For the public register

4 February 2021

Digital Platform Services Inquiry
Australian Competition and Consumer Commission

Via email: digitalmonitoring@accc.gov.au

Dear DPSI team

1. Introduction and purpose of submission

Epic Games, Inc. (**Epic**) wishes to provide this public submission to the Australian Competition and Consumer Commission (**ACCC**) to address a number of key issues raised by the Digital Platform Services Inquiry on competition in app marketplaces (**Inquiry**), and to provide its views on relevant matters for the purposes of the ACCC interim report due to be released in March 2021.

As the ACCC is aware, Epic has recently initiated proceedings against Apple Inc. and Apple Pty Ltd (**Apple**) in the Federal Court of Australia in relation to conduct that Epic alleges contravenes provisions of the *Competition and Consumer Act 2010* (**CCA**) in respect of which Epic is seeking declarations that the restrictions are unlawful as a misuse of market power and unconscionable restraints so as to open up competition

Similar action has been taken by Epic in the United States and the United Kingdom. These proceedings relate to contractual and technical restraints imposed by Apple on app developers that foreclose competition in respect of iOS app distribution and iOS in-app payment processing. Epic believes that Apple's conduct is symptomatic of unrestrained market power that results in significant harm to Australian consumers and the competitive process. In the absence of these anti-competitive restraints, app developers would have a greater ability to distribute their apps leading to increased competition and innovation to the benefit of Australian consumers. In addition, Australian consumers would not be paying the 30% tax that Apple (and Google) impose on the purchase of in-app content, but would be paying a fraction of that, more consistent with the single digit fees charged in financial transactions that exist in an open and competitive environment.

Importantly, while Epic's litigation is in relation to Epic's apps, Epic's case in relation to Apple's conduct has broader implications. Apple's conduct raises significant consumer and public interest issues that

extend substantially beyond gaming and users of these services. Apps available through mobile devices provide important everyday services to millions of Australians across banking and finance, social media, instant messaging, music, photography, maps, food and drinks, travel and numerous other categories. The reliance on mobile apps to access such services is growing. Globally, Apple's iOS and Google's Android OS account for nearly 100% of all mobile operating systems (or "OS") in use. An OS is software that provides basic functionality to users of smart devices. Much like the Windows operating system that controls your desktop computer, a mobile OS is the software platform on top of which other programs can run on mobile devices. The OS is responsible for determining the functions and features available on your device and will determine what third-party applications can be used on your device. In Australia, Apple accounts for over approximately 55% of all mobile devices / mobile OS[1]. Tellingly, many of the restraints that Epic is seeking to have declared as anti-competitive are not imposed in respect of other Apple products where it faces more competition.

This submission seeks to provide relevant background and general insights informed by Epic's experience with Apple (and Google) to the extent that such experience is relevant to responding to a number of key issues raised in the ACCC's Issues Paper, including:

- Intensity of competition in respect of relevant app marketplaces
- App marketplace conduct that raise competition law concerns
- Relationships between app marketplaces and app developers and providers
- Relationships between app marketplaces and consumers (and the resulting harm from anticompetitive conduct)

This submission is not intended to restate Epic's legal case against Apple.

2. Background to Epic

Founded in 1991, Epic Games is an American company founded by CEO Tim Sweeney. The company is headquartered in Cary, North Carolina and has more than 50 offices worldwide, including in Australia. Today Epic is a leading interactive entertainment company and provider of 3D engine technology. Epic operates Fortnite, one of the world's largest games with over 350 million accounts and 2.5 billion friend connections. Epic also develops Unreal Engine, which powers the world's leading games and is also adopted across industries such as film and television, architecture, automotive, manufacturing, and simulation. Through Unreal Engine, Epic Games Store, and Epic Online Services, Epic provides an end-to-end digital ecosystem for developers and creators to build, distribute, and operate games and other content.

Fortnite

Currently, Epic's most popular game is *Fortnite*, which has connected hundreds of millions of people in a colourful virtual world where they meet, play, talk, compete, dance, and even attend concerts and other cultural events. *Fortnite* is a multifaceted online video game that has attracted over 350 million registered users globally that has become a cultural phenomenon. Australia is one of Epic's key markets.

To play together online, users must have the same version of *Fortnite*, so they can appear together in the same virtual environment with the same updated content. Players with an outdated version may play only with other players with the same outdated version. *Fortnite* is one of the first video games

[1] Australian Competition and Consumer Commission, 'Digital Platforms Inquiry – final report' (26 July 2019) available at https://www.accc.gov.au/publications/digital-platforms-inquiry-final-report, page 208.

to offer full "cross-platform" play; players on all the major platforms can play together in the same virtual space, even though their underlying software and hardware is different. *Fortnite* is available on Sony's PlayStation 4 and 5, Microsoft's Xbox One and Series X and the Nintendo Switch, personal computers and Macs, certain Android mobile devices and on Apple mobile devices (until Apple removed Fortnite from the iOS App Store in retaliation for introducing a direct payment option that included a significant price reduction on in-app purchases in August 2020 see further below).

Fortnite is free to download and play. Epic generates revenue by offering users various in-app purchases of in-app content. For example, players who wish to further express themselves within *Fortnite* through digital avatars, costumes, dances, or other cosmetic enhancements may purchase them within the *Fortnite* app. Through this model, Epic makes *Fortnite* widely accessible at no cost to consumers, while earning a return on its artistic and engineering investments through the sale of cosmetic enhancements.

Epic Games Store

Epic also built and runs the Epic Games Store, a digital video game storefront through which users can download various games, some developed by Epic, and many offered by third-party game developers. The Epic Games Store is currently available on personal computers. Epic distributes *Fortnite* to users of personal computers—including users of Apple's own Mac computers—through the Epic Games Store.

Unreal Engine

Epic creates and distributes the *Unreal Engine*, a powerful software suite that allows app developers to create realistic three-dimensional content including video games, three dimensional renderings of architectural plans, television shows, and movies. Epic launched *Unreal Engine* in 1998 and offers it to third-party developers to create three-dimensional digital content. Developers can use it commercially on a royalty model or negotiated license, and it is free for non-commercial use. The *Unreal Engine* is by design a cross platform engine, powering games and other products on all major platforms. Making it widely available is central to Epic's business philosophy. The *Unreal Engine* has been called the most successful video game engine in history with millions of developers using it.

3. Intensity of competition in the relevant markets

Apple and Google each have market power in relation to their respective operating systems, mobile app distribution and in-app payment processing

There are nearly a billion iPhone and iPad users worldwide and over 1.5 billion active iOS devices, including both iPhones and iPads2. Typically, these users will use only iOS devices and will not also use mobile devices with a different OS. In addition to its size, the iOS user base is also uniquely valuable in that its user base spends twice as much money on apps as Android users3. Apple also has

[2] Michael Potuck, "Apple hits 1.5 billion active devices with ~80% of recent iPhones and iPads running iOS 13", *9To5Mac* (Jan. 28, 2020), available online at https://9to5mac.com/2020/01/28/apple-hits- 1-5-billion-active-devices-with-80-of-recentiphones-and-ipads-running-ios-13/

[3] Prachi Bhardwaj, "Despite Android's growing market share, Apple users continue to spend twice as much money on apps as Android users", *Business Insider* (Jul. 6, 2018), available online at https://www.businessinsider.com/apple-users-spend-twice-apps-vsandroid-charts-2018-7#:~:text=Despite%20Android's%20growing%20market%20share,on%20apps%20as%20Android%20users&text=On%20top%20of%20that%2C%20Androida%20distant%20second%20at%2014%25

particularly significant penetration in developed markets such as the US, UK and Australia, making these particularly important markets for app developers.

Apple's iOS is a proprietary ecosystem. All iPhones (and iPads) are shipped with iOS pre-installed. Unlike Google's Android OS, Apple does not licence iOS nor does it permit iOS to be used on other, non-Apple devices. In terms of app distribution, Apple expressly prohibits app distribution other than through the Apple App Store (citing security and privacy reasons). Notwithstanding that iOS is said by some to be a "walled garden", it is highly dependent on third-party app developers who make iOS apps that consumers want.

It is important to recognise that Apple's iOS and Google's Android OS do not operate in the same market(s) on account of iOS being non-licensable (and therefore unable to be used on non-Apple devices). In contrast, Google's business model relies on the license of its Android OS to third-party OEMs. Further, Apple does not permit any operating system other than iOS on its hardware. As a result, each of Apple and Google have a substantial degree of market power in respect of the iOS and Android OS mobile operating ecosystems, respectfully, and do not meaningfully constrain one another.

Aside from Google's Android OS, there are very few, if any, meaningful operating systems available for OEMs. As a result, there are no other suppliers of app marketplaces in Australia that are capable of providing viable alternatives for use on iOS or Android OS for app developers and mobile device users. This stems from the sheer network effects that alternative app distribution platforms would need to overcome to entice a sufficient volume of users away from either iOS or Android OS to remain viable. Therefore, from a developer's perspective, due to the respective market power of each of Apple (in respect of iOS) and Google (in respect of the Android OS), it is critical for app developers to have an app both on iOS and Android OS in order to successfully commercialise an app.

A number of issues and questions posed by the Inquiry stem directly from the substantial market power of Apple (and Google) in a number of relevant markets linked to or arising from their respective operating systems. This submission will focus on market dynamics and conduct relevant to Apple.

The importance of apps to mobile device ecosystems

A mobile app is a piece of software that is designed to be installed and/or run on mobile devices and provide users with a large range of functionality on their devices ranging from tools and applications for banking and finance, social media, instant messaging, music, photography, maps, food and drinks, travel, games and other digital content to name but a few categories. In 2018, there were over 205 billion mobile app downloads globally with a 25% increase in in-app downloads expected to occur between 2018 and 2022[4]. In 2020, Apple's App Store had over 2.2 million apps available for download[5], the overwhelming majority of which are developed by third parties. The vast majority of mobile apps are free to download but have built in optionality that often allow users to make purchases within an app for upgrades, premium features, subscriptions and further content[6]. The ability to distribute and reach mobile device users is essential for all mobile app developers given the importance and value placed on apps by mobile device users. The ability to provide users with the option of purchasing in-app content is also often essential for mobile app developers to monetise their app.

[4] Id at [1].
[5] Id at [1].
[6] Id at [1].

Apple created the App Store in 2008, shortly after it released the first iPhone, to provide a place for iPhone users to discover and download apps. There are now over two million apps available on the App Store. Soon after the launch of the App Store, Apple invited third-party app developers to develop a wide array of apps for the iOS ecosystem. Apple benefits both from the 30% commission imposed on in-app purchases but also from the added value and appeal that third party apps provide to the iOS ecosystem. Those third-party apps contribute immense value to that ecosystem and are one of the primary marketing features for iPhones and iPads. Most people now use their mobile devices for banking, social media, music and entertainment, maps and travel and shopping to name but a few functions. The variety and availability of apps therefore creates a significant selling point for mobile ecosystems. One only needs to look at Apple's own App Store page to see the value and importance of apps to the iOS mobile ecosystem with prominent claims of "over 1.8M apps worldwide" forming a prominent part of Apple's App Store marketing campaign.

In order to develop and offer iOS-compatible apps in the App Store, mobile app developers must enter into a number of standard, non-negotiable agreements set by Apple, including the Apple Developer Program Licence Agreement (PLA)[7]. The PLA, in turn, requires compliance with the App Store Review Guidelines (App Store Guidelines). In addition, the PLA requires app mobile developers like Epic to enter into a separate agreement with Apple in a standard form (known as 'Schedule 2' to the PLA) if they want iOS device users to purchase in-app content.

Apple's market power in iOS operating systems, mobile app distribution and in-app payment processing creates and reinforces significant barriers to entry

Since its inception in 1984, Apple has become the largest publicly traded company in the world. The proliferation of mobile smart phones (and success of the iPhone) has contributed significantly to Apple's success. There are now over 2.7 billion mobile device (in the form of smartphones) users globally; over 1 billion of which use Apple devices, with 90% of mobile device users' time being spent on mobile apps[8]. At the end of 2018, there were approximately 9.1 million active iPhone users in Australia compared to 8.6 million at the end of 2017[9]. According to the ACCC's own Digital Platforms Inquiry, Apple accounted for over 55% of all mobile operating systems in Australia[10]. Apple not only designs and manufactures the iPhone but also operates the proprietary iOS mobile operating system exclusively made for Apple mobile devices. No other operating system is permitted on Apple devices.

Apple faces no constraints on its market power in relation to iOS app distribution or in-app payment processing. Non-iOS app platforms do not constrain Apple's monopoly power because they are not compatible with iOS devices, they cannot provide iOS users with apps for their devices, and they do

[7] The PLA provides that apps may be distributed only if selected by Apple for distribution via the App Store, Custom App Distribution, for beta distribution through TestFlight, or through Ad Hoc distribution. Custom App Distribution, beta distribution through TestFlight, and Ad Hoc distribution are limited distribution channels that can only be used for specific types of commercial users, meaning that the App Store is the only channel through which developers can distribute apps to the broad base of iOS device users. Apple also allows certain Apple-approved large commercial organisations to participate in Apple's Developer Enterprise Program, which permits the approved organisations to develop and deploy proprietary, internal-use apps to their employees. This program does not permit developers to distribute apps to the broad base of iOS device users.

[8] Mobile App Download and Usage Statistics 2020, Available at: https://buildfire.com/app-statistics/#:~:text=There%20are%20to%20places%20where,mobile%20users%20are%20downloading%20apps.&text=The%20Google%20Play%20Store%20downloads,growing%20at%20a%20higher%20rate.

[9] Paul Smith, "Apple's iPhone problem hits Australian sales", *Australian Financial Review* (4 February 2019) available at https://www.afr.com/technology/apples-iphone-problem-hits-australian-sales-20190130-h1ao7y.

[10] Australian Competition and Consumer Commission, "Digital Platforms Inquiry – final report" (26 July 2019) available at https://www.accc.gov.au/publications/digital-platforms-inquiry-final-report, page 208.

not contain iOS compatible apps. If a developer does not develop apps for iOS, the developer must forgo *all* of the over one billion or so iOS users. No developer alone has sufficient power to overcome the network effects and switching costs associated with iOS to entice enough iOS users to leave iOS, such that developing apps solely for other platforms would be profitable. As such, the 'single-homing' nature of mobile operating systems (with most users having only either an iOS or Android OS device but not both) means that developers are unable to access iPhone users through any means other than Apple.

The barriers to entry are also compounded by the fact that the more developers that design useful apps for iOS, the more consumers will be drawn to use the mobile devices for which those apps are designed. This increases the benefits to developers to participate in the iOS, which encourages customers to purchase or retain their iOS mobile devices, and so on and so forth in a positive feedback loop effectively foreclosing any potential rival from being able to generate a sufficient critical mass of appealing content to offer a meaningful and credible alternative.

Apple's market power in iOS operating systems, mobile app distribution and in-app payment processing is enhanced by substantial switching costs imposed by Apple on users

Competition in the sale of mobile devices does not limit Apple's market power. The threat of users switching to non-iOS devices does not constrain Apple because its mobile device customers face significant switching costs and lock-in to the Apple iOS ecosystem, which serves to perpetuate Apple's substantial market power across relevant downstream markets (being mobile app distribution and in-app payment processing).

This gives rise to significant barriers to entry for rival app distribution and in-app payment processing due to substantial switching costs and iOS lock in that users face. Apple reinforces its market power and substantial switching costs for users through the following means, which make it practically difficult for users to purchase a mobile device from a competitor after having committed to Apple's mobile devices:

- consumers are deterred from leaving the iOS ecosystem because of the difficulty and costs of learning a new mobile operating system. Mobile operating systems have different designs, controls, and functions. Customers who use one (and often more than one) Apple product learn to operate efficiently on Apple's specific operating systems;

- switching from Apple's iOS devices may cause a significant loss of personal and financial investment that consumers put into the iOS ecosystem. Consumers choose a mobile device based in part on the OS that comes pre-installed on that device and the ecosystem in which the device participates. Once a consumer has chosen a mobile device, the consumer cannot replace the mobile OS that comes preinstalled on it with an alternative mobile OS. Rather, a consumer who wishes to change the OS must purchase a new device entirely. And because apps, in-app content and many other products are designed for compatibility with a particular mobile OS, switching to a new mobile OS may mean losing access to such products or to data saved by such products. Even if versions of such apps and products are available within the new ecosystem chosen by the consumer, the consumer would have to go through the process of downloading them again onto the new devices and (for paid apps or paid content) may have to purchase some or all of these apps anew. As a result, the consumer may be forced to abandon his or her investment in at least some of those apps, along with any purchased in-app content and consumer-generated data on those apps;

- the switching costs are compounded by the fact that consumers typically commit to the iOS ecosystem on a household or Apple device user group basis. Apple encourages lock-in across users and families. For example, Apple allows family members to access the songs, movies, TV shows, books, and apps purchased by other family members. Apple also provides enticements of free use of Apple Arcade for three months when a consumer purchases a new Apple device, not only preferencing Apple services, but locking in the consumer and their family to the Apple ecosystem Further, apps like FaceTime (which enables video and audio communication), Find My (which enables users to share their physical locations), iMessage (which enables instant messaging), and AirDrop (a simple way to share content between Apple devices) work only between Apple devices. Customers who might consider switching from an iPhone or iPad would lose access to these services that connect friends and family. The loss of these integrated services raises the personal and financial costs for one member of a household or group to go it alone on a separate mobile operating system;

- consumers typically commit to Apple's ecosystem by purchasing more than one Apple device, which further increases their investment in iOS. Consumers are more likely to buy an iPhone, for example, if they already have an iPad or other Apple device because of the complementary services Apple provides for its device users;

- Apple provides services to facilitate upgrading from one generation of Apple devices to the next;

- Apple's mobile devices are protected from competition by their central place in Apple's developed ecosystem. An ecosystem is the network of products and services, including apps and accessories, designed to be inter-dependent and compatible with the specific operating system that runs on a given mobile device. The iOS ecosystem participants include an array of stakeholders, such as Apple, developers of iOS-compatible apps, iPhone and iPad owners, the makers of ancillary hardware to connect to the mobile device (*e.g.*, headphones or speakers), cellular carriers, and others. Being connected to these ecosystems greatly increases the value of the mobile devices to its users, as the more investments that are made by the various stakeholders, the more benefits accrue to the goods and services connected to the network. Apple's iPhone and iPad customers therefore benefit from substantial network effects of being plugged into the iOS ecosystem.

Furthermore, when making mobile device purchases, consumers are either unaware of, or cannot adequately account for, Apple's anti-competitive conduct in the downstream app distribution and in-app payment processing markets. The cost of app downloads and in-app purchases are not determinative of a consumer's smartphone purchase decision.

4. App marketplace conduct

The absence of meaningful constraints on Apple's market power has enabled Apple to create and enforce rules and restrictions that prevent the open distribution of software on iOS devices - as is common, for example, on personal computers, including Apple's own Mac computers - and to restrict options for purchasing digital content for software on iOS devices, enabling Apple to impose a 30% commission on all purchases of digital in-app content consumed within an app. The purpose and effect of this conduct is to foreclose actual and potential competition in the relevant markets for iOS app distribution and iOS in-app payment processing.

Epic's primary concerns as they relate to *Fortnite* arise from Apple's use of contractual restrictions imposed on app developers (including Epic) and technical restrictions on device users, which

individually and together, prevent competition with Apple in the markets for iOS Mobile App Distribution and iOS in-app payment processing.

Contractual restrictions

By the terms of the PLA, App Store Guidelines and Schedule 2, Apple imposes a number of restraints on app developers such as Epic, including but not limited to requiring app developers to:

a. agree to distribute their apps to iOS device users only through the App Store, and not distribute them to iOS device users through any other channel;[11]

b. agree to appoint Apple Inc and its subsidiaries, including Apple Pty Limited, to distribute their apps via the App Store;[12]

c. agree to only use Apple's IAP for the processing of payments for in-app content purchased by iOS device users; and

d. agree that Apple Inc and its subsidiaries, including Apple Pty Limited, will deduct a 30% commission from the price paid by users for in-app content (other than in relation to certain long-term subscription users and smaller developers under Apple's Small Business Program).

Technical restrictions

The anti-competitive effects of Apple's above-mentioned contractual restrictions are exacerbated by several technical restrictions that further limit the ability of device users from accessing alternative sources in which to search for and access apps. The extent of technical restrictions imposed by Apple include:

a. pre-installing the App Store on iOS devices, including in Australia; and

b. preventing the broad base of iOS device users, including in Australia, from deleting the App Store.

In addition to the restrictions above, Apple also requires app developers to agree to refrain from creating or distributing to iOS device users any store or storefront for other apps, or any interface for displaying third party apps similar to the App Store.

The individual and combined effect of these contractual and technical restrictions prevents any means by which app developers (or device users) could reasonably avoid these restrictions. As a result, Apple has foreclosed any alternative ways to reach more than 55% of Australian mobile device users (or 8 million iOS users). This conduct has enabled Apple to insulate itself from competition and retain for itself 100% of the market for the distribution of iOS apps to the users of iPhones (and iPads) and iOS in-app payment processing. Free from the threat of any potential competition, Apple is able to impose an oppressive 30% commission on the sale of every app and on every purchase of digital in-app content made on an iPhone or iPad.

Apple has also responded to Epic's adding a direct payment processing option for in-app purchases to users of *Fortnite* on iOS devices (offering iOS device users a significant reduction (from 30% to 12%)

[11] Subject to the narrow exceptions specified at footnote [7] above.
[12] Subject to the narrow exceptions specified at footnote [7] above.

on the prices of in-app purchases) by removing *Fortnite* and certain other Epic apps from the App Store including in Australia, by terminating Epic's account, and by threatening to terminate the Apple Developer Program accounts belonging to Epic's affiliates (which would affect the *Unreal Engine*). This has further stifled competition in respect of in-app payment processing and has directly harmed users by removing a substantially cheaper alternative to the iOS in-app payment processing mechanism.

5. Relationships between app marketplaces and app developers and providers

Through its control over iOS and a variety of unlawful contractual and technical restrictions that it forces upon app developers, Apple prevents iOS users from downloading apps from any source other than Apple's App Store and requires that all in-app purchases of digital in-app content consumed within the app be funnelled through Apple's in-app payment processing. This conduct forecloses all competition (both actual and potential) in respect of both iOS mobile app distribution and iOS in-app payment processing, to the significant detriment of app distributors and payment processors and app developers.

iOS app distribution

Apple prevents iOS users from downloading app stores or apps directly from websites; pre-installs its App Store on every iOS device it sells; disables iOS users' ability to remove the App Store from their devices; and conditions all app developers' access to iOS on the developers' agreement to distribute their apps solely through the App Store and not to distribute third-party app stores. Although Apple could permit developers to build and offer competing iOS app stores, it deliberately denies all developers any opportunity to do so. App developers therefore have no choice but to offer apps exclusively through the App Store to reach the enormous userbase of iOS devices and are foreclosed from distributing apps by any other means.

But for Apple's restrictions, would-be competing app distributors, such as Epic, could develop and offer iOS-compatible app stores, thereby providing consumers and developers choice beyond Apple's own App Store and injecting healthy competition for iOS app distribution. These stores could compete on the basis of (among other things) price, service and innovation. Competitors could innovate by (among other things) curating the apps available on a competing app store (such as offering selections of apps in particular categories of consumer interest, like gaming, travel, or health), providing more reliable reviews and other information about the apps, showing or advertising apps in different ways, or offering different pricing schemes.

The competitive harm to app developers (including Epic), and subsequently to users of apps, arises directly from the restrictions imposed by Apple:

a. Apple's conduct denies developers the choice of how best to distribute their apps. Developers are barred from reaching over one billion iOS users unless they go through Apple's App Store, and on Apple's terms. Developers cannot distribute their apps through competing app stores that could offer, for example, increased visibility or better or cheaper marketing. Nor can developers offer their apps directly though their own websites. Thus, developers are dependent on Apple's noblesse oblige, as Apple can (and does) deny access to the App Store, changes the terms of access, and/or alter the commission it imposes on developers at its sole discretion.

b. Apple's total foreclosure of any competition in respect of iOS app distribution reduces the competitive pressure for Apple to innovate and improve its own App Store, leaving developers

with inferior distribution outlets compared to what would exist if competition were to drive further development and innovation in the market.

c. Apple's restrictions prevent developers from experimenting with alternative app distribution models, such as providing apps directly to consumers, selling apps through curated app stores, selling app bundles, and more. By restricting developers in this way, Apple ensures that developers' apps will be distributed only on the App Store.

d. Apple's conduct increases developers' costs. Apple is able to extract a supra-competitive 30% commission on purchases of paid apps. Developers require a reasonable return on their investment in order to dedicate the substantial time and financial resources it takes to develop an app. By imposing its 30% commission, Apple necessarily forces developers to forego substantial revenue (and in some cases rendering apps financially unviable), reduce the quantity or quality of their apps, raise prices to consumers, or some combination of the three.

Apple itself has recognised that its commission is prohibitive to many app developers, because the 30% surcharge makes the development of many apps unprofitable. For example, in an internal discussion among Apple's top executives regarding Apple's 30% charge, Steve Jobs acknowledged that a developer cannot "buy/rent/subscribe from iOS without paying us [Apple], which we *acknowledge is* prohibitive for many things"[13].

As can be seen from the above, there is a clear connection between Apple's market power and its ability to impose restrictions that distort and prevent competition in respect of iOS mobile app distribution. This harms not only app developers and would be app distributors but also end users.

iOS in-app payments

But for Apple's restrictions, would-be competing in-app payment processors could offer alternative in-app payment processing tools, giving app developers and consumers choices beyond Apple's in-app purchase processor, and spurring innovation, better service and lower prices. These innovations could include, for example, alternative means to pay for in-app purchases of in-app content—which Apple does not offer—such as using Bitcoin or other cryptocurrencies, offering rewards points to customers, or providing more than one in-app payment processor. Apple's anti-competitive conduct eliminates all of these innovations and alternative payment options.

For example, outside of the restricted iOS ecosystem, Epic has worked with a number of third-party payment companies that provide creative new forms of payment processing solutions for consumers. One such example is Skrill, which offers Epic's customers pre-paid "Paysafe" cards offered in convenience stores across Poland and Germany that can unlock in-game content. Absent Apple's anti-competitive conduct, developers could offer similar payment services on iOS.

The competitive harm to app developers (including Epic), and subsequently to users of apps, arises directly from the restrictions imposed by Apple:

a. Apple's conduct denies developers the opportunity to innovate, which could be provided by would-be competing in-app payment processors, as explained above.

[13] E-mail from T. Cook, CEO, Apple, to Eddy Cue, VP of Internet Software and Services, Apple (6 February 2011) (House Committee On the Judiciary: Online Platforms and Market Power, Apple Documents at HJC-APPLE-014816).

b. Apple's conduct also denies developers choice and coerces them to use Apple's in-app payment processing. Developers are contractually required to use Apple's in-app payment processing to facilitate in-app purchases of digital in-app content on their iOS apps—and no alternative third-party payment processor can be used. But for Apple's restrictions, developers could choose other options. For example, Epic would offer its own payment processing service for *Fortnite*. Epic already does so on personal computers, including Macs.

c. Apple harms app developers' relationship with their customers by inserting itself as a mandatory middleman in every in-app transaction. When Apple acts as payment processor, Epic is unable to provide users comprehensive customer service relating to in-app payments without Apple's involvement. Apple has little incentive to compete through improved customer service because Apple faces no competition and consumers often blame Epic for payment-related problems. In addition, Apple is able to obtain information concerning Epic's transactions with its own customers, even when Epic and its own customers would prefer not to share their information with Apple.

d. Apple's conduct increases developers' costs. As noted, Apple extracts an exorbitant 30% commission on in-app purchases of in-app content. Developers require a reasonable return on their investment in order to dedicate the substantial time and financial resources it takes to develop an app. By imposing its 30% commission, Apple necessarily forces developers to suffer lower profits (rendering some apps financially unviable altogether), reduce the quantity or quality of their apps, raise prices to consumers, or some combination of the three. Notably, Apple's 30% charge on purchases for in-app content is much higher than fees charged by analogous electronic payment processors in competitive contexts, such as PayPal, Stripe, Square or Braintree, which typically charge payment processing rates of around 3%, a 10-fold decrease from Apple's supra-competitive rates[14]. As another example, Google charges 2.9% or less for the use of Google Pay, an electronic payment processor that Google makes available to app developers for processing payments for physical products sold on Android apps. If developers were able to rely on their own solutions, or those of third-party payment processors, they could offer users lower prices for in-app purchases—as well as better customer service and alternative payment options. Apple could not maintain its 30% commission if it did not unlawfully foreclose competition.

Apple's app review processes are used as an anticompetitive screening tool

The review processes associated with the Apple App Store have also provided Apple with an unfettered ability to engage in a screening process that enforces its anticompetitive restrictions in a manner that ensures that it remains insulated from competition in respect of iOS mobile app distribution and in-app payment processing.

Notable large technology companies have recently clashed with Apple and lost in respect of bringing potential competition to the iOS platform that would benefit end users, demonstrating not only that Apple's monopoly power is not constrained by even large and well-capitalized market participants but also that it engages in clearly anticompetitive screening practices. As a result, iOS users are denied innovations:

a. Epic has unsuccessfully attempted to negotiate with Apple to bring the Epic Games store to iOS. In addition, Epics attempt to introduce competition for in-app payment processing by adding a direct payment processing option for in-app purchases to users of *Fortnite* on iOS

[14] Yowana Wamala, "Amazon Payments Review: Should Your Business Use it?", *Value Panguin* (11 June 2019), https://www.valuepenguin.com/credit-cardprocessing/amazon-payments-review.

devices offering iOS device users a significant reduction (from 30% to 12%) on the price of digital in-app purchases resulted in the removal of the *Fortnite* app from the App Store (which has yet to be reinstated). This has caused immediate harm to Epic. It has prevented consumers, including Australian consumers, who use iPhones and iPads from downloading an updated version of *Fortnite*.

b. On August 6, 2020, *The Verge* reported that a new and notable mobile gaming service, Microsoft's xCloud, would be launching its cloud-based online gaming system across a number of different platforms—but, due to Apple's restrictions, not on Apple's App Store[15]. Apple confirmed that it rejected xCloud for violating Apple's policies—the same policies described above that are designed to protect Apple's monopoly in respect of iOS mobile app distribution[16]. Microsoft expressed its discontent with the decision, stating that Apple is "stand[ing] alone as the only general purpose platform to deny consumers from cloud gaming and game subscription services like Xbox Game Pass"[17].

c. On August 7, 2020, *The New York Times* reported that Facebook had unsuccessfully attempted for six months to obtain Apple's approval of a new Facebook Gaming app that would allow users to watch livestreams of online games and play simple games, like the popular Words With Friends[18]. Like it had with Microsoft, Apple unequivocally refused to allow Facebook to distribute its competing game store on the App Store[19]. Ultimately, Facebook caved under Apple's power and removed the ability for users to play games on its app, limiting it to a simple video streaming service[20]. As Facebook's vice president for gaming, Vivek Sharma, explained, Apple's conduct creates "shared pain across the games industry, which ultimately hurts players and developers and severely hamstrings innovation on mobile for other types of formats like cloud gaming"[21].

In contrast, in the personal computer space (including on Macs), software can be purchased through many different sellers, including special digital membership stores. In the gaming space, the leading store is Steam. To compete against Steam, Epic developed its own digital store to sell game software, the Epic Games Store. The Epic Games Store provides access to more than 250 games from more than 200 developers. The Epic Games Store offers personalized features such as friends list management and game matchmaking services. Absent Apple's anti-competitive conduct, Epic would offer the Epic Game Store on iOS.

6. Relationship between app marketplaces and consumers

The restrictions imposed by Apple (and the monopoly power that enables it to do so) also results in significant detriment to Australian consumers.

---

[15] Nick Statt, "Apple confirms cloud gaming services like xCloud and Stadia violate App Store guidelines" *The Verge* (6 August 2020), available online at https://www.theverge.com/2020/8/6/21357771/apple-cloud-gaming-microsoft-xcloudgoogle-stadia-ios-app-store-guidelines-violations.

[16] Id.

[17] Id.

[18] Seth Schiesel, "Facebook Gaming Finally Clears Apple Hurdle, Arriving in App Store", *The New York Times* (7 August2020), available online at https://www.nytimes.com/2020/08/07/technology/facebook-apple-gaming-appstore.html.

[19] Id.

[20] Id.

[21] Id.

iOS app distribution

In relation to iOS app distribution, the restrictions imposed by Apple deny consumers choice, as they are forced to obtain apps solely through the App Store, and Apple alone dictates which apps are available:

a. Apple's elimination of all competition in respect of iOS app distribution prevents innovation by foreclosing potential competing app stores and alternative app distribution channels, as well as reduces the competitive pressure for Apple to innovate and improve its own App Store or reduce its supra-competitive 30% commission. Customers therefore are denied the opportunity to find and access apps by way of new, innovative distribution methods, including specialized app stores catering to their specific interests.

b. Apple's conduct increases consumers' costs as its unconstrained market power permits it to impose a supra-competitive 30% commission on the price of apps purchased through the App Store—a rate that is far higher than what could be sustained under competitive conditions. Consumers bear some or all of that commission in the form of higher prices or reduced quantity or quality of apps.

iOS in-app payments

In relation to iOS in-app payment processing, the restrictions imposed by Apple harms consumers in a number of respects:

a. Apple's conduct denies consumers innovation, which could be provided by would-be competing in-app payment processors, as explained above.

b. Apple's conduct also denies consumers choice, as they are forced to make in-app purchases of in-app content solely through Apple's In-App Purchase.

c. Apple undermines the quality of services that consumers receive because Apple stands as a middleman in every in-app purchase of in-app content. Developers, therefore, are unable to resolve customer complaints arising from in-app purchases directly. For example, Apple does not have a formal mechanism through which developers can determine why a particular refund went through or was rejected, thereby impeding developers' efforts to offer high-quality customer service to consumers.

d. Apple's conduct increases consumers' costs. Apple's market power permits it to impose an exorbitant 30% commission on in-app purchases of in-app content. Consumers must bear some or all of that commission in the form of higher in-app content prices and/or reduced quantity or quality of in-app content.

7. Conclusion

Epic believes this Inquiry by the ACCC into app marketplaces is both timely and critically important. Mobile app stores, such as Apple's App Store and Google Play, are already operating as gateways to essential consumer services through digital platforms. The explosive growth in mobile app downloads means there is every reason to believe that these app stores will play an even greater role in the future. For this reason, Epic contends that these app stores must operate in a manner that facilitates competition, fair access and choice, consumer value for money and innovation.

For the public register

Please contact the undersigned if you would like any further information on this submission.

Yours sincerely

SIGNED

Kayla Page
Associate General Counsel
Epic Games, Inc.