



## Insight

# Outcome of the FTC's Microsoft Merger Challenge Could Impact the Entire Economy

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## Executive Summary

- The Federal Trade Commission (FTC) challenged a proposed merger of Microsoft and video game publisher Activision on the grounds that the transaction would allow Microsoft to leverage the game library of Activision to limit competition in the console market.
- By limiting the market to just two console makers and ignoring the competitive pressures that could prevent Microsoft from behaving in monopolistic fashion, the FTC's challenge could limit the consumer benefits that may result from the transaction.
- The FTC's challenge of this merger follows a recent pattern in which the agency forgoes a proper examination of a transaction's effects on competition and consumers and instead looks at concentration as a per se problem; this strategy could have significant consequences for all sectors of the economy.

## Introduction

In December 2022, the Federal Trade Commission (FTC) [challenged the merger of Microsoft and Activision](#), a video game developer, publisher, and distributor, on the grounds that the merger would harm Microsoft's chief rival in the console market, Sony. The acquisition would help Microsoft compete in [mobile gaming](#), the [quickest growing and highly profitable market](#) in which Microsoft currently lacks a substantial footprint. The acquisition would also help Microsoft in console games, gaining ownership of popular titles such as Call of Duty and Overwatch, which the company could then integrate into offerings such as Xbox Game Pass, a service whereby consumers pay a monthly fee for access to a revolving list of games. The FTC, however, claims that the acquisition would allow Microsoft to offer these titles exclusively on the Xbox console, driving consumers away from its main competitor, the Sony PlayStation, and give the company a dominant position in the console market.

While the FTC often looks at potential competition concerns in vertical mergers, the agency has begun to shift its analysis away from the effect that a merger could have on consumers and instead treat industry concentration itself as a harm, regardless of other competitive effects. Since [revoking the 2020 vertical merger guidelines](#), the agency has begun challenging a wide range of mergers on [unprecedented theories of harm](#). These cases will likely not survive judicial scrutiny, but [Chairwoman Lina Khan has implied](#) that one purpose behind bringing them is simply to put pressure on Congress to change the law. As a result, while much ink has been spilled discussing these cases, the likely impact is not significant unless Congress acts.

Unlike these more novel cases, the Microsoft/Activision case could have a more significant impact on antitrust jurisprudence because it focuses on the practice of packaging a vertically integrated product and excluding it from rivals in another market – a much more established theory of harm. Yet while the underlying theory has more precedent, the FTC has largely ignored potential competition and the procompetitive justifications of the

merger to focus instead primarily on the harm of concentration in isolation. Because the underlying theory of harm isn't novel but the case still embraces a "big is bad" approach to antitrust, the outcome of the agency's challenge could dictate just how far it can go and whether Congress will decide to take up further antitrust legislation soon.

## **The FTC's Case Against the Merger**

The FTC's challenge places significant scrutiny on the potential for Microsoft to exclusively offer the Call of Duty video game franchise to the Xbox console and use the dominance of Call of Duty as a title to drive competition away from the Sony PlayStation. [Call of Duty titles](#) have comprised 10 of the top 15 console games sold from 2010–2019, and the latest title made over \$1 billion in sales within just 10 days of its release. Paired with other successful games in Activision's library, the FTC is concerned that Microsoft will make these titles exclusive to the Xbox. As a result, the FTC suggests, customers may overwhelmingly choose the Xbox over the Sony PlayStation in order to access the larger library of popular games exclusive to Xbox or offered through the Xbox Game Pass, Microsoft's subscription gaming service.

Of note, the FTC's case narrowly defines the market to include only the PlayStation and the Xbox, excluding potential rivals such as the [Nintendo Switch](#) and [personal computer \(PC\) gaming](#). According to the FTC, the Nintendo Switch doesn't compete in the "high-performance segment," as the Switch lacks the processing power to offer the most advanced games, and PCs tailored for high-performance gaming aren't "commercially reasonable." Further, the FTC offers another curious argument to make its case: that subscription services offered by both Microsoft and Sony constitute another relevant market, as these services provide access to a wide range of games for a monthly fee.

## **Consumers vs. Concentration**

The case highlights the radical shift in philosophy at the FTC over the last two years. The agency's complaint largely ignores a wide range alternative products that consumers could choose that would restrain Microsoft from behaving in monopolistic fashion, as well as the significant consumer benefits that the merger could generate. Instead, the FTC's case stems largely from concern over the size of the two companies and the fact that the merger of the two would result in an even larger firm. Nevertheless, focusing on the size of the firm alone and ignoring the wide range of effects of the merger could lead to the ineffective enforcement of competition laws.

In this case, the FTC largely ignores the competitive pressures offered by substitutable services, as well as the restraints they put on any potential monopolistic behavior after the merger. The FTC dismisses the Nintendo Switch as a competitor to Microsoft and Sony because the console lacks the same computing and processing capabilities as the Xbox or the PlayStation. Yet the Switch does offer a wide range of highly successful games and has become the best-selling Nintendo console of all time. Similarly, the FTC dismisses PC gaming as a competitor because it is typically more expensive than console gaming, yet the functionality offered by PCs is generally much more expansive than its console counterparts. What's more, the PC gaming market has been [growing at a faster rate than console](#). While perhaps not perfect substitutes, consumers continually show a strong preference for these options, restricting the ability for Microsoft to seek monopoly rents. The FTC's case ignores these considerations, and instead simply focuses on the size of Microsoft and Activision relative to one specific rival.

The FTC's choice to neglect proper consideration of the competitive landscape of this market suggests that the

agency places little weight on the relative procompetitive benefits of the transaction. By purchasing Activision, Microsoft can make its games available to its customers at lower costs through subscription models (though Microsoft [promised not to include the Call of Duty series](#) in its Xbox Game Pass or make it an Xbox-exclusive title). Despite the FTC's concerns with exclusivity, including more games in one subscription service, or even as a console-exclusive, forces rivals to offer better games or improve their own console-exclusive titles to attract consumers. In the end, consumers could get better services at lower prices. It is entirely possible that these benefits would stem from a Microsoft-Activision merger, but a fuller evaluation of the potential harms and benefits is critical to understanding the competitive effects of a merger. Simply focusing on the size of firms is insufficient.

### **Impacts Beyond This Case**

While the outcome in the FTC's case will have major impacts for the gaming industry, the agency's decision to bring the case speaks to a broader trend in its competition policy. The FTC's new approach to antitrust enforcement, which focuses primarily on industry concentration rather than harms to competition, has yet to be tested significantly in courts. Moreover, some of the agency's more novel cases may produce little insight into how far courts are willing to defer to the agency's judgment.

This case, however, relies on a more precedented theory of harm. If courts are willing to embrace the FTC's view of competition, a case such as this where the underlying legal theory isn't novel could be a good avenue to push the bounds of current law. As a result, a potential judicial decision down the line examining this case could impact not just these firms, or even the gaming industry, but the economy as a whole.

As the FTC continues to shift competition policy toward a focus on concentration alone, the outcome of this challenge will shed valuable insight on just how far the agency can go and whether Congress will need to step in to achieve progressive antitrust goals.