this merger on long-distance customers. But to be fair, as you have acknowledged, Mr. Esrey and Mr. Ebbers have a business to run. They need to be able to anticipate market trends and they need to be able to react to these trends.

How do we reconcile those issues? When should a deal such as this one be allowed? How do we deal with that problem?

Mr. KIMMELMAN. We are in a pickle. I truly wish that our enforcement agencies had approached this very differently over the last few years. Now, that is water over the dam at this point. How do we undo the potential danger that they feel they are responding to, which I think is real, cable concentration and consolidation in the local market? I would suggest this merger needs to be scrutinized carefully because I think for the market we know today, it consolidates too much power in long-distance, however saying at the same time I believe that that should be done in conjunction with the AT&T/MediaOne transaction, which I think—and Mr. Jacobs knows the market better than I do—will send a very, very different signal than has been sent over the last 3 years from the enforcement agencies about how companies can combine and will need to align themselves to meet public policy standards for competition.

I think that is the way we need to go. If there is not the will power in the enforcement agencies to do that, I would suggest that you follow up on the logic you have presented this morning which is extremely consumer-friendly and consider legislation to ensure that with fewer players, whom I don't believe you can absolutely commit in law to living up to their promises—that these fewer

players do not raise prices, do not take advantage of consumers, and ensure that they offer a fair price in the marketplace.

Senator DEWINE. As many of you know, Senator Hatch, Senator Kohl and myself have introduced a bill that would force the FCC to decide these mergers within 6 months so that the industry can have some certainty. So at the conclusion of this hearing, I will put my commercial in for that piece of legislation.

Mr. RILL. We will say that at least for our purposes we endorse that legislation.

Senator DEWINE. Thank you very much. I appreciate that.

Any concluding comments that anyone feels they have to make?

Seeing no one feeling the desire to continue beyond 2 hours, I appreciate your testimony. I think it has been very helpful.

Mr. RILL. Thank you very much, Mr. Chairman.

[Whereupon, at 1:02 p.m., the committee was adjourned.]