COMPLETED ACQUISITION BY

FACEBOOK, INC.

OF

GIPHY, INC.

ME/6891/20

INITIAL PHASE 2 SUBMISSION

19 MAY 2021
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1. EXECUTIVE SUMMARY

A. Introduction

1.1 This submission concerns the acquisition by Facebook, Inc. (“Facebook”) of GIPHY, Inc. (“GIPHY”, together with Facebook the “Parties”) (the “Transaction”) and sets out the Parties’ response to the Phase 1 decision of the Competition and Markets Authority (the “CMA”), dated 25 March 2021 (the “Phase 1 Decision”). Where relevant this submission also refers to the Phase 2 Issues Statement, dated 5 May 2021 (the “Issues Statement”).

1.2 The CMA has extensively investigated Facebook's acquisition of GIPHY, a small United States (“U.S.”) based company for the last 11 months. It has assembled mountains of evidence, based on more than 20 requests for information (“RFIs”) and approximately 25,000 documents produced from over 30 custodians, in addition to market outreach and third party interviews.

1.3 Even at this stage in its investigation, the CMA has still not set out a plausible basis to assert jurisdiction over the Transaction, which is the threshold issue in any merger inquiry, nor could it. GIPHY is a U.S. company. It has no sales into the United Kingdom (“U.K.”). It has no assets in the U.K. It has no employees in the U.K. It has no U.K. customers. There are no overlapping services in the U.K. (or elsewhere, for that matter). Facebook does not have a GIF database or GIF search capabilities. Those are supplied by GIPHY and Google’s Tenor. Yet the CMA--after 11 months of looking at this deal-- still asserts in its Phase 1 decision that the Parties overlap in the supply of these services. In addition, the further assertion of an overlap in an artificially narrow category of “animated (i.e., non-static) stickers” is plainly gerrymandered. No one outside of the CMA understands --let alone is using--this term. But even within these (obviously flawed) categories, the CMA has failed to properly account for Google and Apple. Establishing jurisdiction should be transparent and trivial. Yet the CMA has twisted itself into knots, and is still unable to put forward a plausible case based on the barest bones evidence.

1.4 Just as the failure of the CMA to plausibly establish jurisdiction after almost of year of investigation should give the Panel pause, few events demonstrate the brittle nature of the CMA’s case more vividly than the fact that between the Phase 1 issues paper and the Phase 1 Decision, after for the first time entertaining the testimony of GIPHY’s executives, the CMA dropped two of its theories of harm in a matter of days. The CMA's surviving theories of harm must also be rejected because they are implausible and cannot be squared with undisputed facts that determine the outcome of this case.

(a) The first theory of harm (“TOH”) claims that GIPHY would likely have become a competitor to Facebook within an artificially narrow advertising market described by the CMA’s Phase 1 decision. That is exceedingly unlikely, because (i) GIPHY had [✓] proprietary audience for advertising, and (ii) GIPHY had

1 The CMA contacted the Parties in May 2020 and referred the Transaction to Phase 2 on 1 April 2021.

2 In the Phase 1 Decision, the CMA dropped its theories of harm (TOH 3 and 4) in relation to: (1) loss of potential competition in the supply of searchable GIF libraries; and (3) raising barriers to entry and expansion by increasing Facebook’s data advantage in display advertising. The Phase 1 Decision also dropped part of TOH1 which concerned a loss of potential competition in the supply of social media.
no meaningful access to data about the users of its API partners' services. There is no dispute as to these facts: GIPHY’s “owned and operated” audience is what it is—[3]. With respect to GIPHY’s “API users,” that is, the users of the downstream services such as Facebook that implemented GIPHY’s API, the Phase 1 Decision concluded that GIPHY had no meaningful access to advertising-relevant data.

A variety of potential buyers, including [3], actively courted by GIPHY and its investment bankers, similarly exhibited [3]. In 2020, GIPHY had [3] except for Facebook. Facebook’s motivation for buying GIPHY was entirely straightforward: Facebook was (and is) GIPHY’s largest API partner, and Facebook wanted to continue that mutually beneficial relationship and not see it disrupted by GIPHY failing. The facts are that (1) GIPHY’s tiny “paid alignments” business was no more than experimental, and (2) Facebook had no interest in it. These facts should be dispositive. Even if the CMA were to insist, despite the evidence, that GIPHY was -- or was likely to evolve -- into an advertising competitor, then that would still not translate into a cogent TOH. If GIPHY could be considered a potential competitor in advertising, then, by the same logic, hundreds if not thousands of other companies would have to be considered actual or potential competitors to Facebook as well. In which case Facebook’s ad business faces so much competition from so many actual and potential rivals that the acquisition of GIPHY with its [3] of global ad sales and $0 of U.K. ad sales would not matter for that reason alone.

(b) The second TOH is concerned with Facebook cutting off its downstream rivals from GIPHY. Again, the theory cannot be squared with the facts. GIFs are not a critical (or even important) input and Facebook never considered cutting off rivals as part of its deal evaluation. There is nothing exclusive about GIPHY’s content that Facebook could hope to “reserve for itself” with such a move. There are ready alternatives to GIPHY, including Google-owned Tenor, which--like GIPHY--supplies GIFs to API partners (like Facebook). Tenor is a perfect drop-in substitute for GIPHY with over 300 million+ monthly active users and over 12 billion monthly searches. Tenor and GIPHY are used interchangeably by Facebook and Facebook’s rivals. The primary beneficiary of any “foreclosure” move by Facebook would be Google’s Tenor, without any benefits to Facebook. Lastly, Facebook has already committed publicly to keeping GIPHY open, and has offered long-term agreements to that effect to GIPHY’s large API partners. Pre-commencement of the CMA’s investigation, only [3] took Facebook up on the offer, which shows that no one in the marketplace has real-world foreclosure concerns. No more is required to conclude that Facebook has neither the incentive nor the ability to foreclose its rivals from access to GIF content.

1.5 Further in this executive summary, and in more detail in this paper, we will explain that there was no realistic prospect of the Transaction resulting in a substantial lessening of competition (“SLC”) and, a fortiori, that both theories of harm fall short of the balance of probabilities evidentiary threshold at Phase 2. In short, the evidence does not support a conclusion that it is “more likely than not” that GIPHY would have evolved into a competitive constraint on Facebook in the ads market in the U.K. but for the acquisition. It also does not credibly support a conclusion that it is “more likely than not” that Facebook would foreclose rivals from access to GIPHY such that this
would have materially affected their social media and/or advertising services thereby resulting in an SLC in the U.K.

B. Overview of the Parties’ activities

1.6 **GIPHY** is an online database and search engine that allows users to search and share GIFs and GIF stickers. GIFs\(^3\) are short, looping, soundless videos (typically, 2-5 seconds) that are used to convey emotions or to demonstrate an understanding of popular culture.\(^4\) A so-called GIF ‘sticker’ is essentially the same as a GIF where at least 20% of the pixels in the first frame are transparent. Neither GIPHY nor Facebook differentiate between GIFs and GIF stickers in the ordinary course of business. Users can access GIPHY’s database for free on its website or by downloading the GIPHY app on a mobile device. Users can share GIFs with their contacts (e.g., by email, text message, messaging apps or social media) and/or save GIFs to the internal memory of their device or to their GIPHY account.

1.7 In addition, GIPHY offers an Application Programming Interface (“API”) that allows third party app developers (e.g., Instagram) to access GIPHY’s services from within their apps.\(^5\) The API enables users of the third-party services to search and share GIFs directly within the host app without having to open GIPHY’s own website or app. GIPHY does not charge any fees to its API partners for this integration. GIPHY is not active in social media; nor does it intend to enter this area. GIPHY’s only (very limited) revenues were generated from paid alignment services in the U.S., whereby brands that wished to promote their brand via GIFs (“Brand Partners”) could pay to align their GIFs with popular search terms or insert them into GIPHY’s ‘trending’ feed.

1.8 **Facebook** is not active in the supply of GIFs or GIF stickers. Facebook was founded in 2004 with a mission to give people the power to build communities and bring the world closer together. The Facebook group offers various products and services that help people connect to their friends and family, find communities, and grow businesses. Facebook offers users a broad range of innovative services covering social media, messaging, virtual reality, video and VoIP calling and enterprise solutions.

C. Deal rationale

1.9 As evidenced by its internal documents, Facebook’s rationale for acquiring GIPHY is as simple as it is procompetitive.

(a) **Sustain GIPHY.** At the time of the acquisition, GIPHY was operating at a monthly average loss of c. $3\times10^6$ and $3\times10^6$. Since Facebook had integrated GIPHY’s content via its API into Facebook’s core services, Facebook risked losing access to GIPHY before Facebook could procure an alternative source of supply.

(b) **Enhance user experience.** Owning GIPHY would allow Facebook to enhance the Facebook user experience of GIPHY’s services by significantly investing in additional GIPHY services, introducing improvements and new features.

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\(^3\) Graphic Interchange Format.

\(^4\) A large number of GIFs are clips from popular TV shows.

\(^5\) An API is the software interface that allows users to use and navigate around mobile apps.
enabling Facebook to share its context data with GIPHY and further integrating GIPHY’s library into Facebook’s services.

(c) **Integrate talent.** GIPHY’s team was a good fit for Facebook, who were passionate about and experienced in culturally-relevant content, and were mostly based in New York, where Instagram maintains a large presence.

D. **Jurisdiction**

1.10 As GIPHY generated no revenues outside the U.S., the turnover test is not met. The Phase 1 Decision hypothesizes that the Parties might have a share of supply of at least 25% in the U.K. in relation to either: (1) the supply of apps and/or websites that allow U.K. users to search for GIFs (“Jurisdictional Ground 1”); or (2) the supply of searchable libraries of animated (i.e., non-static) stickers (including both GIF and non-GIF stickers) provided direct to users (“Jurisdictional Ground 2”).

1.11 The CMA does not have jurisdiction to investigate the Transaction on either of these bases for the following reasons:

(a) **The Transaction has insufficient U.K. nexus.** GIPHY has never had assets, personnel, customers or revenues in the U.K. GIPHY’s only revenue-generating activities were paid alignment services and these only took place in the U.S. The U.K. nexus to the Transaction is therefore based on nothing more than the unremarkable fact that people in the U.K. can access the internet. In this regard, nothing distinguishes the nexus that the CMA claims from any country in the world with internet access (or from any other transaction in which U.K. users can access the internet). Parliament cannot have intended this outcome, which both fails to respect international comity and erodes business certainty. Indeed, the Enterprise Act 2002 (the “**Enterprise Act**”) applies to “**enterprises ceasing to be distinct**” and defines an “**enterprise**” as a business that supplies goods or services “**otherwise than free of charge**” – a definition that GIPHY does not meet as regards its U.K. activities.

(b) **The CMA has failed to identify a reasonable description of services where the Parties have overlapping activities.** Neither of the CMA’s jurisdictional grounds is a reasonable (or even plausible) description of services in the U.K. Rather, the CMA’s descriptions of services are arbitrary, irrational and gerrymandered to provide the CMA with some basis to claim jurisdiction over a Transaction that is clearly vertical in nature and therefore, absent meeting the turnover test, squarely outside the scope of the CMA’s jurisdiction.

(c) **Facebook does not offer its own GIF search functionality.** The CMA has committed a fundamental error of fact in asserting that Jurisdictional Ground 1 might be met because users of Facebook’s apps and/or websites search for GIFs. Facebook does not have a searchable GIF library; nor does it have its own GIF search functionality. Facebook’s services interface with GIPHY (and other third-party GIF providers) to allow users to access those third parties’ GIF libraries without leaving the host app (e.g., Instagram, WhatsApp, etc.); GIPHY’s search engine cannot both be a vertical input into Facebook’s services and a horizontal overlap. Accordingly, there can be no overlap in relation to these activities and no increment to GIPHY’s share of supply.
(d) The CMA has failed to properly account for other suppliers of GIFs and animated stickers. Even if one were to accept the CMA’s gerrymandered description of the “overlapping” goods and services as being reasonable, the CMA’s calculation of its shares of supply in relation to both Jurisdictional Ground 1 and 2 is plainly flawed. The CMA has, without explanation, failed properly to account for Google in its calculations, which is by some considerable margin the largest repository of GIFs and stickers in existence and includes the entire searchable libraries of GIPHY, Tenor, Gfycat and others. The CMA has also failed to properly account for other suppliers of GIFs and animated stickers, including -- inexplicably -- Apple, the second major mobile operating system in the U.K. (and in the world), which plainly constitutes a significant source for GIF and sticker searches (and which the Phase 1 Decision suggests accounts for only a negligible share of supply).

E. Counterfactual

1.12 Rather than assessing the Transaction’s competitive effects against the pre-merger conditions of competition, the Phase 1 Decision identifies two highly implausible alternative counterfactuals that the CMA alleges are ‘realistic’: (1) GIPHY would have secured sufficient revenue through external investment and/or paid alignment business to maintain and even grow its activities on an independent basis; or (2) GIPHY would have been acquired by an alternative purchaser, “possibly another social media platform”. In Phase 2, the CMA must choose the most likely counterfactual. However, neither of these alternatives to the pre-merger conditions of competition is plausible.

1.13 With respect to GIPHY’s chances but for the acquisition, the Phase 1 Decision rests upon a series of speculative assumptions and counterintuitive inferences that do not correspond to the commercial reality. In fact, no speculation is required at all, because there is a real-world market test. GIPHY was up for sale. The Phase 1 Decision seeks to amplify GIPHY’s marketing materials designed for prospective investors, whilst ignoring the quantitative reality of plummeting external investment, of missed revenue forecasts, muted revenue growth and . The evidence before the CMA is unambiguous: absent the Transaction, GIPHY would have continued in survival mode and operated in a significantly pared-back form.

(a) GIPHY had failed to secure adequate investment or sufficiently monetise its services. Seven years after inception, GIPHY had generated of advertising revenues in 2019, all in the U.S., which if transposed to the U.K. would equate to approximately share of a domestic online advertising market. – a prerequisite for developing a “display” advertising business. The COVID-19 pandemic exacerbated these structural weaknesses as GIPHY’s paid alignment revenue streams dropped, which made sufficient external investment even more unrealistic.

(b) No other purchasers expressed an interest in acquiring GIPHY. The Parties have explained at length the process leading up to the sale of GIPHY to Facebook. While known to the CMA, this history and context is notably absent from the Phase 1 Decision. The CMA’s analysis appears to stop shortly after the point in time at which GIPHY’s advisors invited initial expressions of interest, failing to attribute any weight to the ensuing months during which those . The simple fact is that over the course of a months-long sales process run
by one of the world’s premier investment banks, Facebook was the [✓] to express a firm interest in acquiring GIPHY, let alone to proceed to exclusive negotiation or sign a term sheet.

F. No loss of potential competition in “display advertising”

1.14 The CMA ruled out a theory of harm in relation to a loss of potential competition in social media in the Phase 1 Decision. However, the Phase 1 Decision posits a theory of harm that the Transaction may (1) reduce GIPHY’s incentives to continue with ongoing efforts towards expansion and/or (2) lessen future competition between Facebook and GIPHY. Yet, the CMA’s surviving theory of harm appears to morph during the course of its exposition in the Phase 1 Decision from a potential loss of competition between Facebook and GIPHY to a potential loss of competition between Facebook and its social media rivals. This theory of harm is both muddled and lacking any realistic evidence.

(a) The Phase 1 Decision fails to consistently apply the relevant frame of reference. The CMA is dancing on the pinhead of its own narrow market definition. The Phase 1 Decision is at pains to describe GIPHY’s paid alignments services as “digital advertising” and not as “display advertising”. It purposefully avoids stating a plain fact: GIPHY’s experimental and meagre paid alignment services are not “display advertising” services under the CMA’s own market definition. Facebook offers brands and customers space to display their ads, customised to the end-user, with a “click-through” return on investment (i.e., users click on advertisements). By contrast, GIPHY’s experimental paid alignment services gave Brand Partners the possibility of creating generic brand recognition by aligning their GIF content with one or multiple search terms and/or pinning it to the trending feed on GIPHY’s website. Thus, under the CMA’s market definition, GIPHY’s service is a search advertising product. Indeed, even if a user wanted to “click through” a sponsored GIF of, say, a Pizza Hut image, there would be no mechanism to do so. The user could not click on the ad (i.e., the GIF) and reach the Pizza Hut website, and GIPHY certainly could not help Pizza Hut track whether the user ordered a pizza. The CMA does not need to take Facebook’s word; all the CMA needs to do is look at GIPHY’s for all the evidence it needs on this question.

(b) GIPHY as a competitor to Facebook can only be sustained as part of a broader “digital advertising” frame of reference. Even if the CMA were to ignore the evidence above, and instead, to conclude that GIPHY’s experimental paid

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6 The CMA relies on its own findings from the July 2020 Market Study into Online Platforms and Digital Advertising to assert that online and offline, and display and search advertising, constitute separate frames of reference with limited substitutability, although that study did not carry out a formal market definition exercise. The Parties consider that the CMA’s approach to market definition is inappropriately narrow.

7 Phase 1 Decision, para. 163.

8 Phase 1 Decision, paras 164(a), 167, 169, 175.

9 As explained in Section 6, Facebook disagrees with the CMA’s narrow product frame of reference. If the CMA rightly accepts Facebook’s submissions on the correct product frame of reference, Facebook would have a much lower share and any potential increment from the Transaction would be utterly trivial.
alignments service could -- one day in the future, in the most implausible of
counterfactuals -- rise as a challenger to Facebook in the advertising space, the
CMA would also have to demonstrate that GIPHY was set to compete with
Facebook in a way that hundreds or even thousands of other advertising
competitors could not, and that Facebook had market power as part of a broader
digital advertising frame of reference (which includes Google and Google’s
Tenor). In other words, the CMA would have to show that Facebook’s
elimination of [취] would somehow “substantially lessen competition” across
the digital advertising space more broadly in the U.K., a space that -- if it is
broad enough to include GIPHY -- is certainly broad enough to include a
multitude of other ad offerings that already apply competitive constraints on
Facebook, or could in the future. The CMA has not attempted to put forth a
plausible theory on these facts -- nor could it. In summary, either GIPHY’s
experimental ads model did not compete with Facebook’s offering, or if it did,
it was one of hundreds or even thousands of actual or would-be competitors, and
the elimination of GIPHY could not possibly have “substantially lessened”
competition in any conceivable advertising market. The CMA cannot have it
both ways and, in either scenario, the CMA’s case cannot be sustained.

(c) The Phase 1 Decision fails to explain any causal link between the use of
GIPHY’s paid alignment services and an SLC in “display advertising” in the
U.K. Notwithstanding the inconsistency in applying the CMA’s own market
definitions, the Phase 1 Decision fails to explain the mechanism through which
GIPHY offering paid alignment services in the U.K. (hypothetically, in the
future because it did not actually offer such services outside the U.S.) would
have resulted in an SLC in “display advertising” in the U.K. The CMA does
not establish with any specificity how it considers this non-existent competition
would have arisen. It is not clear if it is supposed to have occurred through
indirect competition between Facebook and GIPHY, as a result of GIPHY
figuring out how to do what it had not done for the duration of its existence:
establishing revenue share agreements to offer paid alignments on API partner’s
messaging services. Or perhaps it was supposed to arise because the
competitive position of API partners themselves in display advertising would
change as a result of access to a share of revenue from GIPHY’s paid
alignments? This, too, is unclear, and unexplained.

(d) The Phase 1 Decision fails to logically consider each of the steps necessary
for its TOH to transpire. As a matter of simple probability, the longer the chain
of hypothesized events that would need to transpire in order for the CMA’s
theory of harm to materialize, the less likely the CMA’s conclusion becomes.
For the CMA’s loss of potential competition theory of harm to succeed, on the
balance of probabilities, each of the following events would need to be highly
likely, absent the Transaction:

1. **GIPHY would need to have obtained significant external funding.** In
   the midst of a global pandemic, and [취] \(^{10}\), and after having [취], the
   CMA’s loss of potential competition rests on an unsupported hypothesis

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\(^{10}\) [취]
that GIPHY would have obtained significant additional external funding to invest in its (unproven) paid alignment revenue generating activities.

2. **In addition, GIPHY’s significant API Partners would need to have entered into revenue share agreements, including Facebook.** If GIPHY’s traffic comes from its API partners and over half of that is delivered from Facebook’s services. Absent a revenue share agreement, GIPHY makes no money from this traffic and to do so, it would need the cooperation of its API partners.

3. **In addition, GIPHY would need to have successfully expanded its paid alignment services internationally, including into the U.K.** Consistent with the reality of GIPHY’s fundamental business model, the.

4. **In addition, GIPHY would need to have become a significant player as part of a broader digital advertising frame of reference in the U.K.** As explained above, if GIPHY’s experimental paid alignments and Facebook’s advertising services are deemed to compete, such competition would not form part of the CMA’s narrow definition of “display advertising”, but rather any competition would take place within (at least) a broader “digital advertising” frame of reference. Not only does Facebook not have market power under a broader definition in which the Parties compete, the Phase 1 Decision’s conclusion that Facebook’s acquisition of a player that might reach a 0.01% share could result in an SLC in the supply of digital advertising in the U.K. is extraordinary on this basis alone. The absurdity is all the more apparent given the conclusions of the CMA’s own market study (which Facebook disagrees with) which suggests there are significant barriers to entry in the U.K. digital advertising market. Either it is the case that meaningful and disruptive competition can come from anywhere (in which case GIPHY is nothing special) and Facebook is disciplined both by many existing competitors, as well as by constant threat of new entry, or it is the case that GIPHY’s potential entry could not have a meaningful competitive impact on Facebook. But both cannot be simultaneously true.

5. **In addition, GIPHY would need to have succeeded in monetising messaging with advertising where all others had failed.** This theory of harm is predicated on the conclusion that paid alignment services were actually the secret sauce for monetising messaging via ads. The Phase 1 Decision in effect concludes that GIPHY’s investors and its API partners had simply failed to see what the CMA has discovered: GIPHY was the key to monetising messaging with ads at scale. This was manifestly not the market reality. And, if there was any prospect of it being the key to monetising messaging at scale, one would have expected a valuation in the billions, or tens of billions, thereby reflecting its value as the unicorn company finally capable of solving this conundrum. Moreover, on the off chance that might miss the importance of monetizing messaging, GIPHY’s investment bankers expressly pitched GIPHY as a potential solution to that intractable problem.
G. No vertical effects through the foreclosure of rival services

The Phase 1 Decision finds that the Transaction may give rise to vertical effects through the foreclosure of “social media” services. More specifically, the CMA considers that the Parties would have the ability and incentive to engage in one or more total or partial foreclosure strategies to the detriment of Facebook’s rivals. The CMA’s concerns are unfounded and fundamentally at odds with the evidence.

(a) **Rivals are able to switch away from GIPHY to GIF alternatives.** A vertical foreclosure strategy can only succeed if there are no viable alternatives to the relevant input to which access is foreclosed. As the Phase 1 Decision notes: Tenor is a “significant competitive alternative to GIPHY”. In fact, Tenor is simply the largest of these alternatives to GIPHY. There are also numerous other GIF providers, including Imgur, Gifbin, Gfycat, and Vlipsy, all of which offer a similar service to GIPHY and are free to use.

(b) **Tenor is not just an alternative, but is a perfect substitute for GIPHY.** In a white paper submitted to the CMA on 22 January 2021, Facebook analysed evidence from a loss of GIPHY and Tenor service on the Facebook Messenger surface. The analysis shows that during the time period in which GIPHY GIFs were unavailable to users on Messenger, there was almost perfect substitution with Tenor GIFs and there was no loss of overall engagement on the surface (measured by total volume of messages). This indicates that users’ behaviour did not alter as a result of losing access to GIPHY.

(c) **GIFs are not an important input for driving user engagement.** A foreclosure strategy could only be successful if, as a result, rival services’ value proposition would materially decline, which would cause users to shift away from rival services to Facebook. However, there is no evidence to support this theory and the CMA has carried out no analysis to test the importance of GIFs as an input into its partners’ services, nor the extent to which these would be harmed if they switched to using Tenor or another substitute to GIPHY. It is therefore mere speculation on the CMA’s part that GIFs are an important driver of user engagement.

(d) **Facebook would not profit from cutting rivals’ access to GIPHY.** Even if Facebook were able to successfully foreclose rivals’ access to GIFs (which it could not do), the CMA has provided no evidence that users would divert their demand away from rivals and towards Facebook, which is critical for any viable foreclosure strategy. Indeed, any attempted foreclosure would likely drive rivals and their users towards Tenor, and Facebook has no incentive to undertake actions that would only lead to increasing Tenor (and hence Google’s) profitability with no positive impact on Facebook’s own profitability.

(e) **Facebook has publicly committed to keeping GIPHY open.** Unsurprisingly, given Facebook’s lack of ability or incentive to foreclose its rivals, it has been Facebook’s consistent position from day 1 -- both privately and publicly -- that “[...] developers and API partners will continue to have the same access to GIPHY’s APIs; and GIPHY’s creative community will still be able to create

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11 See Phase 1 Decision, paragraph 234.
Facebook has reaffirmed that intention by signing a 5-year extension of GIPHY’s commitment to API partner Snapchat, and has stated that it would offer the same terms to other current and potential API partners.

H. Conclusion

1.16 Facebook did not acquire GIPHY in order to eliminate a potential rival or foreclose established social media rivals from a critical input. Facebook’s primary driver for the Transaction, as demonstrated consistently across Facebook’s internal ordinary course business documents, was to sustain a valued partner relationship in which Facebook had made significant investment, with an opportunity to maintain and enhance the experience of users across its services, working with a smart creative team of people. After 11 months of investigation, the CMA has not even managed to answer the threshold question in a merger investigation and plausibly demonstrate jurisdiction. The CMA’s theories of harm are speculative, unsubstantiated and unrealistic, and certainly cannot withstand the balance of probabilities evidentiary standard of a Phase 2 inquiry.

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2. **BACKGROUND TO THE PARTIES’ ACTIVITIES**

2.1 *Facebook*. Facebook is a publicly traded company listed on NASDAQ, with headquarters in California, U.S. of America (the “U.S.”). Facebook was founded in 2004. Its mission is to give people the power to build community and bring the world closer together. This mission is at the core of Facebook and is central to the services and features that Facebook offers and continues to develop. The Facebook group offers various products and services that help people connect to their friends and family, find communities, and grow businesses. Facebook offers users a broad range of innovative services including:

(a) **Facebook**: Facebook, available as a mobile app or on web browsers at [www.facebook.com](http://www.facebook.com), enables people to connect, share, discover, and communicate with each other on mobile devices and personal computers. There are various ways in which users can engage on Facebook, the most popular of which is News Feed which displays content and advertisements individualised for each user. Facebook is available on a variety of mobile platforms.

(b) **Instagram**: Instagram enables people to take photos or videos, customise them with filter effects, and share them with friends and followers in a photo feed or send them directly to friends. Users can also send messages (including without photos or videos), follow businesses and interests, and shop. Also, like Facebook, Instagram displays content and advertisements individualised for each user. Instagram is available on a variety of mobile platforms.

(c) **Messenger**: Messenger allows for a rich and expressive way to communicate with people and businesses alike across a variety of platforms and devices, seamlessly and securely. Messenger is available on a variety of mobile platforms.

(d) **WhatsApp**: WhatsApp is a fast, simple and reliable messaging and Voice over Internet Protocol (VoIP) calling app that is used by people around the world and is available on a variety of mobile platforms.

(e) **Oculus**: Oculus’ virtual reality technology and content solution powers products allowing people to enter a completely immersive and interactive environment to play games, consume content, and connect with others. Further information can be found at: [https://www.oculus.com/](https://www.oculus.com/).

(f) **Portal**: Facebook’s Portal family of video-calling devices rely on AI technology to make video calling easier and feel more like hanging out in the same room, with a widescreen display that lets users enjoy every moment together. Portal’s Smart Camera automatically pans and zooms to keep everyone in view, and its Smart Sound technology minimises background noise and enhances the voice of the person talking.

(g) **Workplace**: Workplace is Facebook’s enterprise offering that is available for use by organisations around the world, helping them to run their company and keep co-workers connected.

2.2 Facebook offers most of its services free to users globally and in the U.K. Facebook’s primary revenue-generating activity is offering advertisement space to third parties,
which currently accounts for the vast majority [>] of its annual revenues globally. The remaining revenues derive primarily from: the net fee that Facebook receives from third party developers using Facebook’s payments infrastructure when Facebook users purchase virtual goods within those third-party apps (e.g., games and other services) on Facebook and, the sale and delivery of consumer hardware devices (such as Oculus Rift and Oculus Quest headsets).\textsuperscript{13}

2.3 \textit{GIPHY.} 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 (together referred to as a “GIF” or “GIFs” in this Initial Submission).

2.4 A GIF (Graphic Interchange Format) is a short, looping, soundless video (typically, 2 – 5 seconds) which can be used to expressively convey emotions or as a way of demonstrating an understanding of popular culture (with a huge number being clips from TV shows). A GIF sticker is a GIF file in relation to which at least 20% of the pixels must be transparent in the first frame.

2.5 Users can access GIPHY’s database for free on its website (\texttt{www.giphy.com}) or by downloading the GIPHY app on a mobile device. Users can search for and share GIFs from the GIPHY website or app with their contacts on messaging apps (e.g., email, iMessage or WhatsApp), social media services (e.g., Twitter, Snapchat, or Facebook), and/or save GIFs to the internal memory of their device or to their account if they are a registered user and logged-in.

2.6 In addition, GIPHY has created an API that allows third party app developers (e.g., Snapchat, TikTok or Instagram) to access the GIPHY services from within their apps.\textsuperscript{14} This enables users to search and share GIFs directly within the host app without having to open GIPHY’s own website or app. GIPHY does not charge any fees to its API partners for this integration.

2.7 In 2019, GIPHY generated global revenues of [>]. Of this, [>] was generated from paid alignment, and [>] was generated from providing creative production services (e.g., GIF/sticker design) to advertisers. GIPHY does not have any paid alignments nor did it generate any revenues in the U.K. in 2019. Even if paid alignment GIFs can be viewed by U.K. users, these are not monetised. Further information regarding GIPHY can be found at: \texttt{https://giphy.com/}.

\textsuperscript{13} Facebook also currently charges third parties for use of the WhatsApp Business Solution, which enables large businesses to manage high volumes of communications with WhatsApp consumer users on the WhatsApp Network. This charge is based on the number of template messages (i.e., notifications) delivered via the WhatsApp Business API.

\textsuperscript{14} An API is the software interface that allows users to use and navigate around mobile apps. 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.
3. TRANSACTION RATIONALE

A. Facebook’s rationale for the Transaction

3.1 GIPHY provides its API integration to Facebook’s services, including in the Facebook App, Messenger, Instagram, and WhatsApp. GIFs are used across Facebook’s surfaces and help to drive user engagement on the Instagram service in particular. In fact, Facebook is by far GIPHY’s largest API partner, accounting for more than [X%] of GIPHY’s global traffic. Facebook’s rationale for acquiring GIPHY comprised the following principal elements:

(a) **Sustain GIPHY** – at the time of the acquisition, GIPHY was operating at a [X%]. Facebook had concerns about GIPHY’s viability, given the decline in online advertising markets due to COVID-19 and GIPHY’s apparent difficulties establishing a sustainable monetisation model. Since Facebook had integrated GIPHY’s content via its API into Facebook’s core services, there was a risk that losing GIPHY before Facebook could develop an alternative source of supply (in addition to Google’s Tenor) would negatively impact user experience across Facebook’s services in the near term, and in a manner that justified the purchase price but was small in absolute terms relative to Facebook’s revenues.

(b) **Enhance user experience** – Facebook wants to enhance the user experience of Facebook and GIPHY services by significantly investing in additional GIPHY services and additional integration of GIPHY’s library into Facebook’s services. The Transaction will allow Facebook to co-operate more closely with the GIPHY team than it could under a purely arm’s length relationship, thereby enabling Facebook to develop and/or launch additional features and deliver more relevant content to its users.

(c) **Integrate talent** – Facebook was impressed with the quality of GIPHY’s team, in particular its creative production specialists, who were passionate about and experienced in culturally-relevant content. The addition of the GIPHY team would accelerate Facebook’s efforts around other creative expression use cases across its services. The location of the GIPHY team (primarily in New York) is also where Instagram has a large presence.

B. GIPHY’s rationale for the Transaction

3.2 GIPHY’s rationale for the Transaction was to continue operations with access to sufficient funding. Prior to the Transaction GIPHY had engaged with an investment banking deal team at JP Morgan to conduct a formal evaluation of its opportunities to raise financial capital through an external raise, external (debt) financing, a commercial partnership deal, or M&A opportunities (i.e., acquisition by a third party). Fundraising prospects were jeopardised by the Coronavirus (COVID-19) pandemic, which delayed fundraising processes, and concurrently resulted in a significant drop in advertising spend and higher infrastructure costs, and as such, GIPHY pursued its options for a sale.

3.3 As explained in more detail below (see the Counterfactual section) [X%] prior to the Transaction. GIPHY believes that [X%], or would only have been able to raise sufficient external funding to operate under a significantly restricted business model, if it had not
been acquired by Facebook in May 2020.\textsuperscript{15} Indeed, it was GIPHY who approached Facebook for an acquisition (as it did other potential partners) in order to obtain access to capital.

\textsuperscript{15} See Annex 008, submitted as part of the Merger Notice.
4. **The CMA Lacks Jurisdiction to Review the Transaction**

A. **Introduction**

4.1 Facebook and GIPHY are not horizontal competitors and are active at different levels of the supply chain. Facebook is an API partner of GIPHY, meaning that GIPHY allows Facebook, including Facebook, Instagram, Messenger and WhatsApp, to access GIPHY’s services from within the host app. This enables Facebook users to search and share GIFs from GIPHY’s database without having to open GIPHY’s own website or app.

4.2 As noted above, GIPHY provides users with a searchable library of GIFs and GIF stickers.16 This library can be accessed either (1) directly via GIPHY’s website or by downloading the GIPHY app on a mobile device, which allows users to send GIFs to contacts by email, text message or via messaging apps17; or (2) indirectly via an API partner’s app (e.g., Facebook, Snap and Twitter), which allows users to send GIFs to contacts on the messaging app in question. Importantly for the purposes of jurisdiction, GIPHY is neither active in social media nor in display advertising, as confirmed by the Phase 1 Decision.18

4.3 By contrast, Facebook does not have a searchable library for GIFs and/or GIF stickers. Facebook is active in the supply of social media services as well as in the supply of display advertising.19

4.4 As noted in the Phase 1 Decision, Facebook also has a very small number of non-GIF stickers that are available on Facebook.com.20 Distinct from the animated GIF stickers available on GIPHY, the non-GIF stickers available on Facebook.com are both animated and non-animated, are different in nature and serve different purposes, and can only be sent to contacts within the Facebook ‘family’ of apps and messaging services.

4.5 The CMA does not have jurisdiction to review the Transaction for the following reasons:

(a) **The Transaction has insufficient U.K. nexus.** GIPHY is based entirely in the U.S. In the U.K., it has no assets, personnel, customers or revenues. GIPHY’s only (minimal) revenue-generating activity is paid-alignment services and these only take place in the U.S. Therefore, the U.K. nexus to the Transaction is nothing more than that people in the U.K. can access the internet. In this regard,

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16 As noted above, GIFs and GIF stickers are virtually identical. GIFs stickers are animated GIF files where at least 20% of the pixels are transparent in the first frame.

17 This is not a direct send. User must download and/or copy the link for sending in a different service.

18 The Phase 1 Decision does not conclude anywhere that there is an overlap on this basis.

19 Facebook does not accept that these activities constitute their own relevant markets and disagrees with the CMA’s conclusions as set out in its Market Study into online platforms and digital advertising where the CMA did not undertake a formal market definition exercise.

20 In concluding that there is no realistic prospect that GIF stickers and non-GIF stickers are part of the same frame of reference, the CMA also noted that (1) other social media platforms (i.e., GIPHY’s customers/API partners) did not consider GIF stickers to be substitutable with other stickers; and (2) non-GIF stickers are supplied by different suppliers to those that supply GIF stickers.
nothing distinguishes the nexus that the CMA is attempting to establish from any country in the world with internet access. It cannot have been Parliament’s intention that the CMA should have such extraordinarily pervasive jurisdictional powers to intervene in non-U.K. M&A activity.

(b) Neither the turnover test nor the share of supply test is met. It is accepted that, as GIPHY generates no turnover outside the U.S., the turnover test is not met. In the Phase 1 decision, the CMA hypothesises that the share of supply test might be met on either of two alternative bases: (1) the supply of apps and/or websites that allow U.K. users to search for GIFs; or (2) the supply of searchable libraries of animated (i.e., non-static) stickers, provided direct to users in the U.K. (including both GIF and non-GIF stickers). Neither of these is a reasonable description of services in the U.K. and, in any event, the CMA’s calculation of these shares of supply is fundamentally flawed, as demonstrated below.

B. The Transaction has insufficient U.K. nexus

4.6 The merger control provisions of the Enterprise Act apply to “relevant merger situations”. A relevant merger situation is deemed to occur (in relation to completed mergers) where the following conditions are satisfied:

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

(b) either:

(i) the value of the target enterprise’s U.K. 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 U.K. (or a substantial part of the U.K.) of 25% or more in relation to goods or services of any reasonable description (the share of supply test).

4.7 These are cumulative conditions. Therefore, the first issue that must be addressed is whether two or more “enterprises” have ceased to be distinct. If they have not, the CMA’s jurisdictional assessment ends there.

4.8 The Enterprise Act defines an “enterprise” as “the activities, or part of the activities, of a business” and defines “business” as “a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge” (emphasis added). GIPHY does not supply any services in the U.K. “otherwise than free of charge”. Indeed, GIPHY’s services in the U.K. are provided entirely free of charge. Accordingly, GIPHY does not fall within the definition of an “enterprise” and the Transaction does not result in a “relevant merger situation” within the meaning of the Enterprise Act.

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21 Section 23, Enterprise Act.
22 Section 129, Enterprise Act.
4.10 More generally, it was clearly Parliament’s intention for the target to have a presence in the U.K.; either the target has substantial U.K. turnover or it is active in the supply of goods or services in the U.K.. As explained by the Court of Appeal in Akzo v Competition Commission, the Enterprise Act seeks to ensure that there are sufficient “connecting factors between targets of regulatory action and the U.K. which make it appropriate, rather than exorbitant, for the particular jurisdiction in question to be exercised over them…”23 It is plainly “exorbitant” for the CMA to have spent 10 months (and counting) investigating a transaction where the target has no assets, personnel, customers or turnover in the U.K. and where the only nexus to the U.K. is the ability to access the internet.

4.11 Finally, it is highly unattractive from a policy perspective, as well as from the perspective of legal certainty, for the CMA to stretch its jurisdiction under the Enterprise Act in this manner. In doing so, the CMA makes the application of the U.K. merger regime highly unpredictable, as it is virtually impossible for merging parties to be able to determine in advance if their transaction is likely to be reviewable by the CMA, which creates high levels of business uncertainty. Again, this is clearly contrary to Parliamentary intention.

C. The share of supply test is not met

4.12 In the Phase 1 Decision, the CMA set out its belief that the share of supply is met on two alternative bases:

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

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

4.13 A fundamental weakness in the CMA’s jurisdictional position is indicated by the fact that the CMA considered it necessary to set out two bases for attempting to establish jurisdiction. The CMA explained that “as this is a sector that the CMA has not previously examined, the CMA has considered alternatives bases”.

4.14 Facebook does not accept this. There are many historical cases in which the CMA and its Phase 1 predecessor, the Office of Fair Trading, considered sectors for the first time and did not set out multiple, potential bases for attempting to establish jurisdiction. Far more likely is the fact that the CMA has set out alternative jurisdictional bases because it recognised the weakness of its position and therefore decided to ‘hedge its bets’ in relation to how the share of supply test might conceivably be met.

4.15 Indeed, despite repeated requests to do so by Facebook, the CMA refused to engage on the issue of jurisdiction for nine months of its Phase 1 investigation, setting out its jurisdictional grounds for the first time in its Phase 1 issues paper. These are not the actions of an antitrust authority that is confident in the jurisdictional basis of its investigation.

4.16 As demonstrated below, the share of supply test is not met on either of the CMA’s alternative bases as neither is a reasonable description of services in the U.K. and, even

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in relation to this unreasonable description of services, the Parties’ share of supply of is not at least 25% in the U.K.

1. The supply of apps and/or websites that allow U.K. users to search for GIFs is not a reasonable description of goods or services

   4.17 As set out above, Facebook is not active in the supply of searchable GIF libraries. Facebook’s social media and messaging services interface with GIPHY to allow users to access GIPHY’s GIF library without leaving the host app (e.g., Instagram, WhatsApp, etc.). Accordingly, there can be no overlap in relation to these activities. As a result, the CMA has been forced to create an artificial description of services in an attempt to establish a horizontal overlap in the Parties’ activities.

   4.18 In this regard, the CMA has posited an overlap between the Parties in relation to the supply of apps/websites that allow U.K. users to search for GIFs. In this regard, users can access GIPHY’s GIFs via its website and app and users can also access GIPHY’s (or Google/Tenor’s) GIFs from within Facebook, Messenger, Instagram and WhatsApp. However, the Parties do not have a share of supply of 25% or more of apps/websites that allow U.K. users to search for GIFs as there are literally hundreds of such apps/websites. Therefore, in an attempt to establish a share of supply where the Parties might exceed 25%, the CMA has taken the average number of monthly searches for GIFs carried out on the relevant Facebook applications as well as on GIPHY and a sub-set of other GIF suppliers.

   4.19 However, the CMA’s calculations have missed a point of fundamental importance, which is that Facebook does not have its own GIF search functionality. Accordingly, Facebook users do not search for GIFs on Facebook. Facebook’s users search for GIFs on GIPHY and on Google/Tenor. For these purposes, Facebook is simply a mechanism that allows its users to access GIFs provided by GIPHY or Tenor. Accordingly, the number of U.K. users searching for GIFs on Facebook is zero and there is no increment to the share of supply test.

   4.20 To devise this overlap, GIPHY’s activities are being treated as both horizontally overlapping with Facebook (in terms of providing an access mechanism to a GIF search engine) and being vertically-integrated into Facebook’s services (in terms of providing the GIF search engine that Facebook users access to search for GIFs). However, GIPHY cannot reasonably be both of those things at the same time for the purposes of calculating a single share of supply. As a result, this construction fails and the share of supply test is not met on this basis.

2. The Parties’ combined share of supply of apps and/or websites that allow U.K. users to search for GIFs is below 25%

   4.21 Even on the basis of the CMA’s unreasonable description of services, the share of supply threshold is not met and the CMA’s calculations are flawed as it has failed to properly account for significant suppliers of GIFs, such as Google, Apple and others, which significantly understates the correct size of the denominator.

   a. The CMA has failed to properly account for Google in its calculations
4.22 In addition to owning Tenor, Google is by some considerable margin the largest repository of GIFs in existence and as the CMA is aware it includes the entire searchable libraries of GIPHY, Tenor and Gfycat. In other words, if you search for a GIF on Google, you are effectively searching the libraries of GIPHY, Tenor, Gfycat and others at the same time. However, in its calculations, the CMA has only included search results from Google Images and states that, on this basis, Google accounts for only between 0-5% of average monthly searches for GIFs in the U.K. This would imply that there were over 10 times as many searches for GIFs were made on Facebook than on Google, a result which seems inconceivable.

4.23 The Phase 1 Decision explains that the CMA has excluded all other searches made on Google on the basis that they return links to GIFs rather than directly providing a GIF. This is arbitrary and unreasonable. Simply because users would need to click on a link rather than being directly presented with a GIF the CMA considers this a sufficient basis to remove millions of search results from its denominator. Had all of these GIFs results been included in the CMA’s denominator, it is clear that the Parties would have a share of supply well below 25%.

b. The CMA has failed to properly account for other suppliers of GIFs, including Apple

4.24 In response to the Parties’ submissions at the Issues Meeting that the CMA had inexplicably failed to include GIFs sent via Apple iMessage in its calculations, the CMA has now included such GIFs but claims they account for so few searches that Apple only accounts for 0-5% of total GIF searches and this has had no effect at all on any party’s share of supply. Given that Apple has a share of over 50% of mobile operating systems in the U.K. (and that GIF functionality is integrated directly into iMessage, Apple’s default messaging service), it seems unlikely to the Parties that Apple accounts for only a de minimis number of average monthly searches.

4.25 In its Phase 1 Decision, the CMA still does not account for other established GIF providers including Imgur, Gifbin, Reaction GIFs, and others.

D. The supply of searchable libraries in animated stickers provided directly to users is not a “reasonable” description of goods or services

4.26 The share of supply of searchable libraries in animated stickers provided direct to users is an entirely arbitrary and unreasonable description of goods or services for a number of reasons.

4.27 First, for the purposes of establishing an overlap, Facebook’s stickers have been included despite the fact that their use is limited to Facebook’s own applications, which makes them fundamentally different from searchable libraries accessible to third parties like Google, GIPHY, Tenor, Gfycat, Imgur and others.

4.28 Second, it also excludes all GIFs, for which there appears to be no reasonable basis. GIFs and GIF stickers may contain exactly the same image; one is just slightly more transparent than the other. Without any other indicators, it would be very difficult to tell them apart. Indeed, on Instagram and SNAP, the button to add a GIF sticker simply says “GIF” with no reference to stickers at all.
Third, the CMA’s calculations exclude all static stickers. Again, there appears to be no reasonable basis for why the CMA has done this and no explanation has been provided in the Phase 1 Decision despite this issue having been raised with the CMA. It seems that excluding all GIFs and excluding all static stickers simply serves to significantly reduce the size of the denominator and increase the Parties’ purported share of supply.

The Parties’ combined share of supply of searchable libraries in animated stickers provided directly to users is below 25%

Even on the basis of the CMA’s unreasonable description of services, the share of supply threshold is not met and the CMA’s calculations are flawed, which has resulted in a significant underestimation of the denominator.

1. The CMA has failed properly to account for Google, Apple, Bing, and others in its calculations

The CMA has excluded all animated stickers that are not provided “direct to users”. No explanation is provided in the Phase 1 Decision as to what this arbitrary limitation means, why it has been included or why it is considered reasonable. It seems likely that this limitation has been included to ensure that Google is excluded from the denominator on the apparent basis that the millions of stickers available on Google can’t be provided “direct to users”.

Even if this were reasonable – and the Parties do not consider that it is – it is incorrect. Users can share and download stickers that they search for on Google. They simply click on the image and share it via a messaging service (e.g., Facebook or Twitter) or by email. Accordingly, it is unclear in what way they are not available “direct to users” in the same way as stickers searched for on GIPHY, Tenor or Gfycat, and no explanation for this proposition has been provided.

As already mentioned, Google is by far the largest repository of GIFs and stickers. Accordingly, their exclusion from the denominator is a fundamental omission. The CMA has also failed to include Apple, Bing, WeChat, Line and other suppliers of animated stickers.
5. **COUNTERFACTUAL**

5.1 The Phase 1 Decision departs from the default position of assessing the competitive effects of the Transaction against the prevailing conditions of competition (i.e., the continued decline of the GIPHY business). Instead, the Phase 1 Decision identifies two alternative counterfactuals:

(a) Absent the Transaction, GIPHY would have secured sufficient revenue through external investment and/or its paid alignments business to maintain and even grow its activities on an independent basis (see Phase 1 Decision, paragraphs 94-107);

(b) Absent the Transaction, GIPHY would have been acquired by an alternative purchaser, “possibly another social media platform” (see Phase 1 Decision, paragraphs 108-115).

5.2 Neither scenario is realistic. The Phase 1 Decision overlooks clear evidence that GIPHY [3<]. The Phase 1 Decision also fails to draw the appropriate inferences from a months-long sale process over the course of which Facebook was the [3<] in acquiring GIPHY. As explained in the Parties’ Phase 1 submissions, contrary to the findings in the Phase 1 Decision, the most likely counterfactual is that GIPHY would have [3<] would only have been able to raise funding to operate under a significantly restricted business model.

A. **Absent the Transaction, GIPHY would not have generated revenue or secured sufficient external investment to maintain or grow its business**

5.3 The CMA’s conclusion that GIPHY could have generated sufficient revenue on its own account or through external investment appears to rely on three principal sources of evidence:

(a) GIPHY’s modest revenue growth, the increasing volume of search queries through the GIPHY API/SDK, and the general observation that “it is common for technology businesses to take time to become profitable [as they] build a sufficient user base prior to effective monetisation” (See Phase 1 Decision, paragraphs 98-99).

(b) A handful of GIPHY-authored marketing documents in which GIPHY expressed “optimis[m] about its monetisation options” (See Phase 1 Decision, paragraph 96) and isolated Facebook documents describing purely hypothetical ways to monetize GIFs in the event that Facebook acquired GIPHY (See Phase 1 Decision, Paragraph 97) [3<].

(c) A “long list” of possible third-party investors drawn up by GIPHY’s external financial advisors prior to GIPHY commencing its unsuccessful late 2019-2020 funding round (See Phase 1 Decision, Paragraphs 104-106).

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24 See for example, the documents named: ‘Project Tabby XFN Kickoff_updated_VS.pptx’; ‘Annex 010.5 - Request for Approval’; ‘Annex 010.6 - Project Tabby kickoff’; ‘Annex 010.9- Project Tabby Value Analysis’ and a document with the ID TABBY_FTC_000000241.pdf.
5.4 The Phase 1 Decision therefore ignores ample, real-world evidence of GIPHY’s frustrated attempts to develop a sustainable revenue model and the company’s lack of success in generating external investment in the period 2019-2020.

5.5 **GIPHY was a [X].** Prior to the Transaction and since inception, GIPHY was a [X]. Whilst GIPHY’s turnover had grown year-on-year, the [X]and in fact had been operating [X]just prior to the start of the COVID-19 pandemic. [X]. GIPHY had been operating for seven years at the time of the Transaction. It was sold for a [X]after seven years and [X]investment.

5.6 **GIPHY was reliant on users of third-party services.** The Phase 1 Decision describes the “common” scenario in which a technology business invests at a loss in developing a base of captive users, which it hopes to monetize at a later date. This betrays a fundamental misunderstanding of GIPHY’s offering. GIPHY bears no resemblance to the brief selection of digital companies footnoted in the Phase 1 Decision in support of this simplistic analogy. GIPHY is an input provider, supplying plug-in content to companies, including Slack, Snap and Facebook. It is reliant on these downstream services. [X] of all users that interact with GIPHY’s services interact in third-party environments (i.e., on Facebook, on Snapchat, on Tiktok). These are Facebook, Snapchat, Tiktok, etc., users, not GIPHY users. GIPHY in fact had a very small owned and operated (“O&O”) user base as compared to its API traffic. As a result, the [X]. Indeed, Facebook’s internal documents recognized this shortcoming, identifying it as an [X].

5.7 GIPHY contemplated aspirational initiatives, such as GIPHY Messenger, in large part in order to show investors that it was seeking to increase its O&O user traffic. However, as explained in paragraph 18.4 of the Merger Notice, GIPHY soon abandoned plans for GIPHY Messenger as the company realised that it did not have a user-base that would make sufficient use of it, let alone the resources (or expertise for that matter) to build a robust messaging product or thereafter grow its user base in any significant way. Other O&O products that GIPHY did launch in attempts to gain user traffic had failed to gain traction. GIPHY allocated substantial capital and resources, for example, to products aimed at making its O&O products an entertainment destination. None of these attempts had successfully scaled, and since 2018 GIPHY’s O&O traffic has stagnated, despite substantial team-wide efforts to grow O&O products.

5.8 **GIPHY could not demonstrate that a revenue-sharing API-dependent model was sustainable.** Without its own user base, GIPHY’s only prospect for generating meaningful revenues was to find a way of splitting revenue with the third-party services on which it was dependent. (Although the Phase 1 Decision acknowledges these assumptions regarding the willingness of API Partners to share their revenues with

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25 Facebook’s internal documents make abundantly clear, Facebook had [X]: “[X]”. In Facebook’s estimation, GIPHY had been unable to monetise user traffic effectively on an independent basis, which called into question the company’s long-term viability. See page 1, Annex 010.05 submitted with the Merger Notice (email of 1 April, 2020, sent by N. Blumberger to M. Zuckerberg, S. Sandberg, D. Wehner).

26 See Nir Blumberger’s comment that: “[X]” in TABBY_FTC_000000234. Further, Facebook considered GIPHY’s ability to expand its monetisation efforts. Facebook considered “[X]” in estimating future monetisation opportunities, Facebook’s internal valuation exercise concluded that “[X]”. See Annex 010.09 submitted with the Merger Notice.
GIPHY (see Phase 1 Decision, paragraph 95), the Phase 1 Decision fails to critically assess their implications for the reliability of GIPHY’s revenue projections.) Since the overwhelming majority of GIPHY traffic existed on its API partners’ services, GIPHY’s revenue-generating strategy effectively relied on monetising the actions of consumers of third-party services. For servicing its paid alignment contracts, it was necessary for GIPHY to utilise third party inventory (i.e., user traffic) for generating impressions on promoted GIF content in order to meet contractually agreed targets. GIPHY had a handful of Revenue Sharing Agreements and, as part of which, GIPHY paid those API partners for the use of their inventory to service GIPHY’s paid alignment agreements.

5.9 Allowing an outside vendor like GIPHY to control any form of advertising within their services, in a way that generates significant revenue, is largely unprecedented among the large services GIPHY relied on for the large majority of its API distribution. Such partners have no reason to share revenue with a third party or experiment with unproven forms of advertising when the service has the ability to keep 100% of revenue from its existing and proven products. Revenue generation for GIPHY was simply not the value-add to GIPHY’s larger API partners. Rather, as explained to the CMA in the Merger Notice, the principal value-add of GIPHY is to supply features that enhance user experience and drive user engagement.27

5.10 Nonetheless, in order to demonstrate its long-term ability to survive independently, or to convince investors of such ability, GIPHY needed to demonstrate the viability of an advertising business model dependent on sustainably and scalably monetizing its API. [\textsuperscript{3X}].

5.11 \textbf{GIPHY could not provide traditional advertising return on investment (“ROI”), audience data and advertising metrics for proof-of-concept.} Furthermore, because GIPHY lacked a meaningful user base of its own, it was unable to provide the recognizable constituent elements of a robust digital advertising business. Advertisers on digital media monitor closely the ROI from specific advertising opportunities. GIPHY’s paid alignment products (whether existing on its O&O products or on its API partners’ services) did not demonstrate traditional digital advertiser ROI:

(a) First, paid alignments did not offer so-called “direct response” ads, whereby a user performs a specific action in response to being shown the ad with the advertiser able to track the tangible economic value of that action (e.g., the user clicks the ad in order to buy a product).

(b) Second, GIPHY’s third party API ensured that it could provide a GIF search engine, not an advertising service. As a result, it was unable to supply basic audience data (which other services that own their inventory are capable of supplying) and, critically, it was unable to control third-party app environments and user experiences where promoted GIF content could run (since this would have to be implemented by its API partners on their services, not GIPHY’s).28


\textsuperscript{28} GIPHY was not able to control the user experience on such third party websites and applications which meant that including the necessary advertising disclosures on GIFs and digital stickers would have to be
Finally, even on its O&O products, GIPHY did not collect the most basic data about its users to target advertisements in any way, which was becoming problematic as GIPHY sought to secure bigger advertising budgets.

As a result, GIPHY could not provide a compelling paid alignment offering that would enable it to sell hundreds of millions of dollars (or more) of such ads each year.

COVID-19 exacerbated structural weaknesses in GIPHY’s revenue model. [\textgreater{}\textless{}], not least because the COVID-19 pandemic substantially affected the market for new and unproven advertising products like those GIPHY could offer. [\textgreater{}\textless{}]. This was coupled with rising infrastructure costs from heightened COVID-19 internet activity, both of which substantially weakened GIPHY’s financial position and cash runway trajectory.

The same factors substantially undermined external investor interest. The COVID-19 pandemic disrupted financial markets and created a very challenging macroeconomic environment, damaging external investor interest more generally. As explained in the Merger Notice,\textsuperscript{29} as a result of the pandemic and GIPHY’s monetisation challenges, GIPHY struggled to secure investment interest in its last funding round prior to the Transaction.

Of course, even if GIPHY were able to secure limited funding from investors on the basis of a lower company valuation, given the limited level of external funding, GIPHY would have been forced to scale-back its plans and operate on a reduced budget, with fewer employees. [\textgreater{}\textless{}].

For all of these reasons, the Parties submit that it is entirely implausible to suggest that GIPHY would have continued to generate revenue anything more than insignificant revenue via its paid alignments revenue stream, as it had pre-Transaction, and that this revenue stream would have continued to grow, absent the Transaction. GIPHY’s internal documents, to which the CMA points, must be understood in their proper context, namely as fundraising documents aimed at potential investors in which GIPHY is offering in reality the unlikeliest, but most ambitious best-case scenario regarding its prospects of success and future growth trajectory. The aspirational nature of these documents is obvious and it is equally obvious that [\textgreater{}\textless{}] and the impact on advertising markets caused by COVID, GIPHY would most likely not have been able to continue to generate material levels of revenue via its paid alignments revenue stream.

B. There was no realistic prospect of an alternative purchaser emerging for GIPHY

The Phase 1 Decision finds that absent the Transaction, GIPHY would have been acquired by an alternative purchaser, “possibly another social media platform” (See Phase 1 Decision, paragraph 109). The conclusion is based largely on a contrary reading of GIPHY’s internal documents – which the CMA notes contain no explicit confirmations from companies contacted by GIPHY’s financial advisors – as well as completely ignoring the Parties’ testimony on the subject and, instead, seeking to force the Parties to prove a negative, \textit{i.e.}, to prove that each of the companies contacted had

\textsuperscript{29} Merger Notice, paragraphs 11.5.
explicitly declined to pursue the opportunity in writing. However, the CMA in good conscience cannot rely on a bidder’s silence as evidence of intent to pursue an acquisition. The simple fact is that over the course of a months-long sales process, as both GIPHY and Facebook have stated (and as GIPHY’s documents confirm), Facebook was the [3<<], let alone to proceed to a period of exclusive negotiation and signature of a term sheet. [3<<]. The Phase 1 Decision does not identify any evidence to the contrary and, for this reason alone, the counterfactual cannot meet the evidentiary requirements of Phase 2.

5.18 **GIPHY contacted many companies about a potential acquisition.** The Parties have explained at length the process leading up to the sale of GIPHY to Facebook. This history and context is almost entirely absent from the Phase 1 Decision. The Phase 1 Decision’s analysis appears to stop shortly after the point in time at which GIPHY’s advisors invited initial expressions of interest, failing to attribute any weight to the months-long process during which those [3<<]. This is a significant omission and critical to properly evaluating the likelihood of an alternative purchaser emerging absent the Transaction:

(a) Prior to 2019, when seeking additional financing, GIPHY -- from time-to-time -- held informal early-stage discussions with potential merger partners, including Facebook. The table below summarises when GIPHY sought to initiate discussions with these companies. However, GIPHY’s discussions with potential merger partners did not advance beyond such early-stage discussions. With respect to Facebook specifically, the Parties mutually agreed that the opportunity was not suitable for either party at that time. GIPHY ultimately felt that it could secure more attractive terms through external financing.

(b) Of the companies approached, [3<<] indicated their willingness to discuss the opportunity but none of these discussions proceeded beyond initial contacts.
Table [1]: Summary of GIPHY’s Interaction with Alternative Potential Purchasers

5.19 [☒] Facebook signalled firm interest in exploring the opportunity further. Facebook was [☒] company to indicate a willingness to move beyond this initial round of discussions. In March 2020, GIPHY management held discussions with Facebook regarding furthering the Parties’ existing partnership. The discussions initially focused on a commercial relationship or minority investment by Facebook as part of a larger fundraising round. During the course of the discussions, GIPHY initiated discussions and negotiations of a potential acquisition of GIPHY by Facebook. On 2 April 2020, GIPHY received a draft term sheet from Facebook. GIPHY and J.P. Morgan assessed the key terms of the proposal over subsequent days.

5.20 GIPHY and J.P. Morgan also considered summary terms of a proposal from Snap to expand its existing supply agreement (see Annex 011.4). Note that even at this late stage, with confirmed interest from Facebook, [☒].

5.21 GIPHY and Facebook executed the term sheet on 7 April 2020. In early-to-mid May 2020. On 1 May 2020, GIPHY’s Board of Directors unanimously approved the proposed acquisition by Facebook on a call led by GIPHY’s outside legal counsel (see Annex 011.8). On 4 May 2020, Facebook and GIPHY entered into an agreement and plan of merger (see Annex 002). The Transaction completed and was announced on 15 May (see Annex 004).

5.22 As the above timeline shows:

(a) GIPHY began contacting possible bidders in [☒], a [☒] months before GIPHY signed a term sheet with Facebook, more than enough time for alternative bidders to emerge.

(b) Many of the companies contacted were sophisticated technology and media companies with experienced and well-resourced M&A teams, accustomed to quick vetting/exclusion of prospective target businesses. It is not credible that any of these companies would have allowed such a [☒].

(c) Moreover, many of the potential purchasers contacted by GIPHY were companies with which [☒].

5.23 Effectively, the CMA’s counterfactual posits that it is realistic that one or more companies contacted by GIPHY – all of which are sophisticated companies with substantial resources and experienced M&A teams – would be willing to let months elapse, without at any point seeking to engage GIPHY in a period of exclusive negotiation, make a firm bid, proceed to negotiation or even send a communication in writing to GIPHY / its advisors indicating that they were contemplating a bid. Given the implausibility of this scenario, it is incumbent on the CMA to adduce compelling evidence to the contrary, indicating that other purchasers were intending to bid. The CMA cannot simply assert the contrary and insist that the Parties prove a negative. The CMA’s position is unsustainable and cannot withstand scrutiny at Phase 2.
5.24 **Facebook’s internal documents are incapable of filling this gap in evidence.** The Phase 1 Decision attempts to supplement this significant evidence gap by pointing to referring to Facebook internal documents. The evidence does not and could not address this shortcoming, however:

(a) First, as a conceptual matter, speculation by the acquirer of rivals’ possible interest in a target company (or the implications of this interest, if confirmed) cannot possibly substitute for evidence provided by the target company that no such interest existed. For example, the Phase 1 Decision cites two Facebook internal documents speculating about possible interest from [3<]. The counterfactual is an exercise in assessing what would have happened absent the Transaction. The notion that Facebook would have more reliable knowledge regarding GIPHY’s potential bidders than GIPHY itself is simply not credible. The target company’s interactions with prospective bidders – or, in this case, the lack thereof – are the only reliable source of evidence for this predictive analysis.

(b) Second, the CMA’s characterisation of these documents is misleading. The CMA at paragraph 111 of the Phase 1 Decision notes that “several Facebook internal documents suggest that the acquisition of GIPHY was in part to prevent an acquisition by one of Facebook’s rivals (with [3<] specifically mentioned), indicating that Facebook considered an alternative purchaser of GIPHY to be a credible prospect”; however, Facebook’s internal documents [3<]. Whilst Nir Blumberger expressed concern with things “[3<]”, it is a fact that whilst GIPHY approached other partners such as [3<], Facebook has submitted countless documents to the CMA which explain its rationale for the Transaction. In none of these documents does Facebook ever suggest that the acquisition of GIPHY by an alternative purchaser was a key part of its rationale. In any event, [3<]. Accordingly, it is simply not accurate to suggest that there was a realistic prospect that GIPHY would have been purchased by an alternative purchaser absent the Transaction.

(c) Third, in a final effort to bolster its unlikely counterfactual, the Phase 1 Decision refers to evidence provided by JP Morgan, financial advisors to GIPHY. However, the evidence is heavily redacted. It is, as a result, entirely unclear how the observations of JP Morgan could demonstrate, as the Phase 1 Decision claims, that “some of these potential purchasers may have continued to progress in the sales process”. The Parties have been given no opportunity to challenge this redaction, since the evidence did not appear in the Issues Paper, appearing for the first time in the Phase 1 Decision. GIPHY was in regular contact with

30 Annex 010.8 – GIF Product Landscape overview; Annex 010.11 – Re GIPHY proposals.
31 [3<].
32 See Annex 010.11 - Re Giphy Proposals.
33 [3<].
34 [3<]
35 See Response to RFI 1, paragraph 1.15: “[3<].”
36 See Phase 1 Decision, paragraphs 107, 112, and 113.
JP Morgan throughout the process; JP Morgan had both a legal obligation and commercial incentive to notify GIPHY of all possible interest and offers. Given what GIPHY knows from its interactions with JP Morgan, it is highly unlikely that any evidence provided by JP Morgan could support the CMA’s position, as the Phase 1 Decision claims.
6. **Frames of Reference**

6.1 The CMA has assessed the impact of the Transaction in the following frames of reference: (i) the supply of searchable GIF libraries worldwide; (ii) the supply of social media worldwide; and (iii) the supply of display advertising in the U.K. The Parties disagree with the approach to those frames of reference as explained in the following paragraphs.

6.2 In relation to (i) the supply of searchable GIF libraries, the Parties submit that since Facebook is not active in the supply of GIFs (at any level of the value chain), the description of the relevant product frame of reference should be limited to the supply of searchable library for GIFs to partners through the API, in respect of which there is a vertical relationship between the Parties.

6.3 In addition, the Parties note that there are a number of additional strong constraints on GIPHY’s offering which are external to this frame of reference, and provide real alternatives for GIPHY’s API partners. In particular, this frame of reference does not take into account any other content which, as GIFs, is intended to help drive user engagement and, in turn, generate advertising revenues on social media. This would include for instance, videos, music, news, micro-games, animations, etc.

6.4 As regards, the (ii) the supply of social media, the CMA relies on its own findings from the July 2020 Market Study into online platforms and digital advertising (the “Digital Market Study”). First, the Digital Market Study did not purport to carry out a formal market definition exercise. Second, the Parties believe that the CMA’s definition of social media contained in the Digital Market Study is likely to overlook important sources of competition for users’ time and attention, and therefore overstate Facebook’s position downstream.

6.5 In particular, regardless of exactly how a service (or content provider) attracts users – whether by offering features similar to those Facebook currently offers or different features – it is a competitor of Facebook to the extent that it seeks to capture the finite supply of users’ time. Services can attract users’ time and engagement in a variety of different ways, offering features, products and services that evolve over time.

6.6 In relation to (iii) the supply of display advertising, the CMA relies again on its own findings from the Digital Market Study concerning any differentiation between display and search advertising. Again, that study did not purport to reach conclusions having carried out a formal market definition exercise. Moreover, the Parties disagree with the CMA’s conclusions in the Digital Market Study that online and offline, and display and search advertising, constitute separate frames of reference with limited substitutability.

6.7 The Parties consider that online advertising services is inappropriately narrow.

6.8 Both empirical evidence and economic theory show that all advertising channels compete and belong to the same relevant market, as they are all used to increase sales and hence profits for advertisers. Advertisers seek to split their advertising budget across different channels in such a way as to maximise their ROI, i.e., the additional sales and profits that they generate. Where one channel becomes more expensive than another – in the sense that it delivers a lower ROI – advertisers can and do switch away from that channel and towards more effective forms of advertising.
7. **NO LOSS OF POTENTIAL COMPETITION IN DISPLAY ADVERTISING**

**A. Introduction**

7.1 The CMA’s Phase 1 Decision fails to take proper account of a number of undisputed facts that must inform any consideration of a loss of potential competition TOH, which are:

(a) GIPHY is not and would not have become a social media or messaging competitor to Facebook absent the Transaction:
   - GIPHY has no social network;
   - GIPHY has no messaging product;
   - GIPHY has no meaningful audience of its own and was reliant on Facebook for a significant proportion of its user traffic pre-Transaction; and
   - GIPHY tried with little traction to develop certain social media features but abandoned all efforts prior to the Transaction even being in contemplation.

(b) GIPHY would not have become a “display advertising” competitor to Facebook and was not on a path to major independent success:
   - GIPHY has no display advertising product, nor was it developing one;
   - GIPHY generated [\(\$\)] revenues in 2019 all in the U.S.; and
   - GIPHY was sold for [\(\$\)] after seven years and [\(\$\)].

7.2 These facts alone indicate that any loss of potential competition TOH is not credible since GIPHY was not a company on the cusp [\(\$\)] of major success. However, despite this, the Phase 1 Decision concludes that there is a realistic prospect that the Transaction would have resulted in an SLC in display advertising in the U.K.

7.3 For the reasons explained below, the CMA’s loss of potential competition TOH cannot reasonably be sustained at the conclusion of the CMA’s Phase 2 investigation.

**B. The CMA’s concerns**

7.4 In the Phase 1 Decision, the CMA fundamentally re-framed the loss of potential competition TOH which was presented in its Issues Paper during Phase 1. In its Issues Paper, the CMA concluded:

(a) GIPHY would have expanded into social media and digital advertising in the U.K. absent the Merger; and
this would have resulted in greater competition between Facebook and GIPHY in each of these frames of reference.\footnote{37}

Whereas, in the Phase 1 Decision, the CMA concluded:

(a) GIPHY would not have become a social media rival to Facebook (this conclusion is made \textit{in absentia})\footnote{38};

(b) GIPHY would have expanded its experimental paid alignments advertising offering outside of the U.S., including in the U.K.,\footnote{39} concluding that there was evidence to show that GIPHY \textit{“had already taken concrete steps to monetise its business and expand into digital advertising [in the U.K.]”}\footnote{40} and that it was \textit{“realistic that GIPHY’s expansion efforts would have been successful”}\footnote{41}; and

(c) GIPHY would have entered into competition with Facebook in display advertising in the U.K., particularly through the monetisation of messaging via ads, and it would have done so indirectly through entering into revenue share agreements with Facebook’s social media rivals or having been acquired by a third party.\footnote{42} As a consequence, the CMA concluded that \textit{“Facebook would potentially face stronger competitive constraints in display advertising, which could threaten its market power and push it to compete more vigorously”}\footnote{43}

The CMA therefore concluded that the Transaction \textit{“may reduce the growing and future competitive constraint that GIPHY may exert on Facebook”}\footnote{44}

The CMA’s concerns are unfounded, highly speculative, and internally inconsistent.

The Phase 1 Decision fails to explain the mechanism through which GIPHY offering paid alignment services in the U.K. would have resulted in an SLC in \textit{“display advertising”} in the U.K. The CMA does not establish clearly whether it considers this likely to arise through indirect competition between Facebook and GIPHY, as a result of GIPHY successfully establishing revenue share agreements to offer paid alignments on API partner’s messaging services, or whether (and if so how) it considers the competitive position of API partners themselves in display advertising would change as a result of access to a share of revenue from GIPHY’s paid alignments.

The CMA’s re-framing of its loss of potential competition TOH, removing any consideration of GIPHY expanding into social media, is an unambiguous acceptance that there is no realistic prospect of GIPHY having ever become a \textit{direct} competitor to

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\begin{itemize}
\item See Issues Paper, paragraph 107.
\item Strikingly, the CMA’s consideration in its Issues Paper of GIPHY becoming a social media rival to Facebook has been entirely expunged from the CMA’s Phase 1 Decision.
\item See Phase 1 Decision, paragraph 179.
\item See Phase 1 Decision, paragraph 166.
\item See Phase 1 Decision, paragraph 180.
\item See Phase 1 Decision, paragraphs 184 and 193.
\item See Phase 1 Decision, paragraph 184.
\item See Phase 1 Decision, paragraph 191.
\end{itemize}
Facebook, under the CMA’s own framework. This is significant since the CMA concedes that this Transaction does not concern the acquisition of one of Facebook’s social media rivals, or even a prospective one. It is also a tacit acknowledgement of the bedrock facts set out above. However, as part of its fundamental re-frame of this theory, and in the absence of explaining any causal link between the chain of events set out and an SLC in display advertising in the U.K., the CMA has fundamentally failed to analyse robustly the plausibility of its own TOH with the necessary rigour.

7.10 In summary, the CMA has sought to manufacture an indirect loss of potential competition TOH which can be generously described as novel, but more realistically as incoherent.

C. Preliminary observations regarding the frame of reference

7.11 In the Phase 1 Decision, the CMA considered a frame of reference in the supply of “display advertising in the U.K.”. The CMA relies on its own findings from the Digital Market Study concerning any differentiation between display and search advertising. As explained in the Frame of Reference section above, Facebook disagrees with the CMA’s conclusions in the Digital Market Study that online and offline, and display and search advertising, constitute separate frames of reference with limited substitutability. Accordingly, Facebook disagrees with the suggestion that it has market power on any credibly defined advertising market in the U.K.45

7.12 Notwithstanding this, as part of its loss of potential competition TOH, the CMA is dancing on the pinhead of its own market definition. The Phase 1 Decision is at pains to describe GIPHY’s paid alignments services as “digital advertising” and never as “display advertising” in all instances.46 It purposely avoids stating a plain fact: GIPHY’s experimental paid alignment services were not “display advertising” services under its own market definition.

7.13 Facebook’s advertising services consist of offering brands and customers space to display their ads, often customised to the end-user. By contrast, GIPHY’s paid alignment offering gives Brand Partners the possibility of aligning their GIF content with one or multiple search terms and/or pinning it to the “trending” feed on GIPHY’s website. Facebook’s and GIPHY’s activities are further differentiated in that they serve different purposes: advertisers would consider running ad campaigns on Facebook to raise brand awareness, introduce new products and features, raise exposure to a discount campaign, etc., with the ultimate goal of boosting traffic and sales. Indeed, virtually all ads on Facebook contain a click-through link to the advertisers’ website or web-shop. By contrast, GIPHY’s paid alignments do not fit the description of the CMA’s own display advertising frame of reference. It does generally not contain any product features, descriptions, and indeed no invitation to buy or a link to the advertiser’s website or web shop.

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45 In the broader market for digital advertising, Facebook has a share of only 15% in the digital advertising market in the U.K. and a much lower share of all advertising in the U.K. The evidence in the Digital Market Study is insufficient for the CMA to conclude that Facebook has market power, and the CMA has not undertaken the formal steps of a market definition exercise necessary to conclude this.

46 See for example paragraphs 164(a), 167, 169, 175, etc.
Consequently, GIPHY as a competitor to Facebook can only be sustained as part of a broader “digital advertising” frame of reference. Even if the CMA were to ignore the evidence set out in the Counterfactual section above, and instead, to conclude that GIPHY’s experimental paid alignments service could -- one day in the future, in the most implausible of counterfactuals -- rise as a challenger to Facebook in the advertising space, the CMA would also have to demonstrate that GIPHY was set to compete with Facebook in a way that hundreds or even thousands of other actual or would-be advertising competitors could not, and that Facebook had market power as part of a broader digital advertising frame of reference (which includes Google and Google’s Tenor). In other words, the CMA would have to show that Facebook’s elimination of one tiny experimental ad product would somehow “substantially lessen competition” across the advertising space more broadly in the U.K., a space that -- if it were broad enough to include GIPHY -- is certainly broad enough to include a multitude of other ad offerings that already apply competitive constraints on Facebook (which could not have market power in any event), or could constrain Facebook in the future. In which case Facebook’s ad business faces so much competition and potential competition from so many rivals that the acquisition of GIPHY with its [\text{XXX}] of global ad sales and $0 of U.K. ad sales would not matter for that reason alone. The CMA has not attempted to put forth a plausible theory on these facts -- nor could it.

In summary, either GIPHY’s experimental ads model did not compete with Facebook’s offering (under the CMA’s very narrow market definition), or if it did, it was one of hundreds or even thousands of actual or would-be competitors, and the elimination of GIPHY could not possibly have “substantially lessened” competition in any conceivable advertising market. The CMA cannot have it both ways and, in either scenario, the CMA’s case cannot be sustained.

As noted above, the Phase 1 Decision makes no causal connection with how the provision of GIPHY’s experimental paid alignment services in the U.K., via revenue share agreements with its API partners and as an input into their messaging services, could result in an SLC in display advertising in the U.K. since these are not competing services. This is a critical omission. There is no basis on which to conclude that paid alignment services would have made GIPHY’s API partners’ services more attractive. It is GIPHY’s content, not its paid alignment services, which drive user engagement (in fact ads typically harm user engagement) and the importance of this input has been considered in detail in TOH2. In the absence of user engagement being increased on Facebook’s social media rivals’ services, it is not clear how they could have become more effective competitors to Facebook in display advertising in the U.K. given the two-sided nature of these services.

D. The likelihood of an SLC in the supply of display advertising in the U.K. is vanishingly low

Facebook’s motivation for buying GIPHY was entirely straightforward: Facebook was (and is) GIPHY’s largest API partner, and Facebook wanted to continue that mutually beneficial relationship and not see it disrupted by GIPHY failing. The facts are that (1) GIPHY’s tiny “paid alignments” business was no more than experimental, and (2) Facebook had no interest in it. These facts should be dispositive. But even if one were to insist, despite the evidence, that GIPHY may have evolved into a potential advertising competitor to Facebook, then the Phase 1 Decision fails to take a robust,
analytical approach to each of the events that would need to have transpired in order for the CMA’s loss of potential competition TOH to even be realistic, let alone result in an SLC on the balance of probabilities. As a matter of probability, the longer the chain of events that would need to have transpired, the less likely the CMA’s conclusion becomes.

7.18 For the CMA’s loss of potential competition TOH to succeed, on the balance of probabilities, each of the following events would need to be virtual certainties absent the Transaction:

(a) **GIPHY would need to have obtained significant external funding:** in the midst of a global pandemic, the CMA’s TOH 1 rests on GIPHY obtaining significant additional external funding to invest in its paid alignment revenue generating activities. This is one of several prerequisites for GIPHY expanding within the U.S. and building the scale to expand its services internationally, including into the U.K. For the reasons set out in the Counterfactual section above, this is highly unlikely, let alone highly likely.

(b) **In addition, GIPHY’s most significant API partners would all need to have entered into revenue share agreements, including Facebook:** as previously explained to the CMA, of GIPHY’s traffic comes from its API partners and over half of it from Facebook’s services. GIPHY’s dependence on API traffic would have constituted a significant roadblock to the viability of its advertising business.

As the Phase 1 Decision recognises, GIPHY’s revenue-generating strategy relied on monetising the actions of users on third-party services since it had no social media or messaging services of its own, nor was there a realistic prospect of it developing these. GIPHY would have been dependent on entering into revenue-sharing agreements with significant API partners to build a sellable ad-inventory. In reality, however, GIPHY struggled to sign any important revenue-sharing agreements. GIPHY’s biggest partners, including Facebook, In order to generate even the modest growth forecasts set out in its pre-COVID 19 plans, GIPHY’s most significant API partners would need to have entered into revenue share agreements with GIPHY to offer its experimental paid alignment services. It would have been extremely difficult (if not impossible) for GIPHY to have succeeded without Facebook’s support (unlikely) the CMA necessarily must downgrade the (extremely modest) future revenue projections in the absence of Facebook support since -- at the very least -- GIPHY would have been denied access to more than 50 percent of GIPHY’s total volume of usage.

Finally, there is also an incoherence in the notion that GIPHY would have simultaneously established indirect competition between Facebook and its social media rivals, such that these would become even fiercer competitors to Facebook resulting in an SLC in “display advertising” in the U.K., whilst

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47 For this TOH to be more likely than not, the CMA would need to conclude with >90% confidence that each event would have transpired absent the Transaction.

48 See paragraph 6.1 of the Merger Notice.

49 See Response to Question 20 of RFI 3.
Facebook would have continued to support and use its services. In such circumstances, Facebook could have pulled the plug on its support for GIPHY at any point, which would have severely damaged its future prospects or perhaps even been terminal to these, and the downside to it doing so would have been very small (since the worst case scenario impact on its revenues from losing access to GIPHY’s services was very small but sufficient to justify the Transaction value).

(c) **In addition, GIPHY would need to have successfully expanded its paid alignment services internationally, including into the U.K.:** the Phase 1 Decision concludes that GIPHY’s internal documents show that the company had plans to expand its paid alignment activities internationally, since it held discussions with existing Brand Partners to this end, and that it would have been successful in doing so.\(^{50}\) In fact, as previously explained to the CMA\(^{51}\), the discussions that GIPHY held with these Brand Partners (or customers) revealed that [\(\ll\)].

The Phase 1 Decision also fails to take account of the circumstances immediately prior to the Transaction. A GIPHY board presentation, in April 2020, sets out the then current challenges facing the business as a result of COVID-19, showing that it was considering [\(\ll\)].

**Figure 1:** [\(\ll\)]

Given the [\(\ll\)], and the impact of COVID-19 on GIPHY’s ability to obtain finance and on advertising markets more generally, there is [\(\ll\)].

(d) **In addition, GIPHY would need to have become a significant player as part of a broader digital advertising frame of reference in the U.K.** As explained above, if GIPHY’s experimental paid alignments and Facebook’s advertising services are deemed to compete, such competition would not form part of the CMA’s narrow definition of “display advertising”, but rather any competition would take place within (at least) a broader “digital advertising” frame of reference. Despite failing to meet any revenue growth targets for the [\(\ll\)]running-up to the Transaction, and generating only [\(\ll\)]in 2019 (all in the U.S.), the CMA’s theory rests on GIPHY’s experimental paid alignment revenues growing exponentially to become a meaningful competitor to Facebook, including in the U.K. For instance, [\(\ll\)].

The assertion that GIPHY could have generated meaningful revenue in the U.K., and in any foreseeable timeframe, is highly speculative. As previously explained to the CMA\(^{52}\), GIPHY’s best-case forecasts pre-COVID 19 only attributed an additional estimated [\(\ll\)] in FY 2020 from the potential expansion of paid alignments globally. That would bring GIPHY’s global revenues to approximately [\(\ll\)]. Applying pre-existing GIPHY user traffic (6% of which is generated in the U.K.), this would generate an estimated [\(\ll\)]revenues from paid alignment services in the U.K. (which is an overstatement since the large

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50 See Phase 1 Decision, paragraph 169.
51 See Response to Question 42 of RFI 1.
52 See paragraph 18.8 of the Merger Notice.
majority would clearly continue to be generated in the U.S.). Moreover, it is worth reiterating that these forecasts were made in February 2019 and prior to the COVID-19 pandemic.

In order to intervene in a presumed legal transaction, the CMA must prove on the balance of probabilities that any loss of competition is substantial. GIPHY’s own pre-pandemic projections suggest it would not have generated any significant revenues in the U.K., nor in any foreseeable timeframe. The notion that it could have created meaningful indirect competition with Facebook in the supply of display advertising in the U.K. is fanciful.

(e) **In addition, GIPHY would need to have succeeded in monetising messaging with advertising where all others had failed:** the CMA’s finding of a loss of potential competition SLC rests on the conclusion that paid alignment services were actually the secret sauce for monetising messaging via ads. In other words, ignoring the market realities, the CMA has concluded that GIPHY’s investors and its API partners had simply failed to see what the CMA has discovered: GIPHY was the key to monetising messaging via ads at scale.

GIPHY was sold for [3][7]see the Counterfactual section – and it would only ever have targeted a small subset of users’ time on social media apps or messaging services since only single percentage points of users send GIFs and stickers. Therefore, any advertising product would be a niche one designed to monetise only a small percentage of users’ time. In other words, not only are paid alignments experimental, with no traditional metrics demonstrating return on investment, but its growth potential was significantly restricted since it only had a limited use case.

[7].

7.19 In summary, any step-by-step analytical and logical consideration of the CMA’s loss of potential competition TOH renders it both fanciful and incoherent. Even if each event in the list above were to be considered 51% likely, which in itself is wildly unrealistic, the chances of this TOH resulting in an SLC in the U.K. is <2%.

E. The CMA cannot rewrite the legal test to justify Phase 2 reference

7.20 Lacking a credible TOH capable of justifying a Phase 2 reference, the Phase 1 Decision posits an alternative, lowered standard for reference, according to which “the CMA’s concern about any given level of constraint removed or reduced by the Merger may be greater than in a scenario where Facebook did not have significant market power” (emphasis added).53 This is not the reference test in the Enterprise Act or indeed the SLC test at the end of Phase 2.

7.21 At Phase 1, the Enterprise Act requires the CMA to demonstrate a realistic prospect of an SLC in a U.K. market(s) and such concerns must be demonstrated on the balance of probabilities at Phase 2. The CMA itself has emphasised that in digital mergers “the statutory test the CMA is applying to mergers has not changed...” and “[...] When assessing mergers, the CMA considers whether a transaction has resulted or may be expected to result in a "substantial lessening of competition", which is the test set out

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53 See Phase 1 Decision, paragraph 161.
in the relevant legislation.”54 The CMA by its own admission cannot sidestep this legislative requirement. Yet this is precisely what the Phase 1 Decision seeks to do, eliminating the materiality threshold and claiming that any degree of lost competition is sufficient for a realistic prospect of an SLC.

7.22 The CMA must not let policy positions drive its rational consideration of the evidence, nor can policy positions alter the legal standard applied in CMA merger investigations.

7.23 It is essential that the CMA bear in mind this context when considering its loss of potential competition TOH.

F. Conclusion

7.24 The Phase 1 Decision sets out an unbalanced view of the evidence and it fails to take proper account of the long chain events that would need to transpire, each as a near certainty, for it to become more likely than not that GIPHY was on the cusp of major international expansion and revenue generation. The evidence plainly does not support this.

7.25 Critically, the CMA inconsistently applies its own frame of reference, which would need to be broadened to include Facebook and GIPHY as potential competitors, and it fails to make a causal link between the expansion of GIPHY’s paid alignment services, via revenue share agreements with its significant API partners, and an SLC in display advertising in the U.K.

7.26 For all of the reasons explained above, the CMA’s loss of potential competition TOH is fundamentally incoherent, highly speculative and cannot be sustained at the conclusion of the CMA’s Phase 2 investigation.

54 See Bringing the CMA’s Merger Assessment Guidelines up to date, dated 8 April 2021
8. **NO VERTICAL EFFECTS THROUGH THE FORECLOSURE OF RIVAL SOCIAL MEDIA SERVICES**

A. Introduction

8.1 The Phase 1 Decision concluded the Transaction may give rise to competition concerns as a result of vertical effects in the supply of “social media” and of “display advertising”. More specifically, the CMA considers that the Parties would have the ability and incentive to engage in one or more total or partial foreclosure strategies to the detriment of its social media and display advertising rivals. The CMA’s concerns are unfounded and fundamentally at odds with the evidence (including from the Parties’ internal documents) presented by the Parties to the CMA over the course of the CMA’s Phase 1 investigation. As the following paragraphs explain, Facebook has neither the ability nor the incentive to engage in foreclosure strategies to the detriment of rival social media and digital advertising rivals.

8.2 More fundamentally, the CMA’s vertical effects concerns make no sense in a context where Facebook has publicly committed to keeping GIPHY’s services open to developers and API partners, including to companies that may compete with Facebook downstream.\(^{55}\) In line with this commitment, Facebook signed a 5-year agreement with Snap that ensures that it will have access to the GIPHY API on at least the same terms it had prior to the Transaction. These commitments make complete sense given Facebook’s lack of incentives to engage in vertical foreclosure strategies and the advantages Facebook gains from ensuring GIPHY’s continued broad access to downstream providers, maintaining the attractiveness of the GIPHY proposition for artists and creative communities.

8.3 In order for a foreclosure strategy to result in an SLC, four conditions must be met:

(a) Rivals have no substitute for GIPHY;

(b) The user proposition of Facebook’s rival services declines as a result of loss of access;

(c) Users switch away from the rival services to Facebook; and

(d) Facebook would profit or otherwise commercially benefit by cutting off rival access to GIPHY.

8.4 As the sections below explain, none of these cumulative criteria are met.

B. **Rivals are able to switch away from GIPHY to GIF alternatives**

8.5 A foreclosure strategy can only succeed if there are no viable alternatives to the relevant input to which access is foreclosed. Put differently, Facebook does not have the ability to foreclose competitors’ access to GIFs if there is a viable alternative to GIPHY. The

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\(^{55}\) See [https://about.fb.com/news/2020/05/welcome-giphy/](https://about.fb.com/news/2020/05/welcome-giphy/); Vice-President of Product at Instagram, Vishal Shah, highlighted that: “[…] [Facebook is] looking forward to investing further in [GIPHY’s] technology and relationships with content and API partners. People will still be able to upload GIFs; developers and API partners will continue to have the same access to GIPHY’s APIs; and GIPHY’s creative community will still be able to create great content.” (emphasis added).
CMA has acknowledged and third party feedback has confirmed\(^{56}\) that there is a viable alternative to GIPHY in Google’s Tenor, which—like GIPHY—supplies GIFs to third parties (including Facebook). Indeed, the Phase 1 Decision notes that Google’s Tenor is a “significantly competitive alternative to GIPHY”.\(^{57}\) For this reason, third parties noted that “if GIPHY stopped providing its GIFs or degraded the quality of its supply, they would likely switch to, or rely on, another GIF provider”.\(^{58}\)

8.6 In fact, Google’s Tenor is simply the largest of these alternatives to GIPHY. As the Parties’ Merger Notice\(^{59}\) and subsequent submissions have explained, there are a number of other GIF providers, including Imgur, Gfycat, Gifbin, Vlipsy, and Holler, all of whom offer a similar service to GIPHY (they all supply GIFs to third parties; they all have searchable libraries) and are free to use. The CMA’s own market test confirms this as “[s]everal respondents also referred to Gfycat or Holler as alternatives to GIPHY”.\(^{60}\) The Parties’ own experience is that switching between GIF providers is easy to do and can be achieved quickly; indeed, the many examples of partners switching from GIPHY to Tenor in the past confirms the ease of switching.\(^{61}\)

1. **Google’s Tenor is a perfect substitute to GIPHY**

8.7 Focusing just on Google’s Tenor, it is clear that Tenor is a perfect substitute to GIPHY that is widely used by social media services and other partners, including Facebook. Tenor’s library attracted approximately 10 billion monthly searches and 330 million daily searches in 2018, and its popularity has since only increased.\(^{62}\) GIPHY’s own internal documents illustrate that GIPHY views Tenor as a strong competitor.\(^{63}\) Further, third party feedback confirms the significant competitive constraint exercised by Tenor on GIPHY with several of the respondents to the CMA’s market test indicating that “Tenor is at least as good as GIPHY”.\(^{64}\)

The Parties’ own technical analysis confirms perfect substitutability between GIPHY and Tenor. In a white paper shared with the CMA on 22 January 2021, Facebook considered evidence from a loss of GIPHY and Tenor service on the Facebook Messenger surface (“Vertical Foreclosure White Paper”). The analysis shows that during the time period in which GIPHY GIFs were unavailable to users on Messenger, there was almost perfect substitution with Tenor GIFs and there was no loss of overall engagement on the surface (measured by total volume of messages). This indicates that users behaviour did not alter on the surface as a result of losing access to GIPHY.

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\(^{56}\) See Phase 1 Decision, paragraph 219.

\(^{57}\) See Phase 1 Decision, paragraph 234.

\(^{58}\) See Phase 1 Decision, paragraph 179.

\(^{59}\) See Merger Notice, paragraphs 19.8-19.15.

\(^{60}\) See Phase 1 Decision, paragraph 221.

\(^{61}\) See paragraphs 8.13 to 8.15 for examples of partners switching from GIPHY to Tenor in the past.

\(^{62}\) See techcrunch.com [here](https://example.com).

\(^{63}\) See the document entitled ‘Project Gondola_ Illustrative Q&A_2020.03 (1)’ dated March 2020.

\(^{64}\) See Phase 1 Decision, paragraph 219.
Figure 2 below provides a diagrammatic illustration of the substitution that occurred during GIPHY outage on Messenger in May 2020.

Figure 2: Substitution of GIPHY

8.8 As the CMA pointed out at paragraph 183 of its Phase 1 issues paper, “users may not [even] have noticed any temporary deterioration in the quality of GIFs when GIPHY was not available”. Indeed, this shows a lack of barriers for users to switch between GIPHY and Tenor within the same surface, and it confirms the perfect substitutability between GIPHY and Tenor and the content of their respective libraries from the user’s perspective.

8.9 The technical analysis referred to above only confirms what Facebook knows to be true on the basis of its own experience: Tenor and GIPHY are perfect substitutes. For this reason, Facebook’s view that GIPHY and Tenor are perfect substitutes.

8.10 Taken together, the Parties’ own experience, evidence from internal documents and technical analysis, and third party feedback, confirm that GIPHY and Tenor are very close substitutes. Accordingly, any attempt at foreclosure would have no effect because Facebook’s rivals could easily switch to an alternative GIF provider such as Tenor.

C. Rival services’ proposition does not decline as a result of losing access

8.11 Even if Facebook were to cut off rivals’ access to GIPHY, a foreclosure strategy could only be successful if as a result (i) rival services’ value proposition would materially decline, which (ii) would cause users to shift away from rival services to Facebook. This is not the case. In particular, the CMA has not provided any evidence suggesting that:

(a) Rival services would become less attractive to users when using an alternative substitute to GIPHY (e.g. Tenor, Gfycat, etc.);

(b) GIFs are a key engagement driver, the lack of which would drive users towards rival services.

2. Rival services’ proposition does not decline as a result of switching to Tenor

8.12 According to the CMA, several third parties have indicated that if GIPHY were to engage in total or partial foreclosure, they would likely switch to, or rely on, an alternative GIF provider. A number of these third parties have also confirmed that Tenor’s offering is at least as good as GIPHY’s.

8.13 Furthermore, some of GIPHY’s API partners such as. As outlined in the Vertical Foreclosure Analysis White Paper, there are also a number of larger downstream services that are not API partners of GIPHY, and GIPHY understands these services only rely on either Tenor or Gfycat. The services include. This shows that rivals themselves do not believe their proposition is reliant on access to GIPHY’s library, nor is it essential to have more than one GIF supplier. Accordingly, it is simply incorrect to suggest that “losing access to GIPHY’s GIFs could affect user experience and/or
engagement on their platforms” and certainly not materially. This view does not accord with the lived reality of the market and the actual behaviour of Facebook’s rivals. In addition, and as explained above, Facebook (as GIPHY’s largest API partner) estimated some small impact on its user engagement sufficient to justify the purchase price, but none of Facebook’s rivals expressed any firm willingness to buy GIPHY, which suggests that they would not experience loss of user engagement to any material degree.

8.14 Additionally, were Facebook to pursue a foreclosure strategy resulting in the need for rivals to switch GIF providers, there is no evidence that the rivals’ proposition would be damaged due to the process of switching. Evidence outlined above highlights the ease with which switching GIF providers can take place so there would unlikely be any significant disruption to the service.

8.15 The CMA has failed to show that a rival’s proposition would be damaged as a result of switching to Tenor or another GIF provider following a foreclosure strategy by Facebook. There is no evidence that users prefer GIPHY GIFs to Tenor GIFs when both are available on the same service. Further, the fact that some of Facebook’s rivals only source their GIF supply from Tenor suggests that it is simply not the case that a loss of access to GIPHY’s GIFs could affect user experience and or engagement on services.

3. GIFs are not an important input

8.16 In its Phase 1 Decision, the CMA concludes that “while GIFs are currently only used by a minority of users of social media platforms”, “usage is rapidly increasing” and so GIFs are “important for driving user engagement” and their importance may further increase if GIFs were to become an established advertising channel with messaging. As the counterfactual section above explains, it is simply unrealistic to think that absent the Transaction, GIPHY would have had the financial resources to develop its advertising services. Accordingly, the Parties reject as overly speculative any argument that relies on the unrealistic hypothetical that GIPHY’s GIFs were to become an established advertising channel within messaging. Putting unrealistic potential scenarios aside, the fact remains that GIFs are not an essential input to social media services.

8.17 The CMA points to Facebook’s internal documents which [3<]. Accordingly, the CMA believes that this estimate indicates the importance of GIFs for the competitiveness of a social media service. In fact, Facebook recognises that GIFs are a useful engagement driver, but they represent just one of myriad types of content types available to drive user engagement. With respect to the potential revenue loss that could accrue to Instagram, as explained by the Parties in the response to RFI 2, the estimates were based on extreme assumptions and even then still only indicated a very small proportion of Facebook’s overall revenue would be affected.

8.18 More specifically, Facebook assumed that Instagram would lose all access to GIPHY in a context where no alternative was available (i.e., Tenor and other providers were also assumed to be unavailable in this worst-case scenario). Had these assumptions been accurate, Facebook would have only experienced a [3<]. Facebook also noted in
the response to RFI 1 that it took “[3<]”, further confirming that these estimates are an absolute upper bound and that GIFs are a relatively insignificant input for Facebook. This is also supported by the majority of third party views as the CMA noted that “only a minority” of respondents to the CMA’s market testing considered that the impact of a significantly worse GIF offering on their competitiveness would be ‘material’.66

8.19 The CMA’s second argument is that GIF usage is growing and GIFs tend to be more popular among younger users. The CMA presents figures on the total number of GIF searches increasing significantly between 2018 and 2019 and the proportion of messages and stories containing a GIF. However, the Vertical Foreclosure Analysis White Paper shows that despite GIF usage having increased, GIFs are used by a small proportion of users and comprise a small share of content shared across all services. The CMA presents data on GIFs without considering any additional context on how other engagement drivers are also used and evidence on growth in usage of other features of social media services. The CMA’s own evidence presented in the Digital Market Study67 shows that time spent on social media services has typically been increasing over the same period. Therefore the evidence of increased usage of GIFs over this time period does not necessarily imply that GIFs have become a more prominent or important feature of user activities on social media apps/websites over time. Indeed, data submitted by the Parties to the CMA shows that: i) other engagement drivers are shared significantly more than GIFs on Facebook services, ii) GIF users are not sharing GIFs exclusively, and (iii) even when GIFs are entirely unavailable on a Facebook service (as was the case for Messenger Kids during the GIPHY Loss of Service – used exclusively by younger users), there is no impact on the total usage. This confirms that GIFs are not an important input from the user perspective.

8.20 This analysis in the Vertical Foreclosure Analysis White Paper further highlights that GIFs do not seem to be particularly important specifically to younger users. The Messenger Kids service saw no impact on total messages sent during a complete GIF outage as shown in Figure 3. Additionally the data presented by the CMA at paragraph 208 of the Phase 1 Decision is partial and therefore misleading. The CMA has focussed on services on which younger users typically appear to share GIFs more than other users; however, the results do not suggest a significant difference in usage by younger users (only in FB comments is the share more than 1 percentage point higher for younger users). In contrast, higher sharing of GIFs by younger users is not the case across all Facebook services as shown in the data shared with the CMA in the response to RFI 2. For example, based on Facebook’s best estimates at the time, [3<]. More recent data requested by the CMA as part of Phase 2 RFI 2 (Q2) also suggests that GIFs are not particularly important for younger users specifically. In fact, both the number of users who shared GIF content and the proportion of overall content containing a GIF are lower when the sample is restricted to younger age groups as opposed to all users.68

8.21 The evidence provided in the Vertical Foreclosure Analysis White Paper indicates that users use Facebook services for a variety of reasons and to share a range of content/engagement drivers of which GIFs are only one. Similarly on rival services, users have access to a range of engagement drivers and content tools. Since Facebook

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66 See Phase 1 Decision, paragraph 200.
67 See figure 3.8 of the CMA’s Digital Market Study final report.
68 For example, as noted in response to Phase 2 RFI 2 (Facebook) Q2: [3<].
is GIPHY’s largest API partner there is no evidence to suggest that users of rival services are more reliant on GIFs than Facebook users. Given this, there is no reason to think they would divert away from a Facebook rival if they had no access to GIFs.

Figure 3: Total GIFs sent and total messages sent on Messenger Kids (globally, May 2020)

4. Users would not divert to Facebook

8.22 Even if Facebook were able to successfully foreclose rivals’ access to GIFs (which it wouldn’t be able to do), and no viable alternatives were available (which is not the case), there is still no evidence that users would divert their demand away from rivals and towards Facebook.

8.23 At paragraph 243 of its Phase 1 Decision, the CMA suggests that because Facebook has market power in social media, if GIPHY GIFs were unavailable on a rival service, then the user reaction would be to spend more time on Facebook or to send a GIF on Facebook instead. The CMA relies on its Digital Market Study to support its assertion that Facebook has market power in social media. Conversely, the evidence from Messenger Kids shows that when GIFs have been unavailable, there has been no change in user behaviour on that surface. This suggests that even if users were unable to send GIPHY GIFs from a rival service, they would be unlikely to switch to Facebook in order to do so. Accordingly, there is simply no incentive for Facebook to pursue a foreclosure strategy; if users are unable to use GIPHY GIFs on a rival service, they are not likely to increase the time they spend on Facebook as a result. This is further supported by Facebook’s own observations when estimating the potential lost revenue from a loss of access to GIFs on its own surfaces for the purposes of valuing GIPHY: “[≠]”.69 This suggests that the most likely user response to any reduction in quality in one aspect of a social media offering may be to increase time spent elsewhere on that service. No evidence has been presented to support a theory that loss of access to GIFs would result in a switching of time spent to other social media services and more specifically to Facebook.

8.24 Additionally, Facebook is not just competing for user attention from rival social media services, it is competing with any other service or activity which requires users’ time. The Parties previously highlighted this in the Merger Notice, stating that “regardless of exactly how a service (or content provider) attracts users – whether by offering features similar to those Facebook currently offers or different features – it is a competitor of Facebook to the extent that it seeks to capture the finite supply of users’ time.”70 Even if users choose to spend less time on a rival service due to unavailability of GIPHY GIFs (which the evidence above shows has not been the case during a GIPHY loss of Service on Messenger) there is no reason to believe that these users would immediately divert to Facebook. There are a wide range of other activities and services which also

69 See page 2 of Annex 010.9.
70 See page 7 of the MN.
compete for user attention in addition to other social media providers, such as using YouTube, Netflix and other streaming services, or games.

E. Facebook would not profit from cutting rivals' access to GIPHY

8.25 The paragraphs above explain that there is no evidence that Facebook would engage in foreclosure strategies post-Transaction. For this reason, and as the CMA itself acknowledges\(^71\), there are no “internal documents suggesting that Facebook was planning on engaging in a foreclosure strategy post-Merger”. If this was indeed an important (or even peripheral part) of Facebook’s plans for the Transaction then one would expect to see this mentioned in the Parties’ internal documents. The fact that the CMA has been unable to find any internal documents supporting this speculative concern speaks volumes about the lack of incentives that Facebook has in pursuing foreclosure strategies. Facebook’s internal documents mirror what the company has said publicly, namely that it intends to keep GIPHY’s services open to developers and API partners, including to companies that may compete with Facebook downstream. The reason for this is that maintaining the current GIPHY service is likely to benefit Facebook, whilst a foreclosure strategy could actually harm Facebook’s profitability and would likely have no effect on the profitability of rival social media providers.

8.26 With regards to the benefit to Facebook, GIPHY relies on content creators to maintain and improve the quality of the GIF library. Keeping the library open to as many users as possible provides an incentive for content creators to continue producing and uploading GIFs to GIPHY rather than rival services.

8.27 There are also minimal costs for Facebook from keeping GIPHY open to API partners. The marginal cost of keeping GIPHY open relative to the service only being available on Facebook services is low. Facebook would still need to maintain the GIF library and search functionality for Facebook users and the app/website to allow users to upload content. The incremental costs could therefore be expected to be low, relating largely to some costs of negotiating agreements with larger API partners and limited technical support.

8.28 Furthermore, there are costs involved with pursuing a foreclosure strategy as Facebook has already made commitments to keep GIPHY available to other services and has a contractual agreement with Snap; breaking this would incur further costs for Facebook.

8.29 As stated above, attempted foreclosure would likely drive users towards Tenor and/or other providers, and Facebook has no incentive to undertake actions that would only lead to increasing alternatives such as Tenor (and hence Google’s) popularity with no positive impact on Facebook’s own profitability. There would also be no benefit to Facebook with regards to a foreclosure strategy from forcing other services to rely on only one provider. At paragraph 223 of the Phase 1 Decision, the CMA suggests that rivals need more than one GIF supplier for reliability of supply, range of GIFs and negotiating power. Rivals own experience and market practice suggests that this is incorrect; there are many API partners – including Facebook itself in some instances – that rely only on one GIF provider. In any case, as noted above, there are multiple GIF providers available in the market. However, even if this were the case, there is no reason why foreclosure would benefit Facebook’s profitability as foreclosure would still drive

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\(^71\) See paragraph 241 of the MN.
API partners towards Tenor and other API partners, even if rivals’ preference is to use more than one provider. Any impact on rivals’ negotiating power could at most worsen the terms between API partners and GIF providers such as Tenor, but would not impact the quality of service faced by users, therefore there would be no benefit to Facebook.

8.30 Overall, the evidence indicates that the profitable approach for Facebook would be to keep GIPHY open. Even if Facebook did have the ability to effectively foreclose rivals’ access to GIFs, which it does not, there is no incentive to do so. Facebook maximises GIPHY’s value by keeping it open, consistent with the commitments it has already made.

F. The CMA’s partial foreclosure TOHs are not plausible

8.31 The Parties note that CMA distinguishes between partial foreclosure (worsening the terms of GIPHY’s supply) and total foreclosure (ceasing to supply GIFs via the GIPHY API) in its Phase 1 Decision. The points raised above would apply equally to a partial or total foreclosure strategy. If rival API partners faced worsening experiences or higher costs in accessing GIPHY’s services, as with total foreclosure, rivals would have the ability to switch to an alternative provider which offers comparable services and no reduction in quality of services to users would therefore arise. Accordingly, the Parties do not consider it necessary to address partial foreclosure theories separately. However, for completeness, the paragraphs below summarise why the CMA’s partial foreclosure concerns are unfounded and entirely implausible. The partial foreclosure strategies the CMA puts forward are:

(a) GIPHY including advertising among GIFs provided to rivals in order to worsen rivals’ user experience; and

(b) GIPHY requiring additional user data in exchange for providing GIFs.72

8.32 The CMA’s partial foreclosure theory in relation to advertising is in direct contrast with the CMA’s Counterfactual and TOH1. The CMA postulates two scenarios which cannot both hold true. Either:

(a) As the CMA implies through this partial foreclosure TOH, advertising within the GIF functionality is not a beneficial/attractive service and/or could impact user experience and API partners would not be interested in having advertising within GIPHY API on their apps/websites. If this is the case then API partners would not suffer any harm from the acquisition limiting their access to paid alignments and the Transaction would not result in a lessening of potential competition in digital advertising (TOH1 does not hold); or

(b) As the CMA suggests in TOH1, advertising through paid alignments in the GIPHY API is a non-intrusive form of advertising that would not reduce user experience. Indeed, the CMA has even suggested that a foreclosure strategy would mean API partners may not be able to “benefit from revenue share agreements with GIPHY” 73 implying that advertising would be attractive and a potential future benefit to GIPHY’s API partners. If this is the case, Facebook

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72 See Phase 1 Decision, paragraph 195.
73 See Phase 1 Decision, paragraph 253.
including advertising among GIFs post-Transaction would have no foreclosing effect on rivals.

8.33 From a user perspective, the outcome of both of these scenarios is the same – personalised advertising would appear in the GIF library. These equivalent scenarios cannot simultaneously represent both a benefit to competition absent the Transaction and a potential foreclosure strategy arising from the merger.

8.34 Nevertheless, under either of these scenarios the Transaction would not result in any material foreclosing effect if Facebook were to attempt partial foreclosure by including advertising in the GIPHY API.

8.35 In scenario a) if this resulted in a worsening of rivals’ user experience, API partners would switch to an alternative provider. As set out above, the presence of alternatives such as Tenor (which does not include advertising in the API) mean there would be no foreclosing effect and no benefit to Facebook from this strategy. In scenario b) if paid alignments is a non-intrusive form of advertising, then user experience for API partners users would not be affected and there could be no foreclosure.

8.36 The CMA also suggests that a partial foreclosure strategy could include GIPHY requiring Facebook’s competitors to provide more user data to access GIFs. The CMA concluded in relation to TOH3 which was initially considered in Phase 1 that the additional data to which Facebook may gain access post-Transaction would not materially increase its existing data advantage. The evidence presented in relation to TOH3, and recognised by the CMA, indicated that data available through GIPHY would not allow Facebook to identify trending content or provide incremental data on monitoring usage trends for competing services. Therefore Facebook has no incentive to require further data from API partners’ usage of GIPHY. As noted above, Facebook has publicly committed to continuing to offer GIPHY on the same terms and has signed agreements with Snap which continue to allow Snap to use proxying and caching (which limit data available to GIPHY) and do not include any requirements for additional data provision.

8.37 Further, requiring additional data from API partners would not affect the user experience on competitors apps or websites therefore if Facebook did require more data and API partners accepted these terms, there would be no foreclosing effect. The Phase 1 Decision concludes that in the event that Facebook were to require its competitors to provide more user data as a condition of accessing GIPHY, “at least some competitors would likely stop using GIPHY rather than provide more user data”. Accordingly, “[t]his suggests that, even in these circumstances, Facebook may not gain access to a significant volume of additional user data”. On this basis, as acknowledged by the Phase 1 Decision, it is simply not plausible to suggest that Facebook would engage in a particular foreclosure strategy which would require competitors to provide more data in exchange for accessing GIFs.

74 See Phase 1 Decision, paragraph 195.
75 See Phase 1 Decision, paragraph 273.
76 See Phase 1 Decision, paragraph 274.
77 See Phase 1 Decision, paragraph 274.
8.38 If API partners chose to stop using GIPHY rather than continuing to use GIPHY with additional requirements, this is indistinguishable from a full foreclosure strategy and, as set out above, Facebook has neither the incentive nor ability to effectively foreclose rivals' access to GIFs. The CMA itself states in the Phase 1 Decision: “Another third party rival submitted that requiring the removal of user data protection tools (such as its proxy server) would be equivalent to ceasing supply, as it would never accept to provide user-level data to GIPHY.” 78 Therefore there is no way in which Facebook could attempt to partially foreclose rivals through a data strategy – API partners would most likely switch away from GIPHY to an alternative provider such as Tenor, which market evidence demonstrates is a perfect substitute for GIPHY, hence there would be no benefit to Facebook from such a strategy. The evidence presented above in relation to full foreclosure therefore equally applies here.

8.39 There are therefore clear inconsistencies and issues both within the partial foreclosure theories the CMA puts forward, and more broadly across the CMA’s different TOHs. Given the evidence suggests that a full foreclosure strategy would not provide a benefit to Facebook, any benefit from a partial foreclosure strategy (including but not limited to those explicitly raised by the CMA) would necessarily be weaker than full foreclosure. The strategies put forward by the CMA are not consistent with the CMA’s other arguments.

G. Conclusion

8.40 All of the evidence available strongly suggests that the Transaction will not give rise to an SLC as a result of vertical effects in social media and display advertising for the following reasons:

(a) Rivals are able to switch away from GIPHY to ample GIF alternatives;
(b) Tenor is a perfect substitute for GIPHY;
(c) GIFs are not an important input for driving user engagement; and
(d) Facebook would not profit from cutting rivals’ access to GIPHY.

78 See Phase 1 Decision, paragraph 273.