Is Competitor Collaboration Dead After Google-Yahoo?

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On November 5, 2008, the morning after Barack Obama's election, the Justice Department's Antitrust Division issued an unusual press release announcing that Google, Inc. and Yahoo! Inc. had "abandon[ed] their advertising agreement."[1] With that, Assistant Attorney General Tom Barnett put a final nail in the coffin of a controversial deal between two Internet search and advertising behemoths, now competitors,[2] whose growth and changing fortunes have become illustrative of the Web itself.[3]

But what does this decision mean for high-tech antitrust and the broader question of horizontal agreements among competitors? While the structure of the now-defunct Google-Yahoo venture may have been sui generis, it nonetheless presented issues of market definition, anticompetitive effects, and innovation incentives that, if extended, could significantly affect the development of antitrust doctrine. The 2000 Antitrust Guidelines for Collaboration Among Competitors explained that collaborations involving "special technical expertise"[4] are often efficiency enhancing and procompetitive. The government's decision here, however, appears to eschew that presumption, adopting a Clayton Act-like "incipiency" analysis that has not previously been utilized in horizontal restraint cases.

These are only some of the interesting questions raised by the Google-Yahoo deal and its predecessor, Microsoft's aborted merger with or proxy fight for Yahoo. Answers must be approximated, however, because unlike a court challenge or business review, where the

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1 Press Release, Dep't of Justice, Yahoo! Inc. and Google Inc. Abandon Their Advertising Agreement (Nov. 5, 2008), available at http://www.usdoj.gov/atr/pr/2008/November/08-at-981.html ("DOJ Press Release").

2 Many observers appear to have forgotten that for several years, Yahoo's Internet search engine was "powered by" Google's search technology, making the two more partners than competitors in their origins.

3 See, e.g., M. Helft, Google Walks Away From Yahoo Ad Partnership, New York Times (Nov. 5, 2008), available at http://www.nytimes.com/2008/11/06/technology/internet/06google.html?em; W. Tanaka, Google Ditches Yahoo!, Forbes (Nov. 5, 2008), available at http://www.forbes.com/technology/2008/11/05/yahool-google-deal-tech-enter-cx_wt_1105yahoo.html.

4 Fed. Trade Comm'n and U.S. Dep't of Justice, Antitrust Guidelines for Collaboration Among Competitors § 2.1 (April 2000), available at http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf ("Competitor Collaboration Guidelines").

Department would be required to outline its analytical framework publicly, the November 5 press release merely hinted at the antitrust theory underlying this much-publicized non-merger investigation.

Background

In April 2008, in the midst of its hostile reaction to Microsoft's unsolicited takeover bid, Yahoo! began a two-week trial of what it characterized as an advertising "outsourcing" arrangement with Google. Widely viewed at the time as a variant of the poison-pill defense, the prospect of a longer-term deal between Google and Yahoo was immediately denounced by Microsoft GC Brad Smith as "consolidat[ing] over 90% of the search advertising market in Google's hands."[5]

Google and Yahoo both sell "sponsored" advertising links on the Web pages generated by queries to their Internet search engines. Informative, relevant search advertisements – contextually targeted to search results by use of proprietary algorithms – provide a low-cost and increasingly important product for online advertisers. They are displayed separately from the "natural" search results generated by a query and typically are labeled conspicuously as advertisements or "Sponsored Links." Internet search ads are also different from so-called "display" ads, namely Web banners and the like, in that search ads typically consist of a few lines of text. Both forms of online advertising, however, are generally purchased on a "click-through" basis by advertisers, a pricing model different from the per-impression formulas applicable to legacy media advertising.

In addition, Google and Yahoo offer their Internet search and advertising services to third-party partners, for example retailers, newspapers, and blogs. Visitors to these syndication partner's Web site use an embedded search form to query the Internet or site and are provided with context-sensitive ads alongside responsive search results. If a user clicks on an ad link displayed on the partner's search results Web page, the search company shares a portion of the revenues it generates from the click with its partner.

The Google-Yahoo agreement granted Yahoo the option, not an obligation, to use Google's AdSense technology to "serve" (i.e., deliver alongside non-paid search results) paid search ads on Yahoo's and its partners' Web sites in place of sponsored search ads sold through Yahoo's own advertising platform, known as "Panama." It also contemplated the potential for formal antitrust review, with a termination provision linked to notice of an intended enforcement action,[6] and was twice delayed by the parties to permit the opportunity for a governmental

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5 See, e.g., W. Tanaka, Yahoo! Gets In Bed With Google, Forbes (April 9, 2008), available at http://www.forbes.com/technology/2008/04/09/google-yahoo-microsoft-tech-ebiz-cx_wt_0409goog.html.

6 Section 16.2.4 of the agreement allowed either party to terminate "in order to avoid or end a lawsuit or similar action filed on competition-law grounds if . . . defending such action is not commercially reasonable." A heavily redacted copy of the contract was submitted publicly

investigation. Reportedly, during negotiations with the Department, the parties agreed to cap the volume and dollar value of ads Yahoo could outsource to Google and to reduce the term of the agreement from its initial ten to two years.[7]

There was never a question that Google and Yahoo collectively dominate the Internet search advertising business, as their combined share of search exceeds some 90% or so. Rather, the debate was whether that business constitutes a relevant antitrust market and whether the effects of a Google alliance would, as the parties argued,[8] strengthen Yahoo competitively by allowing it to serve more demographically targeted ads via Google's superior search algorithms and technology.

After a congressional hearing, endless press and business speculation, and an intensive but typically secretive DOJ investigation, Microsoft's Brad Smith has been proven not only correct but prescient. The Department's press release concluded that "the agreement between these two companies accounting for 90 percent or more of each relevant market would likely harm competition in the markets for Internet search advertising and Internet search syndication."[9] As explained in the release:

Google and Yahoo! would have become collaborators rather than competitors for a significant portion of their search advertising businesses, materially reducing important competitive rivalry between the two companies. Although the companies proposed various modifications to their original agreement in an effort to address the Department's antitrust concerns, the Department determined that such modifications would not eliminate the competition concerns raised by the agreement.

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to the SEC in connection with securities regulatory filings. See Services Agreement, available at http://www.sec.gov/Archives/edgar/data/1011006/000089161808000399/f42710exv10w19.htm.

7 R. Hoff, Google-Yahoo: Unintended Consequences, BusinessWeek (Nov. 6, 2008), available at http://www.businessweek.com/technology/content/nov2008/tc2008115_251659.htm?chan=rss_topStories_ssi_5; D. Kwanato, How the 'Yahoogle' Talks with Feds Fell Apart, CNet News (Nov. 5, 2008), available at http://news.cnet.com/8301-1023_3-10083272-93.html.

8 "This deal will preserve competition in the online marketplace. This agreement - unlike Microsoft's proposed acquisition of Yahoo! - means that Yahoo! will remain an independent company in the business of search and advertising. Yahoo! has stated that it will reinvest the additional revenue from this agreement into improving its user services and competing vigorously against Google, Microsoft and other companies. This gives all companies the continued incentive to keep improving and innovating." Google, Facts About the Yahoo-Google Advertising Agreement, available at http://www.google.com/yahoogooglefacts/competition.html.

9 DOJ Press Release at 1.

Furthermore, the Department endorsed the premises that (a) Internet search advertising and search ad syndication are relevant product markets, and (b) as a consequence of steering some its advertising revenues to Google, "Yahoo! would have had significantly reduced incentives to invest" in search technology, and "Yahoo!'s competition likely would have been blunted."[10]

For their part, Google and Yahoo continued to defend the merits of the aborted transaction, blaming its termination on the legal costs and externalities associated with mounting an antitrust defense.[11]

Relevant Market

The factual basis for the Department's market definition is difficult to discern because the November 5 press release did not explain the factors yielding the DOJ's determination that Internet search advertising is a relevant antitrust market. There are several indicia supporting a different conclusion, however.

First, while Google's share of search advertising is about 69% today, as BusinessWeek reported, the display advertising shares of Microsoft, MySpace, and Yahoo each substantially exceed that of Google.[12] Internet display advertising has been growing faster than search advertising since 2006, and the increasing presence of broadband, high-speed Internet access indicates that segment of the market is likely to be more important than search advertising in the future.

Second, advertisers increasingly perceive Internet advertising to be a reasonable substitute for legacy media advertising. The reality is that online advertising today is already larger (and growing an order of magnitude faster) than traditional radio and local television advertising, suggesting strongly that advertisers are steadily converting old media advertising dollars into new Internet ad dollars. Recent and dramatic losses at the New York Times and elsewhere, for instance, only underscore the dramatic effect technology is having before our eyes on the allocation of advertising budgets.

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10 DOJ Press Release at 1.

11 According to Google's Chief Legal Officer, David Drummond, "after four months of review, including discussions of various possible changes to the agreement, it's clear that government regulators and some advertisers continue to have concerns about the agreement. Pressing ahead risked not only a protracted legal battle but also damage to relationships with valued partners. That wouldn't have been in the long term interests of Google or our users, so we have decided to end the agreement." Google Policy Bog, Ending Our Agreement with Yahoo! (Nov. 5, 2008), available at http://googlepublicpolicy.blogspot.com/2008/11/ending-our-agreement-with-yahoo.html.

12 See, e.g., J. Greene, Inside Microsoft's War Against Google, BusinessWeek (May 8, 2008), available at http://www.businessweek.com/magazine/content/08_20/b4084036492860.htm ("Microsoft is among the leaders in the fragmented [display advertising] field, while Google is a bit player.").

Taken together, these facts suggest that, from either a supply- or demand-side perspective, the relevant product market is at least as broad as all Internet advertising, and if the Merger Guidelines "SNIP" test is used,[13] almost certainly includes some forms of legacy media advertising. The former is different from the FTC's dictum in 2007, on the Google-DoubleClick merger, that "all online advertising does not constitute a relevant antitrust market," but there the agency was analyzing the relationship between search ads and advertising intermediation rather than pricing cross-elasticities.[14] Opponents of the Google-Yahoo deal suggested that Internet search ads are sold to a different segment of advertiser, smaller-scale and at price points qualitatively different from display ads. This purported "mom and pop" search advertising market is belied, however, by the readily ascertainable fact that sponsored Internet search advertising is now the domain of a majority of Fortune 100 corporations.

Innovation Incentives and Anticompetitive Effects

Even accepting the market definition, what was the exclusionary consequence animating the Department's "competitive concerns"? That too is unclear. The press release suggests that "important competitive rivalry" between Google and Yahoo could have been restricted but specifies only the obvious – that for ads served by Yahoo via Google's platform, competition would "likely have been blunted immediately."[15]

Yet that in itself is both an overstatement and hardly dispositive. The agreement did not contain any price coordination terms – indeed, it allowed Yahoo to set the minimum bid price it wanted, whether above or below Google's – and had no mechanism for giving either party visibility to the search ad auction prices charged by the other. So it is difficult to construct an argument that for Internet search advertising, competition would have been "blunted" because price rivalry, the hallmark of competition in markets (like this) where the product itself is rather undifferentiated, would have remained unconstrained.[16]

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[13] There is clearly sufficient cross-elasticity of demand among search, display, and legacy advertising such that a "significant non-transitory increase in price" could not be imposed unilaterally on newspaper or radio advertisers, for instance, without prompting a substantial substitution of Internet advertising.

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

[15] DOJ Press Release at 1.

[16] Opponents had contended that the Google-Yahoo deal was per se unlawful price fixing because it would increase or stabilize search advertising prices. See C. Holhan, The Case Against Google-Yahoo, BusinessWeek (July 3, 2008), available at http://www.businessweek.com/technology/content/jul2008/tc2008073_184471_page_2.htm; Hearing on the Google/Yahoo! Agreement and the Future of Internet Advertising Before Subcomm. on Antitrust, Competition Policy and Consumer Rights, 110th Cong. 11

Moreover, since Yahoo's steady decline in search over the past five or so years was the result of its inferior search algorithms,[17] permitting it to use Google's AdSense technology would have increased the value of Yahoo's search ads, allowing Yahoo to compete even more vigorously on price and, over the long term, putting downward pressure on Internet search ad rates.[18] Whether or not the competitive effects would indeed have been negative, they would only have existed for whatever segment of ads Yahoo served via Google's platform, a clear minority of the total search advertising inventory controlled collectively by the two companies. The Department's press release declares this would have been a "significant portion" of the market but supplied no metrics and pointedly avoided characterizing the affected segment as "substantial." The share and dollar volume involved are not transparent to third parties, however, because those terms were at Yahoo's discretion, and the basis for its projection of being able to monetize the deal for an additional $800 million ($200 to $450 million in year one) was never disclosed.[19]

Equally inexplicable is the Department's prediction that, over the long run, innovation competition in Internet advertising would have been undermined because Yahoo's incentives to invest in search and advertising technology would have been reduced. First, Google has for years had a search and Internet advertising relationship with America Online, plus a $1 billion equity investment in AOL, as to which antitrust enforcement officials have not voiced objection despite AOL's substantial share of online display advertising.

Second, the government's innovation prediction does not seem to reflect valid microeconomics. Presumably, both Google and Yahoo management rationally concluded that each could profit more from serving up AdSense-sponsored search ads with Yahoo search results than if Yahoo continued to use 100% of its own search ads. If Yahoo really were able to earn an additional $800 million from the deal, that would have given it precisely the cash to invest in technical innovation for search that it had been lacking heretofore. Conversely, only if Yahoo had agreed as part of the venture to exit the search advertising business would the Department's analysis have been correct, but then for a different (i.e., ancillary restraint) reason.

(2008) (Statement of Brad Smith, Senior Vice President and General Counsel of Microsoft), available at http://judiciary.senate.gov/pdf/08-07-14Brad_%20Smith_Testimony.pdf ("the agreement effectively establishes a per se illegal price floor"). This rather odd allegation does not appear to have been taken seriously by the government.

[17] R. Stross, Why the Google-Yahoo Ad Deal Is Nothing to Fear, New York Times (Sept. 20, 2008), available at http://www.nytimes.com/2008/09/21/technology/21digi.html ("Everyone who wants to see Yahoo, the No. 2 search engine, regain some of its lost luster has abundant reason to cheer the deal on.").

[18] See G. Manishin, In the Tech Industry, Small Isn't Beautiful Anymore, San Jose Mercury News (Oct. 4, 2008), available at http://www.mercurynews.com/opinion/ci_10638860.

[19] See Stross, supra note 17.

Third, Yahoo's margins would of course have been less – because it was contractually obligated to return an unspecified (secret) portion of its ad revenues to Google. As a result, any rational company would invest **more** in its own technology. That is, the outsourcing deal, as a matter of basic economics, would have increased incentives for Yahoo to innovate in order to invent itself out of handing a portion of its ad revenue to a rival and to maximize its own margins and profits. The facts support this conclusion, as just weeks before the deal was terminated, Yahoo launched a new advertising platform (known as "Apex" or APT), funded and developed while the whole Microsoft-Google-Yahoo saga was being played out.[20]

This leads to the inevitable next question: what is the Department's conclusion that the transaction would "likely harm competition" based on? If the Department is referring to the relevant civil burden of proof only, then the statement is a tautology. But if, as is apparent, this represents a projection that over time, Yahoo's status as an independent innovation competitor would have been reduced, the question becomes whether the Department has applied the appropriate legal test to this atypical transaction.

Section 1 cases under the rule of reason classically require proof of a present and substantial anticompetitive effect. As a result, the Sherman Act was long ago amended by the Clayton Act to provide a forward-looking incipiency test for mergers, something inapplicable to horizontal restraints analysis.[21] Because no one seriously contended there was any plausible per se basis (under which anticompetitive effects are irrelevant) to block the Google-Yahoo deal, traditional antitrust tests would not support the Department's borrowing of the Clayton 7 standard for a very different Sherman 1 investigation. That is especially troubling in the context of technology industries, as the rapidity of change is something with which antitrust enforcement is inherently in tension.[22] Whether antirust liability in Section 1 technology cases turns on the basis of predictive judgments of likely long-term competitive effects is a matter that should be established by Congress, not through the leverage of a threatened DOJ lawsuit.

Horizontal Vendor and Production Agreements

Joint ventures and technology outsourcing agreements among competitors, even large ones, are nothing unusual. Since GM-Toyota and well before, competitors routinely deal with each other, allowing comparative advantage to determine the efficient allocation of resources and productive

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[20] E.g., R. Hoff, Yahoo Is Counting on Apex, BusinessWeek (Sept. 18, 2008), available at http://www.businessweek.com/magazine/content/08_39/b4101072127089.htm; Hoff, supra note 7.

[21] "The potential for future competition between participants in a collaboration requires antitrust scrutiny different from that required for mergers." Competitor Collaboration Guidelines § 1.3.

[22] E.g., Massachusetts v. Microsoft Corp., 373 F.3d 1199 (D.C. Cir. 2004) (declining to hold operating system software tying per se unlawful due to dynamism and rapidity of market structure changes in technology industries).

capacity. Antitrust law is traditionally offended only if the collaborating parties are precluded from competing in markets outside of the JV business or if the cooperation includes collateral restraints that make it overbroad or facilitate collusion.

The mystery of Google-Yahoo is, therefore, why the Department seems to have abandoned its own guidelines in forcing the parties to abandon the deal. Those 2000 competitor collaboration principles make clear that (1) collaborations involving "special technical expertise" are often efficiency enhancing and procompetitive, and (2) in order to evaluate a collaborative transaction, the enforcement agencies look at six interrelated factors to assess how and to what extent a transaction will impede competition:

> (a) the extent to which the relevant agreement is non-exclusive in that participants are likely to continue to compete independently outside the collaboration in the market in which the collaboration operates;
> (b) the extent to which participants retain independent control of assets necessary to compete;
> (c) the nature and extent of participants' financial interests in the collaboration or in each other;
> (d) the control of the collaboration's competitively significant decision making;
> (e) the likelihood of anticompetitive information sharing; and
> (f) the duration of the collaboration.[23]

None of these factors supports a conclusion that Google-Yahoo presented a likelihood of competitive harm. The deal was non-exclusive, each party retained control of its own assets and technology, there was no shared financing or decision-making, no possibility of information sharing, and the transaction was within the 10-year safe harbor of the guidelines, reportedly even shorter when modified by the parties to secure DOJ approval.

On the other hand, it is plain that the use of Google's AdSense technology for some portion of Yahoo's search advertising needs is an archetypical example of the special technical expertise for which collaborations are typically procompetitive. Why then did the Department not mention "cognizable efficiencies"[24] or the Guidelines' balancing test[25] in its press release? One hopes it is not because these fundamental principles of rule of reason horizontal restraints analysis were overlooked.

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[23] Competitor Collaboration Guidelines § 3.34.

[24] Id. § 3.36.

[25] Id. § 3.37 (Agencies "assess the likelihood and magnitude of cognizable efficiencies and anticompetitive harms to determine the agreement's overall actual or likely effect on competition in the relevant market. To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to offset the potential of the agreement to harm consumers in the relevant market, for example, by preventing price increases.").

Additionally, the announced basis of the Department's competitive concerns seems inconsistent with the Guidelines' recognition that "[c]ontrol over key competitive variables may remain outside the collaboration, such as where participants independently market and set prices for the collaboration's output."[26] That is precisely the structure of Google-Yahoo because the latter was required independently to price, market, sell, and support search ad sales on its own and its partners' Web sites, as well as determine the quantity of ads to be produced collaboratively. Where these "key competitive variables" remain independent, that facially contradicts a conclusion that under the outsourcing deal, Google and Yahoo would have been "collaborators rather than competitors for a significant portion of their search advertising businesses."

Extension of this sort of apparently unfocused antitrust inquiry to future competitor collaborations would be untoward. If competitors in a relatively barrier-free technology market cannot work together to share production capacity for a small portion of one product, while preserving price and other competitive rivalry (both generally and for the "joint" product), merely because their shares are too large – without consideration of efficiencies or the relative substantiality of the market segment potentially affected – the Guidelines are effectively a dead letter. That would not be a positive development for antitrust doctrine and would lead to the unfortunate situation, which seems to have been the case here, in which the enforcement agencies can deter procompetitive transactions among competitors without ever articulating, let alone proving, a concrete or substantial adverse effect on competition.

Conclusion

The Google-Yahoo advertising outsourcing deal is unlikely to be precedential in antitrust law because no opinion, complaint, or public governmental analysis is available. But it nonetheless could have an important impact, not only on the future of Yahoo! – which as of this writing is now inviting another Microsoft overture – but on technology antitrust and competitor collaborations. Perhaps the more significant result may be that, having yielded to governmental pressure, Google is likely to face more intense antitrust scrutiny of its future conduct.[27] While financial analysts have observed that Google had little strategic or financial downside regardless of DOJ's determination, the same may therefore not be true of its legal future. Stay tuned.

[26] Competitor Collaboration Guidelines § 3.34.

[27] DealBook, Google Failed Deal May Mean More Scrutiny, New York Times (Nov. 6, 2008), available at http://dealbook.blogs.nytimes.com/2008/11/06/googles-failed-deal-may-mean-more-scrutiny/; Helft, supra note 3 (DOJ decision "was a departure as well as a sign that Google would receive increasingly close scrutiny in the future."); Hoff, supra note 7 ("with a new and likely more aggressively antitrust Administration about to take power, Google increasingly may be under a regulatory microscope").