Paranoid about Android

July 26 2018 | Contributed by Baker McKenzie LLP

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Key points

On 18 July 2018 the European Commission imposed a record fine of €4.34 billion on Google. In such an innovative and competitive industry, a decision and fine on this scale arguably sends the wrong message.

This update questions whether intervention risks reducing innovation, raising prices and harming consumers. The key takeaways are as follows:

- It is counterintuitive to define a narrow market for licensable mobile operating systems which excludes Apple and BlackBerry. The very existence of Android is evidence of the competitive pressure exerted by operating systems on each other. Since 2008, Google has delivered 14 major releases of Android. There have been year-on-year innovations, including swiping, security, cameras, fitness functions, facial recognition, multitasking gestures and payment systems.
- There is no obvious foreclosure effect – handset makers can choose not to take Google's suite of apps and offer their own instead (eg, Amazon's tablet operating system, Fire OS). In China, handset makers offer a local suite of apps rather than Google's. Further, 80% of consumers customise their home screen. It seems implausible to say that consumers would put up with an undesired (or lower quality) app just because it comes pre-installed.
- *Microsoft v WMP* is an inadequate precedent. The more recent case of *Microsoft v Skype* is directly on point: there were no technical or economic constraints which prevented users from downloading several communications applications on their operating device, especially as the software concerned was free, easy to download and took up little space.
- Pre-installation and pre-set services are at most a transitory – and above all non-exclusionary – marketing benefit. Consumers can and do swiftly change from apps or default services that they do not want. The *quid pro quo* in terms of efficiencies would appear overwhelming. Device makers receive a free operating system, consumers have the latest innovations at their fingertips and handset prices fall.
- It is unclear whether Google will change its licensing practices for Android or reduce its R&D efforts if it cannot secure returns from revenue-generating apps or services. However, either outcome is arguably damaging to competition and consumers – and not the message to be associated with the biggest fine in antitrust history.

European Commision decision

The European Commission concluded that Google is dominant in the markets for:

- general internet search services;
- licensable smart mobile operating systems; and
- app stores for the Android mobile operating systems.

The commission identified the following abuses:

- requiring manufacturers to pre-install the Google Search app and browser app (Chrome) as a condition for licensing Google's app store (the Play Store);
- making payments to certain large manufacturers and mobile network operators on the condition that they exclusively pre-installed the Google Search app on their devices; and
- preventing manufacturers wishing to pre-install Google apps from selling a single smart mobile device running on alternative versions of Android that were not approved by Google (Android forks).

Searching for theory of harm

Is a 'licensable' operating system market too narrowly drawn, and does it mask the true nature of competition in this sector?

The European Commission defines a market for 'licensable' mobile operating systems. Its press release shows that it does not see other operating systems used by Apple and BlackBerry as in the same market because the latter are not available for licence by third party device manufacturers.

Even if few other manufacturers license their operating system on the scale that Android does, it is counterintuitive to argue that there is not fierce competition between operating systems.

The very existence of Android is evidence of the competitive pressure exerted by operating systems on each other. The sea change was the advent of the touch screen smartphone in 2007. Competition from Android – an open-sourced operating system delivered for free to handset makers – has been vigorous ever since to keep pace with smartphone innovation.

If Android were to provide a lower-quality experience, or relax its innovative effort, compared to its rivals, smart phone users, always demanding the latest technology, would surely switch in droves at the next (typically annual) round of handset launches. Operating systems are subject to intense competitive pressure and live or die by their latest release.

This intense competition produces compelling consumer benefits. Android makes cutting-edge handset technology available to a mass market at a reduced price. One statistic suggests the average price of an Android smartphone halved between 2010 and 2016: from $441 to $215.

Is the foreclosure story plausible?

The European Commission alleges that Google's Android licensing practices foreclosed competitors through pre-installing apps or pre-setting default search services.

Publicly available information points the other way. It seems that handset makers can choose not to take Google's suite of apps and offer their own instead – such as Amazon's tablet operating system, Fire OS. In China, handset makers offer a local suite of apps rather than Google's.

Where handset makers do distribute Google's apps, then the question arises as to whether competing apps or services are actually foreclosed. Mobile phones are intensely personal and personalised devices. A quick fact check suggests that there were 82 billion downloads from Google Play in 2016, while 80% of consumers customise their home screen. Intuitively, therefore, it seems implausible to say that consumers would put up with an undesired or lower-quality app, just because it comes pre-installed.

Some of the most popular apps (eg, Facebook, Dropbox and WhatsApp) are more popular with consumers than their Google equivalents, irrespective of whether the Google apps are pre-installed. Among non-Android device users, you would be hard pressed to find any who have not downloaded the popular Google Maps or Waze – and that is regardless of whether the non-Android device has another map function pre-installed. The same is true of Chrome and Search. These are popular apps downloaded by non-Android device users regardless of whether the non-Android device has other search engine or browser apps preloaded.

The European Commission's press release notes that, on Android devices (with Google Search and Chrome pre-installed), more than 95% of all search queries were made via Google Search, whereas on

Windows Mobile devices (where Google Search and Chrome are not installed) less than 25% of all search queries were made via Google Search (meaning that more than 75% of search queries happened on MS Bing).

However, this also means that users are five times more likely to switch from a Bing default to Google (25% Google versus 75% Microsoft) than a Google default to Bing (95% Google versus 5% (mainly) Bing). This suggests quality and preferences overcome pre-installation (which of course is precisely what drives people to download other popular apps such as DropBox, Facebook and WhatsApp).

EU precedent militates against any finding of pre-installation foreclosure in relation to the apps in question. In *Microsoft v Skype* the European Commission and, on appeal, the European Court of Justice examined whether, if Microsoft chose to install Skype on the desktop post-acquisition, that would lead to foreclosure of rival video telephony services. The conclusion highlighted that there were no technical or economic constraints which prevented users from downloading several communications apps on their operating device, especially as the software concerned was free, easy to download and took up little space on hard drives.

More recently in *Facebook v WhatsApp* (2014), the European Commission found that, in relation to the apps in question, multi-homing was facilitated by the ease of downloading – which is generally free, easy and uses little smartphone capacity. The commission also found that using multiple consumer communications apps was easy because users need not log in each time they want to switch between apps.

Facebook v WhatsApp and *Microsoft v Skype* (upheld on appeal in 2013) are clearly better precedents than the older *Microsoft v WMP*. The alleged foreclosure in *Microsoft v WMP* occurred in a world without apps, app stores or user-driven device customisation available with a few swipes and clicks.

The Canadian Competition Bureau found no evidence of foreclosure when it discontinued its investigation into Google in 2016. It found that search engines can and do compete to appear as the default search engine on smartphones. Switching activity over time was significant and manufacturers were able, for example, to ship multiple devices with different pre-loaded search engine defaults. The Competition Bureau noted specifically that consumers "can and do change the default search engine on their desktop and mobile devices if they prefer a different one to the pre-loaded default".

There are offline precedents too. Think back to *Van den Bergh Foods* (ice cream cabinets), *Heineken* (beer dispensing equipment) and *Coca-Cola Undertaking* (drinks fridges). The conclusion from those cases is that full equipment exclusivity (eg, the ice cream cabinets in *Van den Bergh Foods*) might be capable of foreclosure. However, if the supplier allows rivals sufficient space (*Coca-Cola Undertaking*) or makes the restraint easy to change (*Heineken*) then foreclosure risks do not arise. In Google's case, the application of these offline precedents suggests foreclosure is unlikely. If Google has only a few of the approximate 70 or so spots on a device and these can easily be deleted, replaced or added to by rivals, or pre-sets changed, there would seem to be no risk of rival exclusion.

How should efficiencies be evaluated?

Android has created a mobile ecosystem generating significant benefits. This balance between distribution of Google's revenue generating apps as the *quid pro quo* for Android's ongoing R&D would seem to be the clearest example of pro-competitive benefits. The benefits of the 'anti-fragmentation' agreements should also be spelled out. It is not the same as 'non-differentiation': the approach is necessary to preserve the attractiveness of the ecosystem for app developers. It seems likely that developers would not code, or code far fewer, apps for multiple versions of forked mobile operating systems. This in turn drives efficiencies – including lower prices, greater output and innovation in the Android ecosystem – and ensures that it is easier for consumers to switch between devices, increasing competition and innovation between original equipment manufacturers.

Comment

Many would say pre-installation (or pre-set services) are at most a transitory – and above all non-exclusionary – marketing benefit. Consumers can and do swiftly change apps or default services that

they do not want. Further, the *quid pro quo* in terms of efficiencies would appear overwhelming. Device makers receive a free operating system, consumers have the latest innovations at their fingertips and the prices of handsets fall.

The impact of that European Commission's decision will have on these *prima facie* highly desirable outcomes is questionable. It remains to be seen whether Google will change its licensing practices for Android or reduce its R&D efforts if it cannot secure returns from revenue-generating apps or services. However, either outcome is arguably damaging to competition and consumers – and certainly not the message that should be associated with the biggest fine in antitrust history.

Given the ease with which consumers can switch between apps and default services, this latest decision is an attempt to overcome consumer reluctance to move away from a product that they are happy with in order to drive broader policy objectives in the digital sphere.

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