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FEDERAL COMMUNICATIONS COMMISSION  
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FEDERAL BUREAU OF INVESTIGATION  
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In the Matter of )  
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Applications of America Online, Inc. )  
and Time Warner Inc. for )  
Transfers of Control )  
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CS Docket No. 00-30

REPLY COMMENTS OF BELLSOUTH CORPORATION

May 11, 2000

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**Introduction and Summary**

Recent events have demonstrated the anticompetitive potential of an AOL/Time Warner combination. Nevertheless, BellSouth believes that the AOL/Time Warner merger could advance the public interest, standing alone, subject to the right merger-specific safeguards. But a de facto merger of AOL/Time Warner and AT&T/TCI/MediaOne surely could not. And that is, in effect, what is being proposed to the Commission. The parties are apparently of the view that these two camps can remain closely linked through a web of equity and contractual cross-links between them. The Commission cannot possibly conclude that the public interest will be served by this level of entanglement between the two actual and potential competitors that already dominate the center of the converging new marketplace for high-speed, digital services to residential consumers.

The fact that telecommunications markets are converging is hardly debatable. Voice, video, and data are now rapidly converging in the new telecommunications space defined by Internet protocol ("IP") standards and broadband electronics. Today's integrated broadband digital distribution platform is the result. This broadband platform can handle local and long distance voice, Internet access, video programming, and a broad range of messaging and content

services. What were once separate networks and markets, and equally separate regulatory spheres, are now rapidly converging.

The Commission is, of course, well aware of these industry-transforming trends.<sup>1</sup> And the Commission has already concluded that “one-stop shopping”<sup>2</sup> for bundled packages of voice, Internet, and video services promises billing simplicity, better customer service, and lower prices.<sup>3</sup> The question here is not whether these market and technological trends are real (which they are), or important (which they are), or in the public interest (which they are). The question before the Commission is on what terms two very large companies that already occupy the center of this transformation should be permitted to merge or otherwise coordinate their actions. Will the public interest be advanced if the merger goes through, leaving the Applicants tightly tied by contract, equity investment, and other joint market sharing activities to an even larger cable conglomerate, AT&T/TCI/MediaOne, which occupies by far the largest and most commanding

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<sup>1</sup> As Chairman Kennard has observed:

Phone lines are carrying movies, cable lines are carrying phone calls, the airwaves are carrying both. Changes in technology have helped bring about a new era in the telecommunications marketplace, an era in which convergence is king. Old industry boundaries are vanishing, and companies are doing business in ways never thought possible.

William E. Kennard, Chairman, FCC, *Fostering Competition in a Converging World*, speech before the Practicing Law Institute/Federal Communications Bar Ass’n Policy and Regulations Conf., Washington, DC, Dec. 9, 1999, available at <<http://www.fcc.gov/commissioners/kennard/states.html>>. See also Deborah A. Lathen, Chief, Cable Services Bureau, FCC, *The Mind’s Eye*, remarks before the Town Hall, Los Angeles, CA, Nov. 9, 1999.

<sup>2</sup> See, e.g., Memorandum Opinion and Order, *Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, 12 FCC Rcd 19985, 20042-43, ¶ 112 (1997); Memorandum Opinion and Order, *Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, 13 FCC Rcd 18025, 18138, ¶ 199 (1998); see also William E. Kennard, Chairman, FCC, *Section 271 of the Telecommunications Act of 1996*, statement before the Subcommittee on Communications of the Committee on Commerce, Science, and Transportation, United States Senate, Mar. 25, 1998, available at <<http://www.fcc.gov/commissioners/kennard/states.html>> (“Kennard 271 Statement”).

<sup>3</sup> Chairman Kennard has noted that the emergence of the new market for bundled services was “[p]art of Congress’s vision” in passing the 1996 Act. *Id.*

position in this convergent marketplace? The answer is plainly no. The public interest requires a prohibition on any present and future such links between the two largest cable conglomerates.

The Applicants have repeatedly shown a willingness to engage in anticompetitive exclusionary behavior. BellSouth is not calling for broad regulation but for specific safeguards to address the particular dangers posed by these Applicants and this merger. In order for the proposed merger to promote the public interest and to protect competition in this critical marketplace, no fewer than three conditions are necessary:

- The Commission must require AOL and Time Warner to sever ties with AT&T/MediaOne/Excite@Home.
- The Commission must insist that AOL/Time Warner make its content, portals, and applications available on a non-discriminatory basis.
- In order to prevent the use of the cable platform to advantage unfairly the Applicants' commanding position in content, portals, and applications, the Commission must impose a binding condition of truly open access.

**I. Only a Limited Number of National Mega-Companies Will Emerge To Compete in the New Marketplace.**

As merger applicants have repeatedly – and accurately – informed the Commission, they are engaged in an expensive, capital-intensive broadband business.

Conceptually, there are four distinct layers in the provision of these broadband bundled services: content, aggregation of content/applications, Internet access, and physical infrastructure. As the chart below demonstrates, AOL/Time Warner has a strong presence in each of these layers.

Layer	Name	Examples	
1	Content	Time Warner's CNN, Sports Illustrated online, Streaming video (which can stream Time Warner movies and other video content)	
2	Aggregation of Content and Applications	Portals, e.g., AOL, AOL.com Messaging/Chat, e.g., AOL Instant Messaging, ICQ, AOL chatrooms	
3	Internet Access	AOL ISP, Time Warner Road Runner	Physical Distribution/ Infrastructure Layer
4	Physical Infrastructure	Time Warner cable distribution	

Not many companies will be able to compete in this arena against behemoths like AOL/Time Warner. It is costly to enter each of these layers, and costlier still to provide the entire bundled package.

There is, to begin with, the considerable challenge of upgrading physical plants to deliver broadband, IP-protocol services. Cable operators have spent an estimated \$31 billion since 1996 on upgrades.<sup>4</sup> Regional Bell Companies are making comparable, multi-billion-dollar commitments to upgrade phone lines to DSL.<sup>5</sup> Investments in fixed wireless services are

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<sup>4</sup> National Cable Television Association, *Cable Television Industry Overview 2000*, at 1 (visited May 10, 2000) <<http://www.ncta.com/glance.html>> (citing Paul Kagan Associates Inc., *The Cable TV Financial Databook*, 1999).

<sup>5</sup> See, e.g., Sanford C. Bernstein & Co., Inc. and McKinsey & Company, Inc., *Broadband!* 8 (Jan. 2000) ("Repair and upgrade of the national telephone plant for nonvideo DSL are expected to take some \$9.5 billion in incremental capital expenditures . . . with the option for later upgrades to carry video over DSL costing another \$10 billion."). See also BellSouth Corp., 1999 Form 10-K (SEC filed Mar. 2, 2000) ("Significant investments are [] being made to support deployment of ADSL and fast packet switching technologies as well as our IFITL initiative.").

likewise running into the billions per year.<sup>6</sup> So, too, are investments in digital satellite services.<sup>7</sup>

Then there are the costs of gaining access to Internet backbone services. Broadband services require much faster links to backbone networks. Very few players are positioned to gain access to those backbone networks on the most favorable terms. A company must either build its own network, at great expense, or reach an inevitably expensive deal with a backbone provider (as Time Warner/Road Runner is doing by negotiating a long-term contract with AT&T).

Content represents a third, enormously expensive layer of the broadband market. The content available on broadband includes new forms of Internet content (websites and the like) and traditional content (video, magazines, newspapers, etc., that are available both on the Internet and in their more traditional form). Being a successful content provider is no small undertaking. AOL, which is, for now, primarily in the Internet content and packaging end of the business, has a market capitalization of approximately \$126 billion.<sup>8</sup> Time Warner Inc., a more traditional media company, has a market cap that stands at \$107 billion, while Liberty Media Group, another traditional media company, approaches \$61 billion.<sup>9</sup> Yahoo! alone is valued at more than \$60 billion.<sup>10</sup> Market analysts agree that the “cost of producing broadband content is

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<sup>6</sup> See, e.g., *Fixed Wireless Broadband Poised for Explosive Growth; Revenues to Hit \$16.3 Billion by 2004*, According to the Strategis Group, PR Newswire, Apr. 26, 2000 (“Andrew Kreig, President of the Wireless Communications Association International (WCA), agrees that significant growth in fixed wireless broadband is imminent. ‘Our members see tremendous opportunity and have invested billion [sic] of dollars to roll-out services throughout the world. These investments are starting to pay-off now and will accelerate rapidly in the future.’”).

<sup>7</sup> See, e.g., Peter Spiegel, *Dishing Out Data*, Forbes, Jan. 24, 2000, available at <<http://www.forbes.com/forbes/00/0124/6502110a.htm>> (Hughes’s Spaceway system is expected to cost \$4 billion to build and launch.); Todd Wallack, *Why Wait for DSL, Cable Modem When There’s Wireless?*, San Francisco Chronicle, Mar. 28, 2000, available at <<http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2000/03/28/BU98677.DTL>> (Loral is investing \$3 billion in its Cyberstar system, while Lockheed Martin and its partners are spending \$3.6 billion on the Astrolink system).

<sup>8</sup> See generally Bloomberg.com (visited May 10, 2000) <<http://quote.bloomberg.com>>.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

likely to be prohibitive for companies without the economies of scale provided by traditional media companies, which can spread the cost across many different media.”<sup>11</sup>

A company that develops or acquires the assets to compete in every layer of this converged marketplace can indeed realize huge economies of scope and scale. As its customer base grows, it will gain an enormous additional advantage from network effects tied to software, messaging, and other content offerings. And so the Applicants themselves assert, though they utterly fail to back up their assertion with credible facts and analysis, as Commission precedent requires them to do.<sup>12</sup>

The Commission cannot, however, sacrifice wider competition and consumer choice to the interests of one pair of applicants, whatever economies they might realize by merging. And these powerful economies, these network effects, will all tend to reduce the likelihood of effective competition by others. The enormous economies of scope and scale claimed by the Applicants as justifying the merger simply underscore that entry barriers are and will remain very high.<sup>13</sup>

Up to a point – *and only if access to the various hardware, software and content layers of the market remains reasonably open* – smaller, less fully integrated players can overcome these entry barriers through contract and by resale. So far, at least, competitors have retained reasonably equal access to key hardware and software components, which are still supplied

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<sup>11</sup> N. Carter, *et al.*, ABN Amro Bank N.V., Investext Rpt. No. 2076333, *Europe Media – Broadcasting Media: Mediaspace – Industry Update*, Industry Rpt. at \*12 (Feb. 15, 2000).

<sup>12</sup> The Applicants absolutely fail to demonstrate any mechanism that would insure that any of these claimed efficiencies would be passed on to consumers. To the contrary, the ability of the Applicants to foreclose competition suggests that consumers will not realize the benefit of any claimed efficiencies.

<sup>13</sup> The future is one of “titanic telecommunications and titanic telecommunicators, a competitive field dominated by highly capitalized, deep-pocketed giants.” Jim Chen, *Antitrust Symposium: Antitrust Issues in the Telecommunications and Software Industries*, *Titanic Telecommunications*, 25 Sw. U. L. Rev. 535, 545 (1996).

principally by independent vendors. Several major Internet portals – Yahoo! being the most prominent – remain open to all comers, as do a number of major sources of the higher tiers of content, such as Disney, NBC, and Real.com.<sup>14</sup> Many competing providers can and do use telephone company loops to provide high-speed Internet access, portal services, and the content services beyond. But there is, at this point, no assurance that there will ever be comparable levels of open access to cable, currently the dominant medium for high-speed residential access, or to the dominant sources of broadband content, which cable is rapidly positioning itself to control. And, in any event, to the extent a company remains a reseller, it can compete merely for the reduced part of the value that the new market represents.

These network effects, high entry barriers, and powerful economies of scope and scale, guarantee that only a limited number of large players will emerge as full-fledged competitors in the new marketplace. Perhaps no more than four to six, or quite possibly even fewer than that.

## **II. The Proposed Merger Threatens To Reduce Competition If Approved Without Substantive Conditions.**

The AOL/Time Warner merger, together with its entanglements in the AT&T/TCI/MediaOne conglomerate, has far-reaching competitive implications, both horizontal and vertical, actual and potential, and in all major layers of the emerging marketplace for IP-based services. If approved unconditionally, the merger will eliminate these two potent forces as horizontal competitors against one another in all layers of the broadband market. Moreover, the merged AOL/Time Warner will have both the ability and the incentive to leverage its power in the content, portal, and application layers of the broadband market to dominate Internet access

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<sup>14</sup> NBC sites were ranked seventh in March 2000 traffic statistics, and the Real.com network was ranked tenth. Media Metrix Press Release, *Media Metrix Releases U.S. Top 50 Web and Digital Media Properties for March 2000*, Apr. 24, 2000, available at <<http://www.mediametrix.com/usa/press/releases/20000424.jsp>>.

and transport, and to leverage its power in the access and transport segments to dominate content, portals, and applications.

It is critical that these implications be scrutinized very closely now, while it is still possible to address them. The public interest will surely not be served if the Commission permits mergers, equity cross-ownerships, and contractual links to snuff out – at this nascent stage in the evolution of the market – the already limited opportunities for sustainable, long-term competition in this extremely large and important market.

**A. The Proposed Merger’s Horizontal Effects Would Harm the Public Interest.**

Only a few competitors will have the resources necessary to compete in the converged marketplace on a national level, and the AOL/Time Warner and AT&T/MediaOne groups are clearly among them. It is essential that the Commission make sure that these two camps evolve into competitors, not collaborators.

**1. Content and Aggregation of Content (Portal) Layers.**

The content, portal, and application (like instant messaging) layers of the new market are clearly *national* in their geographic scope. As occurs with broadcast networks and all major cable channels, the same content is used and distributed nationwide. The same software platforms, the same superservers, the same databases, the same backbone networks can serve anyone that has high-speed Internet access, wherever the customer is located.

Equally clear is that the content layers are dominated by a relatively small number of sources and players. A relatively limited amount of content accounts for a hugely disproportionate share of the market. The select few who own the most popular content are

therefore in a position to exert enormous power.<sup>15</sup> Although the Applicants suggest that there is far too much content “out there” for any player in the industry to dominate this layer of the market, market realities belie this claim. Cable programming is dominated by a few major channels (and the media conglomerates that own those channels), notwithstanding the fact that hundreds of other much smaller channels are also distributed by satellite. A handful of major portals and messaging services likewise dominate their respective market segments, notwithstanding the fact that anyone with a server can set up an e-mail host or post a Web page. The fact that it is easy to acquire an altogether negligible and uneconomic share of the market is beside the point; what matters is the marquee-type content that the great majority of subscribers strongly favor. This content is competitively crucial and very difficult to develop.

A combined AOL/Time Warner will, by a wide margin, dominate the content, portal, and ISP layers of the new market. AOL is already a leading provider of Internet content – nearly 77 percent of all Internet subscribers visit an AOL site in any given month, and spend approximately 38 percent of all Internet time on AOL sites.<sup>16</sup> In addition, AOL’s instant messaging is the dominant messaging application. AOL operates its dominant Instant Messaging service on a closed basis, a powerful strategy for handicapping competitors. Although AOL is a recent entrant in the broadband ISP market (with AOL Plus), it is so dominant in the narrowband

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<sup>15</sup> “[T]he number of distinct programming voices that the public receives is distressingly small. The [Sixth Video] Report finds that 46 of the top 50 cable networks are owned by twelve large media conglomerates . . . . And two of the remaining four services are C-Span and C-Span2, which are funded almost exclusively by the cable industry. More disturbing, these same entities also control the top commercial television broadcast networks, dozens of television stations and lesser cable networks, many of the major movie, TV and video production studios, and even the country’s largest video rental distributor. Thus, to a significant extent, the video programming that the American public receives is being funneled through a handful of media gatekeepers (not to mention the vast magazine, newspaper, publishing and Internet properties owned by these entities).” Sixth Annual Report, *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, 15 FCC Rcd 978 (1999) (statement of Commissioner Gloria Tristani).

<sup>16</sup> Patricia Jacobus, *AOL, Tax Sites Make Headway in Traffic*, CNET News.com, Feb. 22, 2000 <<http://home.cnet.com/category/0-1005-200-1554872.html>>.

ISP space that its market share in broadband will inevitably rise fast as it sets about shifting its customers to higher-speed access. Indeed, analysts note that “all roads very likely will need to run through AOL” in the broadband world.<sup>17</sup> A full 65 percent of AOL users stated in a recent survey that they would not even switch to a broadband platform if it meant giving up AOL.<sup>18</sup>

And there is no overstating Time Warner’s content holdings – from *The Sopranos* on HBO to the most popular Warner Brothers’ movies and cartoons to CNN and *Sports Illustrated*, Time Warner owns the content that commands a vast and loyal following. Time Warner and its content affiliates make up the largest traditional media company in the world,<sup>19</sup> with four of the top 15 video programming services (TBS #2; TNT #3; Cartoon Network #5; CNN #14)<sup>20</sup> and the largest premium TV network (HBO).<sup>21</sup> Time Warner operates a broadcast network (WB)<sup>22</sup> and one of the largest movie and television studios (Warner Brothers).<sup>23</sup> The Time Warner empire also controls Road Runner and its dedicated broadband portal that serves 32 percent of residential broadband subscribers.

For its part, the AT&T conglomerate controls Excite@Home and its dedicated broadband portal that serves a corresponding 37 percent share of the broadband residential market. The AT&T group and its content affiliates comprise one of the top eight media companies in the

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<sup>17</sup> Marvin V. Greene, *Broadband Pricing Pressures Surface as Subscribers Increase*, TR’s Last-Mile Telecom Report, May 11, 2000.

<sup>18</sup> *Id.*

<sup>19</sup> See Time Warner, *Time Warner 1999 Fact Book* (visited May 9, 2000) <<http://www.timewarner.com/corp/about/pubarchive/factbook/1999fb.pdf>> (e.g., CNN.com).

<sup>20</sup> Sixth Annual Video Report at App. D, *Annual Assessment of Competition in Markets for the Delivery of Video Programming*, CS Docket No. 99-230, FCC 99-418 (rel. Jan. 14, 2000) (“*Sixth Annual Video Report*”).

<sup>21</sup> *AOL Time Warner: World’s First Internet-Age Media and Communications Company*, Bus. Wire, Jan. 10, 2000.

<sup>22</sup> D. Lieberman, *Inside the AOL Media Giant*, USA Today, Jan. 11, 2000, at 1A.

<sup>23</sup> *Media Owner’s Index, Time Warner*, Columbia Journalism Rev. (visited May 9, 2000) <<http://www.cjr.org/owners/time-warner.asp>>.

world<sup>24</sup> and have ownership interests in four of the top 15 video programming services (USA Network #1; Discovery Channel #10; Learning Channel #11; Sci-Fi Channel #13).<sup>25</sup>

In these circumstances, it is inconceivable that the Commission should permit AOL/Time Warner's content operations to remain linked in any way with the AT&T consortium. Yet that is precisely what is being proposed. Through its acquisition of MediaOne, AT&T will own approximately 26 percent of Time Warner Entertainment,<sup>26</sup> with the option to purchase 6.3 percent more.<sup>27</sup> The two groups will be further linked through Road Runner. Upon completion of its MediaOne merger, AT&T will acquire a 50 percent management interest in Road Runner<sup>28</sup> – the main AOL/Time Warner broadband portal, in which Time Warner holds a 40 percent voting interest.<sup>29</sup> AT&T's Liberty owns nine percent of Time Warner Inc.<sup>30</sup> And contractual links between the companies will draw the alliance tighter still.

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<sup>24</sup> R. McChesney, *The New Global Media*, *The Nation*, Nov. 29, 1999 <<http://www.thenation.com/issue/991129/1129mcchesney.shtml>>.

<sup>25</sup> Sixth Annual Video Report App. D.

<sup>26</sup> Time Warner Inc. owns 74.49 percent of Time Warner Entertainment (accounting for half of Time Warner Inc. sales), which in turn owns "substantially all" of the assets of HBO, Warner Bros., Time Warner Cable Networks (with a subscriber base of approximately 13 million), as well as many other film/entertainment companies. Time Warner Inc. also owns 100 percent of Turner Broadcasting System, Inc., which owns over a dozen cable networks, including 3 of the top 5 in ratings. Finally, Time Warner Inc. owns 100 percent of such enterprises as Time Inc. (publishing) and Time Warner Telecom. Time Warner Inc., *Time Warner Inc.* (updated Sept. 30, 1999) <<http://www.timewarner.com/corp/about/timewarnerinc/corporate/>>; *Time Warner 1999 Factbook*, *supra*, note 19.

<sup>27</sup> See Time Warner Inc., 1998 Form 10-K (SEC filed Mar. 26, 1999).

<sup>28</sup> Paul Farhi, *AT&T Poised to Regain Long Reach, Via Cable*, *Wash. Post*, May 6, 1999, at A1.

<sup>29</sup> See Supplemental Information at 9, *Applications of American Online, Inc. and Time Warner Inc. for Transfers of Control*, CS Docket No. 00-30 (FCC filed Mar. 21, 2000); Applications and Public Interest Statement at 18 n.19, *Applications for Consent to the Transfer of Control of Licenses, Time Warner Inc. and America Online, Inc., Transferors to AOL Time Warner Inc., Transferee* (FCC filed Feb. 11, 2000).

<sup>30</sup> Liberty Media, *Liberty FAQ: Investor Relations – Liberty Affiliate List* (visited May 9, 2000) <[http://www.libertymedia.com/investor\\_relations/03-index.html](http://www.libertymedia.com/investor_relations/03-index.html)>.

## 2. Physical Distribution/Infrastructure Layer.

The Commission has long recognized that adjoining cable operators are “the most likely potential overbuilder[s]” in each others’ franchise areas.<sup>31</sup> That possibility remained largely theoretical for many years, blunted by the consolidation within the cable industry,<sup>32</sup> clustering, and the tight content-layer alliances that created strong economic bonds between nominally independent cable operators.

The new broadband marketplace presents significant new possibilities for cable-versus-cable competition of the kind the Commission has long sought to promote. In addition to the cable itself, the provision of broadband services depends on the deployment of arrays of local caching servers and video software. For now, Excite@Home and Road Runner are both independently deploying such systems, often in close geographic proximity. By deploying a significantly better broadband technology at the “head end” (*i.e.*, the server or non-consumer end) of its own cable network, and by delivering a superior range of digital video services to its customers, Excite@Home and Road Runner can each reasonably hope that consumer demand and regulatory pressure will eventually allow it to displace the other as a provider of these caching, server, and software services to cable customers that currently use the other provider’s service. Several local regulators have already ordered their local cable providers to provide access to other distributors of broadband services, thus creating a strong incentive for direct competition at the head end of the cable network. Even in communities with closed cable systems – *i.e.*, systems which have an exclusive relationship with Road Runner or Excite@Home

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<sup>31</sup> Fifth Annual Video Report, *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, 13 FCC Rcd 24284, 24371, ¶ 144 (1998).

<sup>32</sup> *Id.*

– there is a possibility for competition between the two services whenever the exclusive contract (or the exclusive cable franchise itself) comes up for renewal.

Thus, so long as they remain truly independent, Excite@Home and Road Runner will exert significant competitive discipline in each other's nearby geographic markets, by virtue of the fact that a single head-end server can serve multiple cable networks in a single metropolitan area. As independent entities, serving independent families of cable networks, Excite@Home and Road Runner each also knows that the other may set a standard of performance in the delivery of broadband services that will be recognized as superior by customers and regulators. Customers cannot change their monopoly cable operator, but they can demand better service of that operator and exert considerable pressure on it, directly or through their state and local cable franchising authorities and federal regulators. As independent entities, Excite@Home and Road Runner thus exert some additional competitive discipline on each other simply by operating side by side in the public eye and under the scrutiny of regulators.

The feasibility for serving new cable customers through already established cable head-end facilities has been affirmed by AT&T itself. In an attempt to build a case for its latest acquisition, AT&T's MediaOne application states that, because the two companies have many adjoining systems, AT&T will be able to use the upgraded portions of MediaOne's systems to serve AT&T's own systems, and vice versa.<sup>33</sup> AT&T "will not have to duplicate the headend equipment."<sup>34</sup>

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<sup>33</sup> "In several regions of the country . . . MediaOne cable systems that have been upgraded to provide cable telephony adjoin TCI systems that are in the process of being upgraded. This means that AT&T can connect the distribution hubs in the TCI system to MediaOne's existing, upgraded headend offices." *AT&T/MediaOne Application* at 27.

<sup>34</sup> *Id.*

As noted, AT&T already owns nine percent of Time Warner Inc. through Liberty, and MediaOne will bring to AT&T a 50 percent management interest in Road Runner, the main AOL/Time Warner broadband portal, and a 26 percent interest in Time Warner Entertainment. While these cross-ownership links remain in place, it is safe to predict that no “duplicating” of facilities on adjacent AT&T/TCI/MediaOne and AOL/Time Warner cable properties will be permitted to blossom into what is otherwise known as facilities-based “competition.”

**B. The Proposed Merger’s Vertical Effects Would Harm the Public Interest.**

As SBC, the Consumers Union, Consumer Federation of America, Media Access Project, the Center for Media Education, and others explained in their initial comments, the merged AOL/Time Warner will have the ability and the incentive to leverage its dominance in the content and aggregator/portal layers to dominate the Internet access and transport layers, and vice versa.

AOL and Time Warner will own or control the most popular content on the Internet. The Applicants will have the incentive to restrict their competitors (other ISPs, DSL providers, etc.) from obtaining access to this valuable content whenever the gains on Time Warner’s cable network outweigh the losses entailed by narrower distribution of the content. The Applicants’ theory that they will have the incentive to reach as many eyeballs as possible would make good economic sense if the merged company were involved in the content layer alone, but it makes no sense at all for a merged company with major stakes in both content and its distribution.<sup>35</sup>

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<sup>35</sup> This type of behavior is far from novel – just recently the Federal Trade Commission staff recognized that a merger between Barnes & Noble (the largest book retailing chain in America) and Ingram (the largest wholesaler of books) posed “a serious competitive threat to thousands of independent book retailers. The acquisition of an important upstream supplier such as Ingram might have enabled Barnes & Noble to raise the costs of its bookselling rivals by foreclosing access to Ingram’s services, or denying access on competitive terms.” Robert Pitofsky, Chairman, FTC, statement before the Subcommittee on Antitrust, Business Rights, and Competition, Committee on the Judiciary, United States Senate, Mar. 22, 2000, *available at* <<http://www.ftc.gov/os/2000/03/antitrusttestimony.htm>>. The FTC Chairman has observed that the merged firm could employ a variety of

AOL/Time Warner's economic incentive to favor cable and their own Internet offerings over other distribution media is made all the stronger by that fact that, in so doing, it could also advantage its largest stakeholder, AT&T/MediaOne.<sup>36</sup> AT&T/MediaOne would own large, direct interests in both AOL/Time Warner content and AOL/Time Warner cable media; AT&T/MediaOne would also share control of Road Runner; and together, the Road Runner and Excite@Home families of cable companies will reach 80 percent of all U.S. households. In such circumstances, a strategy designed to reach as many consumers as possible with the company's content will surely come second: the first incentive will be to promote cable across the board, and to crush non-cable competitors. The content consumers will then inevitably follow.

These companies have already demonstrated that they are willing and able to engage in such exclusive dealing. For instance, they have announced an exclusive content deal involving Sports Illustrated, a publication of Time, Inc. and Time Warner, that gives AOL members an "exclusive first view" of Sports Illustrated's Swimsuit Issue cover.<sup>37</sup> Many more such arrangements are inevitable, unless the Commission makes clear that such exclusive dealing by such dominant players is unacceptable.

AOL/Time Warner will be able to leverage its control of the AOL and Road Runner portals in much the same manner. AOL's Instant Messaging and ICQ services are by far the largest providers of that service, with an estimated market share approaching 80 percent. AOL

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discriminatory practices "short of an outright refusal to sell to the non-Barnes & Noble bookstores. For example, Barnes & Noble/Ingram could have chosen to (1) sell to non-Barnes & Noble bookstores at higher prices; (2) slow down book shipments to rivals; (3) restrict access to hot titles; (4) restrict access to Ingram's extended inventory of older titles; or (5) price services higher or discontinue or reduce services." *Id.*

<sup>36</sup> Interview by Mark Haines and David Faber with C. Michael Armstrong, AT&T CEO, *Squawk Box* (CNBC broadcast Feb. 10, 2000).

<sup>37</sup> AOL Press Release, *AOL & Time Warner Announce Online Unveiling of the 2000 Sports Illustrated Swimsuit Issue Cover on AOL*, Feb. 17, 2000, available at <<http://media.web.aol.com/media/press.cfm?>>. In

has already gone to some considerable length in its efforts to use that dominant position to forestall competition by Microsoft, Yahoo!, Tribal Voice, and others. As Tribal Voice and iCAST explain in their comments, AOL has refused to open its Instant Messaging and ICQ services, preferring instead to use those applications to put itself in a position to forestall competition.

Finally, with their very large share of all broadband Internet access customers (which stands at 69 percent today, before AOL has officially joined the club) the AT&T/MediaOne/Excite@Home and AOL/Time Warner/Road Runner groups will be equally able to extend their market power from the bottom up – that is, from the cable up into the software and content layers.

Time Warner's recent treatment of Disney's ABC content reveals once again the power the company already has to freeze out even a content competitor as large and popular as Disney whenever it concludes that that is in Time Warner's best economic interests.<sup>38</sup> And the negative effects on consumers would intensify exponentially if the Time Warner and AT&T cable families both engaged in such exclusionary conduct.

Another harbinger of what lies ahead is an agreement recently signed by AOL and Time Warner that makes CNN Interactive the premier broadcast news partner for AOL's Netscape

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addition, AOL Live, AOL's chat and live event destination, will host online chats throughout the week with this year's Sports Illustrated swimsuit models, including an "exclusive" AOL chat with the cover model.

<sup>38</sup> "If Time Warner can get away with blacking out standard cable programming, it also can limit access to the new technology, stifling competition by ensuring that its channels provide the better interactive services." *Time Warner Cheats at Monopoly*, Daily News, May 3, 2000, at 40. Senator Orrin Hatch has noted that the incident reveals that the AOL/Time Warner merger is "a merger of entertainment and information disseminating conglomerates who, if given untoward power, could abuse that power." Press Conference with Senators Orrin Hatch (R-UT) and Chuck Schumer (D-NY), Fed. News Serv., May 4, 2000.

Netcenter. CNN will have a permanent presence on the Netcenter homepage.<sup>39</sup> Road Runner and Excite@Home have entered into comparable deals over the past year that call for similar “exclusive” or “primary” placement of content. Inevitably, such deals will be extended to include cross-over equivalents, in which AT&T/TCI/MediaOne/Liberty content gets distributed on AOL/Time Warner cable systems, and AOL/Time Warner content gets distributed on AT&T/TCI/MediaOne cable.

The two groups have already entered an exclusive joint-marketing deal in Syracuse and Albany under which AT&T will provide phone service over Time Warner’s cable network.<sup>40</sup> The same companies have been negotiating yet another arrangement that would give AT&T exclusive rights to provide cable telephony to residential and small business customers over all of Time Warner’s networks for *twenty* years – an unheard of contractual lifetime in an industry as dynamic as this one.”<sup>41</sup> This kind of reciprocal market sharing is not and will not be in the public interest.

Finally, as SBC explained in its comments, it is especially troublesome for one firm to be in a position to exercise power over products with an architectural character that set standards upon which other applications depend. Inevitably, the dominant firm or group of firms in the new market will select standards for IP telephony, caching, and video streaming. So long as they remain tightly linked, with direct and strong incentives to coordinate their activities, the

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<sup>39</sup> AOL Press Release, *America Online and Time Warner Announce New Content and Promotional Agreements*, Feb. 16, 2000, available at <<http://media.web.aol.com/media/press.cfm?>>.

<sup>40</sup> See Jeffrey Bartash, *AT&T, Time Warner in TV-Phone Link*, CBS MarketWatch, Mar. 8, 2000 <<http://www.cbsmarketwatch.com/archive/20000308/news/current/telecom.htx>>.

<sup>41</sup> The proposed deal also calls for the two companies “to jointly market communications services and to develop other broadband communications services, such as video telephony.” Time Warner Press Release, *AT&T and Time Warner Form Strategic Relationship to Offer Cable Telephony*, Feb. 1, 1999, available at <[http://cgi.timewarner.com/cgi-bin/corp/news/index.cgi?template=article&article\\_id=224](http://cgi.timewarner.com/cgi-bin/corp/news/index.cgi?template=article&article_id=224)>; *AT&T, Time Warner*

AT&T/TCI/MediaOne and AOL/Time Warner groups will inevitably select standards that favor cable generally, and their cable networks in particular, at the expense of DSL and other broadband technologies. This, in turn, will limit the effectiveness of these other technologies to compete against cable in the broadband marketplace.

**III. The Commission Must Impose Conditions To Ensure that Competition Thrives as the Telecommunications Industry Moves Toward Convergence.**

“[T]he public interest demands constraints on the ability of a handful of large communications [companies] to consolidate communications assets that [are] vital to our nation’s economy.”<sup>42</sup> The AOL/Time Warner merger poses enormous horizontal and vertical threats and could substantially curtail competition in the rapidly evolving converged marketplace. The Commission must, therefore, place conditions on the merger to ensure that it will enhance, not subvert, the public interest.

**A. The Commission Must Insist that AOL and Time Warner Sever Ties with AT&T/MediaOne/Excite@Home To Preserve Horizontal Competition.**

Two intertwined cable conglomerates cannot be permitted to establish joint control over all four major layers of the new marketplace for IP-based services – the most popular content, the leading broadband portals and applications, the leading broadband Internet access providers, and the underlying cable systems that reach more than 80 percent of all U.S. homes.

At the very least, the Commission must insist on a definite and complete separation of the AT&T/TCI/MediaOne/Liberty conglomerate on the one hand, and AOL/Time Warner on the other. AT&T/MediaOne’s interests in Time Warner Inc. and Time Warner Entertainment must

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*Set Phone-Cable-TV Service*, TechWeb, Feb. 1, 1999 <<http://www.techweb.com/wire/story/reuters/REU19990201S0001>>.

<sup>42</sup> William E. Kennard, Chairman, FCC, statement before the U.S. Senate Committee on Commerce, Science, and Transportation, *Mergers in the Telecommunications Industry*, Nov. 8, 1999, available at <<http://www.fcc.gov/commissioners/kennard/speeches.html>>.

be considered together – and taken together, these interests make AT&T/MediaOne the largest stakeholder in AOL/Time Warner, with an interest far beyond any of the Commission’s attribution rules. The two groups must be required to divest *all* of these cross-ownership equity interests, not just one or two, not just here or there. Moreover, even if the interests were considered independently, they cannot be condoned. MediaOne’s 26 percent interest in Time Warner Entertainment, Liberty’s nine percent interest in Time Warner Inc., and MediaOne’s 50 percent management interest in Road Runner are each independently troublesome.<sup>43</sup> All of them must go and stay gone.

There can be no arguing that these interests are insignificant because they are “small,” or because they are somehow walled off to eliminate anticompetitive incentives. The Commission has addressed comparable interests, and comparable incentives, in the context of a wide variety of other mergers and joint ventures. It cannot now simply abandon the principles and the quantitative thresholds that it has painstakingly developed in closely analogous contexts.<sup>44</sup> They apply with equal force here, and all principles of consistent, even-handed administrative process require that they be applied with equal force and conviction.

The Commission must likewise insist that the two groups sever all contractual ties and eschew all joint ventures that threaten to create the same economic incentives as equity cross-

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<sup>43</sup> See, e.g., 47 C.F.R. § 76.501 n.2 (all voting stock interests of 5 percent or more are attributable, except a minority interest is not attributable where a single or other shareholder owns a majority interest); Report and Order, *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, CS Docket No. 98-82 (rel. Oct. 20, 1999) (“*Cable Television Report and Order*”). The Commission’s pre-1996 Act attribution rules for when a telephone carrier could provide video programming in its telephone service area were also set at 5 percent. See 47 C.F.R. § 63.54(e) (1995) (“Such interests include partnership interests, direct ownership interests, and stock interests in a corporation where such stockholders are officers or directors or who directly or indirectly own 5 percent or more of the outstanding stock, whether voting or non-voting stock.”).

<sup>44</sup> See, e.g., 47 C.F.R. § 76.501 n.2; *Cable Television Report and Order*; 47 C.F.R. § 63.54(e).

ownerships.<sup>45</sup> That is to say, it must insist on the severance of *all* long-term contracts that put these two groups in a position of unduly favoring each other over competing vendors or customers, for services in any of the key segments of the market, from basic transport to ISP to backbone to portal to advanced services and content. AT&T cannot, for example, be permitted to provide AOL access to AT&T customers on a preferential basis for ISP services in exchange for AT&T access, for telephony purposes, to the cable customers of Time Warner. There will, of course, be some ongoing business relationships between AOL/Time Warner and AT&T and its affiliates. These relationships pose a constant threat of horizontal and vertical collaboration that would harm the public interest. Given the dispositions of these cable giants, competitors will need some assurance that the companies are not free to use these ongoing relationships to implement plans to cement their dominant positions. There must be some mechanism for monitoring these ongoing dealings to prevent discrimination and exclusionary conduct.

The Commission has ample experience policing boundaries of this kind. It has done so for decades in regulating phone companies.<sup>46</sup> The Applicants cannot be heard to argue at this point in regulatory history that policing such boundaries is too difficult from an administrative perspective to be worth the trouble.

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<sup>45</sup> The Commission has recently stated that its 30-percent subscriber cap would apply to joint ventures and cable companies acting in concert – precisely because these arrangements lead to the same harmful results as direct ownership. See Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992: Horizontal Ownership Limits*, 13 FCC Rcd 14462, 14479-80, ¶ 43 n.104 (1998).

<sup>46</sup> See, e.g., Report and Order, *Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, 104 FCC 2d 958, 1125, ¶ 343 (1986); Final Decision, *Amendment of Section 64.702 of the Commission's Rules and Regulations, Second Computer Inquiry*, 77 FCC 2d 384 (1980).

**B. The Commission Must Require AOL/Time Warner To Make Its Content, Portals, and Applications Available on a Non-Discriminatory Basis.**

As regulators learned a decade ago, the cable industry knows all too well how to corner content to suppress competing distribution media. DBS satellite distribution services would never have emerged as a competitive substitute for cable absent regulatory guarantees of equal access to the most popular video content. As the New York Times editorial page recently observed, “federal regulators, as they study the merger, should be guided by the same principle in regard to Internet access and digital television services: non-discrimination.”<sup>47</sup>

AOL already dominates much of the IP-based content, and Time Warner occupies an equally commanding position in markets for content distributed via traditional media. In addition, AOL and Time Warner control portals and websites that command a large viewing audience. And AOL’s instant messaging is the dominant messaging application, which AOL has refused to make interoperable. If other providers of high-speed Internet access services cannot deliver these same offerings, they will operate at an insurmountable disadvantage in signing up and retaining subscribers. Indeed, BellSouth is especially concerned about the combined company engaging in anticompetitive exclusionary behavior because just this month it signed a long-term satellite service agreement with GE Americom to deliver digital TV entertainment and interactive information.<sup>48</sup>

Vague arguments to the effect that there is “limitless content on the Internet” will not do. No such argument was accepted when cable was bottling up cable channels to protect cable distribution against competition from DBS. It cannot be accepted today in the context of a

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<sup>47</sup> *Time Warner’s Power Play*, N.Y. Times, May 5, 2000, at A26.

<sup>48</sup> BellSouth Press Release, *BellSouth Announces Major Home Entertainment Initiative, Building an Even Bigger Bundle of Services*, May 9, 2000.

merger that threatens to promote cable and thwart competing DSL and wireless media. Other ISPs – including BellSouth – require non-discriminatory access to this commanding portfolio of content, portals, and applications for their competitive survival. The Commission must insist on open access to the AOL/Time Warner content, portals, and applications that are distributed over the Internet, just as the Commission insists – under an express mandate from Congress – on open access to traditional satellite-distributed video content.<sup>49</sup> The threat to competition is no less grave when a cable operator seeks to leverage its power over content by using the Internet than when it does so by using satellites. Thus, the program access rules should apply to AOL/Time Warner regardless of how its content is distributed.

**C. The Commission Must Impose a Binding Condition of Open Access.**

The ability of a merged AOL/Time Warner to leverage its position at every level in the broadband chain, including content and distribution, signals the need for a real and enforceable opening of access to the distribution platform. Before it decided to acquire Time Warner, AOL was actively working toward broadly-defined open access to the cable platform, in addition to negotiating contracts with DSL and satellite providers. But AOL's incentive to pursue a conduit-neutral resale strategy is now history, as is its lobbying for broadly-defined open access.

The Applicants have submitted a Memorandum of Understanding that purports to address this very problem. The MOU as it currently stands, however, does not guarantee open access: it is a non-binding agreement that the Applicants can abandon at will. And, its promise of open access is narrow and technical, providing far too much room to the Applicants to define it as they

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<sup>49</sup> The limitation of the Cable Act's program access protections to satellite-delivered programming, which may have made sense in the technological world of 1993, makes little sense now. Video programming may now be delivered over terrestrial fiber, and may thus escape the program access requirements completely. As SBC pointed out in its comments, at 37, program access must be expanded to provide that protection that Congress originally intended.

see fit. To guarantee its effectiveness, the Commission must insist that it be rewritten and made a formal condition of the merger.

**Conclusion**

Unless the proposed merger is subject to the conditions described above, it will not further the public interest and should be denied.

Respectfully submitted,

  
Jonathan B. Banks

James Harralson  
BellSouth Corporation  
Suite 1800  
1155 Peachtree Street, N.E.  
Atlanta, GA 30309-3610  
(404) 249-2207

## CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of May, 2000, I caused copies of Reply Comments of BellSouth Corporation to be served upon the parties listed below by hand delivery (indicated by asterisk) or by first-class mail, postage prepaid.

  
Michelle R. Dawson

\*International Transcription Service, Inc.  
1231 20th Street, N.W.  
Washington, D.C. 20036

\*James Bird  
Office of General Counsel  
Federal Communications Commission  
445 12th Street, S.W., 8-C818  
Washington, D.C. 20554

\*To-Quyen Truong  
Associate Chief  
Cable Services Bureau  
Federal Communications Commission  
445 12th Street, S.W., 3-C488  
Washington, D.C. 20554

\*Royce Dickens  
Cable Services Bureau  
Federal Communications Commission  
445 12th Street, S.W., 3-A729  
Washington, D.C. 20554

\*Matthew Vitale  
International Bureau  
Federal Communications Commission  
445 12th Street, S.W., 6-A821  
Washington, D.C. 20554

\*Marilyn Simon  
International Bureau  
Federal Communications Commission  
445 12th Street, S.W., 6A-633  
Washington, D.C. 20554

\*Monica Desai  
Wireless Telecommunications Bureau  
Federal Communications Commission  
445 12th Street, S.W., 4-A232  
Washington, D.C. 20554

\*Laura Gallo  
Mass Media Bureau  
Federal Communications Commission  
445 12th Street, S.W., 2-A640  
Washington, D.C. 20554

\*Linda Senecal  
Cable Services Bureau  
Federal Communications Commission  
445 12th Street, S.W., 3-A734  
Washington, D.C. 20554

George Vradenburg, III  
Jill A. Lesser  
Steven N. Teplitz  
America Online, Inc.  
1101 Connecticut Ave., N.W.  
Suite 400  
Washington, D.C. 20036

Richard E. Wiley  
Peter D. Ross  
Wayne D. Johnsen  
Wiley, Rein & Fielding  
1776 K Street, N.W.  
Washington, D.C. 20006

Mark C. Rosenblum  
Stephen C. Garavito  
Lawrence J. Lafaro  
AT&T Corp.  
295 North Maple Ave.  
Room 3252G1  
Basking Ridge, NJ 07920

Howard J. Symons  
Michelle M. Mundt  
Mintz, Levin, Cohn, Ferris, Glovsky &  
Popeo, P.C.  
701 Pennsylvania Ave., N.W.  
Suite 900  
Washington, D.C. 20004

Timothy A. Boggs  
Catherine R. Nolan  
Time Warner Inc.  
800 Connecticut Ave., N.W.  
Suite 800  
Washington, D.C. 20006

Aaron I Fleischman  
Arthur H. Harding  
Craig A. Gilley  
Fleischman & Walsh, L.L.P.  
1400 Sixteenth St., N.W.  
Suite 600  
Washington, D.C. 20036

Susan M. Eid  
Sean C. Lindsay  
MediaOne Group, Inc.  
1919 Pennsylvania Ave., N.W.  
Suite 610  
Washington, D.C. 20006

Wesley R. Heppler  
Robert L. James  
Cole, Raywind, Braverman, L.L.P.  
1919 Pennsylvania Ave., N.W.  
Suite 200  
Washington, D.C. 20006

David W. Carpenter  
Mark D. Schneider  
David L. Lawson  
Lorrie M. Marcil  
C. Frederick Beckner  
Sidley & Austin  
1722 Eye Street, N.W.  
Washington, D.C. 20006

Philip L. Verveer  
Michael H. Hammer  
Michael G. Jones  
Francis M. Buono  
Wilkie, Farr & Gallagher  
1155 21st Street, N.W.  
Suite 600  
Washington, D.C. 20036

Harold Feld  
Andrew Jay Schwartzman  
Cheryl A. Leanza  
Media Access Project  
950 18th Street, N.W.  
Suite 220  
Washington, D.C. 20006

Matthew M. Polka  
American Cable Association  
One Parkway Center  
Suite 212  
Pittsburgh, PA 15220

Christopher C. Cinnamon  
Rhondalyn D. Primes  
Bienstock & Clark  
150 South Wacker Drive  
Suite 720  
Chicago, IL 60606

Stephen A. Weiswasser, Esq.  
Gemstar International Group, Ltd.  
135 North Los Robles Avenue  
Suite 870  
Pasadena, CA 91101

Jonathan D. Blake  
Amy L. Levine  
Covington & Burling  
1201 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004

Margaret Hefferman  
iCAST Corporation  
78 Dragon Court  
Woburn, MA 01801

J. Maxwell Williams  
Memphis Light, Gas and Water  
220 S. Main Street  
P.O. Box 430  
Memphis, TN 38103

Erwin G. Krasnow  
Michael M. Pratt  
Verner, Liipfert, Bernhard, McPherson  
& Hand, Chartered  
901 15th Street, N.W.  
Suite 700  
Washington, D.C. 20005

John Knox Walkup  
Wyatt, Tarrant & Combs  
1500 Nashville City Center  
511 Union Street  
Nashville, TN 37219

Jonathan E. Canis  
Michael B. Hazzard  
Kelley Drye & Warren LLP  
1200 Nineteenth Street, N.W.  
Fifth Floor  
Washington, D.C. 20036

William L. Fishman  
Swidler, Berlin, Shereff, Friedman, LLP  
3000 K Street, N.W.  
Suite 300  
Washington, D.C. 20007-5116

David Gusky  
Telecommunications Resellers  
Association  
1401 K Street, N.W.  
Suite 600  
Washington, D.C. 20005

Ross Bagully  
Tribal Voice  
600 17th Street  
Suite 700 South  
Denver, CO 80202

Tara C. Woods  
62 Myrtle Street, #2  
Somerville, MA 02145