ALSTON & BIRD

Epic v. Apple

The Implications of the First Battle in the Antitrust Tech Wars

Presented by:

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Topics for Discussion

1

Epic v. Apple

Summary of the issues and arguments and lessons from the trial

2

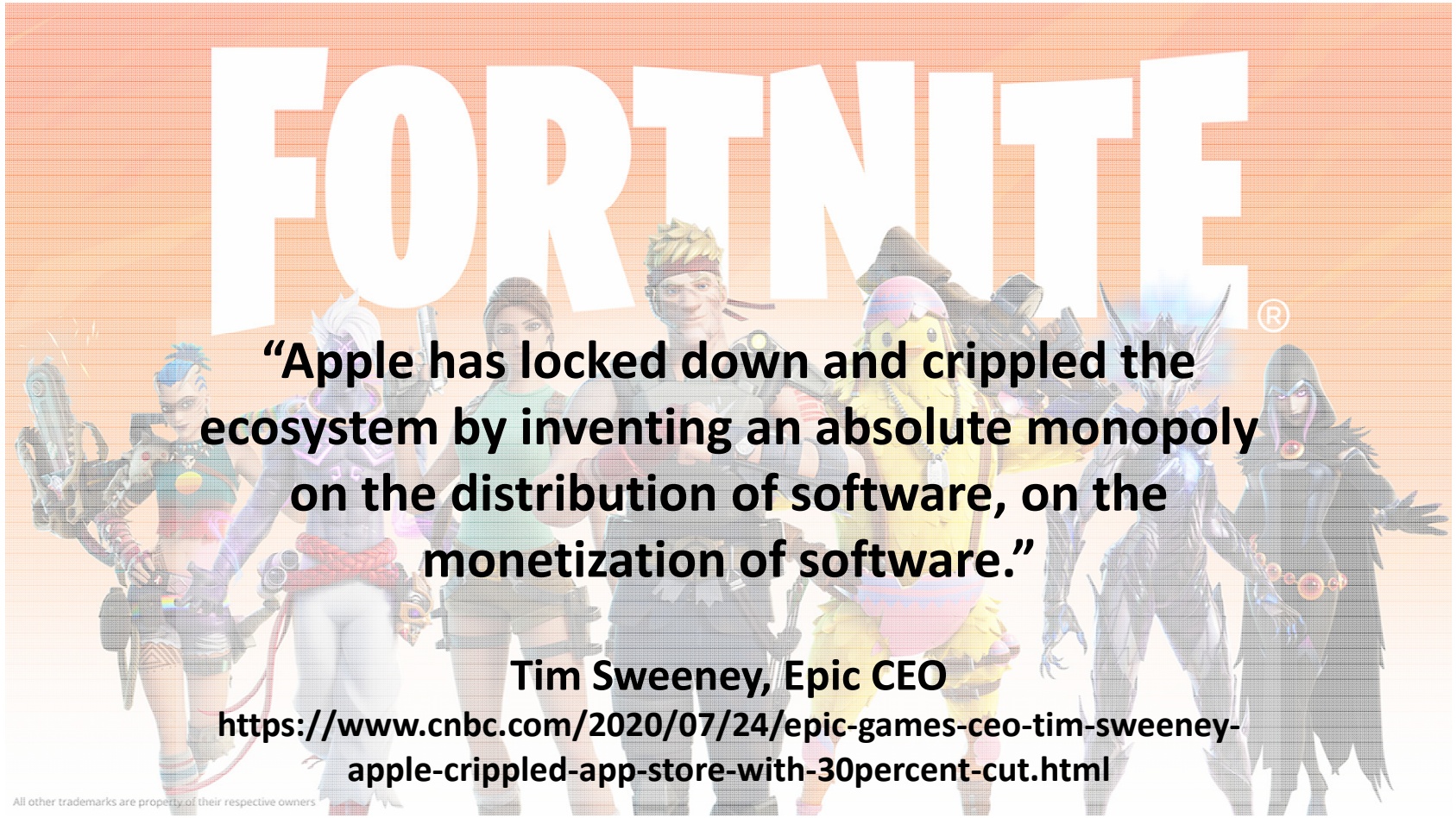
How this case fits into the larger picture of the antitrust assault on Big Tech

Civil litigation; government enforcement; proposed legislation and executive orders

3

Implications for advising clients on antitrust risk

Epic v. Apple: What is this all about?



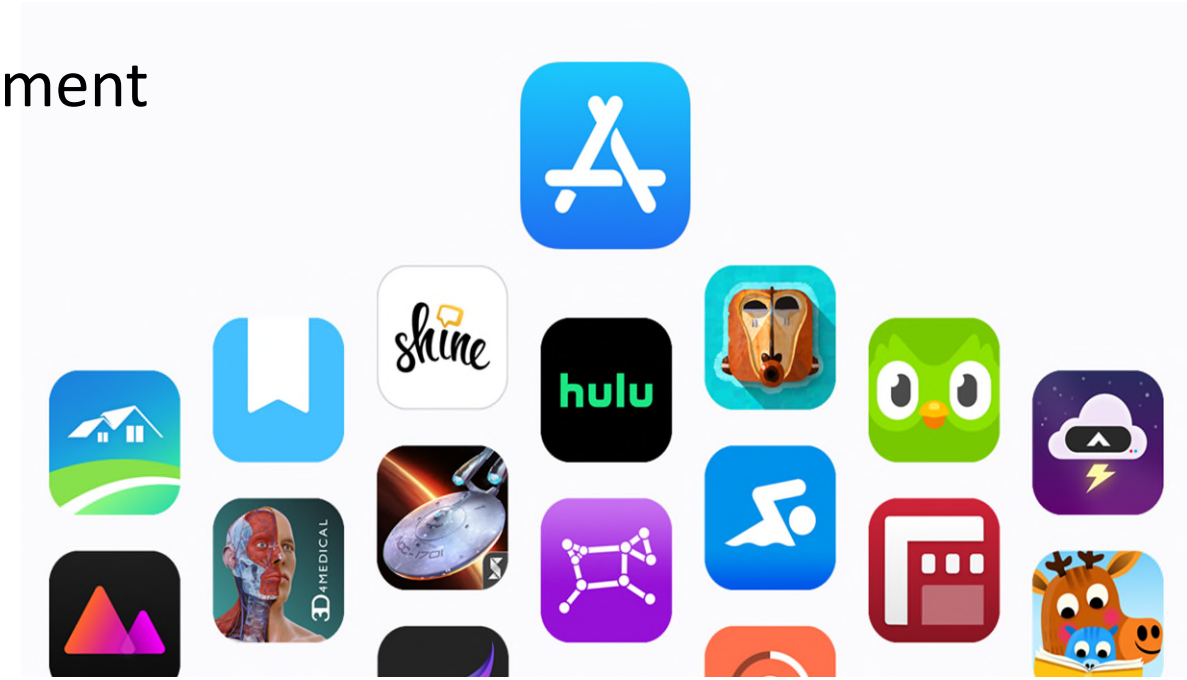
"Apple has locked down and crippled the ecosystem by inventing an absolute monopoly on the distribution of software, on the monetization of software."

Tim Sweeney, Epic CEO

https://www.cnbc.com/2020/07/24/epic-games-ceo-tim-sweeney-apple-crippled-app-store-with-30percent-cut.html

The App Store Rules and Epic's Workaround

- Apple Developer Program License Agreement
  - Terms and Conditions
  - Commissions
  - Customers Communications
- "Project Liberty"
  - Epic introduces feature to allow in-app purchases directly from Epic
  - Fortnite and Epic's Unreal Engine removed from App Store and Google Play Store



Epic Sues to be Reinstated

- Epic files for preliminary injunction in N.D. Cal. (also sues “Don’t be evil” Google)
  - High-profile antitrust counsel on both sides
  - Case is assigned Judge Yvonne Gonzalez Rogers
    - Presiding over Consumer and App Developers Class Actions filed in 2012 and 2019
- Ruling:
  - Fortnite not reinstated; Unreal Engine is
  - Opinion sets up battles for trial
- Trial in May 2021

The Essential Epic Case

- Apple's conduct monopolizes the iOS App Distribution Market and the iOS In-App Payment Market *(See* Findings of Fact and Conclusions of Law Proposed by Epic Games, *Epic Games, Inc. v. Apple Inc.*, 4:20-cv-05640, Dkt. 777-3 at ¶1)
- Consumers are locked into the iOS ecosystem (Id. at ¶5)
- App developers drove the success of the iOS ecosystem (Id. at ¶7); but that success now forces app developers to rely on Apple (Id. at ¶11)
- Apple controls the only method of iOS app distribution (Id. at ¶13-14)
- Apple's claims about curation and security are pre-textual (Id. at ¶16-23)

The Essential Epic Case (cont'd)

- Apple's 30% commission prohibits new apps and innovations; consumers pay higher prices and receive fewer services (Id. at ¶25-26)
- The In-App Payment ("IAP") requirement is solely to allow Apple to collect its monopolistic commission (Id. at ¶27)
- Apple's T&C prohibit app developers from communicating with customers about alternative payment options (Id. at ¶28)
- The IAP requirement is not necessary to recoup Apple's R&D investments (Id. at ¶34)
- Apple is incentivized to reinvest in the iOS ecosystem without IAP (Id. at ¶38)

Apple's Arguments

- Apple's innovations created the opportunity for app developers to reach users of iPhones/iPads (See Defendant Apple Inc.'s Final Proposed Findings of Fact and Conclusions of Law, 4:20-cv-05640, Dkt. 779 at 14)
- Apple, Epic and others participate in a U.S. digital game transactions market on multiple platforms (Id.)
- App users substitute alternative platforms for iOS version transactions (Id. at 16)
- Epic's remedies would destroy the iOS ecosystem's competitive differentiation and make Apple intellectual property available for free (Id. at 17)

Apple's Arguments (cont'd)

- Output and innovation have "increased explosively" since the creation of the App Store (Id. at 18)
- When considering free transactions, Apple's effective commission is less than 9% (Id.)
- Apple's conduct is pro-competitive because it protects the safety, security, privacy, and reliability of devices and users (Id. at 14)
- Epic's "sweeping" remedies would not increase output, lower prices, enhance innovation, or improve choices for developers or consumers (Id. at 19)

Epic v. Apple: The Antitrust Framework

- Does Apple have monopoly power:
  - What's the relevant market? iOS apps or all gaming platforms?
  - The Single Market Unicorn
- Did Apple engage in anticompetitive conduct?
- Does Apple's conduct have procompetitive justifications?
- What power does the Court have to affect change on a business model?

Relevant Market: The Apple Story

- Game App Transactions
  - Game app transactions are distinct from non-game app transactions
    - E.g., non-subscription compared to other types of apps
  - Web- and platform-based game transactions are substitutes
    - Developers make games to work across multiple platforms
    - Most consumers have access to multiple platforms
    - Apple competes with other game transaction platforms, e.g., Google Play, for game developers
  - Key evidence? Stats showing Fortnite retained up to 88% of its spending after getting kicked out of App Store

Relevant Market: Epic's Theory

- Foremarket for operating systems: consumers choose Android OS or iOS
  - Other devices are not substitutes for the smartphone
  - Not mobile, have to be connected to the internet, etc.
  - Developers who lose access to iOS, lose access to consumers on the go
- Once that choice is made, they are locked-in
  - Lack of switching by consumers and developers
  - Economists testified that Apple could increase prices even more and there would be minimal switching
- Hot doc: email from Steve Jobs: goal to tie products together to "lock customers into our ecosystem"

Conflicting Theories: Traditional Rule of Reason *v.* Limited Refusal to Deal

- Epic says balance pro-competitive benefits with anticompetitive harm
- Apple argues that this is refusal to deal – and there is no duty under antitrust law to deal with any particular party on any particular terms, even for monopolists
- Caselaw allows for very limited exceptions

Procompetitive Justifications: Is This Really All About Security?

- Apple witnesses attempted to justify the restrictions
  - Intensive review process to defend against cyberattacks
  - Uphold quality of apps – protect against bad actors
  - Leveraged the good reputation of Apple and the iPhone with users
- Epic shows evidence that the justifications are pre-textual

Does Tim Cook Really Not Know How Much the App Store Makes?

- *"No we haven't done that. But, you know, I have a feel, which is we are [profitable]."* - Tim Cook, explaining why he believes the App Store is profitable, reasserting that the company doesn't assess profit margins for specific business units
- Epic expert estimated 80% profit in App Store
- Numerous news outlets were critical of testimony: *"Tim Cook doesn't know stuff"*
- Judge seemed skeptical and indicated concern over lack of competition

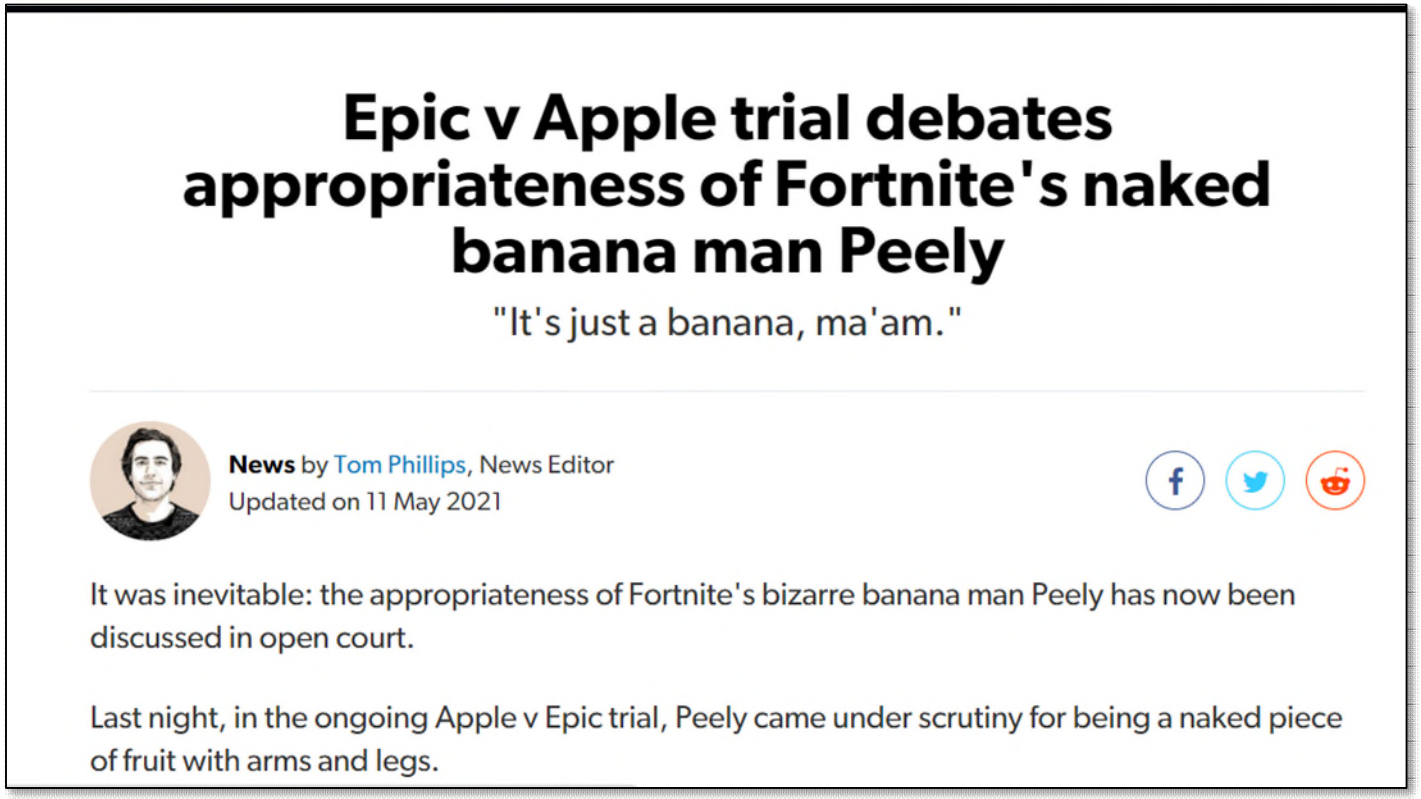
Remedies

- Epic's ask:
  - Apple may not prevent iOS users from downloading/updating iOS apps from other sources
    - Conditioning access to iOS or App Store in any way
    - Disadvantaging iOS apps downloaded from third parties
  - Apple may not discriminate or disadvantage third party IAP systems or apps that use third party IAP
- Apple's response:
  - "Sweeping" injunction that would force Apple to "provide unlimited access to its rivals and forego compensation for the use of its intellectual property"
- The Court's comments:
  - "In cases where courts have found antitrust conduct, how have the courts fashioned remedies to deal with the antitrust conduct? Have they in fact said, "You, billion-dollar or trillion-dollar company, must change the business model under which you are operating? Has a court ever done that?" *(https://law.com/therecorder/2021/05/24/judge-Gonzalez-rogers-is-concerned-that-epic-is-asking-to-pay-apple-nothing/)*

Takeaways from a Trial

- One fact, multiple meanings
- Hot tub conclusions
- Intense public interest
- Moments of levity?

  (https://www.eurogamer.net/articles/2021-05-11-epic-v-apple-trial-debates-the-appropriateness-of-fortnites-naked-banana-man-peely)



Epic v Apple trial debates appropriateness of Fortnite's naked banana man Peely

"It's just a banana, ma'am."

News by Tom Phillips, News Editor
Updated on 11 May 2021

It was inevitable: the appropriateness of Fortnite's bizarre banana man Peely has now been discussed in open court.

Last night, in the ongoing Apple v Epic trial, Peely came under scrutiny for being a naked piece of fruit with arms and legs.

Epic v. Apple: First Battle of a Long War

Civil litigation and enforcement actions against Apple, Google, Facebook, Amazon

Biden Executive Order and appointment of Lina Khan

Federal and state proposed legislation

Unprecedented Parallel Enforcement Actions

- **EU and U.S.:** Multiple enforcement actions against Google, Apple, Amazon, Facebook
  - Concerns about stifling competition, spreading misinformation, eroding privacy
- **China:** Heavy-handed crackdown on tech companies
  - Concerns about too much power and disruption caused by increasing income inequality
- **Russia:** Crackdown to silence protests and tighten political control
- **UK:** Creating tech regulator to police the industry

Summary of Proposed Legislation

- House Bills — Four Focused on Big Tech
  - American Innovation and Choice Online Act: *can't favor own platform*
  - Ending Platform Monopolies Act: *provides for possible divestiture*
  - Platform Competition and Opportunity Act: *makes acquisitions more difficult*
  - Augmenting Compatibility and Competition by Enabling Service Switching (ACCESS) Act: *makes it easier for users to switch platforms*
- Two Other House Bills
  - Merger Filing Fee Modernization Act
  - State Antitrust Enforcement Venue Act

Summary of Proposed Legislation (cont'd)

- "House Judiciary Republican agenda for taking on Big Tech"
  - Response to the six bipartisan bills
  - Conservative agenda — accountability on treatment of speech
  - No final draft bills
- Three Senate Bills
  - Competition and Antitrust Law Enforcement Reform Act of 2021 (Klobuchar Bill)
  - Trust-Busting for the Twenty-First Century Act (Hawley Bill)
  - Tougher Enforcement Against Monopolies Act (TEAM Act) (Lee and Grassley Bill: Comprehensive reforms)

Biden Executive Order

- 72 specific initiatives “to promote the interests of American workers, businesses, and consumers”
  - Establishes “White House Competition Council”
  - Directives to 15 government departments
- Overall concern — less competition in numerous industries, need for aggressive enforcement
- Provisions focused on labor markets
- Industry-specific provisions — Big Tech, agriculture, pharmaceutical, telecommunications, airlines, rail and shipping, healthcare, defense, and financial services

Biden Executive Order (cont'd)

- Takeaways
  - Part of larger effort to prioritize antitrust enforcement
    - *Advances Biden's agenda amid widespread criticism*
  - Some provisions self-executing
  - Most provisions "encourage" direction of agencies
    - *Drafting and implementation of new rules and regulations may take months*
    - *Will be handled by individual departments and agencies*
    - *Likely court challenges to new rules, causing long delays*

Biden's General: Lina Khan

- Appointed FTC Chair
  - *Shows Biden's aggressive approach to antitrust enforcement*
- Gained notoriety by arguing for significant overhaul in application of antitrust laws
- Focus on Big Tech
  - *Worked on congressional investigation into Big Tech monopoly power*
  - *Academic writing*
  - *Open Markets Institute — advocates for breaking up Big Tech*
  - *Facebook has already sought recusal*
- Already taken significant steps
  - *Held first open meeting in decades*
  - *Voted along partisan lines to broaden authority under Section 5 of FTC Act*

What Does This Mean For You and Your Client?

- Has the world changed for advising on Section 2 risks?
  - Who is a monopolist in the everchanging tech world
  - Is government enforcement more likely? (short answer: yes)
- How could the proposed legislation and executive order affect your client?
  - Do you need to get involved in lobbying
- Are there any strategic advantages in getting involved in these lawsuits? (if you're not a defendant)

Questions?

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MAY 5, 2021

The *Epic* Battle Unfolds...

by **Parker Miller** and **Valarie Williams**

The *Epic v. Apple* trial started on Monday, May 3. As antitrust trials go, this one has all the makings of a landmark event. It's the first attempt to take on a modern tech giant, complete with star witnesses (Tim Cook!), nuanced application of new and old antitrust principles, tremendous financial consequences, and even heckling teenagers. The Antitrust Team at Alston & Bird is following the developments closely.

Background

Epic Games launched a high-profile case against Apple in 2020 challenging the 30% commission Apple charges developers on in-app purchases. Epic Games, the company behind blockbuster video games like *Fortnite*, alleges that Apple monopolized the market for distribution of apps on iOS and has used that power to extract anticompetitive commissions and force developers to use Apple's payment processor. There are class actions pending that make similar allegations, but Epic's case is the first to go to trial—in a bench trial in front of Judge Gonzalez Rogers in federal court in San Francisco.

Pre-Trial Events

The Friday before trial began, the EU filed charges against Apple based on similar allegations raised by Spotify and others about these practices for music streaming apps. That doesn't mean Epic has a slam-dunk case in the United States—U.S. and EU law on monopolization and abuse of dominance diverged long ago, with the EU being more aggressive on going after Big Tech for behaviors deemed anticompetitive by the European Commission. U.S. state and federal lawmakers have also taken an interest in the debate over commissions paid to both Apple and Google for access to their app stores. So regardless of the outcome of this trial, there could be legislative changes on the horizon.

The Trial

The parties submitted thousands of pages of testimony from experts and witnesses before the trial even started. Their opening arguments on Monday showcased the themes that will be developed over the next few weeks:

Epic

- Apple intentionally built a walled garden around its App Store to prevent competition.
- The App Store is a single-brand market where Apple exercises monopoly power.
- Apple's security concern rationale for the restrictions are pretextual since Apple does not impose the same restrictions in MacOS.
- Apple makes a lot of money from the App Store.
- Innovation in the App Store has suffered from lack of competition.

Apple

- Apple has grown the market for apps exponentially, which is inconsistent with Epic's allegations that Apple has hurt competition.
- A ruling against Apple would affect other closed video game platforms, such as Sony, Nintendo, and Microsoft.
- Apple's integrated ecosystem is necessary for security and privacy concerns.
- Epic's alleged relevant market (iOS app distribution) is wrong—it should be game transactions, which would include gaming on platforms other than iPhones.

The outcome of the case will likely hinge on Judge Gonzalez Rogers's findings on the relevant market, but the parties seem to be focusing on each other's conduct. Epic said in openings that Apple was never supposed to make money off the App Store but changed its mind to the detriment of consumers. Apple charged Epic with enjoying the benefits of the App Store until Epic thought that its products were too valuable to play by the rules.

Stay Tuned

As the trial progresses, we will be providing updates on the implications for companies that may be subject to these restrictions and for those that have similar business models to Apple's. Ultimately, this is a test case for the ability of antitrust law, in its current state, to deal with the complexities of highly concentrated markets—most notably in Big Tech—in 2021.

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ALSTON & BIRD

MAY 11, 2021

The Battle of the Experts Begins

by **Parker Miller and Valarie Williams**

This week will start the "battle of the experts" portion of the *Epic v. Apple* federal antitrust trial in San Francisco, where leading economists will attempt to help Judge Yvonne Gonzalez Rogers determine the core issues in the case around relevant markets and market power. Last week, the interconnected world of digital media and, more specifically, digital gaming was on full display. The parties battled to show similarities and dissimilarities between Apple and other parties' conduct. From the beginning, Apple has positioned itself as just one among many tech companies with similar policies and practices. Epic has emphasized how competition in the App Store is critical for developers. Like an especially cruel and difficult law school exam, the court must sort through evidence from both parties seeking to demonstrate how other companies' conduct justified their own conduct (or not). Often, the parties used the same evidence to prove radically different points.

Much of the evidence so far has centered on the conduct of other participants in digital media. For instance, witnesses from Sony and Microsoft were questioned about the policies of their app stores, as well as their interaction with Epic. The parties sparred over key facts:

- Apple adduced evidence that Sony and Microsoft also charge a 30% commission on in-app purchases in their app stores, but Epic adduced testimony that demonstrated that both Sony and Microsoft sell consoles at a loss and use the app store revenue to generate profits in their gaming businesses.
- Apple was able to introduce evidence about how companies had worked hard to allow cross-platform play, including access to a cross-platform wallet, for *Fortnite* and other games, but Epic countered with testimony that the need for cross-platform play actually supports the notion that iOS, and the App Store, are distinct markets.
- Apple introduced evidence that Microsoft considers a console gaming market when developing the strategy for its gaming business, but Epic developed testimony that Microsoft's foray into mobile hardwire may have been related to the need to compete in the separate market of mobile media.
- Apple touted its App Store review policy as an important security benefit for consumers, but Epic pointed to Apple's approval of a school-shooting game and apps that carry out malicious ad-fraud tasks.

- The parties disagreed on even the basic necessity of an app. Apple adduced evidence that Microsoft had just expanded a beta test of its Xbox cloud gaming service delivered through the Safari browser. Epic seemed to hint that the very fact that Microsoft would go through the research and development costs to create access to the Xbox cloud gaming service for iOS users demonstrates the power of Apple and the importance of reaching iOS users, even with a more challenging browser work-around.

The same evidence often serves multiple purposes in an antitrust trial. As an example, the fact that a third-party company has developed a work-around that allows consumers to access their products outside the defendant's conduct could be used to prove that the defendant does not have the market power alleged. This same evidence could also be used to show that the defendant is attempting to block competition by requiring rivals to spend money trying to get around those policies and leading to a less efficient marketplace and a lower quality user experience.

The contentions in this case also highlight the way the facts and allegations work together. Apple is asking the court to see its conduct as similar to other app stores because the commission fees and policies are similar. Epic alleges that the 30% commission is a monopolistic rate when charged by Apple *because* of its unique position as the gatekeeper for more than 1 billion iPhone users. Epic seems to be saying to the court that Sony's and Microsoft's commissions are irrelevant because they are positioned differently and operate in related but different markets. Same facts, but different context.

The brief takeaway is that in this trial, and antitrust law more generally, the finder of fact, whether judge or jury, has to really understand and put in context the factual rationale for business and consumer decisions in the marketplace. Businesses, markets, and industries operate in unique ways that require careful and detailed analysis. Rarely does the public have the opportunity to see that analysis play out in a courtroom in industries where consumers are so intimately involved – mobile gaming and smartphones. The upcoming expert testimony should help place all this competing evidence in context for Judge Gonzalez Rogers, antitrust practitioners, and the public following along.

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JUNE 14, 2021

Sizing Up the Final Challenge

by Parker Miller and Valarie Williams

To complete many, if not most, of the classic video games, the player must overcome a final obstacle or a series of obstacles using the strategies and tactics learned playing the game. With much more at stake and the world watching, Epic and Apple entered the closing arguments and post-trial briefing of their federal antitrust trial in the same position. Having listened to the other side and taken questions from the court, both sides had some idea of what arguments were interesting to the court and what needed further support.

Rather than scripted closing arguments, Judge Yvonne Gonzalez Rogers invited the parties to engage in open-ended discussion where she could ask questions (and follow-up questions) with both parties reacting to the questions and the other party's answer, often referred to as "hot tubbing." While the judge questioned both sides on a wide variety of issues, three particular themes emerged:

- **The Static Nature of the App Store.** The App Store hasn't changed much, Judge Gonzalez Rogers pointed out. She seemed hesitant to accept Apple's assertion that it was in a highly competitive environment (an argument seemingly based on Qualcomm's similar assertion that Qualcomm faced a "hyper-competitive" market in its Ninth Circuit Court of Appeals win over the Federal Trade Commission) when the fee paid to Apple for in-app purchases hasn't changed in years. Epic picked up the point, arguing that the terms and conditions of the App Store had become less friendly to app developers. When Apple tried to argue that the App Store Small Business Program was an example of a developer-friendly evolution, Epic argued that the Small Business Program is a result of litigation, not competition. The judge seemed troubled by the fact that a "competitive" market, as Apple claimed exists, had little change in fees and policies.
- **Epic's Requested Remedies.** Apple took direct aim at the scope of the remedies Epic requested. Epic is asking for a ruling that would force Apple to open up the iPhone, allowing other iOS users to download apps from other sources and preventing Apple from favoring its in-app payment system. The judge picked up the argument, asking if a U.S. court had ever enacted the sweeping changes that Epic requested. Further, the judge seemed troubled that if she ordered the remedies requested by Epic, Epic and potentially other developers would end up benefiting from Apple's investment in research and development, and resulting intellectual property, without paying for it.

- **The Economics of the App Store for Game Developers.** During the trial, Judge Gonzalez Rogers asked Apple CEO Tim Cook pointed questions about whether game developers were actually subsidizing the entire App Store, including non-gaming apps that don't generate revenue for Apple, all so Apple could offer a more attractive hardware and software combination. As part of the closing hot-tub questioning, she further questioned whether Apple had any right to revenue after the iPhone user downloads the app. Epic argued that it was developers who kept the customers coming back, and Apple has no right to further revenue after the first download.

So will Epic make it to the final screen? Has it made it past the last obstacle? The answer will likely be more nuanced than the final triumph or failure in a video game. Judge Gonzalez Rogers seemed almost equally troubled by the lack of competition Apple faces in the App Store and by the daunting challenge of implementing the remedies requested by Epic—remedies that would have a significant effect on the business model of one of the world's largest companies. She may try to find a way to put a dent in Apple's armor without actually slaying the dragon. She asked pointed questions about the prohibition against companies even telling their customers that they can go to another device to pay for in-app purchases. She could find that provision illegal without dealing specifically with the 30% fee or opening up the iPhone to other App Stores or even opening up the App Store to other payment processors. But to invoke any remedy, she would have to find that Apple has monopoly power—a finding that would make it hard to address with only small measures. Regardless, both Epic and Apple have multiple lives in reserve. There will undoubtedly be appeals either way. And if Apple wins outright, the failure to rein in Apple under existing antitrust law will be fodder for those in Congress and state legislatures who are prepared to take the battle into their own hands.

So stay tuned—we will continue to follow this epic battle into the next round.

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