

**SPOTLIGHT REPORT**

September 6, 2017

## **GOOG and FB Face Greater Scrutiny in Trump's Washington**

**What's Happening:** Alphabet Inc., the parent company of Google (**GOOG**), and Facebook Inc. (**FB**) have achieved record levels of revenue growth in recent quarters, and have also come to dominate the digital ad market, which is effectively a duopoly between the two companies. With these online companies demonstrating significant influence across digital platforms, regulators and Congress are becoming increasingly aware of the potential for antitrust violations and grassroots organizations have begun pushing for action.

**Why It Matters:** The rapid rise of Google and Facebook has created a host of concerns for antitrust and anti-competition watchdogs. Most recently, Google was slapped with a record-setting \$2.7 billion fine by EU regulators, which charged the company with abusing its market dominance in search. Here in the US, President Trump has taken a big step back from former President Obama's friendly tech policies that helped foster a cozy relationship between Washington and Silicon Valley. In addition, there have been increased calls for oversight from Republicans, as well as certain grassroots organizations, who are concerned that Google and Facebook are pushing a liberal bias through their platforms. On the regulatory and enforcement front, we are still awaiting the confirmation of two crucial posts that will have an important impact on how antitrust action is carried out under the Trump administration. We expect the Senate to confirm Makan Delrahim to run the Department of Justice's (DOJ) Antitrust Division sometime in September and President Trump to formally nominate Joseph Simmons to serve as the chairman of the Federal Trade Commission (FTC). Both Delrahim and Simmons are expected to take a traditional Republican approach to antitrust competition, but could be pushed to start an investigation by the notoriously mercurial President Trump. Any outcome of such an investigation will still need to survive the inevitable scrutiny of the court system, however.

**What's Next:** Congress has been considering legislation that could affect Google and Facebook, including a net neutrality bill and legislation that would hold web hosting companies potentially liable for human trafficking that occurs on their sites. However, the high level of partisanship in Washington suggests that an legislative agreement between the two parties will not happen anytime soon. A more likely scenario, we believe, is that antitrust investigations against the "Big Two" come at

the hands of the FTC and the DOJ, though any such investigations would take considerable time to unfold.

## The Changing Winds for Big Tech

In Trump's Washington, the general mood surrounding big tech – an industry that was closely linked to the Obama administration – is shifting considerably. Now, Google and Facebook are beginning to come under scrutiny for their increasing size and the immense amount of influence both have as they are viewed by many on the right as liberal-based news media outlets.

**The close political ties between Silicon Valley and Obama:** During Obama's tenure as president, Google and Facebook benefitted tremendously from Washington's tech-friendly policies and enjoyed favorable treatment with regard to consideration of antitrust investigations by regulators.

Widely considered "America's first truly digital president," it is not surprising Obama developed a cozy relationship with the tech industry. His 2008 campaign was heavily centered on social media and companies like Facebook and Google devoted considerable resources to the overall operation. Both tech giants also helped organize the new administration and undoubtedly influenced the president's decision to create new executive positions such as the chief technology officer and the chief data scientist.

In turn, an extensive revolving door that brought a number of former high-ranking tech executives into the White House as well as ex-White House staffers into positions within Silicon Valley soon came into existence.

Nowhere was this close political relationship between Silicon Valley and the Obama administration more apparent than with Google. Over the past eight years, at least seven high-ranking individuals left their posts in the Obama administration to work for Google, or vice versa. The "Google Guardians," as some have referred to them as, were able to exert a considerable amount of influence in how antitrust enforcement standards were carried out and across regulatory fronts. As Obama's second largest corporate donor, Google also played a crucial role in the collection of voter data analytics during the 2012 campaign and assisted with the organization of his political operation as well.

The self-serving relationship that the Obama administration cultivated with Google can explain, at least to some extent, why the FTC largely took a hands-off approach when it came to the enforcement of antitrust laws against Google over the course of the last eight years.

The most notable example of this happened back in 2012 after the *Wall Street Journal* leaked [a report](#) produced by the FTC's Bureau of Competition. It found that Google's business "conduct has resulted in – and will result – in real harm to consumers and innovation in the online search and advertising markets." Although the FTC

recommended filing charges, no direct action was ever taken.

Days after the article was published, Johanna Shelton, a Google lobbyist, [wrote an email](#) to the FTC that called on the agency to release a public statement that would help Google clear up any wrongdoing that it was accused of – which it did only a few days later. Despite the initial findings that accused Google of engaging in anti-competitive behavior, the press release that was eventually put out by the FTC stated that “there was no legal basis for action with respect to the main focus of the investigation” and therefore decided not take any direct action.

**The difference lies with Trump:** While Obama largely allowed the size and the overall influence that tech giants have within the digital news media frontier to go unchecked during his presidential tenure, there is a noticeable shift in tone that is being projected by the Trump administration and some Republicans in Congress about the need to make Google and Facebook more responsible moderators of public discourse. Investors should consider the following political dynamics that Trump has brought into Washington and how they might shape the broader tech policy landscape in the Trump era:

- Like Trump, many Republicans are beginning to acknowledge the growing influence that Google and Facebook have in terms of spreading liberal-based news through their online platforms. Last week, *Fox News's* Tucker Carlson said that “Google should be regulated like the public utility it is, to make sure it doesn’t further distort the free flow of information to the rest of us.” After reports circulated that Google fired an engineer who wrote about gender differences and revealed the company’s “left bias,” a number of Republicans expressed concerns about how tech giants are becoming too political.
- As Google and Facebook disrupt traditional markets and become the biggest influencers of online news, the traditional “newspaper industry” is preparing its fight back. Last July, the News Media Alliance, a coalition of print and web-based publications that includes *The New York Times*, the *Wall Street Journal*, and the *Washington Post*, began a campaign aimed at securing the right to negotiate collectively with tech giants such as Google and Facebook. The group seeks a limited antitrust exemption from Congress and argues this will help preserve quality, unbiased journalism.
- Many of Trump’s most controversial policies – such as the Muslim travel ban, the ban on transgender people in the military, and the abandonment of the Paris climate accords – have been met with unenthusiastic responses from Silicon Valley companies. Additionally, the president’s remarks about how “both sides” were responsible for the violence that ensued in Charlottesville, Virginia and the later decision to disband White House advisory councils also have exacerbated tensions between Silicon Valley firms and the Trump administration.

While today’s level of partisanship in Washington and the distaste many Silicon Valley companies have for Trump’s policies will play a factor in how tech policy gets constructed in the coming years, investors should also consider the implications of the EU’s recent

finances imposed on Google for violating antitrust laws and how “winner-take-all” platforms like Google, Amazon, Facebook, and Microsoft have come to concentrate domestic and global markets.

- [eMarketer projects](#) that US digital ad spending will increase by roughly 16 percent to \$83 billion by the end of this year – with Google and Facebook leading the charge. Google is expected to increase its market share and projected revenue growth will account for more than 40 percent of the total US digital ad revenues. Projections also suggest Facebook’s share of the US display market will increase to roughly 40 percent.
- The most recent quarterly filings from Google and Facebook reveal how the digital ad market is effectively a duopoly and how smaller, less capital-rich firms like Yahoo (**AABA**) and Twitter (**TWTR**) are losing their market share. In the US market, no digital ad platform other than Google and Facebook has a market share greater than 5 percent.
- Projections for this year suggest that the tech giants will bring in more than 60 percent of total revenue in the US digital ad market and close to half of all revenue worldwide.
- The \$2.7 billion dollar fine imposed by the EU against Google this June for allegedly abusing its market dominance in search might suggest that European authorities are preparing to take a more aggressive approach to ecommerce and the regulation of the digital economy. The EU is also conducting an investigation into Google’s AdSense and another inquiry is looking at whether Google’s exclusion of competing apps on its Android phones constitutes unfair or monopolistic behavior.

## Potential for Regulatory Action

As of right now, it is mostly rhetoric coming out of Washington about the need to address possible antitrust violations that Silicon Valley titans like Google and Facebook might take part in. Although Google and Facebook are not under any active DOJ- or FTC-led investigations with respect to possible antitrust violations – and have not been for the past four years – investors should understand that there exists some possibility for this to change once the Senate confirms Trump’s picks for both the head of the DOJ’s Antitrust Division and the chair of the FTC.

In the case that the DOJ and/or the FTC choose to take up antitrust investigations against the two tech giants, both federal agencies would be expected to come to their conclusions independently from the political environment. For this reason, investors should avoid any line of thinking that equates a frustrated president who has called out Silicon Valley on Twitter for not being in line with his policies in the past with one that will have the ability to force a DOJ- or FTC-led investigation to come to a completion or for a particular conclusion to be reached. Further, investors should take into account the fact that the administration has yet to take any major policy action – even when it comes to

investigations that Trump has more direct control over (e.g., steel and aluminum imports probe). This, along with the fact that the administration is far behind schedule on a number of investigations suggests that nothing will be taken up in the immediate term.

**Trump's appointment of Makan Delrahim to head the DOJ Antitrust Division:** As a traditional, business-friendly Republican, Delrahim has extensive experience in antitrust matters including the Microsoft (**MSFT**) monopolization trial and the appeal that eventually followed. Given Delrahim's expertise in antitrust matters as well as issues concerning intellectual property, we expect that he will take a practical approach "on the antitrust long view" and be given considerable deference from more senior DOJ political appointees.

We also expect Delrahim's decision-making while at his new post will reflect his "constitutional conservative approach to the law" as well as his belief that competition is good for the US. In the past, Delrahim has indicated that he will not go after a tech company just because it controls a large portion of the market. "Just like any other industry, if there is a wrongdoing, we would investigate," Mr. Delrahim said.

Delrahim's ability to strike deals in a bipartisan manner and the far-reaching political clout he exerts also leads us to believe the new DOJ Antitrust Division will take the charge when it comes to potential investigations against Google and Facebook.

Further, the fact that President Trump designated Delrahim to spearhead the selection process and take the lead at vetting US Supreme Court Justice Neil Gorsuch also implies that the president has placed the highest level of trust in Delrahim and therefore will give him the authority to lead antitrust investigations on tech companies that might be engaging in anti-competitive practices.

Although Delrahim's confirmation was delayed until at least September due to an effort by Senator Elizabeth Warren (D-MA) to block his nomination, we believe Trump's pick to head the Antitrust Division at the DOJ will likely be confirmed by the Senate before the end of September. Senator Warren was the only member of the Senate Judiciary Committee who put Delrahim's nomination on hold before the start of the August recess. Senator Warren said Delrahim would "put the interests of giant corporations ahead of the American people," though she did not explicitly state her concerns about the upcoming merger review between AT&T (**T**) and Time Warner (**TWX**).

**Trump's appointment of Joseph Simmons to chair the FTC:** Reports first circulated that Trump had made his decision to nominate Joseph Simmons to be the FTC chairman last week. Although we expect Delrahim will be confirmed on the Senate floor in September, Simmons has not yet been officially nominated, and consequently no exact timeline exists for when Simmons will be confirmed or when an initial hearing will take place.

Before becoming the co-chairman of the antitrust group at the law firm Paul Weiss, Simmons served in former President George W. Bush's administration as the director of the FTC's Bureau of Competition.

We expect the FTC under the leadership of Simmons to be tougher on mergers than the Obama administration. Once Simmons is confirmed, the FTC will likely begin a more thorough review of Amazon's (**AMZN**) \$13.7 billion deal to acquire Whole Foods (**WFM**).

While Simmons awaits confirmation, Republican Commissioner Maureen Ohlhausen will remain as acting chairman of the FTC. Because she is unable to permanently fill crucial internal positions, the FTC's overall policy agenda has been faced with significant delays.

**Why potential antitrust investigations into Google might be led by the DOJ:** Although there is no concrete evidence that would lead us to say definitively that any potential antitrust investigation into Google's business practices would be conducted by the DOJ rather than the FTC, there are two big reasons why it might be more likely that the DOJ would take the reins.

- Since Makan Delrahim is widely seen as the administration's go-to guy on antitrust matters and will be confirmed and in office well before the FTC obtains a majority quorum that would allow it to officially act on these matters, the DOJ would have both the gravitas and a head start in pursuing an investigation against Google if they are interested in pursuing one.
- Over the past decade, the FTC and the DOJ have decided which agency would take the lead on antitrust actions by using a "take turns" approach. During the last four years, however, the FTC has largely put aside any potential cases involving Google despite there being successful Android prosecutions in European courts and sufficient evidence that shows how the company has engaged in unfair practices. The expectation that the rotational approach to deciding which agency will take the lead on antitrust matters would produce fewer discrepancies with respect to the two agencies' findings and final recommendations never came to be realized. Instead, the DOJ has been significantly tougher on Google's business practices compared to the FTC's much laxer approach. This might suggest that antitrust investigations will be led by the agency that has a stronger reputation for more stringent enforcement practices.

Although there is nothing to suggest Delrahim will want to go after Google for antitrust violations at this time, in the case that more antitrust oversight into the tech giants comes about in the future, the DOJ could very well be at the forefront.

**Why potential antitrust investigations into Google might be led by the FTC:** Although we see the likelihood for the FTC to carry out a formal investigation into Google as being slightly smaller – at least in the short-term without the presence of a majority quorum – investors should not rule this possibility out.

- Conventional wisdom suggests that the FTC might be the agency that would lead the charge in an investigation against Google considering how the last antitrust probe against the company took place in early 2013 under the guidance of the FTC.

- Unlike the DOJ, the FTC can bring about its findings with a lower legal standard of proof under its broader authorities and can do so in a quicker manner.

## Potential for Congressional Action

There are two primary factors that lead us to believe that any antitrust action directed against Google and/or Facebook is unlikely to come out of Congress. The legislative setbacks experienced thus far by GOP lawmakers with respect to healthcare and the current level of animosity in Congress will likely present big roadblocks when it comes to getting tech legislation passed. Further, the fact that Republicans have laid out ambitious goals for tax reform suggests that the GOP will have to achieve these goals if it wishes to maintain its governing narrative. This implies that antitrust action against Google and Facebook as well as legislation concerning net neutrality and the rollback of Title II is further down on the GOP's legislative priority list during the fall and early winter months.

In addition, we remain skeptical that any legislation put forward by the News Media Alliance gets passed given how hard it has been to find bipartisan support in Congress for their cause and also because similar requests from other industries have largely gone unanswered in the past.

On the issue of net neutrality, Google and Facebook have largely been trying to avoid this debate, believing that they need to keep their powder dry for the bigger battles such as tax reform that will be in store in the future. Although executives at the two tech titans have issued statements that suggest they support existing net neutrality rules, in reality this is mostly a publicity stunt in order to appeal to the companies' massive customer bases. If Federal Communications Commission (FCC) Chairman Ajit Pai follows through on his promise to repeal the current rules, which we expect to be the case, tech giants like Google and Facebook would easily be able to pay the higher fees charged by internet service providers (ISPs).

The hostility that has swept through Congress over the past few months is at such a high level that it is largely unclear what a legislative compromise concerning net neutrality would look like. As the debate over net neutrality intensified earlier this summer, Democrats discovered that it is a wedge issue and have therefore chosen to refuse to work with Republican counterparts unless they can get a major win for themselves.

**A rare glimpse of bipartisanship over tech policy:** Earlier this month, Senator Rob Portman (R-OH) and Senator Richard Blumenthal (D-CT) introduced a bipartisan bill that would narrow the scope of protections offered through Section 230 of the Communications Decency Act by making websites liable for advertising that promotes sex trafficking.

Although many on Capitol Hill see the [Stop Enabling Sex Traffickers Act of 2017](#) as a crucial piece of legislation that "is targeted against bad actors," Senator Ron Wyden (D-OR) is siding with the tech community and trade groups such as the Internet Association in opposition. According to the senator, "the bill is so broad" that it will be virtually impossible

“for companies to avoid endless lawsuits, no matter how actively they police their platforms.” Tech companies in opposition to the bill in its current form also cited how it would “limit expression on the Internet and result in steep legal and operational costs for many sites.”

The recent backlash coming out of Silicon Valley in response to the violence that took place in Charlottesville and the larger concerns that tech companies have for hate speech is directly related to the fight the tech industry is preparing for with respect to online sex trafficking legislation. On one hand, tech companies are arguing that it should not be held liable for policing third-party content. At the same time, these companies are beginning to crack down on the online activity of hate groups and white supremacists.

While the Senate Committee on Commerce, Science, and Transportation is still a long way from getting the sex trafficking bill on the floor for a vote – if this even happens at all – the legislation would likely have major implications for Google and Facebook later down the road.



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