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COMPETITION ON THE INTERNET

HEARING

BEFORE THE

TASK FORCE ON COMPETITION POLICY
AND ANTITRUST LAWS

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

JULY 15, 2008

Serial No. 110–193

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE

43–524 PDF WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
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COMPETITION ON THE INTERNET

TUESDAY, JULY 15, 2008

HOUSE OF REPRESENTATIVES,
TASK FORCE ON COMPETITION POLICY
AND ANTITRUST LAWS
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Task Force met, pursuant to notice, at 1:41 p.m., in room 2141, Rayburn House Office Building, the Honorable John Conyers, Jr. (Chairman of the Task Force) presiding.

Present: Representatives Conyers, Lofgren, Jackson Lee, Waters, Cohen, Sutton, Wasserman Schultz, Smith, Sensenbrenner, Goodlatte, Chabot, Cannon, Keller, Issa and Feeney.

Staff Present: Anant Raut, Majority Counsel; Matt Morgan, Majority Staff Assistant; and Stewart Jefferies, Minority Counsel.

Mr. CONYERS. The Committee will come to order.

We are delighted that all six of witness are as distinguished and recognized and well-known and favorably received in the Congress as they are.

This Antitrust Task Force is concerned about competition on the Internet because this technology has changed the way people interact with the world around them, and what started as a research project in the Department of Defense 40 years ago has now become not just a pervasive element of our society, but has worldwide implications. Over a billion people use the Internet. Seventy-one percent of all Americans use the Internet. Every year, we send in this country somewhere in the neighborhood of three trillion e-mails; and it is also quite lucrative.

But, today, we have three of the most significant players on the Internet testifying before us: Yahoo, Google and Microsoft, each one of whom dominates a different aspect of the Internet. A half million users come to Yahoo's Web pages, Google has become synonymous with on-line research, and Microsoft continues to be the most dominant software company on Earth.

For the last 6 months, Microsoft and Yahoo have been in frustrating negotiations. Microsoft initially attempted to purchase Yahoo and was not favorably received. Last month, Yahoo and Google reached an agreement to display Google ads on Yahoo Web pages. Microsoft had a response for that. They brought in Carl Ichan to try buying Yahoo and break it up.

Given how these powerful companies are in any consolidation has raised the potential of anti-competitive effects. The Department of Justice is scrutinizing the Google-Yahoo deal. So are doz-

ens of attorneys, State attorneys across the country, and Attorney Generals. And so we come here this afternoon to consider what impact the proposed Yahoo-Google deal could have on competition.

For their part, Google and Yahoo note that their transaction is nonexclusive and that any company, including Microsoft, is free to pursue a similar arrangement.

But then you need to ask why is it that the Members of this Committee cannot be trusted to see the signed agreement, and why we were offered access to the agreement, but only if we viewed it at a law firm with no notes allowed and a signed non-disclosure agreement?

By contrast, the Committee was given more ready access to the documents surrounding the President's terrorist surveillance program. Every Member was allowed access. We were allowed the right to review it. We were allowed to take notes. We weren't forced to sign any agreements of non-disclosure.

And so I would ask the distinguished counsel for Yahoo to reconsider how these things should be worked on with the Committee on Judiciary, as friendly a group of Members of Congress as I've ever encountered.

And then we need to consider the larger competitive reality of the Internet, what the competitive landscape would look like if Microsoft is ultimately successful in acquiring Yahoo or, looking at it differently, would it be wise to allow a company that controls more than 90 percent of the operating system market and 73 percent of the browser market to combine forces with the largest seller of display advertising on the Internet? Would the combined company simply serve as a counterweight to Google or would that allow them to leverage their market power into other aspects of the Internet?

And so this Committee, the Antitrust Task Force of the House Judiciary Committee, is pleased to have all of you here to join in this discussion.

I turn now to our Ranking Member, Mr. Chabot of Ohio, for his comments.

Mr. CHABOT. Thank you very much, Mr. Chairman.

I would like to thank you for holding this important hearing today and also to thank our witnesses for taking the time out of their busy schedules and also being with us here this afternoon. I will be brief so that we can get on with the witnesses as we have a very distinguished panel here.

It seems a bit redundant to talk about the rise in the Internet use and its increased importance to consumers and businesses. Most of us use the Internet today, but there are a couple of points that I think are worth noting, particularly in light of today's hearing topic.

First, search engines are playing a bigger and bigger role shaping the information made available to consumers and businesses. Through paid listings, search engines are dictating search results at increasing rates. These listings set the parameters for the type of information to which consumers have access.

This leads me to my second point, and that is the need to maintain competition in the on-line advertising industry to keep search

engines operating as a neutral tool, as the Boston Globe would put it.

We can see the influence that advertising has on Internet search results through the revenue generated in the industry. In 2007, on-line advertising generated more than $8 billion; and it is expected to more than double in just the next few years.

As with the success of any industry, the on-line advertising industry is shifting. Google's proposed advertising agreement with Yahoo is just one of a number of recent moves that has the potential to change the market quite dramatically.

Our role on this Task Force is to examine those shifts and the impact that they could have on competition and on consumers. Like I have said in previous hearings, the heavy hand of government does not belong in the marketplace. However, when consumers are impacted as a result of anti-competitive practices, we are obligated to weigh in. This hearing will hopefully shed some light on the facts and just where we stand in this particular proposal and what should be done about it.

I look forward to hearing from our witnesses, and I yield back the balance of my time.

Mr. CONYERS. Thank you, Mr. Chabot.

A senior Member of the Committee on Judiciary and a Chairwoman in her own right, the gentlelady from California, Zoe Lofgren.

Ms. LOFGREN. Thank you, Mr. Chairman. I will be brief.

I would just like to welcome so many people from my constituency in Silicon Valley. It is great to have you here, and I hope we will have a very useful and interesting discussion.

I am mindful that one of the key elements of analysis for antitrust is the barriers to entry to a particular type of endeavor. And I remember I was first elected in '94, took office January 4th of 1995. At that time, Jerry Yang was still in the dorm room at Stanford. I don't think Sergey had even been admitted yet. So I remember going to Google pre-IPO. Eric Schmidt was so excited about it. The Google team had built their own servers with stuff from weird stuff and fries.

And so that was just less than a decade ago. So things move quickly in the Internet, and we are going to keep that in our minds as we evaluate all of the enticing and interesting issues that are before us.

But one of the exciting things about representing the district that I do is that there are so many smart people who are so creative; and we can't even think of the next thing that they are going to invent that is going to be changing the way we are able to be effective and productive people, not only in Congress, but Americans, really citizens throughout the world who are well served by all the cool stuff being invented in the Valley.

I just wanted to say that, Mr. Chairman; and I thank you for having this hearing. I look forward to the further proceedings, and I yield back.

Mr. CONYERS. Lamar Smith, Ranking Member of the full Committee, from Texas.

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman.

I don't think it was intentional, but I notice that my prepared remarks pretty much track your opening remarks as well, with the possible exception of your reference to the Administration surveillance policy.

Today, we will hear testimony from individuals associated with some of the most famous names of the technology era: Google, Yahoo and Microsoft. Together, they have revolutionized the way that we work, communicate and find information.

Recently, two of these companies have been involved in a highly publicized battle for the future of Yahoo, one of the pioneers of the Internet as we know it today. Microsoft initially made a bid to acquire all of Yahoo and was rejected by Yahoo's board. Microsoft later made a revised offer, which was also rejected. Recent news reports indicate that Microsoft has made a third offer together with investor Carl Ichan, who is engaged in a proxy fight with Yahoo's board of directors.

In the face of this corporate intrigue, on June 12th, Google and Yahoo announced a deal that will allow Google to place some of its search-based advertising on Yahoo's Web pages. The amount of advertising that Yahoo outsources to Google is at Yahoo's sole discretion.

In addition, Yahoo and Google agreed to enable their respective instant messaging services to interoperate. A user of Google's IM service will be able to contact someone on Yahoo's IM service and vice versa. This agreement is not exclusive and allows Yahoo to enter into similar agreements with other advertising providers, including Microsoft. In addition, Yahoo will maintain relationships with its own advertising customers and will continue to rely exclusively on its own advertising program outside of the U.S. and Canada.

Microsoft and on-line advertisers have raised concerns that this arrangement will give Google a dominant share of the search advertising market. There has already been considerable consolidation in the on-line advertising world with Google acquiring DoubleClick and Microsoft and Yahoo purchasing their own advertising platforms.

The operative question here is whether on-line search advertising is a separate market. If so, then this deal implicates the number one player, Google, which has about 70 percent of on-line search advertising, and number two player Yahoo, which has about 20 percent. Microsoft is a distant third.

While the deal is not exclusive, it is important to determine whether this arrangement will cause Yahoo to become more or less competitive with Google in page search advertising. Also, there is much that remains unknown about how this deal will affect on-line advertising and whether it will encourage any competitive behavior.

I hope the hearing will address some of these uncertainties, so I look forward to hearing from our witnesses today.

Thank you, Mr. Chairman. I yield back.

Mr. CONYERS. Thank you. We will include everyone else's statements.

[The prepared statement of Ms. Jackson Lee follows:]

PREPARED STATEMENT OF THE HONORABLE SHEILA JACKSON LEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND MEMBER, TASK FORCE ON COMPETITION POLICY AND ANTITRUST LAWS

Thank you, Mr. Chairman, for your leadership in convening today's very important hearing on the state of competition in the internet. I would also like to thank the ranking member, the Honorable Louie Gohmert, and welcome our panelists. I look forward to their testimony.

This hearing will address the specter of growing concentration in our most powerful new form of media: The Internet. Today, we're already seeing rapid consolidation in the various industries that provide the American people the news and information they need to be responsible citizens and voters. We continue to see consolidation in traditional forms of media, such as newspapers, radio, and TV stations. And now, we are also seeing consolidation in newer forms of media, such as satellite radio and the Internet.

This development troubles me, because America thrives on the freedom and the ability of its people to hear and consider different points of view, no matter how unpopular, and to make up their own minds. If the availability of news, information, and different viewpoints is controlled by too few entities, this precious freedom at the foundation of our nation is put into jeopardy.

Today, the Internet is fast becoming the prime source of news and information for many people. And indeed, many of these people who look for their news and information on the Web start first by typing in a keyword in a search engine. More likely than not, that search engine is Google.

Imagine my concern, then, when I learn that Google, which controls about 70% of total search queries, now wants to partner with its closest competitor, Yahoo!, which controls about 20% of all search queries. That would mean, essentially, that one company would control nearly all of the search queries made by Internet users today.

This is a lot of power to give to one company. This company now will have the power to tell us what content to see—and potentially, what to believe.

Google is fast on its way to controlling the Internet. Not only does it control the majority of search queries that Internet users, but it also controls the purse strings—in the form of search advertising revenues. Those are the dollars that search engines like Google get from advertisers who want to reach the millions of Internet users who type in those keywords to find content and sites on the Internet.

Today, Google takes in 70% to 75% of search advertising revenues—the advertising which helps fund the creation of content and services on the Internet that we enjoy today. With Yahoo!, Google-Yahoo! would control some 90% of search advertising revenues.

The only way to ensure that one company does not control what Americans read, hear, or see is through marketplace competition and choice. The American people need alternatives to Google from which they can access content and services on the Internet. Only through competitive alternatives can we ensure that we can have access to diverse points of view that are so important to the functioning of our nation.

The issue of broadband is vital to communities across the country, and yet is often overlooked for communities of color. Every American should be focused on it right now—especially given the current economic crisis and the overwhelming investments that are being made in communities across the country.

It has been widely reported that the recent Google and Yahoo! Agreement will provide new opportunities for Americans. But as I sharing today with you, there are two sides to every story. I hope that we can better understand what this merger will mean for the state of competition on the internet.

On June 13, 2008, Google announced that it reached an agreement that gives Yahoo! the ability to use Google's search and contextual advertising technology through its advertising programs. Under the agreement, Yahoo! has the option to display Google ads alongside its own natural search results in the U.S. and Canada. In addition, Yahoo! can serve contextually targeted ads on its U.S. and Canadian web properties as well as on its current publisher partner sites while operating its own search engine, web properties and advertising services.

In addition, Yahoo! and Google agreed to enable interoperability between their respective instant messaging services bringing easier and broader communication to users. It is expected that this agreement will provide Yahoo! with the opportunity to deliver more relevant ads to users and provide advertisers and publishers with better advertising technology to aid their businesses.

This non-exclusive agreement allows Yahoo! to engage in similar agreements with other advertising providers. Also, Yahoo! will maintain relationships with its own advertising customers and continue to rely exclusively on its own advertising pro-

gram outside of the U.S. and Canada. The agreement lasts up to ten years: a 4-year initial term and two 3-year renewals at Yahoo!'s option. Financial terms between the two companies were not disclosed.

Economics teaches us that in a competitive market, high profits are a signal for "would be" rivals to enter the market and "compete away" excessive earnings. This has not happened in the Google situation. Google's profitability has remained high. In terms of percent return on invested capital, Google was 8.5 times more profitable than Comcast; in terms of percent return on equity, Google was 3.5 times more profitable than Time Warner; in terms of percent return on assets, Google was over 6 times more profitable than eBay or Verizon; in terms of price to cash flow, Google was 5 times larger than the top four Internet Service Providers and twice the major drug companies—Merck, Abbott, and Bristol Myers; and in terms of price to earning ratio, Google was 4 times the size of Exxon. Google's profitability exceeds other web companies, such as Yahoo!, eBay, and Amazon, and other ISPs and other major corporations, such as Exxon and Merck. In short, Google stands alone.

Google's marketshare has only grown. This suggests a lack of competition and competitive entry. Beyond it's sheer market power, there is evidence that Google might be using its dominant market share to harm competition. The evidence lies in Google's manipulation of the placement of its ads. For example, Google's policy council Alan Davidson admitted to Multichannel News (6/12/2006) that consumers using a particular "search term" would see an organization's ad calling for the regulation of Google's potential competitors. This admission was also conceded by Google Spokesperson Jon Murchinson in Technology Daily PM (6/13/2006). The DC Examiner reported in October 2007 that Senator Susan Collins' ads were banned by Google; ads that were intended to defend her against attacks by a group sharing mutual policy interests with Google. The evidence might suggest that Google can direct consumers to ads that are favorable to its public policy positions over paying advertisers.

To stem market power, public policies need to encourage inter-industry rivalry, IT investment, and increased consumer choice, including the market for search and online advertising. The question becomes what steps should the Members of Congress take to correct the state of competition on the internet?

Therefore, I urge not only the members of this task force to scrutinize the proposed Google-Yahoo! deal closely, but also our federal regulators. Thank you, and I yield the balance of my time, Mr. Chairman.

Mr. CONYERS. I am happy to welcome all of you. I am especially sympathetic toward the nonlawyers that are here as witnesses. David Sable, Tim Carter, a hands-on type of person, Professor Pasquale, Attorney Drummond, Attorney Smith.

Mr. CONYERS. We will begin with Mr. Michael Callahan, Esquire, Executive Vice President, General Counsel and Corporate Secretary for Yahoo. You can begin.

TESTIMONY OF MICHAEL J. CALLAHAN, EXECUTIVE VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY, YAHOO! INC.

Mr. CALLAHAN. Is this on? It is. Thank you.

Thank you Chairman Conyers, Ranking Member Chabot and Members of the Task Force. My name is Michael Callahan, and I am Executive Vice President and General Counsel of Yahoo. I appreciate the opportunity to be here today to discuss the dynamic and growing Internet advertising space and the commercial agreement between Google and Yahoo.

Yahoo welcomes this hearing; and we are confident that the more one learns about this agreement the more clear it becomes that it is good for competition, good for consumers, good for advertisers and, yes, good for Yahoo.

The purpose of this commercial arrangement and the intent of Yahoo moving forward is to help make our company an even

stronger competitor to Google, to Microsoft and to others in the dynamic and rapidly growing on-line advertising world.

As I am sure you know, this has been an interesting time for our company, to say the least. While I don't want to dwell on the very public proxy fight in which we are currently engaged, I want to spend a brief moment on it because it will give you a flavor for how intensely competitive the search business has become.

All of the companies at this table are laser focused on being significant players in search. With this business arrangement, Yahoo will continue to execute on its long-term corporate strategy. Microsoft, on the other hand, has turned to activist shareholder Carl Ichan, in the apparent hope that this will force a fire sale of Yahoo's core strategic search business.

Our priority is to build value for our stockholders. That continues to be our core mission. What we will not do, however, is allow our business to be dismantled or sold off piecemeal on terms that would be disadvantageous to Yahoo stockholders and to the market as a whole.

I trust that this will give you context to understand the extraordinary value we all place in the paid search portion of the on-line advertising business and how very competitive it is and will remain and why there are so many misconceptions advanced by our competitors about the agreement we have entered into with Google.

Let's start by reviewing what this agreement is not as well as what it is.

First, this is not a merger. Far from it. We will increasingly compete with Google and they with us. This is a commercial arrangement between two companies who will remain autonomous and compete aggressively in search and display advertising, in mobile, in news, in e-mail, in finance. You name it. Yahoo is here to stay; and we intend to compete across countless platforms, including search, for years to come.

Second, Yahoo not exiting search, nor are we ceding any portion of that space to Google. This will not, as some claim, result in Google controlling 90 percent of the search business. To the contrary, we will continue to do everything we can to grow our share and also strengthen our competitiveness in search and search advertising. This deal is just one more important step along that path; and, with all due respect to Google, we have every intention of fighting them and winning in this and in other areas for years to come.

Furthermore, this agreement does not affect "algorithmic" search at all. When a user comes to Yahoo and performs a search, the algorithmic results returned will still be entirely Yahoo's. Yahoo serves close to a quarter of the searches that consumers make today, and we expect to be serving that or more after the deal is implemented.

Third, this agreement is nonexclusive and gives Yahoo complete discretion over if, how, where and when we will choose to show Google advertising on our sites. There are no minimum requirements either, and Yahoo is free to make similar deals with other companies. In other words, this gives Yahoo the option to show Google ads but does not tie our hands in any important respects.

Fourth, the claim some have made that Yahoo and Google are price fixing is entirely false. Prices for search terms are set by open and fair market-based auctions, and advertisers only pay when consumers click on the ad. This agreement is truly win-win. It benefits consumers, advertisers, publishers and Yahoo. Consumers will now get more relevant advertising on Yahoo's site. Advertisers will reach more consumers. Yahoo will become an even stronger competitor in the broad advertising marketplace.

To put this agreement is perspective, it is helpful to recall until 2004 Yahoo completely outsourced algorithmic and sponsored search to a variety of companies, including an algorithmic search to Google. And, more recently, other companies have outsourced their search functions to Yahoo. In fact, Microsoft outsourced its sponsored search to Yahoo just a few years ago and still does so in some places around the world.

In 2004, Yahoo made the strategic decision to bring algorithmic and sponsored search in-house, and that decision has not changed. Since then, we have invested hundreds of millions of dollars to improve our search products and compete better in the marketplace. For example, just last week, we announced BOSS, an open platform build-your-own search service, which we believe will unleash a wave of innovation. And our efforts to create a robust, open exchange should bring publishers and advertisers together are also well on their way. These efforts are consistent with our complete commitment to continued growth in search and display advertising.

With the additional operating cash flow from this agreement, anticipated to be between $250 million and $450 million in the first year, Yahoo will accelerate our innovation and better compete against Google, Microsoft and others in the on-line advertising marketplace.

Over the coming weeks, Yahoo will continue to work with our advertisers, our users, outside groups and government authorities to explain this agreement and address any questions about the facts of the arrangement. We have kept the United States Department of Justice informed every step of the way and will continue to cooperate with them and with this Task Force. We are confident that the more one knows about this agreement the more it becomes clear that it will increase competition, stimulate creativity, benefit consumers, advertisers and the on-line advertising industry overall.

Thank you again, Mr. Chairman, for inviting me to appear here today; and I look period to answering any questions the Task Force has.

[The prepared statement of Mr. Callahan follows:]

PREPARED STATEMENT OF MICHAEL J. CALLAHAN

Opening Statement of Michael J. Callahan
Executive Vice President and General Counsel of Yahoo! Inc.
Hearing Before the House Committee on the Judiciary
Antitrust Task Force and Competition Policy
July 15th, 2008

Thank you Chairman Conyers and members of the Task Force. My name is Michael Callahan, and I am Executive Vice President and General Counsel of Yahoo! Inc. I appreciate the opportunity to be here today to discuss the dynamic and growing Internet advertising space and the commercial agreement between Google and Yahoo!.

Yahoo! welcomes this hearing and we are confident that the more one learns about this agreement, the more clear it becomes that it is good for competition – good for consumers, good for advertisers, and yes, good for Yahoo!.

The purpose of this commercial arrangement, and the intent of Yahoo! moving forward, is to help make our company an even stronger competitor to Google, to Microsoft and to others in the dynamic and rapidly growing online advertising world.

As I am sure you know, this has been an interesting time for our company, to say the least.

While I don't want to dwell on the very public proxy fight in which we are currently engaged, I want to spend a brief moment on it because it will give you a flavor for how intensely competitive the search business has become. All of the companies at this table are laser focused on being significant players in search. With this business arrangement, Yahoo! will continue to execute on its long term corporate strategy. Microsoft, on the other hand, has turned to activist shareholder Carl Icahn, in the apparent hope that this will force a fire sale of Yahoo!'s core strategic search business.

Our priority is to build value for our stockholders. That continues to be our core mission. What we will not do, however, is allow our business to be dismantled or sold off piecemeal on terms that would be disadvantageous to Yahoo! stockholders and to the market as a whole. I trust that this will give you context to understand the extraordinary value we all place in the paid search portion of the online advertising business, and how very competitive it is and will remain. And why there are so many misconceptions - advanced by our competitors - about the agreement we have entered into with Google.

Since quite a few misconceptions about this agreement have emerged, I think it is important to understand what **this agreement is <u>not</u>** as well as **what it is.**

First, this is not a merger. Far from it – we will increasingly compete with Google, and they with us. This is a commercial arrangement between two companies who will remain autonomous and compete aggressively -- in search and display advertising, mobile, news, e-mail, finance -- you name it. Yahoo! is here to stay and we intend to compete across countless platforms, including search, for years to come.

Second, Yahoo! is not exiting search, nor are we ceding any portion of that space to Google. This will not, as some claim, result in Google controlling 90% of the search business. To the contrary, we will continue to do everything we can to grow our share and also strengthen our competitiveness in search and search advertising. This deal is just one more important step along that path, and with all due respect to Google, we have every intention of fighting them and winning -- in this and in other areas, for years to come.

Furthermore, this agreement does not affect "algorithmic" search at all – when a user comes to Yahoo! and performs a search, the algorithmic results returned will still be entirely Yahoo!'s. Yahoo! serves close to a quarter of the searches that consumers make today, and we expect to be serving that or more after this deal is implemented.

With respect to sponsored search and contextual advertising, this agreement simply allows Yahoo! to replace some of the ads we now sell—which, in practice, will likely be our least valuable ads—with more valuable ads that Google sells. One can think of this as opening up Yahoo!'s search results pages to competition from the ads that Google sells with the same search terms. In fact, the CEO of the world's fourth largest advertising company, Publicis, recently stated that his company is "happy" with the agreement primarily because both Yahoo! and Google "agreed to work … on an open platform." He further noted that "creating this so that it's a more open platform for search (ads) is a good first step."

This agreement also principally focuses on sponsored search and not the fast-growing and dynamic display advertising sector. We see online display as the likely destination for the billions of ad dollars that are beginning to flow from traditional advertising outlets like television, radio and newspapers onto the Internet. More significantly, we see an increasing convergence of the display and search space, and advertisers will increasingly seek ad packages that include both search and display. Yahoo! has invested hundreds of millions of dollars in developing technologies that will better serve advertisers in a newly converged marketplace, and the proceeds from this agreement will permit us to accelerate our efforts. Just this past year we purchased both Right

Media and BlueLithium, additions to Yahoo! that represent significant investments in the future of our search and display advertising efforts.

Third, this agreement is non-exclusive and gives Yahoo! complete discretion over if, how, where and when we will choose to use some Google advertising on our sites. There are no minimum requirements either, and Yahoo! is free to make similar deals with other companies. In other words, this gives Yahoo! the option to show Google ads, but does not tie our hands in any important respect.

We are strongly competitive with Google for many search terms, and where that is the case it will always be more profitable for Yahoo! to sell its own ads rather than backfill with Google ads. We have every incentive to minimize over time how often we use Google ad results. As we continue to improve the performance and monetization of our own advertising, we expect to use Google's ads less and less frequently.

Fourth, The claim some have made that Yahoo! and Google are price-fixing is entirely false. Prices for search terms are set by open and fair market-based auctions, and advertisers only pay when consumers click on their ads.

This agreement is truly win-win – it benefits consumers, advertisers, publishers, and Yahoo!. We believe that this agreement will improve the experience for advertisers and for consumers, by making ads even more relevant to Yahoo! users. This, in turn, will mean a better experience for users who get more ads that interest them, resulting in more click-throughs, and a better experience for advertisers who will get a better return on their investment.

It's worth pointing out that a number of large advertisers have already spoken out in support of this agreement in recent weeks, and I'd like to submit a series of quotes from those advertisers for the record if I may. These advertisers, who understand the implications of the agreement, have determined that it will improve the value of their advertising. Advertisers are also realizing that pricing will remain competitive and will be set by an open and competitive auction process – not set by Yahoo! or Google, as some might have you believe. Advertisers will continue to bid in Yahoo!'s keyword auction and in others' auction marketplaces and will determine where the best value exists. The very nature of the marketplace ensures that prices will be fair.

And to address one last point on the agreement itself, since I know there have been some questions surrounding it, I want to make it clear

that maintaining the privacy of our users will continue to be paramount. The privacy concerns raised about this deal that somehow Google and Yahoo! are merging vast databases of personal information are simply false. While we will share some search terms to obtain sponsored search results from Google, Yahoo! will not be transferring any personally identifiable information in connection with this agreement without user consent.

Before concluding, I think it is important to recall the history of Yahoo!'s efforts in the search space to best understand how and why we came to this agreement, and where we intend to go after it is completed.

When Yahoo! was founded some 13 years ago, the web was in its infancy and our two co-founders, Jerry Yang and David Filo, sought to create a catalog of interesting web sites to make surfing easier. Later, as the number of sites multiplied exponentially it became more difficult for any one site to track and categorize what was on the Internet. As a result, search began to play a larger role, and it became clear to us that we should be providing this service on our sites.

Initially, we provided neither the algorithmic search results nor sponsored search advertising on our own. Before 2000, we outsourced our algorithmic search results to a number of different companies,

ending with a company called Inktomi. From 2000 to 2004, we outsourced algorithmic search to a brand new company in the space. That company was Google.

Likewise, until 2003, Yahoo! outsourced its entire sponsored search advertising business to a company called Overture.

In 2003 and 2004, our company made a strategic decision to bring search and sponsored search in house. We bought Overture and proceeded to incorporate sponsored search into our own company. And we bought Inktomi and did the same with algorithmic search.

This strategic decision to produce our own search product and to serve our own sponsored search advertising has not changed. Contrary to claims that we are somehow exiting a long-term effort on search, we are in fact doing just the opposite, and are on the upswing of our efforts. It was only a few years ago that we took over search and search advertising for ourselves, and we have been investing hundreds of millions of dollars to make it better and better ever since. This deal is a continuation of that process, and one that will allow us to invest even more in this effort and other innovations in online advertising.

Competing in this rapidly-evolving space is not easy, but we are committed to doing so and we believe we are at the beginning of a revolution in online advertising that will transform the way businesses reach their customers. We want to remain at the forefront of this transformation because we believe we are extremely well-positioned to capitalize on the growth we expect the online advertising market will experience in the coming years.

Yahoo! has a number of exciting new technologies with the potential to revolutionize how advertisers and publishers connect with each other and with consumers. For example, just last week we announced BOSS, an open platform build-your-own search service, which we believe will unleash a wave of innovation. And our efforts to create a robust, open exchange to bring publishers and advertisers together are also well on their way. These efforts are consistent with our complete commitment to continued growth in search and display advertising.

With the additional operating cash flow from this agreement – anticipated to be between $250 million and $450 million in the first year – Yahoo! will accelerate our innovation and better compete against Google, Microsoft, and others in the online advertising marketplace.

Over the coming weeks, Yahoo! will continue to work with our advertisers, our users, outside groups and government authorities to explain this agreement and address any questions about the facts of the arrangement. We have kept the U.S. Department of Justice informed every step of the way, and will continue to cooperate with them and this Task Force. We are confident that the more one knows about this agreement, the more it becomes clear that it will increase competition, stimulate creativity and benefit consumers, advertisers and the online advertising industry overall.

Thank you again for inviting me to appear here today. I look forward to answering any questions you may have.

Mr. CONYERS. Brad Smith is the Senior Vice President, General Counsel and Corporate Secretary for Microsoft; and we welcome you today.

TESTIMONY OF BRAD SMITH, SENIOR VICE PRESIDENT, GENERAL COUNSEL AND CORPORATE SECRETARY, MICROSOFT CORPORATION

Mr. SMITH. It is my pleasure to be here on behalf of Microsoft this afternoon.

I will be the first to acknowledge that Microsoft is not disinterested when it comes to the questions before this Committee. No competitor ever is. But we do know a lot about this market, and we're hoping to share our knowledge in the hopes that will help sharpen the focus on the important questions that are being considered.

The principal question before this Committee today is not what might have happened or what could happen, it is what has happened. And so far only one thing has happened. There has been an agreement between Google and Yahoo. The question therefore is whether it is lawful, whether it is appropriate for the largest company in the search advertising market to, in effect, take control of pricing of 90 percent of the market for search advertising by entering into an agreement with its second-largest competitor.

The technology is complicated, but the antitrust issues are, in fact, straightforward. It really starts with the role that search is playing today.

Search is the gateway to the Web. For many Americans, using a PC on the Internet today involves sitting down in front of a computer, typing in a search request, getting the information that comes back and using that to decide what to look at, what to read, even what to buy.

Search advertising has become an important part of the fuel for all of the free content that is on the Internet. It has become a very substantial market. Search advertising is projected to become a $16 billion market by the year 2011. Now that will start to approach the $20 billion that is spent today on all advertising on all cable television in the country combined.

Now we are, in our view, at an historically important moment in time for the future of the Internet. Because right now, when it comes to search advertising, there are only three principal companies. Google has a market share of 70 percent. Yahoo has a market share of 20 percent. Microsoft has a share of less than 10 percent. So the fundamental question is, what will this agreement between Google and Yahoo mean for the future of competition on the Internet?

We believe it will mean four things:

First, it will lead to an unprecedented level of concentration when it comes to search advertising. It will bring together 90 percent of the market. In the history of advertising, no entity has ever been in a position to control pricing of 90 percent of the market—not in television, not in radio, not in publishing. It shouldn't happen on the Internet.

Second, this agreement will mean fewer choices for advertisers. Today, there are advertisers who may choose to buy ads on Yahoo

in addition to or instead of ads on Google. But under this agreement, Yahoo is going to send some of these ads to Google instead, and these advertisers are going to have no choice but to do business with Google.

Third, this agreement will increase prices. Studies released just this morning predict that prices will go up by as much as 22 percent.

Yahoo has been clear in the information they filed with the Securities and Exchange Commission. They said this will enable them to better monetize ads. That is a fancy way of saying this will lead to a price increase. And that price increase, to the tune of $800 million of additional revenue, is going to be paid for out of the pockets of American businesses, large and small, across the country.

Fourth and finally, this agreement has important implications for on-line privacy. If search is the gateway to the Web—and most people agree that it is—then this agreement puts Google in the position of starting to have access to as much as 90 percent of the on-line searches that are conducted. In the same way that that is unprecedented when it comes to economics, it is unprecedented when it comes to privacy.

If this agreement takes effect, this Congress may not need to enact a new Federal privacy policy. We will have a national privacy policy. It will simply be Google's privacy policy.

We recognize that the Internet is very dynamic. We recognized the technology is changing. But for 118 years, since the enactment of the Sherman Act, one rule of the road has remained constant. We are all encouraged to work hard to succeed. We are all encouraged to innovate faster and offer customers a better product. But no one is permitted to buy their way to 90 percent of the market by entering into this type of agreement with their single largest competitor. The question before this Congress, and indeed before the Department of Justice and the country, is whether that principle should be abandoned now.

Thank you very much.

Mr. CONYERS. You know, I never felt so sorry for poor little old Microsoft.

Mr. SMITH. We appreciate your sympathy.

Mr. CONYERS. I am stunned by the fact that these big predator competitors are about to swallow you guys up. You put this in a completely——

Mr. SMITH. Well, the good news is we do have some other businesses that are still doing pretty well.

Mr. ISSA. Mr. Chairman, 20 years ago, if General Motors had said that Toyota was going to become the number two and perhaps number one auto company, what would you and Detroit have said then? Would you have felt sorry for General Motors when they predicted that?

Mr. CONYERS. I am busy staying sorry for General Motors right now, my friend.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF BRAD SMITH

Testimony of Brad Smith
Senior Vice President and General Counsel
Microsoft Corporation
House Committee on the Judiciary
Task Force on Competition Policy and Antitrust Laws

Hearing on Competition on the Internet

July 15, 2008

Chairman Conyers, Ranking Member Chabot, and honorable members of the Antitrust Task Force, my name is Brad Smith, and I am Senior Vice President and General Counsel of Microsoft Corporation. Thank you for the opportunity to provide Microsoft's perspective on these important issues.

I. COMPETITION IN SEARCH AND SEARCH ADVERTISING IS CRITICAL TO OUR SOCIETY AND ECONOMY.

A. Online Search Advertising Is Critically Important to the Internet and the Businesses that Use It to Reach Consumers.

Search engines are a critical gateway to the Internet and its almost limitless content and services. An estimated 65 percent of online shoppers conduct product research using search engines.[1] Search engines enable us to find the content we need and to harness the full power of the web. They are, therefore, critical to the growth and health of the Internet and to our broader economy, particularly as the Internet continues to grow as a destination for information, communication, and commerce. In May 2008, for example, there were *over 7.8 billion* search queries conducted in the United States.[2]

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[1] iCrossing, *How America Searches: Online Retail* at 2 (Sept. 24, 2007).

[2] Nielson Online, *May U.S. Search Share Rankings* (June 19, 2008), *available at* http://www.nielsen-netratings.com/pr/pr_080619V.pdf.

Online advertising is the "fuel" that drives all the Internet has to offer. Advertising, for example, is what enables search engines to provide their important services for free. It also enables content providers on the web, such as MSNBC.com, ESPN.com, and FoxNews.com, to offer free content and services. Online advertising expenditures likely will exceed $27 billion in the United States in 2008 and are expected to grow to about $42 billion by 2011.[3]

Search advertising, in particular, offers a unique value proposition to advertisers because it allows them to target ads to the real-time desires of a user. And the advertiser typically only pays for the ad if the user actually clicks on it. This one-two punch provides compelling value that, at least today, allows small, medium, and large businesses alike to succeed using the power of search ads. In 2007, approximately $8.6 billion was spent on search advertising in the United States.[4]

B. Increasingly, One Company Controls the Search "Gateway": Google.

Google operates the dominant search engine and is the dominant provider of search advertising in the United States. It accounts for approximately 70 to 75 percent of search advertising revenue (and roughly the same number of search queries).[5] Yahoo! is Google's next closest search advertising competitor with around 20 percent market share. Microsoft is a distant third with less than 10 percent. In just 10 years or so, Google has amassed a market

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[3] EMarketer, *Search Marking, the Behemoth Online Advertising Format* (Feb. 2008), *available at* http://www.iab.net/insights_research/iab_research/1675/334424.

[4] *Id.*

[5] *Id.* (estimating that Google raked in 75 percent of U.S. paid search advertising in 2007); comScore qSearch, All qSearch Properties media category (May 2008) (with Microsoft analysis) (listing Google's U.S. query share, along with its partners, at 75 percent in May 2008; noting that Yahoo!'s query share in May 2008 was 17 percent and Microsoft's was 7 percent).

capitalization of around $166 billion, nearly *all* attributable to its search advertising business. To put this in context, Google's market capitalization is as big as Coca-Cola and Boeing *combined*.[6]

Last year, the FTC put to rest any doubt as to whether Google controls the search gateway in its decision on the Google/DoubleClick transaction. Following its lengthy and thorough investigation, which involved a review of Google's internal documents (likely at least a million pages of Google's own documents) and discussions with scores of advertisers and industry participants, the FTC reached an important conclusion: Google is "the dominant provider" in the search advertising market.[7] As a fundamental matter, the FTC concluded that other forms of advertising (online or offline) should not serve as a basis to eliminate concerns about Google's dominance in search.

C. Overview of Search Advertising.

1. The Mechanics of Search Advertising.

Search advertising refers to the text links that typically appear at the top and right side of search engine results pages. Search engines interact with a search advertising platform. Both technologies work together to provide a seamless experience to the user, but work differently behind the scenes and play very different roles in this important ecosystem.

After we enter a query into a search engine, we actually see two different types of results on the same page. The first are the search query results themselves, also called "algorithmic" search results. These unpaid results are generated by the search engine's index of online content and attempt to list the websites the engine decides are most relevant to the user's search query.

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[6] Drake Bennett, *Stopping Google*, BOSTON GLOBE (June 22, 2008), *available at* http://www.boston.com/bostonglobe/ideas/articles/2008/06/22/stopping_google/.

[7] Statement of the FTC Concerning Google/DoubleClick at 3, FTC File No. 071-0170 (Dec. 20, 2007), *available at* http://ftc.gov/os/caselist/0710170/071220statement.pdf.

The second type of search results are links to *paid advertising* that typically appear just above or to the right of algorithmic search results and are delivered by the search advertising platform. Advertisers typically pay only when users click on these textual ads.

Although search ads appear to be quite simple, offering them is a huge and complex business. Operating a search engine and a search advertising platform can require billions of dollars to maintain the necessary infrastructure. That is why there are just three companies participating in this market today — Google, Yahoo!, and Microsoft. When it comes to search *advertising*, alternatives are *not* just one click away. This is a tough business in which to succeed. It is a business where size and "scale" make all the difference. Thus, the bigger the leader gets, the harder it is for everyone else to compete.

2. Google has the ability to influence and manipulate pricing of search advertising.

Google, Yahoo!, and Microsoft use a process to determine which search ads to place and in which order. This process involves an auction among advertisers. Google has suggested that it does not influence pricing of search advertising because it determines the prices through this auction.[8] Contrary to Google's claim, however, the advertiser auction on its system is no ordinary auction where buyers and sellers set prices without active intervention of the auctioneer. Rather, Google has the ability to influence and determine prices through various means, such as minimum prices and secretive "quality scores." In fact, in the Google auction, the highest bidder in the keyword auction may not win, and what an advertiser "bids" is not necessarily what an

[8] Verne Kopytoff, *Thwarting Microsoft Lifts Google*, S.F. CHRON. (May 9, 2008) (reporting that Google CEO Eric Schmidt emphasized that "Google would not set the prices for ads on Yahoo! because those prices are determined by an auction.").

advertiser actually "pays." Indeed, many advertisers have complained about the lack of transparency in Google's auction process.[9]

II. SUMMARY OF WHY THE GOOGLE-YAHOO! DEAL WOULD REDUCE CHOICE AND INNOVATION AND LEAD TO HIGHER PRICING.

Although the online world is still in its relative infancy, we find ourselves at a crossroads. Competition in search and search advertising is critical to our society and economy. The issues before this Task Force today could very well shape the extent to which the Internet continues to develop into a thriving marketplace of commerce and ideas.

In this regard, we want to call your attention to the fact that Google and one of its chief rivals, Yahoo!, have teamed up in a deal that affects approximately 90 percent of all search advertisements sold in this country. If permitted to proceed, we believe the Google/Yahoo! agreement would effectively create a monopoly in search advertising — to the extent one does not already exist — and further reduce competition.

To be clear, obtaining a high market share through ingenuity and hard work is how our system rewards those businesses that succeed in a competitive marketplace. Indeed, Microsoft is quick to recognize that a company like Google has worked hard to achieve many of its great accomplishments. However, compared to earned success, achieving or entrenching dominance through collusive agreements or other artificial means undermines competition.

Microsoft believes the Google/Yahoo! deal harms competition in several critical ways. Advertisers and online content providers would be harmed through price coordination that will establish higher prices and limit choice. Consumers would be put at risk as Google expands its

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[9] *See, e.g.*, Miguel Helft, *The Humans Behind the Google Money Machine*, N.Y. TIMES (June 2, 2008) ("Many [advertisers] say that despite efforts by Google to be more transparent, they remain in the dark about what goes on inside the company's ad machine.").

ability to collect the personal information of users passing through its search gateway. On an even more fundamental level, Google's monopoly power would increase its ability to shape what people get to see and experience online.

Ultimately, the long-term ramifications of this deal would undermine the very diffusion of power the Internet is supposed to promote. There is the very real prospect that we would regress to the days when information and communications were in the hands of only a few national, broadcast television companies — a state of affairs antithetical to the Internet's core purposes, principles, and promise.

The central question faced by this Task Force and regulators is *not* whether this deal is good or bad for Yahoo!'s search advertising business. The antitrust laws exist to protect competition, not individual competitors. Thus, the central question is whether the deal between Google, which accounts for about 70 percent of the search advertising market, and its main search rival Yahoo!, with around 20 percent market share, would harm competition.

Moreover, although we would welcome a discussion about the pro-competitive benefits of a Microsoft/Yahoo! transaction at the appropriate time, it is little more than an academic question at this stage. The Google/Yahoo! agreement is the one that Yahoo! has chosen to pursue. It is the Google/Yahoo! deal that is under investigation by the United States Department of Justice and numerous state attorneys general, and it is the Google/Yahoo! deal that, we believe, poses an immediate and substantial threat to competition.

III. THE GOOGLE/YAHOO! AGREEMENT.

A. Overview of the Agreement.

On June 12, 2008, Google and Yahoo! entered into an advertising agreement. Under the agreement, Yahoo! will be able to place search and contextual advertising from Google on

Yahoo!'s properties in the United States and Canada. In exchange, Google has agreed to give Yahoo! an undisclosed portion of the revenue from Google's ads shown on Yahoo!'s search pages. The deal has an initial four-year term and can last as long as ten years.[10]

Google and Yahoo! have not disclosed their agreement to the public.[11] Instead, they have provided selected details in public statements and mandatory filings with the Securities and Exchange Commission (SEC).[12] While Google and Yahoo! have suggested that Yahoo! is not obligated to place any Google ads next to Yahoo! search results, they are silent on whether there are limits to the amount of advertising from Google that Yahoo! could substitute for its own. In fact, there appear to be several incentives for Yahoo! to hand over more, not less, of its advertising sales to Google.[13]

Yahoo!'s President Sue Decker suggested during the company's June 12 investor call that Yahoo! will rely on whichever search ad(s) will fetch a *higher* price (i.e., "better monetize"). In essence, therefore, the deal effectively creates a "price floor" (i.e., Google's price) because there

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[10] The long-term agreement was the culmination of coordination between the two companies over the last several months, including a two-week "test" that allowed Google and Yahoo! to obtain information about their relative search advertising pricing.

[11] Indeed, Microsoft recently requested a copy of the agreement from both Google and Yahoo!. Neither company has responded.

[12] *See, e.g.*, Yahoo!'s 8-K (June 12, 2008). Illustrations submitted to the SEC by Yahoo! suggest that the exact same search ad in the exact same location could be sourced by Google over Yahoo! under the deal. What is clear is that there is a limited amount of ad space on each Yahoo! search results page, and Google search ads will frequently displace Yahoo!'s in the most valuable positions. Any advertising space used by Google, of course, is space that an advertiser could no longer purchase directly from Yahoo!.

[13] The agreement provides for the payment to Yahoo! of a percentage of Google's revenues under the agreement, "with such percentage adjusting based on specified monthly gross revenues thresholds." Thus, the agreement may be structured so that Yahoo! has the incentive to shift more traffic to Google to earn an even larger cut of Google's growing revenues. In addition, according to the SEC filings, Google may terminate the agreement if certain revenue thresholds are not satisfied. Google's termination right provides a strong incentive for Yahoo! to continue to rely on Google's ads.

is no incentive for Yahoo! to sell its ad space inventory for less than Google's platform can realize.[14]

Yahoo! projects that the deal will generate additional operating cash flow of as much as $800 million per year from Google. This additional money presumably will flow from the pockets of advertisers — in many cases in the form of higher prices for the same ads they purchase directly from Yahoo! today.

Google and Yahoo! have not touted any benefits from operational integration between the companies.[15] This suggests that the Google/Yahoo! agreement is a bare marketing and pricing agreement between head-to-head competitors.[16]

Both Google and Yahoo! have presented the deal as "open," although it hardly seems to be so in any practical way. In the software industry, the word "open" is often synonymous with "interoperability," which is not going to occur as a result of this agreement. Notably, it is a "one-way" agreement — Google can sell search ads on Yahoo!, but Yahoo! cannot sell search ads on Google. Moreover, there is no reason to believe the same arrangement will work in practice for any non-Google competitor, as Google's typically higher auction prices invariably will trump the lower prices of Google's competitors.

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[14] Yahoo! estimated in an SEC filing a few months ago that Google's revenue per search is, on average, 60 to 70 percent higher than Yahoo!'s, which suggests that Yahoo! will want to cede control to Google for a fair number of Yahoo!'s advertisements. Exhibit 99.2, Yahoo! Investor Presentation at 14 (Mar. 2008) *in* Yahoo! Current Report (Form 8-K) (Mar. 18, 2008).

[15] Ms. Decker has explained that Yahoo! will not generate any costs savings as a result of the deal. *See* Transcript of Yahoo!'s June 12, 2008 Conference Call to Discuss Advertising Agreement with Google at 5. Similarly, Google Chairman and CEO Eric Schmidt explained there will be little to no improvement to Google's platform as a result of the deal. *See* Transcript of Google's June 12, 2008 Conference Call to Discuss Advertising Agreement with Yahoo! at 6-7.

[16] The antitrust laws treat such "naked" agreements among competitors less favorably than mergers or joint ventures that hold out the prospect for efficiencies, which could lead to the development of new technologies and products as well as cost savings.

Finally, Google has represented that this kind of arrangement is commonplace in many industries and has compared the deal to Toyota selling its hybrid engine technology to rival General Motors. This analogy simply does not hold water. Google is not selling Yahoo! a part (analogous to a hybrid engine) that Yahoo! needs to build a product (a completed car). Google is replacing Yahoo! as the seller of the product itself — search advertising. If anything, it is more like Toyota selling GM the whole car and the two companies agreeing to sell Toyotas in GM showrooms in instances where Toyotas can fetch a higher price! The reality is that GM and Toyota could no more enter into such an agreement than Google and Yahoo!. *This is anything but a standard supply agreement.*

IV. THE GOOGLE-YAHOO! DEAL WOULD REDUCE CHOICE AND INNOVATION FOR ADVERTISERS, CONTENT CREATORS, AND CONSUMERS AND LEAD TO HIGHER PRICING.

A. The Agreement Entangles the Dominant Provider of Search Advertising with Its Closest Competitor.

The Google/Yahoo! agreement contemplates significant, ongoing coordination between the dominant provider of search advertising and its chief rival. Together, Google and Yahoo! control an estimated 90 percent of search advertising, with Google alone accounting for over 70 percent. With search advertising fueling the anticipated doubling of online advertising over the next three years, the deal could make Google bigger than any newspaper chain or any television network and provide Google the largest concentration of advertising control in history.[17] The growing importance of the Internet, and media in general, makes this concentration of power all the more concerning.

[17] Search advertising revenues reached $8.6 billion in 2007 and are expected to jump to almost $16.6 billion by 2011. That is comparable to both radio and cable advertising, whose revenues each totaled about $20 billion in 2007, but search advertising is growing much faster.

B. The Agreement Harms Competition in Several Ways, All of Which Would Further Entrench Google's Dominance in Search and Reduce Choice.

Microsoft believes that the Google/Yahoo! agreement likely violates the antitrust laws in several fundamental ways. Some of the anticompetitive aspects of the agreement are discussed below.

First, the agreement reduces Yahoo!'s incentive to compete with Google. Because Yahoo! will share in Google's revenue, it will make more money when Google makes more money. Similarly, Yahoo! will make less money when Google makes less money. Thus, Yahoo!'s incentive to compete against Google following the deal will be reduced. In fact, any competitive decision that Yahoo! makes regarding pricing, innovation, or capital expenditures will have to be weighed against the revenue that Yahoo! would receive from Google's higher profits. The antitrust laws have long disfavored agreements that result in incentives for competitors to "pull their punches" with one another. The concerns are particularly acute in instances where the two companies involved in the coordination account for such an enormous percentage of the market.

Second, this agreement increases the probability that Yahoo!'s search advertising platform will enter a downward spiral that will further weaken its competitiveness, particularly as Yahoo! funnels more search share to Google and as advertisers realize they can no longer get "discounts" on Yahoo!'s platform. In turn, this would reduce even further Yahoo!'s incentive to invest and compete in search advertising and would result in an even greater dependence on Google. Interestingly, an internal Yahoo! document from this past January contemplated some

of these same effects when *Yahoo!* suggested that the deal before this Task Force today would be harmful to Yahoo! and result in Google having an "effective monopoly."[18]

Third, the agreement effectively establishes a *per se* illegal price floor. In explaining the deal, Yahoo!'s President stated that Yahoo! will rely on Google's ads when those ads command a higher price (i.e., "better monetize"). Quite simply, Yahoo! and Google are setting a "price floor" (i.e., Google's price) for ads on Yahoo!'s properties. Yahoo! will never have an incentive to sell an advertisement for less than Google is offering.

The legal precedent in this area is straightforward. In *United States v. Socony-Vacuum Oil Co.*, a case taught in law schools across the country as "black-letter law," the Supreme Court established that agreements between competitors that stabilize price or establish a "price floor" constitute *per se* illegal price-fixing under the antitrust laws — regardless of justifications, intent, or the mechanism used to effectuate the fix.[19] In that case, large gasoline refiners effectively created a price floor for gasoline by agreeing to buy from smaller refiners cheaper "distressed" gasoline that otherwise would have reduced prices.

Similar to the situation in *Socony-Vacuum Oil*, Google is effectively agreeing to buy up Yahoo!'s ad space wherever that ad space would otherwise be available at lower prices. As a result, keywords that cost advertisers less on Yahoo!'s platform before the deal would no longer

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[18] The Yahoo! document discussed whether Yahoo! would consider outsourcing search to Google and stated: "We are focused on long-term value creation rather than short term gains (*short term analysis of the revenue potential of outsourcing monetization may not take into account the longer term impact on the competitive market if search becomes an effective monopoly*)." *See In re Yahoo! S'holders Litig.*, Cons. C.A. No. 3561-CC (Unsealed First Am. Verified Consol. Compl. ¶ 94, May 12, 2008), *available at* http://www.blbglaw.com/complaints/YahooFirstAmendedVerifiedComplaint-Unsealed-5.12.08.pdf.

[19] *Per se* offenses are considered so egregious that courts are not permitted to assess the justification offered by the two parties entering into the agreement. The fact that the agreement exists, by itself, is enough to condemn the agreement as illegal.

be available, because those advertisers would have to pay the higher price at which those keywords are sold by Google in order to advertise on Yahoo!. Put another way, advertisers would no longer get the "bargains" they have enjoyed as a result of competition between Yahoo! and Google.

C. The Loss of Competition From the Agreement Would Harm Consumers, Advertisers, and Content Providers in Several Ways.

The reduction in competition resulting from the agreement would have important and longstanding effects on the search marketplace, those that rely on it, and the Internet as a whole. For example:

The agreement will reduce choice and place even more power and control over a major industry and online content in Google's hands. Google will control even more of consumers' personal information. A Google-Yahoo! partnership not only gives Google the ability to place advertisements next to nearly 90 percent of online search results — it also gives Google access to up to 90 percent of all search queries and online behaviors, including the sites consumers click on and, in some cases, what they do on those sites. Similarly, with weaker competition, one has to wonder what would constrain Google's already questionable privacy practices relating to the reservoir of personal data it holds. Even today, Google has shown a willingness to push the line when it comes to privacy. Indeed, only with substantial prodding did Google finally add a privacy link to its home page.

Content providers, which rely on neutral and competitive search in order to reach users through advertising and unbiased search results, will become more beholden to Google's power. Advertisers also will find themselves left with no choice but to place ads with Google, despite its non-transparent policies.

The agreement will result in higher prices for advertisers and content creators. As already discussed, the agreement effectively establishes a minimum price floor and otherwise reduces the incentives of Google's closest competitor to compete. The reduction in competition between Google and Yahoo! may also mean that web content creators would receive less money from Google or Yahoo! for placing toolbars and ads on their sites, which is an important source of revenue for many online businesses.

D. The "Non-Exclusive" Label Does Not Immunize the Agreement from the Antirust Laws.

Finally, both Google and Yahoo! have presented the deal as "open" and "non-exclusive" in the sense that it does not prohibit Yahoo! from running ads served by its own search advertising platform or third parties. Even putting aside the significant incentives built into the agreement to funnel ads to Google, such labels carry little weight. Antitrust courts and regulators focus on the substance and ultimate effect of agreements, rather than their form or labels. In their own guidelines (and enforcement history), regulators recognize that non-exclusive arrangements can violate the antitrust laws if they result in one firm maintaining or obtaining monopoly power, or, more generally, if the arrangement results in conditions that are harmful to competition.[20]

V. CONCLUSION.

I am fully aware that the presence of Microsoft at this hearing must strike some as ironic, given our own antitrust history. There also is no doubt that we have an interest here as a

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[20] *See, e.g.*, *APRIL 2000 DOJ/FTC ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS* at § 3.34 ("The Agencies look to the competitive benefits and harms of the relevant agreement, not merely the formal terms of agreements among participants."); *id.* at § 3.34(a) ("The Agencies inquire whether a collaboration is non-exclusive in fact as well as in name and consider any costs or other impediments to competing with the collaboration.").

competitor to Google and Yahoo!. Given the concerns that have been expressed by others, the Department of Justice will hear from several advertisers, agencies who place advertising on behalf of businesses, consumers, and, of course, the people who create content and services that are freely available on the Internet. Already we have heard from advertisers — many of them Google's own customers — about the negative impacts of the company's deal with Yahoo!.[21]

Ultimately, it is well recognized that Google could not acquire advertising space from Yahoo! as part of an acquisition. When it comes to the issues before this Task Force, Google should not be allowed to achieve an outcome through an agreement that it would not be permitted to achieve otherwise. The effect of this agreement would be to further entrench the control of the dominant supplier of search advertising and, in the process, reduce choice and innovation and increase prices. As a result, we believe the Google/Yahoo! agreement raises some very serious concerns and may very well be illegal under the antitrust laws.

Mr. Chairman and members of the Task Force, thank you for the opportunity to appear before you today.

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[21] Digital marketing executives have voiced significant concern, such as Brian Waldman, a Boston-based Internet marketer (*see* Betsy Schiffman, *Yahoo Customers Pan Google Ad Deal*, *WIRED EPICENTER BLOG* (June 13, 2008), *available at* http://blog.wired.com/business/2008/06/marketers-see-1.html), Arjo Ghosh, CEO iCrossing (*see Sarah Arnott, Discontent flares over Google's 'dominance,' THE INDEPENDENT* (June 16, 2008), *available at* http://www.independent.co.uk/news/business/news/discontent-flares-over-googles-dominance-847920.html), and Bryan Wiener, CEO 360i (*see* Abbey Klaassen, *Google May Gain $1 Billion in Yahoo Ad Pact, Advertisers Suspect Prices Will Increase*, *ADVERTISING AGE* (June 16, 2008)).

Mr. CONYERS. David Drummond is a cultural aficionado of music. His brother is a professional musician known to many of us. But Attorney Drummond is Senior Vice President for Corporate Development and is the Chief Legal Officer of Google. He leads Google teams for legal, government relations, corporate development and new business development.

We welcome you here today.

TESTIMONY OF DAVID C. DRUMMOND, SENIOR VICE PRESIDENT, CORPORATE DEVELOPMENT AND CHIEF LEGAL OFFICER, GOOGLE INC.

Mr. DRUMMOND. Thank you, Chairman Conyers, thanks, Ranking Member Chabot, Members of the Task Force. Thank you especially, Chairman Conyers, for reminding everyone how little talent I have compared to my brother. And I am very glad to be here today.

The Internet is a dynamic and competitive environment, and that is due to the openness that has been its hallmark from its inception. Our nonexclusive commercial agreement with Yahoo will maintain and expand that competition. It creates new efficiencies that will benefit consumers, advertisers and publishers, while protecting privacy and spurring innovation.

When Yahoo chooses to use our technology, consumers will see more relevant ads that better connect them to the products and services that they are interested in. Advertisers will benefit from better ad matching capability, improving the way they that they reach customers. And Web publishers who place ads on Yahoo's sites, Yahoo ads on their sites, will also see more revenue from better ad matching. That's why large and small advertisers, ad agencies and publishers have expressed their support for this deal, including Publicis, Digitas, Overstock, and even Microsoft's own in-house ad firm, Avenue A Razorfish, who recently called it, "good news for advertisers."

The fundamental point I would like to make today is that this agreement promotes ongoing competition and on-line advertising. Let there be no doubt about this point. Google and Yahoo will remain fierce competitors in search and on-line advertising and many other products and services.

Yahoo has said that it will reinvest the revenue from this agreement into improving its search engine and improving its other services. This continued competition will help fuel innovation that's good for the Internet users, good for the Internet and good for the economy.

Now the fact that this arrangement is made between competitors is not unusual. Commercial arrangements between competitors are commonplace on line and in many other industries. As Mr. Callahan said, amongst the parties at this table, we have had such relationships in the past, and they are ongoing. I trust authorities have recognized that customers can benefit from these arrangements, especially when one company has technical expertise that enables another to improve its product.

We are also excited that, as part of this agreement, Yahoo will make its instant messaging network interoperable with Google's. That a big step forward in making instant messaging more like e-

mail, with users able to communicate against different platforms more easily.

Now, I would like to clear up a few things about the agreement.

First, unlike the other alternatives that are being discussed, such as Microsoft acquiring Yahoo's search assets or taking over all of Yahoo, this agreement will not remove a competitor from the playing field. Yahoo will remain in the business, in the search advertising business and its other businesses and continue to be a vigorous competitor in all of them.

Some would have you agree that this agreement will result in Google controlling nearly all search advertising. The agreement does no such thing. Yahoo will continue to operate its own search platforms. It will sell ads to its long-standing deep base of advertisers and continue to operate its own ad auction. The agreement merely gives them the option to show some Google ads in cases where Google ads are likely to generate more overall value, that is, increase the pie for everyone.

It is important to note that this agreement is limited to the U.S. and Canada and excludes emerging fields such as mobile. Simply put, Yahoo will have every incentive; and, as you have heard from Mr. Callahan, they have every intention of remaining in the business and indeed expanding their business in search and on the rest of the Internet.

Second, the agreement does not increase Google's share of search traffic, because Yahoo will continue to run its own algorithmic search engine.

Third, the agreement does not set an illegal price floor. Microsoft would have you believe that the additional revenue that Yahoo and Google might generate from this agreement will be solely the result of higher prices. Nothing could be further from the truth, and it really reflects a fundamental misunderstanding of how search monetization works.

This is a very important point. The fact is, we expect a primary driver of additional revenue will be more relevant ads being delivered to more users who will then click on those ads in greater numbers. In other words, we are not looking to sell ads at higher prices; we are looking to sell more ads. With better targeted advertising what you wind up is with more leads for advertisers, more conversions for them and greater value.

Again, the pie is bigger than it was before. This is good for everyone. Users see more relevant ads, advertisers connect with more interested users, and Yahoo and its partners sell more advertising space.

Fourth, the agreement also upholds Google's deeply held commitment to protecting user privacy. As Google supplies ads to Yahoo and its partners, personally identifiable information of Internet users will not be shared between the companies.

Let me conclude today with some frank talk here. The most energetic critic of this agreement is Microsoft, who, of course, is a major competitor of ours and not exactly a mom-and-pop shop. This is the same Microsoft whose CEO said he was going to "kill Google", along with some other salty language that I can't repeat here. It is the same Microsoft that has a 90 percent share of operating systems, a 95 percent share of productivity software and 80 percent

share of the browser market. You get the picture. A desktop monopoly that Microsoft, frankly, could use to harm the next phase of the Internet, a very important phase of the Internet that we call cloud computing.

Most importantly, this is the same Microsoft that's actively trying to buy or at least destabilize, from what we can tell, Yahoo and eliminate them as a competitor. So if you think all of that gives them a bit of incentive to oppose the agreement, you are right.

In conclusion, let me just say that openness, interoperability and competition is central to our culture at Google. It is central to vibrancy of the Internet and the growth of free markets. Unlike on the desktop, competition on the Internet has always been and will continue to be a click away.

Thank you, and I look forward to answering your questions.

[The prepared statement of Mr. Drummond follows:]

PREPARED STATEMENT OF DAVID C. DRUMMOND

Testimony of David Drummond
Senior Vice President of Corporate Development and Chief Legal Officer, Google Inc.

Before the
House Committee on the Judiciary Task Force on Competition Policy and Antitrust Laws
Hearing on "Competition on the Internet"
July 15, 2008

Chairman Conyers, Ranking Member Chabot, honorable members of the Task Force, my name is David Drummond, and I am Google's Senior Vice President of Corporate Development and Chief Legal Officer.

Thank you for inviting me to discuss the state of competition on the Internet. Because of its founding principles of openness and interoperability, the Internet is an extraordinarily competitive environment, where competition and choice are only a click away. Consumers, creators, and entrepreneurs come together online to communicate and discover information, create and distribute new types of content, and develop and expand new business opportunities. Online advertising is playing a critical role in fueling economic growth and furthering innovation across the Web, benefiting users, promoting free speech, and helping businesses of all sizes succeed.

My message to you today is simple: While there are other threats to the continued competitiveness of the Internet, the online advertising marketplace is competitive, robust and dynamic. Our recent advertising agreement with Yahoo! will maintain and expand that competition, while growing the reach of consumers' favorite instant messaging chat programs. As I will explain, the non-exclusive commercial arrangement creates new efficiencies that make the pie larger, benefiting users, advertisers and publishers, while protecting privacy and spurring innovation.

Yahoo!'s Advertising Agreement with Google:
On June 12th, we announced a non-exclusive advertising agreement giving Yahoo! the option to display Google-supplied ads alongside Yahoo!'s search results, web pages, and partner properties in the United States and Canada. Yahoo! can use Google ads on as many or as few of its search result and content pages as it chooses. The agreement lasts for four years, and can be renewed for two additional three-year terms.

The agreement will not affect Yahoo!'s natural search results. Yahoo! will continue to operate its own search engine and display natural search results in the same manner it does today. The arrangement therefore will not increase Google's share of search traffic, contrary to some claims.

This arrangement is not a merger, nor a joint venture. It is much simpler than that - it is a non-exclusive agreement to supply advertising. Google is providing access to our back-end search and contextual advertising systems to Yahoo! We currently provide these services through our AdSense for Search and AdSense for Content programs to sites like WashingtonPost.com and Ask.com, as well as many other partners. Moreover, this is a non-exclusive agreement. Yahoo! could enter into similar arrangements with any other company, including Microsoft. Indeed, Yahoo! can - and will - continue to supply much of its advertising through its own internally developed ad platform.

We are not required to receive approval from antitrust authorities prior to implementation. We notified the Department of Justice (DOJ) in April, when we conducted a limited two-week test of Yahoo! running Google ads. We stayed in contact with DOJ, and voluntarily agreed to delay implementation for three-and-a-half months, giving regulators time to understand the arrangement.

Benefiting Consumers, Website Owners, and Advertisers:
Why did Google enter into this agreement? We think we'll make money of course, and we think we'll do so by giving millions of consumers, publishers, and advertisers access to more relevant online ads. Where Google's system may provide better results, Yahoo! will be able to use it to complement its own advertising program. The whole system becomes more efficient: people see and click on more ads that are useful to them, publishers get more revenue from ads on their sites, and advertisers get more potentially interested customers. This is not unusual – a large portion of Google's business is simply to partner with thousands of diverse website owners and, in return for a small portion of the revenue, provide these web publishers with ad services.

Consumers
Consumers will not only get better, more interesting ads, but also benefit from continued online competition and innovation. Users value ads that connect them to the information, products, and services they seek. This is the driving philosophy behind Google's advertising business – we strive to deliver ads that are the most relevant to our users, not just the ones that generate the most revenue. We do this through our innovative ad auction system, which factors in the relevancy, or usefulness, of the ad to our users.

Here's how it works: Through a simple online interface, advertisers create short text ads for their products and services and choose associated keywords. Advertisers then place bids indicating how much they are willing to pay if a user clicks on their ad. When a user enters a word or phrase (referred to as a "query") into our search engine, our technology matches the words with those entered by advertisers and selects ads that will appear above or to the right of the search results. The ads are selected and ranked based on advertisers' bid prices, along with a quality score factor. Most search advertising systems now use a measure of ad quality, which provides an incentive for advertisers to show useful ads and reduces ad spam, which is distracting and frustrating for consumers. Advertisers typically pay us only when someone actually clicks on their ad. When Google supplies ads to our content partners' websites, the ads are matched based on search terms or the content of the page displaying the ad.

Google has built a sophisticated tool for matching search queries to highly relevant text ads, and we're constantly experimenting with new algorithms to show users relevant ads. The benefits of our ad system can now be extended to Yahoo!'s users. Consumers will see ads that are better targeted,

which will help them get where they want to go online.

The arrangement will also help Yahoo! remain a vibrant and innovative presence on the Internet. Yahoo! may find that its own advertising platform generates similar revenue on much of its search traffic, and thus not want to use Google for those searches, as that would result in sharing revenue that Yahoo! could otherwise keep fully. For the ads that are supplied by Google, if users find them more useful and click on them more often, this will give Yahoo! additional revenue to invest in its own search engine, advertising tools and other services. That should benefit Yahoo!'s content portal, email, instant messaging, productivity software, photo sharing service, music services, games, finance offerings and all the other products and services Yahoo! offers.

Website Owners
Online publishers (website owners who earn revenue by running syndicated ads from companies like Google and Yahoo!) will benefit from better ad matching technology, potentially increasing the revenue they earn from their site. Simply put, if an ad is better matched to the content of a particular web page, a user is more likely to click on the ad, resulting in more revenue to the owner of the website where the ad appeared.

Google partners with thousands of web publishers, large and small, to place ads on their web pages. Much of Google's success is based on the success of our business partners. When a visitor to our partner's site clicks on a Google-supplied ad, Google shares a majority of the advertising revenue with the website operator. In 2007, we paid out $4.5 billion in advertising revenue back to our partners. A significant portion of that revenue went to small businesses, including bloggers and web entrepreneurs. In this way, online advertising promotes freer, more robust, and more diverse speech, and lets small businesses across the country compete in the global marketplace.

The arrangement lets Yahoo's content partners benefit from Yahoo's ability to use Google-matched ads. Publishers may find that visitors click on their site's ads more often, generating more revenue.

Advertisers
Lastly, advertisers will benefit from better ad-matching capability, giving them improved ways to reach online customers more efficiently.

Google does not control the prices charged to an advertiser when a user clicks on a Google ad. Rather, advertisers themselves determine prices through an ongoing competitive auction for particular keywords. We have found over years of research that an auction is by far the most efficient way to price search advertising and we have no intention of changing this approach.

Advertisers care most about the number of users who ultimately buy the product or service being sold or consumed on their website. The famous department store pioneer John Wannemaker once said that "half the money I spend on advertising is wasted; the trouble is I don't know which half." Online advertising helps solve that problem, by letting advertisers pay only for ads that are of interest to their target audience. The more likely an ad is to result in a user buying something, the more valuable that ad is to the advertiser.

Large and small advertisers have indicated that the arrangement with Yahoo! will benefit them

because Google will better match ads to web users who want to purchase the advertiser's goods or services. Here's what advertisers and other ad industry participants are saying:

- "*[The agreement] is something that isn't threatening to clients, they are not merging, they are independent and they remain competitors. . . . I view it as very positive.*" Maurice Levy, Chairman and CEO, Publicis Groupe (the Guardian, 6/20/08)

- "*The agreement between Yahoo and Google should help the relevancy of our advertising on Yahoo, which should actually make the dollars we spend more efficient.*" Geoff Atkinson, Vice President of Tactical Marketing at online retailer Overstock.com (Bloomberg, 6/20/08)

- "*We are happy with that agreement. . . . It's not a lack of competition.*" David Kenny, CEO, Digitas Inc. (Reuters, 6/20/08)

- "*What it will ultimately do is allow us to get broader distribution out of Google's ad platform. . . . [The partnership] is going to be good news for advertisers.*" Matt Greitzer, Vice President of Search Marketing at Avenue A/Razorfish, acquired by Microsoft through its purchase of aQuantive (Bloomberg, 6/20/08)

When Microsoft's own ad firm – the group within Microsoft that knows online advertising best – confirms the benefits of the agreement for advertisers, we should rest our case right there.

Fostering Competition in the Dynamic Online Advertising Space:
The arrangement will also promote competition and innovation. Google and Yahoo! will remain vigorous competitors, and that competition will help fuel innovation that is good for users and the economy.

Unlike other alternatives, such as Microsoft breaking up Yahoo! by acquiring Yahoo!'s search assets or taking over all of Yahoo!, this arrangement will not remove a competitor from the playing field. Yahoo! will continue to operate its own search engine, ad platforms, and web properties, will continue to control its user interface and the display of advertising on its site, and will maintain relationships with its own advertisers. Indeed, for any given search query, Yahoo! could, for example, choose to keep prominent ad placements for its own ad system and its own advertisers, while using Google's system to supply lower ranked ads. Advertisers using only Google's system will not be guaranteed in advance particular placements on Yahoo! We fully expect that advertisers using Yahoo!'s system today will continue to do so after the agreement is implemented.

Yahoo! has indicated that not only will it continue to use and promote its own search advertising platform, but that the revenue from this arrangement will fuel continued investment and improvement in its platform. Yahoo! will also need to continue using its own ad system outside of the United States and Canada, in supplying ads to new content partner sites worldwide, and in supplying ads to mobile users, a rapidly emerging growth area for online advertising. Moreover, Yahoo! and Google will continue to compete across a wide variety of other products and services, giving both companies an incentive to keep improving and innovating.

Supplier arrangements are commonplace in many industries. For example, Toyota sells its hybrid

technology to General Motors, even though they are the number one and number two car manufacturers globally and compete vigorously. Canon supplies laser printer engines to Hewlett Packard, while also competing in the sale of laser printers. Despite the fact that an underlying service or technology is supplied by a competitor, these and many more examples show that companies can compete aggressively even with their partners.

Outsourcing arrangements have been a common feature as web search has evolved. Yahoo! used Google's search engine to generate its search results until 2004, when Yahoo! transitioned to the search engine that it had developed. Through an ad company it acquired called Overture, Yahoo! also supplied advertising for Microsoft's search site until 2006, when Microsoft phased in its own system.

We are not aware of any similar non-exclusive arrangement that has been blocked by antitrust authorities. As a starting point, DOJ recognizes that competitor collaborations can have pro-competitive benefits. In fact, the Antitrust Guidelines for Collaborations among Competitors, issued by DOJ and the Federal Trade Commission in 2000, state as a matter of principle: "In order to compete in modern markets, competitors sometimes need to collaborate. . . . Such collaborations are not only benign but pro-competitive." The Guidelines recognize that consumers may benefit, especially if, as here, one company has technical expertise that enables another participant to lower its production cost or improve the quality of its product. With its non-exclusive terms and the fact that Yahoo! will remain a strong competitor in this space, we are confident that this arrangement will promote competition, innovation, and consumer choice online.

The Online Advertising Marketplace is Robustly Competitive Today:
Online advertising is critical to the continued growth of our economy, and beneficial to consumers. Although online advertising is a small piece of overall advertising dollars, it is characterized by strong competition, significant innovation, and tremendous growth. Brian McAndrews, Microsoft's Senior Vice President of the Advertiser and Publisher Solutions Group, has commented that the online advertising space is "in the first or second inning of a long game here. There's no monopoly on innovation. I don't think you're going to see two or three big players and then game over. There will continue to be a broad range of companies." (MediaPost, 6/15/07)

There are many formats for online advertisements, including text, display, and rich media ads, and also many ways ads can be matched to users, most notably through search terms, contextual matching, behavioral targeting, and demographic targeting. Google has focused on search-targeted text-based ads. Display advertising – static or moving images that appear on a website you're visiting – are also common. Yahoo! has one of the leading display ad platforms in the world. Advertisers increasingly use multiple forms of online advertising, and multiple targeting technologies. For instance, advertisers and publishers who work with us have asked us to complement our text-based advertising with display advertising to support multi-format campaigns. We know that Microsoft, Yahoo!, AOL, WPP and countless others are building out their array of capabilities as well.

The online advertising space is marked by strong competition. There are thousands of companies selling online advertising, including websites that sell ad space directly and intermediaries. Last year saw several major transactions and capital infusion of more than $10 billion. Microsoft, for

example, spent $6 billion to acquire the online ad firm aQuantive. These acquisitions are strong signals that the market believes this space has significant room for growth and competition.

More players and more capital are combining to create not only more competition but also more innovation in technologies and business models. Facebook, for example, is experimenting with ways to target advertising to its 80 million active users, aided by Microsoft, which is the exclusive third-party supplier of ads for the social network. With its goal of creating an advertising platform across devices and media (including TV and gaming), Microsoft is aggressively taking steps to grow its search and advertising capabilities. Capitalizing on 2007 annual revenues of $51 billion, Microsoft last month launched a search cash-back program through which searchers can earn cash back from Microsoft for eligible purchases. Clearly, this is an area in which Microsoft expects to compete aggressively for a long time to come.

Google will Continue to Protect Online User Privacy:
Google believes deeply in protecting the privacy of our users. We design our policies and products in way that provides transparency, choice, and security for user data.

Google was the first leading Internet company to decide to anonymize IP addresses and cookies (very small files stored on your computer to, for example, remember language preferences). We've also decided that our cookies will expire after two years of inactivity. We continue to innovate in our privacy protection practices. For example, we're exploring better forms of notice within display ads, which we think would benefit consumers if offered industry-wide.

Google is also committed to industry best practices – including the privacy guidelines of the Network Advertising Initiative – and to continuing to work with the Federal Trade Commission to develop workable and widely-adopted behavioral advertising principles. Google supports passage of a comprehensive federal privacy law that would enhance consumer trust and protections, establish a uniform privacy framework, and penalize and dissuade bad actors.

Every day we spend significant time and resources designing products on the principles of transparency, choice, and security - transparency about what information we collect and how we use it, user choice about whether to provide us with personal information at all, and security to protect information stored with us. We lead the industry in making our privacy notices and education efforts clear, concise, and understandable. Many of our products are designed to let people use them anonymously. None of our products use any personally identifiable data unless fully disclosed in our privacy policy.

We have taken a number of steps in the Yahoo! agreement to protect user privacy. As Google supplies ads to Yahoo! and its partners, personally identifiable information of individual Internet users will not be shared between the companies. Yahoo! will also anonymize the IP address of a Yahoo! searcher's computer before passing a query to Google. Moreover, Google will not provide real time pricing data to Yahoo! and will restrict the information that Yahoo! receives when a user clicks on an ad supplied by Google. These enhanced privacy firewalls demonstrate how vigorously the companies plan to continue competing against one another.

Interoperable Instant Messaging Will Benefit Users:
Google is particularly excited for our users that as part of this agreement, Yahoo! will make its instant messaging (IM) network interoperable with Google's. This will mean easier and broader communication among a growing number of IM users, and enable users to choose among competing IM providers based on the merits and features of the services.

Unlike email, not all instant messaging networks are interoperable. Microsoft and Yahoo!, the two leading global IM providers, made their IM systems interoperable in 2006. In contrast to other leading IM systems, the Google Talk IM network is built on an open, standards-based IM protocol. Yet, neither Microsoft nor Yahoo! are interoperable with Google's IM systems.

The lack of IM interoperability has broader implications for competition on the Internet. As websites become more interactive and users more familiar with online chat, the use of instant messaging is growing at home and at work. Rather than walled gardens, interoperability benefits users by breaking down barriers to communication with users of other systems. With interoperability, users can exchange messages across networks, see friends' online presence, view status, and add contacts from either service. This brings more control and convenience to users.

Ensuring Continued Competition on the Internet:
Competition on the Internet is thriving today because, with a few notable exceptions, most Internet companies are staunchly committed to basic principles of openness and interoperability. The web's open standards and protocols allow users to use any browser on any operating system to visit any web site. In the next phase of the Internet's evolution, known as "cloud computing," users increasingly will manage and store their files online, rather than through software stored on their PCs. All consumers will need to access and use their information is a simple device that can connect them to the Internet.

Openness and interoperability are central to Google's mission to organize the world's information and make it universally accessible and useful. Like many companies, we provide Internet users with a variety of products and services, most for free, that let users share, receive and organize digital information - from our search engine to Google Maps to YouTube. We also offer Google Apps, a web-based suite of collaborative productivity tools (*e.g.*, email, calendar, word processing, spreadsheets and presentation software), which provides a cost-effective solution that is popular with small businesses. Google is not alone, as established companies and Internet upstarts alike are heavily investing in revolutionizing the next wave of innovation online.

Unfortunately, some of our competitors have a fundamentally different approach to competition, one that promotes closed systems and limits consumer choice. On the desktop, too often users are trapped within the confines of a single operating system, word processor, or web browser. Dominance of the desktop can let one company favor its own products and services and obstruct the interoperability of competing products or services, overriding the desires of consumers.

Microsoft continues to maintain dominant positions in desktop computing that could be leveraged to harm competition online. For example, Microsoft maintains more than 90% share in operating systems, more than 95% share in productivity applications through Windows Office, and approximately 80% share of the browser market through its Internet Explorer browser that comes

bundled with its other software. Microsoft has a long history of abusing and extending its dominant positions through anticompetitive practices. Seeking to control technical standards or deny interoperability, Microsoft often abuses the licensing process, reveals less than complete information, or prevents data portability. While it's easy to imagine using a different search engine – others are just one click away, and millions of people use different search engines every day – Microsoft has locked consumers into its PC-based software monopolies. For years, Microsoft has been working to leverage that lock-in onto the freer and more open world of the Internet.

Despite publicly proclaiming a new attitude toward opening its products, Microsoft frequently returns to its old habits. Just last year, Microsoft tied its own desktop search into its new Vista operating system, with no way for users to choose an alternate provider from numerous built-in shortcuts. State antitrust regulators stepped in and Microsoft ultimately made some changes to give users partial choice. Similarly, Microsoft's Internet Explorer browser was set up with defaults to send users to Microsoft's search service, until the European Commission stepped in to block Microsoft's attempted tying. Microsoft is currently being investigated for using improper tactics to manipulate the vote of an international standards body. These are troubling examples of Microsoft's longstanding practice of using its control over desktop computing to harm competition.

As you consider the state of competition on the Internet, this Task Force should ensure that Internet users remain in control of their Internet experience. Be wary of a company's attempt to restrict user choice. Companies should compete for users based on the quality of their services, and the innovation they create. That has been the hallmark of the Internet's transformative power as a medium for free expression and economic growth. As the web evolves to become even more interactive and more useful than it is today, we should demand no less.

I appreciate the opportunity to share our view of the competitive dynamics at work on the Internet. Thank you.

Mr. CONYERS. Professor of Law, Frank Pasquale, Seaton Hall Law School. His research on search engines has been widely reported, featured in the New York Times, San Francisco Chronicle, Los Angeles Times and other publications and media.

TESTIMONY OF FRANK PASQUALE, PROFESSOR, SETON HALL UNIVERSITY SCHOOL OF LAW

Mr. PASQUALE. Chairman Conyers, Ranking Member Chabot, thank you very much for giving me this opportunity today.

This is a very complex area, but what I would like to do today is to boil down the considerations of this issue into two large problems and three potential solutions to them.

The first problem that I think has already been highlighted by Attorney Brad Smith here today is Google's increasing domination of the search advertising market and view of the search market in general.

Now I have acknowledged in my testimony that this may well be a natural monopoly. There may well be forces in this industry that lead to there to be one dominant standard overall, and we have to be cognizant of that. But we also have to be cognizant that there are some anti-competitive basis, some restraints on trade that are also driving this development.

For example, Professor Ben Edelman of Harvard Business School has done some terrific research looking at the data portability and the lack of data portability for AdSense customers. Essentially, to make a long story short here, Google makes it very difficult for AdSense customers to effectively port data that they have cooperatively created through the AdSense program to potential competitors.

Now, fortunately, this particular problem of data portability I think is relatively straightforward to solve. As Professor Edelman has said, we could condition or the relevant regulators could condition the deal on that type of data portability. I think it is only fair. Cooperative data creation should lead to sharing.

The larger issue here that I really hope the Committee will focus on and the regulators will focus on is to think about the lack of transparency in terms of search engine practices here overall. And here I think we need to step back a little bit and think about what is a search engine.

I would propose to the Committee—and I think there is lots of work to support this—a search engine is fundamentally a voting machine. It is a way of tabulating and processing the billions and billions of actions on the Internet in order to organize the Internet. The unfortunate thing about these voting machines today is they are a bit like the voting machines that we have come to suspect in some elections, both Republicans and Democrats. They are extremely opaque.

What I would like to ask the Committee today to consider, for example, if an advertiser sues Google over some, say, business dispute and then gradually finds that its rank goes down further and further and organic search for its paid searches just aren't being accepted, does it have any way of finding out exactly why that is happening? Because of the trade secrecy that Chairman Conyers

has brought up with respect to this agreement today, I believe it does not.

Think further about what happens if a politician, say, is investigating Google and then finds that there might be some, say, form of retaliation or potential retaliation, that the search results about them focus primarily on, say, some minor scandal, as opposed to the dominant interest of their career. That is another problem, actually entertainingly talked about in Cory Doctorow's story Scroogled. That is the stuff of science fiction, but I still think there are lots of issues here involving the transparency of search engines that should give the Committee pause.

I think that we have existing, within our legal frameworks, ways of dealing with these problems and ways of dealing with issues that need to be kept secret that we should think about. I have talked about a parallel to the Pfizer court, and I believe that if we have something like the Pfizer court, which potentially puts our national security or national secrets, exposed them to a small select group of people, we should not be afraid doing a similar sort of fact-finding, regularized, administrative fact-finding about data pools and about proving that there is no abuse within search engines within the Federal Trade Commission. Some leading scholars have called for this.

I also believe that we have to think about—just in response to the points that have been made about not setting prices, I do wonder about whether reserve prices are set in the auctions. For example, there has been economic work about reserve prices set in auction for search terms. If I, say, own the trademark to 2bigfeet.com, it is not as if—there are probably not many people going to be bidding for that particular trademark because I own the trademark.

But it is not as if I will be entering into an auction and, say, there will only one or three people there, there most likely will be a reserved price set. I believe that is a form of price setting, and I believe that this type of concentration does give the dominant entity that will result a lot of power over that type of price setting.

And, therefore, I proposed in some of my work and I have seen it done in some other work annotation remedies that would give some rights to trademark holders, if they think the search results were unfair, to annotate trade results, to search results, to put an asterisk next to those results to indicate that they are the ultimate owner of that trademark that was a search term.

In conclusion, I would like to recommend to the Committee or just to ask the Committee to think of these companies as fantastic innovators, as wonderful guides to the Internet. But also think of them in some ways as Tom Sawyer companies. Remember that Tom Sawyer got others in the great Mark Twain story to paint the fence for him. Ultimately, what search engines do is they use data that we all create, actions that we use on the Internet to create a map of the Internet. We have all created this map together, and we all deserve a voice in how it is processed and how it is presented.

Thank you.

[The prepared statement of Mr. Pasquale follows:]

PREPARED STATEMENT OF FRANK PASQUALE

Internet Nondiscrimination Principles for Competition Policy Online

By Frank Pasquale*

Testimony Before the Task Force on Competition Policy and Antitrust Laws of the House Committee on the Judiciary

July 15, 2008
Rayburn 2141, 1:30PM

Executive Summary

American search engines are among the most innovative services in the global economy. They provide extraordinary efficiencies for advertisers and consumers by targeting messages to viewers who are most likely to want to receive them. In order to attract more users, search engines use revenues from advertising to organize and index a great deal of content on the World Wide Web.[1] Like the major broadcast networks they are now beginning to displace, they provide content (organic search results) in order to sell advertising (paid search results).

Recent deals between major search engine providers have provoked scrutiny because they suggest undue coordination of competitors in an already concentrated industry. Certainly antitrust authorities should take into account the unique consumer protection and privacy issues raised by the consolidation of platforms for online advertising. However, to the extent this market naturally tends toward concentration, conventional antitrust analysis may not be able to address the worries of the Committee. Policymakers may need to focus less on promoting competition and more on regulating the inevitable near-monopolist by assuring it does not treat either advertisers or consumers unfairly.

Though I believe such concerns will ultimately warrant creation of a Federal Search Commission to parallel the Federal Communications Commission, I realize that the Committee is now seeking more immediately relevant responses to concentration. I will therefore focus my testimony on some legislative and regulatory steps that could reduce opportunities for major search engines to abuse their dominant positions. In order to reduce opportunities for clickfraud and unfair treatment of indexed entities, *qualified transparency* will be needed in order to open up the "black box" of search engine

* Professor of Law, Seton Hall Law School; Associate Director of the Gibbons Institute of Law, Science, and Technology, Seton Hall University; J.D., Yale; M.Phil., Oxford (Marshall Scholar); B.A. *summa cum laude*, Harvard. Portions of this testimony are drawn from a co-authored work, *Federal Search Commission*; please only cite or quote this testimony with my permission so I can indicate whether that article would be the proper source to cite.

[1] Because of this service, I have advocated for slightly more favorable copyright treatment of search engines' indexing projects. See Pasquale, *Copyright in an Era of Information Overload: Toward the Privileging of Categorizers*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=888410.

operations to at least some third parties.[2] Moreover, precisely the types of common carrier obligations that search engines have advocated for telecommunications and cable companies (in the name of "net neutrality") should be applied to search engines themselves (to assure the fairness of these powerful intermediaries).[3]

Background for This Testimony

I am a Professor of Law at Seton Hall Law School, and the Associate Director of Seton Hall University's Institute for Law, Science, and Technology. I regularly teach courses in intellectual property and administrative law. I joined Seton Hall after practicing law as an attorney at Arnold & Porter LLP, where my work included antitrust and intellectual property litigation. I have also served as a fellow at the Institute for the Defense of Competition and Protection of Intellectual Property in Lima, Peru. In 2002, my co-authored work *Beyond Napster* focused on the intersection of antitrust and intellectual property law in the music industry. Since then I have written a series of articles on the law of internet intermediaries, including search engines. I have presented these works at many venues, including Stanford, Berkeley, Yale, the University of Chicago, the University of Virginia, and NYU Law Schools.

Threats Posed by Consolidation in the Search Market

Internet sites have much riding on search engine results: as Nissenbaum & Introna memorably put it, "to exist [online] is to be indexed by a search engine."[4] While users can locate relevant information on the Net in other ways, search engines now constitute the dominant platform through which content producers and audiences can reach each other. Moreover, the search process itself is structured as a high-stakes, winner-takes-(almost) all competition.[5] Search-results lists may lock sites and advertisers into a fierce

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[2] My co-authored work *Federal Search Commission* explores the ways in which transparency here would be qualified, in order to prevent manipulation of search engines. Pasquale and Bracha, *Federal Search Commission*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1002453.

[3] Frank Pasquale, *Internet Nondiscrimination Principles*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1134159 ("Just as dominant search engines fear an unfairly tiered online world, they should be required to provide access to their archives and indices in a nondiscriminatory manner. If dominant search engines want telecommunications and cable carriers to disclose their traffic management tactics, they should submit to regulation that bans stealth marketing and reliably verifies the absence of the practice. Finally, search engines' concern about the applications and content disadvantaged by carrier fast-tracking should lead them to provide annotation remedies to indexed sites whose marks have been unfairly occluded by the search process. Fair competition online demands common commercial ethics for both dominant search engines and dominant carriers.").

[4] Lucas D. Introna & Helen Nissenbaum, *Shaping the Web: Why the Politics of Search Engines Matters*, 16 INFO. SOC'Y 169 (2000), available at http://www.indiana.edu/~tisj/readers/full-text/16-3%20Introna.html.

[5] For a fuller description of the dynamics of network effects in situations like this, see DAVID GREWAL, NETWORK POWER (Yale, 2008); ROBERT H. FRANK AND PHILIP COOK, THE WINNER TAKE ALL SOCIETY (1995).

zero-sum competition for recognition.[6] The number of users attracted by a listed website steeply drops in correlation with its rank, beginning with the site ranked as second. By the time one reaches later pages of the search-results list, such a rank is almost as bad as not being indexed at all. In such an environment, where both commercial and non-commercial speakers place great weight on attracting users' attention, a high ranking is critical to success. Furthermore, a very small number of significant players dominate the lion's share of the search engine market.

Concentrated control over the flow of information, coupled with the ability to manipulate this flow, may reduce economic efficiency by stifling competition. The centrality of information to efficient markets is well known. Market participants need information about products and services to make informed economic decisions. To the extent information is less available or more costly to obtain, the market will be less efficient and prices will be less competitive. Search engine manipulation may adversely affect the flow of information critical to the decisions of participants in the market. It may highlight market actors that otherwise would have enjoyed less popularity or suppress other actors and their ability to compete effectively. Put differently, attaining visibility and access to users is critical to competition and cooperation online. Centralized control or manipulation by search engines may stifle innovation by firms relegated to obscurity.

Manipulation of this kind is likely to result in high barriers to entry that depress competition. Entrenched and well-established entities are more likely to have the resources necessary to induce search engines to manipulate results, and thus preserve their market dominance.[7] New entrants and smaller competitors may find themselves excluded or unable to reach public consciousness.[8] As the Internet becomes a central site for both market transactions and the information needed to make informed purchasing decisions, the anti-competitive effect of skewed information flows is likely to intensify.

Manipulation is unlikely to be detected if dominant search engines are permitted to keep their search algorithms completely secret. According to one of its court filings, "Google takes extraordinary measures to protect its trade secrets and confidential commercial information." Like FICO scoring and much proprietary voting machine

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[6] Frank Pasquale, *Rankings, Reductionism, and Responsibility*, 54 CLEV. ST. L. REV. 115, 130–131 (2006) ("Economists have explored how positional dynamics in a number of different markets . . . have led to socially wasteful 'arms races' for positional advantage. In ordinary markets, the presence of high-spending consumers will draw more producers so that, eventually, supply will approach demand. However, there can only be one 'top-ranked' site. Tactics to influence unpaid listings and prices for paid listings are sure to escalate, but it is not clear that this competition creates much utility.").

[7] Frank Pasquale, *Internet Nondiscrimination Principles: Commercial Ethics for Carriers and Search Engines*, 2008 U. CHI. LEGAL F. (forthcoming Oct. 2008) (arguing that search engines' advocacy for transparency and accountability for carriers—via principles such as net neutrality—suggests guidelines for the regulation of search engines themselves).

[8] Jon Kleinberg & Steve Lawrence, *The Structure of the Web*, 294 SCIENCE 1849 (2001), *available at* http://www.sciencemag.org/cgi/reprint/294/5548/1849.pdf ("New or niche sites with few links to them may have difficulty competing with highly prominent sites for attention. By favoring more highly linked sites, search tools may increase this effect."); *see also* Abbe Mowshowitz & Akira Kawaguchi, *Measuring search engine bias*, 41 INFO. PROCESSING & MGMT., 1193 (2005).

software, the algorithm that generates Google's search results is a zealously guarded trade secret.

Despite the risks of gaming, there is a strong social interest in transparency and accountability here. Suspicion about FICO scores has led some states to prohibit their use in some contexts, and Finland has prevented employers from using Google results (*inter alia*) in evaluating potential applicants. Such legislation stems from a well-justified suspicion of unaccountable data sources. Many webmasters live in fear of the "Google Death Penalty"—relegation to the bottom of results for a "gray" search engine optimization tactic. The thin and ever-shifting line between "black hat" and "white hat" search engine optimization raises serious questions about arbitrariness. More ominously, search engines can openly profit from opacity here. If there is no clear route to the top of "organic results" for a given term, the only way to assure one's association with it is to buy "paid results" from search engines' themselves. Just as search engines worry that cable and telecommunications carriers may deliberately impair quality of service in order to force application providers to pay for a "fast lane," content providers may legitimately worry that dominant search engines "churn" organic results in order to make paid ads the only guaranteed method of reaching customers.

There is a growing awareness, in a variety of contexts, of the troubling aspects of a "black box society" in which private firms are empowered to lock away information even in the face of strong public interest in disclosure. Consider, for instance, the current turmoil in financial markets resulting from the opacity of collaterlized debt obligations and other complex financial instruments.[9] In a 2003 case, Google used the same law that shields credit rating agencies from liability in order to avoid accountability for a disputed ranking.[10] In many cases, it is essential that *someone* has the power to "look under the hood" and verify the fairness and reliability of business practices. Search engines insist on some degree of transparency in network operators' traffic management practices. There are many reasons for them to commit to limited forms of transparency as well.

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[9] See, e.g. Stephen Mihm, *The Black Box Economy*, BOSTON GLOBE, Jan. 27, 2008, available at http://www.boston.com/bostonglobe/ideas/articles/2008/01/27/the_black_box_economy/ ("[W]hen the mortgage crisis broke last summer, it opened a window on something else: The existence of a huge wilderness of investments in the financial sector that are nearly impossible to track or measure, and which operate out of the view of both investors and regulators. . . . [A] staggeringly complex financial instrument that most Americans had never heard of, and which many financial writers still don't fully understand, became in a matter of months the most important influence on home values in America.").

[10] Dahlia Lithwick, *Google-opoly: The Game Only Google Can Play*, SLATE, Jan. 29, 2003, available at http://www.slate.com/id/2077875/ ("Google argues that the First Amendment protects its right to assemble rankings as 'evaluative opinion' and that the dissemination of that opinion cannot be tortious. [It cites as precedent a case] involving a school district's suit against a bond rating agency. The school district's claim was thrown out, and Google argues that its own rankings of Web pages are no different than a credit agency's judgment about bond ratings."). *See also* Frank Pasquale, *From First Amendment Absolutism to Financial Meltdown?*, at http://www.concurringopinions.com/archives/2007/08/from_first_amen.html ("We might want to suspect any institution that matches "black box" input and unaccountable output. In other words, raters may well plead that whatever goes on inside their shops cannot be transparent because scrutiny would lead to disclosure of their trade secrets. But if their First Amendment immunities grow more absolute, they could become entirely unaccountable for their outputs.").

Market Discipline Alone Will Not Solve these Problems

Defenders of a laissez-faire approach argue that legal intervention is unnecessary because market discipline already keeps search engine abuse in check and does so much more effectively than would any regulatory regime. If a search engine tries to manipulate its results in ways that are prejudicial to or unacceptable to users, the argument goes, users will simply migrate to a competing search engine. Fearful of losing users and market-share to competitors, search engines would avoid abusing their power. Thus, in the late 1990s and early 2000s, competitors overtook search engines like Overture that systematically prioritized paid listings.

While competition occurred in the past, the current search engine market has features that make robust and dynamic competition unlikely. It is unclear whether search engines fall under the strict definition of a natural monopoly, but they exhibit very similar characteristics. Search engines have very high fixed costs and a relatively low marginal cost. This, in turn, results in substantial economies of scale, creating a market with a declining average cost per unit and high barriers to entry. To understand this structure of the search engine market, consider the following:

1) *The Search Engine Algorithm.* The heart of a search engine and the key to its success is its search algorithm. Effective algorithms are protected by a veil of secrecy and by various intellectual property rights. As a result, new entrants cannot easily appropriate existing algorithms. Moreover, many algorithms are trade secrets. Unlike patents, which the patent holder must disclose and which eventually expire, these trade secrets *may never enter the public domain.* Search algorithms may be analogous to the high-cost infrastructure required for entry into the utility or railroad markets.

2) *Network Effects in Improving Search Responsiveness.* The more searches an engine gets, the better able it is to sharpen and perfect its algorithm. The result is that each additional user decreases the cost of a better quality service for all subsequent users. Thus, incumbents with large numbers of users enjoy substantial advantages over smaller entrants.

3) *Licensing Costs.* A key to competition in the search market is having a comprehensive database of searchable materials. The ability to obtain exclusive legal rights over searchable materials, however, may substantially increase the cost of obtaining and displaying this data and the metadata needed to organize it. Exclusion rights entail licensing (or legal advice) fees, which in the aggregate may raise fixed cost substantially. Google's notable fight to obtain favorable fair use treatment for an index of books, for example, obscures its licensing deals with some content providers. To what extent exclusion power through licensing is the industry norm is the subject of a host of legal battles taking place on various fronts. If such licenses become the industry practice, only the wealthiest players will be able to afford to develop a comprehensive database of searchable material.

4) *Consumer Habit*. Many searchers are accustomed to using a certain number of providers, use them relatively habitually, and are reluctant to switch, despite the existence of alternatives. Exactly how high are search engine switching costs is an empirical question that has not been satisfactorily answered to date. To switch a substantial number of users, a new entrant has to supply a product of significantly better quality, again, steeply raising fixed cost. Another factor that may raise switching costs is the trend toward personalized search, which effectively "trains" a service to tailor its results to match the patterns of a user. Just as users "invest" in learning how to use Microsoft Word or Excel, and are reluctant to switch to a new program, they "invest" in training personalized search engines how to find the materials most suited to their interests. The correlation between the quality of search and the length of use in personalized search is likely to further lock users in with an existing provider.

The net results of these structural features of the general purpose search market are substantial advantages for large incumbents and very high barriers to entry. These results suggest that the market's current composition—one dominant firm and a handful of smaller players—is likely to persist.

The assumption of users' responsiveness leading to optimal disciplining of search engines is equally problematic. Due to several characteristics of the search market, users' response is not likely to be highly attuned to search engines' behavior. Moreover, it is unclear why users' preferences, even if they were free from market failures, should be the ultimate measure for evaluating and responding to many of the normative concerns described above.

One major impediment to users' responsiveness is a systematic information gap. If a user looks for a particular business and no relevant result appears or if a search engine completely corrupts its results by paid listings, users are likely to switch to a competitor. But it is difficult to see how consumers can check less drastic manipulations of results. Search tends to be a "credence good," whose value a consumer will have difficulty evaluating even after consuming it. Often the user will have no idea that results are manipulated in a particular way. Even if we assume that a search engine abides by the FTC's guidance letter, and always strictly separates "editorial content" and paid listings, subtler forms of manipulation could slip into the ranking algorithm. In many, if not most cases, consumers lack both the incentive and the even the ability to detect such manipulation or determine its reasons. Given the lack of transparency of the search algorithms, search consumers simply cannot reverse engineer the hundreds of factors that go into a ranking, and they have little incentive to compare dozens of search results to assess the relative efficacy of different search engines.

For example, imagine that after the Google-YouTube merger, Google assigns a higher "authoritativeness" rating to all YouTube videos than those on any competitor sites (such as MySpace, Vheo, Bolt, and Grouper). Such an assignment might be an entirely "objective" decision; if Google itself happens to have the highest PageRanking, it may accurately assign that rank to its new subsidiary. But consumers unaware of the deal may simply believe that the YouTube videos served at the top of the rankings pile are there merely because of "disinterested" ranking algorithms, and not understand the possibility that some proprietary interest of Google (in advancing its new subsidiary's visibility) is driving the ranking. Admittedly, an entirely objective ranking mechanism may produce this result. The problem is that, given the emphasis on secrecy in the search engine business model, no one can verify that such rankings have not been manipulated or that subtler biases in favor of search engines' partners are not being worked into the

search algorithm.

Often search dynamics do not follow the classic economic model under which consumers with predetermined preferences evaluate the extent to which competing goods satisfy these preferences and behave accordingly. The paradigmatic case following this pattern would involve a "navigational" search where a user is searching for a particular known website, or a narrow "informational" search where a user looks for specific and well-defined information. Yet many searches follow a very different pattern. Users conduct searches with varying degrees of prior expectations, and the sought-after information is defined with differing levels of specificity.

Consider a search for the term "net neutrality." There are some results that would clearly poorly satisfy the preexisting expectations of most searchers for this term. But there are also a large variety of significantly different alternative results that are not irrelevant. Note that in such cases the issue is not just the difficulty of the search engine in "mind reading" the user's exact wishes. Initially, the user's preferences are incomplete and not clearly defined, even from the point of view of the user herself.

The implication of such open-ended searches is twofold. First, initial preferences form only a partial yardstick by which a user can evaluate search results and only a weak constraint on search engine's behavior. Second, in such situations the particular results presented to the user are likely to affect and shape her future views and interests. Search engines, in other words, often function not as mere satisfiers of predetermined preferences, but as shapers of preferences.[11] When one types "net neutrality" into a Google search query screen, the vast majority of "organic" links are connected to pro-net-neutrality organizations.[12] There could be many reasons for this state of affairs. One might think that this is a sign that the vast majority of Internet users favor net neutrality and only a handful of companies oppose it. A more skeptical observer might find her suspicions raised by Google's own strong support for net neutrality. There could be other explanations, such as the fact that sites whose Top Level Domain Name (TLD) ends in ".edu" are often prioritized above sites with ".com" or ".org" TLDs. How is a searcher likely to assess these results in view of his preferences when he searched for an open-ended term such as "net-neutrality?" For many users it is hard to imagine in such a case a clear process of judgment in view of preexisting preferences.

Even users who engage in relatively open-ended searches without concrete preexisting preferences may have preferences about their preferences or about the procedure in which their preferences are being shaped. Yet evaluating the performance of a search engine on the basis of such second-order preferences is likely to prove difficult. In most cases it would require access to information that is not readily available on the surface of the search results. Such information about the way the search results were shaped would rather be buried in the black box of the search algorithm and kept away from public view.

Another reason that makes market forces an unreliable means for disciplining search engines is the incomplete overlap between users' preferences and the social values underlying the concerns about search engine manipulation. This claim can be cast in the economic language of externalities. Certain manipulations of results may have little effect on users or even leave users completely indifferent, yet impose substantial cost on

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[11] C. E. Baker made a similar point about traditional media. *See* C. EDWIN BAKER, MEDIA, MARKETS, AND DEMOCRACY 12–13, 87–95 (2002).

[12] Screenshot of "Net Neutrality" Search (Oct. 23, 2006); see also screenshot from Apr. 15, 2008.

others. C. E. Baker's famous "catalog" of externalities demonstrates the various ways in which this dynamics plays out in the context of traditional media.[13] At least some of those typical media externalities seem likely to occur in the different context of search engines.

The externalities formulation, however, fails to capture the full extent of the misfit between some of the normative concerns described above and an exclusive reliance on consumer preferences for disciplining search engines. Whether or not one can point at a substantial cost not internalized by users, a lack of significant response by users is not necessarily sufficient to allay concerns about fairness and democratic discourse. Think, for example, about an exclusion of a commercial website that enjoys only limited popularity and is easily replaceable from the point of view of most users. The fact that users will be relatively indifferent to such exclusion, simply does not answer the concerns about fairness and the arbitrary exercise of (private) power. Similarly, even if it turns out that users' behavior demonstrates no concern about possible biases in favor of content supplied by the search engine allies, this does not necessarily dispel the concerns about a degrading effect that such behavior may have on the public sphere or public discourse. Satisfying users' preference is an important interest that search engines should be able to pursue, but these preferences can not always be counted on to guarantee other social values.

In sum, market discipline imposed by users is certainly not irrelevant. It is likely to have some effect in curbing the more blatant and radical forms of search engine manipulation. Given the combination of a centralized market structure and the severe limitations on users' responsiveness to manipulation, however, it is bound to be an insufficient constraint.

Toward Qualified Transparency

In *Copyright in an Era of Information Overload*, 1 presented Google as a company that could break the dominance of concentrated cultural industries on distribution networks and reviewing capabilities. However, as Google becomes more of an online conglomerate,[14] it may create problems in new areas similar to the ones it is

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[13] C. Edwin Baker, *Giving The Audience What It Wants*, 58 OHIO ST. L.J. 311, 350–66 (1997).

[14] Google, Inc. now offers the following services (and records the following data from each):

a. Google search: any search term a user enters into Google;
b. Google Desktop: an index of the user's computer files, e-mails, music, photos, and chat and web browser history;
c. Google Talk: instant-message chats between users;
d. Google Maps: address information requested, often including the user's home address for use in obtaining directions;
e. Google Mail (Gmail): a user's e-mail history, with default settings set to retain emails "forever";
f. Google Calendar: a user's schedule as inputted by the user;
g. Google Orkut: social networking tool storing personal information such as name, location, relationship status, etc.;
h. Google Reader: which ATOM/RSS feeds a user reads;
i. Google Video/YouTube: videos watched by user;
j. Google Checkout: credit card/payment information for use on other sites.

helping to solve elsewhere. Consider the complexities caused by Google's purchase of YouTube. Does the fact that a company does business with Google lead Google to make it more salient in search results than a company that (*ceteris paribus*) does not? How well are YouTube's rivals doing in searches on Google for videos? Will Google compensate participants in its Android open handset alliance with more salience in search results? Just as Google wants carriers to be open about how they manage traffic, it should be transparent about exactly how its commercial relationships affect the ranking of its business partners and customers. Without such transparency, regulators will not be able to assess whether the company is engaged in stealth marketing, a deceptive trade practice.[15]

As Ellen Goodman has observed, "American mass media law has long been hostile to stealth marketing. It is illegal . . . for a record company to make secret payments to radio stations to play music . . . or for an advertiser or organization to pay broadcasters to feature products . . . without identifying the sponsor."[16] The Federal Trade Commission has made some tentative steps toward recognizing the potential for consumer deception here. In 2002, it sent a letter to various search engine firms recommending that they clearly and conspicuously distinguish paid placements from other results.[17] The letter was sent in response to a complaint by the organization Commercial Alert[18] that requested FTC investigation of whether paid placements practices of several search engines constituted unlawful deceptive advertising.[19] The deception argument as applied to search engines is a variant of the more general criticism

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EPIC Complaint and Request for Injunction, Request for Investigation and other Relief, *In the Matter of Google, Inc and DoubleClick, Inc*, before the Federal Trade Commission (Feb 10, 2000), available at <http://www.epic.org/privacy/ftc/DCLK_complaint.pdf> (last visited Mar 27, 2008) (urging the FTC to address the increasing collection of personal data by internet advertisers).

[15] Goodman, *Stealth Marketing and Editorial Integrity*, 85 TEXAS L REV at 89, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=896239 ("Stealth marketing [can take the form of] conventional payola, where the sponsor promotes a media experience, such as a musical work, by purchasing audience exposure to the experience as a form of advertisement. Pay-for-play in broadcasting is similar to the use of slotting fees in the retail industries to obtain preferential shelf space in supermarkets and book stores. Online retail outlets also use slotting fees of a sort when portals like Amazon and Google accept payments for exposure of a particular product or service.").

[16] Id. at 84. See the Federal Communications Act of 1934, 47 USC § 317(a)(1) (2000) (requiring broadcast stations to disclose the identity of sponsors when "any type of valuable consideration is directly or indirectly paid or promised, charged or accepted.").

[17] Letter from Heather Hippsley, Acting Associate Director of the Division of Advertising Practices, *Re Commercial Alert Complaint Requesting Investigation of Various Internet Search Engine Companies for Paid Placement and Paid Inclusion Programs* (June 27, 2002), available at <http://www.ftc.gov/os/closings/staff/commercialalertattatch.shtm> (last visited Mar 27, 2008) (urging search engines to clearly delineate paid ranking results).

[18] Letter from Gary Ruskin, Executive Director of Commercial Alert, *Re Deceptive Advertising Complaint Against AltaVista Co, AOL-Time Warner Inc, Direct Hit Technologies, iWon Inc, LookSmart Ltd, Microsoft Corp and Terra Lycos SA* (July 16, 2001), available at <http://www.commercialalert.org/PDFs/SearchEngines.pdf> (last visited Mar 27, 2008).

[19] Federal Trade Commission Act, 15 USC § 45(a)(1) (2008).

of stealth marketing in the media. Users, the argument goes, are misled to believe that "search results are based on relevancy alone," when in fact they are based on other grounds.[20]

Of course, those aware of the YouTube merger may assume that Google is going to elevate results from its subsidiary, and may diversify their search custom accordingly. They can use other search engines, or consult the second or third search pages for the results they seek. However, given searchers' documented inertia and unsophisticated understandings of extant search results, it is unlikely that these "self-help" measures will do much to level the playing field.[21] Though consumer education may be helpful here, given search's status as a credence service, it cannot entirely supplant regulation.[22]

Admittedly, for Google to demonstrate that it did not unfairly privilege subsidiaries or business partners, it may seem to need to give away trade secrets about the way its rankings work. For example, a rival video search site might challenge the fact that YouTube's results always appear as the first thirty results in response to certain video queries for which it has demonstrably more relevant content. Google might respond with the following data:

1. The content on YouTube has more comments and therefore is weighted higher in search results.
2. The content on YouTube is clicked on more by searchers.
3. The content on YouTube has been through a copyright filter and therefore is less likely to infringe copyrights owned by large media conglomerates that partner with Google.
4. The opposite of 3: slowing down or de-prioritizing the content of companies like Viacom that sue the search engine for copyright infringement.

Responses (1) and (2) may both provoke gaming of Google's system. Once rival video sites know that comments or clicks directly increase PageRank and salience, they can try to artificially inflate those numbers. The fourth option could make the assertion of copyrights an inevitably Pyrrhic enterprise, as judicial victories might appear trivial compared to the prospect of losing a vital distribution channel. In either case (3) or (4), private lawmaking by search engines and copyright holders may supplant statutory duties in counterproductive ways.

Note that a public avowal of (3) may lose Google customers who flee to less restrictive sites (just as Napster lost many users to upstart P2P sites when it started installing filters for copyrighted content). The more responses Google has to make public, the more plausibly it may claim that the trade secrets embodied in its ranking algorithm are being eroded. Nevertheless, as Oren Bracha and I have argued in *Federal*

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[20] Letter from Gary Ruskin at 1 (cited in note 18).

[24] Andrew Sinclair, Note, *Regulation of Paid Listings in Internet Search Engines: A Proposal for FTC Action*, available at http://www.bu.edu/law/central/jd/organizations/journals/scitech/volume102/sinclair.pdf, 10 BU J Sci & Tech L 353, 357–364 (2004) (discussing which regulatory body is best suited to regulate search engines, arguing that the FTC is the appropriate arm of government, and concluding that "Consumers . . . are unaware that they are not getting the most relevant search results").

[25] Alejandro M. Diaz, *Through the Google Goggles: Sociopolitical Bias in Search Engine Design* 147 (Stanford Honors Thesis 2005) ("The complexity and opacity of search technology makes it almost impossible for users to notice what is 'missing' from their search results.").

Search Commission: Fairness, Access, and Accountability in the Law of Search, there are methods of litigating such cases without exposing trade secrets.

Stalwarts of deregulation may well complain that such procedures would still risk compromising the secrecy essential for search engines' operation and put an undue burden on their legal departments. However, Google has already complied with a government request for information about its search process and a judge has ruled that a protective order in that dispute adequately protected its trade secrecy interests. Such limitations on secrecy are in order. If search engines are to be accountable at all, if their interest is to be balanced against those of the various other claimants involved in search-related disputes, and if social values are to be given any weight, some governmental agent should be able to peer into the black box of search and determine whether or not illegitimate manipulation has occurred.

Beyond Consumer Preferences

Another key question raised by the proposed deal is whether privacy concerns[23] can be folded into traditional antitrust analysis. Peter Swire convincingly argued that they can and should;[24] he believes that "privacy harms reduce consumer welfare [and] lead to a reduction in the quality of a good or service." I am broadly sympathetic with Swire's aims, but I worry that contemporary antitrust doctrine is too etiolated to encompass his concerns.

First, here is Swire's perspective on how things may change for the worse for consumers after the Google/DoubleClick merger:

> Google often has "deep" information about an individual's actions, such as detailed information about search terms. Currently, DoubleClick sets one or more cookies on an individual's computers, and receives detailed information about which sites the person visits while surfing. DoubleClick has "broad" information about an individual's actions, with its leading ability to pinpoint where a person surfs.
>
> If the merger is approved, then individuals using the market leader in search may face a search product that has both "deep" and "broad" collection of information. For the many millions of individuals with high privacy preferences, this may be a significant reduction in the quality of the search product—search previously was conducted without the combined deep and broad tracking, and now the combination will exist.

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[23] *See* Siva Vaidhyanathan, *Google and DoubleClick: A Bigger Anti-Trust Problem Than I Had Imagined*, THE GOOGLIZATION OF EVERYTHING, http://www.googlizationofeverything.com/2007/10/google_and_doubleclick_a_bigge.php (Oct. 21, 2007 16:05 EST)

[24] *See* Peter Swire, *Protecting Consumers: Privacy Matters In Antitrust Analysis*, CENTER FOR AMERICAN PROGRESS, Oct. 19, 2007, http://www.americanprogress.org/issues/2007/10/privacy.html.

Initial points of contention here include a) the definition of the products at issue and b) how to weigh the costs and benefits of a merger. The combined company would have different segments of "customers" in a multi-sided market:

1) searchers trying to find sites
2) ad-buyers trying to reach searchers

Swire argues that many people care about privacy, and "[i]t would be illogical to count the harms to consumers from higher prices while excluding the harms from privacy invasions—both sorts of harms reduce consumer surplus and consumer welfare in the relevant market." But the web searcher category not only includes people who care about privacy, but also includes many people who don't care. According to Eric Goldman's work on personalized search, some may even consider the gathering of data about them to be a service[25]. The more information is gathered about them, the more targeted ads to them may become. If you're going to "pay" for a service by viewing ads, you may well be paying less if the ads bear some relation to things you might buy.

So while Swire models advertising and data collection as a cost to be endured, Google is likely to reply that "deep and broad tracking" (and the resulting ads) are a service to customers. Swire might respond that individuals hyperbolically discount future privacy protection for small monetary gains in the present, and that public policy should prevent that[26]. But in my view, privacy might better be considered an "irreducibly social good"[27] than some quantum of enjoyment individuals trade off for money. As Cass Sunstein and Robert H. Frank suggested in their work on cost-benefit analysis and relative position,[28] given the importance of positional goods in today's society, people who trade off safety or privacy or other intangibles will likely "outcompete" peers who refuse to do so (and therefore have less money). Though this observation was inspired by health and safety regulations, its upshot applies equally well to privacy:

> When a regulation requires all [individuals to purchase] additional [privacy], each . . . gives up the same amount of other goods, so no [one] experiences a decline in relative living standards. The upshot is that an individual will value an across-the-board increase in [privacy] much more highly than an increase in safety that he alone purchases.

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[25] *Frank Pasquale on Eric Goldman's* A Coasean Analysis of Marketing, THE CONGLOMERATE, http://www.theconglomerate.org/2006/07/frank_pasquale_.html (July 5, 2006).

[26] *See* Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not An Oxymoron*, U. CHI. L. REV. (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract-id=405940.

[27] *See Charles Taylor, Philosophical Arguments (1995) Questions & Answers #7: "Irreducibly Social Goods"*, University Research Alliance, *available at* http://www.uraweb.org/writing/Tay7.html.

[28] *See* Cass R. Sunstein & Robert H. Frank, *Cost-Benefit Analysis And Relative Position*, AEI-Brookings Joint Center Working Paper No. 00-05; U. CHI. L. & ECON., Olin Working Paper No. 102 (July 2000), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=237665.

A collective commitment to privacy may be far more valuable than a private, transactional approach that all but guarantees a "race to the bottom."

Can contemporary antitrust accommodate such concerns? Many now believe that consumer welfare only takes into account allocative efficiency. For example, the DOJ was hard-pressed to adequately factor in a basic democratic commitment to diverse communicative channels during many media mergers.[29] The FTC might find it equally difficult to address the political and cultural implications of search engines now.

But what if we shift from thinking of loss of privacy as a "cost" of web searching, to considering it as a reduction in the quality of the product of web searching? Swire quotes *National Society of Professional Engineers v. U.S.*, to validate this consideration:

> "The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain: quality, service, safety, and durability - and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers" (435 U.S. 679, 695 (1978)). The Merger Guidelines, § 4, specifically mention "improved quality" among the possible effects of efficient market behavior, along with lower prices and new products

Douglas Kysar's work on the product/process distinction supports Swire's case.[30] Kysar has claimed that consumers should have a right to make choices of products based on how the products are made, not just how well they work. Kysar argues "in favor of acknowledging and accommodating consumer process preferences within theoretical frameworks for policy analysis, given the potential significance that such preferences may serve in the future as outlets for public-regarding behavior."

Admittedly, the valuation problems here might be difficult; how exactly are we to determine how much consumers are willing to pay to avoid privacy-eroding companies? But on the other hand, consider the array of incommensurables already entering into the decisionmaking process: the different markets for Google's products, the weighing of the value of potential new services against the potential diminution in quality of old ones, etc. Perhaps, as Heinzerling and Ackerman suggest in their book *Priceless*, we should stop even trying to pretend that these decisions can be made on anything approaching a quantitative basis. Or at least acknowledge that the numbers can be cooked in many different ways to produce a desired end result.

Perhaps consumer concerns like the ones Kysar raises can't fit easily into contemporary antitrust analysis. But that might be one reason to establish a regulatory body that could take a more holistic view of the role of search in the contemporary economy--and to suspect any proposals to move to antitrust as the sole constraint on business conduct in certain fields.

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[29] *See* C. Edwin Baker, *Media Concentration: Giving Up on Democracy*, 54 FLA. L. REV. 843 (Dec. 2002), *available at* http://www.flr.law.ufl.edu/pdf/jan03/baker.pdf.

[30] *See* Douglas Kysar, *Preferences for Processes: the Process/Product Distinction and the Regulation of Consumer Choice*, 118 HARVARD L. REV. (2005), *available at* http://lsr.nellco.org/cgi/viewcontent.cgi?article=1007&context=cornell/lsrp.

Conclusion

Unaccountable power at any "layer" of online life can stifle innovation elsewhere. Microsoft's antitrust woes arose in part because it tried to manipulate complementary products to maintain its dominance in the operating system market. Now dominant search engines rightly worry that carriers will use their own power at the physical layer of Internet infrastructure to "pick winners" among content and application providers. Search engines have been much less quick to recognize the threat to openness and fair play their own practices may pose.

There are many parallels between dominant search engines and dominant carriers: at each layer intermediaries accumulate great power over the structure of online life. Just as search engines fear an unfairly tiered online world, they should be required to provide access to their archives and indices in a nondiscriminatory manner. If search engines want carriers to disclose their traffic management tactics, they should submit to regulation that bans stealth marketing and reliably verifies the absence of the practice. Finally, search engines' concern about the applications and content disadvantaged by carrier fast-tracking should lead them to provide annotation remedies to indexed sites whose marks have been unfairly occluded by the search process. Fair competition on the internet demands common commercial ethics for the dominant players at all layers of online life.[31]

[31] For a very thoughtful look at the ambiguities of the meaning of "competition," *see* Maurice Stucke, *Better Competition Advocacy*, 82 ST. JOHN'S L. REV. (2008) (evaluating conventional wisdom underlying competition agencies' advocacy efforts). Stucke's insights struck me as particularly relevant to the deals the Committee is considering, since joint ventures might simultaneously reduce barriers to entry and increase opportunities for collusion.

Mr. CONYERS. President and CEO of AsktheBuilder.com, Tim Carter, who has a Web site that educates consumers on how to best invest their money into their homes. He was named Hotshot of the Year by the International Society of Online Entrepreneurs in 2004 and the Entrepreneur of the Year by ContentBiz in 2005. Welcome.

TESTIMONY OF TIM CARTER, PRESIDENT AND CEO, ASKTHEBUILDER.COM

Mr. CARTER. Thank you and other Members of the Task Force. I really appreciate the opportunity to address you about this very important topic.

The future of the Internet advertising is brilliant. In fact, some might say it is possibly one of the fastest-growing segments of our national economy. The proposed agreement between Google and Yahoo, as seen from my eyes as a consumer and Internet publisher, is a very good idea. There are many more winners who benefit from this business transaction than those who make claims about being harmed.

People like you and me have problems each day. We seek out solutions to those problems, and with the advent of the Internet it has never been easier or faster to discover precise and accurate solutions to those problems.

In my opinion, one of the reasons for Google's success stems from the fact that they are an excellent matchmaker. They created a streamlined search engine that displays search results as well as contextual advertising that matches the exact search term typed by tens of millions of consumers each day, many of whom are your constituents.

Google is not the sole search engine that does this. The advertising that is part of the search results is purchased by small and large companies alike. To the best of my knowledge, this method of displaying a highly targeted ad is quite possibly the key component to the paradigm shift that is happening right now in the advertising industry.

Never before could companies be in front of so many consumers who needed their product or service at that exact instant in time. The old methods of advertising usually had some type of delay built in.

Billions of dollars are being spent on Internet advertising, and the market is growing. It is growing because it is a win-win situation. Consumers who quickly solved their problems win, the companies selling the solution to the consumer wins, the Internet company that sold the ad wins, and, finally, a Web site that displays a syndicated ad wins.

Yahoo has valuable real estate on their Web site pages that is seen by tens of millions people each day. They can sell or lease that virtual real estate to whomever they please or even fill the space with things they create. I do the exact same thing at AsktheBuilder.com, filling my pages with my columns and my videos, ads sold by others or ads I sell myself.

Yahoo is a public corporation, and it is paramount that they do what is best for their stockholders. If they can lease space on their Web site to some other company and derive revenue for doing virtually nothing, why would you or anyone else stop them? Who is

getting harmed? Surely not the people who are clicking the ads. They willingly click them hoping to discover a solution to the problem they have.

Let's take this one more step down the antitrust pathway. When and where will you stop sliding down the slippery slope?

I had a discussion with a fellow Internet entrepreneur named Dan Gray. He said, Tim, are you next? When you become the most visited home improvement Web site on the Internet, will the government come in and tell you that you can't display Google ads? If that were to happen, it would be the most unAmerican thing I could imagine.

Dan was right. If memory serves me right, antitrust actions were initiated when some company or a small group of companies enriched themselves at the expense of many others who were harmed financially by the actions of the company or companies. That can't be said about the proposed deal between Google and Yahoo. The tens of millions of consumers each day who visit the Yahoo Web site are going to see ads that solve their problems. Many will click those adds. Hundreds of thousands of businesses who sell products and services to these consumers will increase their revenues when those ads are clicked. Those companies end up paying more taxes in our economy growth.

Who is harmed in this transaction? Perhaps some other company or companies that decided to follow a different pathway in the business jungle.

My father-in-law taught me long ago there is no substitute for brains. Furthermore, I discovered that healthy competition is a great thing.

In closing, the proposed deal has the potential to increase the revenues of Yahoo by hundreds of millions of dollars each year. The ad revenue that Yahoo receives from Google will flow into Yahoo with virtually no expenses. If the management of Yahoo is wise, they will reinvest this money back into their company to provide the healthy competition that we as consumers want and need.

The deal may also force other companies in the Internet business world to work a little harder. My experience as a builder is that a little hard work never really hurt anyone.

Thank you again for taking the time to consider my opinion in this very important issue.

[The prepared statement of Mr. Carter follows:]

PREPARED STATEMENT OF TIM CARTER

Testimony of Tim Carter - AsktheBuilder.com
to the
Task Force on Competition Policy and Antitrust Laws of the House Committee on the Judiciary

"Competition on the Internet"

July 15, 2008

I sincerely appreciate the opportunity to submit this testimony to the members of the US House of Representatives. It is my hope that my comments will aid you in making an informed decision about this very important topic.

The future of Internet advertising is brilliant. In fact, some say it might possibly be one of the fastest growing segments of our national economy as we move forward. The proposed agreement between Google and Yahoo, as seen from my eyes as a consumer and an Internet publisher, is actually a very good idea. There are many, many more winners who benefit from this business transaction than those who make claims about being harmed.

Real Estate

In the most basic sense, this transaction is about real estate and eyeballs. Those of us who own and operate websites possess pieces of virtual real estate. In the physical world we live in, location, location and location are the three most important axioms in real estate. In the case of Internet websites, great location can be defined as a website that gets a substantial amount of traffic. A number of Internet-traffic-analysis companies, as of July 12, 2008, show Yahoo.com as being the number one website in the USA with respect to traffic or eyeballs.

The consumers whose eyeballs are viewing Yahoo's website are there for one of two reasons: they either have a problem or they have some time to burn and are looking for a little pleasure. But my personal research has indicated that far more people each day are on the Internet to solve problems.

Advertising Solves Problems

People like you and me have problems each day. We seek out solutions to those problems, and with the advent of the Internet, it has never been easier or faster to discover precise and accurate solutions to those problems.

In my opinion, one of the reasons for Google's success stems from the fact they are an excellent matchmaker. They created a streamlined search engine that displays search results as well as contextual advertising that matches the **exact search term** typed by tens of millions of consumers each day, many of whom are your constituents. Google is not the sole search engine that does this. Many, if not all, of the other search engines such as Yahoo, MSN Search, etc. do the exact same thing.

The advertising that is part of the search results is purchased by small and large companies alike. To the best of my knowledge, this method of displaying a highly targeted ad is quite possibly the key component to the paradigm shift that is happening right now in the advertising industry. Never before could companies be in front of so many consumers who needed their product or service at that ***exact instant*** in time. The old methods of advertising usually had some type of delay built in.

But it gets better. A business like mine can buy these contextual ads with ease and a small budget. I have done it for years to market some of my own products. Using Google's system, and similar ones at other search engines like Yahoo, Microsoft Search and Ask.com, I can set my own ad rates, set my own daily budget, determine exactly who can see my ads, when they see my ads and track in real time the performance of my advertising dollars. No wonder growing numbers of businesses large and small are spending their money on Internet ads. They work, and they work very well.

Several weeks ago I testified in front of a US House of Representatives Subcommittee about online advertising and small businesses. One of my newsletter subscribers summarized how powerful online advertising is.

Ms. Rachael Kahne from Nashville, TN wrote, ".....I work for a small business whose bread and butter comes from online advertising. There's simply no other better, more viral way to get in touch with a targeted audience. Online marketing allows a business to track and target what is working, and what isn't. It's certainly one of the most cost effective solutions out there today."

Billions of dollars are being spent on Internet advertising, and the market is growing. It is growing because it is a win-win-win-win situation. Consumers who quickly solve their problems win. The company selling the solution to the consumer wins. The Internet company that sold the ad wins. And finally, a website that displays a syndicated ad wins.

Syndication of Advertising

I happen to write a syndicated newspaper column called ***Ask the Builder***. Syndication is a highly productive method of distribution. I write my column just once, yet it appears

in nearly 100 newspapers each week. Content is not the only thing one can syndicate. You can syndicate ads as well as many other things.

Google, Yahoo and other different Internet companies discovered years ago that it can be beneficial to many to syndicate advertising. I display syndicated advertising on my AsktheBuilder.com website. These ads magically appear on the pages of my website because I copied and pasted small amounts of HTML or javascript code into the pages of my website. You know it's very easy to add this code if a builder like me can do it. My ads are supplied by Google, Kontera and Taboola. I am currently considering an additional company as well called Chitika. These are not the only companies that syndicate Internet advertising.

The real magic of the syndicated ads is they help me and many other websites to dramatically increase productivity. I don't have to worry about running a huge ad-sales team, creating programming infrastructure to display the ads and expanding my accounts payable and receivables department. That is all done by the company serving the ads. I can focus my talents on what I do best, which is create content. I'm not alone. Hundreds of thousands of websites can and do display syndicated ads from Google,Yahoo or a host of other companies that sell these online ads.

Maximizing Revenues and Returns

Yahoo has valuable real estate on their website pages that is seen by tens of millions of people each day. They can sell or lease that virtual real estate to whomever they please or even fill the space with things they create. I do the **exact same thing** at AsktheBuilder.com. I fill my pages with my written or video content, ads sold by others or ads I sell myself.

Yahoo is a public corporation. They need to do, in my opinion, what is best for their stockholders. If they can lease space on their website to some other company and derive revenue for doing virtually nothing, why would you or anyone stop them? Who is getting harmed? Surely not the people who are clicking the ads! They willingly clicked them hoping to discover a solution to the problem they have.

Let's take this one more step down the anti-trust pathway. When and where will you stop sliding down this slippery slope? I had a discussion with a fellow Internet entrepreneur about this topic. His name is Dan Gray, and he is a writer / Internet publisher like me. He said, "Tim, are you next? When you become the most powerful home-improvement website on the Internet, will the government come in and tell you that you can't display Google ads? If that were to happen, it would be the most un-American thing I could imagine."

Dan is right. Why would you punish a company or multiple companies for being successful when few, if any, are harmed in the process?

Summary and Conclusion

This hearing is being held in front of a Subcommittee that considers anti-trust issues. My recollection of what my grade and high-school history teachers taught me is still fresh in my mind. If memory serves me right, anti-trust actions were initiated when some company or a small group of companies enriched themselves at the expense of many others who were harmed financially by the actions of the company or companies. The subject is no doubt far more complex than that, but I feel my explanation is the lowest common denominator of anti-trust.

That can't be said about the proposed deal between Google and Yahoo. The tens of millions of consumers each day who visit the Yahoo website are going to see ads that solve their problems. Many will click those ads. Hundreds of thousands of businesses who sell the products and services to these consumers will increase their revenues when those ads are clicked. Those companies end up paying more taxes, and our economy grows.

Who is harmed in this transaction? Perhaps some other company or companies that decided to follow a different pathway in the business jungle. My father-in-law taught me long ago that there is no substitute for brains. Furthermore, during my own journey in the business world over the past 34 years, I've discovered that healthy competition is a great thing. I personally love to compete against other home-improvement websites as it helps keep me focused and in the zone.

This proposed deal has the potential to increase the revenues of Yahoo by hundreds of millions of dollars each year. The ad revenue that Yahoo receives from Google will flow into Yahoo with virtually no expenses. If the management of Yahoo is wise, they will reinvest this money back into their company to provide the healthy competition that we as consumers want and need. The deal may also force other companies in the Internet business world to work a little harder. My experience as a builder is that a little hard work never really hurt anyone.

Thank you again for taking the time to consider my opinions in this very important issue.

Tim Carter
Founder - AsktheBuilder.com

Mr. CONYERS. Mr. David Sable is the Vice Chairman and Chief Operating Officer of Wunderman, a direct marketing agency. Does he have the clients: Microsoft, Citibank, Kraft, Hewlett Packard, IBM, Colgate Palmolive, Bausch and Lomb and the United States Postal Service. Welcome.

TESTIMONY OF DAVID SABLE, VICE CHAIRMAN AND CHIEF OPERATING OFFICER, WUNDERMAN

Mr. SABLE. Thank you. Not all current clients.

Chairman Conyers, Ranking Member Chabot, honorable Members of the Task Force and distinguished panel members, my name is David Sable. I am Vice Chairman and CEO of Wunderman, the world's largest marketing services network and a leader and innovator in digital marketing. In that capacity, I work with consumer and business-to-business companies, content providers and, of course, all communications channels globally, including print, television, mail, outdoor and, of course, the Web and other digital carriers, using data to help our clients create valued relationships with their own customers and consumers.

Microsoft, as you heard, is in fact one of my many clients, and Google is a channel that we are deeply involved with, and as such we are Google's client in this capacity.

Thank you for allowing me the opportunity to provide a perspective on this deal and what I consider to be not just the future of Internet advertising but the future of the Internet as a free and open medium.

Let me begin by stating that I am a charter Google user. I search. I use Picasa. I have a gmail account. I also believe that Google rose to success on a simple insight—simple yet brilliant. In a landscape populated by portals and cluttered Web sites, Google gave users a pure and simple way to get where they needed today and to find what they needed to find.

Google created the "entry bar" on a plain white background.

And how that bar has change our lives. Search has become effortless. Anyone can do it. The Google brand was easy to remember. It only did one thing. Soon, people were using Google like a nav bar, and they became the default on-line ramp of more and more people around the world.

But the world changed. Business needs a model. The pure white morphed and advertising based on our activities began to appear, as did further plans for more targeted messaging and more applications designed to capture even more of our behavior.

So far, so good. I was and still am willing to pay the price. Google fulfills my needs, so Google can have the data as, by the way, so can Yahoo and Microsoft for that matter.

The advertising business model here is simple. Either consumer accept the ads in return for free or reduced cost service or content. It is a model we all grew up with, a model we all accept.

From a professional perspective, I have no issue either. While many of my advertising and media colleagues worried they were getting disintermediated by Google and others, we saw the opportunity to pick up the consumer at the off-ramp as soon as they hit the page to which they were directed. Portals and Web sites as linear, click-through experiences were dead. Web users wanted to find

specific pages, focused offers and desired the ability to transact as quickly and as efficiently as possible.

Google helped to enable this desire, and the industry built a practice of helping clients make better use of search. Google was and is good for our business, make no mistake.

So why am I being worried about this proposed deal?

On the most basic of levels, my anti-monopoly hackles have risen as the market share that such a deal would represent will eliminate any notion of free and open enterprise. It is an agreement that could create fixed prices, destroy a currently competitive market, and possibly eradicate any sense of auction-style bidding.

However, I believe it is only part of the issue. I know you that have covered this part of the topic in great depth. Allow me to take a slightly different tack.

Search is all about the algorithm, and that is all about control. If you control the algorithm, you effectively control the information it presents. Think about it. By restricting or pushing potential search results—and you just heard this before—at the most benign level, Google could have even more influence on pricing, bringing up and suppressing topics at will.

At another level, do we really want anyone controlling the answers to everything and anything we ask?

Think about it. With few other search options and the built-in lethargy and inertia that Web users portray when it comes to switching, a monopoly in this arena is ill-advised. I don't believe that any single entity should ever yield that much power, influence or control.

So while my objections begin with the notion of monopoly, it is my fear of what any company could do with that position of unbridled power that makes me oppose the proposed merger. I much prefer to see Google remain the important and competitive player that it is, spurring all of us to an even more competitive environment.

In summary, Mr. Chairman, one, Google is a critical competitive catalyst for this market and should be encouraged to remain so. Two, the true consumer benefit is in the search and the accuracy of the information returned to the user.

In fact, I checked this morning with Forester. I was interested in the percent of duplication between search engines. That number is only about 40 percent, meaning that the majority of users use different search engines for different reasons and are happy with the information that they find. We must allow this to continue.

Third, lowering the cost of acquisition through competition is a consumer benefit as it relates to passed-on costs. Raising the cost of acquisition has direct impact on raised cost to the consumer. The promise of the Web has always been more cost-effective acquisition.

Finally, because the flow and accuracy of information and search is so closely related to monitorization, we must provide the consumer with choice that only competition can provide.

Thank you.

[The prepared statement of Mr. Sable follows:]

PREPARED STATEMENT OF DAVID SABLE

Chairman Conyers, Ranking Member Chabot and honorable members of the Task Force, my name is David Sable and I am Vice Chairman and COO of Wunderman, the world's largest Marketing Services network and a leader and innovator in digital marketing. In that capacity I work with consumer and business-to-business companies, content providers and across all communications channels, globally, helping to develop compelling programs that allow our clients to create valued relationships with their own customers and consumers. Microsoft is in fact, one of my many clients; and Google is a channel that Wunderman is deeply involved with as we are Google's client in this capacity.

Thank you for allowing me the opportunity to provide a perspective on the Google-Yahoo deal and what I consider to be not just the future of Internet Advertising but the future of the Internet as a free and open medium.

Let me begin by stating that I am a Google user. I search. I use Picassa. I have a Gmail account. I also believe that Google rose to success on a simple insight—simple yet brilliant. In a landscape populated by "Portals" and cluttered websites Google gave users a pure and simple way to get to where they needed to go and to find what they wanted to find—Google created the "entry bar" on a plain white background.

And how that bar changed our lives! Search became effortless. Anyone could do it. And the Google Brand was easy to remember—it only did one thing. Soon people were using Google like a Nav Bar and they became the default on-line ramp of more and more of us around the world.

But all too soon, the world began to change. Turns out Google was watching us and analyzing our behavior and web journeys' from Day One. The pure white morphed and advertising based on our activities began to appear as did further plans for more and ever more targeted messaging and ever more applications designed to capture even more of our behavior.

So far so good—I was willing to pay the price—Google fulfilled my needs, so Google could have the data. And frankly, Google said it was all "blind" and anonymous anyway—and I believed them.

From a professional perspective I had no issue either. While many of our Advertising and Media colleagues worried that they were getting disintermediated by Google, Wunderman saw the opportunity to pick up the consumer/user at the "off-ramp" as soon as they hit the page to which they were directed. Portals and websites as linear click-through experiences were dead. Web users wanted to find specific pages focused offers and desired the ability to transact as quickly and as efficiently as possible, Google helped to enable this desire and, Wunderman built a practice helping clients make better use of search. Google was good for our business.

So why am I worried about the proposed deal between Google and Yahoo?

On the most basic of levels my American, anti-monopoly hackles have risen as the market share that such a deal would represent will eliminate any notion of free and open enterprise. It is an agreement that would create fixed prices, destroy a, currently, competitive market and it would virtually eradicate any sense of auction style bidding.

However, I believe, that is only a part of the issue and I know that you have covered this part of the topic in great depth. Allow me to take a slightly different tack.

Search is all about the algorithm, and the algorithm is all about control. And, if you control the algorithm you effectively control the information it presents. Think about it—by restricting or pushing potential search results—at the most benign level—Google will have even more influence on pricing—bringing up or suppressing topics at will. At the more Machiavellian level, do we really want Google controlling the answers to everything and anything we ask? Think about it. With few other search options and the built in lethargy and inertia that web users portray when it comes to switching a monopoly in this arena, is ill advised.

I don't believe that any single entity should ever wield that much power, influence or control.

So while my objections begin with the notion of monopoly—it is my fear of what Google or any company could do with that position of un-bridled power that makes me oppose the proposed partnership/merger.

I much prefer to see Google remain the important and competitive player that is—spurring all of us to an even more competitive environment.

Mr. CONYERS. I ask you all only one question, remembering that this is not a merger but an agreement, which has more potential?

I will start with you, Mr. Sable. Which agreement has more potential for anti-competitive effects, the Yahoo-Google agreement or the Yahoo-Microsoft agreement?

Mr. SABLE. Clearly, the Yahoo-Google agreement, as the size of the market share of that particular agreement would be 90 percent plus.

Mr. CONYERS. Mr. Callahan.

Mr. CALLAHAN. I would disagree with, first and foremost, the comment from Mr. Sable that this is like a merger or is a merger. First and foremost, it is not a merger. We will continue to compete.

I think while Yahoo's corporate future has been an open story for several months now, starting with an unsolicited bid from the Microsoft Corporation to a combined Microsoft-Icon proposal over the weekend for our search business and restructuring proposal, Yahoo remains focused on this deal for this hearing today, and we are very much convinced that this is a good thing.

It is good for advertisers, as you heard Mr. Carter say. We believe it is very good for users, who we will be able to provide a more relevant experience, and it's obviously good for Yahoo as we continue to invest in our competitive differentiation going forward.

Mr. CONYERS. Mr. Carter.

Mr. CARTER. Congressman Conyers, the one that scares me the most—actually, I would say it terrifies me—would be a combination of Yahoo and Microsoft. Because Microsoft would effectively either swallow or completely kill off Yahoo's search engine, in my opinion. Then we would only be left with two.

Right now, in my opinion, we need 10 search engines. I can't wait for the next company that comes along and challenges all three of the companies that are here today. I mean, I love all three of them. I personally spend my advertising dollars with all three companies. I would like to spend my ad dollars with 5 or 10 companies.

Mr. CONYERS. Mr. Smith.

Mr. SMITH. Yes, Mr. Chairman.

Certainly, for us, an agreement between Yahoo and Google is going to bring together 90 percent of the market for search advertising. It is going to reduce choices for advertisers. It is going to increase prices. I think that is quite clear.

If you want to talk about what Yahoo and Microsoft might do together, probably the most important word is "might", because we haven't figured out a way to do anything together. But if I look at the proposal that we made most recently, that is a proposal that would bring us together on search and search advertising. It would make Yahoo more efficient, more profitable. It would give us greater scale to do that work together. We would continue to compete with each other in a variety of other ways.

Mr. Drummond usually points out that if Yahoo and Microsoft did a complete combination, he would have concerns about lack of competition in instant messaging, e-mail and display advertising. While, under the proposal that we made, Yahoo and Microsoft would continue to compete in all of those areas. But we would finally have a real counterbalance to Google in the market for search and search advertising.

Mr. CONYERS. Mr. Drummond.

Mr. DRUMMOND. Thank you.

Let me preface—and I will answer the question directly, but let me say we keep hearing this 90 percent number being thrown out as the so-called market share that Google will control if this deal happens. It is just wrong.

The relevant market here is not search advertising. The relevant market—as all three of our companies have told government in various proceedings, the relevant market is on-line advertising, at a minimum. That includes display advertising, which is seen by all three of our companies as a huge area for us to get into, ultimately likely bigger than search and an area converging very much with search.

So if you really look at that market, which is really the relevant one, our share is probably in the 20's. We don't have much in the way of a display advertising business. To my right are the two leaders in that area.

So I think it is very clear. This deal doesn't increase our share in that overall market. Yahoo is staying in the market. They are going to be a competitor going forward.

So if you ask me which deal would restrain competition, I will tell you that our deal is pro-competitive. There will still be three large, aggressive competitors competing across the board in Internet services. If Microsoft is successful at swallowing up Yahoo, you won't have—one will be gone. That is clear.

Mr. CONYERS. Professor Pasquale.

Mr. PASQUALE. Thank you, Chairman.

My view is that perhaps this could be seen as pro-competitive. The Google-Yahoo deal could be see as pro-competitive if Yahoo is seen as a failing firm, although I don't really see the real data for that.

I am wondering, in terms of how we get more search engines, I think the real incentive for alternative search engines to develop is most likely the promise of getting bought out, getting bought by one of the three major players. Anything that consolidates those down from three to two or more joint ventures between them I think the Committee should look on with some sort of suspicion.

I finally would like to note, although technically there is a non-exclusive provision of this particular deal between Google and Yahoo that is proposed, it is really unlikely any other buyer could afford to pay as much as Google. I don't really see how that exactly is envisioned that there is going to be this type of cooperation with others than Google because I think Google has this enormous stable of existing advertisers that would maximize the amount they could pay to Yahoo for that space.

Mr. CONYERS. Thank you very much.

Ranking Member Chabot.

Mr. CHABOT. Thank you, Mr. Chairman.

Let me start with you, Mr. Carter, since you're from the First District of Ohio. Did you go to LaSalle High School?

Mr. CARTER. Roger Bacon. We kicked your butts in football many times.

Mr. CHABOT. Thanks for mentioning that. I have no further questions, Mr. Chairman.

No, let me start with you. Do you work in your business with Google and Yahoo and Microsoft, principally Google, or what?

Mr. CARTER. I work with all three of those companies. I buy ads on all of their services through what I call a super affiliate who works for me that sells a lot of our products. I display Google ads on AsktheBuilder.com through their ad program. I had been approached several years ago by Yahoo when they started a similar program called Yahoo Publisher Network. I also have ads on AsktheBuilder right now from Conterra, Tabula. So there are many other companies out there that also sell Internet advertising. I don't have an exclusive arrangement on AsktheBuilder. I am constantly testing because everybody has a different angle and has a different advertising base.

Mr. CHABOT. Thank you.

You mentioned that you thought that you would like to see another company or entity come into existence at some point that would compete with all the companies that are here this afternoon. Do you think that that is more likely or less likely to happen if this deal went through?

Mr. CARTER. That is a great question, Congressman Chabot. I think if I was either Microsoft, Yahoo or Google, I think I could sleep at night.

But let's go back in time. I have heard the story of how Sergey and Larry started that company. It is unbelievable. There are young men and women in this country right now, this great Nation of ours, that they are going to take down those three companies. I am telling you it is going to happen. So if I was them, even with all the billions of dollars they have, they will not ever be able to stop that.

So I encourage it, because I think that is going to make America a better place to live. So that is why I am excited about it. I just think, from a business perspective, that will help keep those three companies on their toes, which is exactly where we need them. We don't ever want them to rest on their laurels.

So I think this proposed deal is fantastic because it is going to give Yahoo this incredible amount of revenue that currently they are not getting; and if they play their cards right, they will be able to reinvest that and might even become the Google killer. We may go back in history and go, what did we do that for? It's the craziest thing we could have ever done.

Mr. CHABOT. Mr. Smith, let me go to you on behalf of Microsoft. How would you respond to the 90 percent question and more or less likely that this entity will come into existence in the future that is going to, in Mr. Carter's words, kill all three of you?

Mr. SMITH. Let's start with the basics. Google has 70, Yahoo has 20. That equals 90. No doubt about that. I don't think that is possible to dispute.

Now it just turns on how does this agreement between the two of them—how does this agreement work? How does this open, secret agreement work that none of us are really able to see? I think that is a problem in and of itself.

The way it appears to work is that Yahoo can take ads that it is selling at a lower price and send them to Google and have Google sell those ads when Google can sell them at a higher price.

For all the talk about quality and the like, if you look at what Yahoo has filed with the Securities and Exchange Commission, what they have displayed is we are going to see, at least in that case, the exact same ads from the exact same advertisers on the exact same place on the exact same Yahoo search page. It is just that Google is doing the reselling at a higher price; and, therefore, Yahoo is making more money.

Now, on the one hand, you can say, maybe Yahoo will use some of that money and invest in something that will compete with Google. But the reality is every time Google's prices go up, Yahoo benefits.

That is not the way competition is supposed to work. If we want to merge, if we want to have a joint venture that gets reviewed, there are efficiencies that come out of that. But when you are competing, you are supposed to keep on competing, not collaborate in this kind of way, especially around something like pricing.

Mr. CHABOT. My time has almost expired. Let me ask one quick question.

Mr. Callahan or Mr. Drummond, why was the deal limited to U.S. and Canada?

Mr. CALLAHAN. I can comment. The parties had agreed at this time for U.S. and Canada. I think, without speaking for Mr. Drummond, if there was a future opportunity to work together, that is something that might be considered. But that is where the negotiations ended.

As to Mr. Smith's characterization, this 90 percent number—and I think Mr. Drummond spoke to this as well—would be the case if Yahoo was somehow merging with Google, exiting the search business, shutting down our business, none of which is the case. Quite to the contrary. We continue to innovate, not just in sponsored search. I can have a prop here from the Wall Street Journal this past Thursday: Yahoo wields new tool to battle Google. This is about our open search platform that we opened.

We continue to very aggressively compete and not just in search. Mr. Drummond mentioned one small slice of what all our companies do right now. Google has done quite a good job, obviously, in Web search. Yahoo leads in displaying. Yahoo leads in mobile. These are areas that we continue to believe there is a compelling market opportunity for us to continue to invest, and the proceeds from this agreement would be part of that effort, sir.

Mr. CHABOT. I think Mr. Drummond would like to make a quick point.

Mr. DRUMMOND. Mr. Smith repeatedly keeps saying the point of this agreement is for Yahoo to have Google ads at higher prices. It's just not right. It's not just true. I think he knows that if someone says they are improving search monitorization, they are not talking about higher prices. The prices are being set in a dynamic auction where the advertisers are driving it, the advertisers are setting the prices.

If you design an auction that works very well and you work hard on it, what happens is you get more revenue per query. In other words, it is more productive. You are getting more revenue because you are creating more clicks, more between users and advertisers than you would have if you didn't have as good a system.

There may be cases in that kind of setting where the prices might be higher, but, ultimately, what you are looking for is the ultimate advertiser return. That is what drives all of this. What we are talking about with Yahoo is incremental revenues, because Google is going to be able to deliver them more targeted ads. This is not about a price increase.

Mr. CHABOT. Thank you, Mr. Chairman. I yield back.

Mr. CONYERS. Chairwoman Zoe Lofgren.

Ms. LOFGREN. Thank you, Mr. Chairman.

I am thinking about the ad market generally, and in the analysis we got from the staff in our memo they note that if you take a look at on-line advertising as a whole, there are three big players. Yahoo has 18 percent. Microsoft has 6 percent. Google has 25 percent. But if you add that up, that is 51 percent for somebody else, not the three big guys.

We have talked a little bit about competition, actually, the point of this, but the insurgents that are coming at you three, the 51 percent, I don't know who they are. I assume Digg is going to monotize some of the social networking like Facebook and MySpace. Who are the insurgents coming at you and how does that lead to assurance of competition? Any of the three of you.

Mr. DRUMMOND. If I might add, Congresswoman Lofgren, there are lots of them. In fact, we are actually probably most afraid of the ones we don't know about.

A quick history, quick history. I think I met Larry and Sergey 10 years ago, and we ended up setting up the company in September 10 years ago. We were very small. There were many bigger search companies than we were.

Our ad system that everybody is talking about as being alleged to be dominant and will be around forever is 4 years old. It is 4 years old. We have only had it for 4 years.

At the time that we created it, Overture, which was subsequently acquired by Yahoo, was an incumbent player. We did it better, and we were very small. Our first major deal was with AOL back in 2002.

Ms. LOFGREN. You were the big guy.

Mr. DRUMMOND. But, I kid you not, we were afraid that our company would go bankrupt because of that deal—that is just 4 years ago—because of the guarantees we had to make, which turns out we were able to perform, because we did a good job, and we have continued to try to do a good job.

So as we look out at the landscape, the capital formation in Silicon Valley continues. There are new companies getting started all the time. Seems like hardly a day goes by when you don't read about—whether it's Facebook or some other social networking site being the new place, the new gateway to the Internet.

I have every confidence that there are going to be more and more of these startups coming in that have great ideas and can execute them. And the great thing about the Internet is you don't need millions and millions of ideas all the time. You need a good idea. If we don't respond to that, I think we will wind up in the situation that Mr. Carter describes. We have got to innovate, too.

Ms. LOFGREN. Mr. Smith, you were looking eager to say something.

Mr. SMITH. Just two reactions to these comments.

First, the Federal Trade Commission looked at the specific question last year of how the market should be defined. It looked at it in the context of the DoubleClick merger. What they said specifically, and I will quote, was that the evidence in this case shows that the advertising space sold by search engines is not a substitute for space sold directly or indirectly by publishers or vice versa.

So they said quite clearly the relevant market in this context is the market for search ads, not all on-line ads.

Ms. LOFGREN. If I may—because I have got some other questions—I am not going to mention the name of this company because they haven't done their IPO yet, but there are some insurgents in the Valley that are going to take us to new places in contextual ads. It is very interesting.

Which leads me to a question about the possibility of the Microsoft-Yahoo deal, for lack of a better word. I am going to ask this because I have three companies that all—that have a presence in Silicon Valley: Microsoft in Mountainview, Google, Yahoo. My constituents work in your companies. So I am asking this in a very parochial way for my constituents.

I will be honest. To see Icahn's involvement is a little nerve-wracking. He was called the vulture capitalist when he took over some other companies. His reputation—and I don't personally know him—is that he goes in, he does mass layoffs, cuts costs. It is chilling. He said himself that he doesn't know anything about technology.

So I think there is some heartburn among the engineers and employees. I am not talking the management, just my constituents, about what is their fate going to be. Is Microsoft working with Mr. Ichan? Can you put a lid on that on behalf of my constituents here?

Mr. SMITH. Let me say two things. First, Mr. Ichan got involved in these issues with Yahoo in early May. Not any connection with Microsoft. He did it entirely on his own. He is now one of the largest shareholders of Yahoo.

I can certainly allay what I believe is your principal concern. We get the fact that technology companies are fundamentally all about the people who work there. It is all about the engineers. That is why, when we made our initial offer to Yahoo on January 31, we offered a 62 percent premium.

Ms. LOFGREN. I don't want to get into that. You have answered the question. You are not working with Mr. Ichan. That is, I am sure, going to be good news to my constituents, and we are anxious about this.

Let me just ask one more question, because I am running out of time.

There are many ways to grab the attention of people. For example, I have a Yahoo e-mail address, a private e-mail, because I don't like the gmail address function. I have complained about it often, Mr. Drummond, but there has been no improvement.

If you take a look at the free e-mail market—and it is a market because it drives traffic—Microsoft, at least the last time I looked, which was last October, had 38 percent, Yahoo had 38 percent. Combined, that is 76 percent.

So if you take a look at that, with what we know is coming on contextual ads, what concern does that give us in terms of the same thing you say you are concerned about with the contract between Yahoo and Google?

Mr. SMITH. I think, first and foremost, if one considers the proposal we made to Yahoo last week, it would have had no impact on e-mail whatsoever. They would have continued to compete with Microsoft in e-mail. We would have simply come together in one area, one area only, and that is search or search and search advertising.

Ms. LOFGREN. My time is up, Mr. Chairman. I appreciate the recognition.

Mr. CONYERS. Mr. Ric Keller of Florida.

Mr. KELLER. Thank you, Mr. Chairman.

Let me start with our professor. Is it Pasquale?

Mr. PASQUALE. Yes.

Mr. KELLER. Thank you.

Professor Pasquale, part of your testimony is concerned with the so-called black box of the search algorithms. Why do you think Google, Yahoo or Microsoft or any company, for that matter, should be forced to disclose their trade secrets?

Mr. PASQUALE. Thank you, Representative.

I don't believe that they should be forced to disclose them, generally. I mean, that would fly in the face of the fifth amendment on trade secret protection. But I do think there are some occasions for qualified transparency there so someone else can look under the hood, say, in the course of litigation or something like that.

I think you can think of a situation—and there has been a little bit of litigation out there—where someone feels they have been treated unfairly by a search engine. As they become more and more dominant modes of the gatekeepers for on-line life, I think it is important that there be some entity that has a chance to look under the hood, be it in camera or like the FISA court or things like that.

Mr. KELLER. Who would be in the best position to look under the hood of the Google search algorithm, as you suggest?

Mr. PASQUALE. I believe it has been proposed on I believe Michael Zimmer's blog or some other search theorist's that within the Federal Trade Commission there be a committee of engineers, attorneys, and policy experts who would be able to look at this. I think these might help the companies in some ways. Because, right now, you have hundreds of lawsuits over things like trademark, other sorts of things that come up.

You can think about either have this distributed among courts around the country or have it done in a centralized administrative body where the chance of them being inadvertently disclosed is much less likely.

Mr. KELLER. Not talking about a Federal magistrate? You are talking about a private entity?

Mr. PASQUALE. I think there are some opportunities for cooperation there.

One thing I would like to commend Google for doing is they have a fantastic program for identifying sites that have malware or viruses or spyware that they collaborate with the Harvard Berkman

Center on. I think that type of collaboration would serve them well in situations like this.

Mr. KELLER. Much of your testimony today is how this deal will impact on-line advertising. Obviously, as the Antitrust Task Force, our key issue is how things are going to affect or impact consumers. Do you have an opinion as you sit here today about how this deal will impact consumers?

Mr. PASQUALE. I think that my ultimate conclusions here are—and my fundamental point would be we should be wary about simple, subtle stories about Internet innovation in this space. I think that, yes, there was a situation where Google usurped the position of other dominant players. If you look at the way in which it has, say, licensing deals for content with other people, if you look at the cost of indexing the entire Internet, it is not as if someone could just invent this in the garage and challenge Google.

I think they are rapidly approaching the type of tipping point toward dominance that we saw in the Western Union in 1857, that we saw in the Bells in the early 20th century. I think, as we see, that we are going to have to think outside the box of antitrust to much more extensive interventions.

Mr. KELLER. Mr. Drummond, if I could go back to you. What impact, if any, do you think this deal will have on consumers, both pro and con, if any?

Mr. DRUMMOND. If you don't mind a quick response to the point about transparency. I was a little puzzled by the notion if someone wants to sue Google because of they are wronged about our algorithm or anything else, they wouldn't be able to get all the information they need. In fact, we have been sued many, many times by various people on various claims. We have won these suits, by and large. But in all those cases we have had the discovery process. If it is a trade secret, you have a protective order and limit the number of people.

Mr. KELLER. For all their flaws, they haven't had a hard time finding deep pockets.

Mr. DRUMMOND. We have been there. I want to make that quick point that, as I said in my testimony, this deal will be good for consumers.

Mr. KELLER. Explain it to me as if I am in elementary school, as opposed to a general counsel like you. What are the basics of why this deal is good for consumers?

Mr. DRUMMOND. It is good for consumers because ads are a form of information. We didn't see ads as something fundamentally different from results. We figure that if you do a good job, you can make them meaningful, you can make them about the information that the user is seeking. They should be as valuable as the search results.

A lot of folks who search—and you search for a digital camera. You might not want to know how a digital camera works. Maybe you want to buy one. So that is really important information.

So with this deal what this is going to allow is Yahoo to choose to use Google ads in those cases, is the Google ads generate more value, that is to say, they are more targeted, they create more information. So that is more information available to consumers after the fact than there was before. That is a good thing.

We also think, as I said before, this is going to create more value for advertisers and a bigger pie and lead to more sales and more conversions for them. Ultimately, that is good for the markets and for consumers as well.

Mr. KELLER. Mr. Chairman, my time has expired. I yield back.

Mr. CONYERS. Thank you very much.

Lamar Smith, Ranking Member of the Committee.

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman.

I would actually like to follow up on both some recent questions and some recent answers as well.

Mr. Smith, you rightly pointed out that when Google merged with DoubleClick, the FTC said that the search advertising did in fact consist of a separate market. And so I tend to agree with you that if this arrangement is consummated that we are talking about 90 percent of the market. At least I will take the FTC's word for it, and that seems logical to me right now.

That being the question, my follow-up question to some of your answers is I still don't necessarily appreciate where the competition is that is going to keep the price of ads down for the advertisers, for the consumers. You have been asked about that a couple of times.

Mr. Drummond, you pointed to, theoretically, the new companies coming, being founded, started, and providing future competition. But I think I am more concerned about the present. Where is the competition now that is going to keep prices low?

While I want to give you a chance to respond, Mr. Callahan has not yet responded to that question. I would like to ask him to respond first, and that is, where is the competition in a situation where Google, at the option of Yahoo, controls 90 percent of the market? Where is the competition that is going to be good for the advertisers?

Mr. CALLAHAN. Where we see the benefit for advertisers is, currently, if a user was to enter a certain search term into the Yahoo engine, there may be a case where we don't return a result because there is no result. There has been no advertiser that has bid against that search query. In that example, we would then turn to the Google system and an advertiser who had bid. There would be a click. The advertiser may pay but also generate a customer lead.

Similar to that, what we would be looking to do at Yahoo is, in order to augment the overall relevance of our page—and this goes back to the question just asked about consumers' impact—is to the extent, as Mr. Carter mentioned, people that are either looking for a commercial question or looking for information in general, Yahoo would be able to use the Google system to serve a higher quality ad and perhaps generate a click-through. Whether or not—how the pricing gets affected depends on the auction on the Google side. But that is how we would see it on the Yahoo side.

Mr. SMITH OF TEXAS. I can understand why Google benefits from this deal. I am not sure where I see that Yahoo benefits so much.

As I understand it, there is a part of the agreement that allows Google to terminate the agreement if they are not making I think it was $83 million in 4 months. That comes out to about a quarter of a billion dollars a year. How much does Yahoo expect to make?

If they are increasing their revenues, why isn't that going to decrease yours or allow them to dominate the market?

Mr. CALLAHAN. It is correct. The way you described the termination is right. That is set at a level that we believe would mean—and Mr. Drummond will be able to comment better—that would mean we would be using their system at a very, very low level. That is a small amount of ads.

What we expect is about $250 million to $400 million in operating cash flow over the first year, assuming implementation which, as you know, is still under regulatory review. What we see as the benefit for consumers going forward is that, to the extent we are able to take money—and we plan to do this—from this arrangement with Google, invest it in some of the innovations like what I mentioned from last Thursday, invest it in our mobile platform. We are very much speaking today about PC-based search, but we see mobile distribution in other areas as a big developer for the future.

Mr. SMITH OF TEXAS. Let me ask Mr. Smith to respond to that, if I may.

Mr. SMITH. I think the fundamental problem is pretty well captured by your questions. If there is an advertiser today who wants to advertise on Yahoo, it can do so. In the future, it may lose that ability because Yahoo will have decided to serve those ads from Google instead.

It is certainly I think patently clear that, in general, the prices on Google are higher. I am not complaining. That reflects a number of things. But prices for advertisers are higher. In many cases, it is going to be companies that are buying an advertisement on Yahoo today, they are going to have to pay more to get back to where they started just to get back to the same advertisement on the same page. That is what I think Yahoo's filing with the SEC makes clear.

I also think there are a heck of a lot of things about this agreement we don't know and no one is telling us about. If you look at the form 8K that Yahoo filed with the SEC, one of the things it noted was that, while Google is going to pay Yahoo a percentage of the revenue for selling these ads, that percentage adjusts based on specified monthly gross revenue thresholds. That is not explained.

A lot of times what that means is that the more money that is sent, the higher percentage Yahoo may get. There are a lot of incentives here, or there may be a lot of incentives here for Yahoo to send even more business to Google. There doesn't appear to be any ceiling. There doesn't appear to be any limit. Yet it appears to be the case every time Google raises its prices Yahoo makes more money as well.

Mr. SMITH OF TEXAS. Mr. Drummond, do you want to respond quickly? Then I will ask Mr. Carter his opinion about the competition.

Mr. DRUMMOND. Sure. Once again, the reason Google has been successful and generates more revenues per search generally than our competitors is because we have a better ad-targeting technology. The ads are more relevant. More people click on them. More ads get served. As a result, there is more revenue generated.

This is not about price increases. I think it is an awfully broad statement to say that prices generally are higher on Google. They may or may not be. I think you would have to look at the millions of auctions to do such a study.

I mean, you asked the question where is the competition. The competition inherently is in the auction. That is the beauty of this system, that the advertisers are the ones setting the prices every day on every query. You have our system after this deal. You will still have the Yahoo system, the Microsoft system.

Mr. SMITH OF TEXAS. I am not sure I know where an advertiser goes, other than, say, Google if Google has 90 percent of the market. Why would anybody go anywhere else? And that allows you to increase the prices.

Mr. Carter or Professor Pasquale, very briefly.

Mr. CARTER. I understand about the timing. I can tell you that the competition out there—you may or may not believe what I am going to tell you. As crazy as this sounds——

Mr. SMITH. You need to tell me in 15 seconds.

Mr. CARTER. To a large degree, everyone out here in the auction and those of us that create Web sites, we are the ones controlling where people are going. It is not the people sitting at this table.

Now if somebody wants to ask a question, I will tell you how——

Mr. SMITH OF TEXAS. Let me get Professor Pasquale's response.

Mr. PASQUALE. Thank you.

I would just say very quickly about why is there greater revenue. There are two possibilities.

One, as David Drummond said, there may be better ad-targeting technology. However, it may be may be they have more people to match. Because we can't know all about the deals of the ad-targeting technology because of the secrecy, the opacity. We don't know what percentage that is. I think it is the latter case. If it is simply they have more people to match, then that is a self-reinforcing dynamic that is only going to lead to increase their monopolistic position.

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman.

Mr. CONYERS. Mr. Goodlatte of Virginia.

Mr. GOODLATTE. Thank you for holding this hearing. It is very interesting.

Mr. Drummond, much has been made in the media of Microsoft's bid to acquire Yahoo and Google's efforts to keep Yahoo an independent company through that deal. What does Google gain from keeping another competitor in the market? What are you getting out of the deal?

Mr. DRUMMOND. First of all, revenue. We have a program of syndicating our ads to others on the Web that we have had from the beginning of our ad program that is profitable for us. So we like to do it. It is open to anyone. You can sign up for it on line if you are a Web site. We felt that, in addition to providing us revenue, it also helps to create more good content on the Web that we can search.

So we have always felt that that was a good model to have, and we think we sent something like $4.5 billion to Web sites last year in our program. We think that is a very good thing; and it is good

for search, which is our core business. It is a competitor. There are other competitors of ours that use various of our services.

Mr. GOODLATTE. Let me ask you about that. So if you have Google doing business on your site, participating in your auctions, if you will, and that means that the two companies that have 90 percent of the market, if Microsoft said they wanted to participate with you as well, would Microsoft be welcome to have the same kind of deal?

Mr. DRUMMOND. I agree. We are open to a conversation.

Mr. GOODLATTE. That does not raise any antitrust concerns?

Mr. DRUMMOND. Again, I think the issue would be we are creating incremental value in the market. The deal we have with Yahoo is not ceding their business to us.

Mr. GOODLATTE. You are becoming the premier auction house. Yahoo may be running a satellite auction, which will run if somebody goes there and they can't place an advertiser. But they are going to turn it over to you if they can't, and you are going to do that. You also have Microsoft. Don't you become the reason why anybody wouldn't advertise with anything else if all of the three major search companies on the Internet turn to you as the auction house of last resort?

Mr. DRUMMOND. I don't really think that is true. Again, the online advertising market is very big. There are huge opportunities of new ad formats that are not search, that may touch on search but are very different, use different targeting techniques, and we are all interested in going after that. It is a big market. These companies want it, and they are not going to cede it to us.

Mr. GOODLATTE. Mr. Callahan, you were asked why the deal was limited to the U.S. and Canada, and you confirmed it was indeed limited to U.S. And Canada, but you didn't tell us why. Was there any concern that in Europe or someplace else that the anti-trust laws might have a different impact on this arrangement than here in the U.S.?

Mr. CALLAHAN. It was a product of the negotiations between the parties. If there were obviously conversations about pushing this transaction to have coverage outside the United States or Canada, obviously, we would be ready to engage with the proper authorities. But it was a product of negotiations of the parties.

Mr. GOODLATTE. I understand that. But it doesn't tell you why it was the product of the negotiations of the party. Why did you limit it to Canada and the United States?

Mr. CALLAHAN. As we worked through the deal, that is where we saw an opportunity for us to get the most value from this and still be able to reinvest into our business going forward. I think on the Yahoo side we would be open to a conversation about expanding this in the future.

Mr. GOODLATTE. Have any State Attorneys General contacted you about reviewing the deal?

Mr. CALLAHAN. There has been interest expressed from certain States and similar to our work with the Department of Justice.

Mr. GOODLATTE. Have you provided them with the unredacted agreement?

Mr. CALLAHAN. I am not aware of that, sir.

Mr. GOODLATTE. The answer, is no, you have not.

Mr. CALLAHAN. As to the States?

Mr. GOODLATTE. Yes.

Mr. CALLAHAN. I am not aware if we have.

Mr. GOODLATTE. How will they review the deal if they don't have a copy of the deal?

Mr. CALLAHAN. As I understand it, they will discuss with the Department of Justice, I believe is how the arrangements are set up.

Mr. GOODLATTE. Mr. Smith, let me ask you, how would a deal between Microsoft and Yahoo be different for on-line advertisers than a deal between Google and Yahoo? If there are only three search advertising participants in the marketplace, doesn't any deal restrict competition?

Mr. SMITH. I think there are two important distinctions. First, an agreement between Microsoft and Yahoo would bring together about 20 to 30 percent of the market, not 90. Second, it would, in fact, create a stronger counterbalance to Google in the marketplace for search and search advertising.

I do think, with all due respect to Mr. Drummond, that the market will benefit if there is a significant competitor to keep Google honest, and that is what we were striving to create.

Mr. GOODLATTE. Thank you.

Thank you, Mr. Chairman.

Mr. CONYERS. Thank you.

I turn now to Chris Cannon of Utah.

Mr. CANNON. Thank you, Mr. Chairman. I apologize to our panel members. I am the Ranking Member on a Committee doing a markup earlier in this session so I missed some of it.

I take it from Mr. Goodlatte's question the issue of an unredacted contract has come up. Is it possible for this Committee to have access that agreement?

Mr. CALLAHAN. I think we had worked with Committee staff, as I understand it from my team, in advance to provide a copy of the agreement or information about the agreement. We would be, of course, eager to work with the staff on providing information to the Task Force, including access to the agreement.

Mr. CANNON. Thank you. That is I think remarkably important, because the devil—or the angel—is in the details. I can't help thinking, as I sit here looking at Microsoft today and Google today and Yahoo, without thinking back to a time when one of my constituents, WordPerfect, had a conflict with Microsoft and a large lawsuit—I think a $250 million settlement—with Microsoft over its dominance of the market.

I sat down with some of my high-tech guys and said, What do you think about Microsoft? They said, We really like Microsoft because they have the platform that we can develop to. So I have never found myself actually really antagonistic to Microsoft.

Frankly, it is sort of interesting to see the evolution here. In fact, I can't help thinking about a corollary in chemistry where you take a small aperture with high pressure and let chemicals fall into a low pressure environment, where things change dramatically. That is sort of like where we are today.

I am going to address some questions to you, Mr. Drummond, in that regard, because we met 6 or 8 months ago, talked at some

length about what I wanted Google documents to do. So that is a tool that I just love.

The world, seems to me, is changing so remarkably and we are at that point now looking forward at what the possibilities are. Mr. Carter has talked a little bit about that. What I thought I would ask you, Mr. Drummond, if you were your competitors, and not necessarily Microsoft or anybody else but in this world, I want to frame the future, how would you do it and get around the dominating position that you are currently creating with Yahoo?

Mr. DRUMMOND. Well, thanks for the question. It is a big one.

First of all, I don't think we are creating a dominant position with Yahoo in this deal for the reasons that I have stated. I think that if you talk to anybody at Google, the technical people at Google, about the problems we are trying to solve, whether it is search or creating quality ads or doing e-mail or any of the things we are trying to do effectively, they will tell you that we actually aren't doing it very well, if you can believe that. In other words, there is a huge way—we have huge strides to make to still make these products a lot better.

I think that what we are seeing as we go around and talk to engineers, computer scientists, there are a lot of people working on some pretty interesting stuff that will take us to the next level.

I think what I would probably—and I am not in the business of advising people to compete with Google, but were I in that business, I would probably say figure out on one of these really tough problems a new way to do it, a new way to use computing power and to use computer science to do a better job of it.

Mr. CANNON. Professor, do you have a point you want to make here?

Mr. PASQUALE. Thank you very much, Representative Cannon.

I would just say that if we look at the technical economic literature on a lot of this stuff, it can be compared to a dating service. You can think about what they are doing is a two-sided market. You are trying to bring together advertisers and users.

The question I would put is, if you had two dating services that you could go to and one said I have amazing match-matching technology, but I only have 9 members of the opposite sex, and the other side, Well, we have about 70 to 90 members of the opposite sex, I think I know which dating service I would choose.

I think that is another reason to be kind of careful, I think, about mapping out this potential future. I think that was an excellent question, because I think, ultimately, what makes the products better here, if you look at, say, the innovation theory of Eric von Hippel at MIT, it is users, it is tracking user habits. For that reason, the company that has the majority of users using its platforms tracks those users' habits and it can tell which ads work and which do not much better than the others. That is the key to the innovation here.

Mr. CANNON. Mr. Carter.

Mr. CARTER. Yes. Congressman Cannon, I would like to add a little perspective. I think a lot of people don't realize how fragile all of even the search and this advertising situation really is. What I mean by that is it is driven by the people that are using it, meaning, I actually believe that there are ways within the algorithms

that Microsoft or Google uses to where they can actually look at how much time a person spends on a page once they go there, once they deliver them. I know that because I can see that in my own log files at AsktheBuilder.

So people out in the world viewing the search results, if Google or Yahoo starts throwing up garbage search results, I don't know about you, but I know if all of a sudden they are worthless. I am going to say I am not coming to Google anymore or to Microsoft anymore.

Mr. CANNON. I am not sure where my time is, but can I ask you to refine that question? Because if you shift gears and look at social networks, that there is something that informs us here. I think social networks are really in a primitive stage, but at some point people are going to be advertising to other people instead of doing searches with Google.

Mr. Carter, if you would both like to respond. Seems to me that the next evolution really goes not to the credibility of the ads but the credibility of the person who is promoting the ad or the item or the idea.

Mr. CARTER. Absolutely. Remember, there are only two reasons why people are getting on the Internet each day. There are only two: pleasure and problems. So if I go to a Web site and it is not solving my problem, I am out of there. So if the ad doesn't solve my problem, I am out of there. That is how fragile I am talking about.

That is why this all works right now, and it works so well, because people like me, who write the ads, if I just change one word in the headline, I might increase my sales 400 percent. That is a magical thing. We have never had that kind of power before. That is the power that is in my hands as an advertiser as well as a consumer. Because on the other end I click ads all the time when I am looking for a product I want to buy.

So please don't give these guys too much credit. I love them all. Don't misunderstand me. But I am trying to tell you that a lot of this is actually happening because of what all of us in this room do each day when we use the Internet.

Mr. CANNON. I would love to hear what Mr. Sable has to say.

Mr. SABLE. I would add one point. Social

networking is not new. If you go back, there are studies that go back to the '30's that talk about why would you buy a particular product, why would you go to a particular service, and it is because my friend here, Mr. Carter, told me. That is all that we have done, is created new efficiencies on the Web.

I think what Mr. Carter was saying, what I was trying to say in my statement, was the notion of search is really the key. The advertising is great, but the dirty little secret that we all still have to wrestle with is that, unlike in the old days when we say we know 50 percent works and we wish we knew what to do with the other 50 percent, it is a lot less than that today because we are not being able to target as well as we should. So targeting and being able to serve the right target is still the game. The closer we are able to target, the better we are able to use the information that we get, is going to make it work.

But, having said that, it is the critical search at the core that is still really the issue. Because, as I said in my testimony, only 40 percent of search is duplicated.

So if you look today—and I would be interested in what my colleagues have to say—but if you look at the page, take a Google page where the natural search—in other words, the search that just comes up from the search engine is in the middle—the click-through rates on what is natural, on what I have just asked and people like me have asked and sort of works on the basic algorithm, those still have the highest click-through rates, which suggests that the consumer kind of understands where they are going to get the best information.

So the challenge is still to make that advertising not just relevant but incredibly relevant to the content as well as to the user. I think that that is really the issue at hand. We must keep that piece as competitive as possible. Otherwise, we have lost the game.

Mr. CANNON. As I yield back, let me point out that, while I talk about this exciting future, I hope the record is clear how we take the next steps, especially here legally, are really important. That is why I think it is important for this Committee to have a pretty good look at that agreement so we understand what we are doing. Because the predicate we are setting today is going to be the foundation to where we end up.

With that, I yield back.

Mr. CONYERS. Tom Feeney of Florida.

Mr. FEENEY. Thank you, Mr. Chairman.

This is a fascinating thing. The Internet is still such an infant, although it has grown in a hurry. It is very difficult to adopt appropriate regulations. In this case, we are talking antitrust when you are letting us really understand exactly how this incredible growth has occurred. We certainly couldn't have predicted it 10 or 15 years ago.

Mr. Carter, you said something earlier which was essentially that the Web businesses and the customers are what created the drive to specific sites. You are not worried about whether it is a 90 percent combination or theoretically a 100 percent combination. Do you want to elaborate on that?

Mr. CARTER. I will tell you why I am not worried about it. Because I am telling you that in real world every day people are using these search engines, all three of the ones that are here as well as other ones we haven't even discussed today. The consumers that are using those search engines and coming up with the search results, just like any other—that is a business transaction. If I decide to invest my time at Google, they better give me back a good result. Just like last night when I went to eat I didn't get good service.

So, anyway, the point is the consumers are driving this engine. They are driving the bus.

Mr. FEENEY. Mr. Carter, theoretically, if one company controlled 100 percent of the market—8 or 10 years ago we didn't have this sort of incredible customer service on the Internet. So if you didn't have anything to compare it to, we don't really know how theoretically things can get a lot better. We don't know how much better

because we can't micromanage or micro-vision the future in many cases.

Mr. CARTER. I disagree. Because I sell tens of thousands of dollars of advertising myself, and there are hundreds of thousands of Web sites out there that also sell their own ads. So the companies that are buying ads—remember, you are kind of looking at this myopically, because you are just discussing search advertising.

Mr. FEENEY. I am looking at this in a confused way. That is why I am asking you questions.

Mr. CARTER. No disrespect intended. Don't misunderstand me. There are all kind of other ads that people can buy on the Internet. This may come as a surprise, and some of the people in the room may not believe this. I have ads that I sell myself. I have been doing it since 1995, and I get click-through rates of 35 percent. That is unheard of in the marketplace. My advertisers are doing backflips. They are so happy.

So the point is there are other options out there for companies who want to advertise. They don't even have to go to these three giants that are at this table.

Mr. FEENEY. Mr. Pasquale, you don't have a dog in this fight. You are not trying to merge or unmerge or have a semi-secret agreement. On page 3 of your testimony you worry about manipulation that would result in high barriers to entry of new competitors but also barriers presumably to Web sites. I understand why it would be in the interest of Yahoo and Google or Microsoft and Yahoo or whoever to erect barriers to competitors. Why would it be in their interest to erect barriers to a thousand or a hundred thousand new Mr. Carters participating on the Internet? I don't understand that.

Mr. PASQUALE. Sure. And I would like to sort of—I think I can analogize that, actually, to some of Google's own advocacy with respect to the carriers and net neutrality. Let me just start, though, with a concrete example.

There was once a Web site called 2bigfeet.com. This Web site, through lots of hard work and effort, became—if you put in, "I have large feet. I need size 15, size 16 shoes", whatever, your search would be about big men's shoes. It would be the number one site. Suddenly, one day, a few years ago, it dropped off entirely, disappeared. I called Google repeatedly. Like his whole business was built around search results leading people to his site.

Now why would that happen? Why might that be something that could happen and would be troubling? I think one particular theory here that is a possibility is that if you want to sell people paid ads, you may want to churn the organic ads, the stuff that just comes up in the middle of the screen so you can get more and more paid ads sold. So that's one concern.

The other concern—this gets back to Mr. Carter's point. If they provide a bad service, I will just leave them. Well, if you have—there are some searches where, clearly, if you're looking for one particular site, if you're looking for Coca-Cola.com and they give you Pepsi, that is clearly the wrong answer.

But many searches are not like the simple navigational search. If I put in "big men's shoes", I may have no idea what I will come up with. There is nothing I can check it against. It is what econo-

mists call a credence good. And, therefore, I think given the searcher's position as a credence good, I think we have to worry about that.

And, finally, it ties into net neutrality. All three of the companies to my right have talked about their worries, the carriers, telcos and other companies who deliberately impair quality of service in order to raise their costs in order to reach their customers. I think, by the same token, we have to have some worries about search engines potentially churning their organic results or otherwise manipulating results so that people have to buy paid ads rather than relying on organic search to connect them to their customers.

Mr. FEENEY. You know, it is all very interesting.

Mr. Smith, I guess a lot of the tension today has been on the notion that 30 percent market share you don't consider to be an antitrust issue, but 90 percent of the market share you do. How would a 30 percent market share—if you and Yahoo teamed up, how would that benefit the consumers in a way that 90 percent agreement for sharing some sort of infrastructure for auction bids—how would your proposal with Yahoo benefit consumers, compared to the disadvantage you suggested the arrangement in front of the Justice Department would have?

And with that, when you're done, I yield back.

Mr. SMITH. I think the real question is whether there will emerge in this market for search advertising any real counterbalance to the market power of Google. Quarter after quarter, basically, Google's market share has been increasing. And while one can say, isn't it nice all of these people together make up what happens, I really don't think that is the way it works. It is a bit like suggesting that it is we consumers that are setting the price for gasoline because we are the ones who go to the gas station. Actually, there is an organization called OPEC that has a lot to do with it.

And there are a lot of people who go and bid up for auction prices at Google, but the reality is Google sets minimum prices. It sets minimum prices oftentimes by individual advertiser. It has quality scores that determine who wins. There is not a lot of transparency about that.

The market wants a sustainable counterbalance to Google. I think that if in some way, shape or form Microsoft and Yahoo had or could have gotten together in the search area we would create something that would be sustainable, and it would be more competitive. And that is why Google has taken this step with Yahoo.

Let's keep in mind Google didn't create this exercise a year ago. They didn't initiate it 2 years ago. Microsoft offered to buy Yahoo on Thursday evening, January 31st; and the very next day Eric Schmidt, the CEO of Google, called up Jerry Yang, the CEO of Yahoo, and offered his help. I think that says a lot right there.

Mr. CONYERS. Darrell Issa, California.

Mr. ISSA. Being on this Committee is always interesting because people know that all they have to do is define the relevant market their way and they win. And this is no different.

So I am going to limit my questions; and, in fairness to Microsoft, Yahoo/Google, I am going to start and just go back and forth be-

tween Yahoo and Microsoft so that we don't get the inevitable piling on for just a moment.

Today—wait a second here. Nope, I take that back. I think I will go Google and Microsoft for a moment—and nothing personal, Yahoo, but you are not the relevant market leader for a moment.

Let's talk about this. What should we today and for all time consider the relevant market that your two companies believe we are talking about here today and the markets in which each of you believes you do or do not have market dominance? And I ask that because it seems—and I have been fed material by both sides. It seems that you both have shifting sands of whether or not you have market power in a particular market.

And I would say to the Chairman, you might remember that the NAB came to us and told us that satellite radio didn't compete against radio coming through the airwaves from a different starting point. So we have heard it all.

But I would like to ask you on behalf of your companies—Mr. Smith, starting with you, what is the relevant market that the possible acquisition of Yahoo by you or the combining of efforts with Google we are talking about, who's in it? What size do they have together?

Mr. SMITH. Microsoft put a proposal on the table in May and has kept the proposal on the table ever since and reinvigorated it and made it more attractive as recently as last Friday.

Mr. ISSA. And yours is public.

Mr. SMITH. We have made public statements about it, and it was clear that it concerned two things: algorithmic search, which some people sometimes called natural search, and paid search, this paid search advertising market.

Certainly Microsoft is not dominating either of those markets. Our market share in both of those segments is in the range of 10 percent, maybe a little bit less, maybe a little bit more.

I believe that Google clearly is dominant in the market for search and paid search advertising. I think I should acknowledge we know that we have a dominant position, for example, in the market for personal computer operating systems. The Federal Court of Appeals was clear about that earlier in this decade. The European Commission found us to be dominant in the market in certain server markets. And we have stepped up to that, and we have acknowledged it, and we haven't continued to debate and suggest that——

Mr. ISSA. Mr. Drummond, would you agree with that? Is that a pretty good assessment of the relevant markets? Or how would you differ in your definition of the relevant market?

Mr. DRUMMOND. Sure. Actually, I would differ.

Mr. ISSA. Not a surprise.

Mr. DRUMMOND. As I said earlier, we've been absolutely consistent about this. We have had this review we are talking about now. We have the DoubleClick review. Our view is that advertising—a lot of advertising is substitutes for other advertising. You see a lot of advertising that is currently off-line coming on to the Web. So advertisers are literally making that——

Mr. ISSA. So you are yellow pages.

Mr. DRUMMOND. I think there is competition there. But, at a minimum, we believe—and we have been very consistent about

this—that online advertising in its principal forms, or search based and display based, is the relevant market for looking at this transaction. We believe it was the relevant marking for looking at our DoubleClick transaction.

I am somewhat surprised to hear Mr. Smith's answer to that last question. Because, in the DoubleClick deal, they weren't filing papers with agencies saying that on-line advertising was indeed the relevant market. So maybe there are some shifting sands there. But we have been very consistent——

Mr. ISSA. So the 70 percent of the search market is okay with you. You are 70 percent of——

Mr. DRUMMOND. Actually, I think that overestimates it a bit. Because when I look at that information—we pay to our Web sites, which is substantial. So I think it overstates it by a bit, but it is a substantial amount.

Mr. ISSA. Okay. I am going to stay in the same genre, but I am going to make a small change, and that is barriers to entry. Do you both agree that, at this point in the maturity of the Internet, not inconceivable that somebody will start in their basement—or, in California, we have garages, not basements—and come out of nowhere? But today there appears to be a high barrier to becoming a player in the search business. And I say that because many have tried, and even those who had a foothold have disappeared, for the most part, other than the big three as far as having more than a round in here.

Can you agree that today it appears as though this has sort of a success barrier to entry? Can we both agree on that?

Okay, Yahoo, how about you? If you weren't in it, could you get in it today and gain a 30, 20 percent market share that you have today?

Mr. CALLAHAN. I am not sure how quickly a new company could gain a share, but I think the innovation point is an important one, and it goes back to several comments that were made.

I believe I read Microsoft acquired a company that does natural language search called Powerset for some hundred million dollars some time in the last couple weeks. There are companies that do mobile voice activated search, which is a market that no company really explores in detail right now and I think there is a lot of innovation yet to come.

Mr. ISSA. Lastly—and this is only for Microsoft and Google, if you don't mind—tie in. Microsoft, you have been sort of—I am sorry, Mr. Smith, but you have been accused of, because you have so much market share dominance on the desktop 90-ish percent or whatever, that somehow that gives you a tie in. And I am not going to agree or disagree, but every copy of Microsoft XP and Vista arrives with a search engine in it. And Mr. Drummond you have 65, 70 percent of the market.

So can we comment, each of you, on why you think that there is a tie-in value to Microsoft, who has less than 10 percent of the market but puts it in 90 percent of the products when they arrive, versus Google, who arrives from Microsoft without a search in Internet Explorer but in fact gains 65 percent of the market. I want to understand that.

Because I want to know if there is any credence to the allegation that we seem to keep hearing that somehow market power starts with the desktop when, in fact, you have gotten to be the dominant player without ever being in the desktop except when I add it while surfing—starting off surfing, to be honest, with Microsoft's product.

Mr. DRUMMOND. Sure. We have been concerned, and we have expressed this concern a number of times, that what happened on the desktop, that is to say, with software companies that were start-up and through dint of hard work and innovation led the market, then were obliterated by Microsoft, because Microsoft was able to——

Mr. ISSA. My question was they already had the head start when you started.

Mr. DRUMMOND. That's right. What we have been concerned about is the same thing will happen on the Internet through the mechanism you just talked—among other ways, the mechanisms you just talked about. I think we have been out there talking about that, trying to make sure that doesn't happen. We have talked to Microsoft a lot about the design of their products.

Mr. ISSA. Mr. Chairman, indulgence a little bit.

I understand you've been talking about it. What I'm saying is here, today, tell us how, if there is that tie in, not could be a tie in, but tie in, how you went from having zero to having market dominance while, in fact, their product arrives with a search engine on day one. They own, if you will, Internet Explorer, and you've gotten there. That's what I am trying to understand because——

Mr. DRUMMOND. Just to be clear, in the early part of our existence, Microsoft really didn't have a search engine. In fact, they licensed it from someone else. So it wasn't a part of a market they were focusing on. As I think everyone knows, with much fanfare Microsoft turned its attention to the Internet in much the same way they turned their attention to Internet software such as browsers. And you know what happened with Netscape.

So our concern was that that could happen, and we have been urging people to be vigilant of that happening again. But we like competition on the merits. That's what largely has been happening, and we are very happy with that.

Mr. ISSA. Mr. Smith, quickly, for an answer.

Mr. SMITH. Our business is supervised by the Federal Government, a number of States and a number of foreign governments. We have clear practices that we published 2 years ago.

One of the principles that we apply is that, while there is a default setting on Internet Explorer for a search engine for the Internet, any PC manufacturer can change that. So, for example, Google has entered into an agreement with Dell so that if you buy a PC from Dell it has Google as the default. Yahoo had an agreement with HP until recently. So if you bought a PC from HP, it had Yahoo as the default.

We have stepped up, I would say, to a number of responsibilities; and we are seeking to live up with them. We are not still living in the world where we say, oh, we are never dominant. I am not sure that can be said to the gentleman and the company to my left.

Mr. ISSA. Thank you for your indulgence, Mr. Chairman.

Mr. CONYERS. You are welcome.

Closing comments, Zoe Lofgren.

Ms. LOFGREN. Mr. Chairman, I just want to thank you for convening this hearing, and I wish that we could do a second round, because there are still more questions. I do think that for Silicon Valley, certainly the whole country, but the eyes are watching today because all three companies, as I said earlier, are part of the Valley. And we want to make sure that we have competition. Clearly, Silicon Valley thrives on competition, and it is obvious we have competition here today as well.

I really want to thank you, Mr. Chairman, for the quality of this hearing and really the quality of the testimony. And I yield back.

Mr. CONYERS. You and everyone else has 5 days to ask them all the questions they want, and they'll send you all the answers they want, and we will put it all in the record.

So I thank the witnesses. This has been an important hearing. It has shed a lot of light on a lot of complex issues, and we ask that you follow this Committee, the Antitrust, Anti-Competitive Task Force here at Judiciary. It is a valuable Committee, and I am very pleased that we had so many Members that could join us all today.

Thank you very much for your attention.

[Whereupon, at 3:46 p.m., the Task Force was adjourned.]

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