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# Bad Deal Of the Century

The Worrisome Implications  
of the WorldCom-MCI Merger

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by Dan Schiller

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## Economic Policy Institute

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## EXECUTIVE SUMMARY

The proposed \$37 billion merger of WorldCom Inc. and MCI Communications Corp. would constitute the largest acquisition in business history. If allowed to proceed by regulators, it would combine the nation's two largest Internet "backbone" systems and two of America's top four long-distance companies.

The proposed merger raises serious antitrust and competitive issues that affect every U.S. consumer and business. The combined company will control 50% or more of the Internet infrastructure and one-quarter of the U.S. long-distance telephone market, raising concerns that approval of the merger will thwart the pro-competitive intent of Congress in passing the Telecommunications Act of 1996.

WorldCom's bid to dominate the telecommunications industry rests on three strategic initiatives: privileged access to capital markets, a rapid increase in market power based on expanded control over the Internet backbone, and preferential service for high-volume business and well-off subscribers and neglect of the broader consumer market.

The key concerns raised by this report are the following:

- **The proposed merger is an attempt by WorldCom to develop market power over the Internet.** The merger would enable the combined company to dominate the Internet backbone and major network access points of the Internet, giving the company substantial power over the terms and pricing of Internet interconnection. This concentration of power would undermine the Telecommunications Act of 1996, which explicitly intended to promote competition in this critical sector. Indeed, some Internet service providers have already begun to protest that they will face additional levies as a result of the merger.
- **Marketing to high-volume users subverts the intent of the Telecommunications Act of 1996, which codified the objective of universal service for the first time in the nation's history.** WorldCom has gained its current market position through its dedicated pursuit of favored customer groups and an equally deliberate neglect of other subscriber market segments. A WorldCom takeover of MCI will only intensify this focus on business customers and on an elite stratum of high-volume individual users. By integrating the joint company's exclusionary local networks with its long-distance facilities and, specifically, with its tiered Internet services, the merger threatens to establish a freestanding infrastructure that is

***The combined WorldCom-MCI will control 50% or more of the Internet infrastructure and one-quarter of the U.S. long-distance telephone market.***

largely separate from the inclusive public-switched network and that cherry-picks in favor of high-volume users.

***The changes from the merger would harm the nation's telecommunications system at exactly the moment when its health is most important to the overall well-being of the economy.***

- **The combined company's financial health is uncertain.** WorldCom's ability to wage battle for MCI rested upon its uniquely inflated share price and its established practice of financing acquisitions by using its strong stock as its chief currency. Since it was incorporated in 1972, the company that became WorldCom in 1995 used its common stock to acquire a succession of 20-odd local, long-distance, and Internet companies. Its \$36.5 billion takeover offer valued MCI at nearly double the price the carrier had commanded just months before. A combined MCI-WorldCom faces worrisome financial issues, including an appreciably increased debt burden and the likelihood that an MCI under WorldCom management will not generate profits sufficient to justify the high price paid.
- **Consolidation of the two companies could impose serious social costs.** As noted above, the merger may reduce the resources available to modernize the publicly shared telecommunications network. In addition, an increase in market dominance by these two non-union carriers will affect labor relations practices in the industry and will exacerbate the push for lower wages.

MCI-WorldCom is a mistake waiting to happen. The combined company's financial health would be uncertain. Its prospective dominance over the Internet would crowd out rival vendors and imperil interconnection on nondiscriminatory terms. The premium services that it would target at high-volume business and elite residential users would come at the expense of other residential customers. Together, these changes would harm the nation's telecommunications system at exactly the moment when the health of that infrastructure is most important to the overall well-being of the economy. Regulators must address these concerns now, before a combined MCI-WorldCom consolidates its market dominance into an effective monopoly position.

## INTRODUCTION

When AT&T rose to monopoly power early in the 20th century, it relied on a three-prong strategy: it used its privileged access to capital markets to acquire a number of would-be competitors; it exerted leverage over rivals it had not acquired by increasing its stranglehold on crucial communications technology; and it targeted high-volume users with preferential service offerings.

This scenario, carried out decades ago before effective, pro-competitive regulation protected the integrity of markets for consumers, may sound familiar. It applies equally well to WorldCom's bid to acquire MCI Communications Corp.

The proposed \$37 billion WorldCom-MCI merger would be the largest acquisition in business history. If approved, it will create a telecommunications behemoth with revenues of \$32 billion, a market capitalization of \$60 billion, 63,000 employees, and one-quarter of the U.S. long-distance telephone market. The company will also control 50% or more of the Internet backbone, a system of high-capacity circuits and related facilities that are essential to carrying traffic across the global Internet.

The proposed WorldCom-MCI merger raises serious issues that affect every U.S. consumer and business. There are concerns that it violates antitrust laws, which are formulated to assure that no single company gains sufficient power to dominate a market. There are also concerns that it does not protect the public's interest and violates the pro-competitive intent of Congress in passing the Telecommunications Act of 1996.

Thus, the proposed WorldCom-MCI merger raises an important question: as the 21st century dawns, can the United States afford to risk the creation of a new telecommunications monopoly?

As this study shows, the answer is no.

The intertwined acquisitions and strategies involved in WorldCom's offer for MCI constitute an unlawful bid for market domination. WorldCom's proposed acquisition is overtly anti-competitive, and it calls for federal regulators to protect consumers and competitive markets by rejecting the merger.

***The proposed WorldCom-MCI merger raises serious issues that affect every U.S. consumer and business.***