FEDERAL ELECTION COMMISSION
Washington, DC 20463

MEMORANDUM

TO: **The Commission**

FROM: **Commission Secretary's Office** DCB

DATE: **June 5, 2019**

SUBJECT: **Comments on Draft AO 2019-07**
Drafts A and B (Area 1 Security, Inc.)

Attached are comments received from Daniel A. Petalas, Esq., counsel for the requestor. This matter is on the June 6, 2019 Open Meeting Agenda.

Attachment

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June 5, 2019

VIA EMAIL

Lisa J. Stevenson
Acting General Counsel
Federal Election Commission
1050 First Street NE
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Re: Advisory Opinion Request 2019-07, Comment from Area 1 Security

Dear Ms. Stevenson:

This firm represents Area 1 Security, Inc. ("Area 1"). We submit this Comment in response to Draft Advisory Opinions A and B, issued by the Commission on June 3, 2019. The Drafts each take issue with the applied business judgment of Area 1 in setting its prices for certain clients—both political and non-political—based on its reasonable assessment of that client's ability to pay, the desired longevity of the client relationship, and the perceived value to Area 1 in research and development and employee motivation or "pride." These legitimate business considerations are entirely consistent with the modern valuation framework adopted by many of the most successful providers of software as a service ("SaaS"). Not only do the two Drafts essentially substitute the Commission's judgment about the value of the consideration to be received for that of the Requestor, they misapply the relevant prior advisory opinions. We respectfully urge the Commission to reject both Drafts A and B and vote to approve the Request for the reasons stated in the Request and in this supplemental submission.

1. Draft A—Legal Adequacy of Consideration

Draft A would conclude that the legitimate business justifications recited in the request—research and development and the value of enhanced employee motivation or "pride"—when taken together with the targeted client's assessed ability to pay and length of the proposed relationship, cannot constitute an adequate commercial consideration for Area 1's services. That conclusion is inaccurate as a matter of fact and inconsistent with the prior advisory opinions on which it relies.

A. Research and Development as Applied to Area 1's SaaS Business Model

Draft A misapprehends the considerable economic benefit that flows to a company that was formed for the specific purpose of detecting and mitigating phishing attacks by providing its services to the most vulnerable and highly-targeted prospective clients, irrespective of the amount of monetary payment received. Draft A also ignores the considerable economic advantage that Area 1 would reap from affording its employees the opportunity to address the most urgent and compelling problem presented in their chosen field of expertise. Properly understood, those substantial business interests generate far more revenue in the long term for Area 1 than a straight monetary payment, and constitute more than adequate consideration to Area 1 for pricing its services as proposed, as perfectly illustrated by Area 1's decision to offer the same services for the same rates to non-political clients when doing so serves the same interests.

As noted in the Request, the research and development opportunity is significant consideration to Area 1. Federal candidates and political committees are uniquely targeted by foreign government cyber actors. Area 1 benefits from applying and improving its cutting edge and proprietary technical approaches through applied research and development to defend against these foreign cyber actors, particularly given the special vulnerability of political candidates and committees to such attacks. Area 1 would therefore benefit immensely from the unique cybersecurity opportunity that occurs only during U.S. elections and only with respect to these types of prospective clients. Indeed, the Commission expressly recognized the value of research and development in the context of cybersecurity services when granting the request in Advisory Opinion 2018-12 (Microsoft), as did the requestor in that case, notwithstanding Draft A's attempt to dismiss the importance of that factor after the fact.

Indeed, more so than other commercial clients, federal candidates and political committees present a particularly valuable R&D opportunity to Area 1. Foreign government and state-sponsored cyber actors are at the forefront of offensive cybersecurity. They employ particular tactics, techniques, and procedures in specific national security contexts, and in particular in the demonstrated efforts of foreign governments to influence U.S. elections through phishing into political parties and candidate committees. Those national-security related activities are far less likely to be observed in other non-political contexts. As in elections past, the 2020 U.S. elections will be subject to new forms of phishing that are unlikely to be seen by commercial organizations for some time. In return for proposing to service these types of clients, Area 1 accordingly gains much more timely—and far more valuable—threat assessment, intelligence, analysis, and testing opportunities than in the ordinary, non-political commercial context.

Moreover, the specific research and development opportunity presented here is directly related to Area 1's core product and its specific organizational purpose—anti-phishing services—which has been its central mission for years before filing the present Request. As such, the research and development interest identified in the Request is tied directly to that pre-existing and well-established business purpose. Therefore, to whatever extent the Commission may be concerned that the consideration drawn from research and development could in some hypothetical future case serve as a pretext for making a prohibited

corporate contribution to a candidate, that concern is not presented in any respect under the facts of this Request. It would be unfair and improper to deny an advisory opinion where the facts presented raise no basis to conclude that the proposed activity of the particular Requestor is intended to circumvent any concern about corporate influence on federal elections.

In addition, as the Commission likely is well aware, research and development is a particularly valuable commodity in the software technology and SaaS fields in which Area 1 operates. Unlike some other consumer goods, advanced research, development, and continuous testing is core to the development of the software product being offered in the dynamic and ever-changing cybersecurity context. It is thus critical to the effort both to create and to continue to improve new versions of the product as the threat environment continues to evolve and adapt to countermeasures. The immediate financial value of that fact should be plain: better products assure the retention of existing customers and are more likely to attract new customers, all of which tends to generate additional revenues. Indeed, this research and development component of producing the most advanced cybersecurity solution in a highly competitive field is more important to the valuation of the company than is the immediate recognition of revenue. By way of analogy, a company formed to create a cancer drug does not require immediate or continuous monetization. All of the risk, and subsequent reward, is in the science: if the drug works, it's valuable. The business focus on the science—i.e., the research and development investment—is paramount to the company's ability to prove effectiveness and thus subsequently to generate revenues.

Area 1 is in a similar position. The company generates monetizable value via continuous applied research and development, even without the immediate recognition of revenue on every sale. This is true of many modern technology companies that, like Area 1, deliver SaaS. The modern SaaS business model prioritizes customer adoption, retention, product effectiveness, and continuous deployment—all of which hinge on research and development, not immediate revenue streams.

But in the end, the cybersecurity research and development that is critical to Area 1's success depends on its ability to apply its work to the most sophisticated and targeted phishing attacks. In the same way that pharmaceutical research and development relies on a targeted population of patients to prove effectiveness, Area 1's research and development requires that the company address a specific set of customers who are most at risk to test and prove its effectiveness, learn from the experience, and iterate new and improved versions of its software and service. In this particular instance, because the company would be harmed if it were unable to test and continually improve the effectiveness of its products, working with the organizations most at risk—election-sensitive organizations—is a critical driver of Area 1's revenue growth, and is a fundamental interest of the company and of its shareholders. To say that the company's assessment of the value of the research and development information to be gained from servicing these particular clients is not sufficient consideration, as Draft A purports to do, is simply counterfactual and inconsistent with the representations in the Request on which any resulting advisory opinion would be premised.

B. Economic Value of Employee Pride and Satisfaction

Like "R&D," the economic value attributable to the pride factor is also significant in the circumstances presented in this Request, and entirely consistent with modern technology-company business models. Modern technology corporations focus significant attention and resources on acquiring and retaining the most highly skilled computer science talent available in order to further their business interests in an extremely competitive field. Recruiting and retaining the best engineering talent is exceedingly difficult in the present technology economy, and engineering talent is absolutely fundamental to developing and maintaining products that attract and retain customers and generate revenue growth. Perhaps nowhere is that more the case than in the high-risk and evolving cybersecurity space. And for such highly-recruited cybersecurity professionals, the opportunity to protect the most actively targeted and important organizations—federal candidates and political committees—is an essential and extremely meaningful opportunity in the field. The quadrennial presidential elections offer unprecedented opportunity to prove and advance Area 1's mission in that respect. If Area 1 can provide its employees the ability to work on that problem, it will increase their intrinsic motivation to excel and remain committed to the company and its mission. The power and value of intrinsic motivation for its employees is critical in a highly competitive industry like cybersecurity. Intrinsic motivation is what leads the company's employees to work long into the night in order to develop new and better ways of solving the most difficult problems—the source of the financial performance and success of the organization. And this is particularly so where the product is SaaS, as the software is the corporate product and subject to the need for continual revision and improvement, which can only be achieved through the sacrifice and commitment of the talented employees Area 1 seeks to hire, motive, and retain.

C. Prior Advisory Opinions do not Support the Approach in Draft A

In addition to these factual issues, Draft A takes a highly restrictive view of what constitutes legitimate business considerations that is both out of touch with actual business practice and inconsistent with the past Commission advisory opinions that the Draft recites. As explained above and in the Request itself, Area 1 clearly identified the consideration that it receives in return for its services, and represented that those business considerations are of considerable financial value to Area 1, consistent with other tech companies that also provide software-based business services for free or at low cost to certain clients in the modern marketplace. Nonetheless, without any real analysis of the concept, Draft A asserts that "Area 1 must show that its business considerations are sufficient to justify its charges regardless of its ordinary business."[1] Draft A apparently interprets that to mean that the stated consideration must "provide value,"[2] although it does not further attempt to explain what amounts to "value," why research and development and employee motivation isn't valuable, or how much value is needed for the particular service offerings

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[1] Draft A at 8, ll. 5-7.

[2] *Id*., ll. 7-8.

here. Regardless, Area 1 in fact satisfied that value requirement. The Request represented that the research and development opportunity associated with servicing federal candidates and political committees was substantial, and that it is highly valuable to Area 1. The Commission recognized the same in Advisory Op. 2018-12, as did Microsoft itself in its own request. And the same is true of the value to Area 1 provided by the enhanced ability to recruit, motivate, and retain a highly skilled and educated workforce in a hotly competitive tech market that comes from providing those employees the opportunity to address the most pressing and interesting problem in their chosen field. As Area 1 has explained, that pride factor is a highly valuable part of the consideration it received as well, from which Area 1 directly benefits monetarily.

In response to the Request's showing, however, Draft A simply asserts, without actual analysis, that "Like the publicity and goodwill asserted by CompuServe, research and development and pride do not provide the type of consideration that is sufficient to adequately compensate Area 1 for the potentially highly valuable services it would provide federal candidates and political committees."[3] In this, the Draft simply offers a conclusion with reasoning, notwithstanding the express representations made in the Request concerning the substantial value of these factors, as well as the public experience of many other technology companies that also justify the sale of their "potentially highly valuable services" without monetary charge when it returns the same types of valuable benefits that Draft A here rejects out of hand as inadequate consideration.

Draft A, if adopted, would expand the decision in Advisory Opinion 1996-02 (CompuServe) far beyond that decision's stated parameters. The rationale actually applied in CompuServe was that "The Commission has permitted a number of the proposed transactions on the basis that the discount or rebate is made available *in the ordinary course of business*, and *on the same terms and conditions*."[4] Unlike the approach taken in Draft A, that statement of the law is consistent with the language of the relevant regulation,[5] and is precisely what Area 1 in fact proposed in its Request—to apply the same pricing model under the same terms and conditions that it uses in the ordinary course of its business for non-political clientele. Draft A's much broader reformulation of the relevant standard would essentially read the exception out of existence, without any applicable limiting principle or explanation of what constitutes legitimate business consideration other than that it "provide value."

The only justifications for the proposal in the CompuServe AO was publicity and good will. The opinion did not reach any other business consideration, and the Draft's attempt to stretch the opinion to also cover other

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3 *Id*. at 8, ll. 9-12.

4 Advisory Op. 1996-02 (CompuServe) at 2.

5 11 C.F.R. § 100.52(d).

measurable value propositions, like research and development or employee satisfaction, is not based on the Commission's holding.

For all of these reasons, on the law and the facts, the Commission should reject Draft A.

2. Draft B—Application of Pricing Model

Draft B expresses skepticism about how Area 1 applies its pricing model, notwithstanding the specific representations made in the Request and the well-established similar practices of many technology companies that offer similar cloud-based SaaS business services. As explained, the operative pricing factors applied by Area 1 are: (1) the client's financial resources, (2) the potential longevity of the relationship, (3) research and development benefits, and (4) the pride interest. If a client has limited financial resources, that counsels in favor of lower pricing. If the proposed relationship with a client would be short, that counsels in favor of lower or eliminated pricing. When Area 1 desires to enter into a short-term relationship with a client, the motive generally is not generating immediate revenue. If a client presents a research and development opportunity where Area 1 would gain significant and valuable insight and threat analysis, that counsels in favor of lower or eliminated pricing. And if a client presents a special opportunity to attract, motivate, and retain top employees, then that, too, counsels in favor of lower or eliminated pricing.

As noted, Area 1 currently provides its software services at little to no cost to a variety of non-political, commercial clients based on its assessment of the same factors described in the Request. Some of these clients are working on the latest advances in biogenomics and aerospace, and are of significant interest to foreign cyber actors seeking to obtain their technologies illicitly. Some of these clients are non-profit and humanitarian organizations also actively targeted by hostile foreign cyber actors. Area 1 has gained incalculable research and development benefits from working with these non-political organizations, which in turn has led to new patents, enhanced detection algorithms, and new product features. Further, in addressing and resolving the threat of phishing attacks on these companies, Area 1 has identified specific employee measurements that confirm the value that flows from the enhanced employee morale and willingness to make additional contributions to the company as a result of the pride factor. In deciding to offer its services to these clients at little to no cost, Area 1 passed these entities through the same pricing framework it proposes to apply to prospective federal candidate and political committee clients if they choose to adopt its solution and qualify.[6]

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[6] Area 1 did not submit the Request because it was proposing any sort of new or special "election-related" pricing plan. This is yet a further distinction from the case in the CompuServe AO, where CompuServe intended to create a "nonpartisan online election headquarters," named "The Election Connection '96." Advisory Op. 1996-2 at 1. To the contrary, the prices Area 1 proposes to charge candidates and political committees, as is represented in the Request, is the same that it would charge similarly-situated non-political clients who present the same set of non-political business considerations. The Request was submitted simply because Area 1 wants to provide further assurance and create clarity for federal candidates and political committees that its offering of anti-phishing software at little to no cost—entirely consistent with its ordinary business practices

The skepticism stated in Draft B also ignores the prevalence of similar pricing models in modern business practice in the technology field. Establishing tiers of low-cost pricing is a well-established practice in technology startups, and the largest- and fastest-growing software companies in the United States have benefited from the same approach that Area 1 pursues. The messaging tool, Slack, for example, in its S-1 filed with the Securities and Exchange Commission in April 2019,[7] stated that it had 600,000 customers, more than 500,000 of which received the product at no cost. Dropbox, the file storage company, in its S-1 filed in February 2018[8] stated it had over 500 million users, but only 11 million paying users. Zoom, the video conferencing service, in its S-1 filed in March 2019[9] stated that "Our rapid adoption is driven by a virtuous cycle of positive user experiences . . . when attendees experience our platform and realize the benefits." Slack, Dropbox and Zoom established tiers of free pricing and have seen the same research and development benefits, as well as the economic value of employee pride, that Area 1 has experienced and is confident it would continue to experience in servicing political candidates and committees, regardless of the lack of an immediate or substantial monetary charge imposed for such services. It should be revealing and further comfort to the Commission in assessing the credibility of Area 1's representation as to the value of these business considerations, that these companies—among the most successful startups in recent years—have actively promoted the same business strategy in their government filings as Area 1 sets forth here.

Nor is Draft B correct in its contention that Area 1 would "categorically" except from its four-factor price assessment the entire category of political clients.[10] To the contrary, Area 1 fully intends to assess each potential client as it finds it, both political and non-political, and according to the identical pricing criteria. The Request is clear on this point, and Area 1 reiterates it again here. Nonetheless, it is Area 1's experience that federal candidates and political committees on the whole are not able or are otherwise unwilling to expend the amount for cybersecurity services that other commercial entities provide. Indeed, this is a fact that the Commission itself has explored in connection with its recent advisory opinion involving a two-party effort to provide certain discounted cybersecurity services to candidates and others, and as is further

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for non-political clients and on the same terms and conditions, and based on commercial and not political considerations—is consistent with law.

7 Slack Technologies, Inc., SEC Form S-1 Registration Statement at 4 (April 26, 2019), *available at* https://www.sec.gov/Archives/edgar/data/1764925/000162828019004786/slacks-1.htm.

8 Dropbox, Inc., Form SEC Form S-1 Registration Statement at 1 (Feb. 23, 2018), *available at* https://www.sec.gov/Archives/edgar/data/1467623/000119312518055809/d451946ds1.htm

9 Zoom Video Communications, Inc., SEC Form S-1 Registration Statement at 4 (Mar. 22, 2019), *available at* https://www.sec.gov/Archives/edgar/data/1585521/000119312519083351/d642624ds1.htm

10 Draft B at 5.

reflected in a recently discussed potential draft interpretive notice proposed by a Commissioner.[11] Moreover, although it is true that some candidates and committees span many years, the proposed service offering is necessarily focused on the milestones of the presidential election cycles to the extent that those are the landmarks by which foreign threat actors time their phishing attacks, and further the period during which the other relevant business considerations, research and development opportunities and the pride benefit in doing the work—which also are part of the analysis and must be taken into account—are at their peak. Accordingly, Area 1 anticipates that the federal candidates and political committees that may seek to retain its services will qualify for the same pricing as similarly situated non-political entities that receive services at reduced prices or without a monetary payment. This is not, however, a wholesale "election" discount in any respect. Rather, it is merely the anticipated result of the application of Area 1's traditional pricing strategy to the circumstances presented in this relatively unique area within the anti-phishing industry and premised on Area 1's practical experience to date. Draft B's inference to the contrary is unsupported in the Request and factually incorrect.[12]

Regardless, as a legal matter and as the Commission is well aware, an advisory opinion provides no benefit or value to the requestor whatsoever, unless the material factual representations on which the opinion is premised hold true. Here, Area 1 has represented that it applies its pricing strategy across the board, for both political and non-political clients alike, and that its application of the same, legitimate business considerations identified in the Request have led it to price its services to non-political clients at reduced rates or at no charge at all, as it anticipates will happen when assessing potential political clients. Draft B provides no basis for discounting that factual assertion, which is consistent with the marketplace and business valuation standards across the industry in which Area 1 competes, nor does it provide any reason to substitute the Commission's own view about the appropriate value of the market for Area 1's services that should differ from Area 1's considered business judgment.

Accordingly, the Commission should also reject Draft B as inconsistent with the basis of the Request presently before the Commission.

3. Conclusion

Area 1 was formed several years ago for the specific purpose of providing the most sophisticated and effective anti-phishing service available. Had its services been employed during the presidential contest in 2016, it would most certainly have prevented the phishing attacks that prevailed against both candidate and political party committees, to the great detriment of public confidence in our democratic election

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[11] *See* Advisory Op. 2018-12 (DDC); Agenda Doc. No. 19-21-A, Draft Interpretive Rule on Paying for Cybersecurity Using Party Segregated Accounts, May 20, 2019.

[12] Further, so as to leave no doubt that the same four-factor cost-assessment model described in the Request applies to all clients, both political and non-political, Area 1 has broadened its brand marketing to identify that pricing option expressly on its outward-facing website. *See* https://www.area1security.com/overview/pricing/.

system. The Commission, like the U.S. intelligence community, has recognized the devastating effect and continuing vulnerability posed by foreign state cyber-attacks against the U.S. political system. The Commission now has an opportunity to affirmatively act to help protect that system by recognizing that Area 1's provision of services under the same pricing formula that it employs for all of its clients, irrespective of their political nature, would not constitute an impermissible corporate contribution of provided to federal candidates and committees on the same terms and on a non-partisan basis, as described in the Request. We therefore again ask that the Commission vote to approve the pending Request.

Very truly yours,

GARVEY SCHUBERT BARER, P.C.

By 

Daniel A. Petalas

Attachments

cc: Ellen L. Weintraub, Chair
Matthew S. Petersen, Vice Chairman
Caroline C. Hunter, Commissioner
Steven T. Walther, Commissioner