

Microsoft/Activision

20 June 2023

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),¹ as part of a global transaction.
2. To clear an application, the Commission must be satisfied that an acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a New Zealand market.
3. This Statement of Issues (Statement) sets out our concerns about the potential competition issues we have identified following our initial investigation. This is so Microsoft, Activision (together, the Parties) and other interested parties can provide us with submissions relating to those concerns.
4. In reaching the preliminary views set out in this Statement, we have considered information provided to date by the Parties and other industry participants. We have not yet made any final decisions on the issues outlined below (or any other issues) and our views may change, and new competition issues may arise, as the investigation continues.

The concerns we are testing

5. The Parties are competitors in video game development/publishing and video game distribution. However, we consider that the Proposed Acquisition is unlikely to result in horizontal effects in any relevant market, as there will remain several well-resourced competitors and the merging parties do not appear to be each other's closest competitor.
6. At this stage, the focus of our investigation is whether the Proposed Acquisition is likely to substantially lessen competition due to vertical effects in the distribution of video games for cloud gaming services.
 - 6.1 We are concerned that these effects may arise as a result of the merged entity either partially or fully foreclosing its rivals in cloud gaming, such as Sony or NVIDIA, from accessing certain Activision content, and in particular the game Call of Duty (CoD), to the detriment of competition in cloud gaming.

¹ 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/>.

7. We are also continuing to consider whether the Proposed Transaction would substantially lessen competition due the merged entity either partially or fully foreclosing its rivals in gaming consoles, in particular Sony, from accessing certain Activision content, to the detriment of competition in the supply of video game consoles.
8. If Activision's game titles are sufficiently important to driving sales of cloud gaming services or video game consoles, then this could result in the merged entity having both incentive and ability to foreclose rivals' access to this content, weakening their ability to compete.
9. We are considering whether the merged entity would have the ability and incentive to foreclose its rivals, or potential rivals:
 - 9.1 in cloud gaming, by refusing to license Activision content to them in New Zealand; or
 - 9.2 in video game consoles, by making all or certain Activision content available exclusively on Xbox (and/or Game Pass) or degrading the quality of Activision content on rival console platforms.
10. Whether the merged entity would have the incentive to foreclose rivals in video games consoles will depend on the interplay of several factors.
 - 10.1 On the one hand, if the merged entity pursues the strategy set out in 9.2, some users may switch from other consoles to Xbox to access Activision content. The merged entity would earn revenues from these Xbox console sales and also on Xbox game purchases (as the merged entity earns a fee for games distributed on the Xbox Store).
 - 10.2 On the other hand, some users may not switch to Xbox if Activision content is made exclusive. For these users, the merged entity would be foregoing the revenue from sales of Activision content.
11. We continue to assess where the merged entity's incentives are likely to lie post-merger, and whether it would be likely to engage in a foreclosure strategy.

Stopping our administrative clock

12. On 14 September 2022, by agreement with Microsoft, the Commission 'stopped the administrative clock' on its review of the matter.² On 18 April 2023 the Commission re-started the administrative clock.

² Our Merger and Acquisitions Guidelines (MAGs) at [6.32] state that we may "stop-the-clock" and stop counting the working days in specific situations that cause delays to our investigation. These include the review of the merger in other jurisdiction(s), time spent assessing divestment undertakings, or the applicant, target or interested party requesting further time to respond to information requests. Commerce Commission, Mergers and Acquisitions Guidelines, May 2022. Available on our website at www.comcom.govt.nz.

13. Since this time:
 - 13.1 Microsoft has given commitments to the European Commission (EC) as part of obtaining clearance from the EU for the Proposed Acquisition;
 - 13.2 The US Federal Trade Commission and UK Competition and Markets Authority have opposed the Proposed Acquisition pursuant to the processes in their respective countries; and
 - 13.3 A number of jurisdictions have unconditionally cleared or not opposed the merger.

Process and timeline

14. We have agreed with Microsoft an extension of time until 17 July 2023 in which to make a decision.
15. The Commission would like to receive submissions and supporting evidence from Microsoft, Activision and other interested parties on the issues raised in this Statement. We request responses by close of business on 4 July 2023 including a public version of any submission.
16. All submissions received will be published on our website with appropriate redactions. All parties will have the opportunity to cross-submit on the public versions of submissions from other parties by close of business on 11 July 2023.
17. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with the Commission at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

Industry background

18. 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.³
19. There are an estimated 3 billion gamers around the world, and this is expected to grow to 4.5 billion by 2030.⁴

Hardware-based gaming

20. 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 of the following devices:
 - 20.1 PCs (e.g., desktops, laptops and gaming-specific PCs);

³ The Application at [7.1].

⁴ The Application at [7.1].

⁵ Interactive Games & Entertainment Association – “Digital New Zealand 2022 Report”.

- 20.2 dedicated video gaming consoles (e.g., Sony PlayStation, Nintendo Wii and Switch, Microsoft Xbox);
 - 20.3 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); and/or
 - 20.4 other hardware devices which can be used for gaming, including smartphones and tablets running Apple iOS and Google Android.
- 21. 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.
 - 22. However, given differences in technological capabilities across devices, larger and more complex games are typically only available on PC and/or console,⁶ while mobile devices tend to be used more to play 'casual' games (e.g., Candy Crush).
 - 23. 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.

The emergence of cloud gaming

- 24. In addition to console and mobile gaming, cloud gaming has recently emerged as an additional option for gamers. Cloud gaming allows games to be accessed via cloud servers and streamed directly to a device.
- 25. Cloud gaming allows consumers to play games without needing to purchase dedicated gaming hardware, or even install games onto a local system.
- 26. Instead, games are stored and run remotely on a cloud gaming provider's dedicated hardware, and then are streamed as a video back to the gamer's device.
- 27. Because of this, users can access games on a wide range of devices such as mobile devices, computers and smart TVs.
- 28. 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.
- 29. For the cloud gaming experience to be enjoyable, the collective lag of all elements in the cloud gaming system⁷ must be imperceptible, as it is with 'locally' run games.

⁶ 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.

⁷ 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.

30. 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:
 - 30.1 if a player presses a button, their character on-screen will instantly perform the corresponding action.
 - 30.2 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.
31. 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.
32. Because minimizing lag is so important, distance considerations, with respect to the speed of light through optical fibre, are a factor that impacts the quality of a cloud gaming experience. Cloud gaming servers that are located too far away from the user can therefore introduce an unacceptable level of lag.
33. Accordingly, there are several requirements for the provision of cloud gaming services.
 - 33.1 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.⁸
 - 33.2 From the gaming company (supply) side, significant infrastructure, such as data centres and server farms, are required to host and run games.
34. 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:
 - 34.1 while Microsoft initially released a beta version of its cloud gaming service in November 2019, it was only launched in New Zealand in June 2022,⁹ and
 - 34.2 Google's Stadia publicly launched in November 2019, however it was never released in New Zealand before it was shut down in January 2023.

⁸ 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.

⁹ <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. 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.
36. There are several ways that cloud gaming service providers generate revenues, including:
 - 36.1 'multi-game' subscription services, where users pay a subscription fee for access to gaming servers as well as a catalogue of games. Examples of this model include Amazon Luna and Microsoft's Xbox Game Pass Ultimate;¹⁰
 - 36.2 the traditional 'buy-to-play' model, where users pay a one-time fee to purchase a game and play it on the relevant platform. An example of this model is Shadow;¹¹
 - 36.3 the 'bring-your-own-game' model, where gamers pay a regular subscription fee for access to cloud gaming servers and can then play games bought in third-party storefronts.¹² Examples of this model include NVIDIA's GeForceNow; and
 - 36.4 'free-to-play' offerings monetised through advertising revenue and in-game purchases. One such examples of this model includes Facebook Gaming, which allows users to play cloud-streamed games directly in the Facebook app or browser.

The parties

Microsoft

37. 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).
38. 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.
39. 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

¹⁰ Only Microsoft's Xbox Game Pass Ultimate, which is the highest-tier offered for its subscription service, will give users access to the cloud gaming servers. Other tiers will only give users access to the catalogue of games which are then played from the users' console.

¹¹ Shadow markets itself as an "ecosystem in the cloud". By paying a fee, users have access to a gaming server in the cloud through which they can access games they own.

¹² These are the stores through which some publishers make their games available. Examples include Steam and the Epic Games Store.

third-party distributors. Some of Microsoft's games are exclusive to its Xbox platform.

Activision

40. Activision is active in both:
 - 40.1 video game development and publishing; and
 - 40.2 video game distribution on PC through its digital storefront.
41. It develops games for PCs, consoles and mobile devices and publishes them through one of three business units:
 - 41.1 Activision Publishing, Inc;
 - 41.2 Blizzard Entertainment, Inc; and
 - 41.3 King Digital Entertainment.
42. Activision's titles include the CoD, Warcraft, and Candy Crush franchises.

The relevant markets

43. We define markets in the way that we consider best isolates the key competition issues that arise from a merger. In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products and services that fall outside the market, but which still impose some degree of competitive constraint on the merged entity.¹³
44. When assessing relevant markets, we consider whether, in response to a price increase on products or services by the merged entity:¹⁴
 - 44.1 customers would easily switch to alternative products or services (known as 'demand-side' substitution); and/or
 - 44.2 suppliers of different products or services would easily and profitably switch to supplying the products or services (known as 'supply-side' substitution), such that the price increase is unprofitable.

¹³ Commerce Commission, Mergers and Acquisitions Guidelines, May 2022. At [3.7] to [3.12].

¹⁴ 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.

The Applicant's view of the markets

45. Microsoft submitted that the markets relevant to the Commission's assessment of the Proposed Acquisition are:¹⁵
- 45.1 the supply of video game development and publishing for PCs and consoles;
 - 45.2 the supply of video game development and publishing for mobile devices (i.e., mobile games);
 - 45.3 the supply of digital video game distribution services;
 - 45.4 the supply of online display advertising services; and
 - 45.5 the supply and licensing of video game-related merchandising.
46. 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.

Summary of our preliminary views of the relevant markets

47. Our preliminary view is that the following markets are likely to be relevant to our assessment of the Proposed Acquisition:
- 47.1 the distribution of digital video games for mobile devices;
 - 47.2 the distribution of digital video games for PC/console devices;
 - 47.3 the supply of cloud gaming services; and
 - 47.4 the supply of video game consoles.
48. We are still considering the precise boundaries of these markets, including whether the supply of cloud gaming services comprises a distinct market, or is part of a wider digital video game distribution market.
49. With regard to the geographic scope of the relevant markets, we consider that they are likely NZ-wide. However, in our assessment of the competitive effects of the Proposed Acquisition we will consider the constraints likely to be provided from outside of New Zealand. We invite submissions on this point.
50. At this stage we do not consider that the Proposed Acquisition is likely to result in a substantial lessening of competition through unilateral or coordinated horizontal effects in any of the other markets listed at [47] above, regardless of how they are defined. We have therefore not formed any views on the precise boundaries of these markets.

¹⁵ The Application at [8.3].

Digital video game distribution services

What Microsoft submitted

51. Microsoft considers that there is a single, global, market for digital video game distribution. This is because:
- 51.1 it considers that digital distribution provides gamers with immediate access to games, which cannot be lost or destroyed, in comparison to the accessibility and storage of physical buy-to-play games;¹⁶ and
 - 51.2 the same digital distribution channels are available anywhere in the world without cross-border restrictions, and the same video game publishers compete across all major regions.¹⁷
52. It notes that in Microsoft/ZeniMax, the European Commission considered a market for video gaming distribution, and left open the question of whether the market should be further segmented according to:¹⁸
- 52.1 physical and digital distribution channels;
 - 52.2 platform (PC, console, mobile);
 - 52.3 payment model (upfront payment vs. subscription); and
 - 52.4 access method (download vs. streaming).

Our current view

53. At this stage 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.
- 53.1 These distributors are usually “bricks and mortar” retailers.¹⁹ The degree to which physical distribution is likely to compete with digital distribution therefore appears to be growing weaker and we expect this to continue over time.
54. We are continuing to consider whether digital distribution markets should be further segmented by:
- 54.1 platform (e.g., mobile, console, and PC); or
 - 54.2 payment model (up-front payment vs. subscription services).

¹⁶ The Application at [8.18].

¹⁷ The Application at [8.19].

¹⁸ The Application at [8.16].

¹⁹ Commerce Commission interview with [].

55. In relation to platforms, we understand that distribution on different platforms exhibits varying levels of ‘openness’. For example:
- 55.1 Apple and Google are by far the largest players in mobile distribution, and barriers to entry 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;
 - 55.2 Sony, Microsoft and Nintendo all operate their own console storefronts and the majority of digital distribution of console games are made via these storefronts.²⁰ These digital storefronts are console specific – a gamer purchasing games using their Xbox will only be able to access the Xbox store, and the same applies to PlayStation and Nintendo consoles; and
 - 55.3 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 and Steam. A game purchased on these distribution storefronts is generally able to be played on any capable PC.
56. We currently consider that it is appropriate to define a market for digital distribution for mobile games that is separate from the market for digital distribution for PC and console games, given neither Microsoft nor Activision is a significant participant in mobile gaming. Focusing our assessment on a relevant market for the digital distribution of PC and console games best isolates the competition effects that may arise from the Proposed Acquisition.
57. In terms of defining separate markets based on the payment model (e.g., buy-to-play vs. subscription services), we understand that some consumers will play games both on subscription services, as well as purchasing games upfront.²¹
58. However, we do not consider that this, in of itself, implies that these payment models are substitutes for one another.
59. Consumers may treat these two payment models as complements and use them in conjunction with one another because each method has its own benefits. For example:
- 59.1 subscription services give consumers the opportunity to try many games for a single price, that they themselves would otherwise not buy; and
 - 59.2 consumers may use the buy-to-play model to access games that they otherwise would not be able to, or to access new release games that are not available on a subscription service.

²⁰ 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.

²¹ Commerce Commission interview with [].

60. However, we also received feedback that:
- 60.1 publishers will use subscription services to monetize games at different stages of their lifecycle, by launching new versions, content or levels;²² and
 - 60.2 large publishers currently seem to be unwilling to put their 'release' games on subscription. This is typically because these games will earn publishers significant revenues on release. For example, Activision has not made its CoD titles available on any subscription services.
61. Ultimately, it appears that the extent to which these payment models are seen as substitutes will vary across different consumers and suppliers.
62. Buy-to-play and streaming services instead appear to be two differentiated offerings in a market for the digital distribution of video games. In a dynamic industry like video gaming, we consider that market participants will choose the offering, or mix of offerings, which gives them the best result.
63. We are continuing to consider whether it is appropriate to define separate markets for the digital distribution of video games based on payment model and seek submissions on this point.

The supply of cloud gaming services

64. Providers of cloud gaming services remotely run video games on their own servers and then stream them to the user's device. This allows a wider range of consumers to play high-performance games that were previously only accessible to owners of dedicated video game hardware.
65. 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 games at a lower cost through multi-game subscriptions before committing to purchasing the game.
66. This mode of delivery means that the requirements for a cloud gaming service provider are different from that of a supplier of video game consoles.
- 66.1 Providers of cloud gaming services require access to cloud computing infrastructure that is capable of running high performance games with minimal latency.
 - 66.2 On the other hand, suppliers of consoles deal with the development, manufacturing and distribution of physical hardware.
67. These differences in requirements means that it does not appear that firms would be able to easily switch between supplying cloud gaming services and video game

²² Commerce Commission interview with [].

consoles. Accordingly, we can currently see that some companies, such as NVIDIA, are present in one market but not the other.

68. On the demand side, because cloud gaming providers are supplying the processing capability, 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 could indicate that consumers who do not already own the gaming hardware may not view consoles as a viable substitute for cloud gaming.
69. On the other hand, for consumers who have already made the investment in gaming hardware, cloud gaming may represent a valuable complement to their console experience, as it may allow them access to a greater catalogue of content without the additional high up-front cost of individual games.
70. As noted above, cloud gaming is still developing, particularly in New Zealand. We are considering how this form of gaming may develop in New Zealand and the extent to which cloud gaming services would be constrained by console and PC gaming, and vice versa, and how this constraint may change over time (eg, are consoles likely to become unnecessary over time as high-speed internet becomes ubiquitous?).
71. At this stage, we consider that is appropriate to define a separate market for cloud gaming as this best isolates the competition issues that may arise as a result of the Proposed Acquisition. We seek submissions on this issue.

The supply of video game consoles

72. There are 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.
73. We are considering whether the merged entity would be able to limit its rivals' abilities to compete to supply video game consoles by foreclosing their access to Activision content.
74. We therefore consider that it appropriate to define a market for the supply of video game consoles.

With and without scenarios

75. Assessing whether a substantial lessening of competition is likely requires us to compare the likely state of competition if the Proposed Acquisition proceeds (the scenario with the acquisition, often referred to as the factual) with the likely state of competition if it does not (the scenario without the acquisition, often referred to as the counterfactual) and to determine whether competition is likely to be substantially lessened by comparing those scenarios.

76. In the Application, both Microsoft and Activision state that the appropriate without the merger scenario against which to assess the Proposed Acquisition [
77. 23
78.].
79. We are of the view that the merging parties are active in dynamic markets in which innovation may occur with or without the merger. However, our final assessment may reflect that, without the merger, firms could have more incentives to invest and innovate than they otherwise would.
80. We are continuing to investigate the appropriate with and without the merger scenarios and seek submissions on this point, in particular how cloud gaming is likely to develop in New Zealand (both with and without the merger), and over what timeframe. We are also interested in the extent to which Activision content is likely to be made available to cloud gaming providers in the future.

How the proposed acquisition could affect competition

81. We are satisfied that the Proposed Acquisition would not be likely to result in a substantial lessening of competition in any relevant market via:
- 81.1 unilateral effects;
 - 81.2 conglomerate effects; or
 - 81.3 coordinated effects.
82. Based on the evidence currently before us we are not satisfied that the Proposed Acquisition would not result in a substantial lessening of competition in the market(s) for supply of video games consoles and/or cloud gaming services via vertical effects.
83. In particular, we are considering:
- 83.1 whether Activision content would be a key input for the merged entity's rivals to compete effectively in the markets for the supply of:
 - 83.1.1 video game consoles; and/or

²³ []

83.1.2 cloud gaming services; and

83.2 If the merged entity would have the incentive to withhold Activision content from its rivals in the markets for the supply of:

83.2.1 video game consoles; and/or

83.2.2 cloud gaming services.

84. We invite submissions on the issues above.

Vertical effects

85. A merger may substantially lessen competition where the merger increases the merged firm's ability and/or incentive to prevent or hinder competition by:

85.1 refusing to deal with competitors completely (total foreclosure); or

85.2 raising prices it charges (or decreasing the quality it supplies) these competitors (partial foreclosure).²⁴

86. We are considering whether, post-Acquisition, Microsoft:

86.1 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

86.2 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.²⁵

87. 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.

88. Whether Microsoft would have such an ability will depend on the alternatives that rival platforms 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.

89. As outlined below, some third parties have asserted that Microsoft may be likely to have the incentive to engage in foreclosure of Activision content from rivals in console markets. We have also received some evidence that suggests that Microsoft

²⁴ Merger and Acquisition Guidelines at [5.4].

²⁵ 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.

may not have the incentive to engage in this behaviour. We are seeking further information in this regard.

What third parties have submitted

90. Access to a strong portfolio of products, particularly gaming catalogues, is viewed by industry participants as an important factor to success. While some companies such as Sony and Microsoft have in-house video game publishing arms and can offer proprietary (or “exclusive”) content, most rely on third-party developers for their games. Cloud gaming service providers also require access to cloud infrastructure.
91. One third party raised concerns that the merged entity would have the ability and incentive to restrict access to certain Activision content (specifically CoD) to its rivals. In particular, concerns were raised that:²⁶
- 91.1 post-acquisition, Microsoft could make CoD fully exclusive to the Xbox console and/or Game Pass, that is, non-Microsoft users would not be able to play CoD in any form; and/or
- 91.2 Microsoft could engage in partial foreclosure by:
- 91.2.1 making certain versions of CoD exclusive to the Xbox console and/or its cloud gaming service;
- 91.2.2 making new versions of CoD exclusive on Xbox for a certain time period by delaying release on other platforms; and/or
- 91.2.3 restricting availability of gameplay or console features on other platforms (for example, no haptic feedback on the controller).
92. A number of industry participants are of the opinion that content, especially access to a small number of AAA-games²⁷ (including CoD), is the primary driver for the choice of platform for gamers.²⁸
93. We understand that CoD has frequently been the top-selling game each year and is the best-selling first-person shooter ever. This enduring popularity, even in years where the game is considered lower quality than previous titles,²⁹ is said to evidence the level of loyalty and popularity of the game.³⁰
94. However, several other industry participants were more circumspect on the importance of CoD. For example, one distributor did not think that any one game

²⁶ Commerce Commission interview with [].

²⁷ “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.

²⁸ Commerce Commission interview with []; Commerce Commission interview with [].

²⁹ 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 36.1% from 2020.

³⁰ [] response to NZCC Request for Information dated August 12 2022 at [4].

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 you are only two weak releases away from the demise of a game franchise.³¹

95. A distributor noted that Microsoft has traditionally been a “good actor” in this space and there is no indication that they would look to “lock games away”. It did concede however that if there was a “theoretical concern” with the Proposed Acquisition, it would be the risk of Microsoft making games exclusive to Xbox Game Pass.
96. This distributor also considered that if Microsoft were to remove access to CoD to PlayStation, it would cost Microsoft a lot of money as a result of reducing its potential player base.³²

Foreclosure of rivals in the supply of cloud gaming services

97. Cloud gaming currently only represents a small portion of the wider gaming industry but has been growing in popularity as the underlying technology needed to make it work effectively becomes more accessible for a wider group of consumers. As noted, above, although cloud gaming is currently nascent, its use is widely expected to continue to grow rapidly as technological limitations are overcome.
98. Cloud gaming represents an attractive proposition for both:
 - 98.1 gamers, who will be able to access their favourite games on a variety of devices and locations; and
 - 98.2 video game publishers, who will be able to market their games to a higher number of gamers.
99. Much like many multi-sided platforms, we expect that the market for cloud gaming would experience network effects:
 - 99.1 as there are more users on any one platform, they will derive utility by having other gamers to play with;
 - 99.2 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
 - 99.3 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.

Cloud gaming in New Zealand and the potential for new entry

100. Currently in New Zealand, cloud gaming services are supplied by:

³¹ Commerce Commission interview with []; Commerce Commission interview with [].

³² Commerce Commission interview with [].

- 100.1 Microsoft, through its Xbox Game Pass Ultimate service;
 - 100.2 NVIDIA, through its GeForce NOW service; and
 - 100.3 Boosteroid.³³
101. We consider that there are likely to be high barriers to entry in this market. To be a successful cloud gaming provider, firms need access to both:
- 101.1 cloud computing infrastructure (located close to the users); and
 - 101.2 an attractive library of content.
102. Microsoft has significant advantages over its rivals with respect to both of these points:
- 102.1 as a provider of cloud computing services (through its Azure platform), it is able to use its own existing cloud infrastructure to provide its cloud gaming service; and
 - 102.2 as a developer and publisher of video games, it has control over a wide variety of games. With the acquisition, Microsoft would acquire Activision's titles and strengthen its position as a game publisher and developer.
103. Because of the significant costs associated with setting up cloud infrastructure, we consider that the competitors, or potential competitors, best placed to compete with Microsoft in this market would have their own cloud computing services, or partner with a cloud computing infrastructure provider.³⁴
104. Consistent with this, both Amazon and Google either offer, or have previously offered a cloud gaming service:
- 104.1 Amazon offers its Luna service, which is powered by Amazon Web Services and is currently available to users in USA, Canada, UK and Germany; and
 - 104.2 Google previously offered its Stadia service until January 2023, although it was never available in New Zealand. It shut down because it did not gain the traction with users that it expected.³⁵

The concerns we are testing

105. As discussed above, our investigation has identified that having access to a strong portfolio of gaming content is an important aspect for success of a games distribution platform. We are considering whether the Proposed Acquisition could give Microsoft an advantage by giving it control over Activision's library of gaming

³³ While consumers can sign up to Boosteroid in New Zealand, its servers are hosted in USA and Europe.

³⁴ Such as Google or Amazon.

³⁵ Google – "A message about Stadia and our long term streaming strategy" (September 29 2022).

content, which market participants have submitted contains certain must-have games.

106. 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.
107. Cloud gaming is a nascent market which we expect will grow in size in the future. It is currently unclear how competition in this market will evolve. However, if the Proposed Acquisition gives Microsoft the ability and incentive to foreclose its competitors through its control of Activision content this could prevent cloud gaming rivals from competing effectively.
108. This could create ongoing negative effects on the evolution of competition in cloud gaming and could enhance Microsoft's market power compared with the counterfactual. This may enable Microsoft to:
 - 108.1 increase the prices it charges gamers; and/or
 - 108.2 worsen the terms it offers to third-party publishers to host their games on its cloud gaming service.
109. We are therefore currently not satisfied that the Acquisition is unlikely to result in a substantial lessening of competition in the supply of cloud gaming, and seek submissions on this issue. In particular:
 - 109.1 the importance of access to Activision content (such as CoD) for a cloud gaming competitor, and whether Microsoft would have the ability and incentive to foreclose cloud gaming rivals;
 - 109.2 the extent to which network effects are present in cloud gaming markets, particularly as it relates to multi-homing across different services and interoperability (on both the supply and demand sides) between platforms;
 - 109.3 the extent to which cloud gaming is expected to grow and develop in New Zealand; and
 - 109.4 the extent to which the Remedies and Commitments entered into by Microsoft with third-party cloud gaming providers (as discussed further below) are likely to mitigate the risk of a substantial lessening of competition in cloud gaming in New Zealand.

The remedies and contractual arrangements entered into by Microsoft

110. As outlined in paragraph 13, Microsoft has submitted behavioural remedies to the European Commission which were a relevant consideration in the European Commission's decision to grant clearance to the Proposed Transaction.³⁶
111. The remedies submitted to the European Commission provide:³⁷
- 111.1 a commitment to grant consumers the right to stream eligible Activision games for a period of 10 years; and
 - 111.2 a commitment to grant game streaming services a royalty free licence to stream eligible Activision games for a period of 10 years.
112. In addition to and separate to these remedies, Microsoft states that it has entered into contracts with four cloud gaming providers (NVIDIA, Boosteroid, Ubitus and Nware) to allow for access to Activision games for 10 years if the Proposed Transaction goes ahead.³⁸ These contracts provide:
- 112.1 the cloud gaming providers' customers the right to play Microsoft's PC games, including Activision Blizzard titles, on each provider's cloud gaming service, with no territorial limitations on customers or covered games; and
 - 112.2 grants each cloud gaming provider the right to stream Microsoft's PC games, including Activision Blizzard titles, across the relevant territory, which includes all the countries where Microsoft makes its games available, including New Zealand.
113. Microsoft submits that it is appropriate for the Commission to take the existence of the European Commission remedies,³⁹ and the contractual arrangements entered into between Microsoft and cloud streaming providers (together, the commitments) in assessing the likely competition impacts of the Proposed Acquisition in New Zealand.⁴⁰
114. As outlined in our Mergers and Acquisitions Guidelines, we make a pragmatic and commercial assessment of what is likely to occur in the future with and without the merger.⁴¹ We are continuing to consider whether the commitments are sufficiently

³⁶ https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2705.

³⁷ Microsoft has stated that the EC remedy, and the contracts entered into with the four streaming providers would extend to providers active in New Zealand and cover New Zealand consumers. Microsoft 24 April 2023 response to NZCC.

³⁸ Microsoft, Overview of the key provisions of the cloud provider agreements, 12 May 2023.

³⁹ In 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. See [s69A, Commerce Act 1986](#).

⁴⁰ Microsoft 24 April response to NZCC.

⁴¹ Commerce Commission, Mergers and Acquisitions Guidelines, May 2022. At [2.35].

likely to be taken into account as part of our assessment of the likely scenario with the merger. In particular:

- 114.1 the safeguards in place to ensure Microsoft's compliance with its obligations in the commitments and the extent to which those safeguards extend to New Zealand; and
 - 114.2 the appropriateness of placing reliance on the existence of the commitments to remedy concerns in cloud gaming, given the emerging and uncertain nature of this market.
115. We welcome submissions on the appropriateness of taking these commitments into account as part of our assessment.

Foreclosure of rivals in video game consoles

116. We are also continuing to consider whether the Proposed Transaction would substantially lessen competition due to vertical effects in the supply of video game consoles.
117. We are considering whether the merged entity is likely to have the ability and incentive to withhold Activision content from its rivals in the supply of video game consoles in such a way that limits their ability to compete effectively.
118. The incentive to engage in any foreclosure strategy in regard to consoles would also rely on the profitability of doing so.
- 118.1 If CoD (or other Activision content) is made exclusive to Xbox, the merged entity will forego any revenues it may have earned from PlayStation users that are not prepared to switch to Xbox and instead switch to another PlayStation game.
 - 118.2 For users that do switch, the merged entity will earn revenue from the console (if users do not already own an Xbox, though we understand that video game consoles are marginally profitable at best) and also revenue on other, non-CoD, games that Xbox users purchase that they would otherwise have purchased for PlayStation.
 - 118.3 The merged entity's incentive to foreclose would then depend on which of these two revenue effects is larger.

What Microsoft submitted

119. Microsoft has submitted that there are no prospects of vertical foreclosure concerns in the console gaming market in New Zealand. Microsoft submits that were it to withhold CoD from Sony post-acquisition, it would "immediately impair the value of the acquired assets. Microsoft states that modelling has shown that anticipated

future revenues from CoD on Playstation account for approximately []% of the overall value of the Proposed Acquisition for Microsoft.⁴²

120. Microsoft further submits that:⁴³

120.1 any foreclosure strategy would be inconsistent with its strategy post-merger to make CoD available on more consoles, not fewer; and

120.2 Sony has a significantly stronger presence in console gaming in New Zealand compared to the rest of the world. Microsoft asserts that as withholding Activision content from Sony in countries with a lower installed base of PlayStation consoles would be financially destructive, it would be even more so in New Zealand, where CoD would be withheld from more than half the consoles sold.

Our views on Microsoft's incentives to foreclose

121. We currently consider that Microsoft is less likely to have the incentive to foreclose its rivals in the supply of video game consoles in New Zealand, compared to its rivals in cloud gaming. This is primarily because the hypothetical withholding of Activision content on PlayStation in New Zealand:

121.1 may cause Microsoft to lose significant revenues; and

121.2 is unlikely to have any impact on PlayStation more broadly, as New Zealand only accounts for a small proportion of the installed console base worldwide.

122. However, we seek more information to confirm our position, particularly as it relates to:

122.1 the extent to which NZ gamers 'multi-home' with respect to gaming consoles;

122.2 diversion of NZ gamers and the extent to which CoD and other Activision content drives sales of video game consoles in New Zealand; and

122.3 the average spend of console gamers in New Zealand over the lifespan of the relevant console.

Next steps in our investigation

123. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **17 July 2023**. However, this date may

⁴² Microsoft's acquisition of Activision Blizzard, Responses to the NZCC's questions of 30 March 2023, 13 April 2023.

⁴³ Microsoft response to NZCC questions 13 April 2023.

change as our investigation progresses.⁴⁴ In particular, if we need to test and consider the issues identified above further, the decision date is may further extend.

124. As part of our investigation, we will continue to identify and contact parties that we consider will be able to help us assess the issues identified above.

Making a submission

125. We are continuing to undertake inquiries and seek information from industry participants about the impact of the Proposed Acquisition. We welcome any further evidence and other relevant information and documents that Microsoft or any interested parties are able to provide regarding the issues identified in this Statement.
126. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference 'Microsoft/Activision' in the subject line of your email. Please do so by close of business on **4 July 2023**.
127. 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 be likely to unreasonably prejudice the commercial position of the supplier or subject of the information.

⁴⁴ 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.