LAW360

Portfolio Media. Inc. | 230 Park Avenue, 7th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

What Can Be Learned From Adobe-Figma Merger Termination

By **Deidre Taylor and Molly Heslop** (January 15, 2024, 11:46 AM GMT)

Dierdre Taylor

Molly Heslop

On Dec. 18, 2023, Adobe Inc. and Figma Inc. mutually agreed to terminate their $20 billion merger deal, after they concluded that there was "no clear path" to get clearance from EU and U.K. antitrust regulators.[1]

This case is an example where the U.K. Competition and Markets Authority focused on innovation theories of harm in its assessment, and is further notable in that its proposed remedies would effectively amount to a prohibition of the proposed merger.

Background

On July 13, 2023, the CMA announced that it had decided to refer the proposed merger for an in-depth Phase 2 investigation under the Enterprise Act 2002. In its Phase 1 investigation, the CMA found that the parties compete in the supply of:

- Screen design software, where Figma has established a substantial share of the market and Adobe has been continually making investments; and

- Creative design software, where Adobe is the industry standard and Figma is an emerging competitive threat.

The CMA provisionally concluded that the proposed merger may be expected to result in a substantial lessening of competition in the global markets for:

- All-in-one product design software for professional users; and
- Certain creative design software — vector and raster editing software.

Theories of Harm

Substantial Lessening of Competition in All-in-One Product Design Software

In its assessment of the potential substantial lessening of competition in all-in-one product design software, the CMA noted that Figma accounts for over 80% of the relevant market by revenue, and that Adobe's competing product, Adobe XD, has a market share of 5%-10%.

Also, Adobe had significantly reduced investment in Adobe XD prior to the proposed merger and had

also canceled the development of a new product design software — Project SPICE — that would compete more strongly with Figma in product design.

The CMA provisionally found that, absent the proposed merger, Adobe would have continued to be a close competitor of Figma through its innovation efforts in all-in-one product design software.

Given the competitive dynamics in this particular digital market, the CMA's view was that the proposed merger amounted to a so-called reverse killer acquisition: Adobe, a large player in the technology space, would be attempting to nullify the competitive threat from a disruptor that had developed a better version of a capability that Adobe had attempted to develop itself.

Substantial Lessening of Competition in Vector and Raster Editing Software

The competitive harm identified by the CMA in the market for vector and raster editing software was expansive in that the parties do not currently compete in this market; rather, Figma is a potential competitor of Adobe.

The CMA's provisional conclusion was rooted in the premise that Figma has the ability and incentive to develop vector and raster editing functionality, and with Adobe perceiving Figma as posing a competitive threat, it undertook actions to mitigate this threat, for example through product development.

Notably, the CMA considered that the markets for vector and raster editing software on the one hand, and product design software on the other, are adjacent.

In particular, Adobe and Figma's platforms are characterized by network effects, which cause the value of their respective platforms to increase with the number of users, and, importantly, operate across markets. This means, for example, that the value of Figma's vector and raster editing offerings is greater the more Figma is used for product design, and vice versa.

This consideration of network effects is indicative of the new focus by competition regulators on mergers that involve several linked markets or ecosystems, a theory of harm that was central in the European Commission's prohibition of the Booking Holdings Inc.-eTraveli Group AB merger.[2]

Remedies Proposed by the CMA

In light of its provisional findings, the CMA only presented two possible structural remedies in its notice to the parties, in keeping with its preferred stance on remedies:

- Prohibition of the proposed merger — prohibition being regarded by the CMA as a feasible remedy that would provide a comprehensive solution; and
- Divestiture of overlapping operations to eliminate the substantial lessening of competition in each of the markets in which the CMA provisionally identified a substantial lessening of competition.

Despite presenting these two options, the CMA acknowledged that, as substantially all of Figma's business is carried out in the all-in-one product software market, which includes its leading product, Figma Design, this would effectively mean that any partial divestiture involving Figma operations would

in reality be substantially similar to prohibition of the proposed merger.[3]

Likewise, as the CMA remained of the belief that, absent the proposed merger, Adobe would have continued to compete with Figma in all-in-one product design and has a strong position in an adjacent market, any partial divestiture involving Adobe assets may not be sufficient to restore the conditions of competition that would have prevailed, absent the proposed merger.

The CMA also considered, given the nature of the relevant products in the digital design sector, that there may be an unacceptably high level of composition risk relating to identification, allocation and transfer of assets arising from the carve-out of any divestiture package; for example, Adobe's businesses are closely integrated with its operations in creative design.

The parties' inability to formulate a remedy that was perceived as workable by the CMA was fatal to the prospect of the proposed merger receiving clearance. Such remedies are typically required by competition regulators for the approval of most modern mergers in the Big Tech space.

Adobe-Figma is a cautionary tale that, when acquisitions that involve a dominant player seeking to purchase a smaller, disruptive competitor are concerned, finding acceptable remedies that do not nullify the very rationale for the deal can be extremely difficult.

Increased CMA Reliance on Parties' Internal Documents

The CMA's provisional findings in Adobe-Figma also demonstrate its continued reliance on the internal documents of parties when considering evidence for a proposed merger, despite the parties' submission in this case that such evidence had been "mischaracterized and misunderstood" by the CMA.

Importantly, the CMA considered that some documents evidenced concerns by Adobe's management over the competitive threat from Figma weeks before the proposed merger was announced, and others served as proof of future product development plans.

Such documents were brought to light by the CMA during its assessment when querying the parties' intentions for entering into the proposed merger. The CMA's approach in this case is reflective of a wider trend of the CMA increasingly relying on internal documents in merger investigations.

Reliance on internal documents is likely to continue to be even more pronounced in investigations involving dynamic markets such as technology, particularly when so-called killer acquisitions are being scrutinized, as such investigations require forward-looking assessments into potential future competition.

Parallel EC and U.S. Investigations

In parallel to the CMA's probe, the European Commission opened a Phase 2 investigation into the proposed merger on Aug. 7, 2023, citing similar competition concerns to the CMA in the markets for the supply of product design and digital asset creation tools, and came to the provisional view that the proposed merger may significantly reduce competition in both of these markets.

The U.S. Department of Justice had similarly begun an in-depth investigation, which is reported to have also focused on innovation and potential competition, but had not yet brought a formal complaint prior to the abandonment of the proposed merger.

The transatlantic regulatory objections to the proposed merger were undoubtedly decisive in the parties' abandonment of the deal and are indicative of the power of aligned regulators to stifle mergers without even having to veto them.

Conclusion

The approach of the CMA and EC in the Adobe-Figma case indicates an intention on the part of the regulators to continue to be seen as a strong enforcer, particularly in the technology space and anywhere innovation or future competition could be seen to be put at risk through merger activity.

It serves as a warning that it is important for legal teams to acknowledge, and to ensure that boardrooms are aware of, the scale of enforcement risks that a deal may pose, and to address those risks upfront and early.

Key steps for companies contemplating deals that may raise these kinds of risks include building in sufficient time at the outset for a thorough internal document review. This is to pick up potential sources of concern, stress-testing of efficiencies and arguments in favor of competition, and early consideration of possible remedy packages.

Early substantive engagement with the regulators' possible theories of harm and potential remedies will also be key. In this respect, the proposed amendments to the CMA's Phase 2 processes are intended to encourage exactly this kind of engagement.

Deirdre Taylor is a partner and Molly Heslop is an associate at Gibson Dunn & Crutcher LLP.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] https://news.adobe.com/news/news-details/2023/Adobe-and-Figma-Mutually-Agree-to-Terminate-Merger-Agreement/default.aspx.

[2] European Commission, Mergers: Commission prohibits proposed acquisition of eTraveli by Booking (25 September 2023): https://ec.europa.eu/commission/presscorner/detail/en/ip_23_4573.

[3] CMA (28 November 2023).