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Apple vs. Spotify: Congress Unhappy with FTC's Slow Progress on Investigation into Apple's Exclusionary Conduct in Music Industry

Legislative and Regulatory Update

According to sources familiar with the matter, the FTC has been investigating Apple's alleged anticompetitive practices in the music industry for over a year. Based on interviews with several sources following the issue closely, we have seven takeaways for the current state of play regarding the investigation:

1. The FTC fought with DOJ for the right to conduct the investigation.

2. The FTC has stopped or slowed its investigation without issuing CIDs, which is an indication that staff or the front office decided against a full review and which is unusual given how aggressively the FTC fought for the right to conduct the investigation.

3. Both Senate and House staffers for relevant antitrust subcommittees have held meetings with FTC staff to receive updates on the investigation, and Congressional staff have expressed concern that the FTC is not conducting a thorough investigation and is unlikely to act on the myriad allegations against Apple.

4. Given Congressional staff interest, stakeholders should expect hearings at some point or at least pointed questions for the FTC about the status of the investigation the next time the agency appears before Congress.

5. Our investigation and analysis shows that a case against Apple regarding its practices against Spotify in particular would be very compelling and likely winnable under either Sherman Act Section 2 or FTC Act Section 5.

6. The FTC seems sympathetic to Apple's arguments that companies can do whatever they want on their own platforms, even when those platforms are dominant, and even when platform owners want to participate on the platform and disadvantage competitors.

7. The FTC's views appear increasingly out of line with DOJ views on the behavior, with Congressional interests, with an emerging legal, policy, and economic consensus on the need for neutral treatment on platforms, with language in the Democratic platform, and with Democratic Presidential nominee Hillary Clinton's statements regarding the need for more aggressive antitrust enforcement and her intention of appointing antitrust enforcers who are willing to take more aggressive actions.

In this article we focus on conduct that has put Apple under scrutiny and that will likely lead to an enforcement action if Hillary Clinton becomes president and follows up on her tough rhetoric on antitrust.

A Closer Look at Alleged Anticompetitive Conduct

As evidenced by the company's yearlong dispute with Spotify, Apple appears willing and able to disrupt already competitive markets in the App Store through exclusionary conduct. As the proprietor of the iOS platform as well as a competitor within the App Store, Apple uses certain levers to diminish competitiveness for its own gain, add friction to competitors' transactions, or wholly block their attempts to better interact with consumers.

Conduct 1: Sherlocking. One of the biggest worries for app developers is "sherlocking," when Apple updates iOS to include functions similar to third-party app features. Such an update can lead to a reduction in market share, a lack of drive for users to search outside of iOS for a function readily available, and sometimes can put an end to what had been a profitable business for the developer. Apple arguably "sherlocked" Spotify and other music streaming services when it released Apple Music on June 30, 2015, incorporating it into iOS.

Some developers fear any update to iOS could end their business**.** Apple, with its pitch of "There's an app for that", made it clear in the early days of the iPhone what the device was offering: Apple would provide the platform and the essential functions for its device, and developers would fill in any blanks they saw through the App Store. That led to a vibrant ecosystem of independent developers who built businesses off their App Store sales.

Now, however, iOS has matured, and Apple needs to provide new use cases to keep consumers buying new devices. Each year at Apple's Worldwide Developers Conference (WWDC), third-party developers – sometimes sitting in the event's crowd – learn that core functions of their apps have been enveloped by iOS. That forces them to scramble to pivot or add premium features. Some developers just end their projects outright.

Developers we spoke with and sources online helped build an incomplete list of popular apps – some in iOS, some on Apple's other platforms -- potentially sherlocked at the most recent June 2016 WWDC: Scribe, Copied, Sidefari, MacID, Pushbullet, TextExpander, Various Emoji apps, and Various Breathing apps. Past years have seen just as many companies find their newest competitor in Apple. Apple has also prohibited apps from the App Store and then added similar functions itself.

Conduct 2: Tying. Tying is when a company will only sell one product on the condition that the buyer also purchase another product. Apple employs a widespread tying strategy throughout its walled garden ecosystem, which on one hand provides consumers with desired integration and on the other hand is an effective monopolization tool. Most relevant here, Apple tied Apple Music to iOS in June 2015. The anticompetitive effect is clear - consumers new to iOS are unlikely to search out a music streaming service like Spotify when one is built into their operating system. In fact, when Apple Exec Eddy Cue was recently asked how Apple Music competes against services like Spotify, he replied, "It can't be about a service that's just providing the songs, because anybody can do that. It starts by the level of integration that we have within our product."

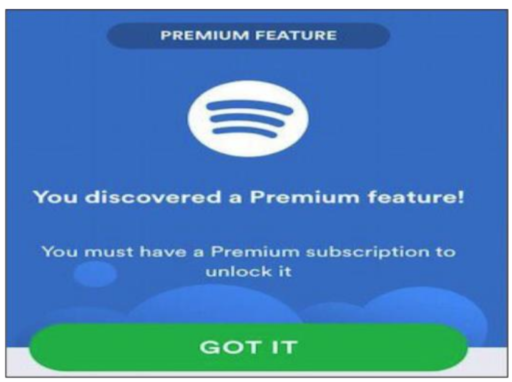
Apple also ties its payment system to the App Store, requiring competitors to use "In-App Purchase" and forcing price increases. Apple requires that all digital services and apps use its "In-App Purchase" (IAP) payment service for in-app purchases. Despite the existence of other options, such as PayPal, Apple will remove any app from the App Store that tries to circumvent IAP. With every transaction on IAP, Apple takes a 30 percent fee off the top – often called the "Apple Tax."

The Apple Tax effectively requires Spotify to raise its subscription price from the regular $9.99 for a premium account to $12.99 to cover costs. Meanwhile, since Apple obviously does not pay itself the same 30 percent surcharge, it can offer its service for $9.99. One aspect worth noting is that Apple likely makes more on a Spotify subscription sold on the App Store than an Apple Music subscription. The 30 percent from a $12.99 Spotify subscription comes without any overhead calculated in – about $3.90. The $9.99 Apple Music subscription requires about 70 percent going back to music publishers as well as deductions for other overhead costs.

Apple also does not allow Spotify to offer its family and student discounts through its iOS app. Meanwhile, Apple Music is able to inform users about the same kinds of deals through its app. Apple generally never negotiates on its IAP requirements or its Apple Tax cut, except within markets it does not have an interest or has no market power. For example, the company does not require services that offer physical goods to use IAP, as a number of payment options are available on Amazon, Uber, and others. That shows some level of flexibility that it refuses to offer digital competitors like Spotify.

Conduct 3: Denial of Updates. Spotify's most recent issues extend from Apple's denial of an update that lets the service communicate with its users. Outside the App Store, a user can purchase a Spotify subscription for the more competitive price of $9.99 per month. However, Apple recently blocked the company from communicating that fact to iOS users in the Spotify app. In Spotify's first version of its recent app update, the company included a popup that appeared with a signup link for Spotify Premium when a user tried to access premium features. That version of the app was rejected from Apple's app review – an opaque process that the company uses to induce behavior.

Spotify resubmitted a new version of the update that had the same popup except it omitted the link to sign up for Spotify premium. Instead, the message simply notified the user that they did not have full access to all of Spotify's premium features. That message seemingly had no call to action or a workaround to push users out of the App Store, yet Apple similarly rejected the update. An image of the second version of the popup message appears below:



Apple has modified its Developer Guidelines during the time that this most recent Spotify dispute has been ongoing. The relevant text from the updated guidelines reads, "Apps may not include buttons, external links, or other calls to action that direct customers to purchasing mechanisms other than IAP." It is unclear where exactly Spotify's most recent update breaks those guidelines, and Apple could not be reached for comment.

Conduct 4: Platform Product Design. With the latest forthcoming numbered update to iOS, iOS 10, Apple is opening its digital Artificial Intelligence assistant Siri for developers to include through APIs across third-party applications, including services like Lyft and Square Cash. One notable exclusion is Spotify and other streaming music services, according to 9to5Mac. Siri will continue to work with Apple Music. It is hard to envision a legitimate business reason for Spotify's exclusion, and this update – along with the 2015 update that incorporated

Apple Music into iOS – shows the power Apple possesses to dictate which firms compete in its ecosystem and the terms of competition.

What a Sherman Act Section 2 Case Would Look Like

Digital platforms competing with businesses dependent on them likely at risk of greater antitrust enforcement moving forward. The Spotify/Apple dispute is part of a widespread problem across digital platforms whereby platforms' own business activities create a highly skewed playing field for competition. This issue is the heart of EU enforcement against Google, which can destroy any robust competition by leveraging its search monopoly into other verticals, like shopping. The EU has indicated its Google decision on shopping will serve as a template for other actions and for global enforcers. Similar to Google, Amazon has leveraged its book monopoly power to eliminate publishers' ability to compete in favor of its own publishing and self-publishing.

Apple's app store has posed the same kinds of problems. Just as net neutrality laws aimed to prevent ISPs' abilities to pick the winners and losers of the Internet, it is unlikely policy makers will continue to allow four major platforms – Google, Amazon, Facebook, and Apple – to pick the winners and losers of a vast percentage of commerce and speech. Based on current legal standards under Section 2 of the Sherman Act, Apple's exclusionary conduct toward Spotify and other music streaming services that depend on its dominant App Store could sustain a claim for attempted monopolization and monopoly leveraging.

At a recent *Capitol Forum* conference, Professor Andy Gavil stated that US monopolization standards are the most difficult for plaintiffs to meet of any leading antitrust regime worldwide. This article applies US enforcement standards to Apple's conduct regarding music streaming, and we will discuss international enforcement risk in future articles.

Sherman Act Section 2 states, "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony…" A monopoly leveraging violation requires: (1) the possession of monopoly power in one market and (2) the use of that power in an anticompetitive or exclusionary manner (3) to create a dangerous probability of monopolizing a second market. For an attempted monopolization claim, the defendant must: (1) engage in exclusionary conduct; (2) with specific intent to monopolize; and (3) with a dangerous probability of achieving monopoly power.

Apple possesses monopoly power in the app store market. Monopoly power is defined as the power to control prices or exclude competition. A market share of over 70% is considered presumptive evidence of monopoly power, as long as barriers to entry exist and competitors cannot expand their output.

When it comes to spending on mobile app markets, iOS is far and away the most important marketplace for developers to land their apps. Market statistics provided by sources familiar with the Apple's music streaming controversy show that 71 percent of all app store revenue in the US takes place on Apple's iOS. And recent reports indicate that Apple's App Store generates four times the revenue per app as does Google Play. In order for mobile apps and services to see any reasonable amount of return from mobile development, they need to be on Apple's App Store.

In the US, iOS has about a 27 percent market share on mobile devices while Android has about a 65 percent market share, according the most recent statistics from analytics provider Net Applications. But Apple's dominance in terms of revenue makes it the essential platform for mobile apps. Apple therefore has monopoly power in the market for app developers to sell their apps. Developers cannot turn to Android as a substitute because their apps do not sell on that platform enough to be financially viable.

Apple's App Store monopoly power is durable due to barriers to entry, including network effects and an "applications barrier to entry." An important barrier to entry for digital platforms is known as network effects, which *Antitrust Law Developments (ALD)* explains as "the value of any product or service increases the more others use the same product or service." Accordingly, competitive entry is difficult because it requires a critical mass of users.

One specific type of network effect is what the Court in the Microsoft monopolization case termed an "applications barrier to entry." As professors Michael Katz and William Rogerson explain, "The applications barrier to entry arises because a new operating system will be desirable to consumers only if a broad array of software applications can run on it, but software developers will find it profitable to create applications that run on an operating system only if there is a large existing base of users of that operating system who could purchase the applications."

They continue, "As a consequence of these network effects, an operating system entrant would face a potentially overwhelming chicken-and-egg problem with users and applications." DOJ "alleged that the applications barrier to entry allowed Microsoft to enjoy significant and prolonged market power in the market for Intel-compatible personal computer (PC) operating systems worldwide," they explain. These entry barriers suggest Apple's dominant app store market share is durable enough to constitute monopoly power under the law.

Apple appears to have used its app store monopoly power in an anticompetitive and exclusionary manner that creates a dangerous probability of it monopolizing the music streaming market. The standards for what constitutes exclusionary conduct, and what is simply robust competition, are unclear. Courts and scholars have recommended at least five different tests, and there is no consensus.

Common principles apply across the board, however, and they include (1) intent (2) the business justification for the conduct and whether less restrictive means could achieve similar goals, and (3) the effect of the conduct and whether it is likely to cause the acquisition of monopoly power. The types of recognized exclusionary conduct most relevant here include tying, anticompetitive pricing, and refusals to deal. These forms of exclusionary conduct were developed over decades of antitrust litigation but may not fully encompass new strategies that dominant digital platforms have at their disposal.

Apple's tying practices may constitute exclusionary conduct. If a defendant uses a tie to maintain its monopoly power in the tying product market or to attempt to monopolize the tied product market, it can amount to a Section 2 violation. Tying is a controversial area of antitrust law and prevailing on an attempted monopolization case based on tying is not easy under current US standards. As explained above, Apple uses numerous tying techniques throughout its walled garden ecosystem. Most relevant here, Apple ties Apple Music to iOS and ties its "In-App Purchase" (IAP) payment service to in-app purchases, to ensure it can charge the 30% "Apple Tax." Arguably, the former is an attempt to monopolize the streaming music market and the latter is an attempt to monopolize in-app payment systems. The tying of IAP also may constitute an attempt to monopolize the music streaming market by facilitating the "price squeeze" explained below.

The Apple Tax is a "price squeeze" that may constitute exclusionary conduct under Section 2. In *United States v. Alcoa,* the Second Circuit held a Section 2 claim satisfied where (1) a firm has monopoly power with respect to a product, (2) its price for that product is "higher than a 'fair price'," (3) that product is required to compete in a second market where the monopolist itself competes, and (4) the monopolist's price in the second market is so low that competitors cannot match it and still earn a "living profit."

The Supreme Court's Decision in *Trinko* modified this somewhat, additionally requiring proof of monopoly power or a dangerous probability of monopoly power in the market in which the plaintiff competes with the monopolist. *Trinko* has posed formidable obstacles for Section 2 enforcement, but it is unlikely antitrust enforcers will indefinitely allow one court decision to eviscerate a more than century-old statute enacted by Congress.

Here: (1) Apple has monopoly power in the App Store, (2) Apple charges a 30% cut for access to the App Store, which arguably is higher than a fair price, (3) Access to the App Store is required to compete in the streaming music market, and (4) Apple's price in the streaming music market is so low that competitors cannot match it. Spotify cannot match Apple's pricing due to the "Apple Tax" together with the cost of music licensing. This price differential creates a dangerous probability of Apple monopolizing the streaming music market.

The dangerous probability of success prong lacks consistent standards, but courts have often required a showing that the defendant has over a 50% share in the second market it is attempting to monopolize. Such a standard has been criticized as bringing relief only after the monopolist has succeeded in competing unfairly to dominate the second market. When it comes to digital platforms, the dangerous probability of success test is likely to be adjusted to reflect market realities as few would doubt Google or Apple's ability to succeed in the second market.

Apple's denial of Spotify's latest version may violate its obligations as an essential facility. Although some interpret the US Supreme Court's *Trinko* decision as weakening the essential facilities doctrine, the doctrine is still good law and is highly applicable to digital platforms. "Generally, a facility is essential if it is vital to competitive viability because competitors cannot compete effectively in the relevant market without access to it" explains *Antitrust Law Developments.*

The court in *MCI Communications vs. AT&T* set fourth four elements of an essentials facility violation under Section 2: "(1) control of the essential facility by a monopolist; (2) a competitor's inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility." The Apple App Store is arguably an essential facility under the antitrust law, as Spotify cannot do business without it. Denying Spotify the ability to publish new versions of its app in the App Store may constitute exclusionary conduct supporting an attempted monopolization or monopoly leveraging claim.

Product design as exclusionary conduct. If competitors' products must interface with a monopolist's product, a product change that makes it harder or more expensive to do so can violate Section 2. Prevailing on such claim is difficult, however, as courts often find in the monopolist's favor as long as they can show some product improvement. A plaintiff can prevail, however, if they can show the change was driven by anticompetitive motives.

As mentioned above, with the latest forthcoming numbered update to iOS, iOS 10, Apple is opening its digital AI assistant Siri for developers to include through APIs across third-party applications, including services like Lyft and Square Cash. One notable exclusion is Spotify and other streaming music services. Since it is hard to imagine a legitimate motive for Spotfiy's exclusion, this product design may constitute yet another form of exclusionary conduct that supports a Section 2 case.

Why a Section 5 Case Might Be More Compelling to Antitrust Decision-makers

Section 5 of the FTC Act may be an easier route to enforcement here than Section 2 for three reasons: (1) it addresses conduct that falls outside of the Clayton and Sherman Acts; (2) it is better suited to "stop anticompetitive conduct in its incipiency," rather than monopolization standards heavily criticized as only providing relief too late; (3) it is particularly adept at addressing changing and dynamic markets due to its flexibility.

Section 5 of the Federal Trade Commission Act declares "unfair methods of competition in or affecting commerce" to be unlawful. 15 U.S.C. § 45(a)(1). "Section 5's ban on unfair methods of competition encompasses not only those acts and practices that violate the Sherman or Clayton Act but also those that contravene the spirit of the antitrust laws and those that, if allowed to mature or complete, could violate the Sherman or Clayton Act," explains the FTC policy statement issued in August 2015.

Ramirez's comments on the statement likewise note, "There has never been any question that Section 5's ban on 'unfair methods of competition' reaches conduct beyond the scope of the other antitrust laws." She adds: " In the absence of a consummated agreement or potential monopoly power, such conduct generally falls through the cracks of Sections 1 and 2 of the Sherman Act. But such conduct can nonetheless violate the spirit of the antitrust laws insofar as it threatens harm to competition without countervailing benefits. We have thus relied on our standalone Section 5 authority to reach such conduct, consistent with Congress's intent for the Commission to stop anticompetitive conduct in its incipiency."

Ramirez further noted that Section 5 is particularly suited to addressing competitive harms in our dynamic economy. "I have previously explained that I favor a common-law approach to the development of Section 5 doctrine rather than a prescriptive codification of precisely what conduct is prohibited," said Ramirez. "As Congress understood when it enacted the FTC Act, it would be nearly impossible to describe in advance all of the conduct that may threaten competition or the competitive process in our dynamic economy," she continued. Therefore, the flexibility of Section 5 is an asset to the FTC in addressing harms in the highly dynamic tech economy and it may prove a more appealing tool for antitrust enforcement here than the Sherman Act.