

COMPLETED ACQUISITION BY

FACEBOOK, INC.

OF

GIPHY, INC.

ME/6891/20

FACEBOOK RESPONSE TO CMA NOTICE OF POSSIBLE REMEDIES

25 AUGUST 2021

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Facebook Response to the CMA Notice of Possible Remedies

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 Facebook’s response to the Notice of Possible Remedies of the Competition and Markets Authority (the “CMA”), dated 12 August 2021 (the “Remedies Notice”). The CMA’s provisional conclusion in the Provisional Findings (“PFs”) contains fundamental errors which Facebook will address in a separate response to the PFs.

A. NO REMEDIES ARE REQUIRED: THE HAS CMA FAILED TO SHOW A SUBSTANTIAL LESSENING OF COMPETITION

1.2 Mergers and acquisitions are presumed legal. If the CMA wishes to intervene in a merger, the burden is on the CMA to prove on the balance of probabilities that a *substantial* lessening of competition (“SLC”) is likely to occur in a market in the UK as a result of the Transaction. In applying the wrong legal test, and by disregarding relevant considerations and considering irrelevant factors, the PFs fall well short of this legal requirement. Facebook’s response to the PFs will demonstrate clearly that no SLC has resulted or will result from the Transaction and accordingly that no remedies will be required.

B. THE CMA’S “RECONSTITUTION, THEN SALE” REMEDY IS DISPROPORTIONATE, WITHOUT PRECEDENT, AND UNSUSTAINABLE IN LIGHT OF LESS INTRUSIVE, EQUALLY EFFECTIVE AND LESS COSTLY REMEDIES

1. THE CMA’S “RECONSTITUTION, THEN SALE” REMEDY

1.3 Paragraph 21 of the Remedies Notice states that

“[...] integration and other steps should be reversed as part of a divestiture process, and that the divestiture package should have the requisite functions and capabilities to allow GIPHY to compete as a standalone business.”

1.4 More specifically, and in addition to reversing GIPHY’s employment contracts with Facebook, the CMA sets out that the reversal steps would include (but not be limited to):

- (a) Reconstitution or re-creation of the GIPHY management team;
- (b) Re-creation of GIPHY’s sales and partnership functions;
- (c) Ensuring GIPHY has sufficient numbers of key employees such as engineers and personnel responsible for GIPHY’s creative functions, and that these employees have suitable retention incentives; and
- (d) Ensuring that GIPHY’s proprietary and licensed IT systems and applications, its library of GIFs and stickers, and the associated IP rights are included in the divestiture package.

1.5 The Remedies Notice indicates that some or all of these steps should be undertaken prior to a divestment being implemented. We refer to this remedy as “reconstitution then sale” (“R&S”).

2. *THE R&S REMEDY IS MANIFESTLY DISPROPORTIONATE SINCE A SALE TO A SUITABLE PURCHASER, WITHOUT PRIOR RECONSTITUTION, WOULD RESOLVE THE STATED CONCERNS JUST AS EFFECTIVELY AT MUCH LOWER COST*
- 1.6 In the PFs, the CMA stated its “provisional view [] that the Merger will lead to a substantial lessening of competition in the supply of display advertising services in the UK arising from a loss of dynamic competition.” The finding is predicated on the CMA’s (erroneous) view that Facebook has significant market power in display advertising in the UK.¹
- 1.7 Consequently, if anyone without “significant market power in display advertising in the UK” would have acquired GIPHY in March 2020, then that acquirer would not be here today facing the same concerns. There would be no basis to conclude (provisionally) that “the Merger will lead to a substantial lessening of competition in the supply of display advertising services in the UK arising from a loss of dynamic competition”.
- 1.8 A complete remedy to the CMA’s concerns, with respect to Facebook’s acquisition of GIPHY, is the sale of the GIPHY business which Facebook acquired to a buyer that does not have “significant market power in display advertising in the UK”, and which has the capabilities to run the GIPHY business in the same manner as pre-Transaction, i.e., sale to a suitable purchaser. Under the CMA’s own view, what matters to the competitive process is who controls the GIPHY assets. A competitive *status quo ante* can therefore plainly be recreated with a transfer of the GIPHY assets to a qualified buyer. Someone, in other words, who: (a) does not have market power in display advertising and does not raise competition concerns; (b) can credibly run GIPHY, and (c) is financially sound.
- 1.9 “Normal sales” (without prior reconstitution) have always been the way in which divestiture remedies have been ordered by the CMA and implemented by the merging parties. The Remedies Guidance confirms that the CMA “will generally prefer the divestiture of an existing business” and that while the CMA may consider “a more extensive and/or more marketable divestiture package”² such an alternative divestiture package would typically comprise “all the core assets necessary to remedy the SLC” and would be reserved for exceptional circumstances where “the marketability of the initially proposed divestiture package or where a business is subject to major asset risks and the speed of divestiture is likely to be a critical requirement”.³ The CMA’s proposal in the present case is without comparable precedent. Rather than a proposal to “remedy the SLC” through the sale of the business acquired by Facebook to a third

¹ See, e.g., PFs paras. 7.16 (“The structure of the market, and Facebook’s market position [in display advertising in the UK], are key elements in assessing the impact of GIPHY as a dynamic competitor”); 7.83 (“our concerns are informed by Facebook’s significant market power in display advertising. This makes it very difficult for platforms offering innovative new services to enter and compete.[1] In this context, we consider that the loss of GIPHY is particularly concerning, given its importance to the dynamic competitive process”, para. 7.162 (“Facebook has significant market power in display advertising in the UK. The impact of GIPHY on dynamic competition is likely to be more significant in the absence of strong existing competitive constraints to Facebook”). See also paras. 7.3, 7.6, 7.24, 7.33.

² Merger Remedies Guidance, para. 5.17.

³ Merger Remedies Guidance, para. 5.18.

party which does not raise competition concerns, the CMA envisages supplementing and enhancing the business that Facebook acquired. This is without any consideration, let alone evidence, that there may be difficulties marketing the GIPHY business acquired by Facebook, that prospective purchasers may be unsuitable, or that the divestment may not be completed within a suitable time frame. Indeed, to the contrary, the CMA found in the PFs that “*a sale to a third party, for example a social media platform, would have remained a possibility*” absent the Transaction.⁴ In fact, if the CMA’s PFs are correct then any suitable purchaser should be highly incentivised to pursue GIPHY’s paid alignments business model irrespective of whether these activities have been reconstituted pre-divestment. The CMA simply needs to be satisfied that a suitable purchaser has the resources to pursue this strategy. Therefore, it is unnecessary to reconstitute GIPHY since any suitable purchaser can do so more efficiently and effectively, and Facebook would be able to work with any prospective purchaser (and the CMA) to demonstrate this.

1.10 Facebook is unaware of any prior investigation in which the CMA has taken the extraordinary step of entirely “*reconstituting*” the Target business, with employees and assets that did not necessarily transfer with the acquired business, prior to selling it to an approved purchaser. This includes cases in which the merging parties had undertaken substantially greater post-closing integration than in the present case. For example:

- (a) In *Tobii/Smartbox*, the merging parties undertook integration steps following completion and prior to imposition of the IEO. They included the withdrawal of various target product lines and the cessation of target R&D activities. Indeed, the CMA considered this post-closing, pre-IEO integration so significant and extensive that it took the exceptional step of issuing an unwinding order to reverse certain of these steps (which it has not done in this case). The CMA nevertheless concluded that “*as a result of the hold-separate requirements under our interim measures since completion of the Merger, limited integration between Tobii and Smartbox has taken place*”⁵ and that it was therefore “*a relatively quick and simple exercise to specify the scope of the divestiture package under a full divestiture remedy without the need for a complex and drawn-out separation process, by requiring Tobii to sell all its shares in Smartbox and transfer all of Smartbox’s assets and staff to a suitable purchaser.*” In stark contrast, the CMA proposes in the present case to enhance the GIPHY business acquired by Facebook despite not considering deterioration of the GIPHY business pre-IEO to have been so extensive as to warrant an unwinding order.
- (b) In *Eurotunnel/SeaFrance*, the SeaFrance business acquired by Eurotunnel was so limited in scope and scale that there was extensive litigation over whether the SeaFrance business was sufficient to constitute an “*enterprise*” for the purposes of the Act or was merely “*bare assets*” (such that no “*relevant merger situation*” had arisen). Nevertheless, the CMA’s divestiture order in that case did not require Eurotunnel to engage in extensive “*reconstitution*” of the SeaFrance business prior to disposal. It was only required to divest the vessels that it had

⁴ Provisional findings, Para. 6.149.

⁵ Critically, the CMA attributed this “*limited integration*” to the standard form hold-separate provisions of the IEO -- which apply equally in the present case -- and not to the exceptional contribution of the unwinding order issued in *Tobii/Smartbox*.

acquired from SeaFrance and the CMA (then the Competition Commission) concluded that a wider package of assets (*e.g.*, including commercialisation contracts) was not necessary to implement an effective divestment, and may make the divestment package unattractive to a suitable purchaser.

- (c) In *Stagecoach/Preston Bus Limited*, the two businesses' bus services had been substantially integrated. As such, substantial parts of the target's commercial services had been transferred to purchaser, unlike in this case where no such ongoing commercial activities have been transferred to Facebook; GIPHY continues to operate entirely independently and [REDACTED] did not form part of the transaction perimeter. The Competition Commission concluded "...we did not consider that it was necessary, for our remedy to be effective, to restore precisely the same conditions of competition that prevailed in Preston before the period of abnormal competition".⁶ Rather, the Competition Commission focused on creating a re-configured (not reconstituted) package of assets, which was commercially viable and *sufficiently attractive* to a suitable purchaser.

3. *RECONSTITUTION IS UNNECESSARY AND WOULD BE UNATTRACTIVE FROM THE PERSPECTIVE OF A SUITABLE PURCHASER*

- 1.11 Reversion of GIPHY staff from Facebook employment contracts onto GIPHY employment contracts, or the re-entering by GIPHY into third party back-office service supply contracts (since GIPHY did not carry on these services in-house), would be entirely unnecessary. (Moreover, as well as being unnecessary, moving GIPHY staff onto GIPHY employment contracts cannot be achieved without consent. Doing so would be detrimental to those employees' personal interests and, [REDACTED]. The employees could be transferred directly by the acquiring company (*i.e.*, Facebook) to the Purchaser at the moment of sale. Back-office payroll, accounting, HR and insurance services, and the provision of pension benefits, could and would be supplied by any purchaser capable of meeting the CMA's suitability criteria. Indeed, any prospective purchaser may strongly prefer to have GIPHY employees transfer to the employment of the purchasing business (as is typical in the vast majority of M&A deals).⁷ Such reversionary steps are therefore neither necessary in order to implement an effective divestment remedy, nor desirable. To the contrary, such steps would render any divestment package significantly less attractive since any suitable third party purchaser would not wish to pay for outsourced services that it can provide to GIPHY in-house.
- 1.12 Pre-Transaction GIPHY was not a standalone, viable business. It was a loss-making business [REDACTED]. GIPHY's revenue-generating activities did not [REDACTED] and by virtue of GIPHY's revenue team not transferring as part of the acquisition (and other factors), GIPHY's burn-rate reduced to less than [REDACTED] post-Transaction. [REDACTED].
- 1.13 Finally, and as previously explained to the CMA, certain of GIPHY's management team and all of its sales staff were not within the transaction perimeter; they did not transfer to the Facebook business as part of the Transaction, and they were not made redundant by Facebook. As such, any suggestion that Facebook should either reinstate US-based

⁶ *Stagecoach/ Preston Bus Ltd.* [2009], para. 10.48.

⁷ More generally, different suitable purchasers will have a different view on the employees and assets which it requires as part of a divestment package, and forcing wholesale transfer could be viewed as an encumbrance.

sales staff that were never part of the Transaction to begin with (and which certainly could not be achieved without their consent, which is unlikely given that the Transaction occurred more than a year ago and the original sales staff likely took other jobs) or replace them with new staff, does not equate to the reversal of steps taken by Facebook and would not be a merger-specific remedy. Rather, it would require Facebook to take affirmative actions and incur significant burden and expense to add personnel that never fell within the transaction perimeter and were not let go as part of any pre-emptive action. In addition, and as explained above, all of GIPHY's revenue was generated in the United States and its revenue-generating paid alignment services were not offered in the UK; and all of its sales staff were US-based. Therefore, having never owned this part of the GIPHY business, Facebook does not consider that it would be either legal, reasonable or proportionate to take steps to reinstate certain of GIPHY's management and its sales team.

- 1.14 To conclude: a complete divestiture of an acquired business is the ultimate remedy and a "normal sale" is the way in which that remedy is implemented.⁸ To be clear, although Facebook disputes that a "normal sale" would be a reasonable and proportionate remedy in this case, anything exceeding a "normal sale" -- such as the CMA's R&S remedy -- would plainly be unreasonable and disproportionate, not to mention unattractive to any would-be purchaser.

C. THE REMEDIES NOTICE FAILS TO PROPOSE ALTERNATIVES TO A COMPLETE DIVESTITURE THAT WOULD BE FAR LESS INTRUSIVE AND EQUALLY EFFECTIVE IN RESTORING THE *STATUS QUO ANTE*

- 1.15 In any event, even if the CMA's PFs were accurate (and Facebook disputes that they are) the CMA's Remedies Guidance states that "[in] *order to be reasonable and proportionate, the CMA will seek to select the least costly remedy, or package of remedies, of those remedy options that it considers will be effective.*" But the CMA's Remedies Notice fails to contemplate *any* alternative remedies that could be at least as-efficient and less costly than a complete divestiture; and in the absence of any such consideration in due course, as part of CMA's remedies working paper, it would have failed to follow its own Remedies Guidance were it to arrive at the R&S remedy. Doing so, without any explanation as to why it would be reasonable and necessary in the circumstances, would be in contravention of the Parties' legitimate expectations.
- 1.16 Assuming that the CMA's findings were correct (they are not), Facebook suggests below a number of hypothetical less restrictive remedies to the full divestment proposed by the CMA. These options are illustrative of the CMA's failure to adequately consider alternatives to its R&S remedy and are made without prejudice to Facebook's position that any remedy would be disproportionate and unreasonable in relation to the SLC identified, in particular given the lack of a UK nexus with the Transaction.

⁸ In *Ernst & Young P/S v. Konkurrenceradet* (Case C-633/16) ("E&Y"), where the Court of Justice of the European Union ("CJEU") considered the proper interpretation of the gun-jumping provisions contained in article 7(1) of Council Regulation (EC) No 139/2004 of 20 January 2004, the CJEU made clear that the termination of a cooperation agreement by the target pre-merger did not fall within the scope of article 7(1), even if it was carried out in the context of the merger. As such, by parity of reasoning, any pre-Transaction steps taken by GIPHY independent of Facebook, even if in contemplation of the Transaction, cannot reasonably be the subject of any remedies order since these would not be merger-specific.

1. GIPHY OPEN ACCESS REMEDY

- 1.17 On 5 March 2021, Facebook informally offered the following commitment to the CMA, which the CMA rejected.⁹
- 1.18 For a period of 5 years:
- (a) Facebook would undertake to maintain existing and new API Users' access to GIPHY's library under the same terms and conditions as pre-Transaction ("**Open Access**").
 - (b) Facebook would undertake that access to GIPHY's API will not be conditional upon sharing user-specific information with Facebook; GIPHY API Users will remain free to use proxy servers or cache GIPHY traffic, as they are permitted to do (and which in fact they do) today ("**No Conditional Access**").
 - (c) Facebook would undertake not to use, without the consent of API Users, any individually identifiable user-level or aggregate data obtained through the GIPHY API for Facebook's advertising business in the UK ("**No Ads Usage**").
- 1.19 Such a commitment would eliminate any concerns regarding a SLC "*in the supply of social media services worldwide (including in the UK) due to vertical effects resulting from input foreclosure.*" (e.g., paragraph 55(b) of the PFs)
- 1.20 Due to the extremely straightforward nature of third-party API access to GIPHY, there are no plausible concerns regarding the effectiveness of the remedy based on a lack of monitoring or enforcement in the event of non-compliance¹⁰:
- (a) Any attempt by Facebook to deny or degrade Open Access to GIPHY's library would be immediately obvious to the relevant GIPHY API User, which would have every incentive to raise such concerns directly with the CMA (e.g., by sending an email).
 - (b) The same is true of the No Conditional Access aspect of the undertakings, whereby if Facebook endeavoured to insert conditions to accessing GIPHY's Services, including restrictions on use of proxies and/or caching, then API Users would raise this issue with the CMA. In such circumstances, Facebook's informally offered undertakings in lieu of reference gave the CMA the ability to issue written directions to resolve those concerns.
 - (c) With respect to the No Ads Usage, the undertakings enable API Users to protect their user data using proxies and caching. Thus, to the extent an API User has any concern about Facebook's access to its user data, the ability to proxy or cache means that no personally identifiable user data will be available for ad targeting. To the extent that API Users elect not to use the option to control Facebook's access to their user data, Facebook could commit to

⁹ Facebook's letter to the CMA is attached in Annex 1 for ease of reference.

¹⁰ Paragraph 7.5 of the CMA's Mergers Remedies Guidance states for behavioural remedies to have the desired impact, it is essential that there are effective and adequately resourced arrangements in place for monitoring and enforcement, so that there is a powerful threat that non-compliance will be detected and that action will be taken to enforce compliance where this is necessary.

updating the CMA on the design, implementation and maintenance of additional internal safeguards to prevent the use of any user information that GIPHY receives for ads in the UK.

- (d) Finally, the 5 March 2021 undertakings addressed a situation where a GIPHY API User raises a concern with Facebook. In those instances, Facebook would seek to resolve that concern as quickly as possible. Where that concern cannot be resolved to each party's satisfaction, Facebook would commit to raising that concern with the CMA which, if necessary, can issue written directions to Facebook in order to resolve the concern strictly for the purpose of meeting Facebook's obligations under the UILs. In other words, where the API User believes Facebook has violated the UILs, the UILs specifically consider a method by which the API User could involve the CMA.
- 1.21 Facebook believes that the above remedy effectively resolves all conceivable concerns relating to foreclosure through requiring rival "*platforms*" to provide more data (*e.g.*, on individual or aggregate user behaviour). Moreover, its self-executing nature eliminates concerns that the CMA has previously associated with access remedies.
- 1.22 But, even if the CMA considered the above remedy and found it not sufficiently effective, it would still have to consider logical extensions and alterations to that remedy if such extensions would make it effective. It is not the Parties' duty to present the CMA with every imaginable remedy. It is the CMA's duty to "*select the least costly remedy, or package of remedies, of those remedy options that it considers will be effective.*"
- 1.23 So, for example, if the CMA had concerns about the effectiveness of the Open Access remedy with respect to its ability to monitor Facebook's compliance, the CMA could consider ordering Facebook to engage a Monitoring Trustee at its own expense for the duration of the undertakings.
- 1.24 Similarly, if the CMA were concerned about Facebook strengthening its position in online advertising as a result of gaining access to user-level GIPHY data (a baseless concern that has been conclusively refuted), the CMA could have considered limiting Facebook's use of GIPHY user-level data to providing and improving the service, promoting safety and security, complying with legal obligations, *etc.*, or could simply have prohibited the use of such disaggregated data for advertising purposes. As indicated above, depending on the implementation, such a remedy could be effectively self-executing as well.
- 1.25 If the CMA's concern was that the undertaking did not sufficiently address the alleged SLC "*in the supply of display advertising in the UK due to horizontal unilateral effects arising from a loss of dynamic competition*" then it could consider a remedy that would include removing the last sentence of Paragraph 1 from the current GIPHY terms of service (italicized below).

"You shall not use content you obtain through Giphy's products and services to create a database, directory, or index containing GIFs or digital stickers or to improve, edit, augment or supplement any existing database, directory, or index containing GIFs or digital stickers. *In addition, you shall not commingle*

Giphy search results with search results of another provider without Giphy's express written approval."

- 1.26 The CMA's horizontal theory of harm is chiefly concerned that Facebook acquiring GIPHY removes "*paid alignments*" as a potential competing display ad format in the UK. A paid alignment is an ad in GIF format. An advertiser pays the paid alignment provider (which would be a competitor to Facebook) to serve the sponsored ad in response to a user typing in certain keywords, either on the paid alignment provider's O&O property or on the services of its downstream API partners. Without a "no commingling" term of service, *anyone could start a paid alignment business using GIPHY's GIFs*. Consider a third party messaging service that wants to offer paid alignment GIFs on its platform. A user of the service is texting her friends about getting pizza. She opens the GIF search box and searches for "pizza." The service forwards the query ("pizza") to GIPHY. GIPHY returns a pizza GIF feed to the service, which is now free to insert its own sponsored pizza GIFs into the feed and present it to the user.
- 1.27 Nothing hinges on the "paid alignment competitor" in this example being an O&O provider of a messaging service. It could just as well be a pure "paid alignment" player that embeds its ad code/wrapper in the platforms of its downstream partners, receives information about user searches in that manner (*e.g.*, instead of routing GIF searches to GIPHY, the partner could route them through the paid alignment service), obtains the GIFs from GIPHY, intersperses its own ads, and then sends the commingled feed to its partner.
- 1.28 Thus by requiring Facebook to strike a single sentence in the existing GIPHY terms, the CMA could create far *more* competition in the "paid alignment" category than by its proposed complete divestiture remedy. The divestiture remedy will enable *one buyer* to compete in paid alignments using GIPHY's database. The change to GIPHY's TOS would enable an *unlimited number of businesses* to compete with their own paid alignment products.
- 1.29 Against that backdrop, the CMA's complete divestiture remedy is grossly unreasonable and disproportionate. This is particularly true in circumstances where GIPHY does not even carry on business in the UK (see section E below) and the CMA proposes to unwind the Transaction on the basis of a weak and unsubstantiated loss of potential competition theory of harm. In fact, the complete divestiture remedy achieves less in terms of promoting competition "*in the supply of display advertising in the UK*" at infinitely greater cost. Cost not only to Facebook and GIPHY, but also to users, advertisers, and [REDACTED].

2. *PARTIAL DIVESTMENT REMEDY*

- 1.30 The CMA's Remedies Notice fails to consider a *partial* divestiture of GIPHY, even though such a divestiture would address the CMA's stated concerns just as effectively as a complete divestiture at significantly lower costs.
- 1.31 A partial divestment package -- limited to the UK -- could, for example, include the following elements, for some specified time period (*e.g.*, 5 years, which is the amount of time that [REDACTED] contracted with a combined Facebook/GIPHY before the CMA enacted the IEO):

- (a) A white label copy of GIPHY’s content library; and
 - (b) A licence to use GIPHY’s search algorithm (and/or other essential) technology.
- 1.32 [REDACTED]. Even based on the CMA’s most positive view of GIPHY’s prospects absent the Transaction, the PFs conclude that “...*the likelihood of successful expansion by GIPHY was necessarily uncertain at the time of the Merger, our provisional view is that its ongoing efforts to innovate and expand would have driven dynamic competition in the display advertising market.*” In other words, the CMA considers it an “effective” remedy [REDACTED].
- 1.33 The hypothetical partial divestment package outlined here would do a lot better than that at far lower cost.
- 1.34 It would enable a suitable purchaser to utilise GIPHY’s content library and IP to drive the dynamic competition in the UK, which the PFs allege would be lost as a result of the Transaction. [REDACTED], a suitable purchaser would likely have its own user base in the UK and perhaps, its own sales team and, as a consequence of the proposed divestment package, it would have all of the assets necessary to deliver paid alignment services for its advertising customers in the UK; thereby not only restoring any hypothetically lost dynamic competition in the UK, but creating a more competitive position than was the case pre-Transaction. This is particularly true given that [REDACTED]. For API users (by far the largest part of GIPHY’s distribution), as previously explained, branding is irrelevant. Users don’t know whether a GIF is served by GIPHY, Tenor, or anyone else.
- 1.35 The SLC test under the Enterprise Act is directed towards competition within any market or markets in the UK (see sections 22(1)(b) and 35(2)(b)). Thus, if the share of supply test is met, which the Parties dispute, the UK has jurisdiction over the impact of the merger only as it relates to markets in the UK.¹¹ As a consequence, the CMA only has the power to remedy competition concerns as these relate to a market or markets in the UK, since its enforcement powers only extend to addressing the SLC identified (see section 41(4) of the Enterprise Act). For the CMA to intervene in the Transaction, which is between two US businesses, it must consider and justify why any enforcement action connected to the Parties’ conduct outside of the UK can lawfully be justified in order to solve competition concerns in a market in the UK; in particular, when GIPHY does not even carry on business in the UK -- see section E below. If the CMA were to improperly conclude that its powers extend beyond the UK borders to regulate activity in the United States in this case, its Remedies Notice might still have considered the remedy outlined above on a global (rather than UK) basis.
- 1.36 To be clear, Facebook does not believe that a “partial divestiture” -- even limited to the UK -- would be reasonable and proportionate. But the fact that yet another (relatively obvious) alternative to the CMA’s R&S remedy exists that would: (i) preserve the benefits delivered by the Transaction; would be (ii) effective at addressing the CMA’s competition concerns; and (iii) far less expansive and intrusive, demonstrates that the CMA is failing to discharge its duty to consider and “*to select the least costly remedy,*

¹¹ *Sabre Corporation v Competition and Markets Authority* [2021] CAT 11 at paragraph 86.

or package of remedies, of those remedy options that it considers will be effective.” As a result, a complete divestiture remedy is not supportable.

D. DIVESTMENT OF GIPHY WOULD BE DISPROPORTIONATE EVEN IF COMPLETE DIVESTMENT WERE THE LEAST COSTLY BUT EFFECTIVE REMEDY

- 1.37 The CMA’s Remedies Guidance states: *“In exceptional circumstances, even the least costly but effective remedy might be expected to incur costs that are disproportionate to the scale of the SLC and its adverse effects (eg if the costs incurred by the remedy on third parties are likely to be greater than the likely scale of adverse effects).”*
- 1.38 Facebook contends that with respect to a complete divestiture remedy these exceptional circumstances apply, given the CMA’s unprecedented application of the SLC test in the present case. Set against the meagre and speculative loss of competition described in the PFs are the real-world and certain costs of preventing GIPHY from merging with its most significant customer, *i.e.*, the loss of the opportunity to:
- (a) Provide innovative updates to the GIPHY offering, including personalisation of the GIPHY service to 44 million UK Facebook’s users thereby delivering direct end-user benefits;
 - (b) Maintain open access for GIPHY’s API partners, consistent with Facebook’s public commitments and the behavioural undertakings already offered to the CMA;
 - (c) Preserve, enhance, and expand GIPHY’s GIF content library; and
 - (d) [REDACTED].
- 1.39 The disproportionate character of the divestiture remedy is illustrated by the fact that the loss of customer benefits would overwhelmingly fall on ex-UK users and advertisers. The Transaction has no material nexus to the UK. GIPHY is a US-based business with no UK assets, employees, revenues or customers. [REDACTED] of GIPHY’s users and 100% of GIPHY’s advertising customers are outside the UK. Requiring the full disposal of the GIPHY business globally means that the effects of the CMA’s order would overwhelmingly not be felt *“in a UK market”* but rather be imposed on advertisers, users (including 2.9 billion Facebook users who would not enjoy the benefits of the GIPHY integration), and employees abroad. In fact, the Remedies Guidance states that *“[the] CMA will seek to ensure that no remedy is disproportionate in relation to the SLC and its adverse effects.”* The adverse competitive effects that the CMA may consider are limited to the UK. In other words: losses to UK advertisers from diminished (potential, dynamic) competition. Those extremely limited effects from the SLC, discounted by their low probability of occurring, must be compared to the costs that the CMA’s divestiture remedy would impose on users, advertisers (who would forego access to an incrementally more engaged global Facebook user base), Facebook, GIPHY, and their employees worldwide.
- 1.40 Given that not even the CMA is confident in GIPHY’s success (such that it has to resort to a theory of harm based on the motivational effect of GIPHY’s experimental paid alignment advertising driving competition even if it fails), the certain costs of a

complete divestiture worldwide clearly outweigh the uncertain losses from a SLC based on a loss of dynamic competition in the UK.

E. GIPHY DOES NOT CARRY ON BUSINESS IN THE UK

1.41 GIPHY has never had assets, personnel, customers or revenues in the United Kingdom (“UK”). GIPHY’s only revenue-generating activities were paid alignment services, which were only made available to customers in the United States (“US”). The UK nexus to the Transaction is therefore based on nothing more than the unremarkable fact that people in the UK can access the internet.

1.42 Section 86(1) of the Enterprise Act 2002 (the “**Enterprise Act**”) sets out the circumstances in which an enforcement order made under Chapter 4 of the Enterprise Act may extend to conduct outside the United Kingdom. It provides as follows:

“(1) An enforcement order may extend to a person’s conduct outside the United Kingdom if (and only if) he is –
(a) a United Kingdom national;
(b) a body incorporated under the law of the United Kingdom or of any part of the United Kingdom; or
(c) a person carrying on business in the United Kingdom.”

1.43 These are the “*connecting factors*” laid down by Parliament to ensure that it is “*appropriate, rather than exorbitant*”, for the CMA to exercise extraterritorial oversight over conduct which takes place outside the UK.¹²

1.44 GIPHY is neither a UK national, nor a body incorporated under the law of the UK, nor a person carrying on business in the UK. The first of these two points should be uncontroversial as a matter of objective fact. As to the third, the Court of Appeal held in *Akzo Nobel NV v Competition Commission* [2014] EWCA Civ 482 that mere “*involvement*” in a business carried out in the UK, such as the supply of goods (or, by parity of reasoning, services) into the UK market, would not meet the test in s.86(1)(c). In that case, the fact that a substantial part of Akzo’s business was “*transacted*” in the UK was sufficient to bring it within the provision ([33]).¹³ By referring to business “*transacted*” in the UK, the Court meant that goods were sold to customers, and revenue was therefore generated, in this jurisdiction. By contrast, none of GIPHY’s revenue is generated by goods or services sold to customers in the UK, as explained in the merger notice.

1.45 This is consistent with the definition of “*business*” in s.129(1) of the Enterprise Act, which defines that term as professional practice or any other undertaking which is carried on “*for gain or reward*”: the key criterion is thus the obtaining of the

¹² *Akzo Nobel NV v Competition Commission* [2014] EWCA Civ 482 (“*Akzo*”) at [26].

¹³ In this respect the Court of Appeal agreed with the first-instance judgment of the CAT, which rejected the Competition Commission’s argument that mere “*commercial involvement*” in the UK would be sufficient. It said that this could have “*far-reaching*” consequences by including any company whose goods or services ultimately end up in the UK market even though the activities of the company (including any relevant supply transaction) took place abroad. This would confuse “*instances of trading in the United Kingdom and instances of trading with the United Kingdom*” ([2013] CAT 13 at [78]-[80]).

gain/reward, *i.e.*, the generation of revenue. For GIPHY, this takes place exclusively outside the UK.

- 1.46 The Parties acknowledge that what does or does not amount to carrying on business in any particular case is a fact intensive question. In this respect, the CMA has previously explained that it does not consider that it is limited to circumstances in which customers or consumers pay a monetary price for goods or services received in the UK. Rather, it asserts that simply having an app available for download and use by consumers in the UK, as well as having third party integrations with several firms serving UK consumers, is sufficient for this test to be met. By way of justification, the CMA explained that it would be entirely illogical if a two-sided platform where services are provided at zero monetary price to one side were excluded.¹⁴
- 1.47 By implication the CMA has conceded that there must be revenue generation on at least one side of a double-sided platform in order for the test under s.86(1)(c) of the Act to be met, *i.e.*, as a result of the sale of paid alignment advertising services in GIPHY's case. By insisting that GIPHY carries on business in the UK, the CMA fails to have proper regard to GIPHY's *actual* (pre-merger) business activities there. First, GIPHY did not generate any revenue monetising impressions advertising to UK consumers. This is not a case where GIPHY supplied advertising services only to ex-UK brand customers, but placed those adverts with UK consumers thereby indirectly monetising activities in the UK. GIPHY did not serve UK advertisers *and* it did not advertise to UK users at all. Therefore, it is self-evident that GIPHY does not carry on business in the UK for the purposes of s.86(1)(c) since in no way were its activities monetised (directly or indirectly) on either side of its double-sided "*platform*" (using the CMA's term) in the UK. Furthermore, the fact that its UK activities might have been monetised in the future is not the test under the Enterprise Act; the requirement is for GIPHY to actually carry on business in the UK. Second, the CMA conflates GIPHY's API integration partners' UK users with GIPHY's. GIPHY does not currently and cannot advertise to those third parties' users absent their agreement and consent, which it did not and does not have. They are not GIPHY's users. The significant presence of GIPHY's partners in the UK, including Facebook, cannot be conflated with a significant UK presence for GIPHY. GIPHY only provides an input into those third parties' services. As the Court of Appeal made clear, mere "*commercial involvement*" in the UK is not sufficient for the test to be met (see footnote 13 above). Third, GIPHY's owned and operated ("**O&O**") website and app were accessed or downloaded, as the case may be, by UK users on a merely trifling basis and [REDACTED].
- 1.48 The fact that GIPHY's website can be accessed and its app downloaded in the UK does not mean it is carrying on business in the UK. This would extend the CMA's extraterritorial oversight to any operator in digital markets. This would be an extraordinary overreach and it cannot have been Parliament's intention. In this regard, nothing would distinguish the nexus that the CMA claims from any country in the world with internet access (or from any other transaction in which UK users can access the internet).
- 1.49 In summary, GIPHY currently has no existing commercial interest in conducting its activities in the UK. It does not carry on business in the UK for the purposes of section 86(1) of the Enterprise Act and in the absence of an enforcement order being capable

¹⁴ CMA letter to Latham & Watkins, dated 7 August 2020, para. 50.

of application to a company like GIPHY's -- a US company with commercial activities strictly limited to the US -- this clearly demonstrates that the legislature was not intended to apply to acquisitions of such companies. This underscores the importance of the CMA not relying upon a speculative loss of *potential* competition theory of harm (with a negligible, if any, *future* impact in the UK) as a basis for forcing the divestment of an exclusively US business. The inability of the CMA to issue any order against GIPHY raises serious questions as to the enforceability of any divestment order and whether any such order could be effective. These are questions which the CMA must carefully consider, and address, before taking the extreme intrusive step of ordering the sale of a company which does not carry on business in the UK.

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5 March 2021

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BY EMAIL ONLY**

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Re: Facebook/GIPHY - Undertakings In Lieu of Reference

Dear Andrea,

In connection with the CMA’s investigation into the completed acquisition by Facebook, Inc. (“**Facebook**”) of GIPHY, Inc. (“**GIPHY**”, together with Facebook, the “**Parties**”) (the “**Transaction**”), and further to the Issues Meeting held on 3 March 2021, we write on behalf of Facebook to confirm that, if required, Facebook is willing to offer undertakings in lieu of reference (“**UILs**”) to an in-depth Phase 2 investigation.

As explained at the Issues Meeting, Facebook considers that there is no realistic prospect of a substantial lessening of competition on any relevant frame of reference.¹ All four theories of harm raised in the Issues Letter of 1 March 2021 are speculative, unsustainable, and fundamentally inconsistent with the Parties’ internal documents, and the testimony of Alex Chung and Brad Zeff. No amount of additional investigation will disturb these facts. Given this, Facebook wants to work with the CMA to achieve an expedient resolution, in lieu of extending the nine-month investigation for another several months into Phase 2. At the Issues Meeting, and in this letter, we suggest a potential path forward in the form of UILs that address the CMA’s vertical foreclosure and data-related theories. Consistent with its rationale for the Transaction, and its public commitments, Facebook is willing to offer UILs at this phase in order to avoid the unnecessary time and expense of an extended Phase 2 inquiry. Facebook does not concede that any theory the CMA has offered in its Issues Letter is meritorious. Nor should the CMA assume that Facebook will offer these or any other undertakings in the future.

Facebook is prepared to formalise in a UILs offer its commitment to provide open access to GIPHY’s access programming interface (“**API**”) for existing and new partners.

Facebook has designed a set of behavioural undertakings that would address, in a clear-cut manner, the CMA’s concerns regarding input foreclosure and any data advantage allegedly

¹ As noted in the Parties’ merger notice, Facebook believes that the CMA’s definition of Social Media (as defined in the Digital Market Study Report) is inappropriately narrow, and overlooks important sources of competition for users’ time and attention. Additionally, the Parties consider that the CMA’s definition of advertising (as defined in the Digital Market Study Report) is inappropriately narrow and does not take into account the two-sided nature of advertising services.

conferred on Facebook as a result of acquiring GIPHY. The UILs comprise three core elements:

1. Facebook would undertake to maintain access to GIPHY's library, for existing and new API partners, under the same terms and conditions as pre-Transaction for at least five years ("**Open Access**").
2. Facebook would undertake that access to GIPHY's API will not be conditional upon sharing user-specific information with Facebook; GIPHY API partners will remain free to use proxy servers or cache GIPHY traffic, as they are permitted to do (and which in fact they do) today ("**No Conditional Access**").
3. Facebook would undertake not to use, without the consent of API partners, any individually identifiable user-level data obtained through the GIPHY API for Facebook's advertising business in the UK ("**No Ads Usage**").

By maintaining Open Access to GIPHY's API, and on the same terms as pre-Transaction, this would eliminate any hypothetical possibility that Facebook could deny or degrade access to GIPHY's searchable library with a view to harming its social media rivals. This addresses in a clear-cut manner the input foreclosure theory of harm set out in the CMA's Issues Letter.

As a result of the No Conditional Access and No Ads Usage commitments, there can be no data advantage conferred upon Facebook. By undertaking not to use, without the consent of API partners, any individually identifiable user-level data obtained through the GIPHY API (*e.g.*, in the event that a partner were not to use proxy servers or cache GIPHY traffic) to enhance and better target its advertising services, the UILs effectively eliminate any hypothetical concern that the Transaction could endow Facebook with a data advantage that would raise barriers to entry and expansion in display advertising in the UK.

The UILs are clear-cut, comprehensive and entirely resolve the CMA's vertical foreclosure and data-related concerns. In addition, the UILs are straightforward, practical to implement and easy to monitor. Critically, Facebook has every incentive to comply with the UILs in line with its deal rationale and since non-compliance would be easily discoverable; indeed, any attempt by Facebook to deny or degrade access to GIPHY's library would be immediately obvious to the relevant GIPHY API partner, which would have every incentive to raise such concerns directly with the CMA. For this reason, whilst Facebook is prepared to accept the appointment of a monitoring trustee to monitor compliance with the proposed UILs, this remedies package is effectively self-executing.

The UILs would constitute a reasonable and proportionate solution to address the CMA's concerns in the event that it is unable to entirely rule-out input foreclosure and data advantage concerns at the end of its Phase 1 investigation. For the avoidance of doubt, however, Facebook does not concede that any such remedy is necessary or that such concerns are founded in fact. Facebook is nonetheless keen to avoid the time and expense of a Phase 2 investigation.

We trust that this provides a helpful summary of Facebook's UILs offer. However, should you have any further queries in relation to the above, Facebook would be happy to set up a call or respond in writing to provide any further clarification that is needed.

This submission is confidential. Please afford it all available protections against disclosure.

LATHAM & WATKINS

Yours sincerely,

/s/

Jonathan Parker
LATHAM & WATKINS (London) LLP