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Fairness and contestability in the provision of software application stores services

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1. INTRODUCTION

On 4 March 2024,[1] the European Commission ('Commission') fined Apple €1.8 billion for abusing its dominant position on the market for the distribution of music streaming apps to iPhone and iPad users ('iOS users') through its App Store. The Commission found that Apple's 'anti-steering provisions' effectively banned music streaming app developers from fully informing iOS users about alternative and cheaper music subscription services available outside the app and from providing any instructions about how to subscribe to such offers. The Commission ordered Apple to remove the anti-steering provisions and to refrain from adopting practices that would circumvent such a prohibition.

The Commission adopted its decision 3 days before Apple was due to submit its compliance proposal in the context of its obligations under Article 8 of the Digital Markets Act (DMA).[2] Article 5(4) DMA requires Apple to allow app developers distributing through the App Store to communicate and promote offers in-app to iOS users and engage in contracts with them outside the App Store. Article 6(4) DMA requires Apple to permit third-party app stores to distribute apps on its iOS devices. Article 6(3) also requires Apple to enable iOS users to easily install and uninstall app stores, easily change default settings, and allow them to select among, for example, competing app stores through easy-to-use and unbiased choice screens. Article 6(12) DMA further requires Apple to provide access to its App Store on fair, reasonable, and non-discriminatory (FRAND) terms.

[1] See European Commission, *Commission Fines Apple over €1.8 Billion over Abusive App Store Rules for Music Streaming Providers*, 4 March 2024. <https://ec.europa.eu/commission/presscorner/detail/en/ip_24_1161> accessed 31 March 2024.

[2] See European Commission, *Regulation 2022/1925,14 September 2022, on Contestable and Fair Markets in the Digital Sector and Amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act)*. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022R1925> accessed 31 March 2024.

Arguably, compliance with these DMA requirements ought to be sufficient to ensure compliance with the orders laid out in the Commission's Decision.

Apple's compliance proposal opens up its devices to entry by third-party app stores at a technical level. App developers who exclusively distribute through Apple's App Store will continue to benefit from the fees currently in offer. App developers who choose to single-home or multi-home in one or more alternative app stores will be subject to a new fee scheme, which includes a fee *per* install that *de facto* translates into a minimum fee *per* user.[3]

This proposal has been criticized by many, including prominent app developers, such as Meta,[4] Microsoft,[5] and Spotify.[6] It has also been criticized by some practitioners[7] and scholars.[8] In particular, Crémer and others[9] note that Apple's new fee structure will stifle the development of alternative app stores.[10] This is because app developers, including those offering free apps (eg apps supported by advertising, which currently pay no fee to Apple) will have to pay a fee to reach their iOS users if they choose to patronize rivals of Apple's App Store. This means that developers with apps exhibiting large installed bases ('popular apps') may have no, or limited, incentive to distribute through alternative app stores. This could frustrate the entry of competing app stores since they are likely to need several popular apps to become credible contestants.

On 25 March 2024,[11] the Commission decided to open non-compliance investigations involving Apple, since it suspects that Apple's compliance proposal may fall short of effective compliance of its obligations under the DMA. Precisely, the Commission considers that (i) Apple's proposals may restrict app developers' ability to freely communicate and promote offers and directly conclude contracts by imposing various charges, in contravention of Article 5(4) DMA; (ii) Apple's design of the web browser choice screen may prevent iOS users to truly exercise its choice of app stores, in contravention of Article 6(3) DMA; and (iii) Apple's new fee structure may be defeating the purpose of its obligations under Article 6(4) DMA. Interestingly, the Commission is not planning to investigate whether Apple's proposal complies with Article 6(12) DMA. In this brief essay, I discuss what may be the explanation and comment on the appropriateness of focusing only on the contestability goal of the DMA in the hope that fairness is guaranteed in contestable markets.

2. THE FAIRNESS—CONTESTABILITY VIRTUOUS LOOP …

The DMA explains that the concepts of contestability and fairness are 'intertwined', since 'the lack of, or weak, contestability for a certain service can enable a gatekeeper to engage in

[3] See <https://www.apple.com/legal/dma/> accessed 31 March 2024.

[4] See Matt Binder, *Meta, Microsoft take on Apple and Lobby EU to Reject New App Store Terms*, 21 February 2024. <https://mashable.com/article/meta-microsoft-lobby-eu-apple-app-store-dma> accessed 31 March 2024.

[5] ibid.

[6] See Spotify, *A Letter to the European Commission on Apple's Lack of DMA Compliance*, 1 March 2024. <https://newsroom.spotify.com/2024-03-01/a-letter-to-the-european-commission-on-apples-lack-of-dma-compliance/> accessed 31 March 2024.

[7] See Damien Geradin, 'When Apple takes the European Commission for Fools: An Initial Overview of Apple's New Terms and Conditions for iOS App Distribution in the EU' (*The Platform Law Blog*, 26 January 2024). <https://theplatformlaw.blog/2024/01/26/when-apple-takes-the-european-commission-for-fools-an-initial-overview-of-apples-new-terms-and-conditions-for-ios-app-distribution-in-the-eu/> accessed 31 March 2024.

[8] See Jacques Crémer and others, Apple's Exclusionary App Store Scheme: An Existential Moment for the Digital Markets Act. (VoxEU Column, 2024). <https://cepr.org/voxeu/columns/apples-exclusionary-app-store-scheme-existential-moment-digital-markets-act#:~:text=Key%20Themes-,Apple's%20exclusionary%20app%20store%20scheme%3A%20An%20existential,for%20the%20Digital%20Markets%20Act&text=Article%206(4)%20of%20the,apps%20on%20its%20iOS%20devices> accessed 31 March 2024.

[9] ibid.

[10] They also argue that the new fee structure will also hinder competition from 'proprietary' app stores: that is, app stores that specialize in the apps produced by one or a small number of app developers.

[11] See European Commission, *Commission Opens Non-compliance Investigations Against Alphabet, Apple and Meta Under the Digital Markets Act*, 25 March 2024. <https://ec.europa.eu/commission/presscorner/detail/en/ip_24_1689> accessed 31 March 2024.

unfair practices' and 'unfair practices can reduce the possibility of business users or others to contest the gatekeeper's position'.[12] It follows that it may be sufficient to adopt measures rendering contestable the provision of the core platform services regulated by the DMA to ensure that gatekeepers offer fair terms to their business users. In the case of the provision of app store services, this would mean that if Apple faces credible competition from alternative app stores, then competition will force its terms and conditions to be fair, as otherwise app developers will migrate *en masse* towards its competitors.

Consistently with this principle, Crémer and others[13] sustain that 'the analysis of gatekeeper practices should concentrate on (a) prohibiting practices that make entry and/or expansion difficult while at the same time hurting the welfare of users; and (b) proposing proactive pro-competitive interventions that make the entry of new platforms and expansion of smaller ones easier'. They further consider that this is a feasible and reasonable approach because 'it is not very difficult to identify practices that reduce [contestability]' such as, for example, 'practices that restrict multi-homing on one or more sides of the market'.

3. ... AND ITS LIMITS

Indeed, the Commission's probe of Apple's proposal will find it contravenes Articles 5(4) and 6(3) DMA if it prevents iOS users to multi-home across app stores, and it contravenes Article 6(4) DMA if it restricts the ability of app developers to multi-home across competing app stores. Suppose the Commission concludes that Apple's current proposal, or a future one, does not limit multi-homing on either side of the market and, hence, it does not undermine the contestability of the provision of app store services in the iOS platform and, therefore, complies with Articles 5(4), 6(3), and 6(4) DMA, would it be correct to conclude that such a proposal satisfies the DMA fairness objective?

I would certainly answer in the affirmative if compliance with Articles 5(4), 6(3), and 6 (4) increases contestability in the provision of application store services so significantly that Apple can be expected to be compelled to behave fairly. In that case, there should be no need to investigate the fairness of the terms and conditions Apple offers to app developers using the App Store.

However, as Crémer and others[14] note that 'due to demand and technological constraints, contestability can be infeasible or only very limited'. In particular, even if the gatekeeper does nothing to erect barriers to entry and expansion, and even if it undertakes actions to limit the existing ones, entry and expansion may not occur due to network effects, economies of scale and scope, and/or coordination problems. Therefore, one should not be surprised if practices found to be in compliance with Articles 5(4), 6(3), and 6(4) DMA (because they do not limit multi-homing) may not be sufficient to make the provision of app store services in iOS effectively contestable. When this is the case, the Commission may have no alternative but to determine whether the terms and conditions offered in the App Store are FRAND.

4. WHITHER ARTICLE 6(12)?

As noted in Section 1, the Commission does not seem to be ready to investigate whether Apple complies with Article 6(12) DMA. Why? Only the Commission can answer but, to the best of my understanding, hitherto it has not done so.

[12] See DMA, Recital (34).

[13] See Jacques Crémer and others, 'Fairness and Contestability in the Digital Markets Act' (2024) 40 Yale J Regul 973. <https://openyls.law.yale.edu/bitstream/handle/20.500.13051/18330/Fairness%20and%20Contestability%20in%20the%20Digital%20Markets%20Act.pdf?sequence=1&isAllowed=y> accessed 31 March 2024.

[14] See ibid 1003.

One possible explanation is that the Commission believes that the competitive constraint exerted by third-party app stores will be sufficient to force Apple to behave fairly towards app developers patronizing the App Store. With this belief in mind, ensuring compliance with Articles 5(4), 6(3), and 6(4) is sufficient. Another possible explanation is that the Commission considers that Apple's proposal meets the criteria laid out in Article 6(12) DMA because it continues to offer the old terms for those that distribute in iOS using exclusively the App Store. A third explanation, not necessarily incompatible with the previous two, is that the Commission may have a limited appetite for regulating the level of prices. (Instead, it may not find it so difficult to complain about the structure of Apple's new fee structure which discriminates between app developers distributing exclusively through the App Store and the rest.) The Commission may not want to discuss the meaning of FRAND in the context of the DMA. I sympathize with that position given how difficult it is defining what FRAND means in the standardization context.[15]

According to the DMA,[16] 'Pricing or other access conditions should be considered unfair if they lead to an imbalance of rights and obligations imposed on business users or confer an advantage on the gatekeeper which is disproportionate to the service provided by the gatekeeper to business users or lead to a disadvantage for business users in providing the same or similar services as the gatekeeper.' Making this definition operational is not easy, but not impossible.

One way to determine the FRAND rate is in relation to the economic value of the platform—that is the net incremental value of the gatekeeper's platform relative to its next best alternative.[17] Business users value a gatekeeper's platform for two reasons: (i) it offers superior value and that is the reason why the market tipped in its favour or (ii) its value is due entirely to the network effects—that is the result of a first-mover advantage or sheer luck. Only (i) counts in the calculation of the net incremental value of the gatekeeper's platform relative to its next best alternative, since (ii) is not idiosyncratic to the gatekeeper's platform.

In the case of application stores, much of the value attributed to the platform is generated by network effects: the creation of a marketplace where many, if not most, business users and many, if not most, end users interact. The differential value of the gatekeeper platform is therefore not explained by its potentially superior technology, but is, in large part, one of aggregation, which saves end users and business users search costs, removes the frictions from transactions and helps clear the market efficiently. While the technology developed by an SEP holder and the incremental value resulting from that technology can be attributed to the SEP holder, the network effects that generate a significant portion of the value of a gatekeeper platform are a property of the market, and are not generated by the gatekeepers.

Network effects are a property of the market where the gatekeeper operates. The value associated with the network effects simply reflects the monopoly power obtained by the winner of the gatekeeping race. Remunerating a gatekeeper for the control of such network externalities would be like remunerating the SEP holders for the hold-up power conferred upon them by the standardization process. This implies that the appropriate price that a gatekeeper can charge is the price it would have charged in the presence of effective competition. Or, in other words, the FRAND access price should not exceed the incremental value that its platform offers over what the next best alternative platform would have been able to offer before the network effects were realized.

[15] See Group of Experts on Licensing and Valuation of Standard Essential Patents, 'SEPs Expert Group' (E03600), *Contribution to the Debate on SEPs*, January 2021. <https://ec.europa.eu/docsroom/documents/45217> accessed 31 March 2024.

[16] See DMA, Recital (62).

[17] See Jorge Padilla and Kadu Prasad, *FRAND Access Under Article 6(12) DMA: The Case of App Stores*, February 2024, available from the authors upon request. See also Crémer and others (n 13) 984–985.

There may be a concern that this may undermine contestability since it is precisely the monetization of those network effects which increases the incentive to invest in order to 'win' the market. If platforms are not allowed to monetize the network effects, we may reduce the general attractiveness and so the contestability of the market. While this is of course not a trivial question, I believe that, to the extent that the FRAND obligation only applies to gatekeepers, the answer is likely to be no.

5. CONCLUSION

This essay has considered whether it is sufficient to ensure compliance with the DMA obligations aimed at promoting contestability to also achieve its fairness goal. For the reasons stated above, I believe that relying exclusively on the contestability of digital markets need not guarantee that business users of gatekeeper platforms are treated fairly. The Commission may not be able to avoid regulating how surplus is divided between the gatekeeper and its business users, hoping that market forces will address the problem indirectly.

The pie should be divided so that the gatekeeper is remunerated in proportion to the net incremental value of the gatekeeper's platform relative to its next best alternative. This means that it is able to appropriate the full value of its superior technology but not the value associated with the network effects that characterize the core platform services regulated by the DMA.

The practical implementation of this surplus-sharing rule is difficult but not impossible. Most importantly, it requires characterizing a hypothetical world where there would have been effective competition between the gatekeeper and others. For application stores, this requires hypothesizing a world where there is competition between the app stores. In the Apple ecosystem, this has never been possible, so the exercise is fully hypothetical. To construct such a counterfactual world, one may need to rely on past business plans identifying actual and potential competitors. Or, alternatively, make use of choice modelling methods asking business users to rank a finite set of alternative app stores, each of which offers a different set of attributes.[18]

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[18] See Padilla and Prasad (n 17) 7–8.

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