

Taking a Bite at the Apple: Ensuring a Level-Playing-Field for Competition on App Stores

Related Lawyers: **Prof. Dr. Thomas Höppner, Philipp Westerhoff, Dr. Jan Markus Weber**

Related Practice Areas: **Competition Disputes**

Authors: Prof. Dr. Thomas Höppner, Philipp Westerhoff and Dr. Jan Markus Weber*

A number of competition authorities around the globe have started investigating Apple's position as a "mobile apps gatekeeper". In particular, after receiving a complaint by music streaming service Spotify in March, the European Commission ("EC") recently sent out formal requests for information ("RFIs") to assess whether Apple abuses its dominance towards app developers and publishers. Additionally, the Dutch competition authority ACM opened a probe into Apple's alleged favoring of own apps over those of rivals, and similar procedures have been initiated in Russia and China. Competition law scrutiny is not limited to public enforcement. On May 13, 2019, the U.S. Supreme Court allowed an antitrust class action against Apple filed by consumers to move forward (*Apple v. Pepper*).

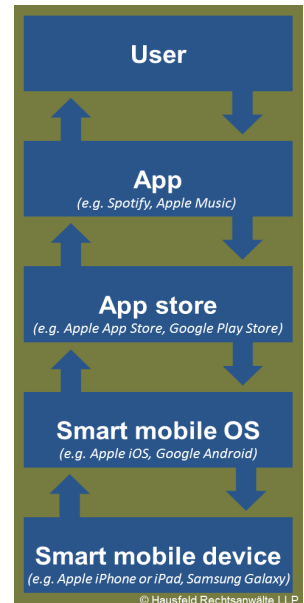
In the EC investigation, on which this article focuses, Spotify alleges that Apple is disadvantaging its rivals, in particular by imposing a "competitor tax" on them. The investigation aims at exploring the interplay between Apple's mobile operating system ("iOS"), its "App Store", in-app purchase functionalities, and Apple's own music streaming service(s).[1] This interplay affects many companies. In fact, media companies, press publisher associations, and screen time/parental control app developers have raised very similar concerns to those of Spotify, arguing that their respective apps are being disadvantaged.

The investigations into Apple's practices have strong similarities to past and ongoing investigations into the other big tech players: Amazon, Google, and Microsoft. One common ground of these investigations is concern about the neutrality of vertically-integrated dominant platforms. Having benefitted from vibrant participation on their multi-sided platforms and resulting indirect network effects for years, dominant platforms may have been incentivized into squeezing the business-side of their platforms to increase overall revenues (also with a view to counter stagnations in their ancient core business models (e.g. iPhone or ad sales), which has been seen as some form of "rent-seeking"). Akin to Amazon, Google, and Microsoft, operating both a dominant platform and services made available via such platform, has created a strong conflict of interest for Apple, as it now benefits from commercially favoring its own services via its platform.

Background: functioning of mobile operating systems and app stores, and resulting conflicts of interests

Apple's App Store is a platform that allows for the intermediation between consumers and developers of mobile applications ("apps"). As a preliminary point, it is worth looking at the ecosystem concerned; particularly the interplay between (i) apps, (ii) app stores, and (iii) smart mobile operating systems ("smart mobile OSs") for (iv) smart mobile devices. **The overall setting of this ecosystem/value-chain can be displayed as follows (simplified):**

Each smart mobile device (the "**hardware**") – e.g. smartphone, smart watch, smart TV, virtual assistant, or tablet – runs a software platform. The smart mobile OS is a central part of such software platform, as it is the "system software" controlling the basic functions of the hardware. It enables users to make use of the electronic device and run any further software on it.[2] In particular, in order to tailor the smart mobile device to its individual needs, the user needs to install specific software (i.e. apps). For this installation the user needs additional distribution software, so-called "**app stores.**"



- Apps are types of mobile-optimized software through which the user can access online content, offline content stored on the device, and other services on the smart mobile device. Such apps can either be developed by the "owner" of the platform, e.g., Apple or Google, or by third-party developers.
- Smart mobile app stores are digital distribution platforms enabling users to download, install, and manage a great variety of apps through a unique interface. By opening app stores to third-party providers, the platform provider tries to benefit from indirect network effects: the more apps users can access in the app stores, the more users opt for a device operating with such platform (and in the case of Apple, this makes even the hardware more attractive for users). Consequently, the platform gets more attractive for developers and publishers (and so on and so forth).

App stores can constitute the single source/distribution point for apps, and are frequently specific to a smart mobile OS. This is the case for both Apple (with its iOS and App Store) and Google (with its Android smart mobile OS and the Play Store). Users do not have to pay a separate charge for app stores. Individual apps, in turn, can be offered "free" or be monetized directly either by offering them (i) against a one-off payment for the download, or (ii) on a subscription basis. If such premium content is acquired directly via the app, the transaction is concluded using "**in-app purchasing systems.**" For any such purchase (e.g. monthly subscription fee), the owner of the app store may charge a fixed percentage of the revenue as a distribution fee.

Given this setting, app developers or publishers rely on the typically bundled software package of smart mobile OS and smart mobile app store to provide their content (music or video streaming, games, news, audio books, tools, office suits etc.). In the case of Apple, such software solutions are the only gateway to the users of Apple's hardware products (iPhones, iPads, Apple TV etc.). Unless a product is "jailbroken"[3], it is the only way how to install apps on it and access the publishers' or developers' content.

The competition concerns arise from the fact that Apple is operating both the App Store, tied to the iOS platform, and services competing with the services of app developers or publishers featured on the App Store.

- In the case of Spotify, Apple competes with its own music streaming services--Apple Music and iTunes. Apple's acquisition of rival streaming service Beats Music for \$3 billion[4] in May 2014 paved the way to launch Apple Music in June 2015 – many years after Spotify started its service.
- A similar rivalry exists for video streaming services (where Apple TV+ and other Apple services compete, by way of example, with Netflix, Sky, and Amazon Video) or news apps (where its aggregating service Apple News competes with the apps of traditional media companies). However, the concerns are not limited to media content, and similarly apply to

other services.

From this hybrid function as both platform and rival app developer apparently follows an incentive for Apple to favor its own services. This very conflict of interest already led to the EC's decision in the *Google Android* case – where Google was fined €4.34 billion for illegal practices such as requiring manufacturers to pre-install the Google Search app and browser app (Chrome), as a condition for licensing Google's app store (the Play Store).[5] Such a conflict of interest can also be found in the ongoing EC investigations into Google's favoring of its own services in its general search results pages (Shopping, Jobs),[6] and Amazon's exploitation of merchant data in its Marketplace to promote its own products and brands.[7]

Spotify's complaint against Apple

In its formal complaint of March 2019 before the EC, Spotify asserts that *"Apple has introduced rules to the App Store that purposely limit choice and stifle innovation at the expense of the user experience."*[8]

Having launched in 2008, in April 2019 Sweden-based Spotify had 217 million monthly active users. 100 million of such users are using Spotify's premium, advertisement-free offer. Since 2009, Spotify's app is also available on the App Store. It was downloaded more than 300 million times in total.

Spotify complained to the EC arguing that Apple uses its dominance in the provision of its mobile operation system iOS and of the App Store to gain advantages on the adjacent market for music streaming services. Spotify criticizes that due to its hybrid business model, Apple is *"essentially acting as both a player and referee to deliberately disadvantage other app developers."*[9] In particular, Spotify complains about the conditions that Apple imposes on developers that wish to offer their apps on the App Store.

- Spotify's primary concern is an alleged "tax" charged by Apple for in-app purchases. This 30% fee applies to apps that use Apple's in-app purchase system, e.g., for monthly subscriptions. After one year, it is reduced to 15% (if the subscription is not interrupted). Spotify asserts that such a fee is not charged to all app developers. Third-party apps like Uber and Deliveroo do not pay such a charge, as they are selling physical goods or services, instead of digital goods or services. Spotify believes this is a discrimination. Moreover, Apple's own services such as Apple Music do not have to pay such a fee and can, consequently, offer more competitive prices than its rivals can offer. Spotify believes this is a favoring of Apple's own services. This concern is shared by other media content providers such as providers of news apps or video streaming services.
- Spotify also claims that Apple prevents it from communicating directly with its customers if Spotify opts to not use Apple's in-app purchase system. Apple does not allow the app developer to advertise deals and promotions or to circumvent Apple's system by sending commercial communications directly to the users who registered a new account. In addition, Spotify claims that Apple makes it harder for users to switch from Spotify's free service to its premium (ads free) version by prohibiting buttons or links to alternative (outside-Apple) ways to pay, product info pages, discounts and promotions.
- Moreover, Spotify claims that Apple is hindering the marketing of Spotify's app by rejecting bug fixes and app enhancements. Additional technical limitations include restrictions on the use of the Spotify app on other devices such as Apple's smart speaker HomePod or the Apple Watch (which Spotify requested but Apple declined initially). Also, via Apple's intelligent voice assistant Siri, users assertedly can only control and address Apple Music – but not Spotify's app.

Further complaints against Apple

Several media companies have welcomed Spotify's complaint. By way of example, the European Publishers Council ("**EPC**") openly supports Spotify's complaint.[10] The EPC claims that the *"same challenge is also faced by news publishers offering apps for media consumers,"* referring to the dominance of both the app stores of Apple and of Google. In particular, the EPC is concerned about Apple and Google taking ownership of the customer relationship, keeping valuable data, and insisting on using their own in-app purchasing system (including the corresponding fees).

The “Apple Tax” even led leading subscription-based video streaming service Netflix to change its business model in late 2018. After testing bypasses to Apple’s billing across several markets, Netflix abandoned the ability of new users to sign up and subscribe to its service within its iOS app across all global markets. Prior to that, Netflix contributed in-app revenues of \$853 million to the App Store, leading to a potential \$256 million share for Apple merely for allowing Netflix to offer subscriptions in its app.[11] Arguably, Netflix only had the option to disable any subscription via Apple’s in-app purchase system because it is a well-known brand. This, however, may not be a feasible resort for the majority of smaller publishers or app developers, who *de facto* have no choice but to share with Apple 30% of their revenue if they want to start building any business with Apple’s walled-off customer base.

In addition, Apple faces a Dutch antitrust probe into the alleged favoring of its own apps over rivals that started in April 2019. It was reported that this investigation will have an initial focus on Apple Music and Apple News, but will likely thereafter extend to other app categories. The investigation followed an official market study into mobile app stores that was published just before the formal investigation opened.[12] This report found that within the iOS-ecosystem, there are no realistic alternatives for apps to the App Store. It follows that the App Store forms a bottleneck within Apple’s ecosystem. More generally, the Dutch authority is concerned that app developers are hampered by other disadvantages such as lack of pre-installation of their own apps. In the same investigation, the Dutch competition authority also calls for app developers to flag issues with Google’s Play Store.

But such complaints are neither limited to media content providers, nor to Europe. Already in 2017, 28 local app developers filed a complaint against Apple in China accusing Apple of charging excessive fees and removing apps without proper explanation.[13] Similarly, in March 2019, Kaspersky Lab filed a complaint against Apple in Russia for delisting its parental control app[14] Kaspersky Safe Kids from the App Store, where it had previously been hosted for three years. And in April 2019, two additional parental control and screen-time app developers – Qustodio and Kidslox – lodged complaints with the EC.[15] These companies argue that Apple used the App Store dominance to give itself an advantage over apps that competed with its newly introduced “Screen Time” feature, a rival service. The two complainants assert that just before Apple released the Screen Time feature, it demanded that Qustodio and Kidslox stop using technology that was critical to their app’s functionality. Otherwise, its apps would be delisted from the App Store. Pursuant to a New York Times’ assessment, Apple has removed or restricted at least 11 of the 17 most downloaded screen-time and parental-control apps. [16]

Apple’s reaction to the allegations

In an attempt to rebut Spotify’s allegations, Apple argues that Spotify wants to freeride, that is, to benefit from the App Store without making any contributions to it. Similar charges are made by other distribution channels (e.g. for distribution via mobile network operators). Apple also counters the allegations with security and privacy reasons, and generally argues that users must be able to trust the integrity of Apple’s systems and transactions on them. Apple further opposes[17] Spotify’s definition of the affected markets and the EC finding that Apple is dominant.

App Store and iOS dominance?

Any finding of dominance requires first the assessment of the relevant markets. Some guidance can be found in the *Google Android* case in which the EC already analyzed the ecosystem for smart mobile OS and corresponding app stores. However, there are some significant differences when it comes to Apple’s ecosystem resulting from Apple’s deep(er) vertical integration.

In *Google Android*, two relevant product markets were defined:

- A market for the “**licensing of smart mobile OSs**,” where developers of mobile OS software compete against each other for OEM – where Google is active with Android;
- A market for the “**provision of app stores running on Android**,” where Google’s Play Store competes against other app store providers for end customers using Android devices.

Being a fully integrated OEM, Apple is active on neither of these two markets.

- Apple does not license iOS to any OEM. Neither does it allow any competing mobile OS or app stores on its hardware. “**Non-licensable smart mobile OSs,**” however, do not belong to the same product market as licensable smart mobile OSs.
- Rather, Apple uses its proprietary iOS software exclusively for its own hardware, i.e., in order to provide end-customers a comprehensive package of a smart device with a corresponding smart mobile OS and app store.
- Since Apple does not allow any third-party app stores on its hardware, its App Store does not compete with such for end-customers. In addition, the App Store is developed specifically for the iOS platform. It does not run on other mobile OSs and is not licensed to third parties.

However, while Apple may not be active on the market for the licensing of smart mobile OS or the *provision* of app stores, it is active on the market for the *distribution* of apps via its App Store. In this market, app developers demand access to the App Store that is pre-installed on any given Apple smart mobile OS in order to reach end-customers.

As far as has been published thus far, in the *Google Android* decision the EC did not (have to) define a corresponding “market for distributing apps on the Play Store.”[18] Because Google’s dominance was already established in the markets for (i) general internet search services, (ii) licensable smart mobile OS, and (iii) app stores for the Android mobile operating system, it was simply not necessary to raise the question whether there was a market downstream to the app stores market.

However, in the case of Apple, it appears necessary to determine the markets downstream of the provision of an app store. There are arguments that there is a separate and distinct “**market for the distribution of smart mobile apps on Apple smart mobile device.**”

- On this two-sided market, app developers and publishers demand from Apple access to the Apple ecosystem by means of a distribution of their apps via the App Store marketplace (that is, to be listed). Users search for and compare apps and ultimately download them on their smart mobile devices.
- Such a market definition is in line with the definition of the markets in the related telecoms and broadcasting sector and other network industries. There too it is assumed, for instance, that the operator of a distinct network that (exclusively) links to a particular consumer group cannot be substituted with any other network that does not lead to the same consumer base.

Apple will likely argue that from a macro-perspective, there are many distribution channels through which app developers and publishers can get to smart mobile device users. However, this argument disregards the fact that the “Apple community” would then basically remain reserved for Apple – a top-level user group usually perceived as having a high purchase power and being particularly valuable for publishers. Most consumers just have one mobile device (per type). Thus, consumers with Apple devices are “walled-off” from any other ecosystem. They can only be reached through the App Store.

Regarding dominance, it follows from Apple’s decision to reserve the provision of an app store to itself, that it enjoys a dominant position also for the downstream market of distributing apps. In other words, since the App Store is the only platform via which apps can be distributed to all Apple users, Apple currently enjoys a “**technological monopoly.**” If the EC defines the markets accordingly, Apple will thus be found dominant.

Potential theories of harm

The crucial question will be whether Apple has abused its dominant position in the market for the distribution of smart mobile apps on Apple smart mobile devices. Apple’s conduct shows elements of several established types of abusive practices. The EC is likely to focus on the exclusionary (rather than the exploitative) elements.

Leveraging

The central competition concern is that Apple is using its (technological) monopoly as provider of the App Store within the “walled-off” ecosystem as a lever to receive (undue) advantages on adjacent markets (such as the market for digital music or digital music obtained through streaming) with a view to expanding its dominance into these markets. In fact, Apple’s conduct relates to several established cases of an expansion of dominance through means that are not competition on the merits.

Self-preferencing: In *Google Search (Shopping)* the EC found that it can constitute a type of leveraging if the dominant company favors its own service on an (otherwise neutral) intermediation platform without objective justification.[19] Apple is providing less functionalities to competing app developers as compared to its own apps. Plus, Apple is (only) charging competing services such as Spotify with a fee, while its own services are distributed for free. Thus, akin to Google in the *Shopping* case, Apple is favoring its own downstream service on the dominant upstream platform. Considering the dependency of app developers on Apple’s indispensable App Store, this favouring is capable to eliminate competition on any downstream markets.

Refusal to deal: Operating an app store that is indispensable for app developers to reach the “walled-off” user group of Apple users, Apple may not refuse to grant an app developer access to the App Store, unless there are objective reasons for it. Spotify is currently listed in the App Store. However, Apple’s restriction of some of the functionalities of the Spotify app on its devices may amount to a constructive refusal to deal if only a “full access” to Apple’s ecosystem allows Spotify to effectively operate on the downstream market for music streaming services. By way of analogy, the same principles could apply to in-app purchase systems. Alternative providers of such a purchase system may request Apple to be allowed to process transactions between app developers and subscribers. There are also arguments that Apple could be obliged to share subscriber data that it gathers through the App Store with the respective app developers and publishers, so that the latter do not lose the direct relationship to their customers.

Margin squeeze: Depending on the end-customer prices charged by Apple Music, Apple’s upstream charge (for access to the App Store) of 30% of the revenues generated on the downstream market, may amount to a margin squeeze allowing Apple’s downstream services to undercut any competing service (that has to pay the 30% commission).

Discrimination: According to Article 102(2)(c) TFEU, a dominant company may not apply dissimilar conditions to equivalent transactions with other (competing) trading parties. This only applies, however, if the discrimination places any trading party at a competitive disadvantage towards another party with which it competes in any given market.[20] Apple charges its “tax” only for digital goods and services – not for services selling physical goods or services such as Uber and food delivery services. Thus, to succeed with its discrimination claim, Spotify would have to demonstrate that it competes with such providers of physical goods.

Exploitation

Excessive pricing: Irrespective of the exclusionary elements of Apple’s conduct, the revenue share of 30% – the “Apple tax” – could also amount to an excessive pricing, as prohibited by Article 102(2)(a) TFEU. There are several approaches to determine whether a price is abusive as it has “no reasonable relation to the economic value of the product supplied.”[21] In multi-sided markets this task is particularly challenging.

- Such excess can be determined objectively by comparing the price charged for the service with the cost of production of service (which would disclose the profit margin). This relatively vague formula makes it difficult to assess under which exact circumstances excessive pricing amounts to an abuse of market power. The EC would therefore be required to compare the revenues generated with the distribution of apps via the App Store and the production/operating costs of this app distribution service.
- Considering the difficulties to determine the costs of production, it could be more promising to rely on the “comparative market concept”. To this end the EC would have to compare Apple’s pricing with that of comparable providers and competitive markets.

Considering the difficulties of assessing a reasonable price, the EC is more likely to focus on other aspects of Apple's conduct.

Unfair trading conditions: Regarding the more general restrictions that Spotify describes (e.g., not being allowed to address its customers directly or conditions in the App Store Review Guidelines), Apple could have imposed unfair trading conditions contrary to Article 102(2)(a) TFEU. Any such abuse of market power would depend on a case-by-case assessment of Apple's individual contractual terms with the respective app provider (e.g. Apple Developer Program License Agreement). Note that such unfair trading conditions are also being assessed in the German *Amazon* probe.[22]

Consumer victims are waiting in the wing

Public enforcers are not alone in scrutinizing Apple for its "Apple Tax". On May 13, 2019, the U.S. Supreme Court allowed the antitrust class action against Apple in the case of *Apple Inc. v. Pepper et al.* to move forward.[23] In this early stage lawsuit, the claimants argued that Apple used monopoly power to increase app prices. The Supreme Court had to decide whether such suit was barred by the 1977 decision *Illinois Brick Co. v. Illinois*, which generally allowed only direct purchasers of products to bring federal antitrust suits. In a 5-4 opinion, the Supreme Court allowed the case to go forward. It declared that Apple's theory: (i) "contradicts statutory text", (ii) "is not persuasive economically or legally" and would (iii) "thwart effective antitrust enforcement." The Supreme Court made it clear that "allowing only upstream app developers – and not the downstream consumers – to sue Apple would [...] directly contradict the longstanding goal of effective private enforcement and consumer protection in antitrust cases."

Conclusion

The EC investigation into Apple addresses modern-antitrust topics related to closed ecosystems ("walled gardens") and the conflict of interest arising out of the hybrid function of companies that operate both an upstream platform and a downstream service intermediated through the upstream platform. Therefore, the case has relevance not just to Spotify but to all developers of apps and publishers dependent on reaching end-customers through dominant content distribution platforms. In the case of Apple, the EC is likely to focus on the exclusionary elements of Apple's conduct, in particular any negative impact on markets for app developers. The EC's *Google Shopping (Search)* and *Android* cases are likely to be of central guidance in dealing with Apple.

This article was published as part of Hausfeld's Spring Competition Bulletin and in Lexology in May 2019.