

3 April 2023

**ANTICIPATED ACQUISITION BY MICROSOFT CORPORATION OF
ACTIVISION BLIZZARD, INC.**

**MICROSOFT'S RESPONSE TO THE CMA'S PROVISIONAL FINDINGS
ADDENDUM**

1. Introduction

- 1.1 This is Microsoft's response to the CMA's Provisional Findings Addendum dated 24 March 2023 ("**Provisional Findings Addendum**") in relation the anticipated acquisition of Activision Blizzard, Inc. ("**Activision**") (the "**Merger**"). Defined terms are the same as those used in the Provisional Findings unless otherwise specified.
- 1.2 Overall, Microsoft welcomes the CMA's revised findings and agrees with the CMA's conclusion that the Merger will not result in a substantial lessening of competition for the market for the supply of console gaming services in the UK.
- 1.3 Microsoft has been clear since the announcement of the Merger: it has no intention to withhold or degrade access to *Call of Duty* ("**CoD**") or any other Activision content on PlayStation. Such a strategy would be in direct contrast to the interests of gamers in the UK and around the world. Rather than limit choice or access, Microsoft intends to use the Merger to bring more games to more people on more platforms and devices.
- 1.4 It is in recognition of this strategy that Microsoft also has offered a comprehensive and effective remedy which addresses any residual concerns the CMA may have in relation to cloud game streaming services. As such, even if the CMA were to maintain its concerns in relation to these services – which Microsoft has explained cannot be sustained – the Merger should be approved on this basis.
- 1.5 The remainder of this submission provides additional observations on the Provisional Findings Addendum. It also draws the CMA's attention to the implications of these conclusions on Theory of Harm 2.

2. The Provisional Findings Addendum correctly concludes that the Merger will not harm console competition

2.1 The Provisional Findings Addendum correctly confirms that Microsoft has no incentive to withhold or degrade access to *CoD*.¹ As Microsoft has explained throughout the course of the CMA’s investigation, such a strategy makes no commercial sense and would result in Microsoft writing off billions from the deal value. Microsoft welcomes the revisions to the CMA’s LTV-based analysis, which rightly amend the previous analysis which was based on incorrect assumptions and outdated data. However, that analysis remains conservative. Indeed, Microsoft considers that there are a number of further observations in relation to the revised analysis in the Provisional Findings Addendum which support and reinforce the conclusions.

(i) Microsoft’s “gains” from a hypothetical withholding strategy are overstated even in the Provisional Findings Addendum

2.2 Microsoft welcomes the CMA’s recognition that the LTV used for the purpose of the Provisional Findings’ incentive analysis relied on outdated estimates based on the behavior of early adopters in the first few months of Xbox purchase, and as such were unsuitable to be used as a basis of a sound analysis. The Provisional Findings Addendum correctly uses a more up to date estimate of the LTV of these users. This leads to a [%<] decrease in the LTV assigned to potential switchers to Xbox as a result of the withholding strategy.²

2.3 As previously explained, however, not only was the LTV used in the Provisional Findings out of date (with later estimates showing a significantly lower value even for early adopters), the equivalent LTV for later adopters is significantly lower – as low as \$[%<] in January 2022.³ As the chart below shows, gamers who [%<].

Figure 1: Xbox Series X and Xbox Series S 5-year LTVs by monthly cohort

[%<]

Source: PFR002 - Keystone comments on gamers LTVs adopted in the Provisional Findings incentive analysis

2.4 Accounting for the lower LTV allocated to later adopters, the weighted average LTV applied to compute Microsoft’s gains from a withholding strategy decreases significantly to \$[%<]. This is lower than both the \$[%<] figure used in the Provisional Findings and the \$[%<] figure used in the Provisional Findings Addendum.

¹ Whilst the CMA has dismissed the console gaming theory of harm based on its incentive analysis, Microsoft wishes to reiterate that it neither has the ability to foreclose Sony using *CoD*, nor would any such hypothetical strategy give rise to anti-competitive effects. See Microsoft’s Provisional Findings Response dated 2 March 2023, Section 2.B, C, D, E and F.

² Provisional Findings Addendum, para 4.6.

³ Provisional Findings Response, para 2.93 and PFR002 - Keystone comments on gamers LTVs adopted in the Provisional Findings incentive analysis, section 3.1.

- 2.5 The Provisional Findings Addendum justifies the decision to restrict its analysis to use of the LTV of early adopters as a basis to compute Microsoft’s ‘gains’ because “*users likely to switch from PlayStation to Xbox in response to a foreclosure strategy are more likely to have spending patterns that resemble early adopters than later adopters*”.⁴ However, it is unclear to Microsoft how the CMA reaches this conclusion. Microsoft has not seen any material cited by the CMA which supports it. In fact, the available evidence clearly does not support this analysis.
- 2.6 First, there is no basis for an assumption that “switchers” would behave like “early adopters” of a newly released console. Since the console that the switchers are switching to is a well-established console, it is difficult to understand why they should be treated like early adopters of a new console at all. Intuitively, early adopters of a new Xbox or PlayStation console will include gamers who are more loyal to the console platform. Such gamers will be less likely to switch due to the availability of a single game franchise on that platform.
- 2.7 Second, the data relating to potential switchers indicates that their profile is likely to be very different from early adopters. As explained in Microsoft’s Provisional Findings Response, potential switchers and early adopters display drastically different purchase and gaming patterns. In particular, early adopters: [REDACTED].
- 2.8 Conversely, potential switchers display almost opposite patterns. As explained in the Provisional Findings Response, those PlayStation gamers whose gameplay time is particularly concentrated around *CoD* are those most likely to potentially divert to Xbox as a result of a hypothetical withholding strategy.⁵ However, those gamers whose gaming focus on *CoD* is strongest [REDACTED]. In other words, they [REDACTED].

Figure 2: Average spending and overall gameplay time of *CoD* gamers on Xbox, 2022
[REDACTED]

Source: Provisional Findings Response, Figure 7.

- 2.9 It is therefore incorrect to conclude that early adopters would have spending patterns similar to potential switchers. In reality, the two groups are at completely opposite ends of the gaming spectrum, and as such the inclusion of early adopters in the LTV calculation itself is highly conservative. Instead, a more balanced yet economically sound approach would be to assign potential switchers a weighted average LTV measured across all gamers, regardless of their time of purchase of an Xbox.

⁴ Provisional Findings Addendum, para 4.7.

⁵ Microsoft notes that this is consistent with the conclusion in the Provisional Findings Addendum that non-surveyed *CoD* gamers would not switch to Xbox as a result of the withholding strategy as they do not engage enough with the franchise to divert to another console to retain access to the game.

(ii) The addendum rightly amends the Provisional Findings’ methodology adopted to compute Microsoft’s “losses” from a withholding strategy

- 2.10 Microsoft welcomes the CMA’s revised approach to compute the foregone profits from a withholding strategy on a five-year basis.⁶ This revised approach correctly reflects five years of foregone profits on PlayStation aligned with the five-year LTV for new Xbox gamers used by the Provisional Findings to compute the gains from a withholding strategy.
- 2.11 Microsoft also agrees with the conclusion that non-surveyed PlayStation gamers would not switch, as they engage too little with *CoD* to ultimately divert to Xbox to “follow” the franchise.⁷
- 2.12 Finally, Microsoft agrees with the Provisional Findings Addendum’s decision to not weight responses based on gameplay time and spending on PlayStation.⁸
- 2.13 Microsoft has previously explained why the use of MAUs as a basis to estimate the average LTV of a *CoD* gamer on PlayStation is preferential to the use of YAUs. YAUs include gamers who played *CoD*, for however little time, during the course of a year. In other words, gamers who played for as little as just a few minutes in the whole 12 months are considered on par with highly dedicated *CoD* players. Conversely, MAUs more accurately measure user engagement level over time, given it reflects gameplay time on more frequent intervals. It is noted, however, that even if YAUs are used as part of the estimate, the LTV-based analysis in the Provisional Findings Addendum still shows that Microsoft does not have an incentive for Microsoft to withhold *CoD* from PlayStation.⁹
- 2.14 Microsoft notes that the CMA rightly does not accept [X] suggestion that “*the most consistent approach would be to track a given cohort’s actual CoD spending on [X] over the course of five years to calculate CoD LTVs that are analogous to the LTVs used to measure gain*”.¹⁰ As the Provisional Findings Addendum correctly suggests, “*the opportunity cost of withholding CoD from PlayStation amounts to all relevant profits that would be lost from this strategy, not just the lost profits on a single cohort of gamers*”.¹¹ Microsoft does not repeat its observations about ‘discounting’ the total

⁶ Provisional Findings Addendum, para 4.9.

⁷ Provisional Findings Addendum, para 4.10 and 4.11.

⁸ Provisional Findings Addendum, para 4.12.

⁹ Provisional Findings Addendum, Table 1.

¹⁰ Provisional Findings Addendum, para 3.1.

¹¹ Provisional Findings Addendum para 3.1 and 4.9

figure although it notes that [X] apparently does not suggest a larger discount than that put forward by Microsoft.¹²

2.15 In simple terms, it makes no commercial sense for Microsoft to forgo the certain profit from *CoD* sales on PlayStation for the possibility of diverting a small and demonstrably less valuable cohort of gamers to Xbox.

3. The Provisional Findings Addendum correctly concludes that partial foreclosure is not a concern

3.1 Microsoft agrees with the Provisional Findings Addendum’s conclusion that Microsoft would not have the ability to foreclose Sony on the basis of partial foreclosure strategies.¹³ However, the addendum does not engage with Microsoft’s arguments in relation to the share of revenue and gameplay time that Sony would risk losing as a result of a withholding of *CoD*.

3.2 The Provisional Findings Addendum refers to an unspecified [X]% of PlayStation’s “range” that Sony would risk losing if Microsoft totally withheld *CoD*. It also asserts that, even in the case of partial foreclosure, Sony’s range would suffer some deterioration of quality. It is, however unclear what the actual source and meaning of this share given the [X]% figure does not feature in the Provisional Findings.¹⁴ The addendum also refers to a range of [X]% share of consumer spend at risk for Sony. However, as described in the Provisional Findings Response, the CMA’s methodology to compute this range is unsound and based on multiple incorrect assumptions that inflate the relevance of *CoD* for PlayStation.¹⁵ As such, the CMA should not use this range as the basis for any calculation of Sony’s lost revenue as a result of a foreclosure strategy – partial or total.

4. The Provisional Findings Addendum recognises lack of concern about Microsoft’s past conduct and overall strategy – this impacts the case in relation to cloud game streaming

4.1 The Provisional Findings Addendum confirms that Microsoft’s incentives in relation to Activision content cannot be extrapolated from past conduct.¹⁶ The recognition that, in fact, Microsoft’s past actions were not good evidence of any incentive to foreclose must also mean that the CMA should revisit its incentive analysis in relation to Theory of Harm 2 (cloud game streaming), which is focussed on qualitative evidence. At the

¹² Provisional Findings Addendum para 3.1. See also PFR002 - Keystone comments on gamers LTVs adopted in the Provisional Findings incentive analysis, para 20, FN 9 and Microsoft’s response to the CMA questions received on 17.03.2023, para 1.11 and footnote 9.

¹³ Provisional Findings Addendum, para 5.6.

¹⁴ To the extent that this share refers to the share of gameplay time on PlayStation as referred to in para 7.268, Microsoft is unclear on why this number would be of any relevance in the context of a price increase.

¹⁵ Provisional Findings Response, section E (ii), para 2.57 to 2.6.

¹⁶ Provisional Findings Addendum, para 4.22.

same time, this should also cause the CMA to re-assess the current evidence available to it relating to Microsoft's incentives in relation to cloud game streaming.

- 4.2 The qualitative factors on which the CMA relies to question Microsoft's incentives to withhold more generally have been re-assessed and ultimately dismissed. The CMA has not undertaken any comparable exercise quantifying incentives in relation to Theory of Harm 2 as it did for Theory of Harm 1. The absence of that analysis does not somehow make the qualitative evidence in relation to Theory of Harm 2 stronger. Indeed, the absence of any, even broad, profitability analysis to support Theory of Harm 2 further undermines the conclusions. As has been explained to the CMA, [§<].
- 4.3 The qualitative evidence available to the CMA in fact shows that Microsoft has entered into agreements with NVIDIA, Boosteroid and Ubitus, pursuant to which the distribution of Activision content on multiple cloud gaming services is provided for, should the Merger proceed. Not only does this show that Microsoft has no ability to withhold Activision content from rival cloud gaming services (given the presence of legally binding and enforceable agreements with these providers), it is also clear evidence of Microsoft's intention not to withhold Activision content from other cloud gaming services. Any analysis of both Microsoft's ability and incentive should be updated accordingly to reflect this development. Simply put, the CMA has found no incentive to withhold Activision content in relation to console, and the evidence shows it should reach the same conclusion in relation to cloud game streaming.