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June 24, 2005

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JUN 24 2005

Federal Communications Commission
Office of Secretary

Via Hand Delivery

Ms. Marlene Dortch
Secretary
Federal Communications Commission
The Portals
TW-A325
445 12th Street, S.W.
Washington, D.C. 20554

Re: In the Matter of SBC Communications Inc. and AT&T Corp. Application for Approval of Transfer of Control; WC Docket No. 05-65

Dear Ms. Dortch:

Please find attached the Response of EarthLink, Inc. to the Joint Opposition of the Applicants for filing in the above-referenced proceeding. In addition to filing a confidential copy of this response, in accordance with paragraph 5 of the Second Protective Order, EarthLink is submitting two copies of the confidential filing in redacted form marked "REDACTED – FOR PUBLIC INSPECTION."

Please contact the undersigned if you have any questions regarding this filing.

Respectfully submitted,

John W. Butler
Robert K. Magovern
Counsel for EarthLink, Inc.

JWB:jmb

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Federal Communications Commission
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Before the
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Washington, D.C. 20554

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	)	
SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control	)	WC Docket No. 05-65
	)	

Response of EarthLink, Inc.

In its Petition to Deny filed on April 25, 2005, EarthLink, Inc. (EarthLink) argued that the proposed merger of SBC and AT&T would increase the combined firm's incentive and opportunity to discriminate against other Internet backbone providers, and that such discrimination would ultimately threaten competition in the retail Internet access marketplace.[1] More fundamentally, EarthLink argued that the Applicants had failed to identify an appropriate product market and to analyze the impact of the merger on that market.

Pursuant to the Commission's request, the Applicants have since submitted new information that is relevant to some of EarthLink's concerns. However, the information that the Applicants have submitted has led to new questions concerning the competitive and public interest effects of the proposed merger. In light of the fact that the Applicants have raised new arguments based on information that was not available at the time of EarthLink's initial filing, we take this opportunity to respond to these new arguments.

[1] *See* EarthLink Pet. To Deny at p. 5.

For the reasons set forth more fully below, although the Applicants have attempted to address concerns over the proposed merger's effect on competition in the Internet backbone market, the Application—particularly Dr. Schwartz's second declaration—still relies on unsupported assumptions and does not adequately define the relevant product markets. As a result, the Applicants still have not addressed EarthLink's largest concern with the proposed merger. Because SBC is currently the largest DSL provider in the nation,[2] and with the addition of AT&T will be the largest Internet backbone service provider in all 13 states in SBC territory, the combined company will have both the ability and the incentive to use its comprehensive control over the network to diminish the ability of other companies to compete in the retail Internet access market.[3] Because the Applicants still have not met their burden of showing that the proposed merger is in the public interest, the Application must be denied.

A. The Applicants Still Have Not Adequately Addressed Several Concerns Raised by EarthLink.

In their Joint Opposition recently filed with the Commission, the Applicants have not addressed several concerns raised by EarthLink relating to the competitive and public interest effects of the proposed merger. Instead, the Applicants suggest that EarthLink lacks a basis to challenge this transaction "on its own merits," i.e. separate from the Verizon/MCI merger.[4] However, in its Petition to Deny, EarthLink addressed three

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[2] *See* SBC Website, "Investor Relations: DSL Overview," *available at* http://www.sbc.com/gen/investor-relations?pid=5676.

[3] *See* EarthLink Pet. To Deny at p. 12.

[4] Joint Opp. at p. 55. For the avoidance of any doubt, EarthLink also respectfully urges that it is both appropriate and essential for the Commission to consider the combined effects of the parallel SBC/AT&T and Verizon/MCI mergers. To do otherwise would necessarily result in a public interest analysis that is incompatible with actual market conditions.

specific concerns regarding the proposed merger's potential impact on independent ISPs and other competitors.

First, EarthLink argued that the proposed merger would result in a reduction in the Internet backbone market shares of Tier 1 providers such as Sprint and Level 3, with a corresponding increase in market share to the combined SBC/AT&T. Second, based on the information provided by the Applicants, EarthLink expressed concern that the combined firm—with an Internet backbone market share three times as large as any other company besides MCI and Sprint—would choose to peer only with the merged Verizon/MCI entity and possibly Sprint, forcing others to pay for transit. Moreover, EarthLink currently peers with both SBC and Verizon. If the proposed mergers go through, it is entirely likely that the merged entities will cease to peer with EarthLink, thus increasing EarthLink's costs with respect to the traffic that it currently exchanges with these Applicants on a settlement-free basis. Third, EarthLink argued that although the competitive concern with the merger begins with increased concentration in the Internet backbone market, the proposed merger's effect would be even more acutely felt in the broadband Internet access market, in which the merged company would be the only provider of end-to-end Internet connectivity in SBC territory.

In this separate and distinct product market, all other competitors would be faced with monopolistic conditions in the 13-state SBC region. Inasmuch as EarthLink requires access to transmission services in order to serve its customers, unless the Commission states unequivocally that end-to-end Internet connectivity will be subject to the reasonableness and nondiscrimination requirements in section 201 and 202 of the Communications Act, or there is a merger-specific requirement with an appropriate

enforcement mechanism with a similar result, the merged company would be able to use its monopoly position within SBC territory to deny competitors its transmissions services.

EarthLink noted in its Petition to Deny that the Applicants relied almost entirely on the declaration of Marius Schwartz with respect to the competitive effects of the merger on the Internet backbone market.[5] In his second declaration, Dr. Schwartz has attempted to address EarthLink's first two arguments, relating to Internet backbone concentration and peering. While parts of Dr. Schwartz's analysis may have some facial appeal in addressing the proposed merger's impact on competition in the Internet backbone market, a closer look reveals that the analysis provides more cause for concern than for comfort. We address these problems with the Applicants' response to EarthLink's first two arguments in more detail below.

As to EarthLink's third argument regarding SBC's unique control over end-to-end facilities, the single largest problem with the Application is its continued failure to identify and analyze a realistic product market. In its Petition to Deny, based on the Applicants' own description of the services that the combined company will offer,[6] EarthLink suggested that the Commission analyze the merger for Internet purposes using a product market of "end-to-end Internet connectivity."[7] Not only did the Applicants dismiss this argument without any explanation in their Joint Opposition,[8] but they still

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[5] *See* EarthLink Pet. To Deny at p. 3.

[6] *See, e.g.,* Joint Opp. at p. 11 (describing the merged company's ability to "expand its global capacity and provide end-to-end service.").

[7] EarthLink Pet. To Deny at p. 11.

[8] Joint Opp. at p. 77. To the extent the Applicants address EarthLink's suggestion of using an "end-to-end Internet connectivity" product market at all, they state only that there is "no separate, less competitive market...for long distance transport of IP-based traffic." This description, however, would include only Internet backbone services and not "end-to-end Internet connectivity." Therefore, in addition to failing to address EarthLink's market definition, the Applicants have mischaracterized it.

have not properly defined the relevant product markets in their analysis. Whatever product market definitions are used to assess the competitive impact of this merger, they must be properly identified and analyzed. As the Eighth Circuit held in *FTC v. Freeman Hospital,* "[w]ithout a well-determined relevant market, an examination of a transaction's competitive effects is without context or meaning. A relevant market consists of two separate components: a product market and a geographic market."[9] The Applicants' continued failure to identify proper product markets renders their Application facially inadequate.

1. *Dr. Schwartz's Analysis Regarding "Targeted De-Peering" Mischaracterizes EarthLink's Concerns and Is Not Supported By the New Information Submitted.*

In his second declaration, Dr. Schwartz addresses EarthLink's argument that a merged SBC/AT&T would be in the position to de-peer an Internet backbone provider ("IBP") like Level 3, which would ultimately raise costs to retail ISPs like EarthLink.[10] Dr. Schwartz asserts that peering criteria are not based on revenue, but instead on factors such as the geographic scope of the two networks and their ratio of inbound to outbound traffic.[11] As an initial matter, EarthLink notes that the only Internet backbone data initially supplied by the Applicants that identified company names other than AT&T was revenue data.[12] EarthLink's arguments were based on the information submitted by the

[9] *FTC v. Freeman Hosp.*, 69 F.3d 260, 268 (8th Cir. 1995). The Commission has also held that "[i]n evaluating the potential competitive effects of a transaction, it is necessary to first define the product and geographic markets." *See In the Matter of General Motors and Hughes Electronics Corp.,* 19 F.C.C. Rcd. 473, 499, at ¶ 50 (2004).

[10] Schwartz Sec. Dec. at ¶ 27.

[11] *Id.* at ¶ 28.

[12] *See* Schwartz Initial Dec. at Tables 2 and 3.

Applicants. Therefore, given that the burden of proof rests on the Applicants, it is somewhat ironic that Dr. Schwartz would seek to discredit an EarthLink argument that was based on the only information that the Applicants offered with the initial Application.

In any event, even granting Dr. Schwartz's contention that peering criteria are not based solely on relative revenues, the new information provided by Dr. Schwartz indicates that inbound to outbound traffic ratios and geographic compatibility do not tell the whole story either. As EarthLink stated in its Petition to Deny, AT&T does not currently peer with SBC despite a [REDACTED] traffic ratio as between the two companies.[13] The data in Table 3 of Dr. Schwartz's declaration, which lists SBC inbound to outbound traffic ratios with other networks, supports this conclusion.[14] If Dr. Schwartz is correct that peering relationships are based on inbound to outbound traffic ratio, then this leaves open the question as to why AT&T and SBC do not peer with each other despite a [REDACTED] ratio. Both the Application and Dr. Schwartz's second declaration are silent as to this question. As to the second criterion—geographic scope of the two networks involved—Dr. Schwartz never discusses how this criterion is applied. Dr. Schwartz asserts that AT&T today peers with numerous companies that are smaller than SBC,[15] but he never explains how it is that a substantial number of networks that are smaller than SBC would have the geographic compatibility with AT&T that would make them a more attractive peer than SBC.[16]

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[13] *See* EarthLink Pet. To Deny at 4.

[14] *See* Schwartz Sec. Dec. at Table 3 ([REDACTED]).

[15] *See id.* at ¶ 28 ("AT&T does peer with companies that are much smaller than SBC based on their Internet revenues and traffic, but whose network topography satisfies AT&T's cost-based peering criteria.").

What appears most to emerge from Dr. Schwartz's information is that peering relationships (particularly Tier 1 peering relationships) are not controlled by any one particular factor, but rather that they are merely arrangements that any given carrier may choose to enter into—or discontinue—at its own discretion. These are not contractual agreements. In fact, as the Applicants themselves admit, most peering arrangements are not even written down.[17] Furthermore, the Commission has never regulated peering arrangements or expressed an opinion as to whether traffic subject to peering is covered by Title II of the Communications Act. Accordingly, while we do not doubt that Dr. Schwartz is correct that traffic ratios are considered in peering relationships, the variety and discretionary nature of peering arrangements makes them an inappropriate basis for the sort of broad and conclusory assurances of continued competition offered by the Applicants. Indeed, the fact that AT&T does not currently peer with SBC provides the Commission with the best evidence as to why this information is not reliable as a predictor of whom (and on what terms) the combined company will choose to peer with after the merger.[18]

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[16] *See id.* at Tables 1 and 2.

[17] *See* Response of SBC to Information and Document Request Dated April 18, 2005 at p. 65 ("In the vast majority of cases, there is no written agreement signed between peering partners.") (hereinafter "SBC Response").

[18] Related to his traffic ratio analysis, Dr. Schwartz provides new statistics regarding inbound to outbound traffic between AT&T and its peers. Based on this information (particularly Tables 1 and 2), he claims that the relative amounts of traffic exchanged between AT&T and its peers are a reasonable proxy for the relative absolute sizes of all the IBPs with whom AT&T peers. *See* Schwartz Sec. Dec. at ¶ 10. Inasmuch as the relative sizes in Table 1 versus Table 2 vary significantly with respect to a large number of companies set forth in these tables, the suggestion that this information reliably shows the relative sizes of IBPs must be rejected. For example, in Table 1, [REDACTED] has a total bandwidth of [REDACTED]. Table 2 reports that during the same time period, [REDACTED] only used [REDACTED] of its total capacity. Additionally, Table 1 shows that [REDACTED] has a total bandwidth of [REDACTED]. Table 2 reports that during the same time period, [REDACTED] only used [REDACTED] of its total capacity. *See* Schwartz Sec. Dec. at Tables 1 and 2. Thus, sorting by relative size based on the data in the two tables

Perhaps more to the point, none of the major Internet backbone players today (including AT&T) controls large numbers of Internet end users. Because these IBPs do not control substantial last-mile facilities or the customers that are dependent on these facilities, they do not today have an incentive to discriminate in providing backbone transmission services. However, as stated above, SBC is the largest DSL provider and the second largest broadband Internet access service provider in the country. Once SBC adds AT&T's very large Internet backbone to its own substantial last mile facilities, the incentive and ability to discriminate against other Internet service providers that depend on access to its transmission services in order to compete with the merged company for customers in SBC territory will increase.

In his second declaration, Dr. Schwartz addresses a second concern raised by EarthLink in that the merged SBC/AT&T would be so large that it would be in the position to refuse interconnection to other Tier 1 IBPs, or threaten to refuse interconnection to force current peers to start paying for transit.[19] Dr. Schwartz suggests that targeted degradation is not a concern in this case because: (1) the degraded carrier must be prevented from exchanging traffic with other IBPs that would peer with the merged firm, and (2) even if the merged entity chose to deny interconnection to another Tier 1 IBP, it would still suffer a loss of competitiveness against all the other IBPs that

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results in significantly different conclusions as between the two. If this information is indicative of anything at all, it is that AT&T is not receiving a large discretionary portion of a number of carriers' total traffic, which underscores the point that using this data to determine the relative sizes of IBPs is not appropriate.

[19] Schwartz Sec. Dec. at ¶ 29. EarthLink fails to see any difference between the concern of targeted de-peering and using the threat of targeted degradation to impose targeted de-peering. In fact, this "different concern" referred to by Dr. Schwartz is very much one of the primary concerns raised by EarthLink in its Petition to Deny.

peered with both it *and* the degraded carrier.[20] There are several problems with Dr. Schwartz's conclusions.

Even if it were true that the above two factors must be present for targeted degradation to be profitable in a narrowly defined *Internet backbone market*, the incentive and ability for discrimination about which EarthLink is concerned would occur in the downstream *retail Internet services market* by making it more expensive for competing retail ISPs to move their Internet traffic from one point to another.[21] EarthLink addresses more fully below the issue of how the Internet backbone market is not the proper product market with respect to the Internet issues raised by this merger.

2. *Dr. Schwartz's Analysis Regarding Cable Companies' Ability to Preserve Competition in the Internet Backbone Market Suffers From a Number of Shortcomings.*

In Dr. Schwartz's second declaration, his primary argument as to why the proposed merger will not adversely affect competition in the Internet backbone market is that cable companies will have the ability and incentive to maintain competition among IBPs.[22] In fact, Dr. Schwartz describes this argument as a "key issue."[23] He states that

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[20] *Id.* at ¶¶ 30-31.

[21] Related to this question, Dr. Schwartz further asserts that opponents should not be concerned that the combined companies of SBC/AT&T and Verizon/MCI will form two "mega peers" that would peer only with each other because even in a "worst case view," the combined *total* traffic of the two merged companies would still be less than the combined *total* traffic of all the remaining IBPs. *See* Schwartz Sec. Dec. at ¶ 36. This argument improperly presumes that all the remaining IBPs will act in concert after the proposed mergers are effective. It is not clear that this is factually likely or even legal. Moreover, as discussed on page 7, these two "mega-peers" would be unlike any other IBP in the sense that they would control large numbers of end-users. Dr. Schwartz's contention therefore fails to note that they would be different in kind, as well as size. Most important, however, this argument misses EarthLink's point about the impact of the combined firm's share of end-user customers. As EarthLink stated in its Petition to Deny, with respect to any one player seeking to compete in the retail Internet access service market, anticompetitive conduct need not be "global" to produce substantial competitive problems. *See* EarthLink Pet. To Deny at p. 3.

[22] Schwartz Sec. Dec. at ¶ 14.

because cable operators are Internet backbone purchasers and would collectively serve a considerably larger share of the Internet end-user base than would a combined SBC/AT&T, they have both the ability and the incentive to maintain competition among backbones.[24] The theory behind this argument is that, should the merged firm seek to de-peer or raise prices for backbone services, any cable company could shift its Internet-bound traffic to another large IBP to create a rival with a customer base comparable to the combined SBC/AT&T. There are several problems with this argument.

First, Dr. Schwartz's argument assumes that it is economically practicable for the cable company in question to switch IBPs, or that it is technically able to switch IBPs at all. Dr. Schwartz's argument does not consider either the costs incurred by switching providers or the technical compatibility of the networks involved. Second, as Dr. Schwartz himself suggests, this argument also assumes that any one cable company would be willing to bear the costs and competitive challenges of changing providers and risk having other competitors not do the same.[25] Furthermore, if cable companies initiated some collective action to avoid this problem, such conduct could potentially constitute a group boycott in violation of the antitrust laws. There is simply no evidence in the record that demonstrates that these serious hurdles would be overcome so as to allow the posited "cable correction" to actually take place.

Finally, economic theory holds that the rational purchaser of backbone services, assuming all other factors were equal, would choose the lowest priced provider of connectivity that meets its technical requirements. Dr. Schwartz's argument, therefore, is

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[23] *Id.*

[24] *Id.*

[25] *See id.* at ¶ 15.

based on the assumption that market participants will make an economically irrational choice in order to preserve the competitive balance in the market. There is no basis to assume any cable company would make such a choice, but if the Internet backbone market depends on cable companies "buying high" for backbone services in order to maintain competition, then the market being described has already failed. A truly competitive market would not require one of its participants to act in such a manner in order for the market to stay competitive.

Based on the foregoing, in light of the fact that this is Dr. Schwartz's main argument as to how the Internet backbone market will remain competitive after the merger, it is clear the Applicants have not met their burden of proof on this vital issue.

B. The Application Still Fails to Properly Define the Relevant Product Markets.

In their Joint Opposition to the Petitions to Deny, like their initial Application, the Applicants have divided their market analyses into mass market, enterprise, special access, and Internet services.[26] Yet, at the same time, the Applicants again urge that the proposed merger will create "an expanded IP network" that allows the merged company to "expand its global capacity to provide end-to-end service" and "a full range of broadband services" to its customers.[27] As EarthLink argued in its Petition to Deny, and does so again now, the Applicants still have not properly identified and analyzed the product markets at issue.

In its Petition to Deny, EarthLink suggested that the Commission analyze the merger using a product market of "end-to-end Internet connectivity"—encompassing the

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[26] Joint Opp. at p. iii-v.

[27] *Id.* at p. ii, 11.

markets separately thought of as "last mile," "special access," and "Internet backbone" services. Such an analysis serves two purposes. First, it recognizes the reality that—as the Applicants themselves assert—the merged company will operate a network that is fully integrated from the end user's premises all the way to the termination facility that connects the user with his or her destination on the Internet. The "end-to-end Internet connectivity" product market is not a hypothetical market created for the purpose of analyzing this merger, but instead is based on the *actual* product that the merged firm would sell on a wholesale basis to EarthLink and other providers, and on a retail basis to end users. The Applicants' own description of the effects of the merger combined with the actual product that the Applicants propose to offer compels the conclusion that the current product markets analyzed by the Applicants do not reflect products that will be available to competing Internet access service providers post-merger. As such, those product markets do not reflect commercial reality and must be rejected.

Second, unlike the Commission's review of the MCI/WorldCom merger where the competitive concern was largely the combined firm's concentration of Internet backbone market share, there are unique competitive concerns with this merger that the use of the "end-to-end Internet connectivity" product market would allow the Commission to properly address. As stated above, none of the major Internet backbone players today controls large numbers of Internet end users. The data submitted in response to the Commission's request for additional information supports that this is the case with AT&T.[28] Because IBPs do not control substantial last-mile facilities, they have no incentive to discriminate in proving backbone transmission services. However, SBC

[28] *See* Response of AT&T to the Commission's April 18, 2005 Information and Document Request at Exhibit 8(b)(1)(IV) (Number of AT&T consumer DSL customers).

is the largest DSL provider and the second largest Internet access service provider in the country. Indeed, in [REDACTED] of the 13 states in its territory—including [REDACTED] and [REDACTED]—SBC leads cable in numbers of retail broadband Internet access customers.[29] Once SBC adds AT&T's very large Internet backbone market share to its own substantial last mile facilities, the combined company will have both the ability and the incentive to use its comprehensive control over the network to diminish the ability of other companies to compete in the retail Internet access market. Indeed, the combined company would be the dominant—and in fact the *only*—player in the "end-to-end Internet connectivity" product market within SBC territory.

It is impossible to place too much emphasis on the fact that both the SBC/AT&T and Verizon/MCI mergers represent a level of vertical integration that far surpasses anything that has been seen since the advent of the commercial Internet. The Applicants continue to assert that this merger would create a new and seamless end-to-end IP network. Therefore, if that is what the Applicants intend to create with this proposed merger, then that is what the Commission must analyze. While EarthLink strongly supports the use of an "end-to-end Internet connectivity" product market, whatever product market definitions are used to assess the competitive impact of this merger, they must be properly identified and analyzed. It is impossible for the Commission to properly analyze the competitive impacts of this merger until the Applicants do so, and their continued failure in this regard renders their Application facially inadequate.

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[29] *See* SBC Response at Exhibit 13(b)(5) (Household Share of Broadband Internet Connections—SBC Footprint in Q4 2004). For this reason, EarthLink has argued that the Applicants must define the relevant geographic market locally and that national statistics are insufficient.

Conclusion

There are numerous unanswered questions in the information provided by the Applicants. There remains considerable concern that the proposed merger would give the merged firm both the incentive and the ability to use its increased market power in the Internet backbone market to de-peer current peering partners and force them to pay for transit. Additionally, the Applicants still have not properly defined the relevant product markets. Specifically, for competitors like EarthLink, the Applicants' submission of new information does not address the fact that there is a very real threat that the proposed merger will harm competition in downstream markets for Internet access and information services. Unless and until the Applicants sufficiently address these concerns, the Commission has no choice but to deny the Application.

Respectfully submitted,

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