COURT ISSUES MIXED RULING IN *EPIC V. APPLE* ANTITRUST TRIAL

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U.S. Litigation and Dispute Resolution Alert

On 10 September 2021, the Northern District of California issued a highly anticipated decision in the *Epic Games, Inc. v. Apple Inc.*[1] antitrust dispute. The case centered on whether Apple's operation of its App Store violates U.S. and California antitrust laws and California's Unfair Competition Law. The result was mixed. The court found that Apple was not in violation of antitrust laws, but it did find Apple had violated California's Unfair Competition Law. The court ordered Apple to allow apps to link to payment mechanisms outside of Apple's in-app payment system (where Apple collects a 30% commission on every sale). The court's injunction leaves room for interpretation, and the true impact of the decision will depend in part on how Apple and app developers implement the court's injunction, if and when it goes into effect.

BACKGROUND

Since unveiling the iPhone in 2007, Apple has maintained tight control over its mobile operating system, known as iOS. The only way to install software (apps) onto iOS devices is through the App Store. Apple does not allow other app stores or the installation of software from the Internet on its devices. This closed system is sometimes referred to as a "walled garden." To use the App Store, developers must sign a Developer Product Licensing Agreement (DPLA), which requires developers to use Apple's in-app payment system for all app transactions and pay a 30% commission to Apple on all app sales and in-app purchases.[2] Stated differently, if a developer wants to distribute its app to iOS users, its only option is to use the App Store and pay a 30% commission to Apple every timer a user pays to download the app, sign up for a subscription, or make an in-app purchase.[3] Developers must also agree to Apple's anti-steering provisions, which prohibit developers from (i) providing buttons or links within an app to outside payment systems, (ii) contacting customers acquired through iOS to encourage use of outside payment systems, or (iii) informing customers of Apple's 30% commission.

Epic had used the App Store to distribute games to iOS users since 2010. It debuted its flagship game, *Fortnite*, on iOS devices in 2018. Starting around the mid-2010s, however, Epic and its CEO Tim Sweeney grew increasingly dissatisfied with Apple's App Store policies. The dissatisfaction culminated in Epic introducing an update to *Fortnite* that allowed users to choose between paying through the App Store or making a direct payment to Epic at a discount. In response, Apple swiftly removed *Fortnite* from the App Store on the same day. Epic then filed suit against Apple in U.S. District Court.

DISTRICT COURT DECISION

Epic alleged that Apple's operation of the App Store violated U.S. and California antitrust laws, and California's Unfair Competition Law. Apple countersued for breach of contract and related claims. Following a three-week trial in May 2021, the Northern District of California issued a 185-page order on 10 September 2021. The court made

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the following decision: (i) Apple did not violate the antitrust laws through either unlawful agreements or misuse of monopoly power, (ii) Apple's anti-steering provision violates California's Unfair Competition Law, and (iii) Epic breached the DPLA.

Antitrust Claims

A threshold issue in any antitrust case is defining the "relevant market." Here, Epic argued that the relevant market is Apple's iOS system. Apple argued that the relevant market is the market for all digital video games, where it is one of many players. The court disagreed with both sides, and it instead defined the relevant market as "digital mobile gaming transactions." Under this formulation, the court found that Apple has a 52–57% market share in the "digital mobile gaming transactions" market. But this was not enough for the court to conclude Apple has monopoly power.

Next, the court examined anticompetitive aspects of Apple's conduct and Apple's procompetitive justifications. The court found that Apple's app distribution restrictions did have some anticompetitive effects. The court noted that Apple collected an artificially high commission and had hindered innovation.

On the other hand, the court found that Apple offered valid, procompetitive reasons for its policies. These procompetitive reasons included (i) maintaining a safe and secure user experience, (ii) promoting interbrand competition in the sense that Apple's "walled garden" approach is a main differentiator between Apple and Google and results in more consumer choice, and (iii) protecting Apple's investment in its intellectual property. Ultimately, the court concluded that the anticompetitive aspects of Apple's App Store practices did not outweigh the procompetitive benefits.

Due to its lack of monopoly power and the absence of anticompetitive effects that outweighed procompetitive benefits, the court concluded that Apple was not in violation of U.S. or California antitrust laws, and it is not required to allow Epic or other developers to open competing game stores on iOS.

Unfair Competition Claim

While the court declined to find antitrust violations, it did hold that Apple's anti-steering provisions violated California's Unfair Competition Law. As discussed above, Apple's anti-steering provisions restrict developers' ability to tell customers about payment methods outside of Apple's in-app payment system. The court concluded that the provisions were unfair because they prevented users from making an informed choice. Thus, the court issued a nationwide (but not global) injunction enjoining Apple from: (i) prohibiting apps and their metadata from containing "buttons, external links, or other calls to actions that direct customers to purchasing mechanisms, in addition to [in-app payment]"; and (ii) prohibiting developers from "[c]ommunicating with customers through points of contact obtained voluntarily from customers through account registration within the app."

Breach of Contract

Finally, the court held that Epic breached the DPLA by introducing an alternative payment method in *Fortnite* and refusing to pay a 30% commission to Apple. The court reiterated that the DPLA provisions at issue did not violate antitrust laws (the anti-steering provision, while unlawful, was independent of the DPLA provisions at issue). The court awarded Apple its uncollected commission and issued a declaratory judgment that: (i) Apple validly terminated its agreement with Epic, and (ii) Apple has the contractual right to terminate its DPLA with Epic or Epic's affiliates "at any time and at Apple's sole discretion." Apple has since informed Epic that it will not reinstate

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Epic at least until the litigation process is complete. Apple's contractual right of termination is likely to be a key factor in how the court's decision is implemented with respect to both Epic and other app developers.

APPEAL

Epic immediately filed its notice of appeal. In initial press releases, Apple stated that it was pleased with the ruling, but the possibility of an appeal from Apple remains open as well.

IMPLICATIONS

The practical impact of the *Epic v. Apple* decision for platform operators, app developers, and consumers remains to be seen. For one, the injunction against Apple will not go into immediate effect. Under the court's order, Apple has 90 days (9 December 2021) to remove its anti-steering provisions, which may be further delayed by post-trial motions and the pending appeal. A lengthy appeals process is likely given the complexity and high-stakes nature of this case. There is a very real possibility the existing injunction as to the anti-steering provisions may be clarified or held in abeyance.

Moreover, even if the injunction goes into effect, its true impact and scope will depend on forthcoming decisions by Apple, app developers, and the court. For example, while developers may link to alternative payment methods (thus potentially sidestepping Apple's 30% commission), the court's ruling does not clarify how purchases made outside the iOS app will be applicable within the iOS app. The ruling also does not establish what technical functionality may be accomplished with a “button” or “external link.”

It is also unclear how the court's decision to uphold Apple's right to terminate the DPLA with Epic and its affiliates “at any time and at Apple's sole discretion” will affect other developers. Apple may apply this same “termination” strategy to other game developers and take the position that, although its existing anti-steering provisions are unenforceable, Apple will terminate contracts with any game developer that attempts to steer customers to outside payment platforms. These and other issues will play out over the next several months and years, as Apple makes decisions about either challenging or implementing the injunction, and the parties litigate the broader case in the Ninth Circuit.

Finally, for companies that have existing app sale platforms, or are developing such platforms, the *Epic Games v. Apple* outcome presents new risks. Although Apple's combination of market share and anti-steering practices may have been relatively unique, the court's conclusion that such practices were “unfair” could very well extend to others in the industry. Platform developers should carefully consider whether their use of payment systems in combination with limitations on customer communications might run afoul of California's Unfair Competition Law.

FOOTNOTES

[1] --- F. Supp. 3d ---, 2021 WL 4128925 (N.D. Cal. Sept. 10, 2021).

[2] Since the filing of this lawsuit, Apple has lowered the commission to 15% for *some* sales.

[3] At least some game developers, however, were able to negotiate an arrangement with Apple regarding cross-platform purchases, in which purchases made on the Internet or other devices would be available within the iOS

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version of the app. Epic had this arrangement for *Fortnite* until Apple terminated the Epic/Apple agreement in August 2020.

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