

## Microsoft's Views on the CMA's Full Text Phase 1 Decision

Microsoft's proposed acquisition of Activision Blizzard will give more people more choices for how to play games and give developers more choices for how to reach those people. It reflects Microsoft's commitment to a future for gaming that expands beyond consoles in which a diversity of business models, distribution mechanisms and payment options are available. Microsoft's gaming business, Xbox, is working to expand choice in two ways: through Game Pass, a subscription service that lets gamers enjoy the best of what Xbox has to offer at an affordable price, and through bringing more games to mobile platforms, including through mobile apps and cloud-based game streaming technology. The acquisition of Activision Blizzard provides Microsoft with capabilities and content on mobile, which it currently lacks, while creating new distribution options for game developers outside of mobile app stores. It also adds new content for Game Pass subscribers, encouraging them to engage with the service on the device of their choice.

Notwithstanding the benefits to gamers and developers, the CMA has referred the Transaction for a Phase 2 review based on potential harms to competitors. First, the CMA is concerned that the Transaction may harm Sony, the market-leading provider of PlayStation consoles. The CMA suggests that Microsoft may foreclose competition in console gaming platforms or multi-game subscription services by withholding Activision Blizzard content—in particular *Call of Duty*—from PlayStation. Second, the CMA has concerns that Microsoft may use Activision Blizzard content either alone or in combination with its wider “ecosystem” to out-compete rivals such as Google, Amazon and Nvidia. In a novel theory of harm unsupported by precedent, economic literature or the evidence, the CMA alleges that a potential increase in network effects and barriers to entry—without evidence or quantification of any effect—is sufficient to foreclose major technology companies from cloud gaming services.

These unsupported theories of harm are not sufficient to justify a reference to Phase 2. Microsoft is confident that following an in-depth review, the CMA will conclude that there is no prospect that the Transaction will give rise to a substantial lessening of competition in any market based on Phase 2's higher “balance of probabilities” threshold. In summary:

The CMA's theories of harm relate to one overarching concern: that Activision Blizzard's game catalogue—in particular the *Call of Duty* franchise—will enable Xbox to foreclose its competitors in gaming markets. This concern is misplaced. The Referral Decision fails to recognise the incredible array of popular and diverse gaming content that is available to market participants and overstates the importance of Activision Blizzard's content to competition in gaming.

Xbox plans to make the *Call of Duty* franchise available to more gamers in more ways than would have been the case in the counterfactual. While this increased competition will benefit gamers, it has not been welcomed by the market leader Sony. In Theory of Harm 1(a), the CMA adopts Sony's complaints without the appropriate level of critical review. Indeed, industry commentators have noted that the Referral Decision is “*written like they want to protect Sony's #1 position in gaming, while claiming there isn't much competition to Call of Duty (!?)*”<sup>1</sup>

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<sup>1</sup> Tweet by Tom Warren, Senior Editor at The Verge, 1 September 2022 (link available [here](#)).

The CMA’s concerns are misplaced for the following reasons:

- Sony PlayStation has been the largest console platform for over 20 years, with an installed base of over 150 million consoles making it larger than Nintendo and more than double the size of Xbox.<sup>2</sup>
- Sony engages in conduct today which is reflective of its market power in console gaming, including increasing prices of its consoles without fear of losing market share.<sup>3</sup>
- The suggestion that the incumbent market leader, with clear and enduring market power, could be foreclosed by the third largest provider as a result of losing access to one title is not credible. There are more than 4,000 games available on PlayStation alone.
- The evidence shows that the number of PlayStation’s monthly active users (“MAUs”) playing *Call of Duty* is not sufficiently material. Even without all of those gamers (a highly improbable outcome from a hypothetical foreclosure strategy), the PlayStation gamer base would remain significantly larger than Xbox is today.
- Since the Transaction was announced, Sony has acquired several game studios—including Bungie, developer of the popular online game *Destiny 2*, Haven Studios, Lasengle and Savage Games—and a minority interest in From Software, the developer of the biggest game of 2022, *Elden Ring* (among other hit games). This complements Sony’s existing minority shareholding in Epic Games, publisher of *Fortnite*, strong first-party game catalogue and extensive portfolio of exclusive arrangements with third-party publishers. There were over 280 exclusive first- and third-party titles on PlayStation in 2021, nearly five times as many as on Xbox.

In short, Sony is not vulnerable to a hypothetical foreclosure strategy, and the Referral Decision incorrectly relies on self-serving statements by Sony which significantly exaggerate the importance of *Call of Duty* to it and neglect to account for Sony’s clear ability to competitively respond. The CMA’s assessment of this theory ignores its acknowledgement in the Referral Decision that the gaming industry is “dynamic”. While Sony may not welcome increased competition, it has the ability to adapt and compete. Gamers will ultimately benefit from this increased competition and choice.

In any event, Microsoft has no intention to take *Call of Duty* away from gamers and, indeed, it has publicly committed not to do so. The value of *Call of Duty* depends on its community of gamers, the majority of whom are on PlayStation. Keeping *Call of Duty* on PlayStation is, therefore, a commercial imperative for the Xbox business and the economics of the Transaction. As such, Microsoft has offered Sony a contractual commitment to continue supplying it with *Call of Duty*, including new releases with feature and content parity. The Referral Decision fails to explain why in the CMA’s view Microsoft would make such commitments publicly and privately, which are also reflected in its internal documents, if it had no intention of honouring them. Foreclosure

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<sup>2</sup> Sony’s installed base at the end of 2021 was 151.4 million, as compared to the Xbox installed base of 63.7 million.

<sup>3</sup> Sony announced an increase in the price of PlayStation consoles in the UK and other countries in August 2022 (“PS5 price to increase in select markets due to global economic environment, including high inflation rates”, 25 August 2022, link available [here](#)). Microsoft confirmed that it does not have plans to increase prices of Xbox consoles (link available [here](#)).

strategies of the type outlined in the Referral Decision would alienate the *Call of Duty* gamer base and tarnish both the *Call of Duty* and Xbox brands, undermining the rationale for the Transaction. Microsoft would place at risk significant annual revenue from sales of *Call of Duty* on PlayStation, as well as substantial revenues from other Xbox games distributed via PlayStation. Microsoft has been clear that it is counting on revenues from the distribution of Activision Blizzard games on Sony PlayStation.

Xbox plans to bring Activision Blizzard content to its multi-game subscription, Game Pass. This will benefit gamers, boosting the value of the subscription and expanding access to Activision Blizzard content. Activision Blizzard has not allowed its content to be included in third-party subscriptions in any meaningful way in the past. Again, this increased competition has not been welcomed by the market leader Sony, which has elected to protect its revenues from sales of newly released games, rather than offer gamers the choice of accessing them via its subscription, PlayStation Plus.

In Theory of Harm 1(b), the CMA again adopts Sony's complaints without considering the potential harm to consumers.

- The Referral Decision relies on an assumption that Activision Blizzard's content strategy would change in the future as subscription services become more popular. There are not facts—anywhere—to support this assertion.
- Nor is there any basis for the idea that acquiring *Call of Duty* could 'tip' subscription services in Xbox's favour. Sony has chosen to block Game Pass from PlayStation, so it is not available on PlayStation. As all games that are available on Game Pass are also available to purchase, PlayStation gamers will continue to have the ability to buy *Call of Duty* on PlayStation. And doing so will still cost less than the cost of switching by buying a new Xbox console.
- Multi-game subscriptions offer consumers an additional payment option, but there is substantial evidence that customers switch between payment options, with subscription being constrained by buy-to-play and free-to-play games. Accordingly, Game Pass will continue to face significant competition, and gamers will continue to have alternative purchasing options post-Transaction.
- Should any consumers decide to switch from a gaming platform that does not give them a choice as to how to pay for new games (PlayStation) to one that does (Xbox), then that is the sort of consumer switching behavior that the CMA should consider welfare enhancing and indeed encourage. It is not something that the CMA should be trying to prevent.

Theory of Harm 2 is novel and without precedent. It suffers from a number of fundamental flaws. First, the CMA alleges that Microsoft has an advantage over rivals in cloud gaming by having a broad "multi-product ecosystem", including a leading cloud platform and PC operating system ("OS"). However, Microsoft's cloud gaming service Xbox Cloud Gaming does not use either of these offerings. It uses bespoke infrastructure—not provided by Azure—and does not stream games from PC hardware. There is no advantage. Indeed, Xbox considers that it faces a number of significant disadvantages as compared to rival providers of infrastructure for game streaming.

Second, the CMA alleges that Microsoft could leverage this “multi-product ecosystem” together with Activision Blizzard’s gaming content to strengthen network effects, raise barriers to entry, and hence foreclose rivals in cloud gaming services. This again makes no sense.

- The CMA provides no evidence that rivals rely on Microsoft’s “multi-product ecosystem” for cloud gaming. The emergence of cloud gaming providers that do not rely on Microsoft’s “multi-product ecosystem” shows that Microsoft does not have the ability to foreclose competition.
- Consumer adoption of cloud gaming remains low. Harming or degrading rival services would significantly set-back adoption of this technology—protecting market-leading incumbents (*i.e.*, Sony on console, Apple and Google on mobile, as well as Steam on PC). Xbox, as a platform which is in last place in console, seventh place in PC and nowhere in mobile game distribution globally, has no incentive to do this—instead its incentive is to encourage the widespread adoption of cloud gaming technologies by as many providers as possible to encourage the major shift in consumer behaviour required for cloud gaming to succeed.
- The evidence shows that streaming services, for example in video, have reduced barriers to entry and encouraged multi-homing, thereby decreasing network effects. As such, the use of Activision Blizzard content to promote cloud gaming (which would not occur in the counterfactual) would have the opposite effect to that alleged by the CMA.

As Microsoft does not have a market-leading position in gaming to protect, the “multi-product ecosystem theory of harm” outlined lacks analytical rigour and a limiting principle. A theory of harm that equates size in a particular sector (*i.e.*, digital) with market power discriminates against digital mergers. The “multi-product ecosystem theory of harm” would—if adopted in Phase 2—represent a significant lowering of the intervention threshold in digital mergers “by the backdoor”. Microsoft strongly urges the CMA to resist this path.

Microsoft has engaged constructively with the CMA throughout pre-notification and the Phase 1 process. Microsoft looks forward to engaging with the CMA through the Phase 2 process, to explain the benefits that the Transaction will bring to gamers, developers and the gaming industry more broadly.