MERGER ANTITRUST LAW

Unit 14: Potential Competition Mergers

Class 21

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Georgetown University Law Center
Fall 2024

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Steris/Synergy Health

STERIS

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News Release

STERIS to Acquire Synergy Health for $1.9 Billion in Cash and Stock

Combination Creates a Global Leader in Infection Prevention and Sterilization

Allows Company to Further Invest in the U.S. and Accelerate International Growth

Conference Call with Senior Management at 8:30 a.m. EDT

MENTOR, OHIO AND SWINDON, U.K. - October 13, 2014 - STERIS Corporation (NYSE:STE) and Synergy Health, plc (LSE:SYR) today announced that STERIS is commencing a "recommended offer" under U.K. law to acquire Synergy in a cash and stock transaction valued at £19.50 ($31.35) per Synergy share, or a total of approximately $1.9 billion, based on STERIS's closing stock price of $56.38 per share on October 10, 2014.

Upon closing, the combined business (New STERIS) will have approximately $2.6 billion in annual revenues from over 60 countries, approximately 14,000 employees, and will bring together geographically complementary businesses. For medical device manufacturers, STERIS's Isomedix and Synergy's Applied Sterilization Technologies (AST) will create a leading global supplier to best serve medical device Customers with a network of 58 facilities covering 18 countries. For hospitals, the combination of STERIS's Infection Prevention and Services businesses with Synergy's Hospital Sterilization Services will strengthen the breadth and depth of the offering, accelerating the development of hospital sterilization outsourcing worldwide.

"Synergy's focus on achievement, accountability, integrity and innovation has enabled it to deliver remarkable growth for its Customers, people and shareholders since its founding," said Walt Rosebrough, President and CEO of STERIS Corporation. "We have great respect for the performance that Dr. Richard Steeves and his people have achieved, and look forward to welcoming them to the STERIS team. Together, we create a balanced portfolio of products and services that can be tailored to best serve the evolving needs of our global Customers. Once the transaction is completed, New STERIS will be a stronger global leader in infection prevention and sterilization, better-positioned to provide comprehensive solutions to medical device companies, pharma companies, and hospitals around the world."

"Synergy shares STERIS's commitment to growth for all of its Customers and partners, and this acquisition joins two great companies that share a similar set of values and a strategic vision," said Dr. Richard Steeves, CEO of Synergy Health. "The combined entity brings together the strengths of both businesses, allowing New STERIS to accomplish much more than either one of us could separately."

New STERIS will be incorporated in the U.K., while its operational and U.S. headquarters will remain in Mentor, Ohio. Walt Rosebrough, current President and CEO of STERIS, will be the CEO of New STERIS. Mr. Rosebrough, along with New STERIS CFO Michael Tokich and most members of senior management, will reside in Northeast Ohio.

STERIS plans to expand the New STERIS Board to thirteen members, of whom ten will be the current STERIS Directors and three will be current members of Synergy's Board of Directors. Included in the three new Directors will be Synergy CEO, Dr. Richard Steeves. New STERIS is expected to be listed on the New York Stock Exchange under the ticker STE. The Boards of Directors of both companies have unanimously recommended the transaction.

Financial Highlights

STERIS has agreed to pay approximately $1.9 billion in cash and stock to acquire Synergy. In fiscal 2014, Synergy generated revenue of approximately $604 million and adjusted earnings before interest expense, income taxes, depreciation and amortization (EBITDA) of approximately $161 million.[1]

Upon completion of the transaction, each outstanding share of Synergy will be converted into the right to receive £4.39 ($7.06) in cash and 0.4308 of a share of New STERIS. The per-share consideration represents a premium of 39% to Synergy's closing stock price on October 10, 2014, the last trading day prior to the announcement, a 32% premium to the thirty trading day volume weighted average price, and a 27% premium to the 52-week high of Synergy. At closing, STERIS shareholders will exchange each share of stock they own in STERIS for one share of stock in New STERIS. STERIS shareholders will retain ownership of approximately 70% of New STERIS and Synergy shareholders will own approximately 30%. The transaction is expected to be taxable, for U.S. federal income tax purposes, to shareholders of STERIS.

The proposed transaction represents compelling value to both Synergy and STERIS shareholders through participation in the future growth prospects expected to result from the combination through their ownership of the combined company.

The transaction is not expected to impact STERIS's adjusted earnings per diluted share until closing. The transaction is anticipated to be significantly accretive to New STERIS's adjusted earnings per diluted share beginning in fiscal 2016.

The transaction is expected to result in total annual pre-tax cost savings of $30 million or more, which will be phased in 50% in fiscal year 2016 and 100% thereafter, from optimizing global back-office infrastructure, leveraging best-demonstrated practices across plants, in-sourcing consumables, and eliminating redundant public company costs. In addition, as a result of incorporating New STERIS in the U.K., STERIS anticipates that the effective tax rate of New STERIS, beginning in fiscal 2016, will be approximately 25%.

The transaction is subject to certain customary closing conditions, including approvals by STERIS and Synergy shareholders as well as regulatory approvals in the U.S. and U.K., and is anticipated to close by March 31, 2015. In conjunction with the transaction, STERIS obtained a 364-Day Bridge Credit Agreement. Bank of America Merrill Lynch, J.P. Morgan and KeyBank provided committed financing in conjunction with the transaction in the amount of approximately $1.6 billion.

Lazard acted as financial advisor and Wachtell, Lipton, Rose & Katz and Jones Day acted as legal advisors to STERIS in connection with the acquisition. Investec Bank plc acted as financial advisor and DLA Piper acted as legal counsel for Synergy.

For more information about the transaction, please go to www.steris.com/synergy (http://www.steris.com/synergy) beginning at 7:00 a.m. Eastern Daylight Time today.

Boilerplate omitted

FEDERAL TRADE COMMISSION
PROTECTING AMERICA'S CONSUMERS

FTC Challenges Merger of Companies That Provide Sterilization Services to Manufacturers

Merger of Steris Corporation and Synergy Health plc Would Harm Competition for Contract Radiation Sterilization Services

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FOR RELEASE

May 29, 2015

TAGS: Bureau of Competition | Competition

The Federal Trade Commission today issued an administrative complaint charging that Steris Corporation's proposed $1.9 billion acquisition of Synergy Health plc would violate the antitrust laws by significantly reducing future competition in regional markets for sterilization of products using radiation, particularly gamma or x-ray radiation.

The Commission also authorized agency staff to seek a temporary restraining order and preliminary injunction in federal court to maintain the status quo pending an administrative trial on the merits.

According to the FTC's complaint, Steris, headquartered in Mentor, Ohio, and United Kingdom-based Synergy both provide contract sterilization services for companies that need to ensure their products are free of unwanted microorganisms before they reach customers. Implanted medical devices and human tissue products, for example, must meet stringent requirements for sterilization. For most companies, in-house sterilization is not a viable alternative. Instead, these customers bring their products to sterilization service facilities on a contract basis, typically within 500 miles of the companies' manufacturing or distribution facilities to minimize shipping costs.

Today, gamma radiation, generated by the radioactive isotope Cobalt 60, is considered the only feasible method of sterilizing large volumes of dense and heterogeneously packaged products. Only Steris and one other company, Sterigenics, provide contract gamma sterilization services in the United States, according to the complaint. At the time the proposed merger was announced, Synergy was implementing a strategy to open new plants that would provide contract x-ray sterilization services. These services – which currently are not available in the United States – would provide a competitive alternative to gamma radiation, according to the complaint. Because it uses electricity rather than Cobalt 60, x-ray does not raise many of the environmental and regulatory issues associated with gamma sterilization. According to the FTC, it is unlikely that new competitors in the market for contract radiation sterilization services would replicate the competition that would be eliminated by the merger. The Commission alleges that the challenged acquisition would eliminate likely future competition between Steris's gamma sterilization facilities and Synergy's planned x-ray sterilization facilities in the United States, thus depriving customers of an alternative sterilization service and additional competition.

The Commission vote to issue the administrative complaint and to authorize staff to seek a temporary restraining order and preliminary injunction in federal district court was 5-0. The administrative trial is scheduled to begin on October 28, 2015.

NOTE: The Commission issues an administrative complaint when it has "reason to believe" that the law has been or is being violated, and it appears to the Commission that a proceeding is in the public interest. The issuance of the administrative complaint marks the beginning of a proceeding in which the allegations will be tried in a formal hearing before an administrative law judge.

The FTC's Bureau of Competition works with the Bureau of Economics to investigate alleged anticompetitive business practices and, when appropriate, recommends that the Commission take law enforcement action. To inform the Bureau about particular business practices, call 202-326-3300, send an e-mail to antitrust{at}ftc{dot}gov, or write to the Office of Policy and Coordination, Bureau of Competition, Federal Trade Commission, 600 Pennsylvania Ave., NW, Room CC-5422, Washington, DC 20580. To learn more about the Bureau of Competition, read Competition Counts. Like the FTC on Facebook, follow us on Twitter, and subscribe to press releases for the latest FTC news and resources.

PRESS RELEASE REFERENCE:
FTC Dismisses Complaint against Steris and Synergy

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

FEDERAL TRADE COMMISSION,	)	**CASE NO. 1:15 CV 1080**
	)	
Plaintiff,	)	**JUDGE DAN AARON POLSTER**
	)	
vs.	)	**OPINION AND ORDER**
	)	
STERIS CORPORATION, et al.,	)	
	)	
Defendants.	)	

On May 29, 2015, the Federal Trade Commission (FTC) filed a Complaint for Temporary Restraining Order and Preliminary Injunction against Defendants Steris Corporation (Steris) and Synergy Health plc (Synergy). (Doc #: 1.) The FTC asked the Court to grant immediate injunctive relief under Section 13(b) of the Clayton Act to prevent Steris from acquiring its alleged potential competitor, Synergy, on June 1, 2015. The parties agreed to maintain the status quo pending an expedited hearing on the motion for preliminary injunction and the Court's ruling. An administrative proceeding on the merits is scheduled to begin on October 26, 2015.

I.

Defendants Steris and Synergy are the second- and third-largest sterilization companies in the world, the largest provider being Sterigenics International LLC (Sterigenics). Sterilization of many healthcare and healthcare-related products is a critical final step in their manufacture; it is required by the Food and Drug Administration (FDA) to eliminate microorganisms living on or within the manufacturers' products before those products are distributed to end-users in the United States. Foreign regulatory bodies require sterilization of these same products when sold in foreign countries. Only a small number of manufacturers sterilize their own products: the bulk of sterilization is contracted to suppliers like Steris,[1] Synergy and Sterigenics.

Three primary methods of contract sterilization are currently used in the United States: gamma radiation, e-beam radiation, and ethylene oxide gas (EO). Customers choose sterilization methods based on their products' physical characteristics and packaging. Gamma sterilization, which sterilizes by exposing products to the radioactive isotope Cobalt-60, is the most effective and economical option for most healthcare products because of its penetration capabilities. It is the only viable option for dense products (e.g., implantable medical devices) and products packaged in larger quantities. E-beam sterilization, a second type of radiation sterilization, does not penetrate as deeply as gamma radiation, though it can be effective for low-density products sterilized in low volumes. It represents only 15% of all contract radiation sterilization in the United States. EO is a non-radiation form of sterilization that exposes products to gas to kill unwanted organisms. It is effective only if gas diffuses freely through packaging and makes contact with all product surfaces requiring sterilization.

Steris, with twelve gamma facilities across the country, is one of only two U.S. providers of contract gamma sterilization services. Sterigenics, the other gamma provider, operates fourteen U.S. gamma facilities and two U.S. e-beam facilities. Together, these two firms

[1]In 1997, Steris acquired a medical sterilization company called Isomedix. (Hr'g Tr. 152 (Steeves).) Today, Steris' contract sterilization business is often referred to as Steris Isomedix.

account for approximately 85% of all U.S. contract sterilization services. Synergy, a British company, is the largest provider of e-beam services in the United States,[2] but operates more than thirty-six contract sterilization facilities, primarily gamma facilities, outside the United States. Of particular note are Synergy's two contract sterilization facilities located in Daniken, Switzerland (Daniken): a gamma facility and an x-ray facility. The Daniken x-ray sterilization facility is the only facility in the world providing x-ray sterilization services on a commercial scale.

The FTC alleges that, prior to the proposed merger announced on October 13, 2014, Synergy had been planning to enter the U.S. with an emerging x-ray sterilization technology it hoped would disrupt the current duopoly in the U.S. contract sterilization market, competing directly with Steris' and Sterigenics' gamma sterilization services. According to the FTC, x-ray sterilization is a competitive alternative to gamma sterilization because it has comparable, "and possibly superior," depth of penetration and turnaround times. (Compl. ¶ 4, Doc #: 1.) The FTC claims that, if consummated, the merger would allow Steris to insulate itself against competition with its gamma business. Synergy's planned x-ray sterilization facilities would have targeted Steris' and Sterigenics' gamma sterilization customers, providing them with options for contract sterilization and resulting in lower prices and improved quality.

After months of investigation, the FTC filed this case several days before the proposed merger was to close, contending that the acquisition of Synergy by Steris would violate Section 7 of the Clayton Act, which prohibits mergers "the effect of [which] may be substantially to lessen

[2]Synergy acquired its U.S. contract sterilization facilities from BeamOne LLC in April 2011. (Tr. 148.)

competition, or to tend to create a monopoly." 15 U.S.C. §§ 18, 45. The FTC sought injunctive relief under Section 13(b), which authorizes the Court to grant preliminary relief if, after considering the FTC's likelihood of success on the merits and weighing the equities, such relief would serve the public interest. 15 U.S.C. § 53(b).

On June 1, 2015, the Court held a teleconference with counsel to determine how to proceed most efficiently in this matter. As a result of discussions, the parties agreed to file a Stipulation and Order wherein Defendants agreed not to consummate the proposed merger until at least four business days after the Court rules on the FTC's motion for a preliminary injunction. (Doc #: 7.) The parties also agreed to provide the Court with a joint proposed expedited schedule for litigating that motion, which the Court issued. (Doc #: 24.)

The Court held a three-day hearing beginning August 17, 2015, during which the following witnesses testified: Joyce Hansen, Vice President of Sterility Assurance at Johnson and Johnson (J & J); David Silor, Principal Sterilization Associate at Zimmer Biomed Orthopedics (Zimmer); Dr. Richard M. Steeves, founder and CEO of Synergy; Andrew McLean, Synergy's CEO of Applied Sterilization Technologies (AST) & Laboratories; Constance Baroudel, one of the outside directors on Synergy's PLC Board; Gaet Tyranski, Synergy's President, AST for the Americas; Gavin Hill, CFO of Synergy; and Walter Roseborough, CEO of Steris. The parties filed simultaneous post-hearing briefs and response briefs. (Doc ##: 77, 78, 80, 81.) The Court, having listened to the evidence and reviewed the briefs, issues this ruling.

(Continued on next page)

II.

Section 7 of the Clayton Act provides that

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the county, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

15 U.S.C. § 18. Section 13(b) of the Clayton Act provides that

> [u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, . . . a preliminary injunction may be granted . . . .

15 U.S.C. § 53(b).

"Section 7 is 'designed to arrest in its incipiency . . . the substantial lessening of competition from the acquisition by one corporation of the whole or any part of the stock' or assets of a competing corporation." *United States v. Dairy Farmers of Am., Inc.*, 426 F.3d 850, 858 (6th Cir. 2005) (alteration in original) (quoting *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 589 (1957)). In enacting this statute, Congress was concerned with probabilities, not certainties. *Id.* (citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962)). As District Judge David A. Katz recently explained,

> The "only purpose of a proceeding under Section 13[(b)] is to preserve the status quo until the FTC can perform its function." *FTC v. Food Town Stores, Inc.*, 539 F.2d 1339, 1342 (4th Cir. 1976). The ultimate determination as to a Section 7 violation of the Clayton Act is an "adjudicatory function [ ] vested in the FTC." *Id.*

FTC v. Promedica Health System, Inc., No. 3:11 CV 47, 2011 WL 1219281, at *53 (N.D. Ohio Mar. 29, 2011) (alteration in original). Under 15 U.S.C. § 25, the FTC is authorized to seek an injunction to enforce Section 7, and it carries the burden of proving a Section 7 violation by a preponderance of the evidence. *See, e.g., U.S. v. H&R Block, Inc.*, 833 F.Supp.2d 36, 48-49 (D.D.C. 2011) (citing 15 U.S.C. § 25).

To show a likelihood of success under Section 13(b), the FTC must "raise questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance, and ultimately by the Court of Appeals." *F.T.C. v. Promedica*, 2011 WL 1219281, at *53, (quoting *FTC v. Butterworth Health Corp.*, 946 F.Supp. 1285, 1289 (W.D. Mich. 1996), *aff'd*, 121 F.3d 708 (6th Cir. 1997)).

According to the FTC, the "actual potential entrant" doctrine specifically addresses this factual scenario: where a potential entrant (i.e., Synergy) merges with a firm already competing in the market (i.e., Steris) and the effect lessens future competition. The FTC asserts that the acquisition of an actual potential competitor violates Section 7 if (1) the relevant market is highly concentrated, (2) the competitor "probably" would have entered the market, (3) its entry would have had pro-competitive effects, and (4) there are few other firms that can enter effectively. (Mem. in Supp. of Mot. for TRO and Prelim. Inj. 6 n.40, Doc #: 5-1.)

Defendants challenge the actual potential entrant doctrine, arguing that it has long been disfavored by numerous courts including the Supreme Court. However, the FTC has clearly endorsed this theory by filing this case, and the administrative law judge will be employing it during the proceeding beginning October 26. Accordingly, in deciding the likelihood of success on the merits, the Court will assume the validity of this doctrine.

Prior to the August 2015 hearing, the Court directed counsel to focus their attention at the hearing on the second prong of the actual potential entrant doctrine, i.e., whether, absent the acquisition, the evidence shows that Synergy probably would have entered the U.S. contract sterilization market by building one or more x-ray facilities within a reasonable period of time. For the reasons that follow, the Court concludes that the FTC has failed to carry its burden.

III.

In 2000, Dr. Richard M. Steeves, a biochemistry doctor with a business background, purchased a facility with a controlled environment for the purpose of manufacturing products to prevent surgeons from acquiring HIV. (Hr'g Tr. 188-89 (Steeves).)[3] In 2007, Dr. Steeves acquired a small business in medical device sterilization, which became Synergy. (Id.) Synergy quickly grew from a privately held company with an annual revenue of £750,000 to a publicly traded company with an annual revenue of approximately £440,000,000 today. (Id. at 189.)

The first time Dr. Steeves came across x-ray sterilization technology was at an international radiation conference in 2011. (Hr'g Tr. 194.) Daniken, the only company in the world providing x-ray sterilization services on a commercial scale, made a presentation on this new technology that piqued Dr. Steeves' interest. (Id.) He found that the technology worked, but generally dismissed it "because all the talk at the conference was this was an expensive white elephant." (Id.)

In 2012, Leoni Studer, the company that owned Daniken, put it up for sale. (Hr'g Tr. 194 (Steeves).) Dr. Steeves had one of his senior directors conduct due diligence to determine whether the business would be worth acquiring. (Id. at 194-95.) He learned that Daniken had

[3]Citation to "Hr'g Tr." refers to the August 2015 Hearing Transcript, Doc #: 72.)

two components: a gamma facility and an x-ray facility. (Id. at 195.) At that time, Daniken's gamma facility was running at 75% capacity, while the x-ray facility was running at 22%. (SH-00968554; PX00423-030.) Synergy reached a valuation the directors thought workable based on the gamma business supporting the x-ray business and, "importantly, what we were expecting in terms of a change in interest in x-ray." (Id. at 195.) This predicted increase in customer interest in x-ray was based on the fact that J & J, one of the world's leading manufacturers of medical devices, pharmaceutical and consumer packaged goods, was about to begin the process of making the change from gamma to x-ray sterilization for one of its products (i.e., Surgicel, a blood-clotting agent) at the Daniken facility—setting what Dr. Steeves believed would be "an industry trend" away from gamma and towards x-ray sterilization. (Id.) At the same time, the directors understood that they faced three significant obstacles in bringing this new technology to the U.S. market: lowering the capital costs, understanding the regulatory hurdles involved in transitioning from gamma to x-ray sterilization, and convincing gamma customers to accept and, more importantly, *support* this new technology. (Id. at 195-96.) Based on forecasts predicting the x-ray facility would reach 52% capacity by fiscal year 2015 and 64% by fiscal year 2016, Synergy decided to purchase Daniken. ((SH-00968554; PX00423-030; Hr'g Tr. 653-55 (Hill).)

Synergy's management hierarchy consists of two main boards. (Hr'g Tr. at 148, 190 (Steeves).) The Senior Executive Board (SEB) runs the day-to-day operations, generates business strategies, and makes decisions on investments up to £10,000,000 (approximately $15.5 million). (Id.) As a publicly traded company, Synergy also has a PLC Board of Directors that represents the shareholders, defines the company's business and investment strategies, and ensures that the company's operational and financial performance respects the shareholders' interests. (Hr'g Tr. 446 (Bouradel), 645 (Hill).) The PLC Board consists of 4 outside directors and 3 inside directors. (Id. at 150 (Steeves).) Together, they have responsibility for governance, signing off on strategy developed by the SEB, and investments over £10,000,000. (Id. at 190.)

At the annual meeting of the combined SEB and PLC boards held in October 2012, Dr. Steeves made a presentation on x-ray technology and Synergy's recent acquisition of Daniken. (Hr'g Tr. 151-55 (Steeves).) Dr. Steeves observed that Synergy could not compete in the U.S. market for contract sterilization services with its gamma, e-beam and EO services, given that Steris and Sterigenics held 83 % of the radiation market and 90% of the EO market. (Id. at 152-53.) He believed that Synergy could only compete with Steris and Sterigenics in the U.S. market by introducing its new x-ray sterilization technology, acquired via its acquisition of Daniken. (Id. at 153.) He pointed out that there were five main hubs in the United States where radiation sterilization is performed, and he hypothesized that Synergy could build a facility in each of those hubs with the prospect of taking more than $120 million of revenue away from Steris and Sterigenics. (Id. at 154.) He recommended that Synergy endeavor to reach an exclusivity agreement with IBA, the only manufacturer of x-ray equipment in the world that could make a machine powerful enough to sterilize medical devices on a commercial scale, to build up to five facilities in the U.S. (Id. at 155.)

Dr. Steeves made a similar presentation to the top Synergy leaders in a conference held in April 2013. (Hr'g Tr.155-56 (Steeves).) Two days later, he hired Andrew McLean to lead the design and project teams for the AST division, beginning in June 2013. (Id. at 157; PX00095-001.) In a letter to McLean dated May 15, 2013 (before McLean came onboard), Dr. Steeves updated McLean on the status of various AST businesses. (PX00095-001.) With regard to x-ray at Daniken, Dr. Steeves noted his concern over "slow customer conversions." (Id.) However, Dr. Steeves considered x-ray at Daniken to be a "potential game changer" in the U.S. contract sterilization market. (PX00095-002; Hr'g Tr. 157 (Steeves), 274 (McLean).) Although Synergy hadn't run the numbers on x-ray in the United States, he commented that "intuitively I think it could be lower cost than gamma, and would beat the gamma service on every other operating metric. This is one of the key projects I would like you to lead through the design team." (PX00095-002.) In April 2014, McLean was promoted to CEO of AST and Laboratories. (Hr'g Tr. 156 (Steeves).)

McLean was tasked with presenting the U.S. x-ray team's strategy to the combined boards at the November 2013 meeting. (Hr'g Tr. 211 (Steeves).) McLean never made that presentation, however, as it was around that time that Nordion, the world's leading supplier of Cobalt-60 (the energy source for gamma radiation sterilization) and one of only two Cobalt-60 suppliers in North America, became available for acquisition. (Id. at 211-12 (Steeves), 461-62 (Bouradel).) Both Steris and Sterigenics participated in a bidding war for Nordion beginning in the fall of 2013 that culminated in an announcement, on March 31, 2014, that Sterigenics entered into a definitive agreement to acquire Nordion.

Now concerned about Cobalt-60 supply in the hands of Sterigenics and motivated by his belief in x-ray technology, Dr. Steeves decided to explore fully the concept of commercial x-ray sterilization in the U.S. and other parts of the world. (Hr'g Tr. 213 (Steeves).) He directed Andrew McLean to "redouble his efforts and do everything he could to try and get this to work, sort out the three issues that he needed to address in order to allow [Synergy] to bring it in the

United States." (Id.) Those issues are the same impediments Synergy faced when it purchased Daniken: (1) developing a business plan requiring significantly less capital than the 18 million euros it cost Leoni Studer to build Daniken, (2) overcoming customer reluctance to switch sterilization modalities, and (3) obtaining revenue commitments from a base load of customers in the form of take-or-pay contracts. (See also Hr'g Tr.195-197, 202-203 (Steeves).)

Synergy's corporation has three businesses: AST, hospital sterilization services, and a linen business. (Hr'g Tr. 646-47 (Hill).) Synergy has an annual maintenance budget of $40 million, and a discretionary budget of $25 to $40 million for investment purposes. (Id. at 650.) The competition for discretionary cash among the businesses has led Synergy to establish a formal process for deciding which projects to fund.

The first phase of the process is aspirational; a Synergy business (e.g., AST) will come up with an idea for a capital project, and do the research to determine whether it can make a business case that supports the investment of discretionary capital. (Hr'g Tr. 678 (Hill); see also 206 (Steeves) ("[M]ost of the ideas I think probably come from me and my team.").) The project team enters the results of its research into a template, designed by Synergy CFO Gavin Hill, which outputs numbers, or metrics, commonly used by corporations when deciding whether to invest significant capital. (Hr'g Tr. 660-61 (Hill).) The project team will present the business case to the SEB for approval, and may return to the SEB several times before the concept is approved. Once the SEB approves the business case, but before it is submitted to the PLC Board, the business model must undergo a rigorous review by Hill and his corporate finance team, known within the corporation as the "black hat" review. (See generally Hr'g Tr. 206-08, 221 (Steeves); 412-13, 418 (McLean); 446-450 (Bouradel); 678-682 (Hill).) When the business case is sufficiently “robust,” the black hat review commences. (Id. at 681 (Hill).)

The black hat process “is a management term for a two-part review.” (Hr’g Tr. 648 (Hill).) The first component is the financial review of “the assumptions underpinning the business case.” (Id. at 678-79.) According to Hill, the project team needs to understand what underpins the revenues, benchmark the costs against other facilities, consider the return on sales, and, generally, make sure that the team has thoroughly done its homework and put together a comprehensive business model. (Id. at 679-680.) The second part of the review is the commercial review. It covers a number of areas such as the contracts underpinning the revenues (e.g., take-or-pay contracts, termination clauses, penalty payments) and all aspects of risk (e.g., pension, insurance). (Id. at 680-81.) The black hat review must conclude, and the SEB must approve, the business model before it is presented to the PLC Board. (Id. at 681, 707).

There are a series of metrics, or “hurdle rates,” that Hill’s team uses to evaluate and compare the expected financial performance of proposed capital projects—measures commonly used by corporations when ranking investments. (Hr’g Tr. 652 (Hill).) Among the metrics is the internal rate of return (IRR), which Synergy targets as 15%. (Id. at 656-675; JDX2859-001, Synergy Group Policies and Governance Manual ¶ 9.3.2.) The IRR is the expected rate of growth from a project over a period to time (Hr’g Tr. 656 (Hill).) It is the cash that is left over after the taxes and operating costs have been removed, which can then be reinvested in the business. (Id. at 659) Synergy considers a project’s IRR over a period of seven to ten years maximum, because investors typically have a short-term perspective, with a three-year horizon. (Id. at 659-661.) That a project has an IRR of 15% does not guarantee that it will be approved by the PLC Board. (Id. at 661.) Just as important is the risk profile. (Id. at 662.) Hill testified that the risk profile is especially important where, as here, Synergy would be considering a capital expenditure (CAPEX) that would consume the company's entire annual discretionary budget. (Id.) Any financial impact from that investment would have a reportable effect on the company's earnings. (Id.)

Another metric is the return on capital employed (ROCE), which Synergy targets at 15%. (JDX2859-002 ¶ 9.3.3; Hr'g Tr. 664 (Hill).) It is the ratio of operating profit to shareholder funds and long-term debt, or a measure of how well the company converts invested capital into profit. (Id.) While the IRR looks at future cash flows, ROCE is a single figure calculation in a single year. (Hr'g Tr. 664 (Hill).) Hill testified that he looks at ROCE as "one of the most important measures for the business . . . as there is an extremely strong correlation between [ROCE] and a company's share price." (Id. at 665.) Under Gavin Hill's five-year leadership, Synergy's ROCE has increased from 10% to 12.4%. (Id. at 669-671.) His short-term goal for Synergy is to reach 15%, and then 20%. (Id. at 668.) To get to 15% ROCE at a company level, Hill requires the businesses, such as AST, to deliver a 30% ROCE. (Id. ("Once you take account of regional costs that are in the business, central overhead that is part of running the business, and good will, we have a large amount of good will on our balance sheet, you then get to 15 percent.").)

Another metric is cash payback, which is the period of time it takes for the operating cashflows of the investment to repay the initial capital outlay. (JDX2869-002 ¶ 9.3.4.) Synergy's target cash payback on all investments is 5 years. (Id.; Hr'g Tr. 667-68 (Hill).)

And last, but certainly not least, Synergy requires revenue commitments from customers who will use the facilities. (Hr'g Tr. 201-02 (Steeves), 680-81 (Hill).) These commitments typically take the form of take-or-pay contracts in which the customer agrees to provide a volume of products for Synergy to sterilize at some point in the future. (IH Hr'g Tr. 62 (Baran).)[4] In the event the customer does not provide those products, it still has to pay for the services. (Id.) These agreements verify that there is a demand for the services, and support the business cases seeking PLC Board approval. (Hr'g Tr. 208-09 (Steeves), 680-81 (Hill).)

Even if a business model satisfies all the metrics, there is no guarantee the PLC Board will approve it. As Constance Baroudel testified, "the finances are important, but it is also the overall strategy that is important," along with consideration of "shareholder expectations." (Hr'g Tr. 473 (Baroudel).) Furthermore, the PLC Board may not reach a consensus on approving the project. (Id.) Gavin Hill testified,

> So if you ask me would you potentially consider a project that maybe just didn't quite hit your hurdle rates but it was guaranteed to deliver, I may say yes, . . . because I know exactly where we are going to be, and I would much rather that over a project that had a much higher potential return but there was huge speculation in the assumptions and could actually deliver a negative return.

(Hr'g Tr. 691 (Hill).) Additionally, the size of the project matters. (Id.) In a project as large as the U.S. x-ray business case, little risk would be tolerated as Synergy would have to forego "many other projects." (Id.)

In May 2014, McLean made a presentation to the SEB, updating the board on the progress of the U.S. x-ray project. The minutes from that presentation show that McLean continued to analyze "as agreed in the previous SEB meeting" the building of combined e-beam and x-ray facilities; determined the location of Sterigenics U.S. facilities and identified the products being sterilized there; and narrowed to eight the number of U.S. locations under

[4] Citation to "IH TR." refers to the Investigative Hearing Transcript.

consideration. (PX00099-012, -013.) Again, he expressed his "concern with proceeding with this course of action, as it would be difficult to guarantee getting take or pay contracts to support the financial model for building these facilities." (Id.) In a subsequent letter dated May 29, 2014 to Synergy's COO, Dr. Adrien Coward, McLean further explained his concerns over the project:

> I know I sound like a broken record on this but the message does not seem to be cutting through. . . . The fact of the matter is that building an x-ray facility today would not guarantee conversions tomorrow. As an example Daniken x-ray is only ~25% capacity utilized after more than 3 years. If we did not force customers to move from Daniken and our other gamma sites, then capacity utilization would be only 10%. These are the facts and if we push ahead and build without a proper baseload customer(s) in the US it is to our peril. And of course we do not have the same footprint in the US that would allow us to "force" customers to convert and cross validate and indeed our competitors would be doing everything possible to stop that occurring, creating further delays and barriers. No one is more enthusiastic about getting an x-ray footprint in the US than myself, however it could be a complete disaster.

(JDX1510-001); Hr'g Tr. 379-385 (McLean).)

A more detailed presentation of the U.S. x-ray strategy was presented to the SEB by McLean's subordinate, Chris Fry, in July 2014. (PX00101.) The minutes of the meeting show, among other things, that McLean again raised his concern over the lack of customer financial backing for the project. (PX00101-013.) He reported that "despite there being a lot of interest from customers about [Synergy] building X-ray facilities in America none had yet given an indication that they would be willing to enter into a long term take or pay contract." (Id.) By way of example, he pointed out that "J & J had declined the opportunity to enter into such a contract despite the fact that they were saving 50% of costs and it was only a two-year payback period for the revalidation costs [due to] concern about the risk." (Id.) With regard to x-ray sterilization of medical devices, he observed that "the big concern was the impact of treatment on the form and function of the device." (Id. See also Hr'g Tr. 214-15 (Steeves).) At the conclusion of the meeting, it was agreed that McLean would present a formal business case at the September 2014 SEB meeting. (PX00101-013.)

Following the July 2014 meeting, McLean tasked Gaet Tyranski, President of AST for the Americas, with preparing the September 2014 presentation. (Hr'g Tr. 511 (Tyranski).) McLean directed Tyranski to generate as many customer letters of interest as possible by the first week in September, to identify two potential U.S. building sites taking into consideration the location of the headquarters, manufacturing, or distribution facilities of the largest medical device manufacturers, and to identify the products manufactured there. (Id. at 504-05.)

In a report circulated to board members prior to the September 2014 meeting, McLean reported that, while a number of major medical manufacturers (J & J, Community Tissue, BD, Stryker Orthopedics, and Bayer) had signed letters of interest in x-ray sterilization services in the U.S., he still had difficulty getting anyone to "bear the risk" of x-ray given that it was new and unproven in the United States. (Hr'g Tr. 307-08 (McLean) (citing PX5771 at 5).) Two days before the September 2014 SEB Meeting, McLean reported to Dr. Steeves and Dr. Coward that he had reached an oral agreement with IBA in which IBA would agree to provide dual x-ray/e-beam sterilization equipment to Synergy exclusively for 10 years for its U.S. operations, provided Synergy would make down payments on the first two x-ray facilities by the end of October 2014.

On September 17, 2014, Tyranski presented the business plan to the SEB. (PX00104-0003 to -00076.) The presentation sought approval for a strategy offering dual x-ray/e-beam sterilization at a network of four to five facilities in the United States. (PX00104-0004, -0027.) Phases 1 and 2 called for the construction of two facilities, one in Indiana and one in Texas, that would be in operation by fiscal year 2016. (PX00104-0007, -0021.) Phase 2 called for the construction of two to three more facilities beginning in fiscal year 2016, with an expected completion date in fiscal years 2017 or 2018. (PX00104-0007.) The presentation contemplated an investment of approximately $20.2 million for each plant— meaning a capital investment of more than $40 million was required for the first phase of the proposed project alone. (Hr'g Tr. 587 (Tyranski); PX00104-0005; JDX2471-016.).

The September 2014 business plan indicated that the first two plants would offer a combined IRR of 6.51%, and a cash pay-back period of 7.7 years. (PX00104-0037.) The revenue assumptions in the plan were based on achieving a target of 15% of the U.S. gamma market after completion of all five plants (i.e., fiscal year 2018). (PX00104-0005, -0007.) The plan assumed that customers would pay a lower cost for x-ray ($2.50 per cubic foot) versus gamma ($3 to $4). (PX00104-0034.) And it assumed that the first two plants would achieve nearly 100% capacity utilization by the end of year 6.

In fact, the only number that was locked down in this business model were the revenues from the volume of products Synergy planned to transfer from its Lima, Ohio e-beam plant to the new plant for e-beam sterilization. (Hr'g Tr. 406 (McLean).) It was later discovered that the revenue from the Lima plant was counted twice. (Id. at 694-95 (Hill).) Correcting this accounting error reduced the IRR from 6.51% to 3%. (Id.) The evidence shows that all the other numbers upon which the business model was based were the product of guesswork and assumptions.[5] Even with an IRR of 6.5%, McLean knew the SEB would not approve the

[5]Since the team did not have any take-or-pay contracts, they could only guess at the volume of medical devices that might go through the facility. (Hr'g Tr. 405 (McLean).) The 15% market share number was an arbitrary number the team thought Synergy "might" be able to achieve "over a seven-to-ten year time frame." (Id. at 407.) The team plugged in some numbers to show

business model. (Id. at 418 (McLean).) And with an IRR of 6.5% *and* no customer commitments, McLean didn't bother to ask Hill to conduct a black hat review because he knew the model was not ready. (Id. at 418-19.) The business model was never presented to the PLC Board. (Hr'g Tr. 472-73 (Bouradel).)

While the evidence shows that the SEB approved the x-ray/e-beam strategy, the minutes of the meeting reflect considerable concern over the numbers in Tyranski's business model. (JDX2471-018.) Specifically, Gavin Hill commented that "he was surprised . . . the financial model did not look better. The output appeared to be the same as for a gamma facility but given the unproven nature of the technology it was considerably riskier, and it assume[d] that [Synergy] would be able to command a premium price for its services." (Id.) Dr. Steeves advised that he considered the strategy right, but "he had concerns that the economics were not right and that these needed to be looked at again." (Id.) Chris Fry advised that "some of the numbers in the model were guess work." (Id.) Dr. Coward "suggested that rapid work needed to be done to build up the cost base from scratch." (Id.) Yet again, McLean pointed out that "it was difficult to get a base load customer to bear any risk of X-ray given that it is new and unproved in the US." (Id.)

At the PLC Board meeting the next day, outside director Constance Baroudel asked for an update on AST's U.S. strategy. (PX00574-001.) Dr. Coward reported that Daniken, while increasing in capacity utilization, "was also undertaking more work for industrial [non-medical device] customers, as the regulatory process to allow [medical] devices to be sterilised using X-rays was taking longer than originally planned." (PX00574-002.) Dr. Steeves reported that

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that the facility would reach 100% capacity utilization "around year seven or so." (Id. at 411.)

McLean was "working on entering into an exclusivity agreement with IBA to ensure that Synergy was the only outsourced sterilisation provider [that] would supply X-ray equipment in the US." (PX00574-002.) However, "in order to secure this exclusivity it was likely that deposits of €300k each would need to be placed for two X-ray facilities before the end of the financial year." (Id.) Dr. Coward made clear that formal approval for the plan involving four facilities "was **not** being sought at this juncture, just for the deposits on two machines." (PX00574-010.) The PLC Board approved the down payments for the two facilities with IBA. (Id.)

On October 7, 2014, core team members from the United States and Europe attended a kickoff meeting in Florida during which Gaet Tyranski made a presentation he called "Project Endurance." (Hr'g Tr. 525 (Tyranski).) He noted that the U.S. x-ray strategy was approved by the SEB at the September 2014 meeting. (Id. at 526.) He also noted that the SEB identified key actions to be addressed, including further reduction of CAPEX by at least $1.5 million, further work on the facility locations, and finalizing the exclusivity agreement with IBA. (Id. at 527.) At the August 2015 hearing, Tyranski testified that, although he did not mention in his presentation that customer commitments would be needed in order for Project Endurance to go forward, it was understood based on his experience at Synergy. (Id. at 529.)

Less than one week later, on October 13, 2014, Steris announced its proposed merger with Synergy. Notwithstanding this announcement, evidence shows that work on the U.S. x-ray project continued unabated.

On October 21, 2014, Tyranski sent an email to his x-ray team stating that, with the exception of market development expense (e.g., "a Synergy branded new x-ray logo and campaign when it will likely be Steris in a few months"), the x-ray project was proceeding as planned. (Hr'g Tr. 531-32 (Tyranski).)

On October 30, 2014, McLean reported that he had executed an option contract with IBA giving Synergy until March 31, 2015 (the end of Synergy's fiscal year), to sign purchase agreements with IBA. (Hr'g Tr. 331 (McLean.) McLean testified that, at that time, he was having standing meetings every two weeks with J & J, whose product Surgicel was recently approved by the FDA for x-ray sterilization, prodding them for a take-or-pay contract "or *any* project with J & J for x-ray in the United States." (Id. at 336.) He testified that "the weeks and months drew on and there was nothing." (Id.) Still, he had cause for optimism because J & J continued to express enthusiasm about x-ray, they complained about the sharp increase in prices for Cobalt-60, and there was concern in the industry over Cobalt-60 supply and tightening regulations over disposal of Cobalt-60 and EO residuals. (Id. at 305-07, 339 (McLean).)

On November 4, 2014, Synergy issued its Interim Results for the Six Months Ending 28 September 2014. (PX00580.) On page 4 of the 25-page document, the report provided, with regard to AST,

> We are pleased to announce that we have signed an agreement with IBA for X-ray technology to be deployed in the United States, supplemented by our in-house knowledge and expertise. Our X-ray services are now the fastest growing of our AST technologies, driven by the higher levels of quality, favourable economics and faster processing speed, which helps our customers to reduce their working inventories. Most recently the first FDA approval of a Class III medical device was achieved by one of our major global customer partners, paving the way for further conversions.

(PX00580-004.)

In an earnings call held the next day, Dr. Steeves stated that AST had a really good half year, commenting that

> [t]he strongest growth has been in the Americas along with good growth in Europe from the new facility in Marcoule, France, our x-ray facility in Switzerland and the new capacity acquired with [the Bioster acquisition] . . . Looking forward, there are few further steps we are taking to support growth and including expanding our network in the U.S. as well as expanding the capacity of a number of our facilities around the world. We've also reach an agreement with IBA that will allow us to get started with x-ray in the U.S.

(PX01773-005.)

Meanwhile, Tyranski continued working on locking down numbers for the U.S. x-ray business model, explaining that, if the merger went through, he would just have to re-present his business model to the new combined Steris/Synergy SEB, and that they would probably not build an x-ray facility right next to a Steris gamma facility. (Id. at 532-33, 548-49 (Tyranski).)

The business plan proposed at the September 2014 SEB meeting anticipated that Synergy's e-beam facility in Lima, Ohio would be closed and that the products would be transferred to Synergy's new dual x-ray/e-beam facility. (Hr'g Tr. 539-540 (Tyranski).) On January 19, 2015, Tyranski sent an email to Gavin Hill asking him to sign a lease extension for the Lima facility (to October 2017), so that the new U.S. facility would have base load e-beam revenues while x-ray customers were being developed. (Id.; PX-01265-001.) Hill extended the lease. (Hr'g Tr. 540-41 (Tyranski).)

In November 2014, Tyranski sent Mark Berger, a business development manager, to the Dallas/Fort Worth area to visit numerous proposed locations for an x-ray facility, while Aldo Rodriguez, an accountant, continued discussions over economic incentives that would lower capital costs in building that facility. (Id. at 541-45.) Tyranski testified that the reason for this activity was to nail down costs so that he could present the best business case to the board for approval. (Id. at 545.) Tyranski himself continued discussions with the Miami Valley Research

Park in Dayton, Ohio, regarding incentives and grants that could be offered in locating a facility there—discussions that continued into February 2015. (Id. at 545-49; PX01270.) Tyranski testified that he could not make a decision on committing to a lease until he presented the business case to the SEB again. (Hr'g Tr. 548 (Tyranski).)

The evidence shows that, on October 9, 2014, Tyranski sent an email to his sales staff reminding them to continue to elicit customer letters of interest under the market development strategy and offering $500 bonuses to those who could get a customer to sign up to send their product to Daniken for x-ray testing by November 15, 2014. (Hr'g Tr. 549-551 (Tyranski); PX00244-001.) He subsequently extended the deadline another several months. (Hr'g Tr. 549 (Tyranski).)

The evidence also shows that, despite Synergy's best efforts to advance the x-ray project, news on the economic front worsened. The machine that formed the cornerstone of the September 2014 business plan was IBA's Rhodotron TT300. (Hr'g Tr. 423-28 (McLean); 555-567 (Tyranski).) IBA had represented that its Rhodotron TT300 was a combination x-ray/e-beam machine that could meet Synergy's needs. (Id. at 424 (McLean).) But in late 2014, IBA began expressing a lack of confidence in the TT300, proposing a reconfiguration of the TT1000 with a €250,000 increase in price.[6] (PX00240-003-004. Hr'g Tr. 562 (Tyranski), 422 (McLean).) While the TT300 provided both e-beam and x-ray services, the greater capacity was on the e-beam side. A machine that provided both services was critical to the September 2014 business model because it guaranteed considerable e-beam revenue for years (which would be

[6]The Rhodotron TT1000, the machine that ran x-ray at Daniken, was an x-ray-only machine.

satisfied by the movement of products from the Lima, Ohio e-beam plant to the new facility) while Synergy's U.S. x-ray business developed. (JDX1722-001; JDX1775 at 25, 27.) However, the ultimate goal driving the plan's economics was always the machine's x-ray capacity. (JDX1760-002 (Slide 20).) The machine needed to have more x-ray than e-beam capacity; it required 400 kW and 7 MeV for x-ray, and 100 kW and 10 MeV for e-beam. (JDX1920-001.) The TT300 could not achieve the 400kW power level, and there was no dual-purpose machine in existence capable of reaching those power levels. (Hr'g Tr. 582, 615 (Tyranski).) The evidence shows that the business plan with a 300kW machine would produce 25% less revenue than the TT1000 with 400kW. (PX00240-004.) According to McLean, the one thing he thought "should have been relatively simple just became more and more complex and more and more costly." (Hr'g Tr. 422-23.)

The uncertainty culminated in a meeting in January 2015 attended by principals from Synergy and IBA, during which IBA told Synergy that the price of the systems was "going up." (Hr'g Tr. 426 (McLean).) Tyranski testified that, at the time of that meeting, IBA's price for a TT1000 with 400kW capacity was €5.304 million and the cost of the machine constituted more than 25% of the capital cost for one facility. (Id. at 577-78 (Tyranski).)

In response to a question at the August 2015 hearing, whether IBA gave Synergy an estimate as to how long it would take to design, build and test the system, McLean responded,

> Well, that's—that's a question I never asked, because at that point, I'm getting quite frustrated and disillusioned with the whole thing. It is going nowhere. And in my point of view, if they have never built one, never tested one, did we want to be the guinea pig?
>
> And I remember discussions with my team saying, you know, do we want to be the experiment here in the U.S. and persuade and influence J & J and other top tier customers to come over to us and then have a failure? It had to work."

(Hr'g Tr. 426-27 (McLean).) When the Court asked Tyranski to gauge, in February 2015, his confidence level that IBA could produce the machine at the required power level, he responded, "Their story kept changing so I was skeptical. I was probably more than 50 percent confident that they could ultimately get there *over time*, but there were no guarantees." (Id. at 577 (Tyranski) (emphasis added).) It is undisputed that there is no machine in existence today that is capable of providing both x-ray/e-beam sterilization at the 400kW power level. (Id. at 425 (McLean), 577 (Tyranski).)

On February 24, 2015, McLean sent a declaration to the FTC stating that he was terminating Synergy's U.S. x-ray project, and listing the reasons for doing so. (JDX2655.) He described his team's "top-down, full-court" efforts, and failure, to solicit customer commitments. (Id. at ¶ 2.) He explained that Synergy's sales and marketing efforts began in July 2013, by identifying 185 leading medical device and pharmaceutical manufacturers as potential candidates for x-ray. (Id. at ¶ 6.) For those companies, Synergy began its marketing efforts with sales calls made in conjunction with sales of other AST products, explanatory brochures, webinars, live seminars, tours of Synergy plants, tours of Daniken, and phone calls. (Id. at ¶ 6.) Of those companies, Synergy targeted 34 as the best candidates to generate a viable processing volume to underpin the x-ray strategy. (Id. at ¶ 7.) This was necessary to guarantee the revenues needed for the business model to meet the minimum hurdle rates and obtain SEB and PLC Board approval. (JDX2655 ¶ 8.) McLean provided file folders for each of those companies with contemporaneous documentation of those efforts. (Id. at ¶ 9.) In anticipation of presenting a business case to the SEB in September 2014, the project team continued its efforts to obtain some form of customer commitment to support the business model. (Id. at ¶ 11.) All they were able to obtain were around six nonbinding letters of interest. (Id.) Following the September 2014 SEB meeting, the project's marketing team continued efforts to obtain customer commitments, to no avail. (Id. at ¶ 12.) As no significant U.S. customers remained to be contacted, McLean concluded that "there [was] no reasonable prospect of customer acceptance for Synergy's X-ray project." (Id. at ¶ 4.)

Attached to McLean's declaration are emails from five of Synergy's top customers stating that they have no present intention of using x-ray sterilization: Covidien/Medtronics ("Although x-ray is interesting to the team, it is not a modality the Covidien Group with Medtronic is actively investigating today."), Boston Scientific ("Xray simply has not proven to have any significant benefit over the big three forms of sterilization to warrant real interest."), J & J ("Per our conversation today, the Business Case for J & J to support transfer of its U.S. gamma processed products (done by 3rd Parties) into a new xray facility near Memphis TN (J & J Distribution Center) does not appear to be compelling."), and Becton Dickinson ("The risk to reward ratio remains stubbornly favorable toward Co60 and Ebeam. . . . The costs in labor, material testing, submissions, reviews, etc., to switch to Xray could approach $400K per product family. Multiplied out by 100s, if not 1000s, for different designs and product families and the investment costs are staggering.") (Respectively, JDX2852, JDX2853, JDX2854, JDX2855.) McLean solicited these communications following his meeting with the FTC on February 17, 2015, when asked for evidence showing that customers had refused to back x-ray *in writing*. (Hr'g Tr. 399 (McLean).) McLean testified that if these customers had said they were really committed to x-ray in the United States, he would not have terminated the project.

> So I wanted to make sure. Remember that myself and my team had put a lot of time and effort, hard work into this, so I wanted to be sure. I asked a direct

question and I got a direct answer.

(Id. at 400.)

That same day, Gaet Tyranski sent an email to his team leaders. (PX00863-003.) Noting that "the FTC inquiry was going down a rat-hole," Tyranski advised, "I do think it's prudent to stop further spend on X-Ray Americas." (Id.) When asked at the August 2015 hearing what he meant by "going down a rat-hole," Tyranski responded, "[The FTC inquiry] was bogging the entire team down. It was burdensome." (Id. at 570.)

Tyranski, who had only been President of AST for the Americas since August 2014, was dealing with numerous other capital projects at the same time he was working on the business case for the U.S. x-ray project (i.e. building a facility in Saxonburg, Pennsylvania, working to obtain approval to build a facility in Northern California, and preparing a business case for greenfield sites in the Carribean). (Hr'g Tr. 585 (Tyranski).) Consequently, he spent no more than 30% of his time on the U.S. x-ray project. He testified that, in discussions with McLean over whether to terminate the project, they knew they were reaching the point where the budget for fiscal year 2016 needed to be set. (Id. at 575.) They were concerned about devoting millions of dollars to the U.S. x-ray project, considering customer interest had not advanced much, there were only a couple of customers sending product to Daniken for testing, and the cost base for the September 2014 business model was not improving. (Id.) They were also mindful that the $40 million investment for phase 1 of the project would consume Synergy's entire discretionary budget for the year. (Id. at 587.)

Today, Daniken's x-ray facility is running at only 25% capacity, and there is no dual x-ray/e-beam sterilization machine in existence that operates at a 400kW capacity.

IV.

The FTC contends that Synergy was poised to enter the U.S. market in Fall 2014 by constructing one or more x-ray facilities, and that the merger with Steris caused Synergy to abandon the effort. As a corollary, the FTC argues that documents created and testimony given after the merger was announced should be viewed with a high degree of suspicion. If the FTC is correct, the evidence should show that if the merger does not go through (either because the parties abandon it or a permanent injunction is issued), Synergy is likely to revive its plans and build one or more x-ray facilities in the U.S. in the near future.

In fact, the evidence shows the opposite in at least three ways. One, while Synergy's PLC Board had endorsed the concept of U.S. x-ray in September 2014, the business plan had not been approved and there were significant obstacles that McLean and Tyranski knew they needed to overcome in order to win approval. Two, the announced merger with Steris in October 2014 had no significant impact on Synergy's plans for U.S. x-ray. McLean and Tyranski continued to mobilize the employees under their direction to try to obtain customer buy-in, to try to bring down the cost of the new facilities, and to work with IBA to develop a dual-capability machine of sufficient power to meet Synergy's needs. Three, it was McLean, and not CEO Steeves, who made the decision in February 2015 to discontinue the U.S. x-ray project after he concluded that there was little to no likelihood of obtaining SEB approval, let alone approval from a combined Synergy/Steris board.

The evidence shows that, at the conclusion of the September 2014 SEB meeting, all that the SEB approved was the U.S. x-ray strategy. The SEB did not have the authority to approve discretionary capital expenditures of more than 10 million pounds. Nor did the PLC Board, which *does* have the authority to approve discretionary capital expenditures over 10 million pounds, approve the September 2014 business plan. In fact, no business plan was presented to the PLC Board for approval. (Hr'g Tr. 221 (Steeves); PX00574-010.) All that Dr. Steeves requested, and the PLC Board approved, was the expenditure of 300,000 pounds each for down payments on the first two facilities, as that is what IBA demanded in order to enter an exclusivity agreement with Synergy.[7] (Hr'g Tr. 223 (Steeves); (PX00574-010.).)

In order to obtain injunctive relief, the FTC has to show a likelihood of proving at trial that, absent the merger, Synergy probably would have entered the U.S. contract sterilization market by building one or more x-ray facilities in the U.S. within a reasonable period of time. The Court concludes, for the following reasons, that the FTC has not met its burden.

A. Customer Commitments

The evidence at the hearing revealed that the most significant reason Synergy opted to discontinue the U.S. x-ray project was lack of customer commitment. According to the FTC, there is no documentation that Synergy solicited customer interest throughout 2014, and in any event, customers continue to be "interested in x-ray sterilization in the United States." (Doc #: 81 at 9.) The Court disagrees.

The evidence shows that Synergy's corporate practice is to secure take-or-pay contracts from customers before making significant capital investments, and this was certainly a significant capital investment. The first phase of the project alone required the expenditure of Synergy's entire annual discretionary budget ($40 million). Despite considerable effort on

[7]Bouradel testified at the August 2015 hearing that the PLC Board didn't even have to approve the down payments, as the total expenditure was less than 10 million pounds.

Synergy's part, as shown by the evidence and described in concise detail in McLean's declaration, not a single medical device customer would sign a take-or-pay contract, and only about 6 of the 185 customers Synergy initially targeted in its sales and marketing campaign would sign even a nonbinding letter of interest.

The evidence, in the form of minutes, emails and testimony, shows that McLean knew he had to obtain take-or-pay contracts or some form of financial commitments in order to support the U.S. x-ray business model; otherwise, the business model underpinning the x-ray strategy would not be approved by the SEB or the PLC Board. In fact, the evidence shows that McLean *repeatedly* raised his concern over the inability to obtain financial backing in any form at every SEB meeting at which the U.S. x-ray strategy was discussed, and expressed his frustration in correspondence with Dr. Coward. The evidence shows that, despite the level of interest expressed by a handful of healthcare products manufacturers in x-ray technology, Synergy could not identify a single customer who would provide the financial commitment required to build x-ray sterilization facilities in the United States. Absent the ability to demonstrate a demand for this service, McLean knew that any business model the x-ray team presented to the SEB or PLC Board would not have been approved. Indeed, McLean testified that he didn't bother to ask Gavin Hill to commence a black hat review of the model because the model just wasn't ready.[8]

[8]Not only does the FTC challenge that a black hat review of the September 2014 business model would have ended the x-ray strategy, the FTC challenges whether Synergy really has a "black hat" process for reviewing business models at all. However, all of Synergy's witnesses who were questioned about the process testified consistently, if in varying detail, about how the corporate finance team conducts its review of proposed capital projects. (Hr'g Tr. 221 (Steeves); 412-13, 418 (McLean); 448-450 (Bouradel); 678-682 (Hill).) Even the FTC conceded that there is documentary evidence referencing the process. (See Doc #: 81 at 2 n.5.) Regardless of what the corporate financial team's review process is called, there cannot be serious dispute that the type of financial review the team conducts (and the metrics it uses) to evaluate capital investments is not standard business practice in the industry.

McLean knew that the September 2014 model, with one exception, was not based on anything more than assumptions (e.g., premium pricing, revenues, market share). (Hr'g Tr. 406-418 (McLean).)

The testimony of the FTC's own witnesses, Joyce Hansen of J & J and David Silor of Zimmer, demonstrates that their interest in x-ray sterilization in the United States was primarily academic. As Hansen testified, she preferred to remain "totally noncommittal" to Synergy until a laundry list of factors were resolved: a decision on where the x-ray facilities would be located in the United States, what machine would be used, which J & J products might benefit from x-ray sterilization, the volume of those products, the completion of functionality studies, and the approval of regulatory agencies in all countries where the x-ray-sterilized products would be sold.

The evidence shows that after McLean asked Hansen for something in writing to support the business model he was preparing to present to the SEB in September 2014, Hansen submitted a letter expressing, *at best*, lukewarm interest. (JDX1188-022.) After articulating a few reasons why x-ray sterilization is "of interest" to J & J, she explained that the primary barrier in transitioning from gamma to x-ray sterilization is "the additional work required to support the physical / functional product testing, regulatory authority submissions, and personnel time and resources for these activities." (Id.) She concluded that "this letter of interest is intended to be a means of communicating our interest in pursuing the use of X-ray processing *in the future*, and is not intended to commit J & J to processing a volume of product in a facility with Synergy Health." (Id. (emphasis added).)

The evidence shows that Hansen well knew how take-or-pay contracts work and the need for volume commitments before building new facilities. When asked about J & J's Albuquerque, New Mexico gamma sterilization facility, Hansen agreed that, in evaluating whether it made sense to build a new facility, J & J would have to consider how much volume would be put through the facility before building it, otherwise it would not be a good use of J & J's capital. (Hr'g Tr. 71-72 (Steeves).) Furthermore, the evidence shows that J & J had previously entered into a $2.8 million take-or-pay contract with Synergy to build an e-beam sterilization facility in Ireland. (Id. at 204-05.) By the time the plant was completed, another medical device company had apparently built a better device than the product J & J intended to put through the facility, and J & J wrote off the entire investment, leaving Synergy empty-handed. So, Synergy had to rely on the $2.8 million to support its investment until it could bring in additional customers. (Id.)

David Silor, Principal Sterilization Associate at Zimmer, testified that he had discussed x-ray sterilization in the U.S. with Synergy for the past two years. (Hr'g Tr. at 116.) But shortly after Zimmer had agreed to conduct a feasibility study at Daniken, Zimmer initiated a major quality remediation project at the FDA's request. (Hr'g Tr. at 119.) Consequently, its resources were shifted to support those efforts and, to this day, Zimmer has been unable to conduct any x-ray feasibility studies at all. (Hr'g Tr. at 119.)

B. Why No Take-Or-Pay Contracts: Customer Concerns

The evidence shows that the problem obtaining customer commitments had nothing to do with the merits or benefits of x-ray sterilization. Sterilization represents only about 3% of the cost of the medical device. (Hr'g Tr. 381.) This means that even if Synergy could promise a customer a 30% price savings over gamma sterilization for a product, the conversion would only reduce the product's cost by 1%. On the other side of the ledger was the significant cost of conversion, estimated to be $250,000 to $500,000 per product. (Id. at 438.) The product would need to be tested, then the conversion would need to be approved by the FDA and the foreign counterpart in any foreign country where the product would be sold, then the site would have to be qualified; and then product would have to be put through the facility for validation. As J & J found out, this conversion process could take several years. And if a manufacturer of a medical device had been on the market for ten to forty or more years, it is likely that the regulatory standards for testing and approving these products would have gotten tighter, and the product may no longer be in compliance. (Hr'g Tr. 371-72 (McLean).) Furthermore, any x-ray facilities built in the United States would need contingency processing options, i.e., other qualified facilities where products could be sterilized if the facility needed repair. (Id. at 361.) There are no existing x-ray sterilization facilities in the United States; Synergy's would be the first. A problem in Synergy's facility could leave a customer with no readily-available alternative for sterilizing its products, and any mistake could jeopardize a manufacturer's business reputation and, consequently, its business.

In fact, the documentary evidence shows that on February 24, 2015, despite the considerable efforts of McLean and his team to obtain some kind of customer support endorsing the U.S. x-ray business model, not one customer was willing to do so. There are four emails from leading manufacturers of medical and pharmaceutical products (Covidien/Medtronics, Boston Scientific, J & J, Becton Dickinson) expressing their reasons for not signing up for the U.S. x-ray project, e.g., there is no significant benefit in x-ray sterilization over the other sterilization modalities, the risk-to-reward ratio favors the other modalities, and the cost of transitioning multiple products from gamma to x-ray is staggering. This was correspondence McLean solicited following his meeting with the FTC on February 17, 2015, when asked for documentary evidence showing that customers had rejected x-ray.

At the August 2015 hearing, the FTC made much of the fact that McLean had solicited J & J's email and had asked Vic Baran, who wrote the email, to go back and look at the numbers again because they did not reflect the numbers McLean had previously discussed with Joyce Hansen regarding the costs involved in obtaining validation, product stability, product functionality and regulatory filings. Vic Baran then sent McLean an email with revised numbers. McLean testified that the costs in the email accurately reflected his discussions with Joyce Hansen and the FTC never called Vic Baran to the stand. In any event, the FTC did not challenge the other emails which clearly showed a lack of interest on the part of industry leaders in backing x-ray sterilization of their products at this time.

The evidence shows that Synergy itself had previously undertaken the black hat process for building a new x-ray sterilization facility in Bradford, U.K. When the Bradford gamma sterilization facility was running out of capacity, Synergy's AST team decided to present two business models to the SEB: one for building a gamma facility and one for building an x-ray facility. (Hr'g Tr. 372 (McLean.) The business models showed that the gamma financials were superior to the x-ray financials, and the project team could not drum up one customer who was willing to back the x-ray business model. (Id. at 373.) In the end, because Synergy had to do "the right thing by [its] shareholders," it built a new gamma facility with higher capacity at the Bradford site. (Id.)

Synergy's experience at Daniken only added to these concerns for several reasons. First, the predicted growth in medical product x-ray sterilization (i.e., 52% capacity by fiscal year 2015) never materialized. Today, Daniken's x-ray facility runs at 25% capacity utilization. Second, most of Daniken's x-ray business is processing non-medical products, and the non-medical business is not the business Synergy prefers to attract. (Hr'g Tr. 385 (McLean) (Synergy's core competence is working "in a highly regulated environment, where you have to deliver an exceptional quality," and the volume is stable with guaranteed revenues.) The evidence shows that over 80% of the product going through Daniken's gamma facility is medical; in contrast, only 5 to 6% of the product going through Daniken's x-ray facility is medical. (Id.) Furthermore, the medical device x-ray business at Daniken is paltry; the $100,000 generated represents only about 2% of Daniken's overall x-ray business. (Id. at 389-393.) The evidence shows that Synergy was unsuccessful in getting its existing gamma customers to convert to x-ray. When Synergy tried to leverage this conversion by telling its Daniken gamma customers that there was little or no remaining capacity at the gamma facility, the customers responded by threatening to go to a competitor's gamma facility. (Id. at 383.) McLean testified, "at one point, we were sterilizing soil, earth, at Daniken x-ray to get product through. That's not what we want." (Id. at 385.)

There was nothing McLean and Tyranski could do to change this paradigm. And of course, any further price reduction Synergy might offer to incentivize its customers would result in lower profit margins and IRR for Synergy.

C. Capital Costs

The evidence shows that, despite Synergy's best efforts, it was unable to harness the capital costs to build x-ray facilities in the United States. Synergy has only $25 to $40 million per year to spend on capital projects. The cost of building two x-ray facilities was estimated to be well over that budget. Because this investment would consume the entire annual discretionary capital budget, little risk could be tolerated. It was clearly incumbent on the project team to lock down real numbers, obtain customer commitments, and lessen capital costs. In short, this particular investment, given its enormity, was a "bet the farm" proposition for Synergy.

As the effort to develop a financial model that more accurately represented the economic realities advanced, the numbers got worse instead of better. The evidence shows that, from the September 2014 board meetings, shortly before the merger was announced, until late February 2015, when the project was abandoned, Synergy's estimates on the cost of building the facilities increased by $2.5 million once actual proposals from contractors were considered. (Invest. Hr'g Tr. 198-199 (Fry); SH00483971 at 10.) By early 2015, it became clear IBA had lost confidence that the TT300, the dual x-ray/e-beam machine on which the team's September 2014 business model was based, would deliver the required 400kW capacity. And the TT1000 with dual x-ray/e-beam technology had never been designed, built, tested or priced. The only certainty about the proposed machine was that it would cost considerably more than the initial business model estimates.

The evidence also shows that the September 2014 business model failed every one of the metrics Synergy uses to rank capital investments. With a few exceptions, the PLC Board generally will not approve funding a discretionary capital investment without an IRR of 15%.[9] The September 2014 business model showed a 6.51% IRR—a number that included a significant accounting error that reduced the projected IRR to 3%. The erroneous IRR was reached by double-counting revenues from the Lima, Ohio plant, and it was the only number in the business model that was not the product of guesswork and assumptions. The evidence also shows that Synergy's target for ROCE was 15%. To reach this goal, the business seeking discretionary funds (e.g., AST) would have to show a ROCE of 30%. The business model presented at the September 2014 meeting would not hit the target until year 7, lowering the current company ROCE from 12.4% to 11.8%: a reportable consequence that, though seemingly small, would raise red flags for shareholders. (Hr'g Tr. 688, 698 (Hill).) Another metric the model failed to meet was cash payback. Synergy's target cash payback for all investments is no longer than five years. The September 2014 business model reflected a cash payback period of 7.7 years.

D. The Prospect of Building X-ray Facilities in the United States

According to the FTC, the current "interest" that a few customers have expressed in x-ray technology, plus the fact that some healthcare products manufacturers have recently sent a few products to Daniken for testing, shows that Synergy was poised to build x-ray sterilization facilities in the United States in the foreseeable future. The evidence of the FTC's own witnesses shows otherwise.

Hansen was asked at the hearing, if Synergy opened an x-ray sterilization facility in the U.S. tomorrow, would J & J send Surgicel to that facility for sterilization? (Hr'g Tr. 77

[9]The evidence shows that this standard could be relaxed where necessary for health and safety, to meet regulatory requirements, or to prevent the potential loss of a customer. (Hr'g Tr. 701 (Malaysia); 702- 703 (China facility); 703 (health and safety, regulatory).)

(Hansen).) Her response was that both parties would have to go through another series of hoops before doing so, i.e., J & J would have to get regulatory approval for the site, Synergy would have to go through installation and operational qualification, and J & J would have to put its product through the facility and conduct validation testing before sterilizing Surgicel there. (Id.)

Silor testified that Zimmer has not evaluated the potential use of x-ray as a sterilization method for the products it manufactures, it has not performed any feasibility testing with x-ray sterilization, it has not evaluated whether x-ray performs better than gamma for its products, it has not discussed pricing for x-ray sterilization with anyone at Synergy, and it has not analyzed the cost of switching to from gamma to x-ray sterilization in any formal way.

Silor testified that, in order to use a new technology for sterilizing medical devices that does not exist here today, Zimmer would have to do a dose mapping study, a dose setting validation, get the subdose verification level, perform sterility testing on the product, modify the manufacturing routers to indicate that the company is using x-ray instead of gamma, make the FDA submissions on Class 3 medical devices, and perform material shelf-life studies and packaging shelf-life studies. (Hr’g Tr. 130 (Silor).) He acknowledged that evaluating an alternative sterilization modality is a long-term project. (Id. at 131.)

E. The September 2014 Minutes

Much examination and cross-examination at the hearing was devoted to the accuracy of the September 2014 SEB meeting minutes. It is undisputed that Jonathan Turner, who was responsible for taking the minutes, did not transcribe the part of those minutes pertaining to the x-ray presentation until March 2015, when Dr. Steeves was preparing to meet with the FTC over the proposed merger, and he realized that the portion of the September 2014 meeting minutes addressing the x-ray team's presentation was missing.

The evidence shows that Turner kept his minutes in a 195-page notebook, which he used to transcribe the minutes. The FTC challenged the credibility of the minutes because they were not taken verbatim from Turner's notes. However, as Dr. Steeves pointed out during his testimony, the entire SEB board was there, along with one of Synergy's outside directors, and there is no doubt that the presentation was given, the discussion took place, and the minutes that are contained in the middle of Turner's handwritten book "exist and are real." (Hr'g Tr. 246 (Steeves).)   In addition, the presentation of the September 2014 SEB meeting is part of the record, and the testimony solicited at the hearing corroborated the minutes.

F. The November 2014 Earnings Call and Interim Report

The FTC contends that the following statements Synergy reported in November 2014 effectively show that Synergy had publicly committed to building two x-ray facilities in the U.S.: "We are pleased to announce that we have signed an agreement with IBA for X-ray technology to be deployed in the United States, supplemented by our in-house knowledge and expertise," "the first FDA approval of a Class III medical device was achieved by one of our major global customer partners, paving the way for further conversions [of products from gamma sterilization to x-ray]," and "[o]ur X-ray services are now the fastest growing of our AST technologies, driven by the higher levels of quality, favourable economics and faster processing speed." (Pl. FTC's Post-Hr'g Br. at 6-7. Doc #: 78.)   However, the fact that they were reported after the merger was announced shows that no one at Synergy viewed the proposed merger with Steris as an impediment to its U.S. x-ray strategy. (Hr'g Tr. 225 (Steeves) (noting, three weeks after the announcement, that he was trying to support the x-ray team and drum up some enthusiasm for the team's efforts "to get customers aligned with what we were trying to do in the United States." (Id.)

G. Timing

The FTC contends that it is the FTC's investigation—and not the numerous business reasons just articulated and supported by evidence—that caused Synergy to "kill" x-ray in the United States. The Court disagrees.

The timing of the decision to pull the plug on the U.S. x-ray project may actually be the best evidence that it was done for legitimate business reasons, as opposed to anti-competitive ones. If the merger with Steris was going to prevent Synergy from entering the U.S. market, Synergy would have stopped working on the U.S. x-ray project as soon as the merger was announced in mid-October 2014. Instead, following the September 2014 meetings, Synergy, led by McLean and Tyranski, continued to go all out to try to win SEB support for the business plan, and ultimately PLC approval,. The x-ray team continued to court customers, signing them up to get their products tested at Daniken. The team continued their detailed discussions with IBA on the appropriate machine. They made road trips to scout out sites, soliciting incentives from the various cities. The evidence demonstrates that this was not a sham to convince the FTC that Synergy wanted to enter the market; it was legitimate effort by Synergy employees who really wanted the project to succeed, but recognized the hurdles they needed to overcome to win approval. The fact that McLean and Tyranski decided to terminate the project in February 2015, four months after the merger was announced and in the midst of the FTC's investigation, supports the conclusion that this was a decision reached by the project managers after serious consideration of all the business factors involved.

More likely, the last thing Synergy would have done, if the Steris merger was driving its U.S. x-ray strategy, would have been to pull the plug immediately after meeting with the FTC staff in January 2015 and hearing their objections to the merger, as Synergy had to know that doing so would only have solidified the FTC's position that the merger was driving the decision. Synergy could have kept its x-ray efforts going in order to convince the FTC that the merger with Steris was not going to prevent its entry into the U.S. market.

If Synergy had terminated the U.S. x-ray project when it entered talks with Steris, or when the merger was announced in October 2014, the Court might view this scenario differently. However, the evidence shows that the negotiations between Steris and Synergy had no effect whatsoever on the work of Synergy's U.S. x-ray team. The team continued to seek take-or-pay contracts from customers and there is evidence that Synergy incentivized that effort financially. The team continued to crunch the numbers in the business model, to negotiate concessions with states where they considered building the facilities, and to work diligently with IBA on the machine that would meet Synergy's needs.

In the end, the evidence unequivocally shows that the problems that plagued the development of x-ray sterilization as a viable alternative to gamma sterilization in 2012, when Dr. Steeves purchased Daniken, were the same problems that justified termination of the project in 2015: the failure to obtain customer commitments and the inability to lower capital costs.

(Continued on next page)

V.

Because the Court finds that the FTC has failed to show, by a preponderance of evidence, that it is likely to succeed on the merits in the upcoming administrative trial, its Motion for Preliminary Injunction (**Doc #: 5**) is hereby **DENIED**.

IT IS SO ORDERED.

/s/ Dan A. Polster September 24, 2015
Dan Aaron Polster
United States District Judge

Visa/Plaid

Visa To Acquire Plaid

1/13/2020

SAN FRANCISCO--(BUSINESS WIRE)--Jan. 13, 2020-- Visa Inc. (NYSE: V) today announced it has signed a definitive agreement to acquire Plaid (https://cts.businesswire.com/ct/CT?id=smartlink&url=https%3A%2F%2Fplaid.com%2Fwhat-is-plaid%2F&esheet=52158071&newsitemid=20200113005921&lan=en-US&anchor=Plaid&index=1&md5=0702cb3c4f748ec52c86c62ebfd83c55), a network that makes it easy for people to securely connect their financial accounts to the apps they use to manage their financial lives. Visa will pay total purchase consideration of $5.3 billion to acquire Plaid.

Plaid's products enable consumers to conveniently share their financial information with thousands of apps and services such as Acorns, Betterment, Chime, Transferwise and Venmo. Consumers rely on these apps and services to help plan their spending, increase their savings and monitor their investments. For example, when a user sets up a Venmo account, it is Plaid that enables the user to link their bank account to their Venmo account.

Connectivity between financial institutions and developers has become increasingly important to facilitate consumers' ability to use fintech applications. 75 percent of the world's internet-enabled consumers used a fintech application to initiate money movement in 2019 versus 18 percent in 2015[1]. Plaid has been a leader in enabling this connectivity at scale. Today, one in four people with a U.S. bank account have used Plaid to connect to more than 2,600 fintech developers across more than 11,000 financial institutions.

"We are extremely excited about our acquisition of Plaid and how it enhances the growth trajectory of our business," said Al Kelly, CEO and chairman of Visa. "Plaid is a leader in the fast growing fintech world with best-in-class capabilities and talent. The acquisition, combined with our many fintech efforts already underway, will position Visa to deliver even more value for developers, financial institutions and consumers."

"Plaid's mission is to make money easier for everyone, and we are excited for this opportunity to continue delivering on that promise at a global scale," said Zach Perret, CEO and co-founder of Plaid. "Visa is trusted by billions of consumers, businesses and financial institutions as a key part of the financial ecosystem, and together Visa and Plaid can support the rapid growth of digital financial services."

Visa's acquisition of Plaid represents both an entry into new businesses and complementary enhancements to Visa's existing business. First, Plaid's fintech-centric business opens new market opportunities for Visa both in the U.S. and internationally. Second, the combination of Visa and Plaid provides the opportunity to deliver enhanced payment capabilities and related value-added services to fintech developers. Finally, the acquisition will enable Visa to work more closely with fintechs through all stages of their development and drive growth in Visa's core business.

"This acquisition is the natural evolution of Visa's 60-year journey from safely and securely connecting buyers and sellers to connecting consumers with digital financial services," said Kelly. "The combination of Visa and Plaid will put us at the epicenter of the fintech world, expanding our total addressable market and accelerating our long-term revenue growth trajectory."

Once closed, the combination of Visa and Plaid is expected to provide significant benefits to developers, financial institutions and consumers.

"We have strong relationships with both Visa and Plaid. The combination of Plaid's capabilities with the security and scale of Visa's global network will provide us with exciting opportunities to enhance our products," said Dan Schulman, president and CEO, PayPal.

"We believe Visa's acquisition of Plaid is an important development in giving consumers more security and control over how their financial data is used. Protecting customer data and helping them share that information safely has long been a top priority for Chase. We look forward to partnering with Visa to continue building a great experience for our shared customers," said Gordon Smith, co-president, JPMorgan Chase and CEO of Consumer and Community Banking.

The transaction is subject to regulatory approvals and other customary closing conditions. Visa will fund the transaction from cash on hand and debt issuance at the appropriate time. This transaction will have no impact on Visa's previously announced stock buyback program or dividend policy. The transaction is expected to close in the next three to six months.

Webcast and Conference Call Information

Visa's executive management team will host a live audio webcast beginning at 5:30 p.m. Eastern Time (2:30 p.m. Pacific Time) today to discuss the announcement. All interested parties are invited to listen to the live webcast at http://investor.visa.com (https://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Finvestor.visa.com%2F&esheet=52158071&newsitemid=20200113005921&lan=en-US&anchor=http%3A%2F%2Finvestor.visa.com&index=2&md5=2c1237ed2e1fbbe3538e6e2ba3b769d4). A replay of the webcast will be available for 30 days. Investor information, including supplemental financial information, is also available at http://investor.visa.com (https://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Finvestor.visa.com%2F&esheet=52158071&newsitemid=20200113005921&lan=en-US&anchor=http%3A%2F%2Finvestor.visa.com&index=3&md5=e68f031d0902fd21f1b0bc8b03f7669a).

About Visa Inc.

Visa Inc. (NYSE: V) is the world's leader in digital payments. Our mission is to connect the world through the most innovative, reliable and secure payment network - enabling individuals, businesses and economies to thrive. Our advanced global processing network, VisaNet, provides secure and reliable payments around the world, and is capable of handling more than 65,000 transaction messages a second. The company's relentless focus on innovation is a catalyst for the rapid growth of digital commerce on any device, for everyone, everywhere. As the world moves from analog to digital, Visa is applying our brand, products, people, network and scale to reshape the future of commerce. For more information, visit About Visa (https://cts.businesswire.com/ct/CT?id=smartlink&url=https%3A%2F%2Fusa.visa.com%2Fabout-visa%2Four_business.html&esheet=52158071&newsitemid=20200113005921&lan=en-US&anchor=About+Visa&index=4&md5=f0fa998a65724c25e8d825fc2c02cd3a), visa.com/blog (https://cts.businesswire.com/ct/CT?id=smartlink&url=https%3A%2F%2Fusa.visa.com%2Fvisa-everywhere%2Fblog.html&esheet=52158071&newsitemid=20200113005921&lan=en-US&anchor=visa.com%2Fblog&index=5&md5=acdfb0c93b5a7f5bc3d90680c4415447) and @VisaNews (https://cts.businesswire.com/ct/CT?id=smartlink&url=https%3A%2F%2Ftwitter.com%2FVisaNews&esheet=52158071&newsitemid=20200113005921&lan=en-US&anchor=%40VisaNews&index=6&md5=3eb4089111ff487f225751d36e77e6e4).

About Plaid

Plaid is a data network that powers the fintech tools millions of consumers rely on to live healthier financial lives. Plaid is used by thousands of digital financial apps and services like Acorns, Betterment, Expensify, and Venmo, and by many of the largest banks to make it easy for consumers to connect their financial accounts with the apps and services they want to use. Plaid connects with over 11,000 financial institutions across the U.S, Canada and Europe. The company was founded in 2013 by Zach Perret and William Hockey and is headquartered in San Francisco, CA.

Forward-Looking Statements

This release contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements generally are identified by words such as "will," "is expected," and other similar expressions. Examples of forward-looking statements include, but are not limited to, statements we make regarding the timing and likelihood of closing, Plaid's future success, the impact of the acquisition on Visa's growth, and the other benefits to Visa, developers, financial institutions and consumers.

By their nature, forward-looking statements: (i) speak only as of the date they are made; (ii) are not statements of historical fact or guarantees of future performance; and (iii) are subject to risks, uncertainties, assumptions or changes in circumstances that are difficult to predict or quantify. Therefore, actual results could differ materially and adversely from Visa's forward-looking statements due to a variety of factors, including the timing and outcome of the regulatory approval process, shifts in the regulatory and competitive landscape, Plaid's maintenance of relationships with sources of data, cyber incidents, the pace and success of integration, Plaid's success in international expansion, and various other factors, including those contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2019, and our other filings with the U.S. Securities and Exchange Commission.

You should not place undue reliance on such statements. Except as required by law, we do not intend to update or revise any forward-looking statements as a result of new information, future developments or otherwise.

[1] Source: https://www.ey.com/en_us/ey-global-fintech-adoption-index (https://cts.businesswire.com/ct/CT?id=smartlink&url=https%3A%2F%2Fwww.ey.com%2Fen_us%2Fey-global-fintech-adoption-index&esheet=52158071&newsitemid=20200113005921&lan=en-US&anchor=https%3A%2F%2Fwww.ey.com%2Fen_us%2Fey-global-fintech-adoption-index&index=7&md5=fde5a4310f5aab30c2284fe0525aa920)

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JUSTICE NEWS

Department of Justice

Office of Public Affairs

FOR IMMEDIATE RELEASE Thursday, November 5, 2020

Justice Department Sues to Block Visa's Proposed Acquisition of Plaid

Acquisition Would Eliminate Nascent Competitor Plaid and Prevent Disruption of Visa's Monopoly in Online Debit

Today, the Department of Justice filed a civil antitrust lawsuit to stop Visa Inc.'s $5.3 billion acquisition of Plaid Inc. Visa is a monopolist in online debit services, charging consumers and merchants billions of dollars in fees each year to process online payments. Plaid, a successful fintech firm, is developing a payments platform that would challenge Visa's monopoly.

"American consumers and business owners increasingly buy and sell goods and services online, and Visa – a monopolist in online debit services – has extracted billions of dollars from those transactions," said Assistant Attorney General Makan Delrahim of the Justice Department's Antitrust Division. "Now, Visa is attempting to acquire Plaid, a nascent competitor developing a disruptive, lower-cost option for online debit payments. If allowed to proceed, the acquisition would deprive American merchants and consumers of this innovative alternative to Visa and increase entry barriers for future innovators."

According to the complaint, Plaid powers some of the most innovative fintech apps. Plaid's technology allows developers to plug into consumers' various financial accounts, with consumer permission, to aggregate spending data, look up balances, and verify other personal financial data. Plaid connects to 200 million consumer bank accounts and 11,000 U.S. banks. Because it accesses data on behalf of so many fintech app customers, Plaid has become the leading financial data aggregation company in the United States. Plaid is planning to leverage its connections to build a bank-linked payments network that would compete with Visa. Plaid's money movement platform would allow consumers to pay merchants directly from their bank accounts using bank credentials rather than a debit card. Plaid's established connections and technology uniquely positions it to enter the payments market and disrupt Visa's monopoly.

The complaint alleges that Visa's CEO viewed the acquisition as an "insurance policy" to protect against a "threat to our important US debit business." This acquisition is the second-largest in Visa's history, with an extraordinary price tag of $5.3 billion. Visa's CEO justified the deal to Visa's Board of Directors as a "strategic, not financial" move, and noted that in part because "our US debit business i[s] critical and we must always do what it takes to protect this business." Unless acquired, Visa feared that Plaid "on their own or owned by a competitor [was] going to create some threat" with a "potential downside risk of $300-500M in our US debit business" by 2024. If Plaid remained free to develop its competing payment platform, then "Visa may be forced to accept lower margins or not have a competitive offering."

Millions of American consumers and merchants depend on debit services to transact business online. The complaint alleges that Visa has dominated online debit for years and has protected its monopoly with exclusionary tactics that have prevented rivals, including Mastercard, from expanding or entering. The lawsuit alleges that Visa's proposed acquisition of Plaid is a violation of both Section 2 of the Sherman Act and Section 7 of the Clayton Act. The Department filed its lawsuit in the U.S. District Court for the Northern District of California.

Visa Inc. is a Delaware corporation headquartered in Foster City, California. Visa is a global payments company that operates the largest debit network in the United States. Visa's 2019 revenues were approximately $23 billion.

Plaid Inc. is a Delaware corporation headquartered in San Francisco, California. Plaid is a financial services company that operates the leading financial data aggregation platform in the United States. In 2019, Plaid earned approximately $100 million in revenues.

Attachment(s):
Download Filed Visa Plaid Complaint

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Component(s):
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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

UNITED STATES OF AMERICA, *Plaintiff* v. VISA INC. and PLAID INC., *Defendants*.	Case No.: **COMPLAINT**

Visa seeks to buy Plaid – as its CEO said – as an "insurance policy" to neutralize a "threat to our important US debit business." Visa is a monopolist in online debit transactions, extracting billions of dollars in fees annually from merchants and consumers. Plaid, a financial technology firm with access to important financial data from over 11,000 U.S. banks, is a threat to this monopoly: it has been developing an innovative new solution that would be a substitute for Visa's online debit services. By acquiring Plaid, Visa would eliminate a nascent competitive threat that would likely result in substantial savings and more innovative online debit services for merchants and consumers. For the reasons discussed below, the proposed acquisition violates Section 2 of the Sherman Act, 15 U.S.C. § 2, and Section 7 of the Clayton Act, 15 U.S.C. § 18, and must be stopped.

INTRODUCTION

1. Visa is "everywhere you want to be."[1] Its debit cards are accepted by the vast majority of U.S. merchants, and it controls approximately 70% of the online debit transactions market. In 2019, there were roughly 500 million Visa debit cards in circulation in the United States. That same year, Visa processed approximately 43 billion debit transactions, including more than 10 billion online transactions. In 2019, Visa earned over $4 billion from its debit business, including approximately $2 billion from online debit.

2. American consumers increasingly make purchases online, attracted by the convenience of being able to shop any time, from anywhere, with fast delivery. In recent years, online transactions have experienced "explosive" growth, a trend that has only been accelerated by the COVID-19 pandemic, with online sales growing more than 30% between the first and second quarters of 2020.

3. American consumers use debit cards to purchase hundreds of billions of dollars of goods and services on the internet each year. Many consumers buying goods and services online either prefer using debit or cannot access other means of payment, such as credit. Because of its ubiquity among consumers, merchants have no choice but to accept Visa debit despite perennial complaints about the high cost of Visa's debit service.

4. Visa's monopoly power in online debit is protected by significant barriers to entry and expansion. Visa connects millions of merchants to hundreds of millions of consumers in the United States. New challengers to Visa's monopoly would thus face a chicken-and-egg quandary, needing connections with millions of consumers to attract thousands of merchants and needing thousands of merchants to attract millions of consumers. Visa's Chief Financial Officer has acknowledged that building an extensive network like Visa's is "very, very hard to do" and

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[1] https://usa.visa.com/.

"takes many years of investment," but "[i]f you can do that, then you can have a business [like Visa's] that has a relatively high margin." He explained that entry barriers are so significant that even well-funded companies with strong brand names struggle to enter online debit.

5. Mastercard, Visa's only longstanding rival in online debit services, has a much smaller market share of around 25%. For years, Mastercard has neither gained significant share from Visa nor restrained Visa's monopoly. Mastercard's participation in the online debit market has not translated into lower prices for consumers, and this appears unlikely to change. For example, Visa has long-term contracts with many of the nation's largest banks that restrict these banks' ability to issue Mastercard debit cards. Visa also has hamstrung smaller rivals by either erecting technical barriers, or entering into restrictive agreements that prevent rivals from growing their share in online debit, or both.

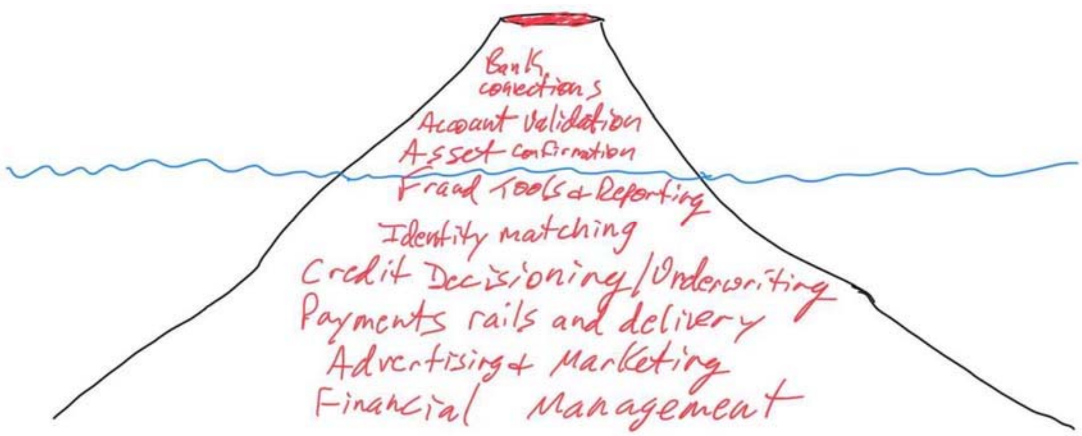
6. These entry barriers, coupled with Visa's long-term, restrictive contracts with banks, are nearly insurmountable, meaning Visa rarely faces any significant threats to its online debit monopoly. Plaid is such a threat.

7. Plaid is uniquely positioned to surmount these entry barriers and undermine Visa's monopoly in online debit services. Plaid powers some of today's most innovative financial technology ("fintech") apps, such as Venmo, Acorns, and Betterment. Plaid's technology allows fintechs to plug into consumers' various financial accounts, with consumer permission, to aggregate spending data, look up balances, and verify other personal financial information. Plaid has already built connections to 11,000 U.S. financial institutions and more than 200 million consumer bank accounts in the United States and growing. These established connections position Plaid to overcome the entry barriers that others face in attempting to provide online debit services.

8. While Plaid's existing technology does not compete directly with Visa today, Plaid is planning to leverage that technology, combined with its existing relationships with banks and consumers, to facilitate transactions between consumers and merchants in competition with Visa. Like Visa's online debit services, Plaid's new debit service would enable consumers to pay for goods and services online with money debited from their bank accounts. With this new

online debit service, Plaid intended to "steal[] share" and become a "formidable competitor to Visa and Mastercard." Competition from Plaid likely would drive down prices for online debit transactions, chipping away at Visa's monopoly and resulting in substantial savings to merchants and consumers.

9. Visa feared that Plaid's innovative potential – on its own or in partnership with another company – would threaten Visa's debit business. In evaluating whether to consider Plaid as a potential acquisition target in March 2019, Visa's Vice President of Corporate Development and Head of Strategic Opportunities expressed concerns to his colleagues about the threat Plaid posed to Visa's established debit business, observing: "I don't want to be IBM to their Microsoft." This executive analogized Plaid to an island "volcano" whose current capabilities are just "the tip showing above the water" and warned that "[w]hat lies beneath, though, is a massive opportunity – one that threatens Visa." He underscored his point by illustrating Plaid's disruptive potential:



10. Several months later, Visa had the opportunity to acquire Plaid. While conducting extensive due diligence, Visa's senior executives became alarmed to learn about Plaid's plans to add a "meaningful money movement business by the end of 2021" that would compete with Visa's online debit services. This prompted Visa's CEO to conclude that Plaid was "clearly, on their own or owned by a competitor going to create some threat to our important

US debit business" and to tell his CFO that purchasing Plaid would be an "insurance policy to protect our debit biz in the US."

11. In making the case to buy Plaid to Visa's Board of Directors, Visa's senior leadership estimated a "potential downside risk of $300-500M in our US debit business" by 2024 should Plaid fall into the hands of a rival. Visa understood that could create an "[e]xistential risk to our U.S. debit business" and that "Visa may be forced to accept lower margins or not have a competitive offering."

12. On January 13, 2020, Visa agreed to acquire Plaid in part to eliminate this existential risk and protect its monopoly in online debit. Visa offered approximately $5.3 billion for Plaid, "an unprecedented revenue multiple of over 50X" and the second-largest acquisition in Visa's history. Recognizing that the deal "does not hunt on financial grounds," Visa's CEO justified the extraordinary purchase price for Plaid as a "strategic, not financial" move because "[o]ur US debit business i[s] critical and we must always do what it takes to protect this business."

13. Monopolists cannot have "free reign to squash nascent, albeit unproven, competitors at will." *United States v. Microsoft Corp.*, 253 F.3d 34, 79 (D.C. Cir. 2001). Acquiring Plaid would eliminate the nascent but significant competitive threat Plaid poses, further entrenching Visa's monopoly in online debit. As a result, both merchants and consumers would be deprived of competition that would drastically lower costs for online debit transactions, leaving them with few alternatives to Visa's monopoly prices. Thus, the acquisition would unlawfully maintain Visa's monopoly in violation of Section 2 of the Sherman Act.

14. Visa's proposed acquisition also would violate Section 7 of the Clayton Act, which was "designed to arrest the creation of monopolies 'in their incipiency,'" *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 505 n.13 (1974), and similarly prohibits a monopolist from bolstering its monopoly through an acquisition that eliminates a nascent but significant competitive threat. The Supreme Court has explained that an acquisition can violate Section 7 when "the relative size of the acquiring corporation ha[s] increased to such a point that its advantage over its competitors threaten[s] to be 'decisive.'" *Brown Shoe Co. v. United States*,

370 U.S. 294, 321 n.36 (1962). Visa already has a decisive market position through its online debit monopoly, and would unlawfully extend that advantage by acquiring Plaid. For the reasons set forth in this Complaint, the proposed acquisition must be enjoined.

JURISDICTION

15. The United States brings this action under Section 15 of the Clayton Act, as amended, 15 U.S.C § 25, and Section 4 of the Sherman Act, 15 U.S.C. § 4, to prevent and restrain Visa from violating Section 2 of the Sherman Act, 15 U.S.C. § 2, and Defendants from violating Section 7 of the Clayton Act, 15 U.S.C. § 18. This Court has subject matter jurisdiction over this action under Section 15 of the Clayton Act, 15 U.S.C § 25, Section 4 of the Sherman Act, 15 U.S.C. § 4, and 28 U.S.C. §§ 1331, 1337.

16. Defendants Visa and Plaid are engaged in interstate commerce and in activities substantially affecting interstate commerce. Visa and Plaid sell online debit and data aggregation services throughout the United States. They are engaged in a regular, continuous, and substantial flow of interstate commerce, and their sales have had a substantial effect on interstate commerce.

17. This Court has personal jurisdiction over each Defendant. Both Visa and Plaid are corporations that transact business within this District through, among other things, their sales of online debit transactions and data aggregation services.

VENUE

18. Venue is proper in this district under Section 12 of the Clayton Act, 15 U.S.C. § 22 and 28 U.S.C. § 1391. Both Defendants are headquartered and transact business in this judicial District.

INTRADISTRICT ASSIGNMENT

19. Assignment to the San Francisco Division is proper. This action arises in San Francisco County because a substantial part of the events that gave rise to the claims occurred in San Francisco. Plaid's headquarters and principal place of business is located in San Francisco. Visa's headquarters are in San Mateo County; Visa has offices in San Francisco and is building new headquarters in San Francisco.

DEFENDANTS AND THE PROPOSED ACQUISITION

20. Visa Inc. is a Delaware company headquartered in Foster City, California. Visa is a global payments company that operates the largest debit network in the United States. Visa provides a two-sided transactions platform that authorizes, clears, and settles debit transactions between businesses, consumers, and banks. Visa reported revenues of approximately $23 billion in fiscal year 2019, including $10.3 billion in the United States.

21. Plaid Inc. is a Delaware company headquartered in San Francisco, California. Plaid operates the leading financial data aggregation platform in the United States. Its technology allows consumers to connect their bank account information to fintech apps, which enables fintechs to aggregate consumer spending data, look up account balances, and verify other personal financial information with consumer permission. Plaid's revenues have been growing rapidly and were almost $100 million in 2019.

22. On January 13, 2020, Defendants announced that Visa would acquire all of Plaid's voting securities for consideration valued at approximately $5.3 billion.

BACKGROUND

23. A debit transaction involves a multi-step process that results in the transfer of funds from a consumer's bank account into a merchant's bank account using the consumer's bank account credentials. When a consumer makes an online purchase using their debit card credentials (i.e. a debit card number, expiration date, and CVV/CVC number on the back of a debit card), a debit transaction withdraws funds from the consumer's bank account. The online merchant uses the consumer's credentials to send a request to the merchant's bank (the "acquiring" bank or "acquirer"), which in turn uses the debit network to send a request to the consumer's bank (the "issuing bank" or "issuer") to confirm whether the issuer will authorize the transaction. The issuer will typically authorize the transaction if there is a sufficient account balance to fund the transaction. If the transaction is authorized, the consumer's bank places a hold on the consumer's funds.

24. Debit networks – Visa, Mastercard, and a handful of smaller networks – operate the systems that transmit these messages. Once the consumer's issuing bank authorizes the transaction, the debit network also guarantees the funds to the merchant. Debit networks typically do not issue cards directly to consumers or establish card-accepting services with merchants. The debit networks typically contract with the acquiring and issuing banks, which in turn contract with merchants and consumers, respectively. The debit network also clears and oversees the interbank settlement process by aggregating all transactions each day for each bank in its system, netting out applicable fees, and providing daily settlement reports to the banks. With few exceptions, the debit networks are not themselves banks and do not move money; rather, the networks' settlement reports are used by the banks to transfer funds among themselves, typically using a wire service available only to banks.

A. Visa is a Monopolist in Online Debit Services

25. Visa is a monopolist among providers of online debit services, with a durable market share of approximately 70%.

26. Visa's next closest rival is Mastercard, which is around one-third the size of Visa in online debit. Mastercard has not constrained Visa's monopoly power by forcing it to lower prices to merchants and consumers. Merchants that accept debit payments have no choice but to accept Visa. In contrast to credit cards, most consumers carry only one debit card. A consumer with a Visa debit card cannot use a Mastercard debit card to withdraw funds from the same checking account.

27. Visa has secured long-term contracts with many of the largest financial institutions in the United States, fortifying the barriers that help maintain its monopoly. These contracts limit these financial institutions' ability to issue debit cards from Mastercard, Visa's only meaningful competitor for card issuance. Visa understands that Mastercard has little ability

to displace Visa's relationships with those financial institutions and consequently little ability to grow its share of consumers' wallets.

28. Merchants are charged two types of fees by Visa and its partner banks, both set by Visa: the "network" fees Visa collects to process the transaction, and the "interchange" fees that Visa compels merchants to pay the banks that issue Visa-branded debit cards. Taken together, the debit network and interchange fees that Visa and its partner banks collect cost U.S. merchants and consumers more than $6 billion per year.

29. While consumers do not pay Visa directly to use its payment network – and relatively few earn significant rewards on Visa debit transactions – consumers indirectly pay for Visa's transaction fees in the price of the goods and services they buy from merchants. In this way, Visa's excessive debit fees operate as a tax on merchants that is passed on to consumers and burdens the entire economy.

30. Recognizing the burden imposed by high debit fees and the barriers to competition in the market for debit transactions, Congress sought to "correct the market defects that were contributing to high and escalating fees" with the Durbin Amendment of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). The Durbin Amendment aimed to reduce high fees charged by debit networks with a regulatory cap and increase the number of meaningful debit competitors.

31. But the Durbin Amendment caps only interchange fees that accrue to Visa's large issuing banks, and does not regulate the network fees that accrue to Visa. As a result, Visa has responded by imposing new fees on merchants that undermine the effectiveness of the Durbin Amendment's fee caps. Even after enactment of the Durbin Amendment, Visa estimates that it earns an 88% operating margin from its network fees on debit payments, illustrating its durable monopoly power.

32. The Durbin Amendment also requires Visa and Mastercard debit cards to include a feature that allows merchants to process transactions using one of the so-called "PIN" debit networks. These smaller PIN networks, such as Accel, Star, NYCE, and Pulse, have some meaningful presence for in-person debit transactions, but have yet to overcome the barriers to

entry for online transactions. This is in part because Visa has erected technological barriers (such as Visa's tokenization service, which withholds essential data from PIN networks) and entered into restrictive agreements that disincentivize the use of PIN networks. As a result, merchants do not use PIN networks in any significant volume to process online transactions, and instead pay higher fees to use Visa and Mastercard networks.

B. Pay-by-Bank is a New Form of Online Debit Service that Threatens Visa's Monopoly

33. For the first time in many years, a new type of payments service is poised to take share away from Visa's online debit business. Pay-by-bank is a form of online debit that uses a consumer's online bank account credentials (i.e. a consumer's online banking username and password) – rather than debit card credentials – to identify and verify the user, bank, account number and balance, and facilitate payments to merchants directly from the consumer's bank account.

34. Pay-by-bank debit services are already widely available in other countries. A pay-by-bank platform facilitates consumer-to-business payments by providing equivalent end-to-end functionality as the Visa debit network: it authorizes payment from a consumer's bank account, facilitates communications with the consumer's bank to clear the transaction, and provides settlement services by initiating a payment to the merchant's financial institution. Pay-by-bank debit services can complete this final transfer of funds using Automated Clearing House ("ACH") or another low-cost alternative to Visa's debit network.

35. ACH enables settlement of transactions through money transfers over a network managed by two utility-like operators, one run by the Federal Reserve and the other operated by The Clearing House, which is owned by a consortium of banks. A pay-by-bank debit transaction using ACH settlement is usually much less expensive than a debit transaction processed by a card network like Visa.

36. Banks typically charge merchants flat rates ranging from two ($0.02) to twenty-five cents ($0.25) for ACH transactions, whereas Visa debit transactions typically cost twenty-two cents ($0.22) plus a percentage of the overall value of the transaction, which can be

significant. For example, merchants and consumers typically pay roughly thirty-nine cents ($0.39) to process a $60 debit transaction (the average online debit transaction size) through Visa's network, compared to as little as two cents ($0.02) through ACH, a 95% savings. By harnessing these savings using its best-in-class technology and existing relationships with banks and consumers, Plaid stands to save merchants and consumers hundreds of millions of dollars per year in debit fees.

C. Plaid is Uniquely Situated to Challenge Visa

37. Plaid's technology currently provides an easy interface for fintech apps to collect consumers' financial data, with consumer permission. When a consumer signs up with a Plaid-supported fintech app and provides her bank log-in credentials, Plaid uses those credentials to access the consumer's financial institution and obtain the consumer's financial data, which it transmits back to the fintech app. The data Plaid retrieves ranges from basic identifying information, such as account and routing numbers, to detailed transaction history and close to real-time account balance information. This data allows fintech apps to offer personal financial management tools, manage bill payments or other expenses, support loan underwriting, and transfer funds, among other uses. Plaid's services can also be used to reduce fraud by verifying the consumer's identity and account balance, examining the consumer's bank account history, assuring that a transaction is bona fide, and confirming that there are sufficient funds to cover a transaction at the time of payment.

38. Plaid is uniquely positioned to offer a pay-by-bank debit service that would compete with Visa's online debit services. Plaid already supports over 2,600 fintech apps, including 80% of the largest such apps in the United States, and has a network of more than 11,000 U.S. financial institutions. Plaid also connects to over 200 million consumer bank accounts through its existing services. Plaid's extensive existing connections with banks and consumers gives Plaid a substantial competitive advantage that cannot be easily replicated by other firms. It also helps Plaid surmount the chicken-and-egg barrier faced by potential entrants to online debit: Plaid already connects with millions of consumers' debit accounts, making them

an attractive partner for merchants looking for an alternative payments provider that has already built scale among consumers.

39. According to Visa, Plaid "has created a leading position of strength in the business of connecting financial institutions in the United States" and is "the preferred connector company by developers." Plaid is regarded by the industry as the best of breed among companies that provide similar services; no Plaid competitor provides the same high-quality connections to such a large number of fintech customers or financial institutions. Plaid's fintech customers are likely to stick with Plaid because they face substantial switching costs once they integrate with Plaid.

40. Plaid plans to build on the success of its current services by creating an "end-to-end payments network that enables instantly-guaranteed money movement" in a system "similar to Visa and Mastercard, but focused on bank-linked payments." Plaid's online pay-by-bank debit service would compete against Visa's online debit services. Plaid's service would give Plaid and other fintechs the capability to make a seamless pay-by-bank debit transaction, by providing a fraud risk score service, bank transfer service, and a consumer-facing interface allowing a consumer to easily switch from a debit card to pay-by-bank debit services during the online checkout process. Plaid has seen "strong interest from the field" for its fraud risk score and bank transfer services and is piloting them with multiple fintech customers.

41. Plaid's development of its own end-to-end pay-by-bank debit service directly threatens Visa's online debit business. Once deployed, Plaid's service would provide a reliable, less-expensive method of online debit payments by enabling consumers and merchants to transact for goods and services.

D. Visa Intends to Buy Plaid to Extinguish this Threat and Protect its U.S. Online Debit Monopoly

42. Visa made an initial investment in Plaid in early 2019. Through that investment, Visa executives learned more about Plaid and came to understand that Plaid posed a significant threat to Visa's debit business. Several months later, in September 2019, one of Plaid's co-founders telephoned Visa's President to inform him that Plaid was putting itself up for sale and

that Visa should expect to pay around $5 billion if it wanted to acquire Plaid. Visa saw that it had to act or risk Plaid falling into the hands of a rival that could use Plaid to compete against Visa in online debit.

43. Visa set to work verifying what makes Plaid a unique competitive threat. It identified Plaid's particular strengths through due diligence, spending thousands of hours reviewing all aspects of Plaid's business. Visa also confirmed that no other firm was in a position to replicate or displace Plaid. As Visa's Chief Product Officer explained, Plaid "has a head start in a network business and have been a highly compelling and attractive developer value proposition with 40% of American banks accounts enrolled – in the US they have a network moat." This view was shared by Visa's CEO, who described Plaid as "by far the best player in the space" with "a huge lead in the connector business."

44. As Visa learned more about Plaid's efforts to launch its own pay-by-bank debit service that would directly compete with Visa, its executives grew increasingly alarmed. During an early November 2019 meeting involving executives from both firms, Plaid's co-founder explained how Plaid's nascent technology would allow merchants to shift transactions easily from traditional forms of online debit to Plaid's pay-by-bank debit service. This prompted a senior Visa executive to report internally that Plaid's co-founder had "described the service with the joy of someone who forgot we had 70% share." Ultimately, Visa recognized that the best course of action for its business was to eliminate Plaid as a competitive threat by purchasing Plaid itself. In internal documents, a Visa executive observed that "[t]he acquisition is in part defensive, not just for Visa but also on behalf of our largest issuing [bank] clients, whom we believe have a lot to lose if [pay-by-bank transactions] accelerate as the result of Plaid landing in the wrong hands. It is in our collective interest to manage the evolution of these payment forms in a way that protects the commercial results we mutually realize through card-based payments."

E. Visa Has a History of Impeding Entry and Expansion into Online Debit Services

45. Visa's proposed acquisition of Plaid fits within an established pattern of Visa trying to thwart others from challenging its monopoly power. Specifically, Visa has a long history of protecting its monopoly in online debit by entering into contracts that forestall entry and coopt would-be rivals with lucrative partnerships. In addition to locking up many of the largest U.S. financial institutions with long-term, restrictive contracts that limit these banks' ability to issue debit cards from Visa competitors, Visa has entered into a number of "partnerships" that benefit Visa at the expense of merchants and consumers. This conduct has prevented cheaper, more efficient online debit options from gaining traction.

46. For example, in 2016, PayPal sought to divert business from traditional online debit providers like Visa by using lower-cost payment methods that moved money via ACH. In response, Visa publicly threatened to target PayPal "in ways people have never seen before." After issuing its threats, Visa induced PayPal to stop promoting alternative payment methods and to instead promote Visa debit in exchange for significant financial benefits. As Visa's Senior Vice President and Head of Product for North America explained, PayPal has been less of a threat to Visa's online debit business in recent years because "Visa and PayPal have figured out a way to be partners, as opposed to, sort of, direct competitors" and have found "ways to work together, as opposed to not work together."

47. In another example, Visa induced a major technology company to agree not to "build, support or introduce payment technologies that disintermediate Visa" in exchange for substantial fee reductions. In current negotiations to renew this ongoing agreement, Visa is demanding that the technology company continue to abide by Visa's exclusionary practices, including not encouraging customers to use less expensive payment methods and prohibiting "marketing to non Visa options during payment checkout."

48. Similarly, Visa recently pushed a large payment processor to limit its use of alternative payment methods because of the "strategic risk" those alternative payment methods present to Visa.

49. In addition, Visa has inhibited the adoption of alternative lower-cost networks for online debit by disincentivizing banks from enabling the use of alternative debit networks. Visa has also tied up merchants' abilities to select less expensive alternative networks for processing debit payments through restrictive rules and agreements, thereby helping Visa grow and maintain its monopoly in online debit.

50. Each of these actions has protected Visa's online debit monopoly from the threat of disruptive entrants, at the expense of merchants and consumers.

RELEVANT MARKET

A. Product Market

51. *Online debit transactions ("online debit").* Providers of online debit transactions serve as intermediaries between consumers and merchants, operating two-sided transactions platforms that facilitate online transactions between merchants and consumers from their respective bank accounts. Online debit payments are made from funds that are already present in a consumer's bank account instead of relying on a line of credit. Visa's traditional card-based debit network facilitates the transfer of funds between merchants and consumers by relying on a bank-issued debit credential to identify the consumer. Plaid provides an alternative mechanism to facilitate payments between consumers and merchants that uses a consumer's online bank login credentials to identify the consumer and facilitate payments via ACH.

52. The online debit market includes traditional online debit services and emerging pay-by-bank debit services. Both the traditional online debit services and new pay-by-bank debit services enable consumers to pay for goods and services directly from the funds in their bank accounts and merchants to accept payments drawn from consumer bank accounts.

53. Online debit in the United States constitutes a relevant product market under the antitrust laws. Few merchants or consumers would find alternative payment services to be a suitable substitute for online debit. Thus, there are no reasonable substitutes for online debit, and a firm that was the only seller of online debit services would be able to maintain prices above the level that would prevail in a competitive market.

54. In-person debit payments, known as "card present" payments, are not reasonably interchangeable because, unlike an online debit payment, the consumer must be physically present in a store or using a physical debit card at a payment terminal to make a card-present debit payment.

55. Credit card payments also are not reasonably interchangeable with online debit because debit payments draw from funds already in a consumer's bank account, rather than drawing from a line of credit. The distinction between credit and debit is widely accepted in the payments industry. Visa and other card networks have different pricing systems for debit and credit transactions, and the Durbin Amendment's limitations on transaction fees apply only to debit. Many consumers do not qualify for credit cards or have a strong preference for paying out of their existing funds rather than taking on debt to make purchases using a line of credit, which can be financially risky.

56. Payments made through basic ACH transfers offered by The Clearing House or the Federal Reserve are often used for disbursements, paychecks, interbank settlements, and recurring fixed payments like mortgage and tuition payments. A basic ACH transfer is not reasonably interchangeable for most online debit transactions. ACH transfers are inconvenient for consumers because they require a burdensome onboarding process in which the consumer must enter her bank account and routing information for each merchant, and then take steps to verify her account, which requires additional input and can take several hours or even days. ACH transfers are inconvenient for merchants because it takes two to three days to determine whether a payment is successful, and such transfers are more subject to fraud.

57. Cash payments are not reasonably interchangeable for online debit transactions because cash cannot be used for online payments. Checks are not reasonably interchangeable for online debit transactions because, like cash, checks are physical tokens that cannot readily be used for online payments.

58. Online debit transactions platforms are two-sided transactions platforms that exhibit a high degree of interdependency between consumers on the one side and merchants on the other. Consumers get more value from a network that connects to more merchants and

merchants get more value from a network that connects to more consumers. The online debit market is a two-sided market for transactions between merchants and consumers. The price for an online debit transaction takes both sides into account.

B. Geographic Market

59. The United States is the relevant geographic market. Both Visa and Plaid treat the United States as a distinct geographic market, as demonstrated in part by Visa's separate rules governing merchant acceptance in the United States and its separate pricing of online debit payments services to merchants in the United States. Federal laws and regulations that govern online debit transactions operate on a national level. A firm that was the only seller of online debit in the United States would be able to maintain prices above the level that would prevail in a competitive market.

ANTICOMPETITIVE EFFECTS

60. Visa has monopoly power in the online debit market, with a durable market share of approximately 70% that is protected by high barriers to entry.

A. Visa's Proposed Acquisition of Plaid Would Result in Higher Prices for Online Debit Transactions

61. Plaid's entry into online debit services as a pay-by-bank debit service would erode Visa's monopoly power by giving merchants and consumers a cheaper, more innovative alternative to Visa's online debit services. This would likely result in lower prices for online debit transactions and a higher volume of online debit transactions.

62. Because pay-by-bank fees to merchants are considerably lower than Visa's online debit fees, many merchants would likely seek to move online transactions from Visa's debit service to Plaid's pay-by bank debit service at the point of sale. Most consumers have only one debit card. Thus, when a consumer is making an online purchase directly from her bank account, she cannot switch between Visa debit and Mastercard debit using the same bank account – but she could switch to Plaid's pay-by-bank debit service during the checkout process. Consumer ability to switch payment options at the point of sale is one of the reasons why Plaid's pay-by-bank debit service poses such a significant threat to Visa even at its nascent stage. To minimize

losses to Plaid and defend its online debit volume, Visa would likely reduce the prices it currently charges for online debit transactions.

63. Indeed, Plaid recognizes that pricing for its pay-by-bank debit service "needs to be highly competitive with debit card pricing." Plaid has considered introducing certain components of its pay-by-bank debit service at a "50% reduction" compared to traditional debit and anticipates that merchants could save millions of dollars a year in fees by making it easier for consumers to switch away from card-based online debit. Plaid was upfront with Visa about its plans to undercut Visa's online debit prices. After meeting with Plaid executives in December 2019, Visa's Vice President of Corporate Development and Head of Strategic Opportunities expressed concern that if Visa did not buy Plaid "they will clearly come after the 'high prices' of interchange as they said several times yesterday and offer alternate payment methods."

64. Thus, as Visa itself has recognized, competition from Plaid would mean that prices for online debit transactions would fall. This would benefit merchants and ultimately consumers, who would pay less for goods and services as merchants pass on their savings. Consumers may also benefit from rewards or other incentives that merchants offer to induce switching to Plaid's pay-by-bank debit service.

65. But Visa's proposed acquisition of Plaid would forestall this competition, allowing Visa to maintain its monopoly position and supracompetitive prices for online debit.

B. Visa's Proposed Acquisition of Plaid Would Result in Less Innovation

66. Visa's proposed acquisition of Plaid also would eliminate a disruptive and innovative competitor. Visa viewed Plaid as a "threat . . . across multiple vectors of our business, including . . . as a potential payment network." If the acquisition were enjoined, Plaid – on its own or in combination with a company other than Visa – would continue to act as a disruptive competitor, developing and launching new, innovative solutions in competition with Visa. In the hands of Visa, this would change dramatically.

67. In contrast to an independent Plaid, Visa would have the incentive to raise the price of, degrade, delay, or shelve altogether Plaid's nascent pay-by-bank debit service because

such a service would cannibalize Visa's profitable online debit business. Indeed, Visa's CEO has already acknowledged that Visa has no intention of introducing Plaid's pay-by-bank debit service for consumer payments to merchants in the United States. Since inking the deal with Visa, Plaid has slowed its plans to pilot its pay-by-bank debit service with prospective merchant customers.

C. Visa's Proposed Acquisition of Plaid Would Raise Entry Barriers

68. As a monopolist with an approximately 70% market share in online debit, Visa has a strong incentive to continue to suppress entry by prospective rivals. It stands to lose more than any other participant in the online debit market from entry or expansion because any new pay-by-bank service is likely to compete away Visa's lucrative online debit transaction volume. As a result, Visa has a greater incentive than any other player in online debit to prevent or delay the emergence of potential competitors.

69. Acquiring Plaid would give Visa the ability to raise the already high entry barriers faced by competitors seeking to enter or expand into online debit payments, further entrenching Visa's monopoly power in online debit.

70. Through its ownership of Plaid, Visa would have a "[f]ront row seat to what is happening in the [f]intech world (e.g. which apps are growing, at what velocity and where)." With this insight into which fintechs are more likely to develop competitive alternative payments methods, Visa could take steps to partner with, buy out, or otherwise disadvantage these up-and-coming competitors. Plaid's current services "sit at the 'decision chokepoint' for many future payment flows." Owning Plaid would position Visa to insulate itself from competition, for example, by buying out or partnering with other fintechs before they can gain traction.

71. Further, Visa would be able to leverage its close relationships with issuing banks to disadvantage other would-be entrants. Both Visa and issuing banks profit from online debit payments. If the proposed transaction is not enjoined, Visa is likely to incentivize issuing banks to refuse to connect with competitors of Plaid, preventing other would-be entrants from threatening the profits that both Visa and issuing banks earn from high online debit transaction fees. Indeed, Visa has already communicated to U.S. banks that "[i]t is in our collective interest

to manage the evolution of these payment forms in a way that protects the commercial results we mutually realize through card-based payments."

72. Acquiring Plaid would also give Visa access to Plaid's enormous trove of consumer data, including real-time sensitive information about merchants and Visa's rivals. Consolidation of this data in Visa's hands could further raise barriers to entry and expansion. Visa could use that data to make it more difficult for others to enter or compete against Visa in online debit or to deter pro-competitive initiatives from rivals.

73. Overall, merchants and consumers stand to benefit from the lower cost of online debit transactions enabled by Plaid's innovative pay-by-bank debit service. Visa acquiring Plaid would diminish or eliminate those benefits, eradicate Plaid as a competitive threat, and raise entry barriers for future competitive threats, in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2 and Section 7 of the Clayton Act, 15 U.S.C. § 18.

LACK OF COUNTERVAILING FACTORS

74. Although Defendants have claimed that the proposed acquisition would generate synergies by combining the operations of Visa and Plaid, any cognizable efficiencies will not outweigh the merger's harm to competition in the relevant market. Visa concedes that there is "very little" about the deal that leads to cost synergies and "[i]n fact, it has cost dissynergies associated with it." Further, Visa's CEO has acknowledged that Visa has no plans to launch Plaid's pay-by-bank debit services for consumer payments to merchants.

75. Visa's proposed acquisition of Plaid would not result in verifiable, transaction-specific efficiencies in the relevant market sufficient to outweigh the transaction's likely anticompetitive effects. The proposed acquisition would harm competition overall in the relevant market. Moreover, the anticompetitive effects of Visa's proposed acquisition of Plaid outweigh any procompetitive benefits in the relevant market, and any procompetitive benefits can be achieved through less restrictive means.

VIOLATIONS ALLEGED

76. If allowed to proceed, Visa's proposed acquisition of Plaid would eliminate the nascent competitive threat that an independently owned Plaid poses to Visa's monopoly power

and unlawfully maintain Visa's monopoly power in the online debit market. The proposed acquisition constitutes monopolization in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2.

77. In addition, if allowed to proceed, the effect of Visa's proposed acquisition of Plaid "may be substantially to lessen competition, or to tend to create a monopoly" in the online debit market in the United States in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

78. Among other things, the transaction would:

(a) maintain Visa's monopoly power, giving Visa the power to raise prices and increase barriers to entry;

(b) eliminate nascent competition between Visa and Plaid;

(c) likely cause prices of online debit transactions to be higher than they would be otherwise; and

(d) likely reduce quality, service, choice, and innovation.

REQUEST FOR RELIEF

79. The United States requests:

(a) that Visa's proposed acquisition of Plaid be adjudged to violate Section 2 of the Sherman Act, 15 U.S.C. § 2;

(b) that Visa's proposed acquisition of Plaid be adjudged to violate Section 7 of the Clayton Act, 15 U.S.C. § 18;

(c) that the Defendants be permanently enjoined and restrained from carrying out the proposed acquisition of Plaid by Visa or any other transaction that would combine the two companies;

(d) that the United States be awarded costs of this action; and

(e) that the United States be awarded such other relief as the Court may deem just and proper.

Dated: November 5, 2020

Respectfully submitted,

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ATTORNEY ATTESTATION

I hereby attest, pursuant to Local Rule 5-1(i)(3), that the concurrence in the filing of this document has been obtained from the signatory indicated by the "conformed" signature (/s/) of John R. Read within this e-filed document.

/s/ John R. Read
John R. Read

Visa and Plaid Announce Mutual Termination of Merger Agreement

1/12/2021

SAN FRANCISCO--(BUSINESS WIRE)--Jan. 12, 2021-- Visa Inc. (NYSE: V) and Plaid today announced that the companies have terminated their merger agreement and agreed with the Department of Justice to dismiss the litigation related to the proposed transaction. The proposed transaction was first announced on January 13, 2020.

"We are confident we would have prevailed in court as Plaid's capabilities are complementary to Visa's, not competitive," said Al Kelly, Chairman and CEO of Visa Inc. "We believe the combination of Visa with Plaid would have delivered significant benefits, including greater innovation for developers, financial institutions and consumers. However, it has been a full year since we first announced our intent to acquire Plaid, and protracted and complex litigation will likely take substantial time to fully resolve."

Mr. Kelly added, "We are focused on accelerating our business by advancing our broader strategy and continuing to drive Visa's three growth pillars: consumer payments, new flows, and value added services. We have great momentum to build upon. Over the past year, our Visa Direct solution moved money around the world using multiple card, ACH and RTP networks, growing nearly 70 percent. In addition, our value added services revenue has grown in the mid-to-high-teens. We have great respect for Plaid and the business they have built and look forward to our continued partnership."

"This past year saw an unprecedented uptick in demand for the services powered by Plaid, and our priority is to support the hundreds of millions of people who now rely on fintech," said Zach Perret, CEO and co-founder of Plaid. "We made great strides last year, growing our customers by more than sixty percent and adding hundreds of banks to our platform. While Plaid and Visa would have been a great combination, we have decided to instead work with Visa as an investor and partner so we can fully focus on building the infrastructure to support fintech."

Webcast and Conference Call Information

Visa's executive management team will host a live audio webcast beginning at 5:00 p.m. Eastern Time (2:00 p.m. Pacific Time) today to discuss the announcement. All interested parties are invited to listen to the live webcast at http://investor.visa.com (https://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Finvestor.visa.com%2F&esheet=52360777&newsitemid=20210112006080&lan=en-US&anchor=http%3A%2F%2Finvestor.visa.com&index=1&md5=f372670deaa8d4b3a9bb06a42077ee2a). A replay of the webcast will be available for 30 days. Investor information is also available at http://investor.visa.com (https://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Finvestor.visa.com%2F&esheet=52360777&newsitemid=20210112006080&lan=en-US&anchor=http%3A%2F%2Finvestor.visa.com&index=2&md5=d0db6efb8a615d26fc335098506a5987).

About Visa Inc.

Visa Inc. (NYSE: V) is the world's leader in digital payments. Our mission is to connect the world through the most innovative, reliable and secure payment network - enabling individuals, businesses and economies to thrive. Our advanced global processing network, VisaNet, provides secure and reliable payments around the world, and is capable of handling more than 65,000 transaction messages a second. Our relentless focus on innovation is a catalyst for the rapid growth of digital commerce on any device, and a driving force behind the dream of a cashless future for everyone, everywhere. As the world moves from analog to digital, Visa is applying our brand, products, people, network and scale to reshape the future of commerce. For more information, visit usa.visa.com/about-visa.html (https://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Fusa.visa.com%2Fabout-visa.html&esheet=52360777&newsitemid=20210112006080&lan=en-US&anchor=usa.visa.com%2Fabout-

About Plaid

Plaid is a data network that powers the fintech tools millions of people rely on to live healthier financial lives. Plaid works with thousands of fintech companies like Venmo, SoFi, and Betterment, several of the Fortune 500, and many of the largest banks to make it easy for people to connect their financial accounts to the apps and services they want to use. Plaid's network covers 11,000 financial institutions across the US, Canada, UK and Europe. Headquartered in San Francisco, the company was founded in 2013 by Zach Perret and William Hockey.

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

OAKLAND DIVISION

UNITED STATES OF AMERICA, *Plaintiff* v. VISA INC. and PLAID INC., *Defendants*.	Case No.: 4:20-cv-07810-JSW **JOINT STIPULATION OF DISMISSAL**

In view of Visa Inc.'s and Plaid Inc.'s decision to terminate their Agreement and Plan of Merger dated January 12, 2020, that was the subject of this litigation, and pursuant to Federal Rule of Civil Procedure 41(a)(1)(A)(ii), the Parties file this stipulation of dismissal, signed by all parties that have appeared, stipulating and agreeing to dismissal of this action without prejudice.

SO STIPULATED:

Dated: January 12, 2021

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I, John R. Read, am the ECF user whose identification and password are being used to file the JOINT STIPULATION OF DISMISSAL. In compliance with Local Rule 5-1(i)(3), I hereby attest that all signatories hereto concur in this filing.

/s/ John R. Read
JOHN R. READ

Meta/Within

FEDERAL TRADE COMMISSION
PROTECTING AMERICA'S CONSUMERS

For Release

FTC Seeks to Block Virtual Reality Giant Meta's Acquisition of Popular App Creator Within

Agency Alleges that Meta and CEO Mark Zuckerberg are Attempting Illegal Acquisition to Expand Virtual Reality Empire

July 27, 2022

Tags: Competition | Bureau of Competition | Merger | Horizontal | Internet commerce | Technology

The Federal Trade Commission is seeking to block virtual reality giant Meta and its controlling shareholder and CEO Mark Zuckerberg from acquiring Within Unlimited and its popular virtual reality dedicated fitness app, Supernatural. Meta, formerly known as Facebook, is already a key player at each level of the virtual reality sector. The company's virtual reality empire includes the top-selling device, a leading app store, seven of the most successful developers, and one of the best-selling apps of all time. The agency alleges that Meta and Zuckerberg are planning to expand Meta's virtual reality empire with this attempt to illegally acquire a dedicated fitness app that proves the value of virtual reality to users.

"Instead of competing on the merits, Meta is trying to buy its way to the top," said FTC Bureau of Competition Deputy Director John Newman. "Meta already owns a best-selling virtual reality fitness app, and it had the capabilities to compete even more closely with Within's popular Supernatural app. But Meta chose to buy market position instead of earning it on the merits. This is an illegal acquisition, and we will pursue all appropriate relief."

The virtual reality industry offers a uniquely immersive digital experience and is characterized by a high degree of growth and innovation. Unlike content on a tablet, phone, or monitor, virtual reality gives users the perception of being completely surrounded as they move. Users typically engage with the virtual reality experience through a headset with displays in front of each eye to place them in a fully rendered, three-dimensional environment. Software and studio companies develop virtual reality apps that run on headsets and are distributed in online app stores. These apps run the gamut of genres from rhythm games to e-sports to creation and exploration and more.

Meta, the global technology behemoth that owns Facebook, Instagram, Messenger, and WhatsApp, is the largest provider of virtual reality devices, and also a leading provider of apps in the U.S. The complaint alleges that under the leadership of Zuckerberg, the company began its campaign to conquer virtual reality with the acquisition of headset manufacturer Oculus VR, Inc. Fueled by the popularity of its top-selling Quest headsets, Meta's Quest Store has become a leading U.S. app platform with more than 400 apps available for download.

In a publicly reported email to executives, Zuckerberg said that it was critical for the company to also be "completely ubiquitous in killer apps," which are apps that prove the value of the underlying technology. As part of its app expansion, Meta purchased seven of the most successful virtual reality development studios, and now has one of the largest first-party virtual reality content catalogues in the world. The acquisition of the Beat Games studio gave Meta control of the wildly popular app Beat Saber.

Within Unlimited is an independent virtual reality development studio that designed and built Supernatural, a popular app in the dedicated fitness virtual reality app market. Supernatural offers a variety of high-quality workouts set to music, including tracks from A-list artists like Katy Perry, Imagine Dragons, Lady Gaga, and Coldplay, and virtually located in striking, photorealistic locales, like the Galapagos Islands. The agency's complaint notes that according to Within's co-founder and CEO, "Fitness is the killer use case for VR."

The complaint alleges that Meta is a potential entrant in the virtual reality dedicated fitness app market with the required resources and a reasonable probability of building its own virtual reality app to compete in the space. But instead of entering, it chose to try buying Supernatural. Meta's independent entry would increase consumer choice, increase innovation, spur additional competition to attract the best employees, and yield other competitive benefits. Meta's acquisition of Within, on the other hand, would eliminate the prospect of such entry, dampening future innovation and competitive rivalry.

The complaint further alleges that the mere possibility of Meta's entry has likely influenced competition in the virtual reality dedicated fitness app market. If Meta is allowed to buy Within, that competitive pressure will slacken. That lessening of competition violates the antitrust laws, according to the complaint.

The complaint also alleges that when viewed against the broader backdrop of the market for all virtual reality fitness apps, Meta's proposed acquisition of Within is also illegal. Meta already participates in this broader market with its Beat Saber app, as does Within with its premium rival app Supernatural. The two companies currently spur each other to keep adding new features and attract more users, competitive rivalry that would be lost if this acquisition were allowed to proceed.

The Commission vote to authorize staff to seek a temporary restraining order and preliminary injunction was 3-2. Commissioners Noah Joshua Phillips and Christine S. Wilson voted no. A federal court complaint and request for preliminary relief has been filed in the U.S. District Court for the Northern District of California to halt the transaction.

The Federal Trade Commission works to promote competition, and protect and educate consumers. You can learn more about how competition benefits consumers or file an antitrust complaint. For the latest news and resources, follow the FTC on social media, subscribe to press releases and read our blog.

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Meta

The FTC's Attempt to Block Meta's Acquisition of Within Is Wrong on the Facts and the Law

July 27, 2022
By Nikhil Shanbhag, VP and Associate General Counsel, Competition and Regulatory

Takeaways

- Meta's acquisition of Within would be good for people and developers and would spark further interest in fitness as a growth area in VR.
- This deal brings more competition and innovation to VR more generally.
- The FTC is wrong on the facts and the law.

Today, the Federal Trade Commission (FTC) filed a lawsuit seeking to block Meta's planned acquisition of Within, the company behind the VR fitness app *Supernatural.*

The FTC's case is based on ideology and speculation, not evidence. The idea that this acquisition would lead to anticompetitive outcomes in a dynamic space with as much entry and growth as online and connected fitness is simply not credible. By attacking this deal in a 3-2 vote, the FTC is sending a chilling message to anyone who wishes to innovate in VR. We are confident that our acquisition of Within will be good for people, developers and the VR space.

There is No Merit to the FTC's Case

Under US law, the FTC is required to prove that an acquisition would "substantially lessen competition" in order to successfully block a deal. We believe it's clear that neither the evidence nor the well-established law will support such a result.

It's always been clear that our acquisition of Within will inject new investment into the VR fitness space, improve the Quest platform to better support all fitness apps and expand the VR ecosystem as a whole – all to the benefit of people and developers alike. The FTC rests its arguments on a number of flawed premises and unsupported assumptions that do not stand up to scrutiny.

First, they allege that *Supernatural* competes closely with Meta's *Beat Saber* app, which is a music and rhythm game, and that people would be harmed by bringing them together. But this position misunderstands the nature of the space entirely and ignores the market realities. *Beat Saber* is a game people play to have fun and it has many competitors. *Supernatural* couldn't be more different. It is a subscription-based virtual exercise service that offers boxing, flow, meditation and stretching workouts in the context of trainer-led sessions for a full body and wellness experience.

Supernatural competes far more closely with the many other fitness-specific VR apps (like *FitXR*, *Liteboxer*, and *Les Mills Body Combat*) and connected fitness more broadly (such as Peloton and many others). In reality, *Beat Saber* and *Supernatural* are fundamentally different products with different user bases, different use cases and different competitive dynamics. And this is not just our take – Within's leadership team strongly believes its competitors are the Pelotons and other established fitness brands of the world, not *Beat Saber* or other casual VR games.

Second, the FTC asserts, seemingly based on little more than Meta's size, that we would either build a fitness-specific service like *Supernatural* from scratch or somehow convert *Beat Saber* into such a service. But given the vastly different uses and audiences for these apps, and the fact that many other well-established brands like Apple and Peloton are far better positioned than Meta to bring their existing fitness products and content to VR, doing so wouldn't make any sense. Indeed, we looked into building a fitness-specific service and decided we simply weren't in a position to do so.

Third, the FTC believes that just the possibility that we might eventually develop our own VR fitness app somehow keeps existing participants in check and is reason enough to block this deal. But this ignores the reality that fitness-specific app developers, including *Supernatural*, don't see us as their current or future competition and are focused on the strong existing players in the space, the well-positioned recent actual entrants and the far more likely future entry from established online and connected fitness brands.

The FTC also insinuates that Meta is trying to buy VR apps in an effort to "control" the VR ecosystem. To the contrary: We have spent nearly a decade and invested billions of dollars in expanding the VR space, supporting and growing a viable and sustainable ecosystem for developers. With over a thousand apps having been built for Quest and the number earning over a million dollars in revenue having doubled year over year, it is clear that the ecosystem we are building is creating meaningful innovation opportunities. Unlike many of our competitors, we don't force developers or users into our store. We offer options like sideloading, linking to play VR content from PC, and App Lab, because we want to foster choice and competition in the VR ecosystem.

Finally, and maybe most importantly, VR is a rapidly growing and evolving space, and the fact that there are so many firms developing hardware and software shows that there is widespread belief in the promise of the technology. We've always recognized that success for the entire industry depends on having a vibrant and interconnected hardware and developer community. In such a world, the FTC has no answer to the most basic question — how could Meta's acquisition of a single fitness app in a dynamic space with many existing and future players possibly harm competition?

The FTC's Burden

The FTC must prove that our deal violates the law and that people and competition will be harmed. We don't believe their case can withstand the required scrutiny. The FTC has had nine months to investigate and we've cooperated throughout, including by producing millions of documents and reams of data in response to the FTC's Second Request, plus hundreds of pages of written responses. We also postponed the closing date of this transaction to August 1, 2022 at the FTC's request to give them even more time to consider this matter.

We are confident this transaction does not reduce competition in any way, will bring countless benefits to people and VR developers, and should therefore be allowed to proceed. At the end of the day, attempting to bar Meta from making acquisitions at all benefits *no one* — especially if the goal is to encourage innovation and competition. If this deal is allowed to go forward, we intend to invest significant resources in growing *Supernatural* to bring more innovation to a new and rapidly developing space, with room for many participants.

Categories:
Competition and Innovation, Meta, Public Policy

Tags: Virtual Reality

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July 7, 2022

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

META PLATFORMS, INC., et al.,

Defendants.

Case No. 5:22-cv-04325-EJD

AMENDED COMPLAINT FOR A PRELIMINARY INJUNCTION PURSUANT TO SECTION 13(B) OF THE FEDERAL TRADE COMMISSION ACT

REDACTED VERSION OF DOCUMENT SOUGHT TO BE SEALED

Plaintiff, the Federal Trade Commission ("FTC" or "Commission"), by its designated attorneys, petitions this Court for a preliminary injunction enjoining Defendants Meta Platforms, Inc., and its subsidiaries (collectively "Meta") from consummating its proposed acquisition (the "Acquisition") of Within Unlimited, Inc. ("Within"). The Commission seeks this relief pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b). Absent such relief, Meta and Within (collectively, "Defendants") have represented that they would be free to consummate the Acquisition after 11:59 p.m. Eastern Time (or 8:59 p.m. Pacific Time) on December 31, 2022.

Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), authorizes the Commission, whenever it has reason to believe that a proposed merger is unlawful, to seek preliminary injunctive relief to prevent consummation of a merger until the Commission has had an opportunity to adjudicate the merger's legality in an administrative proceeding. Preliminary injunctive relief is imperative to preserve the *status quo* and to protect competition while the Commission adjudicates whether the Acquisition is unlawful. The Commission initiated the administrative proceeding on the legality of the Acquisition under antitrust law, pursuant to Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21, and Section 5 of the FTC Act, 15 U.S.C. § 45, by filing an administrative complaint on August 11, 2022. Pursuant to FTC regulations, the administrative trial will begin on January 19, 2023. Allowing the Acquisition to proceed would harm competition and consumers and undermine the Commission's ability to remedy the anticompetitive effects of the Acquisition if the Commission issues an administrative complaint and the Acquisition is found unlawful after a full administrative trial on the merits and any subsequent appeals.

NATURE OF THE CASE

1. Meta, one of the largest technology companies in the world and the leading provider of virtual reality ("VR") devices and applications ("apps") in the United States, seeks to acquire Within, a software company that develops apps for VR devices, including the highly popular and rapidly growing fitness app "Supernatural." If consummated, the Acquisition would

substantially lessen competition, or tend to create a monopoly, in the relevant market for VR dedicated fitness apps. That lessening of rivalry may yield multiple harmful outcomes, including less innovation, lower quality, higher prices, less incentive to attract and keep employees, and less consumer choice.

2. A global technology behemoth, Meta reaches into every corner of the world through its "Family of Apps"—Facebook, Instagram, Messenger, and WhatsApp—with more than three billion regular users. Seeking to expand its empire even further, Meta in recent years has set its sights on building, and ultimately controlling, a VR "metaverse." One need look no further than the rebranding of the company from Facebook to "Meta" in 2021 to understand its vision—and its priorities—for the future. And Meta is serious about its goals: it has become the largest provider of VR devices and apps to customers in the United States.

3. Meta's campaign to conquer VR began in 2014 when it acquired Oculus VR, Inc., a VR headset manufacturer. Since then, Meta's VR headsets have become the cornerstone of its growth in the VR space: its current generation headset, the Meta Quest 2, is by far the most widely used VR headset today, with a significant majority of headset sales in 2021 and 2022. Meta CEO Mark Zuckerberg has publicly stated that Meta subsidizes its VR devices or sells them at cost in order to attract users.

4. And Meta's Quest Store (formerly Oculus Store) has become the leading distribution platform for VR software apps in the United States, connecting app developers and VR users in an online marketplace through which developers can offer their products to users for download onto their individual VR devices. Meta controls the wildly popular app Beat Saber, which it acquired by purchasing Beat Games in November 2019. Beat Saber [redacted] In addition to Beat Games, Meta owns a number of other VR apps, some of which it developed in-house but most of which it acquired by rolling up other app studios.

5. Meta has thus become a key player at each level of the VR ecosystem: in hardware with its Meta Quest 2 headset, in app distribution with the Quest Store, and in apps with Beat Saber and several other popular titles. This is not by accident; Meta has an explicit strategy of harnessing strong network effects in VR to ensure its leading status in this growing industry. Meta could have chosen to try to compete with Within on the merits; instead, Meta decided it preferred to simply buy the [redacted] in a vitally important, [redacted]

6. As Meta fully recognizes, network effects on a digital platform can cause the platform to become more powerful—and its rivals weaker and less able to seriously compete—as it gains more users, content, and developers. The acquisition of new users, content, and developers each feed into one another, creating a self-reinforcing cycle that entrenches the company's early lead. This market dynamic can spur companies to compete harder in beneficial ways by, for example, adding useful product features or hiring additional employees. But it can also make anticompetitive strategies more attractive.

7. Meta seeks to exploit the network-effects dynamic in VR. Indeed, Mr. Zuckerberg has made clear that his aspiration for the VR space is control of the *entire* ecosystem. As early as 2015, Mr. Zuckerberg instructed key Facebook executives that his vision for "the next wave of computing" was control of apps *and* the platform on which those apps were distributed, making clear in an internal email to key Facebook executives that a key part of this strategy was for his company to be "completely ubiquitous in killer apps"—i.e., in significant VR apps that prove the value of the technology. In that same email, Mr. Zuckerberg told his executives that Facebook should "us[e] acquisitions opportunistically."

8. The proposed acquisition of Within would be one more step along that path toward dominance. According to Within's co-founder and CEO, "Fitness is the killer use case for VR." But instead of choosing to compete on the merits through its own VR dedicated fitness app, Meta has resorted to proposing this unlawful acquisition.

9. If Meta is able to proceed with this proposed acquisition of Within, the merger poses a reasonable likelihood of substantially lessening competition in the market for VR dedicated fitness apps, where Supernatural is [redacted]

10. Having simply bought up the [redacted] Meta would no longer have any incentive to develop its own competing app from scratch, add new features to Beat Saber or other existing Meta apps to compete with Supernatural on the merits, or acquire a small generalist studio that could supplement Meta's considerable existing resources and VR know-how to develop an app to compete with Supernatural. Instead of adding a significant new rival to the mix, the Acquisition would simply let Meta assume total control of the [redacted] overnight. That lessening of competition violates the antitrust laws.

11. Moreover, a company poised on the edge of a market may exert competitive pressure on existing participants. Regardless of whether such a company actually intends to enter, the possibility that it may do so can spur other companies already in the market to proactively ramp up their own competitive efforts. Meta, poised on the edge of the VR dedicated fitness app market with its popular Beat Saber app, and with all its vast resources and unique strategic advantages, exerts such an influence. That pressure spurs the market leader, Within, to add new features, retain employees, continue innovating, and generally compete harder in order to stay a step ahead of Meta in the event it decides to enter. The Acquisition would eliminate that incentive for market participants to compete, again in contravention of the antitrust laws.

12. Accordingly, this Acquisition poses a reasonable probability of eliminating competition. That lessening of competition may result in reduced innovation, quality, and choice, less pressure to compete for the most talented app developers, and potentially higher prices for VR dedicated fitness apps. And Meta would be one step closer to its ultimate goal of owning the entire "Metaverse."

13. The Commission voted to file this Complaint seeking preliminary relief pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b). The Commission is entitled to preliminary

relief in this Court because of its likelihood of success on the merits and the weight of the equities. To succeed on the merits, the FTC must prove that the Acquisition violates Section 7 of the Clayton Act, which prohibits mergers the effect of which "may be substantially to lessen competition, or tend to create a monopoly." For the reasons described below, the FTC is likely to succeed in proving an antitrust violation, and the equities weigh strongly in favor of enforcing the antitrust laws.

14. On August 11, 2022, the Commission found reason to believe that the Acquisition would substantially lessen competition in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the FTC Act, 15 U.S.C. § 45. On August 11, 2022, the Commission commenced an administrative adjudication proceeding to determine whether the Acquisition is unlawful. An administrative trial before an Administrative Law Judge, is scheduled to begin on January 19, 2023. The ongoing administrative trial provides a forum for all parties to conduct discovery, followed by a merits trial with up to 210 hours of live testimony. *See* 16 C.F.R. § 3.41. The decision of the Administrative Law Judge is subject to appeal to the full Commission, which, in turn, is subject to judicial review by a United States Court of Appeals.

15. Preliminary injunctive relief restraining Defendants from proceeding with the Acquisition is necessary to prevent interim harm to competition during the pending administrative proceeding. Absent preliminary relief, Defendants can close the Acquisition and combine Meta's and Within's operations. Allowing Defendants to consummate the Acquisition before any administrative proceeding has concluded is likely to cause immediate harm to competition and consumers and would undermine the Commission's ability to remedy the anticompetitive effects of the Acquisition if it is found unlawful after a full trial on the merits and any subsequent appeals.

JURISDICTIONAL STATEMENT

A. Jurisdiction

16. This Court's jurisdiction arises under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and 28 U.S.C. §§ 1331, 1337, and 1345. This is a civil action arising under Acts of

Congress protecting trade and commerce against restraints and monopolies and is brought by an agency of the United States authorized by an Act of Congress to bring this action.

17. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), provides in pertinent part:

> Whenever the Commission has reason to believe—
>
> (1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and
>
> (2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public—
>
> the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond. . . .

18. Defendants and their relevant operating entities and subsidiaries are, and at all relevant times have been, engaged in activities affecting "commerce" as defined in Section 4 of the FTC Act, 15 U.S.C. § 44, and Section 1 of the Clayton Act, 15 U.S.C. § 12.

B. Venue

19. Venue in the Northern District of California is proper under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and 28 U.S.C. §§ 1391(b) and (c). Defendants are found, reside, and/or transact business in this state and district, and are subject to personal jurisdiction therein.

C. Intradistrict Assignment

20. Assignment to the San Francisco Division is proper. This action arises in San Mateo County because a substantial part of the events giving rise to these claims occurred in San Mateo County, where Defendant Meta is headquartered.

THE PARTIES AND PROPOSED ACQUISITION

21. Plaintiff, the Commission, is an administrative agency of the United States government, established, organized, and existing pursuant to the FTC Act, 15 U.S.C. §§ 41 *et seq.*, with its principal offices at 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580.

The Commission is vested with authority and responsibility for enforcing, *inter alia*, Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the FTC Act, 15 U.S.C. § 45.

22. Defendant Meta is a publicly traded company organized under the laws of Delaware with headquarters in Menlo Park, California. Meta develops and sells VR and other extended reality hardware and software through its "Reality Labs" division. Reality Labs has been growing at breakneck speed: it generated revenues of $2.274 billion in 2021, which reflected a 127% jump from 2019 and a 100% increase since 2020. Meta's best-selling VR hardware product to date is the Meta Quest 2, while its best-selling VR software product is the wildly popular Beat Saber, which was initially released by Beat Games, a studio that Meta acquired in 2019. Meta continues to add new downloadable content to Beat Saber; for example, it recently added a "Lady Gaga Music Pack" available for a $12.99 add-on fee.

23. Defendant Within is a privately held virtual and augmented reality company organized under the laws of Delaware with headquarters—and its principal business—in Los Angeles, California. Founded by Chris Milk and Aaron Koblin, Within's flagship product is Supernatural, a VR subscription fitness service. Supernatural offers over 800 fully immersive VR workouts, each set to music and located in a virtual setting like the Galapagos Islands or the Great Wall of China. Through deals with major music studios, Supernatural continues to grow its catalog, which includes songs from A-list artists like Katy Perry, Imagine Dragons, Lady Gaga, and Coldplay. Supernatural's workouts are fitness classes that customers can access by paying a monthly subscription fee of $18.99, or a yearly subscription fee of $179.99. Supernatural is presently only available on the Meta Quest and Quest 2 and is sold in the United States and Canada.

24. On October 22, 2021, Meta and Within signed an Agreement and Plan of Merger, pursuant to which Meta would acquire all shares of Within in a transaction valued at [redacted]

INDUSTRY BACKGROUND

25. The VR industry is currently characterized by a high degree of innovation and growth. Global sales are predicted to more than double in just three years, from $5 billion in 2021 to more than $12 billion in 2024.

26. Users typically engage with the VR experience through a headset with displays in front of each eye to place a user in a fully rendered, three-dimensional environment. Cutting-edge VR technology creates an immersive digital experience like no other. VR users can instantly be transported anywhere in the world, backward or forward in time, into outer space or fictional lands—all from the comfort and safety of their own homes. Unlike a game, video, or app on a tablet, phone, or monitor, the three-dimensional VR environment creates the perception of completely surrounding the user, allowing the user to move around in the projected space. As Mark Zuckerberg explains, "you're right there with another person or in another place and that's very different from every experience of technology that we've had before. . . ."

27. Meta's Quest 2 is the best-selling VR headset and has been since shortly after its launch in 2020. In 2020, Meta shipped more than 62% of all VR headsets sold worldwide. That percentage surged to 78% in 2021, when industry sources estimate that Meta sold more than 8.7 million Quest 2 headsets.

28. The majority of users get apps for VR headsets from online app stores, which distribute products for use on individual VR devices. Meta controls its own app store called the "Meta Quest Store," with more than 400 apps available for download. Meta also offers the "App Lab," a Meta-produced tool that allows third-party developers to distribute apps not present in the Meta Quest Store directly to consumers. Other VR app stores include Valve's Steam Store and SideQuest, but the Meta Quest Store is the leading VR app store in the United States.

29. VR software and studio companies like Within develop the apps that run on VR headsets. These apps run the gamut of genres from rhythm games to shooters to e-sports to creation and exploration and more.

30. [redacted] Meta's Beat Saber, an enormously popular rhythm game "where you slash the beats of adrenaline-pumping music as they fly towards you, surrounded by a futuristic world." Meta acquired control of Beat Saber through its purchase of Beat Games [redacted] in November 2019.

31. Since its acquisition of Beat Games, Meta has continued to acquire a series of studios behind many popular VR apps, and now boasts one of the largest first-party VR content organizations in the world:

a. In January 2020, Meta acquired Sanzaru games, maker of the fantasy Viking combat game Asgard's Wrath.

b. In May 2020, Meta acquired Ready at Dawn Studios, maker of Lone Echo II, a zero-gravity adventure game, and Echo VR, an online team-based sports game.

c. In April 2021, Meta acquired Downpour Interactive, maker of Onward, a team-based first-person shooter.

d. In May 2021, Meta acquired BigBox VR, maker of Population One, a multiplayer first-person arena shooter.

e. In June 2021, Meta acquired Unit 2 Games, the maker of Crayta, a collaborative platform that allows users to create and play their own games.

f. And, in November 2021, Meta acquired Twisted Pixel, a studio that makes various games, including Path of the Warrior (a fighting game), B-Team (a first-person shooter), and Wilson's Heart (a mystery noir thriller game).

32. In addition to the aforementioned acquisitions, Meta has developed and released its own VR apps. These include:

a. Horizon Worlds, a Massively Multiplayer Online game that allows users to build, share, and interact in virtual worlds;

b. Horizon Workrooms, a productivity app that lets teams of people share their computer screens, collaborate on virtual whiteboards, and more;

c. Horizon Venues, a live-events app that lets users experience concerts, sporting events, and more; and

d. Horizon Home, a social-space app that lets users hang out with their friends, watch videos together, and join multiplayer VR games together.

33. Among VR apps, dedicated or deliberate fitness is [redacted] As Within's co-founder and CEO puts it, "Fitness is the killer use case for VR." [redacted] platform-level tools such as Oculus Move, a calorie and time counter that runs in the background of other Quest apps and displays to users data about their activity levels while in VR. [redacted]

THE RELEVANT ANTITRUST MARKET

34. The Acquisition would substantially lessen competition or tend to create a monopoly in the relevant antitrust market for VR dedicated fitness apps in the United States ("VR Dedicated Fitness App market").

A. The VR Dedicated Fitness App Market

35. The VR Dedicated Fitness App market is the relevant product market. The market consists of VR apps, like Within's Supernatural app, that are designed so that users can exercise through a structured physical workout in their own homes.

36. [redacted]

37. Dedicated fitness apps offer distinct functionality when compared to other VR apps, including apps, such as rhythm and active sports games, that provide an incidental fitness benefit ("incidental fitness apps"). For example, they may feature adjusting difficulty so that users never "fail" a workout; they may feature workouts designed by trainers or fitness experts; they are designed to maximize exertion and physical movement for the purpose of exercise; and they may feature classes or other active coaching.

38. VR Fitness App market participants distinguish VR dedicated fitness apps from VR incidental fitness apps like rhythm and sports games that offer fitness benefits simply because they require users to move and physically exert themselves while engaging with the app. Dedicated fitness apps typically entail a higher degree of physical exertion than incidental fitness apps. According to the Virtual Reality Institute of Health and Exercise, which rates energy expenditures during VR app usage, Within's Supernatural currently has the highest energy expenditure, at 12–13 calories per minute.

39. VR dedicated fitness apps are also typically offered using a distinct, subscription-based pricing model. Industry participants recognize that this is a distinguishing characteristic of dedicated fitness VR apps when compared to other VR apps, including incidental fitness apps.

40. [redacted]

41. The VR Dedicated Fitness App market does not include other products that are neither close substitutes for, nor offered under similar competitive conditions as, VR dedicated

fitness apps. For example, it does not include non-VR at-home smart fitness solutions, such as digitally connected exercise bikes, treadmills, weight machines, mobile phone apps, video games, or workout videos.

42. Functional, practical, technological, and price differences show that non-VR at-home smart fitness solutions and at-home exercise products are distinct from VR dedicated fitness apps.

43. VR offers a level of immersion that other at-home fitness experiences do not, and cannot, offer. VR technology allows users to exercise from the comfort, privacy, and safety of home with the feeling and visuals of being somewhere else—atop a mountain, on a tropical island, in a futuristic world, virtually anywhere. The sensors in a VR headset and controllers also allow for a degree of tracking, adjustment, and feedback that non-immersive exercise programs cannot match. As Within's co-founder and CEO explained, "[W]orking out in Supernatural feels like you're a champion of a sport from the future. I love that and haven't felt that sense of athleticism ever on a treadmill or an exercise bike."

44. There also tend to be substantial price differences between VR fitness and smart at-home fitness products. Most smart at-home fitness solutions have much higher up-front costs and much higher ongoing costs than current VR fitness apps. A Peloton smart bicycle, for example, costs over $1,000, with an additional $44 per month subscription cost, compared to the cost of a $299 Meta Quest 2 plus $18.99 per month for Supernatural. It also weighs 135 pounds.

45. In addition to Supernatural, other apps in the VR Dedicated Fitness App market include FitXR, Holofit from Holodia, VZFit from Virzoom, and Les Mills Body Combat from Odders Lab.

46. [redacted] Other than Supernatural and FitXR, [redacted]

B. The Relevant Geographic Market

47. The relevant geographic market in which to analyze the competitive effects of the Acquisition is the United States. While VR app suppliers may be located outside the United States, customers in the relevant markets affected by the Acquisition are located in the United States. The availability of VR apps and headsets for consumers varies by country, and VR consumers in the United States can only buy headsets and apps that are available in the United States. Industry participants recognize the United States as a market.

<u>MARKET CONCENTRATION</u>

48. The VR Dedicated Fitness App market is highly concentrated.

49. Market concentration within a properly defined relevant antitrust market is a useful indicator of the competitive effects of a merger. The 2010 U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines ("Merger Guidelines") measure market concentration using the Herfindahl–Hirschman Index ("HHI"). The Merger Guidelines outline the principal analytical techniques, practices, and enforcement policy of the FTC and Department of Justice with respect to mergers involving competitors. Though the Merger Guidelines are not binding on the courts, courts frequently cite the Merger Guidelines as persuasive authority.

50. The HHI for a given market is calculated by summing the squares of the individual firms' market shares. HHIs range from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). A market HHI above 2,500 is classified as highly concentrated.

51. If a merger combines two participants in a relevant market, thereby increasing the HHI by more than 200 points and resulting in a highly concentrated market, it is presumed to enhance market power and is, therefore, presumptively unlawful.

52. The market for VR Dedicated Fitness Apps is highly concentrated, [redacted]

53. Supernatural [redacted]

54. The VR Dedicated Fitness App market HHI has been well above the thresholds for a market to be considered "concentrated" or "highly concentrated" under the Merger Guidelines.

EVIDENCE OF LIKELY ANTICOMPETITIVE EFFECTS

55. In addition to this presumption of illegality, additional evidence indicates that the Acquisition may substantially lessen competition in the relevant market for VR dedicated fitness apps.

A. Anticompetitive Effects in the VR Dedicated Fitness App Market

56. The Acquisition would cause anticompetitive effects by eliminating potential competition from Meta in the relevant market for VR dedicated fitness apps. These include eliminating any probability that Meta would enter the market through alternative means absent the Acquisition, as well as eliminating the likely and actual beneficial influence on existing competition that results from Meta's current position, poised on the edge of the market. As the Merger Guidelines explain, "A merger between an incumbent and a potential entrant can raise significant competitive concerns."

1. It Is Reasonably Probable That Meta Would Have Entered the VR Dedicated Fitness App Market Through Alternative Means Absent This Acquisition

57. Meta has the economic characteristics, size, resources, capabilities, advantages, and incentives to enter the VR Dedicated Fitness App market—and it has seriously considered

doing so—by means other than this Acquisition. Meta could have chosen to build a VR dedicated fitness app from scratch, add dedicated fitness functionality to an existing app, and/or acquire a smaller studio that could support and supplement Meta's existing strengths to facilitate its entry.

58. Consistent with its long-term strategy for its VR devices to become a widely used platform that it ultimately will control, Meta has committed tens of billions of dollars to its Reality Labs division, which develops its VR and AR products, including more than $7.7 billion in 2020, $12.4 billion in 2021, and $3.6 billion in the three-month period ending in March 2022. Meta is already well on the way to realizing Mr. Zuckerberg's goals of owning both the dominant platform and the "killer apps" on that platform. Meta already produces the best-selling VR headset in the United States by a wide margin. Meta's Quest Store is the leading distribution platform of VR apps. And Meta is the leading seller of VR apps, with a portfolio that includes Beat Saber, the market-leading VR fitness app, and Horizon Worlds, a massive social app that features its own game-creation tools for users.

59. Meta has the financial resources to develop a dedicated fitness app on its own—either by creating a new app or by adding new features to an existing app such as Beat Saber. It also has more than enough resources to enter the market through acquiring a generalist studio that could supplement Meta's formidable first-party studios group in developing a VR dedicated fitness app.

60. In 2021, Meta had an annual profit of $46.7 billion, and spent more than $12 billion on its Reality Labs division.

61. With its vast financial resources, Meta continues to add features and content to the apps it has already released, and to develop and release new apps. Meta has also developed multiple full-featured VR apps in-house. What's more, the [redacted] it proposes to spend on this acquisition is [redacted] During that time and on that budget, Within built Supernatural from the ground up into the [redacted] VR dedicated fitness app.

62. Meta could build instead of buy within a reasonable period of time if it could not proceed with this Acquisition. Indeed, [redacted]

63. Meta has developed multiple VR apps from scratch before, including the ambitious Horizon Worlds, which allows users to create and explore virtual worlds; Horizon Workrooms, an app that lets Meta test out new use-cases and platform-level features in the emerging VR productivity category and allows users to connect and collaborate in real-time; the Horizon Venues live-events app; and the Horizon Home social-space app.

64. Meta has also developed and released Oculus Move, a platform-level fitness tracker on the Oculus Quest that allows users to track active time and calories burned across apps.

65. Through its string of prior acquisitions, Meta already owns seven of the most successful VR development studios in the world, including Beat Games, the studio behind Beat Saber. And, as of March 2021, Meta had nearly 10,000 employees housed within Reality Labs, its division devoted to virtual reality.

66. Meta's control over the Quest platform also gives it unique access to VR user data, which it uses to inform strategic decisions.

67. In addition, Meta controls which VR apps appear and are featured in its Quest Store. This control guarantees that Meta could reach millions of existing VR users with a built-from-scratch or expanded app through an especially important avenue for consumer discovery.

68. Meta—formerly known as "Facebook Inc."—rebranded its entire business as "Meta" to reflect its focus on VR. Its brands, including Meta and Quest, are well-known to VR users. Meta also has substantial marketing experience as to a wide range of VR apps, including Beat Saber, that it could leverage to enter the VR Dedicated Fitness App market. Indeed, users

already associate Meta's Beat Saber app with incidental fitness. This "name awareness" would facilitate Meta's organic entry into the VR Dedicated Fitness App market, as a dedicated fitness-oriented version of Beat Saber would be in line with users' understanding of the Beat Saber brand.

69. Meta also has incentives to enter the VR Dedicated Fitness App market.

70. [redacted]

71. Meta is well aware that fitness VR apps could enable it to reach new categories of consumers. [redacted]

72. [redacted]

73. [redacted]

74. [redacted]

75. [redacted]

76. [redacted]

77. [redacted]

78. [redacted]

79. Thus, not surprisingly, after Meta's acquisition of Beat Games and immediately prior to the launch of Supernatural, Beat Saber released a new track called "FitBeat," which included virtual "walls" or "obstacles" that users would have to dodge. [redacted] Obstacles also appear on other tracks, forcing users to duck and dodge, but they can be turned off.

80. [redacted] has already included both a 360-degree mode where targets come from all sides and a no-fail mode that allows users to complete tracks despite missing blocks in

recent updates—a feature that fitness-focused users can adopt to ensure an uninterrupted workout.

81. [redacted]

82. [redacted]

83. In fact, Meta's internal codename for the proposed acquisition of Within was "Project Eden," a reference to its belief that Apple was also interested in acquiring Within.

84. Meta also hired away the head of product for Supernatural at Within to work at Meta following the Supernatural launch. That individual's portfolio at Meta included expanding Meta's presence into new verticals, including the VR fitness vertical.

85. [redacted]

86. [redacted]

87. Accordingly, absent this anticompetitive Acquisition, there is a reasonable probability that Meta would have exercised one of its other available options to enter the VR Dedicated Fitness App market.

2. It is Reasonably Probable That Alternative Entry by Meta Would Substantially Deconcentrate the Market and Have Other Procompetitive Effects

88. Meta's entry into the VR Dedicated Fitness App market—whether by adding new features to one of its existing apps or developing a new VR dedicated fitness app from scratch—would have the effect of substantially deconcentrating and increasing competition in the market.

89. Building instead of buying would entail developing additional expertise, undertaking product research and design, hiring more employees, and making other key investments. Meta recognizes that building its own VR dedicated fitness app would require time, additional developer talent, and effort. But such efforts would reflect the very essence of competition, the dynamic that the antitrust laws seek to protect and promote.

90. Alternative entry by Meta would introduce a new competitor into the market with the backing of one of the world's largest, most well-resourced, and most experienced VR industry participants. Such entry would increase consumer choice, increase innovation, spur additional competition to attract the best employees, and yield a host of other competitive benefits. Crucially, it would *also* maintain the independent presence and competitive vitality of the [redacted] VR dedicated fitness app [redacted] Supernatural.

91. The Acquisition would eliminate the probability of such entry, potentially dampening future innovation and leading to a market with less beneficial rivalry and competitive pressure.

3. Within Reasonably Perceived Meta as a Potential Entrant to the VR Dedicated Fitness App Market

92. In light of Meta's economic characteristics, size, resources, capabilities, advantages, and incentives, it would be eminently reasonable for a VR dedicated fitness app market participant to perceive Meta as a potential entrant.

93. As explained in detail above, Meta is a massive, wealthy company with extensive control over and experience in various aspects of the VR industry. It has recently expanded into a variety of VR-related areas, including by acquiring the most popular VR incidental fitness app (Beat Saber) and by internally developing a system-level fitness tracking tool that can run in the background of other apps (Oculus Move). In a recent earnings report, Meta announced that it anticipated spending some $10 billion across its Reality Labs division, which has found its biggest success to date with the Quest 2 Headset and Quest Store, and that it is committed to increasing those investments over the next several years. The VR dedicated fitness app market is especially attractive for a host of reasons, giving Meta a strong incentive to enter it. And Meta internally identified multiple means of entering the VR dedicated fitness app market.

94. [redacted]

95. [redacted]

96. Meta also lured away Within's head of product for Supernatural shortly after Supernatural's launch.

4. Meta's Presence as a Perceived Potential Entrant Likely Influences Competition in the VR Dedicated Fitness App Market

97. [redacted] The Acquisition would eliminate that competitive influence.

98. [redacted]

99. [redacted]

100. [redacted]

101. [redacted]

[redacted]

102. [redacted] That competitive pressure—and all of the benefits it yields—would be eliminated by the Acquisition.

LACK OF COUNTERVAILING FACTORS

103. Defendants cannot demonstrate that new entry or expansion by existing firms will be timely, likely, or sufficient to offset the anticompetitive effects.

104. There are multiple barriers to entering or expanding in the relevant market, including time, network effects, ongoing development and content creation costs, post-launch support, capital, brand recognition, and the need for consumers to be able to discover the app. Developing a high-quality entrant also requires hiring the "talent needed to create true triple-A VR experiences," talent that Meta acknowledges is increasingly scarce.

105. To be sold on the Quest store, Meta itself must decide to approve an app through a technical review and a curation process by Meta that examines "quality, polish, entertainment, value, and utility." This can be a lengthy process and there is no guarantee any third-party app will ultimately be approved.

106. No other company has the combination of resources, VR know-how, and control over the leading app store and the overall Quest VR experience that Meta has.

107. Once Meta—which also owns the Quest platform and app store—entrenches [redacted] in VR dedicated fitness through the Acquisition, it will effectively raise barriers to entry and expansion as other companies interested in the space will understand that they need to compete with a deep-pocketed platform operator that owns the [redacted] VR dedicated fitness app.

108. Defendants cannot demonstrate cognizable, verifiable, transaction-specific efficiencies that would be sufficient to reverse the strong presumption and evidence of the Acquisition's likely significant anticompetitive effects.

LIKELIHOOD OF SUCCESS ON THE MERITS,

BALANCE OF THE EQUITIES, AND NEED FOR RELIEF

109. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), authorizes the Commission, whenever it has reason to believe that a proposed merger is unlawful, to seek preliminary injunctive relief to prevent consummation of a merger until the Commission has had an opportunity to adjudicate the merger's legality in an administrative proceeding. In deciding whether to grant relief, the Court must balance the likelihood of the Commission's ultimate success on the merits against the equities, using a sliding scale. The principal equity in cases brought under Section 13(b) is the public's interest in effective enforcement of the antitrust laws. Private equities affecting only Defendants' interests cannot tip the scale against a preliminary injunction.

110. The Commission is likely to succeed in proving that the effect of the Acquisition may be substantially to lessen competition or tend to create a monopoly in violation of Section 7 of the Clayton Act or Section 5 of the FTC Act.

111. Preliminary relief is warranted and necessary. Should the Acquisition ultimately be adjudicated unlawful, reestablishing the status quo would be difficult, if not impossible, if the Acquisition has already occurred in the absence of preliminary relief. Allowing the Acquisition to close before the completion of the administrative proceeding would cause irreparable harm by, among other things, enabling the combined firm to begin altering Within's operations and business plans, accessing Within's sensitive business information, eliminating key Within personnel, changing Within's product development efforts, and preventing Within from raising the funding necessary to continue operations and maintain its growth trajectory. In the absence of relief from this Court, substantial harm to competition would occur in the interim.

112. Accordingly, the equitable relief requested here is in the public interest. The Commission respectfully requests that the Court:

113. Preliminarily enjoin Defendants from taking any further steps to consummate the Acquisition, or any other acquisition of stock, assets, or other interests of one another, either directly or indirectly;

114. Retain jurisdiction and maintain the *status quo* until the administrative proceeding initiated by the Commission is concluded; and

115. Award such other and further relief as the Court may determine is appropriate, just, and proper.

Dated: October 7, 2022

Respectfully submitted,

/s/ Abby L. Dennis
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United States District Court
Northern District of California

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

FEDERAL TRADE COMMISSION,
Plaintiff,
v.
META PLATFORMS INC., et al.,
Defendants.

Case No. 5:22-cv-04325-EJD

ORDER DENYING PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION

Re: ECF Nos. 108, 164, 470

This action was brought by Plaintiff Federal Trade Commission ("FTC") to block the merger between a virtual reality ("VR") device provider and a VR software developer. Defendant Meta Platforms Inc. ("Meta") has agreed to acquire all shares of Within Unlimited, Inc. ("Within," collectively with Meta, "Defendants"). The FTC has come before the Court to seek preliminary injunctive relief pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to enjoin Defendants from consummating their proposed merger (the "Acquisition") pending the outcome of ongoing administrative proceedings before the FTC. ECF Nos. 101, 164.

In addition to the FTC's motion for preliminary injunction, Defendants have filed a motion to dismiss the Amended Complaint ("FAC") and a motion to strike the opinion of the FTC's expert, Dr. Hal J. Singer, regarding the relevant product market definition. ECF Nos. 108, 470.

Over the course of a seven-day evidentiary hearing, the Court heard the parties' arguments and evidence. The Court has also received briefing on all pending motions, as well as pre-hearing and post-hearing submissions of the parties' proposed findings of fact. Having considered the parties' submissions and evidence, the Court DENIES Defendants' motion to dismiss, DENIES the Defendants' motion to strike, and DENIES the FTC's motion for preliminary injunction.

I. FACTUAL FINDINGS

A. Defendant Meta Platforms, Inc.

1. Defendant Meta Platforms, Inc. is a publicly traded corporation organized under Delaware law and headquartered in Menlo Park, California. DX1237, at 11. Meta operates a collection of social networking platforms referred to as its "Family of Apps," which includes Facebook, Instagram, Messenger, and WhatsApp. PX0937, at 51. Meta also manufactures VR devices, such as the Quest 2 and the Quest Pro headsets, through its Reality Labs division. Stojsavljevic Hr'g Tr. 71:2–13; 74:10–19.

2. VR technology enables users to experience and interact with a digitally generated three-dimensional environment by wearing a headset with stereoscopic displays in front of each eye. Stojsavljevic Hr'g Tr. 72:25–74:9. Users can download a wide variety of VR software applications ("apps") from digital marketplaces, or app stores, for use on their personal VR devices. Pruett Hr'g Tr. 219:19–25. Quest headsets are designed so that a user's geolocation determines what content is available and at what price. Stojsavljevic Hr'g Tr. 79:23–80:6.

3. In 2020, 2021, and 2022, Meta spent several billion dollars each year on its VR Reality Labs division. Zuckerberg Hr'g Tr. 1280:9–1282:15.

4. Meta operates an app store called the Quest Store, previously known as the Oculus Store. Third-party app developers can request to have their app distributed in the Quest Store, and Meta also actively seeks out and invites developers to bring apps to the Quest Store. Stojsavljevic Hr'g Tr. 79:16–22; Pruett Hr'g Tr. 220:8–13. Apps must meet several content, technical, and asset requirements before they may be considered for listing on the Quest Store; however, Meta may still reject an app that meets all the requirements pursuant to the Quest Store's curation policy. Pruett Hr'g Tr. 220:25–223:16. Apart from the Quest Store, Meta also operates App Lab, an app distribution service for VR applications that meet basic technical and content requirements but is otherwise free from any editorial curating by Meta. Pruett Hr'g Tr. 260:16–22. Quest users can also download VR apps from other app stores on VR platforms that Meta

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does not own, such as SideQuest and Steam VR Store. Pruett Hr'g Tr. 274:8–21.

5. The content and apps that are available for a particular VR system plays an important role in the widespread adoption of that system, and many users may purchase a VR system for specific content they want to experience. Zuckerberg Hr'g Tr. 1294:16–125:2; Stojsavljevic Hr'g Tr. 101:6–13, 101:21–27. As a result, high quality and popular VR apps—dubbed as "system sellers"—can drive adoption and sales of the specific headsets for which they are available. Stojsavljevic Hr'g Tr. 107:23–108:5. Broad adoption of a specific VR system, in turn, will attract third-party app developers to create more VR content for that system, a phenomenon referred to as a "flywheel" effect. PX0100, at 2–3; Bosworth Hr'g Tr. 1048:21–1049:3.

6. When a VR app is developed wholly by a developer unaffiliated with Meta, Meta refers to that as third-party ("3P") development. When Meta funds all or most of a VR app's development, Meta refers to that as second-party ("2P") development. When a VR app is developed in-house at Meta, either by acquired VR studios or Meta employees themselves, Meta refers to that as first-party ("1P") development. Stojsavljevic Hr'g Tr. 72:12–16; 106:16–21.

7. Meta encourages third-party VR app developers to build apps for the Quest platform by providing funding and technical VR engineering assistance to those developers. Stojsavljevic Hr'g Tr. 106:5–15. Specifically, Meta provides grants that are designed to improve existing VR software or incentivize the development of software on Quest that may only exist on another platform. Meta also maintains a developer relations engineering team consisting of veteran engineers who work directly with developers to improve software quality, fix bugs, or polish the experience they are building. Pruett Hr'g Tr. 285:19–286:12. Meta's VR content organization spends approximately [redacted]. PX0066 ("Rubin Dep.") 24:5–25:8.

8. In addition to providing funding or engineering support to third-party VR app developers, Meta has also sought to increase the VR app content available on its platform by acquiring third-party app developers and developing its own apps internally. PX0055 ("Verdu Dep.") 117:5–118:12.

9. Although decisions may be made on a case-by-case basis, Meta typically will seek to acquire or build its own VR app if: [redacted] PX0127, at 4–5.

10. Similarly, Meta is more inclined to build its own VR app instead of acquiring an existing third-party developer [redacted] PX0127, at 5.

11. In the past three years, Meta has acquired at least nine VR app studios: Beat Games, Sanzaru Games, Ready at Dawn Studios, Downpour Interactive, BigBox VR, Unit 2 Games, Twisted Pixel, Armature Studio, and Camouflaj. Stojsavljevic Hr'g Tr. 87:5–88:2.

12. The VR apps that Meta has independently developed and released include Horizon Worlds (world building), Horizon Workrooms (productivity), Horizon Venues (live events), and Horizon Home (social networking). Meta's Answer and Affirmative Defenses ¶ 35, ECF No. 84. Meta's background and emphasis has been on communication and social VR apps. Zuckerberg Hr'g Tr. 1273:15–1274:22. That said, Meta has also developed and released Dead and Buried, a multiplayer shooter game. Bosworth Hr'g Tr. 1051:18–20.

B. Defendant Within Unlimited, Inc.

13. Defendant Within Unlimited, Inc. is a privately held corporation organized under the laws of Delaware with headquarters in Los Angeles, California. PX0006, at 1, 161. Within is a software development company founded by Chris Milk and Aaron Koblin, who were experienced visual artists. Milk Hr'g Tr. 669:25–670:6; Koblin Hr'g Tr. 649:9–13.

14. Within's flagship product is Supernatural, a subscription VR fitness service launched in April 2020 on the Quest Store. PX0005, at 77. Supernatural releases new workouts daily and continues to add new modalities (*e.g.*, aerobic boxing, meditation) to its lineup of workouts. Koblin Hr'g Tr. 605:15–606:4; Milk Hr'g Tr. 734:1–11. Users access Supernatural's workouts by paying a monthly subscription fee of $18.99 or an annual subscription fee of $179.99. FAC ¶ 24, ECF No. 101-1; Within's Answer and Affirmative Defense ¶ 25, ECF No. 83. [redacted] Koblin Hr'g Tr. 636:15–22; Milk Hr'g Tr. 735:17–21. Within has never changed Supernatural's prices. Carlton Report ¶ 77. At present, [redacted] Milk Hr'g Tr. 735:20–21.

C. The Alleged "VR Dedicated Fitness App" Market

15. The FTC alleges that the relevant market consists of VR dedicated fitness apps in the United States. Mot. 13, ECF No. 164. The government defines "VR dedicated fitness apps" as VR apps that are "designed so users can exercise through a structured physical workout in a virtual setting anywhere they choose to use their highly portable VR headset." *Id.*

16. Both Meta and Within have repeatedly referred to VR apps intended to provide immersive at-home structured physical exercise as "deliberate" or "dedicated" fitness apps. *E.g.*, Rabkin Hr'g Tr. 831:12-24; PX0001, at 5; PX0286, at 1; Milk Hr'g Tr. 681:19-21; PX487, at 4; Pruett Hr'g Tr. 263:6–264:2; PX0004, at 169. Meta now describes these apps as "trainer workout apps." PX0060 ("Paynter Dep.") 24:2–12, 56:14–23. VR dedicated fitness apps are sometimes called "VR deliberate fitness apps" or "trainer workout apps." The Court will use the phrase "VR dedicated fitness apps" throughout.

17. VR dedicated fitness apps are marketed to customers for the purpose of exercise. Pruett Hr'g Tr. 263:6–18. Some other VR apps, often called "incidental" or "accidental" fitness apps, may include mechanics that may allow users to exercise as a byproduct but have a primary focus other than fitness (such as gaming). PX0001, at 5 n.10; PX0529, at 2; Carmack Hr'g Tr. 562:12–18. Unlike VR incidental fitness apps, VR dedicated fitness apps often

have features like trackable progress goals, heart rate tracking, and motion calibration. PX0001, at 5 n.10; Milk Hr'g Tr. 683:8–21. Additionally, VR dedicated fitness apps generally require the producing company to have expertise and assets that allow them to create exercise content, *e.g.*, workout coaches, green screen studios, stereoscopic capture, post processing pipelines. PX0111; PX0251, at 2–3; PX0127, at 7; Koblin Hr'g Tr. 650:3–12; Garcia Hr'g Tr. 1079:16–24. And because VR dedicated fitness apps create content on an ongoing basis to avoid user boredom, they are better suited than most other VR apps to be priced using a subscription model (although not all VR dedicated fitness apps follow this model). Pruett Hr'g Tr. 269:9–270:17; Singer Hr'g Tr. 359:2–18; Vickey Report ¶ 47.

18. The user base for VR dedicated fitness apps differs from that of VR overall. VR users generally skew younger and male, but VR dedicated fitness app users tend to have an older and more female set of users. PX0003, at 17; PX0004, at 167; Rubin Dep. 131:19–132:14; PX0127, at 1, 6; Bosworth Hr'g Tr. 1035:18–22. In addition to the diverse appeal of VR dedicated fitness apps, they have strong user retention and rapid growth. Carlton Report ¶¶ 33–35; PX0386, at 12. [redacted]. PX0003, at 9, 44. [redacted] PX0386, at 12. [redacted] Carlton Report ¶ 67, Table 10.

19. Multiple companies that make VR dedicated fitness apps consider their products to compete with the extensive range of methods by which an individual can seek to exercise. According to Within, Supernatural "compete[s] with every product or service or offering that offers fitness or wellness," ranging from connected fitness devices like Peloton equipment to gyms to YouTube videos intended to be mimicked by a viewer. Milk Hr'g Tr. 724:15–25. Within

does not, however, consider a VR incidental fitness app to constitute a fitness offering. Koblin Hr'g Tr. 606:5–8. The founder of VirZoom, another VR company with a dedicated fitness app (VZfit), made similar claims, and added that VZfit even "compete[s] with somebody who wants to just jump on their bike and go for a bike ride." Janszen Hr'g Tr. 1143:8–12; DX1290 ("Janszen Decl.") ¶ 23. However, Odders Lab, another VR company that makes not only a dedicated fitness app but also a rhythm game app and a chess app, stated that its fitness app competed most directly with other fitness dedicated apps, such as Supernatural and FitXR, and that the launch of its fitness app had not diminished sales of its rhythm game app. Garcia Hr'g Tr. 1105:18–1106:21.

20. [redacted] Apple provides Fitness+, a paid subscription app, and [redacted] but it does not currently offer its own headset. DX1257, at 3, 24–28; Bosworth Hr'g Tr. 1022:13–16.

21. The customers for more established fitness offerings are perceived to be more likely to have long-term or well-developed fitness routines, while VR dedicated fitness app users are targeted more toward "[redacted]" who have less fitness experience. PX0051 ("Cibula Dep.") 84:20–25; PX0318, at 1; PX0563, at 1; DX1081, at 1–2. No record evidence suggests that these firms possess VR engineering expertise. PX0118, at 1; Singer Report ¶ 82. As such, these fitness offerings do not create the 360-degree embodiment in a virtual environment provided by VR dedicated fitness apps. *See, e.g.*, Zuckerberg Hr'g Tr. 1298:5–6; Rabkin Hr'g Tr. 835:24–836:3. Although some fitness offerings may display videos of various locations around the world, those videos are displayed on a flat screen. Vickey Hr'g Tr. 1184:12–21.

22. Connected fitness devices are generally stationary and larger than the portable and relatively small VR headset equipment required to use a VR dedicated fitness app.

See, e.g., Milk Hr'g Tr. 689:17–25. The upfront device cost can be over $1,000, and users pay a monthly subscription fee to access fitness content; for example, Peloton and Tonal are connected fitness device companies, and cost, respectively $1,445 plus $44 per month and $3,495 plus $49 per month. Singer Report ¶¶ 68–69. There are also more affordable alternatives outside of VR, such as a Peloton mobile app-only subscription, which costs $12.99 per month. *Id.* ¶ 65; DX1081, at 1–2. The subscription model is common in the overall fitness industry—in addition to the examples above, traditional gyms and Fitness+ charge monthly subscriptions. PX0001, at 2; DX1081, at 1–2; DX1257, at 3, 24–28.

23. Within's VR app Supernatural is a dedicated fitness app: it was designed specifically for fitness and offers "daily personalized full-body workouts and expert coaching from real-world trainers." PX0906, at 1. Within began developing Supernatural in February 2019, and launched it in the Quest Store on April 23, 2020. PX0005, at 77; PX0906, at 1. Supernatural now offers over 800 fully immersive video workouts set to music in various photorealistic landscapes, such as the Galapagos Islands and the Great Wall of China. FAC ¶ 24, ECF No. 101-1; Koblin Hr'g Tr. 604:18–605:19; ECF No. 83 ¶ 25; PX0906, at 1; *see id.* at 3–4, 6, 8. Through deals with major music studios, Supernatural sets each workout to songs from A-list artists like Katy Perry, Imagine Dragons, Lady Gaga, and Coldplay. FAC ¶ 24, ECF No. 101-1. Within optimized the exercise movements in Supernatural through consultations with experts holding PhDs in kinesiology and biomechanics; the workouts are led by personal trainers, calibrated to users' range of motion, mapped out in VR by dance choreographers, and filmed at Within's studio in Los Angeles. PX0712, at 18–20, 27–29. Within's founders are experienced directors of interactive music videos. *Id.* at 3–4. [redacted] Supernatural is only available to Quest headset users in the United States and Canada. Milk Hr'g Tr. 671:4–9.

24. Other VR dedicated fitness apps include FitXR, Les Mills Bodycombat, VZfit, VZfit Premium, PowerBeats VR, RealFit, Holofit, Liteboxer, Liteboxer Premium VR, and VRWorkout. Singer Report ¶ 39. Like Supernatural, Liteboxer Premium VR costs $18.99 per month. *Id.* Les Mills Bodycombat, PowerBeatsVR, and RealFit have respective one-time costs of

$29.99, $22.99, and $19.99; Liteboxer and VRWorkout are free; and the other VR dedicated fitness apps charge monthly subscription prices ranging from about $9 to $12. *Id.* Companies producing VR dedicated fitness apps generally pursue business strategies optimized for growth and market penetration, [redacted]. Milk Hr'g Tr. 736:15–21; Garcia Hr'g Tr. 1111:8–1112:14; Janszen Hr'g Tr. 1147:22–1148:1. These companies expect that high growth and penetration metrics will render them attractive acquisition targets. *Id.*; Zyda Hr'g Tr. 1227:18–22, 1228:15–18.

25. All of these apps, including Supernatural, were launched within the past five years. Carlton Report ¶ 125. New VR dedicated fitness apps are expected to launch in the near future. *Id.* Supernatural currently possesses an 82.4% share of market revenue among the existing VR dedicated fitness apps (or a 77.6% share of VR apps in the Quest Store's "Fitness and Wellness" category). Singer Report ¶ 75, Tables 2-A, 2-B. [redacted] Singer Rebuttal Report ¶¶ 124–25, Tables 1-A, 1-B.

26. The FTC's economics expert, Dr. Singer, analyzed the concentration of the VR dedicated fitness app market using the Herfindahl-Hirschman Index ("HHI"). Singer Report ¶ 76. Dr. Singer performed the HHI calculation multiple times to account for different conceptions of the firms contained within the VR dedicated fitness app market. *Id.* Using a set of firms based off a list of Supernatural competitors provided by Meta to the FTC, Dr. Singer calculated an HHI of 6,917 by measuring each firm's market share of revenue. *Id.* ¶¶ 46, 76, Table 2-A. Then, to capture broader potential set of firms within the VR dedicated fitness app market, Dr. Singer analyzed all apps listed in Meta's Quest Store under its "Fitness & Wellness" category and calculated an HHI of 6,148 (again, based on revenue). *Id.* ¶¶ 48, 76, Table 2-A. Dr. Singer also calculated HHI using market share of total hours spent and identified outputs 6,307 for the set of firms based off Meta's list and 4,863 for the broader set of "Fitness & Wellness firms." Singer Rebuttal Report ¶¶ 124–25, Table 1-A. Lastly, Dr. Singer calculated HHI using market share of monthly active users and identified outputs of 3,377 and 2,098 for the two respective sets of firms.

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Id. ¶¶ 124–25, Table 1-B. Markets are generally considered “highly concentrated” when the HHI is above 2,500 and “moderately concentrated” when the HHI is between 1,500 and 2,500. Singer Report ¶ 76 & n.129.

D. The Challenged Acquisition

27. Meta and Zuckerberg first expressed interest in acquiring Within as early as February 22, 2021. PX0170, at 1–2.

28. After Zuckerberg showed some interest in [redacted], Michael Verdu (Vice President of VR Content) investigated and [redacted]. PX0118, at 2, Mar. 4, 2022; Verdu Dep. 7:22–8:02.

29. On March 11, 2021, Meta employees met to discuss potential VR fitness investments with Mark Rabkin, the head of VR technology at Meta and one of the final decision makers to approve any VR investment. PX0179, at 2; Rabkin Hr’g Tr. 800:7–11; Stojsavljevic Hr’g Tr. 189:24–190:12. In advance of this meeting, Ananda Dass (Meta’s director of non-gaming VR content) and Jane Chiao (business-side employee) prepared a pre-read document analyzing five potential investment options. PX0127, Mar. 10, 2021; Stojsavljevic Hr’g Tr. 69:18–24, 138:11–18, 140:23–141:1, 149:16–151:12. Shortly before this meeting, on March 4, 2021, Jane Chiao had also prepared a document titled, [redacted]. PX0492, at 7, Mar. 9, 2021. During the meeting, the attendees decided [redacted]. PX0179.

30. On March 17, 2021, Dass and Chiao summarized the advantages and disadvantages of acquiring Supernatural [redacted]. At this time, they proposed spending the next few months inquiring into [redacted]. PX0284, Mar. 17, 2021.

31. On April 20, 2021, Melissa Brown (Head of Developer Relations) prepared an executive summary pre-read in advance of Meta's meeting with Within, which was circulated to Verdu and Dass. The executive summary contains [redacted] PX0565, Apr. 20, 2021.

32. On April 26, 2021, Brown circulated a [redacted] PX0253, Apr. 26, 2021.

33. On May 26, 2021, Anand Dass [redacted] DX1012, at 1, 3, May 26, 2021. [redacted] *Id.*; *see also* PX0123, at 2. [redacted] PX0117, June 10, 2021.

34. Frank Casanova (Apple's senior director of augmented reality product marketing) testified that Apple [redacted]. Casanova's personal recollection was that [redacted]. DX1219 ("Casanova Dep.") 90:20–93:15.

35. In mid-July 2021, Meta and Within entered into a non-binding term sheet regarding a potential acquisition. PX0062 ("Milk Dep.") 129:2–14; Milk Hr'g Tr. 720:12–15. Meta and Within executed the Merger Agreement on October 22, 2021. DX1072, Oct. 22, 2021.

E. Beat Saber Expansion Proposal

36. Beat Saber is a VR rhythm game in which players use virtual swords to slash oncoming blocks timed to music. FAC ¶ 30; Meta's Answer and Affirmative Defenses ¶ 33. Beat Saber is the most popular and best-selling VR app of all time. Stojsavljevic Hr'g Tr. 82:23–83:8; Rabkin Hr'g Tr. 820:9–11.

37. Meta acquired Beat Games, the studio that produces Beat Saber, in late 2019. Meta's Answer and Affirmative Defenses ¶ 4.

38. At the time it acquired Beat Games, Meta viewed Beat Saber as a potential "vector into fitness as a game-adjacent use case." PX0342, at 2, Sept. 27, 2019. There was a continuing internal dialogue at Meta regarding a potential fitness version of Beat Saber, which was referred to as the "perpetual white whale quest to get . . . Beat Games to build a fitness version of Beat Saber." Verdu Dep. 112:04–112:12, 178:12–20. The founders of Beat Games were "warm to the idea" and released a "FitBeat" song for Beat Saber, but the idea otherwise did not gain traction. Verdu Dep. 178:12–20; see also PX0123 [redacted] Sept. 15, 2021.

39. On February 16, 2021, Rade Stojsavljevic (director of Meta's first party studios) was riding his Peloton bike on a workout with a live DJ spinning music when he came up with the idea of a Peloton partnership with Beat Saber. Stojsavljevic Hr'g Tr. 127:20–128:24.

40. Shortly thereafter, Stojsavljevic collaborated on a presentation called "Operation Twinkie," in which he proposed repositioning Beat Saber as a fitness app in a partnership with Peloton. The same presentation recommended [redacted] PX0527, at 5, 8.

41. On March 4, 2021, Chiao responded to comments regarding partnering with Peloton to create VR content, [redacted] PX0251, at 2–3, Mar. 4, 2021.

42. On March 11, 2021, Stojsavljevic attended the VR fitness investment meeting with Mark Rabkin. PX0179, at 2; *see also supra* ¶ 31. Alongside the acquisitions of [redacted] Supernatural, the March 11 meeting concluded that Stojsavljevic was to prepare a presentation to Rabkin to expand Beat Saber to dedicated fitness. PX0179, at 2.

43. On March 15, 2021, Stojsavljevic queried a group chat and solicited feedback on his proposal for a Beat Saber–Peloton partnership. PX0407, at 1, Mar. 15, 2021. The group members discussed different forms the partnership could take. *Id.*

44. On March 25, 2021, Stojsavljevic received a presentation from a consultant, [redacted], titled "Beat Saber x Peloton Opportunity Identification." PX0121, at 2. The presentation provided a quote for [redacted] to investigate the Beat Saber and Peloton opportunity, which was to take about 8 weeks and cost $23,500. *Id.* at 8. [redacted]'s proposed research approach included nine action items, as follows: (1) analyze the home fitness market; (2) analyze the Peloton market; (3) assess the Peloton bike capabilities; (4) analyze the current XR[1] fitness market; (5) analyze Beat Saber's current strategy and its Fitbeat song; (6) identify Beat Saber x Peloton opportunities; (7) identify XR fitness opportunities; (8) define the go-to-market approach; and (9) define how to approach Peloton with the partnership. *Id.* at 5–6. Stojsavljevic ultimately did not engage [redacted] to undertake this research project. PX0052 ("Stojsavljevic Dep.") 219:23–220:1.

45. Based on the parties' representations and to the best of the Court's review of the evidence, the next reference to the Beat Saber–Peloton proposal was on June 11, 2021, after Meta began pursuing Within as an acquisition target. PX0341, at 2, June 11, 2021. In a chat, Stojsavljevic briefly mentioned that Chiao and Dass had disagreed with his Beat Saber–Peloton proposal and had wanted to [redacted]. *Id.* At the evidentiary hearing, Stojsavljevic testified that his enthusiasm for the Beat Saber–Peloton proposal had "slowed down" before Meta's decision to acquire Within. Stojsavljevic Hr'g Tr. 165:12–17. He also testified that he had not undertaken the research project that he had promised Rabkin because he had been busy working on another Meta acquisition. *Id.*; *see also supra* ¶ 44.

46. On September 15, 2021, [redacted] Jason Rubin—who had just transitioned into his role as the vice president of Metaverse content on August 1, 2021—made comments about Beat Saber in response to [redacted] PX0123, at 2, Sept. 15, 2021; *see also* Rubin Dep. 28:8–15. Rubin suggested that [redacted] PX0123, at 2. He

[1] The Court understands "XR" to refer generally to virtual reality, augmented reality, and mixed reality.

subsequently remarked that [redacted] *Id.*

II. PROCEDURAL HISTORY

Defendants signed an Agreement and Plan of Merger for a proposed acquisition of Within by Meta (the "Acquisition") on October 22, 2021. ECF No. 101-1 ("FAC") ¶ 24; PX0004, at 161. On July 27, 2022, the FTC filed a complaint for a temporary restraining order and preliminary injunction enjoining the Acquisition. *See* Compl., ECF No. 1. At the time of the FTC's filing, Defendants would have been free to consummate the Acquisition after July 31, 2022. *Id.* ¶ 27. On July 29, 2022, the Court granted the parties' stipulated order preventing Defendants from consummating the Acquisition until after August 6, 2022. ECF No. 19. On August 5, 2022, the Court granted the parties' second stipulated order and entered a temporary restraining order enjoining the Acquisition until after December 31, 2022. ECF No. 56. The FTC filed its amended complaint on October 7, 2022, *see* FAC, and Defendants moved to dismiss the amended complaint on October 13, 2022, ECF No. 108 ("MTD"). The Court took the MTD under submission without oral argument on December 2, 2022. ECF No. 388.

On October 31, 2022, pursuant to the parties' stipulated order, the FTC filed its memorandum in support of its motion for a preliminary injunction (the "Motion"). ECF Nos. 86, 164. The evidentiary hearing on the Motion began on December 8, 2022. *See* ECF No. 441. Following the in-Court testimony of the FTC's economics expert, Dr. Hal J. Singer, on December 13, 2022, Defendants orally moved the Court to strike Dr. Singer's testimony. *See* ECF No. 464. Defendants subsequently filed a motion to strike Dr. Singer's opinion regarding the definition of the relevant product market. ECF No. 470. The evidentiary hearing concluded on December 20, 2022, *see* ECF No. 492, and the Court granted the parties' stipulated order extending the temporary restraining order to enjoin the Acquisition until January 31, 2023, ECF No. 508.

On January 31, 2023, the FTC filed an emergency motion requesting an extension of the temporary restraining order if the Court either was not prepared to rule on the Motion until after that date or denied the Motion. ECF No. 543 ("Emergency Motion"). The Court's ruling on the

Emergency Motion will be filed in a separate order.

The Court now rules on the Motion, the MTD, and the motion to strike Dr. Singer's opinion on the relevant product market definition. *See* ECF Nos. 108, 164, 470.

III. LEGAL CONCLUSIONS

A. Legal Standard

Section 13(b) of the FTC Act provides that "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond." 15 U.S.C. § 53(b)(2). In evaluating a motion for preliminary injunction brought under Section 13(b), courts must "1) determine the likelihood that the Commission will ultimately succeed on the merits and 2) balance the equities." *F.T.C. v. Warner Commc'ns Inc.*, 742 F.2d 1156, 1160 (9th Cir. 1984) (emphasis added) (citing *F.T.C. v. Simeon Mgmt. Corp.*, 532 F.2d 708, 713–14 (9th Cir. 1976)).

The federal court is not tasked with "mak[ing] a final determination on whether the proposed merger violates Section 7, but rather [with making] only a preliminary assessment of the merger's impact on competition." *Warner Commc'ns Inc.*, 742 F.2d at 1162. To obtain a preliminary injunction, the FTC must "raise questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *Id.* (citations omitted); *see also FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008) ("the FTC [must] 'raise questions going to the merits so serious, substantial, difficult[,] and doubtful as to make them fair ground for thorough investigation.'"). Although a district court may not "require the FTC to prove the merits, . . . it must 'exercise independent judgment' about the questions § 53(b) commits to it." *Whole Foods Market, Inc.*, 548 F.3d at 1035 (citations omitted). The FTC is therefore required to provide more than mere questions or speculations supporting its likelihood of success on the merits, and the district court must decide the motion based on "all the evidence before it, from the defendants as well as from the FTC." *Id.* (citations omitted); *see*

United States v. Siemens Corp., 621 F.2d 499, 506 (2d Cir. 1980) (noting that "the Government must do far more than merely raise sufficiently serious questions with respect to the merits" in demonstrating a "reasonable probability" of a Section 7 violation.).

B. Relevant Market Definition

The first step in analyzing a merger challenge under Section 7 of the Clayton Act is to determine the relevant market. *U.S. v. Marine Bancorporation, Inc.*, 418 U.S. 602, 619 (1974) (citing *E.I. Du Pont*, 353 U.S. 586, 593 (1957)); *see FTC v. Qualcomm Inc.*, 969 F.3d 974, 992 (9th Cir. 2020) ("A threshold step in any antitrust case is to accurately define the relevant market, which refers to 'the area of effective competition.'"). The relevant market for antitrust purposes is determined by (1) the relevant product market and (2) the relevant geographic market. *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 324 (1962).

1. Product Market

"The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325. "Within a general product market, 'well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes.'" *Hicks v. PGA Tour, Inc.*, 897 F.3d 1109, 1121 (9th Cir. 2018) (quoting *Brown Shoe*, 370 U.S. at 325); *see also Newcal Indus., Inc. v. Ikon Office Sol'n*, 513 F.3d 1038, 1045 (9th Cir. 2008) ("[A]lthough the general market must include all economic substitutes, it is legally permissible to premise antitrust allegations on a submarket."). The definition of the relevant market is "basically a fact question dependent upon the special characteristics of the industry involved." *Twin City Sportservice, Inc. v. Charles O. Finley & Co., Inc.*, 676 F.2d 1291, 1299 (9th Cir. 1982). Products need not be fungible to be included in a relevant market, but a relevant market "cannot meaningfully encompass th[e] infinite range" of substitutes for a product. *Id.* at 1271 (quoting *Times Picayune Publishing Co. v. United States,* 345 U.S. 594, 611, 612 n. 31, (1953)). The overarching goal of market definition is to "recognize competition where, in fact, competition exists." *Brown Shoe*, 370 U.S. at 326; *see also U.S. v. Continental Can Co.*, 378 U.S. 441, 449

(1964) ("In defining the product market between these terminal extremes [of fungibility and infinite substitution], we must recognize meaningful competition where it is found to exist."); *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1039 (D.C. Cir. 2008) ("As always in defining a market, we must 'take into account the realities of competition.'") (citations omitted).

Courts have used both qualitative and quantitative tools to aid their determinations of relevant markets. A qualitative analysis of the relevant antitrust market, including submarkets, involves "examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325; *see also, e.g.*, *Klein v. Facebook, Inc.*, 580 F. Supp. 3d 743, 766–68 (N.D. Cal. 2022) (applying *Brown Shoe* factors). A common quantitative metric used by parties and courts to determine relevant markets is the Hypothetical Monopolist Test ("HMT"), as described in the U.S. Department of Justice and the FTC's 2010 Merger Guidelines. U.S. Dep't of Justice & FTC, *Horizontal Merger Guidelines* ("2010 Merger Guidelines") § 4 (2010); *see also, e.g.*, *U.S. v. H & R Block, Inc.*, 833 F. Supp. 2d 36, 51 (D.D.C. 2011) ("An analytical method often used by courts to define a relevant market is to ask hypothetically whether it would be profitable to have a monopoly over a given set of substitutable products. If so, those products may constitute a relevant market.").

There is "no requirement to use any specific methodology in defining the relevant market." *Optronic Techs., Inc. v. Ningbo Sunny Elec. Co., Ltd.*, 20 F.4th 466, 482 (9th Cir. 2021). As such, courts have determined relevant antitrust markets using, for example, only the *Brown Shoe* factors, or a combination of the *Brown Shoe* factors and the HMT. *See, e.g.*, *Lucas Auto. Eng., Inc. v. Bridgestone/Firestone, Inc.*, 275 F.3d 762, 766–68 (9th Cir. 2001) (relying on *Brown Shoe* factors alone in review of district court's determination of relevant market); *United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 20–21 (D.D.C. 2017) (using HMT and *Brown Shoe* factors to analyze relevant market). The Ninth Circuit has "repeatedly noted that the *Brown Shoe* indicia are practical aids for identifying the areas of actual or potential competition and that their presence or absence does not decide automatically the submarket issue." *Thurman Indus., Inc. v. Pay 'N Pak Stores, Inc.*, 875 F.2d 1369, 1375 (9th Cir. 1989) (citations omitted). The suitability of a submarket as a relevant antitrust market "turns ultimately upon whether the factors used to define the submarket are 'economically significant.'" *Id.*

The FTC proposes a relevant product market consisting of VR dedicated fitness apps, meaning VR apps "designed so users can exercise through a structured physical workout in a virtual setting." Mot. 13. According to the FTC, VR dedicated fitness apps are distinct from (1) other VR apps and (2) other fitness offerings. *Id.* 14. To differentiate their proposed market from other VR app markets, the FTC claims that VR dedicated fitness apps have distinct customers and pricing strategies. *Id.* The FTC further argues that VR dedicated fitness apps are in a separate market from other fitness offerings (*e.g.*, gyms, at-home fitness equipment) because they provide users with "fully immersive, 360-degree environments," are fully portable, save space, cost less, and target a different type of consumer. *Id.* 14–15. The FTC claims that these qualitative product differences satisfy the *Brown Shoe* practical indicia of a relevant market, and that the Hypothetical Monopolist Test conducted by the FTC's economics expert further confirms the relevant product market definition. *Id.* 15.

Unsurprisingly, Defendants disagree. They claim that the FTC's proposed market is impermissibly narrow because it excludes "scores of products, services, and apps" that are "reasonably interchangeable" with VR dedicated fitness apps, including dozens of VR apps categorized as "fitness" apps on the Quest platform, fitness apps on gaming consoles and other VR platforms, and non-VR connected fitness products and services. Opp. 8, ECF No. 216. Defendants argue that members of the FTC's proposed market subjectively consider other VR apps and other fitness offerings to be competing products, and that several such products also possess the very features—portability, immersion, and pricing models—that the FTC highlights as distinguishing or unique to its proposed market. *Id.* 8–10. Defendants also contend that Dr. Singer's HMT analysis is fatally flawed due to methodological errors in the survey underlying the test. *Id.* 11.

In this case, the Court finds the FTC has made a sufficient evidentiary showing that there exists a well-defined relevant product market consisting of VR dedicated fitness apps.

a. *Brown Shoe* Analysis

The Court first examines in turn each of the *Brown Shoe* factors, *i.e.*, "practical indicia [such] as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." 370 U.S. at 325.

i. Industry or Public Recognition

The evidence indicates that Defendants and other VR dedicated fitness app makers viewed VR dedicated fitness apps as an economic submarket of VR apps. For example, [redacted] PX0003, at 44. [redacted] *Id.* at 9. Within's contemporaneous view of untapped market segments indicates that a "fitness first" app paired with a VR headset—*i.e.*, a VR dedicated fitness app—would be in a distinct segment of the overall VR market. *See id.* at 31. Likewise, as explained in greater detail in the sections below, Meta repeatedly stated that VR dedicated fitness apps constituted a distinct market opportunity within the VR ecosystem due to their unique uses, distinct customers, and distinct prices. *See infra* Sections III.B.1.a.ii., iv., v. And a representative the VR app company Odders Lab testified that the launch of its VR dedicated fitness app did not diminish sales of its VR rhythm app, acknowledging that its VR fitness app "compete[d] more directly with fitness dedicated applications than gaming applications." Garcia Hr'g Tr. 1105:18–1106:21. Industry companies' internal communications showing frequent distinctions between various categories of applications is "strong[] support" of a distinct submarket. *Klein*, 580 F. Supp. 3d at 758.

Participants in the broader fitness industry also recognized VR fitness as a "separate economic entity." [redacted]

[redacted] *See United States v. Microsoft Corp.*, 253 F.3d 34, 53 (D.C. Cir. 2001) (rejecting inclusion of middleware products in the relevant market where middleware was a potential, rather than current, competitor).

Defendants claim that members of the VR dedicated fitness app industry understood the market in which they operated to consist of "[s]cores of products, services, and apps available to consumers who want to exercise." Opp. 8; Milk Hr'g Tr. 724:15–25 ("[redacted]); *id.* 779:7–8 ("We have thousands of competitors."); *see also* Janszen Hr'g Tr. 1143:8–12 (VR dedicated fitness app VirZoom "compete[s] with somebody who wants to just jump on their bike and go for a bike ride"). Defendants also contend that "[e]stablished fitness and technology firms . . . view VR fitness as competitive with off-VR products," and point as an example to Apple's inclusion of Supernatural and the Peloton Guide in the "competitive landscape" when it [redacted].[2] Opp. 9; DX1257, at 3, 24–28.

Defendants' evidence shows that there is a broad fitness market that includes everything from VR apps to bicycles. This in no way precludes the existence of a submarket constituting a relevant product market for antitrust purposes. *Brown Shoe*, 370 U.S. at 325; *Newcal Indus.*, 513 F.3d at 1045. As the Ninth Circuit has noted, a relevant antitrust market "cannot meaningfully encompass th[e] infinite range" of substitutes for a product—yet this is exactly how Defendants propose to define the market. *Twin City Sportservice, Inc. v. Charles O'Finley & Co., Inc.*, 512 F.2d 1264, 1271 (9th Cir. 1975). The Court therefore acknowledges that VR dedicated fitness apps compete for consumers with every manner of exercise (including gyms, bike rides, and connected fitness), but finds that Defendants and the broader fitness industry recognized VR dedicated fitness apps as an economically distinct submarket.

ii. Peculiar Characteristics and Uses

The evidence indicates that VR dedicated fitness apps have several "peculiar characteristics and uses" in comparison to both other VR apps and non-VR fitness offerings. *Brown Shoe*, 370 U.S. at 325. Even assuming "[a]lmost all VR applications require body movement," Pruett Hr'g Tr. 264:16, VR dedicated fitness apps are "specifically marketed to customers for the purpose of exercise," *id.* 263:6–18. To support that marketing, VR dedicated fitness apps (unlike other VR apps) are often characterized by their fitness-specific features, such as trainer-led workout regimens, calorie tracking, and the ability to set and track progress toward fitness goals. *See, e.g.*, *id.* 263:14–23; Paynter Dep. 24:2–12 ("what [Meta] used to call [dedicated] fitness apps now correspond to a category . . . call[ed] . . . trainer workout apps"); PX0487, at 4 (VR dedicated fitness apps are "[d]esigned to allow a player to deliberately set and attain fitness goals, with fitness-specific features i.e. coaching, trackable progress"); PX0001, at 5

[2] Apple does not currently offer a VR headset. *See, e.g.*, Bosworth Hr'g Tr. 1022:13–16.

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n.10 (“Meta draws a distinction between apps designed to allow users to set and attain fitness goals, with features like coaching and trackable progress (called ‘deliberate’ or ‘dedicated’ fitness apps) and games whose primary focus is not fitness that allow users to get a workout as a byproduct (sometimes called ‘incidental’ or ‘accidental’ fitness apps).”).

The most “peculiar characteristic” of VR dedicated fitness apps in comparison to non-VR fitness offerings is, of course, the VR technology itself. A VR user is “embodied” in a virtual environment. Zuckerberg Hr’g Tr. 1298:5–6. She is “teleported to a different place, feeling like when you move your head and look around, you’re in a new space and seeing virtual things as if they are real, which is virtual reality.” Rabkin Hr’g Tr. 835:24–836:3. Defendants’ fitness industry expert, Dr. Vickey, submitted that non-VR fitness options could also be immersive, describing the non-VR Hydrow rowing machine as an “immersive exercise piece of equipment” because the Hydrow displayed video footage of various locations on a touchscreen the user viewed while rowing.[3] Vickey Hr’g Tr. 1184:12–21. The Court finds that no matter how crisp or accurate a video may be, a two-dimensional screen display is inherently far less immersive than a 360-degree environment. The evidence does not suggest—and the Court is not aware of—any other at-home fitness offering that can transport the user in this way. That a user of a VR dedicated fitness app can exercise in a VR setting is, therefore, a “distinct core functionality” indicative of a submarket. *Klein*, 580 F. Supp. 3d at 767 (quoting *Datel Holdings, Ltd. v. Microsoft Corp.*, 712 F. Supp. 2d 974, 997 (N.D. Cal. 2010)).

The FTC puts forth other hallmarks of VR dedicated fitness apps that generally differ from characteristics of non-VR fitness offerings. For example, the FTC argues that “VR headsets are fully portable and take up little space.” Mot. 14. These appear to be distinguishing features in relation to bulky connected fitness devices, such as the Peloton Bike or Hydrow rowing machine, but Defendants persuasively argue that mobile fitness apps can offer these same functionalities.[4]

[3] Dr. Vickey later testified that he had not used a Hydrow, and that he “would have” evaluated the machine by reviewing the company’s website and watching its videos. Vickey Hr’g Tr. 1202:8–18.

[4] The Court is not persuaded by Defendants’ argument that the Peloton Guide is similarly portable

Opp. 10. Nonetheless, the virtual reality fitness experience created by VR dedicated fitness apps appears to be vastly different from a workout conducted on a large and stationary device or based off a mobile phone screen.

With respect to "peculiar . . . uses," Defendants have shown that consumers use non-VR fitness offerings for exercise. *See supra* Section III.B.1.a.i. Defendants have additionally shown that consumers may use other VR apps for fitness. *See, e.g.*, Carmack Hr'g Tr. 562:12–18 ("You can work up a pretty good sweat in Beat Saber."); PX0529, at 2 ("UXR reports that many users have fitness intent among these [incidental fitness] apps"). As explained above, the existence of a broader fitness market does not mean a relevant submarket does not exist. *Supra* Section III.B.1.a.i. Defendants have themselves recognized the characteristics that distinguish VR dedicated fitness apps from other VR apps. *E.g.*, PX0001, at 5 n.10 ("Meta draws a distinction between apps designed to allow users to set and attain fitness goals, with features like coaching and trackable progress (called 'deliberate' or 'dedicated' fitness apps) and games whose primary focus is not fitness that allow users to get a workout as a byproduct (sometimes called 'incidental' or 'accidental' fitness apps)."); Milk Hr'g Tr. 683:8–21 (Supernatural, unlike Beat Saber, "employed experts in movement and fitness[;] built companion apps for the phones and for heart rate tracking integration[; and] calibrate[d to a] range of motion so that [it would not] injury anybody."); *see also* Koblin Hr'g Tr. 606:5–8 ("VR games that require some incidental physical exertion" are not a fitness offering). The Court therefore finds that the "peculiar characteristics and uses" factor of the *Brown Shoe* analysis supports the finding that VR dedicated fitness apps constitute a relevant antitrust product market. *See, e.g.*, *SC Innovations, Inc. v. Uber Techs., Inc.*, 434 F. Supp. 3d 782, 792 (N.D. Cal. 2020) (finding plaintiffs alleged a submarket for ride-sharing services excluding taxis, in part due to distinguishing features such as ability to rate and review

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to a VR headset. *See* Opp. 10. [redacted] Vickey Report ¶ 43 ("[T]he Peloton Guide uses augmented reality features to track the user's motions and a camera to position the user visually near an on-screen instructor.").

drivers and share rides).

iii. Unique Production Facilities

The parties did not explicitly develop arguments regarding unique production facilities in support of their positions regarding the relevant product market. *See* Mot. 13–16; Opp. 7–11. The Court notes, however, that VR dedicated fitness apps require a unique combination of production inputs. [redacted] *See* Singer Report ¶ 82 ("[T]he talent needed to create true triple-A VR experiences is going to be scarce and really valuable in a few years.") (citing PX0118, at 1); Pruett Hr'g Tr. 286:6–8 ("I have an engineering team . . . [who] are a group of veteran engineers who are particular experts in our VR technology and our hardware."). Similarly, most VR companies are unlikely to have the fitness expertise and equipment necessary to create content for VR dedicated fitness apps. *See* Singer Report ¶ 84 ("[redacted]") (citing PX0251, at 2–3). Koblin Hr'g Tr. 650:3–12 ("[I]t seemed highly unlikely to me that [Meta] would get into virtual reality fitness . . . honestly at that level of depth, it just seemed extremely unlikely that they would hire coaches and build a green screen studio and dive deep into the psychology of what makes fitness fitness."); Garcia Hr'g Tr. 1079:16–24 ("[One of the things that we have done in Odders Lab whenever developing any of our apps has always been looking into – – been looking at the experts. . . . And for our fitness app, we also started reaching out to local experts.").

Although relevant markets are generally defined by demand-side substitutability, supply-side substitution also informs whether alternative products may be counted in the relevant market. *Twin City Sportservice, Inc.*, 512 F.2d at 1271 ("While the majority of the decided cases in which the rule of reasonable interchangeability is employed deal with the 'use' side of the market, the courts have not been unaware of the importance of substitutability on the 'production' side as well."); *see also Brown Shoe*, 370 U.S. at 325 n.42 ("The cross-elasticity of production facilities may also be an important factor in defining a product market."); Julian von Kalinowski et al., 2 Antitrust Laws & Trade Regulation § 24.02[1][c], at 24–55 (2d ed. 2012) ("Another important factor in defining a product market is the ability of existing companies to alter their facilities to produce the defendant's product. . . . The Supreme Court has long recognized the significance of this factor, often referred to as cross-elasticity of supply.") (footnote omitted); 2010 Merger Guidelines, § 5.1 & n.8 (high supply side substitutability may be used to aggregate products into a market description).

Supply-side substitution focuses on suppliers' "responsiveness to price increases and their ability to constrain anticompetitive pricing by readily shifting what they produce." *RAG-Stiftung*, 436 F. Supp. 3d at 293 (citing *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1436 (9th Cir. 1995) ("reasonable market definition must also be based on 'supply elasticity'"), *cert. denied*, 516 U.S. 987 (1995)). Here, as explained above, the evidence indicates that neither general fitness firms nor general VR firms have the production facilities to readily produce a substitute VR dedicated fitness app product, even if VR dedicated fitness apps were to raise prices and make market entry more attractive. *See also* Singer Report, Section F ("Would-Be Suppliers of VR Dedicated Fitness Apps Face Significant Barriers to Entry"). That existing companies are not easily able to alter their facilities to produce VR dedicated fitness apps is additional evidence that such apps constitute a distinct product market.[5]

iv. Distinct Customers

The FTC proffered evidence showing that users of VR dedicated fitness apps differ from those of other VR apps along multiple axes. Internal evaluations by Meta and Within found that although overall users of VR apps skewed younger and male, users of VR dedicated fitness apps tended to have an older and more female user base. For example, Meta claimed in its response to the FTC's Second Request regarding the Meta-Within transaction that the overall Quest user base

[5] This supply-side analysis of whether other firms would be able to switch production to VR dedicated fitness apps is independent of the demand-side inquiry (and main focus of the market definition analysis) of whether users would switch consumption to other products in the event of a price increase in VR dedicated fitness apps.

was about [redacted] *See* PX0004, at 167, May 2, 2022. VR fitness apps, on the other hand, drew far more women. *Id.* [redacted]; PX0003, at 17 [redacted] Apr. 23, 2021; PX0127, at 1 [redacted] Mar. 10, 2021. Meta expected that VR dedicated fitness apps would expand the reach of virtual reality to new customer segments. To that end, Meta's Vice President of Metaverse Content informed the company's board of directors that "Supernatural, FitXR, and . . . other fitness applications, . . . unlike our gaming population . . . had tended to be more successful with on average an older person, on average more women. It was a very different demographic, and . . . we had always been in search of expanding VR beyond gaming into more of a general computing platform." PX0066 ("Rubin Dep.") 131:19–132:14; *see also* PX0127, at 6 ("[g]rowing [dedicated] fitness will broaden and diversify our user base, and bring on a disproportionate % of women).

Defendants acknowledge that VR fitness appeals to different user demographics than other VR apps. Opp. 5 ("Fitness is one such use case that can expand VR's audience beyond gamers (who tend to be younger males) to a broader population (including older and female users)."); *see also* Bosworth Hr'g Tr. 1035:18–22 (Meta perceived that "users of VR fitness apps represent[ed] a distinct category of customer compared to overall users of other VR apps on its platform"). Defendants do, however, dispute that VR dedicated fitness apps have a customer base that is distinct from that of non-VR fitness offerings. Opp. 9 n.1. The evidence indicates that VR dedicated fitness apps are targeted more toward "[redacted]" who have less fitness experience and more difficulty finding motivating fitness products (rather than to individuals who have long-term or well-developed fitness routines.) As stated by Within's executive vice president of business development and finance, it was "Within's understanding that Supernatural appeals to [redacted] in a way that other existing fitness products do not." PX0051 ("Cibula Dep.") 84:20–25. Within insiders also compared Supernatural to [redacted]

[redacted] DX1081, at 1–2, Apr. 13, 2020. And in summer 2021—when Meta was in negotiations regarding the acquisition of Supernatural—a Meta employee described Within's business model as "encouraging users who don't think about fitness much as well as users with a light routine, not the fitness buff who is better served by the likes of Peloton cycling or Crossfit classes." PX0318, at 1, June 22, 2021; [redacted] The Court finds the VR dedicated fitness apps have a customer base that is distinct from those of both other VR apps and several other fitness offerings—[redacted] *See, e.g.*, *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 29–30 (D.D.C. 2015) (finding relevant product market in part based on erstwhile competitors' inability to serve certain types of customers).

v. Distinct Prices

The pricing of VR dedicated fitness apps likewise differs in at least one key respect from other VR apps and non-VR fitness offerings. The main difference in comparison to the former category is that VR dedicated fitness apps are more likely to have a subscription-based pricing model. As one of Within's founders testified, Within's daily release of new workout content requires ongoing revenue, which is supported by a subscription membership. Milk Hr'g Tr. 671:10–19. Likewise, Meta's Director of Content Ecosystem testified that "subscriptions are particularly good monetization strategies for [fitness] applications" because "fitness applications need to produce content on an ongoing basis . . . in order to not get boring." Pruett Hr'g Tr. 269:9–23. However, subscription pricing does not provide a clear basis for delineating between VR dedicated fitness apps and other VR apps. Some VR dedicated fitness apps do not charge subscription fees, Vickey Report ¶ 47, and other VR apps may also be a good fit for subscription pricing, *see* Pruett Hr'g Tr. 268:22–269:4 (the "fitness, productivity, and social genres . . . all seem to be trending towards subscriptions as a default monetization method"). Nonetheless, the evidence indicates that "the majority of the video game applications on the Quest platform are not a good fit for subscriptions" including because "most of them don't have [an] ongoing content pipeline." Pruett Hr'g Tr. 270:12–17.

Many fitness offerings, whether virtual or physical, use subscription models. As Meta noted in its June 2022 white paper to the FTC, Supernatural's "monthly subscription model . . . is similar in structure to other connected fitness solutions included specialized equipment solutions (*e.g.*, Peloton, Mirror, Tonal), paid apps (*e.g.*, Apple Fitness+), and other VR fitness apps (*e.g.*, FitXR, Holofit, VZfit), as well as in-person gym memberships (*e.g.*, Equinox, CrossFit, 24 Hour Fitness)." PX0001, at 2; *see also* DX1081, at 1–2 (listing subscription prices for "leading fitness offering[s]"). The FTC argues that despite sharing a subscription pricing model, VR dedicated fitness apps tend to be "far less expensive" than "other at-home smart fitness devices." Mot. 14. The evidence supports this assertion with respect to several connected fitness devices—Supernatural, the most expensive VR dedicated fitness app,[6] costs $399 plus $18.99 per month, while Peloton costs $1,445 plus $44 per month and Tonal costs $3,495 plus $49 per month. Singer Report ¶¶ 68–69. There are, however, digital fitness options—generally mobile phone apps—with subscriptions "in the sort of $8 to $12 range." Milk Hr'g Tr. 732:22–733:1; *see also* DX1081, at 1–2 (noting $12.99 Peloton app-only monthly subscription); Singer Report ¶ 65 (same).

The Court finds that the VR app and non-VR pricing evidence tilts slightly in favor of the existence of a VR dedicated fitness app market. *See, e.g.*, *FTC v. Tronox Ltd.*, 332 F. Supp. 3d 187, 200–01 (D.D.C. 2018) ("The existence of distinct prices . . . are 'not what one would expect if North American customers were willing and able to substitute one type of titanium dioxide for another in response to a change in their relative prices.'") (citations omitted). Testimony from both Within and Meta indicate a practical reason for VR fitness apps to be generally best served

[6] Some VR dedicated fitness apps charge a one-time price over $18.99, and another VR dedicated fitness app has a free version as well as a premium version priced equally to Supernatural at $18.99 per month. All other VR dedicated fitness apps charge subscriptions lower than $18.99 per month, and one is free. Singer Report ¶ 39.

by a subscription pricing model, which is in line with broader non-VR fitness offerings. And VR dedicated fitness apps are much more affordable than the non-VR fitness products that come closest to offering the level of immersion available in VR. *See* Vickey Hr'g Tr. 1184:12–21 (opining that touchscreen on Hydrow rowing machine provides immersive experience). However, in light of the evidence that there exist both other VR apps that can strategically employ a subscription model and non-VR fitness offerings that are comparably priced to VR fitness apps, the overall weight of this factor is lessened.

vi. Sensitivity to Price Changes

The sixth *Brown Shoe* factor evaluates the change in sales of a possible substitute product given a change in the price of products within the relevant market. Because this is in essence the same question posed by the HMT, *see FTC v. Staples*, 970 F. Supp. 1066, 1075 (D.D.C. 1997), the Court will not duplicate its analysis here. Drawing from that analysis, *see infra*, Section III.B.1.b., the Court finds this factor to be neutral as to the existence of a VR dedicated fitness app market.

vii. Specialized Vendors

The final *Brown Shoe* factor considers whether a product's distribution requires vendors with specialized knowledge or practices. *See Brown Shoe*, 370 U.S. at 325; *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 120–21 (D.D.C. 2016) (defining product market in part due to necessity that vendors have distinguishing capabilities such as sophisticated IT systems, personalized and high-quality service, and next-day delivery). The FTC has not presented evidence that the VR dedicated fitness app market requires specialized vendors.

* * *

For the reasons explained above, the Court finds that the following *Brown Shoe* "practical indicia" support the FTC's assertion that VR dedicated fitness apps constitute the relevant product market: industry or public recognition; peculiar characteristics and uses; unique production facilities; distinct customers; and (to a lesser degree) distinct prices. These factors indicate that VR dedicated fitness apps present in-market firms with an economic opportunity that is distinct from both other VR apps and other fitness offerings. *See Thurman Indus., Inc.*, 875 F.2d at 1375.

The Court therefore finds that the FTC has met its burden of showing that VR dedicated fitness apps constitute a relevant antitrust product market. *Brown Shoe*, 370 U.S. at 325–28; *see also Lucas Auto. Eng.*, 275 F.3d at 766–68 (relying on *Brown Shoe* factors alone in review of relevant market); *Klein*, 580 F. Supp. 3d at 766–73 (same); *Newcal Indus.*, 513 F.3d at 1051 ("Even when a submarket is an *Eastman Kodak* submarket, though, it must bear the 'practical indicia' of an independent economic entity in order to qualify as a cognizable submarket under *Brown Shoe*.").

b. Hypothetical Monopolist Test (HMT)

In the interests of thoroughness, the Court also addresses the parties' HMT arguments. The HMT is a quantitative tool used by courts to help define a relevant market by determining reasonably interchangeable products. *Optronic Techs., Inc.*, 20 F.4th at 482 n.1. The test asks whether a "hypothetical monopolist that owns a given set of products likely would impose at least a small but significant and nontransitory increase in price (SSNIP) on at least one product in the market, including at least one product sold by one of the merging firms." Singer Report ¶ 32; *see* 2010 Merger Guidelines § 4.1.1. If enough consumers would respond to a SSNIP—often calculated as a five percent increase in price—by making purchases outside the proposed market definition so as to make the SSNIP not profitable, then the proposed market is defined too narrowly. Singer Report ¶ 32; *Optronic Techs., Inc.*, 20 F.4th at 482 n.1.

The FTC's economics expert, Dr. Singer, conducted a hypothetical monopolist test on the VR dedicated fitness app market. Singer Report ¶¶ 49–68. To inform his analysis of the response to a SSNIP in the VR dedicated fitness app market, Dr. Singer commissioned Qualtrics to conduct "a survey of Supernatural users to determine what fitness apps they perceive to be a reasonably close substitutes to Supernatural and to VR dedicated fitness products generally." *Id.* ¶ 60. Dr. Singer testified that although an economist's natural path would be to collect data about Supernatural customers' transactions and reactions to any price increases, such data was unavailable here because Supernatural has never changed its price from $18.99 per month. Singer Hr'g Tr. 365:2–13. The survey was his "next best" option, and the approach is supported by the 2010 Merger Guidelines. *Id.* 365:16–18; Singer Report ¶¶ 60–61; 2010 Merger Guidelines §

4.1.3. Based on his analysis of the survey, Dr. Singer determined that VR dedicated fitness apps constituted a relevant market. Singer Hr'g Tr. 360:7–8.

Defendants deride Dr. Singer's survey as "junk science" and urge this Court not to rely on it. Opp. 11; Meta Closing Hr'g Tr. 1508:22–1509:3. In support of their arguments, Defendants relied on the expert reports and testimony of Dr. Dube and Dr. Carlton, who the Court found qualified as experts in the design and implementation of surveys and the economics of consumer demand for branded goods, *see* Dube Hr'g Tr. 872:16–873:19, and industrial organizations and microeconomics, *see* Carlton Hr'g Tr. 1355:15–20. Based on the testimony elicited by Defendants from Dr. Singer, Dr. Dube, and Dr. Carlton, the Court is troubled by various apparent flaws in the survey underlying Dr. Singer's HMT. Most pertinently, there appear to be several indications that a high fraction of the 150 surveyed individuals, on whose answers Dr. Singer's analysis necessarily relied, were untruthful in one or more responses. *See, e.g.*, Dube Hr'g Tr. 895:12–25 (respondents claimed to own multiple pieces of bulky, expensive equipment); Carlton Report ¶ 93 (over two dozen respondents claimed to regularly use all 27 fitness products listed on survey). Another facet of concern is the survey's apparent inclusion of a non-VR product in the question designed to capture a hypothetical monopolist's pricing power in a VR-only market. Carlton Hr'g Tr. 1428:21–1429:9. These questions, among others, suggest that the survey data underlying Dr. Singer's HMT analysis may not be reliable, which in turn casts doubt on the conclusions to be drawn from the HMT.

The Court's reservations about the survey do not change its finding that VR dedicated fitness apps constitute a relevant antitrust product market. Because the Court bases its determination of the relevant product market on its *Brown Shoe* analysis, *see supra* Section III.B.1.a., rather than the HMT, it need not determine the validity of Dr. Singer's survey methodology. *See, e.g.*, Singer Hr'g Tr. 450:25–452:17. The *Brown Shoe* factors are sufficient to inform the Court's understanding of the "business reality" of the VR dedicated fitness app market. *Lucas Auto. Eng.*, 275 F.3d at 766–68; *see also United States v. Anthem, Inc.*, 236 F. Supp. 3d 171, (D.D.C. 2017) (noting *Brown Shoe* factors supported the "business reality" of the government's relevant market despite defense argument of "[in]sufficient economic rigor"); *RAG-Stiftung*, 436 F. Supp. 3d at 293 n.3 ("The *Brown Shoe* practical indicia may indeed be old school, and its analytical framework relegated 'to the jurisprudential sidelines.' But *Brown Shoe* remains the law, and this court cannot ignore its dictates.") (citations omitted). Because the Court does not rely on the challenged portions of Dr. Singer's report, the Court DENIES AS MOOT Defendants' motion to strike Dr. Singer's opinion that VR dedicated fitness apps constitute a relevant product market.[7] ECF No. 470.

2. Geographic Market

"The relevant geographic market is the 'area of effective competition where buyers can turn for alternate sources of supply.'" *Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775, 784 (9th Cir. 2015) (citations omitted). "[I]n a potential-competition case like this one, the relevant geographic market or appropriate section of the country is the area in which the acquired firm is an actual, direct competitor." *Marine Bancorporation*, 418 U.S. at 622. That is, the geographic market must "correspond to the commercial realities of the industry." *Brown Shoe*, 370 U.S. at 336; *see also Staples*, 970 F. Supp. at 1073 (relevant geographic market is region where "consumers can practically turn for alternative sources of the product and in which the antitrust defendant faces competition").

The FTC asserts that the United States is the relevant geographic market, and Defendants do not argue to the contrary. Mot. 15; *see generally* Opp. The Court agrees. As one of Within's founders testified, Supernatural is only available to Quest headset users in the United States and Canada mainly [redacted]. Milk Hr'g Tr. 671:4–9. More broadly, Quest headsets are designed so that a user's geolocation determines the availability and prices of content. Stojsavljevic Hr'g Tr. 79:23–80:6. Because content developed in other countries may not be available in the United States, and because Supernatural is not available

[7] Having independently reached the same conclusion as Dr. Singer regarding the relevant product market definition, the Court will rely on his subsequent analyses regarding the structure and characteristics of the defined market, which Defendants do not challenge. *See* ECF No. 470.

outside of the United States and Canada, the Court finds that the United States is an appropriate relevant geographic market. *See Staples*, 970 F. Supp. at 1073.

Accordingly, the relevant antitrust market for the analysis of the competitive impacts of Meta's acquisition of Within is VR dedicated fitness apps in the United States.

C. Substantial Market Concentration

The FTC has challenged Meta's acquisition of Within on the basis that the merger would substantially lessen potential competition. The Supreme Court has taken note of two species of potential competition theories: actual potential competition and perceived potential competition. *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1973); *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602 (1974). Although the two theories have different elements and are grounded in different presumptions about the market, they share a common requirement: they have "meaning only as applied to concentrated markets." *Marine Bancorporation*, 418 U.S. at 630–31. Because both doctrines posit that potential competitors can or will soon impact the market, there would be no need for concern if the market is already genuinely competitive. *Id.*

In assessing whether the relevant market is "substantially concentrated," the Supreme Court sets forth a burden-shifting framework. First, the FTC may establish a prima facie case that the relevant market is substantially concentrated by introducing evidence of concentration ratios. *Id.* at 631. Once established, the burden shifts to the merging companies to "show that the concentration ratios, which can be unreliable indicators of actual market behavior, did not accurately depict the economic characteristics of the [relevant] market." *Id.* If the prima facie case is not rebutted, then the market is suitable for the potential competition doctrines. *See United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 755 (D. Md. 1976).

1. Market Concentration Ratios

The Court finds that the FTC has sufficiently presented evidence using concentration ratios as permitted by *Marine Bancorporation*. Here, the FTC has provided the Herfindahl-Hirschman Index ("HHI")—a widely accepted measure of industry concentration frequently used by courts considering antitrust merger and acquisition actions—for the relevant market. FTC Proposed

Post-Hearing Findings of Fact ("FTC's Findings") ¶¶ 80–83, ECF No. 516; *Optronic Techs., Inc. v. Ningbo Sunny Elec. Co.*, 414 F. Supp. 3d 1256, 1263 (N.D. Cal. 2019), *aff'd*, 20 F.4th 466 (9th Cir. 2021). The FTC's 2010 Merger Guidelines provide that a market is considered "moderately concentrated" when the HHI exceeds 1500 and "highly concentrated" when it exceeds 2500. 2010 Merger Guidelines § 5.3.

The FTC's expert, Dr. Singer, calculated the HHI multiple times, accounting for different market definitions and stipulations. Dr. Singer first calculated the HHI by measuring each firm's market share using revenue. Singer Report ¶ 75, Table 2-A. This yielded an HHI of 6,917, [redacted] *Id.* Dr. Singer also calculated the market's HHI using "total hours spent" and "average monthly active users" as metrics and data collected from the Quest Store. Singer Rebuttal Report ¶¶ 124–25, Tables 1-A, 1-B. The HHI for "total hours spent" was 6,307; and for "monthly active users" was 3,377. *Id.*

The Court finds that—regardless of the metrics used—every one of these ratios reflect a market concentration well above what the Merger Guidelines have designated as "highly concentrated." Accordingly, the FTC have made their prima facie showing, and the burden shifts to Defendants to "show that the concentration ratios . . . did not accurately depict the economic characteristics of the [relevant] market." *Marine Bancorporation*, 418 U.S. at 631.

2. Defendants' Pleading Challenges

Before continuing to Defendants' substantive arguments seeking to rebut the FTC's prima facie case, the Court first turns to the Defendants' legal attacks on the FTC's pleadings. Defendants argue that the FTC's case stumbles right out of the blocks because the complaint does not allege oligopolistic or "interdependent or parallel behavior." Mot. Dismiss FAC ("MTD") 10–13, ECF No. 108. Defendants' position arises from the following language in *Marine Bancorporation*:

> The potential-competition doctrine has meaning only as applied to concentrated markets. That is, the doctrine comes into play only where there are dominant participants in the target market engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods or services.

418 U.S. at 631.

Defendants' argument is unpersuasive. Their fidelity to a stilted and strained reading of the Supreme Court's commentary conveniently dodges the actual burden-shifting framework that *Marine Bancorporation* set forth and applied. *Id.* at 631–32. In fact, the Supreme Court held that the district court had erred by taking the precise course of action that Defendants urge the Court takes here, *i.e.*, requiring the FTC to allege parallel behavior when it is Defendants' burden to present the absence. *Id.* ("In our view, *appellees did not carry this burden*, and the District Court erred in holding to the contrary. Appellees introduced no significant evidence of the absence of parallel behavior in the pricing or providing of commercial bank services in [the relevant market].") (emphasis added). A similar attempt to stretch the language from *Marine Bancorporation* to pin the burden on the government was likewise unsuccessful. *Black & Decker*, 430 F. Supp. at 750 n.41 (rejecting argument that "the government has failed to produce evidence of any interdependent or parallel behavior in the market or of the market firms' capacity to determine price and total output"). Defendants also are unable to identify any authority that has adopted its proposed inversed framework, not even the one Fifth Circuit decision they cited. *See* MTD 6; *Republic of Texas Corp. v. Bd. of Governors*, 649 F.2d 1026, 1045–46 (5th Cir. 1981) ("Concentration ratios of this magnitude establish here . . . a prima facie case that the [] market is a candidate for the potential competition doctrine, and *shift to Republic the burden to show that the concentration ratios . . . do not accurately depict the economic characteristics of the* [] *market*.") (emphasis added).

For all the reasons discussed, Defendants' theory that the FTC was required to plead oligopolistic, interdependent, or parallel behavior is without merit. To the extent Defendants' motion to dismiss the FAC is premised on this theory, the Court DENIES Defendants' motion.

3. Economic Characteristics of the "VR Dedicated Fitness App" Market

The FTC having established a prima facie case of "substantial concentration" using concentration ratios, the burden now shifts to Defendants to rebut that showing that "the concentration ratios . . . did not accurately depict the economic characteristics of the [relevant] market." *Marine Bancorporation*, 418 U.S. at 631. The touchstone inquiry, however, appears to be whether the relevant market "is in fact genuinely competitive." *Marine Bancorporation*, 418 U.S. at 631; *Tenneco, Inc. v. FTC*, 689 F.2d 346, 353 (2d Cir. 1982) (finding the FTC was "fully justified in concluding that the [] market was not genuinely competitive"); *Republic of Texas*, 649 F.2d at 1046 (finding that rebuttal evidence did not "establish that the overall competition from the thrift institutions was sufficient"); *Black & Decker*, 430 F. Supp. at 755 (noting that "various facets of competitive performance in the gasoline powered chain saw market offer conflicting indications"). The Court addresses each argument that Defendants have raised in rebuttal.

The Court first makes an opening observation that there appear to be at least some characteristics of the market that may be difficult to express with concentration ratios. If nothing else, both parties seem to agree that the VR dedicated fitness app market is a nascent and emerging market, which would be an economic characteristic of the market not fully captured by the concentration ratios. *See* FTC's Findings ¶¶ 68–69; Singer Report ¶ 92. However, the Court must consider whether those characteristics indicate that the market is genuinely competitive.

Nascency. The Court has received conflicting expert evidence from both parties as to whether nascent markets are more or less vulnerable to coordinated oligopolistic behaviors. Dr. Carlton submits that a nascent market with rapidly evolving products is more difficult to coordinate behaviors, while Dr. Singer has asserted that there is no accepted economic theory to support the segmentation of nascent, adolescent, or mature markets. *Compare* Carlton Report ¶¶ 127–29, *with* Singer Rebuttal Report ¶¶ 130-33.

The evidence presented suggests that companies in the VR dedicated fitness market do not exhibit revenue or profit-maximizing behaviors, such as price competition. Koblin Hr'g Tr. 636:11–14; Milk Hr'g Tr. 736:6–8. Instead, their strategies appear to be optimized for growth and penetration—[redacted]—with the expectation that those qualities will render them an attractive acquisition target. *See, e.g.*, Milk Hr'g Tr. 736:15–21 ("[redacted]

[redacted].”); Zyda Hr’g Tr. 1227:18–22, 1228:15–18 (“[S]tartups that work in the VR space can get acquired, and that’s pretty much the dream of almost every startup.”); Garcia Hr’g Tr. 1111:8–1112:14; Janszen Hr’g Tr. 1147:22–1148:1. It is unclear to the Court how this departure from conventional profit-maximization strategies—an assumption often made in defining antitrust markets, *see* 2010 Merger Guidelines § 4.1.1 (noting that the HMT “requires [] a hypothetical profit-maximizing firm”)—should affect the assessment of genuine competition in this market.[8]

Notwithstanding the experts’ robust economics discussions, neither party has presented the Court with a working definition of “nascency,” such that it can distinguish a nascent market from a more mature market. Rather, the parties appear to use the “nascency” label—however the lines are drawn—as a proxy for other more observable market descriptions, such as highly differentiated products, unstable market shares, and new entrants. Carlton Report ¶¶ 127–29. Accordingly, the Court will give limited weight to the fact that the VR dedicated fitness market may be characterized as a nascent market and focus instead on the underlying market indicators.

Market Share Volatility. Dr. Carlton claims that the VR dedicated fitness market exhibits changing market shares, but he does not provide any historical data or evidence that the market shares have changed over time. Carlton Report ¶¶ 124–25. Instead, Dr. Carlton relies on the fact that none of the apps were in existence five years ago, that new entries are occurring, and on Dr. Singer’s data on changes in *other* VR app markets. *Id.* ¶ 125. But new entrants do not necessarily result in shifting or deconcentrating market shares, and Defendants have not presented evidence of actual historical shifts in shares for the relevant market here. Moreover, [redacted] *Id.* ¶ 67, Table 10.

New Entrants. Defendants and Dr. Carlton have made much ado about the incoming

[8] Indeed, the many novel questions of law presented by this case may signal an ill fit between these long-standing antitrust doctrines and the structures of modern technology markets.

entrants and the fact that the FTC's relevant market has effectively doubled since the initiated this litigation. *See, e.g.*, Opp. 14. Although the "introduction of new firms and fluid condition of market entry and exit can indicate competitive behavior," the bottom line is that these new entrants have not significantly deconcentrated the market, nor do they suggest a trend towards such deconcentration. *Black & Decker*, 430 F. Supp. at 751; *see also* Singer Rebuttal Report ¶¶ 124–25, Tables 1-A, 1-B (indicating *de minimis* shares of new entrants).

Barriers to Entry. Defendants rely on the new entrants into the market as evidence that barriers to entry are low. Opp. 13. However, the number of new entrants "does not belie the substantial entry barriers characteristic of the [relevant] market." *Black & Decker*, 430 F. Supp. at 751. The evidence presented suggest that barriers to entry are existent but are not insurmountable. As the Court discusses further in this order, there are several ingredients required for a potential entrant considering entry into the VR dedicated fitness app entrant, including financial resources, VR engineering resources, fitness experience and content creation, and studio production capabilities. *See infra* Section III.D.2.a. On the other hand, for most potential entrants into any VR app market, Meta provides grants, software development kits, infrastructure code, and even engineering support to third-party VR app developers. Pruett Hr'g Tr. 284:18–285:18.

Having considered the VR dedicated fitness app market's nascency, volatility, new entrants, barriers to entry, and price competition, the Court is inclined to find that Defendants have not rebutted the FTC's prima facie case. The Court certainly appreciates that a nascent market with an emerging technology may have some features and market incentives that are not captured by concentration ratios. However, the evidence does not support a finding that the VR dedicated fitness app market exhibits the characteristics or desirable behaviors of a competitive market. And as the Supreme Court noted in *Falstaff Brewing*, the absence of "blatantly anti-competitive effects" may not necessarily preclude the propriety of potential competition theories, because the high degree of market concentration indicates that the "seeds of anti-competitive conduct are present." 410 U.S. 526, 550; *see also id.* n.15 ("[A] market might be so concentrated that even though it is presently competitive, there is a serious risk that parallel pricing policies might emerge

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sometime in the near future.”).

That said, because the Court finds *infra* that the FTC has not satisfied the other elements of the potential competition theories they have brought, the Court need—and does not—decide whether the Defendants’ showing here is sufficient to rebut the FTC’s prima facie case on substantial concentration. *See United States v. Siemens Corp.*, 621 F.2d 499, 506 (2d Cir. 1980).

D. Actual Potential Competition

The FTC first argues that the Acquisition would substantially lessen competition because it deprives the VR dedicated fitness app market of the competition that would have arisen from Meta’s independent entry into the market, a theory known as the “actual potential competition” or “actual potential entrant” doctrine. *See, e.g., United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 633 (1974). Although the Supreme Court has twice declined to resolve the doctrine’s validity when presented, it has nonetheless identified two essential preconditions before the theory can be applied: (1) the alleged potential entrant must have “available feasible means for entering the [relevant] market other than by acquiring [the target company]”; and (2) those “means offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects.” *Id.* The doctrine has since been applied by Courts of Appeal and district courts alike, though the Ninth Circuit has not yet had an opportunity to provide guidance on the actual potential competition theory.

Although “available feasible means” for entry may be established either by *de novo* entry or a toehold acquisition, the FTC has not argued that Meta could have entered the relevant market through a toehold acquisition, nor does it identify any company in the relevant market that could have served as such a target. *See, e.g.*, FAC ¶ 57; Mot. 19. “Since the [FTC] offered no evidence of a toe-hold purchase that was available and attractive to [Meta], any such theory must be rejected for lack of proof.” *United States v. Siemens Corp.*, 621 F.2d 499, 508 (2d Cir. 1980). Accordingly, the Court will only consider whether Meta had “available feasible means” for entering the relevant market *de novo*.

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1. Threshold Issues

Before discussing the evidence, the Court first turns to three threshold disputes of law between the parties, which are: (1) the continued vitality of the actual potential competition theory; (2) the standard of proof the FTC must meet; and (3) the roles and consideration of objective and subjective evidence.

a. Doctrinal Validity

Throughout this litigation, Defendants have sought to cast doubt as to the very existence of the actual potential competition theory because it has never been fully endorsed by the Supreme Court. *See, e.g.*, Opp. 2; MTD, at 2, 16–17. Notwithstanding Defendants' doubts, this doctrine has been applied by multiple Circuit Courts of Appeal, *e.g.*, *Yamaha Motor Co. v. FTC*, 657 F.2d 971 (8th Cir. 1981); *United States v. Siemens Corp.*, 621 F.2d 499 (2d Cir. 1980); *FTC v. Atl. Richfield Co.*, 549 F.2d 289 (4th Cir. 1977); the Federal Trade Commission itself, *Altria Group, Inc.*, 2022 WL 622476 (Feb. 23, 2022); *B.A.T. Industries*, 1984 WL 565384 (Dec. 17, 1984); and various district courts, including one that ordered divestiture upon a finding of actual potential competition and whose judgment was affirmed by the Supreme Court. *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd sub nom. Tidewater Oil Co. v. United States*, 418 U.S. 906 (1974), and *aff'd*, 418 U.S. 906 (1974). Given the actual potential competition doctrine's consistent, albeit distant, history of judicial recognition, the Court declines to reject the theory outright and will apply the doctrine as developed. *See FTC v. Steris Corp.*, 133 F. Supp. 3d 962, 966 (N.D. Ohio 2015) ("[T]he FTC has clearly endorsed this theory by filing this case, and the administrative law judge will be employing it during the proceeding. . . . Accordingly, in deciding the likelihood of success on the merits, the Court will assume the validity of this doctrine.").

To the extent Defendants' motion to dismiss sought dismissal of the FTC's actual potential competition claim on the basis that it is a "dead-letter doctrine," ECF No. 108, at 2, Defendants' motion is DENIED.

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b. Standard of Proof

There is less consistency among courts as to the proper standard of proof by which the FTC must prove its case on actual potential competition, and it is an issue of first impression within the Ninth Circuit. The Fourth Circuit has held that the FTC must establish its case with "strict proof." *Atl. Richfield*, 549 F.2d at 295. The Second Circuit has asked whether a defendant "*would likely have* entered the market in the near future." *Tenneco, Inc. v. FTC*, 689 F.2d 346, 352 (2d Cir. 1982) (emphasis added). The Fifth Circuit adopted the "reasonable probability" standard, which it remarked "signifies that an event has a better than fifty percent chance of occurring [with a] 'reasonable' probability represent[ing] an even greater likelihood of the event's occurrence." *Mercantile Texas Corp. v. Bd. of Governors*, 638 F.2d 1255, 1268–69 (5th Cir. 1981). The Eighth Circuit also appeared to adopt the "reasonable probability." *Yamaha Motor*, 657 F.2d at 977 (defining the inquiry as "would [defendant], absent the joint venture, *probably* have entered the [relevant] market independently") (emphasis added). Finally, the FTC itself has unambiguously adopted a "clear proof" standard. *B.A.T. Industries*, 1984 WL 565384, at *10.

In the absence of guiding Ninth Circuit law, the Court begins with *Brown Shoe*'s teaching that Section 7 deals with neither certainties nor ephemeral possibilities but rather "probabilities." *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 323 (1962). In the context of an actual potential competition claim, however, the Court must not only consider the effects of future scenarios where the Acquisition occurs and where it is blocked, but it must also gauge the likelihood—in the second scenario—that the blocked would-be acquirer would enter the relevant market independently. Furthermore, the harm to competition the doctrine aims to prevent is not the loss of *present* competition but rather the potential loss of a *future* competitor (the acquiring company). Given the many *a priori* inferences required by the doctrine, the Court is wary of any inquiry that strays too close to the specters of ephemeral possibilities, yet it must nonetheless ensure the standard does not require the FTC to operate on certainties. The Court accordingly holds that the "reasonable probability" standard—as clarified by the Fifth Circuit to suggest a likelihood noticeably greater than fifty percent—is the standard of proof that the FTC must present.

To the extent Defendants' motion to dismiss is based on the assertion that the correct standard of proof is "clear proof," the Court DENIES Defendants' motion.

c. Objective vs. Subjective Evidence

Finally, the Court reaches the parties' disagreement as to the roles of objective and subjective evidence. The FTC asserts that it may meet its burden using solely objective evidence regarding Meta's "overall size, resources, capability, and motivation." Mot. 18–19; *see also* FTC Closing Hr'g Tr. 1494:12–18. Defendants, meanwhile, strenuously emphasize subjective evidence that Meta never had any plan to enter the Relevant Market *de novo* and would not do so if the Acquisition is blocked. Opp. 15.

Courts have uniformly recognized the highly probative value of objective evidence in evaluating whether a potential entrant is reasonably probable to enter the market *de novo*; the disagreement only arises as to whether plaintiffs can satisfy their burden using only objective evidence and whether subjective evidence should warrant any consideration. *Compare Mercantile Texas*, 638 F.2d at 1270 ("Not only is objective evidence undeniably probative, but subjective evidence is not required to establish a violation of the Clayton Act standard. On remand, the Board may rely exclusively on objective evidence if that evidence is sufficient to support the findings we require.") (internal citation omitted), *with B.A.T. Industries*, 1984 WL 565384, at *26 (noting that "the inherent limitations of economic evidence mean that, standing alone," purely objective evidence could not "establish liability under the actual potential entrant theory") (Bailey, Comm'r, concurring). Many courts have also consulted both objective and subjective evidence in reaching their conclusions. *See, e.g.*, *Siemens*, 621 F.2d at 507; *Yamaha Motor*, 657 F.2d at 979; *Phillips Petroleum*, 367 F. Supp. at 1239 (recognizing that subjective evidence is "relevant and entitled to consideration, [but] cannot be determinative").

Here, the Court will first consider whether the objective evidence presented by the FTC supports the findings and conclusions necessary to satisfy the actual potential competition doctrine. If the objective evidence is weak, inconclusive, or conflicting, the Court will consult subjective evidence to illuminate the ambiguities left by the objective evidence, with the understanding that the subjective evidence cannot overcome any directly conflicting objective evidence. *See Falstaff Brewing*, 410 U.S. at 570 ("[T]he subjective evidence may serve as a counterweight to weak or inconclusive objective data. But when the district court can point to no compelling reason why the subjective testimony should be believed or when the objective evidence strongly points to the feasibility of entry de novo . . . it is error for the court to rely in any way upon management's subjective statements.").

2. Objective Evidence

Having disposed of the threshold questions, the Court now proceeds to apply the doctrine. The inquiry can be stated as follows: "Is it reasonably probable that Meta would have entered the VR dedicated fitness app market *de novo* if it was not able to acquire Within?"[9]

"In exploring the feasible means of entry alternative to the challenged acquisition, the court must analyze the incentive and capability of the acquiring firm to enter the relevant market." *Black & Decker*, 430 F. Supp. at 755. The Court thus considers in turn the objective evidence on Meta's capabilities and incentives to enter the VR dedicated fitness app market.

a. Capabilities of Entry

There can be no serious dispute that Meta possesses the financial resources to undertake a *de novo* entry. Meta has spent over $12.4 billion in the most recent fiscal year on its VR business, and it anticipates investing more in the VR space. *See, e.g.*, DX1237, at 51, Dec. 31, 2021; ECF No. 514, Defs.' Proposed Post-Hearing Findings of Fact ("Defs.' Findings") ¶¶ 44–47. Unsurprisingly, Meta also enjoys a deep and talented pool of engineers in its Reality Labs Division, who could provide the technical VR expertise to develop a VR dedicated fitness app should Meta so choose. *See* ECF No. 516, FTC Proposed Post-Hearing Findings of Fact ("FTC's Findings") ¶¶ 32–33. In fact, Meta maintains a team of "veteran engineers who are particular experts in [Meta's] VR technology and hardware" and who work directly with third-party VR app developers to "improve the quality of their software or help them fix bugs or [] polish the

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[9] As noted above, because the FTC has not argued that Meta could have entered the relevant market through a toehold acquisition, the Court considers only the question of *de novo* entry.

experience that the developer is building." Pruett Hr'g Tr. 286:4–12. The Court finds that the objective evidence establishes that Meta has the financial resources and ready access to qualified VR engineers to enter the VR dedicated fitness app market *de novo*.

But financial and engineering capabilities alone are insufficient to conclude it was "reasonably probable" that Meta would enter the VR dedicated fitness app market. Indeed, Meta seems willing to concede—as is supported by the evidence—that it "does not take a large team or substantial resources to make a successful VR app." Defs.' Findings ¶ 53. Instead, courts often counterbalance undisputed financial capabilities with those capabilities unique to the relevant market, rarely relying solely on the potential entrant's substantial wherewithal. *Siemens*, 621 F.2d at 507 (finding no evidence that potential entrant could "transfer its acknowledged capability with respect to other types of equipment to *nuclear medical equipment*") (emphasis added); *Atl. Richfield*, 549 F.2d at 295 ("[Potential entrant] has no technological skills readily transferrable to the *copper markets*; it has no channels of distribution which m ay be utilized to distribute copper.") (emphasis added); *cf. Yamaha Motor*, 657 F.2d at 978 (noting that the potential entrant had "requisite experience in the production and marketing of *outboard motors* in areas of the world other than Japan.") (emphasis added). The Court here finds that Meta lacked certain capabilities that are unique and critical to the VR dedicated fitness app market. *See* PX0127, at 7 (noting that Meta "will need to build 4 new [fitness] functions that are not part of Facebook's pipelines; Content development, instructors, studio production . . ., music rights & technology.").

First and foremost, although Meta has an abundance of VR personnel on hand, it lacks the capability to create fitness and workout content, a necessity for any fitness product or market. *See* PX0111 ("The answer is content creation. . . . You need that content variety to serve different ability levels, musical tastes, instructor personalities, etc."), Feb. 23, 2021. As a comparison, Supernatural's VR workouts are led by personal trainers and are optimized for VR activity through consultations with experts holding PhDs in kinesiology and biomechanics. PX0712, at 18, 27. Certainly, this absence is not an insurmountable obstacle; Meta could conceivably circumvent it by partnering with an established fitness brand to provide the fitness content, as

Odders Lab did with Les Mills.[10] FTC's Findings ¶¶ 123, 148; *see also* Garcia Hr'g Tr. 1072:18–1073:1. [redacted] *see also Tenneco*, 689 F.2d at 354 (rejecting as "unsupported speculation" the FTC's suggestion that the potential entrant would have entered the market *de novo* "with the aid of a license" for necessary technology). Regardless of any potential workarounds, the objective fact that Meta presently lacks the capability to create fitness content is, at the very least, probative as to the reasonable probability that Meta would enter the VR dedicated fitness app market *de novo*.

In addition to fitness content, the evidence also indicates that Meta lacked the necessary studio production capabilities to create and film VR workouts. Once again comparing to Supernatural, Within records daily workout classes in its Los Angeles studio, and its founders have directed several interactive music videos. PX0712, at 3–4, 29. When Meta employees were strategizing VR fitness investments, they recognized that "studio production (e.g. green screen ops, stereoscopic capture, post processing pipelines)" was a new function that was "not part of Facebook's pipelines."[11] PX0127, at 7, Mar. 10, 2021. Contrary to the FTC's suggestion, the Court finds that Meta's acquisition of Armature Studio—a third-party VR studio with expertise in co-developing VR apps—does not provide the necessary studio production capabilities to develop a VR dedicated fitness app. *See* FTC's Findings ¶¶ 125, 290. The evidence indicates that

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[10] The Court can imagine more scenarios, *e.g.*, where Meta contracts independent fitness instructors or employs a team of regular fitness instructions, but they would require further speculation.

[11] To clarify, the Court cites this internal Meta strategy document for its identification of functions that are *objectively* absent from Meta's capabilities, and not for any probative value in determining Meta's *subjective* intention, such as whether those absences are sufficient to deter it from entering the VR dedicated fitness app market de novo.

Armature is very much a *game* studio, not a *production* studio [redacted] PX0527, at 6 (listing Armature's [redacted] The FTC highlights an internal Meta presentation that presented Armature as an acquisition target who could "build a fitness-first product based on Beat Saber x their sports experience." *Id.* However, the basis for this suggestion comes not from any prior production studio experience but rather Armature's experience developing the rendered VR video game, Sports Scramble. *Id.* As with Meta's fitness expertise, its lack of production studio capabilities to film a VR fitness workout is a relevant—though less compelling—factor for the Court's "reasonably probable" consideration.

b. Incentives to Enter

In addition to the objective evidence presented of Meta's capabilities of entering the VR dedicated fitness app market, the Court also considers the objective evidence of Meta's incentives and motivations for entering this market.

<u>Users and Growth</u>. The record is replete with evidence supporting Meta's interest in the VR fitness space. Defs.' Findings ¶ 280 ("[E]mployees at Reality Labs were interested in fitness as a promising VR use case"). First, fitness is a use for VR that appeals to a more diverse population, specifically consumers that are female and older. *Id.* ¶ 280 (citing testimony). This demographic is notably distinct from the typical VR demographic, which tends to skew younger and more male. *Id.*; *see also Black & Decker*, 430 F. Supp. at 756 ("[C]ommitment to diversification is an important factor to be considered in analyzing [] desire to enter a particular market."). Fitness is also "retentive," meaning that users will tend to regularly use the product or app. PX0386, at 12 (fitness apps had a "strong [redacted] retention"), Apr. 12, 2022; *see* Stojsavljevic Hr'g Tr. 108:19–25. Meta's internal data also indicated that "deliberate fitness apps" were the "fastest growing segment" with [redacted] year-over-year growth. PX0386, at 12. These promising demographic, use, and growth metrics are especially important to Meta, because it has "bet[] on VR technology as a general computing platform to join today's PCs, laptops, smartphones, and tablets." Defs.' Findings ¶ 44.

Although they undergird Meta's undisputed interest in VR fitness, the aforementioned factors provide limited probative value in assessing Meta's likelihood to enter the VR dedicated fitness app market itself. As the Court established earlier in this section, the relevant inquiry is whether it is "reasonably probable" that Meta would have entered the VR dedicated fitness app market *de novo*, not whether Meta was excited about or interested in more generally investing in VR fitness. Meta's interest in the promising VR fitness app metrics—diverse appeal, strong user retention, rapid growth—stems from the potential for broader VR adoption and market penetration. *See* Carlton Report ¶¶ 33–35. And Meta, as a competitor in the VR headset market, benefits from that growth so long as high-quality VR fitness apps exist in the VR ecosystem; Meta need not itself be a player in that ecosystem. *See* Defs.' Findings ¶ 49. This mutually beneficial relationship between the VR platform and third-party VR apps distinguishes this case from other potential competition cases where potential entrants are typically incentivized to enter the relevant market because they are not capturing any of the neighboring market's growth or profitability. *See, e.g.*, *Black & Decker*, 430 F. Supp. at 755 (electric saw manufacturer entering the gasoline-powered chain saw market); *Phillips Petroleum*, 367 F. Supp. at 1245 (non-California oil company entering the California market for gasoline sales); *Yamaha Motors*, 657 F.2d at 974 (Japanese motor company entering the U.S. outboard motor market). The Court accordingly does not find that these specific features of the VR dedicated fitness app market increase the probability that Meta would enter the market *de novo*, because Meta would enjoy those incentives even if it remained outside the relevant market and provided funding or technical support for in-market VR fitness app developers, as it already does.[12] *See supra* ¶ 7.

<u>Hardware Integration</u>. Apart from the incentives arising from the VR fitness market itself, the evidence also reflects one other incentive that arises from Meta's direct participation in the relevant market. Specifically, entering the VR dedicated fitness app market with its own app

[12] To be sure, there is incentive for any company to enter a market that has stable consumers and is experiencing high growth, and the Court considers these incentives in assessing reasonable probability of Meta's entry. However, those incentives are of a different type and on a different scale from Meta's interest in VR dedicated fitness apps as a VR platform developer.

would facilitate Meta's subsequent development of fitness-related VR hardware. This is an incentive to "first-party" entry that is acknowledge across multiple instances of internal contemporaneous correspondence at Meta. *See, e.g.*, PX0127, at 7 [redacted], Mar. 10, 2021; PX0146, at 10 ("[First-party] will allow us to test and iterate tools in our Fitness platform that we can then surface to other 3P"), June 18, 2021; PX0487, at 5 ("We believe that increasing [headcount] for 1P investment (Option 3) is worth the tradeoffs in order to: 1. Develop a cohesive fitness ecosystem faster by enabling developers and building platform features."), May 14, 2021. That said, the evidence also suggests that *de novo* entry is not strictly necessary to develop fitness hardware, *see* FTC's Findings ¶ 185 (indicating that Meta has also already produced "wipeable interface, wrist straps, and adjustable knuckle straps"), though independent entry into the market could streamline that development.

<u>Profitability</u>. Finally, there is some evidence of the relevant market's profitability and that it [redacted] PX0386, at 12. The profitability of the relevant market is unsurprisingly a relevant incentive that many courts consider. *See, e.g.*, *Phillips Petroleum*, 367 F. Supp. at 1245; *Black & Decker*, 430 F. Supp. at 755. While this factor is often quite salient in other potential competition cases, it is somewhat muted here, [redacted]. PX0062 ("Milk Dep.") 19:8–12. Of course, a market's current profitability does not reflect its future profitability, especially if that market is exhibiting rapid growth as the VR dedicated fitness app market does here. Nonetheless, the fact that [redacted] would indicate that the profitability of the relevant market warrants less consideration than it otherwise would.[13]

* * *

[13] As discussed in the "Users and Growth" analysis above, the record reflects that Meta's interest in the VR dedicated fitness market stems from the market's potential contribution to broader VR adoption and corresponding headset sales. The Court recognizes that a thriving VR fitness market may contribute to Meta's future profitability in headset sales. But that potential profitability in a different market is both too divorced from the likelihood of Meta's *de novo* entry in the relevant market, and too speculative to evaluate under this factor.

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Having reviewed and considered the objective evidence of Meta's capabilities and incentives, the Court is not persuaded that this evidence establishes that it was "reasonably probable" Meta would enter the relevant market. Meta's undisputed financial resources and engineering manpower are counterbalanced by its necessary reliance on external fitness companies or experts to provide the actual workout content and a production studio for filming and post-production. Furthermore, the record is inconclusive as to Meta's incentives to enter the relevant market. There are certainly some incentives for Meta to enter the market *de novo*, such as a deeper integration between the VR fitness hardware and software. However, it is not clear that Meta's readily apparent excitement about fitness as a core VR use case would necessarily translate to an intent to build its own dedicated fitness app market if it could enter by acquisition.

On balance, the objective evidence does not so "strongly point to the feasibility of entry de novo" that the Court should decline to consider subjective evidence of intent. *Falstaff Brewing*, 410 U.S. at 570.

3. Subjective Evidence

The Court first notes that it will accord little weight to subjective evidence and statements provided by Meta employees during the course of this litigation. Although they are relevant, entitled to some weight, and no doubt offered by persons of character, the bias affiliated with such *ex post facto* testimony is widely recognized and unavoidable. *See, e.g.*, *Falstaff Brewing*, 410 U.S. at 565, 570 (Marshall, J., concurring). In reviewing the subjective evidence in the record, the Court will refer primarily to contemporaneous statements made by Meta employees.

The record reveals certain documents created contemporaneously by Meta employees that appear to set forth Meta's overall third-party VR investment strategy, along with individualized analyses of various VR fitness investment options. PX0492 ("Quick Fitness / M&A Thoughts"), Mar. 9, 2021; PX0127 ("VR Fitness Content investment thesis v2"), Mar. 10, 2021; PX0146 ("FB Inc Fitness Strategy Working Draft"), June 18, 2021. The FTC has represented that these documents were sponsored by Meta employees: Rade Stojsavljevic, who oversaw all of Meta's first-party VR gaming studios (Stojsavljevic Hr'g Tr. 69:18–24); Anand Dass, Meta's director of non-gaming VR content (*id.* 138:11–18); and Jane Chiao, a business-side employee who reported directly to Mark Rabkin, the head of VR technology at Meta (*id.* 140:23–141:1, Rabkin Hr'g Tr. 800:7–11). Furthermore, exhibit PX0127 was a "pre-read" circulated in advance of a meeting with Mark Rabkin, *see* Stojsavljevic Hr'g Tr. 149:16–151:12, who would have been one of the decisionmakers needed to sign off on any significant VR fitness investment. *Id.* 189:24–190:12. These are not "memoranda of lower echelon [] employees." *Siemens*, 621 F.2d at 508; *see* also *Atl. Richfield*, 549 F.2d at 297 n.9. Accordingly, the Court finds that the statements in these documents reflect the thoughts and impressions of relatively significant stakeholders, as the authors were generally one or two people away from the final decisionmaker.

The evidence contained in these strategy documents is consistent—Meta's subjective motivations to enter the relevant market were primarily to (1) better develop VR fitness hardware or (2) ensure the continued existence of a high-quality VR fitness app in the market. The Court notes that these incentives would apply to both entry by acquisition and entry *de novo*, though perhaps not with equal force.

First, this subjective evidence corroborates the objective evidence that Meta primarily wanted to be a first-party firm in the VR dedicated fitness market so it could improve its VR fitness hardware (*e.g.*, headsets, heart monitor, wrist straps). *See* PX0492, at 2 ("Deep integration with hardware and software to create best in class experience that other devs can follow"); PX0127, at 7 [redacted]); PX0146 ("1P content is not a goal in itself – *it is only in the service of broader platform objectives* (e.g., help accelerate progress of market phases).") (emphasis added). The importance of this incentive is supported by internal Meta communications. *See* PX0179, at 2 (noting that "strategic rationale already exists" to pursue VR fitness, which was to "[c]reate option value for [Meta's device], software platform and hand tracking"), Mar. 11, 2021.

Second, the evidence also indicates that Meta would want to enter the VR dedicated fitness app market if the availability of VR fitness apps was at risk of becoming constrained and, therefore, Meta could ensure that at least one high-quality VR fitness app remained in the market. Specifically, as early as March 2021, Meta employees were expecting Apple to "lock in" VR fitness content to be exclusive with Apple's VR hardware. *See* PX0492, at 2 [redacted] Mar. 9, 2021; PX0127, at 6 [redacted], Mar. 10, 2021. This incentive was also corroborated by contemporaneous communications. DX1012 , at 1 [redacted], May 26, 2021. The evidence also suggests that this incentive was the primary animating factor that ultimately compelled Meta to pursue Within as an acquisition. *See, e.g.*, PX0117 [redacted].

Meta's prior ventures into other VR app markets also do not support a subjective intention or proclivity to build its own apps as opposed to an acquisition. Courts have considered a potential entrant's history of acquisitions and expansions in determining its likelihood of *de novo* entry. *See Black & Decker*, 430 F. Supp. at 756 (potential entrant had previously "diversified almost exclusively through internal expansion [and] had a definite, if unwritten, policy known to its employees of discouraging growth by acquisition"); *Phillips Petroleum*, 367 F. Supp. at 1240 ("At no time prior to the [] acquisition did [the potential entrant] ever enter a new marketing area by acquiring a major company in that market."). The evidence indicates that Meta has tended to build its own VR app where the experience did not call for specialized or substantive content, *e.g.*, Horizon Worlds (a world-building app where other users can create worlds in VR), Horizon Workrooms (a productivity app), Horizon Venues (a live-events app), Horizon Home (social networking app). Meta's Answer and Affirmative Defenses ¶ 35; *see also* PX0056 ("Carmack

Dep.") 101:15–23 (indicating Meta does not have "anything internally developed that was a hit outside of our browser application"). Meanwhile, Meta has acquired other VR developers where the experience requires content creation from the developer, such as VR video games, as opposed to an app that hosts content created by others. Stojsavljevic Hr'g Tr. 87:5–88:2. With respect to fitness, the Court finds that VR dedicated fitness is more akin to a gaming app—where the emphasis is on the content created or provided by the developer—than a browser or world-building app, where the value is derived from the users' own creativity rather than the developers'. Accordingly, based on Meta's past entries into VR app markets, the evidence would suggest an interest in entry by acquisition instead of entry *de novo*.

But even more pertinent than the record of Meta's past entries into VR app markets is the evidence that Meta had consciously considered and appeared doubtful of the proposition to build its own independent VR fitness app. The pre-read strategy document prepared for Mark Rabkin's attention contains a separate section that "[i]t will be hard to build Fitness from scratch." PX0127, at 7. Specifically, a VR fitness app would require Meta to [redacted] *Id.* The document also recognized that Meta would have to "build new kinds of expertise at the intersection of software, instructor-led fitness, music, media." *Id.* The decision not to build Meta's own VR fitness app is corroborated by the lack of any other contemporaneous discussion on the topic. The record does, however, indicate that Meta attempted to gauge whether it could expand Beat Saber together with a fitness partner, a prospect the Court delves into further below.

In sum, the subjective evidence indicates that Meta was subjectively interested in entering the VR dedicated fitness app market itself, either for hardware development or defensive market purposes. However, the Court again notes that these incentives would support both market entry by acquisition and *de novo*, but the Court's inquiry is only concerned with the feasibility of *de novo* entry. For instance, even though Meta's concern about [redacted] was an incentive to acquire Within, that incentive does not apply with equal force [redacted] PX0127, at 1. And, as the Court elaborates below, the evidence shows that all these factors—Meta's capabilities and incentives, both objective and subjective—did not result in Meta ever seriously contemplating a *de novo* entry, *i.e.*, building its own VR fitness app.

4. Identified Means of Entry

Up to this point, the Court has only addressed Meta's capabilities, incentives, and intent to enter the VR dedicated fitness app market in the abstract. However, an assessment of the probability and feasibility of a hypothetical *de novo* entry would not be complete without addressing the *actual* means of entry that Meta considered. *See Black & Decker*, 430 F. Supp. at 757 ("Three avenues of entry into the gas lawn mower field were explored. . . . "); *Siemens*, 621 F.2d at 502–03 (summarizing multiple possibilities that other acquiring company had considered); *Phillips Petroleum*, 367 F. Supp. at 1243–44 (same).

Nevertheless, the FTC has implied that the Court may infer that Meta would have entered the market *de novo*—irrespective of its actual plans for entry—using "available feasible means" unbeknownst to the parties or the Court. *See* FTC Closing Hr'g Tr. 1494:16–18 ("We don't have to show that Meta actually had a subjective intention to enter the market."). To the extent the FTC implies that—based solely on the objective evidence of Meta's resources and its excitement for VR fitness—it would have inevitably found and implemented some unspecified means to enter the market, the Court finds such a theory to be impermissibly speculative.

The FTC made a similar argument in *BOC International*, where it argued that "[s]imply because no entry had been effectuated at the time the [acquisition] presented itself did not mean that BOC would not have *eventually realized* its 'long-term objectives' of entering the [relevant] market by growth rather than by this major acquisition." *BOC Int'l, Ltd. v. FTC*, 557 F.2d 24, 29 (2d Cir. 1977) (emphasis added). The Second Circuit rejected this "eventual entry" theory as "uncabined speculation," holding that "it seems necessary under Section 7 that the finding of probable entry at least contain some reasonable temporal estimate related to the near future." *Id.* The FTC recently reaffirmed this holding in *Altria Group, Inc.*, 2022 WL 622476, at *70

("Complaint Counsel is arguing that due to Altria's resources as a large company, and economic incentives to participate in the e-cigarette market, Altria would have eventually had a product competing in that market. *This is precisely the position rejected by the court in* BOC.") (emphasis added). Additionally, insofar as the FTC implies Meta could overcome its lack of fitness experience and content creation by hiring experts or partnering with a fitness brand, the suggestion reflects "the kind of unsupported speculation" rejected in *Tenneco*. 689 F.2d at 354 (rejecting the FTC's "conclusion that [potential entrant] would have entered the market de novo with the aid of a license" for the necessary technology).

The Court here does not hold that every case of actual potential competition will require consideration of a potential entrant's actual and subjective plans for entry. *See Falstaff Brewing*, 410 U.S. at 565 ("We have certainly never suggested that subjective evidence of likely future entry is required to make out a § 7 case.") (Marshall, J., concurring). Nor does the Court suggest that a particular entry strategy can only be "reasonably probable" and "feasible" if it has reached a certain inflection point in the firm's decision-making process. Such a conclusion would incentivize corporate gamesmanship and reward decisionmakers for reaching merger decisions hastily without exploring non-merger alternatives. *See generally id.* at 563–71 (Marshall, J., concurring). However, where the objective evidence is "weak or inconclusive" and does not "strongly point[] to the feasibility of entry de novo," *id.* at 570, it is incumbent on the Court to consider the potential entrant's actual plans of entry for the purposes of ensuring that Section 7 enforcement does not veer into the realm of ephemeral possibilities. As applied here, the Court holds that the FTC may not rest solely on evidence of Meta's considerable resources and the company's clear zeal for the VR dedicated fitness app market as a whole; the evidence must show that Meta had *some* feasible and reasonably probable path to *de novo* entry.

Turning then to the evidence, the record indicates that Meta would only have entered by acquisition or a Beat Saber collaboration with a fitness content creator; the Court is unaware of any evidence that Meta considered building a VR fitness app on its own. In the strategy document that was prepared for the meeting with Mark Rabkin, Meta personnel had outlined and analyzed five options for investing in VR fitness: (1) acquire Within and Supernatural; (2) acquire [redacted]; (3) expand Beat Saber into deliberate fitness, likely by partnering with Peloton; (4) increase funding for development of third-party VR fitness apps; and (5) do nothing and maintain the status quo. PX0127, at 2–4. The record reflects that, although Meta initially pursued the first three options in parallel, the frontrunner was the [redacted] acquisition until approximately June 2021 when Meta pivoted to acquire Within. *See, e.g.*, PX0179, at 1–2 (indicating that action items included pursuing due diligence for both Supernatural and [redacted] and having Stojsavljevic "present a proposal to Rabkin on expanding Beat Saber to deliberate fitness"), Mar. 11, 2021; PX0284, at 1 (drafting email to Michael Verdu summarizing the "pros/cons of [redacted] vs. Supernatural"), Mar. 18, 2021; DX1012, at 1, 3 ("[Zuckerberg] asked if we were engaged with [Within]. . . . [Bosworth] responded that our focus has been on [redacted]."), May 26, 2021. Notably, even though Meta personnel had considered the option to increase third-party funding without entering the market and an option to do nothing as comparison, there was never an option for Meta to build its own VR dedicated fitness app to enter the market *de novo*.

Given the degree of analysis evident from these strategy documents, the Court finds that Meta had only considered the acquisition of Within, the acquisition of [redacted], and the partnership of Beat Saber with Peloton as feasible means to enter the relevant market. These three options, therefore, comprise the universe of "available feasible means" that the Court will consider for the purposes of the FTC's actual potential competition claim.

a. Entry by Acquisition

Meta's first two means of entry into the relevant market were both entries by acquisitions, either [redacted]. The evidentiary record indicates that these two options were both among the earliest proposals presented to Mark Zuckerberg, as well as the last two considered before Meta decided to acquire Within. *See, e.g.*, *supra* Section I.D.

The evidence supports a finding that, but for its pursuit of Within as an acquisition, there was a reasonably probability that [redacted] However, the inquiry before the Court is not whether it was reasonably probable that Meta [redacted] The FTC has argued almost exclusively that Meta's "available feasible means" of entering the relevant market is by *de novo* entry, not acquisition. The FTC also does not take the position [redacted] that could have also conceivably had procompetitive effects. *See, e.g.*, Mot. 21 (noting that Meta's entry into the market would have "introduce[ed] a strong, well-established new rival to Supernatural and FitXR"); *see also Marine Bancorporation*, 418 U.S. at 625 (defining a toehold acquisition as a "small existing entrant").

Accordingly, the Court does not consider the "reasonable probability" that Meta could have entered the VR dedicated fitness market [redacted] as an "available feasible means" for the purposes of the actual potential competition analysis.

b. Entry by Beat Saber–Peloton Partnership

This brings us to the final means—and the FTC's main theory—by which Meta could have entered the VR dedicated fitness market: expanding its existing rhythm game app Beat Saber into dedicated fitness and partnering with a fitness brand. The FTC claims that Meta scrapped this Beat Saber proposal once it learned that Within was at risk of being acquired by Apple. Mot. 10, 20–21. However, this theory is neither supported by the contemporaneous remarks regarding the Beat Saber proposal nor the timing of the subsequent investigation into this proposal.

<u>First</u>, the evidentiary record is unclear as to what exactly the widely referenced Beat Saber–Peloton proposal would even look like. On some occasions, Stojsavljevic—the proposal's primary advocate—refers to it as a "brand licensing w/ Peloton" or a "co-branding . . . Peloton mode inside Beat Saber." PX0144, at 1, Mar. 8, 2021; PX0407, at 1, Mar. 15, 2021. On other occasions, Stojsavljevic considers whether the proposal would be a separate Quest Store app. PX0407, at 2. Michael Verdu—another proponent of expanding Beat Saber into fitness—also recalled that the proposal never reached a point of "understanding what that partnership would look like." Verdu Dep. 201:14–23 ("[I]s it a Peloton-branded headset? Is it Peloton-branded content inside of our headset? Like we didn't even get to the point where we were exploring at that level of detail."). This uncertainty is consistent with the March 2021 "Beat Saber x Peloton

Opportunity Identification" presentation that [redacted] prepared at Stojsavljevic's request, which indicated that part of [redacted] task would be to define the partnership opportunity and determine how to present the proposal to Peloton. PX0121, at 5–6, Mar. 25, 2021. Ultimately, Stojsavljevic did not even engage [redacted] to proceed with her proposed research into the Beat Saber proposal. PX0052 ("Stojsavljevic Dep.") 219:23–220:1.

<u>Second</u>, the Beat Saber–Peloton proposal did not enjoy uniform or even widespread support among the Meta personnel who were researching VR fitness opportunities. *See* PX341, at 2 ("Jane and Anand were arguing with me [Stojsavljevic] when I was proposing Beat Saber x Peloton and thought we should buy [redacted] or Supernatural instead."), June 11, 2021. Particularly, Jane Chiao had consistently and contemporaneously expressed doubts regarding the feasibility of repositioning Beat Saber to fitness. *See* PX0492, at 1, 7 ("Jane's quick thoughts" included a section titled "Why not Beat Saber?" setting forth reasons against pivoting Beat Saber to fitness), Mar. 9, 2021. In one exchange, Chiao commented that [redacted]." PX0251, at 2, Mar. 4, 2021. Chiao's opinion was informed by the previous difficulties she had in attempting to reposition Meta's social functions for other uses. *Id.* at 2–3 ([redacted]).

<u>Third</u>, the timeline and dearth of contemporaneous internal discussions on the Beat Games–Peloton proposal is inconsistent with the FTC's narrative that the Within acquisition derailed an otherwise full-speed effort to explore the Beat Games proposal. *See generally* DDX07 (Defendants' timeline demonstrative), at 31. In short, the idea was raised and endorsed by Stojsavljevic on March 11, 2021 (PX0179); he solicited feedback from his peers a few days later (PX0407); and on March 25, 2021, he received a quote for a contractor to look into the proposal, but did not proceed with it (PX0121). After this initial scramble, the record reflects no further discussion about expanding Beat Saber into fitness before June 2021, when Meta began pursuing Within as an acquisition. Although the FTC argues that there is no direct evidence that Meta had

deliberately dropped the Beat Saber proposal, the absence of active discussions could just as reasonably—and the Court finds that it does—support Meta's explanation that the Beat Saber proposal had lost momentum after March 2021. The proposal's main driver, Stojsavljevic, testified that he had already "slowed down before [Meta's decision to pursue Within]," because he was busy with another Meta acquisition. Stojsavljevic Hr'g Tr. 165:12–17. Although subjective corporate testimony is generally deemed self-serving and entitled to low weight, Stojsavljevic's lack of bandwidth is corroborated by his contemporaneous decision to outsource the research for the Beat Games proposal. *See* PX0121, at 1; *see also* Stojsavljevic Hr'g Tr. 163:25–165:11.

Moreover, when viewed alongside Meta's history with Beat Saber, these two months of inactivity between March and June 2021 appear to have been the norm rather than the exception. Although Meta employees like Verdu were excited about Beat Saber's potential as a vector into fitness, Meta has never been able to execute on that excitement in any of the years since they acquired Beat Saber. Verdu Dep. 178:12–20 ("[I]t was the perpetual white whale quest to get . . . Beat Games to build a fitness version of Beat Saber, which was like pushing on a string. We tried and tried and tried, and they never picked it up."); *see* PX0123 ("[[redacted]] was on the goal list for the [beat] saber acquisition. . . . But that goal was never followed up on."), Sept. 15, 2021.

<u>Finally</u>, the FTC cites two instances of contemporaneous Meta communications that suggest the Beat Saber proposal had not died on the vine when Meta pivoted to acquiring Within. *See* FTC Closing Hr'g Tr. 1495:10–24. The first is Verdu's comment on June 20, 2021, that Meta was "in the *midst of a strategy exercise to decide between our alternatives* when Supernatural became in play (supposedly pursued by Apple), which accelerated everything." PX0117, June 10, 2021 (emphasis added). The FTC asserts that the referenced "alternatives" included the Beat Saber–Peloton proposal; however, this theory is inconsistent with the fact that there had been no internal discussion of the proposal in the preceding two months. The more likely interpretation is that "alternatives" referred to [redacted] *See* PX0253, at 1.

The second communication arose in the context of [redacted] requested a sale price of [redacted]. PX0123, at 2, Sept. 15, 2021. In discussing alternatives to the Within acquisition, Jason Rubin suggested that another [redacted] *Id.* He also suggested, "We might be able to buy [redacted], rebrand and redesign to Beat aesthetics." *Id.* In assessing the weight of these statements, the Court makes a few contextual observations. At the time Rubin made his comments, he had only been in his role for about six weeks; Verdu (an employee with extensive knowledge of Meta's history with VR fitness) previously held the role. PX0066 ("Rubin Dep.") 28:8–15 ("On August 1st, I took or was handed the role that I have right now . . . and inherited [the Meta–Within] acquisition in full swing."). Rubin also testified that, before switching roles, he "was not aware of anything having to do with fitness at all in the VR world" and had no knowledge of "how the company had come to its decision making to acquire [Within]." *Id.* 126:9–127:11. Perhaps on a record with more corroborating evidence, Rubin's remarks may warrant more substantial weight towards the FTC's theory that the Beat Saber fitness proposal remained a live proposition. However, given that Ruben's remarks appeared to have been made off the cuff, are inconsistent with the overall weight of the evidence, and were made at a time when he was likely still unfamiliar with VR fitness and Meta's history, the Court is disinclined to accord any significant weight to Rubin's comments.

For all these reasons, the Court finds that it was not "reasonably probable" that Meta would have repositioned their top-selling VR app, Beat Saber, into a dedicated fitness app, even assuming that it could have identified a partner willing to provide VR fitness content.

* * *

After reviewing the evidentiary record and the parties' arguments, the Court concludes that it is not "reasonably probable" that Meta would enter the market for VR dedicated fitness apps if it could not consummate the Acquisition. Though Meta boasts considerable financial and VR engineering resources, it did not possess the capabilities unique to VR dedicated fitness apps, specifically fitness content creation and studio production facilities. As a VR platform developer, Meta can enjoy many of the promising benefits of VR fitness growth without itself intervening in the VR fitness app market. Finally, the proposal for Meta to expand Beat Saber into fitness was not "reasonably probable" for a whole host of reasons, in addition to the aforementioned obstacles to Meta's *de novo* entry.

Accordingly, the Court finds that Meta did not have the "available feasible means" to enter the relevant market other than by acquisition. Because the FTC has not met its burden on this element, the Court does not proceed to the issue of whether Meta's *de novo* entry was substantially likely to deconcentrate or result in other procompetitive effects in the relevant market.

In so finding, the Court concludes that the FTC has failed to establish a likelihood that it would ultimately succeed on the merits as to its Section 7 claim based on the actual potential competition theory.

E. Perceived Potential Competition

In addition to its claim that the Acquisition would lessen competition pursuant to the actual potential competition theory, the FTC also claims that the Acquisition violates Section 7 under the perceived potential competition theory. FAC ¶¶ 97–102. Under this theory, the FTC argues that the Acquisition would eliminate the competitive influence that Meta exerts on firms within the relevant market by virtue of its presence on the fringes of the market. *See, e.g.*, *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 559–60 (1973).

To prevail on a claim that the Acquisition would have eliminate perceived potential competition, the FTC must establish—in addition to showing a highly concentrated market, *see* Section III.C—the following: (1) Meta possessed the "characteristics, capabilities, and economic incentive to render it a perceived potential de novo entrant"; and (2) Meta's "premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market." *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 625 (1974). The same objective facts regarding Meta's capability of entering the market under an actual potential competition theory are also "probative of violation of § 7 through loss of a procompetitive on-the-fringe influence." *Falstaff Brewing*, 410 U.S. at 534 n.13; *see also Black & Decker*, 430 F. Supp. at 770. However, whereas a claim for actual potential competition may consider the potential entrant's intent to enter the market, a perceived potential competition claim ignores the potential entrant's subjective intent to enter the market and instead focuses on the subjective perceptions of the in-market firms. *See Falstaff Brewing*, 410 U.S. at 533–36.

1. Potential Entrant Characteristics

In evaluating the FTC's perceived potential competition claim, the Court considers the same objective evidence regarding Meta's capabilities and incentives to enter the relevant market. Unsurprisingly, and for the same reasons explained above, the objective evidence in the record is insufficient to support a finding that it was "reasonably probable" Meta would enter the relevant market for purposes of the perceived potential competition doctrine. *See supra*, Section III.D.2.

Nor does the subjective evidence of the in-market firms' perceptions move the needle on this point. Although the FTC produced some evidence that Within co-founders and employees had expressed concern that Beat Saber or its fans could create a fitness version to compete with Supernatural, these statements are mostly stale with some significantly preceding the relevant time period. The FTC's strongest evidence that [redacted] were statements made [redacted] before Supernatural even entered the VR market in April 2020. *See, e.g.*, PX0627, at 2 [redacted] The FTC has only produced one document that post-dates Supernatural's launch, which is a June 2020 "Supernatural Product Strategy" presentation that noted [redacted] PX0615, at 8. However, even this document's weight is undercut by the fact that it was created nearly a year before Meta began pursuing Within as an acquisition target.[14]

[14] The FTC also produces an April 2021 internal communication from *Meta*, where a Meta employee remarked that Within "very much worry that [Meta] will create a fitness first app

Furthermore, subsequent but still contemporaneous evidence indicated that Within eventually came to [redacted]" DX1083, at 10, Sept. 22, 2020. In a September 2020 text conversation with a Within investor, Within's co-founder Chris Milk explained that [redacted] *Id.* at 7. In the same conversation, Milk [redacted] *Id.* at 67–68.

In summary, the evidentiary record indicates that [redacted] This finding, in addition to the overall absence of testimony from other in-market firms, would suggest that the FTC has failed to demonstrate that it was "reasonably probable" that Meta was perceived as a potential competitor into the relevant market. However, even if the FTC had prevailed on this element, the Court is convinced that it did not satisfy the second required showing for a perceived potential competition claim.

2. Tempering Effect

Under the second element of the perceived potential competition claim, the FTC must establish that Meta's "premerger presence on the fringe of the target market *in fact* tempered oligopolistic behavior on the part of existing participants in that market." *Marine Bancorporation*, 418 U.S. at 624–25 (emphasis added). In other words, the FTC must present evidence that it was "reasonably probable" that Meta's presence as a potential competitor had a direct effect on the firms in the VR Dedicated Fitness market.

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internally that takes their market share." PX0514, at 2, Apr. 23, 2021. The Court is doubtful of the probative value of this hearsay statement, and the FTC has not produced any evidence to corroborate this statement. FTC Closing Hr'g Tr. 1498:2–9 ("[W]e heard from Ms. Brown, and you may recall that she did not remember much, if anything at all, about this document. . . . It's up to this court to judge her credibility on that store. But she did say that she was being truthful when she wrote this.").

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In setting forth this standard, the Court rejects the FTC's suggestion that it need only provide "[p]robabilistic proof of 'likely influence' on existing competitors." Mot. 21. This interpretation arises from the language used by the Supreme Court in a footnote from *Falstaff Brewing*, specifically "[t]he Government did not produce *direct evidence* of how members of the [relevant] market reacted to potential competition from [the potential entrant], but *circumstantial evidence* is the lifeblood of antitrust law." 410 U.S. at 534 n.13 (emphasis added). The Court reads this language to mean the FTC need not provide *direct evidence* of Within adopting its conduct to account for Meta's presence (*e.g.*, a hypothetical internal email at Within expressly communicating fear of Meta's imminent entry and taking actions in anticipation). Direct evidence, however, is distinguishable from evidence of a *direct effect* experienced within the relevant market (*e.g.*, circumstantial evidence that Within reduced prices shortly after Meta's hypothetical public announcement that it was looking into the VR Dedicated Fitness market). This interpretation is supported by the Supreme Court's statement of the law in *Marine Bancorporation*, 418 U.S. at 624–25 (requiring "presence . . . in fact tempered oligopolistic behavior") and the Second Circuit's interpretation in *Tenneco, Inc. v. FTC*, 689 F.2d 346, at 358 ("The Commission is correct that it need not produce direct evidence that [acquired company] altered its actions in response to a perception of [potential entrant] 'in the wings.' However, it must produce at least circumstantial evidence that [potential entrant's] presence probably *directly affected* competitive activity in the market.") (emphasis added). Accordingly, the FTC must produce *some* evidence—direct or circumstantial—that Meta's presence had a direct effect on the firms in the relevant market.

Under this standard, the FTC's evidence on this element is insufficient. The only evidence that suggests any kind of effect in the relevant market is that Within cited, as reasons not to reduce headcount at Within shortly before launching Supernatural, [redacted] PX0620, at 36, Mar. 8, 2020. As noted above, Within and Supernatural had not even entered the relevant market at the time of this presentation. Consequently, this cannot be evidence of a direct effect within the VR dedicated fitness app market; rather, they are the preemptive considerations of a firm contemplating entry into the market. Moreover, the evidence indicates that Within had [redacted]. *See supra* Section III.E.1. Other than this presentation, the FTC suggests that [redacted]" PX0621, at 2, Dec. 8, 2020. Although this is circumstantial evidence that Within was concerned about hypothetical potential entrants, absent further evidence, this email is no basis to infer the critical nexus, *i.e.*, that Meta was one such potential entrant.

The Court recognizes that its interpretation of the "effect" requirement sides with Defendants' position set forth in their Motion to Dismiss. ECF No. 108, at 15–16; ECF No. 162, at 10–12. Although the Court ultimately determines that the FTC's evidence has not established that Meta's presence had a direct effect on Within's behavior, it finds that the FTC's *pleadings* are sufficient. The FTC had alleged that Within was "concerned about making any moves that would hurt its ability to compete against Meta as a potential entrant" and provided an example. FAC ¶ 101. At the pleadings stage, this satisfies their burden. Accordingly, the Court DENIES Defendants' motion to dismiss the perceived potential competition claim.

In summary, the Court finds that the objective evidence does not support a reasonable probability that firms in the relevant market perceived Meta as a potential entrant. Even if it did, the Court finds that there is no direct or circumstantial evidence to suggest that Meta's presence did in fact temper oligopolistic behavior or result in any other procompetitive benefits. Accordingly, the FTC has not demonstrated a likelihood of ultimate success as to its Section 7 claim arising from perceived potential competition.

F. Balancing of Equities

Because the FTC has not demonstrated a likelihood of ultimate success on the merits per the first § 13(b) element, the Court need not proceed to the balance the equities in the second portion of the § 13(b) inquiry.

IV. CONCLUSION

Based on the foregoing reasons, the Court ORDERS as follows:

1. Defendants' Motion to Dismiss is DENIED;
2. Defendants' Motion to Strike is DENIED AS MOOT; and
3. Plaintiff's Motion for Preliminary Injunction is DENIED.

IT IS SO ORDERED.

Dated: January 31, 2023

EDWARD J. DAVILA
United States District Judge