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Takeaways From the Trial Court's Decision in *Epic* v. *Apple*

The Trial Court Declined to Recognize Any Single-Brand Aftermarkets Arising From Apple's Control of the App Store, and Ruled in Apple's Favor on the Merits of Epic's Federal and State Antitrust Claims, but Enjoined Apple From Enforcing its App Store Anti-Steering Provisions as a Remedy for Apple's Violations of California's Unfair Competition Law

SUMMARY

Following a bench trial, on September 10, 2021, the Honorable Yvonne Gonzalez Rogers of the U.S. District Court for the Northern District of California issued an order resolving antitrust and unfair competition claims brought by Epic Games, Inc. ("Epic") against Apple Inc. ("Apple"). Epic challenged Apple's App Store restrictions that (1) prohibit distribution of iOS applications ("apps") for Apple's iPhone and iPad devices outside Apple's App Store; (2) require app purchases and in-app transactions for digital content to exclusively use Apple's In-App Purchase ("IAP") payment system, on which Apple collects a 30% commission for all transactions; and (3) contain anti-steering provisions that restrict app developers from informing users about other payment mechanisms. The court found that Apple's restrictions have anticompetitive effects and reduce innovation in mobile game distribution, but nonetheless denied all of Epic's antitrust claims based on federal and California state antitrust law. Nevertheless, the court held that Apple's anti-steering provisions violate California's Unfair Competition Law ("UCL"). To remedy that violation, the court issued a nationwide, permanent injunction preventing Apple from enforcing the anti-steering provisions, which extends to all app categories (not just gaming apps). In effect, the injunction gives app developers the ability to avoid Apple's 30% IAP commission by prohibiting Apple from enforcing rules that restrict the inclusion of links to external websites for purchasing in-app content, or that prevent

developers from communicating with their users through points of contact obtained by means of account registration in iOS apps.

The injunction appears to have several significant limitations, however. *First*, the order may allow Apple to require developers to include IAP as one payment option. *Second*, Apple will likely take the position that the order permits it to mandate IAP as the sole mechanism for in-app transactions, and that the injunction permits developers only to promote alternative payment mechanisms outside the app, although the order is unclear on this issue. *Third*, given the injunction's lack of precision around what Apple is permitted to do, there are many important details still to be worked out regarding the extent to which Apple must make it feasible for developers to promote alternative payment mechanisms. Thus, although the order has significant ramifications both for Apple and for app developers, the injunction does not fully address developers' complaints about Apple's restrictive App Store practices.

I. BACKGROUND AND PROCEDURAL HISTORY

As a condition for obtaining a license to design and distribute apps on Apple mobile devices, all app developers must enter into Apple's Developer Program License Agreement ("DPLA") and abide by the App Store Review Guidelines, which contain a series of contractual provisions that ensure in-app purchases are channeled through IAP. For instance, Apple prohibits the distribution of iOS apps through alternative app stores and mandates the use of IAP for all purchases of digital content to be consumed within an iOS app (such as in-game currency or additional game levels in a gaming app, or e-books in an e-reader app).[1] The DPLA also contains anti-steering provisions that prohibit developers from encouraging customers to use, or directing users to, payment mechanisms other than IAP (such as including links to payment pages on developers' websites).

These and similar restrictions have been the subject of recent scrutiny around the world, including in an October 2020 report by the U.S. House Subcommittee on Antitrust, Commercial and Administrative Law finding that "Apple leverages its control of iOS and the App Store to create and enforce barriers to competition and discriminate against and exclude rivals while preferencing its own offerings"[2] and a Statement of Objections by the European Commission in April 2021 finding preliminarily that Apple's IAP requirement and anti-steering provisions distorted competition in the music streaming market.[3] A bill passed on August 31, 2021 by South Korea's National Assembly, which is awaiting presidential approval, would prohibit large app-store operators such as Apple and Google from requiring the use of their own in-app purchasing mechanisms, but the legislation would only affect South Korean transactions.[4] And although Apple announced earlier this month that it had reached a settlement to close an investigation by the Japan Fair Trade Commission by agreeing to allow developers of "reader" apps to include in-app links to their website for users to set up or manage their accounts, this change would apply only to apps that do not offer in-app purchases at all and would not go into effect until early 2022.[5]

Epic, a game and software development company whose flagship videogame is the popular Fortnite, is one of the most vocal critics of Apple's App Store policies. Before filing its lawsuit challenging Apple's App Store restrictions, Epic conceived and executed a plan, called "Project Liberty," to circumvent Apple's 30% commission on in-app purchases.[6] Epic intentionally violated Apple's policies by secretly introducing a "hotfix" into an update to the Fortnite iOS app on August 3, 2020 that, when activated by Epic, would give users the option to directly pay Epic (at a cheaper rate than the IAP payment option) for in-game purchases through an alternative payment system.[7] Epic activated the hotfix on the morning of August 13, 2020, and Apple removed the Fortnite iOS app from the App Store within hours.[8]

Epic filed a complaint against Apple later that day, alleging that Apple's App Store restrictions violated federal and California antitrust laws and the UCL. The case was assigned to Federal District Court Judge Yvonne Gonzalez Rogers in the Northern District of California. A three-week bench trial was held in May 2021, and on September 10, 2021, Judge Gonzalez Rogers issued an Order after Trial that largely sides with Apple on the merits of Epic's antitrust claims but finds that Apple's anti-steering provisions violate the UCL. Accordingly, the court issued a permanent injunction prohibiting Apple from enforcing the anti-steering provisions, but leaving intact Apple's other restrictions—including the prohibition against alternative app stores and the mandate to use IAP for in-app transactions for digital content. By barring the enforcement of Apple's anti-steering provisions, the injunction will permit developers to direct customers to alternative payment mechanisms other than IAP, although, as discussed below, the decision appears to leave the IAP mandate intact such that developers may be required to implement IAP in addition to being able to make alternative payment mechanisms available.

II. THE COURT'S REASONING

A. DEFINING THE RELEVANT MARKET

As with many antitrust claims that do not allege a *per se* antitrust violation (*e.g.*, price fixing), defining a relevant product and geographic market was a critical part of the plaintiff's case. Relying on the framework for demonstrating a single-brand product market adopted by the Supreme Court's 1992 *Eastman Kodak* decision,[9] Epic sought to prove the existence of a "foremarket" for smartphone operating systems, and two single-brand "aftermarkets" for iOS app distribution services and iOS in-App payment processing solutions in which Apple has a total monopoly by virtue of its App Store restrictions.[10] By contrast, Apple advocated for a single relevant market including all digital game transactions.[11]

The court rejected Epic's proposed market definitions on two principal grounds. *First*, the court found that the proposed foremarket for smartphone operating systems is "entirely litigation driven, misconceived, and bears little relationship to the reality of the marketplace" because Apple's iOS operating system is not licensed or sold separately from the iPhone.[12] *Second*, the court found that there was a lack of evidence that consumers were "locked in" to the alleged aftermarkets because there was insufficient evidence of the

high costs of switching to a different brand mobile device[13] and because Epic had not shown that users are unaware of Apple's restrictions on iOS app distribution and in-app payment processing prior to their purchase of an iPhone or iPad.[14] The court also rejected Epic's attempt to characterize the App Store as providing "distribution services" and instead held that the App Store is a two-sided transaction platform, citing the Supreme Court's *Amex* decision.[15]

Turning to the question of which types of transactions should be included in the product market, the court found that there is a relevant submarket for digital game transactions, concluding that "game transactions are disproportionately affected by Apple's challenged conduct."[16] The court cited a number of factors suggesting that gaming app transactions are distinct from non-gaming app transactions[17] and noted that many non-gaming apps are free to users, that developers of free apps pay no commissions to Apple, and that many non-gaming apps are subject to special treatment, such as the "reader rule" that allows users to access content that was purchased outside the App Store within their iOS apps.[18]

But the court accepted Epic's argument (in the alternative) that there is a relevant submarket for mobile-gaming transactions, as distinct from PC and console gaming transactions.[19] In support of this finding, the court noted that (i) mobile gaming accounts for more than half of global gaming revenue; (ii) the rapid growth in mobile gaming has not cannibalized PC and console gaming revenues, suggesting a lack of substitutability between the two; (iii) the most popular games on mobile devices are only available on mobile devices; and (iv) Microsoft did not view game transactions on iOS devices as competition to transactions on the Xbox console.[20]

Finally, the court concluded that the geographic scope of the relevant market is global—excluding China—by discounting Apple's evidence of differences between the App Store's storefronts in different countries and focusing on the fact that Apple "treats app distribution as a global enterprise."[21]

B. FEDERAL ANTITRUST CLAIMS

1. Evidence of Apple's Market Power

The court found that Apple's revenue share of the market for mobile-gaming transactions for the three years in evidence—2015 through 2017—was between 52.9 and 57.1%.[22] The court held that this share was insufficient to show a *prima facie* case of a monopoly and concluded that there was no direct evidence of Apple's monopoly power because mobile gaming transactions were increasing, suggesting that Apple lacked the ability to restrict output.[23] Looking to indirect evidence, although the court acknowledged that the market for digital game stores is concentrated and some barriers to entry do exist, the court also found that "significant changes in both the wider gaming market and the mobile gaming market" were taking place—such as the introduction of the Nintendo Switch and game-streaming services. The court viewed these changes as "evidence that the[] entry barriers are not so substantial [so as] to prevent new market entrants."[24] The court therefore concluded that Apple has market power in the mobile-gaming market for

the purposes of Section 1 of the Sherman Act, but fell short of having the substantial market power required to establish that Apple is a monopolist under Section 2.[25]

2. Sherman Act Section 1 – "Rule of Reason" Analysis

At the outset, the court suggested that the threshold Section 1 requirement of an "agreement" between Apple and app developers may not be met because the DPLA "is a unilateral contract . . . that a developer must accept."[26] The court noted that Apple's unilateral conduct in imposing the App Store restrictions on developers is the exclusive province of Section 2, but nonetheless went on to analyze Apple's contractual restraints on iOS app distribution and in-app payments under the "rule of reason" burden-shifting framework.

The court first found that Apple's refusal to allow any distribution of gaming apps through alternative app stores "do[es] have *some* anticompetitive effects" because this restriction foreclosed competition from other stores that could have led to lower commissions on app transactions[27] and "reduce[s] innovation in 'core' game distribution services."[28] The court nonetheless found that Apple's restraints on app distribution were justified by Apple's desire for security, and because Apple's "walled garden" approach differentiates it from Google's open distribution approach, giving consumers increased choice.[29] It also held that Epic's proposed alternatives—an enterprise model where Apple would certify alternative app stores as trustworthy, or a notarization model where apps may be freely distributed through other app stores and allowing Apple to "notarize" them as safe after they are released—were not viable because they could not provide the same level of security as the app review approach utilized by the App Store.[30]

Similarly, the court found that Apple's requirement that all gaming app transactions utilize IAP has anticompetitive effects because the 30% commission rate increases developers' costs and increases prices paid by consumers when those costs are passed on.[31] But again, the court found Apple's IAP requirement justified by Apple's right to collect a royalty for the use of its intellectual property (*i.e.*, its development of the App Store), and its desire to provide a secure and convenient means of payment to users.[32] Epic's proposed alternative—allowing the use of alternative payment processors other than IAP—would make it harder for Apple to collect a royalty for the use of the App Store and would undermine its security and convenience justifications.[33]

For those reasons, the court rejected both of Epic's Section 1 "rule of reason" challenges to Apple's App Store restrictions.

3. Sherman Act Section 2 – Monopoly Maintenance

Having already concluded that Apple does not have a monopoly in the global market for mobile game transactions, the court held that Epic's Section 2 claims necessarily failed.[34]

4. Sherman Act Section 1 – Tying

The court rejected Epic's claim that Apple had illegally tied app distribution through the App Store to the use of IAP, finding that the threshold requirement—that the tying and tied services are distinct—was not met. Instead, the court held that IAP "is but one component of the full suite of services offered by iOS and the App Store" that is "integrated into the iOS devices."[35] The court also found that there is no demand for IAP as a standalone product.[36]

5. Sherman Act Section 2 – Essential Facility

Finally, the court rejected Epic's claim that Apple had denied it access to an "essential facility"—*i.e.*, the ability to distribute games on the iOS platform—for two reasons. *First*, the court noted that Epic had failed to make the required showing that Apple was a monopolist in control of the iOS platform.[37] *Second*, the court held that Epic had not shown that the iOS platform is an essential facility because Epic could still distribute games through "web apps, by web access, and through other games stores," and that the essential facility doctrine does not require access to a plaintiff's preferred method of distribution.[38]

C. CALIFORNIA CARTWRIGHT ACT CLAIMS

The court rejected Epic's claims under California antitrust law, noting that those claims were based on the same allegations as its claims under Section 1 of the Sherman Act and that the analysis under California law is similar.[39]

D. CALIFORNIA UCL CLAIMS

Having determined that Epic is a consumer of Apple's App Store services and thus has standing to bring a UCL claim as a "quasi-consumer" and not merely as a competitor,[40] the court rejected Epic's claim under the "unlawful" prong of the UCL[41] because Epic had not shown that Apple is violating any state or federal antitrust laws.[42]

Turning to the "unfair" prong of the UCL, the court noted that this prong prohibits conduct that "threatens an incipient violation of an antitrust law" or "violates the policy or spirit of one of those laws because its effects are comparable to or the same as a violation of the law."[43] While the court rejected Epic's UCL claims based on Apple's app distribution and in-app payment-processing restrictions,[44] it separately analyzed Apple's anti-steering provisions—which it did not address in the context of Epic's Sherman Act Section 1 claims—and concluded that they violated the UCL. The court noted that Apple "acts anticompetitively by blocking developers from using" push notifications and email outreach to communicate with users about lower prices on other platforms and the fact that Apple charges a 30% commission, reasoning that the open flow of information is critical in technology markets because "information costs may create 'lock-in' for platforms."[45] Thus, the court noted that developers' inability to provide cross-platform information "may create the potential for anticompetitive exploitation of consumers" and concluded that "the anti-steering provisions 'threaten[] an incipient violation of an antitrust law' by preventing informed choice

among users of the iOS platform."[46] The court also rejected Apple's argument that it should not have to allow advertising of prices on the web or on Android within iOS, observing that Apple "enforced silence to control information and actively impede users from obtaining the knowledge to obtain digital goods on other platforms."[47]

E. REMEDY

To remedy Apple's violation of the UCL, the court found that an injunction against Apple's enforcement of the anti-steering provisions was most appropriate.[48] Noting that the anti-steering provisions apply to all apps and not just gaming apps, the court also found that there was no principled reason for limiting the injunction only to gaming apps.[49] The court therefore issued a nationwide injunction permanently restraining Apple from "prohibiting developers from (i) including in their apps and their metadata buttons, external links, or other calls to action that direct customers to purchasing mechanisms, in addition to In-App Purchasing and (ii) communicating with customers through points of contact obtained voluntarily from customers through account registration within the app."[50]

IMPLICATIONS

The court's injunction opens the way for app developers to avoid Apple's 30% IAP commission by giving them the ability to direct their customers to less expensive alternatives (including by using links within their iOS apps to external payment options). The injunction may also require Apple to allow developers to use push notifications and other means of communicating the availability of alternative payment mechanisms to app users. This development has significant ramifications both for Apple's profit margins from the App Store (the court found that App Store operating margins were over 75% in 2018 and 2019[51]), and for app developers—some of whom have high variable costs that make an additional 30% commission on in-app transactions untenable.

On the other hand, Apple will likely take the position that the court's decision leaves intact Apple's requirement that iOS apps must use IAP as the sole mechanism for facilitating a transaction *within the app itself*—although this issue is far from clear. If Apple prevails on its reading of the decision, that would have three important implications. *First*, Apple could continue to require developers to use IAP if they want to offer in-app purchases; the injunction would only permit the promotion of alternative payment mechanisms outside of an app. *Second*, if an app offers both in-app purchases and links to external payment options, some users may find disruptive the experience of leaving the app to make a purchase of in-app content and may prefer to continue using Apple's IAP over other payment methods. *Third*, if Apple can continue to mandate the use of IAP, there are many important details still to be worked out regarding the extent to which Apple must make it feasible for developers to promote alternative payment mechanisms.

In light of these limitations, the injunction falls short of fully addressing developers' complaints about Apple's restrictive App Store practices. U.S. lawmakers have also said that the court's ruling addresses only some of their concerns and called for federal app store legislation.[52]

Given Epic's notice that it is appealing the court's judgment[53] and the ongoing antitrust litigation against Apple and other large platform operators, several other aspects of the court's decision warrant attention:

First, the court repeatedly emphasized the emergence of new technologies—such as game-streaming services—and the proliferation of cross-platform apps, and the Order notes that both of these market changes make it easier for consumers to switch mobile device brands. The court cited these developments both in rejecting Epic's evidence of consumer lock-in in support of its aftermarkets theory,[54] and in finding that Apple did not have monopoly power because it lacked the ability to restrict output in the mobile gaming transactions market.[55]

Second, given the court's findings that game-streaming services and the Nintendo Switch are new entrants into the mobile-gaming market,[56] the court's decision not to include mobile game transactions on these platforms as substitutes for game transactions on the App Store seems somewhat inconsistent.[57] Another court considering antitrust claims that involve mobile gaming might reach a different conclusion about the scope of the relevant market.

Third, because the court only considered the effects of Apple's conduct in the distinct submarket for digital game transactions, it is unclear whether the court would reach a different conclusion with respect to Apple's conduct as applied to non-gaming apps. In particular, the court noted that apps offering subscription services were another category of apps that appear disproportionately affected by Apple's conduct, but held that those apps fall within a separate submarket and that there was insufficient evidence to form a conclusion as to whether such apps are impacted by Apple's conduct.[58]

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ENDNOTES

[1] The use of IAP is not required, however, for purchases of goods or services to be consumed in the physical world (such as food ordered from a restaurant delivery app, or rides facilitated through a ride-sharing app).

[2] Majority Staff of H. Subcomm. on Antitrust, Commercial and Admin. Law, 116th Congr., Investigation of Competition in Digital Markets 16 (2020), *available at* https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf.

[3] *Antitrust: Commission sends Statement of Objections to Apple on App Store rules for music streaming providers*, European Commission (Apr. 30, 2021), https://ec.europa.eu/commission/presscorner/detail/en/ip_21_2061.

[4] Jiyoung Sohn, *Google, Apple Hit by First Law Threatening Dominance Over App-Store Payments*, The Wall Street Journal (Aug. 31, 2021), https://www.wsj.com/articles/google-apple-hit-in-south-korea-by-worlds-first-law-ending-their-dominance-over-app-store-payments-11630403335.

[5] *Japan Fair Trade Commission closes App Store investigation*, Apple Inc. (Sept. 1, 2021), https://www.apple.com/newsroom/2021/09/japan-fair-trade-commission-closes-app-store-investigation/.

[6] Rule 52 Order after Trial on the Merits, *Epic Games, Inc.* v. *Apple Inc.*, Case No. 4:20-cv-05640-YGR (N.D. Cal. Sept. 10, 2021) ("Order"), at 19.

[7] *Id.* at 25.

[8] *Id.*

[9] *Eastman Kodak Co.* v. *Image Tech. Servs.*, 504 U.S. 451 (1992). In *Kodak*, the Supreme Court identified two factors that support a single-brand aftermarket framework: (1) high information costs, *i.e.*, the inability of users to obtain accurate information about the total lifecycle cost of the foremarket product because of the difficulty or expense of obtaining information about aftermarket costs, *id.* at 473–75; and (2) high costs of switching to a new product in the foremarket relative to price increases in the aftermarket, *id.* at 476–77.

[10] Order at 44.

[11] *Id.* at 120–21.

[12] *Id.* at 45.

[13] Although the court acknowledged that there are costs associated with switching to a new smartphone brand—such as the need to learn a new operating system, reinstall apps, and repurchase phone accessories—it found that Epic had failed to provide evidence of the magnitude of these costs and whether they actually prevented consumers from switching. *Id.* at 49–50. The court also noted Epic's failure to introduce consumer surveys or other evidence showing that users fail to switch even though they are dissatisfied with the high price or low quality and availability of apps on iOS devices, observing that low rates of switching between iOS and Android devices could stem from user satisfaction with their existing device. *Id.* at 51.

[14] *Id.* at 130.

[15] *Ohio* v. *Am. Express Co.*, 138 S. Ct. 2274 (2018).

[16] Order at 124.

[17] *Id.*

[18] *Id.* at 123.

[19] The court declined to find that game transactions for the Nintendo Switch and game-streaming services are a part of the submarket for mobile-gaming transactions, noting that these products

ENDNOTES CONTINUED

were relatively new to the market and there was insufficient evidence that they are reasonably interchangeable with mobile phone- or tablet-gaming transactions. *Id.* at 85, 126.

20 *Id.* at 125–26.

21 *Id.* at 89–90, 133.

22 *Id.* at 87.

23 *Id.* at 137.

24 *Id.* at 138–39.

25 *Id.* at 139.

26 *Id.* at 142.

27 *Id.* at 144–45.

28 *Id.* at 102.

29 *Id.* at 145–46.

30 *Id.* at 148.

31 *Id.* at 144.

32 *Id.* at 149–50.

33 *Id.* at 150.

34 *Id.* at 151–52. Moreover, in light of the court's observation that Section 2's "rule of reason" analysis is more exacting than the analysis under Section 1, and because Epic's Section 2 claims were based on the same conduct as its Section 1 claims, the court noted that Epic's Section 2 claims also failed for that additional reason. *Id.* at 152.

35 *Id.* at 154.

36 *Id.* at 155.

37 *Id.* at 158.

38 *Id.* at 159.

39 *Id.* at 157.

40 *Id.* at 160–61.

41 The UCL prohibits "any unlawful, unfair or fraudulent business act or practice." Cal. Bus. & Prof. Code § 17200.

42 Order at 161.

43 *Id.* at 161 (quoting *Cel-Tech Commc'ns, Inc.* v. *L.A. Cellular Tel. Co.*, 20 Cal. 4th 163, 187 (1999)).

44 *Id.* at 162–63.

45 *Id.* at 163–64.

46 *Id.* at 164–66 (quoting *Cal-Tech*, 20 Cal. 4th at 187).

47 *Id.* at 165.

48 *Id.* at 166.

49 *Id.* at 167.

50 Permanent Injunction, *Epic Games, Inc.* v. *Apple Inc.*, Case No. 4:20-cv-05640-YGR (N.D. Cal. Sept. 10, 2021).

ENDNOTES CONTINUED

[51] Order at 41–43.

[52] Diane Bartz, *U.S. lawmakers say decision in Apple/Epic fight shows need to update laws*, Reuters (Sept. 10, 2021), https://www.reuters.com/technology/us-lawmakers-say-decision-appleepic-fight-shows-need-update-laws-2021-09-10/.

[53] *See* Notice of Appeal, *Epic Games, Inc.* v. *Apple Inc.*, Case No. 4:20-cv-05640-YGR (N.D. Cal. Sept. 12, 2021).

[54] Order at 131–32.

[55] *Id.* at 139.

[56] *Id.* at 138–39.

[57] *See id.* at 85, 126.

[58] *Id.* at 123 n.571.

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