

July 6, 2005

**BY HAND**

Gary Remondino  
Wireline Competition Bureau  
Federal Communications Commission  
445 Twelfth Street, S.W.  
Washington, D.C. 20554

**Re:** *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from AT&T Corp., Transferor, to SBC Communications Inc., Transferee, WC Docket No. 05-65 –*  
**REDACTED – FOR PUBLIC INSPECTION**

Dear Mr. Remondino:

EarthLink, Inc (“EarthLink”) in its most recent filing on June 24, 2005 continues to claim that SBC and AT&T have not met their burden to demonstrate that the proposed merger is in the public interest. Yet a thorough review of EarthLink’s latest complaint reveals that EarthLink has simply chosen to ignore the highly relevant facts that the Applicants have put forward, as reflected in Dr. Schwartz’s Declarations, substituting instead its own, factually unsupported claims of harm to itself, rather than to competition in any relevant market.<sup>1</sup> The Applicants have amply demonstrated that the proposed transaction will not harm competition in the Internet Backbone market, a market previously found to be a “relevant market” in similar transactions.<sup>2</sup> *A fortiori*, there can be no possibility of harm in the downstream market for ISP retail services, which is the express concern raised by EarthLink, because ISPs will continue to have multiple competitive providers of IBP services. EarthLink’s latest filing simply fails to come to grips with the dispositive evidence that the Applicants have submitted, including in the Joint Opposition and the Reply Declaration of Dr. Marius Schwartz. EarthLink does not credibly contest those facts.

**A. SBC/AT&T Have Demonstrated That Even a Large Relative Size Differential Is Not Sufficient for Profitable Targeted De-Peering to Occur**

EarthLink’s principal complaint is that “because the combined SBC/AT&T would be three times larger in market share than all providers other than MCI and Sprint,” such

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<sup>1</sup> EarthLink purports to raise three concerns, but its entire argument distills to the single claim that increased concentration in the provision of Internet Backbone services will harm competition in the market in which EarthLink competes, which is the provision of retail ISP services. As the Applicants demonstrate below, EarthLink fails to establish that there will be any competitive harm in any relevant Internet market from this transaction, whether considered alone, or in conjunction with the Verizon-MCI transaction.

<sup>2</sup> See cases cited in Initial Schwartz Declaration, ¶ 5.

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relative disparity would enable SBC/AT&T to de-peer all other IBPs with the exception of MCI/Verizon and possibly Sprint.<sup>3</sup> The Applicants thoroughly addressed this concern in the Reply Declaration of Dr. Schwartz, and in the Joint Opposition, and will not repeat those arguments here in detail.<sup>4</sup> Rather, we show below the gaps in EarthLink's proffered analysis of the Schwartz Reply Declaration and supporting data.

EarthLink's "analysis" of how peering policies work is fundamentally flawed, which inevitably leads it to flawed conclusions. For example, EarthLink notes that the traffic exchanged between SBC and AT&T falls within the 2:1 ratio that is typically found in peering policies, and then poses the following question:

"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 near perfect 2:1 ratio. Both the Application and Dr. Schwartz' declaration are silent as to this question."<sup>5</sup>

In fact, however, EarthLink completely mischaracterizes the information in Dr. Schwartz's Reply Declaration by omitting other peering criteria. Paragraph 28 of the Reply Declaration states:

28. The answer to Earthlink's concern is that peering criteria indeed are *not* based on the two companies' relative Internet revenues, but on *cost-driving factors* such as the *geographic scope of the two networks and their ratio of Inbound to Outbound traffic*. All the major IBPs include such requirements in their peering policies. And, as explained shortly, AT&T does peer with companies that are much smaller than SBC based on their Internet revenues and traffic, but whose network topology satisfies AT&T's cost-based peering criteria. Thus, there is no reason to think Level 3 will be de-peered on the grounds feared by Earthlink.

Schwartz Reply Declaration, ¶ 28 (emphasis added; footnote omitted). Thus, EarthLink has missed the key points:

- Peering policies are *cost-based*;

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<sup>3</sup> Response of EarthLink, Inc., June 24, 2005, at 3.

<sup>4</sup> See Joint Opposition of SBC Communications Inc. and AT&T Corp. To Petitions To Deny and Reply To Comments, pp. 60-74 and Schwartz Reply Declaration, ¶¶ 12-26 (addressing global de-peering) and 27-34 (addressing targeted de-peering) (hereafter "Joint Opposition").

<sup>5</sup> EarthLink Response at 6.

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- Cost-based policies depend primarily on *both* in-out ratios *and* network topology;
- AT&T peers with numerous companies that are smaller than SBC, but whose network topology satisfies AT&T's cost-based criteria.

By simply denying the clearly-stated facts, EarthLink offers up a straw man – that the FCC should somehow be concerned that AT&T does not peer today with SBC, even though SBC meets the 2:1 ratio. EarthLink's argument, however, fails to account for the full range of cost-based peering requirements, in this case network topology. AT&T addressed this very point in its Response to Specification 9 of the FCC's April 18, 2005 Information and Document Request, by submitting its peering policy, which states, in relevant part, that peers must:

[REDACTED]

AT&T Response, Exhibit 9(a). SBC has not been peered with ATT for the simple reason that SBC's network did not meet ATT's requirements for geographic reach. Therefore, EarthLink errs in offering AT&T's in-out ratio with SBC as the sole benchmark for predicting the post-merger entity's peering partners.

EarthLink, having ignored the most relevant facts concerning peering policies, erroneously concludes that peering policies are “merely discretionary arrangements” that can be terminated at will, with no adverse consequences. But again, SBC and AT&T addressed that concern, as reflected in the Schwartz Reply Declaration, and in the accompanying Tables 1 and 2. As Dr. Schwartz demonstrated, AT&T today peers with companies that, in overall traffic size, are 1/10<sup>th</sup> the size of AT&T or smaller.<sup>6</sup> If it were truly costless, or indeed, profitable, for AT&T to de-peer these smaller companies, it would no doubt have done so. Dr. Schwartz not only laid out these facts in great detail, he explained why it is rational for AT&T to peer with these smaller companies today, and why it would be equally rational for SBC/AT&T to do so post-merger. Schwartz Reply

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<sup>6</sup> EarthLink argues that different results obtain depending on whether one measures traffic or capacity. EarthLink Response, at 8, n. 18. The differences – which may arise from different rates of forecasted growth for, or peak traffic with, specific peers – affect the relative ranking of some of the listed AT&T peers, but are irrelevant to the Applicants' fundamental points, namely that (a) AT&T peers with companies that are 1/10<sup>th</sup> its size, or smaller, and (b) a “two mega-peer” theory is not supported by the data, which show that there are multiple IBPs comparable to, or larger than, MCI. Dr. Schwartz's analysis and conclusions on targeted de-peering are not sensitive to whether traffic or capacity is used as the relevant measure.

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Declaration ¶¶ 30-32. EarthLink’s unsupported conjecture that the “discretionary nature of peering arrangements makes them an inappropriate basis for the . . . assurances of continued competition offered by the Applicants”<sup>7</sup> simply is not credible in the face of the current industry peering policies and arrangements that have arisen from normal, unregulated competitive processes, as reflected in and explained by the economic evidence presented by the Applicants.

EarthLink seems to acknowledge that Dr. Schwartz’s targeted degradation analysis resolves any concerns about competitive harm in the Internet Backbone market, but then avers that “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.”<sup>8</sup> EarthLink does not explain, nor can it, how such discrimination would occur if the merged firm is not capable of selectively de-peering other backbones – meaning that downstream competitors of SBC will continue to have available a choice of backbone providers in a vigorously competitive market. There is no basis for any claim that the merger will harm competition in any market for retail Internet services.

**B. The Presence of Numerous Large Broadband ISPs Will Prevent Any Anticompetitive Behavior**

The Applicants demonstrated that their share of ISP traffic post-merger would be far too small to be able to act anticompetitively vis-à-vis competing backbone providers.<sup>9</sup> Indeed, other broadband ISPs, including cable operators and unaffiliated ILECs, among others, collectively are far larger than the merged firm – and several are individually larger or comparable in size. EarthLink’s quibbles with this showing are meritless.

*First*, while EarthLink implies that there are technology or cost barriers to ISPs switching backbones, it offers no evidence that that is the case, nor can it, because the reality is otherwise. The Applicants have amply demonstrated that such switching is easy, and occurs frequently. As the Applicants noted in their Joint Opposition, it is common for ISPs to connect to backbones at hosted sites such as Equinix, in which case switching backbone providers is as simple as reconfiguring routers at an existing location.<sup>10</sup> The Applicants further demonstrated that such switching occurs:

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<sup>7</sup> EarthLink Response at 7.

<sup>8</sup> *Id.* at 9.

<sup>9</sup> Applicants showed that the same conclusion would hold even if one assumed that the merged firm would act in harmony with a merged Verizon/MCI.

<sup>10</sup> Joint Opposition, at 70.

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“Customer switching is common, and customers can retain their web and e-mail addresses when switching backbone suppliers. In fact, with the now-common use of network address translation technology, they can even avoid assigning new IP addresses internally.”<sup>11</sup>

Large business customers who purchase Dedicated Internet Access services likewise discipline providers of Internet Backbone services, as they have demonstrated that they can, and do, switch in significant numbers.<sup>12</sup> And larger customers have the option to vertically integrate themselves. For example, Comcast has announced that it is building its own Internet Backbone. Schwartz Reply Declaration, ¶ 20, n. 17.

*Second*, EarthLink is wrong in suggesting that it is necessary for multiple broadband ISPs to coordinate a switch of backbone providers in order to provide competitive discipline. As demonstrated above, the relevant “consumers” have the ability to switch IB providers. Further, the Applicants’ evidence shows that a switch by any one of number of very large ISPs, such as BellSouth, Time Warner, Cox, Charter, Adelphia or Qwest, let alone by Comcast, or a switch by only a handful of smaller ISPs, would mark a material change in the traffic shares of the affected IBPs, particularly given the very low shares of IBPs that exist today.

*Third*, EarthLink is mistaken in asserting that Dr. Schwartz’s explanation depends on the cable company “buying high” for backbone services. Quite the contrary, the argument depends on the cable company (or ILEC) acting entirely in its own self-interest to defeat any attempted price-increasing conduct by the merged parties.<sup>13</sup> The very essence of a competitive market is that an attempted price increase is readily defeated by the customer moving its business elsewhere, thus rendering the price increase unprofitable. It is very hard, indeed, to understand how EarthLink managed to turn this fundamental point on its head.

### **C. EarthLink’s Proposed End-to-End Market Is Not the Relevant Market**

Finally, apparently recognizing that the merger cannot harm competition in any relevant market previously considered by the FCC, EarthLink attempts to invent a new one – the “market” for “end-to-end provision of Internet connectivity.” It is not clear exactly what this market is supposed to be or who the customers are. While EarthLink correctly notes that the Applicants expect, through the merger, to be able to offer superior IP-based services on an end-to-end basis to customers who may desire such services,

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<sup>11</sup> Martens Declaration, ¶ 13.

<sup>12</sup> Schwartz Reply Declaration, ¶¶ 24-25 and notes 21-24.

<sup>13</sup> Of course, if the merger enabled the merged firm to be the lowest cost provider of backbone services, that would be a pro-competitive outcome that would benefit consumers of those services.

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EarthLink does not make clear exactly what its alleged market is supposed to include, or how it differs from the retail ISP market. This is merely a repackaging of EarthLink's incorrect and unsubstantiated argument that SBC's base of DSL customers will give the merged firm the power to harm competition at retail – an argument the Applicants have thoroughly rebutted.

Indeed, there is no basis for any fear that SBC does or will dominate the retail supply of broadband access. Although states are by no means relevant markets, it is notable that in only one of the 13 states in which SBC is the ILEC does SBC have a greater share of residential broadband than the cable companies. In all other in-region states, SBC is either not the single largest broadband provider, or its share is smaller than the combined shares of the cable company broadband providers in those states. Moreover, each and every SBC DSL customer that is passed by cable is contestable by the cable company, and it is thus entirely incorrect to claim, as EarthLink does, that SBC somehow “controls” these customers. If SBC is not competitive in the ISP market, it will not long retain its ISP customers. Indeed, SBC recently slashed DSL prices markedly to compete for these customers.<sup>14</sup>

It is more than a little ironic that EarthLink here expresses concerns about a reduction in competition in the retail ISP market when in its filings with the SEC, made after the announcement of the SBC/AT&T transaction, describe the very same market as highly competitive, and increasingly so. In March 2005, EarthLink described the Internet services market as “extremely competitive”, with competitors consisting of

- Established online service companies
- Local and regional ISPs
- Free or value priced ISPs
- National telecommunications companies
- Regional Bell Operating Companies
- Content companies
- Cable television companies
- Utility companies

EarthLink 2004 Form 10-K, at 10. EarthLink further states: “Competition in the market for Internet access service is likely to continue increasing.” *Id.* at 11.

EarthLink's comments here focus on its fear that *increased* competition, arising in part from the merger's efficiencies and the new and innovative services that the

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<sup>14</sup> “SBC Communications Breaks New Ground for Consumers with Residential DSL for \$14.95 When Ordered Online” <http://www.sbc.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=21690>

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Applicants will be able to offer may cause *EarthLink* to lose customers. However, it has utterly failed to show – as it must – how *competition* is diminished in any relevant market related to Internet services. To the contrary, EarthLink itself anticipated the merger would increase competition and that this increased competitiveness might be bad for EarthLink:

As competition in the ISP market continues to intensify, competitors may merge or form strategic alliances that would increase their ability to compete with us for subscribers. These relationships may negatively impact our ability to form or maintain our own strategic relationships and could adversely affect our ability to expand our customer base.

*Id.* at 13.

### Conclusion

EarthLink's latest comments provide no new information of any relevance at all to the analysis of whether the Internet-related portion of this transaction is in the public interest. The Applicants have provided detailed facts, supported by the expert economic analysis reflected in the declarations of Dr. Schwartz, that the transaction will have no adverse competitive effect in the supply of Internet Backbone services, and therefore cannot adversely affect competition at the level of retail ISP services.

Sincerely,

SBC Communications Inc.

AT&T Corp.

/s/ Gary L. Phillips  
Gary L. Phillips  
SBC Communications Inc.  
1401 I Street, N.W.  
Suite 400  
Washington, D.C. 20005  
Tel: (202) 326-8910

/s/ Lawrence J. Lafaro  
Lawrence J. Lafaro  
AT&T Corp.  
Room 3A 214  
One AT&T Way  
Bedminster, NJ 07921  
Tel: (908) 532-1850