

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

In the Matter of )  
Applications for Consent to the Transfer )  
of Control of Licenses and Section 214 )  
Authorizations by Time Warner Inc. and ) CS Docket No. 00-30  
America Online, Inc. Transferors, to )  
AOL Time Warner Inc., Transferee )

**BELLSOUTH REPLY COMMENTS**

BellSouth Corporation and BellSouth Telecommunications, Inc. (“BellSouth”), through counsel, hereby submits the following Reply Comments in response to the *Public Notice* issued by the Commission in the above referenced proceeding on April 4, 2003.<sup>1</sup> The *Notice* seeks comment on a Petition filed by AOL Time Warner Inc. seeking removal of a Commission-imposed condition of the merger of America Online, Inc. and Time Warner Inc. Specifically, the Petition seeks removal of “the condition restricting its ability to offer Internet users streaming video advanced Instant Messaging-based high-speed services (‘AIHS’) via AOL Time Warner broadband facilities (the ‘Condition’).”<sup>2</sup> For reasons more fully set forth below, the Petition should be denied.

AOL asserts that the circumstances existing at the time the FCC imposed the Condition have materially changed to such a degree that the Condition is no longer "necessary in the public

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<sup>1</sup> *AOL Time Warner Inc. Submits Petition for Relief from Instant Messaging Interoperability Requirements*, CS Docket No. 00-30, *Public Notice*, DA 03-1092 (rel. Apr. 4, 2003) (“*Public Notice*”).

<sup>2</sup> AOL Time Warner Petition at 1.

interest" and therefore should be removed. According to AOL, "there is clear and convincing evidence that the assumptions and predictions made at the time the Condition was imposed – which provided the factual predicate for the Condition itself – have proven to be incorrect."<sup>3</sup> It has only been slightly more than two years since the FCC imposed the Condition, and despite AOL's assertions to the contrary, circumstances that gave rise to the Condition have not changed substantially enough to warrant modification or removal of the merger Condition.

In their comments, Professors Faulhaber and Farber, who advised the Commission on the AOL merger, note that a material market condition and an essential predicate of the merger Condition has not changed – AOL's failure to interoperate. As Faulhaber and Farber note, during the Commission's review of the merger analysis, AOL committed to interoperation, which was expected to be completed by August 2001. Yet, in January 2003, in its Fourth Progress Report on Interoperability,<sup>4</sup> AOL announced it was abandoning server-to-server interoperability despite its previous commitment. The timing of and AOL's motives for making this announcement, especially in light of AOL's prior foot-dragging and the recent progress towards such interoperability by the industry's standards bodies, certainly cast doubt upon the sincerity of all of AOL's prior statements to the Commission about its commitment to interoperability.<sup>5</sup> The ramifications of such abandonment are considerable and make suspect any

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<sup>3</sup> AOL Time Warner Petition at 2.

<sup>4</sup> Fourth Progress Report on Instant Messaging Interoperability, letter from Steven Teplitz, AOL Time Warner, to Marlene H. Dortch, Secretary, Federal Communications Commission (Jan. 13, 2003).

<sup>5</sup> AOL's poor record on participating in or cooperating with industry standards efforts is discussed below in these reply comments. AOL's publicized abandonment of server-to-server interoperability came just at the time both the SIP/SIMPLE and newly created XMPP working groups were known to be reaching the final stages of completing interoperability standards. Abandoning industry supported standards as they are nearing consensus would indicate that AOL

claim by AOL that market conditions have changed and that the public interest would be served by a modification of its merger conditions.

Because of the continuing lack of interoperability between AOL's IM service and the rest of the industry, users of both AOL's IM service and competitors' IM services have generally been forced to obtain and operate multiple IM clients if they want to communicate with each other. As a result, according to industry information, a substantial percentage of the accounts included in the statements in AOL's petition about the number of IM users obtained by AOL's competitors actually reflect AOL IM users who have been forced to obtain separate, additional accounts from AOL's competitors in order to be able to exchange IM communications with the users of such competitors' IM services.<sup>6</sup>

This phenomenon of duplication of user accounts not only has the potential effect of appearing to overstate the acceleration in the growth of market share by AOL's competitors, but also is a direct result of AOL's continuing delays and failures to participate in the industry's interoperability efforts in any serious manner.<sup>7</sup> AOL should not now be permitted to use the

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had no intention of seeking interoperability, and is still trying to maintain an anti-competitive position.

<sup>6</sup> For example, the Forrester 2003 report indicates that some 20 percent of AOL users have another IM client. Charles S. Golvin, Chris Charron & Alanna Denton, "This Is Not Your Teenager's Instant Messaging," The TechStrategy™ Report, Forrester Research, Inc., February, 2003. Based on the numbers presented in AOL's petition, this would indicate that somewhere in the neighborhood of at least half of the market share numbers attributed by AOL to its competitors may be merely a reflection of this requirement to obtain these additional accounts in order to overcome AOL's lack of interoperability.

<sup>7</sup> See Third Progress Report on Instant Messaging Interoperability, letter from Stephen Teplitz, AOL Time Warner, to Marlene H. Dortch, Secretary, Federal Communications Commission (July 16, 2002), in which AOL focuses on iChat as an alternative solution to exposing AIM users to other IM providers, and further comments that the interoperability trial was limited in success, that standards are moving too slowly toward completion, and that no other IM service provider is implementing server-to-server communication.

iChat is no more than another domain under the AOL umbrella of users, and affords Apple customers a product-branded interface with exclusive access to AOL's customer base.

result of its failure to meet its interoperability commitment as a justification for the removal of a Condition that was imposed to incent AOL to interoperate with its IM competitors.

Indeed, Faulhaber and Farber observe that AOL's disinclination to offer interoperability makes AOL's claims that it is not dominant in the marketplace suspect. As these professors note:

The only reason it might want to deny these [interoperability] benefits to its users is if by doing so it denied even greater benefits to the customers of its competitors, which is exactly what market tipping is all about. Denying interoperability is a strategic decision of a firm, which only makes sense when its market presence is strong enough to cause tipping, thus increasing its long run profits at the expense of its own customers. Professor Rogerson is silent on this point; if AOL Time Warner really hasn't tipped the IM market, then their optimal strategy is to interoperate, and yet they refuse to do so.<sup>8</sup> (footnote omitted)

As the Commission anticipated when it imposed the Condition, IM would be evolutionary. The evolution of IM usage away from simple one-to-one text messaging toward more multi-user text, audio and video chat applications has paved the way to enabling the broadcast or multicast of various media and content types (including streaming video AIHS) to groups of users who are online and available with broadband connections and can therefore take advantage of such AIHS capabilities.<sup>9</sup> The introduction of initial AIHS capabilities by MSN and

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This demonstrates the type of dominant market position that only AOL could negotiate with a major industry supplier.

AOL claims the IETF is moving too slowly to complete the missing elements of interoperability. As they are making this statement they are not participating in SIP/SIMPLE, and did not comment at the IETF forming meeting (BOF 7/15/02) for XMPP.

The most widely deployed server-to-server interoperable solution exists already and is based on XMPP (extensible messaging and presence protocol), which has come about through the open source movement via jabber.org, which claims over 60,000 servers in use worldwide, albeit, not necessarily interconnected, but capable of doing so.

<sup>8</sup> Faulhaber and Farber Comments at 4.

<sup>9</sup> Faulhaber and Farber (p. 5) suggest that it is not surprising that AOL, as it rolls out its new broadband offering, would request to be relieved of the requirement to interoperate if it offers an IM-based high speed service. "Their behavior suggests that they may well have such a

Yahoo! is asserted by AOL in its petition to be evidence of the lack of a continuing need for the Condition. However, in reality this merely serves to reinforce the conclusion that the IM marketplace is in fact evolving toward AIHS services along exactly the lines the FCC anticipated when it imposed the Condition in the first place, and that the Condition remains as necessary today as it was when the Commission ordered it.

Most of AOL's petition focuses on the numbers of end-users of the various IM services. AOL, in its petition, takes pains to point out that IM services are still typically provided to end-users without charge. It attempts to use that (perhaps temporary) fact to support its argument that AOL lacks market power in the IM marketplace and that the Condition should therefore be removed.<sup>10</sup> However, if one focuses on the most relevant aspect of this market, it becomes obvious that the potential for domination of the AIHS market by the AOL/Time Warner combination, which concerned the FCC when it imposed the Condition, still exists today.

By focusing so heavily on the end-users, AOL may be hoping to distract the Commission from what should probably be the key focus area, and the one in which the AOL/Time Warner combination poses the greatest obstacle to competition. As Rush Limbaugh is so fond of saying, it is important to "follow the money" in analyzing most matters, and this one is no exception. AOL and the other IM providers may, at this point, be providing IM services to the end-users for free. However, they are clearly not doing this simply out of the goodness of their hearts. Somebody is paying for this service.

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service ready to roll out soon as a feature of their AOL Broadband, and wish to keep their network effects proprietary. In fact, it is precisely this case that the Merger Order anticipated when it imposed the IM condition.”

<sup>10</sup> AOL Time Warner Petition at 15-16.

The key sources of revenue supporting IM services, in the traditional narrowband (text chat) model, have generally either been advertising revenues or Internet access service revenues (the latter, apparently, on the theory that the availability of the IM services would aid in the acquisition or retention of Internet access service customers). As broadband connections proliferate and it becomes practical to deliver broadcast or multicast video and other media content through the IM infrastructure, two new potential sources of revenue will likely become increasingly available: (i) end-user subscriber revenue for premium IM services, and (ii) fees charged to media content providers by the IM providers for access to AIHS-enabled IM infrastructures and users.

In either case, the historical phenomenon of simplified IM services being provided to end-users for free should not be relied upon as justification for ignoring the very real potential for AOL's dominance and market power in the AIHS marketplace through extension of its dominance in the IM marketplace. As Faulhaber and Farber state, on the face of it, "free" IM service is not evidence of a competitive market.<sup>11</sup> Accordingly, the zero price for IM services does not provide justification for relieving AOL of the Condition. The potential that AOL could use its dominance in the IM market to extend its positioning in the AIHS market, of course, was at the very heart of the reason for the FCC's imposition of the Condition in the first place, and the need to be concerned about that potential has not decreased.

In its petition, AOL challenges the Commission's findings with respect to the strong network effects exhibited by AOL's NPD.<sup>12</sup> However, AOL makes this argument while essentially ignoring the application of these network effects on the key business players (media

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<sup>11</sup> Faulhaber and Farber Comments at 3-4.

<sup>12</sup> AOL Time Warner Petition at 19-25.

content providers) who will provide the fuel, i.e. money, for the continued evolution of IM services into the AIHS marketplace. Just as the network effects of AOL's large NPD make AOL's IM service appeal to end-users desiring to chat with as many other people as possible, so too does AOL's dominance in the IM marketplace and the network effects of AOL's NPD make AOL's potential AIHS service more attractive to potential streaming video and other media content providers.

If AOL is permitted to leverage its dominant network position through removal of the Condition and to offer content providers the breadth of AOL's system to reach the AIHS audience, AOL is much more likely to be able to extract supra-competitive rates from such content providers. In the alternative, AOL could act anti-competitively, not charge or be charged less by content providers and cross-subsidize the cost of AIHS through its general subscription fees. On the other hand, broadband Internet access providers in general (who are also competing with AOL/Time Warner as network providers) are being constantly pressured to cut their prices and rely on enhanced services such as AIHS to make a profit. AOL's potentially exclusive access to the Time Warner content, in combination with the possible availability of such content only through AOL's AIHS services delivered via non-interoperable IM services, poses a very real danger of continued anti-competitive behavior by AOL.

The need for IM interoperability is just as great today as it was when the FCC adopted the Condition, if not more so with the growth of broadband users and the increased economic viability for potential AIHS products. Interoperability is the key to a sensible and publicly beneficial evolution of the communication services marketplace. While the Commission, in its order imposing the Condition, stopped short of actually ordering AOL to achieve this

interoperability, it at least wisely and correctly determined that AOL/Time Warner should not be in a position to extend its dominance in IM services into the AIHS marketplace.

In speaking of the Condition in its petition, AOL asserts that "this artificial restraint on AOL's provision of streaming video AMS [sic] harms the public interest by negatively affecting investment and innovation."<sup>13</sup> Yet, all that AOL has to do to offer advanced streaming video services without hindrance is to meet its commitment to interoperate. In reality, however, it is AOL's continued refusal to participate meaningfully in industry efforts toward interoperability that is harming the public interest by negatively affecting investment and innovation.<sup>14</sup>

The FCC held out to AOL the "carrot" of entry into the AIHS marketplace, but retained the "stick" of requiring IM interoperability. Barely two years later, as the economy has finally begun to turn around and the prospects for increased investment and activity in the AIHS marketplace appear to be improving, AOL now wants the FCC to hand it the "carrot" and to throw away the "stick." AOL's strategic decision to abandon interoperability should not be rewarded by removal of the Condition. The public interest, however, is not a function of AOL's strategic marketing decisions. All customers would benefit from interoperability, and AOL's participation in achieving a solution is key. The only effective motivation for AOL to participate is the Condition. Accordingly, the public interest requires that the Condition remain in place.

For the reasons discussed above, the Commission should deny AOL's petition.

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<sup>13</sup> AOL Time Warner Petition at 5-6.

<sup>14</sup> Innovation is fostered by allowing the widest audience to invest and benefit from a fair market share in an open market. Having a closed environment does not allow many potential product investments to be realized when the largest portions of the market are segmented and not accessible. E.g., if a bank wished to provide instant alerts to customers who transfer money or are awaiting deposits, without interoperability they would have to negotiate and build separate interfaces and methods to reach each IM provider's users, and a dominant IM provider such as AOL would be in a position to negotiate any anti-competitive or financially attractive terms that they desired. Historically, the Internet evolved through innovation that was supported by interoperability and standards like HTTP, SMTP (Email) and HTML.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I do hereby certify that I have on this 20th day of May 2003 served the following with a copy of the foregoing **REPLY COMMENTS** by electronic filing, electronic mail and/or by placing a copy of the same in the United States Mail, addressed to the parties listed below.

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