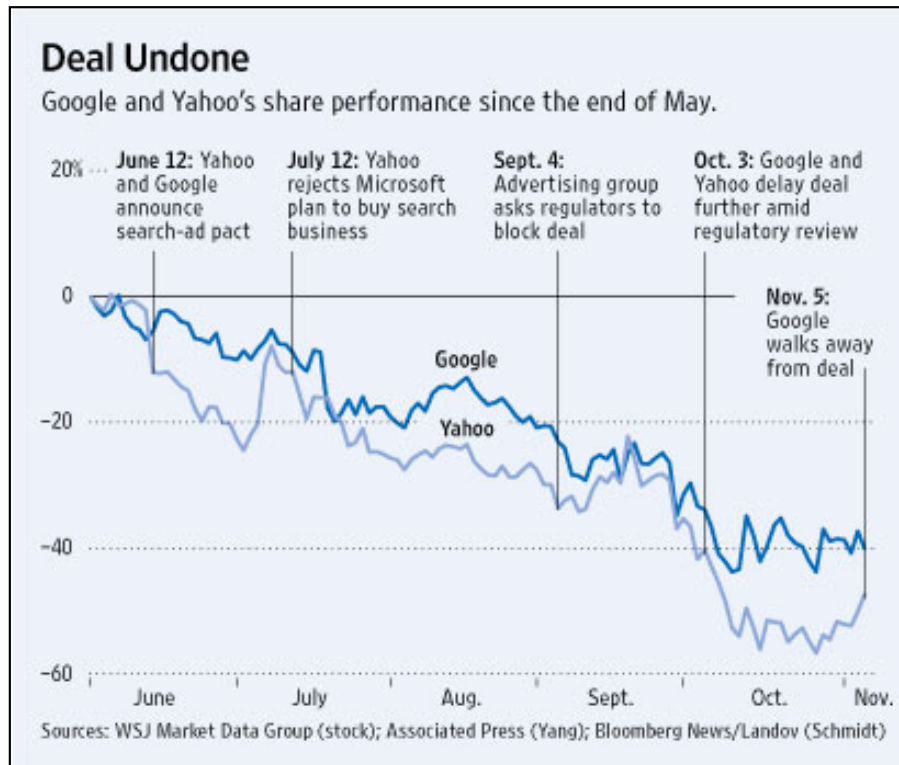


Google Ditches Ad Pact With Yahoo.

Yielding to pressure from regulators, Google Inc. abandoned its partnership with Yahoo Inc.; a move that leaves Yahoo in the lurch and highlights the increasing scrutiny of Google's dominance in the market for Internet search advertising. The deal's demise comes at a pivotal moment for Yahoo and its chief executive, Jerry Yang, who had been counting on the deal to jumpstart Yahoo's flagging business and placate shareholders.



Some investors took Google's retreat as an opening for Microsoft Corp. to renew its interest in Yahoo, driving Yahoo's battered stock up 4.3% to \$13.92 Wednesday. The stock has fallen about 40% this year. At a conference in San Francisco Wednesday, Mr. Yang suggested he is willing to sell the company. "To this day, I believe the best thing for Microsoft to do is to buy Yahoo," he said. A person familiar with Microsoft's thinking said there is still support within the upper echelons of the company for a narrow deal with Yahoo -- such as the purchase of Yahoo's search-engine business -- rather than a full-blown acquisition. However, this person said Microsoft is likely to wait before resuming serious deal talks with Yahoo to gauge how the weakening economy impacts Yahoo and Microsoft's own business. "A deal such as the one turned down this summer with Microsoft, if still available, where Microsoft guaranteed income from search, would be excellent," Mr. Icahn said in an interview. "I never thought a short-term Google deal was that important to Yahoo." To Yahoo's dismay, Google walked away from their pact Wednesday after the Department of Justice, which has been reviewing the agreement for months, told both companies it would sue to block the agreement.

Google said it was ending the pact to avoid a "protracted legal battle." Yahoo said it was "disappointed that Google has elected to withdraw from the agreement rather than defend it in court." At the same time, the Internet giant played down the importance of the deal to its future, calling it "incremental." On stage Wednesday evening, Mr. Yang said the Justice Department's decision indicated "the government does not understand our industry." The deal was a miscalculation for Google CEO Eric Schmidt, who had publicly opposed Microsoft's takeover of Yahoo. Mr. Schmidt had several times stated that his company's deal with Yahoo satisfied antitrust law. Google has steadily grown into an online-ad powerhouse without major regulatory interference. But the Yahoo pact invited a high level of federal scrutiny, which could affect the types of future agreements and deals the search giant decides to pursue.

The agreement, which Yahoo struck with Google in June after talks with Microsoft collapsed, had been on the rocks for weeks. Talks between the companies and regulators had hit a stalemate, even though Google and Yahoo offered compromises like capping how much revenue Yahoo could get from the deal. The Justice Department said attorneys general from 15 states participated in the review and repeatedly highlighted Google's dominance in the search market, noting that it had "shares of more than 70 percent" in

both the Internet search-advertising and search-syndication markets. "This doesn't mean that everything Google wants to do will be challenged by the Justice Department," said Bruce McDonald, a former deputy assistant attorney general with the Department of Justice. But, he said, Google "is on notice that the Justice Department thinks that competition in the [search] space needs to be protected." In the short-term, Google's decision shifts the spotlight to Yahoo and what that company will do next. Yahoo had been hoping that the deal would accelerate growth in its search business to prop up the rest of the company.

The unraveling of the search deal is likely to intensify investors' questions about whether Yahoo can continue to exist as an independent company. Yahoo has continued to actively weigh its options. The company has for months been in talks with Time Warner Inc.'s AOL about a possible combination, according to people familiar with the matter. While talks continue, a deal isn't imminent, they said. Other one-time suitors such as News Corp. aren't actively considering a deal, according to people familiar with the matter. News Corp. owns Dow Jones & Co., which publishes The Wall Street Journal. A Microsoft spokesman declined to say whether the collapse of the Google deal would lead to a resumption of talks between Microsoft and Yahoo.

The person familiar with Microsoft's thinking said two factors that might slow the company's urge to do a deal are the transition early next year to an Obama administration that will bring with it a new set of antitrust enforcers, and Microsoft's continuing hunt for a new executive to lead its online business. In a statement, Microsoft General Counsel Brad Smith praised the government's opposition to the Google deal. "The Department of Justice's finding is significant for advertisers, publishers and consumers, who voiced overwhelming concern about this illegal deal to law enforcement and policymakers," Mr. Smith said. The agreement would have allowed Yahoo to display search ads sold by Google and to share some revenue, but many advertisers and Google partners expressed concern that the deal would raise prices for search ads and give Google too much control over the online advertising market. In a statement Wednesday, the Justice Department said that the deal would have "blunted" Yahoo's ability to compete on search pages where it chose to implement Google ads.

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