

Comment of NetChoice on *Antitrust Applied: Examining Competition in App Stores* before the Senate Judiciary Committee

April 21, 2021

Introduction

Apps, and the app stores that distribute them, are important to modern life. They help us stay connected with friends and family, keep us informed, and offer countless sources of entertainment—all at our fingertips. They also spur economic development. In fact, the app economy is booming: Americans have access to over 2 million apps; app developers and their related businesses employ 5.9 million Americans; and the app ecosystem is worth about \$1.7 trillion.¹

Given that importance, we applaud the Senate Judiciary Committee’s decision to bring apps and app stores to the forefront. That said, we encourage the Committee to expand its fact-finding mission to hear from more voices. To date, Congress has focused largely on popular app store providers—Apple and Google—and some of their most vocal critics like Spotify and Epic. But in the process, other app-distribution systems like the Microsoft Store are all but ignored. While this hearing’s focus is understandable, it threatens to distort Congress’s factual findings.

We’ve designed our testimony to provide additional insights. Even so, we still encourage Congress to widen its scope and to hear from at least other voices like:

- Other popular app distributors like Microsoft;
- Consumers and app developers who benefit from Apple’s integrated, protected-network approach;
- Consumers and app developers who benefit from Google’s integrated *and* direct-to-consumer approaches; and
- Parents and other stakeholders who monitor their children’s access to and use of apps.

¹ STATE OF THE U.S. APP ECONOMY: 2020, ACT: THE APP ASSOCIATION 4 (7th ed. 2021), <https://actonline.org/wp-content/uploads/2020-App-economy-Report.pdf>.

Setting the Scene: Smartphones, App Stores, & Apps

Apps & App Stores

At their core, app stores are just like brick-and-mortar stores. Like Best Buy, the Apple and Google partner with third parties to distribute software to American consumers. And like Best Buy, Apple and Google try to stock up on products that consumers want.

But Apple and Google have more skin in the game. Let's say you buy Microsoft Office 365 from Best Buy only to later find out that the software had security problems and your email was hacked as a result.² You may be angry at Best Buy, but most likely your anger would be targeted at Microsoft. By contrast, if you bought buggy software from Apple's or Google's app store, you'd likely blame them. Why? Because consumers view their smartphones and mobile app stores as one product.

That is one reason Apple and Google guard their app stores. They understand that their mobile operating systems—Apple's iOS and Google's Android—rely on consumer trust. And because most consumers have an impersonal relationship with them, they rely on their reputations to attract and maintain customers. Their reputations for developing high-quality, secure products in turn relies on consumer trust—that their products are safe from bad actors. Without that trust, their customer base would plummet.

Apple and Google must even worry about consumers who distinguish between app stores and apps. In other words, even if consumers hold the app developer responsible for a security breach, that experience alone is enough to dampen their enthusiasm for downloading apps from Apple or Google in the future. Not only is that bad for Apple, Google, and their consumers, it's also bad for app developers.

App developers bank on consumers trusting Apple and Google. First, new app developers with unfamiliar names benefit from consumers trusting apps that appear in the App Store and Google Play. Second, all app developers depend on Apple and Google to filter out harmful apps because they don't want to be associated with bad actors. Nor do they want the app marketplace to become so polluted that consumers leave it altogether or stick to only apps from the largest corporate brands.

² This hypothetical is based on an on-going malware hack of Microsoft's widely used software products. See Frank Bajak, *SolarWinds Hacking Campaign Puts Microsoft in the Hot Seat*, Assoc. Press (Apr. 17, 2021), <https://apnews.com/article/politics-malware-national-security-email-software-f51e53523312b87121146de8fd7c0020>

But if Apple and Google are unable to adequately control their own app stores, or are forced to couple their operating systems with third-party app stores, that trust will likely erode. To be sure, a change in policy won't see consumers flee the app market immediately. But changes will inevitably lead to high-profile security breaches that sow enough doubt in enough Americans that fewer apps will be downloaded.

Smartphones & Bad Actors

About 85 percent of Americans own a smartphone.³ For most of us, smartphones aren't just advanced cell phones; they are personal computers with reams of private, sensitive information detailing the most intimate aspects of our lives. They store photos of our kids and spouses, communications with our family, friends, and coworkers, our banking, health, and medical information, and our search and location history. In fact, smartphones store so much information about our lives that the Supreme Court has felt the need to adapt its Fourth Amendment doctrines to better protect smartphone owners and their privacy rights from government intrusion.⁴ Even as far back as 2014 the Court noted that smartphones contain “a digital record of nearly every aspect of [Americans'] lives.”⁵ At this point they are, as the Court said, almost a “feature of human anatomy.”⁶

Given their widespread use and the vast amounts of sensitive information they contain, smartphones are an appealing target for bad actors, including hostile foreign governments. These bad actors often target American smartphone owners through malware—trojan horse software that gives them undetected access to smartphones and the content within them. Earlier this month, for example, bad actors used malware to infect at least 500,000 Huawei smartphones and secretly sign users up for premium phone services.⁷

Because app stores are integral to smartphones, and because bad actors use them to access smartphones, Congress should not consider app stores in isolation. In other words, although app stores are distinct from smartphones in concept, they are closely linked in practice. So any legislative changes that affect app stores should also weigh unintended effects on smartphone users more broadly.

It is against this backdrop that Apple and Google operate. Both have a strong financial incentive to protect users from bad actors and to give them access to as many apps as possible. Both take significant steps to do so. But balancing consumer choice with user security is not always an easy task and involves a balance of tradeoffs. In fact, Apple and Google approach

³ Pew Research Center, *Demographics of Mobile Device Ownership and Adoption in the U.S.* (Apr. 7, 2021), <https://www.pewresearch.org/internet/fact-sheet/mobile/>.

⁴ See, e.g., *Carpenter v. United States*, 138 S. Ct. 2206 (2018); *Riley v. California*, 134 S. Ct. 2473 (2014).

⁵ *Riley*, 134 S. Ct. at 2490.

⁶ *Id.* at 2484.

⁷ Mayank Sharma, *Half a Million Huawei Android Phones Hit by Joker Malware*, Tech Radar (Apr. 12, 2021), <https://www.techradar.com/news/half-a-million-huawei-android-phones-hit-by-joker-malware>.

the issue quite differently. That is good for competition, good for app developers, and good for consumers.

But a one-size-fits-all or top-down mandate from Congress will hurt competition, innovation, and American consumers.

The Need for Further Study

As the above sections show, it's a delicate balance between protecting consumers and providing choices. Congress, the states, and the public would thus benefit from hearing about more than just Apple and Google. For example, how does Microsoft or Epic strike the balance? What tradeoffs do they make and how have their consumers responded? What does the on-going Microsoft hack suggest about security vulnerabilities and how to prevent them?

Beyond that, other issues the Committee ought to study include risk to small businesses and small app developers. How would policy changes affect them? Will open-to-all-or-almost-all distribution policies hurt consumers, erode their trust in Apple, Google, and other app stores, and dampen their use of apps? If so, what does that mean for small businesses that rely on their customers using apps?

In the meantime, we've briefly outlined Apple's and Google's business models and highlighted the benefits of each.

Apple's Business Model

Apple's founder and former CEO Steve Jobs was known for being a perfectionist. This trait usually resulted in Apple developing exceptional products—from the original Mac to the iPod to the iPhone. His perfectionism extended to virtually all aspects of the user experience. As Oracle's CEO recounted, Jobs “wanted to control every aspect,” even “[i]ncluding how you pay for an item in a store. Or what it looked like in a box.”⁸

Today, most everyone agrees that Apple builds high-quality, seamlessly integrated products. But some also bemoan the key ingredient behind the business's success: its obsessive focus on controlling and improving the user experience. Apple's first instinct is to make and integrate most parts of its products, and to perfect how those products function. Its critics claim that these principles create “closed systems” that stifle competition. A key point of their complaints is that Apple's App Store forces app developers to get Apple's permission to compete on iPhones and thus to pay whatever Apple demands.

⁸ Steven Musil, *Execs Remember Steve Jobs as a Tireless Perfectionist*, CNet (May 30, 2012), <https://www.cnet.com/news/execs-remember-steve-jobs-as-a-tireless-perfectionist/>.

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Jobs saw things differently. In an earnings call to investors a decade ago, Jobs told investors that the “[o]pen versus closed [dichotomy] is a smokescreen.”⁹ The real difference is between “integrated versus fragmented.”¹⁰ So the real question, he believed, was “[w]hat is best for the customer—integrated versus fragmented?”¹¹

As it almost always did, Apple answered integrated. Jobs summed it up this way: “When selling to people who want their devices to just work, we think integrated wins every time. We are committed to the integrated approach.”¹²

Apple stuck with this approach when it invented the App Store. Jobs originally did not want app developers to build native apps for iOS;¹³ he expected that they’d build web apps that could instead run on the Safari internet browser. In part, Jobs feared that Apple lacked the bandwidth to police third-party app developers. But after an uproar from developers, Jobs compromised: Apple would release developer tools that allowed others to create apps that, after close inspection, could then be downloaded from the App Store.

This move paved the way for developers. Before the App Store, wireless carriers like AT&T and Verizon called the shots, determining which apps were on the phones they sold. But Apple’s iPhone, Jobs explained, “was the first phone where we said you worry about the network, we’ll worry about the phone.”¹⁴

Just as personal computers are sold with their own operating systems, with mail, web, and calendar apps pre-installed, smartphones and tablets are sold with mobile operating systems pre-installed. In Apple’s case, it integrated its iOS into its iPhones by default. By contrast, original equipment manufacturers like Samsung and Motorola select which operating system to install. Most choose to license Google’s Android OS, which Google offers for free.

Apple hasn’t changed its App Store strategy since its launch a decade ago. Even so, critics claim that the App Store is anticompetitive because Apple acts as a type of gatekeeper—it decides which apps are available—and because it employs a policy of fee sharing through its payment system when those apps make money through the App Store. In other words, Apple stands accused of anticompetitive behavior that dates to the App Store’s launch—back when Apple was just entering the field and had no market share to boast of.

⁹ Erick Schonfeld, *Steve Jobs: “Open Systems Don’t Always Win,”* TechCrunch (Oct. 18, 2010), <https://techcrunch.com/2010/10/18/steve-jobs-open-dont-win/>.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ Native apps are the ones we’re most familiar with these days: They’re designed specifically for certain operating systems, downloaded from app stores, and take advantage of a smartphone’s features. Web apps, by contrast, are those that resemble native apps but aren’t downloaded to a user’s smartphone. Instead, users must use mobile web browsers to access them.

¹⁴ *Id.*

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That raises the question: Is it appropriate to hold a company liable for conduct that far predates its current market share? The answer should be no. For starters, even now Apple doesn't have monopoly power in the smartphone market. But even if it did, Apple has charged app developers the same price—30% commission—since the very beginning. If Apple were a monopolist, we would expect to see that price increase without any change in quantity.

Instead, the price has stayed the same and is right in line with what competitors charge on smartphone and comparable app markets offered by companies like Microsoft and Epic Games. Critics maintain that internal emails released by the House of Representatives show Apple knows it can extract more from app developers—that it's "leaving money on the table." But given that Apple hasn't changed its rate, it seems the company doesn't mind. And that makes sense: Apple wants as many app developers that meet its standards to join the App Store as possible. If it charged commissions well above the market rate—even if it could theoretically extract more money from existing apps—it would hurt itself in the long run.

Critics also maintain that Apple's integrated App Store acts as a type of "walled garden" that extracts unnecessarily high fees for access. In their mind, the App Store should be free, or as close as possible, for all developers, or Apple should allow competition stores to operate on its handheld devices. These arguments miss the mark. First, it's common for app stores to charge commission—it's a way for them to raise money to invest in and improve those stores. Second, Apple's business model has long focused on integration. By decoupling the App Store from handheld devices like the iPhone, Apple would betray that business model.

Indeed, if Apple did that, competition would actually be hurt. That is, consumers would lose Apple's approach. And even if most consumers don't buy phones for their app stores, it's true that many consumers do buy Apple's products because of the company's reputation for excellence and seamless integration. That, in part, stems from what Jobs recognized a decade ago: integrated products allow the company to set standards that improve the consumer experience. Without such control, the company's brand would inevitably be tarnished. Indeed, consumers would likely blame Apple for "making" harmful apps available in the first place, even though such apps come from a non-Apple app store.

The same is true of the App Store's payment system. Many consumers are understandably wary of sharing their credit card information. By using Apple's payment system, the App Store reduces externality costs associated with payment: consumers trust Apple with their information, which benefits the app developers. They are not worried that a foreign payments processor will take their information and sell it to others or use it for nefarious purposes. They know that if they have a problem, they can reach out to Apple to get it addressed with relative ease.

Plus, the vast majority of app developers—around 85%—pay nothing to be on the App Store. That means they benefit from Apple's reach and reputation for nothing. In many cases, these app developers are able to develop a following by using Apple's App Store. That is, instead of

having to develop and maintain their own app platforms, these app developers use Apple's. In that way, the App Store is like a shopping mall—except it's better because most pay no rent whatsoever.

Apple builds the iPhone's hardware and software to work hand in glove with each other. Under this model, the App Store functions less as an add-on feature and more as an integral part of the iPhone. Because the App Store and its In-App Payment system are part of the iPhone's overall design and function, it cannot be easily separated out without hurting the iPhone and its users' experience.

Google's Business Model

Like Apple, Google runs its own app store and integrates that store with its mobile operating system. Unlike Apple, however, Google is a software business first and hardware business second. It is thus unsurprising that Google has developed a different business model for licensing its software and distributing apps. Since it was founded, Google has been a company dedicated to creating a high-quality user experience, but one that is also more closely tailored to the specific needs and desires of each particular user. That is why Google's business model gives Android users greater leeway in determining which apps they download.

Launched a decade ago, Google Play followed Google's effort to improve the user experience. Originally, Android users had to download apps, games, and entertainment from the Android Market, music from Google Music, and ebooks from Google eBookstore.¹⁵ This fragmented approach made sense when smartphones first entered the mainstream and it was easier to create individualized distribution systems for different types of content. But once Americans grew accustomed to their smartphones, Google sought to streamline its content-distribution channels. It wanted to create a holistic distribution system that provided consumers with a convenient one-stop-shop for a wide variety of the content they enjoy. Enter Google Play.

Google Play is free for app developers who don't charge users, which is the case for the vast majority of apps. But for those who do, Google collects the industry-standard 30% service fee. For subscriptions, Google charges 30% in the first year and half that in the second year. Notably, Google recently announced that it is reducing its commission rate from 30% to 15% for the first million dollars that a developer earns.¹⁶ Under this new fee schedule, all developers would see a major reduction in costs but, even more impressively, over 97 percent would see their fees cut in half.¹⁷

¹⁵ John Callaham, *From Android Market to Google Play: A Brief History of the Play Store*, Android Authority (Mar. 6, 2017), <https://www.androidauthority.com/android-market-google-play-history-754989/>.

¹⁶ Sarah Perez, *Data shows how few Google Play developers will pay the higher 30% commission after policy change*, TechCrunch (Mar. 18, 2021), <https://techcrunch.com/2021/03/18/data-shows-how-few-google-play-developers-will-pay-the-higher-30-commission-after-policy-change/>.

¹⁷ *Id.*

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As a result of this revenue-sharing arrangement, Google's interest mirrors app developers': Google gets paid only if app developers get paid on the app. This alignment of interests serves to provide smaller app developers with a zero-price option for entering the market and distributing their products via an app store and while ensuring Google is able to meet its overhead and recoup some of its investment through well-established, profitable ventures.

While Apple's App Store is available only to Apple users on iPhones, Google's Play Store is available on a wide variety of products. Google's Play Store is thus often run on the same device as other app stores such as Samsung's Galaxy Store and EPIC's app store. In fact, the majority of Android devices come with multiple app stores preinstalled. And for those that don't, installing another app store is as easy as a click of a button.

Google's Android phones also come with Google Play and other app stores pre-installed, and allow for direct-to-consumer¹⁸ app downloads. Unlike on Apple's iPhone where a user must download apps directly and only from the App Store, Android devices allow users to download apps directly from third-party developers. For example, users can easily scan a QR code or pull up a URL that brings them to a video game developer's own website where they can then download the app directly to their smartphone without having to go through a specific store. Users not only have the ability to access other app stores, they have the ability to bypass them entirely.

This serves as a significant source of competitive pressure and a check on Google's ability to exercise power over third-party developers. Indeed, app developers can reach consumers without having to partner with an intermediary. If a company or individual does not like Google's policies or fee structure, it can still build a customer base through a direct-to-consumers approach. So Google can't impose unreasonable policies or exorbitant fees on app developers. If it does, Google risks driving developers to circumvent the entire system.¹⁹ This threat of exit also forces Google to innovate and continually improve the quality of its distribution services.

Problems With the Current Proposals

Recently, several states have started to consider legislative proposals that would alter the way app stores are allowed to operate. These proposals seek to prohibit app store providers from engaging in certain business practices and are often discussed under the guise of promoting "fairness" for app developers. But these proposals have a number of drawbacks detailed below.

¹⁸ Also called "sideloading," direct-to-consumer app downloads allow Android users to download a developer's app directly from its website.

¹⁹ Likewise, Google competes with Apple and ensures that Apple can't impose unreasonable terms or prices on app developers. Apple does the same: It checks Google's power. And like Google, Apple can't easily jack up prices without risking app developers fleeing for other distribution channels.

Interference With Private Contracts

Suppose someone builds a shopping mall. They build the structure, the food court, the parking lots—everything. They advertise the availability of store space to potential tenants. And rather than charge a monthly rental for space in the mall, they enter into a service fee agreement where the mall collects a percentage of each sale. If the business has no sales or gives away its wares, the mall makes no money. If the business makes lots of sales, the mall earns its percentage.

We would balk if the government interfered with this private contract between a mall and its tenants. But many proposals currently under consideration would do just that, only here the mall is a virtual space. Not only is this antithetical to our system of private property and limited government, but it is also ultimately harmful to consumers.

Today, app stores on Apple and Android devices are funded by their service fee agreements with app developers. App distributors earn their revenue primarily by entering into fee-sharing agreements with app-developers that give them the right to a portion of the app price as well as a portion of any transactions within the app. Since most apps are now offered at a price point of zero, distributors earn most of their income through in-app transactions. App stores use their commission on in-app transactions to improve services, scan for malware, engage in marketing, and provide necessary customer service, all of which benefit the app developers and their end-users. These service fees also pay for storage and security for the apps and the internet infrastructure, allowing them to deliver apps to customers effectively and safely. They pay for advertising to potential customers about the app stores. And these service fees may be used to offset the costs of the devices, making it easier for more customers to access the app stores.

Currently, many contracts between these parties have provisions that allow app developers to access these digital marketplaces so long as they use the distributor's payments processing system and share a small portion of the revenue from each transaction. App developers are familiar with this system. In fact, Epic actually launched its own app distributor called Epic Store, which—like other app distributors—charges third-party developers a percentage of their transactions.

The Government Should Not Pick Winners and Losers

Today, these contract issues are being addressed through the courts and on the negotiating table between multi-billion-dollar businesses. The chief supporters of the proposals being considered represent some of the most well-established app developers in the world like Spotify, Epic Games, and Match Group, owner of Tinder.

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These are not small businesses. Spotify is the largest music-streaming service and has a market cap of \$50 billion. Match Group, the parent company of some of the largest online dating services, is worth \$40 billion. And Epic Games, one of the largest video game companies, was valued at over \$17 billion in its most recent funding round.

It is not a group of down-on-their-luck businesses pushing these proposals because they want greater fairness in their fee-sharing agreements. They are powerful players trying to get the government to enable them to avoid paying the service fees they previously agreed to.

These proposals would benefit these well-established app developers by preventing the Apple and Google app stores from entering into contracts that limit the extent to which these app developers can offer their own in-app payments systems. It is better to let the private sector negotiate these contracts rather than having the government step in to distort the market and pick winners and losers.

Consumers and Developers Have Other Options

Contrary to what billion-dollar companies like Spotify and Epic Games say, there are multiple ways for consumers to make purchases without going through the App Stores of Google or Apple. For example, right on the iPhone's web browser, Spotify users can purchase subscriptions directly from Spotify – without going through the app stores. Users can even listen to music via the Spotify webpage without ever installing the app. Users can sign up at Spotify.com on their mobile device and the store never connected to the transaction Epic Games can do transactions with users on mobile devices without using the store's app payment systems.

Likewise, Epic Games makes micro-transactions for Fortnite available without ever having to download the game or the Epic Store app. In fact, users can go directly to the Epic Store webpage on their mobile device and buy V-Bucks or other microtransactions. At the same time, Match.com, Spotify and Epic Games make gift cards available for purchase at drug stores and shopping centers. Here citizens can use essentially their chosen means of payment to buy these gift cards and redeem at Match.com, Spotify.com, and EpicGames.com. This can all be done without any involvement of the Apple and Google stores, so there is simply no “monopoly” on payments.

Increasing Costs to App Developers

Since many of these proposals would make today's contracts illegal, it would force stores to allow app developers to use their own payments processor. As a result, app developers would be able to collect as much money as they please through in-app transactions without sharing any of the revenue with app stores. Considering that app stores make a substantial portion of their revenue through in-app purchases, this would significantly undermine the

economics of app distribution and result in fewer and worse options for up-and-coming app developers as well as those that offer their products for free.

Increasing Costs and Risks to American Consumers

These proposals harm consumers too. Today, the price of consumer devices is partly subsidized by the expectation of service fees from in-app purchases—a loss-leader model akin to razors. With the loss of revenue from in-app transactions, app stores would need to find another way to cover their costs for development and operations. They would have to reduce costs, increase prices for devices, or begin charging to distribute free apps—leaving consumers worse off.

Criminals are trying to con Americans into disclosing banking and credit information for potentially fraudulent purposes. Today, app stores can immediately suspend an App for such behavior. But many of these proposals would prohibit app stores from what could be termed “retaliating” against the app, which would expose American citizens to potential fraud. Further, it would be harder for consumers to seek restitution when fraud does occur. Currently, an aggrieved party can seek redress from Apple or Google in the event of fraud or malice in the processing of payments. However, under these proposals, consumers would be forced to identify the specific payments processor for each individual app and seek redress from them, something that could be extremely difficult or outright impossible in the case of fraud.

In addition, parents would lose a powerful tool to control the devices used by their kids. App stores currently place limits on the dollar amount of in-app purchases and often compensate parents when a child makes purchases without permission. They also provide parental controls that allow parents to restrict access to payments by requiring a password to make a purchase. Each of these would be unavailable if app store providers were forced to allow each app to employ their own payments processor.

We appreciate your consideration of our views, and please let us know if we can provide further information.

Sincerely,

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