COMPLETED ACQUISITION BY FACEBOOK, INC. OF GIPHY, INC.

Issues statement

5 May 2021

Please note that [✄]] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

The reference

1. On 1 April 2021, the Competition and Markets Authority (**CMA**), in exercise of its duty under section 22(1) of the Enterprise Act 2002 (the **Act**), referred the completed acquisition (the **Merger**) by Facebook, Inc. (**Facebook**) of GIPHY, Inc. (**GIPHY**) (together, the **Parties** or, for statements referring to the future, the **Merged Entity**) for further investigation and report by a group of CMA panel members (the **Group**).

2. In exercise of its duty under section 35(1) of the Act, the CMA must decide:

   (a) whether a relevant merger situation has been created; and

   (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition (**SLC**) within any market or markets in the United Kingdom (**UK**) for goods or services.

3. In answering these questions, we will apply a 'balance of probabilities' threshold to our analysis. That is, we will decide whether it is more likely than not that the Merger will result in an SLC.[1]

Implications of Coronavirus (COVID-19)

4. We are publishing this issues statement during the Coronavirus (COVID-19) pandemic, which is having significant impacts on consumers and businesses across the world. The CMA has published a statement on its website on how it has adjusted its working arrangements in response to the pandemic and guidance on key aspects of its practice during the pandemic. Our approach to

[1] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 2.36.

evidence-gathering will take into account the difficulties that the pandemic may be causing for market participants in this sector. If appropriate, we will also take into account the impact of the pandemic in our assessment of the competitive effects of the Merger, although we are required to look beyond the short-term and consider what lasting structural impacts the Merger might have on the markets at issue.

Purpose of this issues statement

5. In this statement, we set out the main issues that we are likely to consider in reaching our decision on the SLC question (paragraph 2(b) above), having had regard to the evidence available to us to date, including the evidence obtained in the CMA's phase 1 investigation. This does not preclude the consideration of any other issues which may be identified during the course of our investigation.

6. The CMA's phase 1 decision (the **Phase 1 Decision**)[2] contains much of the detailed background to this issues statement. We are publishing this statement in order to assist parties submitting evidence to our investigation. This statement sets out the issues we currently envisage being relevant to our investigation and we invite interested parties to notify us if there are any additional relevant issues which they believe we should also consider.

7. At phase 2, while we are not precluded from considering any other issues which may be identified, we intend to focus our investigation on the areas in which the CMA found in the Phase 1 Decision that the Merger gives rise to a realistic prospect of an SLC – that is, as a result of:

   (a) horizontal unilateral effects as a result of loss of potential competition in display advertising in the UK;[3] and

   (b) vertical effects, in relation to social media worldwide, and in relation to display advertising in the UK.[4]

8. We intend to use the evidence obtained during the phase 1 investigation. However, we will also be gathering and considering further evidence on these and any other issues which may be identified during the course of the investigation.

[2] Full text of Phase 1 decision to refer unless undertakings accepted.
[3] See further, paragraph 33, below.
[4] See further, paragraph 39, below.

Background

9. On 15 May 2020, Facebook acquired, via its direct wholly owned subsidiary Tabby Acquisition Sub, Inc., all outstanding equity in GIPHY for consideration of approximately USD 315 million in cash. [✄].[5]

10. The Parties informed the CMA that competition authorities in [✄] and [✄] have also opened investigations into the Merger.[6] The Austrian Federal Competition Authority has also announced that it has opened an investigation into whether the Merger should have been notified to it, with reference to the transaction value threshold.[7]

The Parties

11. Facebook is a publicly traded company listed on NASDAQ, with headquarters in California. The Facebook group offers various products and services, including the Facebook app, Instagram, Messenger, WhatsApp, Oculus, Portal and Workplace.[8]

12. Facebook's total turnover in FY19 was GBP 55,419 million, of which approximately [✄] was generated in the UK.[9]

13. GIPHY, which was founded in 2013 and is headquartered in New York, is an online database and search engine that allows users to search and share GIFs and GIF stickers.[10] A GIF is a digital file that displays a short, looping, soundless video, while a GIF sticker displays an animated image comprised of a transparent (or semi-transparent) background which can be placed over images or text. Both can be used to expressively convey emotions or as a way of demonstrating an understanding of popular culture. For the purposes of this Issues Statement, until otherwise specified, the term 'GIFs' refers to both video GIFs and GIF stickers.

14. GIPHY has created APIs,[11] otherwise known as app 'extensions', that allow third party apps to integrate GIPHY's GIF and GIF sticker databases.[12] GIPHY currently provides its API integration to Facebook's services, including the

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[5] Final Merger Notice, submitted on 26 January 2021 (**FMN**), paragraphs 2.7 and 2.8.
[6] FMN, paragraph 2.15.
[7] Digitalisierung & Wettbewerb: BWB prüft Übernahme von GIPHY durch Facebook - Zusammenschluss wurde bei der BWB nicht angemeldet: BWB - Bundeswettbewerbsbehörde - Weil es uns um Fairness geht!
[8] FMN, paragraph 2.1.
[9] FMN, paragraph 2.2.
[10] FMN, paragraph 2.3.
[11] An API, or an application programming interface, is an interface that defines interactions between software, enabling applications and tools to interact. GIPHY has also developed a Software Development Kit (**SDK**) that provides tools to third-party host apps to program GIPHY's library in such a way that its integration is aligned with the style and functionality of the host app's user interface.
[12] FMN, paragraph 2.4.

Facebook App, Messenger, Instagram and WhatsApp,[13] as well as to a number of other online platforms, including social media platforms such as Snap, Twitter and TikTok. GIPHY's products are offered free of charge to users and companies via APIs globally. Until May 2020, GIPHY generated revenues in the United States by offering brand partners 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 a fee.[14]

15. GIPHY's total turnover in FY19 was approximately [✄], none of which was generated in the UK.[15]

Our intended inquiry

16. Below we set out some specific areas of our intended assessment in order to help parties who wish to make representations to us. However, these will not be the only areas for our assessment. For example, we will also seek to assess how the industry operates, the rationale for the Merger and any other relevant issues.

Jurisdiction

17. In the context of a completed transaction, a relevant merger situation exists where the following conditions are satisfied:[16]

(a) two or more enterprises have ceased to be distinct; and

(b) either:

(i) the value of the target enterprise's UK turnover exceeded £70 million in its last fiscal year (the **turnover test**); or

(ii) the enterprises ceasing to be distinct have a share of supply in the UK, or in a substantial part of the UK, of 25% or more in relation to goods or services of any description (the **share of supply test**).

18. The CMA's Phase 1 Decision found that it is or may be the case that the CMA had jurisdiction to review the Merger on the basis that two enterprises (ie Facebook and GIPHY) have ceased to be distinct and that the share of supply test is met in relation to both:

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[13] FMN, paragraph 2.11.
[14] FMN, paragraph 2.11 and 12.10.
[15] FMN, paragraph 5.2.
[16] Section 23 of the Act.

(a) the supply of apps and/or websites that allow UK users to search for GIFs; and

(b) the supply of searchable libraries of animated (ie non-static) stickers, provided direct to users in the UK (including both GIF and non-GIF stickers).

19. We shall consider the question of jurisdiction in our inquiry.

The counterfactual

20. The application of an SLC test involves a comparison of the prospects for competition with a merger against the competitive situation without a merger. The latter is called the 'counterfactual'. The counterfactual is not a statutory test but rather an analytical tool used in answering the question of whether the merger gives rise to an SLC.[17]

21. We shall assess the possible effects of the Merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation absent the Merger) including how Facebook, GIPHY and other providers would have competed in the absence of the Merger.

22. At Phase 1, the Parties submitted that the relevant counterfactual was one in which GIPHY had deteriorated into a significantly weakened business, due to developments resulting from the Coronavirus (COVID-19) pandemic and the Parties' submission that GIPHY had no realistic prospect of transitioning to a profitable business model or [✂].[18]

23. The CMA's Phase 1 Decision found that there was a realistic prospect that, absent the Merger, GIPHY would have continued to generate revenue through activities such as paid alignment contracts, as it had pre-Merger, either (i) operating independently and pursuing additional funding via external investment; or, alternatively (ii) have been purchased by an alternative purchaser, possibly another social media platform. The Phase 1 Decision did not find that GIPHY would have deteriorated into a significantly weakened business.

24. In making our assessment, we shall consider possible alternative scenarios. The CMA is likely to only focus on significant changes where there are reasons to believe that those changes would make a material difference to its competitive assessment.[19] We will consider the evidence gathered at phase 1

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[17] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 3.1.
[18] FMN, paragraphs 11.1-11.9 and GIPHY Story in Context submission of 21 December 2020, page 299.
[19] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 3.9.

and any new evidence we receive which is relevant to the consideration of the counterfactual in our assessment of the Merger.

Market definition

25. Market definition provides a framework for assessing the competitive effects of a merger.[20] An SLC can affect the whole or part of a market or markets. Within that context, the assessment of the relevant market is an analytical tool that forms part of the analysis of the competitive effects of the merger and should not be viewed as a separate exercise.[21]

26. The boundaries of a market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. We will take these factors into account in our competitive assessment.[22]

27. In practice, the analysis of market definition and the competitive effects will often overlap, with many factors affecting market definition being relevant to the assessment of competitive effects and vice versa.[23]

28. In the Phase 1 Decision, the CMA considered the impact of the Merger on the supply of:

    (a) searchable GIF libraries worldwide;

    (b) social media worldwide; and

    (c) display advertising in the UK.[24]

29. The market definitions used in the Phase 1 Decision in relation to social media and display advertising were also in line with the findings of the CMA's recent Market Study into online platforms and digital advertising (the **Market Study**), which published its Final Report in July 2020.

30. We will use the market definitions adopted in the Phase 1 Decision as a starting point for our analysis. Where relevant, we will consider out-of-market constraints and/or any differences in the degree of competitive constraints from different suppliers within the markets. We will consider the evidence

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[20] Merger Assessment Guidelines (CMA129) (March 2021), chapter 9.
[21] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 9.1.
[22] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 9.4
[23] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 9.2
[24] Phase 1 Decision, paragraph 153.

gathered at phase 1 and any new evidence we receive which is relevant to the appropriate market definition for our assessment of the Merger.

Assessment of the competitive effects of the Merger

Theories of harm

31. The term 'theory of harm' describes the possible ways in which an SLC could arise as a result of a merger. The theory of harm provides the framework for our analysis of the competitive effects of a merger.[25] Identifying a theory of harm in this Issues Statement does not preclude an SLC from being identified on another basis following receipt of additional evidence or further analysis. We welcome views on the theories of harm described below.

32. Subject to the evidence we obtain regarding the market definition (described above), we intend to assess whether the Merger may be expected to result in an SLC as a result of either, or a combination, of the following effects:

(a) horizontal unilateral effects as a result of loss of potential (future and/or dynamic) competition in display advertising in the UK; and

(b) vertical effects through foreclosure by the Merged Entity of access to GIPHY's GIFs by Facebook's rivals, which would result in a loss of current or potential (future and/or dynamic) competition in social media worldwide and/or in display advertising in the UK.

33. At Phase 1, the CMA considered the findings of the recent Market Study when assessing its theories of harm, in particular that:

(a) Facebook has significant market power in social media;[26]

(b) Facebook has significant market power in display advertising;[27] and

(c) a contributing factor to Facebook's market power in display advertising is the significant data advantage Facebook has over smaller platforms and publishers.[28]

34. We will consider the evidence gathered at Phase 1 and any new evidence we receive which is relevant to the theories of harm in our assessment of the Merger. In making our assessment, we shall consider the extent to which the evidence and analysis set out in the Market Study is relevant to our

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[25] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 2.11.
[26] Market Study, Final Report, paragraph 3.250.
[27] Market Study, Final Report, paragraph 5.373.
[28] Market Study, Final Report, page 211.

investigation, and whether such evidence and analysis needs to be updated or supplemented in any way.

Horizontal unilateral effects

35. Unilateral effects can arise in a merger where one firm merges with a competitor that previously provided a competitive constraint. Through the Merger, removing one party as a competitor might allow the Parties profitably to increase prices, lower the quality of their products or customer service, reduce the range of their products/services, and/or reduce innovation relative to what might occur in the counterfactual.[29]

36. In addition to losses of existing competition, the CMA will also consider cases in which the competitive constraint eliminated is a potential or future constraint.[30] Mergers involving a potential entrant can lessen competition in different ways:

   (a) First, a merger involving a potential entrant may imply a loss of future competition between the merger firms after the potential entrant would have entered or expanded.[31]

   (b) Second, existing firms and potential competitors can interact in an ongoing dynamic competitive process (eg potential competitors may be making current efforts or investments that may eventually result in their entry or expansion, while incumbent firms may be making efforts to improve their own competitive offering to mitigate the risk of losing future profits to potential entrants), and a merger could lead to a loss of dynamic competition.[32] Where dynamic competition gives customers the chance to benefit from a wider variety of products or a future increase in competition, this represents value to customers even where there is some uncertainty that these products or services will ever ultimately be made available to customers.[33] The elimination of an entrant as a potential competitor may therefore lead to an SLC even where entry by that entrant is unlikely and may ultimately be unsuccessful, because the removal of the threat of entry may lead to a significant reduction in innovation or efforts by other firms to protect their future profits than would otherwise be the case.[34]

[29] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 4.1.
[30] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 4.2.
[31] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 5.2.
[32] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 5.3.
[33] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 5.20.
[34] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 5.23.

37. In the Phase 1 Decision, the CMA considered whether the Merger may lead to a loss of dynamic and/or future competition in display advertising, in particular as a result of (i) a reduction of GIPHY's incentives to continue with ongoing efforts towards expansion, and/or (ii) a loss of future competition between Facebook and GIPHY. The Phase 1 Decision also considered whether, given the evidence of Facebook having existing significant market power in display advertising (see paragraph 31 above), any loss of competition may give rise to greater concerns than in a scenario where Facebook did not have such market power.

38. The Phase 1 Decision found that while GIPHY was not active in digital advertising in the UK at the time of the Merger, it was active in the US and had plans to start monetising its GIFs internationally outside the US, including in the UK, and to increase the overall scale of its digital advertising activities through its paid alignment services absent the Merger.

39. In the context of Facebook's significant market power in display advertising, the Phase 1 Decision also found that were GIPHY to expand successfully in digital advertising, and were GIPHY's paid alignment opportunities to become a prominent channel for advertising on messaging and other social media platforms, Facebook would potentially face stronger competitive constraints in display advertising.

40. In making our assessment, we expect to consider, among other matters:

(a) the market structure and the market position of the Parties and their competitors;

(b) the scope for GIF-based advertising to emerge as an alternative to existing display advertising formats;

(c) the scope for GIPHY to have developed as a competitor to Facebook in display advertising absent the Merger;

(d) the scope for Facebook to have innovated in relation to features competing with GIPHY; and

(e) the importance of GIPHY as a source of dynamic and future competition, whether as an independent company or under the ownership of another digital platform.

Vertical effects

41. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between a firm and an upstream supplier or a downstream customer. In certain circumstances vertical mergers

can weaken rivalry, for example when they result in foreclosure of the merged firm's competitors.[35] This would weaken the constraints that the merged entity faces and, as a result, harm competition and therefore customers. In assessing an input foreclosure theory of harm, the CMA's approach is to consider whether three cumulative conditions are satisfied:

(a) Would the Merged Entity have the ability to use its control of inputs to harm the competitiveness of its downstream rivals?

(b) Would it have the incentive to actually do so, ie would it be profitable?

(c) Would the foreclosure of these rivals substantially lessen overall competition?

42. In the Phase 1 Decision, the CMA considered whether, as a result of the Merger, the Merged Entity could harm Facebook's rivals and lessen current and potential (future and/or dynamic) competition in social media and display advertising as a result of Facebook (i) ceasing to supply GIPHY's GIFs via GIPHY's API integrations (total foreclosure), and/or (ii) engaging in strategies that worsen the terms of GIPHY's supply or otherwise harm Facebook's competitors, such as requiring them to provide more user data to access GIPHY (partial foreclosure).

43. At Phase 1, the CMA found that GIFs are an important feature for driving user engagement on online platforms and that GIFs may become an even more important input for social media platforms in future as an advertising channel within messaging. The Phase 1 Decision also found that GIPHY had by far the highest share of API/SDK searches in the UK in 2019 ([80-90]%), followed by Tenor ([10-20]%) and Gfycat ([0-5%]). Most third parties responding to the CMA's market testing saw Tenor as being at least as good as GIPHY, but other GIF providers were considered less attractive.

44. With regard to the Merged Entity's incentive to engage in foreclosure, the Phase 1 Decision considered the costs and benefits of a vertical foreclosure strategy and found that total or partial foreclosure may harm Facebook's competitors by affecting user experience on their platforms, to the benefit of Facebook, which would face weaker competitors as a result.

45. Finally, with regard to the effect of any foreclosure strategy, in the context of Facebook's significant market power in both social media and display advertising (as discussed at paragraph 31 above), the Phase 1 Decision found that any reduction in competitive constraint resulting from a foreclosure

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[35] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 7.2

strategy may give rise to greater concerns than in a scenario where Facebook did not have such significant market power in social media and display advertising.

46. In making our assessment, we expect to consider, among other matters:

(a) Ability: (i) whether Merged Entity has market power in the supply of GIFs; and (ii) whether restricting rival's access to GIFs, and/or other content that GIPHY produces or may produce in future, would harm rivals' competitiveness due to the importance of such inputs for driving user engagement on social media platforms and to their potential future importance as an advertising channel within messaging.

(b) Incentive: the benefits to Facebook of protecting its market position in social media and display advertising, relative to any benefits that would be foregone as a result of engaging in total or partial foreclosure of GIPHY's GIFs to Facebook's competitors.

(c) Effect: drawing on the evidence considered under (a) and (b) above, including Facebook's pre-existing position in social media and display advertising, we will consider whether any harm to competitors identified will result in substantial harm to overall competition in the downstream markets. As part of this, we will consider whether Facebook's ownership of GIPHY will protect or strengthen its ability to exert control over the ecosystem in which it operates (including all the services and firms which interact around the provision of social media and display advertising).

Countervailing factors

47. For all the theories of harm, we will consider whether there are countervailing factors which are likely to prevent or mitigate any SLC that we may find. We will also consider evidence to the extent relevant, in our competitive effects assessment, such as:

(a) evidence of entry and/or expansion by third parties, and whether entry and/or expansion would be timely, likely and sufficient to prevent any SLC from arising as a result of the Merger;[36] and

(b) evidence in relation to efficiencies arising from the Merger.[37]

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[36] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 8.28.
[37] Merger Assessment Guidelines (CMA129) (March 2021), paragraph 8.2. At phase 2, in order to form a view that claimed efficiencies will enhance rivalry such that a merger does not result in an SLC, the CMA must expect that the following criteria with be met: the merger efficiencies must (a) enhance rivalry in the supply of those

Possible remedies and relevant customer benefits

48. Should we conclude that the Merger may be expected to result in an SLC within one or more markets in the UK, we will consider whether, and if so what, remedies might be appropriate.

49. In any consideration of possible remedies, we may in particular have regard to their effect on any relevant customer benefits that might be expected to arise as a result of the Merger and, if so, what these benefits are likely to be and which customers would benefit.[38]

Responses to this issues statement

50. Any party wishing to respond to this issues statement should do so in writing, by **no later than 5pm on 19 May 2021** by emailing Facebook.Giphy@cma.gov.uk. Please note that, due to the ongoing Coronavirus (COVID-19) pandemic, the CMA's offices across the UK are closed until further notice. We are no longer able to accept delivery of any documents or correspondence by post or courier to any of our offices.

products where an SLC may otherwise arise; (b) be timely, likely and sufficient to prevent an SLC from arising; (c) be merger-specific; and (d) benefit customers in the UK (paragraph 8.8).

[38] Merger Remedies (CMA87), paragraphs 3.4 and 3.15 to 3.24.