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SPOTLIGHT REPORT

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Google and Facebook's Regulatory Outlook

What's Happening: Antitrust scrutiny of **Google (GOOGL)** and **Facebook (FB)**, and to some degree **Amazon (AMZN)** and **Apple (AAPL)**, has entered a new phase, now that the Department of Justice (DOJ) and the Federal Trade Commission (FTC) have struck an agreement to divvy up potential antitrust probes of four of the largest US tech companies between them. While investor focus in the near term should remain centered on the potential actions that federal antitrust authorities could take, such as further outreach to companies that have complained about possible anticompetitive conduct committed by Big Tech companies or subpoena requests for non-public information, investors should also be aware of the ongoing debate happening on Capitol Hill about whether the existing approach to antitrust is adequate in the digital era as well as the increasing scrutiny that is coming from a growing number of state attorneys general (AGs) who are likely going to fast-track their own antitrust probes into Google and Facebook specifically should it be determined that the actions taken by the DOJ and the FTC are insufficient.

Why It Matters: There have been several developments since Assistant AG for Antitrust Makan Delrahim and FTC Chairman Joe Simons came to the agreement that the DOJ would investigate any potential antitrust violations by Google and/or Apple and the FTC would investigate any potential antitrust violations by Facebook and/or Amazon which we believe signals more antitrust scrutiny is on the horizon for these companies, and potentially even a formal probe. At the FTC, staffers recently traveled to Palo Alto, California to hear from more than a dozen industry players about potential antitrust violations, an unusual move that provides us with yet another clue about the FTC's growing interest in carrying out strong antitrust enforcement in the tech sector. The DOJ is also conducting outreach of its own to Google's competitors such as **Oracle (ORCL)**, **Trip Advisor (TRIP)**, and **Yelp (YELP)**, but a better indication that the DOJ might be preparing to launch a more formal investigation of Google's business practices arose during a widely-circulated speech that Delrahim gave via video at the Antitrust New Frontiers Conference that was held in Tel Aviv on Tuesday. In that speech, Delrahim took direct aim at Google and Facebook and laid out some potential arguments the Antitrust Division might pursue as it trains its sights on Google, which relate specifically to "coordinated, predatory, and exclusionary conduct that harms competition." Delrahim also briefly touched on scenarios involving acquisitions of nascent competitors by Big Tech

firms that would warrant additional antitrust scrutiny by the Antitrust Division, and suggested that it might be challenging for enforcers to determine whether an acquisition of a startup by a dominant firm would have the effect of eliminating the rise of a potential competitor, which is a view shared by Simons as well. Outside of the DOJ and the FTC, Congress has begun to ramp up its scrutiny of Big Tech platforms, which we saw play out on Tuesday during a hearing that was held by the House Judiciary Committee's antitrust subcommittee to examine how Google and Facebook take in the vast majority of US online ad revenue through their digital advertising services while news organizations receive a far smaller cut. That hearing largely focused on bipartisan legislation that Reps. David Cicilline (D-RI) and Doug Collins (R-GA) recently re-introduced, which would grant news publishers an antitrust exemption so they can collectively bargain with the platforms.

What's Next: While it is still unclear what will come out of the DOJ and the FTC's preliminary inquiries into the four largest US tech giants, it is clear that Google faces the highest antitrust risk. However, even if a formal probe gets underway at the DOJ, it would take years to unfold and would likely be met with significant resistance by the federal courts, should it even get that far. Amazon and Apple, on the other hand, appear to be less urgent areas of focus for antitrust regulators, and when it comes to Facebook, we think the antitrust case is even more incomplete. For Facebook, however, the growing calls being made by lawmakers and an increasing number of state AGs for there to be greater emphasis on non-price dynamics of competition, such as privacy and quality of service, when analyzing antitrust issues could pose further regulatory challenges for the social network, but we remain skeptical the FTC and the DOJ under the leadership of Simons and Delrahim, respectively, will decide to view the accumulation of big data exclusively in terms of the impact it may or may not have on competition and the ability of potential competitors to enter the market. Regardless of what results from the DOJ and the FTC's preliminary inquiries into Google and Facebook, both companies are going to have a harder time acquiring nascent competitors, though any effort to completely block certain transactions on the theory of potential competition is going to be a difficult task for the federal courts to get behind, should antitrust enforcers decide to fight future deals in court. Investors should watch closely the degree to which regulators scrutinize Google's recently announced deal to acquire data analytics company Looker for $2.6 billion, as this will be a litmus test for how antitrust enforcers decide to view acquisitions of nascent competitors.

DOJ and FTC Set the Rules of the Road for Big Tech Antitrust Investigations

It was decided at an invitation-only gathering of the world's top antitrust enforcers, held this past May in Cartagena, Colombia. There, according to a *Bloomberg Businessweek* report published on Tuesday, Assistant AG for Antitrust Makan Delrahim and FTC Chairman Simons came to an agreement that the DOJ would lead any potential antitrust investigations into Google and/or Apple and that the FTC would lead any potential antitrust

investigations into Facebook and/or Amazon. To be sure, no formal investigations are underway at this time, but the deal brokered by Delrahim and Simons, which came after eight months of discussions, is indeed the most significant step taken to date by US antitrust authorities to show they are serious about enforcement in the tech space, and in effect, has put Big Tech firms on serious notice. We believe it also signals further action is almost certainly going to follow, as some of the other preliminary steps being taken by the FTC and the DOJ would suggest as well.

Roughly a week before news broke that the DOJ and the FTC had agreed to divvy up jurisdiction over potential antitrust probes, members of the FTC's new 17-person technology task force met privately with more than a dozen industry players to hear their complaints about anticompetitive conduct by Big Tech firms. The fact the meetings were held over a period of several days and in Palo Alto – more than 2,800 miles from the FTC's Washington, DC headquarters – is noteworthy since such discussions with outside parties, even if they were only listening sessions, can be the first step toward a formal probe.

It is unclear what exactly made up the bulk of the complaints that FTC staff heard let alone which companies took part in the meetings. However, we do know that Bruce Hoffman, director of the FTC's Bureau of Competition, made a direct plea to attendees at the GCR Live Antitrust conference, which was also held in Palo Alto the same week the meetings took place, to share any evidence of anticompetitive mergers that might be on the horizon. "The bottom line, for right now, is that to find anticompetitive nascent acquisitions, we need to do it the old-fashioned way: by looking and asking, and keeping our ear to the ground. And we need your help. Participants in these various industries might well be best-situated to spot problematic acquisitions and bring them to our attention," Hoffman said in prepared remarks.

In addition, the DOJ is also conducting its own outreach to companies that compete against Google, including Oracle, Trip Advisor, and Yelp, which have long complained about Google's alleged anticompetitive business practices. Although such outreach does not necessarily mean a formal antitrust investigation of Google will follow, what we heard from Delrahim during a speech he delivered via video at the Antitrust New Frontiers Conference in Tel Aviv on Tuesday is further evidence that Google indeed faces the most antitrust risk out of all the Big Tech firms.

Specifically, Delrahim pointed to the amount of concentration in digital markets, and in doing so, he took direct aim at both Google and Facebook. "The current landscape suggests there are only one or two significant players in important digital spaces, including internet search, social networks, mobile and desktop operating systems, and electronic book sales. This is true in certain input markets as well. For example, just two firms take in the lion's share of online ad spending," Delrahim explained.

Delrahim also provided a historical snapshot of antitrust, including his views on the government's breakup of Standard Oil and an explanation as to why he believes "[t]he government's case against Microsoft arguably paved the way for companies like Google, Yahoo!, and Apple to enter the market with their own desktop and mobile products."

Whether or not this is true is beside the point, as Stratechery founder Ben Thompson argued in a post yesterday, because it might suggest Delrahim believes future innovation in the tech space will depend on whether or not antitrust action is taken against Google.

After giving an overview of some of the major trustbusting cases brought by the US government as well as an explanation for how the Standard Oil case "demonstrates that price effects are not the sole measure of harm to competition under the US antitrust laws," Delrahim turned his attention to countering some of the arguments being made by those in the so-called 'Hipster Antitrust' camp, or more specifically, their "incorrect" belief that the goal of antitrust policy is only to keep prices low. "It is well-settled, however, that competition has price and non-price dimensions," Delrahim said. "Price effects alone do not provide a complete picture of market dynamics, especially in digital markets in which the profit-maximizing price is zero." In addition to price effects, competition analysis is also focused on whether there is harm to innovation, Delrahim explained, referencing a quote by Franklin Foer, author of "World Without Mind: The Existential Threat of Big Tech," about how consumers cannot complain about Google's zero-price business model or Amazon's low prices for that matter.

Diminished quality is another "type of harm to competition," Delrahim said, using privacy as one specific example. "By protecting competition, we can have an impact on privacy and data protection. Moreover, two companies can compete to expand privacy protections for products or services, or for greater openness and free speech on platforms." We will touch on the antitrust implications of privacy and the use of big data in a later section of this report, but it is worth pointing out how Delrahim's views on this subject appear to be evolving. In a speech given back in February, Delrahim argued that while "[c]oncerns over privacy, inadequate notice, unauthorized use of data, and data protection are legitimate policy issues that need to be discussed, [they] should not lead to distortions of our antitrust standards to address them." While these earlier comments do not necessarily differ with the views he put forth in his speech on Tuesday, at the very least it shows that Delrahim is focusing more on the potential consumer harms that could result from the reduction of competition, specifically as it relates to weaker data privacy protections that a dominant firm might offer.

What the DOJ Might Investigate

This was the most important part of Delrahim's Tuesday speech, as he listed three types of specific anticompetitive behavior and the "types of transactions in digital markets that could trigger close scrutiny by the Antitrust Division in some circumstances."

- First, Delrahim explained that "[t]he Antitrust Division may look askance at coordinated conduct that creates or enhances market power." Interestingly, the concern that market power would be enhanced through coordinated conduct was the primary reason why the DOJ threatened to file a lawsuit against Google back in 2008 in an effort to prevent it from implementing an advertising agreement with

Yahoo!.

- Second, Delrahim discussed collusion, which he argued can be "the easiest type of anticompetitive conduct to identify."

- Third, Delrahim mentioned exclusivity, which involves a firm that "requires its customers to buy exclusively from it, or its suppliers to sell exclusively to it." There are some circumstances when such exclusivity arraignments can be procompetitive, Delrahim ackwledged, but that is not the case when "a dominant firm uses exclusive dealing to prevent entry or diminish the ability of rivals to achieve necessary scale, thereby substantially foreclosing competition." Delrahim referenced the Microsoft case as a specific example "of how problematic exclusive tying arrangements may occur in technology markets," arguing that "Microsoft tied its Windows operating system to internet explorer by taking action to discourage OEMS and users from uninstalling," which in effect undermined competition. According to Delrahim, "[t]his theory is broadly applicable to other technology markets."

- Finally, Delrahim discussed the specific types of transactions in the tech space that would warrant closer scrutiny by the Antitrust Division, specifically those involving acquisitions of nascent competitors. Such acquisitions can be procompetitive "to the extent they combine complementary technologies or bring products and services to market that would not have been made available to consumers otherwise," but in other instances may be anticompetitive "if the purpose and effect of [the] acquisition is to block potential competitors, protect a monopoly, or otherwise harm competition by reducing consumer choice, increasing prices, diminishing or slowing innovation, or reducing quality." Under these circumstances, the Antitrust Division's suspicions may be raised, Delrahim said. While this particular section of Delrahim's speech was considerably vague and did not give us any clues about whether the DOJ will review already consummated deals, Delrahim did suggest that a stronger focus on preventing certain types of acquisitions of nascent competitors could also have serious implications for startups or companies looking to sell themselves to a larger, more dominant firm, as was the case when AT&T made commitments to the government in 1913 that it would not acquire independent phone companies without the government's approval. "Indeed, this complaint is evocative of start-ups for whom a popular exit strategy is acquisition by a large firm in the same or an adjacent market," Delrahim said. Importantly, however, Delrahim did not suggest previous transactions by Google were anticompetitive.

It is also worth pointing out that in his most recent speech, Delrahim cited a quote by former Senator Orrin Hatch (R-UT) about how "[v]igilant and effective antitrust enforcement today is preferable to the heavy hand of government regulation of the Internet tomorrow." Although it is not surprising Delrahim referenced Hatch, given the fact that he served as chief counsel of the Senate Judiciary Committee during Hatch's chairmanship, it is somewhat noteworthy that shortly before Hatch retired, he sent FTC Chairman Simons a letter expressing serious concerns about Google's search and digital advertising practices. Hatch also urged Simons to "reconsider the competitive effects of Google's conduct" across these business segments and suggested that "much has changed since the FTC

last looked at Google's conduct regarding search and digital advertising." While investors should not look too deep into this, it is more than likely that if the DOJ decides it has a case, it will first begin to look at the evidence gathered by the FTC back when it conducted its own probe into Google in 2012. Indeed, even if nothing comes out of the DOJ's initial inquiry into potential antitrust violations committed by Google, the company will almost certainly face more challenges as it seeks to acquire nascent competitors, given widespread concerns that some of its past acquisitions have been harmful to competition.

State AGs Turn Up the Heat on Google and Facebook

Although the primary focus for investors in the near term should remain on the DOJ and the FTC, a growing number of state AGs also now want a piece of the action, with Google and Facebook being their most likely targets. While much of the efforts at the state-level are being led by Louisiana AG Jeff Landry (R), Nebraska AG Doug Peterson (R), and Tennessee AG Herbert Slatery III (R), there is largely a bipartisan consensus that the actions taken thus far by the DOJ and the FTC to rein in Big Tech firms and prevent anticompetitive outcomes in digital markets have missed the mark.

We heard firsthand from Landry, Peterson, and Slatery as well as representatives from various state AG offices about where state-level investigations of Google and Facebook currently stand during yesterday's hearings on antitrust and consumer protection that were hosted by the FTC in Omaha, Nebraska. At one point during the discussions, Peterson even suggested his office had started a "discovery process" in an effort to learn more about the tech industry, which was the clearest indication that a formal investigation might already be underway.

One of the biggest areas of concerns that the state AGs mentioned, however, had to do with the vast market power of companies like Google and Facebook, which they said was obtained primarily through the collection of massive amounts of consumer data. On this point, they urged the FTC to consider privacy as a non-price dimension of competition, arguing that antitrust enforcement in the tech space is considerably more complicated than enforcement in other sectors of the economy because companies like Google and Facebook offer their services for free. "You need to look at other areas," Slatery said, suggesting that the benefits consumers get in return for giving up their data is quite minimal. In addition, Slatery expressed concerns about "the extreme concentration of the technology industry," which he said has left consumers to make a decision about staying on one or two social media platforms or disconnecting from the internet altogether. These views were echoed by Peterson, who warned about the "creepy" level of data that Google and Facebook collect on their users. Landry also agreed, and took direct aim at Google, which he said "gets to pick the winners and the losers because the system is rigged in [its] favor and ripe with conflicts."

While it is notable that the only three state AGs in attendance at yesterday's talks were Republicans, we should note that earlier this week, AGs from 43 states, including Louisiana, Nebraska, Tennessee, as well as DC, Puerto Rico, and Guam, submitted

comments to the FTC urging the agency to step up its scrutiny of tech platforms like Google and Facebook, which they said deserve more attention in both the consumer protection and antitrust contexts. Some of the more important takeaways from their comments are listed below:

- "[P]rivacy can be a non-price dimension of competition." Also important for regulators to take into account is the market value of data, which is challenging because consumers "lack complete information on how their data is used, sold, aggregated, or accessed by third-parties." As a result, consumers "are unable to assess the real price of services provided by platforms that collect their data."

- Recent antitrust enforcement in tech markets where there exists zero-price business models "has often failed to meaningfully evaluate non-price aspects of competition such as innovation, consumer choice, and privacy."

- While privacy is an important aspect of competition in tech platform markets, "a dominant platform can reduce user privacy without undue risk of losing users to a rival platform."

- "The sheer scale of the data collected by dominant platforms can entrench their dominance by creating barriers to entry for new competitors, both because of reinforcing network effects and market research analytics unavailable to other market participants."

- "A dominant firm with a significant competitive advantage in user data is often in a position to utilize that data to identify and then exclude actual or potential competitors from that market." There have been instances in the past when dominant platforms such as Google and Facebook have "[leveraged] their unique access to data" in an effort to identify nascent competitors and then make an attempt to "acquire or exclude them."

The AGs also put forward several recommendations that they urge the FTC to take up, including:

- The FTC should adopt "a slight shift in enforcement policy," and seek "to accurately balance the risks of non-enforcement in the technology platform acquisitions."

- "[T]he FTC should expand recent initiatives to work closely with state [AGs]," especially when conducting reviews of "potentially anticompetitive technology platform acquisitions [that] fall below HSR [Hart-Scott-Rodino] filing requirements."

- "[T]he FTC should require prior approval and/or prior notice for future acquisitions as part of more consent decrees in technology platform markets."

- The FTC should give greater priority to the consideration of non-price effects when reviewing technology platform mergers.

- “Clayton Act Section 7 merger analysis of technology platform mergers should address network effects, and Sherman Act Section 2 provides an even stronger tool for policing monopolists’ acquisitions of nascent competitors.”

The Intersection Between Privacy, Big Data, and the Antitrust Analysis

One specific area we expect both the DOJ and the FTC will look into further involves Big Tech firms’ use of big data and whether the data in question poses a barrier to entry or gives a company an unfair competitive advantage, as this is becoming a central concern for numerous state AGs and lawmakers from both parties. On this point, it is worth briefly discussing some of the different views of various stakeholders about the use of big data as it relates to the antitrust analysis. Included below are some of the key takeaways from several stakeholder comments that were submitted to the FTC as part of the agency’s consumer protection and competition hearing series.

- Global Antitrust Institute (GAI): “[I]nvestments in big data can create competitive distance between a firm and its rivals, including potential entrants, but this distance is the result of an activity that antitrust laws should encourage, not penalize.” Just because a firm possesses the data does not mean that it will know how to understand and make use of it. For these reasons, “[w]e find it is best to avoid suggesting that big data is or is not a barrier to entry.”

- International Center for Law & Economics (ICLE): “[F]or antitrust enforcers, data is unlikely to constitute a barrier to entry, and even less likely to amount to an essential facility.” Like the GAI, the ICLE believes that data is not scarce, but rather “the expertise required to generate and analyze it is.” The majority of successful internet companies started out “with little to no data,” which “suggests that data is more a byproduct of the ongoing operation of internet platforms than it is a critical input for their creation.” In addition, “[t]he marginal cost of collecting and employing data is usually close to zero, making it close to non-excludable.” Multiple economic agents can “simultaneously use the same data, making it non-rivalrous in consumption.” Although databases may be proprietary, the underlying data is usually not and there are numerous ways in which data can be obtained through different platforms. For these reasons, “antitrust authorities should be highly skeptical about claims that rivals will be unable to independently generate equivalent data to that which is held by dominant platforms.” Some critics have concerns about the potential for big data to facilitate price discrimination, however, “differential pricing is frequently a good thing.” On a final point, some stakeholders are calling for mandated data portability, however, ICLE believes such proposals would actually chill innovation and present new data security and user privacy risks.

- Software & Information Industry Association (SIIA): “Data is not barrier to entry in the internet ecosystem.” This is because “data is not a finite commodity that one entity can obtain and prevent others from obtaining.” Although antitrust officials in the US are beginning to think about privacy as an antitrust issue, the only time data should matter for the competition analysis is if it is scare and cannot be replicated. Like the

ICLE, SIIA agrees that requiring data sharing would present serious risks to user privacy.

- Public Knowledge: While data-driven advertising may be beneficial in some aspects, it "may also facilitate higher prices and reduce competition." In addition, algorithms can diminish a firms' "need to cut prices to stay competitive." However, "this practice is likely not redress-able under existing antitrust law, because it does not involve an express agreement to fix prices." Big Tech firms' mass collection of consumer data can also enable it to develop "personalized pricing strategies," which "is often not welfare enhancing for consumers." In addition, "[t]he possession of personal data, particularly large amounts of aggregated data, could be considered as a potential barrier to entry during the merger review, even when a merger would not otherwise have significant vertical or horizontal competitive effects."

Although numerous critics, contend that Google and Facebook are too big and possess too much data, both Delrahim and Simons have repeatedly expressed that big is not necessarily bad. On the topic of big data in particular, Delrahim has stated in the past that he is "wary of claims that 'big data' is *necessarily* a barrier to entry or that, *on its own*, it constitutes evidence of market power or an unfair advantage." The reasons for why Delrahim believes data – even large amounts of it – may not act as an entry barrier in digital markets are as follows:

- "[D]ata is often "non-rivalrous," which is a fancy term meaning that a consumer can share the same data with multiple firms. One firm's use of the data does not diminish its availability to others."

- "[D]ata is often widely available and inexpensive to collect. These days, even small businesses can easily and cheaply collect data themselves or acquire data from third-party providers. Technological advancements also make it easier to collect, manipulate, analyze, and store large amounts of data."

- "[M]ost data has a short shelf-life," which means "new entrants can be on the same general footing as incumbents with large stores of historical data."

- "[F]or many online platforms and tech businesses, data is an input and not the product itself. As with other inputs like labor and capital, a new entrant may not need the same type of data or quantity of data to compete effectively against an incumbent."

Delrahim, as well as Republicans at the FTC, has also taken issue with the calls for mandated data sharing, arguing that such proposals would reduce the incentive to invest in innovation. There is also good reason to believe officials at the FTC, like Bureau of Economics Director Bruce Kobayashi, who served as the founding director of the Global Antitrust Institute, would also agree that in most cases, it would be wrong to consider data as a barrier to entry.

In seeking to understand how the FTC might decide to look at future mergers between a large, incumbent tech firms and a smaller firm that possesses a competing database, it can be somewhat useful to revisit the conclusions reached by the commission in 2007 as part of its review of Google's acquisition of DoubleClick. As in all merger cases, the big issue here involved how to best define the relevant market in which to analyze the competitive effects of the transaction. While several commentators, including Microsoft, argued for a single "online advertising market" that would include both Google's ad intermediation service, AdSense for Content, and DoubleClick's third-party ad servers, DART for Publishers ("DFP"), and DART for Advertisers ("DFA"), a majority of the commission decided that ad intermediation services (i.e. Google's AdSense) constitute a distinct product market from third-party ad servers (i.e., DFP and DFA). In addition, a majority of the commission found that Google's access to a large volume of data would not be unique in the online advertising industry. It was also determined by the FTC that Microsoft, Yahoo!, and AOL – Google's biggest competitors at the time – also had access to significant datasets at their disposal, which the commission ultimately came to interpret as not a legitimate reason to fear that Google would gain an unfair competitive advantage. However, while the transaction was ultimately given the greenlight, then-Commissioner Pamela Jones Harbour (I) dissented because she had serious concerns that the deal would undermine competition as well reduce privacy protections for consumers. Harbour also pushed for conditions to be imposed, but as the majority wrote in its statement, "[n]ot only does the Commission lack legal authority to require conditions … [unrelated] to antitrust, regulating the privacy requirements of just one company could itself pose a serious detriment to competition in this vast and rapidly evolving industry."

Defining the Relevant Market in the Absence of Price Competition

As Delrahim explained in a speech this past winter, "the fact that market definition and other issues can be more challenging in the absence of price competition does not mean we should give up on our rigorous, evidence-based approach." For obvious reasons, defining the relevant antitrust market is more difficult when analyzing zero-price platforms because "traditional economic tools that rely on measurements of price are not available."

Then, how exactly should antitrust enforcers assess market power in the zero-price markets? According to Delrahim, first it is critically important that enforcers do "not fall into the trap of believing that, because there is no price, there is no market or market power." However, at the same time, enforcers should not define "markets with subjective definitions that shortcut rigorous analysis," because doing so would mean applying "labels to a market without looking at the real-world competitive dynamics." In addition, regulators should not "simplify the analysis by defining a market by the identity of the platform providing the product."

When analyzing a market for zero-price products or services, it is necessary to look beyond the free products or services, as it is always the case that a for-profit firm that employs "zero-price strategies must be making money from somewhere." If this was not the case, then the firm would quickly go out of business. For this reason, and because

“[t]he existence of a free product usually indicates that there is a related positive-priced product and that the economics of those two goods are related,” any proper antitrust analysis should thus “consider the free product together with its companion money-making product.”