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# UK Competition Law

## CMA Moves Against Big Tech With Decision to Unwind Facebook's Acquisition of GIPHY

### SUMMARY

On November 30, 2021, the UK's competition watchdog, the Competition and Markets Authority (**CMA**), found that the completed acquisition by Facebook, Inc. (now Meta Platforms, Inc.) of GIPHY, Inc. resulted in a substantial lessening of competition (**SLC**) in social media and display advertising, harming social media users and businesses in the UK.

The CMA found that the only effective remedy is a **full divestiture of GIPHY** to a purchaser approved by the CMA.

The decision highlights that:

- **The CMA's jurisdiction is far-reaching**: The CMA asserted jurisdiction over the transaction even though GIPHY does not generate any revenue in the UK. In applying the share of supply test, the CMA found that Facebook and GIPHY overlap in "the supply of apps and/or websites that allow UK users to search for and share GIFs", even though GIPHY's products are vertically-integrated into Facebook's services.
- **The overlap identified as part of the share of supply test need not correspond to the concerns identified in the substantive competition assessment**: Although the CMA asserted jurisdiction on the basis of the parties' share of "the supply of apps and/or websites that allow UK users to search for and share GIFs", its substantive assessment focused on loss of potential competition in display advertising and vertical effects in the foreclosure by Facebook of access to GIPHY's services by rival social media platforms.
- **Acquirers with significant market power face an uphill battle, even when the target is only a *potential* competitor that is expected to be relatively small or *might not be successful at all***: The CMA found that GIPHY's efforts to innovate and monetise its services prior to the transaction increased the likelihood of innovation and new products being made available in the future, even if GIPHY's 'Paid Alignment' model ultimately might not have been successful.
- **The CMA places great importance on merging companies' ordinary course internal documents**: The CMA undertook a wide-scale review, having collected over 280,000 internal documents from the parties.

- **The CMA's remedial powers are not limited to requiring a divestiture of the acquired business, and where an investigation of a completed transaction results in an SLC decision, the acquirer may bear the financial consequences of unwinding the acquisition**: Facebook will be required to reinstate certain of GIPHY's activities and assets and to ensure that GIPHY has the necessary management, technical and creative personnel to enable it to compete effectively throughout and following the divestiture.

## BACKGROUND

GIPHY provides an online database and search engine that allows users to search and share GIFs (digital files that display a short, looping, soundless video) and GIF stickers (animated images placed over images or text). GIPHY's products are offered free of charge and its databases can be integrated into other apps, such as Snapchat, TikTok, Facebook and Instagram.

Facebook acquired GIPHY on May 15, 2020 for around US$400 million. Prior to the transaction, GIPHY generated revenues (in the US only) by offering brands and advertisers a 'Paid Alignment' service to align their GIFs with popular search terms so that users see them first when searching for a GIF, or to insert them into GIPHY's trending feed, in exchange for payment.

Facebook did not seek the CMA's approval before completing the transaction. It was not required by law to do so, as the UK operates a voluntary merger notification regime. However, the CMA's "call in" power allows it to investigate potentially problematic transactions that have not been voluntarily notified to it.

On June 9, 2020, the CMA imposed an initial enforcement order (**IEO**) on Facebook and GIPHY, preventing them from further integrating their businesses while the CMA investigated the transaction, as is the standard practice at the start of an investigation into a completed transaction.

Facebook requested a derogation to allow the part of its business that is unrelated to GIPHY to be released from the IEO. However, the CMA did not grant the derogation request on the ground that it believed it did not have the necessary information from Facebook to reach a decision. The CMA applied to the Competition Appeal Tribunal (**CAT**) for a review of the CMA's position. The CAT, followed by the Court of Appeal on appeal by Facebook, found in favour of the CMA.

On October 20, 2021, the CMA fined Facebook £50.5 million for failing to comply with the IEO. The CMA found that Facebook had approached its compliance obligations as if its derogation request had been granted, unilaterally carving out parts of its business, activities and staff from the scope of its compliance statements. The fine is the highest imposed by the CMA to date for non-compliance with an IEO. It is the first time a company has been found to have breached an IEO by "consciously" refusing to report all the required information.[1] The fine is a reminder of the significant repercussions for companies that fail to comply with the CMA's procedure.

[1] See CMA fines Facebook over enforcement order breach - GOV.UK (www.gov.uk).

On November 30, 2021, almost 18 months after the CMA's initial enquiry letter to Facebook, the CMA published its final report. The CMA's decision highlights several important aspects of the UK merger control regime, which are explored below.

## A. JURISDICTION

GIPHY does not charge for access to its online database and search engine or generate other revenue in the UK. However, the CMA's jurisdiction is far-reaching. The CMA asserted jurisdiction on the basis of the share of supply test, which requires that the merging parties overlap in the supply of a particular good or service in the UK and together supply at least 25% of such good or service in the UK.

The CMA considered that this test was satisfied because Facebook and GIPHY overlap in "the supply of apps and/or websites that allow UK users to search for and share GIFs", in which the parties have a combined share (by average monthly searches) of 50-60%.[2] Facebook and GIPHY argued that the overlap identified by the CMA was artificial because Facebook users do not search for GIFs on Facebook. Instead, Facebook users search for GIFs on GIPHY or its competitor, Tenor, and Facebook is simply a mechanism that allows users to access GIFs provided by GIPHY or Tenor.[3] The CMA nonetheless found there to be an overlap, noting that from the perspective of the user, Facebook supplies websites and apps within which users can search for and share GIFs seamlessly as part of their social media activity. The user does not leave the Facebook platform and may not even be aware that the GIFs they are searching for and sharing are powered by GIPHY or Tenor.[4] According to the CMA, the fact that there is a vertical relationship between Facebook and GIPHY does not preclude the finding of an overlap where that relationship is not wholly vertical.[5]

The CMA's expansive approach to the share of supply test in this case is in keeping with that adopted by it in other recent decisions such as *Roche / Spark*[6] and *Sabre / Farelogix*[7].

## B. THEORIES OF HARM

Despite finding jurisdiction on the basis of an overlap in "the supply of apps and/or websites that allow UK users to search for and share GIFs", the CMA's substantive assessment of the transaction focused on two other 'theories of harm':[8]

1. horizontal unilateral effects resulting from the loss of potential competition in display advertising; and

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2 CMA Final Report of November 30, 2021, paragraph 3.44.

3 *Ibid.*, paragraphs 3.29 and 3.32.

4 *Ibid.*, paragraphs 3.38.

5 *Ibid.*, paragraph 3.37.

6 ME/6831/19 - *Roche Holdings, Inc. / Spark Therapeutics, Inc.* (2019).

7 ME/6806/19 - *Sabre Corporation / Farelogix Inc* (2020).

8 CMA Final Report of November 30, 2021, paragraph 17.

2. vertical effects on competition in the supply of social media arising from input foreclosure.

The CMA rejected the parties' argument that the overlap identified as part of the share of supply test must correspond to the horizontal competition concerns considered as part of the substantive assessment.[9]

The CMA found that the transaction is more likely than not to give rise to an SLC on both counts.

### 1. Horizontal unilateral effects resulting from the loss of potential competition in display advertising

According to the CMA, one of GIPHY's key innovations was its Paid Alignment advertising service, which it first offered in 2017 in the US and which it was making efforts to expand.[10]

GIPHY's forecasts did not envisage becoming anything like the size or scale of Facebook in the medium term. However, given the CMA's finding that Facebook has significant market power in display advertising, the CMA considered Facebook's acquisition of a potential entrant may be concerning, even if that entrant is expected to be relatively small.[11] GIPHY's efforts to innovate and monetise its services prior to the transaction were valuable, as they increased the likelihood of innovation and new products being made available in the future, even allowing for the possibility that GIPHY's Paid Alignment model ultimately might not have been successful.[12]

The CMA's concern relates purely to loss of *potential* competition. The decision demonstrates that acquirers that the CMA considers to have significant market power may face an uphill battle, even when the target is only a potential competitor that is expected to be relatively small or might not be successful at all.

In addition, the decision demonstrates the great importance placed by the CMA on merging companies' ordinary course internal documents. The CMA undertook a wide-scale review having collected over 280,000 internal documents from the parties, and found that GIPHY's internal documents provided contemporaneous evidence that GIPHY hoped to expand its offering internationally, including into the UK.[13]

The parties submitted that "GIPHY has never sold a single ad in the UK (or anywhere else outside of the US) . . . that GIPHY had suspended its efforts to explore international opportunities, and there was no realistic prospect that GIPHY could have expanded its Paid Alignment business into other markets

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9 *Ibid.*, paragraph 3.41. The CMA added that, in any event, they consider that there is sufficient connection between the overlap identified for the share of supply test and their competition concerns.

10 *Ibid.*, paragraph 38.

11 *Ibid.*, paragraph 42.

12 *Ibid.*, paragraph 43.

13 *Ibid.*, paragraph 20.

or geographies outside of the US."[14] However, following a detailed assessment of the parties' internal documents, the CMA concluded that the parties' submissions on GIPHY's potential scale were not robust. The CMA stated that while submissions and views expressed at hearings were an important part of its process, it "place[s] particular evidential weight on contemporaneous evidence such as internal documents in understanding the intentions of decision makers at the time."[15] The CMA noted "from GIPHY's internal documents that GIPHY hoped to develop its Paid Alignment product and expand its offering internationally, including into the UK".[16]

#### 2. Vertical effects on competition in the supply of social media arising from input foreclosure

GIPHY allows apps (*e.g.*, social media platforms such as Snapchat, TikTok, Facebook and Instagram) to integrate GIPHY's GIF and GIF sticker databases into their own platforms. The CMA found that Facebook could disadvantage its rivals in social media by limiting their access to GIPHY, either by preventing them from accessing GIPHY at all, or allowing them to access GIPHY on worse terms than they did before the transaction.

### C. REMEDY

The CMA found there to be only one effective remedy – the full divestiture of GIPHY. Such a remedy poses particular challenges in this case due to the termination of GIPHY's revenue-generating activities and team, the transfer of almost all GIPHY staff on to Facebook employment contracts and the transfer of GIPHY's back office functions to Facebook. These actions took place prior to the CMA issuing its IEO.[17] In fact, Facebook submitted that GIPHY had wound down the revenue-sharing agreements and terminated its revenue team's contracts prior to the transaction.[18]

In order to overcome these challenges, the CMA decided that Facebook would be required to reinstate certain of GIPHY's activities and assets and to ensure that GIPHY has the necessary management, technical and creative personnel to enable it to compete effectively throughout and following the divestiture. The CMA anticipates that Facebook would need to provide financial and other incentives to encourage former GIPHY employees to transfer back to GIPHY, and to recruit appropriate replacements for any key GIPHY staff who choose not to do so. Notably, the CMA stated that it would require Facebook to provide "all necessary incentives" to secure the transfer of the GIPHY management team's employment contracts from Facebook to GIPHY, and not just take reasonable steps to do so.

Further, the CMA found that simply adding back a revenue function and putting a similar level of cash on the balance sheet as immediately pre-transaction would not return GIPHY to its pre-transaction

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14 *Ibid.*, paragraph 7.169.

15 *Ibid.*, paragraphs 7.170-7.188.

16 *Ibid.*, paragraph 41.

17 *Ibid.*, paragraph 62.

18 *Ibid.*, paragraph 2.10. The CMA noted that evidence in Facebook's internal documents indicated that the decision to terminate GIPHY's Paid Alignment revenue stream came from Facebook, as well as the decision not to acquire the GIPHY revenue team as part of the transaction.

position because GIPHY had lost its source of external cash flow as well as the expertise, contacts and relationships it had with advertisers and the actual and potential Paid Alignment advertising contracts. In order to restore GIPHY's ability to generate revenue, additional time and resources would be required.[19]

Finally, as part of the remedy implementation, the CMA assesses a purchaser's suitability as an acquirer of the divestment business. The CMA found that a suitable purchaser would need to show, among other things, "a commitment to developing and providing…GIF-based advertising in the UK".[20] Although GIPHY's internal documents only demonstrated that GIPHY "*hoped*"[21] to develop its Paid Alignment product and expand its offering internationally, including into the UK, the CMA found that a suitable purchaser would need to show a "*commitment*" to providing GIF-based advertising in the UK. The CMA would expect to see consideration being given by the purchaser in its business plans to routes for entry into the UK "*in the near future*".[22] As such, it appears that the remedy may require a greater commitment from the purchaser of the divestment business with respect to UK entry than was even planned by GIPHY pre-transaction.

The decision is a stark reminder that the CMA's powers are not limited to ordering divestiture of the acquired business. The CMA can take such action as it considers reasonable and practicable to remedy, mitigate or prevent an SLC it has found and any adverse effects which have resulted from it. Further, while acquirers are not required to notify transactions to the CMA before completion, in not doing so, they assume the risk that the CMA will decide to investigate the completed transaction. Where the investigation results in an SLC decision, the acquirer may bear the financial consequences of unwinding the already consummated acquisition.

It remains to be seen whether Facebook will appeal the CMA's decision to the CAT. The transaction is also under investigation by other competition authorities, including in Austria.

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19 *Ibid.*, paragraph 11.42.

20 *Ibid.*, paragraph 11.166.

21 *Ibid.*, paragraph 41.

22 *Ibid.*, paragraph 11.167.

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