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UK Merger Control

Microsoft/Inflection Sets the Roadmap for CMA Analysis of “Acquihire” Transactions

SUMMARY

The UK Competition and Markets Authority (“CMA”)’s *Microsoft/Inflection* decision (published yesterday) is the first published decision by a competition authority assessing a so-called “acquihire” transaction. It gives valuable insight into how the CMA will analyse similarly structured transactions in the future. In particular, it illustrates:

- (i) The ease with which the CMA can assert merger control jurisdiction over transactions that lack the features of a classic merger or acquisition;
- (ii) The CMA’s substantive analytical methodology to assess mergers in fast-moving tech markets, and the importance of the parties’ internal documents and third parties’ comments in CMA merger investigations; and
- (iii) The specificity of the UK merger control concepts of “enterprise,” “share of supply” and “material influence,” and how they feed into the CMA’s jurisdictional and substantive analysis.

STRUCTURE OF THE MICROSOFT/INFLECTION TRANSACTION

The Microsoft/Inflection transaction comprises five components: (i) offers of employment by Microsoft to certain Inflection employees, including its CEO and Chief Scientist (“Relevant Employees”); (ii) a non-exclusive license by Inflection to Microsoft (for a fee) of certain Inflection intellectual property; (iii) a waiver and release agreement under which, for a fee, Inflection and its shareholders waived any claims against Microsoft for the soliciting and hiring of the Relevant Employees; (iv) a line of credit agreement under which Microsoft agreed to provide certain funds to Inflection; and (v) a transition services agreement under which Microsoft made available to Inflection a team drawn from the Relevant Employees to provide ad hoc engineering and technical support to Inflection for a transition period.

OUTCOME OF THE CMA'S REVIEW

The CMA concluded that while the transaction structure differs from a classic merger or acquisition, it amounts to a “merger” under UK merger control law because it led to Microsoft acquiring an “enterprise.” As the parties’ combined “share of supply” of chatbots in the UK exceeded 25%, the CMA had jurisdiction to review the transaction under UK merger control law.

The CMA cleared the transaction unconditionally because it found that Inflection did not (and could not be expected to) exert a significant competitive constraint on Microsoft in the two relevant markets, namely the global markets for the development and supply of chatbots and AI foundation models (“FM”).

KEY TAKEAWAYS

A. The CMA has (and uses) wide discretion to exert merger control jurisdiction over novel transaction structures

To have merger control jurisdiction over the transaction, the CMA needed to show that: (i) the transaction led to Microsoft acquiring an “enterprise” (the “Enterprise Test”), and (ii) Microsoft and the acquired “enterprise” supply goods or services of the same type in the UK and together account for at least 25% of the supply of the relevant goods or services in the UK (the “Share of Supply Test”). The CMA had no difficulty concluding that the transaction met both tests.

1. The Enterprise Test

The CMA concluded that Microsoft had acquired an “enterprise,” not just bare assets. It concluded that as a result of the various agreements between the parties, Microsoft had “substantively acquired” Inflection’s pre-Transaction FM and chatbot development capabilities. This gave Microsoft the benefit of continuity of Inflection’s development of consumer-facing AI products. Consequently, the transaction gave Microsoft more than it could have achieved by organic growth by acquiring assets on the open market. The concepts of “economic continuity” and acquiring more than could have been achieved by organic growth and open market asset acquisitions are well-established factors in the CMA’s assessment of whether an “enterprise” has been acquired, although they have not previously been applied by the CMA in the “acquire” context.

2. The Share of Supply Test

UK merger control law gives the CMA notorious flexibility to select categories of goods and services and choose the metrics and data sources when it applies the Share of Supply Test.

As the relevant category of goods or services, the CMA chose the supply of chatbots in the UK. To measure Microsoft’s activities in chatbots, the CMA not only took account of Microsoft’s own Copilot product, but also attributed OpenAI’s Chat GPT product to Microsoft on the ground that the partnership between Microsoft and OpenAI gives Microsoft material influence over OpenAI. As UK merger control law provides that “material influence” can be conferred by rights that fall far short of “control” in EU merger control, the CMA

has broader powers than many other competition authorities to extend the analytical perimeter for a merging party to businesses in which that party may have only a minority shareholding and limited governance rights.

The CMA chose as the metric for its assessment web visits by UK user domains for chatbots. The period for its assessment was limited to February 2024 and the data source was SimilarWeb data. Although the CMA acknowledged the deficiencies in SimilarWeb data (not least because it understates the total number of website visits), the CMA nevertheless relied on it and concluded that “there is a realistic prospect” that Microsoft’s share (including OpenAI) of chatbot visits by UK users was 60%-70% and Inflection’s share was 0%-5%, therefore clearly exceeding the 25% threshold.

The CMA’s analysis is a clear reminder that the CMA is not subject to economic or empirical rigour when it applies the Share of Supply Test. The law allows it, for purposes of asserting jurisdiction, to use analytical parameters and data sources that would not be acceptable in the economic analysis of a merger’s competitive effects.

B. The CMA’s substantive analysis is wide-ranging and relies heavily on the parties’ internal documents and third parties’ views

The CMA assessed the competitive effects of the transaction in two markets: the development and supply of consumer chatbots and the development and supply of FMs. The CMA considered both of these markets to be global in scope.

The CMA noted that market share data for these markets was limited and, in any event, given the differentiated nature of the products, a static analysis based on market shares would not present an accurate picture of the competitive landscape. Hence, the CMA relied on other sources of evidence.

In particular, the CMA’s analysis of Microsoft and Inflection’s internal, ordinary course business documents was central to its analysis. Although much of the detail has been redacted from the public version of the decision, the CMA clearly (as is typical) made a detailed assessment of the parties’ internal documents. It focused particularly on what those documents revealed about: (i) the competing consumer chatbot and FM providers that Microsoft and Inflection typically monitored as part of their ordinary course competitive intelligence gathering; (ii) Inflection’s plans and predictions for its business; (iii) the extent to which Inflection appeared in Microsoft’s analyses of the competitive landscape; and (iv) whether Microsoft’s strategy and market behaviour in consumer chatbots and FMs had been influenced by the desire to respond to action taken by Inflection.

The CMA concluded that the parties’ internal documents did not show Inflection to be a particularly significant competitor to Microsoft.

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Third parties, whose views were also key in the CMA's analysis, largely confirmed that Inflection had a peripheral role in the relevant markets and its products did not have unique features that could have enhanced the competitive constraint that Inflection exerted on Microsoft (or OpenAI), either currently, or in the foreseeable future.

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