Merger ANTITRUST LAW

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READING GUIDANCE

Class 26 (November 24): Microsoft/Activision (Unit 14)

In our last class, we will examine the FTC's challenge to Microsoft Corporation's proposed $69 billion acquisition of Activision Blizzard, Inc., the largest transaction ever in the video-game industry.[1] This guidance first describes the parties and the FTC's theories, then follows the case through the administrative complaint, the district court, and the Ninth Circuit. It closes with a Note on the FTC's economic model, which applies the cutoff test from the Class 23 RRC Note.

Reading assignment. As the end of the semester approaches and you are undoubtedly pressed for time, I will not require you to read all the materials. This reading guidance alone will get you through the class. That said, you should try to read Microsoft's press release (pp. 3-11) for some background and Judge Corley's opinion (pp. 71-123). If you have the time, read the Ninth Circuit's decision (pp. 124-162), which, of course, has greater precedential value than the district court's opinion but not as much factual detail.

Questions to keep in mind. As you read, keep two questions in mind: (1) Would Microsoft have both the ability and the incentive to withhold or degrade Call of Duty, or to disadvantage rivals in subscription and cloud gaming? (2) Would that foreclosure probably lead to a substantial lessening of competition? A third question is interesting but not nearly as important: (3) Did the FTC carry its Step 1 burden under *Baker Hughes*, in particular through the economic model of its expert, Dr. Robin S. Lee, whose assumed 20 percent diversion ratio the court found insufficiently supported?

The parties. Microsoft plays multiple roles relevant to the competitive analysis. As a *console manufacturer*, Microsoft produces the Xbox hardware and operates the underlying software infrastructure that third-party publishers must use to reach Xbox users. As a *storefront operator*, it runs a digital marketplace where users purchase games and in-game content, taking a standard revenue share on those transactions. As a *subscription service provider*, Microsoft offers Xbox Game Pass, which gives subscribers access to a rotating library of games for a monthly fee, providing an alternative business model to individual game purchases. As a *cloud gaming provider*, Microsoft's Xbox Cloud Gaming enables users to stream and play games remotely across devices without requiring dedicated console hardware. Microsoft also publishes video games through Xbox Game Studios, which at the time comprised 23 game development studios, including nine studios acquired as part of Microsoft's 2021 acquisition of ZeniMax Media Inc.

Activision Blizzard is one of the largest third-party game publishers and content creators in the industry, with a portfolio that spans console, PC, and mobile platforms. Its most commercially important asset is the Call of Duty franchise, a first-person shooter game that has historically

[1] FTC v. Microsoft Corp., 681 F. Supp. 3d 1069 (N.D. Cal. 2023), *aff'd*, 136 F.4th 954 (9th Cir. 2025). A reasonably complete set of the most important filings in the litigation may be found here on AppliedAntitrust.com.

been among the highest-selling annual console releases and has a substantial and persistent online user base. Call of Duty generates significant recurring revenue from game sales, downloadable content, and in-game microtransactions. Console purchasing decisions are often influenced by access to popular, annually released franchises. Both Microsoft and Sony have long regarded Call of Duty as a title that can significantly impact platform choice and user retention. In addition to Call of Duty, Activision's catalog included the Diablo and Overwatch franchises, World of Warcraft, and mobile properties such as Candy Crush, giving the publisher reach across segments that differ in business models, user demographics, and platform dependencies.

Although Activision has released Call of Duty games on both Xbox and PlayStation for nearly two decades, Sony has secured agreements that grant PlayStation users preferential benefits, including exclusive or timed-exclusive content and marketing rights. At the time of the merger announcement, however, Call of Duty was not available on the Nintendo Switch or on any cloud gaming services or multigame subscription libraries upon release.

The FTC's theories. The FTC reviewed the proposed acquisition under the HSR Act. In the course of the investigation, the FTC concluded that the acquisition was likely to be anticompetitive in three respects:

- First, the acquisition would give Microsoft the ability and incentive to withhold or degrade Activision content—particularly Call of Duty—from rival high-performance console platforms, thereby softening competition between Xbox and PlayStation.
- Second, the acquisition would enable Microsoft to steer Activision titles toward its multigame subscription service, Xbox Game Pass, either by limiting access for rival subscription providers or by offering more favorable or timely versions of Activision content through its own service.
- Third, Microsoft's ownership of Activision could allow it to foreclose competition in emerging cloud gaming markets by denying competing cloud gaming services access to Activision titles or by making such access less attractive due to price, quality, or timing differences.

Across these theories, the FTC argued that the loss of Activision as an independent publisher would reduce competition, raise entry barriers, and entrench Microsoft's existing position across multiple connected layers of the video game ecosystem.

The administrative complaint. During the investigation, Microsoft sought to resolve the FTC's concerns through a consent agreement. According to Microsoft, before the Commission voted to issue its complaint, Microsoft offered to sign a legally binding consent decree committing to make Call of Duty available on rival platforms for ten years. The FTC did not accept the offer and declined to comment on it. When it announced its complaint, however, the Commission pointed to Microsoft's conduct after acquiring ZeniMax, asserting that Microsoft had made several new ZeniMax titles, including Starfield and Redfall, exclusive to its own platforms despite assurances to European antitrust authorities that it had no incentive to withhold games from rival consoles.[2] More generally, behavioral commitments can be difficult to monitor and

[2] On the offer, *see* Microsoft Corp., Annual Shareholders Meeting Transcript (Dec. 13, 2022) (remarks of Brad Smith); *Microsoft Says It Offered FTC a Consent Decree on 'Call of Duty' Games*, Reuters (Dec. 13, 2022).

enforce, especially in dynamic technology markets where they may not anticipate future competitive developments.

On December 8, 2022, the FTC issued an administrative complaint under Section 7 of the Clayton Act and Section 5 of the FTC Act, alleging that Microsoft's acquisition of Activision was likely to substantially lessen competition in separate relevant markets for high-performance consoles, multigame subscription services, and emerging cloud gaming. The administrative complaint tracked the three foreclosure theories described above and alleged that losing Activision as an independent publisher would reduce Microsoft's rivals' access to critical content, raise their costs, and entrench Microsoft's position across multiple segments of the video game ecosystem.

While the administrative case proceeded, Microsoft pursued a strategy to implement commitments similar to those in its proposed consent decree through private agreements with industry participants. In December 2022, on the eve of the administrative complaint, Microsoft announced a ten-year commitment to bring Call of Duty to Nintendo players, and two months later it signed a binding ten-year agreement with Nintendo to bring future Call of Duty titles to the Switch after the merger closed. In early 2023, Microsoft also signed ten-year agreements with several cloud-gaming providers, beginning with Nvidia for its GeForce Now service, that would make Activision titles, including Call of Duty, available on their streaming services. Microsoft also publicly reaffirmed its offer to enter into a similar long-term agreement with Sony for the PlayStation, but Sony declined to sign an agreement and continued to lobby the Commission to challenge the transaction. (Sony ultimately signed a ten-year agreement on July 16, 2023, after the district court denied the FTC's request for a preliminary injunction.) In the subsequent litigation, Microsoft pointed to these agreements and the offer to Sony as evidence that it lacked an incentive to foreclose rivals and instead sought broad distribution of Activision content across platforms and business models.

The Section 13(b) action. The FTC did not initially seek preliminary injunctive relief in federal court under Section 13(b). The Commission has not publicly explained this sequencing choice. As a practical matter, however, Microsoft could not close the transaction while it remained under review by other competition authorities, including the European Commission and the U.K. Competition and Markets Authority, both of which continued to investigate the deal through 2022 and into 2023.[3] As long as foreign merger control rules independently prevented closing, a Section 13(b) preliminary injunction was not needed to prevent consummation, because the parties could not consummate the transaction even without an injunction. Consequently, the FTC proceeded initially solely through the administrative complaint process.

On ZeniMax, *see* Press Release, Fed. Trade Comm'n, FTC Seeks to Block Microsoft Corp.'s Acquisition of Activision Blizzard, Inc. (Dec. 8, 2022).

[3] Although the U.K. merger regime does not impose a mandatory statutory stand-still or suspension period like the U.S. HSR waiting period or the EU's Article 7 standstill requirement, the Competition and Markets Authority (CMA) can impose interim measures by order to prevent closing or further integration while its investigation proceeds. In the Microsoft Corporation/Activision Blizzard, Inc. review, the CMA referred the anticipated merger for a Phase 2 investigation on September 15, 2022, and prohibited it in its final report on April 26, 2023. It then made an Interim Order under section 81 of the Enterprise Act 2002 on May 5, 2023, followed on August 22, 2023, by a Final Order (the Microsoft and Activision Merger Inquiry Order 2023), each of which prevented Microsoft from acquiring an interest in Activision without CMA consent until the CMA cleared the restructured transaction.

By late spring 2023, the timing calculus had changed, and the FTC moved into federal court. The European Commission cleared the transaction with behavioral commitments on May 15, 2023. Although the CMA had prohibited the deal on April 26, 2023, press reports suggested that the parties were seriously considering closing notwithstanding the CMA's orders and the pending administrative litigation, ahead of the merger agreement's July 18, 2023, termination date. On June 12, 2023, the FTC filed a complaint in the Northern District of California under Section 13(b) of the FTC Act. The complaint tracked the same three foreclosure theories set out in the administrative complaint and asked the district court to enjoin consummation of the merger until the Commission could complete its adjudication on the merits. The FTC simultaneously moved for a temporary restraining order, telling the court that Microsoft intended to close as soon as June 16, 2023; the court granted the TRO and set an expedited evidentiary hearing.

The district court's decision. On July 10, 2023, after a five-day hearing, the district court denied the FTC's request for a preliminary injunction.[4] Judge Jacqueline Scott Corley held that the Commission had not shown it was likely to succeed on the merits of any of its theories. The court articulated the Section 13(b) standard as a two-step inquiry: (1) whether the FTC was likely to prevail in its underlying Section 7 case in the administrative proceeding before the ALJ, applying the Ninth Circuit's Warner Communications "serious questions" test, and (2) whether the equities favored relief.

On the liability side, the court framed the case as turning on whether Microsoft would have both the ability and the incentive to foreclose rivals in any relevant market, and whether such foreclosure would probably lead to a substantial lessening of competition. Relying in part on the Commission's *Illumina/GRAIL* decision, the FTC urged a more lenient, disjunctive formulation: that it need only show the transaction is "likely to increase the ability and/or incentive of the merged firm to foreclose rivals." The court rejected that approach and insisted that, absent a showing of both ability *and* incentive to foreclose, there is no reasonable probability of anticompetitive foreclosure and thus no likely Section 7 violation.[5] The two formulations answer different questions, however. The Commission's "and/or" language concerns what the merger must change: when a monopoly input supplier acquires a downstream firm, as in Illumina/GRAIL, the supplier already has the ability to foreclose, and the merger may change only its incentive. That proposition is consistent with requiring that the merged firm have both the ability and the incentive to foreclose, and the opinion does not clearly separate the two.

Judge Corley also rejected the FTC's view that it needed only to show the combined firm would have a greater ability and incentive to foreclose Call of Duty from its rivals than an independent Activision. Noting that Section 7 requires a reasonable probability of a substantial lessening of competition, Judge Corley observed "[t]hat the combined firm has more of an incentive than an

[4] The evidentiary preliminary injunction hearing began on June 22, 2023, ten days after the complaint was filed. This accelerated schedule was possible because discovery in the administrative proceeding had been completed. Fact discovery had closed on April 7, 2023, and expert discovery closed thereafter. Also, an expedited schedule was necessary if the court was to render its decision before the merger agreement's termination date of July 18, 2023. *See Microsoft Corp.*, 681 F. Supp. 3d at 1076, 1083.

[5] "Illumina, however, provides no authority for this [disjunctive] proposition, nor could it. Under Section 7, the government must show a 'reasonable probability of anticompetitive effect.' 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, then a party's incentive to foreclose is irrelevant. Indeed, the FTC's expert, Dr. Lee, analyzed the anticompetitive effects of the merger based on ability and incentive." *Id*. at 1090 (citation and emphasis omitted).

independent Activision says nothing about whether the combination will 'substantially' lessen competition."[6] Judge Corley concluded: "Thus, to establish a likelihood of success on its ability and incentive foreclosure theory, the FTC must show the combined firm (1) has the ability to withhold Call of Duty, (2) has the incentive to withhold Call of Duty from its rivals, and (3) competition would probably be substantially lessened as a result of the withholding."[7]

On the console theory, the court accepted, for purposes of the preliminary injunction, the FTC's "high-performance console market," consisting only of the Generation 9 consoles, Microsoft's Xbox Series X|S and Sony's PlayStation 5.[8] The court also recognized that Call of Duty is an important input in this market, but concluded that the FTC had not shown Microsoft was likely to pull Call of Duty from PlayStation or materially degrade it. The opinion emphasizes the economic costs to Microsoft of losing existing Call of Duty revenues on PlayStation, the importance of cross-play (which lets players on different consoles play together) and a large multiplayer base to the franchise's value, and the evidence that Microsoft had kept other major titles (such as Minecraft) available on rival platforms after acquiring their developers.

The court also addressed Microsoft's binding written offer to Sony to keep Call of Duty on PlayStation on parity terms for ten years, rejecting the FTC's argument that the offer was a "proposed remedy" that could not be considered until after a liability finding. In the court's view, the FTC had to address the circumstances surrounding the merger as they actually existed. The court stated, however, that the offer was "not necessary" to its likelihood-of-success ruling—a point the Ninth Circuit later relied on in declining to consider the offer. On that record, Judge Corley held that the FTC had not shown a probable foreclosure strategy in the console market.

The court was similarly unpersuaded by the subscription and cloud gaming theories. It questioned whether multigame subscription services and cloud streaming were distinct antitrust markets rather than simply alternative ways of playing games, but it assumed those markets for purposes of the motion. Even so, the court found that the FTC had not shown a likely substantial lessening of competition. In the subscription market, Activision generally did not offer its games on multigame subscription services before the merger because it believed doing so would

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[6] *Id*.

[7] *Id*. The FTC also argued that it could establish its prima facie case of anticompetitive harm through the Brown Shoe factors, such as the share of the market foreclosed, the nature and purpose of the transaction, barriers to entry, whether the merger will eliminate potential competition by one of the merging parties, and the degree of market power that would be possessed by the merged enterprise as shown by the number and strength of competing suppliers and purchasers. *See* Brown Shoe Co. v. United States, 370 U.S. 294, 328 (1962). Judge Corley gave short shrift to this argument. While she did not reject the *Brown Shoe* factors as a circumstantial means of proving anticompetitive foreclosure or raising costs to rivals, she appears to hold that the recitation of the factors is not enough and that the FTC also would have to show that these factors were probative in the circumstances of the case to show that the acquisition would give Microsoft the ability and incentive to foreclose its rivals. *Microsoft Corp.*, 681 F. Supp. 3d at 1099-1100.

[8] Significantly, and as far as I know uniquely, the court appeared at one point in the opinion to believe that in a Section 13(b) proceeding, the only question it could address was whether the FTC made out its prima facie case. "[T]he Court does not resolve conflicts in the evidence" and "the FTC need only make a 'tenable showing that the relevant market' is Gen 9 consoles." *Microsoft Corp.*, 681 F. Supp. 3d at 1085, 1087 (citing FTC v. Warner Commc'ns Inc., 742 F.2d 1156, 1164 (9th Cir. 1984)). Judge Corley also observed that, if she was the "final decisionmaker on the merits," she likely would have found Nintendo Switch to be part of the relevant market. *Id*. Later in the opinion, however, she recited, and appeared to use, the three-step burden-shifting framework of *Baker Hughes*. *Id*. at 1089. The Ninth Circuit later explained that the Warner language does not bar a district court from making the factual findings needed for its preliminary assessment. See the discussion of the appeal below.

cannibalize individual game sales, the FTC offered no quantitative analysis of subscription-market effects, and placing Activision content on Game Pass would expand rather than reduce consumer access.

In the cloud market, Activision content had not been available on any cloud streaming service since 2020, when Activision pulled Call of Duty from Nvidia's GeForce Now after a beta test; Microsoft's ten-year agreements with cloud providers would make it available, and the FTC had not shown that an independent Activision would likely do what Microsoft had agreed to do by contract.

The FTC's economic case. These conclusions about the console, subscription, and cloud gaming theories are closely tied to how the FTC presented its economic case. The FTC's prima facie showing of anticompetitive harm focused only on the harm from foreclosing rivals. The FTC's economist, Dr. Robin S. Lee, modeled Microsoft's incentive to withhold Call of Duty from PlayStation and the resulting competitive harm.[9] Unlike Carl Shapiro's approach in AT&T/Time Warner, however, Lee did not embed a quantitative analysis of the elimination of double marginalization (EDM) or other efficiencies within that model. He responded separately to the efficiencies Microsoft's experts claimed, arguing that they were not merger-specific and had not been quantified. In *Baker Hughes'* terms, the Commission's approach rested on the view that Step 1 requires only a showing that the merger would likely create the ability and incentive to foreclose rivals and thereby cause significant gross anticompetitive harm. Any claimed EDM or other offsets would be raised, if at all, by the merging parties at Step 2, with the court weighing the net effect at Step 3.[10] Microsoft's economist, Dr. Dennis Carlton, rejected this approach, arguing that an analysis of a vertical merger that ignores the merger's benefits "can only find harms."[11]

Even on that approach, Judge Corley concluded that Dr. Lee's foreclosure model failed to establish a prima facie case for foreclosure for two principal reasons. First, its key input was the share of potential Xbox purchasers who would buy an Xbox if Call of Duty were pulled from PlayStation. Potential Xbox purchasers were PlayStation players expected to buy the next Call of Duty release who did not already own an Xbox and would not switch to PC. Lee called this share the "conversion rate" and set it at 20 percent, but the court found that figure assumed rather than grounded in evidence (see the Note below). Second, it did not incorporate important features of

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[9] Lee estimated the harm with a separate "Harm model," a demand model for consoles calibrated to U.S. data that translated a given shift in console shares into an equivalent reduction in PlayStation's quality. Its results depended on the assumed share shift and on an assumed "nesting parameter" measuring how closely Xbox and PlayStation substitute for each other. Lee reported results for a range of values; Dr. Carlton criticized him for having no estimate of the parameter. Direct Testimony of Robin S. Lee, PhD ¶¶ 116–19 & n.87, FTC v. Microsoft Corp., No. 3:23-cv-02880-JSC (N.D. Cal. June 25, 2023), ECF No. 224 (public redacted version) [hereinafter Lee Decl.]; Declaration of Dennis W. Carlton at 25–26, FTC v. Microsoft Corp., No. 3:23-cv-02880-JSC (N.D. Cal. June 26, 2023), ECF No. 247 (public redacted version) [hereinafter Carlton Decl.]. Lee responds to the claimed efficiencies at Lee Decl. ¶¶ 124–141.

[10] It is important to keep in mind that in an RRC-EDM analysis, while EDM will lower costs for the integrated firm's customers, RRC still will increase the costs of customers of the integrated firm's rivals. So the prima facie case of anticompetitive harm still requires the agency in Step 1 of *Baker Hughes* to adduce sufficient evidence to allow the trier of fact to conclude that the customers of rivals will see anticompetitive price increases. If the merging parties satisfy their burden in Step 2 on an EDM offset, then in Step 3 the court would compare the increased costs borne by the rivals' customers against the decreased costs borne by the integrated firm's customers. Unlike many defenses, EDM does not directly offset the harms to the rivals' customers.

[11] Carlton Decl. ¶ 12.

the commercial environment that would influence Microsoft's calculus in relation to downstream rivals. The model did not consider Microsoft's agreements with Nintendo and the cloud streaming providers, its offer to Sony, or the reputational harm to Microsoft from pulling Call of Duty from millions of players. Without accounting for these constraints, the model's predictions rested on assumptions that the court viewed as insufficiently grounded in real-world behavior. On that basis alone, the court held that the FTC had not shown through its economic model that PlayStation users were likely to lose access to Call of Duty, or receive an inferior version of it, postmerger.

The FTC's other evidence. The court also considered the FTC's non-expert evidence of a prima facie foreclosure effect and found it unpersuasive. The FTC relied almost exclusively on the testimony of Jim Ryan, the CEO of Sony's PlayStation business, to argue that Microsoft's offer to Sony was inadequate. Judge Corley discounted that testimony because Sony opposed the merger—understandably so, since the combined firm presumably would not agree to the exclusive Call of Duty marketing rights Sony had paid Activision for. She rejected the FTC's innovation theory, which rested only on Sony's reluctance to share its intellectual property and development kits with Microsoft, as not merger-specific.

She also rejected the FTC's partial foreclosure theory (for example, releasing Call of Duty later on PlayStation or degrading the PlayStation version) because the FTC offered no expert analysis of Microsoft's incentive to engage in such conduct, Activision's CEO testified that he knew of no developer intentionally making a subpar game for one platform, and the record contained no evidence that Microsoft had engaged in such conduct in the past. She further reasoned that if the FTC had not shown an incentive for full foreclosure, it had not shown an incentive for partial foreclosure—a step the Ninth Circuit later rejected.

Even apart from the flaws in the FTC's economic model, this non-expert evidence did not persuade the court that customers of Sony, competing subscription services, or competing cloud gaming platforms were likely to experience higher prices, reduced access, or inferior quality as a result of the merger.

Microsoft's evidence. In reaching these conclusions, the court credited a substantial body of evidence presented by the merging parties, which, in its view, pointed away from a profitable foreclosure strategy. It emphasized Microsoft's public commitments and agreements, including:

- its assurances to Sony, immediately after the merger was announced, that Microsoft would enter a new agreement extending Activision's obligation to ship Call of Duty at parity on PlayStation;
- a ten-year letter agreement that Microsoft signed and sent to Valve committing to keep Call of Duty on Steam (Valve did not countersign, viewing a contract as unnecessary); and
- a ten-year agreement to bring Call of Duty to Nintendo's Switch.

The court viewed these commitments as inconsistent with an intent to withdraw or degrade the franchise on rival platforms. The court also relied on internal deal valuation materials showing that Microsoft's projected returns from the acquisition assumed continued Call of Duty sales on PlayStation and other non-Microsoft platforms, and highlighted evidence that access to Activision's mobile content was a central rationale for the transaction, which made a strategy of sacrificing broad distribution in order to favor a shrinking console business seem implausible.

The FTC countered with Microsoft's 2021 acquisition of ZeniMax: although the deal valuation Microsoft shared with its board contemplated keeping ZeniMax content multiplatform, Microsoft later made two new ZeniMax titles, Starfield and Redfall, exclusive. Judge Corley agreed that this evidence showed that Microsoft's deal valuation was not dispositive of its incentives, but she found that neither title—one not yet released, the other released only in May 2023—was "remotely similar" to Call of Duty, an established multiplatform franchise. Judge Corley further noted that:

- extensive discovery had not uncovered internal documents contradicting Microsoft's stated intent to keep Call of Duty multiplatform;
- cross-platform play and large, multiplatform communities were important drivers of the franchise's financial success;
- both Microsoft and Activision witnesses testified that withdrawing or degrading Call of Duty on PlayStation would cause serious reputational and commercial harm; and
- Microsoft's handling of the prior Mojang/Minecraft acquisition, where it kept and expanded a major cross-platform title on rival systems, provided a concrete example of how it had behaved when given the ability to make a popular game exclusive.

Taken together, this evidence reinforced the court's conclusion that Microsoft was unlikely to withhold Call of Duty from PlayStation and would instead have strong incentives to maintain and expand Call of Duty's availability across platforms. Because the Commission failed to demonstrate likely competitive harm to rivals' customers on the record as a whole, it did not carry its Step 1 burden, and the court did not reach a separate balancing of efficiencies or potential EDM benefits.

The equities. Finally, although it did not need to reach the issue, the court held in the alternative that the balance of equities also weighed against an injunction. Under a pre-existing contract, Call of Duty would remain on PlayStation through the end of 2024, so there would be no foreclosure pending the ALJ's decision. The FTC also had not explained why divestiture would be difficult to order in a vertical acquisition in which Activision would operate as a Microsoft subsidiary.

Closing pending appeal. After the court denied the preliminary injunction, the FTC filed a notice of appeal and moved under Rule 62(d) for an injunction pending appeal, which Judge Corley summarily denied. The FTC then sought an emergency injunction pending appeal from the Ninth Circuit, which the court of appeals likewise summarily denied on July 14, 2023. With no federal court injunction in place, Microsoft closed the acquisition of Activision Blizzard on October 13, 2023—the same day the CMA approved the restructured deal—after obtaining the remaining foreign merger clearance decisions.[12]

[12] The European Commission cleared the acquisition in May 2023 subject to behavioral commitments intended to ensure continued access to Activision titles on rival cloud streaming services. See Press Release, European Comm'n, Commission Clears Acquisition of Activision Blizzard by Microsoft, Subject to Conditions (May 15, 2023). The U.K. Competition and Markets Authority initially prohibited the original transaction but later cleared a revised structure in which Microsoft agreed to divest cloud streaming rights to Ubisoft outside the European Economic Area. *See* Competition & Mkts. Auth. (U.K.), New Microsoft/Activision Deal Addresses Previous CMA Concerns in Cloud Gaming (Sept. 22, 2023); Competition & Mkts. Auth. (U.K.), Microsoft / Activision Blizzard (Ex-Cloud Streaming Rights) Merger Inquiry: Final Decision (Oct. 13, 2023). By the time the

The Ninth Circuit's decision. On May 7, 2025, the Ninth Circuit affirmed. In an opinion by Judge Daniel P. Collins, joined by Judges Danielle J. Forrest and Jennifer Sung, the panel applied the circuit's Warner Communications standard, under which the FTC must raise questions going to the merits "so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." The panel held that Judge Corley had applied the correct legal standards and had not abused her discretion in weighing the evidence. The panel rejected the FTC's argument that, once the district court acknowledged conflicting evidence, it was required to find serious questions. Warner's statement that a reviewing court does "not resolve the conflicts in the evidence" does not bar a district court from making factual findings in its preliminary assessment, and the FTC's "construe-everything-my-way" approach would ignore that a preliminary injunction is an extraordinary remedy the FTC must affirmatively justify.

Turning to the merits, the panel agreed that, in the high-performance console market, the FTC had not shown that Microsoft was likely to make Call of Duty exclusive to Xbox or to supply a degraded version to PlayStation. The panel pointed to evidence that cross-platform play was critical to Call of Duty's financial success, the franchise's PlayStation revenues were roughly twice its Xbox revenues, pulling the game would cause serious reputational harm, and Microsoft had kept Minecraft on rival platforms after acquiring Mojang. In a footnote, the panel deemed forfeited any challenge to the district court's rejection of Dr. Lee's model because the FTC first addressed that analysis in its reply brief.

The panel expressly declined to rely on Microsoft's written offer to Sony and therefore did not decide whether such postmerger arrangements are "proposed remedies" that cannot be considered at this stage. It agreed with the FTC that the absence of an incentive to foreclose completely does not, without more, establish the absence of an incentive to engage in partial foreclosure—for example, by offering a degraded or delayed version on PlayStation. But it found no abuse of discretion in the district court's conclusion that the evidence of partial foreclosure was insufficient.

In the multigame subscription market, the panel stressed that Activision had generally kept its games off multigame subscription services, apart from occasional experimental or promotional arrangements, so the merger's effect of bringing that content onto Game Pass—even if done on exclusive terms—did not plausibly lessen competition relative to the but-for world. Rejecting the FTC's characterization of this reasoning as an improper efficiencies defense, the panel held that in a vertical merger, showing that content will be exclusive after the merger does not, by itself, establish a prima facie case. Because Activision content was not "otherwise open to competitors" in the subscription market, the merger did not foreclose rivals in the traditional sense. The panel also rejected the FTC's alternative argument that exclusive Activision content would let Microsoft, already the market leader, seriously disadvantage its subscription rivals even without foreclosure in that sense: the FTC relied on Dr. Lee's largely conclusory assertions, unsupported by any quantitative analysis.

CMA approved the modified deal, the transaction had already received merger clearance—most without conditions—from a wide range of other jurisdictions, including but not limited to Brazil, China, Japan, South Korea, South Africa, Saudi Arabia, Chile, and Ukraine. *See* Kevin Hitt, FTC Files for TRO, Preliminary Injunction Against Microsoft–Activision Blizzard, Esports Advocate (June 12, 2023).

Finally, in the cloud streaming market, the panel held that the FTC had failed to show that Activision content would be available to cloud rivals absent the merger. It rejected the FTC's parallel alternative argument—that exclusive access alone could substantially harm competition—for the same reason. Although the opinion describes the restructured deal and the divestiture of cloud streaming rights to Ubisoft, the panel found it unnecessary to decide whether those post-decision changes could be considered. It likewise did not decide whether Microsoft's agreements with cloud streaming providers could be considered.

On this record, the Ninth Circuit concluded that the FTC had not raised sufficiently serious and substantial questions about a reasonable probability of anticompetitive effects in any market and therefore affirmed the denial of preliminary relief. Because it affirmed on likelihood of success alone, it did not reach the district court's alternative holding on the equities. Two weeks later, on May 22, 2025, the Commission dismissed its administrative complaint, concluding that the public interest was best served by ending the administrative litigation.

A Note on Professor Robin S. Lee's Complete Foreclosure Model[13]

The FTC's economic expert, Dr. Robin S. Lee, testified that Microsoft would have a financial incentive postmerger to cut PlayStation off from Call of Duty completely. His model is, in substance, the cutoff test from Section 5 of the Class 23 RRC Note and the Harbor homework. In those terms, Activision is the supplier, Call of Duty is the input, Microsoft's Xbox business is the partner, and Sony's PlayStation is the rival. (Here the partner acquired the supplier rather than the reverse, but the economics are the same.) A cutoff would cost Activision its margin on the Call of Duty purchases of PlayStation players who had no other way to keep playing (because they did not own an Xbox and would not switch to PC). The merged firm would recover that margin on the players who bought an Xbox to keep playing, because they would buy Call of Duty there, and it would add Microsoft's margin on each new Xbox owner. So a cutoff pays only if enough PlayStation players switch to Xbox.[14]

Reconstructing the model. The court does not give us much detail on Lee's model, but Lee's declaration describes its structure, and we can reconstruct the model from the declaration and the opinion.[15] Lee described his model as "conceptually similar" to the one Microsoft itself used to

[13] Robin S. Lee is a Professor of Economics at Harvard University, where he received his Ph.D. in Business Economics in 2008. His academic work focuses on industrial organization, applied microeconomic theory, and health economics, with an emphasis on vertical integration, platform and media markets, contracts and bargaining between firms, and the design of networks and matching between intermediaries and consumers. He is also a partner at the economics consulting firm Bates White LLC. In addition to testifying in Microsoft/Activision, he testified as an expert witness for the DOJ in United States v. Google LLC (ad tech), which was tried in the Eastern District of Virginia in 2024 and decided in 2025. *See* United States v. Google LLC, 778 F. Supp. 3d 797 (E.D. Va. 2025). You can find a redacted version of his written direct testimony in Microsoft/Activision here. Dr. Dennis Carlton's direct rebuttal testimony can be found here.

[14] In a cutoff, every PlayStation player of the title loses access to it on PlayStation, so D is the diversion ratio for a complete cutoff, not for a small price increase. As Section 5 of the RRC Note explains, estimates of how customers respond to small price changes do not tell us where they would go after a cutoff. That takes a separate forecast or assumption, like the client's separate cutoff forecast in the Harbor homework. Lee's 20 percent figure was that assumption.

[15] Lee Decl. ¶¶ 100–111. A link to the public version appears in the footnote to the heading of this Note. The public version redacts the model's numerical inputs and results and several passages describing how the model

analyze whether to make ZeniMax titles exclusive. The model had two key inputs: the lifetime value to Microsoft of a new Xbox owner and the share of "potential Xbox purchasers" (defined below) who would buy an Xbox to keep playing Call of Duty, which Lee called the "Xbox conversion rate." In our terms, the conversion rate is the diversion ratio for a cutoff. Using the notation of the class notes and the homework:

- D is the share of potential Xbox purchasers who would buy an Xbox to keep playing Call of Duty after a cutoff (the diversion ratio for a cutoff; Lee's "Xbox conversion rate")
- n is the number of potential Xbox purchasers: PlayStation players expected to buy the next Call of Duty release (Call of Duty 2025 in Lee's model) who do not already own an Xbox and would not switch to playing the game on PC. The court calls this group "affected users," but Lee uses that term for all PlayStation players of the title.[16]
- m_{U} is Activision's profit on one potential Xbox purchaser's purchases of Call of Duty 2025, including in-game spending (the supplier's margin)
- m_{D} is Microsoft's profit on a new Xbox owner over the first five years of ownership, from games, accessories, and gaming services and net of selling the console below cost (the partner's margin)—what Lee called the five-year customer lifetime value (LTV)

The dollar amounts of both margins are redacted in the public documents. The opinion refers to "Prof. Lee's LTV of 40%" without explaining it; a percentage cannot be the dollar margin itself, and the part of Lee's declaration describing how he adjusted Microsoft's own lifetime-value figures is redacted.[17]

As in the Harbor homework, assume that the margins postmerger are the same as the premerger margins (i.e., there are no postmerger price changes or EDM), and set out the change in combined profit from a cutoff:

works. The presentation in this Note is our reconstruction from the redacted declaration and the court's opinion. It captures the structure of the model, but it may not track every detail of the model exactly as Dr. Lee built it.

[16] Lee's model did not simply drop PlayStation players who already own an Xbox or would switch to PC. It counted Activision's lost profits on all PlayStation players of the title as a cost, and it counted as recouped benefits the profits Microsoft and Activision would earn from those who moved to Xbox or PC. If Activision earns the same margin on every platform, those players' lost and recouped profits cancel, which is why the table below can leave them out. The table does omit one benefit: Microsoft's share of the revenue from existing Xbox owners who moved their Call of Duty purchases to Xbox, revenue that Sony would otherwise have collected. Lee Decl. ¶¶ 101, 103.

[17] Activision's margin per user may differ by platform due to negotiated differences in revenue shares, licensing terms, marketing arrangements, and platform fees across Xbox and PlayStation. If it does, then considering only the potential Xbox purchasers in the table, a cutoff adds profit only if $D > m_{\mathrm{U,PS}}/(m_{\mathrm{U,X}} + m_{\mathrm{D}})$, where $m_{\mathrm{U,PS}}$ and $m_{\mathrm{U,X}}$ are Activision's margins on Call of Duty sold for PlayStation and for Xbox. The text assumes the two are equal, as Harbor's margin was in the homework, so the condition reduces to $D > m_{\mathrm{U}}/(m_{\mathrm{U}} + m_{\mathrm{D}})$. With unequal margins, however, the lost and recaptured profits on the players left out of the table (existing Xbox owners and players who would switch to PC) would no longer cancel, so a complete calculation would add those net changes.

Change in combined profit from a cutoff	
Incremental gross profit lost on potential Xbox purchasers' Call of Duty 2025 purchases	$-(n \times m_{\mathrm{U}})$
Incremental gross profit gained on potential Xbox purchasers who switch to Xbox	$n \times D \times (m_{\mathrm{U}} + m_{\mathrm{D}})$
Net change in combined profit	$n \times [D \times (m_{\mathrm{U}} + m_{\mathrm{D}}) - m_{\mathrm{U}}]$
Net change is positive only if	$D > \dfrac{m_{\mathrm{U}}}{m_{\mathrm{U}} + m_{\mathrm{D}}}$

Call the threshold in the last line the breakeven diversion ratio, D^*:

$$D^* = \frac{m_{\mathrm{U}}}{m_{\mathrm{U}} + m_{\mathrm{D}}}$$

A cutoff pays only if $D > D^*$. Lee stated the same condition in terms of recoupment: withholding pays if the merged firm would recoup more than 100 percent of the profits it loses on PlayStation. This is the recapture logic of the RRC Note: Activision already earns m_{U} on the players who switch, because they buy Call of Duty on Xbox, so what the merger adds is m_{D}, Microsoft's margin on each new Xbox owner.

Two features of the formula matter for the case. First, in this simplified model, n drops out. Whether a cutoff pays depends only on D and the two margins; the number of potential Xbox purchasers matters only for translating D into a change in Xbox's console share, which is how Lee tried to corroborate his assumption. Second, D^* is low when the partner's margin is large relative to the supplier's. In the Harbor homework, Harbor's \$24 margin and Outpost's \$12 margin put D^* at \$24 ÷ \$36 = 2/3. In Lee's model, Microsoft's five-year profit on a new Xbox owner was large relative to Activision's profit on a player's purchases of a single Call of Duty release so that a cutoff could pay at a much lower diversion ratio.

Lee's 20 percent assumption. In his full model, Dr. Lee assumed that D = 20 percent: one in five potential Xbox purchasers would buy an Xbox if Call of Duty were pulled from PlayStation. At that rate, his model showed that a cutoff would be profitable for Microsoft. The opinion does not disclose his model's breakeven diversion ratio, but its statement that a diversion ratio of 17.5 percent would make a cutoff unprofitable implies that it lies between 17.5 and 20 percent. Lee's full model also counted a benefit that our table omits—Microsoft's share of the revenue from existing Xbox owners who would move their Call of Duty purchases to Xbox. Holding margins fixed, that benefit lowers his breakeven below what the simplified formula would give. Lee described his inputs as conservative and noted benefits the model left out—for example, players moving the rest of their gaming to Xbox and Microsoft's greater market power if PlayStation were weakened—so that, in his view, withholding could pay even if the model showed less than full recoupment.

The court characterized the 20 percent figure as an assumed input rather than an evidence-based estimate. His model translated that figure into a 5.5 percentage-point increase in Xbox's console share. Dr. Lee sought to corroborate both numbers with two principal sources: (1) an internal 2019 Microsoft strategy memorandum that discussed how an "exclusive AAA release" could shift global console shares; and (2) a separate econometric "share model" he estimated that

related Xbox and PlayStation monthly console shares to the availability and treatment of key titles, including Call of Duty.

The court's critique. Judge Corley found this implementation unpersuasive for three reasons. First, Judge Corley emphasized that Dr. Lee's profitability conclusion was highly sensitive to his assumed 20 percent diversion ratio. Under Lee's own parameter estimates in his breakeven model, a modest reduction in D from 20 percent to 17.5 percent would make a cutoff unprofitable, as the lost PlayStation Call of Duty revenues would then outweigh the gains from additional Xbox users. In the court's view, this sensitivity meant that an accurate estimate of D was essential to his conclusion.

Second, Judge Corley found that Dr. Lee's reliance on the 2019 internal Microsoft strategy memo was misplaced. The memo stated that an exclusive AAA release could shift global console shares by roughly 1–3 percentage points, and Dr. Lee treated that range as broadly consistent with a 20 percent diversion ratio. The court emphasized, however, that the memo's 1–3 percentage-point figure was not tied to any documented methodology. Dr. Lee did not know what data underlay the estimate, what period or set of consoles it covered, or whether it described a new first-party exclusive or the treatment of a long-standing multiplatform title like Call of Duty. Even taken at face value, the memo implied a much smaller marketwide effect than his model required: Dr. Lee's assumed 20 percent diversion ratio translated into a 5.5 percentage-point increase in Xbox's console share, and he acknowledged that a 2 percentage-point share shift would not be enough to make Call of Duty exclusivity profitable under his own breakeven analysis. On that record, the court concluded that the 2019 memo could not credibly support a 20 percent diversion ratio.

Third, Judge Corley found Dr. Lee's separate share model deficient as support for his 20 percent diversion ratio. In parameterizing his foreclosure incentive model, Dr. Lee relied on lifetime-value estimates based on worldwide monetization and platform economics, reflecting that a decision to withhold Call of Duty would affect sales worldwide. (The court found a U.S. relevant market for consoles, but Lee evaluated a worldwide withholding strategy, so his profitability calculation counted worldwide profits.) The share model he used to support the 20 percent diversion ratio, however, was estimated only on U.S. Gen 8 console data and assumed that those historical relationships carried over unchanged to worldwide sales of current-generation consoles. The model predicted that making Call of Duty exclusive would increase Xbox's share of new console sales by about 8.6 percentage points, and Dr. Lee argued that this predicted 8.6 percentage-point shift showed that a large platform response to Call of Duty exclusivity was realistic and therefore that a 20 percent diversion ratio was plausible.

The court disagreed. It found that the share model assigned no measurable role to non-exclusive games in console choice, treated each lost PlayStation user as if they would become an Xbox user rather than allowing for alternatives such as PC, mobile, or cloud play, and failed to justify using U.S. data from the previous console generation to predict worldwide sales of Gen 9 consoles. (Lee explained that he used Gen 8 data because Gen 9 data covered less than three years and were distorted by console shortages.)[18]

The underlying problem, as Dr. Carlton put it, was that the share model measured Xbox's share of combined Xbox and PlayStation sales. That share rises even if PlayStation buyers who lose

[18] Carlton Decl. at 16; Lee Decl. ¶ 31 & n.24.

Call of Duty buy nothing at all, but what matters for foreclosure is how many more Xboxes are sold. When Dr. Carlton relaxed these assumptions, the implied share shift fell to only a fraction of the 8.6 percentage-point figure, so the model no longer provided evidence that Call of Duty exclusivity would generate the kind of large marketwide response that could be reconciled with a 20 percent diversion ratio. Taken together, these flaws left the share model unable to substantiate Dr. Lee's assumed diversion ratio. The court likewise rejected Lee's reliance on a consumer survey (its details are redacted) because he was not familiar with the survey's design.

Putting numbers on the critique. The breakeven formula also lets us quantify the court's critique. Rearranging the formula for D^* gives the ratio of the two margins:

$$\frac{m_{\mathrm{D}}}{m_{\mathrm{U}}} = \frac{1}{D^*} - 1$$

If D^* were between 17.5 and 20 percent in our simplified model, Microsoft's five-year profit on a new Xbox owner would be roughly four to five times Activision's profit on one player's purchases of Call of Duty 2025: the right side is 4.0 at 20 percent and about 4.7 at 17.5 percent. Lee's actual model also counted the extra benefit noted above, so, holding his other assumptions fixed, the same breakeven range implies a smaller margin ratio in his model. The redactions prevent a precise figure. In the Harbor homework, by contrast, the partner's margin was half the supplier's, and a cutoff needed two-thirds diversion. Microsoft's large five-year profit on each new Xbox owner is what made a cutoff look profitable at a diversion ratio below 20 percent. The result was fragile because the assumed rate lay so close to the breakeven: with the breakeven between 17.5 and 20 percent, an assumed diversion ratio only a few percentage points too high reverses the answer. There was also reason to doubt that many PlayStation players would switch. Dr. Carlton cited telemetry data on the share of PlayStation Call of Duty players who played the game fewer than 10 hours a year and spent less than $100 on it (the share is redacted)—players unlikely to buy a new console to keep playing.[19]

The same arithmetic helps explain why the court found that the 2019 memo and the share model did not corroborate the assumption. The translation is rough: the share model measured U.S. Gen 8 shares, Lee's profitability calculation concerned worldwide sales, and Xbox's share of combined Xbox and PlayStation sales can rise without any additional Xbox sales. Treat the figures below as illustrations of the court's reasoning, not as findings. Like Lee, the illustration treats the share model's predicted share shift as a benchmark for the shift implied by his 20 percent assumption. Lee's model translated D = 20 percent into a 5.5 percentage-point increase in Xbox's share of Gen 9 consoles. Holding the number of potential Xbox purchasers and the size of the console market fixed, the share shift is proportional to D—about 0.275 percentage points for each percentage point of diversion. On that rough translation:

[19] Carlton Decl. at 20; *see also id.* at 23 (contrasting a player who spends nearly all of his gaming time on Call of Duty with one who also plays many PlayStation exclusives).

Source	Increase in Xbox's share	Illustrative *D*
Lee's assumption	5.5 points	20%
Breakeven range	about 4.8–5.5 points	17.5%–20%
Lee's concession: not enough for a cutoff to pay	2 points	about 7%
2019 Microsoft memo: exclusive AAA release, worldwide	1–3 points	about 4%–11%

On this translation, even the top of the memo's range implies diversion well below the breakeven range. The share model fares no better. Its 8.6-point prediction was comfortably above 5.5 points, but Dr. Carlton's corrections reduced it to between 1 and 54 percent of that figure—at most about 4.6 points, below the 5.5 points that corresponded to Lee's 20 percent assumption and, on this rough translation, below the roughly 4.8–5.5-point range in which a cutoff would break even.

Takeaways. On this record, the court concluded that the FTC had not shown that PlayStation users were likely to lose access to Call of Duty postmerger. Accordingly, the FTC did not meet its Step 1 burden under *Baker Hughes* to demonstrate likely anticompetitive effects based on Microsoft's postmerger incentives to engage in complete foreclosure.

The treatment of Dr. Lee's model illustrates that, in vertical and platform-content cases, courts are willing to scrutinize both the internal logic and the empirical grounding of an incentive-to-foreclose model as part of the government's prima facie burden. Here, the court rejected that showing at Step 1 of *Baker Hughes* because a key behavioral assumption—the 20 percent diversion ratio—was not supported by credible data and the model did not account for real-world commercial constraints.

Finally, recall the lesson of Section 5 of the RRC Note: an unprofitable cutoff does not rule out a profitable price increase or other partial foreclosure, because partial foreclosure keeps most of the rival's business while still sending some of its customers to the partner. Lee listed partial-foreclosure strategies available to the merged firm—timed exclusivity, exclusive add-on content, and degraded or unoptimized versions on PlayStation—but modeled only a cutoff, and the FTC offered no expert analysis of partial foreclosure. Microsoft's own expert, Dr. Carlton, agreed that partial foreclosure has to be analyzed on its own terms: its gains and losses differ from those of a cutoff, so assessing it would require identifying the specific strategy and modeling its costs and benefits. As noted above, the district court inferred that if a cutoff did not pay, partial foreclosure would not pay either. The Ninth Circuit rejected that inference, consistent with the RRC Note, but affirmed because the FTC's evidence of partial foreclosure was insufficient.[20]

[20] Lee Decl. ¶ 89; Carlton Decl. at 24.

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As always, if you have any questions or want to talk about the materials further, please let me know. See you in class.

P.S. Remember that we have an optional review session scheduled for Tuesday, December 1, from 3:30 pm to 5:30 pm, in McD 110. The session will be recorded and available on Panopto if you are unable to attend.