

GAME OVER OR GAME ON?

MICROSOFT LODGES APPEAL AGAINST CMA'S ACTIVISION DECISION, WHILE EUROPEAN COMMISSION CLEARS THE PATH WITH REMEDIES

The video gaming industry is expected to be worth USD 321 billion by 2026. The recent boom in the video game industry has drawn increased scrutiny by competition regulators, seeking to ensure a level playing field. Perhaps the most notable competition development in this sector is Microsoft's intended acquisition of Activision Blizzard, Inc. The industry recently witnessed a flurry of dramatic developments as regulatory bodies made their moves in this high-stakes acquisition.

This briefing summarises the decision of the UK Competition and Markets Authority ("**CMA**") to block the proposed acquisition and compares the decision of the European Commission to greenlight the transaction, subject to remedies.

A POWERFUL DUO

In January 2022, Microsoft, which already has a strong presence in the gaming industry, announced that it was seeking to acquire Activision Blizzard. Aside from the CMA and European Commission ("**EC**"), the proposed transaction was also notified to competition authorities in Australia, Brazil, Japan, South Korea, and the US, among others.

Microsoft

Microsoft offers a range of products and services at various levels of the video gaming sector. Microsoft runs Azure, a cloud platform with solutions for businesses, and Azure PlayFab specifically caters to the gaming industry by offering game developers managed services, real-time analytics, and live operations to improve gaming experiences. Furthermore, one of Microsoft's flagship offerings is the Windows operating system ("**OS**"), the preferred OS for most PC gamers. According to the CMA, Microsoft's gaming ecosystem also includes the Xbox gaming console (which competes closely with Sony PlayStation and Nintendo Switch), Xbox Game Studios (and over 20 other Microsoft-owned game development studios), and digital distribution platforms

Key issues

- Microsoft's proposed acquisition of Activision Blizzard has been blocked by the CMA on grounds that this may result in a substantial lessening of competition in the market of cloud gaming services.
- The CMA rejected the behavioural remedies proposed by Microsoft, arguing that these would require ongoing regulation of a nascent market.
- The EC, on the other hand, approved the transaction, subject to compliance with the commitments offered by Microsoft, which it considered to be procompetitive.
- Microsoft lodged an appeal with the UK Competition Appeal Tribunal, which will focus on the legality, rationality, or propriety of the CMA's decision.
- As part of its grounds of appeal, Microsoft has challenged the correctness of the CMA's conclusion on Microsoft's position on the market for cloud gaming services, the failure of the CMA to give adequate importance to the commercial agreements Microsoft entered into with cloud gaming providers, and the disproportionate rejection of Microsoft's proposed remedy.

(Microsoft Store and Xbox Store). The company also offers gaming subscription services, such as Xbox Live Gold and Xbox Game Pass Ultimate (which includes Xbox Cloud Gaming, powered by Xbox Series X Hardware).

Activision Blizzard

Activision is a prominent game developer and publisher, operating through three business units: Activision Publishing, Blizzard Entertainment, and King Digital Entertainment. Activision's activities encompass game development and publishing for various platforms, including PCs, consoles, and mobile devices. Furthermore, Activision provides digital distribution services, as well as operating Battle.net, a digital storefront facilitating the distribution of Blizzard and select Activision content.

CMA PULLS THE PLUG

Following an in-depth Phase 2 investigation, the CMA, in February 2023, provisionally concluded that the acquisition of Activision Blizzard would substantially reduce competition in the cloud gaming market and the market for the supply of console gaming services, as a result of Microsoft restricting access to key Activision content (such as Call of Duty) to other platforms.

In a turn of events, the CMA updated its provisional findings shortly thereafter to reject the theory of harm relating to console gaming, clarifying that the proposed acquisition would not result in a substantial lessening of competition in the market for console gaming services. The CMA received a significant amount of evidence demonstrating that making key Activision content (such as Call of Duty) exclusive to Xbox would result in significant losses for Microsoft over a five-year period, among other reputational risks. Furthermore, from Microsoft's acquisition history, the CMA was not able to conclude with certainty that Microsoft would restrict access to Activision Blizzard games, citing Microsoft's acquisition of Minecraft, a game series which was retained on PlayStation and Nintendo post-transaction.

The CMA stressed Microsoft's strong existing position in the global market for cloud gaming services (contentiously estimated by the CMA as a 60%-70% share of the market) and unparalleled vertical strength (as a result of Azure PlayFab, Windows OS and Xbox Cloud Gaming), which meant that any restriction on the availability of key Activision content, which has the potential to transform the gaming industry, would likely harm competition now and in the foreseeable future in the nascent cloud gaming market. Using the example of Google Stadia, the CMA highlighted that merely having some strengths relevant to cloud gaming was not enough, and that access to key content would play a significant role in guaranteeing a platform's success. Therefore, the CMA ultimately declared that the merger would be expected to result in a substantial lessening in competition in the market for cloud gaming services in the UK, and that absent the merger, strong competition in this market would result in greater affordability of these services for the end consumer.

In order to address the CMA's concerns in relation to cloud gaming, Microsoft proposed to license Activision games, such as Call of Duty, to certain cloud gaming providers without charging royalties, through (i) Consumer Licenses (whereby Microsoft would grant consumers who purchased or obtained a licence for certain eligible PC games the right to play those games on eligible streaming services, regardless of when the Consumer Licence was obtained); and (ii) Streaming Provider Licenses (which would allow eligible streaming services to stream eligible games without paying royalties). However, the CMA

rejected Microsoft's proposals, stating that they were insufficient, since they only supported cloud gaming services offering a specific business model, and failed to cater fully to multi-game subscription services or games which operated on a non-Windows PC OS. Furthermore, given that the remedy involved third parties such as the monitoring trustee, and only operated for 10 years, the CMA raised concerns about their ability to effectively monitor and enforce its provisions.

EC PLAYS ON

The EC concluded its in-depth investigation by approving the transaction, subject to compliance with the commitments offered by Microsoft. In response to the EC's preliminary concerns that the acquisition could harm competition in the market for cloud gaming services, Microsoft proposed remedies (similar to those that had been offered to the CMA), which would involve Microsoft offering free licences over a 10-year period, allowing European consumers who purchase Activision PC and console games to stream them on other cloud gaming services. Contrary to the view of the CMA, the EC believed that the proposed remedies were sufficient to alleviate any concerns that the deal would result in harm in the market for cloud gaming services. Margrethe Vestager, the EC Competition Commissioner, stated that the Commission considered the remedy to be pro-competitive, because it "unlocked the potential of the cloud market".

EXTRA LIFE?

On 24 May, Microsoft lodged a formal appeal against the CMA's decision with the Competition Appeal Tribunal ("**CAT**") and hearings have been provisionally listed for two weeks beginning 24 July. Judgments in CAT merger appeals are typically issued around 2 months after the hearings.

The CAT's review will focus on the legality, rationality, or propriety of the CMA's decision (the "judicial review standard"), rather than a comprehensive assessment of the merits. Microsoft's appeal challenges the CMA's decision on various grounds, including the correctness of its conclusion on Microsoft's position within the market for cloud gaming services, alleging that the competition authority failed to take into account constraints from native gaming (i.e., gamers' access to content from digital downloads or physical discs), and that the CMA failed to give adequate importance to the commercial agreements Microsoft had entered into with cloud gaming providers. Another ground of challenge relates to the CMA's "disproportionate" rejection of Microsoft's proposed remedy, and its alleged failure to consider the "benefits and detriments" of a range of remedies, which is likely to be a key issue in light of the EC's emphasis on the pro-competitive benefits of Microsoft's remedy.

ROAD AHEAD

Both regulators agreed that there were limited anticompetitive effects in the market for console gaming services, and that the transaction could lead to foreclosure effects in the market for cloud gaming services. Of greater significance is the CMA's continued reluctance to consider behavioural remedies, which have traditionally proved vital in addressing vertical concerns. In its decision, the CMA expressed scepticism towards behavioural remedies, arguing that these would require ongoing regulation of a nascent market, thereby replacing economic forces in this dynamic market with mandated regulatory obligations overseen and enforced by the CMA. It is worth noting that the CMA has not accepted any behavioural remedies in the recent years during in-depth investigations, notably rejecting such remedies in the Sabre/Farelogix

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and Meta/Giphy acquisition reviews, opting to prohibit those deals instead – a trend which is further reinforced by this decision.

The parties are also gearing up for the US Federal Trade Commission ("FTC") hearing. In December 2022, the FTC issued an administrative complaint to block the proposed transaction on grounds that the merged entity would have the ability and increased incentive to withhold Activision's game content from, or degrade such content for, rivals. This decision to oppose the acquisition broadly reflects the FTC's ongoing antitrust enforcement against vertical transactions, particularly those in the tech sector.

The transaction agreement between Microsoft and Activision is due to expire on July 18. If the deadline is not extended and the deal falls through, Activision has the right to terminate the agreement and impose a break fee of up to \$3 billion on Microsoft.

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