

# Height Commentary

Stefanie Miller  
(202) 629-0039  
smiller@heightllc.com

Chase White, CFA  
(202) 629-0006  
cwhite@heightllc.com

Hunter Hammond  
(202) 629-0038  
hhammond@heightllc.com



## Technology

### The Real Risk Facing Big Tech in the US is Antitrust Enforcement Action

#### THE TAKEAWAY

Today's hearings in the Senate Intelligence [Committee](#) and the House Energy and Commerce [Committee](#) will raise uncomfortable questions around election meddling and issues stemming from the prevalence of fake accounts across platforms run by Facebook (FB), Google (GOOGL), and Twitter (TWTR). But, to the extent that investors are watching these hearings, we suspect it will be to monitor overall sentiment toward the companies. We recognize that ultimately what investors fear most is a scenario where scrutiny of the industry – stemming from issues discussed at hearings today as well as the Cambridge Analytica / Facebook scandal and other privacy issues across multiple companies' platforms – could over time compel the U.S. government to take antitrust enforcement actions against the aforementioned big tech companies and/or others such as Amazon (AMZN). We have been monitoring this sentiment over the past six months since the Cambridge Analytical scandal broke. Based on a series of events that unfolded over the summer, we now put odds at 25% that states and/or the federal government will take antitrust enforcement actions against large technology firms at some point over the next 12-18 months. This report explores what those actions could be and the series of events we think are crucial to monitor through year-end 2018 that will enhance or degrade this view.

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In a Faustian bargain, consumers have given up their personal data in return for free services and cheap products. In the process, major technology firms have grown tremendously. Secured by a fundamental shift in antitrust policy during the mid- to late-1900s, firms like Amazon, Facebook, and Google have yet to be scrutinized like the Bell System or Standard Oil. Even Microsoft (**MSFT**) dodged a break-up in the 1990s. However, concerns over data privacy, foreign influence over U.S. elections, and the treatment of political speech (and searches) has reinvigorated the discussion about market concentration and competition, which was almost absent over the past 40 years.

In this report, we outline the various avenues for big tech antitrust enforcement at the federal and state levels. As part of this analysis, we delve into all of these points in greater detail. At a top level, we make the following conclusions:

- We expect Congressional scrutiny against major technology firms like Amazon, Google, and Facebook will increase if public attitudes towards big tech firms turn sour or if populist candidates and the platforms they run on receive support in November.
- Broad enforcement by the Department of Justice (DOJ) or the Federal Trade Commission (FTC) is also possible, but any impending policy shift would most likely be signaled through upcoming agency [hearings](#), an update to the merger [guidelines](#), or statements made by the Assistant Attorney General or the FTC commissioners.
- State attorneys general could also bring antitrust suits on behalf of the individuals in their state like they did in 1990s when attempting to regulate Microsoft. We identified the upcoming New York attorney general primary as significant to the antitrust landscape.
- The current antitrust framework at both the federal and state levels is grounded in the protection of consumer welfare, measured by price and output. Absent a fundamental shift, regulators and lawmakers will need to come up with clever methods of constraining, dissolving, or simply regulating the largest tech firms.

As we write above, events of the past few months (which we detail further below) prompted us to assign 25% odds that the U.S. and/or state governments will take antitrust enforcement actions against companies in this big tech universe over the next 12-18 months. We consider Facebook, Google, and Amazon as the companies most at risk due to their size. While 25% odds do not indicate that such actions are probable, our 1-in-4 chance is meant to signal that there is real risk for companies in this industry. We see a number of events (**Figure 1**) over the final months of 2018 that we think could increase or decrease these odds based on how they unfold. At the end of this year, we expect to have a better picture of what's possible over 2019-2020.

## What an antitrust enforcement action could look like

We think it is very unlikely the federal or state governments will call for a clean breakup of one of the big tech companies at any point soon. However there are a number of avenues for alternative enforcement actions. Most meaningful, in our view, would be for the FTC or DOJ to prohibit Facebook and/or Google from pooling all the user data each company collects across multiple platforms into a single, comprehensive profile for advertisers. For example, currently Google can aggregate the data it collects from Google AdSense, Google Search, Waze, and YouTube into a single, comprehensive, and highly valuable profile of each user. Regulation to prohibit the sharing of that information across platforms would constrain, likely significantly, the amount of revenue Google could earn from advertisers. For a company like Amazon, the government [could require](#) it to provide its competitors

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with fair and open access to its infrastructure (the marketplace or web services) to reduce any conflicts of interest and limit any anticompetitive behavior.

## Congressional Action

So far, Congress has not proposed legislation that we think will go anywhere or that would be material to any of the big tech companies. We think it is most important to monitor the early months of 2019 to see if in the new Congressional session any new, farther-reaching legislation is introduced that could begin to show us a blueprint for what a legislative approach to big tech antitrust actions might look like.

The only real piece of legislation we've seen in 2018 is the Social Media Privacy Protection and Consumer Rights Act ([S.2728](#)), which was introduced in April by Sen. Amy Klobuchar (D-MN) and Sen. John Kennedy (R-LA). It would require online platforms to gain the consent of users before collecting and distributing personal data. Currently, S.2728 has only its two original cosponsors. Broad, bipartisan support for the oversight of large tech firms would be required for any bill to make it out of both chambers. While members may introduce an increasing number of bills in the future, the bills will die in committee absent lawmakers' will to act.

### *What we are watching*

Public support for or against companies like Amazon and Google is an important (if not the *most* important) metric to watch when gauging the likelihood of Congressional action. A June 2018 Pew Research [poll](#) indicates that 63% of adults think major tech companies' impact on society has been more good than bad. When asked about the impact personally, that figure rises to 74%. With public support still in favor of these large firms, members of Congress will likely be hesitant to act in any way that constrains them.

Public sentiment may change, however, and we see the midterm elections as an important opportunity to gauge voter sentiment towards populist candidates and the platforms on which they run. Democrats have already rolled out their policy platform ahead of the November elections. The Democrat's "Better Deal" includes a [plank](#) devoted to cracking down on corporate monopolies and abuse; however, mention of big tech is absent while the airline, beer, and cable industries are mentioned by name. It is important to note that when Democrats unveiled the Better Deal platform, the Cambridge Analytica scandal had yet to make news, foreign influence campaigns were not fully understood, and political speech had yet to surface as an important and galvanizing issue. President Trump has also toughened his stance on technology firms, [noting](#) that they may be in a "very antitrust situation," and Senator Orrin Hatch (R-UT) [wrote](#) to the FTC urging the commission to "reconsider the competitive effects of Google's conduct in search and digital advertising." So far, we view these events as one-offs rather than the beginning of a trend. If public opinion begins to shift, we would next expect to see an introduction of more bills aimed at constraining the reach and power of large tech firms, and maybe even more policy guidance from the White House.

Another factor we're watching that creates headwinds against Congressional action is the increasing investments made into government affairs and lobbying efforts by major tech firms. Internet companies have continuously increased their annual lobbying [expenditures](#), reaching a historic peak of \$68.5 million in 2017 ([Figure 2](#)). That number pales in comparison to the \$279 million [spent](#) by pharmaceutical and health companies in 2017 ([Figure 3](#)). If tech companies feel public support is turning or Congressional action is percolating, we believe they can and will achieve the type of lobbying effort expected from other heavily regulated industries. Moreover, tech

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firms have access to some of the best individual data available and can wield that information to combat public backlash through public relations and marketing campaigns.

## DOJ, FTC, and State AG Enforcement

The DOJ and FTC are responsible for the enforcement of federal antitrust laws, but their areas of focus are largely **distinct**. For example, the DOJ focuses on telecommunications while the FTC directs its resources to the computer technology and internet services industry. The DOJ's Assistant Attorney General, Makan Delrahim, is in charge of enforcement through the Antitrust Division; the FTC is headed by five Commissioners, three Republicans and two Democrats. Statements by Delrahim and any of the FTC commissioners, especially the Chairman and other Republicans, can signal the antitrust sentiments at both agencies. Statements critical of current market concentration, user data control, or even the technology industry at large offer important insight into future actions and expectations.

Any antitrust enforcement process begins with an investigation by the DOJ and/or the FTC. Pre-merger filings, consumer or business complaints, congressional inquiries, or articles on relevant subject may **trigger** an investigation, which can lead to a number of outcomes. The company being investigated can enter into a consent agreement to alter behavior or change business structure. Complaints can also be handled by an administrative law judge (ALJ), whose decision can be appealed to the entire commission at the FTC. Finally, any decision could be appealed to a U.S. Court of Appeals and ultimately the Supreme Court.

### *What we are watching*

The FTC scheduled six **public hearings** over the next few months examining “whether broad-based changes in the economy, evolving business practices, new technologies, or international developments might require adjustments to competition and consumer protection law, enforcement priorities, and policy.” The first hearing is **scheduled** for September 13-14, and it will focus on market concentration, consumer data regulations, and the consumer welfare standard. For a full list of all hearing dates and topics, see **Figure 1** below.

The DOJ in conjunction with the FTC issue merger guidelines outlining the extent of their review of potential mergers. The horizontal merger **guidelines** were updated in 2010 and the non-horizontal merger **guidelines** were updated in 1997. Importantly, the non-horizontal merger guidelines specifically discuss market concentration and the anti-competitive harms it poses. If the DOJ and the FTC updates the merger guidelines, that would signal a policy shift at the agencies; however, it is unlikely that the update process would be done without public input and advance notice.

An unwise acquisition by any one of the major tech firms could also invite scrutiny from the DOJ or the FTC. Even an acquisition that does not immediately gain the attention of either agency could prove perilous in the future, as was the **case** for Microsoft in the 1990s. After failing to acquire Netscape in 1994, Microsoft bundled its internet browser with its operating system, inviting DOJ **review**.

Moreover, big tech firms need not only fear the DOJ and the FTC; they must also consider the power of state attorneys general. **Eighteen states and District of Columbia** were the first to investigate Microsoft, and they still possess the **power** to enforce antitrust laws on behalf of residents of their state. We have identified the New York

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attorney general (AG) race as significant to the antitrust landscape. Zephyr Teachout, a once fringe candidate in the NY AG race, recently received an [endorsement](#) from the New York Times, bolstering her position. Teachout [promised](#) that, if elected, she would launch a major antitrust investigation to explore breaking up Facebook and Google. The primary election is scheduled for September 13.

## Court Interpretation

Antitrust policy and enforcement in the United States was fundamentally [altered](#) in the mid to late-1900s, reinforced by the Regan administration and its appointees, and entrenched through a series of Supreme Court cases. The Chicago school, led in part by legal scholar [Robert Bork](#), helped construct the antitrust regime that is currently in place; it promotes noninterventionism and focuses on economic efficiencies acquired through scaling. The current [framework](#) of antitrust policy measures competition as it relates to consumer welfare, measured as the impact on price and output. The shift in antitrust policy was accompanied by a significant decline in vertical merger enforcement. Notably, the government's challenge of the AT&T-Time Warner merger was the first challenge to a vertical merger in nearly [40 years](#). Without a substantial reconsideration of the legal interpretation of antitrust laws, regulators and lawmakers will need to come up with creative methods for enforcement.

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## Appendix

**Figure 1. Events and Trends We Are Watching**

Events & Trends	Date	Significance
<b>Planned Events</b>		
Senate Intelligence Committee Hearing	September 5	Hearing will feature Facebook, Twitter, and Google executives
House Energy and Commerce Committee Hearing	September 5	Hearing will feature Twitter executive
FTC Hearing #1 on Competition and Consumer Protection	September 13-14	Review of the competition landscape, competitiveness, and the consumer welfare standard
New York Attorney General Primary	September 13	Democratic primary features a candidate, Zephyr Teachout, who has promised big tech antitrust enforcement
FTC Hearing #2 on Competition and Consumer Protection	September 21	Examines the state of U.S. antitrust law
FTC Hearing #3 on Competition and Consumer Protection	October 15-17	Analysis of predatory conduct by technology-based platform businesses
FTC Hearing #4 on Competition and Consumer Protection	October 23-24	Review of intellectual property policy
FTC Hearing #5 on Competition and Consumer Protection	November 6-7	Review of privacy, big data, and competition
Midterm Elections	November 6	Midterm elections gauge the public's acceptance of progressive and populist candidates
FTC Hearing #6 on Competition and Consumer Protection	November 13-14	Review of algorithms, AI, and predictive analytics
<b>Possible Events &amp; Trends</b>		
FTC Response to Hatch Letter		Sen. Hatch (R-UT) asked the FTC to consider the competitive effects of Google's conduct
Public Attitudes Toward Big-Tech		If public attitudes turn, Congressional will to regulate major tech firms may increase
Lobbying Expenditures by the Technology Industry		If tech firms sense public support is turning or Congressional action is percolating, then they may lobby more
Updates to the DOJ/FTC Merger Guidelines		Updates to the merger guidelines would signal a policy shift at the DOJ/FTC
Statements Made by Delrahim or FTC Commissioners		Any statements made could signal a policy shift at the DOJ/FTC
Acquisitions Made by a Major Tech Firm		An unwise acquisition made by one of the major tech firms could invite scrutiny from the DOJ/FTC
Additional Congressional Hearings		Hearings on data privacy, foreign influence in elections, censorship, and competition are possible

Source: Height Capital Markets analysis

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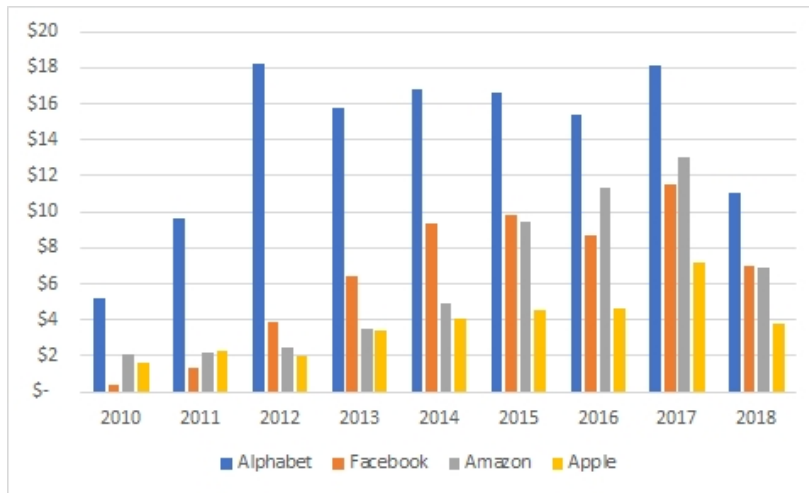
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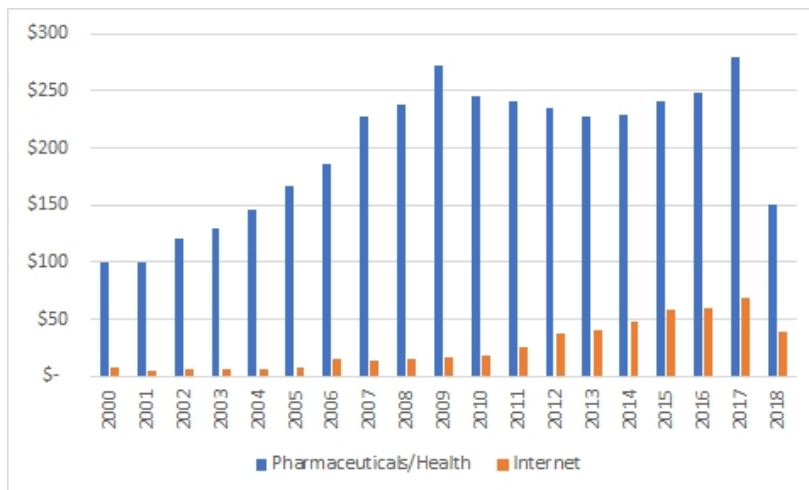
**Figure 2. Lobbying Expenditures by Major Technology Firms (Dollars in Millions)**



Source: OpenSecrets

Note: 2018 expenditures were last updated on July 24, 2018

**Figure 3. Pharmaceuticals/Health Industry Lobbying vs. Internet Industry Lobbying (Dollars in Millions)**



Source: OpenSecrets

Note: 2018 expenditures were last updated on July 24, 2018

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## COMPANIES MENTIONED IN THIS REPORT

Amazon.com Inc (AMZN), Facebook Inc (FB), Alphabet Inc (GOOGL), Twitter Inc (TWTR), Microsoft Corp (MSFT), Apple Inc (AAPL)

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The legislative and regulatory agendas are subject to change at the discretion of leadership. Unprecedented economic conditions could instigate unanticipated and/or sweeping shifts in policy. Predicting the future is a hazardous endeavor and economic / market forecasting is an imprecise science. Actual outcomes may differ substantially from our forecasts. The predictions and opinions expressed herein are subject to change at any time.

## ANALYST CERTIFICATION

We, Stefanie Miller, Chase White, CFA and Hunter Hammond, certify with respect to each security or issuer covered in this research report that (i) the views expressed in this research report accurately reflect our personal views about those subject securities or issuers and (ii) no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by us in this research report.

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