

FTC Sues To Block \$40 Billion Nvidia Acquisition of Arm, Reinforcing Aggressive Enforcement Agenda

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On December 2, 2021, the Federal Trade Commission (FTC or Commission) filed an administrative complaint challenging Nvidia's \$40 billion acquisition of Arm Ltd., a subsidiary of the Softbank Group. The Commission, which voted unanimously in favor of challenging the transaction, stated it is "suing to block the largest semiconductor chip merger in history to prevent a chip conglomerate from stifling the innovation pipeline for next-generation technologies."¹ Since its announcement in late 2020, the transaction has faced scrutiny around the world in multiple investigations, including before the European Commission (EC), UK Competition and Markets Authority, Korea Fair Trade Commission, Japan Fair Trade Commission and China's State Administration for Market Regulation (SAMR).

These ongoing global investigations have prevented the deal from closing, allowing the FTC to challenge the transaction with its administrative process without seeking a preliminary injunction in federal court, a strategy the FTC also used earlier this year in its challenge of Illumina's proposed acquisition of Grail, another vertical transaction. The FTC's challenge, along with recent FTC actions and policy changes, sends a signal to expect ongoing aggressive enforcement in technology markets, substantial scrutiny of vertical transactions that could threaten innovation and tactical use of the FTC's administrative procedural powers.

Nvidia's Proposed Acquisition of the 'Switzerland' of Semiconductors

Nvidia, a California-based semiconductor manufacturer, announced its proposed acquisition of Arm in September 2020. Nvidia is a market leader in the development of graphics processing units (GPUs) and has introduced or acquired complementary products that utilize microprocessors that use Arm technology. In particular, Nvidia has seen rapid growth in products used for computing in artificial intelligence, computer-assisted driving and advanced networking applications that utilize Arm intellectual property. Arm creates and licenses IP in the form of microprocessor core designs and "instruction set architecture" that sit at the heart of myriad semiconductor microprocessor chips used in many different applications. Arm architecture is used in microprocessors for everything from smartphones and driver-assistance systems to networking products and a multitude of devices powering the "internet of things." Arm increasingly has become the go-to technology for CPU microprocessors used in applications other than traditional PCs and servers. Because of the ubiquity of the Arm ecosystem, and the fact that its business model is based around a "neutral, open licensing approach," Arm often is viewed as the "Switzerland" of the semiconductor world, according to the FTC complaint.²

FTC Vertical Theories of Harm

The FTC's concern over the transaction is not a reduction of competition between the merging parties but rather the potential harm caused by Nvidia's alleged ability to use control of Arm to reduce or blunt competition from Nvidia's rival chipmakers. Nvidia and Arm do not compete with one another — rather, Nvidia licenses IP from Arm for use in Nvidia semiconductor products. Arm licenses its IP widely to downstream partners, including Nvidia and its rivals, who in turn compete with one another in semiconductor markets.³ Arm invests a great deal of time and energy into supporting its licensees, including in their efforts to create more innovative products using Arm IP, because the

¹ FTC Press Release, "FTC Sues To Block \$40 Billion Semiconductor Chip Merger" (Dec. 2, 2021).

² *Id.*

³ *Nvidia Corp., No. 9404*, Complaint at ¶ 4 (Dec. 2, 2021).

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more widely their products are used, the more profitable for Arm.⁴ The FTC alleges that post-transaction, Nvidia would have the ability and incentive to foreclose competitors by withholding, delaying or degrading access, changing the terms of availability, or otherwise leveraging Arm IP to harm Nvidia's semiconductor chip rivals rather than continuing to neutrally license and develop Arm technology.⁵

The FTC identified three specific product areas where the Nvidia transaction would allegedly lessen competition: data processing units (or SmartNICs) used in networking, automotive advanced driver assistance system computing chips ("high-level ADAS") and Arm-based datacenter CPUs for cloud computing services.⁶ Nvidia is an active competitor in each of these areas, and the complaint points out that Nvidia's competitors in these products depend upon Arm IP to develop their own products and do not have feasible alternatives to Arm technology. The FTC considered whether different technologies (such as x-86 and MIPS) were potential alternatives to Arm but determined that they were not realistic options for most competitors in these product areas. Notably, the FTC did not provide market share data for any of Nvidia's positions in each of these markets in the public complaint but alleged that Nvidia's "profits on additional sales in the downstream market are likely to be larger than the profits from continuing to neutrally license," providing the alleged incentive to exclude competitors by leveraging its control of Arm licensing and technology development.⁷

The complaint also highlights that Nvidia competitors must routinely share competitively sensitive information with Arm in order to facilitate development and support, and that an Nvidia acquisition might result "in a critical loss of trust in Arm."⁸ The FTC alleges that Nvidia could misuse competitively sensitive information shared with Arm to adjust its own semiconductor strategies and that Arm licensees would be less inclined to share competitively sensitive information with Arm, reducing the innovation that exists today. In addition, the FTC claims that Nvidia's ownership of Arm also would reduce innovation in the semiconductor industry by "skewing" the development of new Arm technology in ways that avoid encroaching on Nvidia's interests in the downstream semiconductor markets.

⁴ *Id.*, ¶¶ 24-25.

⁵ *Id.*, ¶¶ 9-10.

⁶ *Id.*, ¶¶ 58-111.

⁷ *Id.*, ¶¶ 9-10.

⁸ *Id.*, ¶ 10.

Key Takeaways

Scrutiny of Vertical Deals

The FTC's complaint demonstrates that the agency will continue to challenge vertical transactions that threaten to undermine access to technology that is critical to competition. Antitrust has traditionally presumed that vertical mergers may have procompetitive benefits,⁹ including the elimination of double marginalization, combination of complementary functions and elimination of contracting frictions between parties. These benefits can contribute to lower prices to consumers and greater competition, which is why vertical transactions historically have posed less of a concern than horizontal transactions. However, under Chair Lina M. Khan's leadership, the FTC has recently called special attention to potential anticompetitive effects in vertical mergers. In September 2021, in a contentious 3-2 vote, the FTC withdrew from the 2020 Vertical Merger Guidelines (VMGs). The accompanying statement issued by the majority challenged the notion that vertical mergers lead to decreases in price, and argued that they may reduce competition along nonprice areas like product quality and innovation. The statement contends that "the 2020 VMGs' 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."¹⁰

While the Democratic-appointed commissioners signaled the FTC will increase its scrutiny of vertical transactions, the complaint against Nvidia/Arm should not be read as evidence of a significant change in enforcement approach. The complaint was authorized by a unanimous 4-0 vote of the Commission, suggesting that this is a deal that would have been challenged regardless of the recent debate within the Commission on vertical transactions. Arm has staked out a neutral position as a licensor that has made it a critical part of the semiconductor developmental process. The FTC's complaint quotes an analyst describing Arm as "a technology enabler for the entire semis industry."¹¹ Because of Arm's foundational position, downstream rivals have been especially worried about anything that could upset its neutrality. While Nvidia has promised to keep Arm licensing "neutral,"¹² rival chipmakers claimed that the acquisition would incentivize Nvidia to become a "gatekeeper" for Arm technology, and the FTC determined that the risk of Nvidia leveraging access to Arm to disadvantage competitors and reduce innovation was too great.¹³

⁹ See U.S. DOJ & FTC, *Vertical Merger Guidelines* (2020).

¹⁰ [Statement of Chair Lina M. Khan, Commissioner Rohit Chopra, and Commissioner Rebecca Kelly Slaughter on the Withdrawal of the Vertical Merger Guidelines](#), FTC (Sept. 15, 2021).

¹¹ *Nvidia Corp.*, No. 9404, Complaint, at 62.

¹² Ron Amadeo, "Nvidia Will Keep ARM Licensing 'Neutral,' Wants to License GPU Tech, Too," *Ars Technica* (Sept. 14, 2020).

¹³ Sam Sheard, "Qualcomm Objects to Nvidia's \$40 billion Arm Acquisition," CNBC (Feb. 12, 2021).

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Effects on Innovation

The FTC's complaint reflects that the agency will consider impacts on innovation where a transaction involves an important technology that facilitates the development of new competitive products in an industry. In addition to the potential foreclosure of Nvidia's rivals that are competing with it today, the FTC alleged that transaction also would harm future innovation in the semiconductor industry by warping the trajectory of Arm development to enable Nvidia competitors' new products. This theme is consistent with the FTC's position in its recent challenge of Illumina's acquisition of Grail, which was likewise viewed by the agency as harming innovation by potentially giving Illumina control over a critical input needed by rivals to develop new products.¹⁴

Use of FTC Procedural Tools

The Nvidia-Arm complaint also is notable for its use of the FTC's administrative litigation process. Part 3 of the FTC Act allows the Commission to challenge antitrust violations — whether mergers or conduct — through its own in-house administrative process.¹⁵ The FTC seldomly uses standalone Part 3 complaints for merger challenges and typically seeks a preliminary injunction in a parallel action in federal court to prevent the parties from closing the transaction. Here, in light of the ongoing investigations outside the U.S., it was unnecessary for the FTC to seek an injunction in federal court at this time because the deal could not close before receiving foreign approvals. The timeline for an administrative trial on the merits is generally much longer than a typical injunction hearing in federal court, allowing the FTC to sue without litigating the merits in the near term while the transaction continues to undergo review in jurisdictions that have the potential to effectively prohibit the transaction without a trial. EC Commissioner of Competition Margrethe Vestager recently noted that the EC is “deeply concerned” and would not be prepared to make a decision until “quite a while” into 2022.¹⁶

The FTC's tactical use of Part 3 powers is a potential trend to watch, in light of Chair Khan's aggressive enforcement agenda and pledge to use “our full set of tools and authorities.”¹⁷ In addition, the FTC recently voted 3-2 to further streamline the process

by consolidating more power in the chair.¹⁸ The FTC also noted in its announcement of its complaint that the FTC cooperated closely with staff of the competition agencies in the European Union, United Kingdom, Japan and South Korea.¹⁹ With rising scrutiny of global technology transactions, close coordination among competition authorities presents a very challenging path for transactions that have competition issues, due to the variety of process tools regulators collectively have that can slow down transactions or preclude them altogether.

FTC Prior Approval Policy

Another issue to monitor will be whether the FTC seeks to impose a prior-approval condition on Nvidia as a part of a settlement or administrative proceeding. Prior approval provisions require advance approval by the FTC of certain future transactions by the involved parties. Since 1995, the Commission only has sought to use such provisions to block future proposed acquisitions in the same geographic and product market without prior FTC approval.²⁰ However, the Commission recently voted 3-2 to rescind and replace the 1995 policy statement with a broader policy that would seek to impose prior approval more often and potentially beyond transactions in the same geographic and product markets, so that “acquisitive firms ... think twice before going on a buying binge because the FTC can simply say no.”²¹ The Commission also noted that it may pursue prior approval remedies even where parties have abandoned a transaction. So far, the agency's focus on expanding prior approval appears to center on horizontal transactions that result in divestitures, but it is possible the agency also could seek prior approval remedies in vertical cases. If the FTC seeks and successfully obtains an order with such a remedy, it could have the unilateral ability to block covered future acquisitions by Nvidia, in a market the FTC deems relevant, for at least a decade.

The FTC's challenge to the Nvidia/Arm merger reinforces the agency's ongoing intense scrutiny of transactions in technology markets, including vertical transactions that involve inputs that are fundamental to innovation. Merging parties should take note of the potential process and timing challenges associated with navigating global merger reviews in which antitrust agencies coordinate their efforts with their counterparts across borders and have a number of tools to impede the consummation of a transaction.

¹⁴ *Illumina Inc., No. 9401*, Complaint at ¶ 11 (March 30, 2021).

¹⁵ See Maureen K. Ohlhausen, “Administrative Litigation at the FTC: Effective Tool for Developing the Law or Rubber Stamp?,” *Journal of Competition Law & Economics*, 623 (2016).

¹⁶ Morten Buttler, “EU ‘Deeply Concerned’ by Nvidia-Arm Deal, Vestager Says,” Bloomberg (Dec. 10, 2021).

¹⁷ See Chair Khan's Sept. 22, 2021, memo to the staff and commissioners on “Vision and Priorities for the FTC.”

¹⁸ See *Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter on Actions To Expedite Staff Investigations*, FTC (Sept. 14, 2021); *Dissenting Statement of Commissioners Noah Joshua Phillips and Christine S. Wilson Regarding the Issuance of Eight Omnibus Resolutions*, FTC (Sept. 14, 2021).

¹⁹ FTC Press Release, “FTC Sues to Block \$40 Billion Semiconductor Chip Merger” (Dec. 2, 2021).

²⁰ *Dissenting Statement of Commissioners Christine S. Wilson and Noah Joshua Phillips Regarding the Statement of the Commission on Use of Prior Approval Provisions in Merger Orders*, FTC (Oct. 29, 2021).

²¹ FTC Press Release, “FTC to Restrict Future Acquisitions for Firms that Pursue Anticompetitive Mergers” (Oct. 25, 2021).