

District court denies FTC's bid to halt Microsoft/Activision deal

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On July 10, 2023, Judge Jacqueline Scott Corley of the U.S. District Court for the Northern District of California denied the FTC's motion for a preliminary injunction to block Microsoft's acquisition of Activision Blizzard. Judge Corley held that the FTC failed to show a likelihood that it will prevail on its claim that the vertical merger may substantially lessen competition. This decision represents yet another setback to the FTC's expansive enforcement agenda.

History of the deal and enforcers' response

In January 2022, Microsoft Corp. (Microsoft) announced that it had agreed to acquire Activision Blizzard (Activision), including its popular gaming franchises such as *Call of Duty*. The transaction was subject to competition law review in multiple jurisdictions, including the United States, the European Union, and the United Kingdom.

The FTC's challenge to the transaction

In December 2022, the U.S. Federal Trade Commission (FTC) brought an administrative challenge to the deal.¹ The FTC alleged that Microsoft would have the incentive and ability to withhold Activision content from Microsoft's console gaming, cloud gaming, and subscription service gaming competitors, in violation of Section 7 of the Clayton Act and Section 5 of the FTC Act.²

The FTC subsequently filed suit in federal court on June 12, 2023—six months after filing its complaint before the FTC administrative law judge (ALJ)—seeking a preliminary injunction to block the deal from closing because it argued that Microsoft intended to proceed with closing the merger as soon as July 16, 2023. Notably, the FTC ALJ does not have the authority to issue a preliminary injunction blocking the deal from closing, and the FTC likely perceived some risk that the deal would obtain other necessary regulatory approvals and proceed to closing. The district court granted the FTC's motion for a temporary restraining order and began an expedited hearing on the injunction motion on June 22, 2023.

If the transaction does not close by July 18, 2023 (absent some contractual extension), Microsoft must pay Activision a \$3 Billion reverse termination fee. Given the current state of play, it would not be surprising for the parties to extend this date.

Reviews by the European Commission and UK CMA

The European Commission (EC) and the UK Competition and Markets Authority (CMA) likewise reviewed the transaction.

The EC approved the transaction on May 15, 2023, conditional upon Microsoft's 10-year commitment to: (1) offer a free license to European Economic Area (EEA) consumers that would allow them to stream, via any cloud game streaming services of their choice, all current and future Activision PC and console games for which they have a license; and (2) offer a free license to cloud game streaming service providers to allow EEA-based gamers to stream Activision PC and console games.³

On April 26, 2023, the CMA blocked the transaction on the grounds that it could harm competition for cloud-based gaming.⁴ Microsoft's appeal of the CMA decision was due to begin on July 28, 2023. Microsoft, Activision, and the CMA have reportedly filed a joint submission with the Competition Appeal Tribunal (CAT) to stay litigation in the UK while the parties work to negotiate a remedy resolving the CMA's concerns.⁵

FTC's preliminary injunction bid denied in court

On July 10, 2023, Judge Corley of the U.S. District Court for the Northern District of California denied the FTC's motion for a preliminary injunction to block Microsoft's acquisition of Activision.

The district court's decision

Before granting a preliminary injunction under Section 13(b) of the FTC Act, the court had to: (1) determine the likelihood that the FTC will ultimately succeed on the merits; and (2) balance the equities.

The court found that the FTC was not likely to succeed on the merits

Although it was "sharply dispute[d]" between the parties, Judge Corley found that the "likelihood of ultimate success" meant "the likelihood of the FTC's success on the merits in the underlying administrative proceedings, as opposed to success following a Commission hearing, the development of an administrative record, and appeal before an unspecified Court of Appeals."⁶

- The FTC argued that post-transaction, the combined Microsoft/Activision firm "may deprive rivals—primarily Sony—of a fair opportunity to compete . . . by foreclosing an essential supply—*Call of Duty*."⁷ Citing the Commission's decision in the Illumina/Grail matter,⁸ the FTC argued that "it need only show the transaction is 'likely to increase the ability *and/or* incentive of the merged firm to foreclose rivals."⁹ The court rejected that position, writing, "*Illumina* . . . provides no authority for this proposition, nor could it If there is no incentive to foreclose, then there is no probability of foreclosure and the alleged concomitant anticompetitive effect. Likewise, if there is no ability [to foreclose], then a party's incentive to foreclose is irrelevant."¹⁰
- The court likewise rejected the FTC's claim that "it need only show the combined firm would have a greater ability and incentive to foreclose *Call of Duty* from its rivals than an independent Activision."¹¹ Judge Corley reasoned that this standard is inconsistent with Section 7 of the Clayton Act, which requires a *substantial* lessening of competition.

The district court concluded that to establish a likelihood of success on its ability and incentive foreclosure theory, the FTC must show that the combined firm has the ability *and* incentive to withhold *Call of Duty* from its rivals, and that competition would probably be substantially lessened as a result of the withholding.

The court then found that while the combined firm would have the ability to foreclose competitive access to *Call of Duty* post-merger, it would not have the incentive to do so:

- First, the court found persuasive Microsoft's efforts to commit to maintain *Call of Duty* on existing platforms and to expand its availability. Witness testimony and documentary evidence supported this commitment.
 - On this point, the court was unpersuaded by Sony's testimony challenging the commitment because Sony opposes the merger.
- Second, the deal plan evaluation model presented to the Microsoft Board of Directors to justify the Activision purchase price relied on PlayStation sales and other non-Microsoft platforms post-acquisition. Similarly, *Call of Duty's* cross-platform access is critical to its financial success.
- Third, Microsoft would face significant reputational harm if it restricted access to *Call of Duty*, and the FTC did not identify another instance where a game with *Call of Duty's* characteristics was withdrawn from multi-platform access and made exclusive.

The court similarly rejected the FTC's argument that it had established a likelihood of success under "the *Brown Shoe* functional liability factors" in showing that the proposed merger's "very nature and purpose" is anticompetitive, there is a "trend toward concentration in the industry," and the merger would "increase entry barriers in the Relevant Markets."¹²

The balance of equities was not in the FTC's favor

While the above was enough to dispose of the preliminary injunction motion from a legal standpoint, Judge Corley also addressed and rejected the FTC's argument that "the difficulty in ordering post-acquisition divestiture" should allow the FTC to prevail. In particular, the court noted that:

[The FTC did] not cite anything specific about this merger to support that assertion. It is a vertical acquisition. Microsoft and Activision will act as parent and subsidiary. There is no planned dismantling of Operations What exactly about the merger would make it difficult to order an effective divestiture? The FTC does not say. Its argument, at bottom, is the equities always weigh in favor of a preliminary injunction. But that argument ignores the law.¹³

Key conclusions

Market definition was not a material issue in this decision

Judge Corley questioned, but did not significantly dispute, the FTC's product and geographic market definitions. For purposes of the preliminary injunction analysis, she found that the relevant product markets were: (1) high-performance consoles (Xbox and Sony PlayStation); (2) multi-game content library subscription services; (3) cloud gaming; and (4) a combined library subscription services and cloud gaming market. Judge Corley also agreed that the relevant geographic market was the United States.¹⁴

Microsoft's post-complaint agreements were a critical factor

Two months after the FTC filed its complaint, Xbox and Nintendo entered a 10-year agreement to bring future *Call of Duty* titles to Switch (and any successor Nintendo consoles) after the merger closed.¹⁵ Microsoft also committed publicly and under oath to continue to sell *Call of Duty* titles to Sony for use on its PlayStation platform.¹⁶ The court was persuaded that this mitigated competitive concerns raised by the FTC.

The court rejected the FTC's claim that Microsoft's commitment to maintain *Call of Duty* on existing platforms was irrelevant to its prima facie case

Citing the Commission's own *Illumina* decision as well as *United States v. E.I. du Pont de Nemours & Co.*,¹⁷ the FTC argued that Microsoft's commitment was a "proposed remedy," and that defendants bear the burden of proving the remedy's effectiveness. Judge Corley found that *E.I. du Pont* does not support the FTC's position because it involved a remedy proposed *after* a finding of a Section 7 violation (whereas there has been no official finding of liability yet with regard to the FTC's case against the proposed Microsoft/Activision merger).¹⁸ The court therefore placed the burden on the FTC to demonstrate that the merger *including* Microsoft's commitments would substantially lessen competition.

Implications

The FTC's separate administrative suit to block the transaction is ongoing. In the next few days, the FTC is expected to announce whether it will appeal the district court decision. If the FTC appeals, it would likely focus on the legal standard for evaluating a proposed remedy in a "litigating the fix" situation. This has been a controversial issue in multiple recent merger trials. The FTC may also focus on the legal standard for evaluating the competitive effect of a vertical merger.

Nevertheless, as it stands, the decision represents a setback to the FTC's expansive enforcement agenda. Notably, Judge Corley—a Biden appointee—rejected the FTC's attempt to rely on its own *Illumina* decision to argue that remedy discussions are premature before a liability finding. Judge Corley also rejected the FTC's reliance on *Illumina* to argue that a vertical foreclosure theory requires only the ability to foreclose *or* the incentive to foreclose. Finally, Judge Corley rejected the FTC's argument that it is sufficient to establish a change in incentives post-merger, without also establishing the likelihood of a substantial lessening of competition. In all instances, Judge Corley noted that the FTC's views are inconsistent with settled law.

If the FTC continues to advance these theories, for example in the forthcoming revised merger guidelines or in future enforcement actions, the FTC may well see continued and significant pushback from the federal courts.

The status of the CMA's review is also critical. At present, despite their victory in U.S. court, the parties cannot close the transaction because the CMA has issued a decision blocking the deal. It remains to be seen whether the CMA will revise this decision in light of additional remedies offered by Microsoft. The CMA has come under unprecedented political pressure in the UK to reconsider its decision.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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- ¹ Press Release, FTC, *FTC Seeks to Block Microsoft Corp.'s Acquisition of Activision Blizzard, Inc.* (Dec. 8, 2022), <https://www.ftc.gov/news-events/news/press-releases/2022/12/ftc-seeks-block-microsoft-corps-acquisition-activision-blizzard-inc>.
- ² 15 U.S.C. § 18; 15 U.S.C. § 45.
- ³ Press Release IP/23/2705, European Commission, *Mergers: Commission Clears Acquisition of Activision Blizzard by Microsoft, Subject to Conditions* (May 15, 2023), https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2705.
- ⁴ Press Release, Competition and Markets Authority, *Microsoft / Activision Deal Prevented to Protect Innovation and Choice in Cloud Gaming* (Apr. 26, 2023), <https://www.gov.uk/government/news/microsoft-activision-deal-prevented-to-protect-innovation-and-choice-in-cloud-gaming>.
- ⁵ @BradSmi, TWITTER (Jul. 11, 2023, 11:59 AM), <https://twitter.com/BradSmi/status/1678796043545350144?s=20>; see also Tom Warren, *Microsoft and UK Regulators Agree to Pause Their Activision Battle to Negotiate*, The Verge (Jul. 11, 2023), <https://www.theverge.com/2023/7/11/23791149/microsoft-activision-blizzard-uk-regulators-cma-appeal>.
- ⁶ *FTC v. Microsoft*, 23-cv-02880-JSC, at 22 (N.D. Cal. July 10, 2023) (quoting *FTC v. Meta Platforms Inc.*, 2022 WL 16637996, at *6 (N.D. Cal. Nov. 2, 2022)) (hereafter, the "Decision").
- ⁷ *Id.* at 31.
- ⁸ *In the Matter of Illumina, Inc. and Grail, Inc.*, No. 9401, 2023 WL 2823393 (F.T.C. Mar. 31, 2023).

⁹ Decision at 32 (emphasis added).

¹⁰ *Id.*

¹¹ *Id.* at 33.

¹² *Id.* at 50 (internal quotations omitted).

¹³ *Id.* at 52.

¹⁴ *Id.* at 24-30.

¹⁵ *Id.* at 18.

¹⁶ See, e.g., Brad Smith, Opinion, *Microsoft's Activision-Blizzard Acquisition Is Good for Gamers*, Wall St. J. (Dec. 5, 2022), <https://www.wsj.com/articles/microsofts-activision-blizzard-acquisition-is-good-for-gamers-competition-sony-cross-play-ftc-11670260780>; Decision at 19.

¹⁷ 351 U.S. 377, 394 (1956).

¹⁸ Decision at 39 (citing *United States v. AT&T Inc.*, 916 F.3d 1041 (D.C. Cir. 2019); *United States v. UnitedHealth Grp.*, 2022 WL 4365867, at *15-24 (D.C. Cir. Sept. 21, 2022); *FTC v. Arch Coal, Inc.*, No. 04-00534, Dkt. No. 67 (D.D.C. July 7, 2004)).