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July 15, 2005

Via Hand Delivery

Mr. Gary Remondino
Wireline Competition Bureau
Federal Communications Commission
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 Mr. Remondino:

Please find attached the Letter of EarthLink, Inc. responding to the Applicants' recent letter filed July 6, 2005 in the above-referenced proceeding. A copy of this response is also being filed electronically via ECFS.

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

Respectfully submitted,

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

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By Hand

Gary Remondino
Wireline Competition Bureau
Federal Communications Commission
445 12th 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*

Dear Mr. Remondino:

In their most recent filing on July 6, 2005, the Applicants claim that EarthLink has "ignored the highly relevant facts that the Applicants have put forward."[1] In fact, it is the Applicants that continue to ignore the unique vertical integration issues involved with this merger. Moreover, by repeating the argument that the proposed merger will not harm competition in "the Internet backbone market, a market previously found to be a 'relevant market,'"[2] the Applicants essentially ask the Commission to do the same. Instead, the Commission should take notice of the fact that not once in their response to EarthLink have the Applicants addressed the vertical integration issues that the proposed merger represents, or the competitive harm that would necessarily result from such integration.[3]

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[1] Applicants' Ex Parte Letter at 1 (filed July 6, 2003) (hereinafter "SBC/AT&T Letter").

[2] *Id.*

[3] In footnote 1 of the Applicants' response to EarthLink, the Applicants characterize EarthLink's arguments as a "single claim that increased competition in the provision of Internet backbone services will harm competition in the market in which EarthLink competes." *See* SBC/AT&T Letter at 1. The Applicants misstate EarthLink's arguments. The Applicants' formulation reflects purely horizontal concerns with the merger. Although concentration in the Internet backbone market is a concern, this is not the primary concern that EarthLink has addressed. Because of this complete mischaracterization of EarthLink's vertical integration arguments, the Applicants have failed to address the most serious competitive harm associated with this merger.

As EarthLink has stated throughout this proceeding, as well as in the parallel proceeding involving Verizon and MCI, this transaction is not similar to anything the Commission has seen in past mergers. Because AT&T is rich in Internet backbone assets, and SBC is rich in last-mile assets, the combined company post-merger would be both a wholesale provider of transmission services at both the last-mile and backbone levels and also a retail competitor in the market for Internet access service and other IP-based services. As such, the merged company would possess an incentive and ability to discriminate against Internet-based service providers and their backbone transmission providers beyond anything that the Commission has seen in past mergers.

Inasmuch as the burden is on the Applicants to demonstrate that the merger is in the public interest, their continued failure to address the vertical integration concern raised by EarthLink is fatal to their Application. Furthermore, it is impossible for the Commission to perform a meaningful public interest analysis without addressing these concerns. For this reason, EarthLink takes this opportunity to clarify the record, as well as to address several of the shortcomings in the Applicants' response.

A. The Applicants Continue to Ignore the Vertical Integration Concern With the Proposed Merger.

In their response, the Applicants again acknowledge that the combined company will offer "IP-based services on an end-to-end basis to customers" after the merger. Yet, at the same time, the Applicants also suggest that the proposed merger is just another "similar transaction" where the competitive concern arises solely from a horizontal market share increase in the Internet backbone product market. In other words, the Applicants would like to have it both ways. When it comes to expounding the public interest benefits of this merger, the Applicants are more than happy to describe to the Commission the full suite of end-to-end IP-based products that the merged company will offer once SBC adds AT&T's Internet backbone to its own substantial last mile facilities. On the other hand, when it comes to addressing the competitive impacts of the merger, the Applicants abandon this rhetoric and instead choose to revert to a "traditional" Internet backbone product analysis. This kind of blatant inconsistency provides the best example of how the Applicants continue to ignore the vertical integration concerns with this transaction.

AT&T today, like all other Tier 1 backbone providers, controls a relatively small percentage of retail end user customers compared to SBC. As such, AT&T has no real incentive or ability to discriminate against other IBPs. SBC, however, controls the vast majority of end user analog lines in SBC territory and a substantial number of end user broadband lines throughout SBC territory. SBC's control of end users – coupled with its acquisition of AT&T's substantial Internet backbone assets – means that the merged company would have the power to demand that the other backbone providers submit to such terms as the merged entity may require. Imposition of discriminatory conditions on other IBPs, such as requiring the payment of transit fees instead of peering, or degrading or denying interconnection and transmission, would make the services of those other IBPs either more expensive or less desirable, or both. That, in turn, would make the retail services of the providers that rely on those impacted IBPs more expensive or less desirable, or both. That, ultimately, results in higher prices and reduced service options to consumers. These are precisely the results that the Commission is directed to prevent under the public interest standard.

Voice over Internet Protocol (VoIP) provides a good example of how the combination of last mile and backbone assets would provide the merged company the ability to stifle competition in the end user market for services provided over the Internet. VoIP, which requires a broadband Internet connection, can be used to call anyone with a standard telephone line or a VoIP-enabled broadband connection. Because SBC controls in excess of 80% of the telephone lines in its territory[4] (representing the vast majority of voice telephony customers), a merged SBC/AT&T has the ability to threaten each IBP that carries VoIP traffic with disconnection or degradation if that company does not pay to exchange traffic with the SBC/AT&T network. That the threat is credible is demonstrated by playing out a disconnection scenario.

Cox Communications, Inc. has approximately 1 million VoIP customers.[5] Assume that Cox uses IBP "Z." As of June 2004, SBC had *45 million* voice customers.[6] If SBC/AT&T disconnected "Z," then SBC/AT&T's voice customers would not be able to talk to Cox's 1 million voice customers. Looking at the other end of the equation, Cox's customers would be denied access to 45 million SBC customers. Certainly SBC/AT&T's customers are inconvenienced, but the suggestion that SBC/AT&T suffers *as much* harm as Cox is simply implausible. Moreover, once Cox's customers find out that their VoIP service is essentially useless, their choice of services would essentially be limited to either VoIP provided by SBC/AT&T or traditional switched service provided by SBC/AT&T. Thus, while there is arguably some minor "harm" to SBC/AT&T in the short term, there is no question that the long-term harm is far greater on Cox in this scenario. Indeed, in the long term, the merged company clearly benefits by either collecting additional transit fees or putting a voice competitor out of business (and taking over that competitor's customers). This outcome would apply with equal force if the merged entity were to disconnect or degrade all IBPs (except perhaps Verizon/MCI, which also has a disproportionately high share of end users in its core region), because SBC has many times the number of voice customers than all VoIP providers combined.

The potential for the merged companies to use their leverage in the local exchange market to discriminate against other companies that require Internet backbone transmission to provide competing VoIP services is not a new concern. Even absent the mergers, the cable industry has previously warned the Commission that network access is essential to its ability to compete with

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[4] *See* Selected Form 477 Data as of June 30, 2004, Total Lines and Channels Provided to End Users (rel. Jan. 18, 2005) (hereinafter "477 Data").

[5] Ben Charney, CNET News, *Cox Brings VoIP Service to More Cities*, available at http://news.com.com/Cox+brings+VoIP+service+to+more+cities/2100-7352_3-5395528.html.

[6] *See* 477 Data, Total Lines and Channels Provided to End Users.

the BOCs in the voice market. Cox told the Commission in its *IP-Enabled Services* docket that "lack of interconnection would result in the complete inability of a voice over IP service provider to deliver calls from subscribers of the incumbent carrier and other providers."[7] The danger is simply multiplied by the mergers, which would provide the merged companies a dangerous level of network control at two points rather than one.

It is no answer to the VoIP scenario discussed above to argue that the merged company would not threaten or implement degradation of traffic received from other Internet backbones out of a concern that its Internet access service would be disproportionately harmed. Although it is true on a nationwide basis that cable has something over 50% of the broadband Internet access market (with DSL holding the vast majority of the remaining broadband subscribers), the relative number of *broadband* customers served by the merged company is not the critical fact for purposes of evaluating the merged company's ability and incentive to degrade backbone transmission service after the merger. The reason that broadband-to-broadband is not the proper comparison is that the Internet does not function on the basis that broadband customers can only communicate with other broadband customers. Instead, all Internet users can communicate with virtually all other Internet users. The distinction between broadband and narrowband may determine the speed with which users can exchange large amounts of data, but the distinction has no bearing on how many people a given user can reach over the Internet.

Unlike cable companies, which essentially have only one method of transmission to deliver Internet access services to their customers, the BOCs have multiple methods of transmission, including dial-up Internet access, and the vast majority of local loop facilities used by dial-up Internet customers are owned by the BOCs. *Both* Verizon and SBC, for example, have over 45 million end user lines,[8] meaning that each of those two companies by itself has the capacity to provide Internet connectivity to more consumers than all of the cable companies combined currently serve. Nor is it a question of theoretical capacity. Today, the number of Internet users served by a combination of BOC-provisioned DSL and BOC-provisioned dial-up facilities substantially exceeds the number of cable modem service subscribers.[9]

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[7] Comments of Cox Communications, Inc., at 12 (WC Docket No. 02-36, May 28, 2004).

[8] *See* 477 Data, Total Lines and Channels Provided to End Users and Total Lines to Unaffiliated Carriers (The FCC reports that Verizon had 47,062,622 total lines and SBC has 45,630,173 total lines as of June 30, 2004).

[9] According to recent data, broadband Internet connections represent 51% of the total Internet connections in the U.S. *See* Nielson/NetRatings, "U.S. Broadband Connections Reach Critical Mass, Crossing 50 Percent Mark" (Aug. 18, 2004). Recent FCC data indicates cable represents 56.4% of those total broadband connections. *See* FCC High-Speed Services for Internet Access: Status as of December 31, 2004 at Chart 2 (rel. July 7, 2005). Accordingly, cable only represents 29% of the total Internet connections in the U.S. Alternatively, because the BOCs control the facilities that serve the majority of total analog connections provided to end users, and DSL represents 40.4% of the broadband connections, the BOCs control roughly 70% of all Internet connections in this country. *Id.*

Applying these facts to an Internet access scenario parallel to the VoIP scenario described above, if SBC/AT&T disconnected IBP "Z" (or all IBPs except Verizon/MCI), then both SBC/AT&T and Cox would likely suffer some amount of harm to their Internet access services. However, the harm to Cox would be more acute than the harm to the merged company. This is so because, while Cox's customers would not be able to reach any SBC/AT&T broadband *or* dial-up Internet subscriber, SBC/AT&T's customers would still be able to communicate with other SBC/AT&T-provisioned end users and with Verizon/MCI-provisioned end users (the latter because the roughly equal relative pain associated with degradation of traffic from the Verizon/MCI backbone would presumably deter degradation as between the merged companies' backbones). Moreover, of course, SBC/AT&T would have the network capacity to accommodate as new customers those customers that were no longer satisfied with being able to reach less than half of the people using the Internet in the U.S. Within SBC territory, if customers were faced with a choice between an Internet access service that did not allow them to communicate with more than 50% of Internet users on the one hand, and a choice of DSL or dial-up access on the other hand, it is likely most customers would choose the latter. There is nothing in the record to suggest that the merged company would avoid threatening (in order to charge transit where today it peers) or actually taking such action as long as it was profitable in the long term.

Even if one were to assume that SBC/AT&T and or Verizon/MCI would not take this sort of aggressive approach of causing serious short-term disruption of the Internet in order to increase long-term market share, there is nonetheless a great deal of anti-competitive behavior in which Applicants could potentially engage short of such a bold move. Such behavior includes, but is not limited to, delaying the transmission of Internet traffic and/or degrading the service quality of VoIP service.[10] Considering how much this could harm a competitor's business, as well as how little the Commission would be able to prevent or discipline this type of behavior, these forms of anti-competitive conduct arguably are more dangerous than the more obvious approach described above.

Likely aware that the proposed merger presents serious competitive concerns when analyzed using a product market that reflects the vertical integration involved in this merger, the Applicants suggest that EarthLink has invented a new product market for end-to-end-Internet connectivity. EarthLink has thoroughly addressed how the end-to-end Internet connectivity market is based on the Applicant's own description of the products it intends to sell, and

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[10] The Commission should not ignore recent history when considering whether one or both of the merged company would engage in any of the above forms of anti-competitive conduct. The cable companies' treatment of their own affiliated ISPs a few years ago resulted in the bankruptcy and liquidation of Excite @Home and High Speed Access Corp. The cable companies' track record in this regard argues strongly against any expectation that either of the merged companies would cease to engage in short-term anticompetitive conduct in order to maximize long-term profitability.

will not repeat those arguments here. What is most important is that the end-to-end-Internet connectivity product market is a result of the merger. The Applicants suggest EarthLink has not been clear about: (1) who the customers of this market are, and (2) how this market differs from the "retail ISP market."[11] Allow us to clarify. There are two classes of customers—retail and wholesale. The retail customers include all end users that subscribe to Internet-based services (Internet access and VoIP service being two of the most prevalent). The wholesale customers include all other providers of these Internet-based services that depend on all or part of the transmission networks obtained from BOCs in order to serve their retail end users. These would include unaffiliated ISPs and VoIP providers.

Although EarthLink has supported the use of an "end-to-end Internet connectivity" product market to assist the Commission in analyzing the competitive effects of this merger, it is important not to be distracted by analytical labels. Whether one casts the vertical issues in the merger as product market definition issues or competitive impact issues, they are real and they must be addressed. For the first time since the advent of the commercial Internet, the Commission is looking at two potential companies in SBC/AT&T and Verizon/MCI that will control substantial portions of the Internet backbone *as well as* substantial last-mile facilities. The combined companies will therefore have both the ability and the incentive to use their comprehensive control over their backbone facilities to diminish the ability of other companies to compete in the end user market for Internet-based services. That these companies will be in that position is a <u>direct result</u> of the merger. This kind of vertical integration presents serious competitive concerns that the Applicants have simply chosen to ignore. As a result, the Applicants have not met their burden of proving that the merger is consistent with the public interest, and the Commission must reject their Application.

B. Due to the Vertical Integration of SBC and AT&T, Targeted De-Peering Remains a Large Concern.

As the Applicants themselves admit, their analysis regarding the competitive impact of this merger on Internet-related services relies <u>solely</u> on the declarations of Dr. Marius Schwartz.[12] Despite the Applicants' attempt to suggest otherwise, EarthLink noted that the information provided by Dr. Schwartz regarding targeted de-peering really suggested only one thing—that peering relationships are discretionary by nature, and that any given carrier could terminate a peering agreement at any time with no legal consequences.[13] In their response, the Applicants have simply proven the point. The Applicants suggest that EarthLink overlooked the fact that peering policies are "cost-based"

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[11] SBC/AT&T Letter at 5-6.

[12] *See id.* at 7.

[13] *See* EarthLink Response at 7.

and depend on "both in-out ratios and network topography."[14] Yet, the Applicants have provided absolutely no guidance to opponents or the Commission as to what they mean by "cost-based," or why cost issues would not lead to de-peering after the merger. Furthermore, as EarthLink plainly stated in its response, neither the Applicants nor Dr. Schwartz discuss how the "network topography" or "geographic reach" criteria are even applied.[15] In short, the rhetoric substantially outweighs the evidence on this issue, and it is difficult to perceive how the Applicants expect the Commission or opponents with legitimate de-peering concerns to rely on this type of "analysis."

The Applicants further suggest that EarthLink has missed the "key point" that AT&T currently peers with numerous smaller companies, and that "if it were truly costless, or indeed, profitable, for AT&T to de-peer...it would no doubt have done so."[16] What is most remarkable about this accusation is the degree to which the Applicants have either missed themselves, or decided to deliberately ignore, the real "key point" in this merger. EarthLink stated throughout its Petition to Deny, and again in its Response to the Joint Opposition, that *no major Internet Backbone player, including AT&T, controls large numbers of end users.*[17] Because AT&T does not control substantial last-mile facilities or the customers dependent on those facilities, AT&T has not had any real incentive to discriminate in providing backbone transmission services. The same is true for a number of past mergers involving horizontal concentration in the Internet backbone market. What the Applicants continue to miss, and what makes their evidence regarding AT&T inadequate, is that the situation would be much different for the merged company than it is for AT&T today. SBC is the second largest broadband Internet access service provider in the country. Once SBC adds AT&T's backbone to its own last mile facilities, it will have every ability and incentive to discriminate against other providers that depend on access to its transmission services in order to compete with the merged company. The Applicants' suggestion that EarthLink has ignored relevant facts is therefore particularly ironic considering the great lengths to which the Applicants themselves have gone to ignore this most central fact of the merger.

Finally, the Applicants suggest that discrimination by the merged firm would only occur if it was capable of selectively de-peering other backbones.[18] In another attempt to mislead the Commission by glossing over relevant information, the Applicants have ignored the fact that EarthLink currently peers directly with SBC.[19] Contrary to the Applicants' deliberately misleading

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[14] SBC/AT&T Letter at 3.

[15] *See* EarthLink Response at 6.

[16] SBC/AT&T Letter at 3.

[17] *See* EarthLink Pet. To Deny at 12; *see also* EarthLink Response at 8.

[18] SBC/AT&T Letter at 4.

[19] *See* EarthLink Response to Joint Opp. at 3 ("EarthLink currently peers with both SBC and Verizon.").

assertions, EarthLink has every reason to be concerned that the merged firm will discriminate against EarthLink and other Internet-based service providers. That the Applicants choose to remain entirely silent with respect to these concerns only highlights how real these concerns are.

In short, the Applicants have simply not done enough. After all the cant regarding "the highly relevant facts," there is no reliable evidence on the record that suggests whom (and on what terms) the combined company will choose to peer with after the merger. For this reason, the Commission must reject the Applicants' assertions regarding targeted de-peering.

C. Cable Operators Will Not Be in the Position to Prevent Discrimination.

No doubt in an effort to avoid answering serious competitive concerns with this merger, the Applicants have mischaracterized several of EarthLink's arguments with respect to Dr. Schwartz's theory that cable operators could counteract any anticompetitive conduct by the merged company. We clarify the record below.

Initially, the Applicants suggest that they find it hard to understand EarthLink's criticism of Dr. Schwartz's "cable correction" argument.[20] Although EarthLink agrees with the Applicants that a competitive market is one in which a customer can counter a price increase by moving its business elsewhere, the Applicants nonetheless miss several points. First, the Applicants do not question the fact 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. This being the case, it is reasonable to suggest that any given cable company's <u>first choice</u> would be the provider that meets these criteria. This, by definition, would be the cable operators' current backbone provider or providers. Therefore, Dr. Schwartz's argument that cable companies could just switch providers after a price increase is based on the assumption that market participants will move their traffic to a network other than their first choice in order to preserve the competitive balance in the market. It is difficult to understand why the Applicants continue to assert that a market in which one of its participants must, as a result of anti-competitive conditions caused by the intervening merger, pay a second provider more than the first in order to maintain competition somehow reflects the "essence of a competitive market."[21] It does not.

Additionally, the Applicants take issue with EarthLink's argument that no single cable operator could thwart the anticompetitive practices of the merged company alone. The Applicants suggest that any one cable provider

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[20] SBC/AT&T Letter at 5.

[21] *Id.* at 5.

could move its traffic to another backbone to provide competitive discipline.[22] Even if it were true that one cable company could provide competitive discipline by itself, the Applicants nonetheless overlook several important factors which are fatal to their argument.

First, the Applicants have not addressed the question of whether it would be economically practicable for the cable company in question to switch IBPs, or that it is even technically able to switch IBPs at all. Second, Dr. Schwartz himself admits that this argument 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.[23] The Applicants—likely by design—remain silent on these issues. EarthLink simply argued that there was nothing in the record that demonstrated that these kinds of serious hurdles would actually be overcome so as to allow Dr. Schwartz's posited "cable correction" to actually take place. The Applicants have offered nothing further to suggest that it would.

Most importantly, Dr. Schwartz's argument is premised on the assumption that, because cable operators are Internet backbone purchasers and would serve a collectively larger share of end users than would the combined SBC/AT&T, they would have the ability and incentive to maintain competition among backbones.[24] However, as is discussed in detail above, it is simply not true that cable controls more Internet end user connections than the BOCs. Although cable does in the aggregate have more *broadband* subscribers than there are DSL subscribers, both Verizon and SBC nonetheless control more total end user connections than do all of the cable companies combined. Thus, whether acting collectively or individually, cable operators would not be in the position to thwart any anticompetitive conduct by the merged company. For all these reasons, the Commission must reject the Applicants' unsubstantiated arguments.

Conclusion

The Applicants have attempted to classify EarthLink's concerns as "private," that is, that the only result of the merger may be that EarthLink loses customers. This only highlights the extent to which the Applicants have ignored the real issue with this merger. The vertical integration concerns that the Applicants continue to ignore indicate that, given the ability and the incentive that the merged company will have to use its comprehensive control over the network to discriminate against *all* providers of Internet-based services, customers throughout the country may be left with the choice of either one or possibly two providers for Internet-based services. This is a public interest concern, and the Applicants have not met their burden of proving that the merger is consistent with the public interest.. The Commission must reject their Application.

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[22] *Id.* at 5.

[23] Schwartz Sec. Dec. at ¶ 15.

[24] *See* Schwartz Sec. Dec. at 14.

Respectfully submitted,

John W. Butler
Robert K. Magovern

Counsel for EarthLink, Inc.

CERTIFICATE OF SERVICE

I, Robert K. Magovern, do hereby certify on this 15th day of July, 2005, that I have caused the foregoing Letter of EarthLink, Inc., to be: 1) served via hand delivery to Gary Remondino of the Competition Policy Division; 2) filed with the FCC via its Electronic Comment Filing System in WC Docket No. 05-65; and 3) served via electronic mail on counsel of record for SBC Communications Inc. and AT&T Corp., as indicated below.

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