Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Request to Initiate Section 403 Proceeding	)	
Into Activities of WorldCom, Inc. and Other	)	
Commission Licensees	)	
	)	
And	)	RM-10613
	)	
Petition for Rulemaking	)	
To Establish Standards of Conduct	)	
For Telecommunication Providers	)	
	)	

COMMENTS OF VERIZON

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COMMENTS OF VERIZON[1]

Consistent with its rules, well-settled policies regarding the conduct and character of its licensees, and past enforcement precedents, the Federal Communications Commission ("Commission" or "FCC") should issue an order for WorldCom, Inc. ("WorldCom" or the "Company") to show cause why its FCC licenses and authorizations should not be revoked. The record before the Commission today contains sufficient undisputed evidence of wrongdoing to justify WorldCom's disqualification to hold any FCC authorizations. Moreover, as discussed below, WorldCom's repeated violations have caused significant harm to the telecommunications industry that would be exacerbated if WorldCom were allowed to reap further competitive advantage from its misdeeds.

I. INTRODUCTION AND SUMMARY

WorldCom engaged in fraud of unprecedented magnitude—a fraud that ended with the largest bankruptcy in corporate history. Investigations to date have made clear that WorldCom is

1 The Verizon Telephone Companies ("Verizon") are the affiliated telephone companies of Verizon Communications Inc. These companies are listed in Exhibit A.

a company that is imbued with a culture of fraud. Over more than three years, WorldCom's senior management and at least one board member fraudulently inflated the Company's revenues and profits to manufacture over $9 billion in value that did not exist, all to hide the results of its flawed business strategies.

WorldCom's fraud has had enormous negative consequences not only for its own shareholders, employees, and customers, but also for the entire telecommunications sector. WorldCom has imposed billions of dollars of costs on companies throughout the industry. Its actions have driven some of its competitors into bankruptcy and have contributed to a glut of excess capacity. Yet now, WorldCom is poised to reap further gains from its fraud by emerging from bankruptcy with assets it never should have acquired and with a cost structure that will allow it to engage in further destructive pricing behavior. At the same time, to add insult to injury, WorldCom continues to claim that the Commission should provide it with still further subsidies for its flawed business strategies by allowing it to use the networks of other carriers completely risk free, without making any investments of its own the way honest competitors have to do, and at prices that are well below cost.

The Commission cannot allow WorldCom to profit from its repeated and willful violations of law, including false statements to this Commission. Some parties will no doubt try to cast WorldCom's survival as a company as a competition issue. It is not. WorldCom's assets are in place and unquestionably will be used to provide service in the relevant markets. The question confronting the FCC is whether those assets will be controlled by WorldCom—a company that was built on a foundation, and is imbued with a culture, of fraud—or by a new and honest owner with a fair cost-structure set by the free market. That is the question the Commission must answer directly. And it is a question that should be answered without commencing a new proceeding to establish burdensome new requirements for the rest of the industry, the result of which would be to impose still further costs on honest companies. WorldCom is a class of one and should be addressed as such.

II. FACTUAL BACKGROUND

WorldCom has perpetrated the "largest instance of corporate fraud in the history of U.S. commerce."[2] Simply put, the Company—with the knowledge and enthusiastic participation of its senior management and at least one member of the board of directors—intentionally defrauded millions of investors, creditors, and vendors. At least three separate but interrelated fraudulent schemes extended over a period of more than three years. These schemes painted a false picture of WorldCom revenues, capital expenditures, and profitability during that period—in essence "cooking-up" over $9 billion in value that did not exist.[3] As the court-appointed Examiner, former Attorney General Dick Thornburgh, described it in his First Interim Report, WorldCom engaged in "a concerted program of manipulation that gave rise to a smorgasbord of fraudulent journal entries and adjustments."[4] Whenever "WorldCom's revenue figures did not meet or exceed the budgeted amounts, the Company would increase improperly revenues."[5]

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2 Christopher Stern & Kathleen Day, *U.S. Ready to Charge WorldCom Ex-Officers*, The Washington Post, July 26, 2002, at E01.

3 *WorldCom Says Restatements Could Top 9 Billion Dollars*, Agence France-Presse, Nov. 5, 2002.

4 *WorldCom, Inc.*, First Interim Report of Dick Thornburgh, Bankruptcy Court Examiner, Case No. 02-15533 at 105 (Bankr. S.D.N.Y.) (Nov. 4, 2002) ("First Thornburgh Report") (attached as Exhibit B hereto). Attorney General Thornburgh's findings are based on the review of millions of documents as well as testimonial evidence, including interviews with current and past WorldCom employees. *Id*. at 4.

5 *Id*. at 8.

To accomplish this, WorldCom initially "manipulated its reported financial performance by drawing down excess or other reserves into earnings."[6] This scheme involved the conscious inflation of numerous reserve accounts and then the use of these accounts as a financial "cookie jar" to draw down when true revenues did not meet Wall Street estimates. This fraudulent practice was employed from 1999 through 2000 and accounted for approximately $2.3 billion or more in falsified revenues during that period.[7] The Company could have continued this practice, Attorney General Thornburgh found, had it been allowed to merge with Sprint in 2000 because the "combination would have allowed the Company not only to replenish its reserves, but also to increase them dramatically."[8] With the demise of the Sprint transaction, however, "WorldCom did not have adequate excess reserves to draw down as a vehicle to increase earnings going forward."[9]

In evident search of another fraudulent accounting technique, the Company, shortly thereafter, "took the brazen and radical step of converting substantial portions of its line costs into capital items."[10] This improper capitalization of line costs continued for five quarters, from 2001 to 2002, and resulted in an overstatement of capital investment and understatement of expenses of more than $3.8 billion. The scheme resulted in vast overstatements of WorldCom's capital expenditures and existing capital assets, a fact that, as accounting expert Robert A. Howell has noted, could not have been missed by senior management and the board of directors.

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[6] *Id.*

[7] *Id.* at 108.

[8] *Id.* at 8.

[9] *Id.*

[10] *Id.*

> [T]he CEO and Board of Directors should not have missed this one. I assume that the Board, on the guidance of the CEO and senior financial staff, has to approve the annual plan, including capital expenditures. WorldCom reported that the company spent around $8 billion on capital expenditures in 2001. We now find out that this number is overstated by $3 billion. So the company actually spent around $5 billion for capital expenditures. It would seem that this number must have been around the amount included in the 2001 plan. When the actually reported numbers come through at $8 billion, the size of the difference would seem too large to miss, unless people were asleep, or went along with the "program." Neither choice is very good.[11]

Finally, Attorney General Thornburgh's report alludes to a third collection of schemes designed to inflate revenues improperly.[12] These include improper accounting for transactions between WorldCom subsidiaries, misstatement of goodwill, possible improper capitalization of labor costs, and improper accounting treatment of the financial results of certain majority-owned subsidiaries.[13] Some of these schemes may reach back "at least to 1998 and likely earlier."[14] The next report by Attorney General Thornburgh—which will be issued in early March—is expected to address these schemes in greater detail, as is the report being prepared by the Special Investigative Committee of WorldCom's board of directors.

This course of conduct, which extended over more than three years and involved numerous members of senior management, was part of a corporate strategy to enhance illegally the competitive position of WorldCom at the expense of its competitors. As Attorney General

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11 *WorldCom's Accounting Shenanigans Explained*, The Wall Street Journal Online, June 26, 2002, available at http://accounting-net.actg.uic.edu/Enron/WorldCom's%20Accounting%20Shenanigans%20Explained%20-%20June%2026%2002%20-%20WSJ.htm (last visited Jan. 29, 2003).

12 First Thornburgh Report at 8, 110-17.

13 *Id*. at 110-17.

14 *Id*. at 111.

Thornburgh found, WorldCom's management determined that "competition and capital requirements in the telecommunications industry would result in consolidation of competitors to a few dominant companies" and that, "to survive, WorldCom needed to grow its services, customer base and facilities rapidly and continually."[15] In addition, "investment in new technologies was critical to reducing marginal costs, attracting customers, and meeting their demand for new and better services."[16] As a result, WorldCom needed to grow, and

> the most effective means to grow was the acquisition of existing telecommunications companies with desirable shares of geographic or service markets. . . . Public statements by WorldCom executives suggest that these acquisitions were intended to achieve strategically broader geographic coverage of the Company's services, more and better transmission facilities, new services (such as data transmission, Internet, web hosting and wireless services), and new markets.[17]

Because the Company lacked existing capital to fund these acquisitions, its stock became "the fuel that kept WorldCom's acquisition engine running at a very high speed."[18] As a result, the Company "needed to keep its stock price at high levels to continue its phenomenal growth."[19] In order to inflate its stock price, "WorldCom put extraordinary pressure on itself to meet the expectations of securities analysts," which "created an environment in which reporting numbers

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15 *Id*. at 11.

16 *Id*. at 11.

17 *Id.* According to Attorney General Thornburgh's report, WorldCom "acquired other telecommunications companies at an unrelenting pace—over 60 acquisitions in just over 15 years" from 1985 to 2001. *Id.*

18 *Id*. at 6. In fact, Attorney General Thornburgh found that "WorldCom grew in large part because the value of its stock rose dramatically." *Id. See also id*. at 99.

19 *Id*. at 6.

that met those expectations, no matter how these numbers were derived, apparently became more important that accurate financial reporting."[20]

At the same time that WorldCom was capping its acquisition spree, it was busy infusing its business with billions of dollars of fraudulently acquired debt. Between 1999 and 2001, WorldCom increased its outstanding long-term debt from $13.1 billion to more than $30 billion.[21] WorldCom used these funds to expand its business and fund its operations, acquiring equipment, customers, and facilities that it holds to this day. It is, therefore, no overstatement to say that WorldCom is a company built on fraud. A large and unsegregable part of its current business is the fruit of its crime. Many of the assets considered part of the "estate" in WorldCom's bankruptcy would not be a part of that estate but for the Company's illegal conduct.

There are at least four independent reasons why the Commission must take immediate action to remedy the significant public interest harms WorldCom's conduct has caused. *First*, WorldCom repeatedly lied to the Securities and Exchange Commission ("SEC") and FCC in reporting its revenues and capital expenditures. WorldCom also made misrepresentations to this Commission in other filings. In particular, WorldCom obtained approval for its multi-billion dollar merger with Intermedia Communications Inc. ("Intermedia"), in part, by providing the Commission with false statements about WorldCom's financial condition—statements upon which the agency relied in determining that the transaction was in the public interest. These and other WorldCom misstatements are now documented in guilty pleas entered by its officers and in

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20 *Id*. at 7.

21 WorldCom, Inc., Annual Report for the Year Ending December 31, 2001, SEC Form 10-K at 33-39 (filed Mar. 13, 2002) ("WorldCom 2001 10-K").

the Company's consent agreement with the SEC.[22] Yet, in direct contravention of Commission rules, WorldCom has done nothing to correct these willful false statements made to the Commission.

Second, WorldCom, through its principals, engaged in non-FCC related crimes and misconduct that should disqualify it from holding Commission authorizations. As indicated above, four senior managers at WorldCom, including one corporate officer, already have pled guilty to numerous felony charges involving fraudulent conduct. A fifth former corporate officer and former member of the board of directors stands indicted. Concerted criminal activity by the senior management of any FCC licensee over a period spanning more than three years compels Commission action. The FCC has suspended or revoked licenses for substantially more isolated and less egregious non-FCC related criminal conduct in the past.

Third, WorldCom's actions have caused (and continue to cause) substantial harm to competition in the communications markets. WorldCom has seized an unfair competitive advantage by: (1) acquiring facilities, personnel, and customers through mergers and acquisitions that were financed by the Company's fraud and that would not otherwise have occurred; (2) forcing competitors to lower prices to ruinously low levels in order to compete with phantom revenue and profit numbers; (3) obtaining financing through debt instruments issued on favorable terms predicated on the Company's fraudulent financial reporting; and (4) incurring large accounts receivable with other carriers that relied upon the false financial picture painted by WorldCom's fraudulent manipulations.

Fourth, the Commission should not allow WorldCom to profit from its fraud at the expense of the rest of the industry. The continued use of Title II and Title III authorizations by

[22] *SEC v. WorldCom, Inc.*, Civil Action 02 CV 4903, Judgment of Permanent Injunction Against Defendant WorldCom, Inc. (S.D.N.Y.) (Nov. 26, 2002) ("Consent Agreement").

WorldCom is not in the public interest. WorldCom's acquisition spree was not the product of a prudent and coherent business plan, but rather part and parcel of continuing (and concealing) its fraudulent conduct. In an industry already plagued by overcapacity and declining demand, allowing WorldCom to emerge from bankruptcy with unfair competitive advantages gained solely through fraud is not in the public interest. The Commission should direct WorldCom to show cause why it should not be stripped of its licenses. If it cannot meet that burden, market forces should be allowed to determine the highest and best use of WorldCom's assets. This is in the best interest of WorldCom's employees, its customers, and the long-term health of the telecommunications industry, because any buyer of WorldCom's assets, having paid fair market value, would have a cost structure on par with the Company's honest competitors.

III. THE FCC HAS ROUTINELY INVESTIGATED AND REMEDIED VIOLATIONS OF ITS FUNDAMENTAL CHARACTER QUALIFICATIONS POLICIES.

The Commission has clearly articulated standards of licensee behavior that apply to WorldCom no less than to any other Commission licensee. At their core, those standards require that FCC licensees be truthful and candid with the Commission and other government agencies, that they not violate the law, and that they not engage in anticompetitive activities.

A. The Commission's Character Qualification Policies Are Well-Defined And Well-Established.

Evaluation of the character and fitness of parties seeking to become or remain FCC licensees is a primary concern of the Commission—deemed so important, in fact, that the agency has embodied and periodically refined those standards in a *Character Policy Statement*.[23]

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23 *Policy Regarding Character Qualifications in Broadcast Licensing*, Report, Order and Policy Statement, 102 F.C.C. 2d 1179 (1985) ("*Character Policy Statement*"), *modified*, 5 FCC Rcd 3252, 3252-53 (1990), *recon. granted in part*, 6 FCC Rcd 3448, 3448-49 (1991), *modified in part*, 7 FCC Rcd 6564, 6566 (1992). Although character standards were originally applied to broadcast licensees, the Commission has found that the standards "can provide guidance in the common carrier area as well," *MCI Telecommunications Corp.*, Order and Notice of Apparent

Historically, the primary focus of the Commission's character requirements has involved "FCC-related" behavior—*i.e.*, whether a licensee or potential licensee is "likely to be forthright in its dealings with the Commission and to operate . . . consistent with the requirements of the Communications Act and the Commission's rules and policies."[24] Specifically proscribed are: (1) making intentionally false or misleading statements to the Commission; (2) willfully or repeatedly violating the Communications Act or FCC rules; and (3) willfully or repeatedly violating such other laws, regulations, or standards of behavior as to call into question the trustworthiness of the applicant.[25]

The Commission also has identified certain "non-FCC-related" behavior as relevant to its character requirements. Of specific interest to the FCC are: (1) fraudulent misrepresentations to another governmental unit; (2) felony convictions; and (3) anticompetitive actions or violations of the antitrust laws.[26] False statements to another government agency are of particular concern to the Commission because of the "nexus between fraudulent representations to another

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(Continued . . .)
Liability, 3 FCC Rcd 509, 515 n.14 (1988), and has routinely applied the standards to carriers holding Section 214 authorizations and Title III licenses, *e.g.*, *Southern New England Telecommunications Corp.*, Memorandum Opinion and Order, 13 FCC Rcd 21292, 21305 (1998).

[24] *Character Policy Statement*, 102 F.C.C. 2d at 1209. In developing the Character Policy Statement, the Commission said that it "focused on specific traits which are predictive of an applicant's propensity to deal honestly with the Commission and comply with the Communications Act and the Commission[']s rules or policies." *Character Policy Statement,* 102 F.C.C. 2d at 1189.

[25] *Character Policy Statement*, 102 F.C.C. 2d at 1208-12. In particular, the Commission has described the duty of licensee candor as "basic and well known." *See, e.g., Sea Island Broadcasting Corp. v. FCC,* 627 F.2d 240, 243 (D.C. Cir. 1980), *cert. denied*, 449 U.S. 834 (1980) ("*Sea Island*"); *Golden Broadcasting Systems, Inc.*, Decision, 68 F.C.C.2d 1099, 1101-04 (1978). *See also* 47 C.F.R. § 1.17 (requiring truthful written statements in filings with the Commission and prohibiting misrepresentations and willful material omissions).

[26] *Character Policy Statement*, 102 F.C.C.2d at 1196, 1209.

governmental unit and the possibility that an applicant might engage in similar behavior in its dealings with the Commission."[27] Further, the FCC has suggested that "in an era of increasing reliance on marketplace forces to achieve public interest goals, fraud which negatively affects the marketplace might be a proper matter for consideration."[28]

B. Until Now, The Commission Has Routinely Used Its Character Policy As The Basis For Investigations Of And Enforcement Actions Against FCC Licensees.

Where there is credible evidence of wrongdoing, the Commission has routinely investigated wrongdoers and taken steps to remedy any market harms their wrongdoing has caused. In doing so, the Commission has employed the full range of its investigatory powers to discover wrongdoing—including requiring sworn statements, depositions, production of documentary evidence, and evidentiary hearings.[29] In appropriate cases, the Commission has disqualified companies from holding FCC authorizations.[30] Fundamentally, the Commission's character requirements are aimed at ensuring that its licensees, as "'fiduciaries of a great public

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[27] *Id.* at 1196.

[28] *Id.* at 1198.

[29] *See, e.g., MobileMedia Corporation*, Order to Show Cause, Hearing Designation Order and Notice of Opportunity for Hearing for Forfeiture, 12 FCC Rcd 14896 (1997) (instituting a hearing to investigate questions of licensee's lack of candor after extensive investigation including depositions of the company's board of directors); *Norcom Communications Corporation*, Order to Show Cause, Hearing Designation Order and Notice of Opportunity for Hearing for Forfeiture, 13 FCC Rcd 21493 (1998) (hearing to investigate unauthorized transfer of control); *James A. Kay, Jr.*, 10 FCC Rcd 2062 (1994); *Marc D. Sobel*, Order to Show Cause, Hearing Designation Order and Notice of Opportunity for Hearing for Forfeiture, 12 FCC Rcd 3298 (1997); *The Lutheran Church/Missouri Synod For Renewal of Licenses of Stations KFUO/KFUO-FM Clayton, Missouri*, Hearing Designation Order and Notice of Opportunity For Hearing For Forfeiture, 9 FCC Rcd 914 (1994).

[30] *CCN, Inc*, Order to Show Cause and Notice of Opportunity for Hearing, 13 FCC Rcd 13599 (1998); *Radio Carrollton*, Memorandum Opinion and Order, 69 F.C.C.2d 1139, 1146 n.20 (1978); *Grenco, Inc.*, 39 F.C.C.2d 732, 737 (1973) ("[N]o one is allowed 'one bite' at the apple of deceit.").

resource,' will 'satisfy the highest standards of character commensurate with the public trust that is reposed in them.'"[31]

Historically, the Commission has not tolerated dishonesty in licensees or applicants, particularly dishonesty in dealing with the FCC itself. In fact, the Commission has found that "[o]nce we find that we cannot rely on a licensee's representations to us, the only suitable penalty is revocation of the license."[32] For example, in *Pass Word, Inc.*, the FCC revoked a radio common carrier's licenses on the grounds that it had "repeatedly and deliberately misrepresented and concealed facts over a three-year period in forms, correspondence, and pleadings,"[33] noting that "[t]he only appropriate remedy for such flagrant, unmitigated disregard of licensee responsibility is revocation."[34]

The Commission has been particularly intolerant of deception regarding a licensee's finances.[35] For example, in *RKO*, the Commission disqualified a licensee that "knowingly certified to the Commission that certain financial reports were complete and accurate when [it]

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31 *RKO, General, Inc. v. FCC*, 670 F.2d 215, 232 (D.C. Cir. 1981) *quoting FCC v. WOKO, Inc.*, 329 U.S. 223, 228 (1946) ("*RKO*").

32 *Sea Island*, 60 F.C.C.2d at 157 (revoking license because the owner and officers of the licensee company made deliberate misrepresentations and other misleading and deceptive statements to the Commission in order to conceal improper financial practices); *RKO General, Inc.*, Decision, 78 F.C.C. 2d 1 (1980), *aff'd*, 670 F.2d 215 (D.C. Cir. 1981) (denying an application based upon applicant's lack of candor in proceedings before the FCC).

33 *See Pass Word, Inc.*, Order to Revoke Licenses, 76 F.C.C.2d 465, 518 (1980), *aff'd*, *Pass Word, Inc. v. FCC*, 673 F.2d 1363 (D.C. Cir. 1982).

34 *Id.* at 519. Notably, Pass Word had requested that the FCC impose a forfeiture in place of revocation. The FCC denied this request stating "[f]orfeiture is not an appropriate sanction where willful efforts to deceive the Commission have taken place." *Id.* at 520.

35 *Sea Island* 60 F.C.C.2d at 157; *RKO*, 78 F.C.C. 2d at 80-81.

knew otherwise."[36] Likewise, in *George E. Cameron, Jr. Communications,* the Commission disqualified a licensee that had displayed an "egregious" and "inexcusable" lack of candor by filing misleading financial information designed to portray a "solid economic picture" of the Company that was "wholly illusory and in extreme contrast to the deep financial decline being experienced" by the Company.[37]

IV. WORLDCOM'S MISDEEDS FALL SQUARELY INTO THE RANGE OF BEHAVIOR CONSISTENLY FOUND TO DISQUALIFY ENTITIES FROM HOLDING FCC LICENSES AND AUTHORIZATIONS.

Although the full extent of WorldCom's misconduct and violations of law is not yet known, even the Company's known wrongdoing is staggering and touches virtually every aspect of behavior proscribed by the FCC's *Character Policy Statement*. A cursory review of the facts already presented to the Commission[38] or otherwise in the public domain shows that WorldCom repeatedly lied to the FCC and engaged in criminal and other non-FCC-related misconduct and that this misconduct had devastating and far-reaching implications for competition in the telecommunications industry. This behavior displays virtually all the earmarks of conduct that the FCC has deemed predictive of an entity's dishonesty and unreliability and has found sufficient to disqualify others from holding licenses or authorizations.

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36 *RKO*, 78 F.C.C.2d at 80-81.

37 *George E. Cameron, Jr. Communications*, Decision, 91 F.C.C.2d 870, 895-96 (1982).

38 Attachment B of UCC's Informal Objection, which UCC has incorporated by reference in this proceeding, presents a detailed outline of the facts known at the time of filing. *See* Office of Communication of the United Church of Christ, Informal Objection to Assignment Applications, *Applications of WorldCom, Inc., and its Subsidiaries, Assignor, and WorldCom, Inc., and its Subsidiaries as Debtor in Possession, Assignee, For Consent to Assign Commission Licenses*, RM-10613 (filed Oct. 15, 2002) ("UCC Informal Objection").

A. WorldCom Repeatedly Lied To The Commission.

To help conceal its fraudulent and anticompetitive schemes, WorldCom not only deceived investors, vendors, and consumers, but also intentionally deceived regulators, including the FCC. WorldCom submitted to this Commission much of the same false financial information that it submitted to the SEC between 1999 and the first quarter of 2002.[39] For example, as required by Section 43.21(b) of the Commission's rules, WorldCom appears to have filed with the FCC "verified" copies of fraudulent 10-K reports.[40] These fraudulent submissions have tainted everything from the accuracy of Commission reports on the financial health of the telecommunications industry (which serve as official records of the state of the telecommunications market) to the Commission's and other federal and state governmental agencies' assessments of marketplace conditions and development of regulatory policies to the strategic decisions of other industry participants and the investment decisions of innumerable investors.[41]

Moreover, these and other false submissions also contaminated the Commission's approval of WorldCom's acquisition of Intermedia Communications Inc. ("Intermedia") and its

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[39] *WorldCom Announces Additional Changes to Reported Income for Prior Periods*, Press Release (Aug. 8, 2002), available at http://www.worldcom.com/global/about/news/news2.xml?newsid=4111&mode=long&lang=en&width=530&root=/global/about/&langlinks=off (last visited Jan. 29, 2003); *WorldCom Announces Intention to Restate 2001 and First Quarter 2002 Financial Statements*, Press Release (June 25, 2002), available at http://www.worldcom.com/global/about/news/news2.xml?newsid=3230&mode=long&lang=en&width=530&root=/global/about/&langlinks=off (last visited Jan. 29, 2003).

[40] UCC Informal Objection at 16-19. Some of the fraudulent certifications and verifications to the FCC appear to have been signed by then-Senior Vice President and Controller of WorldCom, David Myers, who is now a convicted felon.

[41] *Id.*

controlling interest in Digex[42] and violated Section 1.17 of the Commission's rules, which requires that all written statements to the Commission be truthful.[43] In applications for FCC approval of that transaction, WorldCom falsely reported that it had $37 billion in revenues for 1999.[44] In addition, the Company also asserted to the FCC that: (1) the transaction was "critical for Digex's future growth and development" because it would provide Digex "access to WorldCom's capital"; and (2) the transaction would provide Intermedia "access to financing needed for capital expenditures and operating expenses."[45] Further, in documents filed with the applications, WorldCom represented that its SEC filings complied "in all material respects" with the securities laws and SEC regulations and contained no "untrue statement of a material fact nor omitted to state a material fact."[46] Finally—and perhaps most astonishingly—WorldCom warranted that its financial statements filed with the SEC complied "in all material respects with the accounting rules, [had been] prepared in accordance with GAAP . . .and fairly present[ed] in all material respects the consolidated financial position of [WorldCom] and its consolidated

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42 *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,* Memorandum Opinion and Order, 16 FCC Rcd 1017 (2001) ("*Intermedia Order*"). *See, infra,* Section IV.C. for a more detailed discussion of WorldCom's acquisition of Intermedia.

43 47 C.F.R. § 1.17.

44 *Applications of Intermedia Communications Inc., and WorldCom, Inc., 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 at 4 (filed Oct. 23, 2000) ("Intermedia Application")), available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdflid_document=6511960292 (last visited on Jan. 29, 2003).

45 *Id.* at 6-7.

46 Intermedia Application, Attachment E, Agreement and Plan of Merger § 3.6.

Subsidiaries" as of the dates of filing.[47] All of these representations were false and were known by WorldCom's senior management to be false.

Remarkably, the Company's lack of candor in its dealings with the Commission continues today. For example, when four of its senior managers pled guilty to criminal fraud charges, WorldCom had both debtor-in-possession assignment applications and a number of facilities applications pending before the FCC. Section 1.65 of the Commission's Rules requires applicants to provide the agency with "additional or corrected information" whenever information furnished in pending applications is no longer substantially accurate and complete or when there has been a substantial change as to any other matter that may be of decisional significance in a Commission proceeding involving that application.[48] Despite this clear requirement, it does not appear that WorldCom has ever advised the Commission of the criminal fraud convictions or any other aspect of the Company's wrongdoing.[49] These violations alone are sufficient to require WorldCom to show cause why its authorizations should not be revoked.[50]

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[47] *Id.*

[48] 47 C.F.R. § 1.65(a).

[49] See BLS and ULS File Nos. 20010423AAA, 199809110P, 20010423AAB, 20000808AAA, 20000808AAB, 20010723AAA, 20020507AAA, 20020507AAB, 20020619AAD, 20020619AAH, 20020619AAE, 20020619AAG, and 20020619AAJ.

[50] *See, e.g., AT&T Wireless Services, Inc., Washington, DC*, Notice of Apparent Liability for Forfeiture, 17 FCC Rcd 9903, 9911-12 (2002) (finding a violation of Section 1.65 for failing to inform the Commission that its GSM network would not be compliant with E911 Phase II rules from the date of deployment, in spite of prior representations to the contrary).

B. Undisputed Facts In The Public Record Establish That WorldCom Engaged In Fraudulent And Criminal Non-FCC-Related Misconduct.

WorldCom engaged in fraud of enormous proportions. As Attorney General Thornburgh noted in his First Interim Report, "WorldCom personnel responded to changing business conditions and earnings pressures by taking extraordinary and illegal steps to mask the discrepancy between the financial reality at the Company and Wall Street's expectations."[51] In three separate schemes spanning several years, the Company fabricated more than $9 billion in phantom revenues and assets. The fraud—and the strategic missteps the fraud was designed to hide—precipitated WorldCom's bankruptcy, with the resulting loss of more than $200 billion in debt and equity.[52] WorldCom's senior management not only knew of the fraud but enthusiastically participated in it. Indeed, WorldCom's actions had nothing to do with ambiguous accounting rules or regulatory uncertainty,[53] but were understood by the Company's senior management to have no basis in standard accounting practices.[54]

Based on its own investigation, the SEC, finding that WorldCom "defrauded investors ... [i]n a scheme directed and approved by its senior management," filed a civil fraud complaint

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51 First Thornburgh Report at 117-18.

52 Robert Schoenberger, *WorldCom reveals $3.3B error*, The Clarion (MS) – Ledger (Aug. 9, 2002) (noting that then WorldCom President John W. Sidgmore said that the scandal had led directly to the July 2002 Chapter 11 bankruptcy filing).

53 As SEC Chairman Harvey Pitt has said, WorldCom's actions were not a "mistake" but a "fraud." Harvey L. Pitt, Securities and Exchange Commission, Remarks Before the Economic Club of New York (June 26, 2002), available at http://www.sec.gov/news/speech/spch573.htm (last visited Jan. 29, 2003).

54 WorldCom acknowledged to the SEC on July 8, 2002, that "there was no directly applicable accounting support" for its accounting statements. *Revised Statement Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934 re WorldCom, Inc.*, HP-09440, ¶ 9 (July 8, 2002), available at http://www.sec.gov/news/extra/wcresponse.htm (last visited Jan. 29, 2003). *See infra* note 57.

against WorldCom in July 2002.[55] In November 2002, the SEC secured a consent agreement against WorldCom aimed at enjoining the Company from further violations of the securities law and preventing further false reporting.[56] Among other things, with respect to the purchase or sale of securities, the consent agreement enjoins WorldCom from: "(a) employing any device, scheme or artifice to defraud, (b) making any untrue statement of material fact …, or (c) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person."[57] WorldCom also is enjoined from obtaining "money or property by means of any untrue statement of material fact" and from "failing to make or keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of WorldCom."[58]

In addition, to date, four former senior managers of the Company, including a corporate officer, have been convicted of crimes associated with the fraud. David F. Myers (former Senior Vice President and Controller of WorldCom),[59] Buford Yates (former Director of General

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55 *SEC v. WorldCom, Inc.*, Civil Action 02 CV 4903, Complaint, at 1 (S.D.N.Y.) (June 26, 2002).

56 Consent Agreement at 2.

57 *Id.* at 2-3.

58 *Id.* at 3-4.

59 In pleading guilty, Mr. Myers testified under oath that he "was instructed on a quarterly basis by senior management to ensure that entries were made to falsify WorldCom's books to reduce WorldCom's reported actual costs and therefore to increase WorldCom's reported earnings. Along with others, who worked under my supervision and at the direction of WorldCom senior management, such accounting adjustments were made for which I knew that there was no justification or documentation and which I knew were not in accordance with Generally Accepted Accounting Principles." *United States v. Myers,* Case No. 02 CR 1261 (RCC), at 14-15 (S.D.N.Y. Sept. 26, 2002).

Accounting),[60] Betty Vinson (former Director of Management Reporting),[61] and Troy Normand (former Director of Legal Entity Accounting)[62] have already pled guilty to a variety of charges, including securities fraud, conspiracy to commit securities fraud, and submitting false filings to the SEC.[63] A former WorldCom officer and board member, Scott Sullivan, has been indicted on similar charges, and further indictments of senior managers may occur.[64] In the past, the FCC has found felony convictions of corporate principals, including convictions for crimes unrelated

[60] In pleading guilty, Mr. Yates testified under oath that he "was directed by my supervisors to make certain adjustments to WorldCom's reported financial statements, the effect of which was to reduce WorldCom's reported expenses and increase WorldCom's reported net revenue by approximately $800 million." *United States v. Yates*, Case No. 02 CR 1144 (BSJ), at 14 (S.D.N.Y. Oct. 7, 2002). While he was told "by my supervisors that this reduction was attributable to the release of reserves by other divisions within the company," Mr. Yates testified, he "was not provided with any documentation or detail to support the amount of the reduction." *Id.* at 14-15. Mr. Yates further testified that he and other employees were later "instructed by our supervisors . . . that WorldCom was going to capitalize excess leased line costs. . . . These adjustments had the effect of increasing Worldcom's net revenues as reported to the SEC." *Id.* at 15. Mr. Yates averred that at the time, he "had serious concerns as to whether this new practice was in accordance with generally accepted accounting principles," which concerns he "expressed . . . to my supervisor." *Id.*

[61] In pleading guilty, Ms. Vinson likewise testified under oath that she was "ordered by my supervisors" to make accounting adjustments which "contravened generally accepted accounting principles" and that in doing so she "participated with others at WorldCom . . . in a scheme that involved making false and misleading statements of material fact related to WorldCom's financial condition that operated as a fraud upon the purchasers and sellers of WorldCom stock." *United States v. Vinson*, Case No. 02 CR 1329 (RWS) (AJP), at 30, 31 (S.D.N.Y. Oct. 10, 2002).

[62] Mr. Normand made similar statements under oath and said that he "came to believe that these adjustments were being directed to make in WorldCom's financial statements had no justification and contravened generally accepted accounting principles. I concluded that the purpose of these adjustments was to incorrectly inflate WorldCom's reported earnings in order to meet their expectations of securities analysts and ultimately mislead the investing public as to the company's financial condition." *United States v. Normand*, Case No. 02 CR 1341, at 45 (S.D.N.Y. Oct. 10, 2002).

[63] Felony convictions based on guilty pleas are relevant to the FCC's character qualification inquiry, just as felony convictions based on jury trials are. *See, e.g.*, *Richards*, Initial Decision of Administrative Law Judge, 9 FCC Rcd 3604 (1994).

[64] *United States v. Sullivan*, Case No. 02 CR 1144 (BSJ) (S.D.N.Y.).

to the operation of FCC-licensed facilities—like those resulting from the WorldCom scandal—sufficient to justify revocation of licenses.[65]

C. **<u>Through Its Unlawful Activities, WorldCom Obtained Unfair Competitive Advantages And Caused Significant Harm To Competition In The Telecommunications Industry.</u>**

WorldCom's actions were part of an orchestrated fraudulent scheme with clear anticompetitive goals and, ultimately, significant negative consequences for the entire telecommunications industry.[66] First, WorldCom originated the false claim that Internet traffic was doubling every 100 days, which made its way into a report entitled "The Emerging Digital Economy" issued by the Department of Commerce in 1998.[67] WorldCom's overestimate of the growth rate for Internet traffic distorted the market by triggering a massive wave of investment in network build-out to accommodate the anticipated surges in Internet traffic.[68] Then, when

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[65] *See, e.g., Contemporary Media, Inc*., Decision 13 FCC Rcd 14437, 14459, *aff'd*, 214 F.3d 187 (D.C. Cir. 2000) (1998) (principal's felony convictions on sexual assault charges deemed disqualifying); *Williamsburg County Broadcasting Corp.*, Order to Show Cause and Order Requiring Consolidation, 5 FCC Rcd 3034 (1990) (felony drug conviction of principal results in revocation proceeding). *See also Modification of Character Policy Statement*, Policy Statement and Order, 5 FCC Rcd 3252, 3252 (1990) ("[w]e believe a propensity to comply with the law generally is relevant to the Commission's public interest analysis . . . Thus evidence of any conviction for misconduct constituting a felony will be relevant to our evaluation of an applicant's or licensee's character"(citations omitted)).

[66] *See supra* at 2-6.

[67] *The Emerging Digital Economy*, Report of the U.S. Department of Commerce, at 8 (April 1998), available at http://www.ta.doc.gov/digeconomy/EmergingDig.pdf. In fact, WorldCom had used its own accelerated capacity growth as a proxy for growth in Internet usage. Robert W. Crandall, *Would a Debt-Free WorldCom Wreck the Telecom Industry*, at 4 (January 2003) ("Crandall Study") (attached hereto as Exhibit C). *See also* Yochi J. Dreazen, *Behind the Fiber Glut—Telecom Carriers Were Driven By Wildly Optimistic Data on Internet's Growth Rate*, The Wall Street Journal, Sept. 26, 2002, at B1.

[68] *The Power of WorldCom's Puff*, The Economist (July 18, 2002), available at http://evro.nhh.no/sol/org200/notater/WorldCom'sPuff.htm (last visited Jan. 29, 2003); Yochi J. Dreazen, *Behind the Fiber Glut—Telecom Carriers Were Driven By Wildly Optimistic Data on Internet's Growth Rate*, The Wall Street Journal, Sept. 26, 2002, at B1.

WorldCom's false growth predictions failed to materialize, WorldCom "cooked" its books to show revenues and margins consistent with Wall Street expectations.

Meanwhile, WorldCom's honest competitors, baffled by WorldCom's apparent success in spite of unfavorable market conditions, priced their services at unsustainably low levels in futile attempts to match WorldCom's false revenue growth and margins, with disastrous consequences.[69] According to Sprint's Chairman and CEO William Esrey, "[w]e kept asking ourselves what we were doing wrong. As we discovered, the margins were a work of fiction and their destructive effect on our industry was very real."[70] As a direct result of their reliance on WorldCom's false claims and numbers, a number of companies have been forced to seek bankruptcy protection.[71]

Not only did WorldCom's fraudulent financial filings create unrealistic expectations for all carriers, but they also enabled WorldCom to disadvantage its competitors by extending the Company's geographic and product markets. As discussed above, the Company's preferred means of executing this scheme was to use its fraudulently inflated stock to acquire other business and product lines. It also used its kited balance sheets to borrow billions of dollars on favorable terms it could not otherwise have obtained. The Commission's own processes were

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69 *See* Crandall Study at 5. *See also* Patrick Thibodeau, *Sprint CEO Hits WorldCom, Cites Long-Term Industry Damage*, Computer World, Oct. 21, 2002, available at http://www.computerworld.com/managementtopics/xsp/story/0,10801,75298,00.html) (last visited Jan. 26, 2003).

70 *Id. See also WorldCom Admits to Inappropriately Inflating Reported Earnings by Over 800%,* Press Release, Asensio & Company, Inc., June 26, 2002, available at http://www.asensio.com/WorldCom/wcom1.htm (last visited Jan. 29, 2003).

71 Crandall Study at 5; Yochi J. Dreazen, *Behind the Fiber Glut—Telecom Carriers Were Driven By Wildly Optimistic Data on Internet's Growth Rate*, The Wall Street Journal, Sept. 26, 2002, at B1.

used in furtherance of this anticompetitive conduct.[72] Specifically, as noted above, in October 2000,[73] WorldCom filed an application with the FCC for consent to acquire control of Intermedia.[74] WorldCom paid no cash for Intermedia; it was acquired entirely through the exchange of overvalued stock and acquisition of existing debt.

According to WorldCom, its particular intent was to acquire Intermedia's controlling interest in Digex, "a leading provider of complex, managed web-hosting services to business customers."[75] In fact, in its applications, WorldCom represented to the Commission that the "combination of the complementary strengths of Digex and WorldCom in the website and web-enabled applications hosting businesses will create a stronger, more effective and more

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[72] As calculated by Attorney General Thornburgh, between 1999 and 2001, WorldCom's reported revenues more than doubled—from approximately $17.6 billion to more than $39 billion—and the Company acquired $3.7 billion in additional notes payable and long-term debt. First Thornburgh Report at 19, 20.

[73] By this time, of course, WorldCom had already booked 6 quarters of fraudulent financial reports. *See* First Thornburgh Report at 108.

[74] Among other businesses, Intermedia provided "integrated data and voice communications services, including frame relay services, Internet connectivity, private line data, local, long distance, international and systems integration services to approximately 90,000 business and government customers throughout the United States." *Intermedia Order*, 16 FCC Rcd at 1018.

[75] *See* Intermedia Application at 1. WorldCom represented to the Commission that it intended to sell the assets of Intermedia, except for Digex. *Intermedia Order*, 16 FCC Rcd at 1018. Indeed, WorldCom entered into a Proposed Final Judgment and Proposed Hold Separate Stipulation and Order with the Department of Justice which required the divestiture of Intermedia's other assets, and grant of the applications was conditioned on the divestiture. *Intermedia Order*, 16 FCC Rcd at 1024. However, it appears that WorldCom was eventually allowed to retain all of Intermedia's assets. On November 20, 2001, the Commission announced that, at WorldCom's request and with the agreement of the Department of Justice, it had modified the merger conditions to "permit WorldCom to absorb the non-Internet businesses of Intermedia." *Common Carrier, International, and Wireless Telecommunications Bureaus Modify WorldCom-Intermedia Merger Conditions*, Public Notice, DA 01-2727 (rel. Nov. 20, 2001).

innovative competitor for these services, offering a wider and more robust array of products."[76]

As WorldCom told the FCC:

> The transaction is also critical for Digex's future growth and development. Through this transaction, Digex gains access to WorldCom's capital, a worldwide sales force and a significant base of enterprise customers for cross-selling.[77]

WorldCom stated that by giving Intermedia "access to financing needed for capital expenditures and operating expenses, the merger will ensure that Intermedia remains an effective competitor in the provision of local and long distance services to business customers."[78] Ironically, WorldCom predicted that "a financially stronger Intermedia will be better able to service its core customers and ensure that they continue to enjoy the level of service to which they are accustomed."[79]

In reliance on these various competitive representations, the Common Carrier, International, and Wireless Telecommunications Bureaus, acting on delegated authority, approved the merger. The combined Bureaus found that "the merger is likely to serve the public interest because WorldCom's acquisition of Digex will more quickly provide WorldCom with resources it currently lacks, making WorldCom a stronger competitor in the provision of next generation communications services to business customers."[80] The Bureaus specifically noted WorldCom's claim that "acquisition of Digex's 'state-of-the-art systems' are needed to compete

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76 *See* Intermedia Application at 1-2.

77 *Id.* at 6. Similarly, WorldCom also represented that the transaction "also will provide Intermedia access to the funding that it needs to continue to provide local, long distance and other telecommunications services to its customers." *Id.* at 2.

78 *Id.* at 7.

79 *Id.*

80 *Intermedia Order*, 16 FCC Rcd at 1023.

in the provision of complex managed web-hosting services for businesses against AT&T, Exodus, Verio, IBM, Qwest and GTE, among others."[81]

Yet, it is now clear that WorldCom's acquisition and the Commission's approval were built upon—indeed, they were entirely dependent upon—WorldCom's fraud. In fact, WorldCom used a reported $5.8 billion of its fraudulently inflated stock to close the transaction with Intermedia in July 2001.[82] The exact acquisition price was essentially pegged to the performance of WorldCom's stock immediately prior to closing.[83]

WorldCom also acquired assets and ran its businesses with billions of dollars of borrowed money—funds that likely would not have been lent to WorldCom had its true financial state been known. Specifically, the Company increased its long-term debt by more than $15 billion between 1999 and 2001.[84] The Company used some of these fraudulently obtained funds to acquire CAI Wireless, SkyTel, and Wireless One. Like the Intermedia transaction, the SkyTel transaction received FCC approval,[85] and was intended to "ensure[] that as a major provider of telecommunications services, MCI WorldCom, has the assets necessary to meet the growing demands of customers for all types of telecommunications services."[86] Further, WorldCom financed its acquisitions of a number of companies (including CAI Wireless and SkyTel) in part

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81 *Id*. at 1023, n.38.

82 First Thornburgh Report at 20.

83 Intermedia Application, Exhibit E (Agreement and Plan of Merger) at 3.

84 WorldCom 2001 10-K at 33-39.

85 *Wireless Telecommunications Bureau and International Bureau Grant Consent for Transfer of Control of Licenses of SkyTel Communications, Inc. to MCI WorldCom, Inc*., Public Notice, DA 99-1711 (rel. Aug. 25, 1999).

86 *See* ULS File No. 0000016640, Market Analysis at 7.

through the assumption of debt. In order to assume its targets' debts, WorldCom had to obtain consents from their lenders. WorldCom presumably obtained these consents in the same manner as it obtained the aforementioned loans—by providing the lenders with false information regarding the state of the Company's financial affairs.

To the extent that WorldCom used false financial information to obtain loans or assume debts, and these debts are discharged in bankruptcy, WorldCom will essentially have obtained the assets purchased with these funds for free. In this instance, the bankruptcy process will act as a laundering mechanism for WorldCom's fraudulently obtained assets. The result will be no different than if WorldCom had robbed a bank. If this is allowed to occur, WorldCom will obtain an enduring unlawful competitive advantage from its fraudulent conduct, including conduct within the jurisdiction of this Commission.

In sum, WorldCom's dishonest behavior has been appalling. The Company's lies were frequent, purposeful, and, ultimately, destructive to a vast swathe of the U.S. economy. By lying about its financial health, WorldCom frustrated the efforts of its competitors, its suppliers, its lenders, and the Commission to assess accurately the health of WorldCom and the telecommunications marketplace in general. Indeed, had WorldCom not lied so pervasively, it is possible that other market participants would have made more rational investment and expansion decisions and, in the process, prevented the overly aggressive build-out of transport capacity that led to the current crisis in the industry. Because WorldCom's violations were knowing and willful, because they were designed to unfairly enhance the Company's competitive position at the expense of its competitors, and because those actions now threaten to cause additional harm should WorldCom be allowed to further profit from them, the Commission must take immediate action both to remedy past harms and to protect the public interest in a healthy and stable telecommunications industry.

V. THE PUBLIC INTEREST REQUIRES THE COMMISSION TO REMEDY THE HARMS TO COMPETITION AND THE TELECOMMUNICATIONS INDUSTRY CAUSED BY WORLCOM'S MALFEASANCE.

As established above, WorldCom's wrongdoing has caused substantial harm to its competitors, to competition, and to the entire telecommunications industry. WorldCom's false statements about the growth of Internet traffic and its own capital expenditures were a significant factor in creating the capacity glut that now plagues the industry. WorldCom's fraudulent inflation of its revenues and profit margins had an effect similar to that of a predatory pricing scheme—it forced competitors to lower their prices to unsustainable levels to compete with WorldCom's apparent "success."[87] This scheme succeeded in driving some of WorldCom's smaller competitors into bankruptcy. WorldCom also acquired telecommunications assets and customer relationships it never should have had. Many of the transactions that "built" WorldCom never would have occurred had the truth been known about WorldCom's finances. None of these harms to the telecommunications industry or unfair competitive advantages secured by WorldCom are redressed by changes in personnel at WorldCom or by management's promises to abide by the law in the future.

A. WorldCom's Continued Exercise Of FCC Licenses And Authorizations Would Reward Its Fraudulent Conduct.

It is well established that "an important aspect of the public interest is promoting competition to the extent feasible and taking appropriate regulatory steps to ensure that

[87] *See supra* note 67.

competition is fair."[88] The Commission's failure to investigate WorldCom and remedy its wrongdoing will permit WorldCom to emerge from bankruptcy with a competitive advantage obtained solely as a result of its fraud. Such a result would not serve the public interest. It would be fundamentally unfair to honest competitors, would undermine competition in every telecommunications market in which WorldCom participates and would not represent the highest and best use of WorldCom's assets.

The failure to investigate and redress WorldCom's wrongdoings by disqualifying it as an FCC licensee will give that company a significant competitive advantage over its honest competitors.[89] Because WorldCom will retain its fraudulently acquired assets, it will continue to participate in product and geographic markets that it would not have entered but for its fraudulent activities to the detriment of other carriers competing in those markets. In addition, WorldCom will achieve a further competitive advantage over other carriers when, as a result of WorldCom's bankruptcy and the attendant forgiveness of its debts, these carriers are forced to absorb significant losses for services that they provided to WorldCom but for which they were never paid.

88 *Review of the Pioneer's Preference Rules*, Second Report and Order and Further Notice of Proposed Rulemaking, 10 FCC Rcd 4523, 4527 (1995). *See also Revision of the Rules and Policies for the Direct Broadcast Satellite Service*, Notice of Proposed Rulemaking, 11 FCC Rcd 1297, 1310 (1995); *Amendment of Parts 73 and 76 of the Commission's Rules Relating to Program Exclusivity in the Cable and Broadcast Industries*, Report and Order, 3 FCC Rcd 5299, 5299-300 (1988).

89 *Experts Debate Bankruptcy Policy, Many Worry Scandal-Plagued WorldCom Will Be Rewarded*, PR Newswire, Sept. 27, 2002 (quoting Shing Yin, a Senior Analyst at RHK, Inc.), available at http://www.newsmilleniumresearch.org/news/releases092702.html (last visited Jan. 29, 2003).

Moreover, WorldCom will have the ability and incentive to undercut its rivals' prices and force them to engage in another round of unsustainable price cuts. As economist Dr. Robert W. Crandall has explained:

> [T]he bailout of WorldCom would eliminate the massive debt it incurred to construct its network, which would place WorldCom in "a much stronger position to compete on pricing." … [T]he incentives of a debt-free WorldCom point toward aggressive price-cutting behavior …. Because rival communications networks are strategic substitutes, the best response of one carrier to a price decrease by another carrier is to lower its price. The equilibrium of such a game could be massive industry collapse with the possibility that the remaining carriers would be forced to declare bankruptcy.[90]

Permitting WorldCom to reorganize in bankruptcy and emerge with its FCC authorizations intact, with little or no debt, and with a zero cost-basis for its assets would further destabilize the shaken telecommunications industry. This would allow WorldCom to undercut its rivals on pricing and leave honest competitors—who have been forced to absorb enormous financial losses and may receive only pennies on the dollar for services provided to WorldCom—with the same Hobson's choice they faced when competing with WorldCom prior to bankruptcy: either meet WorldCom's prices and risk being unable to service debt obligations and recover investments in assets or exit the marketplace. Such a result clearly would not serve the public interest or promote stable, long-term competition among telecommunications providers.

Furthermore, WorldCom's emergence from bankruptcy ultimately will not cure the ills—a glut of excess capacity and an unsustainable business plan—that landed WorldCom in

[90] Crandall Study at 24-25. *See also* Teri Rucker, *Analysts Consider WorldCom's Future After Bankruptcy*, National Journal's Technology Daily, Sept. 27, 2002 (quoting Janice Aune, President and CEO of Onvoy, who predicts that WorldCom will "emerge essentially debt free from its bankruptcy and [will] be positioned to offer lower prices that will further stress the telecom industry").

bankruptcy court in the first place.[91] As Dr. Crandall has noted, "[i]f the accounting fraud were the sole reason for WorldCom's failure, perhaps a reorganization coupled with new management could save the enterprise. Unfortunately, the apparently intentional accounting errors were a symptom, not a cause, of WorldCom's ill health."[92] Like many other companies emerging from bankruptcy, WorldCom will "have difficulty using its assets efficiently" and may not be "a viable long-term competitor."[93] Thus, allowing WorldCom to retain its licenses and authorizations will do grave short-term damage to the entire industry, while doing nothing to enhance the public interest in the long-term.

In view of the fact that emergence of WorldCom from bankruptcy will not cure the Company's ills and likely will further undermine competition in the telecommunications industry, the Commission should revoke WorldCom's authorizations and permit market forces to determine the highest and best use of WorldCom's constituent parts. Such action would promote competition and thereby promote the public interest by placing the WorldCom assets in the hands of parties that can use them most efficiently. As Dr. Crandall has put it, "[m]ore efficient firms will be able to use the assets more efficiently, which will lead to lower prices and greater consumer welfare."[94] Revocation of WorldCom's licenses would also level the playing field by ensuring that WorldCom's assets are owned by someone who acquired them at fair market value and, thus, has a cost structure on par with honest competitors that have invested heavily in providing quality services, which is a prerequisite to restoring fair competition.

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91 Crandall Study at 24 ("[T]he causes of WorldCom's failure are systemic—they cannot be undone in a bankruptcy proceeding.").

92 *Id.*

93 *Id.* at 23.

94 *Id.* at 27.

Any result other than revocation of WorldCom's authorizations would permit the Company to further capitalize on its fraud and thus would serve only to disadvantage WorldCom's honest competitors rather than call to account a company that violated the public trust more spectacularly and more egregiously than any other licensee in the history of the FCC. Such an outcome could not possibly serve the public interest.

B. WorldCom's Bankruptcy Filing Cannot Insulate It From FCC Action.

The Commission cannot permit WorldCom's bankruptcy to insulate it from an investigation and the regulatory consequences of its massive fraud. Companies in bankruptcy are not excused from violations of the FCC's rules and policies. Indeed, the Commission itself has stated that the fact of bankruptcy will not "shield" an applicant's or licensee's stewardship of the public interest or its conduct from scrutiny.[95]

Moreover, the FCC undoubtedly has authority to move forward with an investigation of WorldCom's fraud despite the automatic stay provisions of the Bankruptcy Code, which prevent the estate's creditors and other interested parties from taking a variety of actions against the debtor. Section 362(b)(4) of the Bankruptcy Code contains a specific exception to the automatic stay provision that permits "commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit's . . . regulatory power, including the enforcement of a judgment other than a money judgment."[96] Courts have routinely held that

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[95] *Magic Valley Broadcasting, Inc.*, Hearing Designation Order, 1985 FCC LEXIS 2850, n. 7 (1985); *Peoria Community Broadcasters, Inc.*, Memorandum Opinion and Order, 79 F.C.C. 2d 311, 327 (1980). *See also MobileMedia Corp.,* Order to Show Cause, Hearing Designation Order, and Notice of Opportunity for Hearing for Forfeiture, 12 FCC Rcd 14896 (1997).

[96] 11 U.S.C. § 362(b)(4); *NextWave Pers. Comms., Inc. v. FCC*, 254 F.3d 130 (D.C. Cir. 2001), *aff'd* , 2003 U.S. LEXIS 1059, at *17 (2003) ("There are, for example, regulatory exemptions from the Bankruptcy Code's automatic stay provisions."); *Bell Atlantic-Delaware, Inc. v. MCI Telecomms. Corp.*, Memorandum Opinion Order, 17 FCC Rcd 15918 (2002).

where a police or regulatory matter is excepted from the application of the automatic stay under §362(b)(4), the governmental unit is not required to seek relief from the stay. A "governmental unit which determines that its police power or regulatory proceeding is excepted from the automatic stay under Sect. 362(b)(4) is not required to petition the bankruptcy court for relief from the stay prior to continuing its proceeding."[97] "[T]he protection afforded by the bankruptcy laws is not intended to prevent [governmental units] from bringing valid enforcement actions against debtors in possession."[98] "[W]here the matter has been entrusted by Congress to an administrative agency, the bankruptcy court should normally stay its hand pending administrative decision because Congress entrusted to the agency the authority to determine the appropriate remedies."[99]

Because the filing of a bankruptcy petition does not operate as a stay of the Commission's regulatory powers and the predicate for the exercise of those powers is clear, the FCC should issue an order requiring WorldCom to show cause why the Company's licenses and authorizations should not be revoked. The order should also invite industry comment on the appropriate remedy to redress the unfair competitive advantages that WorldCom has achieved as a result of its misconduct.

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97 *NLRB v. Edward Cooper Painting, Inc.*, 804 F.2d 934, 939 (6th Cir. 1986).

98 *City of New York v. 1820-1838 Amsterdam Equities, Inc.*, 191 B.R. 18, 21 (Bankr. S.D.N.Y. 1996).

99 *In re Bel Air Chateau Hospital, Inc.*, 611 F.2d 1248, 1250 (9th Cir. 1979).

VI. CONCLUSION

For all of the foregoing reasons, Verizon respectfully submits that the Commission should immediately issue an order requiring WorldCom to show cause why its FCC authorizations should not be revoked.

Respectfully submitted,

VERIZON

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EXHIBIT A

VERIZON TELEPHONE COMPANIES

The Verizon Telephone Companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Midwest Incorporated d/b/a Verizon Midwest
GTE Southwest Incorporated d/b/a Verizon Southwest
The Micronesian Telecommunications Corporation
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Hawaii Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.

EXHIBIT B