Will Antitrust Probe Keep Microsoft, Yahoo Apart?

Editor's Note: Who's the villain here, or are we too preconditioned to assume that big corporations are the enemy?

(AP) -- Yahoo Inc. and Microsoft Corp. hope that by joining forces, they can tilt the balance of power in Internet search away from Google Inc. First, however, Yahoo and Microsoft have to convince regulators that their plan won't hurt online advertisers and consumers.

As the U.S. Justice Department reviews the proposed partnership, approval figures to hinge on this question: Will the online ad market be healthier if Google's dominance is challenged by a single, more muscular rival instead of two scrawnier foes?

The first step toward getting an answer came this month when Microsoft and Yahoo filed paperwork with federal regulators to comply with the Hart-Scott-Rodino Act, an antitrust law governing mergers and alliances between competitors. The Justice Department has until early September to approve the agreement or - as is likely in this case - request additional information.

European regulators are also expected to review the deal. Microsoft and Yahoo are bracing for the probes to extend into early next year, and the outcome is far from certain.

Just nine months ago, Google abandoned its own proposed partnership with Yahoo to avoid a showdown with the government, which had concluded that Google was already too powerful in the lucrative market for selling ads alongside search results.

Google had hoped to extend its reach even further by selling ads next to some of Yahoo's search results, and in the process, keep Yahoo out of Microsoft's clutches. Microsoft aggressively lobbied against the partnership.

With the Google-Yahoo inquiry behind them, U.S. antitrust regulators are likely to enter this examination with a clearer definition of the Internet search landscape and a better understanding of how it affects the steadily growing online advertising market.

Justice Department spokeswoman Gina Talamona would not comment on the antitrust review, whose existence was confirmed by Microsoft and Yahoo.

Microsoft is counting on the Yahoo partnership to close the wide gap separating the software maker from Google in search. Under the 10-year agreement announced last month, Microsoft's Bing search engine would process all search requests and steer search-related ads on Yahoo.

Analysts believe the move will free Yahoo to phase out of the search business so it can focus on other products. Yahoo would keep 88 percent of advertising revenue generated by searches on its site for the first five years of the deal, and as much as 93 percent in the final five years.

The Microsoft-Yahoo alliance may stand a better chance of winning antitrust approval than the Google-Yahoo pact because it would combine the second and third players in the search market instead of the top two, said Melissa Maxman, head of the antitrust practice group at Baker & Hostetler LLP. In fact, a combination of Microsoft and Yahoo would still lag far behind Google.

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Google handled 64.7 percent of all U.S. Web searches in July, while Yahoo processed 19.3 percent and Microsoft 8.9 percent, according to comScore Inc.

The lopsided competition means neither Yahoo nor Microsoft has a large enough audience on its own to lure a significant amount of search advertising dollars away from Google, argues Microsoft General Counsel Brad Smith.

"Advertisers want scale," Smith said in an interview, "so we need to increase our scale to offer something compelling to advertisers."

Already, one large group of advertisers that opposed the Google deal is supporting the Microsoft marriage.

Last year, the Association of National Advertisers feared Google would gain too much pricing leverage over advertisers through a Yahoo alliance. But Microsoft still won't be in the driver's seat if it teams with Yahoo, said Bob Liodice, president of the trade group. Its members include such big marketers as Procter & Gamble Co., Johnson & Johnson and General Motors Corp.

"This is a whole different ball game," Liodice said. "We are not concerned about monopolization of the market as a result of two weaker competitors coming together. We would still have a very competitive marketplace."

Maxman said regulators will have to consider another factor as well: Yahoo may need Microsoft to survive. Although it remains profitable, Yahoo might not be able to afford to keep spending so much money on search - where it has been losing ground to Google for years - while its hold on its audience is threatened by rapidly growing Internet hubs such as

Facebook and Twitter.

Nevertheless, Maxman said, antitrust regulators could still conclude that Microsoft and Yahoo don't absolutely need each other to compete effectively with Google. Microsoft has deep pockets and plenty of brainpower. And while Yahoo's profits have been slipping for the past three years, the company is now run by a chief executive, Carol Bartz, who has been trying to instill more discipline and focus during the first seven months of her tenure.

"There is no reason that with the right management and right strategy that it can't remain a viable third alternative in the search market," said Matthew Cantor, a New York attorney specializing in antitrust law.

Antitrust regulators generally frown on deals that create duopolies, unless one of the players can show it needs to bow out of a cutthroat competition to stay alive, Cantor said.

"The Justice Department's goal is to prevent the market from becoming too concentrated," Maxman said.

The real challenge for antitrust regulators, she said, is that it can be difficult to predict how a rapidly changing technology market will evolve.

A decade ago, Microsoft's stranglehold on PC software triggered an antitrust case that led regulators to conclude the company had abused its control over PC operating systems. Now, Google has emerged as the industry's fearsome giant - a transformation underscored by the Justice Department's decision to block Google's proposed deal with Yahoo last year. Antitrust regulators are also reviewing the potential effects of a legal settlement that would give Google the digital rights over millions of copyright-protected books.

With the antitrust microscope zoomed in, Google may not be nearly as active in trying to scuttle the Microsoft-Yahoo partnership as Microsoft was in trying to derail the Google-Yahoo pact last year. Google has said little publicly since the deal was announced other than to reiterate that more competition is good for Web surfers and advertisers.

Even if Google doesn't object, the Microsoft-Yahoo agreement merits an examination of how the two companies intend to share the data they gather about Web surfers, said Jeff Chester, executive director of the Center for Digital Democracy, a privacy watchdog group.

"This will be a litmus test for the Obama administration on whether they incorporate privacy into antitrust review," Chester said.

Besides eliminating one of Google's search rivals, the deal would cede Yahoo's market share to a company that still dominates the markets for operating systems and Internet browsers. The antitrust review needs to consider whether Microsoft's clout in those areas would be strengthened by the Yahoo partnership, Chester said.

Yahoo and Microsoft also are among the largest providers of free e-mail and instant messaging services. As a result, even if regulators approve the search alliance, they may impose controls to ensure the two companies keep those other parts of their business separate.

Perhaps the best way to placate regulators may be for Yahoo to sell its search technology to another company besides Microsoft or Google, to spice up the competition, Cantor said.

"If the traditional antitrust doctrines are followed, it is going to be hard for the authorities not to challenge this deal, unless some conditions are placed on the parties," Cantor said.

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