NSR Tech Policy: MSFT-ATVI The Company: How will MSFT respond?

By Blair Levin and Matt Perault | March 12, 2023

New Street Research's Internet Policy Team is publishing a 5-part series of notes on the FTC's suit challenging the Microsoft-Activision merger.

In our first note (LINK), we examined the **case**: regulators' main concerns, MSFT's responses, the legal standards in key jurisdictions, and the role that "litigating the fix" might play in the outcome. Our second note examined the **global landscape**, focusing on international regulators' review of the merger (LINK). The third note looked at the **judge**: the FTC's decision to pursue the case in front of an administrative law judge in its own in-house administrative court, rather than in federal court (LINK).

Today, we examine the **company**: how will MSFT respond to the steps regulators are taking to potentially block the deal?

Our final note will provide our assessment of the most likely **outcome** of the case.

Bottom line:

- MSFT will offer a range of concessions in an effort to resolve the case before trial. It can make several concessions that are directly responsive to concerns in the FTC Complaint.
- It will also offer to make those concessions legally binding, seeking to address the FTC's stated concern that MSFT will not stand behind its public commitments.
- Negotiations may hit a snag if the FTC insists on concessions that could impede MSFT's other core businesses, such as its cloud operation and productivity software.

The issue:

MSFT would prefer to resolve the case in the European Union and the United Kingdom before a decision is announced in their investigations in late April and before it goes to trial in August in the United States. A trial — as well as any subsequent appeals — would significantly delay the closing of the deal. An adverse result in any of these jurisdictions might result in the deal being terminated. To avoid that result, MSFT will seek to offer concessions to the FTC and to international regulators that resolve their concerns and avoid protracted litigation.

Offering concessions will also improve their prospects with antitrust agencies in Europe and the United Kingdom and in court in the United States. As we detailed in Monday's note (LINK), a judge will evaluate the merits of the case based on the concessions MSFT offers, a concept known as "litigating the fix." Because the concessions will address at least some portion of the competitive risks the FTC identifies in its Complaint, putting them on the table will strengthen MSFT's hand in court.

Extracting concessions from MSFT will also help address the political dynamics surrounding the deal. It will be difficult for regulators to accept any settlement agreement that looks weak on its face. In order to agree to any deal, regulators must be able to point to specific, robust concessions that will enable them to defend the deal publicly against its inevitable detractors.

What could MSFT offer?

The FTC's complaint provides a roadmap that MSFT could use as the foundation for a package of concessions to seek to resolve the case. The FTC alleges that the merger would create a "combined firm with the ability and increased incentive to withhold Activision's valuable gaming content from, or degrade Activision's content for, Microsoft's rivals." Specifically, it alleges that MSFT could "fully withhold Activision content from rivals, raise rivals' costs, change the terms and timing of access to Activision content, or degrade the quality of Activision content."

Complaint 1: MSFT could fully withhold ATVI content from rivals.

- Corresponding concession: MSFT has already committed to make *Call of Duty* and "other popular games" available on PlayStation. It signed a binding 10-year contract with Nintendo to offer *Call of Duty* to

Nintendo users "the same day as Xbox, with full feature and content parity." To enhance these offers, it could extend these commitments to any other rival platform or make them applicable to any existing ATVI game that is currently available on rival platforms. It also could commit to make it available not only to rival consoles, but also to rival subscription services.

Complaint 2: MSFT could change the terms of access to ATVI content.

- Corresponding concession: MSFT has already offered Sony a 10-year contract to make *Call of Duty* available on PlayStation. It could extend the duration of that offer to 15 or 20 years, or set a price limit on the agreement to address potential FTC concerns that it could charge an extortionary price. It also entered into an agreement with Nintendo to make *Call of Duty* available on Nintendo for 10 years, if the acquisition closes. It could extend that similar offer to any other rival platforms, and it could extend the contract to cover any existing ATVI game, rather than just *Call of Duty*.

Complaint 3: MSFT could change the timing of access to ATVI content. It could use "timed exclusivity" or "exclusive downloadable content" strategies to advantage the company relative to rivals.

- Corresponding concession: MSFT already offered to "make each new 'Call of Duty' release available on PlayStation the same day it comes to Xbox." Its agreement with Nintendo explicitly commits to same-day access and to feature and content parity. It could make a similar offer to other rival platforms, and it could extend the contract to cover same-day access to any existing ATVI game, rather than just *Call of Duty*. It could commit to make any downloadable content available equally to any console user.

Complaint 4: MSFT might degrade game quality on rival products, or "reduce efforts to optimize Activision content for rival products."

- Corresponding concession: This concern may be the most difficult to address. Evaluating product quality is more subjective than evaluating access to content, and many factors that influence quality are outside of MSFT's control. For instance, if MSFT releases an Xbox console that dramatically outperforms PlayStation consoles, then it would be almost inevitable that ATVI games would perform better on MSFT products. Nonetheless, MSFT could address this concern through a dispute resolution process. For example, it could offer to establish a three-member independent product quality board to evaluate ATVI releases at regular intervals to evaluate quality differences between ATVI game performance on MSFT consoles and performance on rival consoles. Alternatively, it could commit to establish an engineering department at ATVI solely focused on quality-control for rival platform consoles.

Complaint 5: If the deal closes, MSFT is likely to engage in anticompetitive conduct, even if it makes commitments to the contrary.

- Corresponding concession: MSFT could make its commitments binding by providing them as a formal declaration to the FTC as part of a settlement of the case. Any breach of the terms of the settlement could be subject to enforcement action by the FTC and litigation in federal court.

In addition to these concessions, which respond directly to concerns raised in the FTC's Complaint, MSFT could make commitments to consumers, unions, and other organizations that help it to make the case that the ATVI acquisition would benefit consumers. It has already taken steps that fit into this category, such as its announcement of principles for engaging with labor unions, its announcement of a "labor neutrality agreement" that will take effect 60 days after the ATVI acquisition closes, its recognition of a labor union at MSFT-owned ZeniMax, and its app store guidelines. These announcements not only portray MSFT favorably, but they also seem intended to draw contrasts to MSFT's rivals, such as Amazon on labor unions and Apple and Google on app store practices.

What will MSFT try to avoid offering?

MSFT will seek to avoid offering concessions that interfere with its other businesses. For instance, some competitors have filed complaints related to MSFT's integration of certain features into its productivity software and operating systems. Given those concerns, it is possible that regulators might push for a concession related to how MSFT integrates gaming into its Teams and Windows products.

Similarly, some regulators might seek to ensure that MSFT doesn't bundle gaming with Azure, its cloud service, in a manner that disadvantages rivals who do not have in-house access to a significant cloud business.

Cloud integration might be particularly important as gaming services compete for users in the high-performance streaming market.

How will MSFT make these concessions?

MSFT will be pushed to make these concessions as binding commitments that are enforceable in court. In the Complaint, the FTC explicitly raised its concerns about MSFT reneging on its public promises: “Microsoft’s past conduct provides a preview of the combined firm’s likely plans if it consummates the Proposed Acquisition, despite any assurances the company may offer regarding its plans.”

But the FTC does not claim that MSFT’s past promises were accompanied by a legally binding commitment. That omission suggests a path for MSFT to address the FTC’s concern: it could proffer its commitments as part of a court-approved settlement of the case. If MSFT were to act contrary to that agreement, the FTC could sue to enforce the settlement. Including the concessions as an explicit part of the settlement would make them enforceable in court.

When will MSFT make these concessions?

As noted above, MSFT has already made several concessions as part of its efforts to avoid a suit from the FTC and international regulators (see our second note for more detail on the international regulatory process) (LINK). It will likely continue to float options publicly and privately as the April decision dates in the European Union and United Kingdom approach, hoping that it can reach an agreement that will keep the case from proceeding.

Both sides will see the approaching deadlines – the late-April decisions in the European Kingdom and United Kingdom, as well as the August trial date in the United States -- as conferring an advantage in negotiations: the FTC will know that MSFT would prefer to close the deal as soon as possible, avoiding the uncertainty of a litigated result in court and a $3 billion break fee. MSFT will know that the FTC will prefer to avoid losing in court, and as MSFT offers more and more concessions, it will become increasingly difficult for the FTC to be successful if it “litigates the fix.”

Stay tuned...

- **Note 5: The Outcome.** Our final note will provide our prediction for how the case will resolve.
