

# Microsoft and Activision-Blizzard: Examining the Largest Tech Acquisition of All Time

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Introduction.....	17
I. Understanding the Video Game Industry .....	20
A. Free-to-Play versus Premium Games.....	21
1. Free-to-Play Games .....	21
2. Premium Games.....	24
B. The PC and Game Console Markets .....	27
1. The Three Console Manufacturers.....	27
2. Software Sales .....	29
3. Competition Between Microsoft, Nintendo, and Sony .....	30
4. PC Games .....	32
C. Game Subscription Services .....	33
II. Identifying the Relevant Market.....	35
A. Defining a Market .....	36
B. Into the Metaverse .....	37
C. The Entire Gaming Industry .....	38
D. Premium Games.....	38
1. A Distinct Market .....	39
2. Digital Transactions within Premium Games .....	39
3. The Hypothetical Monopolist Test .....	41
E. Subscription-based Game Model .....	42
III. Competition and the Rule of Reason .....	44
A. Premium Games.....	46
B. Subscription Services.....	51
Conclusion .....	54

## INTRODUCTION

Microsoft, the tech giant behind both the Xbox and PC gaming platforms, announced in January of 2022 that it intended to acquire Activision-Blizzard, the prolific publisher of billion-dollar video game franchises like Call of Duty and

World of Warcraft.<sup>1</sup> If completed, the deal, worth \$69 billion dollars, will be the largest acquisition in the history of the tech industry.<sup>2</sup> Given the size of the video game industry, it's unsurprising that the acquisition's size would eclipse that of any other in tech: the industry is larger than the movie, book, and music markets combined, bringing in \$180 billion in annual revenue.<sup>3</sup> Video games are a staple in daily life: 66% of Americans play video games, and significant changes to the industry would have a widespread impact.<sup>4</sup>

In December of 2022, the FTC officially filed an antitrust administrative complaint against Activision.<sup>5</sup> The complaint's framework closely resembled that of the first draft of this paper, which I had posted on SSRN in May of 2022. Soon after it was posted, that draft quickly became the top search result on SSRN discussing the acquisition.<sup>6</sup> The FTC's complaint used very similar market definitions and employed many of the same terms and statistics as the draft.<sup>7</sup> Of course, whether the FTC's lawyers referenced my draft in writing their brief remains unknown; however, I now find myself editing a paper for publication that has already fulfilled much of its original purpose: ensuring the FTC would make the strongest *legal* argument possible in scrutinizing the Activision acquisition.<sup>8</sup> Still, after reading the FTC's filings, there are some arguments in

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1. Subrat Patnaik & Supantha Mukherjee, *Microsoft to Gobble Up Activision in \$69 Billion Metaverse Bet*, REUTERS (Jan. 19, 2022), <https://www.reuters.com/technology/microsoft-buy-activision-blizzard-deal-687-billion-2022-01-18>.

2. *The Biggest Tech Mergers and Acquisitions of All Time*, PC MAGAZINE (Apr. 12, 2021) (showing that the largest previous tech acquisition was worth \$67 billion), <https://www.pcmag.com/news/the-biggest-tech-mergers-and-acquisitions-of-all-time>.

3. Tom Wijman, *The Games Market and Beyond in 2021: The Year in Numbers*, NEWZOO (Dec. 22, 2021), <https://newzoo.com/insights/articles/the-games-market-in-2021-the-year-in-numbers-esports-cloud-gaming>; Patrick Frater, *Global Box Office Hit \$21.4 Billion in 2021, Says Analyst*, VARIETY (Jan. 6, 2022), <https://variety.com/2022/film/box-office/global-box-office-2021-1235148732>; *Book Publishers Global Market Report 2021: COVID-19 Impact and Recovery to 2030*, BUS. RESEARCH CO. (Jan. 2021); *IFPI issues Global Music Report 2021*, IFPI (Mar. 23, 2021), <https://www.ifpi.org/ifpi-issues-annual-global-music-report-2021>.

4. Dean Takahashi, *ESA: 66% of Americans Play Games and 88% of Players Say Gaming Relieves Stress*, GAMESBEAT (June 7, 2022), <https://venturebeat.com/games/esa-65-of-americans-play-games-and-88-of-players-say-games-relieve-stress>.

5. Complaint, *In re Microsoft Corp. and Activision Blizzard, Inc.*, No. 9412 (FTC, Dec. 8, 2022).

6. The draft rose to become the top search result for the terms "Activision" and "Microsoft" together, had nearly two thousand abstract views, and had more than 600 downloads. Eli Pales, *Microsoft and Activision-Blizzard: Examining the Largest Tech Acquisition of All Time*, SSRN (May 13, 2022), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4106912](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4106912).

7. See, e.g., *id.* at 13–16 (using almost the same market definitions as I had proposed in my original draft). Compare *id.* at 1 with Jordan Middler, *FTC's Probe of Microsoft's Activision Acquisition Will Reportedly Focus on Consumer Data, Labour Market*, VIDEOGAMESCHRONICLE (Apr. 6, 2022), <https://www.videogameschronicle.com/news/ftcs-probe-of-microsofts-activision-acquisition-will-focus-on-consumer-data-labour-market> (showing how the FTC had abandoned its earlier privacy and labor-centered arguments in favor of the primarily consumer welfare argument I made in my draft).

8. I was originally afraid the FTC would focus on privacy and labor-related issues in its

the complaint that are less convincing, and I have discussed them in my revised footnotes.

My writing here was not simply borne out of an interest in antitrust and technology, but out of a duty to ensure that the video game industry, which I love, continues to be vibrant, innovative, and accessible to people of all means. As a game journalist prior to entering law school, I traveled the world to cover games, the workers that make them, and the people that love them. My stance is clear: I urge antitrust action against the Activision acquisition not only because it is unlawful under America's antitrust laws, but because the acquisition poses a significant danger to people that love to develop and play video games.

In response to concerned critics like me, Microsoft has framed the deal as a relatively small piece of the larger video game industry.<sup>9</sup> Despite the fact that the \$69 billion deal would be the largest tech acquisition of all time, Microsoft argued that together, the two companies would hold a measly 10% of the entire game market.<sup>10</sup> But, the game industry is not a single behemoth—in fact, quite the opposite: it encompasses competitive gaming tournaments, merchandise, in-person conventions, as well as the video games themselves. Just as the movie industry encompasses numerous individual markets—including movie theaters, streaming platforms, and movie production companies—the gaming industry contains numerous discrete markets.

This Article reviews Microsoft's proposed acquisition of Activision and surveys potential market definitions that proponents and opponents of the deal are likely to employ. The Article settles on two market definitions that would best fit the merger: the premium and subscription game markets. Then, it assesses the pro-competitive and anti-competitive effects of the acquisition on the two relevant markets. While the Federal Trade Commission ("FTC") is likely to promulgate new vertical merger guidelines, this Article uses historical FTC practice and Supreme Court precedent to review the acquisition.<sup>11</sup>

Part I surveys the fundamentals of the video game industry. It explains the necessary prerequisites for understanding the Activision acquisition within the

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investigation of the acquisition. While these are important issues—and I support efforts to expand the antitrust framework beyond the traditional consumer welfare framework—the deal is harmful enough to consumers that the traditional consumer-welfare standard is the likeliest to win in court.

9. Subrat Patnaik and Supantha Mukherjee, *Microsoft to Gobble Up Activision in \$69 Billion Metaverse Bet*, REUTERS (Jan. 19, 2022), <https://www.reuters.com/technology/microsoft-buy-activision-blizzard-deal-687-billion-2022-01-18> (describing Microsoft's argument that the acquisition will only give the company 10% market share in the overall gaming industry and help it better compete against Tencent, the biggest game company in the world—even though it almost exclusively releases free-to-play games).

10. *Id.*; *The Biggest Tech Mergers and Acquisitions of All Time*, PC MAGAZINE (Apr. 12, 2021) (showing that the largest previous tech acquisition was worth \$67 billion), <https://www.pcmag.com/news/the-biggest-tech-mergers-and-acquisitions-of-all-time>.

11. *Federal Trade Commission Withdraws Vertical Merger Guidelines and Commentary*, FEDERAL TRADE COMMISSION (Sep. 15, 2021), <https://www.ftc.gov/news-events/news/press-releases/2021/09/federal-trade-commission-withdraws-vertical-merger-guidelines-commentary>.

broader gaming industry. Furthermore, it describes the differences between “free-to-play games” (those that anyone can play without paying) and “premium games” (those which have a price to access). It also discusses the differential demographics, revenue streams, and features between these two game markets. Lastly, Part I examines the way that video games interact with content platforms, specifically those on PCs and video game consoles, and introduces a new and rapidly growing game market: monthly video game subscription services.

Part II examines several potential market definitions that parties in favor of and opposed to the acquisition have already proposed or are likely to propose. Proponents of the deal push for a very broad market definition, arguing that the relevant market is either the “metaverse” or the entire video game industry. Part II also assesses two narrower alternative market definitions, which are likely to be favored by objectors to the deal. Ultimately, I contend that the proper markets to use in reviewing the acquisition are the “premium” and “subscription” game markets.

Finally, Part III assesses the proposed acquisition’s pro-competitive and anti-competitive effects within the premium and subscription game markets. Using traditional antitrust principles and Supreme Court precedent, I apply the rule-of-reason and consumer welfare framework to assess the acquisition’s probable effects. Part III concludes that within both defined markets, the Activision acquisition poses a substantial threat to competition and consumer welfare. The \$69 billion deal imperils consumer choice, reduces the incentive to produce quality games, and ultimately risks higher consumer prices.

## I. UNDERSTANDING THE VIDEO GAME INDUSTRY

To determine whether the Activision acquisition is anticompetitive, it is integral to understand the scope and nuances of the video game industry. The industry is mammoth, with an annual revenue of \$180 billion worldwide—\$60 billion from America alone.<sup>12</sup> The game industry is also the fastest growing in the broader entertainment space, expanding by almost 10% annually.<sup>13</sup> According to forecasters, the game industry will reach worldwide revenue of

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12. Tom Wijman, *The Games Market and Beyond in 2021: The Year in Numbers*, NEWZOO (Dec. 22, 2021), <https://newzoo.com/insights/articles/the-games-market-in-2021-the-year-in-numbers-esports-cloud-gaming>; Jeffrey Rousseau, *2021 Sets Record for US Games Spending at \$60.4bn*, GAMESINDUSTRY.BIZ (Jan. 18, 2022), <https://www.gamesindustry.biz/articles/2022-01-18-2021-sets-record-for-us-games-spending-at-usd60-4bn-us-annual-report>; Patrick Frater, *Global Box Office Hit \$21.4 Billion in 2021, Says Analyst*, VARIETY (Jan. 6, 2022), <https://variety.com/2022/film/box-office/global-box-office-2021-1235148732>; *Book Publishers Global Market Report 2021: COVID-19 Impact and Recovery to 2030*, BUS. RSCH. CO. (Jan. 2021); *IFPI issues Global Music Report 2021*, IFPI (Mar. 23, 2021), <https://www.ifpi.org/ifpi-issues-annual-global-music-report-2021>.

13. Tom Wijman, *The Games Market’s Bright Future: Player Numbers Will Soar Past 3 Billion Towards 2024 as Yearly Revenues Exceed \$200 Billion*, NEWZOO (July 1, 2021), <https://newzoo.com/insights/articles/the-games-markets-bright-future-player-numbers-will-soar-past-3-billion-towards-2024-as-yearly-revenues-exceed-200-billion>.

nearly \$220 billion by 2024.<sup>14</sup> The industry grows quickly, in part, because access to smartphones has skyrocketed, and the majority of smartphone users are also gamers.<sup>15</sup> Today, there are an estimated 3 billion gamers worldwide, 225 million of them residing in the US.<sup>16</sup>

Much like other industries, the video game industry is not a monolith. To draw an analogy, film has several discrete markets: movie theaters, streaming subscription providers (e.g., Netflix), and film production companies, to name a few. The music industry, too, is broken up into several distinct markets, among them live performances, record labels, music streaming, and physical album sales. The video game industry is no different. For example, there are companies that broadcast video game competitions (colloquially referred to as “e-sports”), provide on-demand streaming, and put on live events. These distinct categories often do not even compete, as they appeal to different audiences and revenue streams.

#### A. *Free-to-Play versus Premium Games*

There are two broad categories of video games. Free-to-play games are those that cost nothing to download and play. These games do, however, usually have what are called “microtransactions”: in-game purchases that nickel and dime users as they play. Usually, these purchases are optional, but they can make the game easier to play, unlock aesthetic options (e.g., by changing the player’s avatar), or unlock new content. By contrast, premium games cost money up front. They range in price, but most “Triple A” games cost between \$60 and \$70.<sup>17</sup> Premium and free-to-play games have important characteristics that define their revenue streams and audience.

##### 1. *Free-to-Play Games*

Free-to-play games constitute the vast majority of the video game market, comprising an estimated 80-85% of total revenue.<sup>18</sup> Free-to-play games are

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14. *Id.*

15. *Id.*

16. *Newzoo Global Games Market Report 2021*, NEWZOO (July 1, 2021), <https://newzoo.com/insights/trend-reports/newzoo-global-games-market-report-2021-free-version>; *2021 Essential Facts About the Video Game Industry*, ELECTRONIC SOFTWARE ASS’N (ESA) (2021), <https://www.theesa.com/resource/2021-essential-facts-about-the-video-game-industry>.

17. “The term ‘AAA Games’ is a classification used within the video gaming industry to signify high-budget, high-profile games that are typically produced and distributed by large, well-known publishers. These games often rank as ‘blockbusters’ due to their extreme popularity. Many are part of successful franchises, with new installments building on the success of previous games.” AAA Games, Glossary, ARM, <https://www.arm.com/glossary/aaa-games>.

18. G. Dautovic, *The Rise of the Virtual Empire: Video Game Industry Statistics*, FORTUNLY (Mar. 8, 2022), <https://fortunly.com/statistics/video-game-industry-statistics/#:~:text=Revenue%20from%20Free%20to%20Play,over%202.2%20billion%20mobile%20gamers;2020 Year in Review for Digital Games and Interactive Media>, SUPERDATA (a Nielson company) 2021, <https://www.digitalmusicnews.com/wp->

generally available on easily accessible platforms, such as smartphones and tablets.<sup>19</sup> The nature of these devices ensure that players frequently play for only small spurts of time (e.g., while riding public transit or waiting in a line). As a result, these games are developed, in a sense, to hold the attention of players for a few minutes at a time; the average gaming session of a mobile free-to-play game is just five minutes.<sup>20</sup>

Of course, the term “free to play” is a misnomer. Yes, the games are free to download and begin playing, but somehow these games manage to bring in the vast majority of industry revenue. How do companies make money on free games? The most common way is through a “microtransaction.” These small purchases users make—often for just a dollar or two—enhance their gaming experience in one way or another. Microtransactions may unlock a new game feature, lower the difficulty of the game, or make a cosmetic change to fit the player’s aesthetic preferences. For example, if a player fails to complete a puzzle in the game, they may be able to skip it and move to the next one for 99 cents.

Most free-to-play games also include in-game advertisements, which are frequently personalized for the user. The game developers may place banner ads alongside the game itself, include video advertisements in between levels, or sell personalized player data.<sup>21</sup> While in-game advertising is near ubiquitous in free-to-play games, they have varied success in bringing in actual revenue. For example, King, the developer of Candy Crush, removed in-game advertisements a decade ago, presumably due to the profitability of its microtransactions.<sup>22</sup> Since players spend so little money at a time within these games, less successful free-to-play apps depend on in-game advertising for a sizable portion of their revenue. One study found that the median free-to-play game makes 21-40% of its revenue on in-game advertising.<sup>23</sup>

Since most users stop playing within a few games and spend little money at all, free-to-play game revenue is highly dependent on the composition of its player base and the proportion that are loyal. According to industry reports, only 2% of players ever spend money after starting a game, a figure which

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content/uploads/2021/01/SuperData2020YearinReview.pdf.

19. While there are prominent free-to-play games available on video game consoles and PCs, they usually have similar business models as their mobile counterparts. Premium games, which I will cover soon, also frequently feature microtransactions.

20. Mihovil Grguric, *Mobile Game Session Length: How to Track & Increase It*, UDONIS (Jan. 3, 2022), <https://www.blog.udonis.co/mobile-marketing/mobile-games/session-length>.

21. Andrea Knezovic, *Mobile Game Ad Formats for Increasing In-App Ad Revenue*, UDONIS (Mar. 13, 2023), <https://www.blog.udonis.co/mobile-marketing/mobile-games/mobile-game-ad-formats>.

22. King is Activision’s only prominent game studio. Kim-Mai Cutler, *King Quits Advertising Since It Earns So Much On Candy Crush Purchases*, TECHCRUNCH (June 12, 2013), <https://techcrunch.com/2013/06/12/king-quits-advertising-since-it-earns-so-much-on-candy-crush-purchases>.

23. *An In-Depth Study of Free-to-Play (F2P) In-Game Advertising in Mobile Games* 12, DELTADNA (Oct. 2015), <https://deltadna.com/wp-content/uploads/2015/11/Adsurvey-report.pdf>.

interestingly reflects an upwards trend.<sup>24</sup> Meanwhile, the median retention rate for free-to-play mobile games is low. Just 20% of users play a game a day after they try it out, and only 5% continue to play after a week.<sup>25</sup>

If only 2% of players ever spend money on a free-to-play game, how are the games so profitable? The reality is that the revenue comes from individuals whom the game industry has come to know as “whales.” A whale is a rare user who spends a large sum of money on a free-to-play game, making up a starkly disproportionate share of revenue. In one documented case, a whale spent \$220,000 within a free-to-play game.<sup>26</sup> Tactics to ensnare “whales”, like gambling, are generally seen as unethical, as they often prey on and perpetuate addictive tendencies.<sup>27</sup> There is limited timely data on “whale spending,” presumably because companies are ashamed to release it. One study showed that just 0.15% (one in every 667) of mobile gamers accounted for *half* of all in-game revenue.<sup>28</sup> In the month examined, less than 1% of users made up roughly 90% of the spending.<sup>29</sup> As a result, the free-to-play business model hinges on a very small number of users spending a lot of money, with almost everyone else paying nothing at all.

The average free-to-play gamer fits a much different demographic profile than does the premium gamer. While the exact figures vary by study, women constitute a disproportionate share of mobile gamers.<sup>30</sup> Data also shows that

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24. Jeremy Levy, *Product Analytics Drives Freemium Conversions — in Mobile Gaming and Beyond*, LINKEDIN (June 10, 2021), <https://www.linkedin.com/pulse/product-analytics-drives-freemium-conversions-mobile-gaming-levy/>

25. Andrea Knezovic, *Why You Need to Track User Retention in Mobile Apps and Games*, UDONIS (Jan. 11, 2022), <https://www.blog.udonis.co/mobile-marketing/why-you-need-to-track-user-retention-in-mobile-apps-and-games>

26. Plus, critics say the game wasn't even particularly good. Alex Walker, *Someone Spent Over \$220,000 in Microtransactions on a Transformers Game*, KOTAKU (Oct. 11, 2019), <https://www.kotaku.com.au/2019/10/someone-spent-over-220000-in-microtransactions-on-a-transformers-game>; Alex Walker, *Someone Spent Over \$150,000 In Microtransactions On a Transformers Game*, KOTAKU (Oct. 14, 2019), <https://kotaku.com/someone-spent-over-150-000-in-microtransactions-on-a-t-1839040151>.

27. Mike Rose, *Chasing the Whale: Examining the Ethics of Free-to-Play Games*, GAME DEVELOPER (July 9, 2013), <https://www.gamedeveloper.com/business/chasing-the-whale-examining-the-ethics-of-free-to-play-games>.

28. *Swrve Finds 0.15% of Mobile Gamers Contribute 50% of All In-Game Revenue*, SWRVE (Feb. 25, 2014), [https://www.swrve.com/images/uploads/whitepapers/swrve-monetization-report-2016.pdf?utm\\_source=blog&utm\\_medium=organic](https://www.swrve.com/images/uploads/whitepapers/swrve-monetization-report-2016.pdf?utm_source=blog&utm_medium=organic).

29. *Id.*

30. Kevin Anderton, *Hypercasual Female Gamers Are Taking Over The Industry*, FORBES (Sep. 29, 2020), <https://www.forbes.com/sites/kevinanderton/2020/09/29/hypercasual-female-gamers-are-taking-over-the-industry-infographic/?sh=5c6176a07c13>; Sandhya Devanathan, *Connecting the Dots: The Data Behind Women in Gaming*, FACEBOOK GAMING (Feb. 22, 2022), <https://www.facebook.com/fbgaminghome/blog/marketers/connecting-the-dots-the-data-behind-women-in-gaming>; Sara Lebow, *A Demographic Breakdown of US Mobile Gamers*, INSIDER INTELLIGENCE (May 18, 2021), <https://www.emarketer.com/content/demographic-breakdown-of-us-mobile-gamers>.

women outspend men on mobile platforms, but not on other types of games.<sup>31</sup> Mobile gamers tend to be older: 54% are at least thirty-five years old.<sup>32</sup> Thus, the data suggests that the median free-to-play gamer is a middle-aged woman. However, only 25% of women who play more than a half-hour weekly identify as a “gamer,” compared to 55% of men.<sup>33</sup> Because they play only for short periods of time, rarely spend money, and typically do not identify as gamers, free-to-play users are frequently called “casual gamers”.

To summarize, free-to-play games are those that cost nothing to download and usually appear on everyday devices, like smartphones and tablets. Many free-to-play gamers are middle-aged, women, and often don’t consider themselves “gamers.”<sup>34</sup> The average free-to-play game session lasts just a few minutes, and a great majority of players spend no money on the games at all. Most transactions within these games are known as “microtransactions”: quick and small payments of just a few dollars. Since only a small proportion of players will continue playing the game, and even fewer will ever spend money, these game developers rely in large part on “whales.” These whales spend a comparatively massive sum of money, making up a majority of free-to-play game revenue.

## 2. *Premium Games*

By contrast, premium games are those that are purchased for a set price and are almost always released on an expensive dedicated gaming device: either a video game console or a personal computer (“PC”). Premium games can vary significantly in price, but Triple-A games – the video game equivalent of movie “blockbusters” – sell for \$60-70. Games with smaller budgets, called “indie games,” usually sell for less (the most popular ones sell for around \$20). Premium games generally, though not always, cost more to develop than free-to-play alternatives.

Here lies the greatest difference between the premium and free-to-play game market: the cost of entry. By its very nature, 100% of those who play a premium game pay for the product (unless they borrow or rent it). These game developers create products which generate revenue on each sale. By contrast,

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31. Mary Brune, *Zooming in on Female Gamers with Consumer Insights Data*, NEWZOO (Mar. 8, 2022), <https://newzoo.com/insights/articles/zooming-in-on-female-gamers-with-consumer-insights-data>.

32. Sara Lebow, *A Demographic Breakdown of US Mobile Gamers*, INSIDER INTELLIGENCE (May 18, 2021), <https://www.emarketer.com/content/demographic-breakdown-of-us-mobile-gamers>.

33. Brendan Sinclair, *Study Highlights Gender Gaps in Gaming Preferences*, GAMESINDUSTRY (June 3, 2020), <https://www.gamesindustry.biz/articles/2020-06-03-study-highlights-gender-gaps-in-gaming-preferences>.

34. See, e.g., Kayleigh Partleton, *“There Are More Middle-Aged Female Gamers Than Teenage Male Gamers”*, POCKET GAMER (Aug. 23, 2021), <https://www.pocketgamer.biz/news/76388/pgc-digital-mission-control-gg-natalie-bell>.



developers of free-to-play games attempt to convert a small number of their users into high-spending customers.

As a result, the attrition rate of premium games is far lower, likely because gamers want to get the most playtime for their money. For example, over 50% of players that bought the \$60 game “God of War”—which takes 20 hours to complete—finished it.<sup>35</sup> Less than 10% of users put the game down within an hour of playtime, a phenomenon contrary to what one would expect of free-to-play gamers.<sup>36</sup> Understandably, premium games have longer play sessions, too. The average gaming session on a game console is 110 minutes, compared to just five minutes on mobile.<sup>37</sup> For these reasons, the term “hardcore gamer” is used to describe those who play premium games because they invest a significant amount of time and money to indulge their gaming habits.

The demographic profile of a “hardcore gamer” is almost the opposite of that of a free-to-play user. On platforms where premium games are dominant, men constitute roughly 55-60% of console gamers and a majority of PC gamers.<sup>38</sup> Premium gamers also skew younger than free-to-play gamers. On the Nintendo Switch console, for example, 37% of players are over 35 years old; for mobile games, that number is 54%.<sup>39</sup> On PC, 79% of gamers are under the age of 38.<sup>40</sup>

There is another significant barrier to access for premium games. In order to play most premium games, a player must first purchase either a video game console or a high-quality gaming PC. This is because premium games are usually more sophisticated and require stronger hardware to run efficiently. Smartphones and tablets simply do not have the capacity to run most premium games. The

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35. Matt Morgans, *More Than 50% of People Who Own God of War Have Completed the Game's Story*, VGR (June 23, 2018), <https://www.vgr.com/people-god-war-completed-story>.

36. See *God of War Trophy Guide*, PSNPROFILES, <https://psnprofiles.com/trophies/7523-god-of-war> (showing that nearly 95% of people completed the game's first mission, roughly an hour into the game)

37. Nina Aghadjanian, *Game Consoles Are Occupying More Time In Consumers' Lives*, A.LIST (Oct. 27, 2021), <https://www.alistdaily.com/entertainment/game-consoles-spend-usage-and-ownership-increase/>

38. Alexander Kunst, *Console Video Game Players in the United States in 2020, by Gender*, STATISTA (Feb. 23, 2022), <https://www.statista.com/forecasts/1221444/us-console-gamers-by-gender>; Sammy Barker, *Almost Half of PlayStation Gamers Are Women*, PUSH SQUARE (May 28, 2021),

[https://www.pushsquare.com/news/2021/05/almost\\_half\\_of\\_playstation\\_gamers\\_are\\_women](https://www.pushsquare.com/news/2021/05/almost_half_of_playstation_gamers_are_women); Mary Brune, *Zooming in on Female Gamers with Consumer Insights Data*, NEWZOO (Mar. 8, 2022), <https://newzoo.com/insights/articles/zooming-in-on-female-gamers-with-consumer-insights-data>.

39. Rebekah Valentine, *EEDAR: Nintendo Switch Attracting More Women, Wider Age Ranges Over Time*, GAMESINDUSTRY (Feb. 11, 2019), <https://www.gamesindustry.biz/articles/2019-02-11-eeedar-nintendo-switch-attracting-more-women-wider-age-ranges-over-time>; Sara Lebow, *A Demographic Breakdown of US Mobile Gamers*, INSIDER INTELLIGENCE (May 18, 2021), <https://www.insiderintelligence.com/content/demographic-breakdown-of-us-mobile-gamers>.

40. Michael Cupello, *Millennials Top Gen Z for PC/Console Gaming in 2020*, ESPORTS OBSERVER (Aug. 27, 2020), <https://archive.esportsobserver.com/millennials-genz-gaming-newzoo>.

Nintendo Switch, currently the cheapest video game console, costs \$300. The PlayStation 5 and Xbox Series X each cost \$500 at retail, and the parts to create a gaming PC can cost well over \$1,000.<sup>41</sup> “Hardcore gamers” will also frequently purchase accessories— headphones, a nice mousepad, or controllers, for example—which can add hundreds of dollars to a gaming budget. By contrast, virtually everybody in the US has a smartphone and can immediately access millions of free-to-play games. The high barrier of access to premium games creates a significant divergence in the overall video game industry between casual and “hardcore” gamers.

Finally, premium games cost more to develop than free-to-play ones do, although there are a few notable exceptions. A console game that sells for \$70 regularly costs \$100-200 million to develop, exceeding the budget of most big-budget movie productions.<sup>42</sup> Premium independent (“indie”) games can cost less, but even the cheapest indie games will regularly cost a few million dollars to develop.<sup>43</sup> Even if a small studio with ten developers creates a game over the course of a year, the labor costs alone would eclipse a million dollars.<sup>44</sup> Of course, if a game is developed by a team of passionate individuals in their spare time, a game budget can be lower because there are substantial savings on labor.<sup>45</sup> However, in most cases, premium game developers must recoup their significant budget with a set price, rather than relying on a few players to engage in microtransactions. By contrast, even the most expensive mobile and free-to-play games usually cost less than \$1 million to produce.<sup>46</sup> Lower-quality mobile games regularly cost well under \$50,000 to develop. Since their development budgets are a fraction of those for premium games, most mobile games can be successful if only a small proportion of users spend money.

To summarize, premium games are sold for a standard price at entry,

41. Most computer gamers will build their own PC by purchasing individual parts. Robert Brandon, *How Much Does it Cost to Build a PC Right Now?*, TECHGUIDED (Apr. 22, 2022), <https://techguided.com/how-much-does-it-cost-to-build-a-gaming-pc>.

42. Wesley Yin-Poole, *Ex-PlayStation Boss Predicts Sony’s PS5 Games Will Cost \$200m to Make*, EUROGAMER (Sep. 5, 2021), <https://www.eurogamer.net/ex-playstation-boss-predicts-ps5-games-will-cost-usd200m-to-make>.

43. Steven Wright, *‘Tunic’ Publisher Says Indie Game Production is ‘Absurdly Expensive’*, INPUT (Dec. 23, 2021), <https://www.inputmag.com/gaming/tunic-publisher-says-indie-game-production-is-absurdly-expensive>; James Brightman, *Rising game dev costs put squeeze on mid-tier studios*, GAMESINDUSTRY.BIZ (Oct. 11, 2017), <https://www.gamesindustry.biz/articles/2017-10-10-rising-game-dev-costs-put-squeeze-on-mid-tier-studios>.

44. See *Game Developer Salary*, ZipRecruiter, <https://www.ziprecruiter.com/Salaries/GAME-Developer-Salary> (accessed Apr. 16, 2023).

45. Developer Thomas Happ, for example, famously spent five years developing the successful game “Axiom Verge” in his free time. “Axiom Verge” released to widespread success, but this development cycle is the anomaly and far from the norm. Thomas Happ, *The Development of Axiom Verge: A 5-year Retrospective*, PLAYSTATION BLOG (Mar. 31, 2015), <https://blog.playstation.com/2015/03/31/the-development-of-axiom-verge-a-5-year-retrospective>.

46. *Calculate the Cost of Mobile Game Development – Step by Step Guide 2022*, CAPERMINT, <https://www.capermint.com/blog/how-to-calculate-cost-of-mobile-game-development> (last visited Apr 24, 2023, 4:51PM).

usually on video game consoles or PC. Hardcore gamers (which make up the typical market for premium games) are more likely to be young and a majority of them are men. The budgets for these games are also significantly higher than for free-to-play games, and as a result can cost as much as \$70 to purchase. Additionally, to access premium games a player must spend hundreds of dollars (*i.e.*, to purchase a video game console) which constitutes a relatively high barrier to entry.

### B. The PC and Game Console Markets

To play the most premium games, you need to own either a specialized gaming device (called a video game “console”) or a sophisticated gaming PC.

#### 1. The Three Console Manufacturers

The current line of modern consoles includes three major players: Microsoft’s Xbox Series X, Sony’s PlayStation 5, and Nintendo’s Switch.<sup>47</sup>

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47. The FTC argues in its complaint that only Microsoft and Sony compete in the modern console market—and that Nintendo has its own separate market with the Switch. Compl. 1, 6, 11–13, *In re Microsoft Corp. and Activision Blizzard, Inc.*, No. 9412 (FTC, Dec. 8, 2022). The FTC carves out a “high performance video game console” market, which purportedly only includes platforms that can play games requiring “more advanced graphic processing.” *Id.* Of course, this argument is a strategic but misleading attempt to eject the Nintendo Switch, the highest-selling game console on the market today and the third-highest-selling game platform of all time, from the relevant market. Oli Welsh, *Nintendo Switch is Officially the Third-Best-Selling Console of All Time*, POLYGON (Feb. 7, 2023, 8:16 AM), <https://www.polygon.com/23589062/nintendo-switch-third-best-selling-game-console>. The argument seems unnecessary, too—a market with three competitors isn’t a lot better than one with only two.

There are a few reasons why Nintendo’s exclusion is incorrect. First off, this market definition does not acknowledge that a company can release several different-powered consoles simultaneously that compete. For example, Xbox releases two versions of its most modern console, one of which costs double the price—it includes extra memory, 4k-quality gameplay, and other technical improvements. Adam Vjestica, *Xbox Series X vs Xbox Series S: Which Xbox is Right for You?*, TECHRADAR (Feb. 7, 2023), <https://www.techradar.com/news/xbox-series-x-vs-xbox-series-s-which-xbox-will-be-right-for-you>. Similarly, Sony still releases many of the *exact same* games on its PlayStation 4 and PlayStation 5 consoles, despite the fact that the older console is almost a decade old. *See, e.g.*, Dalton Cooper, *God of War Ragnarok Release Date Delayed, Confirmed for Both PS4 and PS5*, GAMERANT (June 2, 2021), <https://gamerant.com/god-of-war-ragnarok-release-date-delay-2022-ps4-ps5-cross-gen>. The PlayStation 5 was released more than two years ago, yet the two consoles still have many of the same games and certainly compete for a place in the market. To treat these markets differently is analogous to treating a 55-inch television as a separate market from a 75-inch television because it costs more and has new features.

While the FTC does have an argument that Xbox and PlayStation owners are more likely to buy a Switch than the other console, cross-pollination is common in the game industry. *See, e.g.*, Sam Desatoff, *Report: Nintendo Switch console cross-ownership is at 71%*, GAMEDAILY (Feb. 28, 2020), <https://www.gamedaily.biz/report-nintendo-switch-console-cross-ownership-is-at-71-npd/> (finding that 71% of Switch owners also own a PlayStation or Xbox). For example, for every two PlayStation 4 consoles in 2020, there was an Xbox console; for every four Xbox consoles, there were three PlayStation consoles. Bryant Francis, *Data Suggests Almost Half of Xbox One Users Also Own a PlayStation 4*, GAME DEVELOPER (June 12, 2020), <https://www.gamedeveloper.com/business/data-suggests-almost-half-of-xbox-one-users-also-own-a-playstation-4>. At the time, these cross-ownership rates were comparable to that of Switch owners.

Together, they make up nearly 100% of the market.<sup>48</sup> In 2021, Sony—with its PlayStation line of products—held an estimated 43% market share in the console market.<sup>49</sup> Nintendo, the only company of the three that focuses solely on gaming, held 37% of the market.<sup>50</sup> Finally, Microsoft—with its Xbox line of products—held 20% of the console market.<sup>51</sup> Although Sega, a fourth company, released video game consoles until 2001, the “big three” have dominated the console video game market for the last 20 years.<sup>52</sup> No other console developer has been able to penetrate the market, though many have tried.<sup>53</sup>

Frequently, console manufacturers take a *loss* when they sell a video game console, especially when the technology is new. When Sony released the PS3, for example, the company lost \$240 on each console it sold—even at a \$600 retail price.<sup>54</sup> The PlayStation 5 sold at a loss for roughly nine months before it began to make money.<sup>55</sup> Even Nintendo, which typically attempts to sell every device at a profit, likely lost money on each Nintendo Switch it sold when it launched at \$300.<sup>56</sup> As technology ages, the consoles gradually become cheaper to

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Liam Doolan, *More Than 40% Of Switch Owners In The US Have Another Video Game System*, NINTENDOLIFE (Jan. 3, 2020), [https://www.nintendolife.com/news/2020/01/more\\_than\\_40\\_percent\\_of\\_switch\\_owners\\_in\\_the\\_us\\_have\\_another\\_video\\_game\\_system](https://www.nintendolife.com/news/2020/01/more_than_40_percent_of_switch_owners_in_the_us_have_another_video_game_system).

There has long been a culture of gamers purchasing more than one console, and the consoles—even the outdated Nintendo Switch—have many of the same third-party games. *See, e.g. Buy EA Sports Fifa 23*, EA Sports, <https://www.ea.com/games/fifa/fifa-23/buy> (showing that the latest FIFA game was released on Nintendo’s Switch console and Microsoft’s Xbox simultaneously). The game console market should include Nintendo; but Microsoft’s acquisition is problematic regardless of how you define the console market.

48. Alessio Palumbo, *Xbox Expected to Gain Console Software Market Share over PlayStation & Nintendo By 2026*, WCCF TECH (Mar. 25, 2022, 4:08 PM), <https://wccfttech.com/xbox-expected-to-gain-console-software-market-share-over-playstation-nintendo-by-2026>.

49. *Id.*

50. Interestingly, Nintendo has sold more video game consoles than Sony recently, but brought in less revenue because Nintendo’s premier console (the Nintendo Switch) sells for \$300, while Sony’s flagship PlayStation 5 sells for \$500. *Id.*

51. *Id.*

52. Alex Pham, *Sega to Quit Production of Dreamcast Console, Develop Games for Rivals*, L.A. TIMES (Jan. 31, 2001), <https://www.latimes.com/archives/la-xpm-2001-jan-31-fi-19213-story.html>.

53. A few examples will be discussed in a later section. *See, e.g.*, AJ Dellinger, *Crowdfunded Gaming Console Ouya Will Shut Down for Good on June 25th*, ENGADGET (May 22, 2019), <https://www.engadget.com/2019-05-22-ouya-kickstarter-console-shut-down-june-25-razer.html> (detailing the failure of Ouya, a promising market entrant).

54. Jon Fortt, *Sony’s Loss is at Least \$240 On Every PS3*, FORTUNE (Nov. 16, 2006), <https://fortune.com/2006/11/16/sonys-loss-is-at-least-240-on-every-ps3>.

55. Tom Warren, *Sony’s \$499 PS5 is no longer selling at a loss*, VERGE (Aug. 4, 2021), <https://www.theverge.com/2021/8/4/22609150/sony-playstation-5-ps5-loss-profit>.

56. *See, e.g.*, Samit Sarkar, *Nintendo won’t sell NX at a loss, president says*, POLYGON (May 2, 2016) (revealing that when the Nintendo Switch was in development, Nintendo intended to sell it at a profit immediately). While the parts alone cost \$260 for Nintendo to produce – a \$40 margin – the console likely lost money at launch when shipping, distribution, and retail costs are factored in. Charlie Hall, *Japanese site estimates Nintendo spends \$257 to make one Switch*, POLYGON (Apr.

manufacture and begin to turn a profit.

## 2. *Software Sales*

A console manufacturer makes most of its profit on software that sells on its platform. Sony, for example, made less than 30% of its total game revenue selling hardware in the year it released a bestselling console; it made much more money on its other platform-related revenue streams.<sup>57</sup> There are two primary types of software: first-party software and third-party software.

First-party software is developed by the console manufacturer itself. For example, Nintendo launches approximately a dozen games each year that can only be played on the Nintendo Switch console. Nintendo develops these games at studios it owns or contracts with. Sony does the same thing for PlayStation: it launches several games annually which are exclusive to its PlayStation platform. This model is different from a platform like Netflix, as most of Netflix's production is not done in-house.<sup>58</sup> The majority of Netflix's shows are instead licensed as exclusives for its platform, despite often being tagged as "Netflix Originals". By contrast, first-party games are actually developed within the facilities directly owned by Nintendo, Sony, or Microsoft.

First-party software is important for two reasons. First, it helps sell the underlying game console. If Nintendo releases excellent games each year, and the only way to play them is by buying a Nintendo game console, then people will go out of their way to buy the expensive game console to access the underlying games. Second, Nintendo gets to keep the lion's share of the revenue when it sells in-house games on its own platform. Generally, Nintendo charges \$60 for each game, so if a customer downloads the digital version of the game, Nintendo gets to keep 100% of that revenue. When Nintendo sells a physical game, it must manufacture the physical product and give a commission to the retailer.<sup>59</sup> Still, Nintendo receives roughly 65% of the box price in full.<sup>60</sup> Take, for example, a game like "Mario Kart 8", which sold 60 million units.<sup>61</sup>

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5. 2017), <https://www.polygon.com/2017/4/5/15195638/nintendo-switch-component-cost-estimate>.

57. *Strong Revenue Numbers for Sony and Microsoft Gaming Divisions*, G&M NEWS (Apr. 29, 2021), <https://g-mnews.com/en/strong-revenue-numbers-for-sony-and-microsoft-gaming-divisions>.

58. Ashley Rodriguez, *Netflix Didn't Make Many of the "Originals" That Made it Famous. That's Changing.*, QUARTZ (Feb. 26, 2019), <https://qz.com/1545594/netflix-doesnt-make-most-of-its-originals-now-thats-changing>.

59. *Video Game Prices: Why Games Are \$60, Where Your Money Goes, & Who Benefits Most*, GAMERANT (July 20, 2015), <https://gamerant.com/video-game-prices-breakdown-514>.

60. Serkan Toto, *Price Breakdown of a \$70 Video Game: Digital vs. Physical*, KANTAN GAMES (Dec. 30, 2020), <https://www.serkantoto.com/2020/12/30/price-video-console-game-digital-physical>.

61. Mario Kart 8 has sold over 60 million copies between Switch and Wii U. *See Top Selling Unit Sales: Wii U*, NINTENDO (accessed Apr. 16, 2023), <https://www.nintendo.co.jp/ir/en/finance/software/wiiu.html>; *Top Selling Unit Sales: Nintendo Switch*, NINTENDO (accessed Apr. 16, 2023),

Assuming the game brought Nintendo an average of \$50 in revenue for each game sold, the software made Nintendo hundreds of millions of dollars.

By contrast, third-party games are developed by companies and released on other platforms. Activision, for example, is a third-party developer because it does not have a console of its own; it releases games on other platforms like Microsoft, Sony, and Nintendo. Outside of those “big three,” almost every premium game publisher is considered a third-party company. As a result, these companies must release their software on the PlayStation, Xbox, or Nintendo console to reach console-based gamers; there is no other way to access the market.<sup>62</sup> Usually, a third-party releases its games on several consoles simultaneously to reach the broadest potential market. Rather than launching a game exclusively on PlayStation, for example, third-party publishers may launch their games on PC and Xbox to reach those console owners, too. Activision—at issue in this Paper—is the *largest* third-party game company. Historically, it has launched all its biggest games—including the blockbuster Call of Duty franchise—on at least three platforms.<sup>63</sup>

To release a game on a console, third-party publishers pay a licensing fee to the console manufacturer. Activision, for example, pays the corresponding console manufacturer a seven dollar royalty for each game sold at retail and a 30% royalty for each game sold digitally.<sup>64</sup> So, when Call of Duty sells digitally on the Xbox digital store for \$70, Microsoft gets \$21—even though it does not actually spend any resources to create the game. The licensing fee is earned simply by creating a platform, regulating it, and giving a large audience access to the game. All three companies—Nintendo, Sony, and Microsoft—have nearly identical royalty rates.<sup>65</sup> Digital marketplaces on PC also charge a royalty, although some are starting to lower their fees due to increased competition between different marketplaces.<sup>66</sup>

### 3. *Competition Between Microsoft, Nintendo, and Sony*

The average consumer buys around 12 games over the life of their game console.<sup>67</sup> Console manufacturers have a significant incentive to get people to

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<https://www.nintendo.co.jp/ir/en/finance/software/index.html>.

62. Third-party publishers also release games on PC. We will get to this market a bit later.

63. Jared Ramsey, *Call of Duty List of Games: History of COD Releases*, LINEUPS (June 12, 2020), <https://www.lineups.com/esports/call-of-duty-list-of-games>.

64. Ian Carlos Campbell and Julia Alexander, *A Guide to Platform Fees*, VERGE (Aug. 24, 2021), <https://www.theverge.com/21445923/platform-fees-apps-games-business-marketplace-apple-google>; Alex Pham, Anatomy of a \$60 video game, L.A. Times (Feb. 19, 2010) <https://www.latimes.com/archives/blogs/company-town-blog/story/2010-02-19/anatomy-of-a-60-video-game>.

65. *Id.*

66. *Id.*; Kyle Orland, *Microsoft Follows Epic’s Lead, Lowers its Cut of PC Game Sales to 12%*, ARSTECHNICA (Apr. 29, 2021), <https://arstechnica.com/gaming/2021/04/microsoft-follows-epics-lead-lowers-its-cut-of-pc-game-sales-to-12>.

67. Dr. Serkan Toto, *Attach Rates vs. Tie Ratios (And Why You Should Forget Tie Ratios*

buy their platforms—even selling at a loss—because they want consumers to buy all their games on the same platform. When a third-party game is available on multiple platforms, Sony still wants a customer to buy the game on PlayStation so that it gets the corresponding licensing fee. Using a variety of methods, the console manufacturers compete heavily to win over these consumers. The gaming community has termed this competition the “Console Wars”.

The most straightforward way the console manufacturers compete is by releasing first-party games. Nintendo develops strong games so that consumers purchase its console to access them. If a consumer buys a Nintendo Switch solely to play the newest Pokémon game, they are likely to purchase other games for the console as well. To convince gamers that they cannot go without purchasing their game console, Microsoft, Sony, and Nintendo each announce around a dozen exclusive games every year.<sup>68</sup> By developing high-quality exclusive games, the companies build platforms that gamers want to buy.

Second, console manufacturers compete by paying third-party developers for various perks. Sometimes, a console manufacturer pays a third-party developer to develop a game exclusively for its platform instead of doing it in-house. This outsourced software is called a “second-party game.” For instance, Platinum Games launched its original “Bayonetta” game on the Xbox and PlayStation. However, Nintendo contracted with Platinum to develop the second and third games exclusively on Nintendo consoles.<sup>69</sup> Strategically, this was a great move because fans that played the original game on another platform could only play the sequel by purchasing Nintendo’s device.

There are more nuanced ways these companies compete, too. A console manufacturer might pay a lump sum to release a game on its console a few months earlier than its competitors.<sup>70</sup> Usually, the marketing in such cases indicates that the game will launch “exclusively” on a single console, even though the game will quietly make its way to competing consoles just a few months later.<sup>71</sup> This is a somewhat-deceptive marketing tactic, albeit a prevalent

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Today), KANTAN GAMES (Aug. 21, 2020), <https://www.serkantoto.com/2020/08/21/attach-rates-vs-tie-ratios-and-why-you-should-forget-tie-ratios-today/>

68. Jason Ganos, *Guide: All the First Party Games Coming to Nintendo Switch in 2022*, NINTENDO WIRE (Dec. 28, 2021), <https://nintendowire.com/guides/switch/2022-first-party-games/>; Mack Ashworth, *PS Exclusives in 2022: The Biggest PlayStation-Only Launches*, PLAYSTATION LIFESTYLE (Jan. 7, 2022), <https://www.playstationlifestyle.net/2022/01/07/all-ps5-exclusives-2022-list-only-on-playstation/>; Mehrdad Khayyat, *All Xbox Exclusive Games Coming Out in 2022*, DUALSHOCKERS (Jan. 3, 2022), <https://www.dualshockers.com/all-xbox-exclusive-games-coming-out-in-2022/>.

69. Michael McWhertor, *‘Bayonetta 2’ Would Not Exist Without Nintendo, Says Platinum Games*, POLYGON (Sept. 22, 2012, 12:00 AM EDT), <https://www.polygon.com/gaming/2012/9/22/3371474/bayonetta-2-would-not-exist-without-nintendo-platinum-games-wii-u>.

70. Dalton Cooper, *Xbox Console Exclusive Could Be Jumping Ship to PlayStation*, GAMERANT (Mar. 29, 2022, 08:09 AM EDT), <https://gamerant.com/nobody-saves-the-world-ps4-ps5>.

71. *Id.*

one.<sup>72</sup> Another common strategy is marketing a third-party game and a console together. This year, Sony paid Warner Brothers for a marketing deal wherein promotional material for its new Harry Potter game would only show the game being played on PlayStation.<sup>73</sup> Although the game will also be released on Xbox, the commercials and marketing for that game might suggest otherwise.<sup>74</sup> Up until now, Activision was a third-party company active in this competitive strategy. For years, Sony paid Activision to put additional exclusive gameplay content for “Call of Duty” exclusively on the PlayStation console. Whereas Microsoft historically needed to bid against the other console manufacturers for Activision’s content, by purchasing the company outright, it no longer needs to do so.

#### 4. *PC Games*

Millions of gamers also play premium games on a PC, but many premium games only run on pricy higher-end PCs. An average gaming PC costs \$800 to \$1,200 to build, and gamers that want higher-end performance often spend upwards of \$2,000 on the parts to construct a PC.<sup>75</sup> By contrast, the PlayStation 5—the most expensive console on the market today— sells for only \$500. While the game quality on a PC may be higher, buying a video game console is generally a more affordable option for premium gamers, at least at first. However, the PC has several competing marketplaces that sell games—whereas each console is its own closed ecosystem. On the PlayStation, the only way to purchase a game digitally is through the PlayStation Store, whereas on PC there are several different marketplaces to purchase games. The variety of options stimulates price competition because a better deal might be just a mouse click away. Moreover, anyone can distribute a game on a PC by uploading it to the internet—while on console you must first be approved by the platform manufacturer. As a result, some argue that over the long-term, hardcore gamers end up spending less on a gaming PC because of the platform’s open nature.<sup>76</sup>

For a long time, console manufacturers did not release their first-party games on PC. If you wanted to play a Nintendo game, you had to buy its console. This phenomenon changed recently. Today, Microsoft releases all its Xbox

72. See Alex Newhouse, *E3 2017: Xbox Boss Clarifies What “Console Launch Exclusive” Means*, GAMESPOT (June 13, 2017), <https://www.gamespot.com/articles/e3-2017-xbox-boss-clarifies-what-console-launch-ex/1100-6450919> (admitting that Microsoft’s use of the term “console launch exclusive” means the game will still come to other platforms at a later date).

73. Paul Tassi, *Why Is Sony Doing A ‘Hogwarts Legacy’ State Of Play?*, FORBES (Mar. 15, 2022), <https://www.forbes.com/sites/paultassi/2022/03/15/why-is-sony-doing-a-hogwarts-legacy-state-of-play/?sh=34c876bf6089>.

74. *Id.*

75. Francis Locknear, *Average Cost of a Gaming PC*, THE COST GUYS (Jan. 2022), <https://thecostguys.com/gaming/average-cost-of-a-gaming-pc>.

76. Giuseppe Nelva, *PC Gaming Can be Cheaper than PS4 or Xbox One in the Long Run*, DUALSHOCKERS (Nov. 3, 2013), <https://www.dualshockers.com/pc-gaming-can-be-cheaper-than-ps4-or-xbox-one-in-the-long-run>.



games on PC alongside the game console version. However, these games are technically first-party game releases because Windows, the underlying operating system, is developed by Microsoft. Whether it sells its game on an Xbox or the PC Windows store, financially it mostly operates the same for Microsoft. Sony has released a few of its first-party games on PC recently too, although they arrived several years later than their original PlayStation releases.<sup>77</sup> Still, these games are in the minority, with most first-party games still releasing on the developer's corresponding platform.

PC gaming has a few unique characteristics. Because there is price competition between several popular digital marketplaces on PC, they generally have lower licensing fees than the game consoles.<sup>78</sup> PC games also allow players to modify games themselves.<sup>79</sup> By contrast, on game consoles, the game is standardized and created entirely by its original developers. On PC, players can fundamentally change the code of a game to add certain features, which they can then share with the broader community.

The PC also has certain exclusive games of its own. Since the PC is an open platform, launching a game on it has fewer barriers than does launching one on a game console. As a result, many PC exclusives are released by game developers with limited connections or means. Other developers may choose to release a game exclusively on PC because it is better suited for a mouse and keyboard than for a game controller.

### C. Game Subscription Services

Game subscription services are a brand new market. Rather than paying *a la carte* for each premium game, these services give users access to a catalog of games in exchange for a monthly subscription fee. The market is comparable to video streaming services like Netflix and Disney Plus.<sup>80</sup>

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77. Sammy Barker and Stephen Tailby, *All PlayStation Studios Games on PC*, PUSH SQUARE (Jan. 13, 2022).

78. Ryan Gilliam, *Microsoft Reducing its Cut of PC Sales to Match Epic Games Store*, POLYGON (Apr. 29, 2021), <https://www.polygon.com/22409511/microsoft-store-pc-revenue-share-steam-epic-games>.

79. Mehrdad Khayyat, *The Last Of Us: Part 1 Has A Stunning First-Person Mod In The Works*, DUALSHOCKERS (Apr. 14, 2023), <https://www.dualshockers.com/the-last-of-us-part-1-first-person-mod> (changing the gameplay from a third-person perspective to a first-person viewpoint).

80. In its complaint, the FTC split this market into two: (1) "Multi-Game Content Library Subscription Services," platforms that allow you to *download* a catalog of games and play them on your console and (2) "Cloud Gaming Subscription Services," systems that allow game streaming to a device. *See* Complaint 13–15, *In re Microsoft Corp. and Activision Blizzard, Inc.*, No. 9412 (FTC, Dec. 8, 2022). I believe these two types of offerings compose the same market, most significantly because they both use a subscription-based model and because the experience for the end-user is comparable regardless of which type of service they use. The starkest difference between these two types of subscription services is that cloud streaming services can cast games to devices that otherwise would not have the technical power to support them. For example, cloud services like XCloud can stream games to devices like a phone or a weak computer, devices that otherwise do not have the technological sophistication to play the games on their own. Jason Cohen, *Xbox Cloud*

The biggest video game subscription service is called “Xbox Game Pass” and is operated by Microsoft.<sup>81</sup> The streaming service costs \$10 per month (\$15 if you want it on PC and console) and holds 60% of the game subscription market, even *including* the cloud streaming segment in the market definition.<sup>82</sup> Currently, the game subscription market is still *relatively* small, but it is rapidly growing. In 2020, Xbox Game Pass had 10 million subscribers.<sup>83</sup> By 2021, that number was 18 million.<sup>84</sup> Less than a year later, Game Pass had 25 million subscribers.<sup>85</sup> The second-largest console competitor to Game Pass that year was PlayStation Now—Sony’s competing service—which had just 7% market share.<sup>86</sup> However, Sony retired PlayStation Now and launched a new subscription service last June, which it hopes will be a more successful competitor to Game Pass.<sup>87</sup> Sony has not released data on the number of subscribers to its competing service—called “PlayStation Plus Extra” and

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*Gaming: How to Play Xbox Games on Your Phone and PC*, PCMag (Mar. 15, 2022), <https://www.pcmag.com/how-to/how-to-play-xbox-games-on-your-phone-with-microsoft-xcloud>. By contrast, a non-cloud subscription service allows users to download games directly to a device that has the capability to run them; there is no requirement to maintain a consistent and high-speed connection to the internet as required with cloud streaming.

While the two services are technically distinct, they are frequently bundled together as a single service. Moreover, for the end user, the product is nearly the same. A person looking for a Netflix-style subscription service for video games can have their needs met with either a cloud service or a downloadable one. As long as a person has a consistent internet connection and a sufficiently powerful game console, the services are virtually the same in substance and interchangeable. For the end user, there is very little difference between playing a game off a hard drive or an internet stream.

As relevant here, both Microsoft’s and Sony’s subscription services *include* both cloud streaming and the regular game subscription library in a single service. *See Xbox Cloud Gaming Beta*, Xbox (accessed Feb. 12, 2023), <https://www.xbox.com/en-US/cloud-gaming>; Heather Wald, *What is Xbox Cloud Gaming? How it works and everything you need to know*, GamesRadar (Sep. 23, 2022), <https://www.gamesradar.com/xbox-cloud-gaming>; *Welcome to PlayStation Plus*, PLAYSTATION (accessed Feb. 12, 2023), <https://www.playstation.com/en-us/ps-plus>.

81. The 60% market share includes the cloud streaming segment in the market definition. *See Xbox Game Pass*, XBOX (last visited Apr. 24, 2023), <https://www.xbox.com/en-US/xbox-game-pass>.

82. Stephen Totilo, *Gaming’s Netflix or Spotify Moment Is Still a Long Way Off*, AXIOS (Mar. 28, 2022), <https://www.axios.com/video-game-subscriptions-xbox-game-pass-netflix-d9c70eb3-ae8e-4d07-93bc-15f3885f4eb4.html>.

83. Jacob Kastrenakes, *Xbox Game Pass Hits 10 Million Subscribers*, VERGE (Apr. 29, 2020, 3:15 PM), <https://www.theverge.com/2020/4/29/21242004/xbox-game-pass-10-million-subscribers-microsoft-q3-2020-earnings>.

84. Tom Warren, *Xbox Game Pass Subscribers Hit 18 Million*, VERGE (Jan. 26, 2021, 2:50 PM), <https://www.theverge.com/2021/1/26/22250795/xbox-game-pass-subscribers-growth-microsoft>.

85. Tom Warren, *Microsoft’s Xbox Game Pass Service Grows to 25 Million Subscribers*, VERGE (Jan. 18, 2022, 6:04 AM), <https://www.theverge.com/2022/1/18/22406059/xbox-game-pass-subscribers-25-million-microsoft-activision>.

86. Stephen Totilo, *Gaming’s Netflix or Spotify Moment Is Still a Long Way Off*, AXIOS (Mar. 28, 2022), <https://www.axios.com/video-game-subscriptions-xbox-game-pass-netflix-d9c70eb3-ae8e-4d07-93bc-15f3885f4eb4.html>.

87. Nick Statt, *Sony Is Building an Xbox Game Pass Competitor for PlayStation*, PROTOCOL (Dec. 3, 2021), <https://www.protocol.com/bulletins/ps5-xbox-game-pass-competitor>.

“PlayStation Plus Premium”—which may be helpful for the FTC in its investigation to understand whether it is a viable competitor before and after the proposed acquisition.<sup>88</sup>

Sure, Game Pass was early to the market, but the most important reason for Game Pass’s success is that it is a terrific bargain. Numerous commentators have called Game Pass the “best deal in gaming.”<sup>89</sup> Notably, Microsoft puts all its premium games – which usually sell for \$60-70 alone – on the service on release day at no additional cost. If someone is planning to purchase even two games per year at full price, Microsoft Game Pass pays for itself easily. Game Pass is currently available on both Xbox game consoles and on PC. In addition to offering its own first-party games on Game Pass, Microsoft licenses hundreds of games from third parties to add to the service. For example, Microsoft paid an estimated \$5-10 million to get a superhero videogame on the service about six months after it originally came out.<sup>90</sup>

Microsoft’s dominant and near-monopoly status in the streaming market raises the stakes for the Activision acquisition. Parts II and III will examine this market further.

## II. IDENTIFYING THE RELEVANT MARKET

In order to levy a successful antitrust lawsuit, the Supreme Court has adopted the view that a party must first demonstrate and define the relevant market.<sup>91</sup> A market definition is essential because it contextualizes whether a particular market action hurts competition.<sup>92</sup> While some Justices have argued there are circumstances where a market definition is unnecessary to win a case, the Court has held that, at least for now, a market definition is virtually always essential in an antitrust claim.<sup>93</sup>

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88. PlayStation offers three subscription tiers, but only the top two tiers—“Extra” and “Premium”—have a subscription game library. However, Sony only releases data on the number of subscribers combined, rather than for the tiers individually, and “PlayStation Plus Essential,” the bottom tier, does not offer an extensive game library. All three tiers currently have 45.4 million subscribers combined, and Sony has lost 1.9 million subscribers overall since launching its game subscription service. Oli Welsh, *PlayStation Plus Has Lost 1.9M Subscribers Since Relaunch*, POLYGON (Nov. 1, 2022, 06:53 AM), <https://www.polygon.com/23434321/playstation-plus-subscribers-down-2022-earnings>.

89. Marshall Honorof, *Forget Xbox Series X Restocks — Xbox Game Pass is the Best Deal in Gaming*, TOM’S GUIDE (Jan. 18, 2022), <https://www.tomsguide.com/opinion/xbox-game-pass-best-deal>.

90. Jordan Middler, *Microsoft ‘Paid \$5-10 Million’ to Get Guardians of the Galaxy on Game Pass, Analyst Claims*, VGC (Mar. 27, 2022, 03:08 PM), <https://www.videogameschronicle.com/news/microsoft-paid-5-10-million-to-get-guardians-of-the-galaxy-on-game-pass-analyst-claims>.

91. *Ohio v. Am. Express Co.*, 138 S. Ct. 2274, 2285 (2018).

92. “Without a definition of [the] market there is no way to measure ability to lessen or destroy competition.” *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 177 (1965).

93. “Since the purpose [in a Sherman Act § 1 case] of the inquiries into . . . market power is

Hypothetical litigants challenging the Activision acquisition will attempt to define the relevant market in varying ways. In this section, I will define and scrutinize four potential market definitions for the Activision acquisition: 1) the “metaverse,” 2) “gaming overall,” 3) “premium gaming,” and 4) “subscription gaming.” The first two market definitions are the weakest, in my view, but are likely to be advanced by proponents of the acquisition. The latter two definitions are more proper in my view and are likely to be advanced by potential litigants against the merger.

### A. Defining a Market

The primary way to define a market is to look at the “substitution” or “diversion” of a product. The Horizontal Merger Guidelines define substitution as “customers’ ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service.”<sup>94</sup> Various methods have been used to define the substitutivity/market of a product. However, it is not clear how the FTC plans to define a market when scrutinizing the Activision merger given its decision to withdraw the 2020 Vertical Merger Guidelines last year.<sup>95</sup>

One way to measure substitutability is the “Hypothetical Monopolist Test,” which asks whether a hypothetical monopolist of the defined market could theoretically impose a “small but significant and non-transitory increase in price” (SSNIP) without losing substantial sales.<sup>96</sup> If a SSNIP causes customers to buy another item instead, then the market is likely broader than originally defined. If the consumer would not switch from one product to another in the face of a price increase, they are likely not part of the same market. If a small increase in the price of free-to-play games caused a notable number of people to purchase

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[simply] to determine whether an arrangement has the potential for genuine adverse effects on competition, ‘proof of actual detrimental effects, such as a reduction in output,’ can obviate the need for an inquiry into market power, which is but a ‘surrogate for detrimental effects.’” 138 S. Ct. at 2291 (Breyer, J., dissenting) (quoting *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 460-61 (1986)).

94. See U.S. Dep’t of Justice and Fed. Trade Comm’n, *Horizontal Merger Guidelines* 7 (2010), <http://www.justice.gov/atr/public/guidelines/hmg-2010.html>.

95. In Commissioner Lina Khan’s statement, she wrote that the merger guidelines were withdrawn due to the VMG’s “flawed discussion of the purported procompetitive benefits (i.e., efficiencies) of vertical mergers, especially its treatment of the elimination of double marginalization (“EDM”), could become difficult to correct if relied on by courts. *Statement of Chair Lina M. Khan, Commissioner Rohit Chopra, and Commissioner Rebecca Kelly Slaughter on the Withdrawal of the Vertical Merger Guidelines*, FEDERAL TRADE COMMISSION (Sep. 15, 2021), <https://www.ftc.gov/legal-library/browse/cases-proceedings/public-statements/statement-chair-lina-m-khan-commissioner-rohit-chopra-commissioner-rebecca-kelly-slaughter>. *Federal Trade Commission Withdraws Vertical Merger Guidelines and Commentary*, FEDERAL TRADE COMMISSION (Sep. 15, 2021), <https://www.ftc.gov/news-events/news/press-releases/2021/09/federal-trade-commission-withdraws-vertical-merger-guidelines-commentary>.

96. U.S. Dep’t of Justice and Fed. Trade Comm’n, *Horizontal Merger Guidelines* 9 (2010), <http://www.justice.gov/atr/public/guidelines/hmg-2010.html>.

premium games instead—or vice versa—then we would consider the two products to be part of the same market. If an individual is unlikely to spend more on free-to-play games if the price of premium games rises, then they are likely to be distinct markets. Alternatively, we could ask whether a subscriber to Microsoft Game Pass would buy premium games instead if a hypothetical monopolist raised the monthly subscription fee.<sup>97</sup>

### B. *Into the Metaverse*

In its press release announcing the acquisition, Microsoft performed a rhetorical sleight of hand that misrepresented the nature of its Activision acquisition. Microsoft argued that the acquisition “will provide building blocks for the metaverse.”<sup>98</sup> The “metaverse” does not have a concrete definition, but it has gotten a lot of buzz in the tech industry. Broadly, the “metaverse” is defined “as a graphically rich virtual space, with some degree of verisimilitude, where people can work, play, shop, socialize—in short, do the things humans like to do together in real life.”<sup>99</sup> While most of the definitions of metaverse focus on its virtual and augmented reality spaces; broadly speaking, it is a term to encompass everyone’s lives online. In a move that shook the tech world, Mark Zuckerberg renamed Facebook to “Meta” in 2021, arguing that the metaverse represents the future of the digital world.<sup>100</sup>

Microsoft’s press release was misleading in two ways. First, Activision is not a “metaverse” company in a way that most of the people use that term. Activision is a video game company. Games are theoretically part of a broader “metaverse,” but so is virtually any tech-related product. The term “metaverse” can be stretched infinitely to encompass any product that relates to our increasingly digitized lives. In the same sense, someone could argue that Walmart is a significant part of the metaverse because it sells all sorts of products online, but we do not find that label proper. The “metaverse” as a market definition is as useful as the term “online.” The term is also slightly misleading to investors, who may react to the “metaverse” buzzword even though Activision is just a video game company.

Microsoft may argue that this acquisition concerns the broad “metaverse” market as a whole. On the grand scale of all tech companies that could be

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97. In other industries, a potential litigant may also focus on a geographic market. However, video games can be purchased virtually anywhere or downloaded digitally. As a result, I do not find the geographic factor relevant for the Activision acquisition.

98. *Microsoft to Acquire Activision Blizzard to Bring the Joy and Community of Gaming to Everyone, Across Every Device*, MICROSOFT (Jan. 18, 2022), <https://news.microsoft.com/2022/01/18/microsoft-to-acquire-activision-blizzard-to-bring-the-joy-and-community-of-gaming-to-everyone-across-every-device>.

99. Oli Welsh, *The Metaverse, Explained*, POLYGON (Mar. 6, 2022), <https://www.polygon.com/22959860/metaverse-explained>.

100. Mike Isaac, *Facebook Renames Itself Meta*, N.Y. TIMES (Oct. 28, 2021), <https://www.nytimes.com/2021/10/28/technology/facebook-meta-name-change.html>.

considered a part of the “metaverse,” Activision is just a small sliver of the market by comparison. But this is not a discrete market in any sense. The metaverse—broadly inclusive of all parts of the digital world— includes tech companies, clothing companies, social media, video games, and everything in between. The “metaverse” is not a market; as of now, it’s little more than an indefinite and inconsequential tech-industry buzzword.

### *C. The Entire Gaming Industry*

Microsoft will likely argue that the relevant market should be the *entire* game industry. This argument has already been made by proponents of the deal, who say that after the deal Microsoft will only hold 10.7% of the gaming market, up from 6.5% today.<sup>101</sup> The deal, if defining the game industry broadly, would boost Microsoft to the third largest in the industry. Some even argue that this acquisition will *strengthen* competition because the acquisition will allow Microsoft to compete more effectively against its bigger competitors.<sup>102</sup>

It is inappropriate to define the relevant market as the entire \$180 billion gaming market. Just as it would be inappropriate to define movie theaters, Netflix, and Disneyworld as all part of the same “film” market, so too is it inappropriate to combine every video game company into a broader “gaming” umbrella. The game industry has several distinct markets, each with its own customers, revenue streams, and business models. Microsoft’s market definition would include entire categories of products that are clearly not substitutes for one another: video game competitions (“esports”), in-person conventions, gaming chairs, and others. For example, if all free-to-play games went up to 10 cents tomorrow—a significant price increase—would even a single one of these consumers be deterred from the free-to-play game and instead purchase a \$60 game that requires an expensive game device to access? That is the logic you must buy into, if Activision’s likely market definition is adopted. Despite Microsoft’s attempt to frame the acquisition as just a small piece of a broader gaming market, I will show why the premium game or subscription-based market definition is far more appropriate.

### *D. Premium Games*

Section I(a) showed that most of the gaming market worldwide—over 80%—consists of “free-to-play” games.<sup>103</sup> However, the other gaming markets

101. Samson Amore, *Why Antitrust Concerns Won’t Block Microsoft’s Activision Acquisition*, DOT (Jan. 24, 2022), <https://dot.la/activision-microsoft-antitrust-2656470772.html>.

102. *Id.*

103. G Dautovic, *The Rise of the Virtual Empire: Video Game Industry Statistics*, FORTUNLY (Mar. 8, 2022), <https://fortunly.com/statistics/video-game-industry-statistics>; *2020 Year in Review Digital Games and Interactive Media*, SUPERDATA (a Nielson company) (2021), <https://www.digitalmusicnews.com/wp-content/uploads/2021/01/SuperData2020YearinReview.pdf>.

are nothing to sneeze at. In the US, premium games are more dominant than they are elsewhere. North America accounts for over 57% of the premium game market worldwide, despite representing just a quarter of the worldwide game market.<sup>104</sup> Microsoft is likely to argue that premium games are just a part of the broader gaming market, but the reality is that the premium game segment is its own \$30-40 billion market.<sup>105</sup> In this Section, I will demonstrate how the premium game market is its own distinct market well-suited for analysis of the Activision acquisition.

### 1. *A Distinct Market*

As Section I(a) illustrated, there are substantial differences between the free-to-play and premium game markets. The markets differ in both their audiences and their business models. Even more, free-to-play and premium games are also fundamentally different as products. The average premium game costs substantially more to develop, and as a result, must recoup a higher share of revenue to be profitable.<sup>106</sup> The two types of games also serve very different purposes. Free-to-play games are played for an average of just five minutes at a time, whereas premium games are played for nearly two hours per game session.<sup>107</sup> The only apparent unifying feature between premium and free-to-play games is that they are both interactive digital products. The similarity ends there.

### 2. *Digital Transactions within Premium Games*

Activision is not solely a premium game maker. If you look at the company's financial reports, then you will find that the company made \$5.1 billion in revenue from in-game transactions and \$3.25 billion from all its other products, including premium games.<sup>108</sup> Microsoft may argue that Activision's premium game business is only a small part of the company. I disagree.

While it is true many analysts lump all in-game transactions together,

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104. Using Newzoo's market analysis, America's \$47.3 billion game market is about 26% of the total game market. *Top Countries/Markets by Game Revenues*, NEWZOO (2022), <https://newzoo.com/insights/rankings/top-10-countries-by-game-revenues>; Tom Wijman, *The Games Market and Beyond in 2021: The Year in Numbers*, NEWZOO (Dec. 22, 2021), <https://newzoo.com/insights/articles/the-games-market-in-2021-the-year-in-numbers-esports-cloud-gaming; 2020 Year in Review Digital Games and Interactive Media 12>, SUPERDATA (a Nielson company) (2021), <https://www.digitalmusicnews.com/wp-content/uploads/2021/01/SuperData2020YearinReview.pdf>.

105. Tom Wijman, *Three Billion Players by 2023: Engagement and Revenues Continue to Thrive Across the Global Games Market*, NEWZOO (June 25, 2020), <https://newzoo.com/insights/articles/games-market-engagement-revenues-trends-2020-2023-gaming-report> (showing that 21% of game revenue in 2020, roughly \$33 billion, was from sales of premium game software, not including in-game transactions within those games).

106. See discussion *supra* Section I.A.ii.

107. See discussion *supra* Section I.A.

108. Sampad Banerjee, *Activision Blizzard Made \$5.1 Billion from Microtransactions and DLC Sales in 2021*, GAMINGBOLT (Feb. 7, 2022), <https://gamingbolt.com/activision-blizzard-made-5-1-billion-from-microtransactions-and-dlc-sales-in-2021>.

regardless of whether the purchases are made in a free-to-play or premium game, they should be treated as separate revenue streams. Many premium games—including Activision’s—offer users the opportunity to purchase additional digital products after making the initial premium game purchase. Like in free-to-play games, users can purchase additional game levels or optional aesthetic items. However, in contrast to free-to-play games, these players first had to pay the price of entry by purchasing the premium game and the game console to play it on.

The money Activision makes on many of its in-game transactions are *within* its premium game ecosystem, not auxiliary to the market. For example, a person that purchases Activision’s flagship Call of Duty game for \$60 can spend up to an additional \$60 on additional game levels. The additional digital content cannot be accessed without buying the original game. True to the market differences we have already seen, players are far more likely to make in-game transactions in a premium game because they are already accustomed to spending money on their games. According to one report, 87% of premium gamers overall have purchased additional in-game content, whereas that number is in the single digits for free-to-play games.<sup>109</sup> As a result, additional transactions within premium games should be considered “premium” as opposed to “free-to-play” because the business model is nearly identical to that of the premium games themselves. It would be misleading to consider just a minority share of Activision revenue to be from premium games when the majority of its remaining digital revenue came from purchases within these games.

Activision’s only real free-to-play games are developed by King, a company it itself acquired in 2016 for nearly \$6 billion.<sup>110</sup> Last year, King’s \$2.58 billion in revenue constituted roughly 29% of Activision’s business.<sup>111</sup> The rest of Activision’s business—in my view—belongs to the premium game market.<sup>112</sup>

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109. *New Microtransaction Data: Tricked-Out Gamers—Ready to Play and Pay*, Treasure Data Blog (Nov. 21, 2019), <https://blog.treasuredata.com/blog/2019/11/20/tricked-out-gamers-ready-to-play-and-pay>; James Brightman, *Only 3.5% of gamers make in-app purchases*, GamesIndustry.biz (June 30, 2016), <https://www.gamesindustry.biz/only-3-5-percent-of-gamers-make-in-app-purchases-appsflyer>.

110. Ingrid Lunden, *Activision Blizzard Closes Its \$5.9B Acquisition of King, Makers of Candy Crush*, TECHCRUNCH (Feb. 23, 2016), <http://tcrn.ch/1T42Y49>.

111. *Activision Blizzard Announces Fourth-Quarter and 2021 Financial Results*, BUSINESSWIRE (Feb. 3, 2022), [https://www.businesswire.com/news/home/20220202006035/en/Activision-Blizzard-Announces-Fourth-Quarter-and-2021-Financial-Results?utm\\_campaign=shareaholic&utm\\_medium=copy\\_link&utm\\_source=bookmark](https://www.businesswire.com/news/home/20220202006035/en/Activision-Blizzard-Announces-Fourth-Quarter-and-2021-Financial-Results?utm_campaign=shareaholic&utm_medium=copy_link&utm_source=bookmark).

112. In this Article, I mostly focus on the consequences of Activision’s acquisition on the premium and subscription game markets. I do not cover the consequences of King’s acquisition in as much depth because its effect is likely to be smaller in the comparatively large free-to-play game market.



### 3. *The Hypothetical Monopolist Test*

Given everything we have learned, we can conduct a rudimentary hypothetical monopolist test to demonstrate whether the premium and free-to-play markets are distinct. The hypothetical monopolist test operates on the premise that if a monopolist raised the price of the product, some number of consumers would attempt to substitute the product for another one in the same market.<sup>113</sup> If the premium game market is distinct, then a rise in the price of such games would not cause consumers to substitute them with free-to-play games. Conversely, if free-to-play and premium games were actually a single market, then a rise in the price of premium games would spur a measurable number of consumers to play free-to-play games instead.<sup>114</sup>

We already have a way to run a theoretical experiment with a real-life market phenomenon. When new gaming consoles launch, publishers frequently raise the standard price of a video game to cover increasing development costs. Recently, many studios raised the price of their games from \$60 to \$70 with the release of the new PlayStation and Xbox consoles.<sup>115</sup> It is difficult to imagine that a standard premium gamer—already accustomed to spending a significant chunk of money for a game upfront—would switch to simplistic and cheap free-to-play games as a market substitute. A premium gamer seeks a game they can play for hours at a time. Premium gamers spend a significant entry fee—a game console and the software itself—because they prefer sophisticated games. Free-to-play games, in comparison, are not designed for extensive play sessions and are not used in the same manner as premium games.<sup>116</sup> As such, it is evident that free-to-play games and premium games constitute two completely distinct markets, despite Microsoft’s best efforts to frame that reality otherwise.<sup>117</sup>

113. The relevant question for the hypothetical monopolist test, as used by the FTC Merger Guidelines, is if, “in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Agency will add to the product group the product that is the next-best substitute for the merging firm’s product . . . . The price increase question is then asked for a hypothetical monopolist controlling the expanded product group. This process will continue until a group of products is identified such that a hypothetical monopolist over that group of products would profitably impose at least a “small but significant and nontransitory” increase [“SSNIP”], including the price of a product of one of the merging firms.” Horizontal Merger Guidelines, 4 Trade Reg. Rep. ¶ 13,104, at § 0. .

114. The test can run the opposite way as well: would the rise in the price of free-to-play games cause consumers to buy full-priced premium games instead?

115. Kyle Orland, *The Return of the \$70 Video Game Has Been a Long Time Coming*, ARSTECHNICA (July 9, 2020), <https://arstechnica.com/gaming/2020/07/the-return-of-the-70-video-game-has-been-a-long-time-coming>; Ian Sherr, *Inflation Hits Gaming: Microsoft Will Charge \$70 for Its Biggest Titles in 2023*, CNET (Dec. 5, 2022), <https://www.cnet.com/tech/gaming/inflation-hits-gaming-microsoft-will-start-charging-70-for-its-biggest-titles-in-2023/>; Zack Zwiezen, *The Era Of \$70 Games Truly Begins This Fall*, KOTAKU (Sep. 28, 2022), <https://kotaku.com/70-dollar-games-60-ubisoft-ea-gotham-knights-ps5-xbox-1849593604>.

116. See discussion *supra* Section I.A.i.

117. You can imagine the inverse hypothetical monopolist test, too. If all free-to-play games experience a price rise by 10 cents, or \$1, or even \$5, and assuming customers are prepared to pay

### *E. Subscription-based Game Model*

The subscription-based market occupies just 4% of the industry’s total revenue, but it is quickly taking form as its own distinct market. Microsoft’s subscription service—Xbox Game Pass—now has over 25 million monthly subscribers, bringing in an estimated \$3 billion in forecasted annual revenue.<sup>118</sup> Using Microsoft’s 60% market share, we can estimate the total game subscription market to be an estimated \$5 billion annually.<sup>119</sup> Impressively, Game Pass has averaged an annual growth rate of 40% per year. While growth this strong is not endlessly sustainable, it parallels Netflix’s popularity after its initial video streaming launch.<sup>120</sup>

There are a few key features that distinguish game subscription services from the premium and free-to-play markets. The games offered on subscription services are generally premium games, but a user only pays the monthly subscription fee to access them. That means a user could theoretically buy the same games individually at full price instead of paying a monthly subscription. Xbox Game Pass, for example, provides a catalog of nearly 500 games on its service.<sup>121</sup> Despite this gigantic catalog, the starting price for Xbox Game Pass is just \$9.99 per month. PlayStation launched a competing service in June 2022, which offers two subscription tiers: a catalog of 400 games for \$14.99 per month and additional 340 games for an additional \$3.

The biggest draw for each subscription service is its selection of games, and each company competes by offering exclusive games on its platform. Microsoft, for example, makes all its premium games available on Game Pass at no additional cost on release day. Essentially, a gamer can choose between spending \$60 to buy the game outright, or pay \$10 to play it immediately on a subscription platform. As a subscriber to the service myself, this deal sounds too good to be true. It is especially striking considering how much a game costs to develop. Many top-tier premium games regularly have budgets of \$80-150 million, with

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these relatively small sums, such consumers—most of whom do not even consider themselves “gamers”—may be unlikely to substitute these newly \$5 games with a \$60 game and a \$500 video game console. The converse seems more likely, that a user might find another free experience, such as a book or a social media app.

118. Ben Gilbert, *Microsoft is Quietly Bringing in Billions From Its Netflix-Like Game Pass Service as Subscribers Top 25 Million*, INSIDER (Jan. 18, 2022), <https://www.businessinsider.com/xbox-game-pass-to-make-billions-in-2022-2022-1>.

119. *Id.*

120. While at first it may not have seemed that Netflix alone was creating a new video streaming market that was completely separate from rentals and movie theaters, today the distinctness of the market is evident from the fact that Netflix’s direct competitor is perhaps not a local video rental store, but an online streaming platform like Disney Plus. Compare Game Pass’s rise with that of Netflix after it launched video streaming in late 2007. Brian Dean, *Netflix Subscriber and Growth Statistics: How Many People Watch Netflix in 2022?*, BACKLINKO (Oct. 7, 2022), <https://backlinko.com/netflix-users>.

121. Eddie Makuch et al., *All The Xbox Game Pass Games Right Now*, GAMESPOT (Apr. 20, 2022), <https://www.gamespot.com/articles/all-the-xbox-game-pass-games-right-now/1100-6448286>.

the most expensive hitting as much as \$260 million in development costs.<sup>122</sup> If Microsoft is making an estimated \$250 million per month on Game Pass subscriptions, it returns a significant share of that revenue to the development of its own exclusive games.

In addition to launching its own games on Game Pass, Microsoft also licenses games from video game developers. For instance, Microsoft licensed the popular superhero game “Guardians of the Galaxy” for an estimated \$5-10 million.<sup>123</sup> For smaller games, Microsoft pays an average of \$830,000 (note that this figure is likely to be highly variable and may account for other payments, including those from the digital game store).<sup>124</sup>

How can these companies afford to offer such a vast catalog for such a low price? One reason is that these companies have been around for decades and already have a substantial catalog of historical games which cost virtually nothing to offer on the service. When Playstation launched its subscription service, it offered hundreds of games that were developed decades ago.<sup>125</sup> Sony, Microsoft, and Nintendo alone can theoretically offer hundreds of old games instantly at no additional cost because they have built up an extensive back-catalog over decades of console competition.

It may also be a possibility, at least for now, that these subscription services are operating at a loss. Microsoft has never shared the revenue or profit of Game Pass in its financial reports, instead touting the rapidly growing subscriber count and calling the service “very, very sustainable.”<sup>126</sup> It is difficult to compute how Microsoft would be making money in light of its significant expenditures for content acquisition and in-house development budgets. As the FTC conducts its extensive review, finding figures on Game Pass’ profitability might be key to assessing whether Microsoft is potentially employing predatory pricing tactics.

This story should be familiar, because it mirrors the model video streaming

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122. Matthew Handrahan, *Shawn Layden: “I Would Welcome a Return to the 12 to 15 Hour AAA Game”*, GAMESINDUSTRY (June 23, 2020), <https://www.gamesindustry.biz/articles/2020-06-23-shawn-layden-gamelab>; Bryan Wirtz, *What Are Most Expensive Video Games?*, GAMEDESIGNING (Jan. 7, 2022), <https://www.gamedesigning.org/gaming/most-expensive-games>.

123. Jordan Middler, *Microsoft ‘Paid \$5-10 Million’ to Get Guardians of the Galaxy on Game Pass, Analyst Claims*, VGC (Mar. 27, 2022), <https://www.videogameschronicle.com/news/microsoft-paid-5-10-million-to-get-guardians-of-the-galaxy-on-game-pass-analyst-claims>.

124. Eddie Makuch, *Xbox Game Pass: Microsoft Has Paid “Hundreds Of Millions” To Devs*, GAMESPOT (Mar. 25, 2022), <https://www.gamespot.com/articles/xbox-game-pass-microsoft-has-paid-hundreds-of-millions-to-devs/1100-6501901>.

125. *All-New PlayStation Plus Launches in June with 700+ Games and More Value Than Ever*, PLAYSTATION BLOG (May 29, 2022), <https://blog.playstation.com/2022/03/29/all-new-playstation-plus-launches-in-june-with-700-games-and-more-value-than-ever>.

126. Kat Bailey, *Phil Spencer: Xbox Game Pass Is ‘Very, Very Sustainable,’ Not ‘Burning Cash’*, IGN (Apr. 22, 2022), <https://www.ign.com/articles/xbox-game-pass-sustainable-phil-spencer>; Pramath, *New Game Pass Subscriber Number Report Raises Questions About Service’s Long Term Viability*, GAMINGBOLT (Oct. 29, 2021), <https://gamingbolt.com/new-game-pass-subscriber-number-report-raises-questions-about-services-long-term-viability>.

platforms experienced years earlier. When Netflix first launched, it too seemed like a deal that was too good to be true. Despite dominating the top spot in the video streaming market and amassing hundreds of millions of subscribers, it was making a relatively small profit. In the years after Netflix began video streaming, its profit margin was around 7% and its profit averaged \$130 million from 2009-2013.<sup>127</sup> Over the last decade, Netflix's profit margin has tripled and its annual profits multiplied by nearly 40 times.<sup>128</sup> Investors regularly chastised Netflix for overspending on content acquisition. However, by offering cheap, abundant, high-quality content early on, Netflix was able to amass a massive, loyal customer base. Over the span of a decade, Netflix was able to nearly double its price (from \$7.99 to \$15.49 per month).<sup>129</sup>

It makes sense that Microsoft would model Game Pass's growth after video streaming services, initially prioritizing content and subscriber acquisition as opposed to profit. Its purchase of Activision allows Microsoft to release games exclusively on its subscription platform, keeping its competitors from licensing games from the largest third-party gaming company. Microsoft's \$70 billion all-cash offer to buy Activision is clearly one very few potential competitors could ever muster up the resources to match.<sup>130</sup>

### III. COMPETITION AND THE RULE OF REASON

Many scholars, including current FTC Chair Lina Khan, have argued that modern antitrust law is insufficient to prevent significant harms of agglomeration.<sup>131</sup> As a result, the FTC is expected to broaden the scope of arguments it makes in future antitrust suits beyond the traditional precedent.<sup>132</sup> However, because the FTC has not yet promulgated new vertical merger guidelines, and because the FTC's final complaint adopted a traditional consumer welfare argument, my analysis is grounded in established antitrust precedent.<sup>133</sup> As a result, I will use the Supreme Court's "rule of reason" test to

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127. *Netflix Net Income 2010-2022*, MACROTRENDS, (2022), <https://www.macrotrends.net/stocks/charts/NFLX/netflix/net-income>; *Netflix Revenue 2010-2022*, MACROTRENDS (2022), <https://www.macrotrends.net/stocks/charts/NFLX/netflix/revenue>.

128. *Id.*

129. Jacob Katrenakes, *Netflix Raises Prices on All Plans in US*, VERGE (Jan. 14, 2022), <https://www.theverge.com/2022/1/14/22884263/netflix-price-increases-2021-us-canada-all-plans-hd-4k>.

130. Steve Kovach, *Microsoft to Buy Activision in \$68.7 Billion All-Cash Deal*, CNBC (Jan. 18, 2022), <https://www.cnbc.com/2022/01/18/microsoft-to-buy-activision.html>.

131. See, e.g., Lina Khan, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710 (arguing that the traditional consumer welfare standard fails to properly appreciate the long-term harms of anticompetitive behavior and agglomeration); Tim Wu, *The Curse of Bigness: Antitrust in the New Gilded Age* (2018) (arguing to broaden antitrust law to consider the harms of anticompetitive behavior beyond the consumer welfare standard").

132. See Lauren Feiner, *Lina Khan's FTC Takes a First Step Toward Expanding Antitrust Enforcement*, CNBC (July 1, 2021), <https://www.cnbc.com/2021/07/01/lina-khans-ftc-takes-first-step-to-expanding-antitrust-enforcement.html>.

133. See *Federal Trade Commission Withdraws Vertical Merger Guidelines and*

analyze the acquisition and its potential harm to consumer welfare.<sup>134</sup> The “rule of reason” test balances “all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.”<sup>135</sup>

In this Section, I will assess the potential competitive and anticompetitive effects of the Activision acquisition using the Supreme Court’s “rule of reason test” on two potential markets: premium gaming and game subscription services. While Microsoft is likely to allege that another market definition would be more fitting—the entire gaming industry or the broader “metaverse”—in Section II, I concluded that these were not sufficiently distinct markets.

The rule of reason requires courts to weigh the pro-competitive effects of an action against its anti-competitive effects. To do so, courts consider a myriad of factors, including the competitive position of the potential defendant, its intent in making the acquisition, the relevant market, and the acquisition’s probable effects, particularly on consumer welfare.<sup>136</sup> Courts also consider potential barriers of entry to the defined market, as well as other individualized factors to assess the effects of the defendant’s action.<sup>137</sup> No single factor is dispositive in a rule of reason case; rather, “the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited.”<sup>138</sup> This Section weighs the relevant factors when conducting the rule of reason test for the Activision acquisition.

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*Commentary*, FEDERAL TRADE COMMISSION (Sep. 15, 2021), <https://www.ftc.gov/news-events/news/press-releases/2021/09/federal-trade-commission-withdraws-vertical-merger-guidelines-commentary>. In my original draft, I speculated that the FTC might use alternative legal strategies beyond consumer welfare to oppose the deal because of Chair Lina Khan’s earlier public statements and the agency’s focus on labor and privacy issues. Lauren Feiner, *Lina Khan’s FTC Takes a First Step Toward Expanding Antitrust Enforcement*, CNBC (July 1, 2021), <https://www.cnbc.com/2021/07/01/lina-khans-ftc-takes-first-step-to-expanding-antitrust-enforcement.html>; Jordan Middler, *FTC’s Probe of Microsoft’s Activision Acquisition Will Reportedly Focus on Consumer Data, Labour Market*, VIDEOGAMESCHRONICLE (Apr. 6, 2022) <https://www.videogameschronicle.com/news/ftcs-probe-of-microsofts-activision-acquisition-will-focus-on-consumer-data-labour-market>. However, the FTC’s final complaint employs a traditional consumer welfare analysis, and my paper also uses the traditional antitrust framework. See Complaint, *In re Microsoft Corp. and Activision Blizzard, Inc.*, No. 9412 (FTC, Dec. 8, 2022).

134. See, e.g., *Standard Oil Co. v. United States*, 221 U.S. 1, 66 (1911); *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 59 (1977); *State Oil v. Kahn*, 522 U.S. 3, 10 (1997) (“[M]ost antitrust claims are analyzed under a “rule of reason,” according to which the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition, taking into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint’s history, nature, and effect.”).

135. *Cont’l T.V.*, 433 U.S. at 49.

136. See *Nat’l Collegiate Athletic Ass’n v. Bd. of Regents*, 468 U.S. 85, 103, 107 (1984); *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988); *State Oil*, 522 U.S. at 10.

137. *Cal. Dental Ass’n v. FTC*, 526 U.S. 756, 772 (1999).

138. *Leegin Creative Leather Prod., Inc. v. PSKS, Inc.*, 551 U.S. 886, 885 (2007) (citing *Continental T.V.*, 433 U.S. at 49).

### A. Premium Games

In the premium game market, the Activision acquisition may initially appear to be just a horizontal merger (*i.e.*, a merger between two competitors in the same market). After all, Microsoft and Activision both sell premium games that compete against each other. However, it would be more accurate to describe the acquisition as primarily a vertical merger. Microsoft's main gaming product is not necessarily its own premium games; rather, it is the Xbox platform itself. The Xbox platform includes both the Xbox home console and its PC counterpart, both of which cost hundreds of dollars to purchase. While console manufacturers—of which there are three—make little money on the consoles themselves, they bring in substantial revenue through software sales. So, Microsoft's premium-game offerings—which will include Activision's software if the acquisition is approved—are the raw materials it needs to sell its platform. Once Microsoft successfully draws consumers to its platform, it profits on the sale of other companies' games by charging a royalty.<sup>139</sup> Without in-house studios, Microsoft has little competitive advantage to attract users away from competing platforms.

Microsoft develops its own premium games, exclusive to the Xbox platform, in order to compete with the other console manufacturers. It also generates additional revenue by selling other companies' software—called “third-party games”—on its platform, a service for which it takes a royalty. Microsoft charges a 30% royalty for digital sales and a smaller percentage on physical game sales for Xbox games.<sup>140</sup> On PC, Microsoft takes just a 12% royalty.<sup>141</sup> The reason for the smaller cut on PC software is because Windows is an open platform, meaning Microsoft has to compete with digital marketplaces offered by other companies. If its royalty rates on PC are uncompetitive, developers may choose to release their games on other digital storefronts instead. In short, not only does Microsoft draw in consumers to its platform by offering high-quality exclusive games, it generates additional revenue via their royalty on

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139. Microsoft charges a 30% royalty for digital sales and a smaller percent on physical game sales for Xbox. Tom Warren, *Microsoft Explored Reducing its Xbox Store Cut to Shake Up Console Gaming*, VERGE (May 2, 2021), <https://www.theverge.com/2021/5/2/22415712/microsoft-xbox-store-cut-epic-games-court-documents>. On PC, Microsoft takes just a 12% royalty, but still profits on purchases made through its online store. Jessica Conditt, *Microsoft Follows Epic and Cuts Xbox PC Revenue Share to 12 Percent*, ENGADGET (Apr. 29, 2021), <https://www.engadget.com/xbox-pc-rev-share-88-12-epic-apple-130036485.html>. The reason for the smaller cut on PC software is because Windows is an open platform, meaning Microsoft has to compete with digital marketplaces offered by other companies. If its royalty rates on PC are uncompetitive, developers may choose to release their games on other digital storefronts instead.

140. Tom Warren, *Microsoft Explored Reducing Its Xbox Store Cut to Shake Up Console Gaming*, VERGE (May 2, 2021), <https://www.theverge.com/2021/5/2/22415712/microsoft-xbox-store-cut-epic-games-court-documents>.

141. Jessica Conditt, *Microsoft Follows Epic and Cuts Xbox PC Revenue Share to 12 Percent*, ENGADGET (Apr. 29, 2021), <https://www.engadget.com/xbox-pc-rev-share-88-12-epic-apple-130036485.html>.

third party games.

Sony and Nintendo follow the same business model, and these three companies compete to bring the best games to their platforms. Before this acquisition was announced, Activision was the largest third-party publisher on Xbox and other console platforms.<sup>142</sup> Activision is such an important player that console manufacturers compete to pay Activision for additional content. For example, for many years Sony paid Activision to provide exclusive content on its platform for Call of Duty, the biggest game franchise each year.<sup>143</sup> This agreement incentivized customers to purchase a PlayStation instead of an Xbox to access the exclusive content. By amassing exclusive content from third-party publishers, manufacturers compete to draw players to their platforms. By acquiring Activision, Microsoft acquires significant raw materials to make its Xbox platform successful.

The Activision acquisition is not Microsoft's only attempt to acquire additional game companies to pad its production calendar. Instead, Microsoft has acquired several significant game companies over the last few years to build its exclusive content library. In 2020, Activision acquired the third-party publisher Bethesda Softworks for \$7.5 billion.<sup>144</sup> While this acquisition was a fraction of the cost of the Activision deal, Bethesda was one of the biggest game publishers at the time. Bethesda's game *The Elder Scrolls V: Skyrim* was the sixth best-selling third-party game released in the 2010 decade.<sup>145</sup> And in 2014, Microsoft acquired Minecraft, the best-selling video game of all time, for \$2.5 billion.<sup>146</sup> In addition to these significant acquisitions, Microsoft acquired nine game companies of varying sizes over the last five years.<sup>147</sup> Rather than starting new studios in-house, as Sony and Nintendo have done, Microsoft increased its content by scooping up dozens of game studios through acquisitions. Including the Bethesda and Activision deals, Microsoft increased the number of its game studios from six to thirty-five, an increase of almost 600%.<sup>148</sup> One Microsoft journalist shared a graphic to show the stark difference over just five years:<sup>149</sup>

142. *Games*, ACTIVISION (accessed May 3, 2022), <https://www.activision.com/games>.

143. Rebecca Smith, *Activision's PlayStation Exclusive Content Will Likely End After Call of Duty: Vanguard*, PLAYSTATION LIFESTYLES (Jan. 18, 2022), <https://www.playstationlifestyle.net/2022/01/18/activision-playstation-exclusive-content-will-end>.

144. Tom Warren, *Microsoft Completes Bethesda Acquisition, Promises Some Xbox and PC Exclusives*, VERGE (Mar. 9, 2021), <https://www.theverge.com/2021/3/9/22319124/microsoft-bethesda-acquisition-complete-finalized>.

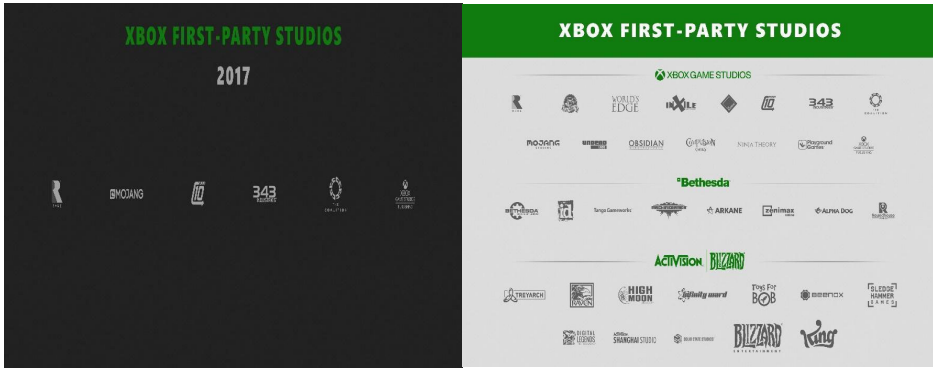
145. *The Top 50 Best-Selling Video Games of All Time*, HP (Sep. 28, 2021), <https://www.hp.com/us-en/shop/tech-takes/top-50-best-selling-video-games-all-time>.

146. *Id.*; Darrell Etherington, *Microsoft Has Acquired Minecraft for \$2.5 Billion*, TECHCRUNCH (Sep. 15, 2014), <https://techcrunch.com/2014/09/15/microsoft-has-acquired-minecraft>.

147. Dalton Cooper, *Images Show Just How Many Studios Xbox Has Acquired in the Last 5 Years*, GAMERANT (Jan. 26, 2022), <https://gamerant.com/xbox-studio-acquisitions>.

148. Klobrille (@klobrille), TWITTER (Jan. 23, 2022, 9:54 AM), <https://twitter.com/klobrille/status/1485264696655630345>.

149. *Id.*



*Id.*

The proposed Activision acquisition is bigger than any video game deal that has ever come before it, by a wide margin.<sup>150</sup> Microsoft valued Activision at \$69 billion in its offer, although the current market cap for the company is “just” \$61 billion (presumably because investors are not confident the deal will go through).<sup>151</sup> By contrast, the next-largest acquisition in the game industry is Take-Two’s purchase of Zynga for \$12.7 billion.<sup>152</sup>

For comparison, Electronic Arts (EA) is the second-largest publisher of third-party games.<sup>153</sup> EA has a market cap of roughly \$34 billion, half the size of Activision, and brought in \$5.6 billion in revenue in 2021—compared to Activision’s \$8.8 billion.<sup>154</sup> Given the size of competing game companies, it is

150. *Compare Microsoft to Acquire Activision Blizzard to Bring the Joy and Community of Gaming to Everyone, Across Every Device*, Microsoft (Jan. 18, 2022), <https://news.microsoft.com/2022/01/18/microsoft-to-acquire-activision-blizzard-to-bring-the-joy-and-community-of-gaming-to-everyone-across-every-device> with Jasmine Gould-Wilson, *The 10 Most Expensive Video Game Acquisitions of All-Time*, GAMESRADAR (Feb. 21, 2023), <https://www.gamesradar.com/biggest-most-expensive-video-game-acquisitions>.

151. Brody Ford & Jason Schreier, *Wall Street Is Betting That Microsoft-Activision Deal Will Fail*, BLOOMBERG (Apr. 28, 2022), <https://www.bloomberg.com/news/articles/2022-04-28/wall-street-is-betting-that-microsoft-activision-deal-will-fail>. If you peruse the list of top gaming companies, you will notice that a few gaming companies are bigger than Activision. However, these companies are either platform holders (Microsoft, Nintendo, etc.), or primarily engaged in the free-to-play game business (Tencent, NetEase). Activision is the biggest third-party game publisher. Joost van Dreunen, *The Biggest Game Companies for 2020*, SUPERJOOST (Apr. 1, 2021), <https://superjoost.net/articles/the-biggest-game-companies-for-2020>; *Activision Blizzard, Inc.*, Yahoo Finance, <https://finance.yahoo.com/quote/ATVI> (accessed Apr. 16, 2023).

152. See Andy Robinson, *Take-Two Announces Acquisition of Mobile Games Giant Zynga for \$12.7bn*, VIDEOGAMESCHRONICLE (Jan. 10, 2022), <https://www.videogameschronicle.com/news/take-two-announces-acquisition-of-mobile-games-giant-zynga-for-12-7bn>.

153. *Biggest Gaming Stocks by Market Cap, Stock Analysis*, <https://stockanalysis.com/list/gaming-stocks> (showing EA as the next-largest third-party publisher among those that release premium games on consoles).

154. *Electronic Arts Inc. (EA)*, YAHOO! FINANCE (May 2, 2022), <https://perma.cc/YQE2-8ZRW>; *Electronic Arts Reports Q3 FY22 Financial Results*, EA (Feb. 1, 2022), [https://s22.q4cdn.com/894350492/files/doc\\_financials/2022/q3/Q3-FY22-Earnings-Release-](https://s22.q4cdn.com/894350492/files/doc_financials/2022/q3/Q3-FY22-Earnings-Release-)



hard to see how any future game acquisition could ever be more significant. If allowed, the Activision deal will likely remain the largest premium game market acquisition for years.

Another significant factor to consider are the tremendous barriers to entry in the game industry. The Court has reasoned that significant market power can cement and increase a market's barriers to entry, which has anticompetitive effects.<sup>155</sup> One of the reasons there are only three primary console manufacturers—and all others have failed—is because the market requires substantial resources for entry. In order to compete against Microsoft, Nintendo, and Sony, a potential competitor would need to develop hardware that could play sophisticated games, successfully sell it to tens of millions of people, and produce a number of \$100 million games per year. Other companies have tried to enter the market and repeatedly failed.<sup>156</sup> In fact, the only company to successfully launch a console line in the last 25 years is Microsoft, when it launched the original Xbox in 2001, shortly before Sega left the game console market.<sup>157</sup> Other large tech companies that presumably have sufficient resources have failed in their attempts to enter the market, too. Despite spending hundreds of millions of dollars, both Amazon and Google have failed in their attempts to provide competing platforms in the last decade.<sup>158</sup> Those companies have the resources to enter the market, but substantial capital far from ensures success in the premium game market.

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vFinal.pdf; *Activision Blizzard Announces Fourth-Quarter and 2021 Financial Results*, ACTIVISION (Feb. 3, 2022), <https://investor.activision.com/news-releases/news-release-details/activision-blizzard-announces-fourth-quarter-and-2021-financial>.

155. *FTC v. Consol. Foods Corp.*, 380 U.S. 592, 601 (1965) (arguing that a two-firm oligopoly, when working together in reciprocal buying, severely limits the ability of new competitors to enter the market); *FTC v. Proctor & Gamble Co.*, 386 U.S. 568, 578 (1967) (holding that the restriction at issue “substantially reduce[s] the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing”).

156. See Jamie Lendino, *Inside Atari's Rise and Fall*, TECHCRUNCH (June 21, 2018), <https://techcrunch.com/2018/06/21/inside-ataris-rise-and-fall> (detailing Atari's success and eventual failure in the console market); AJ Dellinger, *Crowdfunded Gaming Console Ouya Will Shut Down for Good on June 25th*, ENGADGET (May 22, 2019), <https://www.engadget.com/2019-05-22-ouya-kickstarter-console-shut-down-june-25-razer.html> (detailing the failure of Ouya, which had been a promising market entrant).

157. Dan Ackerman & Darren Gladstone, *Microsoft Xbox at 20: Looking Back at the Original 2001 Review*, CNET (Nov. 15, 2021), <https://www.cnet.com/tech/gaming/microsoft-xbox-at-20-looking-back-at-the-original-2001-review/>; Alex Pham, *Sega to Quit Production of Dreamcast Console, Develop Games for Rivals*, L.A. TIMES (Jan. 31, 2001), <https://www.latimes.com/archives/la-xpm-2001-jan-31-fi-19213-story.html>.

158. See Adam Epstein, *Why Amazon Keeps Failing at Video Games*, QUARTZ (Apr. 20, 2021), <https://qz.com/1999032/why-amazon-keeps-failing-at-video-games/>; Andy Chalk, *Sources at Google's Failed Game Studio Say It Should've Just Bought Studios and Left Them Alone Like Microsoft*, PCGAMER (Feb. 26, 2021), <https://www.pcgamer.com/sources-at-googles-failed-game-studio-say-it-shouldve-just-bought-studios-and-left-them-alone-like-microsoft/>; Rachel Kase, *Google Stadia Failed After Spending Millions to Get Popular Games*, ANDROIDCENTRAL (Feb. 26, 2021), <https://www.androidcentral.com/google-stadia-failed-after-spending-millions-get-popular-games>.

The Activision acquisition makes the difficult barrier to entry in the market even steeper. For one, Activision is among the few companies that has enough studios and monetary resources to ever create a successful console competitor to Microsoft, Sony, and Nintendo. It is unlikely that Activision would launch a console anytime soon, but it is one of the only companies capable of doing so. More significantly, the deal robs Microsoft's only two other competitors in the market—Microsoft and Sony—from hosting games from the biggest third-party game publisher. If you want to play a game developed by Activision, you will have to buy an Xbox (or pray that Microsoft charitably brings the game to a competing platform, hurting its own competitiveness).

How could Nintendo and Sony even compete with an Activision acquisition? Assuming Nintendo or Sony even had the desire and resources to do so—though neither does—these companies would have to compete by acquiring the other largest game studios, further consolidating the market. Even then, any potential acquisition would pale in comparison to Activision's because no other third-party publisher is as large.

Following its recent acquisitions, Microsoft's competitors have been cut off from getting games from *two dozen* game studios. Microsoft may claim it will continue to bring Activision games to competing platforms, but it has not done so for its other recent acquisitions. Because developing sophisticated games costs hundreds of millions of dollars, a bill very few companies can afford to foot, acquiring Activision will take the biggest third-party publisher out of the reach of Microsoft's competitors.

Proponents of the acquisition argue that it will help Microsoft better compete. On one view, Microsoft argues that the acquisition will make it the third-largest company in the game industry, allowing it to compete with Sony and Tencent (the top two spots).<sup>159</sup> This is misleading, as Tencent, a Chinese gaming giant, is a free-to-play game producer. It is not a true competitor to Microsoft or Activision. Microsoft only has two competitors in the premium game market: Sony and Nintendo. Even in the console market, Microsoft may argue that the acquisition will allow it to better compete with Nintendo and Sony, because it is frequently behind Sony and Nintendo in the game console market.<sup>160</sup> However, this too is misleading because the companies regularly trade spots in the game console market. In 2021, for example, Microsoft took second place and Nintendo took third in the game console market.<sup>161</sup> Essentially, Microsoft's

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159. Kirsten Errick, *Microsoft to Acquire Activision Blizzard for \$68.7B, Becoming Third Largest Gaming Company*, LAWSTREETMEDIA (Jan. 25, 2022), <https://lawstreetmedia.com/news/deals/microsoft-to-acquire-activision-blizzard-for-68-7b-becoming-third-largest-gaming-company>.

160. See Sage Ashford, *The Best-Selling Video Game Console of Each Console Generation*, CBR (July 3, 2021), <https://www.cbr.com/video-game-consoles-best-selling-by-generation> (showing that Microsoft never produced a console that managed to take first place in the console market).

161. Eddie Makuch, *PlayStation, Xbox, and Nintendo Gaming Revenue Compared: Sony*

primary argument is that it is a smaller competitor against larger companies in the market, whereas in reality, it is one of three major console manufacturers in an ever-consolidating premium game market.

### B. *Subscription Services*

As Part II discusses, the subscription game market—which has a Netflix-like business model—is new but rapidly growing.<sup>162</sup> Microsoft may have a strong argument that its acquisition of Activision helps consumers in the subscription service market. The company will likely claim that consumers only stand to benefit from a broad offering of strong games at an incredibly cheap monthly price. After all, why buy a single \$60 premium game when you can subscribe to Game Pass for \$10 monthly? However, Microsoft’s likely stance does not diminish the heavily anticompetitive consequences that will likely follow if Microsoft continues to consolidate its dominant market position, ultimately harming consumers.

For one, the acquisition creates barriers for other gaming companies to produce competing services. Sony, for instance, launched a competing game subscription service in June, also featuring hundreds of games.<sup>163</sup> It can only effectively compete against Microsoft because it is able to offer hundreds of games at an affordable price. Just like Microsoft, the catalog is filled with old games, newly developed games, and games it licenses from third-party game publishers.<sup>164</sup> However, Sony cannot compete without a strong offering of third-party games. Activision produces some of the biggest games in the entire industry—*World of Warcraft* is the largest massively multiplayer online (“MMO”) game of all time by number of paying subscribers, and *Call of Duty* is regularly each year’s top-selling game.<sup>165</sup> When Activision acquires the largest third-party game publisher in the market, Sony will have no way to guarantee some of the biggest games on its competing platform. Microsoft’s market power would be less legally problematic if its success came exclusively from creating a superior to a better product in-house.<sup>166</sup> However, Microsoft is building the

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*Leads the Way*, GAMESPOT (Feb. 3, 2022), <https://www.gamespot.com/articles/playstation-xbox-and-nintendo-gaming-revenue-compared-sony-leads-the-way/1100-6500267>.

162. See discussion *supra* Section II.E.

163. Jim Ryan, *UPDATE: All-new PlayStation Plus Launches in June with 700+ Games and More Value Than Ever*, PlayStation Blog (Mar. 29, 2022), <https://blog.playstation.com/2022/03/29/all-new-playstation-plus-launches-in-june-with-700-games-and-more-value-than-ever>.

164. *Id.*

165. *MMO Population Tracker*, MMO POPULATIONS, <https://mmo-population.com> (accessed May 3, 2022) (showing that *World of Warcraft* has 119 million players total, far ahead of second-place *Destiny 2*, which has 40 million players); Jeff Grubb, *NPD: The Top 20 Best-Selling Games of the Decade in the U.S.*, VENTUREBEAT (Jan. 16, 2020), <https://venturebeat.com/2020/01/16/the-top-20-best-selling-games-of-the-decade-in-the-u-s> (showing that out of the top fifteen games sold in the 2010s, ten were *Call of Duty* games).

166. “Obtaining a monopoly by superior products, innovation, or business acumen is legal;

Game Pass library by buying the raw materials other companies will need to build a robust competitor.

In addition to raising the barriers to entry in a market it already dominates, the acquisition could also allow Microsoft to carry out monopoly pricing. As it grows, Xbox Game Pass is an incredible deal at just \$10 per month. However, if it continues to consolidate the market—offering most of the largest games—Microsoft will be able to raise prices without consequence. Having a strong second (or third) competitor would require Microsoft to compete more innovatively, either by licensing more content or lowering prices. However, if its numerous recent acquisitions allow it to kill any competition in their nascency, it will quickly be able to raise its Game Pass price with limited repercussions. While a monopoly itself is not illegal if a company like Microsoft offers the best product (many have called Game Pass the “best deal in gaming”), Microsoft’s intention to grow its near-monopoly power in this market by acquiring Activision makes it significantly more difficult for a competitor to emerge.<sup>167</sup> This is exactly the sort of anticompetitive action our antitrust laws are intended to prevent.

Microsoft argues that it is willing to make concessions to help satisfy government regulators. For instance, the company says it is open to launching Activision games on PlayStation platforms in addition to its own.<sup>168</sup> However, this concession is of little use in practice. Microsoft offered to put “Call of Duty” on Playstation and Nintendo platforms for the next decade, but the proposal did not include any offer to bundle the franchise within the competing subscription platforms.<sup>169</sup> Microsoft admitted that the purpose of its recent acquisitions is to offer the market’s biggest games exclusively on its subscription service.<sup>170</sup> The result is that a consumer would be able to purchase the game on PlayStation for the full \$70 premium price, or subscribe to Game Pass for \$10 per month to have

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however, the same result achieved by exclusionary or predatory acts may raise antitrust concerns.” *Monopolization Defined*, FTC, <https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/single-firm-conduct/monopolization-defined> (last visited May 11, 2023).

167. *Id.*

168. For now, the company only promises to carry out Activision’s existing contractual obligations, but claims it will continue to bring its games to other platforms. Brad Smith, *Adapting Ahead of Regulation: A Principled Approach to App Stores*, MICROSOFT (Feb. 9, 2022), <https://blogs.microsoft.com/on-the-issues/2022/02/09/open-app-store-principles-activision-blizzard>.

169. See Jon Porter, Microsoft Signs Binding Call of Duty Deal with Nintendo Ahead of EU Activision Hearing, *Verge* (Feb. 21, 2023), <https://www.theverge.com/2023/2/21/23608256/microsoft-nintendo-call-of-duty-agreement-legal-eu-hearing>; Tom Ivan, *Microsoft Says 10 Years is ‘Sufficient for Sony to Develop Call of Duty Alternatives’*, VIDEOGAMESCHRONICLE (Mar. 21, 2023), <https://www.videogameschronicle.com/news/microsoft-says-10-years-is-sufficient-for-sony-to-develop-call-of-duty-alternatives/>

170. Jay Peters, Phil Spencer Basically Confirms The Elder Scrolls VI is an Xbox Exclusive, *Verge* (Nov. 15, 2021) (admitting that the point of acquisitions “is about delivering great exclusive games for you that ship on platforms where Game Pass exists”), <https://www.theverge.com/2021/11/15/22783314/elder-scrolls-6-xbox-exclusive-pc-phil-spencer>.

access. This one-sided option clearly tips the scales in favor of one platform. Moreover, Microsoft suggested that it would no longer provide access to the franchise to Sony after the ten-year agreement ended because purportedly that would provide Sony sufficient time to create a competitor.<sup>171</sup> The argument is a perverse one: Microsoft can purchase the largest franchise in the gaming industry because it has the resources to do so, but Sony has to invest the resources to create blockbuster competitor with its own hard work.

Consolidation could also hurt smaller game developers. Small game developers have a huge incentive to put their games on Game Pass because they are guaranteed a lump sum licensing fee or royalty from Microsoft, rather than having to risk selling in a digital marketplace.<sup>172</sup> There is also significant evidence that small games on Game Pass regularly have far more players than the other games, in part because it does not cost anything extra for a subscriber to try a game through a subscription service.<sup>173</sup> However, if Microsoft becomes a monopolist in the game subscription market, especially through anticompetitive means, it will have substantially greater bargaining power with these smaller developers.

In a competitive market, each subscription company would bid against one another to license the best games at the most competitive rates. However, if there is no viable Game Pass competitor, game developers will have little ability to refuse a licensing offer with Microsoft. There would be nowhere else for them to go. The choice for a game developer would be between accepting a small, but relatively significant payment from Microsoft, or venturing alone into the risky and hypercompetitive digital marketplace. Many developers will opt for security when there is little bargaining power to license games to a competitor. Moreover, small game developers have a lower incentive to produce great products or take risks when there is a smaller chance to recoup revenue. Simply, in order to succeed, a subscription model must attract millions of subscribers and have the resources to license a library of expensive games. Without a viable competitor to Game Pass, Microsoft will have the ultimate bargaining power to acquire content

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171. *See id.*

172. *See, e.g.,* Danielle Partis, Microsoft reportedly paid \$600k to put Cooking Simulator on Game Pass, *GamesIndustry.biz* (Aug. 23, 2022), <https://www.gamesindustry.biz/microsoft-reportedly-paid-600k-to-put-cooking-simulator-on-game-pass>.

173. Simon Carless, *In-Depth: Game Pass Stats, Probed & Deconstructed*, *GameDiscoverCo* (Mar. 28, 2022), <https://newsletter.gamediscover.co/p/in-depth-game-pass-stats-probed-and>. *See, e.g.,* Alex Gibson, *REPLACED Devs: Microsoft Partnership Has No Cons; "They Actually Care About the Indie Market,"* *TWINFINITE* (July 21, 2021) (showing that indie titles averaged fifteen times more monthly active users on GamePass compared to Steam), <https://twinfinite.net/2021/07/replaced-devs-microsoft-partnership-has-no-cons-they-actually-care-about-the-indie-market>; Joshua Boyles, *Game Pass Launch Helps the Ascent Achieve \$5 Million in Sales*, *GAMEBYTE* (Aug. 6, 2021), <https://www.gamebyte.com/game-pass-launch-helps-the-ascent-sell-millions-of-copies>; Jack Grimshaw, *Xbox Game Pass Stats Show Subscribers Play 40 Percent More Games*, *NME* (Mar. 24, 2022), <https://www.nme.com/news/gaming-news/xbox-game-pass-stats-show-subscribers-play-40-per-cent-more-games-3189615>

at low rates, and on the backside the power to charge high subscription fees to customers.

#### CONCLUSION

Under both the rule of reason test and the accompanying consumer welfare standard, the Activision acquisition is a threat to competition in both the premium game and game subscription markets. In the premium game market, Microsoft argues that the acquisition allows it to better compete against Nintendo and Sony, but the acquisition will rob its competitors from accessing games from the biggest third-party game publisher in Activision. The acquisition strips otherwise-regular access to Activision games from any person without a Microsoft platform.

The acquisition is even more concerning because it has the potential to strangle the nascent and rapidly growing game subscription market. Microsoft argues this is a great deal for consumers, who will benefit by being able to access games for an extraordinarily low monthly price. However, Microsoft's recent acquisition spree greatly increases the barriers to entry in a market in which it already has near-monopoly control. The FTC should reject Microsoft's likely market definition, which attempts to frame the relevant market as the entirety of the game industry. Just as it would make little sense to consider Netflix, movie studios, and movie theaters part of the same market, so too does it make little sense for an agency to assess the relevant market as the entire \$180 billion game industry. Microsoft's proposed Activision acquisition has alarming anticompetitive effects which pose a threat to consumer welfare, and the FTC should continue with great resolve to block it.