

COMPLETED ACQUISITION BY

FACEBOOK, INC.

OF

GIPHY, INC.

ME/6891/20

PARTIES' RESPONSE TO PROVISIONAL FINDINGS

DATED 2 SEPTEMBER 2021

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1. PREFACE: NO COMPETITION CONCERNS CAN BE SUSTAINED IN LIGHT OF THE CMA'S POST-PROVISIONAL FINDINGS DISCLOSURE

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 Provisional Findings (“PFs”) of the Competition and Markets Authority (the “CMA”), dated 12 August 2021.

This section contains information disclosed pursuant to a confidentiality ring.

1.2 [REDACTED]¹

1.3 [REDACTED].

A. Horizontal Theory of Harm

1.4 The CMA is concerned that the Transaction has resulted or may result in a substantial lessening competition in the UK market for “display advertising” (using the CMA’s definitions), as a consequence of a loss of “dynamic competition”. [REDACTED].

[REDACTED]

1.5 The CMA’s horizontal theory of harm entirely rests on the idea that GIPHY would most likely have been successful with its paid alignment business model and rapidly expanded it internationally. As we have observed, this conclusion is not consistent with the conduct of the actual and potential investors in GIPHY at the time (*i.e.*, they did not invest). Facebook, who ended up paying \$315 million for GIPHY attributed no value to paid alignments [REDACTED]

1.6 [REDACTED].

1.7 [REDACTED].

1.8 [REDACTED] Either the CMA has failed thus far to make such enquiries or it has failed to record the answers in its PFs. Either way, this is a serious and unacceptable omission. After all, the CMA’s counterfactual rests entirely on the proposition that paid alignments are a viable and attractive business model and that, absent the merger, GIPHY (either under the ownership of its existing investors or in the hands of a different social media company) would have continued and expanded its paid alignments business. This is a critical line of evidential inquiry that any rational and open minded regulator would be duty-bound to pursue. We invite the CMA now to pursue it (or to reveal the content of any evidence it has already received).

1.9 [REDACTED].

1.10 [REDACTED].

1.11 [REDACTED]. It is simply implausible under basic principles of corporate finance that fundraising at a down valuation would be sufficient to fund a rapid international expansion. Rather, the evidence strongly supports the inference that, even if GIPHY had continued in business at all, it would have continued in a diminished and underfunded state.

1.12 [REDACTED].

The striking absence of paid alignments ads in the real world

¹ CMA Digital Market Study, paragraph [REDACTED].

1.13 If GIF paid alignments were the promising business model that the CMA believes they are, then one would expect to encounter them in the real-world at scale, either offered by stand-alone GIF providers or by vertically integrated firms such [REDACTED]. Yet that is not the case.

1.14 Google, the first to vertically integrate in 2018, [REDACTED]:

[REDACTED]

1.15 [REDACTED].

1.16 [REDACTED]:

a. [REDACTED]

b. [REDACTED]

1.17 [REDACTED]

1.18 [REDACTED].

1.19 [REDACTED].

1.20 [REDACTED].

1.21 [REDACTED].

1.22 [REDACTED].

1.23 [REDACTED]: paid alignments are not an attractive business model. [REDACTED]. [REDACTED], the CMA cannot rationally sustain its optimism in the paid alignments business model, which also means that the CMA's counterfactual fails.

[REDACTED]

1.24 [REDACTED].

1.25 [REDACTED].

B. Vertical Theory of Harm

1.26 The CMA is concerned that Facebook has the ability and incentive to cut-off downstream rivals from access to GIFs as a result of its acquisition of GIPHY. [REDACTED].

[REDACTED]

1.27 [REDACTED].²

1.28 [REDACTED]:

1.29 [REDACTED].

1.30 [REDACTED].

1.31 [REDACTED].

² [REDACTED]

1.32 [REDACTED]

1.33 [REDACTED].

1.34 [REDACTED].

C. [REDACTED]

1.35 [REDACTED]. As the CMA states, “*the counterfactual is an analytical tool that is used in answering the question of whether a merger gives rise to an SLC.*”³ If the counterfactual is incomplete and controverted by actual facts, it follows that the conclusions based on the counterfactual also cannot hold and must be revisited.

D. Procedural Violations

1.36 The CMA operates under a public law duty to act fairly and in accordance with the rules of natural justice protected by common law.⁴ In the current case, basic and highly important facts have only been brought to the attention of the Parties – and only to their external advisors – almost at the end of the CMA’s investigation and in an incomplete manner.

1.37 The Parties’ advisors are unaware precisely when the [REDACTED] became known to the CMA. In redacted para. 8.38 of the PFs the CMA states:

[REDACTED]

1.38 [REDACTED]. If that is so, then it can be inferred this information has been known to the CMA throughout almost the entirety of its investigation, *i.e.*, 15 months at the time of this submission.

1.39 [REDACTED].

1.40 It is trite public law that in order for a consultation process to be legally adequate:

*“First, consultation must be at a time when proposals are still at a formative stage. Second, that the proposer must give sufficient reasons for any proposal to permit of intelligent consideration and response. Third, ... that adequate time must be given for consideration and response and, finally, fourth, that the product of consultation must be conscientiously taken into account ... ”*⁵

1.41 The fact that the CMA has not seen fit to disclose this critical information to the Parties much earlier in its investigatory process has resulted in serious prejudice to the Parties’ rights of defence. It is not sufficient to consider that the CMA has discharged its consultation obligations by making this evidence known to the Parties’ external advisors -- 13 days after the publication of its Provisional Findings (and only following a disclosure request from the Parties’ advisors). As the Competition Appeal Tribunal made clear:

³ CMA, 2021, Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report, paragraph 6.12.

⁴ See, *e.g.*, the application of those principles to the withholding of information on alleged grounds of confidentiality by the CMA’s predecessor in *BMI Healthcare v Competition Commission* [2013] CAT 24.

⁵ These are the well-known ‘Sedley requirements’ first stated in *R v Brent LBC, ex p. Gunning* (1985) 84 LGR 168 and endorsed by the Supreme Court in *R (Moseley) v Haringey LBC* [2014] 1 WLR 3947, para. 25.

*“[...] Although the Applicants will in due course be able to make submissions in response to the Provisional Findings, we think it is unrealistic to suggest that once the Group has reached provisional conclusions based upon those underlying analyses, the Group would readily require the CMA staff to adopt a different methodology, or even significantly to revise the underlying analysis. That stage of the inquiry will effectively be passed. Indeed, it seems to us that this is one of the reasons why it is important for the CMA to receive the parties’ response to the Working Papers sufficiently in advance of the Group producing its Provisional Findings.”*⁶

- 1.42 For the reasons explained in the preceding sub-sections, this is critical information on which the Parties should have been given the opportunity to comment at the earliest opportunity or, at the very latest, as part of the working papers. As a consequence of this failure to disclose, the CMA has not only failed to undertake adequate investigatory steps – *entirely* failing to consider or report on the impact of this development for its counterfactual – but has foregone the opportunity to carry out these necessary investigatory steps and provide interested parties with the opportunity to comment on the evidence gathered. The CMA, in turn, has been unable to ask relevant questions informed by the merging parties’ and third parties’ analysis of this evidence. This flaw is not solved by the current disclosure since (i) the information is only being made available to the Parties’ external advisors, and (ii) it has come at a too late a stage in the investigation for the CMA to “*adopt a different methodology*” since that stage of the enquiry has passed. This is a fundamental flaw in the fairness of the CMA’s investigatory procedure.
- 1.43 The CMA’s approach to (non-)disclosure fails to respect the Parties’ rights to a fair hearing⁷, pursuant to which the decision-maker should allow the affected undertakings an opportunity to comment on material facts.⁸ Critically, neither the Parties (only their external advisors) nor third parties had any opportunity to comment on this [§]. Obtaining input and evidence from market participants on this significant development is an essential step to ensure that the CMA’s decision does not overlook or attribute incorrect weight to matters of fact and to ensure that its decision is arrived at pursuant to a fair procedure within the bounds of rationality and legality.

⁶ *Sainsbury’s and Asda v CMA* [2019] CAT 1, para. 64.

⁷ *Interbrew* [2001] EWHC Admin 367, [2001] UKCLR 954.

⁸ *Unichem v OFT* [2005] CAT 8, para. 269 and 278. This related to information provided by the merging parties, but remains applicable by parity of reasoning.

2. EXECUTIVE SUMMARY

- 2.1 The PFs contain fundamental errors of law and fact. Mergers and acquisitions are presumed legal. Under the statutory regime for merger control in the UK, if the CMA wishes to intervene in a transaction, the burden is on the CMA to prove on the balance of probabilities that a *substantial* lessening of competition (“SLC”) is likely to occur as a result of the Transaction in a market *in the UK*. The PFs fall well short of this evidentiary threshold and the CMA fails to apply the correct legal test, which results in erroneous and unsustainable conclusions.

The market power fallacy

- 2.2 The PFs irrationally and unlawfully conclude that Facebook has “*market power*” without engaging in a detailed market definition exercise, but instead rely on conveniently selected arbitrary functional characteristics to define the market. Had the CMA conducted a proper analysis of market definition it would have recognised the material competitive constraints that Facebook faces in those markets in which it is active.
- 2.3 This finding of market power pervades the CMA’s assessment of the Transaction. The PFs emphasise throughout that “[...] *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*” (para. 7.16) and they rely on this unsubstantiated finding to assert (in effect) that *any* lessening of competition can amount to an SLC. It follows that if the CMA’s finding of market power cannot be sustained, nor can its conclusion that the Transaction has resulted or may result in an SLC.

The PFs apply the wrong legal test

- 2.4 Even if a finding of market power can be sustained, which it cannot, the CMA has applied the incorrect legal test. The relevant provisions of the Enterprise Act 2002 (the “**Enterprise Act**”) require the CMA to prove on the balance of probabilities that a *substantial* lessening of competition will occur in a UK market. GIPHY has no UK turnover or presence in the UK and, accordingly, the CMA must rely entirely on a speculative hypothesis of “*potential*” competition. However, even assuming such competition would have eventuated in the UK (which is itself highly doubtful, to say the least), the CMA makes no attempt to evaluate whether any such potential competition would have been likely to have been “*substantial*”. It is only by apparently assuming -- without legal or factual basis -- that *any potential* impact on competition is substantial where the acquirer has (alleged) market power, that the CMA is able to reach its SLC conclusion. In other words, the CMA assumes that upon an assessment that one of the parties to a merger possesses market power there is no need to establish a “*substantial*” lessening of competition. This is wrong in law and such an approach would render the application of merger control in the UK highly unpredictable and create high levels of business uncertainty. Had the correct legal test been applied the PFs would have concluded that no *substantial* lessening of competition could possibly arise for the reasons explained below.

GIPHY’s potential entry is not sufficient to give rise of a substantial lessening of competition

- 2.5 The PFs conclude that the Transaction will lessen competition in the supply of display advertising in the UK by reducing “*dynamic competition*”. The supposed source of “*dynamic competition*” is GIPHY’s “*paid alignments*” advertising product. Throughout its review, the CMA fails to explain how a US-only advertising business with meagre revenues equivalent to [§] of the UK “*display advertising*” market could possibly represent a sufficient competitive threat to support an SLC finding in a market in the UK. Although the PFs conclude (on what is, on any view, a highly speculative basis) that in the counterfactual GIPHY would have been likely to have survived and (implausibly) even enter the UK’s “*display advertising*” market, the PFs make no attempt to quantify the extent of GIPHY’s potential entry in the medium term. The objective evidence is overwhelming that had there been any such entry at all by GIPHY

into the UK “*display advertising*” market, the extent of its impact would have been negligible. Accordingly, the potential for this entry cannot amount to a substantial lessening of competition.

- 2.6 The PFs on occasion apparently seem to suggest that this inescapable conclusion can be circumvented by concluding that GIPHY’s future success in the UK is irrelevant to the analysis of “*dynamic competition*”. In particular, it seems to be suggested in the PFs that even an attempt at entry without success – and without any quantification as to what a minimum threshold of success might be – is sufficient to result in an SLC in the UK.
- 2.7 As noted above, this finding fails to meet the statutory requirement for a lessening of competition to be *substantial*. As the CMA’s own guidance cautions, even a theory of harm based on a loss of “*dynamic competition*” must be supported by evidence that “*the removal of the threat of entry may lead to a significant reduction in innovation or efforts by other firms to protect [...] future profits*” (Merger Assessment Guidelines (“**MAGs**”), para 5.23). It follows that in order for “*dynamic competition*” to arise as a result of a specific potential competitor, a rival firm must perceive a risk to their future profits resulting from that competitor’s efforts to enter or expand in the market. It follows that the risk to profits must meet some minimum standard to prompt a reaction from the incumbent; the threat of potential competition from *any* possible future entrant, howsoever minor, would not be sufficient to prompt any reaction by the incumbent, or therefore, to foster dynamic competition.
- 2.8 The PFs irrationally disregard real-world evidence that in the *three years* since GIPHY launched its failed advertising product: (1) Facebook had not identified GIPHY (or *vice versa*) as a competitive threat in advertising (among 280,000 internal documents), let alone repositioned its development efforts to address such a threat (as the PFs acknowledge “[...] *To date, we have not identified evidence from Facebook’s internal documents that it perceived GIPHY as a potential competitive threat in display advertising, despite its close relationship with GIPHY*” (para. 7.157)); (2) the CMA’s 400-page market study report on digital advertising in the UK did not identify GIPHY as a source of UK advertising competition or even consider GIFs as a promising means of monetizing direct messaging; (3) no third parties have identified GIPHY as an actual or potential rival in “*display advertising*” in the UK (or elsewhere); (4) Facebook attributed zero value to GIPHY’s paid alignment business in the purchase price. The PFs cannot simply disregard comprehensive evidence that GIPHY’s unproven advertising business was irrelevant to Facebook’s advertising development efforts in the UK or further afield.

Vertical foreclosure concerns are unsubstantiated

- 2.9 The PFs conclude that the Transaction has resulted or may be expected to result in an SLC in the supply of social media worldwide (including the UK) due to vertical effects resulting from input foreclosure.
- 2.10 The evidence shows that Google’s Tenor is a strong alternative to GIPHY:
- a. ***Third parties view Tenor as a strong alternative.*** The third party submissions collected by the CMA show that Tenor is considered a strong alternative to GIPHY, with nine out of eleven parties submitting that Tenor is an effective alternative to GIPHY.⁹

⁹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.52 (“*Over the course of its investigation, the CMA received submissions from 11 third party platforms that are supplied by GIF providers. Of these, nine mentioned Tenor as an alternative to GIPHY. Of these nine platforms: (i) five described Tenor as very similar to GIPHY (two of which explained that they had not noticed much or any difference in user experience after switching from one to the other);*

- b. **Data submitted by the Parties shows Tenor is a near-perfect substitute.** Data provided by Facebook from a two day loss of service shows no impact on user engagement following a loss of access to GIPHY.¹⁰ The CMA does not challenge the results of this analysis or the methodology, but rather dismisses it out of hand with no more reasoning than to say that two days is a short period of time (para. 8.71(a)). However, the CMA does not provide any alternative empirical evidence to show that customers would not switch to Tenor (or alternative providers) if GIPHY were unavailable for a longer period of time.
- c. **GIPHY's partners have successfully switched away post-Transaction.** The PFs refer to real world examples of rival platforms switching away from GIPHY to a different provider following the Transaction, but fail to draw the obvious conclusions from these facts for its theory.¹¹ This switching confirms that downstream partners consider that there are viable alternatives to GIPHY; they are willing to switch; and they can do so easily without any deterioration in service.
- 2.11 Other relevant alternatives include (at least) Gfycat and Holler, each of which has the ability (including the financial means) and incentive to expand its offering in response to any hypothetical foreclosure strategy (as discussed in section 8 below).
- 2.12 It follows that the presence of Tenor, and other alternatives, means that the merged-entity could have no ability to foreclose access to GIFs post-Transaction.
- 2.13 The only real concern that emerges from the PFs appears to relate to the possibility that Google may in the future discontinue or degrade Tenor. However, the CMA cannot base their conclusion of foreclosure on this closure/degrading by Google as a mere future possibility that is short of a likelihood. Unless the CMA considers on the balance of probabilities that Google would close/degrade Tenor then they cannot properly find that Facebook would have the ability to foreclose after the Transaction. Otherwise, there is only a possibility of an SLC at some point in the future and not a likelihood of an SLC.
- 2.14 The CMA's concerns that Tenor may be discontinued rest upon a small number of Facebook and GIPHY internal documents which discuss the possibility of Tenor disappearing in the future. However no reference is made to concrete facts or signals on which Facebook/GIPHY might have considered this a possibility and therefore it appears to be based upon pure speculation and without reference to Google/Tenor's actual intentions. In particular, nowhere in the PFs has the CMA provided any evidence from Google or Tenor (e.g., internal documents or interview evidence) indicating that it would have ceased to make its services available (or changed the nature of those services) post-Transaction.¹² To the contrary, the Transaction has been completed for 15 months at the time of this submission and Google's Tenor has continued to offer its services in the precisely the same manner as pre-Transaction. The CMA cannot make

(ii) three described GIPHY as superior in one or more respects; and (iii) one described Tenor as superior in one or more respects.”)

¹⁰ White Paper on Vertical Foreclosure Analysis.

¹¹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.69.

¹² There are other instances in the CMA's Provisional Findings, for example in Market Definition and Market Power, where it indicates that it has contacted Google in relation to other matters: “Google has confirmed to the CMA in the course of this Merger Investigation...” (footnote 287).

adverse inferences in respect of Tenor’s future activities, unless it has evidence that on the balance of probabilities that it is an action Tenor will take.

- 2.15 In addition to Tenor being a (near-perfect) substitute to GIPHY, the evidence presented also fails to show that it is more likely than not that GIPHY GIFs are an important input into Facebook’s “social media” rivals’ services and “access to GIFs impacts the competitiveness of at least some of Facebook’s main rivals”¹³. In fact, evidence from some third parties “characterised GIFs as ‘nice to have’ but not critical or foundational to their growth or user engagement.”¹⁴ Whilst GIFs are therefore useful, they are not a key input for Facebook’s rivals’ services.
- 2.16 The CMA’s vertical foreclosure theory depends critically on its conclusion that GIFs play an important role in the downstream market. As the CMA states: “*The Merged Entity could only harm the competitiveness of its rivals if the input it supplies plays an important role in shaping downstream competition*”¹⁵ (emphasis added). But, crucially, the CMA has failed to gather data from third parties on the extent of usage of GIFs on their services (while Facebook has presented evidence showing that usage of GIFs on its platforms is [X] on average across all surfaces). This is a critical failing. Instead, third parties confirmed that “it was difficult to precisely quantify the importance of GIFs to the engagement of end-users.”¹⁶ Moreover, “several other platforms submitted that other types of creative content may potentially be alternatives to GIFs.”¹⁷ Platforms also stated that “GIFs [are] ‘nice to have’ but not critical or foundational to their growth or user engagement,” while only one out of 11 third party platforms that are supplied by GIF providers, “submitted that maintaining a competitive GIF offering may be important for winning younger users.”¹⁸
- 2.17 Similarly, the CMA has also failed to establish that any foreclosure strategy would have an effect on competition in the UK, but has simply assumed effects absent any evidence, analysis, or quantification. The CMA dismisses the evidence presented by Facebook that there was no effect on user engagement on Messenger Kids even when no GIFs were available, on the basis that it is not a representative platform (although no reasoning is presented as to why this would make any difference). However, it provides no alternative analysis which would shed light on the impact of losing GIFs on user engagement and hence on effect.
- 2.18 Lastly, the CMA has failed to properly analyse or quantify the costs and benefits of foreclosure and, accordingly, failed to properly consider Facebook’s lack of incentives to engage in a foreclosure strategy. In contrast, Facebook has demonstrated that the evidence shows that Tenor is a perfect or near-perfect substitute for GIPHY which customers could readily switch

¹³ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.81.

¹⁴ CMA, 2021, *Complete acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.78.

¹⁵ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 9.49.

¹⁶ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.74.

¹⁷ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.25.

¹⁸ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraphs 4.56, 5.52, and 8.78.

to, and that user engagement appears unaffected by the absence of GIFs so that there would be no downstream recapture - and hence no incentive to foreclose.

- 2.19 Facebook was GIPHY's first partner and it has been GIPHY's largest customer since 2015. [§]. It is important to recall that GIPHY approached Facebook for a sale in 2020, not the reverse.
- 2.20 Despite the PFs' best efforts to paint it as such, GIPHY is not unique nor does it have market power. Facebook itself is heavily using Tenor alongside GIPHY. In addition, Facebook committed publicly on Day 1 -- and then offered to formally commit to the CMA in March 2021 -- to keep GIPHY free and open to anyone, including supporting any partner's ability to completely anonymize its users' search requests, since Facebook has no ability or incentive to foreclose GIPHY's partners.
- 2.21 By seeking to unwind the Transaction – in circumstances where GIPHY does not even carry on business in the UK – not only is the CMA engaging in extraterritorial overreach, but the CMA is sending a chilling message to start-up entrepreneurs: do not build new companies because you will not be able to sell them. The message to investors is: do not back start-ups since the risks to realising a return on investment have increased even further. From Facebook's perspective, the CMA's industrial policy is driving its provisional SLC decision, which is contrary to the evidence before it and cannot reasonably be sustained.

3. THE CMA DOES NOT HAVE JURISDICTION

- 3.1 In *Sabre v CMA*,¹⁹ the Tribunal ruled that the purpose of the share of supply test is “*to identify a merger which does not meet the turnover test, but in respect of which there is a sufficient prospect of a competition concern arising from an overlap in relevant commercial activity as to render it worthy of investigation*” (emphasis added). In accordance with this, the CMA should identify the relevant description of services (the relevant commercial activity) in such a way as to correspond to prospective competition concerns.
- 3.2 The facts, in the present case, are simple: Facebook and GIPHY do not compete in the UK and there is no overlap in relevant commercial activity giving rise to a competition concern.
- 3.3 The PFs fail to establish any connection between (i) the purported overlapping activities in the UK that the CMA identifies to establish jurisdiction (embodied in the relevant description of services) and (ii) the CMA’s expressed competition concerns. In particular:
- a. The CMA considers that the Parties overlap with a share of supply of at least 25% in (i) the supply of apps/websites that allow UK users to search for and share GIFs; and (ii) the supply of searchable libraries of animated stickers; whereas
 - b. The *only* horizontal competition concerns identified by the CMA relate to a loss of *potential* competition in the supply of display advertising services in the UK.
- 3.4 The CMA is unable to establish a connection between the overlapping activities it identifies to establish jurisdiction and its competition concerns for a simple reason: the Parties activities do not *actually* overlap in relevant commercial activity in the UK. This is a vertical transaction. Taking each putative overlap in turn:
- a. In relation to the supply of GIF services, Facebook does not have any of its own GIFs. It only makes accessible to its users GIFs supplied by GIPHY and Tenor. The lack of any horizontal theory of harm in relation to this “*overlap*” demonstrates that in reality it is a solely vertical relationship.
 - b. Facebook’s tiny sticker library is not offered to third parties via an API, unlike GIPHY’s; it is entirely for self-supply and hence there is no reasonable overlap in *commercial activity* supplying searchable libraries of animated stickers, and accordingly no corresponding theory of harm.
 - c. GIPHY does not offer advertising services (of any sort) in the UK. This is not even 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 supply advertising services in the UK, and does not overlap in this respect with Facebook. Again, the fact that the CMA exclusively pursues a horizontal loss of *potential* (*i.e.*, not actual) competition in relation to “*display advertising*” demonstrates that there is in fact no current or actual overlap in advertising the UK.
- 3.5 The CMA’s approach unreasonably stretches the bounds of the share of supply test under section 23(4) of the Enterprise Act by defining the relevant description of services in a particular manner for an improper purpose. It is clear that the CMA’s chosen share of supply categories bear no resemblance to the Parties’ actual commercial activity and consequently these “*overlaps*” cannot give rise to any genuine competition concern in relation to the Parties’ activities. Indeed, it is because the Parties are competing at different levels of the supply chain

¹⁹ *Sabre Corporation v Competition and Markets Authority* [2021] CAT 11 at paragraph 144.

that the overlaps identified are not capable of giving rise to any loss of existing horizontal competition in a market in the UK. The CMA then subsequently goes on to abandon entirely the overlapping areas it has specified for jurisdictional purposes to evaluate other, quite different, hypothetical competition concerns that do not arise from the overlaps it has identified under the share of supply test.

- 3.6 The CMA must have been aware, when formulating its relevant description of services in the way it did, that such overlaps as it had selected did not themselves give rise to any prospective competition concerns. In essence, the CMA appears to have used the share of supply test so as artificially to ensure that overlaps were established in order that it could assume jurisdiction over the merger and subsequently investigate other potential competition concerns, quite unconnected to the overlaps.
- 3.7 Facebook further contends that it cannot have been the intention of Parliament for the description of services to be defined in such a manner and for such purpose. As *Sabre v CMA* makes clear, the prospective competition concern must “*arise from the overlap*”; in this case not only does no concern ultimately arise from the overlap, but it is plain that no concern could ever have arisen from the overlap. This amounts to the CMA using its powers (to define the relevant services) for an improper purpose.
- 3.8 Below the Parties address a number of issues in relation to the alleged categories of overlap, which if corrected demonstrate that there is no basis for the CMA to assert jurisdiction.
- 3.9 The Parties do not repeat their detailed arguments on jurisdiction which have been previously made.

Supply of apps and/or websites that allow UK users to search for and share GIFs

- 3.10 The PFs accept that “[...] *The GIFs that Facebook users can search for on Facebook platforms are provided to Facebook by GIPHY (or Tenor) through an API.*”²⁰ Despite this, and in its attempts to counter the Parties’ submission that GIPHY’s services cannot simultaneously be treated as being both vertically-integrated and horizontally overlapping with Facebook’s, the CMA compares the position to one of dual-distribution where “...*a manufacturer may compete with its distributor downstream through its own direct sales.*”²¹ In response to the CMA’s working papers, Facebook previously submitted that this dual-distribution analogy was entirely misconceived. Facebook is in no way acting as a distributor of GIPHY’s services. Facebook does not “*resell*” GIPHY’s API. Rather, Facebook uses the GIFs it sources from GIPHY as (small) inputs into its own products (e.g., Facebook, Instagram, Messenger). Also, and rather obviously, Facebook does not offer its own “*GIF search APP*”. If a car manufacturer obtains hubcaps from a supplier and incorporates those into its vehicles sold to consumers, it is not then competing with its supplier in the downstream supply of hubcaps, even though those are incorporated into its vehicles.²² For these reasons, the CMA’s contention that the Parties’ activities horizontally overlap in the supply of apps and/or websites that allow UK users to search for and share GIFs must fail.

²⁰ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 3.38.

²¹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 3.38.

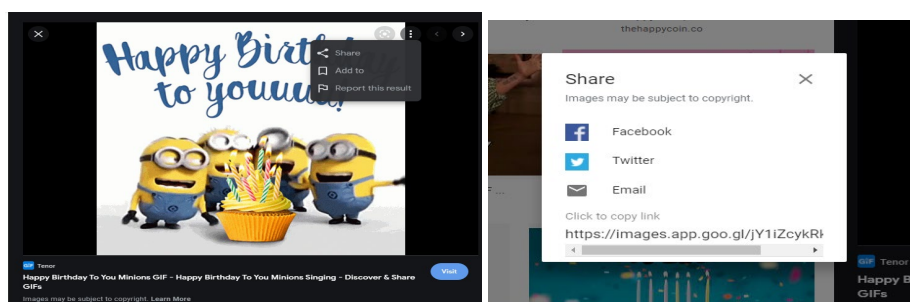
²² Parties’ CMA Working Papers Response – Annex 1, Jurisdiction Working Paper tab, Row 2, Column F.

3.11 Even if one were to hypothetically conclude that the description of overlapping services were reasonable, the PFs make a number of manifest errors in calculating whether the Parties would have a combined share exceeding 25% in the UK.

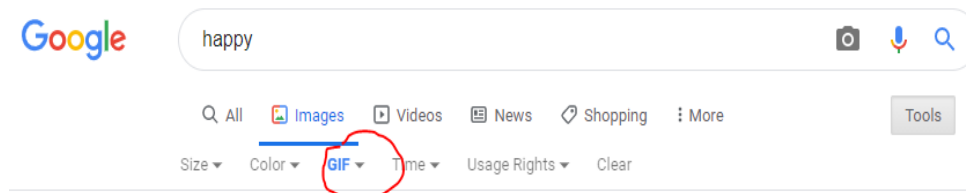
3.12 The PFs purport to exclude Google Web Search since “*Google Web search on desktop does not allow users to ‘search for GIFs’, as the search does not return GIFs in the initial search results; it rather allows users to search for links to GIFs, or static images of GIFs.*”²³ This is an entirely arbitrary distinction. The only difference between Google Web Search using a desktop and Google Web Search using a *mobile* device -- and the latter is included in the share of supply category -- is that the user has to click on the “*Images*” results tab. That’s it. Otherwise, the functionality is identical as explained below.

3.13 The CMA purports to narrow its share of supply category by adding the words “*and share*” to its description (“*The supply of apps and/or websites that allow UK users to search for **and share** GIFs*”). The CMA envisages that to be included in its artificial description of services, the searchable website or app must have a “*share button*”.²⁴ Not only is this arbitrary and unreasonable, since third parties could simply copy the URL link to share the GIF, but the PFs erroneously fail to acknowledge that this share functionality exists using Google Web Search on desktop (the CMA acknowledges this fact when referring to Google Web Search on mobile at para. 3.45(b)):

a. Google Web Search for desktop *does* in fact have a share button. The user can click on the GIF and select the “*share button*” to share it directly on Facebook, on Twitter or by email per the screenshots below:



b. Google Web Search *does* in fact offer a specialised GIF search (contrary to the statement in footnote 104 of the PFs).



3.14 Importantly, the process for searching and sharing GIFs on Google Web Search is no different to the process on GIPHY’s O&O services, which the CMA uses as its basis for creating an “*overlap*” based on the use of GIPHY’s own content on Facebook’s services. The user must: (i) go to GIPHY’s website (or app); (ii) select the GIFs library to search; (iii) enter a search

²³ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 3.45(a).

²⁴ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 3.35.

term; (iv) click-through on that GIF; and (v) click on the “*share button*” to share it, and the button also offers Facebook, Twitter and email (amongst others) as share destinations.

- 3.15 The exclusion of Google Web Search solely on the basis that a user has to click on the “*Images*” tab to see the search results is completely arbitrary. Whilst the CMA asserts in footnote 106 of the PFs that the number of searches for GIFs on Google Web Search is immaterial, it has not provided the Parties (or their external advisors) access to any evidence or data in order to verify that claim. The Parties request that the CMA do so without further delay.

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

- 3.16 The Parties consider that an overlapping category of animated (*i.e.*, non-static) stickers remains artificially narrow for the reasons previously explained.²⁵ These reasons are not repeated. Below the Parties raise a number of additional concerns responding to the reasoning set out in the PFs.
- 3.17 First, the CMA’s use of sticker library size (see PFs Table 2), as the relevant metric for asserting that the share of supply test is met, fails the requirement for a UK nexus. Unlike, say, UK MAUs, the *size* of each Parties’ sticker library says nothing about UK usage or consumption. GIPHY’s searchable content library is powered by technology in and run by employees exclusively in the US. This is not a case of choosing an alternative metric to value or volume sold, as a consequence of another significant overlapping presence in the UK, *e.g.*, number of employees, IP or assets based in the UK; GIPHY literally has no presence in the UK. The fact that GIPHY has a searchable content library which is available to all users of the internet globally, and can of course be accessed in the UK, demonstrates nothing about its share of supply to users in the UK.
- 3.18 Second, the alleged category overlap results from GIPHY making its sticker library available “*direct to users*”, via its O&O website, and Facebook making its sticker library “*direct to users*” on Facebook and Messenger. The PFs concede that the “[...] *The fact that GIPHY also provides GIF stickers to third party platforms via an API/SDK is not material*”. The CMA has failed to properly account for the fact that Facebook’s searchable sticker library is not made available direct to users on a standalone basis at all; rather, it is a self-supplied component of its broader services which can be added by users as an optional sticker pack. In other words, Facebook does not supply a standalone searchable sticker library direct to users, like GIPHY’s O&O services, but rather it is an input into its broader services (much like a car manufacturer supplies hubcaps as part of the car as a whole).
- 3.19 Third, the exclusion of Google’s searchable library of animated stickers on Google Web Search is unreasonable and unsustainable. The only requirement in the category description is to provide a searchable animated sticker library “*direct to users*” in the UK. This is precisely what Google does via its search engine. Contrary to the statement in 3.52(a) of the PFs, users of Google search do not need to click-through to a third party site to share animated stickers (and in any event this is not a requirement of the category description). As explained in paragraph 2.10 above, Google search has a “*share button*” and its “*tools*” functionality enables the image search results to be limited to GIFs only (including animated GIF stickers). Its library is available directly to users in the UK and its sticker content can be shared from the Google web page directly without navigation to a third party site, and in the same manner as users can share content from GIPHY’s O&O services (which are included in the category). Its exclusion is therefore entirely arbitrary.
- 3.20 To the best of the Parties’ knowledge, Google scrapes animated sticker content from GIPHY, Tenor, and all other global providers, and as a consequence its share based on library size would

²⁵ Summarised at paragraphs 3.31 and 3.32 of the PFs.

dwarf the Parties' share by many multiples. For instance, a search for "GIF stickers" returns 275 million results in 0.5 seconds. This compares to GIPHY's library size [§]. If the CMA correctly includes Google's searchable library of animated stickers in the category size denominator, there is no basis to conclude that the Parties would have a combined share exceeding 25%.

4. MARKET DEFINITION AND MARKET POWER

4.1 The CMA has provisionally concluded that:

- a. GIPHY has market power in the global supply of searchable GIF libraries via API/SDK to third party platforms²⁶;
- b. Facebook has significant market power in “*social media*”²⁷; and
- c. Facebook has significant market power in “*display advertising*” in the UK²⁸.

4.2 The CMA has not conducted a sufficient assessment of market definition or market power to meet the evidential standards required to support its conclusion on the balance of probabilities. In particular:

- a. The CMA’s focus on “*functional characteristics*” results in an artificially narrow market definition; and
- b. Even if the CMA’s market definitions were correct, the conclusions on market power are incorrect.

4.3 These points are addressed in detail below.

A. The CMA’s focus on “functional characteristics” results in an artificially narrow definition

4.4 The CMA has failed to carry out a formal market definition exercise. The CMA’s provisional findings in relation to market definition are based on an arbitrary “*functional characteristics*” approach which the Parties have highlighted is not economically robust, and the CMA has itself previously recognised that such an approach is essentially arbitrary and cannot be conclusive evidence in a market definition assessment. The CMA acknowledges that “*just because products display similar physical characteristics, this does not necessarily mean that customers would view them to be close substitutes.*”²⁹ The outcome of this approach is a set of market definitions which draw arbitrary lines between products and services without relying on quantitative evidence or analysis of the economic substitutability of these products and services.

4.5 To the extent that the approach in the PFs makes reference to economic substitutability, in each case this is merely an extension of the functional characteristics approach. The CMA simply argues that because (in its view) the product of one firm has different functional characteristics, this would lead to those products not being substitutes. However, such unsupported assertions do not provide any additional support for the CMA’s views. For instance:

- a. **Social Media:** Despite recognising at several points in its PFs that Social Media providers including Facebook compete for user attention, which is then monetised through advertising, the CMA focuses on a “*social media*” market definition on the

²⁶ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.80.

²⁷ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.113.

²⁸ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.150.

²⁹ OFT, 2004, *Market definition: understanding competition law*, paragraph 3.7.

basis that “*the strongest competitive constraints on Facebook are imposed by providers that are close substitutes, and that providers in other sectors are unlikely to provide a strong constraint on Facebook in relation to social media.*”³⁰ The CMA relies only on an assessment of characteristics to determine these “*close substitutes*” and does not undertake any exercise to establish economic substitutability. In fact, despite YouTube having all the characteristics the CMA initially deems to be important in its Market Study, the CMA is then forced to set out a further degree of delineation to exclude YouTube from the market (which, as the largest single platform at the time of the Market Study on both a MAUs and a time spent basis, makes a substantial difference to shares and hence market power).

The CMA ignores clear evidence that Facebook has responded to the static and dynamic competitive pressure posed by YouTube. For example, in public announcements in July 2021³¹, the head of Instagram stated that Instagram is “*no longer a photo-sharing app*” and that Instagram is repositioning itself to focus on competing with TikTok and YouTube. This move and public announcement was based on internal research by Facebook which suggested that Instagram’s users’ “*number one*” reason for using the app was to “*be entertained*”, which is consistent with a market for user attention in which YouTube and many other firms are competitors.³² The CMA has ignored these developments.

- b. **Advertising:** Facebook considers that economic theory and empirical evidence clearly shows that all types of advertising compete with each other, as all advertising aims to increase current and/or future sales of the advertiser and is therefore substitutable. Advertisers use multiple channels and switch between them to maximise their return on investment, as demonstrated in the “Market Definition and Market Power” paper submitted to the CMA in the Digital Market Study. The PFs fail to consider or present any evidence on the extent of demand-side substitutability between Facebook’s advertising services and GIPHY’s experimental paid alignment advertising services and/or substitutability with other forms of advertising.

Rather, the CMA’s approach to delineating between types of advertising is based on arbitrary functional characteristics. This hinges on an unsupported assumption that search advertising is relevant for targeting consumers with “*intent to purchase*” whilst display (and Paid Alignments) are about “*brand awareness*”. Even a simple examination of examples of “*search advertising*” shows the delineation between search and display on this basis is incorrect. It is likely that a very significant volume of searches on a search engine are unrelated to any intent to buy, but searches still see advertisements. Equally, advertisers can and typically do purchase advertising on Facebook on the basis of click-throughs, conversations or other “*intent to purchase*”-type metrics.³³

³⁰ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.89.

³¹ <https://www.ft.com/content/a204cff9-3a1d-4441-a6e3-28cf6d4a8f99>

³² <https://www.ft.com/content/a204cff9-3a1d-4441-a6e3-28cf6d4a8f99>

³³ For example, a search for the term “Dogs” in Google on 19/08/2021 produces five adverts visible on the first page: two for dog toys, one for a book about dogs and one for an artistic print featuring dogs – these are significantly different and non-substitutable products and yet are shown together. The search term is vague it does not show an intent to buy any of those things, but advertisers have still chosen to align their adverts with that search term and not only with a more specific “dog toy” “dog book” or “dog print” search term which might

Moreover, the CMA is unable to conclude that GIPHY's paid alignment product is a display advertising product, instead only concluding that it is "*closer to*" display than search (para. 5.140). It is not clear how the CMA considers that there is a horizontal overlap where GIPHY's product (under the CMA's *own approach*) is not a display advertising product.

- 4.6 These examples of the arbitrary nature of the CMA's functional characteristics approach demonstrate the need for a proper assessment of economic substitutability. The Parties note that the updated MAGs of March 2021 remove any reference to the hypothetical monopolist test (the "**HMT**") – the standard global framework for assessing the issue of economic substitutability in a market definition context – for the purposes of determining market definition in merger control assessments. (We note that significant concerns were raised by stakeholders as to the removal of this approach.³⁴) However, removing these references does not eliminate the requirement for the CMA to carry out a robust market definition exercise, based on empirical evidence, in circumstances where its conclusion of "*market power*" is based solely or primarily on the level of market share. Indeed, a conclusion of market power – relating to the ability to raise prices above the competitive level – must be based on a properly defined economic market, otherwise it is meaningless. The CMA has failed to undertake a proper market definition exercise based on economic substitutability.
- 4.7 The CMA's approach is out of kilter with the application of competition law and economics across the globe, and with the CMA's previous MAGs of September 2010 (which reflected the prevailing consensus approach that persists to this day). The arbitrary nature of the CMA's approach, coupled with the divergence from global standards, creates significant uncertainty for firms.
- 4.8 In respect of the alleged markets for both "*social media*" and "*display advertising*", the CMA has relied heavily on its findings from the Digital Market Study. However, in that study the CMA acknowledged that it had "*not carried out a formal market definition assessment*" (paragraph 3.25). It is not therefore appropriate or lawful for the CMA simply to rely by reference on the conclusions of the Digital Market Study in this area. Moreover, Facebook made detailed submissions in response to the Digital Market Study, including on market definition and market power, which the PFs fail to address. These submissions are re-attached at Annex 1 in order that they may be properly considered and addressed in the CMA's Final Report.
- 4.9 In addition, the CMA has failed to consider the wider evidence on the changes in competitive constraints and changing nature of competition during a period of significant change – the Covid-19 global pandemic, which has occurred largely in the time since the Digital Market Study. The CMA's Digital Market Study findings relied in part on evidence from Ofcom's Online Nation report 2019. However the 2021 version of this report emphasises significant changes and developments in use of online services since the pandemic, for example highlighting³⁵:
- a. a significant increase in time spent online since 2019;

indicate an intent to buy those products. This is arbitrarily different to a display ad for any of these products appearing on the Facebook page of someone who has shown a previous interest in "dogs".

³⁴ See [Summary of Responses to the Consultation on Revised Merger Assessment Guidelines](#), paras. 2.35, 2.41, 2.91 – 2.96.

³⁵ Ofcom Online Nations report 2021, pages 3 to 8.

- b. changing dynamics in response to the Covid-19 pandemic such as the “*extraordinary growth*” of video calling services³⁶; and
 - c. the competitive dynamics between services such as YouTube, TikTok and Facebook.
- 4.10 These developments clearly indicate that consumer behaviour online has been changing significantly and that new entrants and smaller apps and online services have experienced significant growth, which has undeniably affected competitive dynamics for both consumers and advertisers.
- 4.11 Further, the CMA’s approach to market definition is inconsistent with its competitive assessment. The CMA’s approach to market definition does not recognise the impact of any interactions between the two sides of the market (which an approach based on economic substitutability and the HMT would incorporate). However, at several points in its PFs, the CMA recognises the indirect or “*cross-side*” network effects between the user side and the advertiser side for ad-funded companies which aim to maximise user time spent in order to maximise advertising revenues.³⁷ This analysis clearly supports Facebook’s view that there is a relevant economic market for user attention that is then monetised through advertising, and so that Facebook competes with all platforms that also compete for (finite) user attention given the consequent impact on advertising revenues.
- 4.12 The CMA’s conclusions on the assessment of market power in each market are primarily (if not exclusively) based on its calculation of market shares in its arbitrarily defined markets. A robust assessment of market definition would result in very different findings:
- a. For example, on the user side, the assessment of “*social media*” market shares is heavily biased by the exclusion of YouTube (as well as broader competition from Google and other large news, media, and gaming websites, to name a few examples of services all competing for user attention). Even the inclusion only of YouTube would significantly reduce Facebook’s market share and show that UK users use YouTube more than the Facebook apps combined.
 - b. On the advertising side, the logical and factual inconsistencies in the CMA’s approach to “brand awareness” and “intent to purchase” demonstrate that Facebook competes in a significantly broader market that includes -- at the very least -- other advertising competitors such as Google. In this case, Facebook’s share would be much lower.

B. Even if the CMA’s market definitions were correct, the conclusions on market power are incorrect

- 4.13 Market power, as set out in the OFT Assessment of Market power (adopted by the CMA) “...arises where an undertaking does not face effective competitive pressure...Market power can be thought of as the ability profitably to sustain prices above competitive levels or restrict output or quality below competitive levels.”³⁸
- 4.14 Whilst a high market share may be a necessary condition for the existence of market power, it is not sufficient to base the assessment of market power only on the existence of high market shares. Therefore, even if the CMA’s market definitions were correct, it would still be

³⁶ Data the parties submitted to the CMA from Comscore shows that when considering a broader range of competitors competing for time spent, Facebook and Messenger’s share of time spent across a range of companies fell by 5 percentage points over the one year period from April 2020 to March 2021. Competitors such as TikTok, Twitch and many others experienced a growth in share over that same period.

³⁷ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, e.g. paragraphs 5.113 and 8.153.

³⁸ OFT 2004, *Assessment of Market Power* (adopted by the CMA Board), Paragraph 1.3-1.4.

necessary for it to consider whether the firm in question has been able to sustain prices above competitive levels or restrict output or quality below competitive levels. The CMA has failed to do so and has ignored ample evidence that demonstrates this is not the case. The conclusion that GIPHY has market power in the supply of a searchable GIF library is entirely without foundation:

- a. The CMA ignores the highly relevant evidence that: GIPHY has always offered its content to API partners for *free*, similarly to other GIF providers (and so it is clearly pricing at, not above, the competitive level). The CMA offers no evidence at all of GIPHY’s supposed market power in the form of any hypothetical ability “*profitably to sustain prices above competitive levels or restrict output or quality below competitive levels*”.
- b. [§], in particular since its API partners’ users were not its own.³⁹ The PFs acknowledge that “[...] *One of the greatest challenges facing innovative, digital companies is building a sizeable user base for its products and services, which can be monetised subsequently, often through advertising*”⁴⁰, but the PFs then fail to reach the obvious conclusion that GIPHY’s large API traffic numbers cannot be conflated with a significant user base on GIPHY’s O&O services.
- c. GIPHY’s API partners can easily switch to other providers, including Google’s Tenor (which the overwhelming majority of third parties described as at least as good as GIPHY), and such switching has taken place post-merger. It is clear that GIPHY did not have the “*ability profitably to sustain prices above competitive levels*” or to “*restrict output or quality below competitive levels*”. It follows that there is simply no evidential basis for the PF’s conclusion that GIPHY has market power.

4.15 With respect to the CMA’s conclusions that Facebook has market power in “*social media*” and “*display advertising*”, the CMA has also failed to evidence how this manifests in the form of higher prices or a restriction of output or quality:

- a. Facebook offers its “*social media*” service to users for free, in common with other attention platforms (and so it is pricing at the competitive level, indicating no market power).
- b. Facebook has reacted to the competitive pressure from TikTok by repositioning its Instagram offering, and offering new and recent innovations such as Reels. However, the CMA dismisses the impact of Tiktok on competitive conditions in the market based on the fact that during Tiktok’s growth, based on the CMA’s analysis of shares, Facebook’s share “*remained largely unaffected*”.⁴¹
- c. Finally, as the submissions in Annex 1 demonstrate, Facebook’s cost per action (“CPA”) (*e.g.*, sale, click or form submit) has remained constant over time, demonstrating a constant quality-adjusted price for advertising, notwithstanding the growth in Facebook’s advertising business. Accordingly, there is no relationship between market power and market share in the data and any conclusion that relies on such a relationship is in contradiction of the facts.

³⁹ See the evidence summarised at paragraphs 7.42 and 7.47 of the PFs.

⁴⁰ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 7.44.

⁴¹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.107.

- 4.16 Given the weight placed on GIPHY and Facebook's assumed market power in the remainder of the CMA's PFs, the serious shortcomings in the CMA's approach to market definition and market power undermine the CMA's entire PFs in relation to both horizontal and vertical concerns.

5. COUNTERFACTUAL

- 5.1 The CMA has provisionally concluded that the most likely counterfactual which would have prevailed in the absence of the Transaction is that: (i) Facebook would have continued to procure GIFs from GIPHY, and (ii) GIPHY would have continued to supply GIFs, innovate, develop its products and services, generate revenue and explore (with the financial and commercial support of investors) various options to further monetise its products. The PFs concluded that this would have occurred regardless of GIPHY's ownership, *i.e.*, whether under its pre-Transaction ownership structure (receiving financial support from investors) or if it had been sold to an alternative purchaser, possibly another “*social media platform*”.⁴²
- 5.2 In reaching this provisional conclusion, in respect of GIPHY's activities, the CMA has incorrectly applied its own MAGs and failed to conclude on the single most likely counterfactual absent the Transaction. The MAGs specify that “*the CMA will select the most likely conditions of competition as its counterfactual.*” (paragraph 3.13). In other words, the Guidelines expressly state that, at Phase 2, the CMA will select the *single* most likely counterfactual.
- 5.3 Contrary to its own guidance, the CMA has incorporated a variety of counterfactuals within a single description in order to give the impression that the single most likely counterfactual has been selected (*i.e.*, the continued development and growth of paid alignments advertising services, at paragraph 6.47). Whereas in reality, it is an exercise in obfuscation as part of which the CMA casts a veil over a number of differing counterfactuals, which if properly and independently considered would have significant implications for the conditions of competition against which the Transaction should be assessed. In particular:
- a. ***Absent the Transaction GIPHY would only have received reduced funding from investors sufficient to continue in survival mode.*** [X] required to sustain GIPHY's loss-making revenue business and to enable GIPHY “...to develop its products and services, generate revenue and explore [...] various options to further monetise its products.” As an alternative to the Transaction, the evidence demonstrates that investors were considering a fundraise of only [X], which was substantially below GIPHY's stated aim. This is all in a context where [X]. Plainly, this is not a context which suggests GIPHY was set for rapid international expansion; rather, the circumstances dictated a requirement for scaled-back GIPHY operations thereby making it highly unlikely that GIPHY would have had the means to grow its revenue business, including by expanding into the UK. The record shows that GIPHY was considering substantially reducing, or even eliminating, its revenue-generating activities absent the Transaction.⁴³ Of all the unlikely counterfactuals that the CMA considers, the “*GIPHY would have raised funds and continued*” option is the least likely by far, but even if the CMA considers it to be plausible the CMA cannot ignore the fact that the extent of funds raised would have been insufficient to fund a rapid international expansion.
 - b. ***Absent the Transaction an (entirely hypothetical) alternative purchaser may not have even pursued paid alignments.*** There is no evidence that GIPHY would have been acquired by an alternative purchaser. In the absence of any other offers to acquire GIPHY, despite a sales process conducted over several months, the PFs do not identify a specific alternative purchaser. However, if (hypothetically) GIPHY had been acquired by an alternative purchaser, that purchaser would likely not have wanted to acquire GIPHY's revenue business and sales team; Facebook did not. Another buyer

⁴² CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 6.150.

⁴³ GIPHY board deck, April 2020.

would also likely not have wanted to pursue experimental paid alignments, because such a buyer would have a much more straightforward way of monetizing GIPHY – by selling ads on its own service; in other words, exactly as Facebook intends to do. The CMA has not supplied any evidence from any prospective alternative buyer to suggest that it would have done anything different than Facebook intends to do. The identity of a would-be purchaser is crucial to determining what would have happened absent the Transaction, if GIPHY were acquired by another company, including the impact on its paid alignments offering (this would vary with the identity of the purchaser). No alternative purchaser actually made an offer for the GIPHY business. As a consequence, this element of the counterfactual cannot be sustained.

- c. ***A GIPHY platform fee would have been at the cost of expanding its paid alignments business model.*** The PFs consider that GIPHY could have introduced a platform fee as a short-term solution to its cash-flow issues.⁴⁴ However, notwithstanding that this was unlikely for the reasons previously submitted⁴⁵, the PFs fail to have any proper regard to the impact of introducing a platform fee on GIPHY's prospects for entering into revenue share agreements with its partners in order to pursue its paid alignments business model. Put simply, even if not strictly binary, the CMA cannot escape from the conclusion that the adoption of platform fees would have reduced (even further) the prospects for expansion of its paid alignments revenue business.

- 5.4 The examples raised above further serve to demonstrate that the counterfactual analysis is incomplete. Whilst the CMA has stated that GIPHY would remain in the market, continue to innovate and compete, it has not examined *how* GIPHY's business would be affected by the relevant counterfactual. For instance, how would reduced funding affect its prospects and business plan? Any potentially successful GIPHY would need to obtain sufficient investment in order to be able to continue to experiment with and develop their paid alignments service. [§]. The PFs entirely duck this issue in this counterfactual assessment.
- 5.5 Finally, the PFs allege in the competitive assessment that Google's Tenor may not have been incentivised to offer its services post-Transaction, or not in the same manner, and therefore it would not necessarily have continued to be as effective a rival to GIPHY. That is speculation without evidence. In making this claim, the CMA has failed to consider this point in the counterfactual of the PFs at all and nowhere in the PFs has the CMA provided *any* evidence from Google's Tenor (*e.g.*, internal documents or interview evidence) indicating that it would have ceased to make its services available (or changed the nature of those services) post-Transaction. To the contrary, the Transaction has been completed for 15 months at the time of this submission and Google's Tenor has continued to offer its services in the precise same manner as pre-Transaction. The CMA cannot make adverse inferences in respect of Tenor's activities, unless it has evidence that on the balance of probabilities that it is an action Tenor would have taken.

⁴⁴ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 6.39 and 6.50.

⁴⁵ Summarised at paragraph 6.55 of the PFs.

6. THE TRANSACTION DOES NOT LEAD TO A LOSS OF POTENTIAL COMPETITION

- 6.1 Stepping back, it is important to bear in mind that the Transaction involves adding to Facebook a financially troubled provider of an unproven ad category that never made more than [§] and that never sold anything or had any staff in the UK. Nevertheless, the PFs have provisionally concluded that the Transaction has resulted in or will result in an SLC in the supply of display advertising services in the UK arising from a loss of “*dynamic competition*”. By “*dynamic competition*” the PFs appear to mean, in summary, potential competition together with the propensity of Facebook (or possibly others in the relevant markets) to react to such potential competition.
- 6.2 The insuperable problem for this theory is that the PFs do not come close to establishing that the Transaction would result in a *substantial* lessening of competition in any market or markets in the UK.⁴⁶
- 6.3 The PFs apparently consider that they can satisfy the requirement for the lessening of competition by simply finding that Facebook has “*market power*” in the supply of “*display advertising*” in the UK.⁴⁷ This raises two threshold legal issues:
- a. First, if the CMA’s finding of “*market power*” cannot be sustained, its SLC finding fails.
 - b. Second, even if its finding of “*market power*” were properly substantiated, which it is not, the CMA still cannot ignore the requirement that it must establish that the potential lessening of competition is “*substantial*”. Merely because a party to a merger has “*market power*” does not mean that any loss of competition (howsoever speculative and negligible) amounts to a *substantial* lessening of competition.
- 6.4 The Parties do not repeat their points on (the lack of) market power which are set out in detail in Section 4 above. In respect of the second point, the CMA has irrationally disregarded real-world evidence of [§]; concluding that its success is irrelevant to the analysis of “*dynamic competition*” and apparently suggesting that any attempt at (or desire for) success – without any quantification as to what the minimum threshold of success must be – is sufficient to result in an SLC. This finding fails to meet the standard of proof required by the Enterprise Act. Had the CMA applied the correct legal test to assess the competitive effects of the Transaction, it would have recognized that no SLC could possibly arise from the acquisition of a company with no existing UK advertising business, whose most aspirational forecasts estimate that it might have a share of supply of c. [§] of UK display advertising many years into the future (and the PFs offer no alternative estimate). This cannot possibly be “*substantial*” on any view.
- 6.5 It bears emphasising, and as explained in Facebook’s response to the Remedies Notice, 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, which

⁴⁶ Section 35(2)(b) of the Enterprise Act.

⁴⁷ 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.

clearly demonstrates that the legislation 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 with a negligible, if any, *future* impact in the UK, as a basis for forcing the divestment of an exclusively US business. It must have robust evidence which demonstrates that not only would GIPHY have entered the UK to compete in the supply of display advertising services, but that it would have succeeded to a sufficient extent that any loss of competition would be substantial. The Parties expand on this point below.

6.6 In summary, there are two key failings with the assessment set out in the PFs which completely undermine the CMA’s conclusions on an SLC arising due to horizontal effects:

- a. The CMA’s analysis of horizontal effects does not meet the required standard of proof; and
- b. The CMA has mischaracterised the role of GIPHY as an important source of dynamic competition in the supply of “*display advertising*” in the UK.

6.7 We explain these failings in greater detail below.

A. The CMA’s analysis of horizontal effects does not meet the required standard of proof

6.8 The loss of potential competition theory requires that an extended sequence of events to be more likely than not to occur.⁴⁸ The PFs contend that the Parties’ framework for assessing the impact of the Merger on potential competition ‘*purports to introduce levels of certainty and foresight, in relation to sequential ‘steps’, which are neither necessary nor appropriate*’ and that the steps identified ‘*are not sequential links in a chain that must each be demonstrated*’.⁴⁹ The CMA also contends that these steps are not factually or economically independent of one another and are not binary in terms of outcome.

6.9 In relation to the observation that the steps identified are “*not sequential links in a chain that must be demonstrated*”, the CMA has failed to set out which of the steps it considers not to be sequential. It is very common in merger analysis (or other competition law assessments) that a particular theory of harm only holds if several conditions are present. The steps the Parties have identified are the correct sequence of events that would need to be demonstrated. In other words, these are the necessary conditions which you have to believe for the CMA’s theory of harm to hold water. If any one of these steps is unlikely, then it follows as a matter of logic that the whole theory of harm is unlikely. If the CMA considers that these are not sequential links in a chain, it is incumbent on it to explain why in detail, whether this applies to all of the identified steps and *how* this affects its assessment of likelihood.

6.10 The CMA further attempts to side-step this evidential requirement by arguing that the steps are interdependent, and so seems to suggest that if it can demonstrate that one link in the chain holds, it can conclude that all the links in the chain hold.⁵⁰ In other words, the PFs appear to

⁴⁸ As set out in the Parties’ Initial Submission, at paragraph 1.14(d), the sequence of events was as follows: 1) GIPHY would need to have obtained significant external funding; 2) GIPHY’s significant API partners would need to have entered into revenue sharing agreements, including Facebook; 3) GIPHY would need to have successfully expanded its paid alignment services internationally, including to the UK; 4) GIPHY would need to have become a significant player as part of a broader digital advertising frame of reference in the UK; and 5) GIPHY would need to have succeeded in monetising messaging with advertising where all others had failed.

⁴⁹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 7.20 to 7.21.

⁵⁰ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 7.21.

consider that since events may be interdependent, it does not need to conclude on their independent likelihood.⁵¹ This approach would only be correct if there was a perfect correspondence between the steps, such that if the first step holds, the second step follows necessarily. The CMA appears to assume that this is the case again without explanation.⁵² But it is clearly incorrect. For example, finding a source of funding does not mean that GIPHY would necessarily be able to agree revenue share agreements with other firms, or that its paid alignments advertising product would be demanded at scale by advertising customers in the UK. Even if certain of the steps might be probable, if one of the other steps does not hold true then it is not possible to conclude that there can be an SLC. In other words, the interdependence of the steps does not remove the necessity for demonstrating that *each step* is sufficiently probable so as overall to lead to an SLC on the balance of probabilities.⁵³

- 6.11 More generally, the CMA has attempted to create artificial certainty around certain events by selectively focussing on evidence, disregarding the necessary sequencing of events and ignoring factors which show that on any objective analysis that it is clear that GIPHY was unlikely to have entered “*display advertising*” in the UK in the medium term. The PFs place little to no weight on evidence provided on GIPHY’s fundraising struggles and the evidence from its investors which corroborate the fact that its revenue generating model was experimental and unproven. For instance, one third party considered that “*GIPHY was not yet close to a ‘breakthrough’ with its advertising model*” and “*most [third parties] recognised some substantial challenges with achieving success at scale*”.⁵⁴ The CMA also fails to place any weight on oral evidence given by GIPHY’s Chief Strategy Officer clearly explaining that it was “*...premature to be thinking about entering into any other international market.*”⁵⁵
- 6.12 It is right to note that, with respect to the prospects of GIPHY’s future success in a UK “*display advertising*” market, the PFs concede “*the likelihood of successful expansion by GIPHY was necessarily uncertain*” (para. 7.103). That is, however, a serious understatement.

B. The CMA mischaracterises the role of GIPHY as an important source of dynamic competition in the advertising market

- 6.13 The PFs contend that it is not necessary to establish that GIPHY would have been a successful future competitor in the UK advertising market in order for there to be an SLC. The CMA’s conclusions are heavily reliant on its characterisation of GIPHY being a dynamic competitor which would have had a significant impact on Facebook and others players in the “*display advertising*” market in the UK. The CMA’s most recent merger guidelines state “*Firms that are making efforts or investments that may eventually lead to their entry or expansion will do so based on the opportunity to win new sales and profits, which may in part be ‘stolen’ from*

⁵¹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 7.20 to 7.21.

⁵² In any event, and as a matter of logic, the interdependence works much more strongly in reverse. If GIPHY does not find sufficient alternative funding, it is much less likely to develop a successful advertising product. But, finding a source of funding does not mean that GIPHY would be able to agree revenue sharing agreements with other firms, or that its paid alignments advertising product would be demanded at scale by advertising customers in the UK, or that these would ultimately succeed.

⁵³ For example if you have i) a means of reaching an audience; ii) a good agent; and iii) amazing material/songs; you are still unlikely to become the next big singing sensation if you don’t have iv) a good singing voice. Even though being a good singer might make it more likely that you have a good agent or can get access to the best material, that interdependence does not remove the necessity of each ingredient.

⁵⁴ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, Appendix C: Summary of Third Party Calls, paragraph 21.

⁵⁵ See GIPHY Main Party Hearing Transcript, pages 81 and 82.

the other merger firm. Incumbent firms that are making efforts to improve their own competitive offering may do so to mitigate the risk of losing future profits to potential entrants. In this sense, potential entrants can be thought of as dynamic competitors, even before they effectively enter and begin supplying customers."⁵⁶

- 6.14 It therefore follows that in order for a substantial loss of dynamic competition to arise, the CMA does need at least to establish either that it is likely that GIPHY would, within a reasonable timeframe, have successfully expanded into the UK at scale or that it is likely Facebook would have responded to the threat of GIPHY's expansion irrespective of whether GIPHY succeeded. The PFs establish neither point.

GIPHY would not have successfully expanded into the UK at scale

- 6.15 It is wholly unrealistic to suppose that GIPHY would (within the medium term or within any reasonable period) have successfully penetrated the UK "display advertising" market such as to introduce significant further competition. As the Parties have previously explained⁵⁷, even if GIPHY's boldest (and highly implausible) revenue forecasts were met, GIPHY's share of "display advertising" in the UK would have been [X%].⁵⁸ While the PFs disregard the Parties' calculations⁵⁹ they do not attempt themselves in any way to estimate the magnitude of GIPHY's potential UK revenues or market shares. If the CMA is to rely upon a hypothesis of potential, additional competition it is, however, obliged to forecast, at least in approximate terms, what it contends the extent of that future competition would be and to set out the evidence on which it reaches such an estimate. This is essential so that the extent of the potential competition hypothesised can be assessed. The CMA has thus far failed to do so.
- 6.16 In relation to a response to dynamic competition, the "incumbent firm" (using the term in the CMA's guidance) must perceive a risk to their future profits resulting from that competitor's efforts to enter or expand in the market. It follows that the risk to profits must meet some minimum standard to prompt a reaction from the incumbent -- otherwise the threat of potential competition from any possible future entrant would be sufficient to foster dynamic competition, and on the CMA's approach, lead to a merger concern.
- 6.17 To generate any material dynamic competition effect, the CMA must show that on the balance of probabilities Facebook would have viewed GIPHY as a sufficiently credible threat such that it would have reacted to such a threat absent the merger. However, despite offering paid alignments for three years at the time of the Transaction, there is no evidence to suggest that Facebook ever viewed GIPHY as a credible advertising competitor or would likely have done so in the foreseeable future. Facebook's internal documents confirm this: GIPHY is never mentioned as a competitor, and Facebook showed no signs of reacting to a potential threat of GIPHY in the messaging function, even in circumstances where GIPHY had requested (and Facebook had declined) a revenue share agreement, meaning that Facebook was fully aware of GIPHY's paid alignments services. Indeed, the PFs acknowledge "[...] To date, we have not

⁵⁶ CMA, 2021, *Merger Assessment Guidelines*, paragraph 2.36.

⁵⁷ Parties response CMA Working Papers, paragraph 1.31.

⁵⁸ As previously explained, these numbers also are unrealistically positive since GIPHY's forecasts were predicated on it entering into revenue share agreements with its tier 1 revenue partners, i.e., Facebook and Snap, and the Parties have presented evidence that these partners did not intend to enter into revenue share agreements (see PFs paragraph 7.70). The PFs have failed to take proper account of this relevant consideration when considering GIPHY's future prospects, including by reference to its ability to expand at scale into the UK.

⁵⁹ A response to this dismissal is included in [Annex 2](#).

identified evidence from Facebook's internal documents that it perceived GIPHY as a potential competitive threat in display advertising, despite its close relationship with GIPHY" (para. 7.157).

- 6.18 In truth, not only is the existence of any potential competition in "display advertising" in the UK from GIPHY highly speculative but it is also obvious that any such competition would be negligible in its extent. At most, there was the possibility of a miniscule incremental increase in competition from a miniscule new competitor. It is wholly implausible that Facebook would regard GIPHY's entry to the UK as a credible risk to Facebook's future revenues.
- 6.19 Unsurprisingly, the CMA has also provided zero evidence of any other advertising competitor expressing concerns or responding to the threat of GIPHY's entry into the UK advertising sector. Indeed, in the US, where GIPHY's paid alignment proposition was available for multiple years, there does not seem to be any notable competitive response, even from competitors which offer near-identical products and services in all other respects, as is the case with Tenor. This is a critical failing (amongst others) in the CMA's PFs. The CMA has presented no evidence that would explain why Facebook or other competitors would only react to such a threat in the UK advertising market and not react to GIPHY's advertising activities in the US. The reality is that no one perceived GIPHY's paid alignment model as a threat, and that is a fatal flaw in the CMA's theory of harm.
- 6.20 As the Parties have explained⁶⁰, even if GIPHY's boldest (and highly implausible) revenue forecasts were met, GIPHY's share of "display advertising" in the UK would be between [3%]. While the PFs disregard the Parties' calculations⁶¹ (and do not attempt in any way to estimate the magnitude of GIPHY's potential UK revenues), the miniscule speculative impact this would have is not consistent with Facebook perceiving GIPHY's hypothetical entry to the UK as a risk to Facebook's future revenues.⁶²
- 6.21 Even if Facebook viewed GIPHY as a potential threat to its future revenues (contrary to all evidence), for a conclusion of an SLC arising from the Transaction, the CMA would need to demonstrate that Facebook's competitive behaviour in the UK would differ significantly absent the Transaction (and lead to worse outcomes as a result of the merger). The CMA has failed to meet this threshold:
- a. The CMA relies on Facebook's internal documents to demonstrate that Facebook considered the possibility of monetising GIFs in the future as evidence that absent the merger it would develop products that might compete with GIPHY's paid alignments.⁶³ That is incorrect. Monetizing GIFs does not mean monetizing GIFs *with a paid alignment business model*. GIPHY had no choice but to push a paid alignment model because it had no O&O audience to speak of and no access to the audiences of its API partners. Facebook (or anyone with an O&O audience and an existing ads business) has no such constraints, and thus no motivation to pursue an inferior monetization option. The CMA also ignores that the context of this discussion was as part of

⁶⁰ Parties response CMA Working Papers, paragraph 1.31.

⁶¹ A response to this dismissal is included in Annex 2.

⁶² As previously explained, these numbers also are unrealistically positive since GIPHY's forecasts were predicated on it entering into revenue share agreements with its tier 1 revenue partners, i.e., Facebook and Snap, and the Parties have presented evidence that this was not an option. The PFs have failed to take proper account of this relevant consideration when considering GIPHY's future prospects.

⁶³ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 7.131.

Facebook's internal correspondence in analysing potential benefits of the Transaction, and -- critically -- was ultimately considered too speculative to form part of the valuation or deal rationale. There is no evidence that Facebook would have attempted this absent the merger or in direct response to competition from GIPHY. In fact, internal documents show that Facebook indicated to GIPHY that it was *not* interested in Paid Alignments as a partnership opportunity with GIPHY or any other independent third party.⁶⁴

- b. The CMA also relies on scant evidence that Facebook tested a service which would [redacted]⁶⁵, concluding that, absent the Transaction, Facebook would have developed services that compete against GIPHY's paid alignment offering. That claim is irreconcilable with the facts. Facebook is constantly running myriad ad (and other) experiments at all times. [redacted] is but one small example of Facebook's constant (and consistent) drive to innovate, in the face of strong competition from a wide range of advertising offerings, and that testing is no longer even being carried out.

6.22 The CMA's assessment of dynamic competition relies on GIPHY being a unique and significant source of competition, while disregarding competition (and potential competition) from numerous other sources. The CMA points to its findings on GIPHY's share of the supply of GIFs to suggest that no other potential competitor could have played a similar role in the dynamic competitive process.⁶⁶ That conclusion is implausible on its face. Indeed, the CMA offers no (credible) explanation for why dynamic competition could *only* have come from a *single* competitor supplying GIFs, of all things -- nor is there one.

6.23 Even if one (incorrectly) accepted the CMA's arbitrary focus on GIF providers as the only conceivable source of dynamic competition in advertising, the CMA has not shown why Tenor, which is owned by Google -- the largest online advertiser in the UK⁶⁷ -- could not be an equally important source (let alone *any* source) of dynamic competition in advertising (to pick one of many possible examples).

6.24 In failing to consider dynamic competition from a myriad of existing and potential entrants in the "*display advertising*" category (not to mention actual or potential competition in the broader advertising category), the CMA has plainly mischaracterised the role GIPHY would have played as an important source of dynamic competition. The CMA has presented no evidence to show that Facebook's ongoing investment and innovation would differ with or without the threat of entry from GIPHY in the UK. Facebook faces significant competition from a large variety of sources, many of which currently or have the potential to have a much larger impact than GIPHY had -- or was ever likely to have. For example, Instagram's recent pivot from a 'photo-sharing app' towards a 'entertainment' and 'video' app was in direct response to the strong competitive constraint placed on it by TikTok and YouTube, which in turn was driven by changing consumer habits.⁶⁸ This is but one example of Facebook innovating in response to competition, demonstrating that Facebook does (and will) respond where there is a credible and significant risk to its future profits.

⁶⁴ Facebook Submission, '[Annex 010.5 - Request for Approval](#)', 1 April 2020.

⁶⁵ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 7.134.

⁶⁶ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 7.34(c).

⁶⁷ CMA - Online platforms and digital advertising: Market study final report, 1 July 2020.

⁶⁸ <https://www.ft.com/content/a204cff9-3a1d-4441-a6e3-28cf6d4a8f99>

6.25 In summary, the CMA's loss of potential competition theory is obviously inadequate to establish a *substantial* lessening of competition. The evidence presented by the CMA fails to meet the requisite standard of proof and the CMA has failed to correctly apply the SLC test under the Enterprise Act. In circumstances where GIPHY currently has no commercial activities in the UK, it is incumbent on the CMA to evidence not only would UK entry have occurred, but that any such entry would have been sufficient that its loss would result in a *substantial* lessening of competition. The Parties' position and the evidence is clear: GIPHY would not have entered the UK in any foreseeable timeframe absent the Transaction and, even if it did, it would not pose a sufficient risk to Facebook's future profits for it to be considered a significant competitive constraint.

7. THE TRANSACTION DOES NOT LEAD TO VERTICAL FORECLOSURE CONCERNS

7.1 The CMA has provisionally concluded that Facebook/GIPHY has, or will have, both the ability and incentive to vertically foreclose social media rivals' access to GIPHY, with the effect being an SLC in the UK.

7.2 The PFs have not evidenced on the balance of probabilities that the Transaction has or may result in an SLC as a result of vertical foreclosure effects for the following reasons:

- a. The CMA has put forward no evidence that makes it more likely than not that Facebook has the ability and incentive to foreclose rivals; and
- b. The CMA has neither attempted nor succeeded in establishing (on the balance of probabilities) any effect of foreclosure, or the overall impact on UK consumers, which is necessary to establish an SLC under the Enterprise Act.

7.3 We address each of these failings in turn. First, however, we summarize the key uncontroverted evidence:

- a. All the evidence the CMA has presented confirms that Tenor is an equal competitor to GIPHY; actual switching by third parties from GIPHY to Tenor supports this.
- b. Any foreclosure theory requires that GIFs are an economically important input into social media services. Facebook has demonstrably shown -- using its own data -- that this is not the case. The CMA has collected *no* data from third parties, or presented any of its own empirical analysis, to suggest otherwise.
- c. Crucially, there has been no quantification of the effect of a foreclosure strategy by Facebook, or any evidence that there would be an effect, meaning Facebook would gain nothing from foreclosure and thus has no incentive to pursue such a strategy.

A. Facebook does not have ability or incentive to foreclose rivals

7.4 A balanced evaluation of the evidence demonstrates that the CMA has formed conclusions that cannot be supported on the balance of probabilities.

Tenor is a near-perfect substitute

7.5 The evidence shows that Google's Tenor (among other GIF providers) is a strong alternative to GIPHY. Where GIPHY's partners can easily and straightforwardly switch to at least one strong alternative -- which some have already done -- there is no basis to conclude that the merged entity would be able to successfully foreclose their access to GIFs. The evidence and data demonstrate:

- a. ***Third parties view Tenor as an equivalent alternative.*** The third party evidence collected by the CMA shows that Tenor is viewed as a strong alternative to GIPHY, with nine out of eleven parties interviewed stating that Tenor is an effective alternative to GIPHY.⁶⁹ Indeed, one party stated that Tenor was *superior* to GIPHY. Of the minority who considered GIPHY superior on some characteristics, no evidence was presented on whether these third parties viewed this difference as material.

⁶⁹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.52.

Additionally, internal Facebook documents clearly identify Tenor and GIPHY as equivalent.⁷⁰

- b. ***End users cannot distinguish between GIPHY and Tenor.*** Data provided by Facebook from a two day loss of service shows no impact on user engagement following a loss of access to GIPHY,⁷¹ therefore confirming that end users cannot distinguish between GIPHY and Tenor GIFs. Without citing any analytical work or evidence to the contrary, the CMA has concluded that this observed response is “*not necessarily indicative of the effect of such a change over the longer term*”⁷² which might materialise if a provider did not have access to GIPHY. Moreover, additional evidence presented by the CMA confirms that third parties which have made long term switches to Tenor have seen no adverse impact on engagement, and in some cases have seen greater GIF usage.⁷³ The CMA has presented no evidence that rival platforms, and ultimately users, would face an inferior GIF service such that rivals would be unable to compete with Facebook were they no longer to have access to GIPHY’s GIFs.
- c. ***GIPHY’s partners have successfully switched away post-Transaction.*** The PFs refer to real world examples of rival platforms switching away from GIPHY to a different provider following the Transaction, but fail to draw the obvious conclusions from these facts for its theory.⁷⁴ This switching confirms that downstream partners consider that there are viable alternatives to GIPHY; that they are willing to switch; and that they can do so easily. The CMA has not provided any evidence that these rivals have experienced a loss of competitiveness following the switch, which would be essential to prove the CMA’s hypothesis that rivals would “*likely face a lower quality GIF offering, and reduced GIF-related innovation and product development if they were to switch to an alternative GIF provider (including Tenor)*”.⁷⁵ In direct contrast to this, the CMA has received submissions from two third parties suggesting that “*they had not noticed much or any difference in user experience after switching*” between Tenor and GIPHY⁷⁶ and one third party “*observed a 4% lift in GIFs being sent when integrated with Tenor compared to GIPHY*”.⁷⁷

7.6 As explained in the Counterfactual section above, the CMA suggests that Google may not have an incentive to maintain Tenor’s services in the future. The CMA states that given Google is not a social media platform, it may have different incentives to develop Tenor and as

⁷⁰ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.17.

⁷¹ White Paper on Vertical Foreclosure Analysis.

⁷² CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.22.

⁷³ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.52 (e).

⁷⁴ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.69.

⁷⁵ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.48.

⁷⁶ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.52.

⁷⁷ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 5.52 (e).

Google/Tenor evolve, “it is possible that Google will no longer see Tenor’s availability to third parties as a priority”.⁷⁸ This is pure speculation, based on zero evidence. If Google’s priorities for Tenor are “possibly” different to priorities that Facebook may have, this has always been the case -- with or without the Transaction. If the CMA views it as “possible” that Google’s priorities and the development of Tenor will change in the future for reasons unrelated to the Transaction, this should form part of the CMA’s assessment of the relevant counterfactual based on relevant evidence from Google. The CMA has not considered this in its counterfactual and, therefore, cannot reasonably make adverse inferences as to Google’s post-Transaction conduct, absent any evidence to support those assertions, and in support of its unsubstantiated conclusion that there are insufficient alternatives to GIPHY to defeat a foreclosure strategy.⁷⁹

Other alternatives to GIPHY and Tenor continue to compete and expand

- 7.7 The PFs also dismiss the competitive constraint posed by alternatives such as Gfycat and Holler. The PFs recognise that “[...] both Gfycat and Holler appear to be making efforts to expand, and indeed Holler has recently raised external funding...” However, they then cursorily dismiss each supplier’s expansion prospects on the basis that “...the timeliness and sufficiency of such expansion is not clear...”⁸⁰ The PFs entirely fail to engage in any analysis as to how a (hypothetical) foreclosure strategy would impact the ability and incentive of these providers to expand post-Transaction (as discussed further in section 8 below).

GIFs are not an important input into the downstream services

- 7.8 In addition to Tenor being a (perfect) substitute to GIPHY, the evidence presented also fails to show that it is more likely than not that GIPHY GIFs are an important input into Facebook’s “social media” rivals’ services and “access to GIFs impacts the competitiveness of at least some of Facebook’s main rivals”⁸¹:
- a. ***Submissions from third parties contradict the CMA’s conclusion that GIFs are an important input.*** A balanced assessment of third-party evidence fails to support the CMA’s finding that “GIFs are an important input to compete in the supply of social media services”.⁸² To the contrary: “Most platforms said that it was difficult to precisely quantify the importance of GIFs to the engagement of end-users.” Only two parties claimed that GIFs are “important”, while two parties claimed GIFs are merely “nice to have”.⁸³ The balance of third party evidence demonstrates that the large majority were ambivalent and two expressly said GIFs were not important. On the other side of the ledger, only two (of all third parties interviewed) said that GIFs were

⁷⁸ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraphs 8.24 to 8.27.

⁷⁹ For the avoidance of doubt, speculation in Facebook internal documents as to what Google’s Tenor might have done absent the Transaction, if GIPHY’s services were no longer available, is not dispositive in circumstances where the CMA can ask Google directly.

⁸⁰ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraph 9.66.

⁸¹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraph 8.81.

⁸² CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraph 8.81.

⁸³ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraph 8.78.

important. It is thus a mischaracterisation of the evidence to suggest that, on the balance of probabilities, GIFs are an economically “important” input into social media services.

- b. ***The CMA has failed to gather GIF usage data from third parties.*** Facebook submitted during the Phase 1 Issues Meeting that it was essential to gather GIF usage data from third parties in order to objectively analyse whether GIFs were an important input. The CMA staff indicated that that was beyond the scope of a Phase 1 investigation. However, the case team has failed to gather data from third parties in Phase 2 (or, at least, the PFs do not report this data). This is a critical failing. Indeed, the only third-party data referred to in the PFs demonstrate that GIFs are *not* an important input; and there is no reason to believe that the data would not be the same for other third parties:

“The searches for GIFs and GIF stickers on Apple’s iMessage service represent only a small proportion of the total number of iMessages sent in the UK. On the figures given by Apple we estimate these to be a ratio of 1 GIF search to approximately [redacted] messages. Although this could be seen as a low ratio, we do not consider it indicates that the data on GIF searches provided by Apple is incorrect; the ratio may, for example, be linked to differences in the context in which iMessages are used, as compared with other forms of messaging and social media. Indeed, we have calculated the equivalent ratio of GIF searches to total number of messages sent for WhatsApp and Google Messages, and found these to be lower than the ratio for Apple: [redacted] [redacted]...”⁸⁴

- c. ***GIF usage on Facebook’s services is low.*** Facebook’s data (presented to the CMA) shows that the proportion of content containing a GIF across Facebook surfaces is on average [redacted]. GIFs therefore account for a very small minority of content (notwithstanding the CMA’s attempt to selectively highlight the surface with the highest proportion - in which the proportion of content containing a GIF is still only [redacted] and represents only one part of the wider Instagram service). Despite this clear evidence, as well as data the Parties have provided which shows the relative usage of GIFs compared to other engagement drivers, the CMA has instead based its assessment on a small number of internal documents which did not address the overall importance of GIFs. The CMA has therefore failed to give a fair consideration to the extent to which GIFs drive engagement relative to other tools, misrepresenting both the data and internal documents it has reviewed. Indeed, given that the data precisely identifies how important GIFs are, it is not necessary for the CMA to try to assess this from internal documents.

Facebook has no incentive to foreclose

- 7.9 The CMA has undertaken no analysis to establish the incentive for Facebook to pursue a foreclosure strategy.⁸⁵ The evidence that is available concerning Facebook’s future plans reveals its intentions -- from the very beginning -- to keep GIPHY *open* to third parties. The PFs acknowledge that, in the hands of an alternative “social media” player, there would be no incentive to foreclose GIPHY’s partners, but then inexplicably fail to demonstrate why the situation would be different for Facebook: “[...] *we note that whilst a sale to a third party, for example a social media platform, would have remained a possibility, such a sale would not have, in principle, affected GIPHY’s basic incentives to continue to supply GIFs, innovate,*

⁸⁴ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 3.45(e).

⁸⁵ This is in contrast to other recent cases such as the *Liberty Global Plc / Telefonica S.A., Tesco / Booker* and *ICE / Trayport* merger inquiries in which the CMA presented technical appendices analysing the merged entity’s incentives to foreclose.

*develop its products and services and generate revenues, doing so independently of Facebook.*⁸⁶

- 7.10 There are significant costs involved for Facebook in pursuing a foreclosure strategy. GIPHY would lose users which would reduce the incentive for content creators to keep producing and uploading GIPHY content. The CMA acknowledges that this is important for GIPHY, noting: “[...] *To attract creators of quality content, a GIF provider needs to offer wide user reach*” (para. 4.19) and “[...] *We agree that, as the Parties suggest, there is a benefit to the GIPHY service in maintaining widespread distribution of the service, as this makes it attractive for brand partners and other content creators.*”⁸⁷ Additionally, Facebook would be subject to reputational and tangible costs for renegeing on its public commitments and contractual agreements to keep GIPHY open. The CMA has made no attempt to quantify these costs and weigh this against the potential benefits of foreclosure. As such, there is currently no basis in the existing evidence to suggest that Facebook has any incentive to foreclose rivals. It is unclear how -- against all of the evidence showing that Facebook has no incentive to foreclose -- the CMA has been able to determine that “*the costs of foreclosure are limited*” (but apparently only “limited” for Facebook, not for any of its rivals, whose incentives would be different -- according to the CMA), nor has the CMA sought views from content creators or third parties to support its mystifying conclusion.⁸⁸
- 7.11 As with the costs of foreclosure, the CMA has made no effort to quantify the benefits to Facebook of foreclosure. As shown below, the CMA has presented no evidence that there would be any loss of engagement from rivals that would be recovered by Facebook, and Facebook’s evidence demonstrates no loss of engagement even if no GIFs were available.
- 7.12 Unsurprisingly, given the minimal incremental cost of keeping GIPHY open to other API partners as well as Facebook and the ability to maximise GIPHY’s value by maintaining similar terms of service, Facebook considers the most profitable approach -- entirely consistent with Facebook’s public statements, its internal documents, and its March 2021 offer to the CMA to make a formal commitment -- is to keep GIPHY open and available to third parties. Indeed, the CMA has reviewed nearly three hundred thousand documents, none of which indicate Facebook had any incentive or intention to engage in a foreclosure strategy.
- 7.13 Further, there is no evidence from internal documents that Facebook had any intention or incentive (strategic or otherwise) to undertake the speculative partial foreclosure strategies the CMA has considered. None of these strategies have been considered in any of the many documents considering merger rationale and evaluating the value of GIPHY. Nevertheless, the CMA considers that Facebook could partially foreclose through three potential mechanisms which it broadly characterises as “*degrading the quality of GIPHY’s service to rivals*”⁸⁹. In fact the only way Facebook could do this (in principle) would be if it were to directly degrade the quality of GIPHY’s API/SDK by, for example, reducing the API/SDK response time, reducing the range of content supplied or requiring platform fees. This would result in costs similar to those described above in that usage of GIPHY would reduce and GIPHY would become less attractive to content creators. Additionally, Facebook would risk breaching

⁸⁶ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 6.149.

⁸⁷ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.108.

⁸⁸ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.139 (b).

⁸⁹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.10.

contractual terms of existing agreements with partners such as Snap. Facebook has no incentive to do this and the CMA has failed to explain why it believes Facebook would not honour its current contractual agreements beyond its assumptions from the MAGs that “*such contracts may not completely remove a firm’s ability to harm its rivals*”⁹⁰, and it has failed to evaluate the magnitude of the costs and benefits of such an approach to Facebook.

- 7.14 The other mechanisms the CMA describes (reprioritising innovation and data foreclosure) are limited to effects on rivals’ relative competitive position as these centre around Facebook using GIPHY to enhance its own product offering relative to rivals. Such a strategy would be a merger efficiency which would give rise to benefits to consumers, and hence this theory is an unacknowledged “efficiency offence”. However, the CMA also concludes that it has “*not seen any evidence that there will be such efficiencies as a direct result of the Merger.*”⁹¹ If so, no efficiency offence concerns can arise and the CMA’s approach is internally inconsistent.

B. The CMA has failed to establish any effect of foreclosure, or the overall impact on UK consumers, which is necessary to establish an SLC

- 7.15 Even if the CMA were to overcome the myriad evidential gaps in its assessment of ability and incentive, to conclude that it is more likely than not that there will be an SLC in the UK as a result of vertical foreclosure, it is essential that the CMA provide an analysis of the effect of foreclosure on a market in the UK.

- 7.16 The CMA has not attempted any quantification of this effect. Instead, it suggests four unsubstantiated, hypothetical scenarios which, in the CMA’s view, all lead to the same broad outcome that Facebook’s rivals in the supply of social media services would be weakened.⁹² The CMA’s assumptions are that Facebook could:

- a. Degrade GIF functionalities for rivals, weakening competition;
- b. Limit rivals’ opportunities to improve platforms that do not yet use GIFs or innovate with new functions which could benefit from GIFs;
- c. Prevent rivals’ from benefiting from future GIPHY innovations; and
- d. Use GIPHY’s data to identify emerging trends of competitive effects.

- 7.17 The PFs set out no assessment of the effect on end users if GIPHY/Facebook engaged in any of these strategies. The only available evidence on effect was presented by Facebook and related to the Messenger Kids outage -- which can be used to explore the impact on engagement from a complete absence of GIFs (*i.e.*, a substantially greater impact than any of the speculative scenarios set out above). This showed no impact on user engagement. The CMA rejects this analysis on the basis that the user profile of Messenger Kids may not be representative of the user profile of users of GIFs. However:

⁹⁰ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.98.

⁹¹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 9.88.

⁹² CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraphs 8.146 and 8.147.

- a. the CMA presents no evidence to suggest that the response of users on the Messenger Kids platform to an absence of GIFs would be any different to the response of any other users; and
- b. the CMA presents no alternative evidence of the effect on user engagement of an absence of GIFs, despite the Parties presenting a possible methodology which could be used to assess such an effect.

7.18 The CMA's assessment is therefore entirely unsubstantiated.

7.19 Moreover, in the hypothetical scenario that Facebook were able to foreclose through reprioritising innovation and development towards the requirements of Facebook's own services,⁹³ or through data foreclosure (requiring data from third parties as a condition of supply),⁹⁴ these are "efficiency offences" since they rely on the Transaction enabling Facebook to improve its product offering for users, thereby directly improving consumer welfare. In other words, the theory is that Facebook's service would become so vastly superior as a consequence of owning GIPHY, that rivals would cease to compete (or compete less fiercely) and/or exit the market. In proving such a theory would result in harm to competition, the CMA would need to demonstrate that any consequent adverse effect would outweigh the direct improvement to consumer welfare. For this to hold, the CMA would have to prove the following:

- a. the strategy would allow Facebook to develop a significantly improved product;
- b. rivals would choose not to or be unable to compete with Facebook's improved offering (either with comparable or different innovations);
- c. rivals would compete less fiercely and/or ultimately exit the market; and
- d. the negative impact on users arising from the loss of competition in the longer term would outweigh the short term benefit of the improved product offered by Facebook.

7.20 The PFs fail to address these points at all. However, the available evidence demonstrates that these conditions do not hold:

- a. If Facebook's strategy involved "*reprioritising innovation and development of GIPHY's API/SDK services*", the aim would be to improve the quality of the user experience on Facebook. This does not prevent rivals from innovating. Rather, it is simply the case that Facebook has innovated and rivals will now face competitive pressure to also improve their own products. Rivals would likely choose to compete with that innovation, for example, either by partnering with Tenor or another GIF library, developing their own self supply, or through some other form of innovation to make their platforms more attractive to users. This process would result in further improvements to consumer welfare. The CMA has provided no evidence that rivals would be unable or unwilling to compete with innovation of this type, nor that the overall impact would be detrimental to consumer outcomes.

⁹³ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.10 (b.ii).

⁹⁴ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.10 (b.iii).

b. If Facebook were to make “access to GIPHY’s GIFs conditional on the API/SDK partner providing data about their users or aggregate trends to Facebook”,⁹⁵ this would have no direct impact on the quality of rivals’ “social media” services. As the CMA acknowledges, the additional amount of data available to Facebook from GIPHY “would likely be incrementally small”.⁹⁶ The CMA has failed to show that the potential benefit to Facebook from any incremental increase in data would outweigh any costs if such a strategy gave Facebook an incremental competitive advantage. If Facebook could use that data, the CMA suggests it could “identify competitive threats or react to emerging market trends before other rivals are able to”⁹⁷ - this contradicts the CMA’s finding in its Phase 1 decision that “...the amount of new data gained by Facebook and the impact that this data may have on Facebook’s data advantage may be limited”⁹⁸ and it is not consistent with the CMA’s recognition in the PFs that any benefits of additional data would be incrementally small. Finally, using data to “improve targeting [of] advertising”⁹⁹ would also result in benefits to advertising customers. As above, the CMA has provided no evidence that rivals would be unable or unwilling to compete with innovation of this type, nor that the overall impact would be detrimental to consumer welfare.

7.21 The CMA has stated that Facebook would only gain an incremental amount of data relative to what it already gathers, and that it does not consider that it has seen sufficient evidence that efficiencies would arise from the further integration of GIPHY into Facebook’s services and resulting innovation. There is therefore no basis to suggest that Facebook would be able to produce a product offering that rivals are unable to compete with. Any such finding would be inconsistent with the CMA’s findings on (the lack of) efficiencies resulting from the Transaction.

7.22 It is essential that the CMA is able to evidence the effect on rivals of a foreclosure strategy in order to establish that there is, on the balance of probabilities, an SLC in a market in the UK. Given the complete absence of any analysis, the CMA has failed to meet this evidentiary threshold.

7.23 Finally, it is important to note for the record that Facebook offered at the end of Phase 1 to make a series of commitments expressly designed to address any conceivable concerns related to the CMA’s vertical theory of harm as part of a “GIPHY open access” remedy, which the CMA rejected.¹⁰⁰

⁹⁵ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.10 (b.iii).

⁹⁶ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.91 (a).

⁹⁷ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.93.

⁹⁸ CMA Phase 1 Decision, paragraph 28.

⁹⁹ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings* report, paragraph 8.93.

¹⁰⁰ Letter from Facebook’s advisors to the CMA dated 5 March 2021.

8. BARRIERS TO ENTRY AND EXPANSION ARE LOW

- 8.1 The Parties disagree with the CMA's conclusions that there are high barriers to entry and expansion in the supply of GIFs and have submitted a range of evidence in respect of this previously.¹⁰¹ In particular, the costs of product development are low and network effects can be accessed by multiple firms simultaneously through end user multi-homing (which is common).
- 8.2 The CMA states that post-merger "*the largest social media and messaging platforms would own their own GIF providers, or otherwise have long-standing relationships with GIF providers...and therefore may deter such entry and expansion*"¹⁰² and that "*The significant market power of Facebook in social media and display advertising markets...may intensify the impact of already high barriers to potential entrants in relation to GIF provision.*"¹⁰³ Absent the Transaction, the largest social media and messaging platforms would still have had 'long-standing relationships' with GIF providers, or would 'own their own GIF providers', so it is unclear why entry and expansion barriers would 'intensify' relative to the counterfactual post-Transaction. Whilst it is true that GIPHY was not owned by Facebook previously, Facebook has maintained its access to Tenor and the CMA has not presented any evidence to suggest that Facebook intends to switch to using only GIPHY in the future.¹⁰⁴ As such, the conditions around barriers to entry are almost identical to those faced pre-Transaction.
- 8.3 Importantly, the CMA is inconsistent in the way it considers the counterfactual, the theories of harm and the barriers to entry and expansion. In its counterfactual scenario the CMA assumes that it is possible for GIF suppliers, like GIPHY, to successfully monetise through advertisement. Moreover, in its theories of harm it assumes that customers (*e.g.*, TikTok or Snapchat) will be harmed by foreclosure of GIPHY, creating a need for these customers to contract with another partner. In such an environment, these partners will either switch without harm to Tenor or, if they had concerns with Tenor, they would switch to rivals, like Gfycat or Holler. The Parties maintain that the CMA must analyse the barriers to entry and expansion in a post-merger scenario assuming that its theories of harm apply. Moreover, if the CMA believes paid alignments are a credible route to monetise, it must consider this also for rivals like Gfycat and Holler.
- 8.4 Thus, if there were a barrier to entry resulting from GIPHY's presence and scale,¹⁰⁵ this would fall away if Facebook/GIPHY engaged in a (hypothetical) foreclosure strategy since the removal of GIPHY would mean improved opportunities for smaller players to develop relationships with large API partners to grow in size and quality. This is not a case where *de novo* entry is required: there are a number of existing and viable alternative GIF suppliers, including Gfycat and Holler, which could quickly and easily expand in response to a foreclosure strategy. In respect of Holler, the CMA notes that it recently, in 2021, raised US\$36 million

¹⁰¹ See the summary included in 'CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*', paragraphs 9.4 to 9.7.

¹⁰² CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraph 9.74 (a).

¹⁰³ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraph 9.74 (b).

¹⁰⁴ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraph 5.66.

¹⁰⁵ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraphs 9.31 to 8.33.

in additional funding. [§]– as set out in the Counterfactual section above – yet paradoxically the CMA concludes that “...it is unclear whether this level of funding would be sufficient to enable timely expansion at the scale required.”¹⁰⁶ Whereas for GIPHY it concludes that this sum would be sufficient for it to innovate, grow and compete, including expanding into the UK. The two conclusions are irreconcilable.

¹⁰⁶ CMA, 2021, *Completed acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report*, paragraphs 9.62.

MARKET DEFINITION AND MARKET POWER

Paper on the CMA's analysis to date

March 2020



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1 EXECUTIVE SUMMARY

- 1.1.1 This paper assesses three areas of the CMA’s analysis to date in the course of its market study into online platforms and digital advertising, including in its Interim Report (the “**Interim Report**”), namely the: (i) approach to market definition; (ii) assessment of market power; and (iii) analysis of barriers to entry and expansion.

The CMA’s approach to market definition is too narrow and lacks a robust grounding

- 1.1.2 In relation to market definition, the principal issue with the CMA’s approach is that no rigorous and structured market definition exercise has been attempted. Rather, the CMA has assumed certain (inappropriately narrow) market definitions which do not take into account the two-sided nature of the market in which Facebook operates.
- On the user side, the CMA’s approach is based on an arbitrary and inconsistent ‘functional characteristics’ approach, which contradicts the CMA’s own merger guidelines. No meaningful attempt has been made to assess the extent of economic substitutability between different platforms and services, which is key to any determination of market definition.
 - On the advertiser side, the CMA’s approach is similarly arbitrary and based on the functional characteristics of different types of advertising. No attempt has been made to assess robustly the extent of economic substitutability between types of advertising and, where such evidence exists, it has been ignored.
- 1.1.3 Both empirical evidence and economic theory show that all advertising channels 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 return on investment (“**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.
- 1.1.4 The substitutability between different advertising channels and media is demonstrated by evidence such as: (i) the examples that the CMA itself provides of firms switching between display and search advertising; (ii) shifts in spend between different advertising channels over time, in particular from offline (e.g. TV, radio and newspapers) to online and between video and non-video advertising; (iii) academic studies that measure switching between advertising channels in response to significant events; and (iv) the internal documents of advertising providers.¹
- 1.1.5 Since the market is two-sided and users typically receive the services of platforms for free, the appropriate way to assess market definition on the user side is through the effect on the revenues gained on the advertiser side, which depend on the level

¹ For instance, Facebook’s and Google’s internal documents consistently highlight each other as key competitors as noted in the Interim Report. See Interim Report, paras. 5.119 to 5.120.

of user engagement. To the extent that users leave or spend less time on Facebook, this will lead to a reduction in Facebook's advertising revenues and therefore profits. Any firm that attracts user time away from Facebook is therefore in the same market as (and exercises a competitive constraint on) Facebook. This is borne out by empirical evidence demonstrating that users multi-home across a range of platforms and services and that, as a result, it is straightforward for users to switch their time between platforms.

- 1.1.6 The CMA's failure to carry out a robust market definition exercise affects the remainder of its analysis, which has led to incorrect conclusions being drawn in the Interim Report.

The CMA's evidence does not support its preliminary conclusion that Facebook has significant market power

- 1.1.7 In relation to market power on the user side, the CMA relies on a share of supply analysis which is based on an inappropriately narrow market definition (as discussed above). Even on the basis of the Interim Report's share of supply analysis, it is clear that Facebook's share of time spent has significantly declined and is below any meaningful benchmark of significant market power. Based on an appropriately defined relevant market, Facebook's share of supply is between 13% and 21%.² This illustrates that Facebook does not have significant market power on the user side.
- 1.1.8 The CMA also asserts that Facebook would provide a better customer offer in a "more competitive counterfactual". However, this argument is speculative and without any empirical foundation, so cannot be used to support any contention that Facebook has significant market power.
- 1.1.9 In relation to market power on the advertiser side, the CMA's share of supply analysis is similarly based on an inappropriately narrow market definition, which captures only online display advertising. Even if the CMA were to consider only online advertising, Facebook's share ranges between 17% and 23% and, based on a proper assessment of the market (i.e. including all advertising channels), Facebook's share of supply would only be between 8% and 11%.
- 1.1.10 The CMA has also undertaken an analysis of Facebook's cost per impression and an analysis of Facebook's economic profitability. In separate papers submitted on 6 March 2020, we have explained that neither of these pieces of analysis provides any evidence that Facebook has market power:
- In relation to the CMA's preliminary cost per impression analysis, this fails to account for quality, as advertisers value impressions more highly if they are more likely to lead to a sales-generating action. Taking this into account, the analysis demonstrates that there has been no material change in Facebook's prices over the relevant period.
 - In relation to the CMA's preliminary economic profitability analysis, this cannot be relied upon as it fails to account properly for: (i) the critical role of intangible assets in Facebook's business; (ii) the importance of a "whole of market"

² Depending on whether this relates to time spent on mobile or desktop devices.

approach to avoid survivorship bias; and (iii) the life cycle of the business in order to take account of investment phases.

- 1.1.11 As a result, the CMA has not provided any reliable evidence that Facebook has market power on the advertiser side.

There are no material barriers to entry and expansion

- 1.1.12 The CMA's conclusion that network effects are a barrier to entry is contradicted by the rapid growth and expansion of rivals to Facebook, such as Snapchat and TikTok. As platforms and services on the user side are generally available for free, there are low switching costs and extensive multi-homing, both of which facilitate new entry and allow rivals themselves to benefit from network effects.
- 1.1.13 Given the evidence that new entrants have grown rapidly, the CMA in the Interim Report appears to abandon its view that network effects represent a barrier to entry. The CMA instead argues that an alternative barrier to entry is the ability to monetise user time – however, this issue is not mentioned elsewhere in the Interim Report and the CMA does not provide any evidence to support this claim. To the contrary, rival platforms (such as Snapchat and TikTok) have introduced and are starting to develop advertising-based monetisation strategies, consistent with the business cycle of ad-supported platforms (and indeed other types of businesses) that often seek to grow their user bases before then focusing on monetisation.
- 1.1.14 Similarly, the Interim Report claims that Facebook enjoys economies of scale which form a barrier to entry. However, this is contradicted by evidence relating to profitability elsewhere in the Interim Report, which demonstrates that economies of scale do not pose a barrier to entry.
- 1.1.15 Finally, the CMA seems to argue that the high quality of Facebook's offering is a barrier to entry for rivals, which appears to be a form of an "efficiency offence". However, there is no evidence to demonstrate that: (i) the high quality of Facebook's proposition has had any impact on entry by new platforms; (ii) if the quality of Facebook's offering were worse, users would be better off; and (iii) to the extent that additional entry would have occurred (if at all), this would have been beneficial to users.

2 THE CMA'S APPROACH TO MARKET DEFINITION IS TOO NARROW AND LACKS A ROBUST GROUNDING

2.1 Introduction

- 2.1.1 In the course of its market study into online platforms and digital advertising, including in its Interim Report, the CMA has not properly defined the markets in which Facebook competes on either the user side or the advertiser side. Indeed, there is no dedicated section on market definition in the Interim Report. By not carrying out a market definition exercise, the CMA does not provide a rigorous and structured approach for understanding the competitive constraints affecting Facebook (and other firms). As a result, the CMA draws erroneous conclusions as to the scope of the market, the existence of market power and the extent and nature of any barriers to entry and expansion. This is concerning given that these erroneous conclusions underpin the CMA's proposed recommendations.
- 2.1.2 Section 2.2 below describes in detail the reasons as to why the approach used by the CMA is deficient. In conflict with the CMA's own guidelines, the CMA relies on an arbitrary "functional characteristics" approach, without any assessment of economic substitution or a proper account of the interactions between the two sides of the market (for advertisers and users respectively).
- 2.1.3 Section 2.3 below demonstrates that if the CMA were to properly account for these factors, this would lead to the conclusion that Facebook faces significant competitive constraints on both sides of the market from a wide range of platforms and content providers.³

2.2 There are significant deficiencies in the Interim Report's approach to market definition

- 2.2.1 The Interim Report does not carry out a structured market definition exercise. The main purpose of defining a relevant market is to identify, in a systematic manner, the key competitive constraints that affect firms. This is clearly set out in the CMA's own guidelines on market definition,⁴ as well as its guidelines on merger assessments⁵ and market investigations.⁶
- 2.2.2 For instance, the CMA's guidelines on market definition state that:

"Market definition is not an end in itself but a key step in identifying the competitive constraints acting on a supplier of a given product or service. Market definition provides a framework for competition analysis. For example, market shares can be calculated only after the market has been defined and, when considering the

³ Section 3 discusses the implications this correct market definition for Facebook's market power.

⁴ OFT, "[Market definition – understanding competition law](#)", 2004, para. 2.1.

⁵ OFT/CC, "[Merger Assessment Guidelines](#)", 2010, Section 5.2.

⁶ CC, "[Guidelines for market investigations – their role, procedures, assessment and remedies](#)", 2013, paras. 132 et seq.

*potential for new entry, it is necessary to identify the market that might be entered. Market definition is usually the first step in the assessment of market power.*⁷ (emphasis added)

- 2.2.3 By not carrying out such an exercise, the Interim Report reaches incorrect conclusions as to the competitive constraints acting on Facebook.

The approach used in the Interim Report contradicts the CMA's own guidelines on market definition

- 2.2.4 The Interim Report assumes a market definition based on a “functional characteristics” approach. This approach is based on a simplistic assumption that if one platform has certain functionalities and another platform has other different functionalities, they are in different markets.

- a. On the user side, the Interim Report focuses only on social media. This is on the basis that social media platforms “*have some common features*”, such as user accounts or profiles (which allow users to create an online persona), messaging features (which allow users to communicate directly with each other), a “feed” or homepage (where users can engage with organic content, including posts, photos and videos), and adverts.⁸ The Interim Report thus looks only at competition between social media platforms, on the basis that they share common features, and does not consider the significant competitive constraints imposed on Facebook by other platforms and content providers that do not share this narrow (and arbitrary) set of features.
- b. On the advertiser side, the Interim Report similarly uses functional characteristics to segment the market.⁹ For example, search and display advertising are segmented based on a view that they “*perform different roles within the customer purchase journey*”, with search being focused on “*in-market consumers*” whereas display is focused on “*out-of-market consumers*”.¹⁰ The Interim Report does not consider the significant competitive constraints imposed on Facebook by a wide range of (online and offline) advertising channels.

- 2.2.5 The CMA's heavy reliance on products' functional characteristics to draw conclusions in relation to market definition contradicts the CMA's own guidelines on market definition, which state that:

"[J]ust because products display similar physical characteristics,¹¹ this does not necessarily mean that customers would view them to be close substitutes [...] products with very different physical characteristics may be close substitutes if, from a customer's point of view, they have a very similar use."¹²

⁷ OFT, “[Market definition – understanding competition law](#)”, 2004, para. 2.1.

⁸ Interim Report, para. 3.102.

⁹ Interim Report, para. 5.23 to para 5.36.

¹⁰ Interim Report, para 5.28.

¹¹ In this case, physical characteristics would relate to the technical characteristics of platforms. However, more generally, there is no particular reason to distinguish “physical” characteristics from other types of characteristics, to the extent that those characteristics affect consumer choice.

¹² OFT, “[Market Definition – Understanding competition law](#)”, 2004, para. 3.7.

2.2.6 This is also in line with the approach set out in the European Commission’s guidance on market definition, which states that:

“[P]roduct characteristics and intended use are insufficient to show whether two products are demand substitutes. Functional interchangeability or similarity in characteristics may not, in themselves, provide sufficient criteria, because the responses of customers to relative price changes may be determined by other characteristics as well.”¹³

2.2.7 The CMA has therefore relied on the wrong analytical framework in the Interim Report to assess the competitive constraints faced by Facebook from its competitors.

The “functional characteristics” approach to market definition in the Interim Report lacks a robust economic grounding

2.2.8 The CMA’s “functional characteristics” approach does not have a robust economic grounding. It is not possible to rely on differences in functional characteristics to draw well-founded conclusions about the degree of substitutability between different platforms – which is the key factor in assessing market definition. Platforms that have certain characteristics are not necessarily close substitutes from a user’s or an advertiser’s perspective, and vice versa. For example, even though Facebook and Google Search have very different functional characteristics, both have the ability to satisfy a number of the same user needs, including (but not limited to) checking product reviews, finding other individuals who share the same interests, and discovering small businesses in the area you live in. More generally, there are other factors beyond functionalities that affect whether users/advertisers view two platforms as substitutable in practice, such as the relative importance that users and advertisers place on platforms’ different functional characteristics,¹⁴ the attractiveness of the platform’s products/services and the quality of the user experience.

2.2.9 By adopting a limited “functional characteristics” approach, the CMA fails to properly take into account the evidence on substitutability explicitly referred to in the Interim Report, both on the user and advertiser sides of the market. For example:

- a. On the user side, Figure 3.7 of the Interim Report (reproduced in Figure 15 below) suggests that users have been shifting their time from Facebook to YouTube. In particular, Facebook’s share of user time decreased from around 60% in July 2015 to approximately 30% in May 2019, while YouTube’s share increased from around 30% to approximately 40% over the same period.
- b. On the advertising side, the Interim Report acknowledges that some advertisers have switched spend from display to search advertising, for example when *“display was not performing as well in terms of return on*

¹³ European Commission notice [on the definition of the relevant market for the purposes of Community competition law](#), para. 36.

¹⁴ A functional characteristics approach could in principle lead one to the conclusion that each individual firm operates in its own market, given that every firm has a slightly different set of characteristics.

investment (ROI) and other KPIs".¹⁵ This indicates that switching between different advertising channels occurs.

2.2.10 The Interim Report’s approach to assessing functional characteristics is also arbitrary, as it relies on the CMA’s discretion to determine which characteristics are relevant and important, without any analysis of user preferences or behaviour. For instance, in one version of its share of supply analysis, the CMA excludes YouTube from its consideration of “social media platforms” on the basis that YouTube is “a content-focused platform and appears to compete more closely with providers of audio-visual content (including music-streaming platforms and video streaming platforms) rather than Facebook’s social media platforms.”¹⁶

2.2.11 However, looking at the functionalities of the different social media platforms identified in the Interim Report, there are no clear distinctions between Facebook and other social media platforms, in particular YouTube. This is clear from Table 3.1 of the Interim Report (reproduced in Figure 1 below), which shows that:

- almost all of the listed platforms have the same core functionalities, such as offering profiles, messaging, and video sharing; and
- Facebook and YouTube, in particular, offer an identical range of features.

Figure 1 Table 3.1 of the CMA’s Interim Report

Table 3.1: Social media platforms’ functionalities

	Profile/ Account	Curated/ Personalised Feed	Friends/ Contacts/ Connections	Followers/ Subscribers	Photo Sharing	Video Sharing	Comments	Messaging
YouTube	✓	Recommended	✓	✓	✓	✓	✓	✓
Facebook.com	✓	News Feed	✓	✓	✓	✓	✓	✓
Snapchat	✓	Discover	✓	✓	✓	✓		✓
WhatsApp	✓		✓		✓	✓		✓
Instagram	✓	Explore	✓	✓	✓	✓	✓	✓
Twitter	✓	Timeline		✓	✓	✓	Replies	✓
LinkedIn	✓	✓	✓	✓	✓	✓	✓	✓
TikTok	✓	For You	✓	✓		✓	✓	✓
Pinterest	✓	✓		✓	✓	✓*	✓	✓
Reddit	✓	Front Page	✓	✓	✓	✓	✓	✓
Tumblr	✓	Dashboard		✓	✓	✓	✓	✓

Source: Adapted from Ofcom (2019), [Online Nation](#).
* Available on iOS only

Source: CMA’s Interim Report, Table 3.1

2.2.12 Therefore, based on the CMA’s approach of focusing on functional characteristics, it would follow that Facebook and YouTube should belong in the same relevant market. The fact that the CMA appears to conclude that they do not compete closely indicates that the method adopted in the Interim Report is inconsistent and arbitrary.

2.2.13 On the advertiser side, the Interim Report relies heavily on third-party comments to support its market segmentation. As detailed in Section 2.3 below, this does not properly take into account evidence of advertisers switching between channels and is based on an outdated view of differences between advertising channels. The

¹⁵ Interim Report, para. 5.30.

¹⁶ Interim Report, para. 3.116.

evidence shows that advertisers use many advertising channels for a range of objectives.

2.3 A proper market definition exercise shows that Facebook faces competition from a wide range of platforms and content providers

- 2.3.1 A proper market definition exercise needs to take account of the fact that Facebook is a multi-sided platform. In line with the CMA's standard approach to assessing two-sided markets,¹⁷ the advertiser side and the user side should first be explored separately, before considering the interactions between both sides.

On the advertiser side, the relevant market should be for all advertising

- 2.3.2 The Interim Report differentiates between online and traditional advertising media. Within the digital advertising market, the Interim Report further segments this market between search and display and, within the display advertising market, between video and non-video segments.¹⁸
- 2.3.3 As explained in detail below, this is an outdated view of the advertising market and inconsistent with the substantial amount of evidence that there is a single advertising market capturing both online (including search and display) and offline channels.

Advertisers use a wide range of advertising channels to achieve sales

- 2.3.4 Advertisers present their advertising messages to potential customers with the intention that the advertising drives a particular audience response (e.g. prompting them to purchase particular products and services) in order to drive sales and profits for the advertiser.
- 2.3.5 Potential customers can be reached through a wide and constantly evolving variety of advertising channels. The Interim Report provides no evidence that there are specific customer groups that can only be accessed through a specific type of advertising medium and no evidence (outside the cost of advertising) that a sale would be more profitable via one advertising channel rather than another.
- 2.3.6 This is supported by the conclusions from a forthcoming Boston Consulting Group report commissioned by Facebook, which finds that:

“New local players continue to emerge in digital hubs such as London and Berlin, but also increasingly in France, where venture capital investments have gained speed as French venture investment had increased 35% annually from about €2.2 billion in 2017 to about €4 billion in 2019. New digital media companies, such as

¹⁷ See, for example, the [CMA's final report on the anticipated acquisition by JUST EAT plc of Hungryhouse Holdings Limited](#), para 4.11; and the [CMA's provisional report on the anticipated acquisition by Experian plc of Credit Laser Holdings Limited](#), para 7.1 and 7.2.

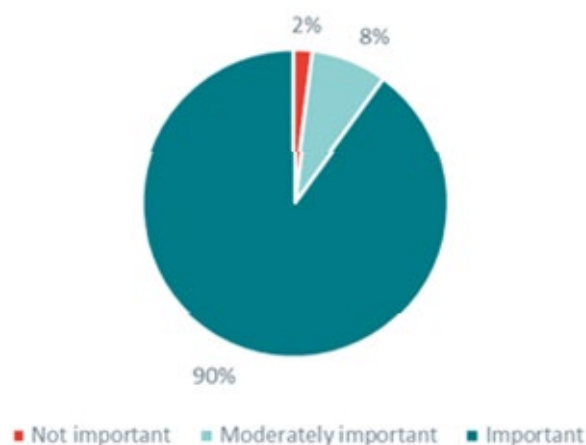
¹⁸ Interim Report, para. 5.36.

TikTok, are entering the market as well, resulting in 90% of marketers using more channels today than they did three years ago.”¹⁹

Advertisers switch their spend between channels to maximise their return on investment

2.3.7 Companies invest in advertising that they believe will produce the desired response, and seek to maximise their return on investment (**ROI**), i.e. to allocate advertising spend to the channels that will generate the most incremental response at the lowest cost. This is unsurprising as advertising is effectively an input cost for firms seeking to maximise profits. Figure 2 below presents survey evidence confirming that ROI is very important for advertisers.

Figure 2 Survey responses from advertisers on the importance of measuring/proving ROI



Source: Kantar, “Getting media right: marketing in motion”, 2019, page 29

Note: This is based on responses from advertisers to the question “how important is measuring/proving ROI for marketers today?”

2.3.8 To maximise ROI, advertisers must optimise advertising expenditures across channels. Consequently, if a particular advertising channel gives rise to a lower ROI, advertisers would be expected to reduce spend on that channel and reallocate (some or all of) that spend to alternative channels with a higher ROI. Advertisers would continue to reallocate advertising spend across channels until the ROI of the marginal unit of advertising is equal across channels.

2.3.9 There are many services and businesses available to help advertisers switch between and among channels to maximise ROI. Demand Side Platforms (**DSPs**) and Agency Trading Desks (including those operated by agencies such as WPP, Omnicom, Publicis, and Interpublic Group) routinely run campaigns on behalf of advertisers and use sophisticated techniques to optimise advertiser spending across various online and offline advertising channels. A number of DSPs, including, but not limited to, MediaMath, Verizon Media DSP, DataXu and Adobe

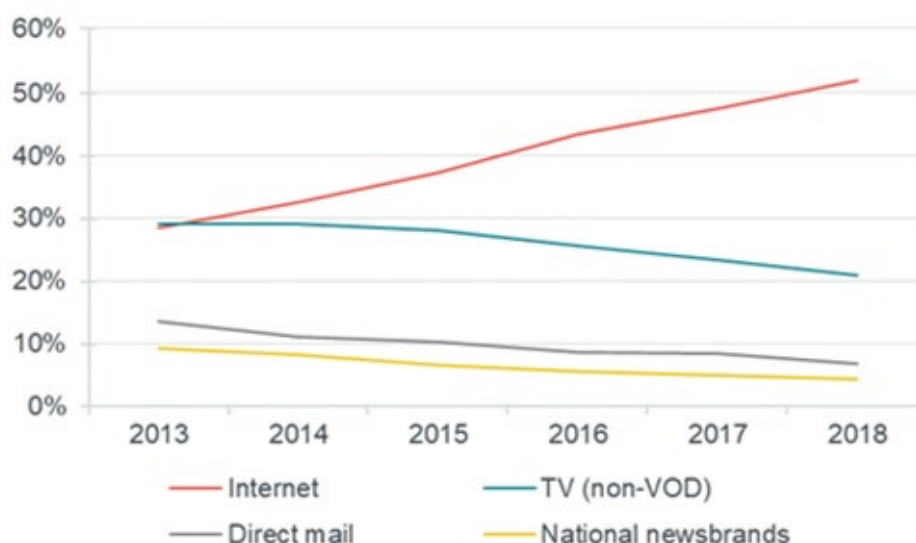
¹⁹ Boston Consulting Group, “Maximizing Results from Europe’s Marketing Ecosystem”, forthcoming 2020; data available from: Preqin Venture Capital deals in France from 2017-2019, accessed via Preqin.com in January 2020.

Advertising Cloud, offer multi-channel advertising and, in some cases, the dynamic reallocation of advertising spending across channels.²⁰

2.3.10 The CMA recognises the overarching importance of ROI, stating that “[the] choice of appropriate digital advertising inventory is largely based on optimising the outcomes of advertising”.²¹ However, the CMA’s contention that the maximisation of ROI only occurs within a particular channel, but not across channels, is inconsistent with its own recognition and conflicts with the evidence.

2.3.11 For instance, Figure 3 describes changes over time in UK advertising expenditure shares across advertising channels. The divergence of the share of advertising expenditure on digital and non-digital advertising is inconsistent with the contention that advertisers allocate the same share of their advertising budgets across advertising channels year after year.²² Instead the data is consistent with advertisers readily switching expenditure across all channels in response to changes in ROI.

Figure 3 Share of advertising expenditures by channel in the United Kingdom from 2013 to 2018



Source: Frontier calculations based on data from Statista (see <https://www.statista.com/statistics/262492/advertising-spending-in-the-uk-by-media/>). Accessed on 25 February 2020.

2.3.12 Figure 4 and Figure 5 show similar divergence in advertising expenditure growth rates and shares across channels at more disaggregated levels. In particular, Figure 4 shows significant differences in growth rates across advertising channels with advertising expenditure increasing in some online and offline channels (e.g. online display and out of home) and decreasing in other channels (e.g. TV), while

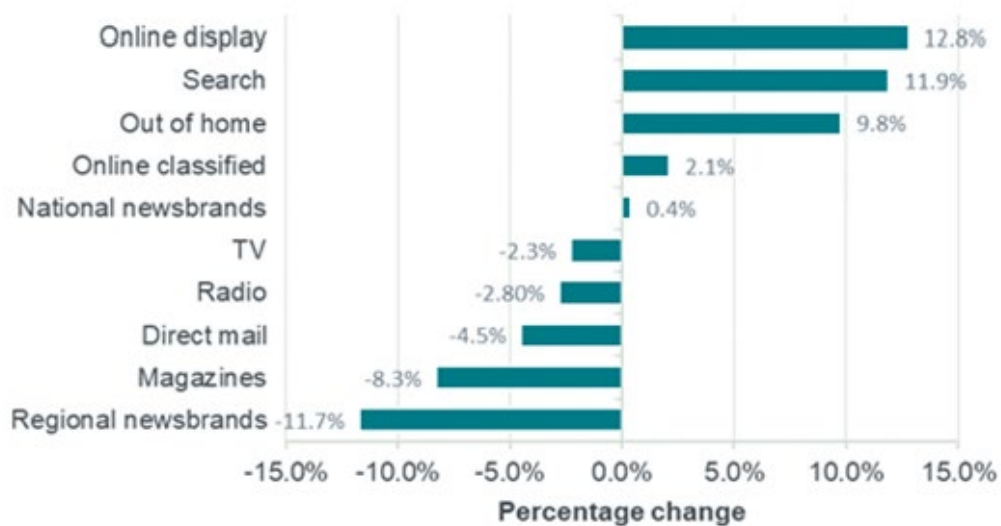
²⁰ See MediaMath: Cross-Channel Media, available at <https://www.mediamath.com/dsp/> (accessed on 25 February 2020); Verizon Media DSP available at <https://b2b.verizonmedia.com/c/vm-dsp-updated-1?x=CTeAAY> (accessed on 25 February 2020) DataXu: Audience-Based Buying, available at <https://www.dataxu.com/media-activation/#automated-media-buying> (accessed on 25 February 2020); Adobe Advertising Cloud, available at <http://www.adobe.com/advertising-cloud/media-optimizer.html> (accessed on 25 February 2020).

²¹ Interim Report, para. 5.12.

²² These spending patterns could only be consistent with fixed allocations of advertising spending across channels if large year-to-year changes in the composition/population of advertisers are assumed (which is implausible).

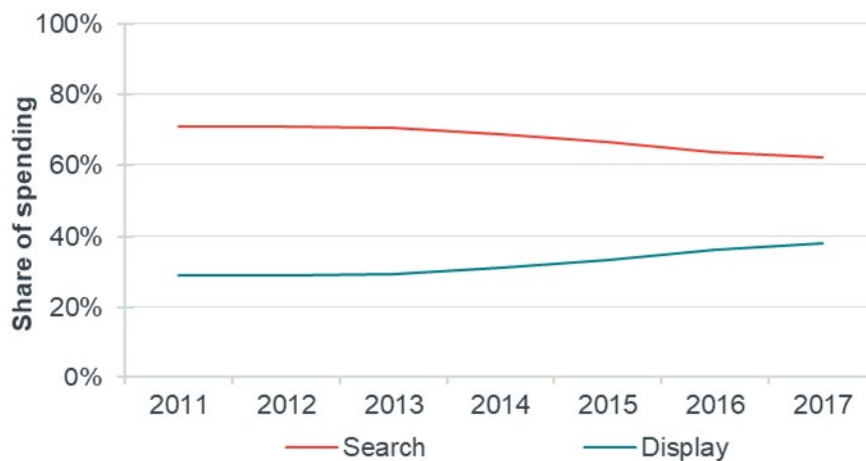
Figure 5 shows that display advertising has grown faster than search advertising over time, consistent with advertisers switching relative spending from search to display advertising.

Figure 4 Relative change in advertising expenditure in 2019



Source: Advertising Association/WARC Expenditure Report, 2020

Figure 5 Proportion of search and display advertising spending in the United Kingdom 2011 to 2017



Source: Frontier calculations based on data from Statista (see <https://www.statista.com/statistics/257242/distribution-of-digital-ad-spend-in-the-uk-by-format/>). Accessed on 25 February 2020.

- 2.3.13 As noted in paragraph 2.2.9b above, the CMA itself acknowledges switching across channels, reporting that advertisers mentioned several recent instances of switching budget from display to search advertising based on ROI and other KPIs.
- 2.3.14 Further evidence of substitutability across advertising channels, including between online and offline channels, is provided by academic studies that take advantage of natural experiments. For instance:

- a. Goldfarb and Tucker (2011a) demonstrate that regulatory restrictions placed on offline alcohol advertising significantly increase the effectiveness of online adverts.²³ The authors conclude that *“online advertising substitutes for (rather than complements) offline advertising”*.²⁴
 - b. Similarly, Goldfarb and Tucker (2011b) find regulations that restrict the ability of personal injury lawyers to solicit clients offline leads to an increase in the demand for online advertising, reflected in higher prices for online advertising.²⁵
- 2.3.15 It is thus unsurprising that economic models of advertising assume that firms substitute between online and offline advertising channels.²⁶
- 2.3.16 Evidence of advertising switching across channels is consistent with evidence from the advertising community that there is only a single advertising market. For example, a report by IPA, which looked at the commercial media network and potential areas for advertisers to place adverts, considered social media platforms (such as Facebook) to be part of the wider commercial media network (including other media such as radio, commercial TV and “functional internet” (i.e. search and shopping)).²⁷ This suggests that, at a minimum, search and display online advertising should be treated as a single market, which is consistent with the views of several suppliers of display advertising inventory who reported to the CMA that *“they also competed with Google search.”*²⁸ The IPA report also supports the view that online and offline channels should be included in the same advertising market.

Empirical evidence supports a market definition that includes all advertising channels

Facebook’s display advertising competes with providers of search advertising

- 2.3.17 The Interim Report distinguishes between search advertising and display advertising on the basis that they *“target different KPIs”* and *“perform different roles within the customer purchase journey.”* The Interim Report finds that *“[s]earch is intent-based advertising designed to provide immediate answers to those consumers that have already shown interest in buying the product and are at the end of the purchase funnel (‘in-market consumers’), whereas display is suitable for raising brand awareness and reaching new audiences that might not yet have shown interest (‘out-of-market consumers’).”*²⁹

²³ Specifically the results suggest “online advertising is approximately 15% more effective in places where offline advertising is banned.” See Goldfarb and Tucker (2011c). “Substitution between offline and online advertising markets. *Journal of Competition Law and Economics*, 7(1), 37-44.

²⁴ Goldfarb and Tucker (2011a). Advertising bans and the substitutability of online and offline advertising. *Journal of Marketing Research*, 48(2), 207-227.

²⁵ Goldfarb and Tucker (2011b). Search engine advertising: Channel substitution when pricing ads to context. *Management Science*, 57(3), 458-470.

²⁶ See for example Athey and Gans (2010). The impact of targeting technology on advertising markets and media competition. *American Economic Review*. 100(2) 608-61; and Bergemann and Bonatti (2010). Targeting in advertising markets: Implications for offline vs. online media. Cowles Foundation Discussion Paper 1758R, Cowles Foundation, New Haven, CT.

²⁷ IPA, “Making sense: the commercial media landscape” – for example, see page 10.

²⁸ Interim Report, para. 5.31.

²⁹ Interim Report, paras. 5.28 – 5.29.

- 2.3.18 This characterisation of display and search advertising not only fails to give sufficient weight to the switching evidence presented above (see for example Figure 5) and the fact that Facebook’s and Google’s internal documents consistently highlight each other as key competitors,³⁰ but also underestimates the overlap in the characteristics and objectives of search and display advertising.³¹
- 2.3.19 **First, a distinction between different intermediate marketing objectives is artificial.** Ultimately, all advertising is designed to increase sales. In particular, “brand awareness” is not the ultimate objective in and of itself. The purpose of raising brand awareness is to make it more likely that users will be aware of, consider and choose a particular brand when they are next purchasing a particular item, i.e. to increase future sales. The key driver of an advertiser’s choice is the ROI of each type of advertising. If generating future sales is lower cost (so has a high ROI) relative to generating current sales, advertisers would be expected to shift advertising spend to boost future sales, and vice versa. As a result, it is not sensible to distinguish between marketing objectives from a market definition perspective.
- 2.3.20 **Second, the intermediate marketing objectives of search and display advertising overlap.** More than a decade ago, the European Commission’s decision in Google/DoubleClick acknowledged that it was somewhat artificial to separate search and display advertising.³² Since that decision, rapid technological and industry-wide developments mean that any distinction between search and display advertising is no longer competitively meaningful.^{33, 34} For example:
- a. Display advertising is suitable for a range of intermediate marketing objectives, not only “raising brand awareness and reaching new audiences”.³⁵ Facebook’s display advertising enables advertisers to select from several value-enhancing marketing objectives when creating an ad campaign, including app downloads,

³⁰ Interim Report, paras. 5.119 – 5.120.

³¹ See Facebook Response to Questions 47 RFI 1 Tranche 2.

³² See [Case No COMP/M.4731 Google/DoubleClick](#). In the Google/DoubleClick decision, the Commission left open whether the advertising market ought to be segmented between search and non-search, noting that “the differences between the different types of ads seem to be diminishing ... [T]he ability of non-search ads to target relevant customers is improving” (para. 52) and “[i]t can be... inferred that, from an advertiser’s point of view search and non-search ads can be considered substitutable to a certain extent” (para. 53). The Commission also noted:

- (i) in relation to non-search advertising, “[n]on-search advertising has been used predominantly for brand awareness purposes but the increasing, and increasingly sophisticated, use of behavioural targeting (that is based on web surfing behaviour) is closing the gap between search and non-search in terms of effectiveness” (para. 12); and
- (ii) in relation to search advertising, “whereas non-search and in particular display ads have largely focused on building brand awareness, a significant part of search advertising expenditure is nowadays also focused on generating brand awareness and not only towards directly generating sales” (para. 52).

³³ This is recognised in the recent [independent report by the economic consultancy Lear](#) which was commissioned by the CMA, which noted: “advertisers may not consider the social graph as a distinctive feature, and still consider the advertising services provided by social media (e.g. YouTube) as a substitute of the service provided by social networks. By the same reasoning, display advertising (which is typically provided by social networks) can be deemed as a substitute for search advertising (which is instead typically provided by search engines)” (para. II.57).

³⁴ This is also recognised by the European Commission in the Microsoft/Yahoo! Search Business transaction, where the Commission noted that the distinction between search and non-search advertising is “increasingly blurred in practice” because of the growth in behavioural targeting and because “the main players [...] offer all types of advertising”. See [Case No COMP/M.5727, Microsoft/Yahoo! Search Business Decision](#), para. 74.

³⁵ Interim Report, para. 5.28.

driving website traffic and targeting sales. Moreover, it is clear from Facebook's own data that the focus of advertisers on Facebook is on achieving action-based objectives (i.e. objectives that entail a user taking an action of some type after seeing an ad, such as visiting a website or downloading an app). Figure 6 below provides a breakdown of Facebook's advertising revenue on a monthly basis between April 2016³⁶ and January 2020,³⁷ split between action-based and impression-based objectives (i.e. objectives that relate to the awareness/reach of an ad, but no specific action).³⁸



³⁶ For observations between January 2016 to March 2016, data on the advertising objective selected is unavailable. Revenue data by advertiser objective is therefore reported from April 2016 onwards.

³⁷ The data submitted in response to the CMA's Request for Information of 18 February 2020 covers the period up to December 2019. To account for the most recent data as it becomes available, observations from January 2020 have also been included in this analysis.

³⁸ This breakdown includes all advertising objectives on Facebook. 'Action-based objectives' are defined as objectives that entail a user taking an action of some type after seeing an ad. 'Impression-based objectives' are defined as objectives that relate to awareness/reach of an ad (but no specific action).

Figure 6 shows that, since 2016, [✂] of Facebook’s advertising revenues in the UK have related to action-based objectives (with the remainder relating to impression-based objectives). The proportion of Facebook’s advertising revenue that is targeted at actions is also increasing over time. Much of this is driven by an increase in spending using the objective ‘Offsite Conversions’, where the advertiser’s objective is for users to carry out a specific action on their website, such as adding items to a cart, registering for the advertiser’s website or making a purchase.

- b. Display advertising can target “consumers that have already shown interest in buying the product”. Advertisers can target display adverts based on a host of factors about the user’s online behaviour, including the websites visited, mobile applications used, links clicked, time spent on specific Web pages or apps, and other factors. These tools enable advertisers to target display adverts on the basis of interest and intent in the same way that they can target search adverts.
- c. Search advertising can build brand awareness. Survey, experimental and case study evidence support the view that search advertising is used effectively to build brand awareness.
 - i. A State of Search Engine Marketing survey,³⁹ conducted by SEMPO (a non-profit Search Engine Marketing Professional Organisation), asked 890 search engine advertisers “What is your company using search engine marketing to accomplish?”. There were six possible responses (plus “other”), with multiple responses allowed. A majority (63%) of all respondents stated that they used search engine marketing “[t]o increase/enhance brand awareness.” This rose to 70% among respondents with more than 500 staff. Moreover, this brand-building response received the most mentions out of all seven possible answers.
 - ii. A meta-analysis of 61 studies by Google and Ipsos MediaCT found search has a positive impact on both top-of-mind awareness and unaided brand awareness even when the consumer does not click on the ad.⁴⁰
 - iii. A Microsoft case study analysis of search data for a well-known automotive OEM brand found that search adverts early in the consumer journey (i.e. on a category or competitor query) increased eventual conversion by 15%.⁴¹
- d. There has been significant convergence in the characteristics of search and display advertising. Performance Market Insider has explained several reasons behind the “convergence between display and paid search”, including:
 - i. search advert providers copying display adverts: the adoption of retargeting by search ad providers to enable the targeting of users who have visited a merchant’s sites;

³⁹ Cited in Rubinfeld and Rattliff (2010). Online Advertising: Defining Relevant Markets, Journal of Competition Law and Economics.

⁴⁰ Search ads drive brand awareness, thinkwithGoogle, 2014. Available at : https://www.thinkwithgoogle.com/qs/documents/106/search-ads-drive-brand-awareness_articles.pdf

⁴¹ The value of search: drive brand awareness, Microsoft 2017. Available at : <https://advertiseonbing.blob.core.windows.net/blob/bingads/media/library/insight/brand-awareness/brand-awareness-insights-ebook-en-us.pdf?ext=.pdf>

- ii. display advert providers copying search adverts: the adoption of automated bidding systems by display advertising providers which involves selecting which adverts are going to appear for a user according to certain objectives of the advertiser;
- iii. the increased use of images in search adverts; and
- iv. the development of display advert delivery systems by the traditional search advert players, such as the Google Display Network.⁴²

In a notable example of this convergence in search and display advertising, Google has changed its privacy policy, such that it no longer keeps data on its users' searches separate from data on its users' Web browsing history. By combining user data collected from Google searches with data collected through embedded Web code, Google is able to offer both search and display advertising services that are targeted in the same manner.⁴³

- e. *The marketing of Facebook's competitors reflects the fact both search and display advertising can target a range of intermediate objectives.* For example, Amazon markets its display advertising offering as a way to "*inspire customers to take action*" and markets its search advertising offering as a way to "*drive discovery of your brand*".⁴⁴

2.3.21 Therefore, even a functional characteristics assessment should conclude there is significant overlap between search and display advertising.

Both online and traditional advertising media offer targeted adverts

2.3.22 Contrary to the switching evidence presented in paragraphs 2.3.11 to 2.3.14, that demonstrates advertisers do switch spend between online and offline channels, the Interim Report distinguishes between online and traditional advertising media based on a functional characteristic: "*the ability for advertisers to use data to target specific audiences online distinguishes it substantially from traditional advertising media*".

⁴² See Performance Market Insider, Pierre Kiciak, The Where and Why of Convergence Between Display and Paid Search, 6 June 2016, available at: <https://performancein.com/news/2016/06/06/where-and-why-convergence-between-display-and-paid-search/> (accessed on 25 February 2020). See also Matt Maltby, How Leading Advertisers Are Using Search for Brand Building, June 2014, available at: <https://www.thinkwithgoogle.com/advertising-channels/search/how-advertisers-are-using-search-for-brand-building/> (accessed on 25 February 2020).

⁴³ See Google, About Search Network with Display Select, available at: <https://support.google.com/adwords/answer/3437721?hl=en> (accessed on 25 February 2020). When an advertiser chooses Google's 'Search Network with Display Select' option, Google helps that advertiser to 'reach people as they use Google search or visit sites across the web.' More specifically, Google explains to advertisers that, with this tool, '[y]our ads can appear when people search for terms on Google search and search partner sites that match your keywords. They can also appear on relevant pages across the web on the Google Display Network. However, your ads are shown selectively on the Display Network and bidding is automated, helping you reach people who are most likely to be interested in the products and services you're advertising.' See also Julia Angwin, Google Has Quietly Dropped Ban on Personally Identifiable Web Tracking, 21 October 2016, available at <https://www.propublica.org/article/google-has-quietly-dropped-ban-on-personally-identifiable-web-tracking> (accessed on 25 February 2020).

⁴⁴ See: (i) Amazon Advertising, Display ads, available at: https://advertising.amazon.co.uk/products/display-ads?ref=a20m_uk_hnav_da (accessed on 25 February 2020) (stating that display ads both inform customers and 'inspire customers to take action'); (ii) Amazon Advertising, Sponsored Brands, available at: https://advertising.amazon.co.uk/register/?ref=a20m_uk_sb_h_gs (accessed on 25 February 2020) (stating that Sponsored Brands search ads 'help drive discovery of your brand' to '[g]row brand awareness' while also 'reach[ing] customers when they're looking for what to buy'); and (iii) Amazon Advertising, Sponsored Products, available at: https://advertising.amazon.co.uk/register/?ref=a20m_uk_sp_h_gs (accessed on 25 February 2020) (stating that Sponsored Products search ads help products '[g]et discovered' while also increasing sales).

- 2.3.23 However, the Interim Report does not take into account that traditional advertising media can also be targeted to specific audiences effectively. Most advertising in any media (whether online, television, newspaper, direct mail, or outdoor) seeks to identify and address a targeted audience. For example, a restaurant might place an ad in the Lifestyle section of a local newspaper to target local patrons who are interested in fine dining; a petrol station might place signs to target people in its physical proximity; an action movie might place a television commercial during a sporting event to target young male viewers; and so on.
- 2.3.24 Offline channels are becoming increasingly capable of delivering targeted advertising more precisely. Recent developments in TV advertising are illustrative of this trend:
- a. In order to use many of the services available on connected TVs,⁴⁵ users are often required to log in or provide personal information. This may then be combined with third-party data to complete a user's profile, which will typically include information on geolocation, postcode, interests, online behaviour, device and language.⁴⁶ Connected TV therefore provides opportunities for highly targeted adverts and is becoming increasingly popular with users – household penetration of Smart TVs in the UK reached 48% in 2019, up from 11% in 2014,⁴⁷ with commentators suggesting that connected TV *“is going to be the default way most people watch long-form, full-screen video in the near future.”*⁴⁸
 - b. TV companies have introduced innovative targeted advertising products.⁴⁹ For example, Sky's AdSmart targeted advertising product allows advertisers to target its customers based on nearly 1,400 different attributes, with the most commonly used being geographical location and household income. Advertisers can also provide their own data to Sky in order to target users more effectively.⁵⁰ Sky's partnership with Virgin Media has increased AdSmart's reach to 30 million households in the UK and Ireland.⁵¹ ITV has also announced the launch of a new addressable advertising platform, which will offer advertisers data-enabled targeting services.⁵²

⁴⁵ Connected TVs are also often referred to as Smart TVs.

⁴⁶ See, e.g. <https://smartyads.com/blog/connected-tv-advertising/> (accessed on 25 February 2020).

⁴⁷ Statista, Household penetration of smart TV sets in the United Kingdom (UK) from 2014 to 2019, available at <https://www.statista.com/statistics/654074/smart-tv-penetration-in-uk-households/> (accessed on 25 February 2020).

⁴⁸ Danielle Gibson (Aug 2019). Connected TV is the future of advertising: The Drum Programmatic Punch APAC, available at <https://www.thedrum.com/news/2019/08/21/connected-tv-the-future-advertising-the-drum-programmatic-punch-apac> (accessed on 25 February 2020).

⁴⁹ See Facebook's Response to Question 38 in RFI 1 Tranche 2.

⁵⁰ See Sky AdSmart: what is it and should we be using it?, available at: <https://www.allresponsemedia.com/sky-adsmart-what-is-it/>; Analysys Mason, Convergence of TV and Digital Platforms: Increased Innovation and Competition for Advertisers' Budgets, 21 December 2017, p.20, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3092181.

⁵¹ See Virgin Media press release “Virgin Media and Sky unveil UK launch date for AdSmart partnership”, 28 March 2019, available at: <https://www.virginmedia.com/corporate/media-centre/press-releases/virgin-media-and-sky-unveil-uk-launch-date-for-adsmart-partnership> (accessed on 25 February 2020).

⁵² See ITV press release “ITV announces new addressable advertising platform: Planet V”, 12 November 2019, available at: <https://www.itv.com/presscentre/press-releases/itv-announces-new-addressable-advertising-platform-planet-v> (accessed on 19 March 2020).

c. In addition, the Digital Video Broadcasting organisation and the global hybrid broadcast broadband TV initiative ⁵³ are working together to standardise technical specifications in order to improve targeted advertising on broadcast TV channels.⁵⁴ This is expected to be rolled out in 2020.

2.3.25 More generally, traditional media companies have expanded significantly into digital media. For example, according to a forthcoming Boston Consulting Group report, Axel Springer, a leading German publisher, now receives 87% of its advertising revenues from digital channels.⁵⁵

2.3.26 Therefore, from an advertiser’s perspective, both offline and online advertising channels offer ways to target specific audiences. Third-party services enable advertisers to reallocate advertising spend dynamically across offline and online channels and target sought-after audiences to optimise their ad campaigns, and these services are widely used by advertisers in practice.⁵⁶

2.3.27 As a result, Facebook increasingly competes with offline channels (such as TV networks and cable providers) for advertising revenue, and this competition is likely to intensify further in the future. Competition between Facebook and TV was acknowledged by advertisers in their responses to the CMA’s questionnaire, where some identified TV as *“the closest substitute to Facebook.”*⁵⁷

The Interim Report does not provide a reasonable justification for segmenting video and non-video advertising

2.3.28 The Interim Report’s segmentation within display advertising of video and non-video advertising is based exclusively on a selection of third-party comments.⁵⁸ The Interim Report appears to interpret these comments as suggesting that:

- a. the *“advertiser’s message”* is a key driver of the advertiser’s choice between video and non-video advertising;⁵⁹ and
- b. the advertiser’s message is determined *“at an early stage of the [advertising] planning process, driven by input from the creative agency”*.⁶⁰

2.3.29 Based on this, the Interim Report concludes that substitutability between video and non-video advertising is limited.⁶¹ However, this is not supported by the empirical evidence and the fact that advertisers seek to maximise their ROI when deciding

⁵³ This body is aimed at harmonising the broadcast and broadband delivery of entertainment services to consumers; see <https://www.hbbtv.org/>.

⁵⁴ The DVB is working on developing signalisation specifications and HbbTV is working on developing terminal specifications; see <https://www.v-net.tv/2018/01/26/dvb-hoping-for-2020-market-implementation-of-first-standards-based-targeting-advertising-systems/> and https://www.hbbtv.org/wp-content/uploads/2018/11/11_Angelo-Pettazzi_How-DVB-and-HbbTV-are-working-together-on-Addressable-Advertisement_Berlin-2018.pdf.

⁵⁵ Boston Consulting Group, “Maximizing Results from Europe’s Marketing Ecosystem”, forthcoming 2020; data available from: <https://www.axelspringer.com/data/uploads/2019/10/19-10-08-roadshowpresentation.pdf>.

⁵⁶ See, e.g., DataXu: TouchPoint™, available at <https://www.dataxu.com/dsp/> (accessed on 25 February 2020). Adobe Advertising Cloud: Adobe Media Optimizer, available at <http://www.adobe.com/advertising-cloud/media-optimizer.html> (accessed on 25 February 2020).

⁵⁷ Interim Report, footnote 231.

⁵⁸ Interim Report, para. 5.34.

⁵⁹ Interim Report, para. 5.34.

⁶⁰ Interim Report, para. 5.34.

⁶¹ Interim Report, para. 5.34.

how to allocate their advertising spend (as explained above in paragraph 2.3.7 above).

- 2.3.30 **First**, an advert’s overall ROI will depend on a variety of factors, including the advertising message and the advertising format. As the choice of advertising format can impact the overall ROI, advertisers will readily switch to a different advertising format (e.g. from video to non-video) if this improves their overall ROI. As a result, when the advertiser’s message is determined – whether this is “*at an early stage of the [advertising] planning process*” or not – is not a relevant consideration when assessing the substitutability of video and non-video advertising.
- 2.3.31 **Second**, video and non-video advertising are substitutable both from an economic perspective and a “functional characteristics” perspective.
- a. From an economic perspective, advertisers do not face any barriers to switching spend across advertising formats (e.g. video vs non-video) and have strong incentives to do so when ROI differs across advertising formats.
 - b. From a “functional characteristics” perspective, for both video and non-video advertising, advertisers can use the same tools (e.g. Facebook Ad Manager), target the same audiences, target the same intermediate marketing objectives, and use the same measures of advertising effectiveness.
- 2.3.32 **Third**, in contrast to the view that the “advertiser’s message” is a key driver of the advertiser’s choice between video and non-video advertising, evidence from all advertisers on Facebook and Instagram indicates that many advertising messages can be conveyed effectively through either video or non-video adverts.⁶²
- 2.3.33 Figure 7 shows the video and non-video shares of advertiser spend on Facebook and Instagram for different marketing objectives on an annual basis between 2016 and 2019. If marketing objectives were a key driver of advertisers’ choices between video and non-video advertising, one would expect advertising spend to be heavily skewed towards either video or non-video advertising for each objective, as well as broadly constant over time. In contrast, the data suggests that advertisers choose to address all high-level marketing objectives (i.e. awareness, consideration, conversion) using both video and non-video advertising.

[✂]

⁶² The Interim Report does not provide any examples of advertising messages, particularly those adopted widely by the advertiser population, that could not be effectively delivered by video or non-video advertising.

2.3.34 Figure 8 below shows that a similar picture also holds for sub-objectives. For each marketing sub-objective, advertisers spend a material share on both video and non-video advertising (with the exceptions of the three marketing sub-objectives relating to video views, where the particular nature of the sub-objectives implies that spend is exclusively on video advertising). Furthermore, advertising spend shifts considerably over time between video and non-video advertising for several of these sub-objectives.

[REDACTED]

2.3.35 Furthermore, this conclusion is supported by data at the advertiser level, which indicates that the use of both video and non-video advertising is widespread across individual advertisers. Based on the top 100 advertisers on Facebook by spend in each year between 2016 and 2019 (leading to a sample of [REDACTED] unique active advertisers in December 2019),⁶³ 98% of these advertisers used both video and non-video advertising in December 2019. Moreover, 95% of these advertisers used both video and non-video advertising to achieve the *same* marketing sub-objective during this period.

⁶³ An active advertiser is defined as having non-zero spend on Facebook on one or more advertising objective in a particular month. Looking at the top 100 advertisers in each year between 2016 and 2019 produces a sample of [REDACTED] unique active advertisers on Facebook in December 2019 as a number of these advertisers appeared in the top 100 in more than one year. Together, these advertisers accounted for [REDACTED] of Facebook's total annual advertising revenues in 2019.

- 2.3.36 **Fourth**, advertisers on Facebook often use both video and non-video adverts for a single advertising campaign and also switch between using these different formats from campaign to campaign.⁶⁴
- 2.3.37 Figure 9 below shows significant changes in the share of Facebook advertising revenue accounted for by video and non-video advertising over time. Video advertising increased from [X] of Facebook’s advertising revenues in January 2016 to [X] in December 2019.
- a. Figure 7 and Figure 8 above show that the proportion of revenue that advertisers spend on video and non-video advertising for a given marketing objective or sub-objective also varies year on year.

[X]

- b. Figure 10 below shows that, at the level of individual advertisers, there were significant changes over time in the share of advertising spend accounted for by video and non-video advertising, based on a sample of individual advertisers on Facebook between 2016 and 2019.⁶⁵ For a number of these advertisers, the proportion of total spend on video and non-video advertising is evenly split on average over this period. In addition, in some cases, the proportion of spend on video and non-video advertising changes considerably over time (see, for example, Advertiser 50 and Advertiser 60). This demonstrates that individual advertisers use video and non-video advertising interchangeably.

⁶⁴ Advertiser switching between video and non-video adverts can also occur within an advertising campaign. For example, Facebook offers an advertising product that will change format based on what an algorithm has observed that a specific user is more likely to engage with.

⁶⁵ The sample of individual advertisers has been constructed using data on the [X] largest advertisers on Facebook by spend during the period 2016-2019. [X] advertisers have been selected from each decile of this distribution. For example, ‘Advertiser 10’ in Figure 10 below is the advertiser at the 10th percentile of this distribution, ‘Advertiser 20’ is the advertiser at the 20th percentile of the distribution, etc.



- 2.3.38 Unless advertising messages change significantly month-to-month and year-to-year – for which there is no evidence – the observed changes in the spend shares of video and non-video advertising indicate that advertising messages do not determine advertisers’ choices between video and non-video advertising.
- 2.3.39 The Interim Report’s observations on segmenting video and non-video advertising, which appear to rely on a small number of third party comments from media agencies, are not based on a robust evidence base. The evidence set out above demonstrates that video and non-video advertising falls within the same market.

On the user side, the relevant market should include all platforms and content providers

Platforms and content providers compete for high quality, engaged user time

- 2.3.40 When considering the relevant market on the user side, it is critical to consider the interaction between the two sides of the market. Ad-funded platforms typically generate all or almost all of their revenues from advertisers.
- 2.3.41 The presence of active users on a platform (and the time that they spend on that platform) provides value to advertisers which, in turn, enables the platform to attract advertising revenues. This means that competition between platforms on the user side is focused on attracting user time. The greater the user time that a platform can offer, the more attractive it is for advertisers, and the more profitable it is for that platform from the perspective of advertising revenues.
- 2.3.42 Since users have a finite amount of time, there is an opportunity cost associated with not being able to use an alternative platform at the same time. This opportunity cost plays a central role in driving competition between user platforms, all of whom are competing for a greater proportion of users’ time.⁶⁶

Multi-homing across different platforms makes it easy for users to switch their time to the platforms that are most attractive to them

- 2.3.43 It is straightforward for users to sign up to a new platform: there is typically no need to buy new hardware and platforms tend to be free on the user side, with quick and straightforward new user registration processes. Users are thus able to access different platforms at no financial cost, the result being that users can (and do) multi-home across a range of platforms.
- 2.3.44 The Interim Report recognises that “consumers do appear to ‘cross-visit’ across multiple social media platforms”⁶⁷ and this is supported by the evidence that it presents in Table C.5 of the Interim Report (reproduced below in Figure 11) and Figure C.18 in Annex C of the Interim Report, which shows that there is extensive multi-homing across different platforms. For example, the evidence in the Interim Report states that 56% of Facebook’s user base also uses Twitter and 53% also uses Snapchat.

⁶⁶ Interim Report, para. 3.143.

⁶⁷ Interim Report, para. 3.142.

Figure 11 Users’ multi-homing behaviour

Table C.5: Consumer cross-visiting behaviour

	Facebook*	Instagram	WhatsApp	Twitter	Snapchat	LinkedIn	Pinterest	Reddit	Tumblr	TikTok
Facebook*	N/A	66%	58%	56%	53%	44%	33%	24%	6%	4%
Instagram	97%	N/A	69%	63%	58%	49%	37%	29%	10%	7%
WhatsApp	97%	78%	N/A	66%	59%	54%	37%	28%	8%	7%
Twitter	93%	71%	66%	N/A	60%	54%	42%	39%	12%	7%
Snapchat	95%	69%	63%	64%	N/A	44%	39%	29%	9%	9%
LinkedIn	94%	70%	68%	69%	53%	N/A	38%	35%	13%	8%
Pinterest	93%	70%	62%	70%	61%	51%	N/A	34%	13%	6%
Reddit	86%	70%	59%	82%	57%	58%	43%	N/A	16%	8%
Tumblr	73%	80%	57%	91%	65%	77%	57%	57%	N/A	7%
TikTok	70%	84%	68%	76%	86%	62%	36%	41%	10%	N/A

Source: Comscore MMX MP, Total Digital Population, Desktop aged 6+, Mobile aged 13+, June 2019, UK.

*Including Messenger.

Source: CMA’s Interim Report, Table C.5, Annex C

2.3.45 This is further supported by third-party data and Facebook’s own internal research. For instance:⁶⁸

- Facebook’s internal research shows that, between mid-2017 and 2019, a decrease in the share of users’ time spent on Facebook was associated with a gain in the time spent on YouTube⁶⁹ – this is consistent with the CMA’s own findings, as shown in Figure 3.7 of the Interim Report;
- on average, people in the UK have 7.1 social media accounts;⁷⁰
- a large and increasing share of Facebook’s users visit other social media platforms (i.e. multi-home) – for example, third party data shows that in 2018, 53% of Facebook users also used Snapchat, having increased from 13% in 2015, whilst 59% of Facebook users in 2018 also used Twitter, up from 39% in 2015;⁷¹ and
- the share of time spent on Facebook and Instagram has been trending downwards over time whilst the share of time spent on other social media platforms, such as Snapchat, has been trending upwards.⁷²

2.3.46 It is straightforward for users to switch their time to the platforms that are most attractive to them. The Interim Report has provided no evidence, and there is no reason to believe, that users set aside certain amounts of time for platforms with particular functional characteristics. Instead users are willing to switch their time between platforms with different functionalities (e.g. search, messaging, social media, entertainment, gaming, shopping, information and education), depending

⁶⁸ This evidence was previously submitted to the CMA as part of Facebook’s response to Q31 of the CMA’s RFI 1 of 18 July 2019 (Tranche 2).

⁶⁹ Facebook internal research, “Mobile App Category Two-Year Forecast with Onavo Data”, page 6, FB_CMA_00004144. See Figure 8 in Facebook’s response to Q31 of the CMA’s RFI 1 of 18 July 2019 (Tranche 2).

⁷⁰ GlobalWebIndex, “Social – GlobalWebIndex’s flagship report on the latest trends in social media”, 2019, available at: <https://www.globalwebindex.com/hubfs/Downloads/2019%20Q1%20Social%20Flagship%20Report.pdf>.

⁷¹ See [Lear, Ex-post assessment of merger control decision in digital markets for the UK Competition and Markets Authority, 9 May 2019.](#)

⁷² See [Lear, Ex-post assessment of merger control decision in digital markets for the UK Competition and Markets Authority, 9 May 2019.](#)

on how attractive those platforms' offerings are to the user in question at the relevant time.

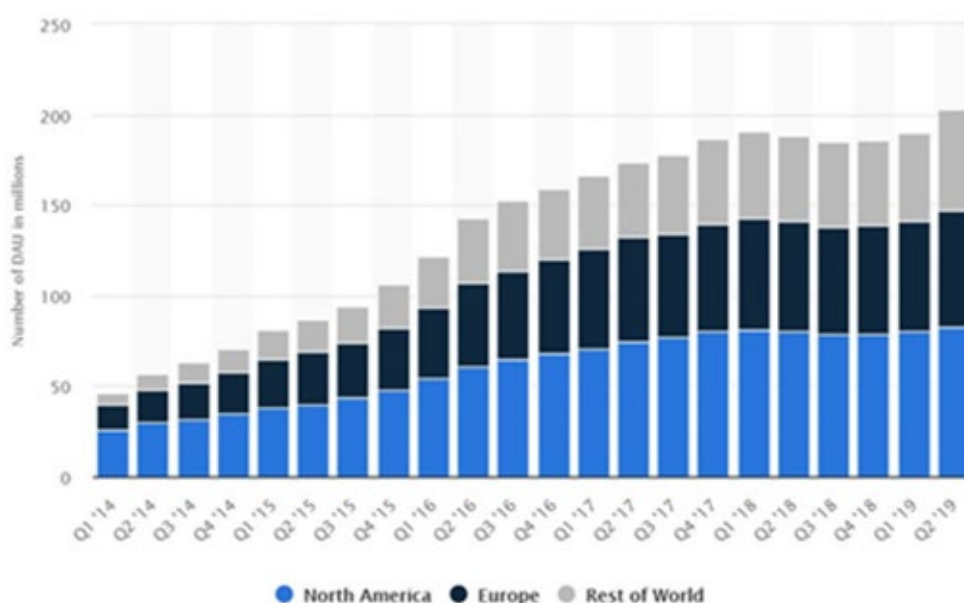
Shifts in user time are demonstrated by new platforms that have been successful in attracting a large user base from scratch

2.3.47 As explained above, multi-homing helps to facilitate new entry. Many platforms have been successful in attracting a large user base from scratch. For instance, Snapchat has been able to:

- grow its user base in Europe by more than 300% between 2014 to 2019; and
- grow to a network of around 25 million Monthly Active Users (“MAUs”) in the UK, as shown in Figure 3.6 of the Interim Report.⁷³

2.3.48 Figure 12 below demonstrates that Snapchat has experienced significant user growth since entry, increasing its global user base from under 50 million in 2014 to more than 200 million in 2019.

Figure 12 Snapchat’s Daily Active User (“DAU”) base from 2014 to 2019



Source: Statista, available at: <https://www.statista.com/statistics/552671/snapchat-app-dau-region/> (accessed on 25 February 2020)

2.3.49 Similarly, TikTok has been able to attract a substantial volume of new users since its launch in 2016:

- a. in January 2019, TikTok’s app had around 420,000 monthly downloads on iOS devices in the UK and around 884,000 monthly downloads on Android devices in the UK,⁷⁴ and

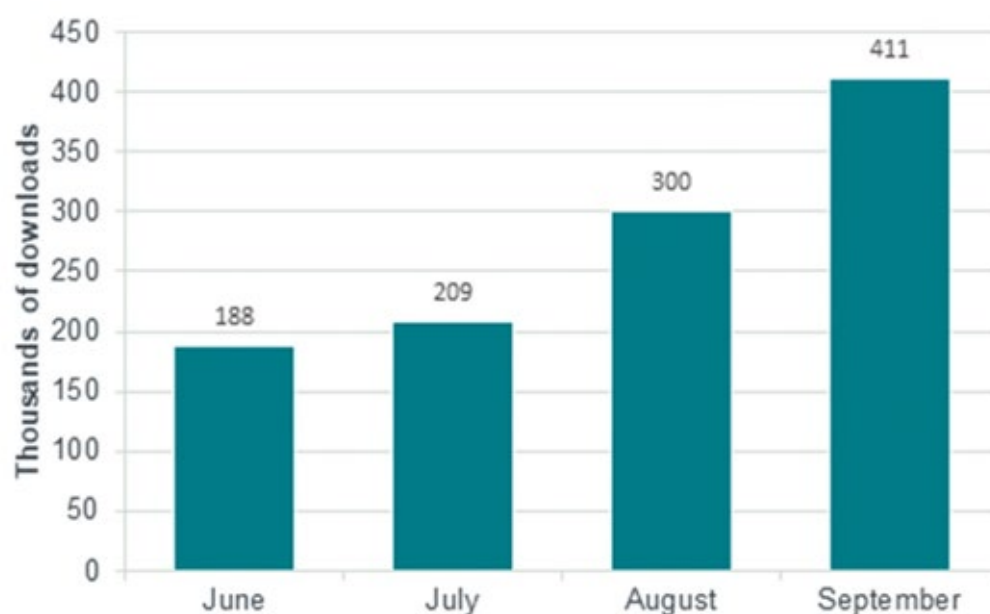
⁷³ Interim Report, Figure 3.6.

⁷⁴ Statista, available at: <https://www.statista.com/statistics/1064633/tiktok-monthly-downloads-ios-uk/> (accessed on 25 February 2020), and Statista, available at: <https://www.statista.com/statistics/994319/tiktok-monthly-downloads-android-great-britain/> (accessed on 25 February 2020).

b. as of July 2019, TikTok had attracted around 500 million monthly active users worldwide.⁷⁵

2.3.50 Figure 13 below also shows that, since June 2019 (i.e. the period covered by Table C.5 of the Interim Report, which shows the level of multi-homing across different platforms), TikTok has continued to add users at a rapid rate, with a further 411,000 monthly downloads on iOS devices in the UK in September 2019.

Figure 13 Monthly downloads of TikTok on iOS devices in the UK, 2019



Source: Statista, available at: <https://www.statista.com/statistics/1064633/tiktok-monthly-downloads-ios-uk/> (accessed on 25 February 2020)

2.3.51 The Interim Report acknowledges that newer entrants such as Snapchat have grown successfully on the user side of the market, noting that: “*Snapchat has been successful in generating consumer engagement and is particularly popular with younger demographics*”.⁷⁶

2.3.52 Moreover, newer platforms such as Snapchat and TikTok have started to develop their advertising-based monetisation strategies.⁷⁷ This is consistent with the business cycle of ad-supported platforms that often seek to grow their user bases before then focusing on monetisation.

Facebook therefore competes with many other ad-supported online services for high quality, engaged user time

2.3.53 In light of the above, Facebook and other platforms must continue to innovate to maintain and improve their user propositions, so that they can generate advertising revenues through user engagement.

⁷⁵ See, <https://www.oberlo.co.uk/blog/tiktok-statistics> (accessed on 25 February 2020).

⁷⁶ Interim Report, Box 3.5, page 89

⁷⁷ See for example page 11 in https://investor.snap.com/~/_media/Files/S/Snap-IR/reports-and-presentations/2018-annual-report.pdf; and <https://www.theverge.com/2019/11/26/20975168/tiktok-bytedance-advertising-brands-sponsorship-flighthouse> (accessed on 25 February 2020).

- 2.3.54 Regardless of exactly how a platform (or content provider) attracts users – whether by offering functional characteristics similar to those Facebook currently offers or other features that are attractive to users – they are competitors to the extent that they seek to capture the limited supply of users’ time, pushing each other to innovate and improve the user experience. As noted in the academic literature: *“[a]ntitrust analysis should ... focus on competition for securing and delivering attention in considering market definition, market power, and competitive effects. Focusing on competition between specific products and services, rather than attention, could result in competition authorities and courts making either false-negative or false-positive errors in their decisions.”*⁷⁸
- 2.3.55 The importance of user engagement is supported by the Interim Report, which acknowledges that digital platforms compete for users’ time, given that *“the more of consumers’ attention platforms can capture [...], the more attractive the platform’s inventory is to advertisers, and the more inventory they will ultimately have to sell”*.⁷⁹ This is also corroborated by the views of several suppliers of digital advertising, who told the CMA that *“the way to enter display advertising was to first offer a compelling platform which captures consumer attention”*.⁸⁰
- 2.3.56 This logic and evidence indicates that Facebook’s success depends upon its ability to attract users and deliver the right ad, to the right user, at the right time. As a result, on the user side, the relevant market should be for all platforms and content providers that capture user time by providing relevant and engaging services to users.

⁷⁸ David S. Evans, Attention Rivalry Among Online Platforms, 9 J. Competition L. & Econ. 313, 314 (2013).

⁷⁹ Interim Report, para. 2.10.

⁸⁰ Interim Report, para. 5.141.

3 THE CMA'S EVIDENCE DOES NOT SUPPORT ITS PRELIMINARY CONCLUSION THAT FACEBOOK HAS SIGNIFICANT MARKET POWER

3.1 Introduction

- 3.1.1 The Interim Report argues that Facebook has significant market power on both sides of the market, based primarily on its share of supply analysis. However, as set out in Section 2 above, the Interim Report's conclusions on market definition suffer from material deficiencies, with a material knock-on impact on its share of supply analysis. Viewed correctly, Facebook's market shares on either side of the market are much lower than the Interim Report suggests, and are not at a level that gives rise to significant market power.
- 3.1.2 Section 3.2 shows that other evidence in the Interim Report supports the view that Facebook does not have significant market power on either side of the market, and provides further evidence that this is the case.

3.2 The evidence suggests that Facebook does not have significant market power

- 3.2.1 The Interim Report's assessment of market power is based on the following factors.
- a. On the user side:
 - i. Facebook's share of supply based on the Interim Report's approach to market definition – in particular, the Interim Report states that *"Facebook.com's share has declined over the last five years having fallen from 80% in July 2015. However, we note that the number of users accessing Facebook.com has increased throughout the period and the absolute time spent by users on Facebook.com has increased in the last two years."*⁸¹
 - ii. an assertion that Facebook's user proposition would be better in a more competitive counterfactual; and
 - iii. an assertion that Facebook extracts more data from users than it would be able to in a more competitive counterfactual.
 - b. On the advertiser side:
 - i. a preliminary analysis of increasing cost per impression (**CPM**); and
 - ii. a preliminary analysis of economic profitability, which the CMA argues shows that Facebook's profits are above the cost of capital.

⁸¹ Interim Report, para 3.117.

Facebook does not consider that this evidence is robust, and it does not support the conclusions that the Interim Report has drawn on market power.

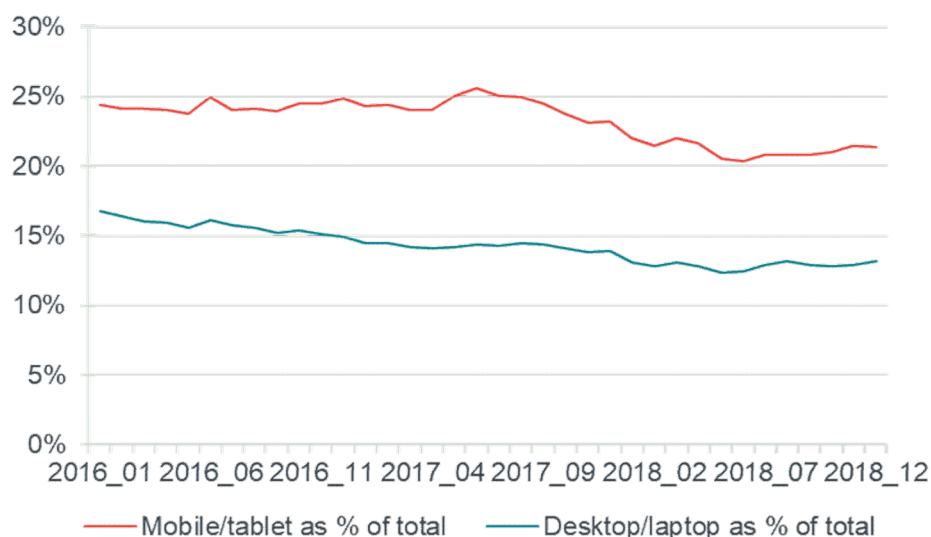
Market power on the user side

Facebook’s share of supply demonstrates that it does not have significant market power on the user side

3.2.2 The Interim Report concludes that Facebook has significant market power on the user side, placing significant weight on its share of supply analysis to draw this conclusion. However, the shares of supply set out in the Interim Report are based on an incorrect market definition, as explained in Section 2 above.

3.2.3 Figure 14 below shows Facebook’s share of user time as a proportion of total time spent online by the average UK user. Including the correct set of platforms (based on an appropriately defined relevant market),⁸² Facebook’s share of supply ranges between 13% and 21%, depending on whether this relates to time spent on mobile or desktop devices. This is considerably lower than the shares estimated by the CMA in the Interim Report.

Figure 14 Facebook’s user market share figures based on a single user market, 2016-2018



Source: Data from Facebook and Statista (available at: <https://www.statista.com/statistics/300201/hours-of-internet-use-per-week-per-person-in-the-uk/>, accessed on 25 February 2020)

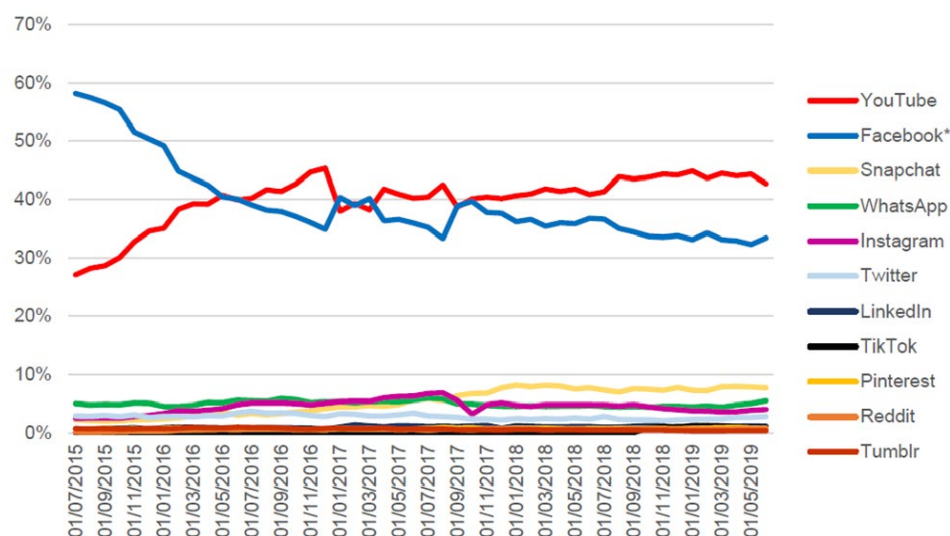
3.2.4 Moreover, the CMA fails to acknowledge that, even on the basis of its own share of supply analysis, there is no evidence that Facebook has significant market power on the user side. In particular, the shares of supply set out in Figure 3.7 of the Interim Report and reproduced in Figure 15 below (which are based on time spent on social media platforms including YouTube) show that Facebook’s share of supply declined from approximately 60% in July 2015 to around 30% in May 2019. At the same time, YouTube’s share of supply increased from approximately

⁸² This includes all platforms that capture user time by providing relevant and engaging services to users, such as social media platforms, dating platforms, news websites and search platforms.

30% to more than 40% over the same period. In addition, Snapchat’s share of supply increased from just above 0% in July 2015 to almost 10% in May 2019.

Figure 15 Figure 3.7 of the CMA’s Interim Report

Figure 3.7: Shares of supply by user time spent on social media platforms from July 2015 to June 2019 (including YouTube)



Source: CMA’s Interim Report, Figure 3.7

3.2.5 Even on this excessively narrow market definition, it is clear that Facebook’s share of time spent has significantly declined and is below any meaningful benchmark of significant market power.

The CMA does not provide any evidence to support its notion of a more competitive counterfactual

3.2.6 The Interim Report argues that a “more competitive counterfactual” would give rise to better outcomes for users. In particular:

“[T]he price charged by Google and Facebook to access their services is currently zero. It’s plausible that the price charged in more competitive circumstances would be negative, with consumers rewarded, financially or otherwise, for entering a search query or scrolling through their news feed.”⁸³

3.2.7 However, the CMA does not provide any concrete evidence to support what a more competitive counterfactual would look like (for example, whether one actually observes such “more competitive” outcomes in competitive markets), let alone whether such an outcome would be plausible in practice. As such, this approach is purely speculative.

3.2.8 Users place significant value on being able to use Facebook’s innovative services, which means one counterfactual could involve users paying to use Facebook’s services. For instance, one of the studies referred to by the Interim Report finds that the benefits of Facebook’s free service to users amount to around \$40 per month, which if replicated in the UK would amount to around \$20bn per year in the

⁸³ Interim Report, para. 2.69.

UK across Facebook’s user base.⁸⁴ Other studies have reached similar conclusions.⁸⁵ As such, the suggestion in the Interim Report that there is a more competitive counterfactual involving users being rewarded for using Facebook’s services is entirely speculative and unevicenced.

3.2.9 In addition, the Interim Report claims that Facebook may be able to extract less data in a more competitive counterfactual than it currently does:

“In a more competitive market, consumers might not need to provide so much data in exchange for the services they value.”⁸⁶

3.2.10 Similarly, however, the Interim Report does not provide any evidence to demonstrate Facebook’s data extraction practices are different to those that would occur in a competitive market or that Facebook extracts an excessive amount of data per customer compared to other online platforms and services.

3.2.11 The CMA appears to rely on survey evidence from third party sources in support of its conclusion⁸⁷ (although does not explicitly draw the link between this evidence and its conclusion), and more generally in its discussion around user data sharing.⁸⁸ In general, survey evidence should be treated with caution, given that it is based on stated preferences (rather than revealed preferences, i.e. actual observed behaviour) and responses can suffer from a number of biases. Moreover, the survey questions the CMA relies on are vague and abstract (e.g. *“are you happy to share your personal data in order for companies to show you adverts or information that might be more relevant to you?”⁸⁹*) and do not support the CMA’s conclusions. For example:

- a. none of the questions ask for respondents’ attitudes to current *levels* of data sharing (however, the CMA’s conclusion appears to be predicated on the fact that current levels are excessive);
- b. none of the questions ask about data sharing in a sufficiently specific and relevant scenario to elicit reliable responses. A better designed survey question might, for example, ask about attitudes towards sharing certain specific types of information with Facebook;
- c. none of the questions ask about *how much* users value sharing certain types of data in specific scenarios (which is crucial for an assessment of a more competitive counterfactual, taken together with the value to the platform); and
- d. none of the evidence is focused on what a more competitive counterfactual would actually look like (and the CMA makes no proper attempt to articulate this).

⁸⁴ Brynjolfsson, E., Collis, A., & Eggers, F. (2019). Using massive online choice experiments to measure changes in well-being. *Proceedings of the National Academy of Sciences*, 116(15), 7250-7255.

⁸⁵ For example: Herzog, B. (2018). Valuation of digital platforms: Experimental evidence for google and facebook. *International Journal of Financial Studies*, 6(4), 87; Corrigan, J. R., Alhabash, S., Rousu, M., & Cash, S. B. (2018). How much is social media worth? Estimating the value of Facebook by paying users to stop using it. *PloS one*, 13(12), e0207101; Mosquera, R., Odunowo, M., McNamara, T., Guo, X., & Petrie, R. (2019). The economic effects of Facebook. *Experimental Economics*, 1-28.

⁸⁶ Interim Report, para. 2.69.

⁸⁷ Interim Report, paras. 4.41 to 4.51.

⁸⁸ Interim Report, section 4.

⁸⁹ See Harris Interactive (2019), Adtech – Market Research Report. As referenced by the CMA in paragraph 4.19 of the Interim Report.

3.2.12 As a result, the Interim Report’s hypotheses on a “more competitive counterfactual” are speculative and unfounded.

Market power on the advertiser side

Facebook’s shares of supply demonstrate that it does not have significant market power on the advertiser side

3.2.13 As with the user side, the CMA’s assessment of shares of supply on the advertiser side is based on markets defined on an artificially narrow basis. On a proper assessment of the market (i.e. including all advertising channels and based on industry estimates of total UK advertising expenditure), Facebook accounted for between 8% and 11% of total UK advertising spending in 2018.⁹⁰

3.2.14 Even if the CMA were to consider only digital advertising (i.e. search and display advertising combined, rather than the Interim Report’s unduly narrow market definition based on display advertising only), Facebook’s market share would range between 17% and 23%. This is considerably lower than the Interim Report’s estimates, which range between 35 - 40% to 40 - 45%. This calculation is based on the market expenditure figures used in the Interim Report and is summarised in Figure 16 below.

Figure 16 Facebook’s advertising market share figures based on a single digital advertising market, 2018

GBP billions	Scenario 1	Scenario 2
Advertising expenditure on Facebook in 2018	£2bn*	£2.6bn*
UK digital search advertising in 2018	£6.4bn**	£6.4bn**
UK digital display advertising in 2018	£5.1bn***	£5.1bn***
% share of expenditure on Facebook of total digital search and display advertising	17%	23%

Source: Figures extracted from the Interim Report. * See para. 132 of Appendix C. ** See para. 89 of Appendix C. *** See Table C.6 of Appendix C.

Note: The figures used by the Interim Report for advertising expenditure on Facebook in the UK in 2018 (see para. 132 of Appendix C) are between £2bn and £2.6bn. Scenario 1 and Scenario 2 in the table relate to the lower and upper bounds of these figures.

3.2.15 In addition to the share of supply analysis, the Interim Report also suggests that there is evidence of harmful effects arising from Facebook’s exploitation of its alleged market power. In particular, the CMA finds that:

- “the profitability of both Google and Facebook has been well above any reasonable estimate of what we would expect in a competitive market for many years”; and

⁹⁰The Advertising Association/WARC estimate that total UK advertising spend in 2018 was £23.6bn (see Advertising Association/WARC Expenditure Report, April 2019). Based on the figures used by the Interim Report (see para. 132 of Appendix C), advertising expenditure on Facebook in the UK in 2018 was between £2bn and £2.6bn. This implies that Facebook’s share of total UK advertising spend in 2018 was between 8% and 11%.

- *“Facebook’s prices have been increasing over the last three years and are significantly higher on average than its rivals, YouTube and Instagram”.*⁹¹

- 3.2.16 On Facebook’s profitability, the CMA’s preliminary analysis suffers from significant errors and omissions and does not provide any grounds for concluding that Facebook has significant market power. In particular, the CMA’s analysis:
- a. fails to account for Facebook’s significant non-recorded intangible asset base;
 - b. adopts a time period that is arbitrary and too short to capture the lifecycle profitability of many online platforms and services; and
 - c. erroneously focuses on just Facebook, whereas it should assess profitability across the entire market, including failed platforms, to avoid “survivorship bias” concerns.⁹²
- 3.2.17 As for Facebook’s advertising prices, the initial analysis of CPM presented in the Interim Report is not reliable. CPM fails to capture the quality/value for money (of Facebook’s advertising service) for advertisers, in terms of how cost effectively they are able to achieve their ultimate business outcomes (typically sales, as facilitated by the advertising objectives Facebook offers). The CMA itself acknowledges that its CPM analysis is incomplete and has issued a further data request to explore this issue further.⁹³ Accordingly, no reliable conclusions can be drawn from the current analysis.
- 3.2.18 These two concerns are addressed in detail in the two supporting papers submitted by Facebook on 6 March 2020 as part of its response to the CMA’s section 174 notice of 18 February 2020, entitled “Profitability Analysis” and “Advertising Pricing Analysis”.

Facebook is continuously innovating and making substantial investments in R&D

- 3.2.19 If Facebook did have significant market power on either the user or advertiser side, one would expect Facebook to have substantially reduced its investment in R&D, i.e. its investment in future product development, innovation and quality improvements. However, empirical evidence shows that Facebook is continuously innovating to improve its services.
- 3.2.20 The chart below, based on analysis by the Italian telecoms regulator (“**AGCOM**”), compares global R&D spend for a number of tech companies, both in absolute terms (shown on the horizontal axis) and as a percentage of revenues (shown on the vertical axis). This demonstrates that:
- a. Facebook spends significantly more on R&D as a percentage of its revenues than many other major tech companies, including Google, Microsoft and Amazon, and substantially more than Apple and Netflix; and

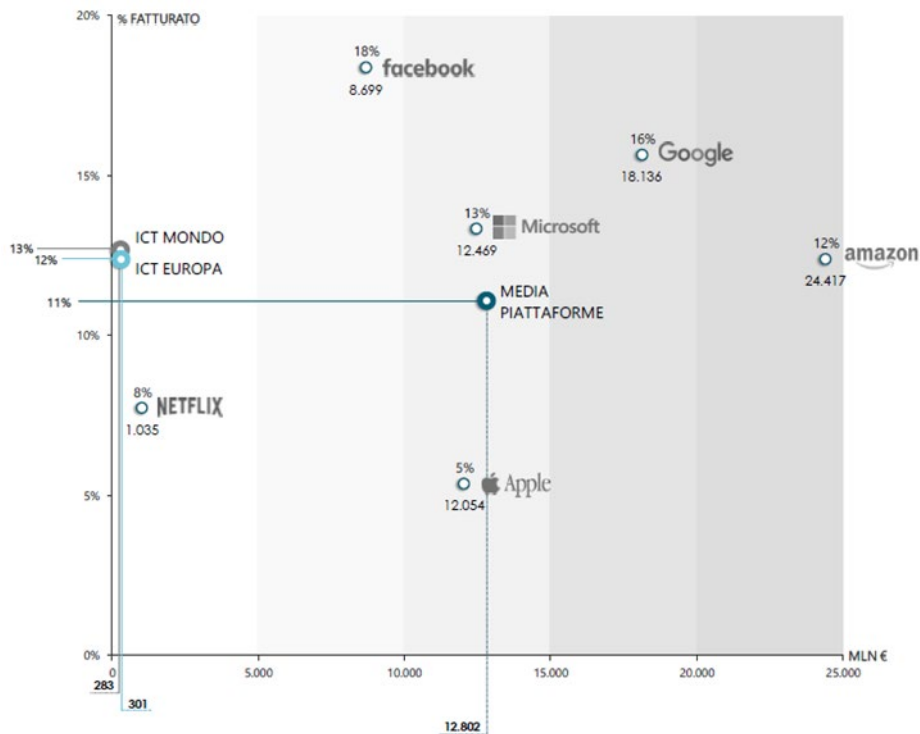
⁹¹ Interim Report, paras. 59 to 60.

⁹² Survivorship bias is a type of selection bias where the results, or “survivors”, of a particular outcome are disproportionately evaluated, with “failures” in some cases ignored entirely. In this context, existing players are the “survivors” and failed entrants the “failures”.

⁹³ Interim Report, para. 5.112.

- b. Facebook’s R&D spend in proportionate terms is well above the average for Information, Communications, and Technology companies in Europe/globally and for media platforms as a whole.

Figure 17 Global R&D spend of online platforms, 2018



Source: “Osservatorio Sulle Piattaforme Online”, Autorità per le Garanzie nelle Comunicazioni (AGCOM), December 2019, Figure 1.9

3.2.21 Moreover, as shown in Figure 18 below, Facebook’s levels of R&D expenditure have been increasing significantly over time: starting at around [€] in 2011, Facebook’s global R&D expenditure was nearly [€] in 2019.

[€]

3.2.22 The high levels of R&D spend illustrate the significant competitive pressure Facebook faces to innovate, in order to remain relevant and attractive to both users and advertisers in a highly competitive and dynamic industry.

4 THERE ARE NO MATERIAL BARRIERS TO ENTRY AND EXPANSION

4.1 Introduction

- 4.1.1 The CMA's assessment of barriers to entry and expansion is internally inconsistent and at odds with the empirical evidence set out in the Interim Report.
- c. Section 4.2 shows that the Interim Report's assessment of economies of scale is internally inconsistent.
 - d. Section 4.3 shows that the nature of network effects does not hinder platforms' ability to enter and compete effectively.
 - e. Section 4.4 highlights that several of the arguments raised in the Interim Report around barriers to entry relate to Facebook's high-quality offering. However, having a high-quality product cannot credibly be characterised as a barrier to entry.

4.2 The Interim Report's approach to economies of scale is internally inconsistent

- 4.2.1 In the main body of the Interim Report, the CMA concludes that "*social media platforms seem to experience some economies of scale, that may make it difficult for new entrants to compete*".⁹⁴ The Interim Report refers to evidence that Facebook generated economies of scale in its earlier stages and the views from other platforms that significant scale is needed for an entrant to be viable in the long term.⁹⁵
- 4.2.2 However, this assessment is inconsistent with the CMA's views in Appendix D of the Interim Report, where the CMA acknowledges that economies of scale are limited and that "*there are no insurmountable cost-related barriers to entry*".⁹⁶
- 4.2.3 The CMA also concludes in Appendix D that:
- "The evidence from the figures above suggest that Facebook's costs have also increased in line with its increasing scale. A successful smaller social media firm should be able to operate profitably with lower market share than Facebook."*⁹⁷
- 4.2.4 The CMA's assertions in the main body of the Interim Report, where these contradict the more detailed findings in Appendix D, are speculative and unsupported. There appears to be no concrete evidence to support such assertions (e.g. from other platforms' evidence), and the examples of rapid growth and entry from players such as Snapchat and TikTok contradict these assertions.

⁹⁴ Interim Report, para. 3.161.

⁹⁵ Interim Report, para. 5.140.

⁹⁶ Interim Report, Appendix D, para. 98.

⁹⁷ Interim Report, Appendix D, para. 92.

- 4.2.5 Moreover, Facebook’s experience when it entered the market in 2004 is not necessarily applicable to new entrants today. For instance:
- a. the rise of cloud-computing platforms hosted by Amazon Web Services and Google (among others) has dramatically decreased the time and capital necessary to start and grow an online platform.
 - b. App stores run by Google, Apple, Microsoft and Amazon (among others) provide pre-existing distribution platforms for applications to reach most of the UK population and therefore grow quickly.

4.3 The Interim Report’s approach to network effects is incorrect

The Interim Report ignores the importance of localised networks effects

- 4.3.1 The Interim Report concludes that network effects serve as a barrier to entry for new platforms and argues that “*same-side network effects reinforce Facebook.com’s competitive position*”, referring to the fact that “*Facebook.com’s consumer base is significantly larger than that of its competitors*”.⁹⁸
- 4.3.2 However, the Interim Report fails to acknowledge the importance of localised network effects. In particular, network effects often do not depend on the overall size of the network – what matters more for an individual user is having connections (and content) that are relevant to that user. A number of studies have found that network effects for social media are largely local.⁹⁹
- 4.3.3 Localised network effects enable platforms to easily attract and retain users by reducing the number of available connections that a platform needs in order to entice a user to join. Therefore, a new entrant does not need to replicate Facebook’s entire user base in order to benefit from localised network effects – it simply has to attract a user’s close connections. This could be done, for instance, by importing users’ phone contacts onto the app, as people typically keep contact information for their close connections.

The Interim Report’s conclusion that network effects are a barrier to entry is internally inconsistent

- 4.3.4 The Interim Report states that the existence of network effects acts as a barrier to entry and expansion. However, this is inconsistent with the evidence in the Interim Report on the rapid growth of platforms such as Snapchat. The Interim Report therefore appears to abandon its conclusion that network effects act as a barrier to entry, and instead suggests that the barriers to expansion faced by firms such as Snapchat relate to their ability to monetise their propositions: for instance

⁹⁸ Interim Report, para. 3.145.

⁹⁹ See for example: Tucker, Catherine. “Network Effects and Market Power: What Have We Learned in the Last Decade?”. Antitrust, Spring (2018): pp. 72-79. Tucker, Catherine. “Identifying formal and informal influence in technology adoption with network externalities”. Management Science, 55 (2008): pp. 2024-2039. Zhu, Feng and Marco Iansiti. “Why Some Platforms Thrive and Others Don’t”. Harvard Business Review (January-February 2019)

*“[Snapchat] has been less successful than Instagram at monetising its services, despite achieving comparable levels of consumer engagement in terms of consumer time spent on the platforms”.*¹⁰⁰

- 4.3.5 However, this apparent “barrier” is not discussed elsewhere in the Interim Report and no evidence is presented to support its existence.¹⁰¹ To the contrary, as noted above in paragraph 2.3.52, Snapchat (and TikTok) have introduced and are starting to develop advertising-based monetisation strategies, consistent with the business cycle of ad-supported platforms (and indeed other types of businesses) that often seek to grow their user bases before then focusing on monetisation.

Multi-homing facilitates new entry and expansion

- 4.3.6 The Interim Report recognises that users multi-home widely across different platforms, assisted by the fact that they face no financial cost to join a new platform. In particular, and as explained above, users “*appear to ‘cross-visit’ across multiple social media platforms*”¹⁰² and “*multi-homing can increase the competitive pressure faced by incumbents such as Facebook.com*”.¹⁰³
- 4.3.7 However, the Interim Report fails to properly explain the role of multi-homing in facilitating new entry and reducing barriers to entry and expansion. The fact that users use multiple social media platforms means that users easily can (and do) re-allocate their time across different platforms, which makes it easier for new platforms to attract their time. This means platforms do not face the hurdle of having to “displace” an existing platform in order to enter and gain traction.
- 4.3.8 In addition, network effects are not exclusive to a single platform. As users multi-home across different platforms, it is possible for multiple platforms to benefit from network effects at the same time. Whilst Facebook has benefited from direct network effects through user growth, so have other platforms, such as YouTube, Snapchat, Twitter and TikTok.
- 4.3.9 Network effects can also assist in a platform’s expansion. It is clear from the rapid expansion of Snapchat, Twitter and TikTok (amongst others) that these platforms are at the stage of benefiting from network effects amongst their user base rather than being hindered by them. The success of Snapchat and other new entrants in growing their user bases demonstrates that network effects do not act as a barrier to entry.

The Interim Report ignores the potential for network effects to operate in reverse

- 4.3.10 The presence of network effects is not a guarantor of success.¹⁰⁴ While localised network effects can help a platform quickly gain popularity, they can at the same time lead to a platform quickly losing popularity. As a platform loses users, the remaining users who are connected to those individuals receive less benefit from

¹⁰⁰ Interim Report, Box 3.5.

¹⁰¹ Interim Report, Box 3.5.

¹⁰² Interim Report, para. 3.142.

¹⁰³ Interim Report, para. 3.141.

¹⁰⁴ See Facebook’s response to Q32 of the CMA’s RFI 1 of 18 July 2019 (Tranche 2).

continuing to use the platform. Accordingly, the presence of network effects implies that platforms cannot engage in actions that would reduce users' enjoyment of the platform, as well as providing a strong incentive for platforms to innovate in order to retain users. Otherwise, they risk triggering a negative feedback loop whereby the loss of users would lead to their connections – and hence more users – leaving the platform.¹⁰⁵

- 4.3.11 There are several prominent examples of platforms rapidly losing users because of network effects. A recent example of such a negative loop is Yik Yak, a messaging app launched in 2014 which allowed users to send anonymous messages which could be shared with other users nearby. Despite its initial success, which led to the company having (at one point) a valuation of US\$400 million, it was unable to retain its users (which was attributed to the failure to continue offering engaging content/features) and this led to the company shutting down in 2017, only three years after it had been launched.¹⁰⁶
- 4.3.12 Tumblr has also experienced a considerable drop in the size of its user base, with a reduction from 640 million visits in July 2018 to 380 million visits in August 2019. This has been attributed to its inability to offer a direct messaging service to its users and its failure to attract a large number of advertisers.¹⁰⁷
- 4.3.13 The Interim Report does not address the potential for network effects to operate in reverse and therefore significantly underestimates the ability of new platforms to enter and compete effectively with more established platforms, such as Facebook.

4.4 The Interim Report relies on unevidenced “efficiency offence”-type arguments

The Interim Report appears to conclude that high quality is a barrier to entry in this market

- 4.4.1 The CMA acknowledges throughout its Interim Report that Facebook offers a high-quality service to users. For instance, “*Google and Facebook grew by offering better products than their rivals.*”¹⁰⁸
- 4.4.2 However, whilst recognising that Facebook’s service has been beneficial for users, the CMA appears to draw the conclusion that the high quality of Facebook’s offering has itself created an additional barrier to entry for competing platforms.
- 4.4.3 For example:

¹⁰⁵ See for example Tucker, Catherine. “Network Effects and Market Power: What Have We Learned in the Last Decade?”. Antitrust, Spring (2018): pp. 72-79 and Tucker, Catherine. “Network Stability, Network Externalities, and Technology Adoption”. Advances in Strategic Management (2017): pp. 151-175.

¹⁰⁶ See <https://www.forbes.com/sites/marijuetten/2018/11/13/failed-startups-yik-yak/#3fd417c25725> (accessed 25 February 2020).

¹⁰⁷ See <https://www.wsj.com/articles/tumblr-and-the-end-of-the-eyeballs-are-everything-era-11566014411> (accessed 25 February 2020).

¹⁰⁸ Interim Report, summary box, page 6.

- “[T]he wider breadth of services offered by Facebook.com and the scale of its consumer network mean that it can fulfil a wider variety of consumer needs compared to other social media platforms”.¹⁰⁹ (emphasis added)
- “None of the platforms currently active in the UK’s social media sector appear to impose a strong competitive constraint on Facebook.com. No existing social media platform offers a comparable range of consumer services, has access to as extensive a consumer network or has a similarly well-developed social graph. Consumers are unlikely to be able to replace Facebook.com’s services entirely with another platform’s unless that platform can offer access to each of these components”.¹¹⁰ (emphasis added)

4.4.4 Facebook should not be penalised for delivering a high-quality service. The Interim Report presents no evidence that the high quality of Facebook’s offering has itself resulted in harm to users. Rather, as noted above in paragraph 3.2.8, academic studies, including the Brynjolfsson et al study cited in the Interim Report,¹¹¹ consistently find Facebook delivers significant net consumer benefits.¹¹²

4.4.5 Therefore, the CMA’s concerns appear to be “efficiency offence”-type concerns. In a merger context, such concerns arise where the merger efficiencies make the merged entity so attractive to users – for example, through cost savings or improvements in product quality – that its competitors would be unable to compete effectively and would be forced to exit the market as a result. For such a concern to arise, one would need to demonstrate a decline in dynamic rivalry that outweighed the benefits for users in the form of lower prices and/or better quality. In a market study context, such concerns would then relate to the quality of an incumbent’s offering acting as a barrier to entry. Note that the European Commission has on a number of previous occasions dismissed the “efficiency offence”, noting that it is not a valid concern.¹¹³

High quality cannot be a barrier to entry in this market

4.4.6 The Interim Report’s suggestion that the high quality of Facebook’s offering has itself created an additional barrier to entry for competing platforms is not tenable for the following three reasons.

4.4.7 **First**, it is unclear that the high quality of Facebook’s proposition would have had any impact on entry by new platforms. The Interim Report acknowledges that “*new entrants attract consumers by providing a sufficiently differentiated proposition*”

¹⁰⁹ Interim Report, para. 3.127.

¹¹⁰ Interim Report, para. 3.165.

¹¹¹ Interim Report, footnote 20.

¹¹² See: Brynjolfsson, E., Collis, A., & Eggers, F. (2019). Using massive online choice experiments to measure changes in well-being. *Proceedings of the National Academy of Sciences*, 116(15), 7250-7255; Herzog, B. (2018). Valuation of digital platforms: Experimental evidence for google and facebook. *International Journal of Financial Studies*, 6(4), 87; Corrigan, J. R., Alhabash, S., Rousu, M., & Cash, S. B. (2018). How much is social media worth? Estimating the value of Facebook by paying users to stop using it. *PLoS one*, 13(12), e0207101; Mosquera, R., Odunowo, M., McNamara, T., Guo, X., & Petrie, R. (2019). The economic effects of Facebook. *Experimental Economics*, 1-28.

¹¹³ See Mario Monti, “Review of EC Merger Regulation — Roadmap for the reform project,” Speech/02/252, 4 June 2002: “*There is no such thing as a so-called ‘efficiency offence’ in EU merger control law and practice. In other words, the Commission does not rely on the fact that efficiencies resulting from a merger are likely to have the effect of reducing or eliminating competition in the relevant market (for example, by enabling lower prices to be charged to customers), as a ground for opposing a proposed transaction.*”

and that “*the most important ‘input’ to a new social media platform is a compelling idea*”.¹¹⁴ However, the conception of new ideas that differ from existing offerings in the market is not hampered or inhibited by the quality of Facebook’s offering. Those ideas can (and do) co-exist alongside Facebook and it is the very fact that they are different which generates increased consumer welfare. The Interim Report itself states that “[a] *key aspect of competition amongst social media platforms is their ability to offer consumers a different experience from the others*”.¹¹⁵ The examples of Snapchat and TikTok mentioned earlier provide evidence of this proposition.

- 4.4.8 **Second**, if the quality of Facebook’s offering were worse, it is not the case that users would be better off. To the extent that the quality of Facebook’s offering were worse, then by the logic of the “efficiency offence” concern, the only possible way in which this might benefit users would be if it were to facilitate new entry (i.e. by increasing competition from a dynamic perspective). However, it is entirely speculative for the CMA to suggest that users would be better off as a result, given the direct harm they would suffer from the reduction in the quality of Facebook’s offering. At the very least, it would be necessary for the CMA to demonstrate that these (speculative) benefits outweighed the direct and concrete losses.
- 4.4.9 **Third**, the form of additional entry that the Interim Report seems to expect to occur would be of an identical or very similar platform to Facebook.¹¹⁶ However, as the Interim Report itself acknowledges, “[a] *key aspect of competition amongst social media platforms is their ability to offer consumers a different experience from the others*”.¹¹⁷ Moreover, a platform with an identical proposition to Facebook would offer no incremental value to users in terms of additional features offered (and since both products would likely be offered for free to end users, there would be no price benefit). For the same reason, there would be no incentive for those users to use this alternative platform and therefore no resulting increase in the competitive constraint on Facebook.
- 4.4.10 Facebook operates in a market prone to disruption and innovation, particularly given the fast-changing nature of new technologies. This is further fuelled by the large amounts of venture capital investment with deal values growing continuously across all regions between 2011 and 2017.¹¹⁸ As such, the key source of competitive pressure on Facebook is from differentiated propositions, as demonstrated by Snapchat, TikTok and YouTube (amongst others), and it is exactly this type of entry which would be unaffected by changes in the quality of Facebook’s offering.

¹¹⁴ Interim Report, para. 3.140.

¹¹⁵ Interim Report, para. 3.104.

¹¹⁶ There is no identical proposition for Snapchat, TikTok, Pinterest or YouTube. The absence of an identical or very similar platform to Facebook is therefore not a Facebook-specific issue.

¹¹⁷ Interim Report, para. 3.104.

¹¹⁸ Assessing the impact of big tech on venture investment, Oliver Wyman 2018, page 19. Available at: <https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2018/july/assessing-impact.pdf>.



ANNEX 2

Response to the CMA's critique of the Parties' calculation regarding GIPHY's market share in a hypothetical advertising market

In the response to the CMA's working papers, the Parties included a calculation which showed that even if the CMA took GIPHY's boldest revenue projections and apportioned these to the UK (based on the UK's share of GIPHY's global search traffic through API/SDK partners), GIPHY's share of a hypothetical future display advertising market in the UK would only be between [REDACTED] and thus would not have imposed a competitive constraint on Facebook or other competitors within the display advertising sector.¹

The CMA dismisses these calculations on the basis that i) the '*GIPHY forecast on which they are based relates only to US revenues, so it is not correct to allocate a proportion of these revenues to the UK based on share of search*' and ii) that '*the Parties take the last forecast in a rapidly growing trend without making any allowance for the possibility of future growth*'.² The CMA itself has made no attempt to indicate the magnitude (quantitatively, or otherwise) of GIPHY's future revenues, and thus the size of any future horizontal overlap.

In relation to i), it is notable that the document that the CMA refers to³ does not provide any forecast of UK revenues (or forecast revenues for any other market outside the US). It only notes that '*monetisation of rest of world inventory*' as an '*upside*' – suggesting that GIPHY had no credible plans to enter the UK or other markets in the medium term. Moreover, the revenue projections for the US are clearly extremely ambitious, [REDACTED]. Given this, GIPHY had every incentive to include future revenues for non-US countries. Yet despite GIPHY's extremely optimistic revenue forecasts, [REDACTED]

In relation to ii), it is not clear what '*rapidly growing trend*' the CMA is referencing or why this wouldn't be included in GIPHY's forecasts. As the CMA itself notes within the PFs, GIPHY '*continued to project rapid growth*', despite revising its estimates downwards in later forecasts.⁴ This was despite the CMA recognising in their Market Power and Market Definition Working Paper that the evidence

¹ Parties' CMA Working Papers Response, paragraph 1.31

² CMA, 2021, Complete acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report, paragraph 7.84(a)

³ GIPHY submission, '2019.09.30 LRP Scenario.pdf', September 2019 [GPCMA_0001953]

⁴ CMA, 2021, Complete acquisition by Facebook, Inc of GIPHY, Inc.: Provisional Findings report, paragraph 7.95

suggested that '*GIF use may have plateaued over the last year*'.⁵ In relation to the display advertising market, any further growth would reduce GIPHY's hypothetical future market share (as is indicated by the range of market share estimates calculated by the Parties).

⁵ CMA, 2021, Market Definition and Market Power Working Paper, paragraph 38(a)