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August 12, 2008

The Honorable Herb Kohl
Subcommittee on Antitrust Competition Policy
and Consumer Rights
Attn: Margaret Horn
308 Hart Senate Office Bldg.
Washington, DC 20510

RE: Follow-up Questions for Matthew Crowley

Dear Senator Kohl:

Enclosed is AT&T's response to your follow up questions directed to Matthew Crowley regarding the hearing entitled "The Google-Yahoo Agreement and the Future of Internet Advertising", conducted on July 15, 2007.

Sincerely,

Bruce R. Byrd

Enclosures

Response of AT&T to Follow-up Questions from Senator Kohl
"The Google-Yahoo Agreement and the Future of Internet Advertising"

Q. The price of internet search advertising is set by an auction among advertisers for search terms, isn't it? So why do you worry that this agreement between Yahoo and Google will raise ad prices?

A. Google and Yahoo! do sell search advertising through processes that employ certain auction *features*, but those processes are by no means true auctions in which there are transparent, public sales to the highest bidder by a neutral "auctioneer." That is, while the Google and Yahoo! auctions involve the acceptance of bids from advertisers that want their ads featured on search results pages when particular search keywords are used, Google and Yahoo!, not the advertisers, retain ultimate discretion over search ad prices through their complete control over, among other things, the minimum bid reserve prices, the black-box ad "quality" rankings, and the number of advertising "slots" they choose to make available for a keyword search.

The ability of Google and Yahoo! to raise prices in the "auctions" they conduct is relatively simple to illustrate. First, either one can simply reduce the number of ad slots it makes available. If, for example, Google offers five ad slots for a popular keyword (*i.e.*, one that is highly relevant to many advertisers' products), an advertiser must achieve a top-5 ranking in a Google auction for that keyword in order have its ad shown. All else being equal, if Google reduces the number of ad slots to 3, prices are likely to rise, as the same pool of advertisers competes for fewer slots. Google's dominant share of the search advertising business already gives it the incentive and ability to employ this strategy to some extent today,[1] and it would be even more inclined to do so if Yahoo! is allowed to cede a significant portion of *its* ad slot capacity to Google, reducing the competitive threat of Yahoo! as an alternative supplier.

Second, both can raise prices even if neither chooses to reduce the number of available ad slots. Google establishes a "minimum per click" reserve price for each keyword, which represents the lowest amount an advertiser may bid to be considered eligible for delivery with the search results when a search includes that keyword. Google can even set different reserve prices for each advertiser based upon experience with that advertiser's bidding practices. Simply by raising the undisclosed reserve prices that are entirely within its control, Google can raise the prices that bidders that qualify for one of the available ad slots must pay. Indeed, a recent paper published by Google research employees recognizes that "enforcing minimum prices can improve revenue" and that "bidder-specific minimum prices" are "not innocent."[2] Yahoo! similarly sets minimum bid prices in its "auction."

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1 Saul Hansell, "*Google Deliberately Sells Fewer Ads — and May Have Gone Too Far,*" N.Y.Times blog, July 17, 2008, *available at* http://bits.blogs.nytimes.com/2008/07/17/ google-deliberately-sells-fewer-ads-and-may-have-gone-too-far/index.html?ref=technology.

2 *See* Even-Dar, Feldman, Mansour, and Muthukrishnan, *Position Auctions with Bidder-Specific Minimum Prices*, available at http://research.yahoo.com/workshops/ad-auctions-2008/schlpapers.html.

Finally, Google and Yahoo! select the ads that will appear with search results, not simply by ranking advertiser bids per click from highest to lowest, but by combining those bids with their own proprietary ad and advertiser "quality" scores, which are also entirely within their control. That is, after contending with shifting minimum prices and the ad networks' full control over the number of ad slots, advertisers then are subject to the particularly non-transparent quality scores that are the final arbiters of whether an ad appears and, if so, in which ad slot. In short, there should be no mistake that Google and Yahoo!, not advertisers, set prices for search advertising on their respective ad platforms.

To be clear, none of this suggests that these pseudo-auctions necessarily are illegal or improper. Rather, the pressing issue worthy of the committee's attention is that, today, competition from an independent Yahoo! is a significant check on Google's incentive to exercise its discretion to raise prices through the various means available to it – *i.e.*, Google understands that advertisers could and would shift more of their business to Yahoo!-supplied ad slots in response to a Google price increase. But under the proposed agreement between these competitors, Yahoo! would turn over many of its ad slots to Google, seriously weakening Yahoo!'s vitally important role as a competitive constraint on Google's pricing practices.