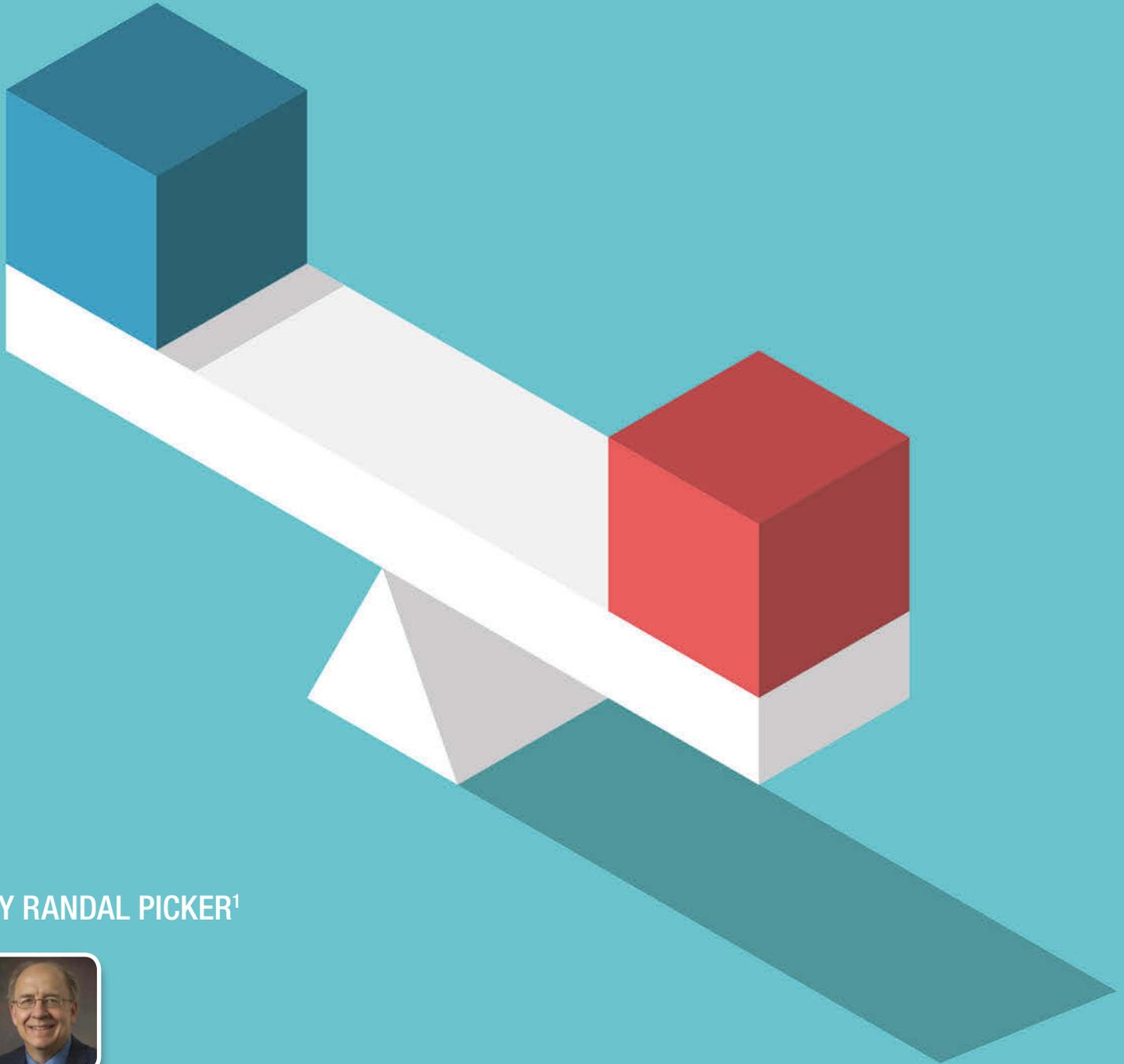


GOOGLE ANDROID ANTITRUST: DOMINANCE PIVOTS AND A BUSINESS MODEL CLASH IN BRUSSELS



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I. INTRODUCTION

On July 18, 2018, the European Commission announced a new €4.34 billion fine over Android and ordered Google to change how it licenses Android software.² This is the second Commission fine for Google in roughly a year — the other was over Google's comparison shopping service and that fine was €2.42 billion.³ You can connect those two points with a line and Google can't like what that looks like.

This is an exercise in platform engineering by European antitrust authorities. The new decision makes a statement about acceptable entry paths for firms dominant in one market by demanding that a successful firm pivot away from the practices that consumers have found valuable and that indeed led in the first place to the emergence of dominance in the new second market. Call this a "dominance pivot." Yes, consumers like your product and indeed preferred it over the competition, now change that product to make it look much more like the product that consumers have already rejected.

Google offered a new business model for operating system software for mobile devices and the Commission didn't like the way it might extend Google's dominant position in desktop search into mobile. There is an element of truth there, but in requiring a dominance pivot, the Commission appears to undervalue the virtues of business model competition at least based on what we have seen from the choices that consumers actually made.

II. A SHORT HISTORY OF THE EC'S PURSUIT OF GOOGLE

It is worth retracing briefly what has happened here. On November 30, 2010, the Commission announced that it had opened an antitrust investigation to assess whether Google was abusing a dominant position in online search. In its press release, the Commission set out quickly how Google worked — organic search results matched with advertisements above and to the right of those — and that it was receiving complaints by Google competitors that it was favoring its own services compared with those of its competitors.⁴

² European Commission, Antitrust: Commission fines Google €4.34 billion for illegal practices regarding Android mobile devices to strengthen dominance of Google's search engine, July 18, 2018 (online at http://europa.eu/rapid/press-release_IP-18-4581_en.htm).

³ European Commission, Antitrust: Commission fines Google €2.42 billion for abusing dominance as search engine by giving illegal advantage to own comparison shopping service, June 27, 2017 (online at http://europa.eu/rapid/press-release_IP-17-1784_en.htm).

⁴ European Commission, Antitrust: Commission probes allegations of antitrust violations by Google, November 30, 2010 (online at http://europa.eu/rapid/press-release_IP-10-1624_en.htm?locale=en).

On May 21, 2012, then DG Competition head Joaquín Almunia gave a speech in which he offered an update and said that the pending investigation was focusing on the concern that Google was preferring its own vertical search services against those of competitors like Yelp.⁵ In that framing, Google's core business was organic horizontal search results that were matched with ads paid for by third parties. This of course is the classic business model of media markets offering consumers content, sometimes for a fee, sometimes for free, and charging advertisers to reach those consumers. An eyeballs business.

So-called vertical search competitors had entered to offer specialized search results. In many cases, this wasn't just about organizing Web content in a different or more selected way but instead about building business models that produced new content. Google's original business was one of copying websites, building an index, and figuring out how to rank webpages in response to search queries, but it wasn't actually creating new content and instead was just offering a path through the internet. Yelp and other vertical sites pushed consumers to create new information rather than just relying on preexisting information available somewhere on the internet.

But the original case would narrow to a fight over comparison shopping services and after a series of proposed settlements by Google, on April 15, 2015, the Commission sent a statement of objections to Google regarding comparison shopping and also announced that it had opened a separate investigation into Google's licensing practices for Android.⁶ On June 6, 2017, the Commission announced that it had fined Google €2.42 billion for abusing its dominant position in search and ordered Google to fix the underlying competition problem by applying to Google's own comparison shopping service the same rules it applied to third-party comparison shopping services.

It would take the Commission the better part of another six months to release the actual decision — it arrived on December 18, 2017, just in time for Christmas — and the released decision was heavily redacted and therefore ideal for readers who found it really valuable to read bits and pieces of economic and legal reasoning largely shorn of the factual basis for the conclusions.

Google moved to implement that remedy by providing that other firms would have a chance to bid in auctions to run the comparison shopping advertisements. That was a natural response to the Commission's call for neutrality between Google's shopping service and those of its competitors. After all, as the Commission made clear in its original November 2010 press release, the top space on a Google search result has typically been filled with advertising. That is where Google has made money for returning the organic search results down the page. It is hard to imagine that Google's competitors would get free access to Google's advertising slots, though in a letter dated November 22, 2018 directed to Commissioner Margrethe Vestager that seems to be exactly what they are seeking.⁷ Google has appealed the Commission's decision. And press reports in mid-November 2018 indicated that the Commission was perhaps nearing the end of a third investigation of Google relating to its rules regarding Google AdSense.

III. GOOGLE'S LICENSING OF ANDROID

Eight years in, Google now faces three fronts in Europe. It has appealed the July 2018 Android ruling, though for the public that ruling still sits in limbo as no public version of the decision has yet been issued. The press release and related speeches are all we have to go on at this point.

In the Android case, the Commission found that Google had impermissibly tied its Google Play store to the Google search app and to its Chrome browser. Android is a mix of open-source software and proprietary software owned by Google. That means that parts of the Android software are available for use by anyone and a firm could produce its own version — or flavor if you like — of Android, but other parts are controlled by Google.

The Google Play store belongs to Google and the Commission concluded that it had become dominant among competing Android stores. The EC doesn't bar dominance as such, but a dominant firm is barred from abusing that position and the EC tries to police that line actively. The Commission found that Google insisted that Android handset makers pre-install the Google Search app and Chrome in order to get Google Play. That might not matter really if Google Play were just one choice among Android app stores, but handset makers wanted Google Play given its

⁵ Joaquín Almunia, Vice President of the European Commission, Competition Policy, Statement of VP Almunia on the Google antitrust investigation, May 21, 2012 (online at http://europa.eu/rapid/press-release_SPEECH-12-372_en.htm).

⁶ European Commission, Antitrust: Commission sends Statement of Objections to Google on comparison shopping service; opens separate formal investigation on Android, April 15, 2015 (online at http://europa.eu/rapid/press-release_IP-15-4780_en.htm).

⁷ Letter of November 22, 2018 to Commission Vestager (online at http://www.foundem.co.uk/Comparison_Shopping_Open_Letter_Commissioner_Vestager_Nov_2018.pdf).

strong position in the Android store market. Insisting that handset firms take the Google Search App and Chrome with Google Play seems like a straightforward example of tying and that was what the EC found problematic.

Second, the Commission found that Google had made payments to device manufacturers and mobile network operators to preinstall Google search as their exclusive search app across all of their Android devices. And third, handset manufacturers who wanted to install Google Play and Google search had to agree that they would not develop devices running an Android fork. That is not an Internet of Things eating utensil but rather a competing flavor of Android. The open source parts of Android are available to be used by others to produce their own operating systems and a fork does just that. That is not a purely hypothetical notion as Amazon built an Android fork, as Commissioner Vestager noted in her statement announcing the EC's Android fine.

I am going to focus my attention here on the tying claim. Exclusive dealing is an old idea in antitrust. It can have virtues or vices, and I don't think that I have something new to say about it here, though one could easily imagine why a firm with Google's market share should be especially cautious, as a matter of practical antitrust, in negotiating for exclusive arrangements. And the same might be said for the anti-forking or anti-fragmentation clause. That clause seemed to limit the number of potential competitors in possible versions of the Android operating system. Antitrust officials aren't likely to respond well to that type of clause even if it is true that forking — or fragmentation — matters in how Android competes with iOS.

IV. BUSINESS MODEL COMPETITION IN SMARTPHONE OPERATING SYSTEMS

Focus instead on the tying claim and start with a little history. In mid-2005, Google acquired Android with the vision of launching a new software ecosystem for smartphones. In 2007, based on worldwide sales, Nokia's Symbian operating system had 63.5 percent of the market; Microsoft Windows Mobile, 12 percent; and RIM's Blackberry, 9.6 percent.⁸ Apple introduced the iPhone in January 2007 to rave reviews but you couldn't buy it until later that year.

Both Microsoft and Google faced competitive challenges as the new smartphones threatened to diminish the importance of personal computers. Microsoft had dominated the market for PC operating systems but it had not done that with smartphones. Google had dominated the PC Internet search market, but would that position be at risk if everyone switched to smartphones?

Android was Google's response to the new competitive threat. Google had zero experience in smartphones and there is no obvious reason that it would achieve success in this new market. But by 2018, Android would come to hold roughly 80 percent of the market worldwide with most of the rest belonging to Apple. Microsoft, Nokia and RIM have basically vanished.

Google's plan when it launched Android was to build a new software ecosystem around it and to give away Android for free. Google helped to form the Open Handset Alliance, initially a group of 34 handset manufacturers, phone system operators and others to jumpstart development around Android.

But how would Google make money from Android? Microsoft charged users or PC makers for MS-DOS and Windows and that was the plan for smartphones as well. Apple sold the iPhone and iOS came bundled with it. The app store for the iPhone didn't come until July 2008. Google was entering a new market, a market that Google believed could be disruptive of its position in search. It could charge a fee to license Android but that would almost certainly have reduced the uptake of Android as Microsoft was playing exactly the same strategy and was ahead.

Google undoubtedly wanted to support Android through its advertising business as that was its great competitive advantage. Embedding Google search in Android is the natural way to do that. It meant that Android would come with a third-party payment mechanism built in and it meant that the price of Android handsets would presumably be lower given that the Android software itself would be free.

This is really the point of business model competition. Apple was being Apple: vertically-integrated hardware and software. Did that with the Macintosh, did that with the iPhone. Microsoft was being Microsoft: it had dominated the OS market for the open IBM PC architecture and it hoped to do exactly that for mobile phones. There would be lots of handset makers, just as there were PC makers and Microsoft would make money off of phone OSs. Google was offering a different business model: lots of handset makers and advertising-supported software. This is

⁸ Gartner Says Worldwide Smartphone Sales Reached Its Lowest Growth Rate With 3.7 Per Cent Increase in Fourth Quarter of 2008, March 11, 2009 (online at <https://www.gartner.com/newsroom/id/910112>).

very much a two-sided markets approach, though again one that looks very much like that used by traditional media companies. The competition between Microsoft and Google was precisely over which way of paying for phone OS software would win.

V. THE DOMINANCE PIVOT

Did the European Commission really want to force Google to enter the mobile OS software market by insisting that Google charge a cash fee for that software? That would have restricted the business model competition in mobile operating systems and would have forced Google to adopt a business model that consumers rejected when offered a choice of the Microsoft approach to mobile OSs.

The reasoning here would be that the EC could have thought that it was sensible to block competitive choices in mobile OSs if that somehow limited Google's ability to extend its position in desktop search into mobile. Sacrifice competition in one market to benefit competition in a second market. That approach isn't unthinkable, though it would seem to require an exquisite sense of knowing what was going to happen in the mobile OS competition.

But the EC didn't do that. Instead, the takeaway at this point — and recall that like the rest of the public, I haven't actually read the actual case analysis yet — is the EC thought that Google's initial entry choice in mobile OSs was acceptable and instead the problem was that Google didn't switch its original business model at the point that Google Play became dominant. That is what I am calling a dominance pivot, a demand that a dominant firm switch strategies at the point that they achieve dominance.

Switch to what? Switch presumably to the business model that consumers had rejected when they chose Android over Microsoft and also over Apple. As that sentence suggests, there are many moving pieces here. Apple has almost always had elegant hardware and software, but it was expensive. Microsoft has always charged for software. Google's vision for Android was a phone that was, at least in part, advertising supported. Different consumers presumably would make the choice that worked best for them, and it was in that framework that the original business model for Android succeeded.

Notwithstanding the wonder of the internet with instantly downloadable software, the behavior of the best situated people in the mobile OS industry suggests that pre-installation of software matters. Google pays Apple *billions* of dollars to get its software pre-installed on iPhones. If default settings didn't matter, Google would keep all of that money in Mountain View instead of shipping it by the truckload to Cupertino. The internet isn't slow but human beings are slow to make change and that makes default starting positions valuable and sticky. And the Commission itself noted in its press release that 75 percent of search queries on Windows Mobile devices are made using Bing. (One of course could imagine that the universe of Windows Mobile users might be restricted to people living in Redmond, WA, so this presumably is very much a self-selected group of users.)

If the EC forced Google to walk away from its original business model for mobile based on tying and instead switch to a framework in which Google would now have to buy carriage of its search products from Android handset makers just like it does from Apple, that would almost certainly change the economics of Android for Google. As I suggested in a blog post after the fine was announced, the natural response for Google would be to charge for Google Play to rebalance the funds flows of Android software. And of course, Google has announced that it plans to do just that.

VI. WHAT IS AT STAKE HERE?

I don't think that the Android case is really about the distribution of Google search on mobile devices or Google's eventual market position there. Had Google been blocked from tying search to Google Play, I think that there is every reason to think that Google search products would have been the default install on most Android handsets. Why? For the same reason that DuckDuckGo is not the default search engine on Apple's iOS. Google has no mechanism to force Apple to preinstall Google apps and services. Apple effectively auctions off distribution and Google wins those auctions because it does the best job of monetizing search.

The difference then isn't whether Google apps and services would have ended up on Android handsets. The difference is in how we organize the cash flows and the type of mobile OS competition that would have taken place. Google may well have had to buy distribution of its search app. While the European Commission seems to believe that Google has done just fine with just the revenues from the Google Play store,

I have no idea whether that is right but there certainly was little reason to believe that upfront when it launched Android.

That suggests that the natural alternative for Google if it was going to have to buy distribution on Android handsets was full-blown vertical integration *à la* Apple or to charge a licensing fee for the Android software *à la* Microsoft. Vertical integration might have reduced handset competition — there are no competing iOS handsets — but even if not — if the alternative to iOS were again an “openish” IBM PC style platform — there still would have been the upfront licensing fees for the mobile OS software.

What the Commission seems to want is to force Google to buy distribution for search as it does on iOS and to charge a cash fee for Android. I understand why the Commission is concerned about Google extending its desktop position on search into mobile, but, as I have suggested, I think that was going to happen one way or the other. I don't think that the Commission can change that without more direct intervention.

But the real question is why would the Commission want to restrict competition to cash payments for mobile OSs? I get why Microsoft would want that, as they don't run an advertising-based business model. But consumers were actually presented with the choice of a fee-based OS handset — Windows mobile — and Android and obviously chose the latter.

Condemning the original Google business model here would be a mistake for the reasons already suggested. And forcing a business model pivot at this point will lead to lots of euros moving around — Google buying distribution and handset makers paying to license Android — without, at this point, any obvious change in actual competition or even here the net flow of funds between Google and handset makers. We've seen lots of empty remedies in antitrust — Microsoft MS-DOS in the U.S. in 1994, Windows Media Player in Europe in 2004 and the browser choice screen in Europe in 2009 — and the natural question is why this won't just be more of the same?



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