

Why the U.S. Government Is Suing Apple

A few years ago, Apple CEO Tim Cook was on stage at a major tech conference.

I heard you were busy today. / It was a fun day.

While he was there, he took a question from a person in the audience that had to do with something that annoys a lot of smartphone users. When someone with an iPhone texts someone with an Android, the quality is much worse and the text bubbles show up as green. The person wanted to know whether Apple was planning to fix it and Cook had an interesting response at the time. He said the company wasn't planning to do anything about.

I don't hear our users asking that. We put a lot of energy in on that at this point and so now I would love to continue I would love to convert you to iPhone.

It's just, it's tough not to make it personal but I can't send my mom certain videos or she can't send me certain videos. And so... / Buy your mom an iPhone.

I have interviewed Tim Cook several times over the years and I have never known him to be one who is off script or who is really glib or that particularly funny. And so this moment of candidness was very unusual.

That's Wall Street Journal columnist Tim Higgins

And I remember hearing it live and thinking to myself, wow, this is a moment that I think is going to live on. It's a moment that we're going to turn back to years later and just remember because it's going to live in infamy.

And just as our colleague Tim thought, it might Cook's comments from that conference have come back to haunt him because last week the Department of Justice in 15 states sued Apple and US Attorney General Merrick Garland pointed to that moment as an example of how Apple deliberately stifles competition

"Not to make it personal but I can't send my mom certain videos," close quote. Apple's CEO responded "Buy your mom an iPhone." Apple has maintained monopoly power in the smartphone market not simply by staying ahead of the competition on the merits, but by violating federal antitrust law.

Apple says it will vigorously fight the lawsuit.

If Apple loses, it means a key part of its business could see dramatic changes. If it wins, it might come after years of bitter fighting and huge distractions. So either way, Apple is in a tough spot.

Welcome to the Journal our show about money, business and power. I'm Ryan Knutzen. It's Monday March 25th. Coming up on the show. The US government takes on Apple.

When Tim Cook took over as CEO of Apple in 2011, he inherited a company that was known for some of the best tech products in the world. Since then, Cook's focus has been on keeping the company on top.

He has taken the jewels of the iPhone that he inherited from Steve Jobs and really figured out a way to just milk as much money and profit out of that business line as possible, probably more so than people could have imagined when he took the reins all those years ago.

One way Cook did that was by trying to make more money from the apps and other software that run on iPhones.

And Cook really looked at and identified the services part of the business, the app store, the music, the TV, all the kinds of things you consume on your iPhone as a way to see kind of huge growth going forward and really push that.

Inside the company, according to the Justice Department's lawsuit there was a concern that as apps became more and more important, the iPhones themselves could become irrelevant. The lawsuit cites an Apple manager worrying about cheap Android devices that someone could buy for quote 25 bucks at a garage sale and then use to access all of their favorite apps.

Whether it's a Samsung made phone or some cheaper Chinese made phone or some competitor that emerges where it is raced to the bottom for price. In that world, it doesn't matter because the user is just jumping to whatever the hot physical feature is or the cheapest price. And that's really the threat to Apple is that the hardware and the software becomes divorced.

Mmmm. And then it doesn't really matter if you have an iPhone or if you have an Android phone because the thing that you want is the app that runs on both of them that does everything that you need

Right, exactly.

But in trying to keep the iPhone relevant, the Department of Justice is alleging that Apple may have engaged in monopolistic behavior that shut down competition. Here's Attorney General Merrick Garland again in last week's press conference.

Monopolies like Apple's threaten the free and fair markets upon which our economy is based. They stifle innovation, they hurt producers and workers and they increased costs for consumers.

Garland in the Justice Department say that Apple uses unfair practices to give the iPhone in its apps an edge over the competition like with iMessage and how Apple makes it so that text sent

between iPhones and Androids are so much worse.

As a result, iPhone users perceive rival smartphones as being lower quality because the experience of messaging friends and family who do not own iPhones is worse.

What we've seen also over the years is internal emails from Apple come out that show that Apple executives realize the power of iMessage versus Android. And there was some talk about taking iMessage to Android and the thinking was that it would hurt Apple more than it would help that iMessage amounts to a serious lock in is what one Apple executive said.

Apple says it's now working to improve the quality of text messages between iPhones and Androids. The Justice Department says Apple employs a similar tactic with Apple Wallet, the app that includes Apple Pay.

Apple has blocked third party developers from creating competing digital wallets on the iPhone. They use what is known as tap to pay.

Apple makes a lot of money from charging transaction fees on every purchase made with Apple Pay and Apples made it extremely difficult for other companies like banks to create rival digital wallets for the iPhone. Apple says it restricts third party digital wallets in order to protect users' sensitive financial information.

The Justice Department also takes aim at the Apple Watch, which it says the company is using as a tool to protect its monopoly. Here's Meric Garland Again,

When it comes to smart watches, Apple not only drives users to purchase an Apple watch which is only compatible with an iPhone. It also uses its technical and contractual controls to make it harder for someone with an iPhone to use a non-Apple smartwatch.

One of the key features about the Apple watch is that they can see their messages pop up on the watch screen. They can see notifications about social media. The Apple Watch experience is just so easy with the iPhone.

Right? So the Justice Department is saying that because the Apple Watch only works with iPhones, if you own an Apple watch, you're really not going to want to switch to an Android because now you have this watch that's like kind of useless.

Exactly.

You start buying all these things and then it's like, well, do you want to have something that doesn't work? If you get to the next, if you get to Samsung, then all of a sudden, all the investment you've made over the years on all these Apple devices then seem lost.

Apple says it looked into making the Apple Watch compatible with Android phones but decided not to because it says the quality wouldn't have been up to its standards.

So what's the allegation though that the Department of Justice is making here as to why Apple shouldn't be allowed to do this? I mean, Apple is a business. Of course, they're going to try to protect their profits and they're going to try to make it hard for others to compete with them. So what is the Justice Department saying is illegal about what Apple's doing here?

Yeah, that's one of the interesting things about antitrust law. Apple doesn't have to make it easier to compete against it. But the allegations are, is that the steps they are taking are excluding rivals from being able to compete? And that is really kind of where you start to run into trouble, according to the DOJ.

As a result of all this power the Justice Department says Apple is able to extract unfair payments like through the app store. iPhone users can only get apps from the Apple App store but Apple takes a fee of as much as 30 percent on every sale or in app transaction. The Justice Department says this amounts to a tax.

Essentially if you want to play in the digital market that Apple has created, you have to pay Apple to be part of that.

What this case could mean for Apple and its CEO Tim Cook. That's next.

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How has Apple responded to this lawsuit from the Justice Department?

Apple came out swinging, sending a really strong message that it is going to fight very vigorously against these charges. Apple believes that the lawsuit is wrong on the facts and says that it will vigorously defend against it.

Over the years. Apple has defended against the idea that it is an improper monopoly, that it often talks about the intense competition it faces from the likes of Google's Android operating system against the likes of Samsung, and it portrays it almost as a knife fight for customers in a day in and day out fight.

And Apple also argues that its customers are happy and they like iPhones like this functionality is why people choose iPhones.

Apple has a huge user base, many of whom are happy with the product they get and buy it because of the way it operates, the ease of use and that is one of the things that Apple has kind of pushed over the years. It has defended itself and has seemingly won on this idea that it is creating a product that consumers benefit from and that they want.

Apple says that if the DOJ's lawsuit is successful, it would hinder our ability to create the kind of technology people expect from Apple where hardware, software and services intersect.

One thing Apple often says its customers like is its privacy in security features. And to be more secure, it says it needs to be more restrictive about what apps can operate on the iPhone.

When they push back against criticism about the closed ecosystem as being pro consumer, about providing protection for customers from hackers and malware and all the nastiness of the open Internet, it is the product that it is selling in essence that there is the open Internet and then there is the curated experience that the iPhone user is agreeing to enter with the purchase of that. And that is a compelling argument one that seemingly has kind of helped it in its defense over the years against antitrust claims.

Although the Justice Department is taking very specific aim at this defense and says that Apple sort of chooses this privacy argument selectively.

There's definitely frustration among antitrust officials around the world over this defense and they argue that it's a red herring, that Apple could make decisions that could open up the system in a way but is choosing not to, to protect its kingdom.

Apple has successfully fought off antitrust cases before. For instance, in 2020, Apple was sued by Epic Games, the company that makes Fortnite. Epics said that the 30 percent fee Apple charges in the app store was too burdensome.

Now Apple would say they're offering this huge platform they're offering this technology they're offering a user base. It's their world that they've created and they have created a huge opportunity for these developers who sometimes, they say, are really just greedy and don't want to pay.

Apple mostly prevailed on the Epic lawsuit. The judge ruled that some app store restrictions were unjustified, but said that Apple didn't have a monopoly over mobile games and those 30 percent fees are still in place. But the company's antitrust playbook is not bulletproof. Earlier this month, the European Union ordered Apple to pay an antitrust penalty of about two billion dollars. And this morning European regulators also announced an antitrust investigation into Apple along with Meta and Google's parent company Alphabet.

The European Union is working to enforce its new laws intended to rein in the power of big tech in particular platforms such as Apple. Apple is having to make changes to how its app store operates in Europe to get in line with those laws that are really kind of designed and with the aim of allowing third parties greater access to the iPhone. What's at stake here is potentially billions of Dollars worth of fines if Apple is found not to be in compliance and it's just one of the regions

where Apple faces increased scrutiny over its practices. The UK, Japan, South Korea have all been taking more aggressive stances against big tech and Apple.

How big of a threat then is this DOJ lawsuit for Apple?

The threat is enormous. The fact that Justice Farman has brought a case against Apple is a pretty big deal. These things don't happen lightly. It's been years in the works and at the very least it means Apple is going to face a huge distraction for years to come.

Right? Because these lawsuits can sort of famously slow tech companies down and make them less aggressive and less likely to respond or try to build new products because they're a little bit, can be a little bit more hesitant and worried about running afoul of antitrust regulators who are right on their case.

Yeah, everything is under intense scrutiny, everything is of potential worry. The business, the day-to-day business is now also making sure the Department of Justice doesn't win. That's the challenge for Tim Cook here as he enters some of the final years of his career. He's 63 years old. He has helped build Apple into an enormous beast of a company in really a legendary way. And now he faces potentially years ahead of defending that kingdom of ensuring that what he has built and what he has helped oversee can continue.