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Facebook's \$1B Instagram Buy Gets Closer Look By FTC

By Melissa Lipman

Law360, New York (May 30, 2012, 10:27 PM ET) -- The Federal Trade Commission has asked Facebook Inc. for more information about its \$1 billion deal for trendy photo-sharing application Instagram, a move attorneys said Wednesday may be driven by worries that the social networking giant is squelching competition from a potential future rival.

Facebook announced plans in early April to snap up Instagram, which lets its more than 30 million smartphone users edit and share photos, in a cash-and-stock deal, quickly prompting speculation that regulators might take a closer look.

A company spokesman said Wednesday that it would "continue to work closely with the FTC" and "look[ed] forward to answering any questions that arise" during the agency's investigation.

While Facebook has not disclosed any details about what the agency is asking for and the FTC itself has declined to comment on the matter, experts suggested that there were a range of reasons why the FTC might be examining a tie-up of two companies that do not appear to be head-to-head competitors, including the chance that Instagram might have been well-positioned to take its users and leverage its photo-sharing network into a rival to Facebook.

"The technology business model is you get the users, then you monetize," said Constantine Cannon LLP partner Ankur Kapoor. "It doesn't take much to go from sharing photos with visual effects to let's add some text, let's add some updates, let's maybe work with Twitter, and all of the sudden you have maybe a social network competitor for Facebook."

The merger guidelines the FTC and the U.S. Department of Justice put out in 2010 would also provide support for that kind of case, even though it hasn't been tested in the courts, according to University of Iowa law professor Herbert Hovenkamp.

"The 2010 merger guidelines, which are just starting to get some real traction in merger assessment, have a section on mergers that restrain innovation, and this occurs when a firm that's fairly dominant in its market acquires a smaller, highly innovative rival that could pose a competitive threat down the road," Hovenkamp said.

Under that theory, two companies don't need to be direct rivals at the time of the acquisition to raise antitrust concerns, according to Hovenkamp.

"This is a highly innovative photo-sharing technology that has proven its ability to migrate into new platforms like Android quite easily [and] photo-sharing is very very popular," Hovenkamp said. "The inquiry that's consistent with the guidelines' story is that this merger could be anti-competitive to the extent that Instagram is uniquely positioned to expand."

"Worst case scenario from Facebook's point of view is that [Instagram] becomes a very powerful player in the photo-sharing market and then starts leveraging this into ... a social networking website that competes with Facebook," Hovenkamp added.

Even though that kind of argument would be unusual for a merger case, it's not unheard of in the

technology sector, according to Kapoor. The concern was at play in the DOJ's landmark case against Microsoft Corp., which targeted the software giant for allegedly trying to keep Netscape's browser off Windows computers.

"The issue was: ... Was Microsoft thereby reinforcing its position in operating systems because Netscape was a potential competitor to Windows?" Kapoor said. "It wasn't an acquisition, it was a monopoly case, but it was the same underlying theory."

To make that kind of case, however, the FTC would need to turn up considerable evidence indicating that Instagram was poised to challenge the social networking giant, according to Kapoor.

"If, for example, you see lots of internal Instagram documents talking about taking on Facebook, [about] Instagram is the next social network, then there's some real factual basis to that legal theory," Kapoor said. "If Instagram wanted to remain just a photo app specialty and not get beyond that, then there's no concern."

Still, a number of other worries could also be behind the FTC's request for more information on the deal, attorneys said.

One possibility is that the agency is concerned that the deal might end up harming advertisers using either Facebook or Instagram by driving up prices or lowering quality.

"There's another side to the markets here and frankly I've always thought ... that if there's really any kind of plausible case to be made in these kinds of arguments, it's probably going to be on the advertising side," said Geoffrey A. Manne, the executive director of the International Center for Law & Economics and a lecturer at Lewis & Clark Law School. "That's not because I think it's a plausible case, it's because there's actual prices and actual transactions taking place where you could see ... something plausible that would actually count as antitrust harm."

Still, the FTC might have a hard time coming up with a relevant market that would support the notion that Facebook would exert enough power to raise advertising prices after absorbing Instagram, according to Manne.

"The relevant market just can't be something as narrowly circumscribed as just even all social networks ... it has to be, at its smallest, advertiser access to eyes on the Internet," Manne said. "But they can still go to about a billion other places, including Google, so it's hard to conceive that that market could possibly be threatened by this."

Yet another possibility is that the agency might be worried that Facebook might shut off its competitors' access to Instagram, attorneys said.

Though Facebook has said it won't do that, the question becomes whether the company might start charging rivals like Twitter and Google for access to Instagram and whether that, in turn, would hurt competition, Kapoor said.

"That's the same as the concern in Google-ITA: Was Google going to foreclose other travel search companies' access to the technology?" Kapoor said. "The Google-ITA concern may be a concern in this Facebook-Instagram deal."

Whether the FTC will decide to take the next step and actually seek to challenge the deal or place conditions on the combination, however, will depend on what the agency turns up on its second

request, attorneys said.

"If the government decides that this is a very nimble firm that's very well-positioned to become a head-to-head competitor with a significant portion of Facebook's business down the road, I think it will challenge the merger," Hovenkamp said. "But there's a whole lot of ifs."

Facebook is represented in the transaction by a team from Fenwick & West LLP led by Greg Roussel, including Christian Lymn, Matthew Karwoski, Morgan Sawchuk, Ralph Pais, Chris Joslyn, Michael Riskin, Scott Spector, Gerald Audant, Elizabeth Gartland, Adie Sherwood, Adam Halpern, Natalie Pardo de Zela, Jeffery Vetter, James Evans and antitrust attorney Mark Ostrau.

Counsel information for Instagram was not immediately available.

--Editing by Sarah Golin

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