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27 **UNITED STATES DISTRICT COURT**
 28 **FOR THE NORTHERN DISTRICT OF CALIFORNIA**
SAN FRANCISCO DIVISION

29 FEDERAL TRADE COMMISSION
 30
 31 *Plaintiff,*
 32
 33 v.
 34
 35 MICROSOFT CORPORATION and
 36 ACTIVISION BLIZZARD, INC.,
 37
 38 *Defendants.*

Case No. 3:23-cv-02880-JSC
**DEFENDANTS' MEMORANDUM OF
 LAW IN OPPOSITION TO MOTION
 FOR PRELIMINARY INJUNCTION**

 Hon. Jacqueline Scott Corley

 Date: June 22, 2023
 Time: 8:30 a.m.
 Courtroom: 8 – 19th Floor

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INTRODUCTION

1
2 Seventeen months ago, Microsoft Corporation, the third-place manufacturer of video game
3 consoles, announced an agreement to purchase Activision Blizzard, Inc., one of many video game
4 publishers. Microsoft's motivations are simple. Its gaming division (Xbox) has next to no presence
5 in mobile gaming, the fastest-growing gaming segment where 94% of gamers spend time today. By
6 contrast, Activision's King division makes popular mobile games (such as *Candy Crush*), allowing
7 Xbox to compete in this critical market. [REDACTED]

8 [REDACTED]. Activision publishes several
9 popular video game franchises, including *Call of Duty* ("COD"), which are profitable precisely
10 because they generate sales on many different platforms. Indeed, the majority of COD sales—a
11 significant part of Activision's revenues—occur on Sony's PlayStation, the dominant console that
12 routinely outsells the Xbox console 2:1.

13 The FTC has *never* persuaded a court to preliminarily enjoin a merger involving anything
14 close to the facts here. Unlike in other merger contexts, the government gets no presumption of
15 harm as to vertical mergers because they do not eliminate a competitor from the marketplace and are
16 widely recognized to be procompetitive. The U.S. antitrust agencies have rarely sought to enjoin
17 vertical mergers and have lost every recent case when they tried. Indeed, the FTC is asking this
18 Court to be the first in decades to find a vertical merger unlawful.

19 Moreover, unlike in every recent vertical merger case, the Court need not just rely on the
20 defendants' claims that they will not foreclose their rivals and that the merger will increase output
21 and lower prices. This is the exceptional case where the Court can rely on actions rather than words.
22 Microsoft's valuation of the deal was premised on making Activision's limited portfolio of popular
23 games *more accessible*. And since the transaction was announced, Microsoft has sought to address
24 any concerns that might be raised about the deal. Here is what Microsoft has done:

- 25 • Committed to bring Activision's games to Xbox Game Pass, a subscription gaming
26 service offering numerous games for \$9.99 per month, rather than up to \$70 per game;
- 27 • Signed a binding contract to bring *COD* to Nintendo (which does not currently have it);
- 28 • Offered Valve, the popular digital PC game distributor, a ten-year deal for Activision
 content, which Valve declined [REDACTED]

- 1 [REDACTED]
2 [REDACTED]
- 3 • Signed contracts to make Activision games available on leading services that “stream” popular games to devices of consumers’ choosing;
 - 4 • Obligated itself, as part of the global regulatory process, to grant streaming rights to current and future Activision games to other cloud gaming services, regardless of whether Xbox decides to stream those games on its own service; and
 - 5 • Offered Sony a contract to guarantee access to Activision content on PlayStation for ten years, on equal footing with the Xbox console versions, [REDACTED]
 - 6 [REDACTED]
 - 7 [REDACTED]

8 Microsoft’s actions to try to give *COD* to anyone who wants it eliminate any conceivable claim of
9 foreclosure. This deal will make popular content more broadly available and at a lower price.

10 The FTC simply ignores these facts, claiming that it needs to offer only scant proof to stop
11 the transaction. The FTC is wrong. The government has the burden of proof in seeking the
12 “extraordinary and drastic remedy” of “a preliminary injunction prior to a full trial on the merits.”
13 *FTC v. Exxon Corp.*, 636 F.2d 1336, 1343–44 (D.C. Cir. 1980). Because the FTC’s central claim is
14 that Xbox will withhold Activision content from rivals (principally the market leader, Sony), it must
15 also show that the combined firm would have “the ability and incentive” to foreclose competitors.
16 *U.S. v. UnitedHealth Grp.*, 2022 WL 4365867, at *25–27 (D.D.C. 2022). And the FTC must show
17 that such foreclosure “is likely to substantially lessen competition” in a properly pleaded product and
18 geographic market. *U.S. v. AT&T, Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019). On each of these
19 issues, the FTC must show that the evidence “raise[s] questions going to the merits so serious,
20 substantial, difficult and doubtful as to make them fair ground for thorough investigation, study,
21 deliberation and determination.” *FTC v. Warner Commc’ns Inc.*, 742 F.2d 1156, 1162 (9th Cir.
22 1984) (citation omitted).

23 The FTC cannot come close to carrying its burden. After 18 months of investigation and
24 litigation, including 56 investigational hearings and depositions and the production of nearly 6
25 million documents, the FTC offers only a minuscule collection of incomplete quotations in support
26 of its motion. The record will decisively refute the FTC’s claims.

1 *First*, there is no evidence to support the FTC’s central theory that Xbox will take *COD* away
 2 from PlayStation. The FTC does not cite a single document or witness even suggesting this will
 3 happen. On the contrary, Jim Ryan, the CEO of Sony Interactive Entertainment (“SIE”) and the chief
 4 commercial opponent of this deal, said privately on the day it was announced [REDACTED]
 5 [REDACTED]
 6 [REDACTED] Ex. 1.¹ [REDACTED] Withholding *COD* would harm
 7 Xbox. It would contradict the valuation the Board relied on in approving the deal, which assumed
 8 profits from continued PlayStation sales. It would cut off a highly lucrative income stream to one of
 9 Microsoft [REDACTED]. And it would make *COD* a worse game and enrage the gaming
 10 community, because much of the game’s popularity stems from the way it brings together players
 11 who use competing consoles. It is therefore unsurprising that *every single worldwide regulator that*
 12 *has examined the deal other than the FTC* has rejected this theory—including both the European
 13 Union and the UK’s Competition and Markets Authority (“CMA”).

14 *Second*, even assuming Xbox were to withhold *COD* from Sony’s PlayStation, it would not
 15 harm *competition*. The acquisition of a single game by the third-place console manufacturer cannot
 16 upend a highly competitive industry. *COD* may be popular, but it is just one game: [REDACTED]
 17 [REDACTED].
 18 [REDACTED]

19 [REDACTED]—a wildly implausible scenario—PlayStation would still remain the
 20 console leader. Put simply, foreclosing access to *COD* would at most put a small dent in
 21 PlayStation’s massive lead, making the market *less concentrated*. Defendants are aware of no case
 22 where a court has blocked a merger to protect a dominant firm’s position.

23 *Third*, the FTC has failed to identify relevant antitrust markets, dooming their entire case.
 24 Potential anticompetitive effects can be measured only in a properly defined market. But the FTC
 25 has replaced sound economic analysis with results-oriented “contort[ions] to meet [its] litigation
 26 needs.” *Hicks v. PGA Tour, Inc.*, 897 F.3d 1109, 1120–21 (9th Cir. 2018). As one example, the FTC

27 _____
 28 ¹ Exhibit citations (“Ex.”) refer to the contemporaneously filed Declaration of Beth Wilkinson.

1 claims that gaming PCs and Nintendo’s consoles (both far more popular than Xbox) are not in the
2 same market as PlayStation and Xbox, even though both the economic evidence ██████ have said
3 the opposite. Why does the FTC contradict ██████ in this respect? Because recognizing Nintendo and
4 PCs as part of the market would destroy the FTC’s flimsy foreclosure theory: Nintendo has been
5 successful for years without *COD*, as was the dominant PC game store, Valve’s Steam. *COD* cannot
6 be essential to competition if market participants thrive without it.

7 *Fourth*, the FTC has literally no factual basis for its claim that the merger will harm
8 competition in the supposed markets for multi-game library subscription and cloud gaming services.
9 Among other things, there is *absolutely no evidence* that Activision content would put its content on
10 these services without the deal. To the contrary, Activision views such a step as anathema to its
11 business strategy. The transaction will thus *benefit* consumers by bringing Activision content to
12 Xbox Game Pass for the first time.

13 *Finally*, the equities cut sharply against injunctive relief. The merger agreement expires on
14 July 18, 2023. The injunction sought by the FTC would thus almost certainly scuttle the transaction.
15 *Warner*, 742 F.2d at 1165 (such “private injuries [are] entitled to serious consideration” in balancing
16 the equities). Moreover, there is no need for a preliminary injunction because the FTC could obtain
17 effective relief at the end of the administrative process if it prevailed. Microsoft intends to operate
18 Activision similarly to other recent acquisitions, whose studio and creative operations remained
19 separate and continued to build games as they had done pre-acquisition. That means divestiture
20 would be possible if it ever proved necessary.

21 The Court should deny the FTC’s motion for a preliminary injunction.

22 **BACKGROUND**

23 **The gaming industry.** Gaming is one of the fastest-growing and most competitive industries
24 in the world. There are 3 billion gamers around the world, and 4.5 billion are expected by 2030. Ex.
25 2. ██████ Gaming generates hundreds of billions of dollars of revenue each year—more revenue than
26 music and movies combined—and is projected to continue to grow still more. *Id.* Seeing this rising
27
28

1 demand, new and established companies are competing fiercely by regularly releasing new games
2 and continuing to innovate new ways for gamers to play.

3 Activision is a well-known game developer with popular titles such as *COD*, *Diablo*, and
4 *World of Warcraft*. But Activision is not the biggest or most successful publisher. Ex. 3, Bailey Rep.
5 ¶ 29 & ex. 16. And the size and pedigree of a publisher is no guarantee of success. Many popular
6 games were unexpected breakout successes by small independent studios. Ex. 3, Bailey Rep. ¶ 8.
7 Many highly anticipated and well-funded games are busts. Ex. 60. [REDACTED].

8 Gamers can play on many different devices. The three major gaming consoles are the
9 PlayStation 5, the Nintendo Switch, and the Xbox. But consoles now represent the smallest share of
10 video game revenue. Ex. 2. [REDACTED]; see Ex. 3, Bailey Rep. ¶ 9. More gamers play on PCs,² and
11 substantially more play on mobile devices—the fastest growing segment. Ex. 2, at 3; Ex. 3, Bailey
12 Rep. ¶ 9 & ex. 3; see also Ex. 4. As a result, the industry is exploring how to expand beyond the
13 traditional model of selling individual games. Some companies have had great success with free-to-
14 play games, which allow gamers to download the game and then decide whether to make in-game
15 purchases such as costumes or special powers. Free-to-play games have allowed small independent
16 companies to grow quickly. For example, Epic Games’ valuation has increased from \$1 billion in
17 2012 to over \$30 billion, powered by the 2017 launch of its flagship free-to-play game, *Fortnite*.
18 Exs. 5, 6. Free-to-play games are a key part of Activision’s strategic vision, and it has successfully
19 launched free-to-play versions of popular games like *COD*.

20 Innovation is also occurring in distribution. In 2017, Xbox launched Game Pass, a
21 subscription service allowing consumers to play a library of games for \$9.99 a month rather than
22 having to purchase each individual title. Xbox invests heavily in Game Pass, making its own new
23 games available in the service immediately upon release (so-called “day and date” releases).
24 Although this means Xbox loses revenue on the sales of individual game titles, Xbox believes that
25 Game Pass will ultimately prompt subscribers to engage with a variety of games and spend more

26
27 ² Games for PC can be purchased and downloaded from the publisher directly or from an online
28 distributor like Steam. Ex. 3, Bailey Rep. ¶¶ 22, 91.

1 overall. But others in the industry are much more skeptical. [REDACTED]

2 [REDACTED]
3 [REDACTED]
4 [REDACTED]
5 See Ex. 3, Bailey Rep. ¶ 76 & n.117; [REDACTED] Sony [REDACTED]

6 [REDACTED]
7 primarily puts old games in its service,⁴ forcing customers to pay high per-game fees to access new
8 content.

9 Last, some companies are experimenting with delivery of games through cloud gaming
10 “streaming,” which runs games on remote servers that gamers can access on consoles, PCs, mobile
11 devices, or TVs. The idea is to let gamers play games on less highly powered and more affordable
12 devices, particularly salient in less developed nations. Several companies, including Xbox, Amazon,
13 Nvidia, and smaller upstarts, have experimented with different forms of cloud gaming. But the
14 technology remains challenging, particularly for latency-sensitive multiplayer games. Gameplay is
15 balky, and it has proved hard to generate consumer demand or consistent profits. Here too,

16 [REDACTED]
17 [REDACTED]. Likewise, Sony Group’s CEO has admitted that
18 cloud gaming faces substantial “technical difficulties” and is “very tricky” from both a financial and
19 technological standpoint.” Ex. 56; see Exs. 16, 1 [REDACTED]

20 **Sony’s dominance.** Sony is a gaming giant. [REDACTED]

21 [REDACTED] Sony’s PlayStation has
22 been the leading console both worldwide and in the U.S. for over two decades and through five
23 console generations. As a game publisher, Sony’s in-house developer, PlayStation Studios, is
24 responsible for major hits like *God of War*, *The Last of Us*, and *Spider-Man*, most of which can be
25 played only on PlayStation. As a purchaser of third-party games, Sony pursues exclusivity [REDACTED]

26 _____
27 ³ [REDACTED] Ex. 12, at 39.

28 ⁴ See [REDACTED]

1 [REDACTED]
2 [REDACTED]
3 Sony dwarfs Xbox on exclusives, [REDACTED]

4 [REDACTED] Ex. 3, Bailey Rep. ¶ 19 & ex. 11A.

5 **Xbox’s position.** By contrast, Xbox’s console has consistently ranked third behind
6 PlayStation (first) and Nintendo (second). Ex. 3, Bailey Rep. ¶¶ 13–15; *see, e.g.*, Ex. 23

7 [REDACTED] Ex. 24, at 6.

8 Xbox has thus pivoted to a different business strategy of making games more accessible. As noted
9 above, Xbox invests heavily in Game Pass. For years, Xbox has tried to get a foothold into mobile
10 gaming, but has had no success. Ex. 28, [REDACTED] [REDACTED]

11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 **The transaction.** Against this backdrop, Xbox and Activision determined that, together, they
15 could significantly improve gaming and increase Xbox’s competitiveness. Xbox’s vision is to
16 expand choice for gamers and developers by making games more widely accessible on Xbox Game
17 Pass and on mobile devices. Ex. 53, [REDACTED]; *see also* Ex. 34, [REDACTED].

18 [REDACTED] A key driver of the merger was Activision’s mobile gaming business, which includes
19 popular games like *Candy Crush Saga* and *COD Warzone*, a free-to-play variant. Ex. 35. Acquiring
20 these mobile games would enhance Microsoft’s ability to compete in the fastest growing industry
21 segment. On January 18, 2022, Microsoft and Activision announced the merger. *See* Ex. 36.

22 Regulators around the world have been reviewing the transaction ever since. And Microsoft
23 has tried to accommodate any concerns they raised—however speculative those concerns may be. As
24 noted above, Microsoft has signed a ten-year agreement to bring *COD* to Nintendo for the first time
25 since 2013. [REDACTED]

26 [REDACTED]); *see also* Ex. 38. It has offered

27 _____
28 ⁵ *See also* Ex. 29; Ex. 30 [REDACTED]

1 a similar agreement to Sony that would preserve Sony’s access to the game [REDACTED] it
2 [REDACTED] but Sony has refused to deal—instead focusing on trying to derail a transaction that
3 would strengthen a rival. Xbox offered a ten-year agreement to keep *COD* on Valve, the popular PC
4 game platform, but Valve turned down the agreement as unnecessary [REDACTED]

5 [REDACTED]
6 [REDACTED] Separately, Xbox has entered five separate ten-year agreements with cloud gaming
7 providers—Boosteroid, EE, Nvidia, NWare, and Ubitus, *see* Exs. 39–44—to ensure that all Xbox
8 games, including Activision games, can be played on their services. In addition to those agreements,
9 during the European Commission’s regulatory process, Xbox committed to grant streaming rights to
10 Activision games to other cloud gaming services—regardless of whether Xbox ultimately decides to
11 stream those games itself. Ex. 45.

12 As a result of these efforts, all but one foreign regulator to pass on the issue has cleared the
13 transaction. The lone exception is the United Kingdom’s CMA. But like the European Commission
14 and other global competition authorities, the CMA rejected the FTC’s core theories of harm here,
15 tied to console foreclosure and subscription service foreclosure. Its only objection to the transaction
16 was that it might harm, at some point in the future, the evolution of cloud gaming. Xbox is currently
17 appealing that decision.

18 **This proceeding.** After investigating the transaction, the FTC filed an administrative
19 complaint (“FTC Complaint”) on December 8, 2022, alleging that the merger violates Section 7 of
20 the Clayton Act, 15 U.S.C. § 18, and Section 5 of the FTC Act, 15 U.S.C. § 45. *See In re Microsoft*
21 *Corp.*, FTC Matter No. 2210077, Docket No. 9412 (F.T.C.).

22 The FTC alleges that Xbox will withhold access to Activision games in three “markets”:
23 high-performance consoles, multi-game content library subscription services, and cloud gaming
24 subscription services. *Id.* ¶¶ 63, 73, 83. The FTC defines the high-performance console market to
25 include only Xbox and Sony, excluding even Nintendo, the second most popular console maker. *Id.*
26 ¶ 65. The FTC defines the geographic market as the U.S. *Id.* ¶ 92. The FTC claims this foreclosure
27 “is reasonably likely to substantially lessen competition in the Relevant Markets.” *Id.* ¶ 118. The
28

1 FTC makes no allegations of harm to competition in any game publishing or distribution market, or
2 involving PC or mobile gaming.

3 The administrative hearing on the FTC’s complaint was scheduled to begin on August 2,
4 2023. *See In re Microsoft Corp.*, FTC Matter No. 2210077, Docket No. 9412 (F.T.C.). On June 12,
5 2023, the FTC filed this lawsuit seeking to enjoin the transaction until its years-long administrative
6 process concludes.

7 LEGAL STANDARD

8 **I. Section 7 of the Clayton Act**

9 The FTC is pursuing only a vertical theory of harm—in other words, it is challenging Xbox’s
10 acquisition of an input, rather than the consolidation of two firms in an area of overlap, such as game
11 publishing. As a result, the burden of persuasion “remains with the government at all times.” *U.S. v.*
12 *Baker Hughes, Inc.*, 908 F.2d 981, 983 (D.C. Cir. 1990). To satisfy its burden, the FTC must first
13 “define the relevant market,” which in turn requires identifying both “(1) the relevant product market
14 and (2) the relevant geographic market” in which the anticompetitive effects will allegedly occur.
15 *FTC v. Meta Platforms Inc.*, 2023 WL 2346238, at *8 (N.D. Cal. 2023) (citing *Brown Shoe Co. v.*
16 *U.S.*, 370 U.S. 294, 324 (1962)). If it identifies a proper market, the FTC must then prove that the
17 merger “is likely to substantially lessen competition in the relevant market.” *U.S. v. AT&T, Inc.*, 916
18 F.3d 1029, 1032 (D.C. Cir. 2019) (emphases added).

19 **II. Preliminary Injunction Standard**

20 Section 13(b) of the FTC Act authorizes federal district courts to preliminarily enjoin a
21 challenged merger “[u]pon a proper showing that, weighing the equities and considering the
22 Commission’s likelihood of ultimate success, such action would be in the public interest.” 15 U.S.C.
23 § 53(b). This standard requires a court to (1) “determine the likelihood that the [FTC] will ultimately
24 succeed on the merits” and (2) “balance the equities.” *Warner*, 742 F.2d at 1160.

25 A sufficient likelihood of success requires “more than mere questions or speculations
26 supporting” allegations of anticompetitive conduct. *Meta*, 2023 WL 2346238, at *8. The FTC meets
27 its burden only by “rais[ing] questions going to the merits so serious, substantial, difficult and
28

1 doubtful as to make them fair ground for thorough investigation, study, deliberation and
 2 determination.” *Warner*, 742 F.2d at 1162. The Court must exercise “‘independent judgment’ and
 3 evaluat[e] the FTC’s case and evidence on the merits.” *FTC v. Meta Platforms, Inc.*, 2022 WL
 4 16637996, at *5 (N.D. Cal. 2022).

5 If the FTC can establish a likelihood of success, a court must then weigh the public and
 6 private equities. *See FTC v. H.J. Heinz Co.*, 246 F.3d 708, 726–27 (D.C. Cir. 2001). Public equities
 7 include the merger’s procompetitive benefits. *Warner*, 742 F.2d at 1165. Harm to the merging
 8 parties if the merger is enjoined—*i.e.*, “private equities”—are also “entitled to serious
 9 consideration.” *Id.* And in weighing these concerns, a court must keep in mind that the issuance of a
 10 preliminary injunction is an “extraordinary and drastic remedy.” *Exxon*, 636 F.2d at 1343. Thus,
 11 even where an injunction may be warranted, any less intrusive alternatives should be considered. *Id.*
 12 at 1344.

13 ARGUMENT

14 **I. The FTC Is Unlikely to Prevail on the Merits Because It Cannot Prove a Likely** 15 **Substantial Lessening of Competition.**

16 **A. The FTC Has Failed to Identify a Relevant Antitrust Market.**

17 To meet its burden to show a substantial lessening of competition, the FTC first must “define
 18 the relevant market” in which anticompetitive effects will occur. *FTC v. Qualcomm Inc.*, 969 F.3d
 19 974, 992 (9th Cir. 2020). Courts determine “[t]he outer boundaries of a product market” based on
 20 “the reasonable interchangeability of use or the cross-elasticity of demand between the product itself
 21 and substitutes for it.” *Brown Shoe*, 370 U.S. at 325. Within a relevant market, “[p]roducts need not
 22 be fungible.” *Meta*, 2023 WL 2346238, at *9. Rather, the “overarching goal of market definition is
 23 to ‘recognize competition where, in fact, competition exists.’” *Id.* (quoting *Brown Shoe*, 370 U.S. at
 24 326). By those metrics, the FTC’s proposed markets fail entirely.⁶

25 _____
 26 ⁶ The relevant market has a geographic component, which is where “the defendants compete.” *See*,
 27 *e.g.*, *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 37 (D.D.C. 2009); *see also FTC v. Sysco Corp.*,
 28 113 F. Supp. 3d 1, 48 (D.D.C. 2015). As will be demonstrated at trial, the FTC also baselessly seeks
 to limit the relevant geographic market to the United States, when both Microsoft and Activision
 compete in dynamic global markets. *See Ex. 3*, Bailey Rep. ¶¶ 114–16.

1 **1. Nintendo Switch and PCs Compete With “High-Performance Consoles.”**

2 The FTC offers two unduly narrow proposed definitions of its “high-performance consoles”
3 market. The FTC primarily proposes that PlayStation and Xbox alone compose the entire console
4 market and then alternatively adds Nintendo Switch but still excludes PCs. Both Nintendo and PCs
5 are “economic substitutes,” *Newcal Indus., Inc. v. Ikon Office Sol.*, 513 F.3d 1038, 1045 (9th Cir.
6 2008), that must be considered in any relevant market.

7 *Nintendo*. There is no basis for excluding Nintendo. [REDACTED]
8 [REDACTED]
9 [REDACTED]
10 [REDACTED] [REDACTED]

11 [REDACTED] By excluding Nintendo, the FTC inflates Xbox’s market share. Ex. 3,
12 Bailey Rep. ¶ 13 ex. 4. It also conveniently excludes a key competitor that has thrived without *COD*
13 for the past decade.

14 In response, the FTC offers its expert’s *ipse dixit* that Nintendo’s Switch is so differentiated
15 along price, specifications, and content that it is in a different product category than the other two
16 consoles. To the contrary, Xbox and Sony compete with Nintendo and with each other on all of these
17 features. For example, the entry-level versions of the current Xbox and Nintendo consoles are
18 offered at the same price point (\$299.99). Ex. 48, Lee Rep., fig. 14; Ex. 3, Bailey Rep. ¶ 89 & ex. 42.
19 Moreover, while the FTC makes much of Nintendo’s supposed technical differences from the other
20 consoles, it ignores that Xbox and Sony also differentiate their consoles based on performance.⁸ The
21 substantial overlap in the three consoles’ content libraries further demonstrates that they compete:

22 _____
23 ⁷ Customer preference likewise demonstrates that Xbox and PlayStation compete with Nintendo
24 Switch for customers and playtime. *See* Ex. 47, [REDACTED] Ex. 3, Bailey Rep. ¶¶ 85–
87.

25 ⁸ Both the Xbox Series S and PlayStation digital edition are offered at lower entry price points in
26 exchange for less advanced technological specifications. The Xbox Series S, for example, has less
27 GPU processing power, system memory, and internal storage and renders images at a lower
28 resolution than the Xbox Series X. *See* Ex. 48, Lee Rep. ¶ 194 fig. 13. PlayStation, meanwhile,
currently offers two different versions of the PlayStation 5—one with a Blu-Ray player (Standard)
and one without (Digital)—and is anticipated to release further differentiated Pro and Slim models
in the near future. Exs. 49–50.

1 of a market to consideration of a subscription based payment model” without explaining why the
2 market is not instead “the broader video game market generally”); *see also Reilly v. Apple Inc.*, 578
3 F. Supp. 3d 1098, 1108 (N.D. Cal. 2022). [REDACTED]

4 [REDACTED]
5 [REDACTED] . [REDACTED] [REDACTED]
6 [REDACTED]
7 [REDACTED]. That cannibalization risk is why many game
8 publishers, Activision included, do not embrace the subscription model.¹⁰

9 **b. Cloud Gaming Subscription Services.** The FTC’s proposed cloud-gaming
10 subscription services market is similarly incoherent. As an initial matter, cloud gaming is not a
11 separate product—it is a euphemism for a technology that allows for a game to be streamed from an
12 external source, such as the cloud, rather than downloaded onto a device (like a PC or console) and
13 played natively. In addition, the FTC’s proposed market includes some multi-game subscription
14 services, like Game Pass, that offer cloud streaming of console games as feature for subscribers, who
15 typically use it to try games before downloading them. But it also includes other distinct services,
16 like Nvidia’s GeForce NOW, that allow consumers to stream games they already own on PC. The
17 FTC provides no explanation for how these products are substitutable, particularly given its own
18 argument that consoles and PCs are in distinct markets.

19 Beyond that, cloud-gaming is entirely unproven—while the technology has been around for
20 some time, it has never seen significant demand—and predictions about its future development and
21 Xbox’s role are conjectural. Even assuming that perceived harm to a future market is relevant,¹¹ the
22 FTC itself has recognized that projecting harm in future markets “can be difficult,” must be
23 “strongly rooted in the evidence,” and requires “considerable evidence” that the market will emerge

24 [REDACTED]
25 [REDACTED]
26 [REDACTED]
27 [REDACTED]
28 ¹¹ The Supreme Court has never addressed whether harm to “potential competition is a viable theory of section 7 liability.” *U.S. v. Aetna Inc.*, 240 F. Supp. 3d 1, 75 (D.D.C. 2017).

1 and that the merger will result in a substantial lessening of competition. *Nielsen Holdings, N.V. &*
2 *Arbitron Inc.*, FTC File No. 131-0058, at 2–3; *see also, e.g., FTC v. Facebook, Inc.*, 560 F. Supp. 3d
3 1, 4 (D.D.C. 2021) (rejecting reliance on a future market as “too speculative and conclusory”).

4 The FTC cannot make those showings. As noted, Sony Group’s CEO recently acknowledged
5 the financial and technical difficulties cloud gaming faces. Ex. 56. And even if the FTC had
6 evidence of what this segment would look like in the future, it is wholly speculative that Xbox would
7 participate in it in a meaningful way, [REDACTED]

8 [REDACTED]
9 [REDACTED]
10 **B. The FTC Cannot Show that the Merger Will Result in Vertical Foreclosure in**
11 **the Console or Gaming Services Markets.**

12 The FTC alleges a single theory of harm: vertical foreclosure. Courts appropriately place a
13 heavy burden on the government in vertical merger cases because “[v]ertical mergers often generate
14 efficiencies and other procompetitive effects.” *U.S. v. AT&T Inc.*, 310 F. Supp. 3d 161, 197 (D.D.C.
15 2018); *see also* Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust*
16 *Principles and Their Application*, ¶ 755c (online ed. Aug. 2022) (“Vertical integration is ubiquitous
17 in our economy and virtually never poses a threat to competition when undertaken unilaterally and in
18 competitive markets.”). These considerations apply with particular force here as the merger will
19 make Activision’s games *more accessible* to consumers.

20 The FTC’s central claim is that the combined firm would withhold certain Activision
21 content—in particular, *COD*—from Sony, the longtime market leader. In citing such “foreclosure”
22 as its basis for opposing this transaction, the FTC must prove, among other things, (1) that the
23 combined company would have the *incentive* to withhold *COD* from rivals to whom an independent
24 Activision would otherwise sell *COD* (*i.e.*, that doing so would be profitable despite the forgone
25 Activision sales), (2) that it has the *ability* to foreclose (*i.e.*, that rivals cannot effectively compete
26 without *COD* and could not offset any harm through a competitive response), and (3) that
27
28

1 *competition* (as opposed to individual competitors) would likely be harmed. *See UnitedHealth, 2022*
 2 *WL 4365867*, at *25–27. The FTC cannot make these showings.

3 **1. The FTC Cannot Show a Substantial Likelihood of Harm in the Gaming**
 4 **Console Market.**

5 *No incentive.* This element is simple. Microsoft has committed not to withhold from anyone
 6 by signing binding contracts to bring *COD* on nondiscriminatory terms to Nintendo and multiple
 7 different cloud gaming providers. The FTC must account for these economic realities in trying to
 8 meet its burden, rather than relying on “assumptions and simplifications that are not supported by
 9 real-world” facts, *Am. Booksellers Ass’n v. Barnes & Noble, Inc.*, 135 F. Supp. 2d 1031, 1041 (N.D.
 10 Cal. 2001), and that ignore “economic reality,” *Craftsmen Limousine, Inc. v. Ford Motor Co.*, 363
 11 F.3d 761, 777 (8th Cir. 2004). The government fails to do so.

12 As further proof of its lack of incentive, Microsoft has offered to provide Activision content
 13 to Sony for the next *ten years*. Ex. 57. [REDACTED]

14 [REDACTED]
 15 [REDACTED]
 16 [REDACTED] The only plausible reason why Sony has declined to sign is not because it fears
 17 “foreclosure” (which it could prevent with the stroke of a pen), but because it believes this
 18 transaction will make third-place Xbox a more effective competitor. Sony is presumably worried that
 19 putting Activision games in Game Pass “day and date” will increase consumer interest in
 20 subscription services—a business model Sony believes is less profitable than making consumers pay
 21 \$70 for each new release. But that belief is a reason to *approve* this deal because the antitrust laws
 22 “were enacted for the protection of competition not competitors.” *Brunswick Corp. v. Pueblo Bowl-*
 23 *O-Mat, Inc.*, 429 U.S. 477, 488 (1977). The antitrust laws do not protect a dominant firm’s profit
 24 margin.

25 Even setting aside the offer, withholding *COD* would harm Xbox economically. *See Sewell*
 26 *Plastics, Inc. v. Coca-Cola Co.*, 720 F. Supp. 1196, 1216–17 (W.D.N.C. 1989) (rejecting antitrust
 27 claim where defendants had no “economic incentive” to “lock out existing suppliers” and “raise the
 28

1 cost of an input”). Xbox would be losing *COD* revenues on the *largest* console provider, Sony. Ex.
2 58, Carlton Rep. ¶ 11. Those revenues were critical to the price Microsoft paid for Activision, the
3 Board’s evaluation of the transaction, and the financial targets to which Xbox is held accountable.
4 Ex. 2; Ex. 68, J [REDACTED]

5 Withholding would cause even greater harm by degrading the game and infuriating gamers.
6 A significant appeal of *COD* is that it is a multi-player game oft-played by groups across different
7 platforms, including PlayStation (known as cross-play). Ex. 58, Carlton Rep., at 6; Ex. 8, A. Zerza
8 Dep. 39:8-39:20; Ex. 69, C. Schnakenberg Dep. 143:22-144:5. Having a broad community of
9 gamers ensures players can easily find groups of comparable skill levels, making the game fun.
10 Removing *COD* from PlayStation would dramatically shrink the community, making the gaming
11 experience worse for anyone left. Ex. 58, Carlton Rep. ¶ 14.

12 Microsoft’s acquisition of Mojang’s *Minecraft* franchise in 2014 illustrates why all of these
13 incentives cut against withholding. *Id.* ¶ 15. Like *COD*, *Minecraft* is a popular franchise with
14 substantial cross-platform play. Under the reasoning advanced by the FTC, Xbox would have had
15 incentives to make *Minecraft* exclusive to its Xbox. *Id.* It did not, and has not since. On the contrary,
16 Xbox has expanded access to the game, and continues to release new editions available on
17 PlayStation. *Id.* Indeed, Defendants are not aware of *any* situation where a publisher has chosen to
18 take exclusive an existing game franchise that is multi-player and offers cross-platform play. *Id.*
19 ¶¶ 14–15. There is no reason to believe this would be the first.

20 The government’s two responses to this straightforward logic are unavailing. The FTC
21 primarily relies on its expert, Dr. Lee, [REDACTED]

22 [REDACTED]
23 [REDACTED]
24 [REDACTED]
25 [REDACTED] Ex. 48, Lee Rep., at 148. Dr. Lee initially tried to justify this
26 prediction with his [REDACTED], *id.*, but Defendants’ expert Dr. Carlton demonstrated that it had
27 serious conceptual flaws Ex. 58, Carlton Rep., at Section IV.A. Dr. Lee then pivoted to saying that
28

1 his [REDACTED]
 2 [REDACTED]. Ex. 63, Lee Rebuttal, at 6. Even assuming that is a proper
 3 role for an expert (which it is not), the sources do not support his conclusion. And Dr. Carlton
 4 further shows that Dr. Lee's [REDACTED]
 5 [REDACTED]. Ex. 58,
 6 Carlton Rep., at Section IV.B.6. Ultimately, Lee's analysis provides no basis to disregard the real
 7 world, where Sony has a favorable offer for *COD*, Xbox has made plain that it wants to provide
 8 *COD* to Sony (and in fact needs to continue to sell to Sony), and regulators around the world all
 9 agree that withholding *COD* from Sony would be unprofitable and is thus not a serious concern.

10 The FTC's strained analogy to Microsoft's acquisition of ZeniMax, a fundamentally different
 11 game developer, likewise fails to establish that *COD* would become exclusive. The first two
 12 ZeniMax games Xbox released post-acquisition (*Deathloop* and *Ghostwire*) were exclusives for
 13 Sony, [REDACTED]

14 [REDACTED]
 15 [REDACTED]
 16 [REDACTED]
 17 [REDACTED] The ZeniMax story thus says
 18 nothing about what Xbox would do with an existing, multi-player, cross-platform franchise like
 19 *COD*—the relevant analogy there is *Minecraft*.¹²

20 **No ability.** There is likewise no reason to think Xbox could foreclose PlayStation by
 21 withholding [REDACTED]
 22 [REDACTED]

23
 24 ¹² In drawing its analogy to Zenimax, the FTC wrongly implies that Xbox misled the European
 25 Commission about its intent regarding future Zenimax titles. The European Commission took the
 26 extraordinary step of responding directly when the FTC made this claim in its administrative
 27 complaint, by stating publicly that Microsoft did not make any "commitments" to the European
 28 Commission, nor did the European Commission "rely on any statements made by Microsoft about
 the future distribution strategy concerning ZeniMax's games." Instead, the European Commission
 cleared the transaction "unconditionally as it concluded that the transaction would not raise
 competition concerns." Ex. 61.

1 [REDACTED] Ex. 3, Bailey Rep. ¶ 15. If any such shift occurred between Xbox
 2 and PlayStation, that would serve only to make the console market *less concentrated* and more
 3 competitive. But the existence of such an extreme shift is implausible: Nintendo outcompetes Xbox
 4 even though it does not currently have access to *COD*. *Id.* ¶ 14. Likewise, Steam, the leading PC
 5 game store, has also risen in popularity without *COD*. *Id.* ¶ 55 & ex. 35. That is no doubt why the
 6 FTC tries to exclude Nintendo and PC from the console market—they are proof that *COD* is not
 7 essential to competition.

8 Moreover, any claim that Xbox could foreclose PlayStation would need to take account of
 9 Sony’s ability to respond competitively. *See Fruehauf Corp. v. FTC*, 603 F.2d 345, 352 n.9 (2d Cir.
 10 1979) (requiring assessment of competitive response). The myriad options available to Sony are fatal
 11 to the FTC’s case. Sony could lower prices or improve the quality of its console. It could invest in
 12 other first-party or third-party games, as it recently did with Bungie in a deal the FTC quickly
 13 cleared. Ex. 62. Or, as Sony’s CEO told investors in the wake of news of Microsoft’s acquisition of
 14 Activision, it could “grow [Sony’s] own studios organically” to increase Sony’s own value
 15 proposition to consumers. Ex. 67. These likely competitive responses are integral to antitrust
 16 analysis, but the FTC simply ignores them. *See Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d
 17 227, 232 (1st Cir. 1983) (Breyer, J.) (the “long term effects” of any proposed merger will “depend in
 18 large measure on competitors’ responses.”); *Paddock Publ’ns, Inc. v. Chi. Trib. Co.*, 103 F.3d 42, 44
 19 (7th Cir. 1996) (rejecting challenge to exclusivity agreement between incumbent newspaper and
 20 content creators because any rival newspaper “deprived of access” even to the “best known” content
 21 can compete on the basis of alternative content).

22 ***No harm to competition.*** In any event, even if Microsoft *could* be expected to make *COD*
 23 exclusive, the FTC has not shown harm to competition. The entirety of the FTC’s analysis is Dr.
 24 Lee’s assertion that [REDACTED]

25 [REDACTED]
 26 [REDACTED]
 27 [REDACTED] That is not the law. *See Fruehauf*, 603 F.2d at 352 n.9

1 (rejecting the proposition that foreclosing a competitor from a previously available input is sufficient
 2 to demonstrate a lessening of competition). Exclusivity arrangements (whether from contract or
 3 vertical integration) are ubiquitous throughout the economy and are usually procompetitive. *See,*
 4 *e.g., Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 395 (7th Cir. 1984). Indeed, both Sony
 5 and Nintendo have entered into a wide range of exclusivity arrangements of their own with various
 6 game publishers, and each has far more exclusive gaming content than Xbox does. Ex. 58, Carlton
 7 Rep. ¶ 20 & n.51; *see also id.* ¶ 11. Dr. Lee himself has recognized in his prior academic work about
 8 gaming that such arrangements can be procompetitive. Ex. 58, Carlton Rep. ¶ 11 n.22 (citing Dr.
 9 Lee’s academic work); *id.* ¶ 20.

10 This transaction also does not exhibit, and the FTC’s motion does not address, any of the
 11 special features that have led courts in unusual cases to conclude that vertical integration will give
 12 rise to anticompetitive outcomes. In particular, *COD* is not a “necessary input” for Xbox rivals, *see*
 13 *Sprint Nextel Corp. v. AT&T Inc.*, 821 F. Supp. 2d 308, 330 (D.D.C. 2011), and any “foreclosure”
 14 percentages would be far too small to warrant any presumption of competitive harm.¹³ Tellingly, Dr.
 15 Lee never seeks to show that competition would be harmed such that Xbox would be able to raise
 16 console (or game) prices. *See Alberta Gas Chems. Ltd. v. E.I. Du Pont De Nemours & Co.*, 826 F.2d
 17 1235, 1244–46 (3d Cir. 1987) (“foreclosure” concerns are only raised where withholding of inputs
 18 would result in “post-merger market power”); *cf.* Ex. 58, Carlton Rep. ¶ 140.

19 In short, the FTC cannot show what it must to justify blocking this vertical transaction: that
 20 the supposed withholding of *COD* would make the combined company’s rivals *ineffective as*
 21 *competitors*. *See McWane, Inc. v. FTC*, 783 F.3d 814, 838–39 (11th Cir. 2015) (vertical integration
 22 is generally found to raise antitrust concerns only where it leaves rivals “stunted” as competitors and
 23 materially impairs their ability to discipline the defendant’s prices); *U.S. v. Microsoft Corp.*, 253
 24 F.3d 34, 71 (D.C. Cir. 2001) (issue is whether exclusive dealing keeps competitors “below the

25 _____
 26 ¹³ Even if, counterfactually, Xbox had the incentive to withhold all of Activision’s content, that
 27 would be a modest share of the console game publishing by any measure— Ex. 3,
 28 Bailey Rep. ¶¶ 28, 31. Such a “foreclosure percentage” would be far smaller than the level (30–50%)
 needed to raise any presumption of anticompetitive effect even if Xbox were a platform *monopolist*.
See Microsoft, 253 F.3d at 70; *Fruehauf*, 603 F.2d at 352–54.

1 As a threshold matter, the FTC misconceives the law. Even accepting the government’s
 2 framing of the standard,¹⁵ the question is whether this “merger will likely lead to a substantial
 3 lessening of competition,” *Oracle Corp.*, 331 F. Supp. 2d at 1109—*i.e.*, whether the world with this
 4 merger is “likely” to be substantially less competitive than the but-for world without it. *See AT&T*,
 5 916 F.3d at 1032. The FTC does not even purport to make that showing as to content-library
 6 subscription services and cloud gaming subscription services. Instead, Dr. Lee contends that he need
 7 only show that [REDACTED]

8 [REDACTED] Ex. 63, Lee Rebuttal
 9 ¶ 39; *see also id.* ¶¶ 44, 48. But that is not enough under the law— [REDACTED]
 10 [REDACTED]
 11 [REDACTED] *See AT&T*, 310 F. Supp. 3d at 246–47 (rejecting claim of
 12 increased coordination risk given the Government expert’s concession “that he was not in a position
 13 to say that coordination is more likely to happen than not”) (cleaned up). [REDACTED]
 14 [REDACTED], Ex. 63, Lee Rebuttal ¶ 48 & n.389, which dooms the government’s case
 15 here, just as it did in *AT&T*. *See* 310 F. Supp. 3d at 246–47.

16 More generally, to carry its burden as to the content-library and cloud-gaming “markets,” the
 17 FTC must prove that *all* of the following claims are likely true. In fact, *none* is true.

18 *First*, the FTC must prove that, but for this merger, Activision would allow *COD* to be
 19 included in third-party content-library or cloud-gaming services. [REDACTED]
 20 [REDACTED]
 21 [REDACTED]

22
 23 ¹⁵ A plain-meaning interpretation of Section 7 precludes liability for the simple reason that
 24 Activision does not make *COD* available to content-library or cloud-gaming providers today; thus,
 25 continued withholding could not constitute a “substantial lessening” of competition. *U.S. v. Falstaff*
 26 *Brewing Corp.*, 410 U.S. 526, 537 (1973) (“[w]e leave for another day the question of the
 27 applicability of § 7 to a merger that will leave competition in the marketplace exactly as it was” but
 28 will nonetheless result in “less competition than there would have been” in the but-for world); *U.S.*
v. Marine Bancorp., Inc., 418 U.S. 602, 639 (1974) (continuing to “express no view on the
 appropriate resolution of the question reserved in *Falstaff*”). As discussed in the text, the FTC’s
 alternative-market theories of harm fail even if the relevant Section 7 comparison is between future
 but-for and with-merger worlds.

1 [REDACTED]
2 [REDACTED] This merger
3 could only *increase* access to *COD* on these services, to the benefit of consumers—as cloud provider
4 Nvidia agrees. Ex. 64.

5 *Second*, the FTC must then prove that the post-merger combined company would likely
6 withhold *COD* from subscription and cloud gaming services. Again, however, the FTC does not
7 even try to make that showing, nor could it—particularly in light of the binding contracts Microsoft
8 has already struck with Nvidia and other cloud providers.

9 *Third*, the FTC must additionally prove that any post-merger withholding would substantially
10 lessen *competition*. It cannot do so because exclusivity arrangements are ubiquitous; Sony and
11 Nintendo already use them more than Microsoft does; and, as discussed above, they raise no
12 competitive concerns except in narrow circumstances involving substantial market power and large
13 foreclosure percentages, neither of which is present here. *See, e.g., McWane*, 783 F.3d at 838–39;
14 *Microsoft*, 253 F.3d at 71; *Alberta Gas*, 826 F.2d at 1244–46.

15 *Fourth*, as to the cloud-gaming “market,” the FTC must prove that cloud gaming will
16 develop in the near-to-intermediate term as a genuine alternative to consoles or performance PCs, in
17 particular for multi-player, fast-twitch, graphics-intensive games such as *COD*. [REDACTED]

18 [REDACTED]
19 [REDACTED] The FTC can show no such thing. As Sony admits, network engineers are
20 nowhere close to solving the immense technological challenges presented by that cloud game-play
21 model, *e.g.*, Exs. 65–66, which is one of the reasons why Activision refuses to make *COD* available
22 for cloud gaming. And there is no basis for blocking a merger based on speculation about harm to
23 non-existent markets that are unlikely to materialize anytime in the foreseeable future. *See*
24 *Facebook*, 560 F. Supp. 3d at 4.

25 *Fifth*, if the FTC could establish that a cloud-gaming market will develop, it would also have
26 to show that Xbox will be a major player in it; otherwise, it would have no cloud-gaming business to
27 promote through exclusivity arrangements. The FTC cannot substantiate that speculation either.

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED]

7 **II. The Equities Weigh Against a Preliminary Injunction.**

8 The FTC’s failure to demonstrate a likelihood of ultimate success means there is no reason to
9 consider the equities. *Meta*, 2023 WL 2346238, at *33. But in any event, the equities—both public
10 and private—weigh against granting the “extraordinary and drastic remedy” the agency requests.
11 *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 115 (D.D.C. 2016).

12 As a threshold matter, Microsoft’s merger with Activision does not implicate the “principal”
13 “public equity consideration [that Congress had] in mind when it enacted section 13(b)” —namely,
14 the need to maintain the pre-merger “status quo” so the FTC can award effective relief if it succeeds
15 on the merits. *Heinz*, 246 F.3d at 726. This consideration applies chiefly in the context of horizontal
16 mergers where two competing companies integrate their operations and, in the process, often
17 eliminate stores, factories, or other redundant assets, making it difficult to unscramble the merger.
18 *FTC v. Dean Foods Co.*, 384 U.S. 597, 606 n.5 (1966); *Sysco Corp.*, 113 F. Supp. 3d at 87.

19 Microsoft’s *vertical* merger with Activision, however, raises none of these concerns. *Cf.* FTC
20 Br. 23. Microsoft and Activision are not competitors in the relevant markets alleged. And Microsoft
21 intends to operate Activision similar to other recent acquisitions, such as *Minecraft* developer
22 Mojang. In other words, Activision’s creative operations will remain separate and continue to run as
23 they did pre-merger. Consequently, even in the (unlikely) event the FTC continues to press its Part 3
24 case and then succeeds on the ultimate merits in that proceeding, the agency can order Microsoft’s
25 divestiture of Activision—“an effective ultimate remedy,” *FTC v. Great Lakes Chem. Corp.*, 528 F.
26 Supp. 84, 99 (N.D. Ill. 1981). As a result, the “principal public equity” cuts against the government,
27 *Heinz*, 246 F.3d at 726.

1 In addition, granting a preliminary injunction would kill the deal, robbing consumers of the
 2 “beneficial economic effects and procompetitive advantages” resulting from this merger, including
 3 increased availability of Activision content. *FTC v. Pharmtech Rsch., Inc.*, 576 F. Supp. 294, 299
 4 (D.D.C. 1983); *see also Warner*, 742 F.2d at 1165. By contrast, there is no risk that consumers
 5 would be injured while the administrative process runs its course—Sony’s existing contract for *COD*
 6 runs through 2024 and it has an offer for much longer access.

CONCLUSION

8 For the foregoing reasons, Microsoft respectfully requests that the Court deny the FTC’s
 9 motion for a preliminary injunction.

11 Dated: June 16, 2023

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