

May 9, 2024

Ms. Lavinia de Havilland and Ms. Georgia Cummings  
Competition and Markets Authority  
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Ms. de Havilland and Ms. Cummings,

On behalf of the Information Technology and Innovation Foundation (ITIF), thank you for the opportunity to provide comments to the Competition and Markets Authority (CMA) on the recent events related to Microsoft and Inflection AI.<sup>1</sup>

ITIF is an independent, nonprofit, nonpartisan research and educational institute that has been recognized repeatedly as the world's leading think tank for science and technology policy. ITIF's mission is to formulate and promote policy solutions that accelerate innovation and boost productivity to spur growth, opportunity, and progress. ITIF's Center for Data Innovation focuses on the intersection of data, technology, and public policy.

These comments make three points. First, Microsoft's non-exclusive licensing of Inflection AI's model and its hiring of former Inflection AI employees (which the CMA refers to collectively as "the Transaction") does not meet the criteria set for a "relevant merger situation" as set forth in the Enterprise Act 2002, and thus the CMA should not intervene. Second, even if the CMA believes that the Transaction reaches the threshold to create a relevant merger situation, these activities have not had a negative impact on competition. Third, CMA's intervention in the hiring of former Inflection AI employees would discourage other companies from competing for talent—an outcome that would be at odds with the goals of antitrust regulators.

## **THE CMA SHOULD NOT INTERVENE IN THE TRANSACTION**

The first question CMA is considering is "whether it is or may be the case that the Transaction has resulted in the creation of a relevant merger situation under the merger provisions of the Enterprise Act 2002."<sup>2</sup>

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<sup>1</sup> "Microsoft Corporation's Partnership With Mistral AI," Competition and Markets Authority, n.d., [https://assets.publishing.service.gov.uk/media/6627c058d29479e036a7e68c/A\\_Microsoft\\_Mistral\\_ITC.pdf](https://assets.publishing.service.gov.uk/media/6627c058d29479e036a7e68c/A_Microsoft_Mistral_ITC.pdf).

<sup>2</sup> Ibid.

More specifically, there are two events that CMA has raised questions about. First, Microsoft has obtained a non-exclusive license to distribute Inflection AI's model on its cloud service. But the licensing agreement has no direct impact on either organization's corporate structure. Indeed, licensing agreements are routine business transactions. Presumably, CMA's concern is that Inflection AI allegedly used a portion of those proceeds to buy back some of the equity from previous investors.<sup>3</sup> However, Inflection AI's decision to buy back equity likely reflects its announcement that it is reorienting its business strategy away from a direct-to-consumer AI chatbot and towards providing business-to-business (B2B) licensing of AI models. As Inflection AI stated in its announcement:

Our plan going forward is to lean into our AI studio business, where custom generative AI models are crafted, tested and fine tuned for commercial customers. Our success at training, tailoring and improving the performance of large AI models makes us uniquely well placed to be the AI platform for businesses around the world.<sup>4</sup>

Some initial investors were likely more interested in Inflection AI's initial business model, and buying back equity allows the company to ensure its investors remain aligned with its objectives and timelines. This alignment is necessary for strategic decision-making and long-term growth. Many startups change their business models in response to dynamic market conditions. Indeed, if companies like Inflection AI were unable to adjust their business models, that would limit competition. In this case, Inflection AI is now competing with other companies that produce large language models (LLMs) for enterprise use.

Second, Microsoft hired two of Inflection AI's cofounders, as well as several of its staff, to join a newly constituted unit within the company. The movement of several Inflection AI employees to Microsoft reflects a competitive labor market. Some Inflection AI employees saw greater professional rewards from this opportunity and chose to pursue it. Others did not, which naturally reflects divergent professional interests. Inflection AI's near-term focus will be on developing an application programming interface (API) for developers to access its model. Inflection AI staff interested in researching and developing next-generation LLMs may not want to spend their time building out an API for B2B usage.

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<sup>3</sup> "Microsoft's Inflection AI grab likely cost more than \$1 billion, says an insider (exclusive)," *Fast Company*, March 26, 2024, <https://www.fastcompany.com/91069182/microsoft-inflection-ai-exclusive>.

<sup>4</sup> "The new Inflection: An important change to how we'll work," Inflection AI, March 19, 2024, <https://inflection.ai/the-new-inflection>.

The Enterprise Act 2002 plainly states that “a relevant merger situation has been created if...two or more enterprises have ceased to be distinct enterprises...”<sup>5</sup> In this case, despite some important changes at both companies, these two firms remain distinct entities not under any *de facto* common control., And none actions of these two companies do not meet CMA’s threshold for a relevant merger situation. Both organizations continue to operate independently, maintaining distinct governance and operational structures.

### **THE TRANSACTION DOES NOT HARM COMPETITION**

The Transaction has not had a negative impact on competition in the UK (or elsewhere) in terms of reduced innovation, consumer welfare, or choice. First, there is no loss of horizontal competition between the companies, as both companies continue to develop their own products and services.

With respect to vertical effects, Microsoft’s licensing of Inflection AI’s models has not, and will not, prevent competitors from using Inflection AI’s models or Microsoft’s cloud services. The partnership does not give Microsoft exclusive access to Inflection AI’s large language models (LLMs). Moreover, Inflection AI has committed to ensuring Inflection-2.5, its flagship model, “comes to other cloud hosting platforms in the near future.”<sup>6</sup> Indeed, Inflection AI’s new business model focused on B2B licensing will require that it make its model widely available on multiple platforms to get exposure to as many developers as possible.

In addition, Inflection AI does not have exclusive access to Microsoft’s cloud services for its LLM. Microsoft’s Azure AI Studio offers a catalog of leading AI models, including competitors to Inflection AI such as GPT-4 (OpenAI), Llama (Meta), Command (Cohere), and Dolly (DataBricks).<sup>7</sup> In addition, many companies compete with Microsoft’s Azure AI platform, including major cloud providers such as Amazon Web Services, Google Cloud Platform (GCP), and IBM Watson.

### **THE TRANSACTION HAS HAD PRO-COMPETITIVE EFFECTS**

Far from reducing competition, the Transaction will likely prove to be pro-competitive and bring additional consumer benefits going forward. Microsoft’s licensing of Inflection AI’s LLM creates more competition between different AI models because developers can easily experiment with different models from different providers within the Azure platform. Given Microsoft’s global footprint for its cloud services, this partnership allows Inflection AI an opportunity to compete worldwide with larger companies like OpenAI. It also

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<sup>5</sup> “Enterprise Act 2002, Section 23,” The National Archives, n.d. <https://www.legislation.gov.uk/ukpga/2002/40/section/23> (accessed December 14, 2023).

<sup>6</sup> Ibid.

<sup>7</sup> “Azure AI Studio,” Microsoft, n.d., <https://ai.azure.com/explore/models>.

increases competition because before this licensing agreement Inflection AI's model was not available for use by outside developers. Inflection AI's focus on "emotional intelligence" of its chatbot—such as having a friendly personality and empathetic responses—represents a unique focus among LLM providers and creates a new dimension for competition, thereby fostering more innovation.

Microsoft also continues to develop its own LLMs, including MAI-1, a new, 500 billion parameter LLM that is significantly larger than any of Microsoft's previous AI models.<sup>8</sup> Mustafa Suleyman, the former CEO and co-founder of Inflection AI, has overseen the development of this model, but this new LLM is reportedly not based on work from Inflection AI and was developed entirely at Microsoft.<sup>9</sup> The development of MAI-1 creates another direct competitor to frontier AI models such as Llama, GPT-5, Gemini, Claude, and others.

Moreover, Microsoft's successful recruitment of several Inflection AI employees reflects a competitive labor market. This hiring is not anti-competitive because it is not designed to keep key employees away from a competitor, but rather to establish a new competitor in the AI sector in the form of Microsoft's new AI business unit. Indeed, it is ironic that CMA suggests that this competition for labor might be viewed as anticompetitive. As the U.S. Department of Justice and Federal Trade Commission have noted,

Just as competition among sellers in an open marketplace gives consumers the benefits of lower prices, higher quality products and services, more choices, and greater innovation, competition among employers helps actual and potential employees through higher wages, better benefits, or other terms of employment. Consumers can also gain from competition among employers because a more competitive workforce may create more or better goods and services.<sup>10</sup>

Moreover, the FTC recently announced a new rule to ban noncompete clauses in employment agreements. The FTC argues that this ban is necessary to protect "fundamental freedom of workers to change jobs, increasing innovation, and fostering new business formation."<sup>11</sup> If Inflection AI had imposed noncompete requirements on its employees, then they could not have left for Microsoft. It is ironic that one competition regulator argues that employees should be able to freely move between companies, but then another competition regulator suggests that when employees exercise this freedom, their actions are anticompetitive.

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<sup>8</sup> "Meet MAI-1: Microsoft Readies New AI Model to Compete with Google, OpenAI," *The Information*, May 6, 2024, <https://www.theinformation.com/articles/meet-mai-1-microsoft-readies-new-ai-model-to-compete-with-google-openai>.

<sup>9</sup> Ibid.

<sup>10</sup> "Antitrust Guidance for Human Resource Professionals," Department of Justice Antitrust Division and Federal Trade Commission, October 2016, <https://www.justice.gov/atr/file/903511/dl>.

<sup>11</sup> "FTC Announces Rule Banning Noncompetes," Federal Trade Commission, April 23, 2024, <https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes>.

## **CONCLUSION**

Given that the Transaction does not create a relevant merger situation, does not harm competition, and has a pro-competitive impact on the market, the CMA should not intervene. Intervention would have a deleterious impact on digital innovation in the AI sector by discouraging investment in the sector if investors believe regulators may limit the ability of startups to adjust to changing market conditions and form strategic partnerships.

Moreover, given that the Transaction involves two U.S.-based companies, the CMA should be cautious when considering extraterritorial enforcement of its authority, especially in hotly contested emerging markets like AI, because intervening could create the impression that the UK is attempting to stifle foreign competition by sabotaging successful technological partnerships. Instead, in the absence of evidence of harm and any clear impact on the UK market, the CMA should defer to U.S. regulators to consider whether to investigate any antitrust concerns arising from this partnership.

Thank you for taking this analysis into account in your review.

Sincerely,

Daniel Castro  
Vice President, ITIF  
Director, ITIF's Center for Data Innovation