

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of)	
)	
Applications of America Online, Inc.)	CS 00-30
and Time Warner, Inc. for transfers of Control)	

PETITION TO DENY

Of

CONSUMERS UNION

CONSUMER FEDERATION OF AMERICA

MEDIA ACCESS PROJECT

And

CENTER FOR MEDIA EDUCATION

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EXECUTIVE SUMMARY:

POLICY CONCERNS RAISED BY THE AOL TIME WARNER MERGER

A. CROSS OWNERSHIP BETWEEN AT&T AND AOL IN TIME WARNER

The AOL Time Warner merger adds a dangerous new dimension to the emerging structure of the cable TV/broadband Internet industry (see Exhibit ES-1). It extends the reach of two huge, vertically integrated firms across the cable TV, broadband Internet and narrowband Internets. It removes the most likely competitor for the still entrenched cable TV monopolists. By bringing AOL into the club of huge cable companies, it dramatically diminishes the likelihood that it will compete head-to-head with cable companies in the video programming market. By focusing the attention of the largest narrowband ISP on cable modem service as the delivery medium for the broadband Internet, it dramatically reduces the chance that telephone based DSL service will become a significant competitor for high-speed Internet service in the residential sector. Therefore, the AOL Time Warner merger is inconsistent with the public interest and should be rejected or substantially restructured by the Federal Communications Commission (FCC).

An emerging AT&T-AOL duopoly through the combination of AT&T/MediaOne plus AOL Time Warner has a pervasive impact across several markets and concentrate ownership in many different aspects of market structure.

- ◆ The horizontal aspects of these mergers involve concentration of cable programming (to the extent that programs compete to gain access to customers) and concentration of broadband Internet services (to the extent that @Home and RoadRunner sell the same thing to the public, or that narrowband competes with broadband). AOL time Warner also involves an inappropriate ownership relationship between the second largest cable television company and its direct competitor, satellite provider DirecTV.
- ◆ The merger vertically integrates programming and distribution services substantially in narrowband (by linking AOL and Time Warner) and significantly in broadband (to the extent that AOL, @Home and RoadRunner are interrelated). It also involves the integration of distribution and equipment (to the extent that AOL has made forays into equipment, which will now be integrated with Time Warner's distribution).
- ◆ It is a conglomeration in that it involves product extension merger, integrating Time Warner's broadband content and distribution into AOL's narrowband.

The horizontal concentration problems arising from the AT&T-MediaOne merger and the vertical/conglomerate problems resulting from the AOL-Time Warner merger are severely compounded by the cross ownership of AT&T in AOL. Eliminating the cross ownership problem would create much greater balance in the capital size of the dominant firms. It would balance their assets (the cable, telephone giant would face the dominant Internet/content firm). Each would have better incentives to bargain at arms length with the other. This more competitive dynamic would open the door to greater business opportunity for firms not affiliated with the two dominant firms, especially if a non-discriminatory, open access requirement were imposed by the FCC.

B. CHOKEHOLD ON EMERGING INTERACTIVE TV CONTENT

The AOL Time Warner merger also raises a fundamental question about whether this new giant will be able to quickly capture the new product market for interactive TV. The wedding of these two dominant firms—with their control over access to the cable broadband infrastructure and control of the world’s largest narrowband subscriber base—gives them a chokehold on the future development and preservation of a robustly competitive Internet.

AOL Time Warner will have substantial market power in the video and Internet access markets. It will possess an enormous stockpile of popular television channels (approximately one-half of the of the 20 most popular cable networks) and other valuable content (e.g., 33 magazines, 10% of the nations books, one-sixth of the domestic record market, one-fifth of domestic movie production). This will be combined with AOL, @Home and Roadrunner Internet services (more than three-fourths of the U.S. broadband internet business and more than one-half of the narrowband business) that are distributed on affiliated cable television systems. As a result, AOL Time Warner will be in a position to dominate the new consumer market for combined services.

The unique combination provides AOL Time Warner with immense economies of scale and scope, but their market power over content goes well beyond these basic economic factors. Closed proprietary products such as e-mail, instant messaging, buddy lists, calendar management, electronic programming guides and keyword search engines have become the basic utilities of Internet communications and usage. Consumers hesitate to give these up, since changing ISPs requires significant changes in identification, cuts the consumer off from communities of interest, or requires significant learning costs. These interfaces are the sticky

features that glue the customer to the service provider. Leveraging these Internet utility functions of AOL, the new entity will be able to bundle in a variety of proprietary Time Warner products (e.g. Time Warner cable programming, entertainment and music), as well as other products (e.g. telephone service). Controlling both content and distribution, the company can design interfaces that capture and lock-in customers, while they lock-out competitors, except on terms and conditions that are set by the entity controlling the choke point.

The new consumer market for interactive services may combine the strengths of the merging companies without traditional public protections against monopolistic practices. For example, AOL TV involves the combination of television programming and split-screen functionality to access Internet services through cable television transmission using a remote control device. With the simple "point and click" ease of channel surfing, consumers could select an AOL icon that opens the door to all AOL Internet services (on part of the screen) while they are simultaneously watching television. Despite enormous market power over the content of this new service, and the cable distribution systems that carry the service, it is unclear whether AOLTV would come under the cable programming nondiscrimination requirements of the 1992 Cable Act, or even AOL Time Warner's open access promises.

C. OPEN ACCESS IS EVEN MORE CRITICAL TO A COMPETITIVE BROADBAND INTERNET IN LIGHT OF THE PROPOSED MERGER

The threat posed by the horizontal concentration and vertical integration of this digital cartel with a closely integrated duopoly at its core is heightened by the efforts of these companies to impose a fundamental change on the public policy governing communications

infrastructure in our society. Before they purchased cable TV companies, both AT&T and AOL recognized the problem that closed, proprietary networks pose for fair competition. They were advocates for the proposition that governments must intervene to ensure open access to the broadband Internet (and still are when it comes to transmission systems they do not own).

In comments filed at federal and local agencies, AOL and AT&T presented a detailed description of the broadband market structure that gives rise to the need for open access. The key characteristics included: (1) vertical integration between access and content, (2) market power in related markets, (3) paucity of alternative facilities, (4) the essential nature of access, (5) a need to ensure openness in the design of the architecture of the network, (6) stimulation of investment by increasing services, (7) the inability of narrowband to compete with broadband, (8) the high cost to consumers of switching technologies, (9) bundling of monopoly and competitive services.

While AT&T and AOL demanded a great deal as outsiders of the cable TV industry, they have offered much less now that they are the dominant insiders in the industry. What they offer falls far short of the key elements of open access that have produced the remarkable flowering of communications, commerce and creativity on the narrowband Internet. The narrowband Internet infrastructure is operated in a fastidiously open manner based on three sets of policies.

- ◆ The architecture of the Internet is based on open standards and end-to-end (transparent) design principles.

- ◆ The communications infrastructure on which this network architecture is built is operated on a nondiscriminatory, common carrier basis with few technological constraints in accommodating all of the demand for interconnection.
- ◆ Policy makers have adhered to a strict regime of open communications.

Because of these policies, “proprietary” restrictions on or governmental intrusions into the flow of information have been minimized. Consumers and service providers have achieved a high degree of freedom to reach the Internet and, therefore, each other. Any (and therefore every) Internet Service Provider (ISP) has access to the communications infrastructure on the same rates, terms and conditions as every other similarly situated ISP and the infrastructure is operated in a manner that does not discriminate between ISPs. Any (and therefore every) consumer has the ability to reach every other consumer or ISP without restriction. Open access to the communications network has resulted in vigorous competition to provide services to consumers. This unprecedented openness of communications has combined with the relative ease of production and distribution of information to create uniquely rich and diverse civic discourse.

- ◆ As the broadband Internet becomes the primary platform for electronic commerce and the central marketplace of ideas in the “Internet Century,” competition and open communications must be maintained to the greatest extent possible.

Cable companies, who own the networks that are likely to be the dominant communications infrastructure for the broadband Internet for the foreseeable future, claim that network engineering imposes technical limitations on the cable-based broadband Internet that

preclude this extreme level of openness. Policy makers should be skeptical of these claims. If the debate over open access to the broadband Internet has proven anything, it has shown that one person's technical limitation is another's anticompetitive barrier to entry. Cable systems in other countries (e.g. Canada, Australia and Panama) have demonstrated the feasibility of open access. However, to the extent that there are technical limitations, the correct public policy response should be to:

- ◆ Actively work to minimize the technical limitations on access, proactively manage any limitations so as to impose the least restriction possible on open Internet communications, and prevent commercial interests from embedding and increasing technical limitations through network design decisions.

D. OPTIONAL PROPRIETARY ACCESS IS INADEQUATE TO PROTECT THE PUBLIC INTEREST

The word “any” used in the context of open access is very powerful. Once a network owner invokes proprietary control over the network in access negotiations, a host of problems arise.

1. POLICY AND ENFORCEMENT: WHAT COMMUNICATIONS NETWORKS REQUIRE TO REMAIN OPEN

Under the voluntary approach now espoused by AT&T and AOL Time Warner, there is no unbiased dispute resolution mechanism. If discrimination occurs in implementation, there is nothing that private parties or government entities can do about it, except, perhaps, file an antitrust case. Public policy should start with a ban on discrimination.

***The Any Principle:** Network owners shall provide any requesting Internet Service Provider access to its broadband Internet transport services (unbundled from the provision of content) on rates, terms and conditions that are at least as favorable as those on which it provides such access to itself, to its affiliates, or to any other person.*

How many ISPs will be allowed access? AOL Time Warner will not commit to a number. AT&T has said that it will make access available to the five or six largest commercial ISPs in an area. These commitments do not even begin to deliver the competition and diversity that we enjoy on the narrowband Internet.

***Competition:** The network operator shall support as many ISPs as technically possible and shall commit to the research, development and deployment of technologies to maximize the functionalities available and the number of ISPs that can be supported by the network.*

The type of ISPs that can gain access is also important. Once one abandons the “any ISP” principle, the question of which services will be able to gain access to the network on commercial terms (not just because of discrimination) also becomes a concern. Therefore, open access policy should make a broader commitment to diversity and discourse.

Diversity: The network operator should ensure that at least one unrestricted ISP is available on its network and shall endeavor to make access for local and noncommercial ISPs available in proportion to network capacity.

How do we police the offer of rates, terms and conditions? Since these are private negotiations, no unaffiliated ISP has any idea of what has been offered to any other ISP. How

does any ISP know that the offer it has been made is not discriminatory? How does an ISP enforce its rights, if nondiscriminatory terms are offered but not delivered?

***Legal Rights:** Any ISP should have an enforceable right of action to seek injunctive relief from discrimination.*

***Governmental Rights:** Government agencies (antitrust, regulatory) should have a right to prevent discrimination on their own motion.*

2. ARCHITECTURE: AVOIDING TECHNOLOGY BIAS

If there are technical limitations, who decides what they are and how do we monitor their implementation? For example, AOL Time Warner commits to allowing streaming video. What happens if it determines that only one video stream is possible and AOL Time Warner's affiliate got there first? A "technical limitation" may eliminate choice for consumers and act in favor of the AOL Time Warner affiliate. However, to the extent that there are legitimate technical limitations, the correct public policy response should be as noted above.

***Minimizing technical limitations:** Network owners should actively work to minimize the technical limitations on access and proactively manage any limitations so as to impose the least restriction possible on open Internet communications.*

***Technical Neutrality:** (1) Technical limitations must be demonstrated by some agreed upon standard. (2) Implementation of measures deemed necessary to enforce technical limitations should not discriminate between affiliated and nonaffiliated ISPs.*

In order to ensure technological non-discrimination a number of principles must govern the relationship of the ISP to the network owner.

Comparably efficient interconnection: *In providing non-discriminatory access, network owners must allow competitors to access their broadband distribution network in the most efficient manner possible on terms that are technically and economically equivalent to those provided by the network owner to itself or affiliates or partners in terms of scope, quality and price including a physical connection at any place where a cable company exchanges consumer data with any Internet service provider, or at any other technically feasible point selected by the requesting Internet service provider.*

Non-discriminatory change management: *To the extent that standards are developed for interfacing with broadband access services, the network owners should not be permitted to implement any non-standard, proprietary interfaces and any new network or operational interface that is implemented should be made available on a timely, non-discriminatory basis.*

Access to infrastructure: *It is vital to ensure that unaffiliated ISPs can deploy and gain access comparable to that the network owners afford to their affiliated ISP.*

Operational support and operating support systems: *Non-discriminatory access for multiple ISPs extends to all relevant aspects of the technical and operational infrastructure, so that all business system interfaces will be open to all ISPs and performance levels will not favor the affiliated ISP. The cable operator must provide equal treatment for local content serving (caching or replication) that the affiliated and nonaffiliated ISPs can provide, specifically, no firewalls, protocol masking, extra routing delays or bandwidth restrictions may be imposed in a discriminatory manner.*

3. NORMS: SERVICE RESTRICTIONS PROVIDERS/CONSUMERS

AOL Time Warner adopts a narrow definition of discrimination that identifies affiliation and one functionality (streaming video) as a criteria that will not be the basis for discrimination. AT&T gives no assurances about any specific characteristics. The “any ISP” principle of the narrowband Internet affords much broader protection against discrimination.

Protected Characteristics: The network owner should place no limits on or provide favorable treatment to ISPs--based on affiliation, content, applications, functionality or type--in making service available to users or in allowing users to reach the Internet.

Both the AT&T and the AOL Time Warner commitment open the door to market foreclosure based on permissible (not “undue”) discrimination. How much “due” discrimination will be tolerated? Will ISPs be able to find rates terms and conditions that suit their needs, or will AT&T/AOL Time Warner only make a very restricted set available? If the affiliated ISP does not need certain speeds, or tiers of service, then AOL can meet its non-discrimination pledge by simply not making them available to anyone.

Availability: Network owners should make access available on a variety of terms and conditions to meet the needs of ISPs of different types who have different needs for interconnection.

4. BUSINESS LEVERAGE

Open access cannot ignore business reality. If the network owner inserts himself in the relationship between the customer and the independent ISP in such a way as to ensure that

its affiliated ISP has a price, product or customer care advantage, then competition between ISPs will be undermined.

Control of information is vital to the marketing of services.

***Confidential treatment of information:** Broadband access providers that are affiliated with or have joint marketing arrangements with broadband service providers should also be required to enter into non-disclosure agreements.*

By controlling a bottleneck, network owners can place price conditions on independent content providers that undermine their ability to compete. Both AOL and AT&T have offered to allow consumers to purchase service from unaffiliated ISPs without paying for the affiliated ISP, other cable operators have not and pricing principles for network access for unaffiliated ISPs has not been addressed in detail. Price squeeze is still a distinct threat.

***Paying once for service:** Pricing must allow the consumer to choose any ISP they want without being required to pay for or go through the cable-affiliated ISP.*

AOL Time Warner agrees to allow unaffiliated ISPs to purchase services without a direct commercial relationship. AT&T appears unwilling to do so.

***Commercial transport service:** Network owners should provide "broadband Internet access transport services"--which is the transmission of data between a user and his Internet service provider's point of interconnection with the broadband Internet access transport provider's facilities--on rates that prevent vertically-integrated access providers from engaging in predatory pricing or cross-subsidization of their affiliated ISP.*

Bundling of services raises concerns because it provides a great deal of leverage, especially where monopoly services are bundled with competitive services. Because cable companies exercise control over bottleneck facilities and video programming, they have both the incentive and the opportunity to bundle these facilities with their other services and offer the entire package to their customers for a single price.

Unbundling: *Unaffiliated content providers should be allowed to resell (and therefore bundle) the cable programming--i.e., to create a complete bundle.*

Prohibition on cross-subsidy: *The bundled service must cover its cost.*

Critical aspects of the customer relationship must be controlled by Internet service providers including marketing, billing and boot screen customization. The importance of controlling the boot screen is becoming better understood as the information age unfolds. The network owner can control the boot screen that the subscriber sees which creates the potential to steer customers. The initial boot screen is like prime real estate and advertising space. Location on the initial screen can predispose customers to use affiliated services at the expense of unaffiliated services. AT&T insists that customization of the boot screen be negotiated, thereby retaining control over the independent ISP.

Wholesale relationship between the ISP and the Network Owner: *Network owners should enter into wholesale relationships with ISPs for the purposes of the sale of transport over the network and not interfere in the relationship between the customer and the unaffiliated ISP. By establishing this commercial relationship between ISP and the network owner, the network owner cannot dictate the relationship between the ISP and the customer*

including all the critical aspects of that relationship to the customer – billing, marketing, boot screen, etc.

Because of the substantial increase in horizontal and vertical concentration and the clear market power over essential functions and choke points in markets affected by the proposed AOL Time Warner merger, the FCC should reject or substantially restructure the transaction. By severing all ownership between AT&T and AOL Time Warner and imposing an enforceable and explicit open access requirement for Internet services, the FCC can reduce the public interest concerns with this transaction.

ANALYSIS

In this, as in all other Commission licensure proceedings, the merging parties must demonstrate that the merger will serve the public interest and necessity. *See Communications Act of 1934, 47 USC §§214(a), 310(d) & 309(e); Application of Tele-Communications, Inc. and AT&T Corp., 14 FCCRcd 3160, 3168-69 (1999) ("ATT/TCI")*. In merger cases such as this, the public interest analysis goes beyond the traditional antitrust analysis employed by the Department of Justice and the federal Trade Commission; in addition to fostering competition, the Commission must strive to effectuate the purposes of the Communications Act. *ATT/TCI, 14 FCCRcd at 3169.*

In addition, the Commission has found that, in light of the general purpose of the Telecommunications Act to promote competition in the communications marketplace, merger applicants must demonstrate that merger will enhance competition, *i.e.*, that the benefits to competition outweigh the harms to competition posed by the enhancement of market power. *ATT/TCI, 14 FCCRcd at 3168; Application of Nynex Corporation and Bell Atlantic*

Corporation, 12 FCCRcd 19985, 19987 (1997) ("*Bell Atlantic/Nynex*"). Furthermore, the merger must not "impair[] this Commission's ability properly to establish and enforce those rules necessary to establish and maintain" competition. *Bell Atlantic/Nynex* 12 FCCRcd at 19987.

Finally, and most importantly, the Commission has long recognized that the public interest standard of the Communications Act and the First Amendment ***require the Commission to encourage diversity in the marketplace of ideas, and to take steps to insure that this diversity is not lost.***

The Applicants have failed to demonstrate that grant of the merger would serve the public interest. To the contrary, grant of the merger would produce unacceptable levels of concentration and market power in the relevant markets. This level of concentration would inhibit diversity in the marketplace of ideas, frustrate the development of competition in the Internet, cable, and cable programming markets, and make it impossible for the Commission to promote and enforce the pro-competitive purposes of the Communications Act.