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Dear Mr. Kelly,

Investigation into the Video on Demand joint venture between BBC, ITV and Channel – Project 'Kangaroo'

We would like to thank the Competition Commission for the opportunity to express our views on the development of online video services, and online advertising. This response is given on behalf of Google Inc., Mountain View, California, USA and YouTube LLC, San Bruno, USA. This non-confidential document can be made available on your homepage.

Please do not hesitate to contact us if you have further questions.

Kind regards

Julia Holtz
Competition Counsel – Europe

I. The relevant markets i.e. your view of the services which the JV partners offer;
II. How these markets evolve over time in the light of technological and other developments

i. Introduction to our services

Google and YouTube, as well as the Kangaroo JV, operate in highly competitive and dynamic markets. There are several options to finance such services. Similar to the Kangaroo JV, we have chosen to support our services through advertising.

a. Google.com (search)

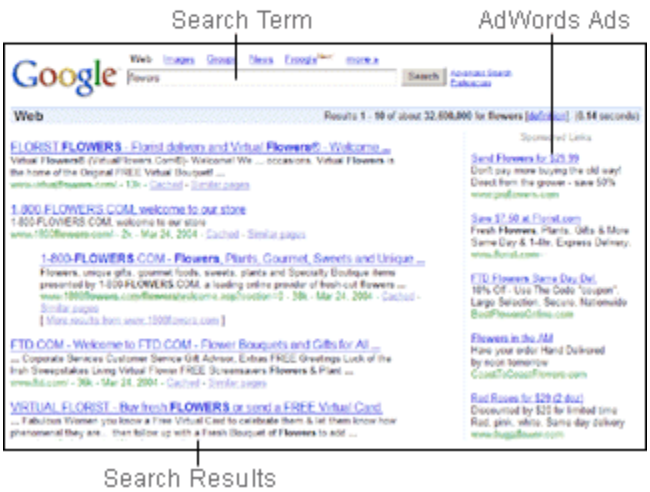
Google's mission is to organise the world's information and make it universally accessible and useful. When you visit www.google.com or one of the dozens of other Google domains, you'll be able to find information in many different languages; check stock quotes, maps, and news headlines; search billions of images and peruse the world's largest archive of Usenet messages -- more than 1 billion posts dating back to 1981.

Google's utility and ease of use have made it one of the world's best known brands almost entirely through word of mouth from satisfied users.

Our products are described in more detail here: http://www.google.com/press/descriptions.html.

When a search is conducted by a user, the search results and the Google search-based text advertisements that match the keywords are both displayed on-screen. The example below illustrates a search page with Google-generated search-related text ads. Following a user's search query for "flowers", the search results are displayed on the left-hand side, whereas the search-related text ads appear – clearly labeled as "sponsored link" advertisements – on the right-hand side. These ads are relevant to the search terms entered by the user. Google believes that users should know when someone has paid to put a message in front of you, so we always distinguish ads from the search results or other content on a page. We don't sell placement in the search results themselves, or allow people to pay for a higher ranking there. (See further below more detail on our activities in advertising.)

SEARCH RESULTS PAGE WITH ADVERTISING



b. YouTube (video)

YouTube officially launched in December 2005 (and a localised interface for the UK was launched in June 2007) and has attracted users at a very fast pace. Today, YouTube has several hundred million unique users each month worldwide and has the 6th largest audience on the Internet.[1] YouTube allows users and other media companies to easily upload and share video clips on YouTube.com and across the

[1] According to Nielsen.

Internet through websites, mobile devices, blogs and email. Everyone can participate in the YouTube community by watching, sharing and commenting on videos. People can see first-hand accounts of current events, relive their favourite TV moments, find videos about their hobbies and interests, discover new artists and filmmakers and even uncover the quirky and unusual.

As more people capture special moments on video, YouTube is empowering them to share their experiences, talents and expertise with the world. Some of the site's features include:

- Video embedding: users and partners can insert YouTube videos onto third party websites - for example into their Facebook and MySpace accounts or blogs, where anyone can watch them;

- Public or private videos: on upload, users can elect to either broadcast their videos publicly or just share them privately with friends and family;

- Subscriptions: users and partners are able to keep track of their favourite users' new videos;

- Quick Capture: users with a webcam and Flash software are able to instantly record video responses rather than having to pre-record and then upload the video;

- TestTube: this is an area where YouTube engineers and developers conduct alpha testing for new features in development. Users are encouraged to participate in the development process and to evaluate the features concerned.

By registering, users are able to upload and share videos, save favourites, create playlists and comment on videos. YouTube is building a community that is highly motivated to watch and share videos. The YouTube service is free and is supported by advertising (see below under iii).

Part of YouTube's goal is to extend its reach beyond the Internet browser and enable users to discover and share compelling video content. As part of this, YouTube continues to innovate and enhance its APIs and tools. This includes wholesale access to its extensive video library, worldwide audience and the underlying video hosting and streaming infrastructure that powers the site, giving users yet another way to engage the world of video and actively participate in the YouTube community wherever they are, whenever they want.

Users can reach Youtube at www.youtube.com (and the national domains). Users can upload videos free of charge and watch videos free of charge. Currently, approximately 13 hours of new video content are uploaded every minute. Most videos on YouTube are under five minutes long and there is a 10-minute limit for all user videos, although official partners do not have a video size or length limitation. Hundreds of large and small content rights holders in Europe alone, from major broadcasters to music labels and independent production companies, use YouTube every day to reach new audiences, engage with users around the world, gather important marketing data, generate advertising revenue and use tools such as Video ID to monitor and manage videos uploaded by users that may include some of their own material.

c. Advertising

Google derives most of its revenue from providing online advertising space to advertisers and advertising agencies (see also http://www.google.com/ads/ and http://www.google.co.uk/services/).

- "AdWords": Google's advertiser-facing product is called AdWords. AdWords is an auction-based advertising program that lets advertisers place ads targeted to search queries or web content on (i) Google sites and (ii) websites in the Google network of third party website publishers using its proprietary ad matching technology. Advertisers can also use display/video/gadget ads in their AdWords account.

- "AdSense": Google's publisher-facing product is called AdSense. AdSense includes AdSense for Content ("AFC") and AdSense for Search ("AFS"). AFC technology places ads targeted to the content on a publisher's site. A publisher can add a Google search box to the site and can use the AFS technology to deliver text ads that are targeted to the user's search query. The revenue generated by the provision of ad space on partner sites is shared by Google and the third-party website publisher, with the large majority retained by the publishers on whose websites the advertisements appear.

On the search results pages of Google.com, and for AFS, we only allow text ads. In AFC, as on

YouTube, advertisers can also use other ad formats such as display or video ads. Marketers have embraced the YouTube platform as an innovative and engaging vehicle for connecting with their target audiences and they are using it to increase sales and exposure for their companies and brands in many different ways. In some cases they run video advertising, such as InVideo Ads, or display ad campaigns, but they are also sponsoring contests, creating brand channels and adding their own original content to the site. This model is a natural fit for our community because it follows one of the general philosophies of the site itself—user experience comes first. Our community has defined what works in this space and we'll continue to innovate based on their feedback.

Advertisers are able to advertise on YouTube directly via the YouTube site or via Google's Adwords auction. Prices for display ads are charged on a "CPM" basis (cost per 1,000 impressions). For further detail, see http://uk.youtube.com/t/ads_specs_policies.

ii. Relevant markets

As a business, Google generates revenue by providing advertisers with the opportunity to deliver measurable, cost-effective online advertising that is relevant to the information displayed on any given page.

a. All advertising

Google generates most of its revenues from online advertising. However, Google is also working on extending its offering into radio, TV and newspaper advertising. These services are already available in the US, and are likely to be expanded to Europe. In our experience, all forms of advertising, in all types of media compete with one another. An increase in the cost of online advertising that reduces the return on an advertiser's investment relative to advertising through other channels would be expected to lead to a reallocation of spending to those channels. Advertisers take all media into account when planning their advertising campaigns; the spend on online advertising has grown partially at the expense of other advertising media, and providers of advertising space consider themselves to be in strong competition with other (offline and online) media.

b. Online advertising

At the very least, Google considers that all forms of online advertising compete. There are significant overlaps between different ad formats (e.g., text or display) and targeting methods (e.g., contextually, behaviorally, geographically, etc., or in response to a search query). The blurring of distinctions in the online advertising space reflects the fact that: (i) advertisers and publishers increasingly view different forms of online advertising as substitutable, regardless of format and the way in which they are targeted; and (ii) publishers are able to easily switch between different formats according to customer demands.

Traditionally text advertising has been aimed at direct response marketing, while display advertising has focused to a greater extent on building brand awareness. However, text and display advertising have significantly converged over time in terms of the purpose that each form of advertising serves. In particular, as acknowledged by the European Commission in its Google / DoubleClick Decision,[2] search based text advertising and display advertising have become increasingly substitutable for the following reasons:

- Display advertising has become increasingly better at targeting those consumers who are interested in receiving the marketing message of the advertiser. Display advertising has therefore become a viable alternative to text at least for those advertising dollars that are focused on generating a direct response from users viewing the display ad. In particular on YouTube, advertisers are often interested in a direct response by placing a video ad;

- A meaningful percentage of search advertising expenditure is focused on generating brand awareness. Display advertising is a viable alternative to search at least for the part of expenditure on search advertising that is made for the purposes of improving brand awareness; and

- Innovation in online advertising continues to blur any distinction between ad formats.

Website publishers do not typically have a preference for any format, but simply seek to maximize

[2] See, COMP/M.4731 – *Google/DoubleClick*, Commission Decision of 11 March 2008.

revenue from the sale of ad space. The same web page will therefore, depending on the sales terms that the publisher has concluded with advertisers, show display ads, contextual ads and text ads in an identical slot at different times. In addition, the fact that online ads are created according to standard layout formats and can be interchangeably placed on the same spot of the webpage facilitates supply side substitution between the provision of ad space for different formats of ads. Thus, a user that opens the same webpage twice may first see a display ad and the second time a text ad in the same slot. YouTube sells display, video and text ads on its site.

Online advertising is a highly dynamic and innovative business, which is evolving at a fast pace. The annual growth rate is impressive. As noted by industry commentators, the online ad business "*is growing at double-digit rates, which makes it difficult to argue that any one player would be able to influence the market in an inappropriate way.*"[3] Microsoft recently commented that "*online advertising is exploding, it's kind of a white hot space.*"[4] Indeed, IAB reported a 40% year on year increase for Europe from 2006 to 2007.

Growth attracts investments, and rapid evolution of the technology in online advertising has driven product innovation, and continues to undergo rapid transformation. As noted recently: "*The market for advertising online is still in its infancy. Advertisers continue to experiment with ways to reach Web surfers, and they're not yet sure how much to spend online instead of on television and other venues. And neither Google, DoubleClick, nor anyone else dominate the emerging market for video advertising, which in the broadband era may emerge as the most effective and lucrative sector yet.*"[5] "*The Online Industry is in a state, where there will be plenty more innovations….There are all kinds of ad formats driving the market….the entire ad market will move online, not only what is there today*".[6]

Online ad formats have evolved over time from simple display banner ads to search-based text ads and, more recently, rich media ads with video and other moving or interactive features have been growing in particular at the expense of static display banner ads. This evolution is expected to continue: as noted by industry analysts, online advertising is "*very immature and growing fast – there's plenty of room for someone to come along with a better idea.*"[7] Competitors therefore have significant opportunities rapidly to gain share through new and innovative products and services.

Recent innovations include:

- from the advertiser side, new ad formats (video ads, in-video ads, interactive (gadget) ads; YouTube's InVideo ads are particularly interesting in that we first show a transparent 'overlay' in the bottom 20% of the ad which can be clicked on to view the InVideo ad at the user's election;[8]
- from the advertiser side, new and refined ad targeting methods (e.g., contextual, on the basis of a search query, geographical, frequency capping);
- from the advertiser side, improved ways to target specific sites to place your advertisement (if sold through a network, rather than directly from the publisher's website);
- from the publisher side, a large number (significantly more than 100) of highly differentiated ad networks such as Google AdSense, Advertising.com, Bluelithium, 24/7 Real Media Network, AdLINK, Right Media's Remix Media Network, and TradeDoubler (that aggregate publisher websites) are a new way to sell advertising space (inventory) to advertisers, which allows more

[3] Advertising Expenditure Forecasts March 2007, ZenithOptimedia, p. 12

[4] Steve Berkowitz, Microsoft Senior Vice President – Online Services Group, May 22, 2007, speaking at the J.P. Morgan 35th Annual Technology Conference

[5] Antitrust Irony: It's a Fast Changing World when AT&T and Microsoft point fingers at a Google Internet Deal, Los Angeles Times, April 17, 2007

[6] Steve Ballmer, Microsoft CEO, interview with WirtschaftsWoche June 4, 2007

[7] Google's Power Play, U.S. News and World Report, April 22, 2007, referring to a statement of equity analysts at CIBC World Markets, available at: http://www.usnews.com/usnews/biztech/articles/070422/30google.htm

[8] Since launching in August, our InVideo ads have shown very strong results. When we launched, our trials showed that lass than 10% of users closed the overlay (as opposed to pre-roll ads, which often have abandonment rates as high as 70%). They also had "click-through-rates" that were 5-10 times the click-to-play rate of standard display ads. As we expected, advertisers have been thrilled with the InVideo ad campaigns they've run, with click-to-play rates that have met -- and often exceeded -- those we saw in our initial tests. See the **Annex** for an illustration of an InVideo ad.

effective sales for larger websites, and easy selling for smaller sites without a direct sales force. Sales through networks enjoy an even higher growth than online advertising overall;

- from the publisher side, new methods of distributing sales –[confidential] and
- from both the advertiser and publisher side, ad exchanges allow real-time auctions that optimise the buying and selling processes.

c. Online video

As set out above, the relevant market is, at the very least, online advertising. No distinction should be made according to the type of ad, or depending on the type of page / publisher it appears.

It is questionable whether there is an additional market from the product angle, in this case online video or films, and Google does not take a position on this question . However, irrespective of the existence or exact delineation of a potential market for online video, it is obvious that the space is highly dynamic and characterised by new business models and constantly evolving technology.

New business models

Over a short period of time, the following business models have been developed:

- Pay-per-view or pay-per-download (e.g., iTunes);
- Combination with TV subscription (e.g., BT Vision);
- Purely advertising funded (like Joost, YouTube or Dailymotion);
- [confidential][9].

Ever-changing and advancing technology

Online video and related/supporting businesses are characterized by rapid innovation and improvements. For example:

- YouTube recently launched VideoID, which allows accurate identification, choice for copyright holders and a great user experience. In particular, YouTube Video Identification will help copyright holders identify their works on YouTube, and choose what they want done with their videos: whether to block, promote, or even—if a copyright holder chooses to partner with us—create revenue from them. VideoID can also be used by third parties for their own offering, free of charge.
- YouTube is offering high definition on its pages;
- Google/YouTube is constantly innovating to provide user friendly ad formats suitable for these new platforms.

III. Information as to the JV partners' competitors, customers and suppliers

The Internet is characterized by intense competition between websites for users and advertisers. This competition is not diminished by the fact that there are also partnerships in place between online companies in order to offer new products, and to sell ad inventory most effectively.

YouTube is unique in that it offers an open platform that allows partners to reach new audiences through a branded channel, and engage with the community using innovative tools that allow them to explore new revenue opportunities. The YouTube platform can be used as complement to their own offerings, for research, reach and revenue.

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[9] [confidential]

i. Competitors

Online services compete for users and advertisers, and in this sense with YouTube as with many other players. The joint venture faces competition in particular from very similar services, i.e. companies such as Joost and Bablegum, BSkyB, and other online TV offerings that provide full-length videos and films. These players are very close substitutes for Kangaroo. The degree that YouTube will compete with the JV in this narrow sense depends largely on the material that the JV members decide that they wish to make available via YouTube.[10]

ii. Customers

The JV will have the same customers as YouTube, i.e., advertisers. The user base will also overlap to some degree.

iii. Suppliers

The JV's suppliers are rightsholders, production companies, music labels, studios and broadcasters, (including the parent companies), and thus largely overlapping with YouTube's suppliers.

IV. Current and future competition in the relevant markets;

i. Online advertising

In relation to online advertising, there is, and will be, a broad range of companies providing online advertising space, both directly (as sales of inventory on their own websites) and indirectly (in the form of ad networks and ad exchanges). Brian McAndrews, President and CEO of aQuantive – which was acquired by Microsoft, recently commented that the online advertising space is "*in the first or second inning of a long game here. There's no monopoly for innovation… I don't think you're going to see two or three big players and then game over. There will continue to be a broad range of companies"*. A number of major competitors are building platforms and broadening their range of products and services. Many recent transactions are illustrative of the high level of competition and innovation in the online advertising industry, in which suppliers are expanding in different ways and providing novel mixes of services. In addition to their other activities in online advertising, certain major competitors operate/will operate both as major website publishers and as ad networks: Yahoo! (Yahoo.com, Yahoo! Publisher Network and Right Media), Microsoft (MSN and DRIVEpm), AOL (AOL.com and Advertising.com), IAC (Ask.com and the ASL Network), and ValueClick (various websites and CJ Marketplace). Other major competitors operate networks in conjunction with other activities in the online advertising sector, such as WPP (24/7 Real Media network which provides ad serving and is an ad agency).

ii. Online video

In online video, we expect that developments will be equally rapid, with significant and the emergence of new business models. As noted above, YouTube's open and collaborative approach in relation to tools, services and advertising did not exist before, which is evidence of the fast-changing nature of the Internet.

V. Barriers to entry to the markets;

i. Online advertising

The provision of online advertising is characterized by low barriers to entry and expansion. This is true for both direct and indirect sales (which from Google's perspective form part of the same product market).

For the (direct) sale of inventory on a website (such as YouTube), there are virtually no barriers to establishing a website on which to sell ad space, and there are no barriers preventing a good website from succeeding in attracting viewers, and thus ad impressions to sell. Witness, for example, YouTube's dramatic development from an unknown startup in December 2005 to one of the most popular Internet

[10] As we do not offer downloads, no competition for download-to-own videos exist.

destinations. Similarly, until very recently, Facebook was unknown, when it eclipsed very popular MySpace. Websites need to compete for advertisers every day, and contracts with advertisers have very short durations. For example, advertisers on Google.com can set daily budgets and can stop their campaigns at any time. Similarly, campaigns on YouTube do not have to have a minimum duration, and can be cancelled at short notice. There is no exclusivity: obviously, no advertiser would accept to be exclusively bound to one outlet.

As for <u>ad networks</u> such as Google AdSense (and its competitors as mentioned further above), while one needs access to buyers and sellers of media and a technology platform to match the buyers and sellers, the sheer number of successful ad networks and the growing number of ad exchanges illustrate the ease with which these can be obtained or developed. There are no legal or regulatory barriers to entry/expansion in the market for the provision of ad space, both in terms of creating websites to offer advertising space as well as the direct sale of that ad space by the publisher, and in terms of selling ad space indirectly through the creation and operation of an ad network or ad exchange. There are also no technical barriers to entry or expansion. For example, the ability for ad networks to differentiate themselves by innovating targeting and other technologies has encouraged entry and expansion. In addition, the industry is not characterized by the existence of long-term contracts (1 - 3 years max. between publishers and networks, and with limited exclusivity provisions). Network effects are also very limited due to competitive pressures from direct sales, and the ability to differentiate (e.g., a small network can be very successful if it targets a specific audience).

[confidential]

<u>ii. Online video</u>

The barriers to entry for online video are limited. Obviously, it is necessary to attract users, but that this is possible as a start-up without any significant resources is best exemplified by YouTube, which was only founded in 2005. Consequently, even though there are some network effects (more content means more users, and vice versa) these are limited in nature. There is ample scope for differentiation, and users typically go to more than one video site, as they use multiple channels on TV, on multiple devices to satisfy different content needs at different times of the day.

Technical barriers to entry (such as the need for data centers) are constantly diminishing as storage becomes cheaper over time. In addition, data storage becomes more efficient and optimization solutions are offered by third parties such as VMWare. This means that the initial investment for start-ups would be limited. All that is required is the lease of some space in a third party data center.

Offerings that include music of some sort may face difficulties in negotiating the usage of rights with the collecting societies in Europe. We are hopeful that the recent European Commission Decision[11] will enhance competition between collecting societies, and will prove to be beneficial for the Internet industry.

V. The effect of the JV on current and future customers.

Google does not expect this JV to have any negative impact on competition or customers. We hope that the JV would be willing to partner with us.

[confidential]

[11] See, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1165&format=HTML&aged=0&language=EN&guiLanguage=en