Testimony of

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September 27, 2007

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Before the
Subcommittee on Antitrust, Competition Policy and Consumer Rights
Committee on the Judiciary
United States Senate

September 27, 2007

Chairman Kohl, Ranking Member Hatch, honorable Members of this Subcommittee, my name is Brad Smith and I am Senior Vice President, General Counsel and Corporate Secretary of Microsoft Corporation. I want to thank the Subcommittee for inviting me to testify on one of the most important issues confronting businesses and consumers today: the state of competition in online advertising. The online advertising industry is currently undergoing rapid and fundamental changes that could alter irreversibly the structure of key markets. The decisions made today by companies, regulators, and policymakers will be felt for years to come.

Any discussion on the future of online advertising, in my view, is fundamentally a discussion about the future of the Internet. That is because online advertising has become the fuel that powers the Internet and drives the digital economy. Online advertising spending is set to reach $27 billion this year and double that amount - $54 billion - in 2011. Consumers today have free online access to an almost unimaginable variety of news, entertainment and other content, and increasingly to powerful online services as well. Most websites can offer this content and these services for free solely because of the income they receive from advertising. Online advertising is particularly critical for the thousands of smaller websites that have no off-line revenue sources. Online advertising also plays a crucial role in e-commerce, especially for the growing number of consumers who rely on Internet search engines to learn about products and locate suppliers.

As important as online advertising is today, it will become even more important in the future for one simple reason: convergence. Although convergence is not unique to online advertising, its effect in this sector is so striking because it is happening across so many dimensions at once - between content delivery channels, devices, and business models. The Internet is already becoming a content delivery tool for traditional media such as television and radio, which means that soon even more advertising will be delivered primarily through what we today think of as online advertising platforms.

In short, online advertising is not only an important industry in its own right, but is having an increasingly powerful influence on all types of publishing and media and on the broader digital economy. Given the central role of these industries in our social and civic life, it is not surprising that policymakers, regulators, consumers, and other stakeholders are beginning to raise questions about these market developments and to ask whether they are likely to enhance, or instead restrict, competition.

Today, the millions of websites and advertisers that purchase and sell online advertising rely on a small number of firms to make the process work - to match websites to advertisers, to select which ads to display to which consumers, and so on. This small number has gotten even smaller in recent months due to the significant consolidation that is taking place. Given the current state of the industry, however, it is fair to say that only one transaction poses an imminent risk of giving a single company the degree of market power that could foreclose competition.

Specifically, Google today already holds a dominant position over one of the two main types of online advertising - namely the advertising that we see when we use a search engine and paid ads appear in the margins of the search results page, known as search advertising. Google accounts for nearly 70 percent of search queries worldwide and a similar percentage of the amount advertisers spend on search ads. If Google is permitted to acquire DoubleClick, it will obtain a dominant position over the other main type of online advertising as well - namely, the ads that appear on other websites across the Internet, known as non-search advertising. A combined Google-DoubleClick would serve ads that account for nearly 80 percent of all advertisers' spending on non-search ads appearing on websites that use third party technology to serve those ads, giving the company tremendous power over every major form of online advertising.

Allowing Google to become the dominant gateway connecting advertisers and websites through its purchase of DoubleClick raises important questions for the entire online advertising ecosystem. Advertisers could face higher prices as the number of viable choices for reaching websites diminishes. Websites could see lower revenues, since a dominant provider with few competitive constraints will have the incentive and the ability to keep more of total online ad spending for itself. And online consumers could be left with poorer-quality content, since websites will have less revenue to spend on developing that content, and could also face higher prices for goods and services as advertisers seek to pass on their increased online advertising costs to their customers.

In addition, this acquisition would give a single firm exclusive control over the largest database of information on individual online behavior the world has ever known. Google would also have an unrivaled ability to collect even more user data and assemble an even more comprehensive data library in the future. The privacy implications of this are profound and, like the broader competitive issues raised by this proposed acquisition, raise serious questions that deserve close attention.

I. An Overview of Online Advertising

To understand the state of competition in online advertising today, it is important to understand the two principal types of online advertising - namely, search and non-search ads - and their related business models.

- Search ads. Search ads are the ads users see, along with search results, when they enter a word or phrase into an Internet search engine. Search ads generally appear either at the top of the search results or along the right-hand side of the page. Search ads are selected based on the search term entered by the user, and sometimes also on data that has been collected about the user, such as the user's history of prior searches. Advertisers bid against each other for the right to have their ads appear when a specific search term is entered (also known as a "keyword"), and they typically pay only when a user "clicks" on their ad. The order in which ads appear, and the process of serving them on the page, are handled by the search engine operator using an "ad exchange" system.1

Here are examples of search ads on a Google search results page:

One of the great advantages of search ads is that they provide a cost-effective means of advertising even for small companies with niche, geographically dispersed customers. Consider, for example, a book dealer that specializes in selling rare, out-of-print books on history. This company probably could not afford to advertise through traditional channels such as television or newspapers, because the number of potential customers interested in this book dealer served by any particular TV channel or newspaper is likely to represent a small percentage of the outlet's viewers or readers. Search ads, by comparison, allow the company to target people who are most likely to be interested in what it has to sell - specifically, by displaying ads only to people who enter "rare history books" or a similar phrase into an Internet search engine. Search ads are effective because they are, by their very nature, targeted and interactive - users essentially tell advertisers what they are looking for.

- Non-search ads. Non-search ads are what users see when they visit virtually any site on the Internet other than a search engine site. A web publisher, much like a newspaper, typically sets aside a portion of the space on its web pages to display ads. Websites normally have a choice to sell this ad space either directly to advertisers - in which case it will typically use specialized software (known as "publisher ad-serving tools") to manage which ad will be displayed when, etc. - or indirectly, typically through an ad network or an ad exchange. Smaller websites often choose to have one network sell all their ad space;2 larger sites may contract to sell certain portions of their ad space to a network, or they may sell ad space to different networks using publisher ad-serving tools to serve the ads. When websites sell ad space directly to advertisers, these are sometimes referred to as "premium" (or "reserved") ads, while ads sold through an ad exchange or ad network are sometimes described as "discretionary" (or "remnant") ads.

Non-search ads are sold on the same price-per-click basis used to sell search ads or may use some other pricing model (e.g., cost-per-thousand-impressions). Also, the choice of which ad to display may be made on the basis of the content of the web page on which the ad appears, or on the basis of information about the user (such as past browsing history, location, demographic information, etc.), which is often collected through the use of cookies, IP addresses, and related mechanisms.3 Historically, premium ads used graphics and rich media and were displayed primarily on commercial websites that could afford to employ a direct sales force to sell their ad space to advertisers, while discretionary ads were more often text-based and were sold and served through ad networks and ad exchanges. However, ad networks and exchanges increasingly are used to serve all types of non-search ads, including rich graphical ads. Thus, distinctions between the different "flavors" of non-search ads (textbased vs. graphical, premium vs. discretionary) are quickly disappearing.

Here are examples of two non-search ads, the top one served by Google and the bottom one served by DoubleClick. Note how similar they are in appearance:

II. Online Advertising and the Future of the Internet

There is a growing consensus among industry observers that online advertising will have a profound impact on the future development of the Internet. To understand why, it is worth taking a step back to consider online advertising's recent growth trajectory.

Starting from virtually nothing a decade ago, online advertising has exploded to become the fastest-growing segment of advertising. Advertisers last year spent more than $21 billion on online advertising and are widely expected to spend $27 billion or more this year.4 Online ad spending grew at an astounding 45 percent annually between 2003 and 2006 and is expected to reach $54 billion or more in 2011. In the UK, online advertising spending already exceeds spending for advertising through radio and magazines,5 and experts predict that within a few years it will exceed total spending for television advertising.6 The following graph illustrates the remarkable growth trend of online advertising:

A. Online Content

One reason for this rapid growth is the sheer quantity and diversity of content on the Internet. Consumers today enjoy free online access to an almost limitless variety of news, information, opinion, entertainment, and other high-value content, as well as access to a growing array of free online services. Websites can offer this content and these services for "free" only because of the income they receive from advertising.8 Just as newspapers and TV news programs rely on offline advertising, online news sites and other commercial websites rely on advertising for their economic survival. Online advertising is particularly critical for the thousands of smaller websites - including the blogosphere that is proving to be so central to political and policy discourse in America - that do not publish through offline channels and thus depend entirely on online advertising revenue.

The reasons for the migration of advertising to the Internet are varied, but two reasons stand out. The first is the ability to target online ads to specific customers. Unlike traditional advertising channels such as print media or TV, the Internet is interactive. This interaction yields a wealth of data about user's activities and preferences that can be used to dynamically target ads "on the fly" toward those demographics, interest groups, or even individuals that are most likely to be interested in the advertised products or services.

This ability to target ads towards individuals and interests has led some companies to assemble or obtain access to massive amounts of online user data - about the websites users visit, the searches they run, etc. - data that consumers essentially barter away, often unwittingly, in exchange for access to free content on the web. Access to this data enables these companies to target online ads more effectively, but it also has raised important privacy concerns. Although some of these concerns relate to how such information is collected, many of these concerns relate to the unique risks that would arise if one company were to gain control over a large percentage of this data. I address these concerns in more detail below.

The second reason for the increasing importance of online advertising is the phenomenon of convergence that I mentioned in the introduction. Convergence, of course, is not unique to online advertising. Not long ago, a phone was a phone and email was something you did on your computer. Today, people use their phones to send email, surf the web, take pictures, play music - occasionally even to make a call.

The impact of convergence on online advertising is striking because it is taking place across so many dimensions at once. The convergence of content delivery channels means that people increasingly are watching TV, listening to the radio, reading print media, and enjoying their favorite movies and music on what are basically Internet pipes - and getting online ads along the way. The devices people use to access this content are likewise converging. Sit down with any video game aficionado whose gaming console also surfs the Internet, plays movies, and supports instant messaging, and you'll see this convergence in action. Another important dimension of convergence in this space, however, is in business models. Companies that once provided either Internet search, or online advertising, or social networking services, or hosted email, or online music and video, are now pursuing all of these businesses, and more. Increasingly, companies are using each of these various businesses to serve online ads - and, critically, to target these ads more effectively by amassing all the information they've collected about you across all of these businesses. Further evidence of the impact of convergence on online advertising is the fact that ads accompanying "offline" content such as radio and print media are increasingly being sold over the Internet.

B. Online Commerce

Online advertising is also a key driver of online commerce. Internet search engines and search advertising increasingly serve as a portal to online commerce for consumers, who use them as a launching pad for shopping online. Consumers use search engines not only to locate suppliers, but also to gather information about products and to engage in comparison shopping. Advertisers, for their part, have been quick to recognize the tremendous value of being able to reach only those consumers who have already expressed an interest in their product.

This close linkage between Internet search, online advertising and online commerce is reflected in the amount advertisers spend on search advertising in proportion to all forms of online advertising. Advertising on search results pages accounted for an astonishing 61 percent of global online advertising spending in 2006.9 As one advertising analyst recently stated, on the Internet, "[w]e're all searchaholics."10

C. The Online Advertising Ecosystem

In sum, many thousands of advertisers, online publishers and e-commerce providers today rely on online advertising to survive. To view online advertising as simply another ad medium would be a mistake, for it fails to recognize the central role of online advertising in sustaining the vibrant ecosystem of e-commerce providers and websites the world over that collectively comprise the Internet.

If this is correct, then policymakers and consumers have a strong interest in ensuring that competition in online advertising remains vibrant. There are, of course, thousands of advertisers who use online advertising, and millions of websites that display online ads, making it unlikely that either of these segments is at risk of monopolization. However, these groups increasingly rely on a relatively small number of advertiser and publisher tools, ad exchanges, ad networks, and other intermediaries to make this ecosystem function. Moreover, the number of viable intermediaries has decreased significantly in recent months in light of recent consolidation in the industry.11 Represented graphically, today's online advertising industry looks something like this:

Given the central "gateway" role that advertising technology providers are increasingly playing in online advertising,12 it is vital that competition between providers remains robust to ensure that those in the center of this ecosystem do not use their power to foreclose competition. It is to this issue that I now turn.

III. Competition in Online Advertising

Like many industries, providers of online advertising technologies are subject to economies of scale. This means that, as more advertisers and publishers use a specific provider's advertising solution, the fixed costs of providing that solution can be spread across a larger number of customers, which results in lower costs. While economies of scale typically benefit the leading firm more than smaller players (who have fewer customers across which to spread their costs), they also generally benefit consumers in the form of lower prices or superior products.

A. Online Advertising and Returns to Scale

The online advertising industry, however, also demonstrates positive feedback effects that are distinct in important ways from economies of scale, but which may have the effect of entrenching the position of the leading firm. Economists sometimes refer to these positive feedback effects as "returns to scale." In simplest terms, these effects mean that the leading advertising solution - i.e., the solution with the largest amount of available ad space and therefore the largest number of participating advertisers - has an inherent advantage over its competitors and will be able to increase its lead over time as its market share grows.

To illustrate this point, consider the economics of search advertising. The search engine with the largest number of users will, by definition, be able to show a larger number and variety of ads than any of its competitors (who have fewer users and thus fewer opportunities to show ads). This allows the leading search engine to attract more advertisers than its competitors, since advertisers value having more opportunities to show their ads. The leading search engine will also be able to collect more user search history and related data than its smaller rivals, which it can use to serve more relevant ads and thus attract even more advertisers.

Similar economics apply to non-search online advertising. Specifically, the advertising solution with the most publishers can offer advertisers more opportunities to find more appropriate audience segments, which in turn attracts advertisers. The ability to display more ads also gives the leading firm more opportunities to watch where users go on the Internet, what issues interest them, and how they react (or not) to specific ads. The ability to collect more data about individual Internet users enables the leader to target ads more effectively, which leads to more clicks for advertisers and higher rates of returns for publishers.13

These phenomena mean that the leading firm - whether in search or non-search advertising - will not only tend to be more powerful than its competitors, but also that the magnitude of its advantage will grow as its access to websites and their ad space (also known as "ad inventory") grows, making it increasingly difficult for competitors to exert discipline or compete effectively. Moreover, simply having better technology, without critical mass, may not allow competitors to overcome the leader's inventory advantage.

B. Areas of Concern Arising from Google's Proposed Acquisition of DoubleClick

1. Relevant markets

In simplest terms, the technologies used to bring advertisers and websites together to buy and sell ad space on the Internet effectively act as a "pipeline." The advertisers and websites are on opposite ends of the pipeline, while the middle of the pipeline provides the link for handling the financial and ad content exchange. The merger of Google and DoubleClick would affect this pipeline in at least three areas:

- Publisher Tools. Websites use publisher tools software to manage their ad space, find and then serve ads to their sites, and track the financial performance of their sites. Ads appearing on a website are actually stored offsite on an advertiser's or agency's server. They are served to the website each time a user views a particular web page. This means websites have a unique opportunity to determine which ads should be displayed each time a page is viewed. Publisher tools help websites capitalize on this opportunity by synthesizing the available information about a user or about the content of the page the user is viewing. The information is then matched to the advertisers willing to pay the most to get their ad in front of a particular kind of user, or paired with a particular kind of content. Chosen ads are then served to the website to be viewed by the user. Publisher tools also monitor the return a website earns on any given ad space to maximize the profitability of the site, e.g., to ensure that the most relevant ads are shown to particular users and thus can earn the most revenue. Publisher tools are also used to serve ads based on other criteria, such as showing an ad a given number of times to a pre-agreed number of viewers.

- Advertiser Tools. Advertisers use advertiser tools software to receive requests for ads from a website and then to serve the requested ad. These tools also help advertisers manage and track the effectiveness of their online campaigns, e.g., how often viewers click on an ad, and what return on investment the advertiser is earning by advertising on a particular website, or generally across multiple websites.

- Intermediaries. Ad networks and ad exchanges are two common types of intermediaries. These intermediaries act as "middlemen" to bring advertisers and websites together to buy and sell online ad space. In the search world (as described earlier), advertisers use a search engine's ad exchange system to bid against each other for the right to have their ads appear on search results pages when a user searches a specific keyword. In the non-search advertising world, ad networks aggregate ad space from many websites and then resell access to this inventory to advertisers. Advertising exchanges provide a marketplace to pair willing buyers and sellers of ad space on websites on a real-time basis, in much the same way that a stock exchange pairs buyers with sellers of listed stocks. These networks and exchanges are proving increasingly effective and efficient as compared to traditional methods of direct selling between websites and advertisers.

2. Google and DoubleClick today

Google, at present, is active in all of these areas with respect to both search and non search advertising via its AdWords and AdSense exchange system. DoubleClick is also active in all three areas, but only with respect to non-search advertising.

- Google. Google AdWords is the leading exchange system for search advertising, accounting for 68 percent of paid search advertising world-wide. Google's share of this market has been growing steadily for several years - due in large part to the returns-to-scale phenomenon described in the prior section. Google's AdSense is an exchange system for non-search advertising that is built upon the AdWords keyword bidding system. AdSense is the second-leading technology solution used to serve non-search ads,14 accounting for roughly 27 percent of global advertiser spending on non-search ads. AdSense is an integrated solution that combines - within a closed, end to-end network - all of the advertiser tool, publisher tool, and intermediary components of the non-search advertising pipeline.

- DoubleClick. As noted, DoubleClick competes in all three of the markets identified above with respect to non-search ads. Specifically, DoubleClick offers the "DART" family of publisher and advertiser tools, and it recently launched the "DoubleClick Advertising Exchange" (discussed further below) DoubleClick's "DART for Publishers" is a set of publisher ad serving tools that currently is used to serve roughly 51 percent by revenue of non-search ads to third-party websites. DoubleClick also has a very successful ad-serving product for advertisers, called "DART for Advertisers," which is used by an estimated 40 percent or more of advertisers.

Represented graphically, the stages of the online advertising pipeline in which Google and DoubleClick currently compete are as follows:

3. Impact if Google and DoubleClick were to merge

If Google were permitted to acquire DoubleClick, this acquisition would lead to serious concentration in each of the areas identified above and would enable Google to exert market power over the online ad pipelines that today connect advertisers to websites.

a. Competitive effects on publisher and advertiser tools

Today, the publisher and advertiser ad-serving tools that Google hard-wires into AdSense are substitutes for DoubleClick's leading ad-serving tools. As such, each company imposes competitive constraints on the other. Advertisers and websites who are dissatisfied with Google's end-to-end solution can choose to use DoubleClick's neutral solution as the gateway to their non-search advertising needs, and vice versa. Although DoubleClick's software has historically been used primarily to serve ads to "premium" ad space, rather than the "remnant" ad space typically sold via ad networks, the lines between these two types of ad space are blurring. Also, many websites and advertisers increasingly view ads served by Google via AdSense as substitutable for ads they might buy or sell using DoubleClick.15 Moreover, ad networks that aggregate and then resell website ad inventory also compete directly with AdSense, and they also use (or can use) DoubleClick technology to serve the ads they sell.

If Google were to acquire DoubleClick, this competition between the two firms would end. The transaction would combine the two largest suppliers of publisher ad serving tools used to serve non-search ads. The combined company's publisher tools would be responsible for serving roughly 78 percent of all such ads on a revenue basis.

The Google/DoubleClick merger also raises significant concerns because it would eliminate what is, by far, the most significant "neutral" gateway through which other non-search ad networks can today compete with Google. By seizing control of DoubleClick's previously unbiased but dominant gateways (for both publishers and advertisers), Google likely would be able to change trading conditions to entrench its position, foreclose others, and increase barriers to entry, including by: (i) obstructing the interoperability of competing products with its dominant search network; (ii) favoring its own tools and networks to the detriment of competitors to capture the best ad inventory and advertisers; and (iii) being able to observe confidential pricing and fulfillment information of competing networks obtained through DoubleClick.

b. Competitive effects on intermediation services

If Google were to merge with DoubleClick, it would also take control of DoubleClick assets that otherwise would constitute a direct rival to the intermediation services embedded in Google's AdWords/AdSense. DoubleClick recently launched "DoubleClick Advertising Exchange," an ad exchange that provides an automated alternative to Google's integrated offerings. DoubleClick was uniquely positioned to compete with AdSense because of its strong position in ad serving tools and its corresponding relationships with publishers and advertisers.16

Advertising exchanges are fast emerging as a leading channel for distribution of ads on the Internet. Like any exchange, a successful ad exchange must have a sufficient critical mass (or "liquidity") of advertisers looking to buy ad space on the one hand, and sufficient ad space or inventory available from websites on the other. Today, Google has the largest number of advertisers by far participating in its AdWords exchange system, more than Yahoo! And Microsoft Live Search combined. Similarly, DoubleClick's DART For Publishers is used by 8 of the 10 largest websites and nearly 70 percent of the top 100 sites. Thus, DoubleClick effectively controls access to a significant portion of the ad space on the Internet that could be traded via an exchange. If Google acquires control over this ad space, the resulting company would have an overwhelming lead over rival exchanges in both advertisers and access to ad space necessary to launch a successful ad exchange "out of the box."

In short, if Google and DoubleClick are allowed to merge, one company will become the overwhelming dominant gateway that connects the universe of online advertisers to the millions of websites that display ads. Given Google's existing dominant position in search advertising, the acquisition would make Google far and away the leading provider of the technologies used to serve both search and non-search ads. This would give Google market power over both major forms of online advertising and create considerable barriers to competition. Over time, this likely would accelerate the network effects resulting from Google's scale and information advantage, weaken competitors and thwart new entrants, permitting the combined firm to increase prices and capture more money for itself.

Allowing one company to purchase its way into a dominant position in this way is a bad result for the entire online advertising ecosystem - advertisers, online publishers, and consumers - and is likely to lead to:

- Advertisers having to pay higher prices, because they will have fewer alternatives for reaching large numbers of consumers or for reaching the consumers that are relevant to them.

- Websites receiving less compensation for making their content available online, because they will have fewer alternatives for obtaining advertising revenue for this content.

- Consumers facing poorer quality and less diversity of content over time because websites will have less revenue to invest in content creation and delivery, and facing higher prices from advertisers who seek to pass on the higher costs of online advertising.

4. Competition and Privacy

A related competitive concern arising from Google's proposed acquisition of DoubleClick involves the collection and aggregation of user data. As already noted, the ability to target online ads to interested users is a key benefit of online advertising. But such targeting often relies on the collection and use of online user data, which can raise important legal and policy concerns where this is accomplished through data collection and user profiling practices that are non-transparent or that do not give users meaningful choices.

Microsoft is committed to protecting consumer privacy, which is why we were one of the first Internet companies to support comprehensive consumer privacy legislation. Microsoft has long adhered to globally recognized privacy practices of notice, choice, access, security, enforcement, onward transfer, and data integrity. We have led the industry in adopting privacy notices that are clear, concise, and understandable, and enable users easily to locate more detailed information on our privacy policies if they are interested. We also recently released a set of privacy guidelines designed to help developers build meaningful privacy protections into their software programs.

We also recognize, however, that customers and those in the privacy community have expressed a growing interest in the privacy implications of online advertising. That is why, in July of this year, we announced an enhanced set of five fundamental privacy principles designed to help protect the privacy of Microsoft's Windows Live users, including users of our Live Search service.17 Microsoft has also committed to join the Network Advertising Initiative (NAI), a cooperative of online marketing and advertising companies that addresses important privacy and consumer protection issues in emerging media. As a member of the NAI, Microsoft will follow applicable NAI Principles, including giving customers the ability to opt out of behavioral ad targeting by Microsoft's network-advertising service.

The privacy concerns around online advertising become particularly acute when the company engaging in such practices also holds a dominant position. Google holds this position today with respect to search advertising and may well achieve this position with respect to all online advertising if it were to acquire DoubleClick. Google and DoubleClick, between them, have already likely amassed the two largest databases of online user data in the world. Allowing these companies to merge would result in an unprecedented concentration of online user data and give a single company the unilateral power to exploit that data for its own ends. The merger would also give a single company an unrivalled ability to collect even more user data and assemble an even more comprehensive data library in the future. This would raise serious risks for user privacy and make it exceedingly difficult for other suppliers of online advertising to constrain Google's market power or practices.

Beyond the straightforward dangers that would arise from allowing one company to amass and exploit such vast amounts of online user data, Google's acquisition of DoubleClick raises additional competitive concerns respecting its data collection and privacy practices, including:

- Reduced Incentives to Compete on Quality of Privacy Practices. Acquiring a dominant position through its purchase of DoubleClick would weaken Google's incentive to compete on the quality of its privacy practices. Insulated from competitive pressure, Google would have little reason to heed consumer demand for stronger privacy protections and would face no significant competitive pressure from other firms offering superior practices. Indeed, to the extent Google could generate additional profits by diluting its privacy practices, there is a significant risk it would do so.

- Reduced Consumer Choice. A combined Google-DoubleClick would serve far more advertisements on more websites than any other company in the world. This would make it very difficult for consumers to avoid confronting Google-served ads and thus nearly impossible to avoid the data collection and profiling that these advertisements would facilitate. Even if competing online advertising networks offered superior consumer privacy practices, their limited presence on websites would mean that consumers would have little effective means to "choose" these practices.

Consumers are only now beginning to understand what data is being collected about them online and how companies are using this data. If Google - a company that quite probably holds the world's most extensive database of user search histories - is permitted to acquire DoubleClick - a company that quite possibly holds the most extensive online user data in the world - there is a significant risk that consumer privacy interests will be cast aside in the drive to maintain market share and increase profits.

IV. Conclusion

Online advertising provides the primary source of revenue for most websites today, and in the future it will fund the online delivery of an even wider array of news, entertainment, and other content. Moreover, it is likely that a significantly greater proportion of all advertising will eventually be delivered online as traditional offline forms of content increasingly migrate to Internet-connected devices.

The online advertising industry is currently undergoing rapid, fundamental changes that could irreversibly alter the competitive landscape. Some of these changes raise important questions about the future of competition in online advertising and the implications of a single company controlling the largest database of information on individual behavior the world has ever known. These questions deserve careful consideration by all stakeholders. This hearing is an important step in this process.

Appendix A:

Microsoft's Privacy Principles for Live Search and Online Ad Targeting

Microsoft's Privacy Principles for Live Search and Online Ad Targeting represent the continuing evolution of Microsoft's long-standing commitment to privacy. They build on our existing policies and practices, as reflected in our privacy statements. They also complement our other privacy efforts, such as the public release of our Privacy Guidelines for Developing Software Products and Services and our work to advocate for comprehensive federal privacy legislation in the US and strong public policies worldwide to protect consumer privacy. Some parts of these principles reflect current practices, while other aspects describe new practices that will be implemented over the next 12 months.

In addition to guiding our own practices in the areas of Live Search and online ad targeting, we hope that these principles will be even more valuable in helping to advance an industry dialogue about the protection of privacy in these areas. We also recognize that these are dynamic technologies that are rapidly developing and changing. As such, we will continue to examine and update our privacy approach to ensure that we are striking the right balance for our customers.

Principle I: User Notice
We will be transparent about our policies and practices so that users can make informed choices. For example:

- Our current Microsoft Online Privacy Statement provides clear disclosures in an easy to navigate format that is readily accessible from every page of each major online service that we operate.

- We will regularly update the Microsoft Online Privacy Statement to maintain transparency as our services evolve or our practices change.

- In addition, we will shortly update our privacy statement to provide more detail on online advertising and search data collection and protection.

Principle II: User Control
We will implement new privacy features and practices as we continue to develop our online services. For example:

- We will continue to offer controls that help users to manage the types of communications they receive from Microsoft.

- Once we begin to offer advertising services to third party websites, we will offer users the ability to opt-out from behavioral ad targeting by Microsoft's network advertising service across those websites, in conformity with the Network Advertising Initiative (NAI) Principles.

- We will continue to develop new user controls that will enhance privacy. Such controls may include letting individuals use our search service and surf Microsoft sites without being associated with a personal and unique identifier used for behavioral ad targeting, or allowing signed-in users to control personalization of the services they receive.

Principle III: Search Data Anonymization
We will implement specific policies around search query data, be explicit with users about how long we retain search terms in an identifiable way, and inform users of when and how we may "anonymize" such data. Specifically:

- We will anonymize all Live Search query data after 18 months, unless we receive user consent for a longer time period. This policy will apply retroactively and worldwide, and will include irreversibly removing the entirety of the IP address and all other cross-session identifiers, such as cookie IDs or other machine identifiers, from the search terms.

- We will ensure that any personalized search services involving users choosing a longer retention period are offered in a transparent way with prominent notice and consent.

- We will follow high standards for protecting the privacy and security of the data as long as it is retained, as described in Part IV below.

Principle IV: Minimizing Privacy Impact and Protecting Data
We will design our systems and processes in ways that minimize the privacy impact of the data we collect, store, process and use to deliver our products and services. For example:

- We will store our Live Search service search terms separately from account information that personally and directly identifies the user, such as name, email address, or phone numbers ("individually identifying account information"). We will maintain and continually improve protections to prevent unauthorized correlation of this data. Moreover, we will ensure that any services requiring the connection of search terms to individually identifying account information are offered in a transparent way with prominent notice and user consent.

- We have also designed our online ad targeting platform to select appropriate ads based only on data that does not personally and directly identify individual users, and we will store clickstream and search query data used for ad targeting separately from any individually identifying account information, as described above.

- We will continue to implement technological and process protections to help guard the information we collect and maintain.

Principle V: Legal Requirements and Industry Best Practices
We will follow all applicable legal requirements as well as leading industry best practices in the markets where we operate. For example:

- We adhere to the standards set forth in the Organization for Economic Cooperation and Development (OECD) privacy guidelines.

- We follow the Online Privacy Alliance (OPA) guidelines.

- We are a member of the TRUSTe Privacy Program.

- We abide by the safe harbor framework regarding the collection, use, and retention of data from the European Union.

- As we begin to offer advertising services on third party websites, we plan to follow applicable Network Advertising Initiative (NAI) Principles, for example:

o We will give users the opportunity to opt out of behavioral targeting on third party websites (including the delivery of behaviorally targeted ads on third party websites and the usage of data collected on third party websites for behavioral targeting).

o We will not associate Personally Identifiable Information with clickstream data collected on third party websites without user notice and consent.

1 I use the term "ad exchange" to refer to technologies for serving online ads that also handle various aspects of the transactions between online publishers and advertisers - e.g., setting prices, determining which ad to display to which consumer, etc. Google's AdWords is the leading ad exchange for serving Internet search ads. Yahoo! And Microsoft also operate search ad exchanges in connection with their respective search engines.

2 Indeed, Google's AdSense reportedly has exclusive agreements to sell and serve ad space for a large portion of smaller websites that do not have direct sales forces.

3 Thus, for instance, if I have visited several web sites on political history and clicked on ads for books at those sites, I am more likely to see an ad from the rare book dealer mentioned above than will a teenager who mainly visits the fan sites of pop music bands.

4 The 2006 figure of $21 billion for online advertising includes paid search (including contextual text-links), rich media/video, display ads, sponsorships, and slotting fees and excludes online classified advertising, advertising associated with referrals / lead generation and email solicitations.

5 See David Meyer, Online advertising overtakes magazines, ZDNet. co.uk (Aug. 11, 2006), at http://news.zdnet.co.uk/internet/0,1000000097,39280770,00.htm.

6 Louise Story and Eric Pfanner, The Future of Web Ads is in Britain, The New York Times (Dec. 4, 2006) (citing media analyst predicting that online ad spending will exceed television ad spending in the UK by 2010), at http://www.nytimes.com/2006/12/04/technology/04adcol.html?ei=5088&en=05b0dcf2bba31217&ex=1322888400&adxnnl=1&partner=rssnyt&emc=rss&adxnnlx=1165256273-88PlrXEiXjT/dXO3/7VV4Q.

7 Data from Piper Jaffrey Dec. 2006 and internal Microsoft estimates.

8 For instance, NBC Universal recently announced that it will allow users to download copies of popular NBC programming, and that this service will generate revenue through embedded ads. See Bill Carter, NBC to Offer Downloads of Its Shows, The New York Times (Sept. 20, 2007).

9 The figure for worldwide search share of 61% is derived by dividing the search page advertising market ($13.1 billion) by the total website advertising market ($21 billion).

10 See The Future of Web Ads is in Britain, supra note [6].

11 One example of this consolidation was Microsoft's acquisition of aQuantive. This acquisition, however, did not raise competition concerns, both because Microsoft and aQuantive do not compete, and because the acquisition did not pose any risk of foreclosing competition. The FTC allowed this acquisition to proceed without objection, and it was completed on August 13, 2007.

12 See, e.g., Tobi Elkin, Madison Avenue's Most Popular Boardroom Game, MediaPost.com (July 2007) (quoting media analyst as saying that "[Google] has been telling the market that eventually it will be the gateway for all advertising dollars."), at http://publications.mediapost.com/index.cfm?fuseaction=Articles.showArticleHomePage&art_aid=63222.

13 Because publishers (and many advertisers) typically incur significant fixed costs in using any given ad-serving solution, and incur additional fixed costs for each additional solution they use, they generally prefer to use fewer solutions.

14 Microsoft and Yahoo use their own custom-built software programs to serve ads on their own websites. These programs, with the exception of Yahoo's recently launched "Panama" ad platform, are not available to other websites except on a limited basis. Although Microsoft recently launched a version of such an ad exchange, called AdCenter, it is currently only in beta form.

15 The amount of inventory sold via these channels will increase as networks and exchanges become a more efficient, profit-maximizing solution for more customers. Moreover, as the graphic of non-search ads above illustrates, these ads are, from the consumer's perspective, effectively indistinguishable.

16 Google apparently was also developing expanded ad serving tools and other technologies for publishers and advertisers aimed at competing even more aggressively with DoubleClick's DART For Publishers and DART For Advertisers technology. The proposed transaction would eliminate the prospect for this heightened competition - known generally in the industry as "Google For Publishers" - as well.

17 These principles include commitments to transparency, user controls, anonymization, security, and best practices. A detailed statement of these principles is set forth in Appendix A.