Internet platform companies (Google, Facebook, Amazon, Apple) are in the antitrust spotlight. Legal precedent for lawsuits varies by company. But the political environment is challenging and could affect regulators’ decisions on lawsuits.

Upcoming reports from the FTC (Dec. 2019) and the House Judiciary committee (2Q:2020) will provide insight into prospects for lawsuits against the platforms.

A Trump win in 2020 materially reduces federal overhang. But state AG investigations will continue and likely represent underappreciated risk for Google and Facebook.

A Democratic win in 2020 would heighten companies’ exposure, with Warren and Sanders being the most problematic scenarios.

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THE ROAD AHEAD FOR BIG TECH & ANTITRUST - AHEAD OF THE CURVE SERIES

THE COWEN INSIGHT
Among the regulatory risks for the dominant platforms (Facebook, Google, Amazon, Apple), antitrust may be the most significant. In this deep dive, we examine the law and politics around Big Tech. Our take is antitrust action appears likely against Google and Facebook, and unlikely against Amazon and Apple -- with the 2020 election representing a key long-term variable.

EXECUTIVE SUMMARY (Paul Gallant, Washington Research Group)

Antitrust remains the leading regulatory risk to Google, Facebook, Amazon and Apple. This report makes several points:

* Around December 2019, the FTC will release tech platform/antitrust guidance that should provide insight into the companies' risk levels.
* The FTC's Section 5 power ("antitrust plus") is underappreciated and favors lawsuit filing in a close-call scenario.
* State Attorney Generals are a underappreciated risk for Google and Facebook.
* 2020 election is a critical long-term variable for Big Tech.
* Courts today are favorable to the pro-platform "Chicago School" of antitrust -- unless Justice Kavanaugh takes a Left.
* FTC's leaked Google memo from 2015 shows forward-leaning staff on tech-antitrust.
* But Microsoft case shows judicial questions about breakup as remedy
* House Antitrust Chairman David Ciciline is providing cover for FTC/DOJ/state AGs to challenge the platforms.
* Democrats' nomination of Sen. Warren could increase Trump's pre-Nov. 2020 incentive to file lawsuit
* Pre-November 2020: Lawsuit versus Google and Facebook more likely than not. Amazon and Apple likely avoid.
* Post-November 2020: Trump win means lower odds across the board -- but don't underestimate state AGs. And a Democratic win keeps lawsuits very viable.
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   B. Clayton Act – Section 7 (the anti-merger statute)
   C. FTC Act – Section 5 (FTC’s “antitrust plus” power)

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12. THE ROAD AHEAD: AFTER THE 2020 ELECTION

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B. Democrats win – but which one?

i) Warren/Sanders: Real lawsuit risk

ii) Biden/Buttigieg/Klobuchar/Harris: Only slightly less risk
House Judiciary Committee releases report on Platform/Antitrust investigation

APRIL 2020

APRIL 2020:
Democratic nominee likely known (Key is Warren/Sanders vs Others)

APRIL 21, 2020:
ABA Antitrust Meeting (DC) – Simons/Delrahim speak

JULY 2020

Democrats & Republicans release 2020 platforms. Positions revealed on Big Tech.

NOVEMBER 3, 2020

Presidential election. Trump good for Big Tech, Democrats bad.
• Trump wins: If lawsuits not already filed, going-forward odds: GOOGL 75%, FB 40%, AMZN 30%, AAPL 30%
• Democrat wins: If lawsuits not already filed, going-forward odds:
  – Warren/Sanders: GOOGL 75%, FB 65%, AMZN 55%, AAPL 40%
  – Other Democrat: GOOGL 75%, FB 60%, AMZN 40%, AAPL 30%

MARCH 2022

Trial court decision on any Trump lawsuit filed pre-Nov 2020

DECEMBER 2022

Appeals Court decision on any Trump lawsuit filed pre-Nov 2020

Source: Cowen Washington Research Group
The Road Ahead For Big Tech & Antitrust (Paul Gallant – Washington Research Group)

1. INTRODUCTION

For most of this century, Google, Facebook, Amazon and Apple enjoyed exalted status in Washington. Democrats liked the companies’ financial support, liberal politics, and incumbent-disrupting capabilities. Republicans bristled at the liberal politics but liked their national security cooperation post-9/11 and held them up as global champions and examples of what non-regulation could produce.

That bipartisan alliance – bolstered by broad public popularity – produced a remarkably favorable regulatory environment that left these companies not only unscathed by regulation but often supported by regulators (e.g. the FCC’s 2016 attempt to enable Google and others to deeply integrate into the pay TV ecosystem via access to set top boxes).

That is changing. Both parties now see political gain in attacking the largest tech companies, which creates various types of governmental risk – antitrust, privacy, and platform liability. These risks aren’t new, but they gather steam as the political environment darkens.

Antitrust likely represents the most significant government risk both because the potential for divestitures or ongoing regulatory obligations via consent decree and because of the protracted uncertainty of multiyear litigation.

The market appreciates this but also faces a nonstop flow of news (FTC testimony, state AG announcements, agency white papers, congressional hearings, etc.) that make it challenging to separate signal from noise. This note identifies the critical legal and political factors for investors to focus on in evaluating how antitrust activity will play out, along with our own estimate of each company’s path forward.

BOTTOM LINE: There are two time periods for assessing tech companies’ antitrust risk – before and after November 2020.

Before November 2020:

We think Google (75%) and Facebook (60%) are likely to face antitrust action. We suspect no action on Amazon (40%) and Apple (40%).

After November 2020:

A) If Trump wins:

* Any pre-November 2020 lawsuit would continue.

* If Google and Facebook avoid a lawsuit in next 12 months, under Trump 2, their odds of a lawsuit drop: Google 65% (down from 75%) and Facebook from 40% (down from 60%).

* If Amazon and/or Apple avoid lawsuits in next 12 months, their lawsuit odds both drop from 40% to 30%.
B) If the Democrat wins:

* President Warren/Sanders scenario: Google and Facebook face 75% chance of lawsuit. Amazon and Apple 65%.

* Any-Other-Democrat scenario: Google 75% chance of lawsuit, Facebook 60%, Amazon 40%, Apple 35%.

(Note: These odds represent the risk of either the FTC/DOJ or state AGs bringing lawsuits).

2. THE LAW: WHAT IT SAYS

There are three statutory antitrust provisions that matter for the large Internet companies:

A. Sherman Act – Section 2 (The anti-monopolization statute): In 1890, in response to economy-wide consolidation in the 1870s and 1880s, Congress passed the Sherman Act. Section 2 of the Act makes it unlawful for a company to “monopolize … any part of trade or commerce.” This language is terse -- Congress expected the courts to give shape to the statute’s broad mandate.

Assassination Lead to Trust Busting. The Supreme Court’s first ruling on Section 2 was in Northern Securities v. U.S. (1904) -- and it happened by accident. President McKinley was expected to approve this combination of three large railroad lines. But before the deal closed, McKinley was assassinated, and his progressive Vice President -- Theodore Roosevelt -- became President. Roosevelt directed the Department of Justice to file a monopolization case, and the Supreme Court voted 5-4 to support Roosevelt’s lawsuit.

With that victory in hand, Roosevelt wanted to challenge Standard Oil but moved slowly because of its political power. In 1904, investigative journalist Ida Tarbell detailed the aggressive and sometimes violent means by which John D. Rockefeller had elevated Standard Oil to an oil refining monopoly. Riding a wave of public anger against Standard Oil, Roosevelt directed a two-year investigation and then a lawsuit in 1906 to break up Standard Oil. Five years later, the Supreme Court voted 9-0 in Roosevelt’s favor, and broke the company into 34 separate companies.

The takeaway from Standard Oil is the Court’s establishment of the two-part legal standard that still governs Section 2 cases. For DOJ/FTC to win a monopolization case, it must show two things:

A) Possession of monopoly power. The Supreme Court requires DOJ/FTC to show that the target company possesses a monopoly. The Supreme Court has never supported a “monopoly” finding with less than 75% market share, although lower courts have found it at 70%. The exact number can vary depending on how durable the market share has been, the nature of entry barriers, etc.; and

B) Exclusionary or predatory conduct. The government also must show exclusionary conduct by the monopolist. “Exclusionary” is when it “tends to impair the opportunities of rivals” and “either does not further competition on the merits or does so in an unnecessarily restrictive way.” Examples include “exclusive dealing” with customers or suppliers (which foreclose competitors from sources of distribution or supply); “refusals
to deal” with competitors; tying (using market power in one product to require the purchase of a less popular product); exclusionary product design; and predatory pricing (pricing below cost to drive out rivals and then raising prices).

Historical note: The 1912 Presidential election became a referendum on the monopoly breakup program by Presidents Roosevelt and Taft from 1904-1912. Strangely, Roosevelt’s pitch in 1912 was to replace his own “break up monopolies” approach with “let’s accept monopolies and regulate them.” By contrast, Democrat Woodrow Wilson pledged to continue monopoly breakups. Wilson won and used his anti-monopoly mandate to persuade Congress to pass the following two additional antitrust statutes.

B. Clayton Act – Section 7 (the merger statute): In 1914, Congress passed the Clayton Act. Section 7 prohibits mergers and acquisitions where the effect “may be substantially to lessen competition, or to tend to create a monopoly.” The FTC and DOJ typically use Section 7 to challenge mergers before they close by seeking an injunction. But importantly, regulators can also use Section 7 to unwind previously-approved mergers. To win such a Section 7 case against a closed merger, the government must show that the merger in retrospect has harmed competition.

FTC and DOJ attempts to unwind prior mergers are actually not that rare, although they usually involve small companies. In 2004, the FTC filed a lawsuit to unwind a hospital merger that it had approved four years earlier. (The agency won the case.) In 2014, DOJ reversed Bazaarvoice/PowerReviews (companies selling customer review platforms); in 2017, FTC v. St. Luke’s (hospital merger); and in 2018, the FTC reversed Otto Bock v. FIH (makers of prosthetic knees). In a March 2012 speech, then-FTC Commissioner Tom Rosch said that “consummated merger investigations have in recent years become an increasingly important part of the FTC’s caseload” and that during the 2001-2009 Bush Administration, he said the FTC and DOJ challenged 18 previously-approved mergers.

C. The FTC Act – Section 5 (the FTC’s “Antitrust Plus” power): Also in 1914, Congress passed the FTC Act, which: 1) Created a five-member FTC (under 3-2 control of the President’s party) to co-enforce antitrust law with DOJ; and 2) Gave the FTC exclusive Section 5 power (i.e. only the FTC has this authority) to prevent “unfair methods of competition.”

For decades, it has been hotly debated whether this “unfair methods” language actually expands existing antitrust law by letting the FTC challenge company conduct that would not violate traditional antitrust law (Sherman Section 2, or Clayton Section 7).

The answer appears to be yes. Professor Herbert Hovenkamp is considered the leading U.S. antitrust scholar and courts regularly cite his views. He says Section 5 clearly enables the FTC to bring lawsuits against conduct that would be not be actionable under the traditional antitrust law. Professor Hovenkamp has written, “The view that the FTC can condemn practices because they are anticompetitive, even though they do not fall within the literal coverage of the Clayton or Sherman Acts, is historically justified.”

We highlight the “antitrust plus” nature of Section 5 because traditional antitrust law may not neatly address the platforms’ business models. So it is possible the current FTC would use Section 5 in any lawsuit against Facebook or Amazon. And if Democrats win the election, we believe they are quite likely to exploit the incremental power of Section 5 against the major tech companies, if the Trump FTC has not already done so. As we explain below, the FTC’s leaked Google memo from 2012 shows that agency staff explicitly relied on Section 5 power – and Professor Hovenkamp’s expansive view of it – in recommending an antitrust lawsuit against Google.
D. Hart-Scott-Rodino Act (1976) (Gives State AGs federal enforcement authority). For tech platform purposes, the significance of HSR Act is it authorizes state attorneys general to enforce the federal antitrust statutes. In California v. American Stores (1990), the Supreme Court confirmed that state AGs were authorized to bring antitrust lawsuits under the federal statutes. This is why the states’ investigations of Google and Facebook could pose a more realistic threat than currently appreciated.

3. “CONSUMER WELFARE” – OBJECTIVE OF THE ANTITRUST STATUTES

A. The Chicago School Rules

The statutes governing antitrust law are vaguely worded, so courts have developed their meaning through case-by-case enforcement. From the early 1900s to the mid-1970s, courts and enforcement agencies viewed the role of antitrust broadly – not just promoting competition, but limiting corporate size, protecting small businesses, and limiting the political power of large companies.

Chicago School is born. In 1978, Judge Robert Bork published “The Antitrust Paradox” which urged rigorous economic analysis by antitrust agencies and courts. He argued that antitrust had become too aggressive and unpredictable, which led to underinvestment and harmed American companies’ competitiveness globally. Bork said improved enforcement should focus exclusively on “consumer welfare” – maximizing economic efficiency and output – and not other societal goals like limiting companies’ political power and protecting small businesses.

A year after the book was published, the Supreme Court in Reiter v. Sonotone embraced it, saying “On the contrary, [the legislative history] suggests that Congress designed the Sherman Act as a ‘consumer welfare prescription.’ R. Bork, The Antitrust Paradox 66 (1978).” And the election of Ronald Reagan in 1980 resulted in the appointment of regulators and judges who were sympathetic to the Chicago School’s focus on consumer welfare. Since then courts have honed in on economic effects as the core objective of antitrust enforcement actions.

It is important to note however that even under the Chicago School, consumer welfare analysis includes non-price factors – principally innovation and product quality. For example, when the DOJ/FTC issued revised Horizontal Merger Guidelines in 2010, they added Section 6.4 explicitly to increase the chance of enforcement action when an acquisition could reduce innovative activity below the level that is likely absent the merger. Section 6.4 states: “Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger.”

“Harm to innovation” is actionable under current law. Two top antitrust regulators have recently stressed this point. On September 24, 2019, FTC Competition Bureau Chief Bruce Hoffman submitted written testimony to the Senate Antitrust Subcommittee stating: “In some cases, a company may acquire an innovative upstart rival in an effort to snuff out future innovative competition. The Commission will consider whether a merger would incentivize the merged firm to slow or curtail its innovative efforts below the level that would prevail but for the merger.”
In a June 11, 2019 speech, DOJ’s Makan Delrahim said, “Price effects alone do not provide a complete picture of market dynamics, especially in digital markets, where the profit-maximizing price is zero. Harm to innovation is also an important dimension of competition that can have far-reaching effects….In addition, diminished quality is also a type of harm to competition. As an example, privacy can be an important dimension of quality. By protecting competition, we can have an impact of privacy and data protection.”

B. Prospects for changing Chicago School

‘Brandeisian School’ is the challenger. The prevailing Chicago School could present a hurdle in any antitrust lawsuit against Google, Facebook, Amazon or Apple. So an important question may be whether the judicial pendulum could ever shift away from the Chicago School. The main challenger is the “Brandeisian” School, which wants to expand the goals of antitrust enforcement beyond economic efficiency.

Brandeisian philosophy stresses the downsides of bigness and economic concentration. It argues that courts have mistakenly de-emphasized Congress’s or original antitrust concerns (beyond pure competition) with protecting workers, small business, and citizens.

There are three ways courts potentially could adjust their Chicago School orientation:

1. Policy signals from DOJ/FTC/state AGs. The FTC, DOJ, and state AGs can attempt to persuade courts to shift their views on antitrust policy in two ways:

   a) Case selection: The FTC/DOJ/state AGs face resource constraints, so their choice of cases send signals to courts about what direction they believe courts should go.

   b) Formal agency guidance. While the FTC and DOJ don’t adopt formal antitrust regulations, they periodically take public input and revise their antitrust guidelines (best example is the Horizontal Merger Guidelines). Guidelines are not legally binding on courts, but they are influential.

   Importantly, we believe the Trump-led FTC is gearing up to furnish new guidance on antitrust generally and tech platforms in particular. Over the past year, the agency held 15 workshops with academics, industry and consumer advocates on how the agency should revise antitrust and privacy guidelines, particularly for tech platforms.

   On September 10, Bilal Sayedd, Chief of the FTC’s Office of Policy Planning, gave an important and under-reported speech describing the agency’s plans to update merger guidelines, especially regarding tech platforms. Mr. Sayedd said that the FTC guidelines in the coming months will include: i) Whether to expand the aims of antitrust enforcement beyond the strict “consumer welfare” test; ii) Whether to become more active in unwinding mergers found to harm competition; iii) Whether agencies should be more skeptical of platform conduct that falls into a gray area under current court precedent; iv) Whether to bar more acquisitions of nascent competitors.

   We believe these forthcoming FTC reports could provide important signals on where the agencies are heading on tech antitrust enforcement, and how much judicial rethinking may be required to successfully update antitrust law for the digital age.
2. **Supreme Court appointments -- or Kavanaugh takes a Left?**

*Importantly, even if a Democrat wins the White House in 2020, Supreme Court’s 5-4 conservative majority is likely intact through 2029.* That’s because the two oldest Justices (Ruth Ginsburg (86) and Stephen Breyer (81)) are liberals, so replacing them wouldn’t undo the 5-4 conservative majority. The oldest conservatives are Justices Clarence Thomas (71) and Samuel Alito (69). So even under a Democratic Administration that lasted from 2021-29, we assume no conservative would depart the Court except involuntarily (death or incapacitation).

*Kavanaugh skeptical of tech platforms?* In Justice Brett Kavanaugh’s first quasi-antitrust ruling in *Apple v. Pepper* (2019), he unexpectedly sided with the liberal Justices in a 5-4 decision saying iPhone users have legal standing to sue Apple for possible anticompetitive conduct. This was not a pure antitrust case – only a standing question – but tech company briefs made it clear that the case had negative antitrust implications for a wide swath of tech platforms like Amazon, OTAs and eBay.

Given Justice Kavanaugh’s strong pro-business record on the D.C. Circuit, his *Apple* vote may well prove to be a head fake. But at least a few of Kavanaugh’s generational Republican peers (Senators Ted Cruz and Josh Hawley) also think major tech companies have too much power. And of course Kavanaugh was appointed by a President with concerns about major tech companies. So Kavanaugh’s antitrust views will bear watching for the Internet companies.

3. **Congress revises antitrust law.** The last three times Congress revised antitrust law were 1914, 1950 and 1976 – each strengthened antitrust enforcement after courts had become too pro-business. Democrats clearly feel that’s the case today, but whether they can pass a new antitrust statute depends on the 2020 election. If Democrats win two of the three (Presidency/Senate/House), we see at least a 50% chance they change the antitrust laws in a leftward direction. But if Democrats only hold one (or none), we don’t see Congress passing a new antitrust statute.

4. **50 YEARS, THREE BREAKUP ATTEMPTS**

In the last 50 years, there have been three major antitrust actions against dominant U.S. companies. They may have implications for how the FTC, DOJ and state AGs will resolve their ongoing tech company investigations:

A. **U.S. v. IBM.** On January 17, 1969, the Lyndon Johnson DOJ brought an antitrust lawsuit against IBM for violating Section 2 in monopolizing the general purpose computing market. In 1972, the DOJ filed its desired remedy, which was a breakup. The trial dragged on for 13 years, and prior to its conclusion, DOJ withdrew its lawsuit in 1982. Some commentators have said DOJ mismanaged the lawsuit, while others say it was misguided from the start because IBM was already moving toward unbundled business lines.

B. **U.S. v. AT&T.** On November 20, 1974, the Nixon DOJ sued AT&T for violating Section 2 of the Sherman Act by unlawfully maintaining its monopoly in the local, long distance, and telephone equipment markets. It did so after AT&T resisted attempts by the DOJ and FCC to promote competition in the long distance and equipment markets. On January 8, 1982, while the trial was ongoing under Judge Harold Greene, AT&T agreed to be broken up.
C. U.S. v. Microsoft: On May 18, 1998, the Clinton DOJ sued Microsoft under Section 2 for “monopoly maintenance” by attempting to block the rise of Netcape and Java middleware, which could have enabled the emergence of competing operating systems. On June 28, 2001, the D.C. Court of Appeals ruled unanimously that DOJ had proven its Section 2 case, but remanded the breakup remedy for further consideration due to procedural errors by the trial court. Before Judge Jackson could re-address the breakup remedy, however, the newly-installed Bush DOJ settled the case via consent decree on November 1, 2001.

Lessons:

* Antitrust cases take years to conclude. Microsoft took three years from DOJ’s complaint to the Appeals Court ruling (which the court noted was “remarkably fast.”). AT&T took 7.5 years from complaint to settlement/breakup. And IBM took 13 years before being withdrawn.

* Breakup lawsuits were filed only after years of DOJ imposing consent decrees on IBM, AT&T and Microsoft that were aimed at promoting competition. Only when each of those decrees proved ineffective did DOJ revert to formal antitrust litigation. It’s possible that this history might lead the FTC/DOJ to skip consent decrees and go straight to court.

* Were the lawsuits a success? AT&T: Unambiguously yes, and more broadly than DOJ expected when it brought the lawsuit. The breakup promoted competition not just in the long-distance market (DOJ’s main goal) but in equipment and services that enabled the attachment of devices (fax machines, PCs) to phone lines for data transmissions that became the Internet. IBM: Most commentators agree the case achieved little. No breakup and possible harm to IBM’s willingness to innovate and be aggressive during the 13 year lawsuit. Although Columbia Law Professor Tim Wu argues that the lawsuit pressured IBM into separating its previously-bundled hardware, software and services offerings, which may have helped Microsoft and others to emerge purely as software competitors by selling to customers of IBM’s hardware. Microsoft: DOJ did not win a final breakup ruling, and Microsoft remains dominant in operating systems. But a few observers (notably including DOJ’s Makan Delrahim and FTC Democrat Rohit Chopra) have argued that the lawsuit and subsequent consent decree created a “government at the elbow” mindset at Microsoft that might have created breathing room for Google and Apple to emerge.

5. U.S. V. MICROSOFT: KEY PRECEDENT FOR TODAY’S BIG TECH INVESTIGATIONS

While the other breakup lawsuits (AT&T, IBM) remain instructive today, the D.C. Circuit’s ruling in U.S. v Microsoft (2000) is the central legal guidepost for the FTC and DOJ. Reasons: 1) Microsoft was the dominant tech platform of its day; 2) The case involved a Section 2 monopolization claim – the same as what the FTC is now considering for Facebook; and 3) The ruling was bipartisan and unanimous.

What the D.C. Circuit concluded. On June 28, 2001, the D.C. Court of Appeals ruled that Microsoft had violated Section 2 of the Sherman Act by maintaining its monopoly in operating systems by preventing the distribution of products (Netcape’s browser and Sun’s middleware) that might have threatened its operating system monopoly, and had no offsetting consumer benefits.
Lessons:

* Breakup wasn’t DOJ’s initial plan. When DOJ filed against Microsoft on May 18, 1998, it simply asked the court to find Microsoft guilty of violating Section 2. It said nothing about what remedy it wanted. It was only two years later—in April 2000, after the trial judge found Microsoft liable and settlement talks failed—that DOJ decided to request a breakup. So if the FTC/DOJ files against Facebook or Google, they could specify the remedy upfront. But they also might wait until the trial is over—potentially up to two years after filing the initial lawsuit.

* Appeals court actually didn’t rule on validity of breakup order. Contrary to popular belief, the Appeals Court did not reject Judge Jackson’s breakup ruling on the merits, but remanded it because a) Judge Jackson failed to give Microsoft due process in the remedy phase; and b) the Appeals Court did not accept all of Judge Jackson’s liability analysis, which might affect his view of a proper remedy on remand.

* But it did provide encouraging language for tech companies on a breakup remedy. However, the court did provide nonbinding guidance on breakups. It contains what we think is encouraging language for Facebook and Google regarding breakups in the tech sector. It is worth quoting in full --

“*What is somewhat problematic, however, is that just over six years have passed since Microsoft engaged in the first conduct plaintiffs allege to be anticompetitive. As the record in this case indicates, six years seems like an eternity in the computer industry. By the time a court can assess liability, firms, products, and the marketplace are likely to have changed dramatically. This, in turn, threatens enormous practical difficulties for courts considering the appropriate measure of relief in equitable enforcement actions, both in crafting injunctive remedies in the first instance and reviewing those remedies in the second. Conduct remedies may be unavailing in such cases, because innovation to a large degree has already rendered the anticompetitive conduct obsolete (although by no means harmless). And broader structural remedies present their own set of problems, including how a court goes about restoring competition to a dramatically changed, and constantly changing, marketplace. That is just one reason why we find the District Court’s refusal in the present case to hold an evidentiary hearing on remedies—to update and flesh out the available information before seriously entertaining the possibility of dramatic structural relief—so problematic.*" 

* Interesting sidebar that might matter today: President Trump’s two top antitrust officials actually played important roles in reining in Microsoft 20 years ago. FTC Chairman Simons was lead counsel to Sun Microsystems (co-plaintiff with DOJ), and DOJ’s Makan Delrahim was Counsel to the Senate Judiciary Committee, which pushed DOJ to file the lawsuit against Microsoft.

6. BEHIND THE CURTAIN: IMPORTANT LESSONS FROM THE FTC’S LEAKED GOOGLE MEMO

On March 24, 2015, in response to a Freedom of Information Request, the FTC inadvertently disclosed to the Wall Street Journal every other page of a 160-page staff analysis of its 2012 Google antitrust investigation. Key portions are missing, but most of the analysis and conclusions are available. We think the memo is a valuable and underappreciated window into how the FTC and DOJ are likely investigating the tech companies today.
The memo analyzed whether four Google behaviors were unlawful acts to maintain its search monopoly: A) Down-ranking specialized search engines (Staff: “Close call” but no lawsuit); B) Scraping content from Yelp/TripAdvisor/others over those companies’ objections (Staff: File lawsuit); C) Preventing advertisers from using web tools to manage campaigns across multiple search engines (Staff: File lawsuit); D) Deterring websites using Google search boxes from splitting their business with Bing (Staff: File lawsuit).

We see several implications for the major tech company investigations, particularly for Facebook and Google:

* **Section 5 may let FTC exceed traditional grounds for platform liability.** As noted above, Section 5 permits the FTC to challenge “unfair methods of competition” which is broader than Section 2. The FTC memo shows that staff was willing to use this expansive power.

* **Free services can still violate antitrust law.** A common investor question is whether Google or Facebook could truly be shown to harm consumer welfare when their services are free. Page 80 of the FTC staff memo says “The theory of harm to competition is mainly one of reduced innovation … new or innovative vertical websites will cease to enter the market; and consumers will be faced with a corresponding reduction in innovation and choice.”

* **Narrow ad markets are possible.** Any Section 2 monopolization lawsuit against Google or Facebook will require the government to show Google or Facebook has a monopoly in a properly-defined antitrust market. The FTC memo says Google had only 41% of the total digital ad market. But the FTC staff concluded that a discrete “search advertising” market existed, and that Google had a monopoly share (71%).

### 7. STATE ATTORNEYS GENERAL: NEW SHERIFFS IN TOWN

State AGs have their own antitrust power yet rarely act alone. But we believe their increasing independence represents a material new risk for Facebook and Google both as potential filers of antitrust lawsuits, and as added pressure on DOJ/FTC to file their own lawsuits.

**Bipartisan concerns with Google and Facebook.** In early September, 48 states announced a formal antitrust investigation of Google, and in late October, 47 states said they are investigating Facebook. This broad and bipartisan level of concern contrasts with the Democrat-heavy state AG lawsuit against T-Mobile/Sprint, where 16 of the 17 AGs are Democrats. This suggests Google and Facebook may face continued state antitrust risk regardless of which party controls the DOJ/FTC even after November 2020.

**States may act alone if no action by DOJ/FTC.** Given the states’ historical lack of antitrust action, their Google and Facebook investigations could be viewed as political grandstanding. We think that would be a mistake. Based on meetings we’ve held – plus the unprecedented state-only lawsuit against T-Mobile/Sprint (which no one, including us, saw coming) – we believe state AGs are now willing to take antitrust enforcement actions independent of DOJ and the FTC. At the AGs’ Google press conference, D.C. AG Karl Racine said: “State AGs can be an independent bunch and can be quite tenacious. This bipartisan group will be led by the facts and not swayed by any conclusion that
may fall short ... on the federal side. So we're going to do what is right based on our own investigation."

**AGs’ press conference on Google.** The September 9th press conference (video) also provided insight into what state AGs are concerned about with Google. They focused on several areas: 1) Search bias: providing search results overweighted to Google properties and advertisements; 2) Possible exclusionary conduct: buying nascent competitors; 3) Raising ad prices: Harm to businesses and consumers. 4) Harm to publishers from ad revenue splits.

**AG’s press conference on Facebook.** Democratic NY AG Letitia James said of the 47 state AGs: "We are all concerned that Facebook may have put consumer data at risk, reduced the quality of consumers’ choices and increased the price of advertising."

**Keystone cops?** On the plus side for Google and Facebook, it will be unwieldy for a large group of state AGs to conduct a major Section 2 monopolization case. Making decisions by committee with millions of pages of documents, ambiguous legal precedent, and different political agendas could be a recipe for delay or inaction. AGs also turn over, which creates opportunities for the companies to persuade their successors to drop off the investigations. And states don’t have the dedicated resources of DOJ and the FTC.

**Encouraging inference for Amazon and Apple.** State AGs have limited resources, so we view their focus on Google and Facebook as lowering the relative antitrust risk as for Amazon and Apple. This is both from the perspective of removing direct threat of a state lawsuit, and also from the incremental pressure on the DOJ/FTC to challenge Amazon and Apple. Of course it’s conceivable at some point that states might decide to look at Amazon given the political influence of retailers at the state level.

### 8. ROLE OF CONGRESS: CICILLINE IS THE NEW HATCH

Congress does not bring antitrust lawsuits itself but creates the political environment that can influence regulators decisions. The Microsoft case is a good example.

In 1997, DOJ was investigating Microsoft, a widely admired American company. Republican Senate Judiciary Chairman Orrin Hatch held a series of hearings in 1997-98 that raised public awareness of Microsoft’s aggressive tactics and gave Netscape a platform. This provided the necessary political cover for the Clinton DOJ to file the lawsuit against Microsoft.

Today, House Antitrust Subcommittee Chairman David Cicilline (RI) seems to have taken up Hatch’s mantle to put pressure on DOJ/FTC to file lawsuits. At a July 16 hearing, he said (video at 18:35), the tech platforms have “contributed immense technological breakthroughs and economic value to our country... But Congress and antitrust enforcers allowed these firms to regulate themselves. As a result, the Internet has become increasingly concentrated, less open and growing hostile to innovation.”

Finally, we expect Cicilline’s committee to go beyond just holding hearings. We expect the committee to release its own report -- based on confidential company materials -- that will describe what the committee sees as anticompetitive conduct by the platforms. This will be a high-profile event with the potential to affect the DOJ and FTC investigations. We expect this report around 2Q 2020.
9. ROLE OF THE WHITE HOUSE

We assume President Trump will be involved in any decision about a lawsuit against the major tech companies. His DOJ Antitrust Division appears quite responsive to his preferences:

In AT&T-Time Warner, the belief that the lawsuit was motivated by Trump’s dislike of CNN was certainly reinforced when both the trial judge and appeals court rejected DOJ’s attempt block this merger.

In Disney-Fox, on the day the merger was announced, Trump called Rupert Murdoch to congratulate him. DOJ went on to approve the merger involving borderline-high market shares in theatrical releases remarkably quickly (six months, versus 12 months for AT&T-Time Warner, and 15 months for Sprint/T-Mobile).

In Sprint/T-Mobile, following press reports that DOJ staff was opposed, the White House publicly signaled its support for the merger via Fox’s Charlie Gasparino, who tweeted on May 12: “White House econ advisors say they support T-Mobile-Sprint merger despite opposition from DOJ antitrust staff.” DOJ approved the merger two months later.

So what factors might Trump consider? The main one is winning reelection. If he believes a lawsuit against Facebook or someone else will move the needle, that’s what we would expect to see. The other factors we see:

Could Warren provoke Trump on tech? Elizabeth Warren has made breaking up Big Tech a 2020 campaign issue. Given Trump’s involvement in antitrust decisions, the Democrats’ nomination of Warren potentially could increase Trump’s incentive to file a lawsuit to neutralize her Big Tech position. In fact, Trump may have laid the groundwork for this two months ago when his DOJ took the unusual step of asserting “co-jurisdiction” with the FTC over Facebook (Trump has more control over DOJ than the FTC -- see “FTC Independence” below).

Beating China in AI might protect Big Tech (but only after 2020 election). We expect the dominant tech companies to argue that any antitrust action will harm U.S. leadership in AI by hindering economic growth and national security. The defense community is on board with this view -- just last week, a preliminary report from the National Security Commission on Artificial Intelligence concluded that “U.S. global leadership in AI technology is a national security priority.” While the China/AI angle could well help Big Tech, we suspect Trump’s exclusive lens before November 2020 is reelection, not long-term economic growth national security.

Trump less able to reach Amazon. Ironically, for all of Trump’s attacks on “the Amazon Washington Post,” we think he’s less able to reach Amazon than the other tech companies. Unlike DOJ (which has oversight of Google/Facebook/Apple), the FTC is an independent agency. Trump appoints the chairman but does not control him, and Chairman Joe Simons is viewed as a neutral balls-and-strikes regulator. DOJ, by contrast, is part of the Executive Branch, and Makan Delrahim is viewed as very supportive of Trump’s interests.
10. MICROSOFT PRECEDENT: HEADWINDS DESPITE AVOIDING BREAKUP

There is clearly a view in the market that some companies, if broken up, are worth more than together. That might well be the case, we don’t know. We would just offer a couple of observations:

1. *Litigation is slow and unpredictable.* The fastest a lawsuit could be resolved is three years, during which we assume some degree of management distraction, reduced ability to do even small-scale M&A (e.g. DOJ’s recent second request for Google buying Looker), and rivals pursuing lines of attack that platforms might be slower to shut down.

2. *Brand effect.* As consumer-facing businesses, the major tech companies value their reputations. Journalist John Heilemann’s 2001 book *“Pride Before the Fall: The Trials of Bill Gates and the End of the Microsoft Era”* was the definitive account of the Microsoft trial. He wrote “Vindication will be bittersweet,” a Microsoft official told me. “The company has suffered too much. Before, people thought the world of us. That we were great innovator. That we were this great engine of the new economy. Now, either the decision stands, in which case people think we’re criminals, or the decision is overturned, and people think we somehow got away with something. No vindication will erase that stain.”

3. *Distraction & settlements.* Microsoft President Brad Smith has spoken publicly about management distraction and the consent decree helping the company missing major technology shifts.

*September 2019 to CNBC:* “My own personal view, having been in the middle of it for so long, was the single greatest cost was the distraction. Having a Bill Gates, a Steve Balmer, great engineering leaders at our company, spending so much time figuring out how to prepare for a deposition, how to defend themselves at the witness stand, how to implement this, that or the other thing. And you know, you look at the early 2000s, we missed search.”

*May 2018 to Code conference:* “Because of antitrust regulations, we were forced to ensure that somebody else’s browser could be more popular on our own operating system. That’s called Chrome. That somebody else’s search engine could be more popular than our own search engine. On Windows that’s called Google and search. … So yeah, the reality is, once you make your bed and the regulators force you to lie in it, you may look across at the hotel across the street and say, ‘Wow, I wish we could design our rooms that way.’ And you don’t necessarily have that opportunity.”

11. THE ROAD AHEAD: PRE-NOVEMBER 2020

This section applies the law and politics to the four major tech platforms. They are necessarily rough estimates because (as the FTC’s leaked Google memo makes clear) antitrust cases are highly fact-specific and depend on regulators’ confidential data-gathering from the target companies, competitors and customers.

Our take – greater than 50% chance of antitrust lawsuits Google and Facebook, but less than 50% odds against Amazon and Apple.
A. Google (75%)

We suspect DOJ – with state AG support – is likely to file a lawsuit against Google. There are multiple aspects of Google’s business that DOJ is likely to investigate. We think that ad tech (including Google’s acquisitions of AdMob, Doubleclick and possibly others ad network technology/services) is likely at the top of DOJ’s list for any enforcement action.

* Ad tech: Five months ago, the Australia Competition and Consumer Commission issued a 623 page report on Google and Facebook antitrust issues. We believe it is the most thorough public analysis of the competition issues of Google and Facebook’s ad tech services, and we strongly suspect DOJ is investigating these issues today. This is what the ACCC report said on ad tech:

“Discrimination may occur in multiple ways where a digital platform is active in related markets. For example, owned and operated platforms may be given advantages in the operation of auction processes (for example, by enabling a last look in auctions for ad inventory) or a greater degree of interoperability. Data obtained by key platforms or interfaces may also be used to advantage their own related businesses at the expense of rivals. Monopoly or near monopoly businesses are often subject to closer oversight due to the risks of competitive harm.”

Politically, there is broad support in Washington for antitrust regulators to examine Google/Facebook’s effect on publishers because of journalism’s central role in democracy. The first hearing held by the House Antitrust Committee this year was on Google and Facebook’s negative impact on news publishers. And importantly, Rupert Murdoch (News Corp. owner and friend of Trump) supports action against Google and Facebook.

* Android: It’s possible that DOJ might also decide to follow the EC’s lead 16 months ago and seek to loosen Google’s grip on OEMs so that device makers can strike deals with other apps companies on preloading on Android devices. DOJ probably could make a winning legal argument that Google has monopoly power in Android, and that its contracts represent exclusionary conduct to preserve that monopoly (i.e. OEMs are forbidden from selling devices with forked (non-Google) versions of Android). But so far, the EC’s Android ruling appears to be having little effect on Google’s mobile market positions in both Android and in preloading of Google apps. Although we note that in 2017, the Russian Anti-Monopoly Service -- by ordering Google to offer a choice screen for search apps -- seems to have reversed Google Search’s momentum toward overtaking Yandex in search. This July 2019 analysis by Matt Stoller of Open Markets Institute (the leading anti-monopoly think tank in D.C.) urges DOJ to take the Russian approach toward Google/Android.

* Search bias. The leaked FTC memo from 2012 said it was “a close call” but recommended against suing Google for search bias because of Google’s “strong pro-competitive justifications.” We’re inclined to think DOJ will reach the same conclusion this time around, but even if they do, the state AGs’ focus on search bias at their press conference makes us think this issue is not off the table.

Could be difficult to prove. To win a search bias case, DOJ (or state AGs) must show both “monopoly” and “exclusionary conduct” by Google:

1) “Monopoly”: It’s very likely DOJ could establish Google has a monopoly. The FTC’s 2012 memo concluded that Google likely had a monopoly both in free retail Search
service and separately in the "search advertising" market based on extensive internal documents and advertiser depositions.

2) "Exclusionary conduct": At least two possibilities for showing exclusionary conduct, but neither seems easy to prove:

a) **Unlawful refusal to deal**: DOJ can argue that down-ranking a competitor is a "refusal to deal," a type of exclusionary conduct aimed at maintaining a monopoly. But for this to be actionable, DOJ must show both a prior course of dealing between the two companies and that the dominant company is sacrificing short-term profits by refusing to deal with the smaller competitor. The "prior course of dealing" seems achievable (Google returned those sites in search results and presumably generated some revenue from doing so). But the "sacrificing short-term profits" element appears difficult to prove since Google probably was more profitable (not less) by putting its own properties at the top of search results. Or,

b) **"Exclusionary product design"**: While down-ranking competitors probably harms competitors, Google may well have a plausible pro-competitive explanation (which Microsoft lacked and which is why it lost) – that Google's own verticals provide faster answers to their questions. The FTC staff's 2012 memo on search bias seems to bode well for Google today: "The evidence paints a complex portrait of a company working toward an overall goal of maintaining market share by providing the best experience, while simultaneously engaging in tactics that resulted in harm to many vertical competitors, and likely helped to entrench Google's monopoly power over search and search advertising ... Although it is a close question, Staff does not recommend that the Commission move forward on this cause of action."

What's the remedy? Even if DOJ decides it has a good case on search bias, we question whether it would go forward given the difficulty of designing a remedy. DOJ prefers structural remedies – so would it really ask a court to force Google to divest either Search or its apps/verticals like Maps, Hotel Finder/Flight Search, and PLAs? Or could the DOJ really envision a workable non-discrimination consent decree for Google Search that could be effectively managed by DOJ?

**State AGs are stressing "search bias."** While a search bias case seems challenging, we were struck by the state AGs' focus on this topic at their September 9th press conference. It was by far their top concern – they said repeatedly it was unfair to small businesses and to consumers looking for the "best" answers to their questions. The states have been investigating Google informally for months before their press conference, and they've seen the same FTC memo we have. Are they just making noise about search bias or do they think there is actually a case there? With 48 states involved, we expect leaks – so we could well get signals on whether we are underestimating the risk of a search bias lawsuit against Google.

**A possible Warren/Sanders approach to search bias.** A more sweeping remedy for search bias was proposed by Lina Khan in her June 2019 Columbia Law Review article entitled "The Separation of Platforms and Commerce." She argues for either an antitrust lawsuit or legislation to separate all dominant platforms from apps/verticals. She says both assets could still be owned by the original company but that the dominant platform would operate under new FTC nondiscrimination rules that require it to treat all verticals/apps (both its own and unaffiliated) in a nondiscriminatory fashion. Khan argues that FTC's Section 5 authority (its "antitrust plus" power) and its rulemaking power lets the FTC file lawsuits that – if successful – would lay the groundwork for the FTC to adopt formal nondiscrimination regulations for the dominant platforms. We think such a dramatic restructuring exceeds the ambitions of the Trump Administration, but
with FTC Democrat Rohit Chopra supporting Khan’s proposal a few weeks ago (here), we do not rule out either a Democratic Administration or state AGs seeking this fundamental restructuring of Google.

B. Facebook (60%)

A combination of law and politics leads us to think that Facebook will face an antitrust lawsuit by the end of 2020 from one or more of the FTC/DOJ/state AGs.

The law: A Section 2 monopolization case requires the government to show both “monopoly power” and “exclusionary conduct” by the dominant company. Legal precedent suggests a colorable case but far from a lock.

1) "Monopoly" The FTC/DOJ must show Facebook has 65/70% of properly defined market. It will likely analyze two markets:

a. Social networking service. Two scholarly studies show real market variation, which suggests the FTC will need to perform careful analysis: In 2018, Dina Srinivasen published a law review article saying the social media market consists principally of Facebook/Instagram, Snap, Pinterest, Twitter. Based on time spent with each, Facebook had an 83% market share. Contrast that with a 2018 study by the Brookings Institute that said YouTube was also in the social media market, and based on total monthly user visits, Facebook had a 41% market share.

The FTC/DOJ probably will supplement that functional analysis by showing that Facebook’s privacy policy became less user-friendly as its market share in social networking rose. (FTC Democrat Rohit Chopra recently made this point).

b. Digital advertising. Per the FTC’s Google memo, the FTC/DOJ will also try to define Facebook as having monopoly share of digital advertising. Today, Facebook only has 22% share of the overall digital ad market – well below the ~70% level for monopoly. But the leaked memo shows how the agency will try to show Facebook nonetheless has a monopoly – by defining a market more narrowly than “digital advertising.”

-- We already know from the FTC memo that search advertising is separate from all other digital advertising. So in calculating Facebook’s share of the digital advertising market, staff would first remove Google/Bing advertising revenues from overall “digital ad market.”

-- What’s left is “display advertising.” Staff would then try to show “social media advertising” is a distinct sub-market of “display advertising” in which Facebook has 70% or more share. The leaked memo shows the FTC will try to prove a distinct "social media advertising market" via:

i) Facebook internal presentations/memos/emails on the performance of its own ads versus other display providers.

ii) Click rates (or conversion rates) on Facebook ads versus other display ads.

iii) Advertiser statements to agency staff:

2) “Exclusionary conduct.” If the FTC can show Facebook has a monopoly, it would likely argue Facebook exhibited exclusionary conduct via its acquisitions of nascent competitors. FTC leadership seems to be hinting in this direction:
* On September 17, FTC Chairman Simons told Congress: “Another thing we’re looking at is monopoly maintenance claims to go after acquisition programs with nascent competitors, because we think the burden on the plaintiff [i.e. the FTC] to show harm is less. And so we think that might be a very advantageous avenue.”

* On September 24, FTC’s Competition Bureau Chief Bruce Hoffman submitted written testimony to the same committee that explained what Simons meant by “burden on the FTC is less.” Hoffman wrote “Sherman Act liability does not turn on proof that the potential entrant would have improved competitive conditions in the market or that entry would have actually occurred. Rather, as the Microsoft court pointed out, the question is whether, as a general matter, the exclusion of nascent threats is the type of conduct that is reasonably capable of contributing significantly to a defendant’s continued market power.” In other words, Hoffman is saying Section 2 is a “totality of the circumstances” showing that avoids the need for the FTC to prove that Instagram, on its own, would have emerged into a meaningful competitor to Facebook – the required FTC/DOJ showing under Section 7.

**Politics & tea leaves.** Our anticipation of a lawsuit against Facebook is also based on several non-legal factors:

A) Facebook is the only platform being investigated by all three antitrust bodies – FTC, DOJ and state AGs. The more regulators who investigate, the greater chance one of them will see an actionable case. And the negative political clouds over Facebook for various content reasons make it a uniquely tempting political target, especially before November 2020.

B) Elizabeth Warren is now the favorite to be the Democratic nominee. Trump potentially could be incentivized to file his own breakup lawsuit pre-election to neutralize Warren’s “break up Big Tech” position.

C) Earlier this week, the FTC voted 5-0 to unwind a consummated merger between two medical device manufacturers (FTC v. Otto Bock). The opening paragraph was unusually broad and seemed to signal an appetite for challenging additional consummated mergers.

D) Finally, while the unusually candid comments of Chairman Simons and Bruce Hoffman (above) may be problematic for Facebook, we also admit to uncertainty about why they made those statements. The best read for Facebook is those comments are just saber-rattling and aimed at preserving the FTC’s role in Big Tech investigations. For the past 18 months, Simons has watched DOJ’s Makan Delrahim drop broad public hints about his tech-antitrust concerns and realized that he better start matching Delrahim’s public rhetoric on the platforms or risk having all tech investigations go to DOJ. But our read is Joe Simons and Bruce Hoffman come from the buttoned-down antitrust bar and are less political than Delrahim, who comes from Capitol Hill and the Trump White House. So we suspect Simons/Hoffman made those public comments because they actually see a potential case, and less (or not at all) for FTC “turf” reasons.

**C. Amazon (40%)**

We suspect the FTC will not bring an antitrust lawsuit against Amazon.

To start, Amazon may not have received a CID yet. We think it will (if it hasn’t already), but the uncertainty at least suggests that Amazon is a lower priority for the FTC than Facebook is.
The law. Any case against Amazon likely would be under Section 2 monopolization, requiring the government to show “monopoly” and “exclusionary conduct.”

1) “Monopoly” -- This could be challenging for the FTC. eMarketer recently lowered from 47% to 38% its estimate of Amazon’s share of the U.S. ecommerce market, which is well below the 65/70% that courts have accepted as monopoly levels. So the FTC is likely considering whether it can properly define a narrower market than ecommerce. The agency might explore whether it can properly define a market consisting of “online marketplaces that connect buyers and sellers.” (This may sound results-oriented against Amazon, but courts will sometimes accept agencies’ narrow market definitions that sound targeted at one company. In Microsoft, for example, the D.C. Circuit accepted the DOJ’s market definition of “Intel-compatible PC operating systems,” rather than Microsoft’s proposed “PC operating systems” that included Apple and others.)

So a definition such as “online marketplaces connecting buyers and sellers” would exclude vendor-operated sites (nike.com, e.g.) and raise Amazon’s market share above its current 38% of all of ecommerce. But getting Amazon to 65/70% share also might require exclusion of sites like Walmart.com and target.com, perhaps on the grounds they are curated and do not act as a platform for any third-party seller. Whether the FTC believes evidence from third-party sellers and others would support a narrower market definition than “e-commerce” will be key to whether the agency moves forward.

2) “Exclusionary conduct” -- The FTC also must show “exclusionary conduct.” We see a couple of possibilities:

a) “Refusal to deal.” As a general rule, companies – including those with monopoly power – are free to decide whom to do business with. This means Amazon is presumptively not required to deal with any third party seller at all. The limit on that freedom is if Amazon fits the definition of an unlawful refusal to deal: i) There has been a course of dealing between the dominant company and its competitor; and ii) The termination of that course of dealing hurts the dominant company’s short-term profits for the sake of enhancing the company’s long term monopoly.

Amazon has a course of dealing with all of its third-party sellers, and it has on occasion formally terminated that relationship or offered terms that the FTC might view as an effective refusal to deal, which courts have recognized (the new term might be “your product will be significantly down-ranked if you don’t use Fulfilment by Amazon, e.g.). The FTC might view it as a close call those situations in which Amazon has terminated a seller’s privileges because the foregone listing fees from those sellers harmed Amazon’s short-term profits. But Amazon still might respond that the terminated sellers were harming the shopping experience, or even that Amazon wasn’t taking a short term profit hit because it was now selling more of X product without that seller on Amazon’s platform.

b) “Predatory pricing.” In its 1993 ruling Brooke Group v. Brown & Williamson (1993), the Supreme Court made it fairly difficult for agencies to prove predatory pricing because the Court said it did not want to chill price competition, which usually benefits consumers. Brooke requires an agency to show two things in a predatory pricing claim: 1) Pricing a product below cost; and 2) “Dangerous probability” of recouping those losses upon elimination of competition.

A well-reported story is Amazon buying Quidsi (seller of baby goods) in 2010. After Quidsi reportedly rebuffed Amazon’s acquisition offer, Amazon cut its own baby goods prices. Quidsi then agreed to be bought, and Amazon raised prices for its baby products. That or comparable situations the FTC might uncover – if not outweighed by any
consumer benefits proffered by Amazon -- could present predatory pricing exposure for Amazon.

Section 5 wild card. With Amazon (and Facebook), it’s important to remember that it’s the FTC doing the investigations. This matters because only the FTC (not DOJ or state AGs) has “antitrust plus” power from Section 5 of the FTC Act, which lets the agency challenge “unfair methods of competition.” Courts have said this means the FTC can challenge not only anything that constitutes a Section 2 or 7 violation, but also conduct that goes beyond those areas. The exact boundaries of Section 5 are unclear, but given the gray legal areas likely to arise in investigating Amazon, and Section 5 could encourage the agency to file a lawsuit on a close-call matter.

Politics and tea leaves. Yes, President Trump regularly criticizes Jeff Bezos and “the Amazon Washington Post.” But it’s important to remember that Amazon is being investigated by the FTC, which is harder for Trump to reach. That is true both institutionally (the FTC is an independent agency that reports to Congress, while DOJ reports to the White House) and personnel-wise (DOJ’s Makan Delrahim came from the Trump White House, while the FTC’s Joe Simons came from private law practice). So unlike Google, Facebook and Apple – which DOJ has control of – we don’t think Trump can singlehandedly get a lawsuit filed against Amazon.

Finally, we think Amazon is better positioned than Google or Facebook to use strategic concessions to avoid a lawsuit. Earlier this year, Democratic Senator Richard Blumenthal complained that Amazon lowered product rankings for vendors who offered a lower prices outside of Amazon. Shortly thereafter, Amazon eliminated that factor in its ranking system. Amazon has various other arrangements with third-party sellers that Amazon potentially could offer up both to let regulators declare victory while making an FTC lawsuit harder by shrinking the number of exclusionary behaviors the government could point to in a lawsuit.

D) Apple (40%)

We suspect Apple will avoid a lawsuit from the DOJ. We see a colorable legal case, but we think Apple will avoid a lawsuit because of its more favorable political circumstances than the other tech platforms.

To begin, Apple apparently has not yet received a civil investigative demand (CID), which kicks off a formal investigation. If it doesn’t receive one by roughly January 2020, it might not receive one at all, which would avoid any lawsuit risk between now and November 2020 (and maybe never if Trump is re-elected).

Even assuming it does receive a CID in the coming months, the delay probably signals Apple is a lesser priority for DOJ than Google or Facebook.

The law: DOJ could investigate Apple under both Sections 1 and 2 of the Sherman Act.

Section 1: “Tying arrangement” between app distribution and payment system: Section 1 of the Sherman Act prohibits any “contract, combination or conspiracy in restraint of trade.” One example is tying arrangements. For the DOJ to establish an unlawful tying arrangement, it must show that: 1) The company sells two separate products; 2) The company has market power in one of the products; and 3) It requires the buyer to also take the second, undesired product.

DOJ might argue that the App Store (the first product) is a monopoly and Apple leverages that power to require app developers to use Apple’s payment system (the
second product) in order to take a 30% cut. Apple probably responds that it doesn’t sell two products, only one – the App Store, which both distributes apps and enables payments – so there are not two products that Apple can be charged with tying. This could be a critical point in DOJ’s analysis of Apple.

What courts look at in determining whether a company is selling one product or two is the “character of the demand.” This means what the buyers of that product want -- do they typically want the two products be sold together or separately?

Apple doesn’t offer them separately, but Android does. So we assume DOJ will obtain evidence from Google that at least some Android app developers are using direct user payments rather than the Play Store. So DOJ’s decision on Apple could depend on what it learns about the relative popularity among app developers of Google Play’s option to bill users directly rather than through the Play Store. DOJ probably would need to show there’s enough developer demand for unbundled payment systems that Apple’s conduct is anticompetitive.

Section 2: “Attempted monopolization”: Separately, DOJ might also examine whether Apple’s App Store violates Section 2 monopolization by favoring Apple apps in search results. Monopolization requires the DOJ to show both “monopoly” and “exclusionary conduct.”

Attempted monopolization. For DOJ to prove this case, it must show: 1) Anticompetitive conduct; 2) Specific intent; and 3) “Dangerous probability” of succeeding. We suspect elements 1 and 2 are realistic for DOJ to show given the likely reduced take rates of down-ranked apps. The “dangerous probability” of gaining monopoly power in specific iPhone apps is where the case will rise or fall. The term “dangerous probability” sounds like a difficult showing for DOJ to make, and it might be. But DOJ’s own 2007 guidance document says the ”'dangerous probability' inquiry requires consideration of 'the relevant market and the defendant’s ability to lessen ... competition in that market.'” It seems plausible that DOJ could decide that Apple had a dangerous probability of “lessening” competition in certain apps. If yes, that might be a case DOJ would consider bringing.

Politics and tea leaves. Politically, Apple is the best situated of the Big Tech companies – it is widely admired, avoids the problems of user-supplied content, and has fewer business and political enemies than Facebook, Google and Amazon. CEO Tim Cook also is the one Big Tech executive who appears to have a consistently good relationship with President Trump. And Apple is not under state AG investigation like Google and Facebook, which reduces its total exposure. We think these factors will help Apple avoid a lawsuit.

12. THE ROAD AHEAD -- AFTER THE 2020 ELECTION

A) Under Trump 2: It is likely that FTC Chairman Simons and DOJ’s Makan Delrahim will be replaced in early 2021. Who succeeds them will obviously be important. The antitrust agencies give Trump real leverage over a variety of companies, so we expect he’ll appoint loyalists. This probably means some ongoing risk even under a re-elected Trump for Google/Facebook/Amazon.

First, any lawsuit that DOJ/FTC file before November 2020 will likely continue, although settlements are always possible.
For companies that avoid a lawsuit between now and November 2020, we generally see their risk declining but not disappearing in Trump 2. Key factors: 1) No reelection incentive to file lawsuit; 2) DOD push to beat China in artificial intelligence; 3) State AGs probably aren’t going away.

For Google, we see only modest reduction in lawsuit risk (75% to 65%) under Trump 2. We think the company has more points of exposure than the others and is under both DOJ and state AG investigation. But we do assign a modest reduction in risk because post-election there’s less incentive for Trump to file a lawsuit -- and because DOD might push Trump to leave Google alone for AI-China reasons.

For Facebook, our pre-election lawsuit odds of 60% drop to 40% post-election under Trump 2. This reflects the reduced political value (re-election) of Trump filing a lawsuit, and the fact that the FTC examined Facebook before November 2020. The reason our post-2020 risk is still 40% is we that we see state AGs as a realistic candidate to file a lawsuit if Trump doesn’t file one. And with Democrats now claiming Facebook is tilting its advertising policies to favor Trump’s re-election, there will be some unhappy Democratic AGs if Trump is reelected.

For Amazon and Apple, we reduce our pre-November 2020 lawsuit odds of 40% to 30% under Trump 2. This is based on the elimination of the pre-election incentive to sue Big Tech, as well as the FTC and DOJ possibly having examined the companies pre-November 2020 and declined to sue.

B) Under Democratic President:

If the DOJ/FTC/state AGs file a tech lawsuit before November 2020, we expect it to continue under a new Democratic Administration. Beyond that, we need to differentiate between Warren/Sanders and Everyone Else.

i) Warren/Sanders: Lawsuit odds: Google 75%, Facebook 65%, Amazon 55%, Apple 35%. Warren in particular has led the charge on “break up Big Tech” and has been specific about her reasoning, so we think it will be difficult for her to walk away from that if elected. The reason we’re not at 100% lawsuits for Google/Facebook/Amazon is we can envision at least some chance a President Warren/Sanders would first let Congress consider revising antitrust law or imposing some other type of platform regulation that entails less risk than the coin-flip odds of going before a judge to prove Facebook or Google actually violated antitrust law.

ii) Biden/Buttigieg/Klobuchar/Yang/Harris: These Democrats appear less hostile than Warren/Sanders toward Big Tech. But we think they still pose considerable risk -- perhaps more than the market is appreciating relative to its rising fear of a Warren Administration. Lawsuit odds: Google 75%, Facebook 60%, Amazon 40%, Apple, 30%.

First, even in the wild west of today’s campaigns, we think candidates (other than Warren) are reluctant to literally name names of who’s getting broken up before expert agencies have done any analysis. At last month’s debate, Beto O’Rourke probably spoke for other candidates when he said he would “be unafraid to break up big businesses if we have to do that, but it isn’t the role of a president or a candidate for the presidency to specifically call out which companies will be broken up.”

Second, the Democratic party right now is gradually developing its positions on Big Tech outside of the presidential race. It is happening principally through the House Antitrust Subcommittee, which has opened a formal antitrust inquiry and held three Tech Platform-Antitrust hearings between June and October. Mainstream Democratic thinking...
is moving toward confronting the tech platforms on antitrust, and it’s mainstream Democrats who would run DOJ and the FTC. For example, at an October 18 House Antitrust-platform hearing, FTC Democrat Rohit Chopra told the committee that breakups should be on the table, as well as FTC- or congressionally-mandated structural separation of platforms and verticals/apps. Chopra’s pitch was well-received by Democratic Chairman Cicilline, who told reporters after the hearing that Chopra’s concerns “are serious, and I share them.”

So we actually view Warren as the outlier – both this election cycle and historically – in calling out specific companies to be broken up. Nixon didn’t run on breaking up AT&T, but his DOJ did it. Bill Clinton didn’t run on breaking up Microsoft, but his DOJ attempted it. Warren and Sanders are clearly high-risk outcomes for Big Tech, but we suspect the other Democratic candidates – while less risk than Warren/Sanders – clearly pose more Big Tech risk than a reelected Trump.

Fundamental Take for Google, Facebook and Amazon (John Blackledge, Cowen Internet & New Media Analyst)

US Faces Dilemma Regulating Dominant Services Whose Products Are Typically Free

As we wrote on June 4 [LINK], US regulators are accustomed to investigating anti-competitive practices with the goal of preventing harm to consumers who could pay higher prices if competition is diminished. In the case of advertising-supported Search & Social Media (in particular FB & GOOG), however, the services are largely free of charge to the consumer and also have innovated at a rapid pace, creating a dilemma for regulators who per press reports may nonetheless focus on actions viewed as anti-competitive, such as GOOG’s alleged favoring of its own content in the knowledge Graph. Below we summarize our thoughts on antitrust scrutiny around FB, GOOG, and AMZN respectively.

FB Scrutiny Could Home in on IG Acquisition: Among our names under coverage, FB arguably is most at risk of regulatory / anti-competitive scrutiny, largely because i) the controversies that began with Cambridge Analytica back in ’18 have made FB a fashionable political scapegoat, and ii) relative to smaller social media peers, FB and its vast data cache are viewed as significantly more pervasive given the scale and scope of its portfolio of services. From an antitrust perspective, however, (and ignoring the privacy controversies), FB’s services are largely free to consumers, creating a dilemma for regulators.

We do expect FB’s ownership of Instagram (acquired in 2012) to be an area of interest for antitrust regulators given IG could be framed as a potential competitor to Facebook. In fact, CEO Zuckerberg addressed this issue on the 3Q19 call (Oct. 30), noting the environment has changed vs. 2012, when IG was viewed as mobile photo service while FB was transitioning from desktop to mobile; IG at the time was thus seen as complementary. Also, Zuckerberg noted IG would not likely have reached its current scale without the benefit of FB’s tech and ad stack. This underscores, in our view, the flaw in assuming that IG’s independent path would have mirrored the current trajectory. For instance, while SNAP and Twitter have significant scale globally, they remain sub-scale relative to Core FB and IG, as they have tended to not enjoy the global network effects that FB’s family of services enjoy. While the lack of similar global network effects could be rooted in SNAP and Twitter’s respective services and/or user value propositions, it certainly would be interesting to see how IG would have fared on its own. Since FB’s acquisition, IG’s MAUs have risen from ~30MM to >1BN.
GOOG in Focus for Search, Android, & Vertically Integrated Products: Similar to FB, we believe it’s unlikely GOOG would be broken up by regulators, and as we wrote in June (see link above), we expect NT impact to be limited given the drawn-out nature of any potential US regulatory action. We note that EU’s recent regulatory action (largely fines) has not caused US tech companies to change their business practices in a way that was markedly negative, and these outcomes followed a multi-year period of pending legal action. Any US action would presumably be equally drawn out, and highly controversial in this politicized environment, in our view. Even in a worst case scenario of a breakup, we think additional shareholder value could be unlocked at GOOG through the stripping out of any conglomerate discount.

AMZN’s US Retail Market Share Sits at ~4%; Lack of Large Acquisitions Also a Factor. In any regulatory discussion, we would highlight that AMZN’s US GMV only comprises roughly ~4% of US retail sales (on our ’19 estimates), underscoring the disconnect between the company’s share of the total retail market and how AMZN is frequently mis-characterized in the media, in our view. AMZN’s value prop (while not free like FB & GOOG) is also predicated on a consumer-friendly approach, with its aggressive focus on low prices and near constant innovation, such as the rollout of 1-day delivery this year, available to AMZN’s Prime customers. AMZN critics sometimes focus on the company’s roughly ~35% of US eCommerce (per our estimates), though this is obviously a much smaller slice of the overall US retail market. Finally, we note that unlike the Facebook / Instagram dynamic, AMZN’s most valuable assets, particularly AWS, were developed internally; thus AMZN lacks a large historical acquisition that regulators could target for reversal / breakup.

Fundamental Take for Apple (Krish Sankar, Cowen Semiconductor Capital Equipment and IT Hardware Analyst)

Apple

Our Outperform rating on Apple continues to be predicated on the Services business as a long-term growth driver for new recurring revenue streams that should drive the valuation multiple higher while the iPhone business remains a steady cash flow generating annuity for the company with the new TV+ video streaming, Arcade gaming, and News+ subscription services. As Apple extends its presence from hardware platforms to a growing footprint in software and services, we believe it is possible that US regulatory agencies could examine the company more frequently along with other Big Tech companies that have software- or cloud-centric platforms. At present, we think there are two outstanding legal items that have been modest overhangs for the stock this year and include: (1) the Supreme Court of the US (SCOTUS) ruling in the “Apple vs Pepper” class action lawsuit. (2) the US Department of Justice (DoJ) having jurisdiction over Google and Apple.

App Store: Downside of Givebacks to Consumers Represents ~3% of Cash

We believe the SCOTUS ruling (May ‘19) on the Apple vs Pepper case 5-4 in favor of the plaintiffs increases the probability that Apple may have modest financial risk due to monetary awards. As a reminder, the SCOTUS ruling only gives merit to the idea that Apple App Store customers can sue the company even if the 30% App Store fee is charged to developers (who are not plaintiffs in the case) and not end consumers. The SCOTUS ruling does not take a stance or position on the App Store’s business model, possible wrongdoing, or anti-competitive behavior. As a result, the case gets reverted back to the US Federal court system for further trial and any decisions or verdicts.
regarding the App Store’s viability longer term in its current form along with any monetary award implications could be 18-24 months away.

While there are several possible outcomes, any remediation that entails some “giveback” of prior revenues generated from the App Store fee could amount to ~3% of gross cash assuming consumers receive 10-30% of giveback with developers. Through the end of FY19, we estimate cumulative App Store net operating profit at $39B or 19% of gross cash.

Our scenario analysis of the EPS impact from a worst case scenario where it has to giveback a substantial portion of its cumulative operating profit from the App Store would amount to a $39B impact through the end of FY19 assuming consumers and developers receive the award. Assuming consumers receive 10% / 20% / 30% of the monetary giveback, this would total $3.9B / $7.8B / $11.7B or 2% / 4% / 6% of gross cash. We assume no forward impact to the App Store’s operating model at this time.

**DoJ to have Jurisdiction for Probes**

In June ’19 the DoJ announced that it will have jurisdiction over potential future reviews of Apple’s business practices. This disclosure came amidst a similar announcement about the DoJ’s jurisdiction over a potential anti-trust probe of Google, and the Federal Trade Commission (FTC) over Facebook and Amazon. We believe any anti-trust probes for Apple could center on its App Store (~5% of total sales) given the strong control that Apple has over its app ecosystem.

**Stocks Mentioned In This Report**

- Alphabet, GOOG, Outperform, $1308.86, covered by John Blackledge
- Amazon, AMZN, Outperform $1788.20, covered by John Blackledge
- Apple, AAPL, Outperform $259.43, covered by Krish Sankar
- Facebook, FB, Outperform $190.42, covered by John Blackledge
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VALUATION METHODOLOGY AND RISKS

Valuation Methodology

Internet:
Our valuation methodology is primarily based on Discounted Cash Flow analysis, comparable company multiples such as EV/FCF, EV/EBITDA, and P/E, and sum-of-the-parts analysis (for companies with ownership stakes in other equities or significant assets such as patents/IP). However, this varies by company; for instance, we will often use EV/Revenue for high-growth companies that have recently entered the public equity markets.

Telecom Equipment/Wireless:
Our core valuation methodology is the analysis of a company’s prospects to change its cash flow in future periods. Our primary tool to measure that expected change in cash flow – and the value of it today – is the 10-year DCF. Since earnings are typically a solid proxy for cash flow and are often more easily compared across companies and sectors, we also use Price-to-Earnings (P/E) ratios to value companies. P/E ratios compared to historical ranges and competitive companies can help to determine whether there is incremental value to be found in company shares.

Investment Risks

Telecom Equipment/Wireless:
High subsidies on mobile smartphones are the result of high end-user ARPDUs; if ARPU declines, we would expect mobile phone ASPs to decline, pressuring OEM profitability. Mobile voice has driven wireless ARPU for two-plus decades; if the industry cannot convince end-users to increase dramatically data and Internet application consumption then revenue (ARPU) would be impacted. CAPEX to support the roll-out of LTE, LTE-A, and other 4G networks must stay available for our forecasts to be maintained; if a decline in global GDP occurs, CAPEX likely would be impacted negatively.

Internet & New Media:
The industry in which our companies operate is fiercely competitive and technological change is rapid. All of our companies face the risk that they are unable to keep pace with new innovations or that new innovations impact competitive positioning. Additionally, our companies are international operators and are therefore exposed to currency fluctuations and other factors associated with operating in a foreign territory. Finally, our names sit within the advertising industry more broadly and are exposed to the same seasonality and macro trends as the rest of the group, including competition from TV and other offline channels.

E-Commerce:
The industry in which our companies operate is fiercely competitive and technological change is rapid. All of our companies face the risk that they are unable to keep pace with new innovations or that new innovations impact competitive positioning. Our companies are international operators and are therefore exposed to currency fluctuations and other factors associated with operating in a foreign territory. Finally, our names sit within traditional commerce and retail space and are exposed to the same seasonality and macro trends as the rest of the industry, including competition from offline retailers.
Stocks Mentioned In Important Disclosures

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**Assumption:** The expected total return calculation includes anticipated dividend yield

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**Cowen and Company Equity Research Rating Distribution**

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Closing Price  Target Price
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