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Determination

Microsoft Corporation and Activision Blizzard Inc [2023] NZCC 21

The Commission:	Dr John Small Sue Begg Nathan Strong
Summary of application:	An application from Microsoft Corporation seeking clearance to acquire 100% of the common stock of Activision Blizzard Inc.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission give clearance to the proposed acquisition.
Date of determination:	07 August 2023

Confidential material in this report has been removed. Its location in the document is denoted by [ ].

The Proposed Acquisition

1. On 14 April 2022, the Commerce Commission registered an application (the Application) from Microsoft Corporation (Microsoft) seeking clearance to acquire 100% of the share of Activision Blizzard Inc (Activision) (the Proposed Acquisition).[1]

Our decision

2. The Commission gives clearance to the Proposed Acquisition because it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Our framework

3. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines (our guidelines).[2]

The substantial lessening of competition test

4. As required by the Act, we assess mergers and acquisitions using the substantial lessening of competition test.

5. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[3]

6. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise prices above the price that would exist in a competitive market (the 'competitive price'),[4] or reduce non-price factors such as quality or service below competitive levels.

When a lessening of competition is substantial

7. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[5] Some courts have used the word 'material' to describe a lessening of competition that is substantial.[6]

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1 A public version of the Application is available on our website at: http://www.comcom.govt.nz/businesscompetition/mergers-and-acquisitions/clearances/clearances-register/.

2 Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019).

3 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

4 Or below competitive levels in a merger between buyers.

5 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

6 Ibid at [129].

8. As set out in our guidelines, there is no bright line that separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgement and depends on the facts of each case.[7]

9. A lessening of competition or an increase in market power may manifest itself in a number of ways, including higher prices or reduced services.[8]

10. While we commonly assess competition effects over the short term (up to two years), the relevant timeframe for assessment depends on the circumstances. A longer timeframe will be appropriate if, on the evidence, competition effects are likely to arise in later years.[9]

When a substantial lessening of competition is likely

11. A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility but does not mean that the effect needs to be more likely than not to occur.[10]

The clearance test

12. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.[11] If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.

Industry background

13. Microsoft asserted that video gaming is the fastest growing portion of the media and entertainment sector. It currently accounts for higher combined revenues than pay TV, home video (including streaming), cinema, music, books or newspapers and magazines.[12]

14. There are an estimated 3 billion gamers around the world, and this is expected to grow to 4.5 billion by 2030.[13]

Publishing and distribution of video games

15. Video game software development and publishing involves the development (including design, art, programming and testing) of a video game. This development is carried out by a development studio (such as Activision) and the game is then made available to the public for purchase, rental or free of charge through a video game distributor.

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7 *Mergers and Acquisitions Guidelines* above n2 at [2.23].
8 Ibid at [2.21].
9 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [131].
10 Ibid at [111].
11 Section 66(3)(a).
12 The Application at [7.1].
13 The Application at [7.1].

16. This distribution is either physical through retailers, or digital through online digital storefronts. Online distribution can be through download or streaming and available through mobile app stores, storefronts and subscription services.[14] These distributors act as intermediaries between game developers and publishers on the one hand, and gaming consumers on the other.

17. Gaming consumers choice of platform is influenced by the games available on that platform, and developers' choice of platform is influenced by the number of gaming consumers using that platform. Further discussion on the two-sided nature of these markets can be found in our market definition section below.

Hardware-based gaming

18. In New Zealand, two-thirds of the population, or about 3.7 million people play video games. The majority of these gamers typically use one or more of the following devices:[15]

    18.1 PCs (e.g., desktops, laptops and gaming-specific PCs);

    18.2 dedicated video gaming consoles (e.g., Sony PlayStation, Nintendo Wii and Switch, Microsoft Xbox);

    18.3 handheld dedicated portable video game devices with a built-in screen (e.g., Nintendo's Game Boy or DS line; Sony's PlayStation Portable and Valve's Steam Deck); or

    18.4 other hardware devices which can be used for gaming, including smartphones and tablets running Apple iOS and Google Android.

19. There are a range of games available to be played on each of these devices. Improved technological capabilities on mobile devices such as smartphones and tablets has made these devices more attractive for gaming.

20. However, given differences in technological capabilities across devices, larger and more complex games are typically only available on PC and/or console,[16] while mobile devices tend to be used more to play 'casual' games (e.g., Candy Crush).[17]

21. Until recent years, consumers have typically accessed games by paying an upfront fee and purchasing a copy (either physical or digital) of the game from physical retailers, mobile app stores, console-owned storefronts or publisher-owned storefronts.

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14 The Application at [7.8].

15 Interactive Games & Entertainment Association – "Digital New Zealand 2022 Report".

16 We understand that some PC/console games may be redeveloped to be able to be played on mobile devices. This usually involves simplifying some elements of the game.

17 Casual games are a mobile game genre that is designed for a broad audience and have simple rules, shorter sessions, and a low barrier to entry.

The emergence of cloud gaming

22. In addition to console and mobile gaming, cloud gaming has recently emerged as an additional option for gamers. Cloud gaming allows games to be stored and run remotely on a cloud gaming provider's dedicated hardware accessed via cloud servers and streamed directly to the gamer's device.

23. Because there is no need to store a copy of the game on the device (or rely solely on the computing power of the device), users can access the same games on a wide range of devices such as mobile devices, computers and smart TVs.

24. One of the main factors affecting the quality of a cloud gaming experience is latency, also referred to by gamers as 'lag'. Lag is the delay between a user's inputs and the time they are actioned by the server and observable to the user (and, in the case of multiplayer games, other users).

25. For the cloud gaming experience to be enjoyable, the collective lag of all elements in the cloud gaming system[18] must be imperceptible, as it is with 'locally' run games.

26. While lag is a consideration in other forms of online gaming, such as online multiplayer games on console or PC, the players' hardware will render the graphics locally and it is only information about the player's in-game actions that are sent to the server. For example:

    26.1 if a player presses a button, their character on-screen will instantly perform the corresponding action.

    26.2 However, the consequences of that action will only be seen after a short delay due to the time it takes for the action to reach the server.

27. However, with cloud gaming, because the graphics are rendered remotely, there can be short delays between entering inputs and viewing them on screen. If this delay is too noticeable, it can mean that the quality of even single player games becomes unacceptable to many gamers.

28. Accordingly, there are several requirements for the provision of cloud gaming services.

    28.1 From the gamer (demand) side, the ability to stream high-quality video is needed, which in turn requires high-speed internet connections with low latency rates.[19]

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[18] This includes the controller inputs being sent to the cloud server, game execution on the server, video and audio compression and decompression and the video being displayed back to the user.

[19] For example, NVIDIA recommends at least 35Mbps for its GeForce NOW service. For reference, the latest Measuring Broadband New Zealand report indicates that the average entry level fibre connection speed is 50Mbps.

28.2 From the gaming company (supply) side, significant infrastructure, such as data centres and server farms, are required to host and run games.

29. The infrastructure and internet connectivity required to make cloud gaming feasible has until recently been unavailable in New Zealand, and there are still very few cloud gaming service providers in New Zealand compared with other countries. For example:

29.1 while Microsoft initially released a beta version of its cloud gaming service in November 2019, it was only launched in New Zealand in June 2022;[20] and

29.2 Google's Stadia publicly launched in November 2019, however it was never released in New Zealand before it was shut down in January 2023.

30. Cloud gaming is nascent, largely due to evolving technology. However, many industry participants, including in New Zealand, expect it to grow and develop further in the future.

The parties

Microsoft

31. Microsoft is a publicly listed global technology company headquartered in Redmond, Washington, USA. It offers a wide range of products and services to customers organised around three operating segments – productivity and business resources, intelligent cloud, and personal computing (under which its gaming activities sit).

32. Microsoft manufactures the Xbox game console, and operates the Microsoft Store, Xbox Store and Bethesda.net. It also offers multi-title gaming subscription services that include access to games, online multi-player capabilities and cloud gaming functionality, through Xbox Live and Xbox Game Pass.

33. In terms of video game publishing, Microsoft owns 24 development studios. Microsoft develops and publishes games such as Minecraft, Forza, Elder Scrolls and Halo, which are distributed both directly through the Microsoft store, and through third-party distributors. Some of Microsoft's games are exclusive to its Xbox platform.

Activision

34. Activision is active in both:

34.1 video game development and publishing; and

34.2 video game distribution on PC through its digital storefront.

[20] https://www.gameshub.com/news/news/xbox-cloud-gaming-expands-to-new-zealand-in-june-2022-20921/#:~:text=Previously%20known%20as%20'xCloud'%2C,being%20added%20in%20June%202022.

35. It develops games for PCs, consoles and mobile devices and publishes them through one of three business units:

    35.1 Activision Publishing, Inc;

    35.2 Blizzard Entertainment, Inc; and

    35.3 King Digital Entertainment.

36. Activision's titles include the Call of Duty (CoD), Warcraft, and Candy Crush franchises.

Market definition

Our approach to market definition

37. Market definition is a tool that helps identify and assess the competitive constraints the merged firm entity would face. Determining the relevant market requires us to judge whether, for example, two products or services are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.

38. We use the hypothetical monopolist test (HMT) as a conceptual tool to assess the closeness of substitution. This test asks whether a hypothetical sole supplier of a set of products (or locations) would profitably increase prices for at least one of the merging firms' products (or locations) by at least a small, but significant, amount. This amount is often referred to as a 'SSNIP'. We generally use 5% as a SSNIP.

39. We consider substitution on both the demand and supply side in response to a SSNIP. On the demand side, we consider the extent to which customers would switch between products or services. On the supply side, we consider the extent to which producers would switch production between products or services.

40. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[21]

The markets where we did not identify competition concerns

41. While our investigation focused on vertical effects that could arise from Microsoft's acquisition of Activision, we also considered whether the Proposed Acquisition could give rise to horizontal unilateral effects in any of the markets in which Microsoft and Activision are active.

[21] Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

42. Microsoft submitted that the merging parties compete to supply the following services:[22]

    42.1 the development and publishing of video games for PCs, consoles and mobile devices;

    42.2 video game distribution (in relation to digital distribution of PC and console video games only);

    42.3 online display advertising; and

    42.4 video game-related merchandising.

43. The evidence gathered during our investigation indicated that for all of these markets, the aggregation arising from the acquisition would be minimal, with the merging parties having a low combined market share and continuing to face vigorous competition from a range of significant global competitors. Accordingly, we do not consider these markets further.

What Microsoft submitted

44. In the Application, Microsoft submitted that the relevant markets for the Commission's assessment of the Proposed Acquisition are:[23]

    44.1 the supply of video game development and publishing on PCs and consoles;

    44.2 the supply of video game development and publishing on mobile devices (i.e., mobile games);

    44.3 the supply of digital video game distribution services;

    44.4 the supply of online display advertising services; and

    44.5 the supply and licensing of video game-related merchandising.

45. Microsoft also submitted that the markets for the supply of video game consoles and the supply of cloud services are relevant to the assessment of vertical effects.

46. In response to our Statement of Issues, in which we sought submissions on the appropriateness of defining a separate market for cloud gaming, Microsoft submitted that "[n]either the required legal framework, nor the evidence, supports any finding that there is a separate market in New Zealand for the "supply of cloud gaming services"".[24]

47. It considers that applying the required framework demonstrates that there is no distinct market for cloud gaming services. It states that cloud gaming is no more than

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22 The Application at [8.1].
23 The Application at [8.3].
24 Submission from Microsoft in response to Statement of Issues at [4.4].

a feature that provides an alternative means for gamers to access content on a device (ie, they can purchase a physical disc, download or stream content).

The Commission's view of market definition

48. As the technology within the gaming industry progresses, the closeness of substitution and thus the precise boundaries of the relevant markets are becoming less clear.

49. For example, gamers used to play games on dedicated hardware. As the industry has evolved, they are now able to play games on a range of devices, including smartphones and tablets. That said, while consumers now have more choices about the mode of delivery of a video game, gamers may not view these as perfect substitutes for one another.

50. We therefore consider that the following markets most accurately characterize the state of competition in the industry.

Digital video game distribution services

51. We consider it is appropriate to consider digital video game distribution separately from physical distribution in this case. We understand that the use of physical games in consoles is declining and, indeed, the merging parties are not active in physical distribution and instead use third party distributors in New Zealand.

52. Physical distribution is usually done through "bricks and mortar" stores, whereas digital distribution usually takes place on digital storefronts. These storefronts appear to exhibit varying levels of 'openness' depending on the platform:[25]

    52.1 Apple and Google are by far the largest players in mobile distribution, and barriers to entry for new mobile distributors appear high, with both Apple and Google exerting a degree of control over access, standards and revenue from games able to be distributed to their mobile devices;

    52.2 Sony, Microsoft and Nintendo all operate their own console storefronts and the majority of digital distribution of console games are made via these storefronts.[26] These digital storefronts are console specific – a gamer purchasing games for use on their Xbox will only be able to do so through the Xbox store. Likewise, gamers wishing to purchase games to play on a PlayStation or Nintendo console will need to purchase through Sony and Nintendo storefronts respectively; and

    52.3 by contrast, distribution of PC games appears to be open, with several options for consumers, both vertically integrated providers such as Microsoft and via third party distributors, including the Epic Games Store, EA, Tencent

[25] In this context, openness refers to the extent to which games purchased in a storefront are able to be played on different manufacturers devices (consoles, mobile devices or PCs).

[26] Data provided by Microsoft indicates that over [ ]% of all digital game sales both internationally and in New Zealand for consoles were made via the Sony, Microsoft or Nintendo stores. The Application at Table 12 and Table 16.

and Steam. A game purchased on these distribution storefronts is generally able to be played on any compatible PC.

53. As gaming has become more accessible to a wider range of people on a wider range of devices, these distribution methods have become closer substitutes. We therefore consider it most appropriate to consider a single market for the digital distribution of video games. However, we consider it appropriate to define a separate market for cloud gaming– for the reasons set out below.

The supply of cloud gaming services

54. Providers of cloud gaming services remotely run video games on their own servers and then stream them to the user's device. Gamers no longer need to pay the upfront cost associated with purchasing the relevant gaming hardware, which can be significant when compared to the subscription cost of a cloud gaming provider. This allows a wider range of consumers to play high-performance games that were previously only accessible to owners of dedicated video game hardware. Cloud gaming may therefore be a complement to, rather than substitute for, digital distribution of video games on the demand side. Indeed, there is likely to be a subset of gamers (ie, those without consoles) for whom cloud gaming is the only way in which they can access many games.

55. Cloud gaming therefore represents an opportunity to attract a wider range of consumers to play games, particularly when considering that cloud gaming can be used to access individual games at a lower unit cost through multi-game subscriptions before committing to purchasing the game.

56. On the supply side, the requirements for a cloud gaming service provider are distinct from suppliers of digital distribution services.

    56.1 Providers of cloud gaming services require access to cloud computing infrastructure that is capable of running high performance games with minimal latency.

    56.2 On the other hand, suppliers of digital distribution will usually just need a "digital storefront" – that is, a place where games can be purchased and either downloaded or streamed from.

57. Equally, providers of cloud gaming are able to offer a gaming experience for consumers without needing to invest in the manufacturing of a console.

58. These differences in requirements make it unlikely that distributors of video games, such as Steam, would be able to easily start supplying cloud gaming services in response to a SSNIP.

The supply of video game consoles

59. There is a significant number of gamers in New Zealand who use video game consoles to play their desired games. The most popular consoles in New Zealand are

Microsoft's Xbox, Sony's PlayStation, and Nintendo's Switch. Activision does not manufacture a console.

60. Compared with cloud gaming:

    60.1 on the demand side, gamers have to pay the upfront cost associated with purchasing the relevant hardware; and

    60.2 on the supply side, console manufacturers need to invest in production capability as well as designing the appropriate hardware and software.

61. Because of current technical factors, gaming on consoles offers a superior experience (less lag, increased image resolution) compared to cloud gaming services. We therefore consider it unlikely that gamers who are used to playing on consoles would switch to cloud gaming in response to a SSNIP of consoles.

62. As technology is rapidly evolving substitution between gaming on consoles and cloud gaming may change over time. However, for the purposes of this determination we adopt a conservative approach and currently consider them as separate markets.

63. We therefore consider it appropriate to define a market for the supply of video game consoles.

With and without the Proposed Acquisition

64. To assess whether an acquisition is likely to substantially lessen competition in a market, we compare the likely state of competition if the acquisition proceeds (the scenario with the acquisition), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition). We make a pragmatic and commercial assessment of what is likely to occur in the future with and without the merger.[27]

65. In determining the appropriate with- and without-the-merger scenarios, we have considered:

    65.1 the expected growth and development of cloud gaming in New Zealand;

    65.2 the steps Microsoft has taken to remedy competition concerns about the Proposed Acquisition, including the commitments it has made to the European Commission, and the contractual arrangements it has entered into with third parties; and

    65.3 the likelihood of Activision content being available on cloud streaming platforms in New Zealand.

[27] Commerce Commission, Mergers and Acquisitions Guidelines, May 2022. At [2.29] to [2.35].

Our assessment

66. We consider that, while cloud gaming is still an emerging technology, we cannot rule out the real chance of it becoming a more significant means by which gaming companies distribute their content to consumers, and how consumers access this content, over the medium term.

67. We also consider that with the rapidly evolving nature of technology markets such as this, it is likely that the performance and quality of cloud gaming (and therefore its substitutability with digital distribution, and economic prospects) will improve.

68. A Grand View Research Report into cloud gaming noted that the advent of 5G mobile technology and high-speed internet is expected to accelerate the growth of the cloud gaming market. This report also noted that the increase in download sizes of modern game titles, and the consequent increased storage demands on devices will also drive gamers towards cloud gaming.[28]

69. Accordingly, in both the with- and without-the-merger scenarios, we cannot rule out the real chance of cloud gaming continuing to grow as a means by which New Zealand consumers access gaming content, at least in the short to medium term.

With the Proposed Acquisition

70. We considered the extent to which certain Activision gaming content, which may currently be available on third-party platforms,[29] would be made available on those platforms (and on what terms) by the merged entity in the future.

    70.1 Currently, Microsoft is a developer and publisher of video games both for its own Xbox platform, as well as rival platforms, such as Sony's PlayStation, and for mobile devices. Microsoft's stable of games includes the Minecraft, Forza, Elder Scrolls and Halo franchises.

    70.2 With the Acquisition, Microsoft would own Activision's stable of games, including the CoD, Diablo, World of Warcraft and Candy Crush franchises.

71. In light of concerns raised by other competition regulators, and some interested parties, Microsoft has entered into arrangements with the owners of four rival

[28] Grand View Research, Cloud Gaming Market Size, Share & Growth Report, 2023 – 2030, retrieved from https://www.grandviewresearch.com/industry-analysis/cloud-gaming-market#:~:text=Report%20Overview,45.5%25%20from%202023%20to%202030.

[29] For convenience, we use platforms to cover all distribution methods by which gamers can play games on, including natively on mobile devices, personal computers, consoles, and on cloud-based services. Where context dictates otherwise, we use the specific distribution method.

gaming platforms to make certain games available on those platforms, if the Proposed Acquisition proceeds (the Contractual Arrangements).[3031]

72. In addition, in giving approval for the Proposed Acquisition the European Commission imposed behavioural conditions on Microsoft, to make certain games available to third-party cloud gaming providers and consumers (the EC Commitments).[32]

73. Microsoft has stated that the EC Commitments and the Contractual Arrangements would extend to providers active in New Zealand and cover New Zealand consumers.[33]

74. We have considered the extent to which we can take into account the EC Commitments and the Contractual Arrangements in our assessment of the likely scenario with the merger.

The Applicant's submissions

75. Microsoft submitted that it is necessary for the Commission's assessment of the likely scenario with the merger to take into account the EC Commitments, and the Contractual Arrangements. Microsoft submitted that:[34]

    75.1 these Contractual Arrangements and commitments are forward-looking and legally enforceable;

    75.2 taking the Contractual Arrangements and commitments into account would be consistent both with the Commission's past practice, and with the Commission's stated approach in our Mergers and Acquisitions Guidelines of taking "a pragmatic and commercial assessment of what is likely to occur in the future";[35]

    75.3 the Contractual Arrangements and commitments will apply globally and therefore are relevant to the competitive dynamics in New Zealand; and

    75.4 there are sufficient legal obligations and safeguards to satisfy the Commission that Microsoft will comply both with the EC commitments, and the

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30 Microsoft has entered into contractual arrangements with four cloud gaming providers (NVIDIA, Boosteroid, Ubitus and Nware) which provide for access to all Microsoft games (including Activision titles) on these providers cloud gaming platforms worldwide for ten years. Microsoft, Overview of the key provisions of the cloud provider agreements, 12 May 2023.

31 Microsoft has also entered into arrangements with Nintendo and Sony to make Call of Duty available on those parties gaming consoles for a period of ten years. Microsoft Sony Games Publishing Agreement (14.07.23).

32 Microsoft has submitted behavioural remedies to the European Commission in which it commits to grant access to Activision games to game streaming services and consumers for a period of ten years. https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2705.

33 Microsoft 24 April 2023 response to NZCC.

34 Microsoft, Response to NZCC Statement of Issues Dated 20 June 2023, 4 July 2023 at [4.42] to [4.46], and [4.49].

35 See Commerce Commission, Mergers and Acquisitions Guidelines, May 2022, at [2.35].

Contractual Arrangements entered into with cloud streaming and console gaming providers.

76. Microsoft submitted that the EC Commitments and the Contractual Arrangements are enforceable by the European Commission and the relevant counterparties, respectively, and are subject to ongoing independent monitoring and a robust dispute resolution procedure.[36]

Our assessment

77. When deciding whether to give clearance to a transaction under s66 of the Commerce Act 1986, the Commission can only accept undertakings to dispose of assets or shares. The Commission is not able to accept behavioural remedies such as those accepted by the European Commission[37] and these remedies were not offered by the parties to the Commission.

78. As such, the EC Commitments and Contractual Arrangements can only be considered by us to the extent that they form part of the scenario with the merger (the factual). We discuss this further below.

<u>The Contractual Arrangements</u>

79. We consider that, with the Proposed Acquisition, Microsoft's contractual relationships with cloud streaming and console gaming providers discussed above would become binding. Further, the terms of the Contractual Arrangements are global in nature and, as a consequence, prescribe that the Activision content covered by those arrangements needs to be made available on rival gaming platforms active in New Zealand.

80. We consider that, while these Contractual Arrangements will be entered into with the Proposed Acquisition, the parties to the Contractual Arrangements could elect in the future to amend them or not enforce them. This could include amendments that lessen or eliminate entirely any protections to New Zealand consumers that the Contractual Arrangements were previously providing.

81. As a consequence, it is possible that the benefits to New Zealand consumers may not extend for the full duration of the Contractual Arrangements. That said:

    81.1 we do not consider that the parties would have an incentive to amend, or not enforce, the agreements to the detriment of New Zealand consumers; and

    81.2 during the course of our investigation, no third parties raised concerns that the Parties would be likely to do this.

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36 Microsoft, Response to NZCC Statement of Issues Dated 20 June 2023, 4 July 2023 at [4.49]

37 See section 69A of the Commerce Act 1986

The EC Commitments

82. Similarly, with the Acquisition Microsoft would be required to comply with the EC commitments.

83. As with the Contractual Arrangements, there is a risk that the EC Commitments could be amended, at some point in the future, in a way that is adverse to New Zealand consumers. That said, as with the Contractual Arrangements, we consider that the European Commission is likely to have little incentive to amend the geographic scope of the commitments.

Conclusion on the relevant with the merger scenario

84. We consider that with the merger there is a real chance that the Contractual Arrangements and EC Commitments continue for their full term, and the benefits to consumers in New Zealand of them continues for the full term.

85. Under this scenario, the impact of competition of the Proposed Acquisition may be at worst competitively neutral, and at the least would not rise to the level of a substantial lessening of competition in a relevant New Zealand market.

86. The question therefore remains whether we can exclude the real chance of an alternative with the merger scenario in which the benefits of the contracts/commitments do not extend to NZ for the full term currently anticipated. This could occur, for example, where the parties agree for any reason to exclude NZ from the list of jurisdictions currently covered by the Contractual Arrangements and EC Commitments.

87. We have seen no evidence to indicate that this is likely. Applying a "commercial common sense" lens we fail to see a reason that the parties would agree to carve out NZ alone. We recognise the reputational risk that Microsoft would face if it sought to back out of agreements it had made to satisfy competition regulators. We have explicitly tested this issue in our SOI and heard no comments/concerns from third parties that Microsoft would take such a step.

88. In sum, we have sought to elicit, but have not received, any positive evidence to suggest Microsoft would seek to exclude NZ from the benefit of the contracts/commitments.

89. We recognise, however, that much can change in 10 years, including commercial incentives and motivations, and therefore consider it prudent to continue with our competition analysis on the assumption that NZ is carved out of these contracts/commitments. As we will set out below, even in this scenario, we do not think the transaction is likely to result in a substantial lessening of competition.

Without the merger

90. We have considered how Microsoft and Activision would be likely to behave if the Proposed Acquisition did not go ahead, and therefore how competition in the relevant markets would be likely to evolve without the Proposed Acquisition. In

particular, we have considered whether there is a real chance Activision would license its games to cloud gaming platforms active in New Zealand.

91. For the reasons set out below, we consider that it is likely that in the without-the-merger scenario Activision would license its games to cloud gaming platforms, if given sufficient incentive.

92. Microsoft and Activision submit that, absent the Proposed Acquisition, [ ].[38]

93. In our view, while cloud gaming is currently not part of Activision's business strategy, due to its concerns over performance and user experience, we cannot exclude the real chance that it would license its game content to cloud gaming providers, if performance of cloud gaming improves such that it provides an incentive for Activision to do so to maximise its profits.

The Parties' submissions

94. Activision submitted that [ ].[39,40]

95. Activision said that there are [ ] criteria that it considers when evaluating new distribution technologies.[41]

95.1 [

95.2

[38] Submission from Microsoft in response to NZCC Statement of Issues Dated 20 June 2023 (4 July 2023) at [4.28]

[39] Response to New Zealand Commerce Commission: Information and Document Request for Activision Blizzard (June 2023), 7 July 2023 at [1].

[40] Activision Blizzard Statement to the NZCC Regarding Cloud-Gaming Services, 3 July 2023 at [3].

[41] Activision Blizzard Statement to the NZCC Regarding Cloud-Gaming Services, 3 July 2023 at [11] to [24].

95.3

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96. Activision states [ ].[42]

Our assessment

97. We consider that, absent the acquisition, there is a real chance that [ ].

98. As noted above we have reached the view that there is a real chance scenario in the factual and counterfactual where cloud gaming will grow in popularity globally and in New Zealand, particularly with our ubiquitous high-speed fibre broadband network.

99. We note the statements and testimony given by Activision, however:

    99.1 the weight we can give such statements is limited given they were made in the context of an ongoing investigation into whether the merger should be permitted; and

    99.2 having reached the view above there is a real chance that cloud gaming would grow in popularity and became a profitable distribution platform for game publishers, it is necessarily the case that one or more of the factors that [ ]. In such a scenario we consider Activision is likely to include distributing content via cloud gaming providers so as to maximise its profits.

How the acquisition could substantially lessen competition

100. With the Proposed Acquisition, the merged entity would operate in both upstream and downstream markets within the gaming supply chain, being:

    100.1 video game publishing; and

    100.2 video game distribution and the provision of cloud gaming services.

101. The Proposed Acquisition would eliminate competition between the Parties in video game development/publishing and video game distribution. However, we are satisfied that the Proposed Acquisition is unlikely to result in a substantial lessening of competition due to horizontal effects in any relevant market, as there will remain

[42] Activision Blizzard Statement to the NZCC Regarding Cloud-Gaming Services, 3 July 2023 at [28].

several well-resourced competitors and the merging parties do not appear to be close competitors.

102. We also considered whether the Proposed Acquisition would substantially lessen competition in a market due to vertical effects. A merger may substantially lessen competition where the merger increases the merged firm's ability and/or incentive to prevent or hinder competition in a market by limiting access to an important input to competitors in a downstream market, or limiting access to a sufficient customer base to competitors in upstream markets by:

    102.1 refusing to deal with competitors completely (total foreclosure),

    102.2 raising prices it charges (or decreasing the quality it supplies) these competitors (partial foreclosure).[43]

103. We have considered whether, post-Acquisition, Microsoft:

    103.1 would have the ability and incentive to make Activision content (including the CoD franchise) exclusive to Microsoft's Xbox and associated cloud gaming platform (total foreclosure), or otherwise reduce the value of Activision content on alternative platforms (for example, by lowering the quality or delaying releases of new content) (partial foreclosure); and, if so

    103.2 whether such conduct would be likely to substantially lessen competition by reducing the ability of rivals to compete in the markets for the supply of video game consoles or cloud gaming services.[44]

104. If the Proposed Acquisition gives Microsoft the incentive and ability to do this, consumers (gamers) may be harmed through higher prices, lower quality, or less innovation in these markets. Our consideration of the input foreclosure risks focussed on CoD as industry feedback was that this was a 'must have' game for a distributor to have. We were concerned that absent access to CoD, rival distributors may not be able to attract users who wanted to play CoD, and potentially all other gamers if users were to single home (use a single gaming platform).

105. We are satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in either the console or cloud gaming markets as a result of vertical effects. With the Proposed Acquisition Microsoft would not have the ability or incentive to foreclose rivals in the markets for the supply of video game consoles or cloud gaming services by making Activision content (including the CoD franchise) exclusive to Xbox, or otherwise reducing the value of Activision content on alternative platforms. This is because:

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[43] Merger and Acquisition Guidelines at [5.4].

[44] We do not currently consider that the merged entity would have the ability or incentive to foreclose Nintendo in any market. Nintendo focuses primarily on its own first-party games such as the popular Mario franchise. As a result, it does not appear to compete closely with Sony or Microsoft, and instead is marketed as a more family-friendly, casual offering.

105.1 we consider that Microsoft would not have the ability to foreclose rivals in either market. The evidence we have gathered leads us to conclude that Activision games, in particular CoD, are not "must have" content for rival console and cloud gaming platform suppliers to compete effectively with Microsoft; and

105.2 we also consider that Microsoft would not have the incentive to foreclose rivals in either market by pursuing a strategy to make Activision content exclusive, or otherwise reduce its value to rivals. We consider that such a strategy would not be financially viable, and would likely result in substantial losses to Microsoft.

106. We also considered whether the market for cloud gaming was vulnerable to tipping, by allowing a large competitor (in this case Microsoft) to emerge. We consider that notwithstanding our conclusion that Microsoft would not have the ability or incentive to foreclose its rivals, the tendency of consumers to 'multi-home' in relation to cloud gaming providers is likely to minimise the risk of this market tipping, and tipping in Microsoft's favour.

107. We expand on these reasons below.

Foreclosure of rivals in video game consoles

108. We have considered whether the Proposed Acquisition would substantially lessen competition due to vertical effects in the supply of video game consoles.

109. In particular, we have considered whether the merged entity is likely to have the ability and incentive to withhold Activision content (specifically CoD) from its rivals in the supply of video game consoles in such a way that limits their ability to compete such that a substantial lessening of competition is likely in this market.

110. Our concerns focussed on whether a substantial lessening of competition is likely if:

110.1 post-acquisition, Microsoft could totally foreclose rivals by making CoD exclusive to the Xbox console and/or Game Pass, such that non-Microsoft users would not be able to play CoD in any form; and/or

110.2 Microsoft could engage in partial foreclosure by:

110.2.1 making certain versions of CoD exclusive to the Xbox console and/or its cloud gaming service;

110.2.2 making new versions of CoD exclusive on Xbox for a certain time period by delaying release on other platforms; and/or

110.2.3 restricting availability of gameplay or console features on other platforms (for example, no haptic feedback on the controller).

111. We are satisfied that the Proposed Acquisition will not have, and would not be likely to have, the effect of substantially lessening competition in the market for the supply of video game consoles due to foreclosure of rivals in video game consoles.

112. We consider that:

112.1 CoD is unlikely to be a 'must have' game on consoles, and as a consequence, Microsoft is unlikely to have the **ability** to foreclose its rivals in New Zealand; and

112.2 even if CoD is a 'must have' game, Microsoft is unlikely to have the **incentive** to foreclose its rivals in New Zealand.

Is Activision content, in particular CoD, 'must have'?

113. Whether Microsoft would have an ability to foreclose its rivals in console gaming markets by restricting access to Activision content will depend on the alternatives that rivals have to that content. If access to Activision content is important for rivals to compete in the relevant downstream markets, and there are limited or no good substitutes available, then competition issues are more likely to arise.

114. In particular, if Activision's library of gaming content contains must-have games, this advantage could be such that Microsoft's rivals (either current or potential) in console gaming could not compete effectively if they are foreclosed from distributing this must-have content. This could have the effect of substantially lessening competition in the market for the supply of video game consoles.

What Microsoft submitted

115. Microsoft says that it does not have a substantial degree of market power in the upstream game publishing market and will not have the ability to foreclose its rivals.[45]

116. Microsoft submitted that if the Commission were to just focus on game publishing for consoles, Activision Blizzard's share by value in New Zealand is [ ]% for 2021 – which falls short of any threshold where the Commission would usually consider that a firm has any market power.[46]

117. Microsoft also considers that Activision is only one of many publishers with popular content, but not the largest or most popular in the broader, highly fragmented console publishing landscape. It lists EA, Take-Two, Sony, Epic and Ubisoft as some of the other well-resourced competitors in this market.[47]

118. Microsoft submitted that Steam, the largest PC digital storefront, did not carry any new Call of Duty releases for three years (until November 2022) following Activision's commercial decision to sell its PC games only on its Battle.net storefront.

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45 Submission from Microsoft in response to Statement of Issues at [4.27].

46 Submission from Microsoft in response to Statement of Issues at [3.5(b)].

47 Submission from Microsoft in response to Statement of Issues at [3.5(b)(ii)].

Microsoft asserted that this did not prevent Steam from maintaining its leading position in PC game distribution, and increasing its revenues.[48]

119. It also cites console market dynamics as proof that Activision content is neither essential nor important to compete, given that Nintendo, which does not offer Activision titles, has an estimated [ ]% market share, which is comparable to Microsoft's [ ]%.[49]

Our assessment

120. Over the course of our investigation, we received mixed evidence as to how important access to Call of Duty is for rivals to effectively compete in console gaming markets.

121. A number of industry participants are of the opinion that content, especially access to a small number of AAA-games[50] (including CoD), is the primary driver for the choice of platform for gamers.[51]

122. We understand that CoD has frequently been the top-selling game each year and is the best-selling first-person shooter game ever. This enduring popularity, even in years where the game is considered lower quality than previous titles,[52] is said to evidence the level of loyalty for and popularity of the game.[53]

123. However, several other industry participants were more circumspect on the importance of CoD. For example, one distributor did not think that any one game title was a "must have" and a developer noted that while it is an advantage to have a popular franchise, it is a stretch to say that any game is a "must have". It further considered that irrespective of how popular a game is, the release of two poorly received titles could be fatal to a game franchise.[54]

124. [ ] advised that the availability of a small number of AAA-games is the most important driver of a console purchase decision and considered that Call of Duty is the most important on a year-to-year basis.[55] [ ] argued that the uniqueness of Call of Duty stems from the fact that it is released on a yearly basis and other publishers cannot match this level and consistency of output.[56]

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48 Submission from Microsoft in response to Statement of Issues at [4.27(c)].

49 Submission from Microsoft in response to Statement of Issues at [3.6].

50 "AAA" is a designation that industry participants use to classify games which are high-profile, high-budget and often associated with well-known developers and publishers. These classifications are informal and lack strict cut-offs.

51 Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

52 The 2021 edition of CoD was not considered as strong as previous years but was still the best-selling game of 2021, even though its sales were down [ ]% from 2020.

53 [ ] response to NZCC Request for Information dated August 12 2022 at [4].

54 Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

55 Commerce Commission interview with [ ].

56 Commerce Commission interview with [ ].

125. We acknowledge that Call of Duty is an important franchise and consider that for some gamers, exclusivity could drive purchasing decisions. To some extent, exclusivity is an established practice in the gaming industry and industry participants agreed with this sentiment.

125.1 [ ][57] commented that gamers have strong and strict expectations and generally have the expectation that games will enable cross-platform play and are available on multiple platforms. However, it also added that gamers understand that there will be exclusives to help promote a platform and are comfortable with that in that context.[58]

125.2 It also added that it had never heard of anyone buying a certain console purely for a title or IP with the exception of Nintendo, which achieves a lot of success due to the Mario franchise.[59]

126. In New Zealand, data provided by the Applicant indicates that while CoD is a popular game which is played by a significant proportion of New Zealand gamers, it is just one of a number of titles which are popular.[60]

126.1 In relation to PC games, CoD was the [ ] most popular game by monthly average user ('MAUs') in New Zealand in 2021 and 2022.

126.2 In relation to console games, CoD was [ ]. Its market share in these three years was between [ ]% and [ ]%, with the top 10 best-selling games in all three years ranging in market share from [ ]% to [ ]%.

126.2.1 In comparison, games by other game developers and publishers make up [ ] of the top ten selling console games in 2020, [ ] in 2021, and [ ] in 2022.

126.3 In 2021 and 2022 CoD was the [ ] most played (by share of game time) game in New Zealand, with less than [ ] the share of game time of the number [ ] title, [ ].

126.3.1 Games by other publishers and developers made up nine of the remaining top ten games by share of game time in these years.

127. Call of Duty appears to be important to [ ] appears to be particularly loyal:[61]

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57 [ ].

58 Commerce Commission interview with [ ].

59 Commerce Commission interview with [ ].

60 Submission from Microsoft in response to Statement of Issues at [Appendix six].

61 [ ] response to Commerce Commission RFI (23 August 2022).

127.1 In 2021, [ ]% of all PlayStation users globally spent more than [ ]% of their PlayStation console playtime on Call of Duty.

127.2 Equally, [ ]% of all PlayStation players globally did not play any Call of Duty.[62]

128. The fact that Call of Duty has a dedicated fanbase does not necessarily imply it is a required input for gaming distribution providers to compete effectively in the wider market.

129. Video game distributors also seem to hold a similar view when it comes to the importance of Call of Duty to their business.[63] For example [ ], commented that it doesn't know if there is any title which is a "must-have". It acknowledged that although Call of Duty is an important game, [ ]. It noted that big, successful games tend to attract customers to its platform, and then customers often purchase other games. However, it considered that each year there are between 25 and 100 games that would bring people to its platform.

130. Indeed, non-exclusive games often make up the top-selling games each year. For example, out of all the gameplay hours of the top 100 games for PlayStation in 2021, the Call of Duty franchise accounted for [ ]% of this playtime.[64]

131. In comparison, the FIFA franchise accounted for [ ]%, Fortnite accounted for [ ]%, and Grand Theft Auto (which was last released in 2013) accounted for [ ]%.[65]

132. The enduring success of Grand Theft Auto, and other older games such as "The Elder Scrolls V: Skyrim", and "Fallout: New Vegas" indicates that there are several other games that cloud gaming providers would be able to rely on in order to draw customers to their platforms if Microsoft pursued a foreclosure strategy.

Our views on Microsoft's ability to foreclose

133. Based on the above considerations, we consider that CoD is not a 'must have' game, and access to it is not necessary in order for console providers to effectively compete with Microsoft in New Zealand. While CoD is popular, and does feature consistently in the list of games which New Zealanders buy and spend time playing, it is just one of a number of games on that list, with other popular titles being purchased and played by New Zealanders.

134. Overall, we do not consider that Microsoft's Proposed Acquisition of Activision would give it control over a 'must have' input, in this case CoD, such that rival

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62 For completeness, [ ]% of PlayStation players spent between 0 and 25% of their gametime on Call of Duty, and [ ]% spent between 25% and 50%.

63 Commerce Commission interview with [ ].

64 [ ] response to Commerce Commission RFI (23 August 2022).

65 [ ] response to Commerce Commission RFI (23 August 2022).

console manufacturers would be unable to compete effectively without access to that content.

Would Microsoft have the incentive to foreclose rivals from CoD?

135. Notwithstanding our conclusion that Activision content, in particular CoD is not 'must have', in order for console rivals to compete with the merged entity, we have considered whether Microsoft would have the incentive to foreclose rivals by making CoD exclusive to Xbox.

136. We consider that Microsoft would not have the incentive to withhold CoD games from PlayStation in New Zealand because a foreclosure strategy would likely be unprofitable.

137. If, with the Proposed Acquisition, the merged company stopped selling CoD games for the PlayStation platform, Microsoft would forego the revenue, and associated margin, from the sales of CoD content on PlayStation.

138. On the other hand, some customers who currently play CoD on PlayStation might purchase Xbox consoles to be able to continue playing CoD. This would generate additional revenues and associated margin for Microsoft.

139. A console foreclosure strategy would be profitable, and Microsoft would have the incentive to engage in that strategy, only if the margin from additional sales of Xbox consoles to CoD players switching away from PlayStation would be at least equal to the lost margin on sales of CoD content on Playstation.

140. Microsoft has submitted the following additional information regarding the popularity of CoD and the margins on the sales of Xbox consoles and CoD content in New Zealand:[66]

140.1 In 2022, an average of [ ] MAU played CoD on PlayStation in New Zealand.

140.2 In 2022 Activision accrued approximately USD $[ ] in margin from CoD content per year and per monthly average user ('MAU') of CoD on PlayStation in New Zealand;

140.3 The [ ] discounted "Lifetime Value" (LTV)[67] of a CoD gamer on PlayStation in New Zealand for Microsoft is estimated at between USD$[ ] - USD $[ ].

140.4 On average, a new Xbox purchase is expected to generate a margin of USD $[ ] - $[ ] over [ ] years.

66 Keystone report in support of Microsoft's submission on the Statement of Issues at [15]-[20].

67 Lifetime Value refers to the average spend of a console gamer over the lifespan of the relevant console.

141. By withholding CoD from PlayStation, over the [ ] year period, the merged company would forego between USD$[ ] - USD $[ ] of margin per each of the [ ] monthly average users of CoD totalling between USD $[ ] million - $[ ] million.

142. In order to recoup this loss, given that the [ ] year margin associated with a purchase of a new Xbox console is between USD $[ ] - $[ ], its foreclosure strategy would need to result in the sale of at least [ ] additional Xbox consoles.

143. This implies that over [ ]% of consumers currently playing CoD on PlayStation in New Zealand would need to switch to an Xbox console for the foreclosure strategy to be profitable.

144. While we have not conducted a survey of consumers playing CoD on PlayStation in New Zealand, the UK CMA conducted a survey of CoD players finding that less than 25% of CoD players on PlayStation would consider switching to an Xbox console if CoD was only available on Xbox.[68] Most consumers would not switch or would purchase a rival console. We consider that these findings likely also apply to New Zealand CoD players.

145. This suggests that any targeted withholding of CoD from PlayStation consoles in New Zealand would likely generate significant losses for Microsoft.

146. In addition, the targeted withholding of CoD in New Zealand is unlikely to have any impact on PlayStation more broadly, as New Zealand only accounts for a small proportion (approximately [ ]%[69]) of the installed console base worldwide.

147. We conclude that Microsoft would not have a financial incentive to withhold CoD from PlayStation in New Zealand.

Foreclosure of rivals in cloud gaming

148. We have considered whether the Proposed Transaction would substantially lessen competition due to vertical effects in the supply of cloud gaming services.

149. In particular, we have considered whether the merged entity was likely to have the ability and incentive to withhold Activision content (specifically CoD) from its rivals in the supply of cloud gaming services in such a way that limited their ability to compete effectively so that a substantial lessening of competition is likely.

150. We focused on concerns that post-acquisition, Microsoft could make CoD fully exclusive to the Xbox cloud gaming service, that is, non-Microsoft cloud gaming users would not be able to play CoD in any form.

151. We consider that CoD is unlikely to be a 'must have' game such that rivals would be unable to compete effectively without it, and as a consequence, Microsoft is unlikely to have the **ability** to foreclose its rivals in cloud gaming in New Zealand.

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68 CMA, Playstation gamer research, December 2022

69 Keystone report Keystone report in support of Microsoft's submission on the Statement of Issues.

152. We have also considered whether the Proposed Acquisition would result in the market for cloud gaming "tipping" to a single provider. We consider that this is unlikely, as both consumers and publishers are likely to "multi-home" across a range of service providers.

Is Activision content, in particular CoD, 'must have'?

153. Whether Microsoft would have an ability to foreclose its rivals in cloud gaming markets will depend on the alternatives that rivals have to Activision content. If access to Activision content is important for rivals to compete in the relevant downstream markets, and there are limited or no good substitutes available, then competition issues are more likely to arise.

154. If Activision's library of gaming content does contain must-have games, this advantage could be such that Microsoft's rivals (either current or potential) in cloud gaming could not compete effectively if they are foreclosed from distributing this must-have content. This could have the effect of substantially lessening competition.

155. We have considered whether there are any unique aspects to cloud gaming markets in New Zealand that would indicate that CoD has a materially greater influence on consumer choice (and therefore rivals' ability to enter and compete effectively) in cloud gaming than in console gaming markets. We do not consider this is likely to be the case.

156. We consider that our conclusion above that CoD is not 'must have' content in order for Microsoft's console rivals to effectively compete, is also likely to stand when considering cloud gaming. In other words, what is popular and influences consumer choice in native console gaming, is likely to be popular and influence consumer choice in cloud gaming, given the likely similarities in consumer preferences.

What Microsoft submitted

157. In its submission in response to our Statement of Issues, Microsoft submitted that, in the factual, the Merged entity would have neither the ability nor the incentive to foreclose other cloud gaming providers by withholding Activision content. Microsoft submitted that Activision content cannot be considered "must-have" for cloud gaming because there are competing cloud gaming providers that are entering and expanding without such content.[70]

158. In particular, Microsoft submited that Pentanet, the distributor of NVIDIA's cloud gaming service in Australia and New Zealand, has been able to launch its service and achieve subscriber growth without Call of Duty or other Activision games in its offering. It claims that this indicates that Activision content is not "must-have".[71]

159. It noted that when Fortnite was added to Xbox Cloud Gaming, [ ]. The number of gamers

[70] Submission from Microsoft in response to Statement of Issues at [4.27(d)].

[71] Submission from Microsoft in response to Statement of Issues at [4.27(d)(ii)].

using the service was [ ] Fortnite was available as a native app on iOS.[72]

160. Microsoft also submitted that there is no evidence that the availability of Activision Blizzard content would materially alter consumer choice in relation to cloud gaming providers.[73]

Our assessment

161. It seems that targeted marketing and competitive pricing can all greatly influence the popularity of a game. We consider that the merged entity's rivals in cloud gaming would be able to effectively compete along these lines, even if they do not have access to Call of Duty.

162. In addition to the range of available games, consumers will also make decisions based on other aspects like graphical quality, latency and customer support.

163. Microsoft asserted that Pentanet's NVIDIA service has been able to launch successfully in New Zealand and Australia and is able to leverage its leading position in GPUs[74] to provide a high-quality product and, as such, has been able to gain market share even without access to Call of Duty.

164. [ ].[75]

165. NVIDIA was also confident that, post-acquisition, it will be able to compete with the merged entity.[76]

166. We consider that while the content available for consumers to play on cloud gaming services is an important aspect of competition, it is just one factor that influences consumer purchasing decisions. Other aspects of cloud gaming service delivery are also important (and may be more important).

167. Even if Activision content is exclusive to Microsoft, and CoD is an important driver of choice, then rival suppliers will still be able to compete by offering superior quality, support and user experience.

<u>Availability of other titles</u>

168. We consider that cloud gaming is likely to mature into a viable, standalone market in the medium-term. It is likely that the latency issues that people claim impact the

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72 Submission from Microsoft in response to Statement of Issues at [4.59(b)].

73 Submission from Microsoft in response to Statement of Issues at [4.58].

74 NVIDIA is a leading manufacturer of graphics processing units (GPUs) which are electronic circuits designed to accelerate computer graphics and image processing.

75 [ ].

76 Submission from NVIDIA in response to Statement of Issues at 2.

user experience will be overcome, particularly as graphical processing speeds increase with time, and datacentres become located closer to cloud gamers.

169. As these quality issues are alleviated and more gamers are attracted to cloud gaming, it follows that more game publishers will use cloud gaming as a method of game distribution.

170. Within the context of console gaming, several publishers advised that they look to have their games available on as many platforms as possible:

170.1 [ ] advised that it wants its games to be able to be played as much as possible, and it doesn't want to limit its earning power.[77]

170.2 [ ] thought it probably wouldn't be commercially viable for publishers to make their games available only on one platform.[78]

170.3 [ ] commented it doesn't see any economic benefits to exclusivity unless a publisher were paid a lot by a platform to be exclusive to it.[79]

171. On the distribution side, [ ] advice to publishers is to always make the game available wherever they would think customers would be interested.[80]

172. In terms of making games available on many platforms, [ ] said there are several dedicated "porting houses" which exist to import or export games made on one platform to another platform. Specifically, [ ] cited NVIDIA as a company which is able to "port" games to other platforms, which it did for the game Portal 2.

173. Given that NVIDIA is also active in cloud gaming, we consider that game publishers would not need to make significant investments in order to make their games available on NVIDIA's cloud gaming service.

174. We believe that NVIDIA would likely be motivated to have as many games on its platform as possible and would be able to partner with publishers to make their games run smoothly on its cloud gaming platform.

175. We further understand that there are little to no additional costs associated with publishers distributing their games on multiple cloud platforms, as they would all stream the same PC version of the game.

176. In addition to this, several other publishers make popular games that may be more suited to the cloud gaming experience than Call of Duty:

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77 Commerce Commission interview with [ ] (17 August 2022).
78 Commerce Commission interview with [ ] (9 August 2022).
79 Commerce Commission interview with [ ] (27 July 2022).
80 Commerce Commission interview with [ ] (27 July 2022).

176.1 for example, the Assassin's Creed titles are listed amongst the most popular games on Microsoft's Cloud Gaming Service.[81]

176.2 Assassin's Creed is an open-world, single player adventure game. Because of the nature of the gameplay, latency issues are less likely to severely impact the playability of the game.[82]

177. During our investigation, we were told that publishers may look to make their games available on streaming services in order to monetise them at different stages of the game's lifecycle.[83] We therefore consider that publishers would also make their games available to cloud gaming providers for similar reasons.

178. It follows that it is unlikely that Activision will be the only large game publisher to license its games to cloud gaming providers and cloud gaming providers will have access to other important titles.

Our view on the merged entity's ability to foreclose rival cloud gaming providers by withholding Activision content.

179. Based on the above considerations, we do not consider that access to Call of Duty is a prerequisite for any cloud gaming provider to compete effectively. We are of the view that:

179.1 Call of Duty is just one of many popular titles that might draw consumers to a certain cloud gaming provider. Other similarly popular titles include the Grand Theft Auto and FIFA franchises, and Fortnite;

179.2 the library of available titles is only one factor which would drive consumers' choices in relation to cloud gaming providers. Other relevant factors which impact gamers' cloud gaming experience would include cost, ease of use, image quality and latency.

180. Based on the above considerations, we conclude that the merged entity would not have the ability to foreclose rival cloud gaming providers by withholding Activision content.

Would the Proposed Acquisition result in the market for cloud gaming 'tipping' to a single cloud gaming provider?

181. We considered whether network effects may result in "tipping" in the cloud gaming market and whether the Proposed Acquisition would make 'tipping' more likely We consider that having access to a strong portfolio of gaming content is an important aspect for success of a game distribution platform. We were concerned that the

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81 Xbox – Most popular on cloud (27 July 2023). Retrieved from: https://www.xbox.com/en-us/play/gallery/popular

82 This is in comparison with a multiplayer, first-person shooter like Call of Duty, where increased latency of even 0.1s could mean that a gamer's character is killed.

83 Commerce Commission interview with [ ] (20 July 2022).

proposed acquisition could give Microsoft an advantage by giving it control over Activision's library of gaming, particularly any 'must have' games.

182. Specifically, we consider that game distribution markets are characterised by network effects such that:

182.1 as there are more users on any one platform, they will derive utility by having other gamers to play with (direct network effects);

182.2 if there are more gamers on a platform, video game publishers will be more incentivised to make their games available on these platforms due to the larger audience; and

182.3 this in turn would draw in more users onto the platform as the wider range of games available will make the platform more appealing compared to others.

183. We have considered whether in a growing market with what appear to be high barriers to entry, the existence of these network effects could mean that potential competitors are deterred from entering, thus allowing the merged entity to develop a dominant position in the market.

What Microsoft submitted

184. According to Microsoft, cloud gaming is a market with uncertain prospects. Microsoft submitted the following as evidence of [ ].[84]

184.1 [

184.2

184.3

184.4

[84] Submission from Microsoft in response to Statement of Issues at [4.34(a)-(f)].

184.5
].

185. Accordingly, Microsoft considers
[ ].

Our assessment

186. We consider that cloud gaming is a nascent market and as such its long-term viability is not certain. However, we consider that it may undergo substantial growth in the future particularly if investment, innovation and economies of scale reduce the costs to serve in the future. As discussed above, investment in New Zealand-based infrastructure is not necessarily a pre-requisite to competing in cloud gaming markets.

187. The fact that there are several competitors making significant investments in this market would indicate that there is a real chance that cloud gaming becomes a viable method of delivery of games in the future.[85]

188. We have considered whether the Proposed Acquisition would make the market for cloud gaming more vulnerable to tipping. If the nascent cloud gaming market (or other distribution platforms) are vulnerable to tipping, then the Proposed Acquisition could result in a substantial lessening of competition by making it more likely for the market to tip, and to tip in Microsoft's favour. This would particularly be the case if Microsoft had the ability and incentive to foreclose.

189. The network effects described above are likely, in our view, to make the cloud gaming market vulnerable to tipping. However, as outlined above, we do not consider that Microsoft it likely to have the ability or incentive to foreclose its rivals by restricting access to Activision content. We also consider that there is some evidence of multi-homing by both gamers and game developers

190. The key promise of cloud gaming is that players are able to access games on different types of devices, including PC, consoles and mobile devices. The relatively lower cost of cloud gaming services[86] compared with the upfront cost of a console, and the fact that consumers are not locked into a particular device to access cloud gaming, means that we would expect to see higher rates of multi-homing and switching between cloud gaming providers than between console platforms.

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85 In a submission to the CMA, Google advised that it views cloud gaming as an important distribution option for ChromeOS gamers. Its own internal estimates in 2019 forecasted that the total addressable cloud market is expected to grow to US$31 billion, accelerated by the rollout of 5G cellular. Source: Follow-up submission from Google to the CMA after meeting of 15 December 2022 at 3.

86 For example, Pentanet's NVIDIA cloud gaming service is available for AU$3.49/month.

Determination on notice of clearance

191. Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to Microsoft Corporation to acquire 100% of the common stock of Activision Blizzard Inc.

Dated this 7th day of August 2023

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Dr John Small

Chair