

Microsoft Corporation's hiring of certain former employees of Inflection and its entry into associated arrangements with Inflection

ME 7103/24

SUMMARY

OVERVIEW OF THE CMA'S DECISION

1. The Competition and Markets Authority (**CMA**) has found that the transaction described below involving the acquisition by Microsoft Corporation (**Microsoft**) of certain assets of Inflection AI, Inc. (**Inflection**), is a relevant merger situation falling within the merger control jurisdiction of the CMA but that the transaction does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects.
2. On 19 March 2024, Microsoft announced that it had hired several former Inflection employees, which the CMA understands amounted to almost all of Inflection's team, including two of its co-founders: Mustafa Suleyman and Karén Simonyan. In addition to hiring the core team, Microsoft also entered into a series of arrangements with Inflection including, among others, a non-exclusive licensing deal to utilise Inflection IP in a range of ways. The CMA refers to these various arrangements as the '**Transaction**'.
3. The CMA considers Microsoft to be the '**Acquirer**', and those assets acquired by Microsoft as a result of the Transaction as the '**Target Enterprise**'. Together the Acquirer and Target Enterprise are the '**Parties**'.

Who are the businesses and what products/services do they provide?

4. Microsoft is a global technology company, which as part of its operations, and those of its related entities, is engaged in a range of artificial intelligence (**AI**) related activities, including as a foundation model (**FM**) developer and supplier of downstream AI applications, such as chatbots. Microsoft also has a longstanding partnership with OpenAI. For the purposes of its jurisdictional and substantive analysis set out in this Decision, the CMA has treated OpenAI's products, such as ChatGPT, as also falling within Microsoft's activities. This is on the basis that Microsoft's initial investment in 2019 conferred on it the ability to materially influence OpenAI's policy.¹
5. Prior to the Transaction, the Target Enterprise also developed FMs and its flagship AI powered chatbot Pi, which has been supplied in the UK since May 2023. The Target Enterprise had also commenced an 'AI studio business' for enterprise customers.
6. The products that the CMA looked at in detail were:
 - (a) FMs, which are a type of technology trained on vast amounts of data to perform a wide range of tasks; and
 - (b) consumer chatbots, which are built on top of FMs and provide responses in text, speech, image and/or code to user prompts.

Why did the CMA review this merger?

7. Given the overlapping activities of Microsoft and the Target Enterprise outlined above, the CMA sought to understand whether the Transaction falls within the merger control jurisdiction of the CMA and whether it may give rise to competition concerns in the UK through the elimination of the Target Enterprise as a competitive constraint.
8. The CMA's primary duty is to seek to promote competition for the benefit of consumers. It has a duty to investigate mergers that could raise competition concerns in the UK, provided it has jurisdiction to do so. In this case, the CMA has concluded that the CMA has jurisdiction to review this Transaction because a relevant merger situation has been created. In making the

¹ The Microsoft/OpenAI partnership is under ongoing investigation by the CMA. The CMA has not reached any view on whether Microsoft's partnership falls within the merger control jurisdiction of the CMA and/or gives rise to competition concerns in the UK.

jurisdictional assessment, the CMA has applied the standard legal framework, as set out below.

9. The definition of a relevant merger situation under the Enterprise Act 2002 (the **Act**) covers various kinds of transactions and arrangements, subject to the following three criteria being met: (i) two or more enterprises cease to be distinct, (ii) either the UK turnover test or the share of supply test is met, and (iii) in the case of a completed merger, the reference is made not more than four months from the later of the merger taking place or material facts being notified.
10. In assessing the first criterion, the CMA applied its standard framework for assessing what constitutes an enterprise. An 'enterprise' in this context does not mean a separate legal entity, but rather the activities, or part of the activities of a business. To determine whether an enterprise has ceased to be distinct in this case, the CMA considered whether the assets that Microsoft acquired through the Transaction constitute at least part of the activities of the pre-Transaction Inflection business. An important part of its assessment is whether the relevant combination of assets enable a degree of economic continuity in the activities of the Target Enterprise pre-Transaction.
11. There is no particular combination of assets that constitutes an enterprise. As set out in the CMA's guidance, it may include a group of employees and their know-how where this enables a particular business activity to be continued.²
12. Prior to the Transaction, the objective of the Inflection team was 'creating personal AI for everyone'. Following the Transaction, the vast majority of this team was employed by Microsoft, and with them, Microsoft acquired the team's collective know-how of Inflection's activities pre-Transaction to support and grow Microsoft's AI activities. Given that any technology in this space can quickly become obsolete without ongoing development, the CMA notes the importance of expertise to the development and supply of FMs and chatbots. Based on the evidence seen by the CMA, the team of staff responsible for development is therefore at the core of any business seeking to develop FMs or chatbots. In this context, the CMA considers that acquiring a team with relevant know-how – even without further assets – may fall within the CMA's merger control jurisdiction.

² [Mergers: Guidance on the CMA's jurisdiction and procedure \(CMA2\)](#), January 2021 (as amended on 25 April 2024), paragraph 4.9.

13. In addition to hiring the core former Inflection team, Microsoft also acquired additional assets, including access to Inflection IP. The combination of acquiring the core team together with these assets was key to the value of the Transaction, as it enabled the former Inflection team to continue the pre-Transaction Inflection roadmap for consumer-facing AI product development within Microsoft.
14. On this basis, the CMA believes that Microsoft has substantively acquired Inflection's pre-Transaction FM and chatbot development capabilities. Accordingly, the CMA has found that at least part of the activities of pre-Transaction Inflection has been brought under the control of Microsoft and, as a result, that two enterprises have ceased to be distinct such that the Transaction falls within the CMA's merger control jurisdiction for review.
15. In assessing the second jurisdictional criterion, the CMA considered whether the share of supply test is met on the basis of Microsoft's and the Target Enterprise's overlapping supply of chatbots in the UK and globally. Based on SimilarWeb data for web visits by domain for chatbots in February 2024 in the UK, the CMA considers that Microsoft and the Target Enterprise's share of supply is above 25%, with an increment of [0-5%]. On this basis, the CMA considers that the share of supply test is met.
16. In assessing the third jurisdictional criterion, the CMA notes that its decision has been made before the statutory deadline of 20 September 2024.

What evidence has the CMA looked at?

17. In assessing this Transaction, the CMA considered a wide range of evidence in the round.
18. The CMA received several submissions and responses to information requests from Microsoft and Inflection. The CMA examined internal documents provided by each of them, which show the rationale for the Transaction, the activities and future plans of each of Microsoft and the Target Enterprise for their businesses, and how they view their rivals in the ordinary course of business.
19. The CMA spoke to and gathered evidence from other companies and organisations to understand better the competitive landscape and to get their views on the impact of the Transaction. In particular, the CMA received evidence from competing FM developers and chatbot suppliers, and potential customers of the Target Enterprise.

What did the evidence tell the CMA...

...about the effects on competition of the Transaction?

20. The CMA looked at whether the Transaction would lead to a substantial lessening in competition in:
- (a) the development and supply of consumer chatbots globally; and
 - (b) the development and supply of FMs globally.

Theory of harm 1: horizontal unilateral effects arising from the loss of competition in the development and supply of consumer chatbots

21. As noted above, both Microsoft and the Target Enterprise developed and supplied consumer chatbots pre-Transaction. The CMA considered the impact of the Transaction on this market, including in relation to product development and innovation. An important part of its assessment was the extent to which the Parties were close competitors based not only on the strengths and weaknesses of the Target Enterprises' offering but also its plans and product development pipeline.
22. The CMA found that prior to the Transaction, Inflection had a very small share of UK domain visits for chatbots and conversational AI tools and unlike many of its competitors, had not been able to materially increase or sustain its chatbot user numbers. The evidence shows that despite Pi having broadly comparable general intelligence and accuracy capabilities to many of its competitors at the time of the Transaction and being differentiated by its focus on emotional intelligence (**EQ**), it is not a material competitive constraint on the consumer chatbots that have been developed directly by Microsoft (Copilot), or in partnership with OpenAI (ChatGPT), or other competitors. These competitors did not regard Inflection's capabilities with regard to EQ or other product innovation as a material competitive constraint. This was consistent with other evidence that showed the Target Enterprise is not an important source of product innovation which may exert material competitive constraint now or in the future, as many of the features it was developing could be readily replicated by competitors to the extent that they became valued by consumers. In addition, the CMA considers that the Target Enterprise would have faced significant challenges in winning customers from its competitors and realising its development ambitions.
23. On this basis, the CMA found that the Transaction does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects arising

from the loss of competition in the development and supply of consumer chatbots.

Theory of Harm 2: horizontal unilateral effects arising from the loss of competition in the development and supply of FMs

24. The CMA found that the Target Enterprise's plans for its AI studio business for enterprise customers were in the initial stages and understands that it would have involved the development and supply of an FM (for example by providing access through API or licensing arrangements) which could be fine-tuned to meet the use-case requirements of enterprise customers.
25. The Target Enterprise's development and supply of FMs to enterprise customers was to be largely aligned with its consumer business – leveraging the same underlying FM and FM post-training techniques developed by the former Inflection team, such as fine-tuning for EQ to develop Pi-styled applications for the Inflection FMs. Of the potential customers that engaged with the Inflection FM offering, none identified any features that made it more attractive than other competitors with more established enterprise offerings. Meanwhile, the Target Enterprise's competitors, including those that have built FMs specifically for enterprise use, are actively developing or are capable of innovating their FMs to address the developing needs and preferences of enterprise customers. As such, the CMA found that the Target Enterprise's FM offering would not exert material competitive constraint on Microsoft or other suppliers of FMs to enterprise customers.
26. On this basis, the CMA found that the Transaction does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects arising from a loss of competition in the development and supply of FMs.

What happens next?

27. The Transaction will therefore **not be referred** under section 22(1) of the Act.