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Epic v. Apple: An Epic Fail?

By David H. Evans

Epic sued Apple in the U.S. District Court for the Northern District of California alleging that Apple's iOS walled garden, and, specifically, that its refusal to allow app makers to use a payment system other than the Apple store, the privilege of which cost app makers 30 percent of the fee collected, violated the Sherman Act and the California Unfair Competition Law ("UCL").

On September 10, 2021, in a 185-page opinion, Judge Yvonne Gonzales Rogers held that Apple was not a monopoly and, therefore, that all of the Sherman Act causes of action failed. Judge Rogers did, however, hold that the restrictions on apps using alternative payment systems were anti-steering provisions that violated the UCL. Epic has vowed to appeal. Apple has refused to let Fortnite, the Epic app that was the subject of the case, back into its eco-system.

The fact that the court did not find an antitrust violation was not shocking. The law of unilateral refusals to deal and product innovation is fairly clear. If you offer to deal with someone, it is not a refusal to deal if the counterparty does not like the terms. The law on product innovation is also fairly clear. So long as there was a plausible efficiency-enhancing argument for a particular innovation, the Sherman Act will not condemn the innovation even if it excludes a competitor from the platform.

Indeed, it was shocking the case was not disposed of at the 12(b)(6) stage. The perplexing aspects of the decision were how the court arrived at these conclusions – market definition and the characterization of the requirement to use the Apple store as an "anti-steering" provision.

MARKET DEFINITION

The plaintiffs alleged the relevant market was "(i) Apple's own system of distributing apps on Apple's own devices in the App Store and (ii) Apple's own system of collecting payments and commissions of purchases made on Apple's own devices in the App Store."

Basically, Apple's environment was a relevant market and it had leveraged that monopoly to prefer its own app store over alternative app stores that could be on the environment. Apple alleged that Fortnite participated in a digital game market. Basically, Apple's argument was that platforms competed and that it was wrong to consider just the Apple environment as a relevant market. The court disagreed with both and found a relevant market consisting of digital mobile gaming transactions.

That is not the relevant market. Apple was correct. It is gaming platforms.

What is Epic selling, who are its customers and how can Epic reach those customers? Epic makes

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games and makes money off selling the games as well as how folks interact with the games. It can distribute its games on iOS, PlayStation, xBox, Android, PC and websites, among others. It can and has made its games interoperable across platforms so that gamers can play against or with anyone else in the universe. That means also that gamers can go to other platforms, log in and play its same characters. Whatever advancements and enhancements they make or purchase on the other platform will carry over to the iOS platform. That includes in-game purchases.

If Epic wanted to discourage users from using the Apple store, it could raise iOS fees by 30 percent and make the same profit as a platform that does not charge. The price sensitive gamers would switch to other platforms to buy whatever enhancements they wanted. It is simply incorrect to state that the switching costs are "high" and few would "buy a new phone" to get access to Epic's alternative purchasing.

If folks enjoyed gaming and wanted to play Fortnite with a different enhancement purchasing mechanism, they could switch to any other platform to get that, and still keep their iPhones. The app store requirement has not foreclosed Epic from reaching anyone.

In essence, Epic wants access on its terms to the highly valuable inframarginal customers on the Apple platform who are happy to pay Apple's premium for the convenience of purchasing on that platform and will not switch to other platforms to do so. Epic wants access to Apple's customer list so Epic can sell things to those customers and cut Apple out of the deal. This is free-riding. The antitrust laws simply do not afford Epic this privilege.

"ANTI-STEERING"

Requiring all purchases to be run through the Apple store is not analogous to the anti-steering provisions American Express imposed on merchants, moreover. American Express charges a higher transaction fee to merchants. Some merchants would suggest to customers that they use Visa or Mastercard instead of American Express to save on the fee. American Express banned that practice. The U.S. Department of Justice and several states sued with the ultimate result that the U.S. Supreme Court found the practice perfectly legal and reversed the lower courts and halted further litigation.

Apple is not requiring users to use its credit card. A user can use whatever card it wants in iOS. The app store is more appropriately conceived of as a payment terminal one would swipe one's credit card through at any retail establishment. What Epic is saying, in effect, then, is that customers are entitled to bring Epic's payment terminal into a retail store, plug it into the cash register and that store has to use it. The Apple store is a technical innovation on the platform.

Apple's decision to require users to use the app store to make purchases is no different than a merchant choosing a particular payment terminal to integrate with its cash register and inventory control system. This argument is the same as arguing an automotive manufacturer must give equal access to its dash boards to all radio manufacturers because it has a monopoly over the cars it makes. Again, not an antitrust issue, even an incipient one. No more harm to consumers than a merchant picking one payment terminal over another.

THE 30 PERCENT CHARGE SEEMS HIGH

The court also felt the 30 percent fee was "high," and suggested that it could represent market power. It could also represent the fact that the iOS platform is a premium platform that users are more than happy to pay a premium to access. It is Apple's business acumen that has driven those customers to that platform. And app makers are happy to pay the 30 percent because it gives them access to the highly valuable customers Apple has amassed with its premium platform.

Think of the early days of the PC and the MacIntosh environments. Microsoft made PC-DOS and later Windows open to anyone, and it won the platform battle. Apple kept its environment closed and remained a small niche player. It is still doing that with iOS and just happens to have won this battle.

CALIFORNIA

First, the most obvious. The California UCL applies to California. If the app store requirement for in app purchases truly violated the UCL, only Californians would have been harmed because the UCL only protects them. The national injunction is ridiculous.

Second, for the reasons stated previously, it is not entirely correct to analogize the app store requirement to American Express' anti-steering provisions. The antitrust laws do not compel merchants to use a processing terminal a customer brings in.

It does not compel Apple to allow users to create their own payment systems within the Apple environment. To hold the UCL applies in this fashion would pry open any multi-function system.

CONCLUSION

Apple's win is not surprising. But the case does not enhance our understanding of how antitrust applies to unilateral refusals to deal or product design. It only muddies that and does so by confusing the technology and its real world analogues.

The appeals court should correct the lower court's product market definition, the inapplicability of the *American Express* anti-steering concepts to in app purchases, and reverse the injunction.