Senator Kohl's Follow-Up Questions to Michael Callahan
<u>Hearing on "The Google-Yahoo Agreement and the Future of Internet Advertising"</u>

1. *(a) Mr. Callahan, at the hearing Microsoft General Counsel Brad Smith testified that Yahoo! CEO Jerry Yang told Smith at a meeting on June 8, 2008 that if Yahoo! entered this agreement with Google that "Yahoo! would become part of Google's pole" in a "bipolar search market." You testified that you were present at that meeting, but when both I and Senator Specter asked you if Mr. Yang made this statement you replied that "you didn't recall" whether Mr. Yang made that statement. Now that you've an opportunity to reflect on the meeting and what was said, do you recall whether Mr. Yang made that statement or something similar? Did he say that Yahoo! would become "a part of Google's pole" (or words to that effect) if Yahoo! entered into this agreement with Google?*

As I stated at the hearing last month, I do not recall such a comment. Such a statement would have been inconsistent with the Yahoo! Board's decision to maintain Yahoo! as an innovative, robust competitor in the search advertising space.

Yahoo! believes that the future of online advertising lies with the convergence of display and search. By remaining fully engaged in the search business and accelerating its strategy to provide one stop shopping for advertisers, we believe Yahoo! will be even better positioned to succeed in this evolving market. The financial benefits of this commercial business arrangement will, in part, enhance the resources Yahoo! has to invest in advancing its core strategies and make us a stronger competitor to Google and other companies. Yahoo! is ceding nothing to Google and is not exiting search through this agreement.

(b) In conversations generally, did Mr. Yang ever say anything that sounded like Brad Smith's recollection of the June 8 comments either at that meeting or at any other time? Did he say anything that caused you to believe that Mr. Yang considers that there would only be one strong pole in the internet search market, and Yahoo! would be part of it, as a possible outcome of this deal?

Not that I recall. As stated, any such statement would have been inconsistent with the Yahoo! Board's decision to maintain Yahoo! as an innovative, robust competitor in the search advertising space. Our actions throughout this process make it clear that the decision made by the Yahoo! Board was to improve our competitive position, not cede it.

2. *By its own estimates, Yahoo! will eventually realize as much as $ 800 million more in ad revenue annually with this deal with Google. This windfall must come from somewhere, and we know it won't come from Yahoo! taking business from Google. So we must conclude from that this additional revenue will come from higher advertising rates. How do you respond?*

One of the great benefits of Internet advertising is that advertisers generally do not pay for ad placement – they only pay when a search user actually clicks on an ad. The more clicks an ad generates, the more revenue it generates for the company hosting the ad (Yahoo! or Google, for instance), and at no cost to the consumer. Therefore, more relevant ads translate into higher revenue for all parties and more lead generation for advertisers. Also, keep in mind that, as before, ad prices will continue to be set by fair, open auctions, where advertisers bid in accordance with the value they expect to receive, so competition in this space will remain as robust as always. This agreement allows Yahoo! to supplement its own ad offerings with more relevant advertising from Google. We believe that the additional consumer engagement generated by this additional relevancy will be a boon to advertisers and will ultimately generate a great deal of the additional revenues in this deal.

3. *At the hearing, you argued that advertisers should not worry about price increases because the price of internet search ads is set by "open and fair market-based actions" among advertisers, not by Yahoo or Google. A couple of questions about this:*

First, doesn't Yahoo! set a minimum price for each search term in the auction? Isn't there a risk that this minimum price will increase if Google and Yahoo! no longer compete as vigorously?

Google and Yahoo! will compete as vigorously as always – prices will be set by independent, open auctions. Any minimum prices will be set with regard to relevance and Yahoo!'s own marketplace.

Second, isn't it true that the highest winner in the auction doesn't always win? You determine the winner by looking at other factors, such as whether the bidder is a strong advertiser which consumers are likely to click on, right?

It is certainly true that relevance to our users plays a key role in where advertising is placed on our site and, in some cases, who "wins" the right to have key placement. It does no good to our advertisers or our users (or to Yahoo! itself) to have irrelevant ads that receive no clicks. Because an advertiser pays nothing unless the ad is clicked on by a viewer, it sometimes makes no sense to have a high priced, completely irrelevant advertisement in a key area. This process is not designed to simply increase revenue to Yahoo! – it is designed to help advertisers and users with increased relevance and thus generate more click-throughs and more conversions.

4. (a) In response to my question at the hearing about what Yahoo! would do if the Justice Department recommended against the Yahoo!-Google deal, you said that you would "work through any issues." But this does not answer my question, so let me restate it. If the Justice Department opposed this deal as anti-competitive, would Yahoo! terminate it or would you go through with it anyway, forcing the Justice Department to bring, and win, an antitrust suit in court in order to block it?

While we believe we would win any action taken against this agreement, we do not believe it would ever come to that. We have kept the Department of Justice informed and are cooperating fully, and we are confident that the Justice Department will agree with us that this agreement is not anti-competitive.

(b) Would Yahoo! agree to make monthly or quarterly reports to the Justice Department regarding the competitive consequences of the deal – including how much revenue Yahoo realizes under this arrangement; the number of advertisers that have left or joined Yahoo's network; whether this has led to increases in minimum ad prices – should the Justice Department request such reports after its review of the deal?

Yahoo! has been having discussions with the Department of Justice about this agreement for some time, and will continue to discuss whatever concerns or suggestions they have.

5. Yahoo! has stated that eventually it will realize $800 million more annually from the deal with Google. It is fair to say that as Yahoo! earns more for the advertisements that it places, Google will likewise make more money. If Yahoo! chooses to be an independent company again at some point, as it has stated, at that point Yahoo! will have to forego the extra revenue made as a result of Google's success. It seems doubtful that at some point you will be willing to tell your shareholders that you are going to choose to make less money. Can you comment?

First, nothing in this agreement changes Yahoo!'s status as a strong, independent company. Yahoo! remains committed to the search business, and one purpose of this agreement is to help Yahoo! compete successfully in the converged search and display online advertising space. We have invested millions in improving our technology and functionality in online advertising and, and we intend to remain a formidable competitor and a significant principal in paid search. Over time, as Yahoo! strengthens its competitive presence, we have every intention of generating more revenue from Yahoo!'s own ads. We have every incentive over time to minimize the use of Google's system to advance our own strategic objectives. Meanwhile, Yahoo! has already told its shareholders that it has chosen, through a measured and thoughtful implementation of the Services Agreement, to make less money than it could through a complete outsourcing of sponsored search ads. The reason is simple: in the long run, strengthening Yahoo!'s advertising initiatives will make Yahoo! a stronger competitor.

6. We understand that under this agreement the amount of advertising outsourced is at Yahoo!'s discretion. We can all agree that if almost none is outsourced that we have fewer competition concerns than if most or all of it is.

What is the correct way to analyze this transaction under the antitrust laws? Given that the amount of advertising outsourced is at Yahoo!'s discretion, should we presume in the analysis that Yahoo! does, in fact, outsource all of its advertising as it could do under the agreement?

It would make no sense to speculate that Yahoo! would outsource all of its advertising, since that is contrary to our announced intentions. The correct framework is to view the Services Agreement as a vertical agreement in which Yahoo! as a publisher will call upon Google for ads that supplement Yahoo!'s own sponsored search. Prices will be set by independent auctions, and we have every intention to increase our share of online advertising over time.

7. The Federal Trade Commission analyzed the most recent transaction in this sector – when Google purchased DoubleClick. Given the FTC's background and understanding of the market, is there a reason that you gave the review to the Justice Department and not to the FTC? Do you think that the FTC should also review the agreement?

It is our understanding that the Department of Justice and the FTC mutually allocated this responsibility to the Antitrust Division of the Department of Justice, and this is why we have been in discussions with the Department.