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Facebook's Stealth M&A Puts Focus on Deals Under Antitrust Radar
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Last year, Facebook Inc, did something U.S. technology giants have done countless times before: It bought a smaller company and closed the deal without notifying competition regulators.

But this transaction -- the $400 million acquisition of image library Giphy Inc. was particularly bold. At the time, Facebook was under investigation by antitrust enforcers for what the government says was an illegal practice of buying companies in order to eliminate them as potential threats to its monopoly power.

Giphy used a common -- and legal -- maneuver that lets companies avoid scrutiny from merger watchdogs: It paid a dividend to investors. The payment, described by two people familiar with the matter, reduced the size of Giphy's assets enough so that the companies weren't required to report the deal to antitrust officials. The people asked not to be identified discussing non-public information.

Maneuvers like Giphy's make policing deals all the more challenging at a time when authorities are being called on to take more aggressive steps to curb the growth of dominant companies, especially in the technology industry. It also raises questions about whether the system used to screen mergers for anticompetitive threats is in need of an overhaul.

"Firms basically are running wild," said Thomas Wollmann, an economics professor at the University of Chicago's Booth School of Business who has studied the issue. "It's a little bit like what happens if the police station closes at 5 p.m. That's when all the crime starts."

Facebook declined to comment about the Giphy deal.

Researchers who study these so-called stealth deals say they've found evidence that some companies are manipulating acquisitions to avoid notifying regulators. Others have documented how unreported deals allow companies to consolidate markets and shut down rival products. These acquisitions present yet another challenge for antitrust cops, who are increasingly strapped as a merger boom stretches their resources.

Facebook's acquisition strategy was targeted Thursday in a new antitrust complaint filed by the U.S. Federal Trade Commission, which said the company has illegally maintained a monopoly in social media by buying companies it sees as competitive threats.

Most mergers in the U.S. are never looked at by regulators. Slightly more than 2,000 deals were filed to government antitrust enforcers between October 2018 and September 2019, the most recent period reported by the FTC and the Justice Department, which share antitrust duties. The government reviews account for about 10% of nearly 22,000 acquisitions or company investments announced in that period involving a U.S. company, according to data compiled by Bloomberg.

M&A Running Wild

U.S. antitrust enforcers only review a fraction of the total deals involving American companies

Source: Bloomberg data and annual reports published by the FTC and the Justice Department

Note: Years are fiscal years from October to September. Total deals are a count of mergers and investments involving U.S. buyers and target companies that are pending, completed or have been terminated.

The U.S. system for screening mergers was created by the 1976 law known as the Hart-Scott-Rodino Antitrust Improvements Act. The law requires companies to notify antitrust officials about deals that meet annually adjusted thresholds. Transactions worth $92 million or less don't have to be reported, while those over $368 million do. For deals between $92 million and $368 million, filing requirements are based on assets and sales of the buyer and seller.

Those levels are far below the multi-billion-dollar deals that typically garner the most attention. The thinking behind the cut-offs is that small deals don't raise antitrust concerns and looking at every deal would be a waste of resources. Now concerns about unexamined deals are prompting calls from some quarters to reform the rules.

A House report last year recommended that dominant platforms like Facebook be required to notify enforcers about all their deals. The FTC last year started a review of unreported acquisitions by the five biggest U.S. tech companies. One purpose of the study is to determine whether these deals are a threat to competition, the agency said. The review is ongoing, according to the commission.

The Giphy acquisition shows how deals can fall through the cracks. By paying the dividend, Giphy lowered the value of its assets below the threshold required for filing, which was $18.8 million last year.

Under the FTC's rules at the time, the agency looked the other way when companies doing deals made dividend payments. The FTC withdrew that guidance in September, saying it would take a "more holistic review" of dividends to determine if a deal is structured to avoid filing. The change was prompted by the Giphy deal, according to one of the people familiar with the matter.

Giphy offers a library of video clips and animated images known as GIFs that can be attached to messages to express emotion. At the time of the deal, about half of Giphy's activity came through Facebook and its family of apps. Giphy provides the same search service to many of Facebook's competitors, including Apple Inc.'s iMessage, Twitter Inc., Signal, TikTok and others. The company has a view of the health of those platforms and how often people use them, insight that's valuable to Facebook.

Facebook is now in danger of being forced to sell Giphy. The U.K.'s antitrust watchdog has provisionally determined that the acquisition threatens competition in social media and display advertising. The Competition and Markets Authority said the only way to address its concerns is for Facebook to sell Giphy. The CMA plans to issue its final report in October.

Facebook said it disagreed with the regulator's findings and said the deal was in the interest of people and businesses in the U.K. and around the world.

During a House investigation of Facebook and other tech platforms, Representative David Cicilline, the Rhode Island Democrat who led the probe as chairman of the House antitrust panel, asked Facebook why the Giphy deal wasn't reported under merger notification laws. Facebook responded it wasn't required to, without explaining.

Economists who have studied the effect of unreported deals on competition argue that the thresholds for all deals should be lowered or that enforcers should have more flexibility to set different thresholds for different industries.

"There's an argument to be made that says, we should be looking at a lot more of these acquisitions because they're happening everywhere," said Florian Ederer, an economist at Yale University's School of Management, who has studied how unreported deals in the pharmaceutical industry can harm competition.

In a 2018 paper, Ederer and his co-authors found evidence of so-called killer acquisitions in the pharmaceutical industry, where one drug company acquires another and then discontinues a drug under development by the target company that poses a competitive threat to its own product.

The researchers estimated that dozens of such deals occurred annually during the period they studied. Many went unreported because the companies didn't meet the requirements for filing. The researchers found that those deals below the threshold were more likely to be killer acquisitions.

Wollmann, the University of Chicago economist, raised concerns about how small deals that go unreported can lead to what he calls "stealth consolidation" of markets. In a paper last year, Wollmann looked at acquisitions of more than 4,000 dialysis treatment facilities in the U.S. over a 20-year period, about half of which were never reported to regulators.