ARTICLE

Recap of Distribution Essentials: App Distribution and Related Antitrust Considerations

Yeseul Hyun and Lolo Palacios

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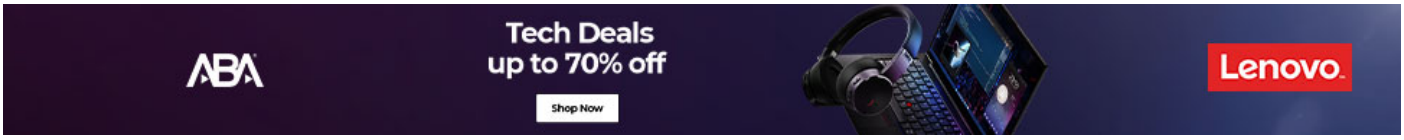
Despite their relatively short history, app stores have brought a new paradigm for the mobile economy. Since the launch of Apple's App Store in 2008 with 500 apps, [1] its catalog has expanded to 1.8 million apps in June 2023. [2] Global consumer spending across app stores has rapidly increased, from $86 billion in 2017 to $167 billion in 2022. [3] [4] The rapid growth of app stores and technology companies has sparked antitrust concerns regarding app store policies. In addition to a number of lawsuits filed by app developers and companies against Apple and Google with antitrust claims against certain App Store and

Google Play policies, Apple and Google have also been facing increasing scrutiny from the Biden administration, as summarized in a February 2023 report from the Commerce Department titled "Competition in the Mobile Application Ecosystem." [5] In that report, the administration asserts that "[t]he policies that Apple and Google have in place in their own mobile app stores have created unnecessary barriers and costs for app developers." [6]

On May 11, 2023, the Distribution and Franchising Committee of the ABA Antitrust Law Section hosted a webinar titled "App Distribution and Related Antitrust Considerations," as part of the committee's Distribution Essential Series. The webinar was co-sponsored by the Pricing Conduct Committee and the Media and Technology Committee, and was moderated by Caiti Zeytoonian (Morgan Lewis) who was joined by panelists Professor John M. Yun (George Mason University Antonin Scalia Law School) and Dr. Samuel Weglein (Analysis Group).

The panelists' discussion drew heavily from the recent antitrust suit brought by Epic Games against Apple and highlighted the complexity of potential antitrust issues arising in the context of app distribution, including:

- Market characteristics, such as the multisided nature of platforms and the indirect network effects, and the implication of the aftermarkets doctrine;
- Challenges to determine harm, such as defining market power, and App Store policies that are under scrutiny; and
- Implications of the court's finding that anti-steering provisions are anticompetitive.



I. Market Characterization

Dr. Weglein began the discussion by describing how one might think about markets in the context of app stores. He provided an economic framework for how app stores operate by introducing the concept of platforms, which economists typically use to describe app stores. Platforms bring two or more sets of customers together so that they can transact with each other. App stores are examples of two-sided platforms in which indirect network effects are prominent: greater value to one side of the platform is generated as more participants join the other side. Users will find it more valuable when there are many app developers active on the platform. Similarly, developers will be drawn more into an app store if it has many users. Dr. Weglein contrasted such indirect network effects to "direct network effects," which

occur when the value of a service increases simply because the number of users increases, expanding the network (e.g., telephone service becomes more valuable as the number of people with a telephone increases).

The stronger the indirect network effects are, the greater the potential for value to be created is on the platform as matches are facilitated between the two sides. A platform—like an app store—can enable a greater number of matches by reducing two types of costs: search costs and transaction costs. One way that a platform can facilitate matches is by helping a user find a service or product they cannot otherwise find; for example, by providing a search tool for users looking for a fitness app for tracking trail running. Another way that an app store can facilitate efficient matches is by making transactions less costly; for example, by not requiring users to enter their billing information each time they purchase an app or make an in-app purchase. By lowering search and transaction costs, app stores create value on the platform and, in exchange for the value they create, charge a fee. Dr. Weglein noted that the central question at the heart of antitrust disputes and inquiries related to app stores is how the rents that are generated by strong indirect network effects and the value created by the platform should be divided among different parties.

Next, Professor Yun complemented Dr. Weglein's market characterization by introducing another important aspect of app stores: the aftermarket. Professor Yun noted that aftermarkets are not an inherent characteristic of app stores but a doctrine that arose within antitrust context, which was recognized by the Supreme Court in the *Eastman Kodak* case. [7] The foremarket refers to durable goods that are used period after period, for example, a printer. The aftermarket refers to services or parts to operationalize and maintain the initial good from the foremarket, for example, ink cartridge for that printer. In the case of the App Store, Professor Yun explained that apps are part of the complementary nature to the durable iOS foremarket. An important implication from this case is that it is not necessary for a firm to have market power in the foremarket to monopolize the aftermarket. Professor Yun explained that complainants are creating a digital revival of the Kodak doctrine by referencing the aftermarket to characterize a platform's conduct as a violation of the Sherman Act even if the foremarket is relatively competitive. This is the reason why Professor Yun sees aftermarket as an important concept in characterizing app stores.

II. Theories of antitrust Harm in the Context of App Stores

Attorney Zeytoonian then asked the panelists about the concept of "harm" in the context of app stores. Noting that it is often helpful to understand market definition before addressing questions about market power, nature of competition, and harm, Dr. Weglein first described the complexity of defining a market in the context of app stores. To start, he introduced the hypothetical monopolist test—a test commonly used to define the relevant product market —which seeks to identify the smallest market within which a hypothetical monopolist could

profitably impose a "small and but significant and non-transitory increase in price," typically considered to be 5 to 10 percent. If it is not profitable for a hypothetical monopolist to increase prices by 5 percent in a proposed market, then the boundaries of the market need to be widened and the test reapplied. Due to the two-sided nature of app stores, this thought experiment becomes more complicated as both sides of the market must be taken into consideration. The operative question in the context of app stores is whether a hypothetical app-store monopolist can raise the commission rate from app developers by 5 percent. If the monopolist did this, in the short run, only a few developers would drop out. However, over a longer time horizon, there is a dynamic effect that needs to be considered. Users who valued developers who had dropped out might, in turn, drop out of the platform, which would, in turn, cause more developers to drop out, and so on.

Dr. Weglein then proceeded to discuss another question economists grapple in the context of app stores related to the existence of monopoly power. In *Epic v. Apple*, a central question was whether Apple had monopoly power. Dr. Weglein explained that Epic invoked an "aftermarket" theory of relevant markets. Under Epic's view, definitionally, Apple would have a 100-percent share of its own aftermarket because all apps are purchased through the App Store. Epic's theory of harm alleged that Apple had a 100-percent share of the relevant market and therefore had monopoly power. Apple, however, offered a different view, arguing the company faced "massive competition on a worldwide scale," including mobile competition from Android and gaming competition from consoles and PCs. In her ruling, Judge Gonzalez Rogers disagreed with both definitions and defined a "digital mobile gaming transactions" market, [8] calculating Apple's market share in the range of 52 to 57 percent, depending on the year. When other consoles and purchases made on these consoles were included in the calculation, Apple's market share was calculated to be approximately 30 percent. Dr. Weglein also noted that there was substantial work conducted by economists in the case related to the 30-percent commission that Apple receives from developers and whether the fact that Apple has had that commission level since the start of the App Store is evidence of Apple's market power.

Next, Dr. Weglein made an observation about Judge Gonzalez Rogers' reaction to Apple's argument that zero-price apps lower the effective commission rate over time. Judge Gonzalez Rogers' opined that if zero-price apps led to increased sales of the handsets, those additional sales should also be taken into account. Dr. Weglein viewed this as the judge's consideration of the two-sided market nature of app stores, which connects the effect of a lower commission rate on the developer-side with its potential effect on the consumer side. Dr. Weglein commented that while he personally does not agree with such a view as he sees the handset market as a distinct market, he found the judge's observation intriguing.

Next, Dr. Weglein discussed Judge Gonzalez Rogers' opinion that the 30-percent commission was supracompetitive and that if a competitor existed then Apple's commission would have

been lower. However, the court found that there was no evidence that quantity was reduced as a result of a higher price. [9] The court also pointed to potential reduction in innovation based on negative commentaries from developers featured in Apple's developer survey. [10] Dr. Weglein suggested an alternative view on the survey results in consideration of the purpose of the survey. Apple developed the survey to gather critical feedback from app developers to consider, which Apple would not have an incentive to do if it were a monopolist. He noted that, in that sense, the developer survey can be seen as a sign of competition.

Professor Yun offered his view that the theories of antitrust harm related to the App Store are largely associated with Apple's governance decisions on how to administer its online marketplace, which include:

- Exclusivity (i.e., the only way a user can receive a third-party software in a legitimate way is through the App Store);
- In-app payment tie (i.e., all in-app payments are processed through Apple);
- Non-steering provision (i.e., third-party app providers are not allowed to send consumers to the web to do business directly with them); and
- The 30-percent commission on all transactions.

Next, Professor Yun offered his view on the basics of the App Store's business. The App Store was introduced one year after the introduction of the iPhone and has had largely the same policies since then. Several of the policies that are now viewed as controversial—for example, exclusivity and the 30-percent commission—were in effect when Apple had no market power. Professor Yun explained that this observation should affect how one would evaluate antitrust concerns associated with these policies, and it can either be explained by an extreme aftermarket theory where everyone has monopoly power or described as an efficient policy.

Regarding exclusivity, Professor Yun noted the two-sided nature of the App Store and explained Apple's need to help users feel confident in their transactions by approving and vetting apps to ensure that they will not interfere with the software or cause a breach of personal information. Apple's efforts also benefit developers, especially smaller developers, as they can gain trust from users by simply being on the platform. Apple's trust-building effort is also relevant to the in-app ties. By having the in-app payments go through Apple, payment information is not shared with a third party. This assures customers that their payment information is safe, which benefits developers, especially smaller developers that may not be well known. Professor Yun concluded his thoughts by noting that many of the policies that are now scrutinized are common sense policies with which the consumers have

been comfortable since the start of the App Store, and as a result, complainants may face an uphill battle in claiming antitrust harm.

Dr. Weglein agreed with Professor Yun, noting that there was no question that Apple's approach—also known as the "walled garden" approach where Apple makes the hardware and the software and controls the experience—is valued by consumers. He stated that although there is often a concern that innovation would be impeded without a "head-to-head" competitor, innovation has been and is still occurring as firms are competing *for* the market.

Dr. Weglein also commented on Judge Gonzalez Rogers' view in *Epic v. Apple* that after the original app purchase is made on the Apple Store, developers and users do not need Apple as intermediary. Dr. Weglein noted that the financial intermediation—which continues after original app purchase—also yields value.

III. The anti-Steering Provisions Going Forward

The panelists then discussed their thoughts on whether the court's decision on *Epic v. Apple* opened the door for developers to send users to the web for purchases. Professor Yun commented that from his read of the decision it does open that door and that the question is now how that will affect Apple's, developers', and users' incentives and the price. He shared that the immediate effect will be that more traffic will be driven to alternative distribution points, such as the web. This, in turn, will most likely have an effect on how Apple sets their policies.

Dr. Weglein responded by saying that the "devil will be in the details." If users are on an app and want to make a purchase that can be conducted through the web, they might still choose to make an in-app purchase instead of going to the web if they feel the process is onerous. The more seamless the process for purchases and payments, the closer the web transaction will be to the in-app purchase experience.

This article was prepared by the Antitrust Law Section's Distribution and Franchising Committee.

Endnotes

Authors

Yeseul Hyun
Analysis Group

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Lolo Palacios

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