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Google EC Antitrust Enforcement: Expected Android EC Remedies Likely to Make Google Vulnerable to Competitive Threats in Mobile Advertising

Outlook and Timing Update

The European Commission (EC) is widely expected to void the terms in Google's contracts with mobile device manufacturers, or Mobile Application Distribution Agreements (MADAs), that contractually tie a suite of Google apps to the must-have Google Play app on phones using the Android operating system. Given that recent reports put Android's worldwide market share at 86%, the opportunities for other tech giants as well as new market entrants to take a slice of the mobile app market are likely to grow significantly as a result.

Google has already begun to face this outcome in Russia, where Yandex has reported gaining search market share soon after winning a parallel antitrust case in that country, which opened the door for Yandex to get pre-installed on Android devices. Europe is next, with the potential for antitrust authorities around the world to bring copycat cases. Google is therefore likely to face unprecedented competitive threats in mobile search and mobile app data collection, and hence mobile advertising.

Google's response to the Android charges is due on October 7; a decision in the case is expected by Spring 2017. In April 2016, the Commission formally charged Google, issuing a Statement of Objections ("SO"). The Commission allowed Google an extra six weeks to respond, making the response due on September 7. It since gave Google two additional extensions, and a response is now due on October 7. Additional delays remain possible.

Deadlines have also been extended in the Google Shopping case to October 13 and in the search advertising case to October 5. Sources currently expect a Google Shopping decision in the Spring or Summer of 2017, followed by a search advertising decision in Fall 2017 or even early 2018.

In-depth Look at Business Implications of the EU's Android Case

At the recent "Digital Platforms Under The Microscope" Conference co-hosted by The Capitol Forum and the George Washington Institute for Public Policy, Harvard Business School Professor Ben Edelman, who teaches about the economics of online markets, provided a thorough explanation of the ways in which Google's MADAs have foreclosed competition in mobile search and mobile apps. The video can be viewed here, and the following excerpts from Edelman's speech give a helpful overview of how the MADA terms foreclose competition:

"So what's the bite to the MADA? What did we learn when we finally got to read this secret contract, the very existence of which had been denied by Google and others until finally I managed to get my hands on a copy of it? What we learned was that if you want any of the Google apps, you have to take all of them. And there's a whole list… You've got to take all of the Google apps, even the ones for which there are viable competitors."

"…It might be that Yahoo Maps is willing to pay, I don't know, they're willing to pay LG a dollar per phone. For each phone on which you install only Yahoo Maps and not Google Maps, we'll pay you a dollar because we think that consumers, if they try our app and they have to use it for a while until they figure out how to get Google Maps, they'll like it, and that's worth enough to us that we can afford a dollar per phone to get that. And so forth for other sectors. Imagine if there was no Gmail app, but there was a Hotmail app, would that get some more users for

Hotmail? Maybe. Well, that's all off the table. You can't go around taking out some of the Google apps. You've got to keep them all intact. And furthermore, Google Search will have to be the default. So you couldn't make Bing Search the default on some phones or Yandex in Russia or Naver in Korea. Pretty tough medicine for those few search engines that are still hanging on and fighting, for the Yandexes and Navers and Bings too for that matter. No guarantee that Bing will still be around five years from now. To be told they can't even buy pre-installations on these phones."

"…So what would Google say in response to these requirements? Well, the first thing Google said initially was that doesn't exist. We don't have any such requirements. But when the document came out, they couldn't keep on saying that. Then they said, you're always free to say no. You could put some other operating system on your phone and not Android. Good luck with that. What are you going to use? Like Blackberry OS? I don't think that's really going to be viable for anyone, a community that has no apps…"

"…My bottom line, of course, is that it's awfully nice to have competition on the merits. I don't know what mapping service is better than Google Maps. I'm not sure there is one that's better than Google Maps right now. But I could imagine one being better than Google Maps. And if that thing actually exists, I kind of want Samsung to be free to put it on the phone. I want that company to have a fair shake at telling me about it, including by paying Samsung to put it on the phone."

Experts following the EU's Android case expect an unfavorable result for Google. Industry and legal experts following the case consider the tying charges straightforward given established legal precedent that such contracts by a dominant firm are *per se* illegal under EU antitrust law, meaning automatically illegal without consideration of pro-competitive justifications under the rule of reason that applies in the US. Of the three EU cases against Google, the Android case is viewed as the easiest one for the Commission. The tying allegation closely resembles the landmark EU Microsoft case, where Microsoft tied its Internet Explorer web browser to its Windows operating system as well as Windows Media Player.

Professor Nicholas Economides compared the Android charges to the Microsoft case on a recent Capitol Forum conference call: "Essentially, the cases are similar because they are tying cases. The operating system, Windows, was tied with Internet Explorer. You were getting immediately Internet Explorer if you got Windows. You were getting immediately Windows Media Player if you were getting Windows…The difference is that Microsoft had argued that the software code was comingled, the software code of Internet Explorer and Windows, for example, was comingled. And therefore, they couldn't be untied. Now, this issue does not arise in the present case against Google because Google admits that the applications that were tied were separate, that Google Play and Google Search were separate applications and they are tied by contract and not by having their software code comingled."

Professor Edelman also compared the Android charges to the Microsoft case, saying the competitive harms in Android are comparatively more severe: "The business model foreclosure seems like a more serious issue here. You know, if you had built a better maps app or you had built a better video ecosystem, even a better tablet ecosystem like Amazon Fire, and you wanted that to get traction, could you actually do it in light of these restrictions? In a prior era, it seemed like it would still be okay for a better browser to get access to consumers. Or so I thought at least, not withstanding what courts ultimately held. In this case, it looks like things are pretty tough, even at the very top of the pyramid, even for the Amazons and Samsungs and so forth."

Unlike the US, the EU does not need to sue Google in court on the charges. It simply publishes a decision and Google has the burden to appeal to an EU court. In the last 25 years, the European Commission has never lost a dominance case in the EU courts. **"**I think the deck is heavily stacked against Google and I would be very surprised if the Commission did not side with antitrust law, as I would be surprised if the Courts did not support these decision," said Thomas Vinje, outside counsel for Fair Search Europe, the lead complainant in the Android case. "The Commission is contending contractual conduct in all three of the areas it is pursuing… The fact that it is all contract-related basically means that the requirements can be undone by contract, which generally speaking is less difficult than what is being sought in the Search case," he explains.

A fine and voiding of offending MADA provisions are expected remedies, among other possibilities. Potential remedies could be as simple as the Commission finding that the contractual provisions are illegal, and forcing Google to dissolve them. Or, they could allow the provisions to be replaced by new provisions that do not foreclose competition. Although uncertainty remains as to the exact contours of the EC's likely remedies, Professor Economides explained that "the straightforward measure for sure is to cut the tie and impose a fine."

Alternatively, as was the case in Microsoft, they could impose more invasive remedies. "For example," Vinje, who was also counsel in EU-Microsoft cases, explained that in Microsoft, "the Commission concluded that the consequences of the tying had become so entrenched, in particular, by virtue of websites targets and other standards, that [the Commission] had to do something more to reverse the consequences of the illegal behavior; and the decision was to require Microsoft to provide choice [or "ballot box"] screens…" He added, "There is a possibility that the Commission could conclude that something more is required than merely undoing the illegal contractual decisions."

Dissolving the contracts and opening up the mobile market to competitors' apps is likely to make Google more vulnerable to competitive threats, particularly in mobile advertising. By offering the Android OS for free to manufacturers as a quid pro quo for pre-installing and preferentially placing its bundle of apps, Google leveraged its Android dominance to generate significant ad revenue within apps, like travel, local, search, maps, etc. This conduct mirrors Google's leveraging of its dominance in horizontal search to influence search results in adjacent vertical search markets, as explained in detail in our previous report on Google Shopping.

Additionally, Google accessed all the data in the location services installed in its apps. This Android strategy has allowed Google's revenue growth to grow in tandem with mobile usage, at a time when its desktop search revenues were stagnating. An unfavorable decision that would open up the mobile market to competitors' apps thus has the potential to profoundly affect Google's position. "If Google doesn't have all of its stuff preinstalled and locked down, then Android users are able to switch too, if a new and better app comes along," said a digital platforms expert following the EU's cases. "It definitely makes [Google] weaker and vulnerable to the next competitive threat and leaves the competitors free to go into the device manufacturers and make their own deals because Google is no longer dominant in the space," the expert continued. "After all, there is no prohibition to doing something like that if you are not dominant," the expert concluded.

As advertising converges from different media silos with most growth in mobile, numerous industry players likely will seek to challenge Google if given the opportunity to deal with device manufacturers. One tech executive close to the case explained, "…there is an overlap in the target audience of online advertising, and print, TV, and telecom, to some extent, are on a collision course – heading from their respective traditional areas into the other areas. All

are competing for the same dollars of ad spend and, essentially the same eyeballs, which only pay attention to media and ads for a certain amount of time per day."

Commission likely to use Android case as precedent to address Google's conduct more broadly across mobile. In our last piece on the Google Shopping case, we reported that the Commission had intentionally narrowed its previous broad focus from search overall to the comparison shopping vertical, aiming to set a precedent for other verticals, such as travel, local, and mapping. The Commission has followed that same strategy here.

The Commission's investigation confirmed initial complainant reports that Google's MADAs with device manufacturers included the tying and preferential placement of a broader range of products and services than mentioned in the SO – which only referenced Google Search and Chrome. Antitrust experts believe that the limited scope is intentional to ensure that the case will hold up in EU Courts and to establish clear precedent that Google's conduct is illegal, which would inevitably affect the entire Android ecosystem. As one expert put it, the Commission "gets the bang for their buck. They narrow the scope reducing the burden of information gathering and necessary resources, but they also get the benefit of a precedent-setting principle that spans more broadly."

Global copycat cases and private damages action expected to increase the effect of an EU decision. Also like the Google Shopping case, if the Commission issues a prohibition decision, other antitrust agencies across the globe are expected to pursue copycat cases. In addition to other jurisdictions, Google also likely faces civil damages actions in Europe if the Commission issues a prohibition decision. For a detailed explanation of the difference between a commitment decision and a prohibition decision, please see our previous Google report.

In-depth Look at the European Commission's Android Allegations

The Commission outlines three primary allegations in the Android Statement of Objections. In April of 2015, the Commission began formally investigating complainant allegations that Google had entered into licensing and distribution contracts, which imposed requirements on device manufacturers who used the Android operating system ("OS"). Complainants argued that these requirements allowed Google to favor its own mobile products and services and strengthen its dominant position in the global smartphone market. The SO outlined three main allegations:

1. Requiring that Google Search and Google Chrome be preinstalled and set as default services on Android devices;
2. Requiring manufacturers to sign "anti-fragmentation" agreements which prevented them from selling smart mobile devices based on the Android open source code, but running on competing operating systems;
3. Giving financial incentives to the largest smartphone and tablet manufacturers and mobile network operators in exchange for exclusive pre-installation of Google Search on their devices.

The Commission alleges that Google unfairly imposed a range of contractual and technical constraints that: (a) were not required for the successful operation of Android; and (b) dissuaded licensees from using a Google competitor for search, search advertising, and a variety of other services, foreclosing competition in these markets. "At this stage, the Commission considers 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 system," reads the press release accompanying the SO. "Google generally holds market shares of more than 90% in each of these markets in the European Economic Area (EEA)."

First allegation: Google contractually bundles Google Search, Chrome and Play Store apps and requires preferential placement of Search and Chrome. Google made the licensing of the Play Store on Android devices conditional on Google Search and the Chrome mobile browser being pre-installed and set as the default search service. Because browsers are an important entry point for search queries on mobile devices, tying the dominant Google Search and Chrome browser assets – two of its most dominant channels of revenue generation – to its dominant Android OS locks in Google's mobile dominance, regardless of consumer preferences.

Although companies like Apple also engage in preferential placement, the difference is Google's dominant smartphone market position. Under European antitrust law, particularly Article 102 of the EU Treaty, the "contractual tying" (i.e. bundling of Google Search, the Chrome browser, and Play Store apps -- products that otherwise are separate markets) is considered an illegal abuse of dominance.

The contractual tie is set forth in MADAs as follows: If manufacturers want users to have access to GMS (a collection of applications or apps, most notably the must-have Google Play; Google Search; Google Chrome Browser; YouTube, Gmail and others), they must join the Open handset Alliance ("OHA"), which requires that: (a) Manufacturers make their respective modifications based on Android's open source code; (b) Google tests for compatibility; (c) Once approved, manufacturers must offer the bundle of Google apps that must be preinstalled on these devices.

These MADAs ensure that Google has control over how its apps are installed, positioned, and displayed on devices, as well as that other popular apps like Uber and Yelp – many of which embed Google Maps or other Google technology – function as desired on the devices. Manufacturers that choose not to comply with these device-licensing requirements lose access to Google Mobile Services (GMS) apps like Gmail, Google Play, and YouTube. Because Google Play is a must-have for downloading apps onto the Android OS, device manufacturers using Android OS have no real choice but to accept the bundle.

The EU's press release states that Google Play is not only dominant, but Google Search is as well. "But the Google Play program or app is indispensable for a manufacturer," explained Professor Economides. He continues: "It updates and downloads the apps. I mean, if any of you has an Android phone, you are very familiar with Google Play and the role it plays. It would be extremely difficult to work on the phone without something like Google Play. So it's almost indispensable to the manufacturer, and that's why it can be leveraged to other apps such as search. Now, once you have a big market share in search, you could leverage that as well. And in many of these monopolization cases, there is this discussion of reinforcement of market power from one line of business to another."

Second allegation: Google enforces anti-fragmentation agreements. Membership in the OHA also requires that device and chip manufacturers, app developers, and some multi-national organizations, sign "Anti-fragmentation" Agreements (AFA's), which prohibit the creation, promotion, or distribution of any device or software powered by an Android "fork," (i.e. a modified version of the Android OS), regardless of whether it's a third party product or the manufacturer's own product. Complainant allegations include examples of Google forcing companies like Acer and Skyhook to cancel highly anticipated launches of products that ran on Android forks.

A Fair Search Europe statement released earlier this year, states "OEMs who thought they were investing in the development of an open source product that would allow them to provide differentiated offerings by licensing

Google Android are now effectively locked into Google Android and Google Play Services, and the applications barrier that relies on Play Services. Developers of competing AOSP [Android Open Source Project] distributions are starved of innovations and applications, which rely on Play Services and the Play Store, both of which are reserved for Google Android."

Eliminating this contractual term will promote experimentation, explained Professor Edelman: "Under Google's anti-fragmentation rules, it really is an all or nothing company-wide decision. That raises the stakes. Now you'll get some companies like Amazon that don't have a legacy business in this space and so they're willing to experiment. But the folks best positioned to experiment, the ones who actually know how to make and sell phones and tablets, aren't allowed to because they'd have to bet the company and it's just too big a bet."

Third allegation: Google provides financial incentives in the form of revenue-sharing agreements in exchange for Google Search pre-installation. Complainant reports indicate that Google participates in revenue sharing agreements with the largest smartphone and tablet manufacturers in exchange for promised exclusivity and preferential placement and pre-installation of Google Search as the default search service. This conduct resembles exclusivity rebates whereby manufacturers would receive discounted licensing fees; however, in this case, because manufacturers do not pay a fee to pre-install Google's Search app, Google rewards them with cash.

Antitrust experts argue that these revenue sharing agreements are tantamount to the creation of a cartel and a violation of Article 101 of the EU Treaty, which prohibits agreements involving market sharing or price fixing between two or more independent market operators that restrict competition. The Intel-AMD case where Intel was sued for offering financial incentives to coax computer makers away from using AMD's microprocessors is clear precedent. Nevertheless, it is early in the case, and the question of whether this is enough evidence to support an Article 101 violation is open.

Next Steps

In future reports, we will discuss:

1) The current competitive landscape for mobile advertising and the competitors that will have a better chance of seizing a larger slice of the pie in light of the EC likely voiding anticompetitive terms in the MADAs.
2) Google's incentive to settle or litigate the Android charges.
3) What an antitrust case in the US would look like for Google's Android conduct.
4) Google's lobbying in Europe related to its antitrust charges.