UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Economics

August 8, 2012

MEMORANDUM

To: The Commission

From: Christopher Adams and John Yun, Economists[1]

Re: Google, Inc., Matter No. 1110163

Rec: Close the investigation

Executive Summary

In June 2011, the Commission authorized compulsory process to determine whether Google is engaging in anticompetitive practices with respect to its online search, online advertisement, and mobile phone businesses. In February 2012, staff apprised the Commission of the numerous theories of harm being considered and the evidence gathered to date. In this memo, we update the evidence and offer our final recommendation.

We analyze Google's market power in search advertising and consider four theories of harm regarding Google's business practices:

(1) *preferencing of search results* through the practice of favoring its own web properties at the expense of rival content providers;
(2) *exclusive agreements with publishers and vendors in various distribution channels* which deprive rival search platforms of users and advertisers;

[1] Ann Miles provided valuable research assistance. We thank Jon Byars for his extraordinary work in programming the API feeds from comScore, creating data sets and analyzing the large amounts of data collected and provided. Thanks also to Matthew Chesnes and other colleagues in the Bureau of Economics for their assistance in various aspects of the case including data requests and analysis.

(3) *restrictions on porting advertiser data to rival platforms* through Google's terms and conditions governing the use of its AdWords API (application programing interface) software;
(4) *misappropriating content from Yelp and TripAdvisor.*

As we consider these theories, our guiding approach must be beyond collecting complaints and antidotes from competitors who were negatively impacted from a firm's various business practices. It must be determined that a firm's practices can plausibly be shown to have an adverse impact on competition, i.e., on the competitive constraints imposed by rivals. Moreover, any weakening of rivals' ability to compete that is a consequence of legitimate aggressive conduct by even a dominant firm cannot in of itself be sufficient to allege an antitrust violation.

Market power in search advertising

Each of the theories of harm is premised on Google having significant market power in a well-defined antitrust product market.

- We find that Google has significant market share in a search advertising market, with 65% of paid clicks and 53% of search ad impressions among the top five U.S.-based search engines.

- We find that Google's market power in search advertising is derived from its 65% share of user queries, but that this power *may* be mitigated by the fact that 80% use a search engine other than Google.

- We find empirical evidence *consistent* with search and non-search Internet advertising being substitutes, and documentary evidence that Google considers vertical search providers to be competitors. These findings raise questions about the evidentiary support for search advertising as a well-defined antitrust product market.

The preferencing theory

The *preferencing theory* is that Google is blending its proprietary content with its customary blue links and demoting competing content sites such as Nextag, eBay, Yelp, and TripAdvisor in a manner that significantly impedes their ability to exercise a competitive constraint on Google.[2]

[2] Traditionally, Google's search results would provide "ten blue links," which are hyperlinks to websites that are crawled and indexed by Google.

- We find that Google has limited ability to impose significant harm on vertical rivals as it accounts for only 10-20% of traffic to them. Results do suggest that a shopping blend significantly reduces the likelihood of a click from Google to shopping comparison sites, but the effect on traffic from Google to local sites is very small and not statistically significant.

- Google's blends represent a significant quality improvement for users.

- Google's documents show that Universal Search was a procompetitive response to pressure from vertical sites and general search sites and an improvement for users.

The exclusive agreements theory

The alleged *exclusive agreements* involve conduct in three distribution channels: desktop search distribution, search syndication, and mobile search distribution. In all three channels, the assertion is that Google is depriving sales to Microsoft in an anticompetitive manner.

- We find that direct access to a search engine's site, i.e., access that is not dependent on a third-party agreement, is the most efficient and most common distribution channel. This method to access rivals is not being impeded by Google's conduct. Additionally, we find strong reasons for doubting that search toolbars and default status on web browsers (both desktop and mobile) can be properly viewed as "exclusives" in the sense that users are unable, with relatively low cost, to access rival search engines.

- In search syndication, Microsoft and Yahoo have a combined share greater than Google's.

- We find no support for the assertion that rivals' access to users has been substantially impaired by Google. Microsoft and Yahoo combined have accounted for a reasonably steady 30% of all searches for a number of years. Since the announcement of Microsoft and Yahoo's search alliance, the alliance has grown query volume faster than Google, and has approximately the same number of search engine users per month as does Google.[3]

[3] In July 2009, Microsoft and Yahoo announced a ten-year syndication agreement where Microsoft would exclusively deliver search results and search ads for Yahoo, but not blended results. In February 2010, the agreement received regulatory approval.

- In December 2011, Microsoft had access to query volume equivalent to what Google had less than 2 years ago. It is thus difficult to infer that Microsoft is below some threshold level of query volume.

- We assess whether Google is using distribution agreements to buy up users and advertisers so as to raise the input costs of rivals and, by depriving them of feedback effects, make them less effective competitors.[4] We find that the characteristics of the online search market are not consistent with this theory of harm.

Restrictions on porting advertiser data via the AdWords API

The *restrictions on porting advertiser data to rival platforms theory* is that Google's terms and conditions for its AdWords API software anticompetitively disadvantages Microsoft's competing adCenter platform. Google's AdWords API allows advertisers and intermediaries, such as search engine marketing firms (SEMs), to more effectively interface with Google's advertising platform, AdWords. Google prohibits intermediaries, however, from creating products that "co-mingle" data from Google's ad platform with other platforms.

- We find that the introduction of the API with the co-mingling restriction lowered transaction costs, made users and Google better off, and rivals' costs were unaffected. Consequently, any objection to the restriction on its own would imply that when Google introduced the API it had an obligation to do so in a way that allowed its rivals to also benefit from this increased functionality. We see significant risks to long term innovation incentives from imposing such an obligation on innovators.

- We find that the advertisers who are responsible for the overwhelming majority of spending in the search ad market use both Google and Microsoft despite these co-mingling restrictions. Additionally, multi-homing advertisers of all sizes spend a significant share of their budget on Microsoft.

- Evidence from SEMs and end-advertisers suggests the policy's impact on ad spending on Microsoft's platform is negligible.

[4] This theory differs from the *Microsoft* and *Dentsply* version of raising rivals' costs which is premised on a dominant firm pushing fringe competitors into less efficient distribution channels.

The misappropriation theory

The "scraping" allegation is that Google has misappropriated content from Yelp and TripAdvisor in order to advantage its own local blend and local site.

- We have substantive concerns regarding Google's behavior and the implication for competition in this industry. To address these concerns we present an industry-wide solution that is discussed in Annex 11.

- In order for Google's action to be an antitrust violation there must either be evidence that it increased users on Google at the expense of Yelp and/or TripAdvisor or decreased incentives to innovate. We find no strong evidence of either.

Recommendation

Given the above evidence, we respectfully recommend that this investigation be closed.

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1 Does Google possess monopoly power in the relevant antitrust market?

In order for Google to be in violation of Section 2 of the Sherman Act it must be found to be a monopoly or have substantial market power in a relevant antitrust product market. Google provides numerous products from email services, to video hosting, to computer tablets. Our interest, however, is in its search advertising business.

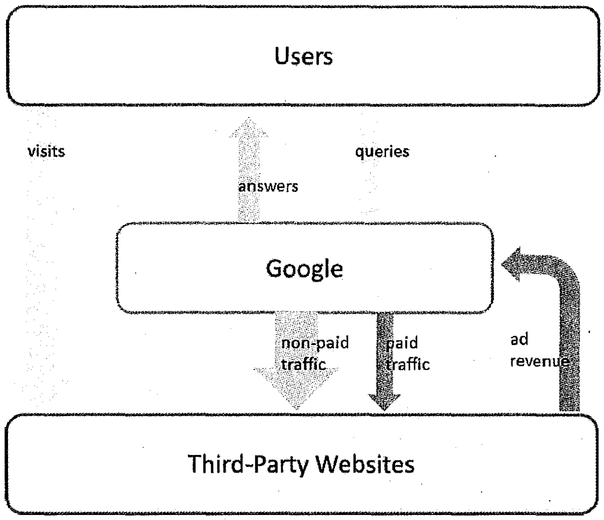
Online search advertising can be thought of as being similar to any other sort of advertising. The framework that has been used by economists for analyzing advertising markets is what is called a "two-sided platform" market. A platform may be a radio station, a television station, a newspaper, a yellow pages book, or a webpage like Google Search. The advertising platform offers free services to one set of users, for example Top 40 songs to radio listeners or *American Idol* to television viewers, in order to attract them to the platform. It then sells access to those users to advertisers interested in getting those users to purchase their products.

Competition between platforms for advertisers depends upon the extent to which advertisers consider users on one platform to be substitutes for users on another platform. Consider a city with two radio stations, a Top 40 station and a classical music station. If an advertiser sells products that are mostly purchased by teenagers then that advertiser will only be interested in advertising on the Top 40 station and will not consider the classical music station to be a competitor. However, if an advertiser sells a product that reaches across various age groups, such as iPhones, then that advertiser may not care that listeners to the Top 40 station are teenagers while listeners to the classical station are their parents. Both want iPhones and the advertiser will go to both stations and will choose how much to advertise based on the prices the radio stations charge and the number of listeners that those radio stations have.

Thus, radio stations compete for both listeners and advertisers. Stations compete for listeners by improving their product, e.g., playing more and better songs, by offering promotions, and by having less advertising. Stations compete for advertisers by having more listeners, by providing better ads to those listeners, and by charging less to advertisers. As listeners want less ads and advertisers want more ads, the radio station will have to balance the two sides of the platform and that balance will change depending on how much competition the radio station faces for either users or for advertisers.

A search engine, like Google, behaves in exactly the same way. It has two sides to its platform. It has users who are interested in getting information and access to websites and it has advertisers who are interested in putting their ads in front of the searchers. See the figure below for the relationship between a search platform, users, and advertisers.

Figure: *Search engine traffic and monetization flow chart*



Google provides users with free access to its database and search algorithm in the hopes that they will frequent Google for their searches. Google offers advertisers access to these users by helping them provide ad links to those searchers that are most likely to be interested in their product. Google competes with other search engines and other websites *for users* by offering better information, quicker access to websites, and less annoying advertising. Google competes with other search engines and websites *for advertisers* by offering more users, better targeted advertising, more advertising opportunities, and lower prices. Like the radio station, Google balances the two-sides of the platform and that balance will depend on how much competition Google has for users and for advertisers.

Principally, Google's market power depends on its share of Internet users. If Google has a large share of users, then advertisers must advertise on Google in order to reach those users. If on the other hand, advertisers can access Google's users at other search platforms such as Yahoo or Bing or access users at other Internet platforms such as Facebook, Google's market power is a lot less. If a large fraction of Google's users "multi-home," that is use both Google and Bing-Yahoo, then advertisers may be willing to switch to competing search platforms if Google raises prices to advertise on Google. If advertisers have the ability to target the same or similar users on other websites, then advertisers may be willing to reduce search advertising expenditure and increase Internet display advertising expenditure.[5]

[5] Online advertising can be categorized by (1) how an ad is targeted and (2) its visual format. There are three basic methods to target ads. *Search targeting* uses the keywords from queries. *Contextual targeting* uses the content found on a particular page, section, or overall site. *Behavioral targeting* uses information particular to a user—e.g., a user's profile on social networks and geo-location information on mobile devices. Irrespective of the targeting mechanism, ads can have different visual formats including text, display, and video. One could, for instance, have a search ad that is formatted as a display (which Google

Evidence

Google's importance as a website integral to reaching users on the Internet with a specific interest or intent confers Google with some degree of market power over search advertising. Google has the ability to adjust prices in its search advertising auction marketplace by changing reserve prices.[6] Advertisers are willing to pay higher prices to advertise on Google because of its share of Internet users and the specificity of search keywords to the user's interest. That said, the Commission should be aware that there exists evidence contradicting the proposition that Google has substantial market power in the search advertising market. This evidence is laid out below.

Google does possess a large share in a search advertising market. In February 2012, 65% of the search advertising paid clicks on the top 5 general search engines went through Google and that share has steadily risen from 55% in September 2008.[7] In terms of search advertising impressions, Google's share in February 2012, was 53% and that number has hovered around 50% for the last three years.[8] Both sets of figures show that a large proportion of search advertising is allocated to Google, which suggests that Google offers advertisers what they want.

What advertisers want are "eyeballs." Advertisers want users that will click on the links that they offer, navigate to the advertiser's website and purchase the advertiser's product. Google accounts for 65% of user queries on the top 5 general search engines.[9] This large share of user queries conveys to Google market power with respect to search advertisers. If a search advertiser such as StubHub, which sells concert tickets online, wants to be in front of a user who types in "Justin Bieber," then there is a good chance that the user is on Google and so StubHub wants to be advertising on Google. There are, however, three pieces of evidence that suggest Google's market power in search advertising is somewhat mitigated.

First, a large number of search users multi-home. About 80% of search users use a platform other than Google in a given month.[10] This means that while an advertiser on

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has recently introduced). Here we follow industry convention and use "display ads" to refer to non-search ads, i.e., contextual and behavioral ads, formatted as display.

[6] See Annex 1 for an economic model of Google's ad auction.

[7] See Figure 1 for further details. A Microsoft study using Internet Explorer data indicates a similar percentage (see Microsoft, Keystone Strategy, "Advertiser Multi-Homing in Online Search Advertising in Europe," June 26, 2011).

[8] See Figure 2.

[9] comScore qSearch for 2011. Other sources including Experian Hitwise, Compete, Nielsen, and calculations based on internal Google and Microsoft data report similar percentages. For a historic plot of search shares and a brief overview of each of the primary search competitors, see Annex 2.

[10] Specifically, comScore data indicates that 20% of users only use Google, 15% never use Google, and 65% use Google and at least one other search engine. Thus, 80% of searchers access a general search

Yahoo or some other search engine may not get in front of a particular user for the query "Justin Bieber," they may get in front of that same user for a different query. The extent to which advertising on Yahoo is a substitute for advertising on Google depends upon the extent to which users do the same queries on competing search engines and the extent to which the advertiser is targeting the query or targeting the user. If the advertiser is targeting the query, then they need to be on Google because a large fraction of the queries take place on Google. If the advertiser is targeting the user, then there is less need to be on Google because many users also use other search engines. It should be noted that based on Google's overall query share, the intensity of use per searcher is clearly less on Yahoo and Bing.

The second piece of evidence comes from our analysis of firm-level purchases of search ads and Internet display ads. We find that firm-level advertising across search and display ads is negatively correlated.[11] For example, if an advertiser like eBay increases search advertising, it tends to decrease display advertising and *vice versa*. It is important to note that we do not observe exogenous relative price changes; consequently, we can only comment on *potential* explanations for the negative correlation. For instance, one explanation for the empirical finding is that advertisers have a budget constraint and allocate advertising spend between search and display based on the relative prices for the two advertising products. There is some support for the idea that display and search ads have some degree of functional overlap. Two Yahoo studies show that display ads, like search ads, can directly lead to greater sales for the advertised product.[12] Google presents evidence that search advertising can be effective for brand awareness and display advertising can be effective for direct response.[13] Other empirical evidence finds that Internet advertising and offline advertising are also substitutes, although the authors do not have a way to quantify the extent of the substitution.[14] Ultimately, we make no claim that search and display are in the same relevant market; yet, we similarly cannot conclude they are unrelated.[15]

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engine other than Google in a given month. (See Figure 3.) Other studies confirm the prevalence of user multi-homing. See Keystone Strategy for Microsoft, "User Multi-Homing in Europe," May 24, 2011, and White, Ryen W., and Susan T. Dumais (2009), "Characterizing and Predicting Search Engine Switching Behavior," *CIKM 2009*, p. 3.

[11] See Annex 3 for full details of our analysis on the movement of search and display ad quantities.

[12] Lewis, Randall A., and David H. Reiley (2011), "Does Retail Advertising Work? Measuring the Effects of Advertising on Sales via Controlled Experiment on Yahoo!," Yahoo Research (the study uses a panel of over 1 million Yahoo users). See also, Lewis, Randall A., David H. Reiley, and Taylor A. Schreiner, (2012), "Ad Attributes and Attribution: Large-Scale Field Experiments Measure Online Customer Acquisition," Yahoo Research (measuring how display ads directly generate new customers).

[13] See Google, RBB Economics, "Substitutability of Different Forms of Online Advertising," September 14, 2010, particularly Figure 1.

[14] See Goldfarb, Avi, and Catherine Tucker, (2011), "Substitution between Offline and Online Advertising Markets," *Journal of Competition Law & Economics* 7, pp. 37-44, and Goldfarb, Avi, and Catherine Tucker, (2011), "Search Engine Advertising: Channel Substitution when Pricing Ads to Context," *Management Science* 57, pp. 458-470.

[15] Havas Digital stated that search ads and contextual ads are in the same relevant market (Havas Digital interview, 10.05.11). Resolution Media stated that a 5-10% decline in the ROI in paid search would result

The third piece of evidence comes from the substantial documentary evidence that Google competes against specialized search engines for certain types of queries.[16] Google's competition with specialized search engines is similar to a supermarket's competition with a convenience store. Supermarkets and convenience stores offer overlapping products like milk, but also offer different products where they do not compete. Whether supermarkets and convenience stores compete depends on the product. If there was antitrust concern about the retail milk market, then it would be difficult to say that convenience stores and mass market retailers do not compete with supermarkets in that market. If the concern, however, is about a merger between two large supermarket chains, it would be reasonable to leave convenience stores out of the antitrust product market.

Similarly with search, if we are analyzing a merger between Google and Yahoo then it is probably correct to leave specialized search engines such as Amazon out of the product market. On the other hand, if our concern is in regards to competition for advertising on product search queries such as "Nikon 5100," a platform like Amazon *may* provide a differentiated but competing product.[17] For commercial queries, general search engines provide an "option value" in terms of offering different types of results.[18] Specialized sites such as Amazon and eBay offer potentially deeper, richer content such as the ability to rank the search results by popularity, price, and reviews.

In sum, Google's shares of paid search advertising clicks and search advertising exposures suggest that Google is a leading seller of search advertising. Google's market power in search advertising, however, could be mitigated by the large proportion of users who also use other search engines; by substitution between search advertising and Internet display advertising; and by competition from specialized vertical search engines for certain queries and advertisers. This brings into question the evidentiary support for the premise that Google has monopoly power in a search advertising market, a necessary condition for all the theories of harm.

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in a diversion of advertising dollars to social networks (Resolution Media interview, 11.07.11). The Apollo Group, one of Google's top 10 advertisers, stated that in face of a 5-10% price increase to advertise on Google Search, it would move dollars to Microsoft's Bing and move aggressively into display advertising on Microsoft, Yahoo, and Facebook (Apollo Group interview, 01.04.12).

[16] See Annex 7 for a discussion of documents indicating that general search engines consider specialized search engines as direct competitors.

[17] We do not have direct evidence on the market shares for specific queries such as "Nikon 5100," but we can infer such market shares by looking at other data. In particular if we assume that a user searching for "Nikon 5100" is looking to purchase this particular model of camera, then we can look at data from a site that sells such cameras and determine where the users came from. Google's share of traffic to the site can be considered a proxy for Google's market share in specialized search for related commercial queries.

[18] See Marissa Mayer (then Google Vice-President of Local and Maps) Investigational Hearing, June 20, 2012, "For example, on my searching behavior there's lots of times when I'll search for a product in general Google not even necessarily even on our shopping site because I want to make sure that I'm getting as comprehensive an answer as possible" (p. 81).

2 Theory 1: The preferencing theory

2.1 Overview

The *preferencing theory* is that Google's practice of blending its proprietary content such as shopping comparison results and local business listings with its customary blue links effectively forecloses or disadvantages competing content sites such as Nextag, eBay, Yelp, and TripAdvisor.[19] Google labels the practice of integrating blends with blue links as "universal search."

The mechanism of harm is premised on Google increasing its user-base at the expense of competing content sites by effectively foreclosing traffic to those sites. This in turn will give Google greater market power over advertisers, who, but for the exclusion, would have substituted some advertising to these competing sites.

Our approach is a general one. For instance, when a blend appears, if there is a corresponding demotion of competing content sites, e.g., Nextag, then the demotion will be part of the effect that we measure. If Google is simply putting in blends without merit, then we are able to measure the effect on users' behavior in terms of their click patterns.[20]

2.2 Analysis

When a blend appears, it has two effects. First, a blend can negatively impact traffic to specialized "vertical" search engines to the extent that a blend (i) pushes down competing vertical search site links on the search results page and (ii) could impact Google's incentive to show competing vertical search site links in the first place.[21] This is

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[19] Inserting blends does not actually exclude or foreclose blue links. Rather, it can affect the location of the blue links on the results page. If a blend appears, then all, some, or none of the blue links are pushed lower on the page. Additionally, Google might institute complementary design changes that further pushes down competing content. Thus, blending is more properly described as *preferencing of content.*
[20] Another issue is consumer deception and manipulation. If users are easily confused regarding which links are likely the most useful, then it follows that users are unable to make meaningful search engine quality comparisons. Consequently, all search engines using blends (including Microsoft, Yahoo, Aol, Ask, Blekko, and DuckDuckGo) are engaging in deception and manipulation. This would make the practice an industry-wide issue and one based on consumer protection rather than antitrust. We do not address the potential consumer protection issues in this memo since it is not a firm-specific allegation.
[21] An example would be the "diversity algorithm" which limits the number of shopping comparison links and promotes other types of commercial sites including direct retailers and manufacturers.

the *external effect*. Second, a blend can impact the consumer value from the search results. This is the *internal effect*.[22]

The potential antitrust issue is the external effect. Google not only competes with vertical search sites for users and advertisers but also acts as a significant source of traffic to these sites. Thus, the question is whether Google is effectively foreclosing vertical competitors. With fewer users, vertical search sites are less attractive to advertisers. To the extent that vertical search sites and Google compete for advertising dollars, this will, in turn, help Google have more advertisers and raise the price to advertise on Google. In the overall welfare assessment, however, we must consider both the external and internal effects. For example, if Google is driving traffic away from rivals and to itself because its product has been improved, we would of course not seek to prohibit or penalize that.

From this framework emerges a number of key empirical questions:

(1) To what extent does Google account for the traffic to vertical sites?
(2) To what extent do blends impact the likelihood of clicks to vertical sites?
(3) To what extent do blends improve consumer value from the search results?

The first question addresses whether or not Google represents a significant enough percentage of traffic to vertical sites to materially impact the viability of these vertical sites. The second question addresses the magnitude of the effect of a Google blend on clicks to vertical sites' links. If the impact of the blends on vertical site traffic is not significant, then Google is not engaging in a practice to monopolize various vertical markets or to maintain a monopoly in a general search market. The third question is important for the overall welfare assessment.

2.3 Empirical evidence

We focus on two categories of blends that have received the most complaints: shopping comparison and local business blends. Our approach, however, is generalizable across all vertical categories.

(1) To what extent does Google account for the traffic to vertical sites?

Google search is responsible for approximately 10% of the traffic to shopping comparison sites.[23] For local business search sites, Google search is responsible for

[22] See Annex 4 for a complete discussion of our platform model.
[23] comScore Media Metrix. See Figure 4.

17.5% of the traffic.[24] [25] [26] It is important to note that these percentages represent the overall category averages. Consequently, a particular site might be significantly more dependent on Google; for instance, in comparison shopping, the percentage of traffic from Google can range from 56% to less than 10%. Nonetheless, if Google is foreclosing rival vertical sites to protect its search monopoly, we must assess the firm's impact on the category as a whole.

(2) To what extent do blends impact the likelihood of clicks to vertical sites?

Blends do not always appear in Google's search results. When they do appear, however, we are interested in understanding the impact of their appearance on the likelihood that users will click a rival vertical blue link. We use a regression model applied to Google's internal click data to measure this effect.[27]

Our results indicate that, when a shopping blend appears, the clicks to other shopping comparison sites drop by a large and statistically significant amount. For example, if a shopping comparison site had a pre-blend click-through-rate (CTR) of 9%, the CTR would drop to 5.3%, which is a 40% decline in the CTR.[28] However, not all result pages have blends, including those associated with navigational queries. Ultimately, these results must be taken together with the prior section's finding that Google search is responsible for a significant, but limited, percentage of traffic to shopping comparison sites as a whole.

When a local blend appears, the clicks to other local sites drop by 0.4 percentage points. Thus, if a local search site had a pre-blend CTR of 6%, the CTR would drop to 5.6%.[29] Overall, local blends have a smaller effect on competing local sites and we cannot rule out that they have no effect.

It is worth noting that the above result for shopping comparison sites is not the same as finding that overall traffic from Google to shopping sites declined due to universal

[24] The percentage is a weighted average calculated using September 2011, data and it excludes Google's own local/mapping site.

[25] The correlation coefficient between overall traffic levels and the percentage of traffic from Google for shopping comparison sites and local search sites is -0.03 and 0.11, respectively (comScore, September 2011). This suggests that low-volume or relatively new sites are not systematically more or less dependent on Google traffic than high-volume sites.

[26] We have also received traffic referral data from third-party complainants through CIDs and voluntary access request letters. Much of the submitted data are broadly consistent with comScore's traffic referral data, with some exceptions. See Annex 5 for a detailed summary of the third-party web traffic data. We detail the traffic changes from Google and other search sites and find no systematic evidence that declines in traffic to shopping comparison sites, presuming there is a decline, are Google-specific.

[27] See Annex 6 for details on the data and the empirical methodology.

[28] 9% is the actual baseline percentage for shopping comparison sites that appear when Nextag is offered.

[29] This is the actual baseline percentage for local search sites that appear when Yelp is offered.

search. As we describe below, if blends represent a quality improvement, this will increase demand and drive greater query volume on Google, which will boost traffic to all sites.

(3) To what extent do blends improve consumer value from the search results?

To measure the impact on consumer value, we determine whether the offered blend leads to fewer clicks on search ads.[30] Intuitively, all links on a search results page are substitutes, whether it is blue links, vertical blends, or advertisements. As blends are introduced, the one constant is the option to click on ads. Thus, if users are less likely to choose an ad when Google offers a blend, compared to when Google offers no blend, we can infer that users prefer blends to no blends.[31]

Our results indicate that shopping blends reduce the ad CTR by 32 percentage points and the result is statistically significant. Thus, if a given ad, prior to the shopping blend, had a CTR of 50%, its post-blend CTR would drop to 18%. This is very large effect. For local blends, while the CTR falls by 1 percentage point, the result is not statistically significant. Overall, the results indicate that when Google presents a shopping blend, it significantly improves consumer value.[32]

Relatedly, Google submitted an empirical study finding significant quality improvements from its universal search product.[33]

2.4 Documentary evidence

Since the late 1990s, general search engines have incorporated vertical blends into their search results.[34] Today, all the major search engines including Google, Microsoft, Yahoo, Ask, and Aol extensively use blends with their customary blue links.

In our review of the documents concerning the practice of blending, we find three broad strands: (1) documents detailing the importance of blends as it relates to general search competition; (2) documents detailing how blends are competitive responses to

[30] See Annex 6 for details on our model and empirical methodology.
[31] This test relies on standard economic assumptions regarding preferences.
[32] The average ad CTR for a shopping comparison site when Nextag is offered is 21% and the average ad CTR for a local site when Yelp is offered is 8%.
[33] Salinger, Michael A., Robert J. Levinson, and Elizabeth X. Wang, "Google's Products Universal Search Result: Rater Reviews and Relative Triggering," Charles River Associates, July 2012. In the study, the authors find a given search results page with universal search has a higher "precision score" than without.
[34] For a fairly detailed history of vertical blends, see Wilson Sonsini, "Google Search Innovation: An Overview of Developments in the Delivery and Display of Thematic Search Results," December 21, 2011.

specialized search competitors; and (3) documents detailing the benefit to users and the benefit to Google in terms of revenue.[35]

The value of these documents is that they suggest that general search competitors such as Google view blends as a way to differentiate their products from each other and as a way to respond to the competitive pressures from specialized, vertical search sites. In that effort, documents indicate that Google perceived blends as benefiting users and benefiting Google in terms of revenue. Ultimately, a platform such as Google will balance the interests of users and advertisers and the documents reflect this.

2.5 Summary of the preferencing theory

Our analysis suggests Google is not a significant enough source of traffic to foreclose its vertical rivals. Additionally, while blends may reduce the likelihood of clicks to rival links, they may also improve the user experience.

Finally, it is worth noting that, in June 2012, Google announced a change to its shopping blend. Starting in the fall of 2012 (with experiments beginning in July 2012), Google is making its shopping blend an advertising product. Thus, placement in the shopping blend will be based on an auction and will be independent of the current search ad auction. Given that the change has not been implemented (beyond experimentation), we have no actual measure of its net effect. One potential change is that the shopping blend will be clicked on less since it is now contains ads, which data consistently show are clicked on substantially less by users. From the perspective of Google, this drop in clicks will be offset to a degree from the direct revenue that a click now brings.

3 Theory 2: Exclusionary practices in search distribution

3.1 Overview

The second theory of harm is that Google is engaging in exclusionary practices in order to deprive Microsoft sufficient economies of scale to compete effectively. There are three primary distribution channels in which Microsoft is alleging this behavior is occurring: (1) *desktop search distribution agreements*; (2) *search syndication agreements* with third-party websites publishers;[36] and (3) *mobile search distribution agreements*.

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[35] See Annex 7 for a sample of documents in each category.

[36] We analyze search syndication as another distribution channel rather than as a separate product market. Nonetheless, the evidence we develop is applicable to variations of the theory including an allegation that Google is using exclusive agreements to foreclose competitors, notably Microsoft and Yahoo, in a search syndication market. Importantly, this more narrow theory divorces itself from scale

Our approach to this allegation is to consider three foundational issues. First, are Google's various distribution agreements substantially impairing the opportunity of rivals to compete for users? Second, what is the empirical evidence that Microsoft and Yahoo are excluded and being denied access to users? Third, what is the evidence that Microsoft is at a competitive disadvantage in terms of scale?

We also consider the effects that various distribution agreements can have on a search engine platform if the agreements substantially increase or decrease the number of users, data, or advertisers. In this final assessment our approach is more general than the theory advanced by the complainant Microsoft.

3.2 *Are the various Google distribution agreements in fact exclusionary?*

Exclusionary agreements merit scrutiny when they materially reduce consumer choice and substantially impair the opportunities of rivals. Below, we consider these issues as it applies to Google's various distribution agreements in the three primary channels.

(1) Desktop search distribution agreements

On a desktop computer, users can access a search engine through (a) direct access, (b) a web browser search box, or (c) a search toolbar.

Direct access occurs when users enter queries on a search engine's homepage. Users can arrive at a homepage through a bookmark, URL entry, or a navigational query on another search engine. For searches on desktops, Google, Microsoft, and Yahoo receive 73% of their traffic from direct navigation.[37] This percentage is important since *all search engines have equal access to consumers in terms of direct access.* Consequently, Google has no ability to impair the opportunities of rivals in the most important and efficient desktop distribution channel.

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issues. In other words, one cannot argue that Google's syndication agreements deny Microsoft scale while failing to address the other channels of distribution in which Microsoft can obtain scale.

[37] We calculated this percentage by taking comScore's total monthly query volume (in December 2011) for each search engine and subtracting out the (i) browser search box queries; (ii) toolbar queries; and (iii) widget/application queries. As a check, we also used an alternate approach. In December 2011, there were 183 million unique searchers using Google to do web search. That compares to 133 million unique visitors who visited both the Google.com homepage and did a Google search. Taking these numbers on their face, about 73% of searchers use the Google.com homepage, which is the same as the first method's percentage of 73% for Google. A related statistic is that 66% of Google's traffic comes from sources where Google does not pay traffic acquisitions costs. This percentage is interpolated from percentages given in Katz, Michael L., Andres Lerner, and Emmett Dacey, "An Economic Analysis of Microsoft's Allegations that Google's Conduct Harms Competition by Reducing Bing's Scale," May 14, 2012. One explanation as to why the 66% value is lower than the 73% we estimate is that the former also includes mobile queries.

In addition, there is an absence of evidence that Microsoft has been denied access to desktop users through web browsers or search toolbars. For instance, Microsoft is the search default on Internet Explorer and approximately 70% of U.S. PCs sold.[38]

(2) Search syndication agreements

The second major distribution channel for general search engines is search syndication agreements with third-party publishers. Websites such as *The Wall Street Journal* and Amazon can partially monetize their websites through search ad revenues, which are shared with the providing search engine.

One defining characteristic of search syndication is that the search results and ads are hosted on third-party websites. Some third-party sites allow branding such as "powered by Google" while others do not, e.g., Yahoo's search results and ads make no mention of Microsoft.

Like the other distribution channels, agreements in search syndication typically involve a revenue share. For some larger publishers and web portals, Google and Microsoft can receive as low as 10-20% of the ad revenue. For example, Microsoft receives 12% of the search ad revenues from its deal with Yahoo. Also, since the results and ads are delivered to a different user-base, the value of the data is different. From what we have learned, syndicated click data is not always useful and may be of significantly lower value than click data from a search engine's own user-base.[39] Indicative of this, Google has never used search syndication data to improve its search algorithm.[40] Microsoft only uses syndication data from Yahoo and Facebook to improve its algorithm.[41] Because of the discounted value of the click data and the relatively high traffic acquisition cost, *search syndication represents one of the most inefficient channels of distribution in terms of value per query.*

Google uses two types of agreements to syndicate search results and ads: (1) standard, online contracts and (2) negotiated contracts.[42] The negotiated contracts account for 97% of Google's syndication revenue.[43]

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[38] Katz, Michael, and Andres Lerner, "Scale & Competition in Online Search," October 13, 2011, p. 21.

[39] *Microsoft Response to FTC Inquiries Regarding Syndication Partners*, January 31, 2012, ("Data related to search queries conducted on inferior syndication partners' websites are not always useful; in fact, if incorporated wholesale into Bing relevance experiments, this data may even be detrimental to relevance and cause Bing user dissatisfaction," p. 2).

[40] Google letter to Per Hellström, European Commission, August 29, 2011, p. 2.

[41] *Microsoft Response to FTC Inquiries Regarding Syndication Partners*, January 31, 2012, p. 1.

[42] Negotiated contracts are also referred to as Google Service Agreements (GSAs).

[43] For U.S.-based publishers in 2010, Google had 38,642 publishers on standard contracts and 85 publishers on negotiated contracts. See Letter to Barbara R. Blank from Wilson Sonsini Goodrich & Rosati, January 17, 2012.

Google states that it does not have an exclusivity provision for its standard contracts; however, for agreements where Google only syndicates the ads and not the search results, it did have a "premium placement" provision for its search ads. In May 2012, Google removed the placement provision for all its standard, online contracts.[44]

For negotiated contracts, Google uses a base template. The base template contains a form of the premium placement provision which stipulates that, if Google search ads are displayed, they must be displayed in a continuous block of at least three ads, if available, and above all other search providers' ads on the same page.[45] Google's rationale for this placement requirement is to achieve "a minimum level of remuneration to Google in return for making its search technology available."[46] Additionally, Google states, "In practice, the clause is often subject to negotiation and modified to allow a partner to display ads in a way that otherwise contravenes the clause."[47]

There are no other required exclusivity provisions. Often, however, publishers put an entire site or suite of sites up for bid in order to maximize the competition for the business. Thus the fact that a negotiated agreement covers all the pages on a given site or set of sites is not exclusivity *per se* but rather a bundled discount. Indicative of this is the fact that some publishers with negotiated agreements do not have exclusivity provisions.[48] By placing its entire site or suite of suites up for bid, publishers are able to bargain more effectively with search engines. This intensifies the *ex ante* competition for the contract and lowers publishers' costs. Consequently, eliminating the ability to negotiate a bundled discount, or exclusivity, based on site-wide coverage will result in higher prices to publishers.[49] This suggests that to the extent Google is depriving rivals such as Microsoft of scale economies, this is a result of "competition on the merits"—in much the same way as if Google had caused Microsoft to lose traffic because it developed a better product and offered it at a lower price.

Have Google's premium placement requirement and bundled discounts effectively denied Microsoft access to publishers? One approach to address this question is to consider the market shares in the syndication channel. Google and Microsoft are the only two search engines with their own ad platforms, which would suggest that they are the only two market participants. However, competing search engines such as Yahoo,

[44] Letter to Barbara R. Blank from Wilson Sonsini Goodrich & Rosati, May 25, 2012.
[45] "Assessment of obligations in AdSense contracts," RBB Economics for Google, Sept. 16, 2011, p. 9.
[46] "Assessment of obligations in AdSense contracts," RBB Economics for Google, Sept. 16, 2011, p. 9.
[47] Response of Google Inc. to the EC, Nov. 22, 2010, ¶98.5.
[48] For example, Amazon is able to use either Google, Yahoo, or Microsoft. Amazon also stated that it does not want to mix different ad platforms on the same page. Amazon interview, 02.15.12.
[49] IAC (Ask) strongly expressed the view that the ability to negotiate an exclusive, longer term contract is central to Ask's competitive position in search and search distribution and strength as an independent competitor to Google. IAC interview, 08.02.12. Aol also shared the view that exclusivity is a benefit to Aol. Aol interview, 12.07.11.

Aol, Ask, and meta-search sites,[50] who all receive syndicated results and ads from Google or Microsoft, can, in turn, re-syndicate search results and ads to third-party publishers.

We will take the approach that syndication shares should be based on who actually receives the primary profit share from the syndication agreement with publishers. Thus, for Yahoo Search, Microsoft is the syndication provider.[51] For sites that Yahoo in turn syndicates, Yahoo is the syndication provider.[52]

Thus, within the search syndication channel/market, among the top 3 firms, Google's share is 44%, which includes queries on Aol and Ask.[53] Microsoft's share is 31%, which includes queries on Yahoo Search.[54] Yahoo's share is 25%. Combined, Microsoft and Yahoo have a 56% share.

If we exclude searches on Yahoo Search from Microsoft's syndication total, then Google, Microsoft, and Yahoo have shares of 63%, 1%, and 36%, respectively, among the top 3 firms.[55]

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[50] Meta-search sites provide search results from more than one search provider.

[51] Microsoft has recently attempted to re-characterize its syndication agreement with Yahoo as a "joint venture" in an effort to lower its market share in a syndication market or channel (Microsoft meeting, 06.11.12). This new characterization is contrary to Microsoft's prior submissions (see *Microsoft Response to FTC Inquiries Regarding Syndication Partners*, January 31, 2012; *Microsoft Letter to the FTC*, January 31, 2012; *Microsoft Response to the EC*, November 21, 2011, MS-FTC-SRCHAD-10_001062). The re-characterization is also inconsistent with Microsoft's internal documents (see MS_FTCGOOG_00050314 @ 27; MS_FTCGOOG_01067591; MS_FTCGOOG_00053244 "Yahoo has undergone major changes including the outsourcing of search to Microsoft") and 10-K filings submitted to the SEC ("Microsoft will provide the exclusive algorithmic and paid search platform for Yahoo websites," Microsoft 10-K, 2009). It is also inconsistent with Yahoo's 10-K filings ("We will be relying on Microsoft as our exclusive platform technology provider of algorithmic and paid search services," Yahoo 10-K, 2010).

[52] This approach is consistent with the language in Yahoo's 10-K, 2010, "Yahoo! shall not assign any Syndication Partnership Agreements to Microsoft, but rather shall continue to be the contracting party and primary partner manager for all of Yahoo!'s existing Syndication Partnership Agreements."

[53] These calculations are for 2011 using Google and Microsoft data. See Figure 5. Note that Microsoft has submitted presentations using comScore data to measure syndication shares. While comScore is suitable for many purposes related to web activity, its qSearch data is limited to less than 200 web properties and many of Yahoo's syndication partners fall outside of this list. For this and other reasons, we find there are significant advantages to using the actual syndication suppliers' data in measuring shares.

[54] This percentage omits search queries originating from Yahoo's other O&O sites, which our understanding is also serviced by Microsoft; consequently, Microsoft's share is somewhat understated.

[55] These shares are in line with shares reported in the *U.S. Department of Justice Memorandum on Google/Yahoo Services Agreement* (September 2008), p. 55 ("Yahoo indicated that it has a 36% market share in this 'affiliate search' category, whereas Google has a 58% share"). The shares are also consistent with an Efficient Frontier report indicating that Yahoo receives over half of its ad clicks from its syndication network (http://blog.efrontier.com/insights/2008/05/search-syndicat.html). As a check, we also calculated syndication shares based on revenues (which are less subject to potential issues involved with reconciling two different data sets). Using data from 2010/11, Google has a share of 78%; Yahoo has a 22% share; and Microsoft has a less than 1% share (assuming again that Microsoft and Yahoo are a joint venture). Yahoo's lower share in revenues likely reflects the composition of its syndication partners and

Thus, combined, Microsoft and Yahoo's syndication shares are higher than their combined shares in a general search engine market. Importantly, Yahoo, despite using Microsoft's search algorithm and search ads for its own sites, is a significant competitor in the search syndication channel.

Google estimates that 3.2% of its total U.S. search query volume comes from exclusive syndication agreements.[56] This equates to about 7.7% of Microsoft's query volume (including Yahoo). Thus, even if we assume Microsoft would win all the queries from these Google syndication partners but for the exclusivity, the queries represent a relatively small percentage of Microsoft's overall output. Importantly, there is fairly compelling evidence that Microsoft would not win all or even most of the queries in competition with Google, which is the question we address next.

What would Microsoft's additional syndicated search volume and search ad volume be but for Google's exclusionary restrictions?

The overwhelming evidence from market participants is that the additional volume to Microsoft would be small. Market participants unambiguously state that Google's success in securing syndication agreements is due to its superior monetization compared to Microsoft. Estimates for Google's monetization advantage range from 30% to 67%.[57]

Both eBay and Nextag stated that they would prefer to be able to mix and match different search ad providers, at least on an experimental basis, without restriction.[58] Despite this stated desire, we have no basis to conclude that, without the restrictions, Microsoft would receive materially more volume. If we use Amazon as a benchmark, the magnitude of switching to Microsoft would be low. Amazon is able to show either Google, Yahoo, or Microsoft search ads for a particular query. Even with this flexibility, Amazon chooses to use Google well over 90% of the time. Given that Nextag and eBay are also shopping sites with similar queries as Amazon, we find Amazon's use of Google relative to Microsoft to be informative. Ultimately, while Nextag and eBay might use more Microsoft without Google's premium placement requirement, we find no basis to suggest that the increased use of Microsoft would be significant.

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the lower price to advertise compared to Google. As a consequence, Yahoo's 22% revenue share indicates that Yahoo's query share is within a reasonably consistent range.

[56] Katz, Michael L., Andres Lerner, and Emmett Dacey, "An Economic Analysis of Microsoft's Allegations that Google's Conduct Harms Competition by Reducing Bing's Scale," May 14, 2012, ¶32.

[57] Aol gave a range of 50%-67% (Aol interview, 12.07.11). Kayak gave a range of 30%-40% (Kayak interview, 12.20.11). Time Warner Cable gave a range of 50%-58% (TWC interview, 09.08.11). Synacor stated Google is 50% better than Microsoft (Synacor interview, 11.29.11).

[58] eBay meeting, 09.15.11; Nextag interview, 05.10.11.

Overall, relative to desktop and mobile queries on owned and operated search sites, search syndication (if we exclude queries on Aol, Ask, and Yahoo) represents approximately 25% of all queries. Even if Google is foreclosing a third of its 63% share (which assumes Microsoft and Yahoo are in fact in a "joint venture") in this channel due to its premium placement clause and bundled discounts, this represents approximately 5% of all search queries—in the least efficient distribution channel in terms of value per query.

(3) Mobile search distribution agreements

The final major distribution channel is mobile search. Are Google's various mobile agreements substantially impairing the opportunity of rivals to compete and reach users?

In terms of background, using data from December 2011, in a U.S. smartphone market, Android OS has a 47% share; Apple iOS has a 30% share; RIM and Microsoft have a 16% and 5% share, respectively.[59] Market shares have changed dramatically over the past two years. For instance, in December 2009, Android and Apple iOS had a combined 30% share, while in December 2011, they have a combined 77% share. The primary change, other than Android's growth, has been the decline of RIM, Microsoft, and Palm during this period.

Relative to other search channels, mobile searches account for 8% of all queries. Focusing specifically on Google, in 2010, excluding syndicated queries, mobile queries (which includes tablets) accounted for 11% of Google's total queries[60] and 2% of Google's total search ad revenue.[61] Thus, while mobile is a rapidly growing distribution channel for search, it still represents a relatively small percentage of overall queries and an even smaller percentage of search ad revenues.

Google has mobile distribution agreements with both Apple and Android OEMs. Microsoft currently has agreements with RIM's Blackberry and Microsoft's Window phones; Microsoft previously had been the default on some Android phones through its agreement with Verizon. Yahoo has also previously been the default on some Android phones through an agreement with AT&T.

[59] comScore MobiLens. Nielsen reports similar percentages. See Figure 6.
[60] This percentage is calculated compared to Google.com searches (which excludes other Google site searches and syndicated searches). Mobile queries are from GOOG-BC-CD-016, submitted February 13, 2012; Google.com queries are from GOOG-BC-CD-18, submitted February 17, 2012.
[61] Google data submission, September 22, 2011, Excel worksheet "All_Advertiser_Revenue_Count."

Google's agreement with Apple stipulates that Google is the search default for the mobile Safari browser[62] and covers no other search access point on Apple's mobile devices. Consequently, Apple can preinstall another search engine's app; set the home-screen search widget to another search engine; and use a different search engine for voice search (which Apple has set to its own Siri search).

Additionally, similar to the desktop Safari agreement, both Microsoft and Yahoo are preloaded alternatives to Google in mobile Safari. According to Apple, to change the default, go to "Settings > Safari > Search Engine."[63] Moreover, when iPhone users navigate to Yahoo or Bing's webpage on their mobile browsers, they are prompted by Yahoo and Microsoft, respectively, to change their default search option.

While the switching cost is likely not as low as for desktop browsers, *a few taps to switch to another search provider must be near the lower bound of switching costs*.[64] Similar to desktop browsers, in order to argue that mobile default agreements limit consumer choice, one would have to argue that a few taps is prohibitively exclusionary.

Even if we consider the switching costs for mobile browsers to be at a level such that rivals' access to consumers is materially impaired, what would the counterfactual be to a default? In response to an EC questionnaire regarding whether Apple would consider simultaneously installing competing search engines on its products, Apple stated: "Apple would not offer simultaneous installation of competing search or mapping applications. Apple's focus is offering its customers the best products out of the box while allowing them to make choices after purchase. In many countries, Google offers the best product or service...Apple believes that offering additional search boxes on its web browsing software would confuse users and detract from Safari's aesthetic. Too many choices lead to consumer confusion and greatly affect the 'out of the box' experience of Apple products."[65]

For Android OS, Google has distribution agreements with the various OEMs who produce Android phones. The agreements typically involve setting Google as the default search option for the mobile web browser and preloading the Google search app on the phone. Again, on the question of whether these agreements are exclusionary, similar to the Apple agreement, alternative search engines are preloaded on the web browser and changing the default involves a few taps.[66] The agreements also do not prohibit users from downloading competing search engine apps or navigating to competing search engines within the browser.

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[62] Apple's mobile agreement is the same as its desktop agreement with Google: Apple receives a revenue share of 40% based on search ads.

[63] http://manuals.info.apple.com/en_US/iphone_user_guide.pdf.

[64] This is not to suggest the agreement confers no value to Google. Our focus is on the switching cost since it is an essential component of assessing restrictions on consumer choice.

[65] Apple Response to the EC, February 18, 2011, p. 6.

[66] Response of Google, Inc. to the EC, June 3, 2011, Annex 2.

While Google is currently the default search engine on most or all current Android phones, Google does not require Google to be the default search engine in order to license the Android OS.[67] As evidence of this, between 2010-11, Verizon shipped seven Android phones with Bing as the default; the OEMs involved were Samsung, Motorola, LG, and Casio.[68] Verizon's agreement with Microsoft to set Bing as the default also prohibited Verizon from preloading other search options such as Google and Yahoo. All seven devices passed Google's Android certification process, and Verizon stated Google never denied a certification request. HTC and Motorola also state Google does not require Google search on its Android phones.[69]

Like Verizon, AT&T has also used a non-Google search default on its Android phones. For some of its HTC, Motorola, Samsung, and Sony Ericsson models, AT&T set Yahoo as the default search widget, hard-key search option, or default search homepage.[70] AT&T stated that customers disliked Yahoo search on Android phones and subsequently has not tried a search provider other than Google.[71] Motorola stated that users expect Android phones to have Google services.[72]

The above evidence indicates that each carrier-OEM-model can choose to implement non-Google search defaults but that the carriers clearly choose Google for market-based reasons rather than because their choice is restricted due to required exclusivity.

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[67] Specifically, according to Google, "Under the MADA [Mobile Application Distribution Agreement], the OEM/carrier can choose to install Google applications (including the Google Search Widget) and set Google Search as the default on a device-by-device basis, but remains free not to install Google applications and set Google as the default search on some or all of its devices at its election. For those devices on which the OEM/carrier chooses to install Google applications and set Google Search as the default search provider, it can nevertheless pre-load any number of other third party applications (such as search widgets from Bing and/or Yahoo!) in combination with the Google applications...Moreover, in certain circumstances, even where an OEM has entered into a MADA or Revenue Sharing Agreement with Google...Google has nevertheless allowed the OEM to ship its compatible devices with competing search providers set as the default search setting" (Response of Google to the EC, June 3, 2011, ¶2.13, 2.15).

[68] Verizon Wireless, 11.07.11.

[69] HTC interview, 11.16.11; Motorola Mobility interview, 09.28.11. HTC further added that, while carriers can put different search engines on Android phones through a waiver, it believes carriers realized it is not a good thing to put two search engines on a phone. Users believe Android phones are Google phones. Additionally, HTC did a study that showed users searched more with Google search. Thus, from HTC's perspective, based on internal deliberations, it wants to keep the interface simple and offer one search engine and users prefer Google. Consequently, HTC has no desire to use Microsoft. Similarly, Motorola stated that there are no provisions which prevent Motorola from loading a third-party app along with Google's apps. For instance, Motorola preloads the Facebook app. Motorola also states that Verizon and carriers have some degree of control over the apps that go on a phone. When questioned whether Motorola would consider using a non-Google search application as the default, Motorola responded that it would not work with Microsoft since Microsoft has been attempting to sue Motorola.

[70] Response of Google, Inc. to the EC, June 3, 2011, Annex 1; http://androidandme.com/2010/03/news/att-removes-google-search-from-android-in-favor-of-yahoo/.

[71] AT&T interview, 03.08.12.

[72] Motorola interview, 03.20.12.

Consequently, the amount of available opportunities to Microsoft and Yahoo at a given point in time are greater than the total Android OS shares would otherwise indicate. Additionally, Mozilla plans on entering the mobile market with Mozilla OS[73] and reports are that Amazon will as well.[74] These planned entries along with the relatively recent entry of Google suggest that barriers to entry are not particularly high in mobile phones and other mobile devices.

In summary, similar to the desktop and syndication channels, *we find Google has little ability to deny rivals access to users.* First, mobile smartphone shares are volatile and can change quickly given the continued competition between the current suppliers and the planned entry by Mozilla and Amazon. As recently as two years ago, Google and Apple had a combined 30% of the market. Since that time, Google and Apple have significantly expanded output, which has correspondingly increased the number of mobile phones with Google set as the default. It would be peculiar, however, to characterize this output expansion and growth as part of an anticompetitive scheme to deny rivals access to consumers and reduce consumer welfare. Second, mobile queries remain a relatively small percentage of overall query volume—although this is changing rapidly. Third, changing the default search option on mobile browsers involves a few taps and downloading other search apps can be achieved in a few seconds. These are trivial switching costs.

3.3 Are rival search engines being excluded from the market?

In the prior section, we find that many of Google's distribution agreements do not substantially impair the opportunity of rivals to reach users. Nonetheless, is it the case that the agreements have, in effect, denied Microsoft and Yahoo access to users? We address this question by considering both market shares and growth trends as well as the number of users each search platform has in a given month.[75]

First, Microsoft and Yahoo's market shares and query growth data show no evidence that they are being excluded from the market. Microsoft and Yahoo combined have accounted for a steady 30% of all searches over the past four years.[76] Since the

[73] http://blog.mozilla.org/blog/2012/07/02/firefox-mobile-os/.
[74] http://www.bloomberg.com/news/2012-07-06/amazon-said-to-plan-smartphone-to-vie-with-apple.html. Amazon already has an Android tablet and separate Android app marketplace.
[75] We note that the evidence of Microsoft and Yahoo's share and growth cannot, even in theory, tell us whether Google's conduct has had a significant impact. Nonetheless, if we find that rival shares have grown or not diminished, this fact can be informative. Additionally, assuming that Microsoft would have grown dramatically in the counterfactual, despite the fact that Google itself is improving its product, requires a level of proof that must move beyond speculation.
[76] See Annex 2 on general search market shares.

announcement of Microsoft and Yahoo's search alliance, Microsoft has grown query volume faster than Google.[77]

Second, we calculate that Microsoft-Yahoo have approximately the same number of search engine users as Google in a given month.[78] This is consistent with the prevalence of user multi-homing—as previously documented.

3.4 Does Microsoft have sufficient scale to be competitive?

In order to assess Microsoft's scale, we need an understanding of Microsoft's cost curves.[79] It is not enough to simply show that having additional click data is useful. Microsoft has stated to staff that, even with its access to internal data, it cannot articulate or estimate the impact of having additional queries and advertisers on its cost curves.[80] As a consequence, neither Microsoft nor staff can demonstrably measure the query volume sufficient to be competitive. Thus, there is little basis for suggesting Microsoft is below some threshold point.[81]

In an effort to offer some guidance on scale, we compare Microsoft's query volume with Google's query volume—noting that query volume is only a proxy for scale economies.

The primary consideration when making this comparison is what queries to include for Microsoft and Google. Our approach is to use three measures of query volume for Microsoft. The first is simply the sum of all the queries on Microsoft and Yahoo sites. We include Yahoo's queries since Microsoft uses Yahoo's queries to improve its algorithm. Additionally, Microsoft acknowledges that it observes and uses the data from 20%-30% of Google search queries and user clicks,[82] which Microsoft calls "clickstream" data. Clickstream data is primarily collected through tracking users on Internet Explorer and Bing toolbars. Susan Athey, Microsoft's Chief Economist, expressed the view that this partially bridges the scale gap with Google.[83] Microsoft also publically acknowledges

[77] Microsoft's query volume increased 134% while Google's increased 54% (comScore qSearch). Focusing solely on 2011, using internal data from Google and Microsoft, from 2011Q1 to 2011Q4, including both desktop and mobile queries, Google increased 7% while Microsoft increased 10%.
[78] comScore qSearch December 2011.
[79] Our focus is on user-base scale. While there is also an advertiser-base scale, the size of the user-base largely dictates the size of the advertiser-base for search engines.
[80] Microsoft-Susan Athey meeting, 11.04.11.
[81] In a March 2012, submission, Microsoft's Susan Athey revised Microsoft's scale claim to suggest that relative scale is more important that absolute scale. See Athey, Susan, Keystone Strategy, "Scale in Online Search," March 10, 2012. While absolute scale is a well-defined concept, relative scale is less so. In the submission, Athey suggests that since Microsoft has lower shares, it is at a perpetual cost disadvantage. Microsoft offers no actual evidence to support this claim.
[82] Microsoft-Susan Athey presentation to staff, 07.11.11.
[83] Relatedly, in an academic paper on news aggregators, Susan Athey offers details on the value of clickstream data including the ability to track users and their searches. See Athey, Susan, and Markus

using clickstream data to improve its search algorithm since 2007.[84] Based on this, the second measure we use for Microsoft is "Microsoft+20%," which assumes the lower bound of Microsoft's estimated use of Google data. For the third measure, "Microsoft+30%," we use the upper bound of Microsoft's estimated use of Google data. For Google, we do not include queries from syndicated agreements, namely Aol and Ask, since Google does not use syndicated click data to improve its algorithm.[85]

In December 2011, Microsoft had 45% of Google's traffic. As a point of comparison, this is equivalent to Google's traffic from February 2008. Using "Microsoft+20%," Microsoft had 65% of Google's traffic, which is equivalent to Google's traffic from September 2009. Using "Microsoft+30%," Microsoft had 75% of Google's traffic, which is equivalent to Google's traffic from August 2010. We do not find these relative traffic levels to be compelling evidence that Microsoft is below some scale threshold to be competitive.

A related question is whether Microsoft's inability to match Google's overall query volume results in a pervasive inability to compete across all types of queries, particularly queries with high commercial value. To address this question, we examined 28 major query categories tracked by comScore (e.g., retail, travel, news). We find significant variation in shares. Microsoft-Yahoo's share can fall as low as 18%, e.g., Education and Technology, and rise as high as 43%, e.g., Gambling. The variability of shares across categories suggests users make search engine decisions based on query-type rather than as an "all or nothing" decision. We also examined the correlation between the commercial nature of a query category (i.e., the ratio of ad clicks to organic clicks) and Microsoft-Yahoo's share in that category. There is a positive correlation of 26%. This finding does not support the idea that Microsoft does more poorly in the commercial, revenue-generating categories. Overall, the category-level evidence is not consistent with the idea Microsoft's scale disadvantage results in a pervasive inability to compete across all category types or in categories which are more commercial.[86]

Finally, Microsoft's public statements are not consistent with statements made to antitrust regulators. Microsoft CEO Steve Ballmer stated in a press release announcing the search agreement with Yahoo: "This agreement with Yahoo! will provide the scale we need to deliver even more rapid advances in relevancy and usefulness. Microsoft

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Mobius, "The Impact of News Aggregators on Internet News Consumption: The Case of Localization," working paper, February 2012.

[84] See http://www.seomoz.org/blog/director-of-bing-discusses-holistic-search-and-clickstream-data-whiteboard-friday. Additionally, Microsoft's Stefan Weitz, Director of Bing, states using clickstream data "is a very common practice because it has enormous user benefits...You're actually able to say 'I know 84 percent of people who go to AlaskaAir.com, the first thing they do is go to flight status.' So now, when I'm building a product like Bing, I can make flight status more prominent, and answer Alaska Air with a flight status answer" (http://news.cnet.com/8301-10805_3-20030454-75.html).

[85] See Google letter to Per Hellström, European Commission, August 29, 2011, p. 2.

[86] See Figure 7 for a plot of Google's share in organic and paid click shares where each observation is a specific vertical category and month.

and Yahoo! know there's so much more that search could be. This agreement gives us the scale and resources to create the future of search."[87]

There is a variant of the scale theory which states that tail-queries, which are less common queries, are where Google's scale advantage manifests itself—even if Microsoft has sufficient scale for head queries. We find little support for this variant of the theory.[88]

Importantly, the prior discussion is based on the premise that more click data is the primary and critical determinant of competitive position and quality. This premise is contrary to the history of the general search market. It is also contrary to the evidence that factors such as the quality of the web crawler and web index; quality of the search algorithm; and the type of content included in the search results (e.g., rich snippets, blended results) are as or more important determinants of the quality of a search engine. Again, according to Microsoft CEO Steve Ballmer, "We [at Microsoft] have come from nowhere to having a product today which I can tell you in a blind-test beats Google in the US. We will beat Google in all markets. It's about how deep you index. It's not really a language question, it's a question of how deep do you index, what percentage of the Internet do we actually see in a country."[89] Microsoft also acknowledges that it would have achieved greater revenue per search (RPS) if not for the technical problems it has had dealing with its syndication agreement with Yahoo.[90] Finally, Microsoft is investing in differentiation through "game changers" that "have the potential for material query share impact."[91] These pronouncements are inconsistent with the assertion that query volume is the sole or primary determinant of quality and competitiveness.

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[87] http://www.microsoft.com/Presspass/press/2009/jul09/07-29release.mspx. In October 2011, at the Web 2.0 Summit, Steve Ballmer also stated: "I would say today, I will issue you all a challenge: take any search you want, and try it out on Bing, try it out on Google...According to our internal stats, 70 percent of the time you probably won't care, 15 percent of the time you'll probably like us better, and 15 percent of the time you'll like the other guy better" (http://www.pcmag.com/article2/0,2817,2394924,00.asp; video of the interview can be found at http://www.youtube.com/watch?v=de8en0Sqy9s). Note that we are not suggesting these public statements by the CEO are sufficient evidence to prove Microsoft has enough scale to be competitive. These type of statements, however, will certainly be used by Google in a potential defense.

[88] See Annex 8 for a detailed discussion of tail queries and scale.

[89] "We Will Beat Google in All Markets," Business Today, June 24, 2012 edition, http://businesstoday.intoday.in/story/steve-ballmer-interview/1/184984.html.

[90] Microsoft meeting, 06.11.12. Microsoft estimates that its RPS is 17% below what it would be if it were not for the complexities of the agreement.

[91] MS_FTCGOOG_00050314 @ 22.

3.5 Theory based on raising rivals' costs

Despite the conclusions reached in the prior sections, could it still be the case that Google's various distribution agreements deny users and data to rivals to the degree that "feedback effects" are triggered, which iteratively render rivals less effective competitors through higher input costs?

Search engine competition for distribution is about user acquisition. Normally, we are not concerned about this competition even if a firm with a particularly large market share wins the majority of the agreements. The concern emerges when winning agreements can trigger feedback effects that lead to the exit or severe diminishment of rivals. The classic example is predatory pricing. If an incumbent prices below cost, then this leads to dynamic effects on the viability of smaller competitors who ultimately exit. Similarly, in the competition between search platforms, there are theoretical feedback effects that might be triggered.

In particular, there are four potential feedback effects:

1. Scale effect: With more users, the cost per unit of quality or ad matching decreases.
2. Indirect network effect: With more advertisers, the number of users increases.
3. Congestion effect: With more advertisers, the number of advertisers falls.
4. Cash flow effect: With more advertisers, revenue increases, which in turn lowers the cost per unit of quality or ad matching.

For the scale effect, the evidence from the prior section suggests there is little basis to conclude click data is the sole or even principal determinant of a search platform's cost per unit of quality.

For the indirect network effect, is it the case that a greater number of advertisers raises the value to search engine users? In one sense, if more advertisers results in better matched ads, then this is a benefit to users. Although, the premise that higher quality ads are significantly more likely to surface with more advertisers is not obvious and certainly difficult to prove.[92] Additionally, even if a greater density of advertisers improves ad quality, the relatively low click through rates for ads suggests that most consumers prefer not to have ads or simply ignore them.[93] For some users, if more advertisers results in more ads on the results page, then this would actually lower quality. Empirical evidence also suggests that more advertisers do not drive user traffic. Since 2008, Google's query volume increased 50% while the number of advertisers on

[92] The statement hinges on how "quality" is defined. If it is based on willingness to pay, then "quality" would increase with more advertisers. However, if quality is based on matching the consumer's query intent—even if the advertiser's site has limited commercial value—then it is not clear that quality would improve. It could also be the case that bad ads repulse users much more than good ads attracting users.

[93] Ads represent 6% of Google's user clicks (Katz, Lerner, and Dacey, May 14, 2012, ¶128).

Google increased 5%;[94] this suggests something other than an advertiser feedback effect is driving user traffic growth.

The third potential feedback effect occurs when a greater number of advertisers on a platform leads to congestion, i.e., more advertisers on a platform lowers the value of the platform to existing advertisers. The effect is to raise the price to advertise, which will result in less advertisers. This will tend to mitigate the indirect network effect.

Finally, we can allow for more advertisers to lower the cost of providing a certain level of quality or certain level of ad matching, i.e., a cash flow effect. Having more cash may allow Google to "invest" more in improving the quality of its search results. Given that Google's primary rival, Microsoft, is not cash constrained, we find little basis to suggest this feedback effect is material.

In sum, while there are theoretical feedback effects that can be triggered, we find the characteristics of the general search engine market do not suggest these effects are of a sufficient magnitude to find Google has the ability to anticompetitively raise rivals' costs.

3.6 Summary of the exclusionary practices theory

Like in many markets, general search engines seek to expand output through greater product distribution. Given that search is monetized through the delivery of search advertisements, both Google and Microsoft have an incentive to expand output and increase their user-base. There are well recognized instances, however, when a firm disrupts the competitive process and uses exclusive practices in order to foreclose rivals and deny them access to consumers or inputs.

Google's behavior, to the extent it denies Microsoft business or even useful scale, is doing so as a consequence of competition on the merits. Even if we assume *all* of Google's distribution agreements are in fact or effectively exclusionary, the agreements cover only 28% of the total available queries.

Finally, if we pursue a more narrow case focusing solely on Google protecting a search syndication monopoly, then this approach necessarily divorces itself from scale considerations. One cannot argue that Google's syndication agreements anticompetitively denies Microsoft scale while failing to address the other, more efficient, channels of distribution in which Microsoft can obtain scale.

[94] Katz, Lerner, and Dacey, May 14, 2012, ¶126.

4 Theory 3: AdWords API limits interoperability across platforms

4.1 Overview

The theory of harm is that Google's AdWords API policy anticompetitively hinders interoperability and growth of the Microsoft ad platform.

Google's AdWords API is intended to facilitate the use of Google for its advertisers. Google introduced the API in January 2005, when Google's general search market share was 35%.[95] Since its inception, the API terms and conditions limit third-party intermediaries such as search engine marketing firms (SEMs)—but not end-advertisers—from co-mingling AdWords data with other ad platforms' data in a manner that would allow for campaign synchronization.[96]

We believe the most candid antitrust theory is premised on Google having a duty to lower rivals' costs by enabling interoperability with rival platforms. Alternatively, the theory would be that when Google introduces innovations that improve the quality of its advertising platform, it has a duty to allow its rivals to benefit from the improvement as well.

One argument in favor of requiring such a duty is that Google is not being asked to spend money to lower rivals' costs. Rather, Google is simply being asked to remove the contractual restrictions. Admittedly, this is less intrusive and less inefficient than requiring Google to engage in product design changes. This type of assessment, however, is focused on potential short-run gains without consideration of long-run incentives and overall welfare effects of implementing such an antitrust policy.[97]

Our approach to address this theory is to first detail advertisers' ability to port their ad campaign data across ad platforms. We then develop an economic framework to assess the welfare effects of the API policy. Next, we present a statistical analysis of advertisers' use, and intensity of use, of both Google and Microsoft. Finally, we detail the perspective of market participants on the impact of the policy.

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[95] "Google's AdWords API Terms and Conditions Do Not Have Anti-Competitive Foreclosure Effects—An Analytical Framework," Google Submission to the EC, ¶1.2.

[96] The specific language is "The AdWords API Client may not offer a functionality that copies data between Google and a Third Party" (http://code.google.com/apis/adwords/docs/terms.html, Section III(2)(c)2). There are also requirements on reporting ad campaign data and performance in a manner that allows for proper platform-specific attribution; however, our understanding is that this reporting requirement is not material to the antitrust story.

[97] Even apart from long-run incentive effects, such a policy by competition authorities could induce firms such as Google, Facebook, and Twitter to evade a remedy by instead incurring costly design changes to make interoperability less feasibly technically.

We do not specifically address Google's primary efficiency defense, which is the API restriction is intended to prevent third-party intermediaries from not fully incorporating the differentiated features found on Google's AdWords. We do note, however, that there is evidence that the efficiency defense is not pretextual.[98]

4.2 Addressing the issue of data portability

On the issue of user-data portability, while the API policy prohibits direct synchronization, it does not prohibit an automated process to export data. Consequently, to the extent advertisers wish to transfer, copy, or port data from Google to another platform, this appears to be a fairly straightforward process.

Microsoft's adCenter support page states advertiser can "easily and quickly move entire campaigns from Google AdWords to adCenter."[99] Microsoft offers step-by-step instructions for exporting AdWords data that involves three clicks and typing in a filename for the exported data.[100] Similarly, in November 2011, Microsoft introduced a new feature labeled "Import Campaigns" for its adCenter platform, which "will enable you to migrate search campaign data from other platforms such as [Google's] adWords, Yahoo! or even a modified excel sheet *directly into adCenter, and keep it synchronized, with minimal effort*" [emphasis added].[101]

In statements and presentations to antitrust authorities, Microsoft suggests that switching platforms and porting data is much more involved and time consuming.[102] We find it more credible to rely on Microsoft's public statements to end-advertisers. Additionally, posted statements from third-parties also suggest porting data can be done easily and quickly.[103]

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[98] Documents citing this rationale go as far back as March 2006. See GOOGEC-0182331 for a summary of these documents.

[99] http://advertising.microsoft.com/small-business/product-help/adcenter/topic?market=en-US&project=adcenter_live_std&querytype=topic&query=MOONSHOT_CONC_ImportingProcess.htm.

[100] http://advertising.microsoft.com/small-business/product-help/adcenter/topic?market=en-US&project=adcenter_live_std&querytype=topic&query=MOONSHOT_PROC_ExportGoogleDesktopCampaign.htm

[101] http://community.microsoftadvertising.com/blogs/advertiser/archive/2011/11/02/making-you-more-productive-import-campaigns-feature-for-desktop.aspx.

[102] *Microsoft EC complaint* and "Google's Obstacles to Ad Platform Interoperability," Microsoft presentation to FTC staff. Google's response to these specific claims can be found at *Google AdWords API paper*, ¶4.13-¶4.16.

[103] According to eCommerceCircle.com, advertisers can "Import All Your Google AdWords Campaigns Into Microsoft adCenter In Less Than Two Minutes" (http://www.ecommercecircle.com/import-google-adwords-campaigns-microsoft-adcenter_3913286.html). According to Clixmarketing.com, "Exporting out of Google AdWords is now relatively easy" (Chapter 12: Month 9—Migrate Your Campaign to Microsoft and Yahoo," Clixmarketing.com). According to *Search Engine Watch*, Microsoft's "adCenter has done a *great* job of mapping the AdWords file export, but there are some idiosyncrasies" [emphasis in the original] (http://searchenginewatch.com/article/2081573/Ensure-Your-Success-When-Porting-

4.3 *Analysis*

We developed a standard economic model to assess the welfare effect on advertisers from the API and the API policy.[104] In this framework, an advertiser optimizes over two ad platforms. Subsequently, if one platform introduces a complementary good, e.g., an API, which lowers the cost of using the platform, we consider the change in the advertiser's optimal choice.

After considering various scenarios, we conclude that the introduction of the complementary good *will make advertisers that use Google better off and will not harm advertisers using Microsoft.* Advertisers who only use Microsoft are not affected by the change. Advertisers that only use Google are better off. Advertisers that use both always have the option of not using the API so they cannot be worse off. That being said, under certain circumstances, removing the restriction has the potential to increase ad spend on Microsoft, potentially with positive overall welfare consequences in the short run.

We also assess the dynamic impact from permitting Google to impose the restrictions on use of its API. In that assessment, we find it unlikely that having more advertisers increases the value of the platform to other advertisers. In particular, the restriction would need to have a significant impact on the number of advertisers using Microsoft.

In summary, by offering an API with a co-mingling restriction, Google increased static advertiser welfare and it is unlikely that this increase in static consumer welfare would be offset by some decrease in competition at a later period.

4.4 *Empirical evidence*

We empirically examine ad platform use and intensity of use across Google and Microsoft using two data sets. If it is the case that Google's API is materially restricting the use of rival platforms, then we should observe either significant single-homing on Google or *de minimis* use of Microsoft for those that multi-home.

The first data set is a list of the top 20,000 advertisers and their spending volume on both Google and Microsoft. After spending a considerable amount of time matching the two accounting systems, our results indicate, in 2010, advertisers that use both Google

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Campaigns-from-Google-AdWords-to-Microsoft-adCenter). Another *Search Engine Watch* article states: "Excel is a terrific tool to build and load ads into a platform such as AdWords or adCenter" (http://searchenginewatch.com/article/2071678/Streamline-Your-PPC-Workflow-With-Excel).

[104] See Annex 9 for the consumer choice model.

and Microsoft were responsible for 73% of ad spending on both platforms. We also found a trend towards greater multi-homing between 2007 and 2010.

The second data set is search advertising impressions from comScore's Ad Metrix. We tracked every search ad impression from approximately 100,000 advertisers across Google, Microsoft, and Yahoo, over a 3 year period. While most prior studies on multi-homing are aggregated (e.g., to the corporate-entity level), we are able to measure multi-homing at the campaign-level (i.e., the ad URL-level). Additionally, we are able to measure ad impressions rather than ad clicks. The advantage of impressions over clicks, for the purposes of evaluating multi-homing, is that impressions offer a better measure of platform use and access. For instance, we are better able to capture advertising by smaller advertisers who receive significantly less clicks and likely at a lower frequency.

In 2011, for the top 25% of advertisers, the percentages on Google and Microsoft are 88% and 80%, respectively. The percentage that multi-home is 68%. For those that multi-home, the ad split between Google-Microsoft is 50%/50%.[105]

For the top 50%, the percentages on Google and Microsoft are 86% and 71%, respectively. The percentage that multi-home is 57%. For those that multi-home, the ad split between Google-Microsoft is also 50%/50%.

For the bottom 25%, the percentages on Google and Microsoft are 76% and 46%, respectively. The percentage that multi-home is 24%. For those that multi-home, the ad split between Google-Microsoft is 51%/49%.

Overall, the results indicate that most of the top advertisers multi-home while most of the smaller advertisers do not. Importantly, even among the bottom 25% of advertisers, half are on Microsoft. Revealingly, for those that multi-home, the ad impression split is evenly split between Google and Microsoft irrespective of whether the group is composed of larger or smaller advertisers. Consequently, there is no empirical support for the idea that smaller advertisers (often characterized as long-tail advertisers) do not use Microsoft's ad platform or, if they do use Microsoft, it is at a *de minimis* amount.

Both Google and Microsoft also report advertiser multi-homing statistics. In one study, Google finds that 80% of paid clicks on Google are from advertisers who are also on Microsoft's ad platform.[106] In another study using DoubleClick data, Google finds 64% of advertisers multi-home and 98% of total ad spending is from advertisers who multi-home.[107] In the same DoubleClick study, Google find that the percentage of spending devoted to Microsoft is around 17%-20%, which does not vary depending on

[105] Empirical evidence presented in Annex 3 is consistent with the finding that advertisers spend on search platforms in fixed proportions.
[106] RBB Economics, "Analysis of advertiser multi-homing," September 23, 2011, p. 5.
[107] NERA Economic Consulting, "An Empirical Analysis of the Extent of Advertiser Multihoming," Lawrence Wu and John Scalf, May 3, 2012, p. 4.

advertiser's size. There is also no meaningful difference in the keywords per campaign on Microsoft relative to Google.[108] Similarly, Microsoft's study on advertiser multi-homing finds, for U.S. advertisers across all deciles, using a weighted average based on ad clicks, the percentage of advertisers who multi-home is 80%-85%.[109]

In all, the data on advertising multi-homing strongly suggest that advertisers use Microsoft and use it at an intensity commensurate with its market share of users. Also, for those who do not multi-home, it is not necessarily the case they are all on Google.[110]

4.5 Views of market participants

Over the past year, staff has also conducted numerous interviews with various SEMs and advertisers, both large and small, to document their views on the impact of Google's AdWords API policy. Very few parties state that the API policy has resulted in materially less spending on Microsoft.

Of the thirteen SEMs that we spoke to that were familiar with the issue, ten stated Google's API policy had no effect, or only a minimal effect, on their advertising decisions.[111] Secondly, large advertisers stated that they allocate spending between platforms based on monetary performance—not the API policy. Finally, small advertisers who multi-home stated they allocate their spending based on the return on investment and relative traffic levels. Of the small advertisers who do not multi-home, the reasons given involve either relatively low traffic levels on Microsoft or an aversion to Microsoft. Some would, however, use a freely provided hypothetical software product that would facilitate campaign management and synchronization across platforms, while others stated they would not.

A related point is that the median keyword count for the lowest three tiers of Google advertisers (which represent 6% of total spending) is 36, while the top two tiers (which represent 80% of total spending) have a median keyword count of 802.[112] This suggests that, for the smallest advertisers, which likely have an average keyword count well below 36, the cost to manage multiple ad platforms, in terms of keyword management, is correspondingly small. It could be the case that other costs associated with multi-

[108] NERA Economic Consulting, "An Empirical Analysis of the Extent of Advertiser Multihoming," Lawrence Wu and John Scalf, May 3, 2012, p. 5.
[109] "Advertiser Multi-Homing in Online Search Advertising in Europe," Keystone strategy-Microsoft, June 26, 2011.
[110] See Figures 8 and 9 which plot campaign-level multi-homing by advertisers on Google and Microsoft-Yahoo, respectively.
[111] See Annex 10 for more details and documentation of the views of market participants summarized in this paragraph.
[112] Google, "Google's AdWords API Terms and Conditions Do Not Have Anti-Competitive Foreclosure Effects—An Analytical Framework," September 23, 2011, Figure 5.

homing, unrelated to the API co-mingling clause, limit the use of multiple ad platforms by smaller advertisers.[113]

4.6 *Summary of the API issue*

The AdWords API lowers the cost of use for consumers and has no impact on rivals' cost of production, cost of distribution, or on rival users' costs. It contains no provisions "that would prevent or discourage licensees from developing, using, or selling any other program."[114] Consequently, we find it difficult to articulate a mechanism where consumers are harmed whether in the short-run or long-run.

The views of market participants, including SEMs and end-advertisers, indicate that the allocation of spending between Google and Microsoft is explained by factors other than the API policy. While it is conceivable that some SEMs and end-advertisers would benefit if the co-mingling clause was removed, there is no indication that the effect would be large. Moreover, the argument that some advertisers and SEMs would benefit from the removal of the clause is not sufficient to establish an antitrust violation.[115]

Additionally, despite Microsoft's characterization, the API policy does not restrict the ability of advertisers to use their own campaign data. The API policy applies to third-party software developers who make commercial products.

Finally, imposing antitrust liability on a firm that introduces a product that strictly improves consumer welfare will diminish long-run incentive effects and create a degree of uncertainty in related markets.[116] Such a policy would also be inconsistent with the *DOJ/FTC Intellectual Property Guidelines,* which states: "Nor does such market power impose on the intellectual property owner an obligation to license the use of that property to others."[117]

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[113] Google's Chief Economist, Hal Varian, expressed the view that "the time that I think is more important [than campaign synchronization] is the attention time subsequently of tracking that progress, tracking what's happening" (Varian IH, p. 139). An analogy would be a small business running more than one location in town, which involves significant costs in terms of management and operational resources.

[114] *DOJ/FTC Antitrust Guidelines for the Licensing of Intellectual Property*, Section 2.3, Example 1.

[115] This includes arguments that, if a platform allowed unfettered use of its API, new software products would be developed.

[116] For instance, both Marin Software and Acquisio state that Facebook has a similar co-mingling restriction (Marin Software interview, 03.02.12; Acquisio interview 09.12.11). According to comScore, in 2011Q1, Facebook had a 31.2% share of all display ad impressions (http://www.comscore.com/Press_Events/Press_Releases/2011/5/U.S._Online_Display_Advertising_Market_Delivers_1.1_Trillion_Impressions_in_Q1_2011). Twitter also has a restrictive ad API policy ("Google's AdWords API Terms and Conditions Do Not Have Anti-Competitive Foreclosure Effects—An Analytical Framework," September 23, 2011, ¶5.17, 5.18).

[117] *DOJ/FTC Antitrust Guidelines for the Licensing of Intellectual Property*, Section 2.2.

5 Theory 4: Potential misappropriation of content (scraping)

5.1 Overview

During a one year period between 2010 and 2011, Yelp and TripAdvisor allege that Google misappropriated their content, including reviews and aggregate review counts, in order to bolster Google's local blend and local site.

Below, we consider various anticompetitive theories based on a Section 2 violation.

5.2 Analysis

First, it is relevant to note that a key component of Google's business model is to surface and organize crawled content to end-users, e.g., Google News. Moreover, we will proceed under the presumption that the actions that Google took in terms of using Yelp and TripAdvisor content are not illegal in of themselves.

The question then becomes: combined with Google's market power in general search, did Google's misappropriation of Yelp and TripAdvisor's content violate Section 2? There are two broad possibilities.

The first is that Google monopolized or attempted to monopolize the local search market with Google Local, based on the misappropriated content.[118] Given Google Local's actual market share in a local search market, there is no support for this possibility.[119]

The second is that Google protected its general search and search advertising monopoly through the use of misappropriated content. The idea is that Yelp/TripAdvisor's content improved and bolstered Google's local blend and Google Local, which is a complement to Google Search. If you increase the quality of a complement, then the quality adjusted price falls, which, in turn, increases the demand for Google Search.

There are two key, potential anticompetitive effects from bolstering Google Search through an improved Google Local include (a) *making the Google platform more attractive to users and advertisers*, relative to Yelp and TripAdvisor, and (b) *diminishing Yelp and TripAdvisor's incentive to innovate*. We discuss each effect below.

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[118] For convenience, we use the term Google Local to identify Google's local search site apart from Google's main search site.

[119] See Figure 10 for Google's share in local search. Note that Google's share is significantly overstated since Google Maps is also used for driving directions in addition to local business search.

The platform effect involves making Google Local more attractive, which in turn makes Google Search more attractive. This will result in more users and advertisers on Google and, consequently, higher prices for advertisers. A question is where the increase in demand originated from. If the increase in demand is from new users to local queries, then the price increase is an efficient response to the demand increase. If the increase in demand, however, is from Yelp and TripAdvisor users, then the price increase is due to greater market power relative to competitors and the net welfare effect is not necessarily positive.

The diminished incentive effect is that Google's misappropriation did not allow Yelp and TripAdvisor to fully internalize the benefit of their content, which in turn resulted in a sub-optimal amount of innovation.[120]

Both the platform effect and incentive effect have the potential to result in greater market power to Google and the associated negative welfare implications. One offsetting welfare effect is that an improved Google Local (and this must be true in order to drive the above two negative effects) results in consumer welfare gains. This balancing of consumer welfare gains with potentially negative incentive effects is a well-recognized exercise, e.g., "fair use" under U.S. copyright law. That being said, we are only identifying this as an economic effect. It may well be that antitrust law discounts or does not recognize this type of consumer welfare improvement, e.g., possible consumer welfare gains due to *per se* violations.

5.3 Evidentiary burden

Given the above framework, we consider the key evidence required to support an antitrust claim.

First, we would need good evidence that Google Search and Google Local are indeed complements. We would want to observe, at the very least, an increase in local queries during the misappropriation, and also an increase in non-local queries.[121]

Second, in order to show the platform effect, we would need evidence of users and advertisers moving from Yelp/TripAdvisor to Google during the period of misappropriation. We find, however, that Yelp's share of local increased from 3.5% to 5.1% from June 2010, to June 2011, and TripAdvisor's share decreased slightly from

[120] Google's actions may also reduce innovation incentives more generally, however we note the evidence previously presented regarding Google's relative importance as source of traffic to various vertical categories.
[121] Note that, to the extent the misappropriation effect is primarily on mobile, then this evidence is weakened by the fact that the Google Places app is unlikely a complement to Google Search.

4.65% to 4.4%.[122] Additionally, the greater traffic to Google for local and non-local queries results in greater traffic to all prominently ranked websites on Google Search, which includes Yelp and TripAdvisor. Consequently, this "total traffic effect" will mitigate, or even conceptually overwhelm, any possible negative platform effect on Yelp/TripAdvisor.

Third, in order to show the negative incentive effect, we would need evidence that Yelp and TripAdvisor actually reduced their innovation relative to the counterfactual.

5.4 Summary of the potential misappropriation theory

We find there is a reasonable basis to theorize that Google's conduct in regards to misappropriating content could, under certain conditions, result in a Section 2 violation. The question becomes whether there is sufficient evidence of these conditions being present *in this particular case* to allege a credible and material antitrust harm.

One limiting issue is the fact that the misappropriation occurred for a period of one year.[123] Given this relatively short duration, perhaps it is not surprising that we are not aware of evidence of negative consequences on innovation.[124] Similarly, in terms of the platform effect, we do not have good evidence that Yelp/TripAdvisor's traffic declined or that a decline was due to the misappropriation. A lack of traffic decline is not in of itself proof that Yelp and TripAdvisor were not affected; however, it makes the burden of proof exceedingly difficult. Additionally, Google will offer a defense of "fair use." As stated at the outset, we find an antitrust violation is possible even under fair use; nonetheless, if Google did indeed conform with U.S. copyright law, Google will have a strong argument that a finding of fair use is inconsistent with the idea of misappropriation or scraping.

While the effects of this particular misappropriation likely do not rise to the level of a Section 2 violation, the possibility of future misappropriation either by Google or another large platform, e.g., Facebook, Twitter, Apple's Siri, remains. We find that there is a potential public policy initiative that would improve the ability of third-party sites such as Yelp to control the use of their content. The idea is to allow third-party content

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[122] See Figure 10.

[123] Google will likely argue that the misappropriation period was significantly less than one year given that Yelp's CEO Jeremy Stoppelman and Marissa Meyer, who was at the time in charge of Google's local search, were exchanging mock ups on how Yelp content should appear as late as January 2011 (Stoppelman: "Hi Marissa, Thanks for sending along the mock. It looks like your new approach is to not aggregate Yelp reviews, but simply point at them from Places when relevant...If that's the case, we're supportive of this approach...However, if this is not your intention, I don't think this mockup represents enough of a change to keep us involved in Places...Thanks for your continued efforts and focus on solving this," FTC-Yelptx-00000095).

[124] Yelp did not present evidence in their presentation to the FTC, 03.05.12.

providers to easily communicate their preferences to various platforms, including Bing and Yahoo, in terms of how to use their content.[125] We find an industry-wide solution offers clear advantages to a Google-specific approach or an opt-in approach, which will result in enormous and debilitating transaction cost inefficiencies.

Respectfully submitted,

Christopher Adams
Economist

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Economist

APPROVED:

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Kenneth Heyer
Deputy Director, Bureau of Economics

[125] One potential method of implementation is through a change in the industry's current robots.txt standard, which is a way for third-party sites to communicate with search engine crawlers. See Annex 11 for discussion of modifying the robots.txt standard.

United States of America
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580
Division of Advertising Practices

TO: Commission

FROM: Laura M. Sullivan
Division of Advertising Practices

DATE: August 20, 2012

RE: Google Inc.,[1] Matter No. 1123064 (Program Code I01)

I. Introduction

The Division of Advertising Practices staff recommends not taking enforcement action against Google in connection with our investigation into its search business. Our inquiry has focused on three aspects of that business: (1) whether Google's blending of its specialized or "Universal" results into what are known as organic results is a deceptive act or practice; (2) whether Google adequately distinguishes paid results or "advertisements" from its unpaid results (whether through labels or visual cues); and (3) whether Google knowingly disseminated, and unfairly profited from, fraudulent search ads for such things as mortgage relief services and weight-loss products. In our January 31, 2012 memorandum, we offered our preliminary assessment that Google's integration of its Universal results does not constitute a deceptive act or practice in violation of Section 5, and explained that our review of documents at that time principally had focused on that issue.

Based on our further review of Google's documents, studies by Google and others, and DAP-commissioned focus group research, we continue to believe that Google has not deceived consumers by integrating its own specialized search results into its organic results. Further, we do not recommend bringing an enforcement action regarding Google's disclosures of its paid results, even though we believe that Google, as well as other search engines, should improve their disclosures. Instead, we propose updating DAP's 2002 Search Engine letter[2] to account for

[1] Google is represented by Susan Creighton, Lydia Parnes, Scott Sher, and Seth Silber of Wilson Sonsini Goodrich & Rosati in Washington, D.C., and by Rebecca Engrav and Albert Gidari of Perkins Coie LLP in Seattle, Washington.

[2] In 2002, in response to a complaint by the consumer organization Commercial Alert, the Division of Advertising Practices published a warning letter concerning search results ("2002 Search Engine Letter"). To avoid the potential for deception, that letter warned search engines of the need to clearly distinguish editorial content from "paid inclusion" or advertising content. Letter from Heather Hippsley, Acting Associate Director for Advertising Practices, to Gary

significant developments in search, and the devices on which consumers view search, since that letter was issued; and working with Google and other search engines to improve their disclosure practices.

Finally, we do not recommend pursuing law enforcement in connection with our investigation into Google's dissemination of fraudulent weight-loss product and mortgage relief services ads. Google's documents show that it recently has significantly stepped up its efforts to enforce compliance with its advertising guidelines, including developing automated means to detect fraudulent ads. At the same time, without extensive additional discovery, we cannot know whether, in the past, Google aided in creating or developing fraudulent ads. Documents reviewed to date indicate this was not the case. Unless we make such a showing, Google likely would be entitled to immunity under the Communications Decency Act of 1996 for FTC law violations relating to its publication of ads provided by others.

II. Google's Insertion of Universal Results Is Not Unlawful

A. Google's Blending of Specialized Results Complies with the 2002 Search Engine Letter

As discussed in our January 31, 2012 memo, DAP's 2002 Search Engine letter forms the primary basis for our analysis into whether Google has violated Section 5 in blending Universal results (*i.e.,* results from its own specialized websites) into its organic results.[3] That letter advised search engines to disclose clearly any results that were included or placed based on payments the search engines received from third parties.

Google's use of Universal results complies with the 2002 letter. We found nothing in the documents Google submitted on this issue, or in investigational hearing testimony, that contravenes Google's claim of only monetizing specialized results through the sale of traditional search ads, which it discloses. Google does not receive direct payments from any of the websites listed in its specialized results. Nor does Google select or order its specialized results based on whether website owners purchased or used other Google services that otherwise generate profits for the company.[4]

Ruskin, Executive Director of Commercial Alert, *available at* http://www.ftc.gov/os/closings/staff/commercialalertletter.shtm.

[3] Microsoft's Bing and Yahoo! similarly integrate results from specialized websites into their organic results. The results, however, usually do not come from their own websites but from third parties such as Yelp or Expedia. We do not know whether these third-party websites pay Bing or Yahoo! to be included, although Bing has indicated in meetings with FTC staff that it has revenue-sharing agreements with some websites.

[4] For example, we examined whether Google favored websites that offered its online payment service Google Checkout, which is now defunct. Merchants using Google Checkout paid

This summer Google converted some of its specialized search properties to a paid inclusion model. The discussion that follows only applies to Google's prior use of its Universal results; we will address Google's disclosure of its new paid specialized results in Part III.B of this memo.

B. Google's Use of Universal Results Comports with Ordinary Consumer Expectations

Even though Google's prior use of Universal results complies with the 2002 Search Engine letter, we further examined whether, in light of affirmative representations Google has made or consumers' expectations, its integration of these unpaid specialized results would mislead consumers about a material fact. We believe consumers ordinarily expect that search engines return results that are relevant, as determined by objective criteria. As noted in our previous memo, Google has made no advertising claims that would alter that expectation. Nor are we aware of any studies by Google or others to the contrary.[5]

Based on our review of materials submitted by Google, there is no evidence that Google's Universal results operate in a manner that is at odds with customary expectations as to how a search engine operates. As it does for general-purpose search, Google retrieves and ranks its

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Google fees to process purchases. There is no evidence indicating, however, that Google considered whether a website used Google Checkout in including or ranking that website in its specialized shopping results.

[5] As discussed in our previous memo, Google did not study the issue of how consumers perceive search generally; nor have any of the other major search engines, based on documents submitted in response to BC subpoenas. Since the 2002 Search Engine letter issued, a few studies have found that users generally believe search engines to be fair and unbiased sources of information, despite not knowing exactly how search engines retrieve and rank results. Internet & Am. Life Project, *Search Engine Use 2012: Even though online Americans are more satisfied than ever with the performance of search engines, strong majorities have negative views of personalized search results and targeted ads*, at 10 (Mar. 9, 2012), http://pewinternet.org/Reports/2012/Search-Engine-Use-2012/Summary-of-findings.aspx ("2012 Pew Search Engine Study") (telephone survey reporting that 66% of search engine users believe search engines are fair and unbiased sources of information); Pew Internet & Am. Life Project, *Search Engine Users: Internet searchers are confident, satisfied and trusting – but they are also unaware and naïve*, at 15 (Jan. 23, 2005), http://www.pewinternet.org/Reports/2005/Search-Engine-Users/1-Summary-of-Findings.aspx ("2005 Pew Search Engine Study") (telephone survey reporting that 68% of search engine users believe search engines are fair and unbiased sources of information, with younger searchers more likely to hold that view); Consumer WebWatch, *False Oracles: Consumer Reaction to Learning the Truth About How Search Engines Work: Results of an Ethnographic Study*, at 11, 13 (Jun. 30, 2003), http://www.consumerwebwatch.org/dynamic/search-report-false-oracles.cfm ("2003 Consumer WebWatch False Oracles Study") (consumers trusted that search engines presented only the best, accurate, and unbiased results on the first page of results).

specialized results based on impartial criteria; but with specialized search, the criteria are designed only to retrieve specific categories of content, such as images or consumer products.

There is no research specifically on consumers' perceptions of Universal search.[6] Nor have we found any evidence suggesting that consumers are dissatisfied with how the Google search engine performs. No consumer group complained about the practice; the only complaints are from competing search engines. Moreover, in a survey this March, more than half of the participants said that, in their experience, search results, including Google's search results, have improved in quality, relevance, and usefulness over time.[7]

Given the absence of research by Google or others on the issue, we commissioned focus group research to obtain at least a qualitative understanding of consumers' awareness and impression of Google's Universal results.[8] The research company's report summarizing the focus group findings is attached to this memo. Three focus groups were conducted at a research facility in Baltimore, Maryland, one consisting of frequent searchers, another of less-frequent searchers, and a third of mobile searchers.[9] During the focus groups, the moderator: (1) showed participants several Google screen shots containing Universal results for shopping, flights, and local businesses; and (2) explored their impressions of these pages, both before and after he provided an explanation of how Universal search works and its benefits to Google.

Although focus group research does not provide a definitive empirical basis on which to evaluate consumers' understanding,[10] it offers some insight into how consumers may perceive

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[6] Google submitted more than 800 studies but, as noted in our previous memo, none relates to consumer perception of Universal results.

[7] 2012 Pew Search Engine Study at 11-12.

[8] Staff worked closely with Dr. Manoj Hastak, our in-house marketing consultant, and James Lacko and Marc Luppino of the Bureau of Economics, in designing and implementing the focus groups. We also consulted our colleagues in BC during the process. Carrie Gelula of the Division of Business and Consumer Education provided invaluable assistance in creating the mock web pages and combined mobile screen shots presented to the focus groups.

[9] Each group, consisting of nine participants, also was screened based on the frequency with which they conducted desktop and mobile searches for shopping-related purposes. Participants were limited to those who identified Google as their primary search engine.

[10] Focus group research is useful in providing rich, qualitative insight into a problem or issue but has limited value for drawing definitive (statistically valid) conclusions or for testing causal hypotheses. Moreover, we cannot project the findings observed in these small groups to a larger population of Google users. The Commission typically undertakes focus group research to determine the need for quantitative research and, if such a need exists, to inform the design of that additional research. As discussed herein, because this Google focus group research provides

Google's use of specialized search. Overall, the focus groups provided no indication that consumers view Google's Universal results as inconsistent with what they normally would expect of a search engine. Although participants demonstrated some confusion as to the origin of the Universal results, most participants in all three groups said Universal results were a good idea after receiving the explanation of how those results work, with the rest saying that they did not care.[11] Even after the moderator explained the specific benefits to Google in favoring its own specialized results, across all three focus groups, only a couple of participants expressed some discomfort. Not one participant, moreover, said that the information about how Google benefits from using the specialized results would change their use of Google's search results.[12]

In contrast, participants reacted strongly to the hypothetical of Google requiring payment from third-party websites to be included in the specialized results. Participants said they would view these results as biased, incomplete, and limited, expressing an overarching concern that, with paid inclusion, the results would not be as comprehensive, and therefore less valuable to them.[13]

Accordingly, based on the strong indication from this focus group research that Google's use of Universal results is not a material fact influencing consumers' decision-making, and the absence of any other evidence to the contrary, we do not believe Google engaged in a deceptive practice in violation of Section 5.

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no indication that Universal results concern consumers, we do not recommend expending further resources to study the issue.

[11] Interestingly, the focus groups revealed that many participants believed websites did pay Google to be included in the Universal results. Upon learning that Google did *not* receive payment from the websites included as part of the Universal results, they had a more favorable view of the results and found them useful.

[12] We had concerns that providing an explicit explanation of how Google benefits from displacing competing websites and sending more ads might, if anything, bias participants to react more negatively to Universal results. However, sharing that information elicited little to no reaction from participants.

[13] Former Google executive Marissa Mayer similarly views this aspect of search to be important to search engine users. During BC's investigational hearing, she testified that:

> I think in many different facets the search engines' measured comprehensiveness is something that matters a lot to the user. They don't want to miss a result if it exists somewhere on the web.

III. Google and Other Search Engines Should Improve Their Disclosures of Paid Search Results

A. Google's Disclosures of Its Top Ads

Our recent focus group research, and the few studies conducted since the 2002 Search Engine letter was issued, underscore the need for disclosures of paid inclusion and paid placement.[14] As noted in our January 2012 memo, in the aftermath of the 2002 Search Engine letter, search engines typically have disclosed paid results on the Search Engine Results Page ("SERP") by labeling them as "sponsored" or "ads" or using visual cues such as background shading or segregated placement. As part of our inquiry into Google's search business, we investigated whether Google has adequately distinguished paid results from the organic results on its SERP, particularly with respect to paid results appearing above the organic results, known as the "top ads."

Through our review of materials submitted by Google, we have confirmed that in May 2010, as part of a SERP design overhaul called "Skunkworks," Google made certain changes to its disclosures of paid results, including: (1) switching the background shading of the top ads to a beige color known as "cosmic latte," which was less visible or luminous than the prior shading; and (2) changing the label for the top ads from "sponsored links" to "ads" with a smaller font size.[15] During the course of the investigation, we have observed additional modifications to the top ads on Google's SERP. Google has switched among several background colors, some of increased luminosity, until reverting back to cosmic latte this summer.[16] In addition, Google recently modified the labels for top ads to read "ads related to [search term]," and also adding the phrase "why these ads."[17]

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[14] 2005 Pew Search Engine Study at 20 (45% of surveyed users would stop using search engine if it was not clear about offering some results for pay); 2003 Consumer WebWatch False Oracles Study at 5, 20 (search engines that are not transparent about paid inclusion are perceived to be less credible).

[15] The CID issued to Google only requested documents and information concerning these May 2010 modifications to its SERP; therefore, we only know of subsequent SERP changes based on publicly available information.

[16] We have determined that the colors are an exact match by comparing the web source code for Google's current SERP with that found in documents discussing the SkunkWorks version of its SERP.

[17] This label may be of improved prominence for several reasons. First, the disclosure appears in the top-left-hand corner of the top ads block, as opposed to the top-right-hand corner. Google's documents indicate that users tend to read information on its SERP from left to right, and thus are not likely to notice disclosures located to the right of the results. Second, the label has a larger font size and consists of more words, resulting in the label occupying more space on the SERP.

We do not recommend bringing a law enforcement action on this issue. Although we believe Google should have paid more attention to the prominence and clarity of its disclosures, our review of materials Google submitted shows Google adopted changes to its top ads primarily for aesthetic reasons. Nor have we found research in these materials indicating whether its modified SERP made it difficult for consumers to notice and comprehend those paid results.[18] We are not foreclosed from showing deception in the absence of extrinsic evidence; however, in this case staff believes we would have to consider whether to conduct some quantitative research measuring what consumers notice and understand about Google's various disclosures and search disclosures generally before moving forward. We, therefore, propose working with Google to improve its disclosures, rather than pursuing legal action at this time. Moreover, as described below, we believe this issue would be better addressed by publicly updating our 2002 Search Engine letter.[19]

B. Google's Disclosure of its New Paid Specialized Results

As mentioned above, very recently Google introduced paid specialized results for some categories such as shopping, flights, hotels, and credit cards. These new specialized results exclude third parties who do not agree to pay Google on a per-click or per-purchase basis. Google labels these results as "sponsored," accompanied by an encircled "i," and surrounds them with a very thin, gray-lined box. Clicking on the "i" triggers the display of a box with the following text:

> Based on your search query, we think you are trying to find a product. Clicking in this box will show you results from providers who can fulfill your request. Google may be compensated by some of these providers.

These paid specialized results appear either above the organic search results or on the right-hand side. Screen captures of two Google SERPs displaying these paid specialized results are attached.

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[18] Overall ad clicks increased substantially after Google reduced the luminosity of the shading for its top ads in May 2010. Google claims that because short clicks back to the SERP (also known as "bad clicks") did not correspondingly increase, the disclosure's effectiveness was unaltered. It makes a similar claim for changes to the labeling for its top ads. Although we do not agree that bad clicks are a proxy for a disclosure's degree of effectiveness, at the same time, we are unaware of any research, by Google or others, that would correlate increased ad clicks with reductions in a disclosure's effectiveness.

[19] Danny Sullivan of Search Engine Land similarly has asked the FTC to scrutinize search engines' compliance with the 2002 Search Engine letter and to determine whether that letter should be updated. Danny Sullivan, *A Letter to the FTC Regarding Search Engine Disclosure Compliance* (June 10, 2012), http://searchengineland.com/a-letter-to-the-ftc-regarding-search-engine-disclosure-124169.

Based on what we have observed of these new paid search results, we believe Google can strengthen the prominence and clarity of its disclosures. At the same time, we are unaware of any research by Google or others testing the effectiveness of these new disclosures.[20] As with its top ads, we believe the best course of action is to work with Google to improve its disclosure practices.

C. Updating the 2002 Search Engine Letter is Warranted

The concerns we have regarding Google's disclosure of paid search results also apply to other search engines. Studies since the 2002 Search Engine letter was issued indicate that the standard methods search engines, including Google, Bing, and Yahoo!, have used to disclose their paid results may not be noticeable or clear enough for consumers.[21] For example, many consumers do not recognize the top ads as paid results,[22] while for others the commonplace label

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[20] As discussed above, the primary purpose of the focus group research was to understand consumers' perceptions of Google's unpaid Universal results. To the extent time permitted, however, the moderator also attempted to explore participants' reactions to two different disclosure formats: (1) a modified heading for Google's specialized results reading "Results from the Google Shopping Website"; and (2) a disclosure similar to the one Google now uses for its paid specialized results. The participants indicated that the sponsored icon of Google's new disclosure format led them to believe there was some form of payment to Google, but they only assessed the disclosure's noticeability in terms of how it compared to the disclosure with the modified heading.

[21] Documents also indicate Google itself believed that many consumers generally do not recognize top ads as paid. For example, in June 2010, a leading team member of Google's in-house research group, commenting on general search research over time, stated:

> I don't think the research is inconclusive at all – there's definitely a (large) group of users who don't distinguish between sponsored and organic results. If we ask these users why they think the top results are sometimes displayed with a different background color, they will come up with an explanation that can range from "because they are more relevant" to "I have no idea" to "because Google is sponsoring them."

BCPGOOGAU-000005316.

[22] SEOBook, *Consumer Ad Awareness in Search Results*, *2 (Apr. 15, 2012), http://www.seobook.com/consumer-ad-awareness-search-results (SEOBook Study); BCPGOOGHUFF-000000453 (2008 field study conducted by Google revealing that many consumers do not interpret top ads to be ads); BCPGOOGMAYE-000006554 (Google's 2007 Epcot Study finding that 56% of less sophisticated users did not differentiate top ads from organic results); 2005 Pew Search Engine Study at ii, 17 (only 18% of searchers surveyed said always can differentiate paid from unpaid results, with 62% reporting that they are not even aware of the distinction between paid and unpaid results).

"sponsored" can be misleading.[23] Interestingly, this April, a survey by the search engine strategies company SEOBook found that a majority of search engine users did not: (1) recognize top ads as distinct from organic results on seven major search engines; and (2) notice background shading used to denote top ads on Google, Yahoo!, or Bing.[24]

Since initiating our investigation, we have observed that all three major search engines – Google, Bing, and Yahoo! – introduced pastel color schemes for their SERPs with background shading for their top ads comparable to each other in terms of hue and luminosity. Consumers' inability to detect top ads may be attributable in part to these search engines optimizing their SERPs for viewing on advanced monitors and mobile devices, while failing to ensure that the colors, including background shading, continue to be visible on older monitors.[25]

An updated Search Engine Letter also would address the developments in specialized search and new paid-inclusion models that search engines increasingly are using to generate revenue and often are less transparent to consumers. For example, although Google integrated its *own* specialized results, another general-purpose search engine, such as Bing, may have revenue-sharing agreement with a third-party website, such as Expedia, that it shows as part of its organic results. That would be a form of paid inclusion that should be disclosed to consumers. Through an informal survey of general-purpose and specialized search engines, we are discovering many other instances where search engines fail to notify consumers of paid inclusion, or use poor disclosures.[26] Updating the 2002 Search Engine letter will establish an updated framework for ensuring that future conduct in this evolving industry is not deceptive. We will share a copy of this updated letter with the Commission before sending it to search engines, including Google.

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[23] 2003 Consumer WebWatch False Oracles Study at 26-27 (nearly all participants indicated that "sponsored" label was "confusing and potentially misleading to the consumer").

[24] SEOBook Study *2, 7-8.

[25] Search engines can differentiate whether a page is rendered on a mobile as opposed to desktop device, based on the operating system detected, and thus can optimize the page for that particular device. However, it is not possible for search engines to know the type of desktop or laptop monitor on which a user will view search results.

[26] This summer we undertook a survey of general-purpose and specialized search engines for travel, local businesses, and shopping, based on lists BE compiled in the antitrust investigation. Among other things, we are cataloging the use of paid inclusion and various disclosure techniques, but are still in the process of refining and evaluating the survey of more than 100 websites, including the seven major general-purpose search engines. Once we complete the survey, it will aid us in framing the concerns we will address in the updated Search Engine letter.

IV. Google's Display of Fraudulent Search Ads

Another aspect of Google's search business that we investigated is Google's dissemination of search ads for certain products prone to fraud, such as mortgage relief services and weight-loss products.[27] Our inquiry sought to ascertain whether Google facilitated the fraud of others by publishing ads for financial services or health products it knew or consciously avoided knowing were deceptive in violation of Section 5, Section 12, or the Mortgage Assistance Relief Services Rule. A letter to the Chairman from Consumer WatchDog complaining about the high incidence of advertising for fraudulent mortgage relief services on Google's SERP prompted us to investigate.[28]

A significant consideration in our investigation has been the immunity Section 230 of the Communications Decency Act of 1996 ("CDA") confers upon online publishers of third-party content. 47 U.S.C. § 230(f)(3). In *Goddard v. Google*, 640 F. Supp. 2d 1193, 1199 (N.D. Cal. Jul. 30, 2009), a district court ruled that, pursuant to the CDA, Google was immune from liability for the precise category of conduct that is the subject of our investigation, *i.e.,* displaying fraudulent search ads. Short of a showing that Google was "responsible, *in whole or in part*, for the creation or development of" the unlawful ads, and thus acted as an "information content provider," the CDA likely forecloses the FTC from pursuing a case against Google. *Swift v. Zynga Game Network*, No. C 09-05443, at *3 (N.D. Cal. Nov. 3, 2010) (quoting CDA); *see also Fair Housing Council of San Fernando Valley v. Roommates.com, LLC*, 521 F.3d 1157, 1162-63 (9th Cir. 2008).[29]

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[27] Our investigation was limited to Google's display of search ads, and did not extend to display ads appearing on third-party websites. Google has separate systems, compliance guidelines, and sales personnel for search and display ads.

[28] At the time, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIG-TARP") separately contacted us about similar concerns, which remained unresolved despite SIG-TARP's efforts to work with Google voluntarily. Through press reports, we also became aware of the Department of Justice's criminal investigation into Google's display of search ads for illegal online pharmacies. This suggested to us that DOJ had reason to believe Google disseminated those ads with knowledge of their illegality.

[29] Website operators such as Google can be found to act both as a service provider and a content provider, depending on their level of involvement in creating or developing any particular ad. *Fair Housing Council of San Fernando Valley v. Roommates.com, LLC*, 521 F.3d 1157, 1162-63 (9th Cir. 2008). In *Goddard v. Google*, 640 F. Supp. 2d 1193 (N.D. Cal. Jul. 30, 2009), the plaintiff's sole basis for claiming Google contributed to the ads' development was Google's automated keyword suggestion tool. The court held that "substantially greater involvement" than provision of this "neutral" tool was required to affect the availability of CDA immunity. *Id.* at 1198-99.

Accordingly, our investigation has focused on two primary areas: (1) Google's efforts to enforce compliance with its ad content policies; and (2) Google's contributions to the development and creation of violative search ads. We prioritized the former issue to assess the potential for future consumer harm, and the latter to evaluate the likelihood of developing an evidentiary record to overcome CDA immunity.

Through our review of materials Google submitted, we learned that, in late 2009, the company launched aggressive efforts to prevent ads, referred to as "bad ads," from violating its ad content policies. These ads include those that are "misleading, unverifiable, or inaccurate."[30] That effort has included significant investment in automated systems to detect violative ads;[31] targeted manual sweeps; and lower thresholds for account suspensions.[32] One innovative policy that Google has adopted is its restriction on serving ads for legal products subject to "consumer advisories" that agencies such as the FTC issue.[33] For example, under this policy, no ad is shown for payday loans unless consumers specify the phrase "payday loan" in their search queries. These intensified measures have resulted in marked improvement. Google's own metrics for bad ads show a reduction of more than 13% in the rate of these ads since early 2010, with only 1% constituting actionable ads.[34] Moreover, staff informally has observed a lessened prevalence of problematic weight-loss product and mortgage relief services ads on Google's SERP.

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[30] Bad ads encompass a range of advertising that violate Google's content policies, including ads for counterfeit and negative-option-billed goods.

[31] Google has developed three separate systems for automated review of ad campaigns to detect fraud at the account, ad creative (*i.e.*, search ads appearing on SERP), and ad landing page level.

[32] This June, StopBadware also announced the formation of an alliance of online companies, of which Google is a founding member, to combat bad ads. Google Official Blog, *Ads Integrity Alliance: Working together to fight bad ads* (June 14, 2012), http://googleblog.blogspot.com/2012/06/ads-integrity-alliance-working-together.html#!/2012/06/ads-integrity-alliance-working-together.html.

[33] Google Advertising Policies Center, Consumer Advisories, http://support.google.com/adwordspolicy/bin/answer.py?hl=en&answer=1314225 (last visited August 16, 2012). This policy provides an opportunity for the FTC to work with Google to reduce consumers' exposure to certain fraudulent advertising, including mortgage relief services and weight-loss products, subject to advisories.

[34] This May, staff met with Google engineers and policy specialists in its ad compliance group, who reported that Google's rate of bad ads was 7%, with 1% deemed actionable and the other 6% meriting policy development. *See also* Google Public Policy Blog, *The fight against scam ads – by the numbers* (May 25, 2012), http://googlepublicpolicy.blogspot.com/2012/05/fight-against-scam-adsby-numbers.html. We know from Google's documents that in January 2010 the bad ad rate was at least 20%.

In contrast, there is no indication so far that Google played any role in developing or creating the search ads we are investigating. The norm is that Google has no interaction with a search ad other than publishing it; advertisers independently use AdWords' automated tools to develop and upload the ad creative. In some cases, Google sales personnel, known as "maximizers," may assist certain advertisers with their ad campaigns, including optimizing keywords and ad text. These services are only available to larger, established advertisers, and to new advertisers for up to a one-month "onboard" period. We have found nothing to suggest that the specific fraudulent advertisers at issue would likely have received this form of assistance, let alone actually received assistance from Google to develop their ad creative.[35] Knowing whether this occurred would require undertaking extensive supplemental discovery.[36]

Accordingly, given Google's substantially improved measures to detect bad ads and our failure to find evidence indicating we could overcome Google's likely claims of CDA immunity, we recommend not pursuing this investigation further.

V. Conclusion

For the foregoing reasons, we recommend taking no legal action against Google with respect to all aspects of DAP's investigation into its search business. In addition, we plan to work with Google to improve its disclosures and send letters to various search engines, including Google, updating our 2002 Search Engine letter outlining the need to clearly delineate paid from unpaid search results.

APPROVED:

Richard Quaresima
Assistant Director
Division of Advertising Practices

Mary K. Engle
Associate Director
Division of Advertising Practices

[35] In consulting with FTC colleagues who have brought cases against larger online marketers engaged in fraud, we also are not aware of an instance where a defendant has received assistance from Google to optimize its search ad campaign.

[36] In DOJ's case against Google, Google ultimately agreed to forfeit $500 million for improperly assisting Canadian pharmacies to run search ads targeting U.S. consumers. Our understanding is that DOJ initiated its grand jury investigation into these practices based largely on information obtained from an informant and an undercover operation in which the government posed as offshore pharmacies engaged in the illegal sale of controlled and non-controlled prescription drugs.

United States of America
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580
Division of Advertising Practices

TO: Commission

FROM: Laura M. Sullivan
Division of Advertising Practices

DATE: September 5, 2012

RE: Google Inc.,[1] Matter No. 1123064 (Program Code I01)

I. Introduction

Commissioner Rosch has suggested that Google may be engaging in an "unfair method of competition" by collecting and using consumer data in connection with its search advertising business. The Bureau of Competition has opined that the "threshold question" in that analysis is whether Google's conduct "violates a consumer protection norm," *i.e.*, whether its conduct is deceptive or unfair under a consumer protection theory. This memo provides an analysis of whether Google has: (1) misrepresented its use of consumer information; or (2) has failed to disclose that it uses consumer information to send targeted advertising, and makes money in doing so, in violation of Section 5 of the FTC Act.[2]

As discussed below, Google does not appear to deceive consumers about either its information use and collection practices for its search engine product or about its financial benefits from advertising. Google has made no affirmative representations that we believe would mislead consumers about these practices and benefits. We also believe Google's refinement of its search ads based on consumers' past searching behavior is consistent with the function of search engines, which is to deliver information relevant to consumers' search queries.

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[1] Google is represented by Susan Creighton, Lydia Parnes, Scott Sher, and Seth Silber of Wilson Sonsini Goodrich & Rosati in Washington, D.C., and by Rebecca Engrav and Albert Gidari of Perkins Coie LLP in Seattle, Washington.

[2] We do not believe there is a sound basis to allege Google's conduct is unfair. With respect to the online privacy area, the Commission has only alleged unfairness when companies retroactively applied material changes to policies governing their use of consumer information. *See Facebook, Inc.*, Docket No. C-4365 (Jul. 27, 2011) (final decision and consent order); *Gateway Learning Corp.*, Docket No. C-4120 (Sept. 10, 2004). We have no information suggesting that Google has engaged in such conduct in connection with its search engine. Nor do we have evidence that Google has used sensitive search data to target advertising, which might be treated differently than other forms of search data under an unfairness analysis.

Nor is there evidence that consumers do not understand that Google makes money through its targeted advertising.

Moreover, because other search engines engage in the same conduct as Google, we have concerns that if the Commission were to impose a disclosure requirement only on Google, consumers may be misled as to the degree of privacy protections other search engines offer.

II. Use of Consumer Data in Search Advertising[3]

A. Background on Google's Search Advertising

Google's core business of sending targeted, textual search ads to users of its search engine remains extremely lucrative. The content of users' queries reveals their interest in a particular subject *at that precise moment*. Advertisers, therefore, have always perceived search advertising as an especially effective method of reaching consumers who might be interested in purchasing or learning more about their products.

Advertisers bid on specific search terms, known as "keywords," to get their search ads displayed on Google's Search Engine Results Page ("SERP"). In determining which ads to display and where to place them, in addition to the amount of advertisers' bids, Google considers a number of quality factors indicative of an ad's relevance and usefulness to users. The algorithms Google uses to evaluate ad quality are similar to those on which Google relies in determining which organic (unpaid) results are relevant to a particular query. Based on what we know generally of Google's search business and Google's public statements, we believe that Google takes into account a user's search history and clicking behavior on its SERP in assessing an ad's quality.

B. Google's Information Collection and Use Practices

Google can track search request information to a single user through two primary means: (1) cookies associated with an Internet Protocol ("IP") address;[4] and (2) when signed-in, a Google

[3] We did not take discovery of Google on the issues discussed herein. The Civil Investigative Demand the Commission issued on June 29, 2011 sought information and documents regarding other aspects of Google's business. We derive our understanding primarily from publicly available sources, supplemented by what we gleaned from materials Google submitted in response to the CID.

[4] Google's servers automatically log information about that user's browser and activities on its website, including the IP address; search terms entered; clicking behavior; and date and time of the user's visit. For location-enabled devices, Google also logs information that allows it to determine the device's physical location.

account the user has created such as a Gmail or YouTube account.[5] Google collects two key pieces of information from all users, whether logged in or not: (1) the specific search terms entered; and (2) the search or advertising results the user clicks (collectively "search history data").[6]

Among other things, Google uses individual search history data to improve its search results. It also uses that information to personalize the search ads it shows users.[7] Google, however, only personalizes search ads if past searching behavior would improve the ad selection for a particular user.[8] Consumers can opt out of receiving personalized search ads and results, but cannot opt out of Google's collection and use of their search data to improve the overall performance of its search product and other services.[9]

C. Privacy Notifications Provided to Users of Google's Search Engine

Google's privacy policy provides details about its practice of personalizing search ads and results. It also informs consumers through its blog posts on privacy in the Policies and Principles section of its website, and in Google Help. In addition, in November 2011, Google began disclosing information about ad personalization with a link that is labeled "Why these ads?".

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[5] For non-signed-in users, Google retains these records for a period of nine to eighteen months, partially anonymizing IP addresses after nine months and cookies after eighteen months. *See* Google Policies and Principles, FAQ, http://www.google.com/policies/privacy/faq/ (last visited September 3, 2012). Google keeps search records tied to a particular Google account indefinitely. *See* Zero Hedge, *How to Clear Your Google Browsing and Video History Before the New Google "Privacy" Policy Is Implemented* (Mar. 1, 2012), http://www.zerohedge.com/contributed/2012-09-01/how-clear-your-google-browsing-and-video-history-new-google-privacy-policy-im.

[6] We limit our analysis to Google's use of search history data for its general-purpose search engine. In this memo, we do not consider Google's potential combination of information collected through its general-purpose search engine with that of its other services, such as Gmail, DoubleClick, and YouTube.

[7] Google's personalized search ads share aspects of both contextual and behavioral advertising. While a user's past searching behavior may inform which search ads Google selects for display, Google only shows ads that match the context of the user's current search.

[8] For example, if a user searching for "vacations in Costa Rica" also recently searched for the term "surfing," or clicked on a search result for a surfing website, Google may show that particular user ads for surfing vacations, as opposed to ads for other types of vacations.

[9] Google also may apply what it learns about users of its search engine to improve its other services such as Google + or Gmail.

Google places this link to the top right of the search ads shown on its SERP. *See* attached copy of Google's SERP.

III. Potential Deception in Connection with Google's Information Collection and Use Practices

It does not appear that Google has either affirmatively misrepresented its collection or use of search history data or failed to disclose material information about that collection and use to consumers. To assess whether Google has misrepresented the nature or extent of its consumer information collection and use practices for its search engine product, we examined Google's privacy policies since 2000, and its other public statements since approximately 2006. We did not find any Google representations that would create a false impression for consumers that Google does *not* gather and use search history data to personalize search ads, or does *not* profit from doing so.

Neither does it appear that Google has failed to disclose a material fact about its information collection and use practices to consumers. Google's practice of using search history data to improve its search products or send targeted ads, and make money through those ads, seems consistent with ordinary consumer expectations. Thus, Google's failure to make a separate, prominent disclosure, and to obtain consumers' express consent before collecting and using that search history data, does not appear to deceive consumers. Returning relevant and useful results is the core function of a search engine, and we believe that search engines' use of search history data to provide the best results is not at odds with that function. Our recent focus group research supports the view that consumers understand that search engines monetize their service through advertising, and, therefore, search engines have an incentive to make their search ads useful and attractive to consumers in the same way they do organic search results. Almost all the focus group participants understood that Google made money through advertising, and they were not surprised that Google used their search history data to target its search ads.

Finally, it would be difficult to prove that any failure by Google to disclose how it uses search history data to improve its search product and to target ads, and obtain express consent prior to doing so, would be material to consumers in their use or choice of Google's search engine.[10] In our focus groups, although a few consumers expressed some discomfort with targeted advertising, no one stated they would be less likely to search on Google because of it. The consensus of the focus group participants was that "it's the price you pay for convenience."

[10] A recent Pew Study did report that two thirds of consumers view personalized search results and targeted advertising in general negatively. However, the study did not indicate whether consumers holding these views would be more likely to stop using a search engine if it did this.

IV. Potential Disclosure Remedy

If the Commission does conclude that Google needs to specifically and prominently disclose to consumers that it collects, saves, and uses their search data to send targeted search ads, and must obtain express consent from consumers before doing so in the future, we would urge the Commission to consider the potential consumer protection ramifications of imposing this obligation only on Google. Other search engines, such as Bing and Yahoo, appear to use substantially similar methods as Google in collecting and using consumer information to personalize search ads and results, as do most major websites, including Amazon, engaged in first-party marketing. Requiring only Google to provide that form of disclosure may mislead consumers into believing other search engines and websites provide greater privacy protection than they actually do.

V. Conclusion

For the foregoing reasons, we do not believe that Google has deceived consumers by not providing a separate and conspicuous notice of its collection and use of consumer search history data to send targeted advertising, and by not obtaining consumers' express consent prior to such collection and use. Nor do we recommend imposing a disclosure remedy that only would apply to Google's search engine.

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Ken Heyer
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September 1, 2012

TO: The Commission

FROM: Ken Heyer

SUBJECT: Google

I. Introduction

The multiple allegations against Google that staff has been investigating for more than a year overwhelmingly involve claims that Google, in one way or another, has been engaged in anticompetitive conduct to maintain its monopoly power in general search. Monopoly maintenance, in turn, would enable Google to exercise great market power in search advertising, profiting handsomely from the enormous revenues it thereby obtains.

The major competitive threats that Google is alleged illegitimately to be weakening or eliminating come from two broad sources. The first is from rival general search engines—specifically, Microsoft's Bing. The second is from so-called "vertical" search engines, such as Nextag and Kayak and many others. This latter category threatens Google's monopoly position not so much by serving as a complete substitute for Google—at least not any time soon---but as a substitute for some of the important segments (shopping, travel, others) that Google serves.

The collection of Google's alleged "bad acts" fall into two broad categories. The first involves conduct that Google engages in in conjunction with independent third parties (e.g., providers of distribution for search engines). The effect of such conduct may be to weaken the competitive constraint otherwise provided by Bing. A second is most accurately described as "unilateral" conduct engaged in by Google—primarily vis a vis competing vertical sites. Here, most particularly, Google is claimed to be unfairly (perhaps also inefficiently) presenting the search results of these rivals in ways, and on terms, that prevent the latter from increasing their popularity, their revenue, and their ability to constrain Google.

In evaluating whether Google should be prosecuted for violating the antitrust laws, or induced under threat of litigation to modify its behavior, we are faced with a host of issues relating both to the factual evidence in front of us, and also to the standard that should be applied to conduct by a dominant firm. While I recognize that, for reasons the BE and BC recommendation memos are careful to point out, proving dominance in a relevant antitrust market may not be a "slam dunk" in this case, I am personally of the view that Google is in fact a dominant firm, and that it is appropriate to analyze its conduct taking that as a given.

I discuss below some of the most critical evidentiary and policy questions arising from this investigation. None can be resolved through recourse to precise estimation tools (such as we may at times rely on via "merger simulations"). Invariably, as is typically the case with monopoly maintenance cases, we will need to make judgments. This is not to say, however, that judgments can, or should, be untethered from relevant principles (and factual evidence).

In asking whether antitrust intervention against Google is justified and appropriate, relevant questions, taken separately or in combination with one another, include the following:

A. Has Google's conduct impaired significantly the ability of rivals to constrain its market power?

Even if the evidence were to show that Google's behavior has harmed its rivals, or seems "unfair" or "unreasonable," antitrust intervention requires more than this. It requires also a showing that the conduct has likely weakened in more than a trivial way the competitive constraints that Google faces. Antitrust enforcement is not about helping to ensure that competitors get their fair share of available profits, or about making sure that dominant firms "play nice."

In this regard, an important evidentiary issue is the strength of our evidence as to the magnitude of any effect from Google's suspect conduct. This is, we know from the BE and BC memos, a matter of some considerable disagreement among members of the investigative staff. I discuss my own sense of the strength of the evidence on "magnitude" in Section II., below.

B. Has Google's conduct amounted to something more than "competition on the merits"?

Simply showing that Google's successes have harmed its rivals is not by itself sufficient to make out an antitrust case, even if we can show that the effect of the conduct is to weaken or eliminate a competitive constraint. While we might prefer that there be a structurally competitive marketplace in general search, the role of the antitrust laws in our economy is not to help engineer such an outcome. We ought not, for example, prevent a dominant firm from creating very attractive products or setting low (but still above cost) prices that less efficient rivals are unable to match, even if the result is that rivals exit the market and the incumbent is able to charge monopoly prices. Rather, antitrust law is properly directed only at conduct that cannot be considered competition on the merits.

This, of course, requires us to determine just what we mean by "competition on the merits." I argue below that the concept should include certain conduct that may not provide direct benefits to consumers, but which are nevertheless a legitimate exercise of legally obtained market power.

C. Does Google have a "duty to deal" with its rivals?

As indicated above, this policy issue is presented most directly by allegations of harm to competing vertical sites; less so with respect to conduct implicating the competitiveness of general search engines (i.e., Bing). To the extent we believe that a dominant firm such as Google ought not be required to facilitate competition by vertical rivals, the case for intervening to prevent/remedy practices such as "preferencing" is weak.

Regardless of whether we believe that the marketplace might be made more competitive by forcing Google to behave differently, something much more is surely required before imposing upon it a duty to assist its competitors. One can imagine any number of things that competition authorities might wish to do to make markets operate more competitively, from compelling monopolists to charge lower prices, to demanding that owners of valuable patents license their IP on reasonable terms to all comers, to requiring owners of efficient factories to allow potential competitors to access and use their privately owned facilities. Antitrust is not, however, about trying to correct static inefficiencies that arise from the exercise of legitimately obtained market power.[1]

D. Should Google's conduct be evaluated piecemeal, or as a unified collection of actions?

Google is alleged to have engaged in multiple bad acts—"preferencing," "exclusive arrangements with distributors," "API restrictions" and "scraping/misappropriating rivals'

[1] Though a bit of a digression, I cannot resist commenting here on the oft-cited legal guidance drawn from Aspen Ski, to the effect that a prior course of dealing with rivals argues for requiring that such cooperation continue—presumably on roughly the same terms. Quite apart from the sensible concern that such a rule amounts to an "anti-divorce" statute that could weaken the incentive for firms to efficiently cooperate with rivals in the first place, there seems to me a more fundamental problem with the reasoning. Firms that have previously cooperated with rivals but no longer wish to do so are presumably changing their preference not because they suddenly realized that the previous policy made no sense, but because there has been some relevant economic change in the marketplace. Maybe it is now more costly to deal with rivals than it once was. Maybe the firm has developed a new service of its own that it wishes to promote in competition with its rivals. Or maybe the firm now wishes to refrain from cooperating in order to lessen the competitive constraint from the competitors who now rely on it as an important, conceivably even an "essential," complement. The point here isn't that we know that a change in conduct is a good thing or a bad thing. It is simply that something, and perhaps a collection of things, has led to the change. Firms don't flip coins and decide from day to day whether to cooperate with rivals. They pursue conduct that they feel, given the existing environment, helps maximize their profits. Unless we know just what the something is that has led to the change in conduct (and determined that we don't want to allow the firm to respond profitably to it), all we can say is that the firm once found it feasible and profitable to cooperate with rivals. We can't say more. In particular, there is no logical basis for inferring that because the firm once cooperated with others, sound policy is for competition authorities to require that this continue as before. End of digression/rant.

content." Each raises its own issues, and for each the staff has obtained and presented to us considerable evidence. Although the recommendation memos examine and evaluate these types of conduct piecemeal, I believe that in deciding whether Google is violating antitrust law it is appropriate for us to consider the effects of its actions in aggregate, not ask whether each form of conduct alone rises to the level of an antitrust violation.

The allegation against Google is that it is behaving anticompetitively to maintain its monopoly power. Even if no individual "bad act" by Google causes sufficient harm to competition to warrant intervention, it may still be that the totality of its conduct does so. It would be inappropriate to give dominant firms immunity from prosecution when the effect of their practices is anticompetitively to maintain a monopoly position, simply because no individual action viewed in isolation is likely to be having that effect.

Nevertheless, it is necessary to examine each of the allegedly anticompetitive actions individually, both because some may upon close inspection turn out to be legitimate (and hence any effect they have on rivals is a consequence of "competition on the merits") and as a way of determining, or "adding up," the magnitude of any potential harm created in the aggregate.

E. Is there an effective and cost-justified remedy?

The difficulties of effectively remedying anticompetitive single-firm conduct are widely known, and are readily conceded by even some of Google's most vocal and most articulate detractors. Such costs would include not only unintended adverse consequences to the competitive process, but also the cost to the FTC and the courts of policing and enforcing the remedy.

These costs are doubtless greatest in attempting to remedy "unilateral" conduct—such as if the Commission determined that Google has a duty to deal. They also arise whenever competition authorities attempt to remedy dominant firm conduct without structurally eliminating the firm's dominance. Dominant firms who have the ability to impair rivals will often have many clever ways of evading the spirit, if not the letter, of specific behavioral decrees. Unless the Commission is going to entertain a *structural* remedy, i.e., one that eliminates Google's ability to do evil, or imposing very blunt prohibitions on Google's conduct (e.g., it cannot create and compete through its own vertical sites), protecting rivals in this case will likely be very costly.

That having been said, difficulty in crafting a remedy is not a sufficient reason for abandoning the field entirely and allowing dominant firms to engage in anticompetitive conduct without restraint. It is, however, a fact of life with which we would need to deal, and I would advise that before even considering seriously filing a Complaint or negotiating a remedy with Google, we commit ourselves to crafting a remedy that we believe would efficiently solve the problem we've identified, and which seems quite likely to do more good than harm.[2]

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[2] It is appropriate to include as a benefit from even an imperfect remedy the procompetitive deterrent effect it may have on the conduct of dominant firms in the future. That having been said, the higher the "short run" costs of such a remedy, the weaker the case for imposing it. And to the extent that a proposed remedy will not serve even to effectively prevent anticompetitive

II. Discussion

a. Monopoly Maintenance I. Google v. Bing

The allegation here is that Google has been engaged in conduct that, by denying Bing scale, significantly impedes Bing's competitiveness. Further, the claim is (or would need to be) that any potentially significant denial of scale has been due to something other than competition on the merits.

The key mechanisms through which Google has allegedly harmed Bing's competitiveness are *de facto* (if not *de jure*) exclusive agreements with publishers and vendors in key channels of distribution (desktop search distribution, search syndication, and mobile search distribution), and contractual restrictions impeding the ability of advertisers efficiently to port their data to Bing when using Google's AdWords API.[3]

<u>Distribution</u>

This is not the place to recite and attempt to evaluate every piece of evidence presented in the two very long and thorough staff memoranda. That said, I should note that I found relatively persuasive the empirical evidence reported by BE on the potential *magnitude* of any effect from Google's arrangements with distributors. That evidence suggests strongly that regardless of whether Google has a strong efficiency justification for this conduct, it is unlikely to be affecting very significantly consumers' access to Bing.

The BE memo notes (pp. 17-18) that Google does not appear to have any significant advantage in reaching consumers via the most important distribution channel, desktop search. In addition to documenting the fact that consumers most commonly reach search engines through "direct access"—a channel through which all search engines have equal access to consumers--BE notes also that Google is not alone in obtaining "default" status for its search engine. Microsoft, it seems, is the search default on Internet Explorer and approximately 70% of U.S. PCs sold. This indicates both that there are likely explanations for "exclusives" other than monopoly maintenance, and also that—at least as regards desktop search--Microsoft has been as successful in "denying scale" to Google as Google has been in denying scale to Bing.

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conduct (due to, for example, alternative means through which the still-dominant firm can achieve a similar effect) the argument for not imposing any remedy is especially strong.

[3] I am aware that Microsoft, in addition to arguing that Google has been acting anticompetitively to deny it scale, has made the very general claim that harm to verticals "weakens the ecosystem" and thereby, indirectly, harms Bing's ability to thrive via, e.g., arrangements with valuable complements. As with many of the other allegations in this investigation, this one falls squarely into the category of "That's certainly possible in theory, but do we have anything beyond speculation (and the claims of a very self-interested competitor) that would inform us as to how significant any such effect is, or might be?." For the balance of this memo, I will ignore this particular argument linking the effects on verticals to the effect on Bing.

On the issue of (allegedly *de facto*) exclusive arrangements to deny Microsoft scale in search syndication, I felt that the evidence presented in the BC memo offered very weak support for the claim.[4]

As an initial matter, Google's agreements with publishers do not require exclusivity. Rather, they ask for "preferred placement."[5] In addition, according to the BE recommendation memo, Google estimates that 3.2% of its total U.S. search query volume comes from exclusive syndication agreements, and that this equates to only about 7.7% of Microsoft + Yahoo query volume. Thus, the universe of commerce available here for Google and Bing is not very substantial. Moreover, the BE memo reports that, partly because Bing is the search engine provider for Yahoo's popular site (and some others), it seems already to be receiving a significant share of the total search syndication business.

As to the impact of these agreements on Bing, the BC memo notes that "all interviewees" reported that Bing's search and search advertising syndication product is not competitive across-the-board with Google today. And while this certainly leaves open the theoretical possibility that many publishers might greatly value using Bing for only certain important segments of search, our investigation turned up little evidence that Google's arrangements preclude very much of this.

The BC memo reports, for example, that "Most of the publishers that reported exclusivity provisions did not complain to us about them," and few indicated that, but for the provisions, they would use Bing instead of, or in addition to, Google.[6] One clear (and benign) explanation for this, is the virtually unanimous view among publishers that Google does a much better job of monetizing search (which in turn permits Google to provide publishers with greater compensation than Microsoft is in a position profitably to do). In addition, evidence indicates that showing multiple versions of the same ad on a single page is viewed by some (Walmart, for example) as a highly undesirable end user experience." Even Amazon, one of the few firms

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[4] All quotes from the BC memo are from the "long version," possibly the penultimate draft. While the discussion in the text focuses on the argument that syndication agreements help deny Bing valuable scale, claims that "exclusive" syndication generates static harm even absent any impact on Bing's efficiency seem to me weak as well. Such arguments ignore plausible efficiencies that arise from exclusives—including the fact that exclusivity can intensify ex ante competition among providers, and that they would be justified to the extent that relationship investments are made ex ante by search engine providers. Moreover, as discussed in the text, the number of publishers expressing a strong demand to use multiple search engines in ways unfettered by Google's restrictions appears to be very limited.

[5] While ubiquitous "preferred placement" would not necessarily be benign, it is at least qualitatively different than complete exclusivity.

[6] The BC memo reports that many of the publishers Staff interviewed had little interest in using multiple providers of search and search advertising syndication services.

currently using Bing for a limited share of its searches, faces some challenges in using multiple syndication providers." Amazon also noted that Microsoft imposes page-level exclusivity whenever Amazon calls a Microsoft ad, in order to "avoid end-user confusion."

It would be too much to say that the arrangements being negotiated between Google and the publishers have absolutely no impact on Bing. One might ask, for example, why Google and the publishers enter into these arrangements if they have no effect. That having been said, and even if Google were not presenting any efficiency justifications for this conduct (which it is), it seems highly implausible that Microsoft is being denied any significant amount of business as a consequence.[7]

Google's API Restrictions

On the issue of Google's restrictions on advertiser porting of data, I would note as an initial matter that although Google's API constitutes a quality improvement, this alone ought not provide it with *per se* legality for any and all contractual restrictions that it might impose on those using it. Such a policy, taken to its extreme, would immunize from the reach of Section 2 virtually all practices engaged in by a dominant firm that happens also to be better or more efficient than its actual or potential rivals.

Having rejected a possible *per se* legality defense, the relevant questions would seem to be "Are there in fact legitimate business justifications for the contractual restrictions Google is imposing?" "What is the likely magnitude of the effect that these restrictions are having on Bing's competitiveness?" and "What would be the costs of remedying the practice if we conclude that it is anticompetitive?"

It would tax the reader's patience (and the writer's stamina) to recite here all the evidence and arguments that are already presented carefully in the BC and BE recommendation memoranda. Let me simply note the following as pieces of evidence I find most relevant.

On the question of business justification, I am not sold on Google's defense that its practice is an efficient way of keeping search engine marketing firms from adopting a "lowest common denominator" approach to running campaigns on Google's AdWords platform. Rather, I find the BC memo's analysis of its "lack of cognizability" to be persuasive.

I do, however, question whether there may be a "free rider" defense to the restrictions Google has imposed in this area. The BC memo describes the interaction between advertisers and Google's AdWords platform as follows:

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[7] Moreover, prohibiting Google and the publishers from entering into these arrangements risks harming the publishers, by denying them whatever compensation Google provides in exchange for the rights that it is negotiating for. Absent evidence of some significant effect of these agreements on the competitive constraint imposed by Bing, that would be an unambiguously poor outcome.

> In order to set up a Google AdWords campaign, advertisers prepare extensive bids, consisting of thousands—even hundreds of thousands—of keywords…Advertisers then prepare advertisements (called "creative" in industry parlance), and match those with various groups of keywords. After an ad campaign is up and running, the advertiser receives data from AdWords that enables it to evaluate the effectiveness of the campaign. Based on that information, the advertiser can modify bids, add or drop keywords, and modify its creative. When done manually, this iterative process, known as ad campaign "optimization," is very expensive and time-intensive.

What is not entirely clear to me from this description is whether Google is, in effect, providing something to the advertiser which (absent contractual restrictions) the advertiser is then free to use for the purpose of improving its ad campaigns on a competing search engine (e.g., Bing). To the extent something of this sort is going on (and it may not be, I simply cannot tell), Google is not simply "preventing an advertiser from using its own data as it would like,"

The extent to which Google's restrictions may be reducing the amount of advertising on Bing is a matter of some significant debate and disagreement between the BE and BC staffs. There seems to be agreement on some things; such as that a significant majority of advertisers currently have advertising campaigns on both Google and Bing and that the share of advertisers that "multi-home" is especially high for large advertisers (who, because they find it profitable to develop in-house tools to simultaneously manage campaigns across platforms, are unaffected by Google's API restrictions). Beyond that, it is hard to find much consensus at all—either on the implications of BE's detailed data analysis, or even on the overall views of market participants.

One important concern raised in the BC memo is that although the data demonstrate a great deal of multi-homing by advertisers, the intensity of advertising on Bing by some of these firms might be much less as a result of the restrictions. Another concern is that the importance to Bing of the group that might arguably begin advertising on Bing, or might advertise more intensively but for the restrictions, may have significance to Bing's competitiveness out of proportion to its potentially modest size.

It is difficult to prove definitively whether or not these concerns are worth weighting heavily. The various cuts at the data and the empirical analysis reported in the BE memo suggest that they are not. To help sort out the disagreement between BE and BC it would be nice to have at least a ballpark estimate of the incremental cost to an advertiser of "manually" porting its data—the incremental cost *net of the likely expense associated with obtaining and employing cross-platform SEM software*.

To the extent this cost seems "large" as compared with the net income an advertiser might expect to earn by advertising (or by advertising more intensively) on Bing, the more likely it is that the API restrictions are having a significant effect. If, on the other hand, these incremental costs appear small relative to the profit opportunity from advertising (or from advertising more) on Bing, then the effect would be at most small. A finding along the latter lines would be consistent both with Microsoft's own public statements that the costs of "getting around" the API restrictions are not large, and with the empirical evidence presented by BE staff.

The evidence obtained from interviews is a bit of a mixed bag, with the BC and BE memos citing their own sets of facts and factoids in support of opposite inferences and conclusions. On balance, the documents do support at least the claim that Google had in mind the potentially adverse effects on Microsoft and YAHOO! from continuing its restrictive API policy.

Relevant Highlights Presented by BC and BE

The BC memo states that

> Nearly all small advertisers tended to support the thesis that many small advertisers would extend their advertising to other search networks if they had access to a cross-platform optimization tool.

It asserts further that "if there were no incremental transaction costs"—presumably ones created by Google's API restrictions—"it would be reasonable to assume that all rational advertisers would multi-home." Many small advertisers do not multi-home, and BC, implicitly at least, attributes this entirely to the API restrictions.[8]

The BC memo further reports that, with respect to demand for a cross-platform optimization tool,

> Nearly all small advertisers interviewed showed interest in such a tool. They believed such a cross-platform optimization tool would be central to addressing their core constraints: time, sophistication, and money.[9]

The BE memo summarizes its take on the views of market participants as follows:

> Of the thirteen SEMs that we spoke to that were familiar with the issue, ten stated Google's API policy had no effect, or only a minimal effect, on their advertising decisions [that] large advertisers stated that they allocate spending between platforms based on monetary performance—not the API policy [and Finally,

[8] This inference seems to me too strong. I would not expect that in the absence of Google's API restrictions all non-multi-homing advertisers would begin advertising also on Bing. Some might continue not doing so because of the cost of a multi-homing tool, or because of the cost of also monitoring an ad campaign on another search engine. Others may not find it profitable to work with and pay Bing for capturing it more eyeballs and clicks. Recall that "clicks" do not themselves translate automatically into sales for the advertisers, and Google quite possibly does a superior job of helping firms monetize their investments in advertising.

[9] It is unclear whether the fact that these respondents expressed interested in such a tool means that they would actually buy one (i.e., pay money it) if these were for sale in the marketplace.

that] small advertisers who multi-home stated they allocate their spending based on the return on investment and relative traffic levels. Of the small advertisers who do not multi-home, the reasons given involve either relatively low traffic levels on Microsoft or an aversion to Microsoft. Some would, however, use a freely provided hypothetical software product that would facilitate campaign management and synchronization across platforms, while others stated they would not.

The BC memo emphasizes that in evaluating internally whether to relax or remove its API restrictions, Google considered explicitly the effect that doing so might have on its search rivals. Internal documents also confirm Google's view that a cross-platform tool would be efficient for advertisers to use. Perhaps the strongest Google document on this point—a communication authored by an API product manager and endorsed by Google's director of product management)—is the following:

> If we offer cross-network SEM in [Europe], we will give a significant boost to our competitors. Most advertisers I have talked to in [Europe] don't bother running campaigns on [Microsoft] or Yahoo because the additional overhead needed to manage these other networks outweighs the small amount of additional traffic. *For this reason, [Microsoft] and Yahoo still have a fraction of the advertisers that we have in [Europe], and they still have lower average CPAs [cost per acquisition].*

Granted, this refers to Europe (where I believe Google is even stronger than it is in the U.S.), and from 2007 (at which time Bing's quality was far lower than it is now). And perhaps more recently Microsoft has developed for advertisers more efficient workarounds to the API restrictions. Still, and despite the high overhead costs of managing accounts on Microsoft that would not be eliminated entirely by using a cross-network tool, use of the phrase "will give a significant boost to our competitors" surely reveals a broad recognition by Google that the restrictions might have been having some non-trivial bite.

BC cites other documents confirming both that Google viewed cross-platform technologies as potentially making the market more efficient, and at least some concern that a risk of permitting these might be "existing spend being channeled to MS/Yahoo! due to a more lenient official policy on campaign cloning." Google ultimately decided at the highest levels against relaxing these restrictive conditions, though the rationale for that particular decision remains opaque.

On the issue of how effectively and efficiently this conduct by Google's could be remedied if there were justification for doing so, it is clear that eliminating contractual restrictions tends to be lower cost than, say, demanding modifications to a dominant firm's technology. That said, there are undoubtedly ways that a dominant firm such as Google might be able to mimic the results of its API restrictions, perhaps inefficiently. Ways of avoiding such an outcome without either imposing significant additional costs or failing to effectively remedy the problem would need to be thought through more carefully.

Mobile

As an initial matter, recall that Google's agreements with smartphone manufacturers do not actually require exclusivity. Rather, they are contracts that require Google search to be the initially installed default search engine. Consumers are free to switch to other search engines, or even to replace Google as their default search engine, should they wish to do so.

I am slightly more agnostic than BE staff on the issue of whether Google's default agreements amount to more than a trivial impediment to consumer switching. Users don't pay anything to search, and hence it is not as if competition between search engines on price could be used to induce switching from one search engine (the default setting) to another. Quality competition, however, would be expected to have an effect, and it is undeniable that customers can in principle switch search engines with very little effort.

The BE memo notes the relative ease with which consumers are able to change the default, and points out that

> While the switching cost is likely not as low as for desktop browsers, a few taps to switch to another search provider must be near the lower bound of switching costs. Similar to desktop browsers, in order to argue that mobile default agreements limit consumer choice, one would have to argue that a few taps is prohibitively exclusionary.

This seems to me a reasonable statement.

A sense of how much Google pays for the right to be the default search engine on a smartphone might help shed further light on this issue, since if default status is not much of an advantage we would not expect to see large payments being made. It might also be interesting to know—though perhaps learning it is infeasible—just how much switching actually takes place away from one's default search engine on a mobile device. Do those whose devices have Google set as the default do much switching to Bing? Do those with a Bing default setting switch significantly to Google?[10]

How big is the mobile search market? i.e., how important might it be for Bing to have additional access to it? According to data analyzed by BE, as of December 2011 mobile searches accounted for a mere 8% of all queries. Even if Google has been anticompetitively "locking up" this channel completely and we assume also that in the absence of the "exclusives" Bing would be capturing roughly the same share of mobile that it obtains elsewhere, the magnitude of any effect on Microsoft's scale would be very modest.

[10] In a recent communication, BE's John Yun indicated that his preliminary review of the available evidence suggests that consumer switching is relatively infrequent.

In fact, even this overstates the potential anticompetitive harm to Bing, as it ignores the fact that Google does not have default setting agreements with all mobile devices. Microsoft currently has agreements with RIM's Blackberry and (not surprisingly) Microsoft's Window phones. Those mobile devices have roughly twenty percent of the smartphone market, perhaps suggesting that a not insignificant fraction of the current 8% mobile search market is being "locked up by Bing."

We do not yet know the future importance of the mobile market as a channel for search engine distribution. It will of course grow, but by how much, by how much relative to other channels, and with what significance for the ability of general search engines to capture and exploit additional scale, are unknowns.

What we do know is that the market is not currently a major source of search traffic for Google or Bing, and that Google's practices fall well short of "exclusive dealing." We know also that Google and Microsoft currently compete for default status on individual mobile devices. Preventing this form of competition would have uncertain and plausibly quite small effects on any Bing scale disadvantages relative to Google.[11] Moreover, competition for default status doubtless redounds to the benefit of smartphone manufacturers. Any such benefits would be sacrificed if such competition were prohibited.

b. Monopoly Maintenance II. Google v. the Vertical Sites

There are at least three questions here. One is whether Google is actually engaging in the practice in question. A second is the effect the practices may be having on verticals' ability to compete. A third is whether Google's conduct, whether it harms rivals or not, can be justified as "competition on the merits."

Google's documents confirm that it recognized the growing competition from vertical sites and, at least implicitly, the desirability of responding. The primary message of subsequent documents on this subject—or at least those I recall seeing—is of the importance to Google of developing its own competing product(s) and working harder to improve their quality relative to the competition. This sounds, on its face, highly procompetitive, and is in contrast to that other widely-cited monopoly maintenance case with which we are all familiar, where internal documents used considerably more troubling language such as "Let's do this to cut off their oxygen supply." While absence of such documents is hardly proof that a dominant firm's

[11] Google is selected as the default search engine not simply because of any payments or threats it may be making to manufacturers, but because it offers the best product. As noted in the BE memo, Apple, for example, in its response to an EC questionnaire regarding whether it would consider simultaneously installing multiple search engines on its products, stated that it would not do so, as "Apple's focus is offering its customers the best products out of the box while allowing them to make choices after purchase. In many countries, Google offers the best product or service…Apple believes that offering additional search boxes on its web browsing software would confuse users and detract from …the 'out of the box' experience of Apple products."

conduct is not anticompetitive, their relative absence from the record here seems at least worth noting.

To the extent that Google is engaged in the conduct being alleged (e.g., "preferencing," or contracting for exclusive distribution rights), there is of course a possibility, as Google claims, that its conduct has a legitimate business justification. Even if true, that wouldn't mean that the conduct is *per se* legal. One can readily imagine (and the law would find objectionable) circumstances where conduct has an extremely small benefit while simultaneously producing a substantial competitive harm. Therefore, asking whether problematic conduct makes "no economic sense" but for its ability to harm the competitive process is, in this respect, technically only a one-sided test.

That having been said, conduct for which there is a legitimate business justification (i.e., that would be profitable even absent its ability to harm the competitive process) warrants considerable deference by competition authorities. In large part this is because of the considerable difficulties in performing an accurate balancing test—which would require one to know, for example, just how much preferencing contributes to monopoly maintenance.[12]

One way of thinking about whether Google's conduct has a legitimate business justification is to ask whether Google's actions are ones that would be profitable for it to engage in even absent any benefit it receives by harming the competitive process. Indeed, this is one reason why we not infrequently ask whether firms operating in the same market as the dominant player—firms clearly not acting to maintain or obtain monopoly power—are engaged in similar types of conduct. Evidence that they are, while not dispositive, should properly weigh against government intervention.[13] Conversely, conduct that appears profitable only because it may harm the competitive process is troubling.[14]

In cases where it is clear that the harm to competition from a dominant firm's conduct likely exceeds any benefits--including the dynamic benefits of permitting even a dominant firm to

[12] "Legitimate business justifications" properly include more than simply conduct that lowers one's costs or improves the quality of one's product. Price discrimination, for example, is a tactic commonly employed by firms to earn greater profits and which does not necessarily "improve efficiency."

[13] Examples of such behavior in competitive markets are not uncommon. I spent some time last month watching the Olympics on NBC. Interestingly, but unremarkably, most of the (innumerable) ads being shown for the upcoming television season were for programs on NBC. I doubt (seriously) that ads for shows on other stations were clearly inferior—whether judged by quality of the ad itself, or by the attractiveness of the show being advertised. Still, and despite the fact that it was not favoring its other business units to help maintain a monopoly of anything, NBC found it profitable to "favor itself" in this way.

[14] Conceivably, Google's use of API restrictions may fall into this category.

legitimately maximize its profits—imposing an efficient remedy would of course be entirely appropriate.

Preferencing

"Preferencing" is surely one of the central claims being made by critics of Google's conduct. The BE and BC staff memoranda both do an outstanding job of laying out the documentary and empirical evidence, as well as relevant legal considerations. They both conclude, BC with somewhat less confidence, that preferencing does not make out a strong and sufficient basis for an antitrust case.

Although much of the available evidence is subject to alternative explanations, I would not dismiss the claim that, at least under certain well-understood meanings of the term, preferencing is to some extent going on. The considerable empirical work reported by the BE economists, however, makes a strong case that any such conduct is not having a very significant negative impact on the ability of verticals as a group to compete. That having been said, it is clear that numerous individual complainants have proffered evidence and testimony suggesting otherwise.

Preferencing, to whatever extent it may be harming the ability of vertical sites to compete, is not unambiguously being done for anticompetitive purposes (or with anticompetitive effect). Google operates in a two-sided market, attracting both users and advertisers. The two are of course related, though optimizing the user experience need not be the best way for a search engine firm to maximize its profits (which come solely from advertising revenue, given that search engines provide search to users free of charge). In determining how to maximize its profits Google would reasonably consider not simply the user experience, but the impact on its advertising revenues as well.

Like many other firms who are integrated into complementary services and operate in a two-sided market, Google may "favor itself" at times in order to more effectively maximize its profits. And it may find this a desirable strategy regardless of whether such favoritism weakens or eliminates the competitive constraints imposed by rivals. Its conduct, that is, may well make sound business sense even absent any adverse effects on competition (as distinct from "adverse effects on competitors").[15] The Appendix to this memo consists of a concise discussion by BE

[15] Potentially benign reasons for "favoring oneself" could include some or all of the following. Risk avoidance (e.g., if Google makes relationship-specific investments based on third-party content, a third-party provider could engage in hold-up; change its business model; change the quality of its content; or change its willingness or desire to partner with Google) and related to this, the ability of Google to control the content. Vertical search properties are complements to general search properties, and as Google improves the content and quality of its vertical search sites, this, in turn, makes Google Search more attractive. This internalization of benefits will result in more users and advertisers on Google, and Google consequently has strong incentives—arguably stronger than independent complements have—to develop its vertical content in ways that enhance overall welfare. Vertically integrating and perhaps favoring oneself may also reduce transaction costs associated with negotiating explicit or implicit agreements with third-party content providers. In addition, Google benefits from greater traffic if it keeps the user on a

economists John Yun and Chris Adams of benign or procompetitive incentives to favor one's own product in a two-sided market. Several of the points made in the Appendix are mentioned also in Fn. 15, above.

Google has presented considerable evidence attempting to show that its evolving methods of doing business benefit consumers greatly.[16] Regarding accusations that Google anticompetitively overrides the results of its organic search algorithm to vault its own thematic results ahead of the listings of rivals, we have learned that this exact type of favoritism is commonly employed by non-monopolists such as Microsoft Bing as well. Hence, the practice is consistent with a non-monopoly-maintenance business justification.

While there are responses one might make to Google's claims, at bottom the argument for a case needs to be that Google should be required to deal with its rivals on terms they find acceptable.[17] At least as significant, and not unrelated to the fact that there are facially plausible but difficult to disentangle arguments on both sides of the preferencing debate, is the issue of appropriate remedy. It seems exceedingly difficult and costly to impose a remedy for this sort of practice that would prevent the bad conduct without inevitably impeding in a significant and costly way Google's ability to improve its product and run its business efficiently and profitably.

Google owned site. Perhaps the longer users are on Google owned sites, the higher the probability the user will click on an ad or enter another query. If so, then Google receives a greater benefit from favoring itself--even if Google has no foreclosure effect on vertical rivals, and even if Google is somewhat degrading the quality of its product. Widely recognized "Halo" effects, for example, are benefits from having customers use your products more often or more intensively, again regardless of whether monopoly maintenance is the purpose or effect. Google also argues, doubtless with justification in many circumstances, that it wishes to exclude sites that may be providing users with poor or misleading information.

[16] If nothing else, creating a large and valuable Universal Search Box near the top of one's search results page "demotes" and crowds out the ability of rivals to appear prominently. Moreover, consistent with the view that Google's conduct has benefitted users is the fact that even independent analyses show that Google Search has markedly improved the user experience over time. See, for example, the results of the Pew Study cited at Fn. 7 of the August 20, 2012 recommendation memo from Laura Sullivan in the Division of Advertising Practices. To be clear, this is not itself proof that, but for preferencing, Google would have made its search product even better, much less that the potential costs to competition couldn't outweigh the benefits from having an improved Google product.

[17] Recall again that Google's unwillingness to deal with its rivals on terms they demand is qualitatively different from conduct (e.g., exclusive dealing) that enlists third-parties in an effort arguably to impede the competitive process. Google does not, at least insofar as I know, make it a condition of displaying vertical sites on Google that these sites not also work with or show up on Bing. Nor does it require advertisers to refrain from patronizing competing sites as a condition of being allowed to advertise on Google (the API restrictions notwithstanding).

Scraping

Vertical sites such as Yelp have voiced complaints that Google has been misappropriating content, such as restaurant and travel reviews, that they had created. Google had apparently been not only searching and displaying these websites on its search results pages, but also "scraping" the content from these sites and incorporating it into Google's own competing vertical sites.

Such conduct, which I believe Google may have recently announced an end to, could well reduce economic welfare by reducing the incentive that "to-be-scraped" sites have to invest and innovate. If, once you have developed a successful product, your competitor freely copies it and displays it – perhaps even more prominently—on its own website as its own, the return you can expect from your initial investment is reduced. For this reason, there would be an argument for prohibiting such conduct—assuming that an effective and efficient remedy could be crafted.[18]

On the other hand, there is an argument that because Google has absolutely no duty to deal with these vertical sites in the first place, it perhaps ought to be permitted to demand, as a condition for the right to have their sites and their results displayed by Google at all, agreement that Google will be allowed to copy and use their content. This is the sort of issue that invariably arises when we are considering whether to require a dominant firm to deal with its rivals; and if so, on what terms.[19]

Google does not charge Yelp or other vertical sites for the right to be displayed on Google's search page. Why shouldn't it have the right to do so by demanding something in exchange? In particular, what should limit their right to say "We'll display your site if you allow us to use your content. If you don't like it, go to Bing, and/or advertise elsewhere so that internet users will know to type www.Yelp into their web browser if they want to find your cool content?

One might argue that although Google does not actually charge vertical sites for the right to be shown, Google does receive benefits from showing their content, as doing so helps make Google more popular with users (and thus advertisers). Maybe so. But simply because Google receives a non-monetary benefit, this doesn't imply that it should be required to accept that benefit as "payment in full." And even if vertical sites did offer Google monetary compensation, should Google be required to accept that and ask for nothing more?[20]

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[18] The magnitude of any effect on the incentives of sites such as Yelp to continue innovating following Google's conduct may or may not be great. That remains an empirical question. The direction of the effect, however, would seem clear.

[19] If Google had announced at the outset of its dealings with vertical sites that it would never copy and use their content in this way, doing so after those firms had made investments in reliance of such assurances might be deemed a contract violation, if not an antitrust violation as well. I have not seen any evidence, however, of Google having provided vertical sites with *ex ante* assurances of this type.

[20] It has been argued that because Google threatens to not even display popular vertical sites if they refuse to allow Google to scrape and "misappropriate" their content, this is strong evidence of a monopoly maintenance motive. Not displaying these sites would likely impose a cost on

Speaking of which…

A Hypothetical

Yelp, or some other vertical site, wishes to be shown on Google. We prohibit Google from scraping Yelp's site in exchange for the right to be shown on Google's search results page. Google now says "Ok, I won't scrape your site and copy your content as my own. But I do want to be compensated for the service I provide to you, as being compensated helps cover my costs and provides me with a reward for innovating and creating this great search engine product that you value so highly. In exchange for my displaying your results, I would like a payment consisting of 75% of your profits. This seems a fair percentage to both of us, since perhaps 25% of your profits are due to your own efforts and the services provided to you by other search engines."

If this appears to resemble a legitimate use of Google's property rights and the market power it obtained through skill, industry and foresight, note that it may be providing a very strong disincentive for Yelp to invest and innovate in the future. The effect might even be as great as if Google were to charge Yelp in the form of scraped content that Google subsequently displayed on its competing vertical site.[21]

III. Conclusions and Recommendations

The great American philosopher Yogi Berra once famously remarked "Predicting is difficult, especially about the future." How right he was. And yet predicting, and making decisions based on those predictions, is what we are charged with doing. Ignoring the potential problem is not an option. So I will be reasonably clear about my own tentative conclusions and recommendation, recognizing that reasonable people, perhaps applying a somewhat different standard, may disagree. My recommendation derives from my read of the available evidence, combined with the standard I personally find appropriate to apply to Commission intervention.

Regarding concerns about anticompetitive conduct that denies necessary scale to Bing, my overall impression is that while Google's conduct has likely been having a negative effect on Microsoft's profitability, this is not clearly damaging significantly Microsoft's "but for" ability to compete. That, not the mere possibility that it may be doing so, is the standard I would apply. What effect there has been, or is likely to be, does not seem to me large, and at least some may

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Google, and one might infer that the only sensible explanation is that Google is foregoing profits in order to help maintain its monopoly. But Google and these sites have essentially been bargaining over surplus. I have seen no evidence that Google has adopted a policy of flatly refusing to deal with these firms on any terms that these firms might, however unhappily, be willing to accept.

[21] Modifying the Hypothetical slightly, a similar argument could readily be made with regard to preferencing.

be a result of competition on the merits. Whether viewed piecemeal or, as I think appropriate, in aggregate, I do not see Google's conduct here to warrant intervention.

My impression is that if Google were guilty of monopoly maintenance because of conduct vis a vis Microsoft, efficiently remedying those forms of conduct where Google "may" have stepped over the line might be feasible, though that is merely a hunch, since there may be costs—long-run as well as short-run—that I am not fully appreciating. That said, "Ease of remedy" is not a strong argument for imposing a remedy if we have not first reached a sound conclusion that Google's conduct is anticompetitive and rises to the level of an antitrust violation. Furthermore, the mere fact that Google may be willing to offer up some concessions to ward off litigation does not seem to me evidence either that its conduct is having an anticompetitive effect, or proof that accepting what Google offers would be economically desirable.

Were it the case that intervening to prevent even what seems to me a small (but uncertain) effect would plausibly make a huge difference in the going forward competitiveness of the general search market, my recommendation might well be different. For example, if even a small "thumb on the scale[22]" (i.e., a very minor foreclosure percentage) by Google seemed likely to reduce Bing's efficiency dramatically, or make the difference between whether it survives or not, that would be an argument for intervening. The evidence I have seen does not, however, support viewing this as anything more than speculation—Microsoft's strong, but obviously self-interested, assertions notwithstanding.

More generally, I do not accept the argument that any actions engaged in by Google that potentially harm or disadvantage Microsoft in any way, no matter how modest, is cause for government intervention absent a clear and compelling efficiency justification by Google. While Google does seem to have plausible efficiency justifications for some of its actions, I can't say that I am persuaded that it has a persuasive one for all. Nevertheless, the burden of proof for intervening in the marketplace, particularly given inevitable costs of imposing a remedy, should in my view be more on the Commission to show likely and significant harm than on the defendant to prove that every element of its conduct is benign or procompetitive.

As to the allegations that Google has anticompetitively maintained its monopoly by harming vertical sites through "preferencing" and scraping, I again feel that its behavior does not rise to the level of an antitrust violation meriting intervention by the Commission. These allegations raise serious questions regarding whether and when a firm such as Google should have a duty to deal with its rivals—on terms they desire. There are good arguments that regulators ought not impose a duty to deal, and there is strong evidence (e.g., from the BE memo) that the effects of Google's alleged preferencing have not been severe, may have been efficient, and have in large part consisted of competition on the merits. Even if the evidence on these points were not compelling, it seems undeniable that any attempt to remedy this type of conduct effectively would require substantial intervention into the way Google exercises its business judgment, improves and modifies its products, and legitimately maximizes its profits.

[22] Pun definitely intended.

The scraping concerns, I would concede, raise particularly thorny issues in light of the evidence that the conduct was unquestionably being engaged in, has clear potential for reducing innovation, and "may" be feasibly remedied. It is perhaps of some limited comfort that Google appears already to have modified its conduct in this area, albeit by implementing policy changes to which it is not legally bound.

On the issue of remedy more generally, my own feeling is that when exercising our prosecutorial discretion, ease of remedy should be a consideration to be weighed against likely magnitude of harm. Where harm to the competitive process is arguably small or speculative, as I believe to be the case here, and where legitimate business justifications for much of the conduct are plausible, high remedy costs argue for doing nothing—much as we might feel frustrated.

Gary Reback, who represents several vertical site complainants, emphasizes in his submission that any piecemeal approach to remedying Google's anticompetitive conduct would likely amount to "fighting the last war," and is otherwise doomed to costly failure. He argues that a firm in Google's position would have any number of skillful ways by which to evade a narrowly drafted decree.[23] I tend to agree. Reback argues that some sort of structural remedy is required, and proposes in his lengthy White Paper that Google should be prevented from developing or purchasing vertical sites of its own.[24]

If the perceived problems here can be solved only through a draconian remedy of this sort, or perhaps through a remedy that eliminates Google's legitimately obtained market power (and thus its *ability* to "do evil"), I believe the remedy would be disproportionate to the violation and that its costs would likely exceed its benefits. Conversely, if a remedy well short of this seems likely to prove ineffective, a remedy would be undesirable for that reason. In brief, I do not see a feasible remedy for the vertical conduct that would be both appropriate and effective, and which would not also be very costly to implement and to police.

One final argument is worth discussing. While it does not appear to me that Google has violated the law through the exercise of its market power to impede competition significantly, Google might conceivably do so in the future. For this reason, some might ask, wouldn't it be appropriate for the Commission to act *now* to reign in and constrain Google? Doing so, it could be argued, would be a valuable way of assuring potential innovators and inventors, many of whom may fear that any investments they make in helping consumers will eventually be lost if they are targeted and anticompetitively quashed by Google, that this will not happen.

[23] This specific point was re-emphasized—strongly—by Nextag's General Counsel in an August 30th meeting with Reback and officials in the BE and BC Front Offices.

[24] Reback also, to be sure, emphasizes the value of deterring bad acts that a trial and positive court opinion would likely have, independently of any specific and legally enforceable remedy. He argues that Microsoft was deterred from engaging in many bad acts simply because of the successful case brought against it, rather than the particulars of the remedy that was ultimately imposed.

I respectfully, but strongly, disagree with this line of argument, and with the recommendations that flow from it. It seems to me highly inappropriate for competition authorities to punish and/or regulate a firm based simply on the possibility that the firm might at some future point in time violate the antitrust laws. Our charge is to investigate whether the law has been violated, not whether it could be broken. The law itself sets the proper limits on what even dominant firms are permitted under the antitrust laws to do. Regulating the conduct of a firm that has not violated the law is, in effect, creating and applying a more stringent standard than that.[25] The law informs everyone as to the rules of the game and the available penalties for violating them. If and when a firm such as Google is shown to have violated the law, competition authorities have both the authority and the responsibility to consider imposing a remedy; not before.

[25] Moreover, as already discussed extensively in this memo, remedies threaten to impose serious costs even when they are imposed to remedy actual harm.

Appendix

Incentives to Favor One's Own Product in a Two-Sided Market

John Yun and Chris Adams

1 Issue

If Google has, under one or another plausible interpretation of some evidence, been favoring its own sites, what would be a benign or procompetitive reason for its doing so?

2 Defining Favoring

There are two potential definitions for "favoring" in this context: (i) favoring one's own content in a blend ("content favoring") or (ii) placing one's own vertical blend/link higher than it otherwise "deserves" based on an objective measure of quality ("rank favoring").

Content favoring is an indisputable fact. Rank favoring, however, is speculative (to our knowledge) and virtually impossible to "prove." Gary Reback is referencing content favoring when he states that Google is using its own local results on the blended map rather than Yelp local results.[26] Consequently, we will focus primarily on content favoring (although we do briefly comment on rank favoring).

3 Framework

As a platform in a two-sided market, whenever Google makes a change to its search results page, Google is doing one of the following:

1. Improving the user experience (e.g., offering content from Wikipedia),
2. Improving both the user and advertiser experience (e.g., faster page loads),
3. Improving the advertiser experience while degrading the user experience (e.g., more top ads).

In of itself, Google is allowed to do all three, including the third option which degrades the user experience. The potential antitrust issue is if there is an additional, negative effect on traffic to specialized search competitors (e.g., when Google's shopping blend takes clicks away from Nextag).[27] That being said, this negative traffic effect can also be a byproduct of legitimate procompetitive behavior due to quality improvements.

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[26] Reback, Gary, "The Legacy of the Microsoft Case," June 2012, p. 77.

[27] A key legal issue is how big an effect the negative traffic decline has to be in order to be considered an antitrust violation.

The issue before us is, when Google engages in content favoring and rank favoring, can Google's behavior be explained by one of the above three scenarios (i.e., benign incentives derived from participating in a two-sided market) and why.

4 *Content Favoring*

For content favoring, the question is why would Google use its own inferior content, e.g., Google+, over superior content, e.g., Facebook and Twitter?[28] First, we are working under the premise that a blend with inferior content is superior to no blend at all. Thus, even a blend with Google+ content is a quality improvement for users. (This is why Google buys firms such as Zagat and Frommer's even if Yelp and TripAdvisor are considered objectively superior. Purchasing content, even if it is not the best content, allows Google to offer search results that are better and will improve user welfare.) The issue then becomes: why doesn't Google improve quality *further* by using Facebook or Twitter content rather than Google+? We offer a number of rationales.

One rationale is risk-avoidance. Ownership insulates a firm from certain types of risk. For instance, if Google makes relationship-specific investments based on third-party content, e.g., a Twitter feed, then Google has exposed itself to certain risks. For instance, a third-party provider could engage in hold-up; change its business model; change the quality of its content; or change its willingness or desire to partner with Google. An example is Google's prior relationship with Twitter which was subsequently terminated by Twitter after considerable investment by Google.

A second rationale, which is related to the first, is the ability to directly control the content. Vertical search properties are complements to general search properties. As Google improves the content and quality of its vertical search sites, this, in turn, makes Google Search more attractive. This will result in more users and advertisers on Google. Consequently, Google has strong incentives to develop its vertical content, such as Google+, in a manner that maximizes the complementary with general search. If Google partners with Facebook and Twitter, these content providers face different incentives which likely do not include maximizing the complementarity with Google Search. In fact, a firm like Yelp explicitly does not want to be a complement to Google; rather Yelp will work with Google to the extent that Google sends greater traffic to Yelp but likely no further.

A third rationale is the transaction costs associated with negotiating agreements (explicit or implicit agreements) with third-party content providers.

[28] In other verticals, such as shopping, the question of whether Google's content is objectively inferior is subject to vigorous dispute.

5 *Rank Favoring*

For rank favoring, the question is why would Google place its vertical blend higher on the results page than it objectively deserves based on relative quality with competing vertical site links? In other words, why would Google purposely degrade its search results through link promotion?

For instance, suppose there are two possible search results pages that Google could show:

Search Results Page 1	**Search Results Page 2**
Rank 1: Yelp link	Rank 1: Google Local blend
Rank 2: Google Local blend	Rank 2: Yelp link

Suppose that consumer welfare is greater if they see Page 1 than Page 2. What benign justification does Google have of showing Page 2 rather than Page 1 (if in fact Google is engaging in rank favoring)?

Under Page 2, Google will send more user traffic to Google Local than under Page 1. Google benefits from this greater traffic since it keeps the user on a Google owned site. Let us assume that the longer users are on Google owned sites, the higher probability the user will click on an ad or enter another query (which, in turn, keeps the user on Google for even longer). If so, then Google receives greater short-run monetary benefit from Page 2 than Page 1 even if Google has no foreclosure effect on Yelp and even if Google is somewhat degrading long-run quality. Additionally, by promoting Google Local, Google is improving Google's brand for local searches, which in turn, will increase local queries on both Google Search and Google Local.

Ultimately, Google has incentives to engage in rank favoring for reasons unrelated to anticompetitive foreclosure. There will be instances where a platform will balance quality improvements with the need to monetize the platform—particularly if the monetization model involves free access to users. We must also take these changes into account with other Google changes. We cannot, for a two-sided market, look at one user quality-monetization trade-off and make a welfare judgment. For instance, if Google improves its blue link rankings below slots 1 and 2, this will cannibalize ad clicks and improve user quality. In this case, the "net" quality change for the period could be positive even if Google is rank favoring in slots 1 and 2 due to improvements in slots 3 and beyond.

6 *Summary*

Ultimately, design choices that degrade the user experience are consistent with benign incentives in a two-sided platform. When Yahoo and Microsoft promote their own content and, perhaps even rank it higher than it should objectively go, there is no suggestion that this is to foreclose rival sites. Similarly, when Google uses Google+ instead of Facebook, nobody would suggest Google is attempting to foreclose Facebook.[29]

What degradation can do, however, is point to incentives that might be related to an antitrust violation. If so, then we must observe some degree of actual foreclosure. Absent this, we necessarily move to benign explanations.

[29] Google Search is responsible for less than 3% of Facebook's traffic (and this includes navigational queries). Source: comScore, June 2012.

[User]

United States of America
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

October 14, 2012

TO: The Commission

FROM: Ken Heyer

SUBJECT: Settling the Google Matter

In early September the Bureaus of Competition and Economics circulated their long and thoughtful memoranda analyzing the results of the investigation into Google's conduct. They also presented their somewhat divergent recommendations for consideration by the Commission. At that time I circulated a memorandum offering my own evaluation, concluding that the evidence did not in my view support bringing an antitrust action against Google.

I now write again, briefly, to provide the Commission with my view on why the conduct uncovered by our investigation not only does not merit litigation, but does not warrant settlement through a consent decree. My recommendation is therefore that we close the investigation without taking any action.

While there are often perfectly legitimate justifications for entering into out of court settlements with targets of an investigation, and even in some circumstances where litigation would not be contemplated, those justifications do not, for reasons discussed below, seem to apply in this particular case.

Google's Conduct Does Not Rise to the Level of an Antitrust Violation

The single most important reason for closing this investigation is that, in my judgment at least, the weight of the available evidence (including the highly persuasive BE staff analysis in late September and early October of "scraping" and exclusives with mobile device manufacturers), indicates that Google's conduct has not risen to the level of an antitrust violation.

Reasonably persuasive business justifications have been presented by Google for much, though perhaps not all, of the initially suspect conduct that staff has been investigating. That said, it would be an overstatement to claim that Google's actions have all been unambiguously pro-competitive. In addition, although the evidence does not indicate significant competitive harm from Google's activities, it is seldom (if ever) possible to dismiss concerns over dominant firm conduct with absolute certainty. It is well known that disadvantaged rivals with much at stake will seek to use the antitrust laws to their own private advantage. However, dominant firms, particularly ones engaging in multiple creative business strategies in a dynamic marketplace, will seldom be entirely free from concerns that they have in some way or another impeded the ability of rivals to compete and constrain--if not in the short run, then conceivably in the longer run.

All of that having been said, in deciding whether to intervene against Google--whether by litigating, or by accepting an out of court settlement-- it is important to consider seriously what the appropriate standard for intervening is (and/or should be). Marketplace competition often involves the throwing of at least a few sharp elbows in the course of maximizing profits. The antitrust laws surely do not require even a dominant firm to prove with mathematical precision that its aggressive conduct has been competitively benign.

Would we be Willing to Litigate?

Although my own view is that Google's conduct does not violate the antitrust laws, I can of course appreciate that others may not be entirely certain of this. For those who harbor significant lingering concerns, I would ask that before voting for any out of court settlement they pause and reflect upon whether they would be comfortable actually litigating this case if that were to prove necessary.

Some may feel that we have a strong case and would for this reason recommend going to trial, if necessary, to prove it. Though I disagree that Google is violating the law, this is certainly a clear and logically defensible position; one consistent with a view that the evidence and the law are on our side. For those who may be inclined to support a settlement but *would not* be willing to go trial should doing so be necessary, I would ask them to consider just *why* they are unwilling to go to trial. Upon further reflection, the reason may be that we simply do not have a strong case. And if this is true, then for reasons discussed below, I do not believe they should feel comfortable even seeking (or accepting) a settlement.

One good reason for being unwilling to litigate the case is that the conduct does not rise to an antitrust violation. That is my reason. There can be others for not being prepared to litigate, some of which are consistent with a view that Google's conduct violates the law. One of these is that negotiating an out-of-court settlement saves on considerable litigation costs. Another is that settling obtains a remedy more quickly. Litigation, like war, can be very costly (cold-blooded economists would label both as "highly inefficient"). Not only are the direct costs of litigation high, but even a victory in court does not—as with challenges to anticompetitive mergers--automatically resolve the competitive concern by maintaining the status quo ante. Winning a single-firm conduct case still leaves the difficult task of crafting, monitoring, and enforcing an efficient remedy.

For these reasons, when the Commission concludes that a dominant firm's conduct has violated the antitrust laws (as it did, for example, in the recently concluded Intel case), crafting and agreeing upon an out of court settlement that efficiently resolves the competitive concerns can be highly desirable.

There are other reasons for preferring an out of court settlement, ones that we might collectively refer to as "litigation risk." Why might litigation be very risky even when the plaintiff's case is compelling? One is that we (the Commission) may know a lot more about the consequences of the firm's actions—and whether they actually violate the antitrust laws—than would an impartial finder of fact after a full trial on the merits. Circumstances under which this seem most likely are those where either the critical issues to be resolved require serious econometric analysis that is beyond the competence of even a highly intelligent judge, or where there are credible industry witnesses with powerful stories to tell who are unwilling to testify publicly due to fear of retaliation by the defendant.

Finally, there are times when a firm is, for its own business reasons, very eager to have an investigation resolved quickly; and prior to the Agency having had an opportunity fully to investigate its legitimate concerns. In such cases, if the target of the investigation is willing to settle on terms that resolve any competitive concerns that might plausibly be uncovered and confirmed, settling quickly and without possible litigation may be a "win-win."

Unwillingness to Litigate: A "Legitimate" Basis for Entering into a Settlement?

My own sense is that these particular arguments for being unwilling to litigate are not strong in this case. Yes, litigation would be costly. That said, I do not sense that this is the primary reason for a reluctance to go to trial. Bringing and winning a case would perhaps delay relief, but it is worth noting that many of the most vocal complainants seem to strongly prefer that we go to trial rather than settle for whatever out of court agreement we are able to obtain from Google. In addition, successfully litigating would send a much stronger signal to other dominant firms than would an achievable out of court settlement.

As to litigation risk, while the issues implicated here are in some respects complex, they do not involve impenetrable "black box" econometric analysis. They are ones that, it seems to me, intelligent triers of fact can be expected to be able to get their arms around in the course of a full trial on the merits where both sides get to put on their best evidence. As for concerns over the reluctance of critical witnesses to testify, that hardly seems worthy of mention. The most knowledgeable and concerned industry participants in this matter--Microsoft, Yelp, Nextag and others--have been very vocal public complainants who appear more than happy to help us litigate this case, should we choose to do so.

Finally, this is hardly a case in which the defendant wishes to resolve things early on and before a full investigation is conducted. The parties—Google and its rivals—have already expended considerable time and energy working with us throughout a long investigation, and we have ourselves devoted considerable resources conducting a thorough investigation. "Getting this resolved" prior to when the true facts might come out does not seem to me a plausible reason for engaging in settlement discussions at this time.

Settling When There is not a Persuasive Case

A final reason for seeking a settlement when one is unwilling to litigate, and a reason that I believe may be underlying the views of at least some, is the following: "We do not believe we have a strong case, and for this reason believe that if we go to trial we will probably lose. Still, we are concerned that Google is engaged in conduct which, if modified, would enhance the performance of the marketplace. Hence, we should take this opportunity to obtain a settlement that at least marginally improves the market's economic performance and the interests of consumers."

Some might feel that it would be a good idea to use our power and negotiating leverage to induce Google to perform in ways that might be more consumer-friendly; even if the exercise of its market power falls short of violating the antitrust laws. I do not. Doing so strikes me as activity that arguably goes beyond our mission, and is quite plausibly poor economic regulation besides.

Unlike, say, FERC, the FCC, or Pepco, all regulatory agencies tasked with creating and enforcing their own rules for industry participants, we have already been given the rules to enforce; these are the antitrust laws. Obtaining settlements from firms that do not violate those laws is, in effect, stretching those laws in an effort to prohibit more than what the courts who interpret those laws would require.

In many cases dominant firms, perhaps including Google, will find it desirable to settle with the competition authority even if they are confident that they have done no wrong. Litigation is costly for them as well as for us, and they may have very legitimate concerns over the types of internal information—business plans, or perhaps simply embarrassing statements—likely to come out during a full trial. Google may also feel that settling with us will somehow help them in settlement discussions or business disputes with other jurisdictions. Litigation, even if one were to prevail, is bad for public relations. Few firms are eager to be sued, litigate at great cost, and win. All things considered Google may rationally wish to just reach an agreement and help put this behind them.

Should Google's own reluctance to litigate be leveraged by us to obtain a settlement even if there has been no violation of the law? I do not believe so. Any settlement aimed at improving static economic welfare would run the risk of inadvertently introducing inefficiencies into the marketplace. In addition, any settlement aimed at constraining in any serious way Google's exercise of market power would likely impose significant monitoring and policing costs on the Agency and on the courts.

Even if these were not serious concerns with potential settlement terms, i.e., even if a settlement would clearly improve static welfare on balance, I would not support it. Doing so seems to me to go beyond our mission, to risk impeding dynamic efficiency as Google and all future innovators realize that even legitimately obtained and exercised market power will be capped by regulators, and provides competitors with even stronger incentives than they already have to lobby the Agency in an effort to handicap their larger rivals—even when the evidence does not show that the law has been violated. Such efforts, and the resources we as an Agency would incur to deal with them, likely impose significant economic costs of their own.

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Competition

Project Code: DXI

MEMORANDUM

TO: Commission

FROM: Barbara R. Blank, Gustav P. Chiarello, Melissa Westman-Cherry, Matthew Accornero, Jennifer Nagle, Anticompetitive Practices Division; James Rhilinger, Healthcare Division; James Frost, Office of Policy and Coordination; Priya B. Viswanath, Office of the Director; Stuart Hirschfeld, Danica Noble, Northwest Region; Thomas Dahdouh, Western Region-San Francisco, Attorneys; Daniel Gross, Robert Hilliard, Catherine McNally, Cristobal Ramon, Sarah Sajewski, Brian Stone, Honors Paralegals; Stephanie Langley, Investigator

DATE: October 12, 2012

SUBJECT: Google Inc.
File No. 111-0163[1]

RECOMMENDATION: That the Commission Authorize Staff to Negotiate a Consent Order with Google Resolving Mobile Issues

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[1] Google is represented by Susan Creighton, Jonathan Jacobson, Lydia Parnes, Scott Sher, and Seth Silber of Wilson Sonsini Goodrich & Rosati in Washington, D.C., and by John Schmidtlein and David Kendall of Williams & Connolly LLP in Washington, D.C. Microsoft is represented by Charles ("Rick") Rule and Jonathan Kanter of Cadwalader Wickersham & Taft LLP in Washington, D.C., and Deborah Garza of Covington & Burling LLP in Washington, D.C. Yahoo! is represented by Hanno Kaiser of Latham & Watkins LLP in San Francisco, California. Facebook is represented by Thomas O. Barnett of Covington & Burling LLP in Washington, D.C. Amazon.com is represented by Scott Gant of Boies, Schiller & Flexner LLP in Washington, D.C. Motorola Mobility is represented by Scott Sher of Wilson Sonsini Goodrich & Rosati in Washington, D.C. Apple is represented by Amanda Reeves and Hanno Kaiser of Latham & Watkins LLP in San Francisco, California. LG Display is represented by Beau Buffier and Vittorio Cottafavi of Shearman & Sterling LLP in New York, New York. Verizon Communications is represented by Thomas O. Barnett of Covington & Burling LLP in Washington, D.C. Samsung Telecommunications America is represented by Gregory Huffman of Thompson & Knight LLP in Dallas, Texas. Research In Motion ("RIM") is represented by Logan Breed of Hogan Lovells in Washington, D.C. Sony Corporation of America is represented by M. Sean Royall of Gibson Dunn & Crutcher LLP in Washington, D.C. T-Mobile U.S.A. is represented by Douglas C. Ross and Jonathan Lloyd of Davis Wright Tremaine, LLP in Seattle, Washington. Sprint is represented by in-house counsel Mary Jean Fell.

As part of the broader investigation of Google Inc. ("Google"), Staff investigated allegations that Google has engaged in anticompetitive conduct related to the manufacture and sale of mobile devices. Principally, Staff evaluated whether Google uses exclusive dealing agreements with wireless carriers and device manufacturers to maintain (or to attempt to maintain) its monopoly in web search and search advertising.[2]

Google has entered into exclusive agreements with the 4 major U.S. wireless carriers and Apple to pre-install Google Search on mobile devices. The agreement with Apple requires that Google is the sole pre-installed search provider on every mobile device model manufactured and sold by Apple. The agreements with the wireless carriers require that Google is the sole pre-installed search provider on every model of Android device sold by the carriers. As a result, Google is the sole pre-installed search provider on the mobile devices of 86 percent of U.S. smartphone subscribers, foreclosing Bing (and any other search provider) from access to a critical source of search queries. Today, the carriers and Apple are not inclined to pre-install non-Google search providers on their devices because Google's monetization is far superior to the alternatives, and consumers currently prefer Google on Android and Apple devices. Nevertheless, if Bing improves its monetization, or becomes more popular with users, it may promote competition and benefit consumers if these companies had the flexibility to pre-install Bing on mobile devices in the future. This could be effectuated by allowing search providers to vie for placement on mobile devices on a model by model basis, instead of allowing Google to enter into exclusive deals covering every device model on the two most popular mobile operating system platforms. To that

[2] Staff also investigated allegations that Google (1) improperly prevented mobile device manufacturers from shipping Android devices with competing, non-Google applications (*e.g.*, Facebook, Skyhook geolocation technology), and (2) improperly forced its proprietary applications, including search, onto Android devices manufactured by its OEM partners. These allegations were not supported by the evidence. A brief discussion of these issues is attached hereto as Appendix A.

end, Staff recommends that the Commission seek a consent agreement with Google to eliminate these exclusive agreements.

I. History of the Mobile Investigation

Google submitted approximately 118,000 mobile-related documents, and Staff obtained approximately 40,000 documents pursuant to subpoenas issued to wireless carriers and to mobile device manufacturers. In addition, Staff conducted five investigational hearings with Google employees and executives, and interviewed employees at Apple, HTC, Motorola, Samsung, Verizon Wireless, AT&T, T-Mobile, Sprint, Facebook, Mozilla, Microsoft, and Amazon.

II. The Relevant Parties

A. Google

Google is an Internet search technology company, founded in 1998, and headquartered in Mountain View, California. Google's products and services include a general "horizontal" search engine, as well as numerous integrated "vertical" websites that focus on specific content areas, such as product or shopping comparison, maps, finance, books, and video. Google sells search advertising and search syndication services. In addition, Google offers the Android operating system for mobile devices, along with a host of applications for those devices.

B. Wireless Carriers

The 4 largest wireless carriers serving the U.S. market are AT&T Inc., Sprint Nextel Corp., T-Mobile USA, Inc., and Verizon Wireless, Inc.

C. Apple

Apple, Inc., headquartered in Cupertino, California, designs, manufactures, and markets mobile communication and media devices, personal computers, and a variety of related software and services. Apple released the iPhone, the first "smartphone," in June 2007.

D. Microsoft

Microsoft Corp., headquartered in Redmond, Washington, develops, manufactures and licenses a wide range of products and services related to computing, including smartphones. Microsoft introduced its general search engine, MSN, in 1998, and rebranded it as Bing in May 2009. In 2011, Microsoft filed complaints with the FTC and with the EC, alleging that Google has unlawfully monopolized markets for search and search advertising, including in the mobile space.

III. Statement of Facts

Consumers today are switching from feature phones to smartphones in increasing numbers. This has led to a massive growth in search queries performed on mobile devices. Mobile queries accounted for 9.5 percent of Google's total queries in 2010, increasing to 17.3 percent in 2011.[3] The number of mobile queries is increasing ten times faster than the number of desktop queries. Industry analysts predict that eventually the number of mobile queries will overtake the number of desktop queries.[4] Both Google and Microsoft consider mobile devices to be a critical source of search and search advertising volume.[5]

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[3] *See* Google Submission, "Google Query Volume – U.S. Users (2010 - 2011)" (Jun. 27, 2012) ("Google Query Volume"). In October 2010, mobile search provided 53 million search results pages daily, and earned an estimated $155 million per year in search advertising revenue. **CX-0264 (GOOGBRAP-000013567-608)** (2010), at 70.

[4] Google Query Volume (showing that from 2010 to 2011, desktop queries grew by 11.4 percent, while mobile queries grew by more than 122 percent); *see also* Claire Cain Miller, *Google, a Giant in Mobile Search, Seeks*

Foreseeing that access to the Internet, and computing in general, would become increasingly reliant on mobile devices, Google purchased the Android operating system ("OS") in 2005, and in 2007 created a team to focus on developing mobile products.[6] Google recognized that securing a substantial share of mobile queries (and related advertising revenue) was crucial to its continued success in search and search advertising, and responded with a strategy aimed at securing dominance over this emerging source of search queries.[7] Part of Google's mobile strategy was to enter into exclusive agreements with mobile partners to pre-install Google Search on mobile devices. As Google executive Andy Rubin stated in 2009 (with respect to Google's pending deal with Verizon Wireless): "If we can pull this off and turn them into a true strategic partner, then we will own the US market."[8] In return for exclusivity, the mobile partners receive from Google a negotiated share of the search advertising revenues generated by consumers' use of such devices.

New Ways to Make It Pay, New York Times (April 24, 2011), *available at* http://www.nytimes.com/2011/04/25/technology/25mobile.html?_r=1 (quoting Scott Huffman of Google as stating that "[m]obile search is definitely going to surpass desktop search. The lines will pass, and I think they'll pass before anyone thought they would.").

[5] **FTC-0000636-752** (Google Q2 2012 Form 10Q) (2012), at 691 ("More people are using devices other than personal computers to access the internet. If users do not widely adopt versions of our web search technology, products, or operating systems developed for these devices, our business could be adversely affected."); Microsoft Submission, "Google's anticompetitive conduct in mobile search and search advertising" (Jul. 18, 2011) (Submitted to the European Commission's Directorate General for Competition) ("MSFT Mobile EU White Paper"), at 4 ("As search engines are the primary means by which consumers navigate the Internet, the volume of search queries and search advertising revenues generated on mobile devices has increased massively in the last few years and is expected to skyrocket in the two or three years to come. Mobile is at the very core of the search and search advertising strategy of Google and its rivals.").

[6] Rubin Tr. 27:4-25; Barra Tr. 18:16-19:8.

[7] *See e.g.,* **CX-0269 (FTC-0001089-197)** (2008), at 119 (listed as a risk factor, Google's 2007 10-K states that "[i]f we are unable to attract and retain a substantial number of alternative device users to our web search services or if we are slow to develop products and technologies that are more compatible with non-PC communications devices, we will fail to capture a significant share of an increasingly important portion of the market for online services, which could adversely affect our business."); **CX-0235 (GOOGBART-000021319R-26R)** (2011), at 19R ("The exclusive across all the android search entry points is very strategic to mobile search. the nightmare scenario is for msft (or others) to come and scoop us by simply paying more."); at 22R ("I think this approach is really important otherwise Bing or Yahoo can come and steal away our Android search distribution at any time, thus removing the value of entering into contracts with them.").

[8] **GOOGSCHM-000005854-55** (2009), at 54.

It appears that Google has accomplished its goal of dominating mobile search. Google has agreements with Apple and the 4 major U.S. wireless carriers to pre-install Google Search on mobile devices.[9] Today, Google is the sole pre-installed search provider on the devices of approximately 86 percent of U.S. smartphone subscribers.[10] Within the mobile search channel, Google has a 96.9 percent share worldwide.[11]

While there is some dispute as to the best interpretation of these agreements (detailed below), on balance, it appears that Google has foreclosed competing search providers from a significant portion of the smartphone market through its exclusive agreements. Apple reports that it is contractually required to pre-install Google as the search default on all of its mobile devices, including the iPhone and iPad.[12] Verizon also reports that it is contractually required to pre-install Google Search on all of its Android devices.[13]

The other major U.S. wireless carriers – AT&T, Sprint and T-Mobile – assert that their agreements with Google regarding mobile search are not exclusive. However, Google's written contracts with Sprint and T-Mobile appear to mandate exclusivity. As for AT&T, the tiered method of sharing revenue set up by Google results in a *de facto* exclusive agreement. Thus, Google Search is currently loaded on nearly all Android devices sold by the 4 major U.S. wireless carriers.

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[9] Most mobile devices have multiple search entry points where a user can input a query: a search box in a browser, search "widgets" and search applications which appear as icons on the device's screen, and hardwired keys that launch a search provider and voice search. Although a user can generally change a default search provider, or install an alternate search application, as described more fully below, users most often use the pre-installed search provider.

[10] In the U.S., Apple has 34.3 percent of the smartphone subscribers and Android has 52.6 percent. Press Release, comScore, comScore Reports August 2012, U.S. Mobile Subscriber Market Share (Oct. 2, 2012) *available at* http://www.comscore.com/Press_Events/Press_Releases/2012/10/comScore_Reports_August_2012_U.S._Mobile_Subscriber_Market_Share.

[11] Alex Cocotas, *BII Chart of the Day: Google Completely Dominates Mobile Search*, Business Insider (Jun. 15, 2012) *available at*, http://www.businessinsider.com/google-completely-dominates-mobile-search-2012-6#ixzz23qLeUkK2.

[12] Apple IR (Jul. 31, 2012).

[13] Verizon IR (Sep. 20, 2012).

Google acknowledges the exclusive nature of its agreements with the mobile carriers. The purpose of revenue share agreements with wireless carriers is summed up by former Google business development manager Chris Barton:

> So we know with 100% certainty due to contractual terms that
> - All Android phones on T-Mobile will come with Google as the only search engine out-of-the-box
> - All Android phones on Verizon will come with Google as the only search engine out-of-the-box
> - All Android phones on Sprint will come with Google as the only search engine out-of-the-box
>
> I think this approach is really important otherwise Bing or Yahoo can come and steal away our Android search distribution at any time, thus removing the value of entering into contracts with them.
> Our philosophy is that we are paying revenue share *in return for* exclusivity.[14]

A. Google's Agreement With Apple

Today, 34.3 percent of the smartphone subscribers in the U.S. are using Apple devices.[15] Apple confirms that its revenue share agreement with Google is exclusive, and has been exclusive since 2005. Google is the pre-installed default search provider in the Safari browser, which Apple confirms is the sole pre-installed search entry point on its iPhone and iPad devices.[16] The current agreement is set to expire in 2015.[17]

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[14] **CX-0235 (GOOGBART-000021319R-26R)** (2011), at 21R-22R. An agreement between Yahoo! and AT&T prevented AT&T from signing an exclusive agreement with Google. Yahoo! was pre-installed on AT&T's first Android device. Based on negative customer feedback, AT&T began using Google Search and has used Google Search exclusively since then. AT&T is no longer selling devices pre-installed with Yahoo! Search. AT&T IR (Mar. 8, 2012); AT&T IR (Sep. 11, 2012).

[15] Press Release, comScore, *comScore Reports August 2012, U.S. Mobile Subscriber Market Share* (Oct. 2, 2012) *available at* http://www.comscore.com/Press_Events/Press_Releases/2012/10/comScore_Reports_August_2012_U.S._Mobile_Subscriber_Market_Share.

[16] Apple's Brian Croll stated that Siri is not a search competitor to Google. Siri, iPhone's so-called "personal assistant" (1) translates a voice query into words; (2) determines what those words mean; and (3) determines whether the query is a domain it knows about. It then farms out the query to different information services that know about the domain, including Yahoo!, Wolfram Alpha, OpenTable, and Stats. General search queries are sent to the pre-installed Google Search through the Safari Browser. Apple IR (Aug. 17, 2011); Apple IR (Jul. 31, 2012). Siri's functions are not limited to search – it also controls the iPhone (e.g., writes and sends emails, sets reminders and makes calls).

[17] Apple IR (Jul. 31, 2012).

B. Google's Agreements With Major Wireless Carriers

1. Verizon Wireless

In 2008, Verizon had a deal with Microsoft that required Verizon to pre-install Bing on all mobile devices sold by Verizon. Pursuant to this deal, Microsoft paid Verizon a fee of $4.75 for each Bing-enabled device.[18] By April 2011, Microsoft determined that it could not sustain the relationship with Verizon under the then-current terms, and sought to negotiate a new contract.[19] Today, Bing is pre-installed on RIM and Microsoft devices sold by Verizon, and Google is pre-installed on all Android devices.[20]

Verizon reports that its search deal with Google is exclusive; the company may not pre-install an alternative search provider on any Android device. According to Verizon executive Colson Hillier, if Verizon sells an Android device with Bing as the pre-installed search provider, Verizon will be in breach of its contract.[21] Verizon receives a 40 percent share of the search advertising revenue generated by its Android devices. The current agreement with Google expires in July 2014.[22]

2. T-Mobile

T-Mobile's search agreement with Google appears to require exclusivity. The contract, which expires in January 2013, directs that T-Mobile shall not:

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[18] MSFT Mobile EU White Paper at 25. Google also vied for this deal, offering a revenue share based proposal but no up-front payments. Verizon IR (Sep. 20, 2012).

[19] MSFT Mobile EU White Paper at 29. Microsoft was losing money because conducting searches on feature phones generated less money than the per-device payment Microsoft agreed to, and search on smartphones was barely breaking even or losing money. Verizon received negative reactions from the marketplace for setting the search default to Bing on Android devices; customers were requesting Google instead. However, Verizon executive Colson Hillier stated that while he cannot recreate the "but for" world, Verizon was making money on the deal and would have continued the relationship with Microsoft if Microsoft had not asked to renegotiate. Verizon IR (Sept. 20, 2012).

[20] Verizon IR (Sept. 20, 2012).

[21] Verizon IR (Sep. 20, 2012).

[22] **GOOG-ANDR-00001399-411** (2011) at 400-409.

> (i) implement on the T-Mobile service, the Portal or on *any* device *any* application, product or service which is the same as or substantially similar to the Google Mobile Search Service (or any part thereof); or (ii) preload, install, incorporate or otherwise make available on the T-Mobile Service or any device any application, product or service that is the same or substantially similar to the Google Mobile Search Service as provided via Google Application(s).[23]

In addition, the contract provides that T-Mobile "will use commercially reasonable efforts to pre-load the Google Applications on *all* Android and Windows Mobile Devices."[24] T-Mobile receives between 15 and 30 percent revenue share, depending on the amount of advertising revenue generated by devices that meet the contractual requirements.[25]

Executives from T-Mobile deny that the company's search agreement is exclusive. T-Mobile points to Exhibit B of the contract, authorizing Google to terminate the agreement if T-Mobile fails to pre-install Google Applications, including Google Search, on at least 74 percent of its Android devices. According to T-Mobile, this provision permits the carrier to pre-install an alternative search provider on up to 26 percent of those devices.[26]

Staff questions T-Mobile's veracity regarding its interpretation of its contractual obligations because it is blatantly contradicted by its own internal documents. For example, a T-Mobile presentation discussing the deal to pre-install Google Search states explicitly that the agreement applies to "[a]ll smart phones and feature phones."[27] There are some devices carved out of the agreement, but none that suggest that T-Mobile has the flexibility to simply choose to pre-install another provider on 26 percent of its Android devices.[28] Moreover, as

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[23] **CX-0252 (GOOG-ANDR-00001276-309)** (2009), at 276, 283 (emphasis added).
[24] *Id.* at 91 (emphasis added).
[25] *Id.* at 98. T-Mobile also receives up to 40 percent revenue share for non-Android devices with pre-installed Google Search.
[26] *Id.* at 91; T-Mobile IR (Sep. 6, 2012).
[27] **TMO-FTC003450** (2009), at 4.
[28] *Id.* For example, Microsoft and Palm devices are not subject to the agreement. There is a carve-out for devices where "issues prevent T-Mobile in meeting obligations" which likely applies to technical difficulties,

described above, the contract itself requires T-Mobile to pre-install Google Search on "all" Android devices, and prohibits the pre-installation of "any" competing search provider. Google itself interprets its agreement with T-Mobile to require that Google Search is the sole pre-installed search provider on every Android device sold by T-Mobile.[29]

3. Sprint

The most recent agreement between Google and Sprint is an amendment to a 2008 agreement that runs until May 2013. The contract requires that Sprint "will not . . . implement as part of the 'out-of-the-box' default configuration of an Android Device any application, product or service which is the same as or substantially similar to PTS[30] or the Google Mobile Search Service . . . ."[31] For devices that comply with the contract, Sprint receives 32 percent of net advertising revenues from Android devices, and 40 percent from non-Android devices.[32]

Sprint interprets this clause as prohibiting Sprint from pre-installing an additional search provider with better placement than Google Search.[33] Under this interpretation, Sprint could pre-install a non-Google search provider in addition to Google, as long as it did not have better placement than Google Search.

As with the T-Mobile contract, Sprint's interpretation of its obligation under the contract appears to be erroneous. The contract prohibits the company from placing a competing search provider on Android devices sold by Sprint. There is nothing in the

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and is the type of exclusion that is probably contemplated in the requirement that Google must be pre-installed on at least 75 percent of T-Mobile's Android devices.

[29] **CX-0235 (GOOGBART-000021319R-26R)** (2011), at 21R-22R.

[30] Phone Top Search, the Google Search widget.

[31] **CX-0233 (GOOGBRAP-000015356-67)** (2011), at 58.

[32] *Id.* at 61. Sprint could receive an additional 3 percent on top of its Android generated revenue for pre-installing Google Search on all search entry points on all of Sprint's RIM BlackBerry devices.

[33] Sprint IR (Sep. 14, 2012).

contract that supports the contention that Sprint can pre-install a non-Google search provider as long as it not more prominently placed than Google Search. Indeed, Google interprets its agreement with Sprint to require that Google Search be the sole pre-installed search provider on every Android device sold by Sprint.[34]

4. AT&T

AT&T's current contract with Google is nominally non-exclusive: AT&T is permitted to pre-install a non-Google search provider and to forgo revenue share on that device. However, the contract provides for a tiered revenue share system. AT&T earns no share of revenues until its devices earn at least $49,999.99 in a calendar month. The company receives a 15 percent share of revenues once its devices generate between $50,000 and $199,999.99, and 30 percent for generating revenue of $200,000 or more.[35] This tiered approach to sharing revenue provides AT&T with the incentive to only pre-install Google Search on its devices. Needing to ensure that its devices generate enough query volume to meet the upper revenue share thresholds dissuades AT&T from offering customers alternative pre-installed search options. Thus, AT&T pre-installs Google Search on every Android device that it sells, creating a *de facto* exclusive arrangement. As AT&T executive Jeffrey Ezell stated, it does not "make economic sense" for AT&T to pre-install a non-Google search provider.[36]

[34] **CX-0235 (GOOGBART-000021319R-26R)** (2011), at 21R-22R. There is a carve-out in the Sprint contract for SprintID – a function that allows third parties to build a themed user experience for the device. Yahoo! provides a SprintID pack which replace a device's five screens, gives Yahoo! home screen placement, and switches defaults on the device to Yahoo!. The Yahoo! ID pack is only available as a pre-installed option to Sprint's 56 million subscribers on 8 million devices. If the user chooses the Yahoo! ID, Yahoo! pays Sprint a share of revenue from the sale of "premium content." If the user chooses Google, or switches from Yahoo! back to Google, Google pays Sprint a share of the generated revenue. Sprint IR (Sep. 14, 2012).
[35] **GOOG-ANDR-00000120-133** (2011) at 129.
[36] AT&T IR (Sep. 11, 2012).

5. Declining Revenue Share

Google has implemented a deliberate strategy to reduce the revenue share of partners over time. (This is similar to Google's broad strategy of reducing the revenue shares of its website publishing partners in the syndication market.) In a 2010 quarterly review presentation, Google executive Andy Rubin laid out an Android strategy timeline, with phases for "Ecosystem Building," "Extend[ing Google's] Core Business," introducing "New Monetizable Services," and finally "Change[ing] The Rules/Get[ting] A Better Deal."[37] He explained that getting a better deal would include renegotiating carrier agreements to reduce the revenue share percentages paid to carriers under those agreements.[38]

Google has already begun the phase of reducing the share of revenue given to search partners. Google lowered Apple's search revenue share from 50 percent in 2005 to 40 percent starting in 2010,[39] and Sprint's share from Android devices from 40 percent in 2008 to 32 percent in 2011.[40] Google provided T-Mobile with a 30 percent revenue share for the first Android device, the G1. However, since late 2009, Google and T-Mobile have a tiered revenue share structure which only provides a 30 percent share on Android devices if the monthly generated advertising revenue is $200,000 or more. T-Mobile receives less if the amount of revenue does not meet that threshold.[41] Since the release of Android, Google's search revenue share to AT&T[42] and Verizon[43] has remained the same.[44] However, Andy

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[37] **CX-0264 (GOOGBRAP-000013567-608)** (2010), at 82.
[38] Rubin Tr. 140:25-143:15.
[39] **GOOG-ANDR-00000065-69** (2005), at 66; **GOOG-ANDR-00000076-77** (2009), at 76; **GOOG-ANDR-00000078-79** (2010), at 78.
[40] **GOOGBART-000004503-30** (2008), at 15; **CX-0233 (GOOGBRAP-000015356-67)** (2011), at 61.
[41] **GOOG-ANDR-00001180-239** (2007), at 16-17; **GOOG-ANDR-00001632-33** (2008) at 32; **GOOG-ANDR 00001276-309** (2009), at 98. In addition, Google does not pay T-Mobile revenue share for devices Google markets and sells directly to consumers. **GOOG-ANDR-00001240-60** (2009) at 59.
[42] Google has a tiered revenue share structure with AT&T: 30 percent on monthly advertising revenue of $200,000 or more; 15 percent between $50,000 and $199,999; and 0 percent below $49,999. **GOOG-ANDR-00000120-33** (2011), at 29.

Rubin believes that Google would be justified in reducing revenue share payments to carriers and keeping more of that money itself. Google agreed to the revenue share percentages in the original carrier agreements when Android was first introduced, and both its adoption and the success of its business model were uncertain. Since that time, Android has gained wide acceptance, Google has continued to improve the platform, and the revenues generated have increased dramatically. As a result, Rubin notes that carriers are receiving "humongous" payments even though their role in the Android ecosystem has stayed the same – selling Android devices to consumers.[45]

6. Mobile Industry's Views on Search Providers

The 4 wireless carriers all state that they would sell their Android devices only with Google, and Apple would sell all of its devices only with Google, even in the absence of the current exclusive contracts. All five companies state that Google Search monetizes extremely well, and generates more revenue than Bing or Yahoo! even when those search competitors offer a higher percentage of revenue.

T-Mobile has told Staff that adding an additional or alternative search provider would generate less money, and could possibly confuse customers and detract from the overall smartphone experience because customers expect to see Google on Android devices.[46] AT&T has told Staff that even if Google lowered its portion of revenue share, the company might not switch providers because of concerns about bad press coverage for using a non-

[43] Google's revenue share to Verizon has remained at 40 percent. **GOOGBRAP-000055858-911** (2009), at 884; **GOOG-ANDR-00001399-411** (2011), at 409.
[44] The AT&T and T-Mobile agreements which address search revenue share will be up for renegotiation in less than 4 months. **GOOG-ANDR-00000120-33** (2011), at 20; **GOOG-ANDR 00001276-309** (2009), at 276. The Sprint agreement will be up for renegotiation on May 31, 2013. **CX-0233 (GOOGBRAP-000015356-67)** (2011), at 56. The Verizon agreement is not up for renegotiation until the summer of 2014. **GOOG-ANDR-00001399-411** (2011), at 400.
[45] Rubin Tr. 243:7-244:13.
[46] T-Mobile IR (Sep. 6, 2012).

Google search provider on Android devices.[47] Verizon has reported to Staff that if Google lowered the revenue share it offered, Verizon still would not consider pre-installing Bing. Verizon is looking for devices that sell data plans and keep customers loyal to Verizon, and Verizon's customers prefer Google Search on Android devices.[48]

Sprint appears to be the wireless carrier most likely to consider switching search providers. Sprint executive Kevin McGinnis states that if Bing presented better opportunities with more revenue share or improved consumer experience, Sprint would consider pre-installing Bing. Nevertheless, Sprint is not interested in "fixing something that is not broken," and has not seriously considered switching since entering into the original agreement with Google in 2007.[49] AT&T also suggested that it would consider Bing if, among other considerations, Google lowered AT&T's revenue share and Microsoft offered more money.[50]

Like the wireless carriers, Apple states that Google is the overwhelming preference of its customers. Its exclusive agreement with Google remains lucrative despite Apple's declining portion of revenue share over time, and Apple would not consider a pre-installed search provider other than Google in the U.S. in the foreseeable future due to customer preferences.[51]

C. Google's Relationships with Smaller Carriers

Smaller wireless carriers – such as Cricket and MetroPCS – also sell mobile devices. Google offers the mobile device manufacturers associated with these carriers a free license to

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[47] AT&T IR (Sep. 11, 2012) (There would have to be a large enough change in economic incentives to justify "degrading the customer experience.").
[48] Verizon IR (Sep. 20, 2012).
[49] Sprint IR (Sep. 14, 2012).
[50] AT&T IR (Sep. 11, 2012).
[51] Apple IR (Jul. 31, 2012).

pre-install Google search on a non-exclusive basis, but the device manufacturer does not receive a share of search revenues. Mobile device manufacturers report that they generally do not pre-install multiple search providers on a single device.[52] The result is that Google is the sole pre-installed search provider on many mobile devices sold by the smaller wireless carriers.[53]

IV. Legal Analysis

The competitive concern with Google's agreements with the wireless carriers and Apple is that Google may be improperly foreclosing rival search providers from a critical source of search and search advertising volume. This foreclosure arguably hampers Microsoft in its efforts to gain scale, to become more efficient, and to constrain the exercise of monopoly power by Google.

The BC Staff recommendation memo dated August 8, 2012 ("Recommendation Memo"), previously submitted to the Commission, describes the legal framework for analyzing exclusive dealing arrangements. In summary, a plaintiff must show that a monopolist has harmed competition by foreclosing rivals from needed relationships with distributors, suppliers, or end users. The magnitude of foreclosure must be "significant."[54] The fact that an agreement is not explicitly exclusive does not preclude a finding of liability.[55] A court must also consider any efficiency justifications for the conduct.

[52] HTC IR (Nov. 16, 2011); Apple IR (Jul. 31, 2012). The exception is that smartphone browsers often have a default search provider that offers additional choices in a drop down menu. However, users rarely change default search providers.
[53] We have not yet obtained data on the number of devices sold with Google search through these channels.
[54] *U.S. v. Microsoft Corp.*, 253 F.3d 34, 69 (D.C. Cir. 2001).
[55] *See id.*; *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 326 (1961) ("Even though a contract does 'not contain specific agreements not to use the [goods] of a competitor,' if 'the practical effect . . . is to prevent such use,' it comes within the condition of the section as to exclusivity") (quoting *United Shoe Machinery Corp. v. United States*, 258 U.S. 451, 457 (1922)). *See also, e.g.*, *LePage's Inc. v. 3M*, 324 F.3d 141, 158-59 (3d Cir. 2003) (relying on *Microsoft* in holding that non-exclusive discount and rebate agreements between the

A. Google's Agreements Foreclose a Critical Channel Within the Relevant Market

In its *Microsoft* decision, the D.C. Circuit held that a plaintiff is required to show "a significant degree of foreclosure," although the court did not specify how to measure that foreclosure.[56] In finding that the foreclosure alleged against Microsoft was sufficient under Section 2, the court emphasized that the company had reached exclusive agreements with 14 of the top 15 Internet access providers in the United States, which accounted for "a large majority of all Internet access subscriptions in this part of the world."[57] Other cases measure foreclosure as either the percentage of the market or the percentage of distribution outlets covered by the exclusive arrangements.[58]

Here, Google has entered into explicit exclusive agreements with 3 of the 4 major U.S. wireless carriers and Apple, and a *de facto* exclusive agreement with AT&T. These agreements make Google the sole pre-installed search provider on nearly 87 percent of all smartphones in the United States.[59] As Google's Andy Rubin stated, while wrapping up negotiations on the Verizon deal, "[i]f we can pull this off and turn them into a true strategic partner, then we will own the US market."[60]

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defendant manufacturer and key retailers had the effect of excluding rivals in violation of Section 2 of the Sherman Act).

[56] *Microsoft*, 253 F.3d at 69.

[57] *Id.* at 70-71.

[58] *See* Recommendation Memo at p. 103 (citing cases).

[59] In the U.S., Apple has 34.3 percent of the smartphone subscribers and Android has 52.6 percent. Press Release, comScore, *comScore Reports August 2012, U.S. Mobile Subscriber Market Share* (Oct. 2, 2012) *available at* http://www.comscore.com/Press_Events/Press_Releases/2012/10/comScore_Reports_August_2012_U.S._Mobile_Subscriber_Market_Share.

[60] GOOGSCHM-000005854-55 (2009), at 54.

In 2011, mobile queries accounted for 17.3 percent of Google's total queries, increasing from 9.5 percent in 2010.[61] This suggests that Google's foreclosure (through its exclusive agreements) of the overall market for search (and search advertising) is quite low. Although it can be difficult to identify a specific threshold courts will require, Professor Areeda suggests that anything below 30 or 40 percent "would seem to be harmless to competition."[62] Exclusive agreements affecting smaller percentages of the market, however, have previously been found anticompetitive where the foreclosed distribution channel is particularly significant.[63] Here, the mobile channel represents such a significant distribution channel because of its unique potential as a rapidly expanding source of query volume (and associated search advertising revenues). Indeed, both Microsoft and Google acknowledge the importance of this source of queries, internally recognizing that mobile queries will likely quickly surpass desktop queries in the near-term future.[64]

Google argues that its agreements do not exclude competitors, as users are free to download alternative search applications or to navigate to other search providers with the browser.[65] (Thus, competition is said to be just "a click away.")[66] However, these alternatives are far less efficient channels for search providers seeking to reach potential users. John Lagerling, the head of business development for Android, testified that the

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[61] *See* Google Query Volume. In October 2010, mobile search provided 53 million search results pages daily, and $155 million per year in advertising revenue. **CX-0264 (GOOGBRAP-000013567-608)** (2010), at 570.
[62] Areeda and Hovencamp, ANTITRUST LAW, ¶1821c1.
[63] *United States v. Dentsply International, Inc.*, 399 F.3d 181, 191-96 (3d Cir. 2005) (finding anticompetitive effects based on evidence that defendant's exclusive deals severely restricted rival's access to "the preferred distribution channels – in effect, the 'gateways' – to the . . . market"); *LePage's*, 324 F.3d at 160 (holding that "the jury could have reasonably found that [defendant's] exclusionary conduct cut [plaintiff] off from key retail pipelines necessary to permit it to compete profitably").
[64] *See* footnote 4, *supra*.
[65] Rubin Tr. 102:22-103:17, 185:16-187:13; Lagerling Tr. 171:5-173:3. BE Staff makes similar arguments in its Sep. 25, 2012, mobile memorandum to the Commission.
[66] Adam Kovacevich, "*Google's Approach to Competition*," Google Public Policy Blog (May 8, 2009) *available at* http://googlepublicpolicy.blogspot.com/2009/05/googles-approach-to-competition.html.

company has studied this issue, and that Google fares much better when it is the pre-installed search provider than when it is not.[67] This is the reason why Google pays so much money – 25 to 30 percent of its advertising revenue – to secure the exclusive pre-installed position.[68]

Users generally do not change pre-installed search providers or download an additional search provider.[69] When a user does change, it appears that it is *to* Google, not away from Google.[70]

Bing appears today on smartphones running the Windows and RIM operating systems. Together these account for approximately 12 percent of smartphones in the U.S. market today.[71] Like the OEM and Internet access provider distribution in *Microsoft*,

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[67] Lagerling Tr. 159:12-160:12.

[68] *Id.* at 160:13-23 (even after accounting for revenue share payments, securing exclusive default position is "significantly ROI positive"); **CX-0247 (GOOGBARR-000000528-29)** (2010), at 28 (estimating that Google's search volume could decrease by approximately 50 percent if Apple replaced Google Search with Bing); Lagerling Tr. 179:21-180:21; 171:25-172:1 ("We are paying for the promotional placement and the default setting."); 187:24-25 ("We believe again that search is the main revenue stream and the placement is critical there . . .").

[69] *See* Lagerling Tr. 159:12-160:7 (stating that Google search monetizes better when it is the exclusive search default, as compared to situations where it is either one of several options or not present as an option); Gundotra Tr. at 117:9-120:2 (discussing e-mail estimate of search queries that would be lost if Apple changed its default search provider from Google to Bing); **CX-0247 (GOOGBARR-000000528-29)** (2010), at 28 (estimating that Google's search volume would drop approximately 50 percent if it was no longer the search default); Microsoft Presentation (January 13, 2012), at 15 (only 1 percent of iPhone users switched the search default to Bing, even after substantial marketing push by Microsoft); id. at 19 (default position is important, as Bing's position as search default on a few Verizon Android devices accounted for 22 percent of its mobile queries in the U.S.).

[70] For example, Verizon sold Samsung's Fascinate device in 2010, which had Bing as the sole, and unchangeable, pre-installed search provider. Internal Samsung documents show that users were unhappy, and Samsung scrambled to find ways to respond to the Bing "backlash" and to make Google search available for download by the user. *See e.g.*, **STA00012774-81** (2010), at 74 ("we will continue to monitor the comments on Bing being default and the only Search engine choice in Fascinate. We will need to monitor the backlash associated with that."); **STA00012678** (2010), at 78 ("QUESTIONS ABOUT THE FASCINATE . . . Can you download Google Search to replace the Bing search? Customers/reps prefer Google over Bing."); **STA00012673-75** (2010), at 73 ("I have some good news… I did more fact checking and confirmed with our Google liaison that the inability to see Google Search in the Android marketplace is due to Fascinate being on Android 2.1 (Éclair), but when the phone's upgraded to 2.2 (Froyo), we should be able to download it… that's exciting news and great reason to upgrade once [Froyo is available]."). *See also*, **CX-0247 (GOOGBARR-000000528-29)** (2010), at 28 (Organic Google searches increased on devices pre-installed with Bing).

[71] *See* Press Release, comScore, *comScore Reports August 2012*, U.S. Mobile Subscriber Market Share (Oct. 2, 2012), *available at* http://www.comscore.com/Press_Events/Press_Releases/2012/10/comScore_Reports_August_2012_U.S._Mobile_Subscriber_Market_Share (attributing the following share of total U.S. smartphone subscribers to the

distribution as a pre-installed search provider on smartphones is a very efficient channel of distribution, and as in *Microsoft*, Google's contracts exclude potential rivals from that channel.

B. Google's Exclusive Agreements Tend to Harm Competition

Even with a showing of significant foreclosure, it is necessary for the plaintiff to show likely anticompetitive effects in an exclusive dealing case. The evidence indicates that Google's exclusive agreements with the wireless carriers preclude established search providers such as Microsoft and Yahoo! from becoming the pre-installed search provider on even *some* Android devices. These agreements create a high barrier for any potential entrant.

There is no guarantee that, absent the agreements, Microsoft or another search provider could secure enough pre-installed placement to achieve minimum efficient scale. Nevertheless, at least some of the wireless carriers report that they would consider alternative search providers in the face of the right economic incentives. For example, Sprint would consider switching search providers if Microsoft presented better opportunities, such as higher revenue share or an improved consumer experience. Similarly, AT&T suggested that it would consider Bing if, among other considerations, Google lowered AT&T's revenue share and Microsoft offered more money.

Loosening the restrictions that Google places on the carriers and Apple would enable these companies to take an alternate search provider for a "test drive." They could ascertain whether and when Bing has improved its ability to monetize, or has made some impact in securing consumer confidence, without being subject to financial penalties from Google.

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following smartphone platforms: Google Android – 52.6 percent; Apple – 34.3 percent; RIM – 8.3 percent; Microsoft – 3.6 percent; Symbian – 0.7 percent).

There is evidence that Google views its agreements with the wireless carriers, at least in part, as a way to deny Microsoft access to query volume.[72] As Google executive John Lagerling wrote regarding Google's deal with AT&T, "Congrats guys. This is a big one. Imagine Bing on all those devices [AT&T] announced at [the Consumer Electronics Show] . . . ."[73] Indeed, Microsoft views additional pre-installed placement of Bing on mobile devices as essential to its ability to compete in the mobile world,[74] and has told Staff that it would be willing to make significant investments in the absence of the exclusive agreements. As Microsoft executive Jon Tinter reported, when Microsoft previously spotted opportunities to access the mobile market (as with Verizon Wireless), "we have made incredibly aggressive bids." He noted that Microsoft would likely take a similar "aggressive" approach if additional opportunities are presented.[75]

C. Google Has Not Proffered Any Valid Efficiency Justifications for Maintaining Its Exclusive Agreements

We anticipate that Google will assert several justifications for its exclusive agreements.[76] First, Google will contend that the wireless carriers prefer, and are requesting, exclusive arrangements. As discussed above, carriers previously entered into exclusive agreements with other search providers – Verizon with Microsoft, and AT&T with Yahoo!. The carriers report that it is easier to market and to implement a single search provider on

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[72] **CX-0235 (GOOGBART-000021319R-26R)** (2011), at 19R ("The exclusive across all the android search entry points is very strategic to mobile search. [T]he nightmare scenario is for msft (or others) to come and scoop us by simply paying more.").
[73] **GOOGBART-000023183-85** (2011), at 83.
[74] MSFT Mobile EU White Paper, at 12; Microsoft IR (Jan.13, 2012); Microsoft IR (Oct. 12, 2012) (the mobile channel is "uniquely interesting to us" because "the returns on acquiring scale are big" compared to the query volume available through the desktop channel).
[75] Microsoft IR (Oct. 12, 2012); *see* MSFT Mobile EU White Paper, at n. 30.
[76] Google has not submitted a White Paper on these issues.

devices, and that placing multiple search providers on a single device may confuse customers and detract from the user experience.[77]

In addition, Google will likely argue that competition between Google and Bing for the exclusive right to be pre-installed on mobile devices results in higher payments to the wireless carriers and OEMs. This generates revenue for the carriers without raising the cost of wireless plans to users, which could benefit consumers. The converse of this is that there is a strong possibility that wireless carriers will continue to use Google, even in the absence of contractual obligations. Without a guarantee of exclusivity, Google may even more aggressively reduce revenue share, perhaps resulting in more money in Google's pockets. This loss of revenue to the carriers could result in higher prices for devices or wireless plans.

The counter-argument to both of these expected justifications is that today's (asserted) high payments to "distributors" are not pro-consumer in the long term if the effect is to perpetuate Google's monopoly over search and search advertising, ultimately allowing Google to raise prices. In this regard, it is significant that when entering into exclusive agreements with the wireless carriers, Google considered it beneficial that the agreements would deny Microsoft access to query volume.[78]

Google will also likely assert that its exclusive agreements are necessary in order for Google to continue to provide the Android OS for free, while continuing to innovate on the platform. However, while providing Android at no cost to OEMs is the way Google has chosen to recoup its investments into Android, this business model does not – in and of itself – justify the effects of any anticompetitive conduct.

[77] Sprint IR (Sep. 14, 2012); AT&T IR (Sep. 11, 2012); T-Mobile IR (Sep. 6, 2012)..
[78] *See* footnote 71, *supra.*

D. Potential Remedies

If the Commission elects to pursue a remedy to address the anticompetitive effects of Google's exclusive search distribution agreements with U.S. wireless carriers, Staff recommends a conduct remedy that would (1) void any and all provisions in Google's current carrier agreements that enforce search exclusivity, (2) modify Google's Mobile Application Distribution Agreements (MADAs) with mobile device manufacturers to allow the manufacturers to effectuate a carrier's decision to use a search provider other than Google, and (3) prohibit Google from imposing contract terms with the effect of preventing a carrier from installing a competing application (defined broadly) on any mobile device for a period of five years. The purpose of the recommended remedy is to ensure that Google cannot use its dominance to suppress competitive threats to its search and search advertising monopolies by denying competitors access to the increasingly important mobile channel.

More specifically, in order to restore the possibility of competition on the merits, an order should void any provision in Google's carrier agreements that prevent a carrier from using a search provider other than Google. This would include any provision explicitly requiring the carrier to use Google search exclusively, prohibiting the installation or use of a competing search provider, or setting forth a revenue-sharing scheme that acts as a *de facto* exclusivity provision (e.g., by penalizing a carrier for using an alternate search provider). An order should also require any modifications to the MADA necessary to implement a carrier's choice to use an alternate search provider.

Today, a manufacturer wishing to load Google's mobile services is required to include search, and generally must place Google Search within one swipe of a device's home screen. If a carrier decides to pre-install an alternate search provider, our remedy should allow that carrier to give its selected default preferred placement and consequently, to move Google search to a less prominent placement.

Looking forward, an order should prohibit Google from imposing any contract terms that would prevent a mobile carrier or manufacturer from installing "competing software" on any mobile device. Competing Software would include any general search provider (*i.e.*, anything offering functionality similar to Google or Bing today), but should also be broad enough to include other products or services that generates revenue in competition with any Google product or service. For example, mobile applications represent another potential threat to Google's search advertising business.[79] We see stories almost daily about firms experimenting with ways to transfer business models to the mobile sphere. Similarly, we have testimony that Google continues to experiment with different mobile advertising formats and revenue sources.[80] While it is too early to tell whether or how the next threat to Google's business model will develop, we should prevent Google from banishing potential competitors from the mobile channel in the same way that it has already targeted search competitors.

Although enjoining the exclusive agreements would not, and should not, guarantee distribution for Bing, it would provide Microsoft with the opportunity to succeed or fail on its own merits, and opens up the possibility for an innovator to provide a new mobile search

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[79] **CX-0270 (FTC-0001306-415)** (2010), at 324 (Google's 10-K filing for fiscal year 2009, listing mobile applications as a source of competition: "As the mobile application ecosystem develops further, users are increasingly accessing e-commerce and other sites through those companies' stand-alone mobile applications, instead of through search engines."); Rubin Tr. 256:11-258:6 (describing how mobile applications threaten Google's advertising business).

[80] Lagerling Tr. 184:18-185:15 (discussing Google experiment running ads on its Maps application); *id.* at 186:19-187:14 (discussing similar experiment with ads on YouTube); Rubin Tr. 96:4-23 (explaining that top-line revenue from content sales – including apps, books, music, and magazines – is roughly equal to advertising as a source of mobile revenue). *See also* **CX-0233 (GOOGBRAP-000015356-67)** (2011), at 61 (provision in Sprint revenue sharing agreement states that the parties will discuss in good faith how to split revenue Google may generate in the future from additional products or services).

product. Specifically, in the absence of the exclusives, Microsoft may pay a wireless carrier or Apple to pre-install Bing on one (or perhaps more than one) model of their devices. Our proposed remedy would provide Apple and the carriers with the ability to exercise that option.

IV. Litigation Risks

There are considerable litigation risks associated with bringing an enforcement action on the mobile agreements. Most importantly, the agreements are incredibly lucrative for the wireless carriers and Apple. The companies have made it apparent to Staff that they have no interest in being released from their current contracts, and little interest in pursuing negotiations with alternative search providers. The wireless carriers will likely be hostile to any proceeding aimed at voiding their deals with Google. Specifically, AT&T, T-Mobile and Sprint will likely testify that their contracts are not exclusive, and do not prevent them from pre-installing non-Google search providers on their devices. They, along with Verizon and Apple, will also likely testify that regardless of the exclusive agreements, no company would seriously consider switching to Microsoft or any other search provider in the near-term. If pressed, at least two of the carriers will testify that, at best, they would consider switching if Bing could monetize as well as, or better than, Google, or if there were a strong shift in consumer preference from Google to Bing.

In addition, the argument that competition is just "a click away" is a compelling one. Unlike Microsoft, which hardwires Bing Search into its mobile operating system, Android devices allow users to change the pre-installed search provider in at least some mobile search entry points. Google provides competing search applications in the Google Play application store at no charge. There is evidence that users generally use defaults and pre-installed software. But there is also evidence that, when presented with Bing as a default, users have sought out and downloaded Google.[81] This fact will certainly allow Google to cast serious doubt on any allegation that Google's exclusive agreements with wireless carriers constitute a significant impediment to its rivals' ability to gain scale.

Also, there is an argument that Microsoft can gain scale in the mobile channel through its Windows Phone devices which already come with Bing Search pre-installed as part of the mobile OS. This is a source (albeit a very small source currently) of mobile queries to which Microsoft has sole pre-installed access.[82] The existence of such a channel certainly raises questions about the critical nature of Android queries.

[81] *See* note 69, *supra*.

[82] Currently, Windows represents 3.6 percent of the mobile market. *See* Press Release, comScore, *comScore Reports August 2012*, U.S. Mobile Subscriber Market Share (Oct. 2, 2012), *available at* http://www.comscore.com/Press_Events/Press_Releases/2012/10/comScore_Reports_August_2012_U.S._Mobile_Subscriber_Market_Share.

V. Conclusion

Whether an enforcement action is warranted in this case a close call. We have serious concerns that Google has used its exclusive agreements to maintain its search and search advertising monopolies in the mobile arena, and foreclosed its competitors – and any potential entrants – from this important and rapidly growing source of search queries and advertising revenue. However, the risks associated with litigating this case are substantial. Therefore, we recommend that the Commission seek a consent agreement with Google based on the proposed remedies discussed in section III.D. above.

Respectfully submitted,

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Appendix A

Compatibility

Staff investigated complaints regarding Google's use of its Android compatibility program. In order for a device OEM to pre-install Google's proprietary applications on its Android devices (e.g., Search, Google Play, Google Maps), which most of them do, those devices must be manufactured according to specifications set forth in the Android Compatibility Definition Document ("CDD"), and must pass the Compatibility Test Suite ("CTS"). The CDD defines the pathway for building an Android device. The CTS is software that an OEM runs on a prototype of a new device. It attempts to identify any incompatibilities between the implementation of the Android OS on that particular device, and the model OS as defined in the CDD. Google creates both the CDD and CTS, and has the final say on whether a device meets compatibility requirements and may ship containing the bundle of Google applications.

Competitors allege that Google has used these compatibility requirements to prevent companies from shipping Android devices pre-installed with competing applications. One allegation involves Skyhook, a company that makes geolocation technology. Geolocation refers to "services or software that provide information relating to [the] location of objects on the earth."[83] Basically, it tells a mobile device where it is geographically located. Google provides a competing geolocation technology called NLP, and Skyhook alleges that Google fabricated compatibility failures in order to prevent Samsung and Motorola from shipping Android devices employing Skyhook's technology.

[83] Brady Tr. 157:14-16.

A second allegation involves Android devices sold by Verizon that came pre-installed with Bing as the search provider. Before Verizon began selling Android devices, Microsoft and Verizon entered into a deal whereby Verizon agreed to pre-install Bing on all of its wireless devices. In 2009, when Verizon began selling Android phones, it pre-installed Bing in all of the search entry points, including voice search, on several Android devices.

Microsoft contends that Google decided that voice search related software used to translates voice to text – essentially computerized dictation – would be required software on Android devices in order to pass compatibility testing.[84] Microsoft did not have equivalent dictation technology. Microsoft reports that previously, the Google dictation technology was separate from Google's proprietary search technology, and available to third parties for use with applications that needed dictation. Microsoft asserts that Google decided that the dictation technology would become part of its proprietary voice search technology for the purpose of preventing Microsoft from providing a complete search product, and then declared the Verizon devices incompatible during compatibility testing.[85] Ultimately, the deal between Verizon and Microsoft was renegotiated on terms much less favorable to Microsoft, with Microsoft paying a $70 million early termination fee.[86] Microsoft claims that it was required to renegotiate the deal because of the compatibility issues.[87]

Our investigation revealed that neither allegation is supported by the facts. The allegation related to dictation technology in connection with Microsoft's Verizon contract is undercut both by testimony and documents. Microsoft was unable to provide a full menu of voice search services and wanted to use Google's technology to fill its gap in technology. In

[84] MSFT Mobile EU White Paper at 25-26.
[85] *Id.* at 27.
[86] *Id.* at 29.
[87] *Id.* at 27-29.

addition, Microsoft wanted to hide the fact that Google's technology was being used to make up for Microsoft's shortcoming. Google actually allowed this to happen initially, but eventually decided that it was not in the company's best interest. Ultimately, Google disallowed this practice, and evidence suggests that Microsoft was unable to provide a technological solution in a timely manner.[88]

The further allegation that the dictation technology issue resulted in Microsoft renegotiating an inferior deal with Verizon is also contradicted by information obtained during the investigation. The day that Verizon informed Google's CEO Eric Schmidt that Verizon would enter into the Microsoft deal, Verizon executive John Stratton told Schmidt that Verizon wanted to continue to work with Google on several fronts, including the development of a "joint Google phone" which would include Google mobile search, and would be outside of the exclusive Microsoft search deal.[89] Verizon's Colson Hillier, who oversaw the relationship with Microsoft, confirmed that the deal between Verizon and Microsoft fell apart because Microsoft was losing money.[90] There is nothing to support the contention that Google's interference led to the dissolution of the Microsoft-Verizon deal.

The allegation that Google kept Skyhook Wireless's geolocation technology off of Samsung and Motorola devices is similarly unsupported by the evidence we have reviewed. It appears that Skyhook's technology generated inaccurate data that could have negatively

[88] Microsoft was unable to provide its own voice to text technology within Verizon's expected time table. Microsoft Submission, "Submissions Relating to Microsoft's Distribution Agreement with Verizon Wireless in the United States" (Apr. 13, 2012), at 11 (Submitted to the Federal Trade Commission). Other companies report that this is an ongoing problem with Microsoft. For example, only older versions of Windows Phones are available on some wireless networks because Microsoft has not designed for the new cellular platform. HTC IR (Jun. 14, 2012). Motorola chose Android as its sole OS platform because Microsoft could not provide a competing option for timely consideration. Motorola IR (Mar. 20, 2012).

[89] **GOOGROSE-000045353R-56R** (2008), at 54 ("the other agreement allows the use of Android and we should do a joint Google phone.. Google centric device"); **GOOGRUBI-000008026-27** (2009), at 26 ("MSFT is the exclusive search provider to VZN and this agreement circumvents MSFT's exclusivity because the device is branded Google.").

[90] Verizon IR (Sep. 20, 2012).

affected third party applications that relied on that data.[91] It appears that Skyhook could readily have fixed this technological problem, but did not. Former Motorola executive Christy Wyatt stated that Motorola removed the technology from its devices because Skyhook was unwilling to give Motorola a workaround that was compatible with the Android framework.[92]

Google Mobile Services Bundling

We also examined Google's requirement that, if an OEM wants to pre-install any Google applications on its devices, it must take an entire suite of applications. The applications contained in the Google Mobile Services ("GMS") are dictated by Google, and Google has the contractual right to add required applications at any time. Facebook complained that the Facebook application may in the future be precluded from being pre-installed by OEMs. This has not occurred so far.[93]

As an initial matter, because the GMS is only available for Android devices, the only relevant product market in which Google arguably has the ability to control this suite of applications is a market for the Android OS. Such a narrow market definition would prove problematic due to the existence of competing OSs, including Apple's iOS, and to a lesser degree RIM's BlackBerry OS and Microsoft's Windows Mobile OS. There is evidence that these companies compete vigorously for customers and that there are consumers who consider the various types of devices to be substitutes.[94] In addition, although most OEMs

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[91] This would include Google as an app developer as well. Brady Tr. 160:20-164:23.
[92] Motorola IR (Mar. 20, 2012).
[93] Facebook IR (Feb. 9, 2012).
[94] *See, e.g.*, Microsoft Corp. FY 2011 Form 10K (Jul. 26, 2012), at 8, *available at* https://skydrive.live.com/view.aspx?cid=59E8B947004DDBEC&resid=59E8B947004DDBEC!107 ("Windows Phone faces competition primarily from Apple, Google, and Research In Motion"); Apple Inc. FY 2011 Form 10K (Oct. 26, 2011), at 6, *available at* http://investor.apple.com/secfiling.cfm?filingID=1193125-11-282113&CIK=320193 ("The markets for the Company's products and services are highly competitive and the Company is confronted by aggressive competition in all areas of its business."); Jeff Bounds, "*22 percent of*

want to install GMS on their devices, no company is required to install the GMS bundle in order to make an Android device. Ultimately, it would be extremely difficult to show that Google's alleged ability to control which applications are pre-installed on Android devices causes harm in a relevant market.

<u>Conclusion</u>

Because there is insufficient factual support to sustain an enforcement action with respect to compatibility and GMS bundling, Staff recommends closing these parts of the investigation without further action.

Android users eye iPhone switch, survey says," Dallas Business Journal (Sep. 25, 2012) http://www.bizjournals.com/dallas/blog/2012/09/survey-22-of-android-users-eye.html.

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the General Counsel

September 6, 2012

MEMORANDUM

To: Commission

From: Willard K. Tom
General Counsel

Subject: Google, Inc. -- File No. 111-0163
Comments on BC Staff Memo Recommending Issuance of a Complaint

Although it is relatively rare for OGC to provide written views on a case recommendation, I thought it might be useful to provide a few thoughts to the Commission in advance of the meeting, particularly because my oral comments will be delivered from 12 time zones away.

First, as is probably obvious, it is both exceptionally difficult and especially important to explain to the public -- including courts, academics, and lawyers who follow our work -- our thinking in this case. Whether this matter litigates, settles, or closes, it will stand for something in the minds of those constituencies. Thus, we should be thinking about what courts will think even if we expect the case to settle, because there are judges who do follow our work, like Judge Ginsburg on the D.C. Circuit, Judge Sloviter on the Third Circuit, or Judge Wood on the Seventh Circuit, and what they think matters. Cases this novel implicitly (and sometimes explicitly) generate rules of conduct for future market participants, and we will need to demonstrate that we have thought through the implications.

If the case proceeds, we need to think through both theories of liability and the nature of the remedy. If the Commission votes out a complaint, it should not do so until it has had the opportunity to review and study a pro forma draft of the relief sections of an order and of an Analysis to Aid Public Comment. I would recommend this course regardless whether we expect the case to be fully litigated or to be resolved by a settlement. If the Commission votes to close the investigation, it should consider, as it did in Google/AdMob,[1] what it will say about its

[1] Statement of the Commission Concerning Google/AdMob, File No. 101-0031 (May 21, 2010) (available at http://www.ftc.gov/os/closings/100521google-admobstmt.pdf).

reasoning. Analyses to Aid Public Comment and closing statements that thoughtfully articulate the Commission's rationale can provide important opportunities to establish precedents (or perhaps "quasi-precedents"), even where cases are not litigated to a conclusion. At a minimum, such statements often exert a significant influence on the direction of antitrust law and policy. They are even more important in cases in which the Commission plows new ground -- such as *Pool Corp.* and *Transitions Optical*[2] -- and especially where the Commission relies in significant part on Section 5 as a basis for its legal authority – as in *N-Data* and *Intel*.[3]

As to the specific theories in the staff recommendation:

First, I endorse the staff's recommendation not to bring a case on search preferencing.[4] To bring such a case would intrude deeply into product design, an area into which courts have been extremely reluctant to go unless the design feature in question has no legitimate justification. Take Universal Search, which puts substantive content, not just links, onto the search results page itself. Universal Search was indisputably a product improvement, so any challenge to Universal Search would have to argue, in effect, that Google could have made an even better product by reaching agreements with its established vertical rivals to put their superior content there instead of its own start-up content. That is a judgment that courts are generally unwilling to make, for both static and dynamic reasons. The static reason is a humility about how much a court or regulatory agency really knows to enable it to second-guess a firm's choices about product design, technological development, or whether and under what terms to enter business relationships with particular suppliers, distributors, or customers.[5] The dynamic reason is that it is unclear that consumers would be better off in the long run if Google were prohibited from deviating from its algorithm and were not allowed to favor start-ups, either its own or someone else's. It is even less clear that consumers would be better off in the long run if the rule were generalized, as legal rules need to be, so that every dominant firm were prohibited from discriminating in its own favor, and were essentially turned into a public utility or common carrier.

Of course, dominant firms are not entirely free to engage in practices that favor their own products and disfavor those of their competitors; such practices may be condemned as exclusionary if they can be demonstrated to impair rivals' ability to compete effectively.[6] But most cases that accept this principle involve recruiting third parties to assist in the exclusion, as in the case of tying, exclusive dealing, bundled discounts, and loyalty discounts.[7] The cases that

[2] *Pool Corp.*, File No. 101-0115, Analysis to Aid Public Comment (Nov. 21, 2011) (available at http://www.ftc.gov/os/adjpro/d9341/100804intelanal.pdf); *Transitions Optical, Inc.*, File No. 091-0062, Analysis to Aid Public Comment (Mar. 3, 2010) (available at http://www.ftc.gov/os/adjpro/d9341/100804intelanal.pdf).

[3] *Negotiated Data Solutions, LLC*, File No. 051-0094, Analysis of Proposed Consent Order to Aid Public Comment (Jan. 23, 2008) (available at http://www.ftc.gov/os/caselist/0510094/080122analysis.pdf) ("*N-Data Analysis*"); *Intel Corp.*, Docket No. 9341, Analysis of Proposed Consent Order to Aid Public Comment (Aug. 4, 2010) (available at http://www.ftc.gov/os/adjpro/d9341/100804intelanal.pdf) ("*Intel Analysis*").

[4] *See* Memo to Commission from Barbara R. Blank, *et al.*, Bureau of Competition, at 18, 80-82, 86 (Aug. 8, 2012) ("BC Staff Memo").

[5] *See Allied Orthopedic Appliances, Inc. v. Tyco Health Care Group*, 592 F.3d 991, 998-1001 (9th Cir. 2010); *United States v. Microsoft Corp.*, 253 F.3d 34, 65 (D.C. Cir. 2001) (*en banc*, *per curiam*); *cf. Verizon Communications, Inc. v. Law Ofc. of Curtis V. Trinko*, 540 U.S. 398, 408 (2004).

[6] *See, e.g.*, *Microsoft*, 253 F.3d at 58-59.

[7] *See, e.g.*, *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992) (tying); *Lorain Journal Co. v. United States*, 342 U.S. 143, 154-55 (1951) (exclusive dealing); *United States v. Dentsply, Inc.*, 399 F.3d 181,

accept this proposition in the case of product design generally do so only when the only purpose for the design change is to exclude, and there is no efficiency justification whatsoever.[8] As staff points out, that is not the case here.[9]

Second, as to scraping, it is important *not* to think of scraping as equivalent to stealing. Staff's theory is not really that Google has stolen content from its rivals, since it concedes that much of the early use of content was done with consent or at least acquiescence. Rather, staff's theory is that Google used its monopoly power to force vertical sites such as Yelp and TripAdvisor to acquiesce in its use of their content in Google's vertical websites.[10] There are essentially two elements to staff's rationale supporting this theory.

One element of the rationale, relying on *Aspen*, is that there was a pre-existing voluntary -- and "thus presumably profitable"-- course of dealing that Google repudiated (or threatened to repudiate) -- thereby, as in *Aspen*, revealing that it was "willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival[s]."[11] But the *Aspen* analogy does not work well, because it depends on what snapshot in time you choose to represent the pre-existing course of dealing. Was it when Google was not trying to compete with the verticals, or was it the instant before Yelp, upon learning of Google's intent to develop a competing property, discontinued its data feed to Google and asked Google to remove all Yelp content that Google featured on Google Local? That is, the dealing was voluntary as long as both sides were providing value to each other without charge. But who was "free-riding" on whom? Was Google "free-riding" on third-parties' content, or were the third parties' "free riding" on the powerful distribution channel provided by Google's search engine? When TripAdvisor, Yelp, *et al.*, wanted to stop providing free content, why couldn't Google stop providing its service for free, too? Isn't this just like any other cross-licensing negotiation the world has ever seen?

The other element of the rationale that staff advances to support the "scraping" theory is that Google engaged in an anticompetitive practice when it threatened to degrade its own product by taking links to Yelp and TripAdvisor off of its results page. This is a much more interesting theory, and it might well be right. It is, after all, akin to the standard for predatory pricing and predatory innovation. We should be prepared, however, for a great deal of skepticism. Negotiating by threatening to do something that harms oneself as well as the counterparty is, after all, as old and instinctive as a toddler threatening to hold its breath. So we will need to explain why a dominant firm, uniquely among market actors, is not entitled to resort to this particular form of negotiation. In particular, we will need to explain why the implicit rule from this case makes sense even under conditions of uncertainty, *i.e.*, that on balance, discouraging this ordinary business practice will do significantly more good than harm even though a party may not know for certain in advance whether it will be adjudged a monopolist or whether the

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191-96 (3d Cir. 2005) (same); *LePage's, Inc. v. 3M*, 324 F.3d 141, 154-57 (3d Cir. 2003) (*en banc*) (bundled discounts); *Intel Analysis* at 4-5 (loyalty discounts).

[8] *See, e.g., Microsoft*, 253 F.3d at 65-67.

[9] BC Staff Memo at 81-82, 86.

[10] *Id.* at 88-94.

[11] BC Staff Memo at 88-90; *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 610-11 (1985);*Trinko*, 540 U.S. at 40.

conduct will be deemed to degrade its own product for the purpose of preserving or enhancing monopoly power.

It is conceivable that such a showing could be made, but it will require a great deal of thought and care. Are we saying that it is sufficient that we as government bureaucrats think that Google's product was worse without the links to Yelp and TripAdvisor, or is the standard that Google must intend that result, or is it that there must be clear and convincing evidence, or is there some other standard? Are we saying that a firm that thinks there is *some chance* it will be judged a monopolist must avoid bargaining the way any other firm would do in that situation? If not, then what is a firm that does not think it is a monopolist but thinks there is a chance that a court or enforcer will think it is supposed to do? Is the harm from that kind of deterrence outweighed by the good that an enforcement action will do here, and how do we know that to be the case? These are the kinds of questions that seemed to be bothering the Second Circuit when, in *Ethyl*, it rejected the FTC's last major foray into stand-alone Section 5.[12]

Furthermore, displaying snippets of content from other sources is at the heart of all web search. Can a principled and logically coherent line be drawn to distinguish between permissible display of excerpts from third-parties' sites in connection with web search results, on the one hand, and unconscionable and anticompetitive expropriation, on the other? If a dominant firm improperly steps across that line, how far does it need to go for its conduct to be deemed "oppressive" or "unfair"?[13] This line might be akin to the limitations of "fair use" under copyright law -- but how would one determine when such a copyright violation transcends liability to an individual website operator and rises to the level of anticompetitive conduct affecting the market as a whole (*i.e.*, harms competition, not just individual competitors)? And how would the relief section of an order be drafted to provide coherent guidance to other participants in the industry?

Third, as to the API theory, the case is remarkably similar to the *Microsoft* server protocol case that the European Commission brought but that the U.S. never did.[14] In contrast to

[12] *E.I. Du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 138-40 (2d Cir. 1980) ("*Ethyl* "). Staff suggests that the Commission condemn Google's scraping conduct as a stand-alone violation of Section 5, even if that conduct does not rise to the level of a Section 2 violation. BC Staff Memo at 91. Consistently, in a recent article, Professor Herbert Hovenkamp suggests that the FTC could justifiably bring a stand-alone Section 5 case where a dominant firm abuses its power in one market to obtain improper competitive advantages in a collateral upstream or downstream market – even if such conduct might not violate Section 2. Hovenkamp, *The Federal Trade Commission and the Sherman Act*, 62 Fla. L. Rev. 1, 6, 12-14 (2010). Hovenkamp and other commentators, however, strongly caution that any cases premised on stand-alone Section 5 theories must be justified by well-articulated limiting principles – most importantly, that the challenged conduct truly affects *competition* and that the proposed remedies would benefit *consumers*, and not just the dominant firm's competitors. *Id.* at 8, 23; *accord*, *N-Data Analysis* at 5-6 (specifying "limiting principles" such as that the challenged conduct is "inherently 'coercive' and 'oppressive,'" has an "adverse effect… on competition," and has "competitive significance [that] extended not to a single firm, but rather… industry-wide"). Participants in the Commission's 2008 workshop on *Section 5 of the FTC Act as a Competition Statute* (http://www.ftc.gov/bc/workshops/section5/index.shtml) offered other thoughtful proposals; and many other commentators also have addressed the issue. As noted above, it is particularly important for the Commission to think through the ramifications before proceeding on such a basis, and to carefully explain its rationale.

[13] *See N-Data Analysis* at 5 (citing *Ethyl*, 729 F.2d at 139-40).

[14] *See Microsoft v. Commission*, Case T-201/04, E.C.R. II-3601 (EC Ct. of First Instance, Sept. 17, 2007) (available at http://curia.europa.eu/juris/document/document.jsf?docid=62940&doclang=en&mode=&part=1) (affirming Commission Decision, Case COMP/C-3/37.792-*Microsoft*, Proceeding Under Article 82 of the EC Treaty (Mar. 24,

the European case, the U.S. Justice Department's case against Microsoft involved either exclusive dealing/tying arrangements designed to prevent Netscape's APIs from becoming ubiquitous, or deception designed to "pollute" Java so that it would not become an alternative source of APIs.[15] Both exclusive dealing and deception are recognized acts of monopolization if they produce the requisite effects without justification.[16] Staff analogizes its theory to exclusive dealing; but arguably customers are being told only that they cannot deal with competitors with the benefit of the optimization advanced or enabled by Google's API. If that is the theory, BE staff reasonably criticizes it as tantamount to saying that a monopolist must share its innovations if it can do so at no cost to itself.[17] This argument would have force, because U.S. law has generally not been averse to using self-help, such as contractual restrictions, to protect innovations, as in the case of contracts that protect trade secrets.[18] If that is not the theory, then we would all benefit from further explication of the facts, to demonstrate that optimization was not furthered by Google's API.[19]

Fourth, as to exclusive or preferential syndication, such restrictions on third parties can indeed be acts of monopolization.[20] BE staff's critique of the factual underpinnings for such a theory here seem fairly strong, however, and should be given careful consideration.[21]

In sum, this *may* be a good case. But it would be a novel one, and as in all such cases, the Commission should think through carefully what it means.

2004) (available at http://ec.europa.eu/competition/antitrust/cases/dec_docs/37792/37792_4177_1.pdf). The EC's theory was that Microsoft's dominance over the client PC operating system market had a significant effect on the adjacent market for operating systems for work group servers, which cannot function efficiently unless they can interoperate with client PC operating systems; and that Microsoft's refusal to provide interface information that competing developers of server software needed for their products to interoperate with Windows PCs was anticompetitive, since withholding this "indispensable input" could destroy competition in the server operating system market. *See supra* note 12.

[15] *See United States v. Microsoft Corp.*, 253 F.3d at 54-55, 65-66, 74-77.

[16] *Id.* at 69-71, 76-77.

[17] Memo to the Commission from Christopher Adams and John Yun, Bureau of Economics, at 31, 41 (Aug. 8, 2012) ("BE Staff Memo").

[18] *See, e.g., United States v. E.I. DuPont de Nemours & Co.*, 118 F. Supp. 41, 219 (D. Del. 1953), *aff'd*, 351 U.S. 377 (1956) ("*Cellophane*"). One might question this outcome where the amount of innovation in the protocol itself is tiny -- think of a patent on the shape of an electrical outlet, for example. But we don't yet have any accepted, adequate theory for when an antitrust authority can mandate access in such cases.

[19] Staff concedes that customers accounting for a substantial majority of spending on search advertising are "multi-homing" -- *i.e.*, placing search ads both on Google and on competing search networks such as Bing. BC Staff Memo at 46-47. This seems to indicate that the transaction costs allegedly imposed by Google's API restrictions may not create significant "lock-in" effects or "stickiness" that impede competition in the search advertising market as a whole -- and consequently, that the restrictions may not appreciably add to Google's supposedly entrenched dominance. Staff emphasizes, however, that transaction costs are driving the smaller advertisers, comprising over 62% of the total *number* of advertisers, not to "multi-home." *Id.* at 47. Under either Section 2 of the Sherman Act or a stand-alone application of Section 5 of the FTC Act, it is incumbent on staff to explain why it is the alleged effect of the API restrictions on the *number of advertisers* -- rather than their effect on the *dollar amount of advertising spending* -- that really matters.

[20] *See, e.g., United States v. VISA U.S.A., Inc.*, 344 F.3d 229, 240-41 (2d Cir. 2003).

[21] BE Staff Memo at 3, 18-22.

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Economics

Howard A. Shelanski
Director

September 6, 2012

MEMORANDUM

TO: The Commission

FROM: Howard Shelanski

SUBJECT: Google investigation

The purpose of this memorandum is very briefly to express my views of the Google investigation and the staff memoranda that have circulated to the Commission in advance of the upcoming meeting.

The BC and BE staffs have done an outstanding job on this complex investigation. The memos from the respective bureaus make clear that the case for a complaint is close in the four areas of conduct that the staffs have examined. In each of those areas, three key questions emerge: (1) whether the relevant conduct is on balance harmful; (2) whether the anticompetitive harm is sufficiently provable for the FTC to win in court under current law; and (3) even if particular conduct would be hard to block in court, whether there are good legal and economic reasons to pursue remedies for that conduct through a consent order.

For most of the conduct at issue I generally agree with the BE staff analysis and with the memo that Ken Heyer sent to the Commission on September 1st. I agree with both BC and BE staff recommendations that the Commission not issue a complaint or pursue remedies for discriminatory "search preferencing" by Google. And if the choice before the Commission were between closing the investigation and litigating any of the possible counts, I would adopt Ken Heyer's memo and recommend closing the investigation altogether. But there is one type of conduct discussed in the staff memos, scraping, that I think may create harm without offsetting benefit and for which I think the Commission has sound basis for pursuing a settlement despite the likely difficulty of prevailing on that count in court. With regard to scraping, I am more in agreement with the BC than the BE staff recommendation.

Scraping. My concern with Google's alleged scraping of content from vertically related websites is that it could create a strong disincentive for on-line content and application providers to invest and innovate. When Google scrapes, it essentially sends the message to vertical application providers that, no matter how good they are, they can never be better than Google; Google will simply appropriate for itself the best of the content that others create. In other words, if Google chooses to enter a particular "vertical," it can reduce its own investment and free-ride on the work of others. To the extent Google can use its market power in general search to force verticals either to allow Google to scrape or else forego appearing in Google's search listings, Google can harm competition and consumer welfare even while increasing its private returns.

The extent of harm from scraping is difficult to gauge. Some websites might want Google to scrape their content because they find scraping to expand their reach and exposure. Other online businesses like Yelp and TripAdvisor have actively opposed Google's appropriation of their content. We cannot reasonably assess the value of investment that scraping might deter. The point is not that scraping always will harm vertical websites but that it *can* do so. While websites should therefore be able to permit Google to scrape their content, Google should not be able to use its market power in general search to force vertical applications into opening their content to scraping. The economic theory of harm is that forced scraping diminishes innovation while distorting downstream competition; the legal theory of harm is more fragile, but as explained in the BC staff memorandum (pp.128-133), forced scraping arguably fits within the category of conditional refusals to deal covered by *Aspen* and *Trinko*.

The remedy for scraping is likely to be imperfect but need not be ineffective. I do not recommend an outright prohibition on scraping, but instead think Google should be required to: (1) provide an easy and automatic way for any website to opt out of any scraping Google might undertake in the future; and (2) ensure that openness to scraping does not factor into Google's algorithms for matching websites to consumers' queries. Such a remedy narrows future compliance inquiries to one specific dimension of Google's algorithms. That remedy would not prevent Google from finding subtle ways to demote websites for reasons apparently unrelated to scraping but, because such artificial demotions are ultimately contrary to Google's self-interest in returning consumers the best possible results, there is some internal check on Google's incentive to punish verticals that opt out of scraping. Any stronger remedy could require the Commission to undertake ongoing, detailed reviews of Google's algorithms, which I think should be strictly avoided.

I recognize that it might not make sense for the Commission to pursue the scraping conduct alone, especially in light of evidence that Google may have stopped the practice. But should the Commission decide to seek a remedy for scraping or to accept one that Google might offer, I think the agency would be on solid ground in doing so.

Exclusive dealing, API restrictions, and search preferencing. The main factor that distinguishes scraping from the search preferencing, exclusive dealing, and API conduct is that these latter three have more credible efficiency justifications. Assessing the net benefits or harms of particular search algorithms, exclusive deals, or APIs is very difficult for the reasons explained in the memos already circulated. I think the risks and enforcement difficulties of restrictions on search algorithms are particularly great. While I think a stronger case can be made for seeking remedies for exclusive dealing and API restrictions—and the BC staff memo does a good job making such a case—I think the Commission is still better off forbearing from challenging or seeking to remedy such conduct.

With respect to exclusive dealing, the BE staff memorandum provides compelling evidence that many customers desire exclusive search syndication and distribution deals with Google. The facts show that Google generally offers much better returns than Bing does for syndication partners. Even those customers that do prefer multiple sources for syndication overwhelmingly use Google over Bing. The end result is that Google appears to be foreclosing very little demand for Bing through exclusive dealing. That said, we do not know how important even marginal increases in traffic could be for Bing's growth and development. If it is true that customers want to use Google for search syndication and not Bing, then there is no need for Google to contract for exclusivity; it will just happen. One might therefore conclude that we would likely have little success in court proving harm from Google's exclusive dealing but that preventing such exclusion could nonetheless have some modest benefits for competition.

Weighing against the foregoing conclusion are two considerations. First, competition for exclusive deals can reduce prices for syndication clients. Second, there is evidence that exclusive deals between Google and its search syndication clients sometimes arise as the result of Google's making investments specific to the needs of those clients. There is documentation of such specific investments by Google in support of AOL and Ask.com. Any prohibition on Google's offering of differing terms for exclusive versus non-exclusive syndication deals could interfere with beneficial, specific investments. With little evidence that Google's exclusive deals result in significant foreclosure, a remedy here could be counterproductive and may at best be inconsequential.

I similarly think the evidence is ambiguous with respect to the AdWords APIs and Google's limitations on the portability of customers' ad campaigns to rival platforms. The BC staff memo does a good job of showing evidence that Google's ban on ad portability may be as motivated by an intent to limit competition as by the desire to protect against free-riding. On the other hand, the evidence is unclear about the extent to which the APIs actually raise rivals costs. I agree with Ken Heyer that we do not know enough about the comparative costs and benefits of the APIs or about the effects of the portability limitation to pursue a remedy through either settlement or litigation. While I think the case for challenging the portability restriction is stronger than the case for challenging search preferencing, and is perhaps stronger than the case for challenging exclusive syndication deals, I on balance do not recommend that the Commission seek a remedy based on the API-related theories of harm.

In sum, I think the staff memos do an admirable job of laying out the complexities related to each of the four investigated areas of Google's conduct. I join the consensus against bringing a challenge based on search preferencing, would support seeking a consent order related to scraping, and recommend (although less strongly than with respect to search preferencing) against bringing a challenge to either Google's exclusive dealing or its API restrictions.

Given the many memos that have already circulated on this matter I am keeping this one brief, but I would be happy to discuss any of these issues in greater detail.