

## Statement of Preliminary Issues

### Microsoft/Activision

13 July 2022

### Introduction

1. On 15 June 2022, the Commerce Commission registered an application (the Application) from Microsoft Corporation (Microsoft) seeking clearance to acquire 100% of the common stock in Activision Blizzard, Inc. (Activision) (the Proposed Acquisition)<sup>1</sup>, as part of a global transaction.
2. The Commission will give clearance if 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.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.<sup>2</sup>
4. We invite interested parties to provide comments on the likely competitive effects of the proposed acquisition. We request that parties who wish to make a submission do so by **27 July 2022**.

### The parties

5. Microsoft and Activision are both active in the gaming industry, as developers, publishers, and distributors of video games. Microsoft's game titles include the Forza, Minecraft, Halo and Elder Scrolls franchises. Activision's games include the Call of Duty, World of Warcraft and Candy Crush franchises.
6. Microsoft is a publicly listed global technology company headquartered in Redmond, Washington. 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).
7. It 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.

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

<sup>2</sup> The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

8. Activision is a video game developer and publisher founded in 2008 and headquartered in Santa Monica, California, USA. It is publicly listed on the NASDAQ, although it offers its products and services to all major markets worldwide. Activision is exclusively dedicated to gaming.
9. It develops games for PCs, consoles and mobile devices, and publishes them in most countries around the world through three business units:
  - 9.1 Activision Publishing, Inc;
  - 9.2 Blizzard Entertainment, Inc; and
  - 9.3 King Digital Entertainment.

## **Our framework**

10. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.<sup>3</sup> As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.
11. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).<sup>4</sup> This allows us to assess the degree by which the proposed acquisition might lessen competition.
12. If the lessening of competition as a result of the proposed acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:
  - 12.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
  - 12.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
  - 12.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

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<sup>3</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at [www.comcom.govt.nz](http://www.comcom.govt.nz)

<sup>4</sup> *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

## Market definition

13. 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.<sup>5</sup>
14. In the Application, Microsoft submitted<sup>6</sup> that the relevant markets for the Commission's assessment of the Proposed Acquisition are:
  - 14.1 the supply of video game development and publishing on PCs and consoles;
  - 14.2 the supply of video game development and publishing on mobile devices (ie, mobile games);
  - 14.3 the supply of digital video game distribution services;
  - 14.4 the supply of online display advertising services; and
  - 14.5 the supply and licensing of video game-related merchandising.
15. Microsoft also submitted that a market for cloud computing services is relevant, because of the vertical relationship between Microsoft's cloud computing services, and downstream video game developers/publishers.<sup>7</sup>
16. Microsoft submitted that the development and publishing of games for PCs and consoles should be considered a separate market from the development and publication of games for mobile devices. Microsoft submitted that while there are some commonalities between the development and gameplay experience of PC and console games (such as shared art, animation or audio content), games developed for mobile devices must account for the lower performance of the devices compared to PCs and consoles, are typically much cheaper, and have less developed cloud gaming functionality.<sup>8</sup>
17. Microsoft also submitted that it is not appropriate to define separate video game development and publishing markets based on genre or game type as both consumers and developers/publishers will readily switch between creating, and playing, different types of games.<sup>9</sup>
18. Regarding digital video game distribution services (the distribution of video games through online marketplaces such as Xbox Live and the Microsoft store), Microsoft submitted that this is distinct from physical distribution of video games because of

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<sup>5</sup> Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

<sup>6</sup> The Application at [8.3].

<sup>7</sup> The Application at [8.27 – 8.32].

<sup>8</sup> The Application at [8.9(a) – (b)].

<sup>9</sup> The Application at [8.9(c)].

the differences in access, storage, and supply chain of the two distribution channels.<sup>10</sup>

19. Microsoft also submits that all of the relevant markets are global in nature.<sup>11</sup>
20. We will test whether the markets proposed by Microsoft are the most appropriate for assessing the competition effects of the Proposed Acquisition, or whether its impact is better assessed with reference to other markets. As part of this, we will consider whether the relevant markets should be considered more narrowly, for example, whether:
  - 20.1 there are video game development and publishing markets further segmented by:
    - 20.1.1 genre;
    - 20.1.2 price/quality (including whether there is a premium or 'AAA' market);<sup>12</sup> and
    - 20.1.3 platform (PC, console and mobile).
  - 20.2 video game development and publishing are in separate markets.
21. In considering the relevant video game distribution market, we will consider whether it is appropriate to define separate relevant markets for physical and digital distribution, and whether digital distribution should be further segmented by platform (console, PC and mobile), payment model (subscription or upfront payment) and/or method of access (download to device or streaming).

## **Without the acquisition**

22. We will consider what the parties would do if the proposed acquisition did not go ahead. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or whether the parties would seek alternative options, for example, finding a different buyer for Activision.

## **Preliminary issues**

23. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant market (or markets) by assessing whether horizontal unilateral, coordinated, vertical or conglomerate effects might result from the proposed acquisition. The questions that we will be focusing on are:

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<sup>10</sup> The Application at [8.18].

<sup>11</sup> The Application at [8.5].

<sup>12</sup> In the video-game industry, AAA (pronounced and sometimes written Triple-A) is an informal classification used to categorise games produced and distributed by a mid-sized or major publisher, which typically have higher development and marketing budgets than other tiers of games. The Application at [fn69].

- 23.1 unilateral effects: would the loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?<sup>13</sup>
- 23.2 coordinated effects: would the proposed acquisition change the conditions in the relevant market/s so that coordination is more likely, more complete or more sustainable?
- 23.3 vertical or conglomerate effects: would the proposed acquisition increase the merged entity's ability and/or incentive to foreclose rivals?

**Unilateral effects: would the merged entity be able to profitably raise prices by itself?**

- 24. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses.
- 25. Microsoft submits that the merging parties compete to supply the following services:<sup>14</sup>
  - 25.1 the development and publishing of video games for PCs, consoles and mobile devices;
  - 25.2 video game distribution (in relation to digital distribution of PC and console video games only);
  - 25.3 online display advertising; and
  - 25.4 video game-related merchandising.
- 26. In the Application, Microsoft submitted that the proposed acquisition would not be likely to substantially lessen competition in any of the relevant markets due to unilateral effects because:<sup>15</sup>
  - 26.1 in the markets for video game development and publishing:<sup>16</sup>
    - 26.1.1 the merging parties have low combined shares and there is no material increase in concentration arising from the Proposed Acquisition;

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<sup>13</sup> For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, i.e. it could increase quality-adjusted prices.

<sup>14</sup> The Application at [8.1].

<sup>15</sup> The Application at [1.3].

<sup>16</sup> The Application at [9.1 – 9.15].

- 26.1.2 there are a significant number of competitors of all sizes across both PC, console and mobile game development and publishing such as Tencent, Sony, Nintendo, EA, Bandai Namco and Roblox;
  - 26.1.3 the relevant markets are dynamic and competitive with a large fragmented number of competitors using different business models and other innovations to stay competitive; and
  - 26.1.4 there are low barriers to entry with development tools readily available and game success not dependent on resources or investment, particularly for mobile games.
- 26.2 In the markets for the supply of video game distribution:<sup>17</sup>
- 26.2.1 there is no material change in concentration, or market dynamics, even if PC and console games are considered separately;
  - 26.2.2 there are significant global competitors active in the digital distribution of video games both in console games (Sony's Playstation Store and Nintendo's eShop) and PC games (Valve's Steam and the Epic Games Store); and
  - 26.2.3 the market for video game distribution is a dynamic and competitive market which "calls for innovation".<sup>18</sup>
- 26.3 In the market for video game-related merchandising:<sup>19</sup>
- 26.3.1 the merging parties have small market shares both in relation to broad merchandising sales, and for video game specific merchandising; and
  - 26.3.2 there are a number of competitors to the merging parties, both video game developers and publishers who are active in merchandising markets (such as Sony and Nintendo), and entertainment companies, such as Walt Disney Company and Hasbro.
- 26.4 In the market for online display advertising:<sup>20</sup>
- 26.4.1 there is no material change in concentration and the merging parties' offerings are differentiated; and
  - 26.4.2 there are numerous alternative providers of display advertising including Facebook and Google who will continue to constrain the merged entity.

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<sup>17</sup> The Application at [9.15 – 9.30].

<sup>18</sup> The Application at [9.30].

<sup>19</sup> The Application at [9.31].

<sup>20</sup> The Application at [9.32 – 9.36].

27. We will consider, in each relevant market:
- 27.1 closeness of competition: the degree of constraint that Microsoft and Activision impose upon one another. To the extent that any constraint is material, we will assess whether the lost competition between the merging parties could be replaced by rival competitors;
  - 27.2 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity;
  - 27.3 entry and expansion: how easily rivals could enter and/or expand; and
  - 27.4 countervailing power: whether customers have special characteristics that would enable them to resist a price increase by the merged entity.

**Coordinated effects: would the proposed acquisition make coordination more likely?**

28. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.<sup>21</sup>
29. In each relevant market, we will assess whether any of the relevant market/s are vulnerable to coordination, and whether the proposed acquisition would change the conditions in the relevant market/s so that coordination is more likely, more complete or more sustainable.

**Vertical or conglomerate effects: would the merged entity be able to foreclose rivals?**

30. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical or conglomerate effects. This can occur where a merger gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.
31. In the Application, Microsoft submitted that the merged entity will not have the ability or incentive to foreclose rival console and PC video game distributors from accessing the content they need to offer a competing game distribution product. Microsoft submits that:<sup>22</sup>
- 31.1 the market for the development and publication of video games is fragmented, with low barriers to entry, and an active content market exists for rival distributors;

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<sup>21</sup> *Mergers and Acquisitions Guidelines* above n3 at [3.84].

<sup>22</sup> The Application at [10.3].

- 31.2 there is nothing unique about the video games developed and published by Activision Blizzard that is a "must have" for rival PC and console video game distributors that could give rise to a foreclosure concern;
  - 31.3 it has made a public commitment to apply a new set of Open App Store Principles to the Microsoft Store on Windows and to the next-generation marketplaces it will build for games, these principles are focussed on providing fair and transparent of apps and developer choice; and
  - 31.4 it has demonstrated that it is not withdrawing content from other platforms, having made multiple public statements that it will continue to make Call of Duty and other popular Activision titles available on PlayStation through the term of any existing agreement and beyond.
32. We will investigate whether:
- 32.1 the merged entity would have the ability or incentive to foreclose rival console and PC video game distributors from accessing content that enables them to compete in relation to game distribution, for example by making "must have" games only available through Microsoft products or distribution channels; and
  - 32.2 the merged entity would have the ability or incentive to foreclose rival video game developers and publishers through limiting access to Microsoft's digital storefronts such as Xbox Game Pass.
33. We will also consider the extent to which the public commitments made by Microsoft are binding on the merged entity, such that they would prevail with the acquisition.

### Next steps in our investigation

- 34. The Commission is currently scheduled to make a decision on whether or not to give clearance to the proposed acquisition by **11 August 2022**. However, this date may change as our investigation progresses.<sup>23</sup> In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
- 35. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

### Making a submission

- 36. If you wish to make a submission, please send it to us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference "Microsoft/Activision" in the subject line of your email, or by mail

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<sup>23</sup> The Commission maintains a clearance register on our website at <http://www.comcom.govt.nz/clearances-register/> where we update any changes to our deadlines and provide relevant documents.

to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **27 July 2022**.

37. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
38. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.