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FEDERAL COMMUNICATIONS COMMISSION
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December 6, 2000

VIA HAND DELIVERY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
Room Number TW-A325
445 12th Street, S.W.
Washington, DC, 20554

Re: Intermedia Communications, Inc. WorldCom, Inc. –
CC Docket No. 00-206

Dear Ms. Salas:

On behalf of AT&T Corp. ("AT&T"), please find enclosed an original plus four copies of Petition of AT&T Corp. to Deny Application in the above referenced proceeding in response to the Public Notice issued November 6, 2000. Please direct any questions to the undersigned.

Respectfully submitted,

Aryeh S. Friedman / ha
Aryeh S. Friedman

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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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OFFICE OF THE SECRETARY**

In re Applications of)
)
INTERMEDIA COMMUNICATIONS Inc.)
Transferor)
)
and)
)
WORLDCOM, Inc.)
Transferee,)
)
for Consent to Transfer Control)
of Corporations Holding Commission)
Licenses and Authorizations Pursuant)
to Sections 214 and 310(d) of the)
Communications Act and Parts 21,)
63, 90, 101)

CC Docket No. 00-206

PETITION OF AT&T CORP. TO DENY APPLICATION TO TRANSFER CONTROL

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December 6, 2000

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63, 90, 101)	

PETITION OF AT&T CORP. TO DENY APPLICATION TO TRANSFER CONTROL

Pursuant to the Commission’s November 6, 2000 Public Notice, AT&T Corp. (“AT&T”) hereby respectfully submits this Petition to Deny the Applications of Intermedia Communications, Inc. (“Intermedia”) and WorldCom, Inc. (“WorldCom”) (collectively “Applicants”) for authority to transfer control of Intermedia’s FCC authorizations to WorldCom (hereinafter “Application”). WorldCom’s acquisition of Intermedia includes Intermedia’s approximately 62 percent equity interest and 94 percent voting interest in Digex.¹ As modified by the Proposed Final Judgment recently entered into between the United States and the

¹ Application at 1, n.1.

Applicants, WorldCom will, after the acquisition, divest itself of all of Intermedia's assets except for the capital stock of Digex.²

INTRODUCTION AND SUMMARY

The merger of Digex's web hosting business with WorldCom's web hosting and near dominant Internet backbone, will have anticompetitive vertical effects. Specifically, in light of WorldCom's control, through its UUNet subsidiary, of such a large share of the "eyeballs" necessary to any successful web site, interconnection with UUNet's Internet backbone is essential. This merger will increase WorldCom's incentives and ability to benefit unfairly Digex, a web hosting company already shown to be one of the "winners" in the web hosting market, by raising its rivals' costs to interconnect with UUNet's backbone and/or degrading the quality of that interconnection.

The Applicants have demonstrated no public interest benefits to offset the anticompetitive effects of this merger. WorldCom's claim that this merger will allow it to "catch up" with systems development it neglected for 18 months as it focused on other priorities, is not a "merger specific" benefit. To the contrary, this argument effectively concedes that WorldCom could have unilaterally developed (or acquired from a supplier rather than by merger) such a

² United States of America v. WorldCom, Inc. and Intermedia Communications, Inc., Civ. Action No.: 1:00CV02789 (D.D.C.) filed November 17, 2000 (hereinafter "U.S. v. WorldCom and Intermedia") <http://www.usdoj.gov/atr/cases/f7000/7043.htm> (Complaint); http://www.usdoj.gov/atr/public/press_releases/2000/7002.htm; (press release). As a result of UUNet's near dominance of the Internet Backbone market, the Applicants and the Department of Justice ("DoJ") have entered into a Proposed Final Judgment relating to this merger, <http://www.usdoj.gov/atr/cases/f7000/7042.htm> requiring the Applicants' divestiture of, *inter alia*, Intermedia's Internet Backbone assets. AT&T urges that caution is necessary in light of the serious questions raised concerning WorldCom's purported breach of its prior commitment to divest the MCI Internet Backbone assets. In any decision it issues, the Commission should impose conditions (with an expedited process for hearing complaints and the imposition of penalties for any violations found) to assure the Commission that the divestiture will be fully implemented.

state-of-the-art system. Nor does any neglected “systems development” appear to have harmed WorldCom in the marketplace; the Application clearly indicates that WorldCom continues to attract “a significant base of enterprise customers.”³ Moreover, there is no evidence that this transaction is “critical to Digex’s future growth and development.”⁴ There is no evidence that Digex could not have continued as it had been, and there is evidence that even assuming it could not, Digex was an extremely attractive acquisition/investment target at the time this transaction was announced.⁵

The Applicants also claim that the merger is in the public interest because it “ensure[s] that Intermedia remains an effective competitor in the provision of local and long distance service to business customers” in two ways: first, by giving Intermedia (without its interest in Digex) greater access to needed financing; and second, by freeing Intermedia from the capital demands of supporting and expanding Digex. These arguments are unsubstantiated and counterintuitive. It is unclear how WorldCom’s acquisition of Intermedia and subsequent resale of Intermedia’s business without its most valuable asset – the Digex investment – and with the high employee turnover and reduced morale created by the uncertainty inherent in even one acquisition (and here there will be two), will give Intermedia greater access to needed financing. Nor is there any evidence regarding what capital demands were made by Digex on Intermedia as

³ Application at 6.

⁴ Id.

⁵ See, e.g., In re Digex, Inc. Shareholders Litigation, Consolidated Civil Action No. 18336 (NC) filed in the Court of Chancery of the State of Delaware in and for New Castle County, October 19, 2000 (hereinafter “Digex Shareholders Litigation”) ¶ 33 (Exodus Communications Inc. (“Exodus”) offered \$120 a share for Digex, representing a premium of nearly 50 percent over Digex’s shares on September 1, 2000 and a three way merger with Intermedia, was proposed by Global Crossing).

its largest shareholder, or that the magnitude of whatever capital Intermedia made available to Digex was not rewarded with an increased market valuation for either Intermedia or Digex.

This merger thus fails the Commission's public interest analysis. It would result in no public interest benefits while competition and consumers would clearly be harmed.

ARGUMENT

The standards for reviewing this Joint Application are well established. Applicants bear the burden of proof and the Commission must determine whether the proposed merger would enhance competition or provide other public interest benefits that outweigh any anticompetitive effects.⁶ As explained below, Applicants fail to make the requisite showings.

I. THE MERGER WILL SUBSTANTIALLY LESSEN COMPETITION IN THE WEB HOSTING MARKET AND FURTHER ENTRENCH UUNET'S NEAR DOMINANCE OF THE INTERNET BACKBONE MARKET BY RAISING THE INTERNET CONNECTIVITY COSTS OF DIGEX'S RIVALS.

A. UUNet Has a Near Dominant Position in the Internet Backbone Market

WorldCom, through its UUNet subsidiary, has near dominance of the Internet backbone market. The Applicants' continued insistence to the contrary in their Application⁷ is belied by this Commission's Order in the WorldCom/MCI merger⁸ and the record assembled in that

⁶ Memorandum Op. and Order, Application of Consent for the Transfer of Control Licenses and Section 214 Authorizations from MediaOne Group, Inc. to AT&T Corp., 15 FCC Rcd. 9816, ¶ 9 (2000) ("AT&T-MediaOne Merger Order"); see also Bell Atlantic-NYNEX Merger Order ¶¶ 2-3.

⁷ Claiming that there is no Internet backbone market (referring instead to an "ISP industry"), Application at 22 and n. 65, and that it is merely one of many competitors with declining market share, Application at 23, in an industry with no meaningful barriers to entry, Application at 19.

⁸ Memorandum and Order, Application of WorldCom, Inc., and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., CC Dkt No. 97-211 (rel. Sept. 14, 1998) ("WorldCom/MCI Order"). The Department of Justice's analysis of WorldCom/MCI merger is set forth not only in the

(footnote continued on next page)

proceeding and in the subsequent WorldCom/Sprint proceeding.⁹ In each of these proceedings, the evidence accumulated demonstrated that: (a) the Internet backbone market is a discrete economic market;¹⁰ (b) UUNet is already approaching a dominant position in this market, with more than twice the market share of its nearest competitor; and (c) anticompetitive “network effects” are a very real possibility if WorldCom is allowed to merge with another Internet Backbone Provider (“IBP”).¹¹

Thus, it was no surprise that, with respect to the merger at issue in this proceeding, the DoJ filed a Complaint alleging that: (1) since 1996, WorldCom has acquired Internet backbones in order to achieve its near dominant position; (2) the relevant market is the provision of Internet

(footnote continued from previous page)

DOJ’s Press Release, Justice Department Clears WorldCom/MCI Merger After MCI Agrees to Sell Its Internet Business (July 15, 1998), http://www.usdoj.gov/atr/public/press_releases/1998/1829.htm. but also the Speech of Constance Robinson, Director of Operations and Merger Enforcement, Antitrust Division, U.S. Department of Justice, before the Practising Law Institute, San Francisco, California, August 23, 1999, entitled “Network Effects in Telecommunications Mergers, MCI WorldCom Merger: Protecting the Future of the Internet” (“Robinson Speech”), appended as Exhibit C to Petition of AT&T Corp. to Deny Application in WorldCom/Sprint, CC Docket No. 99-333, filed February 18, 2000, which is incorporated herein by reference.

⁹ In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Sprint Corporation, Transferor, to MCI WorldCom, Inc., Transferee, CC Docket No. 99-333 (“WorldCom/Sprint”). See also, the DoJ Complaint filed in United States of America v. WorldCom, Inc. and Sprint Corporation, Case No. 1:00CV01526 (D.D.C. June 27, 2000) (“U.S. v. WorldCom and Sprint”).

¹⁰ Indeed, in MCI/WorldCom, the Commission held that “based on the record before us, we are inclined to agree with GTE and other commenters that Internet backbone services, which we define to be the transporting and routing of packets between and among ISPs and regional backbone networks, constitutes a separate relevant product market We agree with GTE that there do not appear to be good demand substitutes for ISPs and regional backbone service providers to obtain national Internet access without access to IBPs.” WorldCom/MCI Order at ¶148

¹¹ Id. ¶150.

connectivity by Tier 1 IBPs in the United States;¹² (3) based on a traffic study conducted by the DoJ in February, 2000, WorldCom's market share was 37%, more than twice the share of the next largest provider;¹³ (4) the proposed merger would lead to anticompetitive network effects because WorldCom would refuse to peer with current Tier 1 IBPs for interconnection, and either fail to augment (e.g., by denying, withholding, or "slow rolling" requested upgrades) or otherwise degrade the quality of interconnection capacity between peers, which will, in turn, decrease the quality of the experience for Internet customers;¹⁴ and (5) entry barriers are high and the merger of the Applicants' backbones would only raise those barriers.¹⁵ The record before the Commission in the prior WorldCom merger proceedings substantiates each of these allegations.¹⁶

¹² U.S. v. WorldCom and Intermedia at ¶¶ 15-27.

¹³ Id. ¶ 28.

¹⁴ Id. ¶ 38.

¹⁵ Id. ¶¶ 39-40. Indeed, WorldCom's control of public interconnection facilities could further exclude rivals. id.

¹⁶ AT&T incorporates herein by reference its entire Petition to Deny in the WorldCom/Sprint proceeding, filed on February 18, 2000, as well as the supplemental submission by its economist, John Preston, filed on May 26, 2000. The affidavit of Rose Klimovich appended as Exhibit F to AT&T's Petition to Deny, was the only evidence in that record by a witness with first hand knowledge of the industry. AT&T also submitted data on market share including an International Data Corporation report that noted the "continuing dominance of UUNet" and concluded that UUNet controls 43% in the wholesale segment, "at least almost double the share of the nearest competitor." IDC, "Internet Service Provider Market Review and Forecast, 1999-2004" http://cyberatlas.internet.com/big_picture/hardware/print/0,1323,5921_304631,00.html. See also, Exhibit D to AT&T's Petition to Deny.

B. The Merger Will Raise the Costs of Web Hosting Rivals and Further Entrench UUNet's Near Dominance of the Backbone Market

The web hosting market includes colocation and managed hosting. Colocation involves the provision of data center space which users can use to locate servers to connect to the Internet backbone. Managed hosting includes the provision of value added services such as security services, firewall management and application hosting services.¹⁷ Web hosting services are becoming a “critical enabler” of e-commerce and an “essential element” of telecommunications.¹⁸

Digex is a “leading” provider of managed web and application hosting services and related value added security services such as firewall management, with “state of the art data centers.”¹⁹ It has approximately 700 customers, from “mainstream enterprise corporations” such as First Republic Bank and Forbes, to Internet-based businesses and Application service providers.²⁰ Its revenues were \$59.8 million in 1999 and \$70 million in the first-half of 2000.

UUNet similarly offers Internet protocol virtual private networks (“IP/VPNs”), web hosting, colocation at data centers, applications hosting and Internet security systems. It was

¹⁷ Merrill Lynch, *Internet Infrastructure 2000* (25 July 2000) at 139-142.

¹⁸ Deutsche Banc Alex. Brown, Web Hosting Update: Digex Gains New Parent in WorldCom. Digex and Exodus Remain in Excellent Position, October 3, 2000 (hereinafter “Web Hosting Update”) at 6.

¹⁹ Digex 8K filed October 27, 2000; Web Hosting Update at 7 (Digex and Exodus remain fundamentally very sound and are positioned to be definitive winners in the Web hosting and manages services space”); Merrill Lynch, Digex Inc.: New Leader in the Making Q3 Earnings Analysis (October 27, 2000) (hereinafter “Merrill Lynch, Q3 Earnings Analysis”) at 2 (“the transformation should position Digex to challenge Exodus for hosting industry leadership”).

²⁰ Digex 8K, supra.

recently reported that WorldCom hosted 178 of the top 500 busiest sites.²¹ Owning the “premier” e-commerce web sites is critical for competing for web hosting business.²² Switching costs are high, leading to customer churn that averages 2% per year. As noted in a recent Merrill Lynch report:

“since customer churn is all but non-existent, competing for a customer once it has entered a data center is extremely difficult. These customers become captive to the existing provider and make their acquisition by another hosting provider very costly.”²³

Moreover, the provider with an advantage in the cost of Internet backbone interconnection has a decided advantage in obtaining new customers. Internet connectivity constitutes the main cost of providing web hosting service. Because Internet connectivity is the largest component of providing collocation for an Internet application (sometimes up to 60% of the total charges), “connectivity providers have a great deal of leverage.”²⁴

The merger will have obvious anticompetitive vertical effects. With WorldCom’s near dominance of the Internet backbone market, and the need of web hosting companies to interconnect with that backbone, the merger will increase WorldCom’s incentive and ability to raise its web hosting rival’s costs to interconnect with the UUNet backbone or degrade the quality of their interconnection.²⁵

²¹ <http://www.data.com/issue/990607/topisps.html>

²² Morgan Stanley Dean Witter, Exodus Communications, (October 2, 2000) at 4; see also, Merrill Lynch, Internet Infrastructure, supra, at 144.

²³ Morgan Stanley Dean Witter, Exodus Communications, supra, at 3.

²⁴ Merrill Lynch, Internet Infrastructure, supra, at 143-144.

²⁵ Michael Kende, Director of Internet Policy Analysis, Office of Plans and Policy, The Digital Handshake: Connecting Internet Backbones, OPP Working Paper No. 32, Federal Communications Commission (September, 2000) (hereinafter “OPP Working Paper”),

(footnote continued on next page)

As noted above, the need to reduce Internet connectivity costs is critical to compete in the web hosting market. Indeed, it is a key, if not the key, driver of this merger.²⁶ As Bernard Ebbers, WorldCom's CEO, stated during a September 5, 2000 conference call with the press: "WorldCom's relationship with Digex will be one of providing certainly network connectivity and capacity at very attractive pricing."²⁷ If UUNet's web hosting competitors' connectivity costs to the UUNet backbone are raised or the quality of that interconnection degraded²⁸ the proposed merger will allow Digex to have an improper, yet insurmountable competitive advantage.²⁹

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cited by the Applicants at 19, n.50. As noted therein (at 19 and n. 77) Genuity and PSINet reportedly refused to enter into a settlements-free peering arrangement refused by Exodus.

²⁶ Merrill Lynch, Q3 Earnings Analysis at 3 (noting the merger of "WCOMs ... extensive peering relationships [with] with DIGX's hosting expertise") (emphasis added).

²⁷ Digex Shareholders Litigation, ¶ 39.

²⁸ See, e.g., Memorandum Opinion and Order, Applications of Ameritech Corp. and SBC Communications Inc. For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules, 14 FCC Rcd. 14712, ¶ 237 (1999).

²⁹ Web Hosting Update at 7 (Digex and Exodus remain fundamentally very sound and are positioned to be definitive winners in the Web hosting and manages services space"); Merrill Lynch, Q3 Earnings Analysis at 2 ("the transformation should position Digex to challenge Exodus for hosting industry leadership"). It would be insurmountable even over Exodus. The need to reduce Internet connectivity costs is apparently a key driver of the announced Exodus/Global Center transaction; Exodus will now purchase most of its transit services from Global Crossing at below market rates. Forrester, Exodus Must Fire Up Managed Services Engine (October 3, 2000) at 1; see also, IDC Flash, Exodus Nabs Global Center (2000) at 3-4; CIBC World Markets, Exodus Communications (September 28, 2000) at 1. In light of the near dominance of UUNet's backbone (generally and certainly relative to Global Crossing), the new WorldCom/Digex web hosting entity will have a marked competitive advantage.

The shift of Digex's sizeable web hosting traffic to UUNet's backbone will also further entrench UUNet's position in the Internet backbone market by increasing the volume of traffic carried by UUNet's backbone. This could very well tip the Internet backbone market in WorldCom's favor even with the divestiture of Intermedia's Internet backbone assets ordered by the Department of Justice.³⁰

II. THE PROPOSED MERGER PROMISES NO LEGITIMATE BENEFITS

As shown below, Applicants claimed public interest benefits for their merger cannot withstand review.

A. The Proposed Merger Will Not Promote Internet Competition

Applicants' merger will not promote Internet competition either in the backbone market or in the web hosting market. The Applicants claim that the "complementary strengths" of Digex

³⁰ In the Proposed Final Judgment filed with the Complaint, WorldCom commits to divest Intermedia's assets other than its interest in Digex. Proposed Final Judgment, ¶ IV.A. While the Proposed Final Judgment sets forth in broad terms the employees and assets to be divested, and some minimum qualifications for the Acquirer, *Id.* ¶¶ IV C-G, WorldCom still has discretion to choose the least threatening Acquirer. More significantly, as demonstrated by Cable & Wireless ("C&W") in sworn, detailed factual affidavits in the *WorldCom/Sprint* proceeding, which AT&T incorporates herein by reference, WorldCom purportedly breached the commitments it made under the Divestiture Order in that case. Specifically, in the *WorldCom/MCI* proceeding, WorldCom committed to the Commission that it would transfer all of MCI's contracts with wholesale and retail customers, all necessary employees and all other necessary support arrangements to fulfill existing contractual obligations of the MCI business; MCI/WorldCom was also to refrain from soliciting or contracting to provide dedicated Internet access services for a specified period. *WorldCom/MCI Order*, ¶ 151. Yet C&W's sworn affidavits set forth the detailed factual basis for believing that WorldCom did not fully transfer iMCI's Internet customer base to C&W; did not provide the employees, assets or services necessary to operate iMCI as a viable business, and did not refrain from soliciting MCI's Internet customers. WorldCom paid \$200 million to settle C&W's Complaint during the same time that WorldCom sought approval of its merger with Sprint by proposing that Sprint's Internet backbone assets would be divested. Cable & Wireless Press Release, March 1, 2000, http://www.cw.com/th_print.asp?ID=mc_114mar0100. AT&T accordingly suggests that the Commission should impose conditions (with an expedited process for hearing

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and WorldCom in “the website and web enabled applications hosting businesses ... will create a stronger, more effective and more innovative competitor for those services.”³¹ That claim is misleading, unsubstantiated and irrelevant.

The crux of the Applicants’ argument is that WorldCom is not as strong as Digex in this market in terms of support structure and automated systems, while Digex is not as strong as WorldCom in terms of sales force, access to capital and customer base.³² The claim of having “complementary strengths” is misleading to that extent that it suggests that the Applicants do not compete in the same market. As shown above, the Applicants currently compete against each other in the web hosting market. Equally important, that claim is unsubstantiated. The Application is bereft of any explanation, supporting affidavit or other evidence demonstrating how WorldCom’s “support structure and automated systems” is different from, let alone inferior to, that of Digex.

Even if the Applicants were to provide some credible evidence substantiating a claim of different systems, WorldCom is already able to compete effectively in this market, despite its 18 month lag in developing the allegedly needed state-of-the-art systems. Indeed, WorldCom’s concedes that it has a “significant base of enterprise customers.”³³ WorldCom does not even claim that it cannot develop the “necessary” systems. Rather, it merely asserts that it has not

(footnote continued from previous page)

complaints and the imposition of penalties for any violations found) to assure the Commission that the divestiture will be fully implemented.

³¹ Application at 1-2 and 6.

³² Id. at 6.

³³ Id.

done so because it has “focused its efforts on expanding its colocation business” during these past 18 months.³⁴ But absent this merger, WorldCom would have both the identical incentives and the identical resources to focus on developing whatever systems it deems necessary. The critical difference from a competitor and consumer perspective, however, is that the two competing services will be reduced to one if the merger is consummated.

Finally, the Applicants’ “public interest” argument with respect to Digex is not that Digex cannot make the necessary investments, but rather that this merger “avoid[s] the need for redundant investments.”³⁵ But that is what competition is all about.

B. This Merger Is Not Necessary To Ensure Competition For Telecommunications Services

The Applicants claim that the merger is in the public interest because it “ensure[s] that Intermedia remains an effective competitor in the provision of local and long distance service to business customers” in two ways: first, by giving Intermedia (without its interest in Digex) greater access to needed financing; and second, by freeing Intermedia from the capital demands of supporting and expanding Digex. These arguments are unsubstantiated and counterintuitive. It is unclear how WorldCom’s acquisition of Intermedia and subsequent resale of Intermedia’s business without its most valuable asset – the Digex stock – and with the high employee turnover and reduced morale created by the uncertainty inherent in even one acquisition (and here there will be two), will give Intermedia greater access to needed financing. Nor is there any evidence regarding what capital demands were made by Digex on Intermedia as its largest shareholder, or

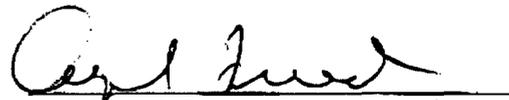
³⁴ Id.

³⁵ Id.

that the magnitude of whatever capital Intermedia made available to Digex was not rewarded with an increased market valuation for either Intermedia or Digex.

CONCLUSION

For the foregoing reasons, this merger fails the Commission's public interest analysis; it would result in no public interest benefits while competition and consumers would clearly be harmed.



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Attorneys for AT&T Corp.

December 6, 2000

CERTIFICATE OF SERVICE

I, Karen Kotula, do hereby certify that on this 6th day of December, 2000, a copy of the "Petition to Deny the Applications to Transfer Control" was mailed by U.S. mail, first class delivery, postage prepaid, to the parties listed below:

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