Kluwer Competition Law Blog

A Bad Apple in the Basket? Market Power in Digital Markets illustrated by the Epic-Apple Case

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The market power of big tech firms like Google, Apple, Facebook, Amazon, and Microsoft (the GAFAM) has long been a thorn in the eyes of the European Commission (EC).[1] Ever since the EU drafted the Digital Markets Act[2] to regulate market power in the digital markets, they faced strong protests.[3] The widely received Epic-Apple court decision in the US illustrates why regulation in digital markets is so complex and difficult. The ruling finds that there is competition between Apple's App Store and Google's Play Store, which fails to acknowledge the type of economic competition in the market. Instead of being competitive, Apple and Google create local monopolies because consumers are locked-in by monetary costs and by convenience. First, consumers are locked-in because they incur the monetary investment costs of having all choices. There cannot be competition between app stores when consumers can only choose the one app store that is tied to the phone. To have competition between app stores, consumers would need to purchase another phone, which is costly. Second, consumers are locked-in because of their convenience or "laziness". Apple exploits this convenience by allowing the one-click purchase option only for their own payment system. To use the external payment, consumers must click several links, which is costly in terms of time and effort. The EU Digital Market Act will spur competition by eliminating lock-in effects from both monetary investment and from convenience. For instance, phone makers will be forced to allow all app stores and give equal treatment to external payment systems.

The Epic-Apple case.

The situation escalated when Fortnite was banned from Apple's AppStore in August 2020. [4] Fortnite developer Epic Games was unwilling to pay the so-called "Apple Tax" of 30% which grants automatically one third of all profits coming from apps and in-app transactions to Apple. Epic, eager to reclaim the total ownership over its profits, tried to circumvent this "tax" by integrating a link into the game. The link recommends users to buy directly from Epic at a 20% discount using "VBucks" instead of Apple Pay. Apple then banned Epic from the AppStore because the implementation of the link violates Apple's anti-steering clause that forbids developers to offer alternative payment systems in their apps.

Only a few hours after the ban, Epic Games filed a lawsuit against Apple's abuse of market power.[5] Google followed Apple in throwing out Fortnite from its App store. But many companies, such as, AirBnB, and Facebook, publicly sided with Epic Games.[6] Spotify followed EpicGames in filing an antitrust complaint against Apple,[7] alleging that the "Apple Tax" harms consumer choice and stifles innovation.[8]

There are some big questions behind this case of Apple and Google against Epic Games and Spotify: Do Apple and Google create illegal monopolies with their app stores? Are Apple and Google abusing their in-app market power? Are consumers and users paying too much for apps and for items in these apps? Should we regulate the App stores of Apple and Google? Do we generally need more regulation to break up the GAFAM Tech Giants?

Epic win or Epic fail?

A widely received US court decision on the case Epic against Apple demonstrates how complex the regulation of big tech companies is. At first, the mixed ruling reads like a split decisions that favors both parties.[9] At second glance, we see that it fails to acknowledge Apple's monopoly from lock-in effects.

On the one hand, Judge Yvonne Gonzalez Rogers states that *"the Court cannot ultimately conclude that Apple is a monopolist* and that the "*AppStore is not in violation of antitrust law*." [10] This part of the ruling allows the iPhone maker to continue its prohibition of third-party app stores and in-app payment systems. It further implies that consumers who buy from the Apple App Store still must pay the Apple tax price of 30%.

On the other hand, Judge Rodgers decided that Apple partly engages in anticompetitive conduct by implementing its anti-steering clause that forces consumers to buy apps and in-app purchases directly from Apple's app store. Trying to foster effective price competition, the ruling forces Apple to allow developers the integration of links into their apps that redirect users away from Apple's in-app purchasing system towards alternative payment systems.

This seems like a fair ruling for Epic: It can integrate links into games that redirect consumers to a homepage of Epic where consumers can make in-app purchases at a price chosen by Epic. So why does Epic announce to appeal against the decision?[11] The following intuitive example shows why lock-in effects play an important role and shift market power to gatekeepers like Apple.

A simple illustrative example is enough to understand the AppStore's Monopoly Power

Imagine a young couple named Eva and Jazz who live in the city "Appletown" where all buildings are owned by the powerful landlord named "Apple". To print their wedding invitations, Eva and Jazz walk to the Apple Superstore, owned by the Apple landlord, to buy an Epic printer and some complementary ink cartridges. As there are no other stores in town, Eva and Jazz must buy the printer and all the cartridges at whatever price faced in the Apple Superstore.

Epic wants to enter the market and finds that it is profitable to run an Epic Superstore that allows selling printers and ink at prices that are 30% lower than the ones of the Apple Superstore.[12] However, despite many attempts Apple refuses to let Epic open a new store inside Apple town. Instead, the Apple landlord tells Epic that it can sell from outside the city walls, at a location

10kms away from the Apple Superstore. Consumers like Eva and Jazz face the following two options: (i) buying from Apple at a higher price or (ii) walk 10 kms to buy directly from Epic at a lower price.

Following a series of complaints against the Apple landlord and a court trial, a judge denies the opening of the Epic store in Appletown but forces the Apple Supermarket to inform Eva and Jazz about the alternative option to buy printers and ink outside town, at a possible lower price. This does not help our young couple. To enjoy the benefits of a lower price, Eva and Jazz still need to travel invest money and time to travel outside the city.

This is not a ruling that allows fair competition. Intuitively, a fair competitive environment includes competition between stores. To stay within the illustrative example, this means that Epic should be allowed to sell printers next to the Apple Superstore at a competitive price. Only the competitive pressure from stores side-by-side forces Apple to either reduce its markup and to improve its service in order to keep up with the competitor.

Lock-in Effects are a source of market power and can create local monopolies

It is easy to see that Eva and Jazz are the Fortnite players (or app users in general), who arrive at Apple's store to purchase Epic's apps (printers) and the complimentary in-app items (ink cartridges). Apple controls consumers' access to the apps on the iPhone, which makes Apple a gatekeeper. The gatekeeper Apple has a local monopoly in the app- and in-app markets. The monopoly power stems from the fact that consumers are locked-in in two ways: by monetary costs and by habit or convenience. Both types of lock-in effects are internalized in the pricing decisions, which gives Apple market power to raise prices for the apps, and for items in these apps, well above the competitive level.

The first lock-in effect arises from the monetary investment costs of having all choices. Eva and Jazz, for instance, must invest money into transport to have free choice between two options. Similarly, Apple argues that they cannot have monopoly power given the free choice for consumers between several smartphone manufacturers, such as, HTC, Samsung, and Huawei. The fact of the matter is, iPhone users cannot choose between all the App Stores given that Apple offers only the AppStore on its phones. To have free choice between app stores, users would have to buy two or more phones, which is unrealistic for most consumers given the high smartphone costs of 500-1800 Euros.

The second type of lock-in effect stems from consumers' convenience and their habits. Eva and Jazz might be busy with the wedding planning and prefer to pay a higher price in the local store instead of traveling outside the city walls. Lock-in from habit or convenience is the simple idea that once you purchase a good or service, you stick to it. This habit then makes it difficult for you to leave this company. The real-world analogue of consumers locked-in by their habits and convenience is being lead out of a game like Fortnite while playing it. The last thing that users want to do is to follow a link (or several) to register to a new payment system, purchase an item and then return to the game. This clearly reduces the gaming fun. The US court ruling, however, is agnostic about how Apple introduces the links that inform and direct users to alternative payment systems outside the apps.

Should we regulate the Big Tech?

The EU's Digital Markets Act aims at making digital markets a fairer environment for consumers and app developers. It regulates the gatekeeper, that is, the one firm (Apple in our case) that controls access to final consumers and filtrates the access of other firms (Epic in our case). The upcoming Act addresses what the US court decision fails to address: lock-in effects that mainly benefit the GAFAM gatekeepers.

First, the Acts will require phone makers to allow the download of all app stores on each phone. This ingredient eliminates monetary investment costs and creates competition between app stores by letting consumers have all relevant choices on one phone. Second, the Act will reduce consumers' convenience costs by giving equal and fair treatment to alternative payment systems. Now, consumers can make one-click purchases using Apple's payment systems. When they want to use a different payment system, they are redirected out of the game to a different platform, which gives gatekeepers like Apple power to raise prices due to lock-in from convenience. The regulation would require Apple to allow Epic and others the integration of own one-click purchase buttons next to Apple's payment system. This creates competition given that users can choose between equal payment systems.

This type of regulation is urgently needed because it ensures fair competition and protects consumers. It is easy to see how consumers would benefit from lower prices if Epic, for instance, introduces its own app store and payment system. Reducing market power of the gatekeepers Apple and Google would also allow consumers to have access to more products. Furthermore, competition for new and existing consumers puts pressure on companies to also offer more products of better quality. Apple, for instance, could respond to the new competition by introducing better features in the AppStore and find innovative ways to cut costs for maintaining the App Store's quality control.

That is not to say that Apple's and Google's services are bad *per-se*. The Act that regulates market power from lock-in effects is more like the hand that removes the bad apples from a basket full of good ones.

DISCLAIMER: All opinions in this column reflect the views of the author. The author is independent researcher and has no affiliation (nor connection of any kind) to the parties mentioned in the text.

[1] https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age/digital-markets-act-ensuring-fair-and-open-digital-markets_en

[2] https://ec.europa.eu/competition-policy/sectors/ict/dma_de

[3] https://www.euractiv.com/section/digital/opinion/eu-must-resist-attempts-to-dilute-digital-markets-act/

[4] https://www.nytimes.com/2020/08/13/technology/apple-fortnite-ban.html

[5] https://www.nytimes.com/2020/08/13/technology/apple-fortnite-ban.html

[6] https://www.reuters.com/article/us-apple-epic-games/epic-games-wins-support-from-fortnite-gamers-firms-on-apple-standoff-idUSKCN25A21J

[7] https://ec.europa.eu/commission/presscorner/detail/en/ip_21_2061

[8] https://newsroom.spotify.com/2019-03-13/consumers-and-innovators-win-on-a-level-playing-field/

[9] https://choice.npr.org/index.html?origin=https://www.npr.org/2021/09/10/1036043886/apple-fortnite-epic-games-ruling-explained

[10] See https://storage.courtlistener.com/recap/gov.uscourts.cand.364265/gov.uscourts.cand.364265.812.0_2.pdf

[11] https://twitter.com/timsweeneyepic/status/1436370670166945792

[12] https://www.pcgamesn.com/steam-revenue-cut-tim-sweeney

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