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REGULATORY AFFAIRS

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JULY 2022

# POWERING UP

## How will the Digital Markets Unit affect competition and innovation?

Who regulates the regulators? Paper 4

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# Summary

The government proposes to give a new Digital Markets Unit (DMU) powers to regulate firms in digital markets. This new *ex ante* regulatory approach is designed to overcome the claimed inadequacies of existing competition law to regulate the digital sector yet will be housed in the Competition and Markets Authority (CMA).

Digital firms will be regulated if they have Strategic Market Status (SMS). SMS 'will be applied to a small number of firms which have at their core substantial and entrenched market power in an activity, giving the firm a "strategic position"'.

We believe that the CMA already has the tools (which will be enhanced by concurrent reforms of the UK's competition laws) to adequately regulate competition in the digital sector.

Furthermore, we believe that the basis for a new regime is weak. The proposals view network effects and big data as inevitably entrenching the market power of large digital platforms which will under-invest and under-innovate unless the government acts. There is little empirical evidence to support these claims and the theoretical grounding is weak.

Given the central role played by SMS status, its vagueness reduces legal certainty and gives the DMU excessive discretion.

The proposed codes of conduct will allow the CMA to substitute its 'business models' for those of SMS firms, to a level of detail that includes their terms of business, and mandatory data sharing and interoperability. Firms will require approval for changes to their business models and technologies. This 'central planning', reminiscent of the regulation of old-style utility industries, is likely to reduce innovation, investment and

UK start-ups, create security risks and harm consumers, who will receive reduced services.

The DMU will instil a precautionary mentality to regulation that is at odds with the disruptive and innovative nature of digital platforms. The government should re-examine the evidence for, and possible unintended consequences of, the proposed regime before bringing forward legislation.

# Regulator profile

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| **Who** | The Digital Markets Unit (DMU) was established within the CMA on the recommendation of the CMA Digital Markets Taskforce and the Digital Competition Expert Panel ('the Furman Review'). |
| **Purpose/ establishing legislation** | It currently operates on a non-statutory basis within the CMA under Terms of Reference set by the Department for Business, Energy and Industrial Strategy (BEIS) and the Department of Culture, Media and Sport (DCMS). Its activities are:<br>• carrying out preparatory work to implement a proposed statutory regime for digital markets, and supporting and advising government on its establishment<br>• evidence-gathering on digital markets for the CMA's work under its existing powers in competition in digital markets, and<br>• engaging stakeholders across industry, academia, other regulators and government.<br>The proposed statutory objective of the DMU is 'to promote competition (which includes promoting competitive outcomes) in digital markets for the benefit of consumers'. |
| **Accountability** | At present the DMU is subject to the governance of the CMA more generally and the Terms of Reference described above.<br>Under the proposed regime, it will have a director and will be directly accountable to Parliament.<br>Those affected by the DMU's decisions would have recourse to appeal to the Competition Appeals Tribunal. |

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| **Rulemaking power** | None at present. Under the proposed new regime, the DMU would have power to designate firms to Strategic Market Status and set rules and guidance applicable to such firms in codes of conduct. |
| **Price-setting power** | Codes of conduct on matters such as terms of business, self-preferencing and bundling could heavily influence pricing.<br><br>Binding arbitration of pricing disputes between platforms and publishers could form part of the regime to ensure ‘fair compensation’. |
| **Enforcement powers** | The government proposes powers of investigation backed by fines and court orders for compliance. |
| **Funding** | At present the non-statutory DMU is funded through the CMA’s departmental budget. The impact assessment estimates running costs for the new unit at between £5 million and £25 million per annum. This will be partly funded by way of a levy on SMS firms. |
| **EU element** | The CMA has taken over competition law functions in respect of the UK market that would formerly have fallen to the European Commission. |

# Introduction

The UK government established the Digital Market Unit (DMU) in April 2021 on the advice of the Competition and Markets Authority (CMA). It is part of the CMA but does not yet have a statutory basis as the government has been consulting on a new 'pro-competitive' regime for digital markets and the DMU's remit. The UK government has published its response to the consultation. Unexpectedly, the government did not include draft legislation to establish the DMU's powers and its framework, and has stated it will do so when Parliamentary time allows (DCMS and BEIS 2022).

The government's proposals were originally set out in the consultation document *A new pro-competition regime for digital markets* (DCMS and BEIS 2021a) and were updated in 2022 following consultation responses (DCMS and BEIS 2022). In particular, the main merger control proposals from the original proposals have now been dropped. The amended proposals focus on the DMU's role as a conduct regulator.

The remaining proposals are based on some of the findings of the Furman Review (Furman et al. 2019), endorsed by the CMA, that the existing tools available to the CMA under competition law are inadequate to deal with the 'systemic harms associated with the substantial and entrenched market power held by a small number of digital firms'. The (then) chief executive of the CMA, Andrea Coscelli, considers that 'digital markets are not working as they should'. To this end the government proposes a new 'pro-competition regime' to 'proactively shape the behaviour of digital firms with significant and far-reaching market power, by making clear how they are expected to behave'. The regime is intended to boost competition and innovation by 'tackling the sources of existing and future strategic market power' (DCMS and BEIS 2021a).

The central question is whether the staff of the DMU can fully understand and anticipate the best way that these complex and dynamic markets should develop and guide them to better outcomes without impeding innovation and indeed competition.

This paper will examine the proposed objectives and powers for the DMU as they stand after consultation responses, and the surviving reforms proposed for merger control in digital markets. We will consider the evidence so far put forward by the government to support its policy, how the success of the new regime will be measured and evaluated, and some implications for regulatory accountability and the rule of law.

# Objectives of the DMU

According to the government the DMU's 'core objective will be to promote competition, including competitive outcomes, in digital markets for the benefit of consumers' (DCMS and BEIS 2022). It will do this by 'tackling the harmful effects and sources of substantial and entrenched market power' using new *ex ante* regulatory powers and tools to fill the alleged gaps in the existing competition law regime, which itself is undergoing reform (BEIS 2022).

The DMU's proposed objective contrasts with that of general competition law. The latter sets out a negative objective which outlaws anticompetitive practices. The inclusion of the objective 'to promote' competition is therefore more interventionist and prescriptive, inherent in the regulatory nature of the DMU's remit.

While it accepted that digital markets are dynamic and innovative, the government rejected the inclusion of a duty to promote innovation on the grounds that the general duty to promote competition was sufficiently elastic to include innovation.

The government also rejected the CMA's proposal that the DMU's objective should be 'to further the interests of consumers *and citizens* in digital markets, by promoting competition' (CMA 2020a; our emphasis). It concluded that to 'include citizens as well as consumers would reduce the clarity of the regime and the role of the DMU' (DCMS and BEIS 2022). The government favoured the more limited objective put forward for consultation as being 'as lean and as simple as possible'. From the perspective of the rule of law and free market values, this is welcome.

***What are the harms that the new powers are supposed to prevent or address?***

The government considers that the 'unprecedented concentration of power' of a small number of firms in digital markets is 'undermining effective competition, stifling growth and innovation and giving rise to consumer harms' (DCMS and BEIS 2022, DCMS and BEIS 2021a).

According to the proposals, the CMA's existing 'pro-competition tools' and other consumer protections are 'not well suited to address the unique and novel challenges posed by these complex and fast-moving digital markets': 'the concentration of market power and weak contestability in these markets is unlikely to be rebalanced through market forces or existing regulatory tools' (DCMS and BEIS 2021a).

The proposals include *ex ante* interventions to regulate the activities of firms. The underlying concern is the risk of 'winner takes all' outcomes, in which the market tips into unassailable dominance by a single operator who, because it faces no effective competitive threat, can raise prices, reduce quality and cease to innovate. As described by CMA Executive Director of Enforcement Michael Grenfell:

> many of the big online platforms already have a degree of market power where their commercial conduct is not sufficiently constrained by effective competition, allowing them more easily to exploit their customers. The temptation is then to use that market power to reinforce it still further, squeezing out current competitors and blocking the path for new entrants, the potential competitors offering new waves of innovation. If that happens, we as consumers, and we as a society, risk losing the benefits of market competition…: lower prices, better quality, more choice, greater innovation (Grenfell 2021).

The features of digital markets that drive these concerns are:

- network effects and economies of scale
- unequal access to user data
- consumer decision making and the power of defaults, where default settings can act as a barrier to entry by influencing a consumer's use of particular services, and the platform's ability to collect users' data

- lack of transparency around complex decision-making algorithms, and
- the importance of 'ecosystems' of integrated complementary products and services around a core service, designed to favour the firm's services over those of a competitor.

While these features can give rise to competition and consumer protection concerns, many are also consistent with enhanced consumer welfare (Veljanovski 2021a, 2022). By definition, a firm that benefits from network effects is providing a service that attracts and benefits consumers. But this does not mean that other firms that also require a network to be viable cannot coexist, as is clear from the success of multiple platforms and social media firms that compete with Facebook and YouTube for users' attention (and advertisers' expenditure): Twitter, TikTok, Discord, Snap and Twitch, to name a few, that have managed to enter the market and gain millions of users and billions of dollars in revenue, despite the claimed barriers to entry. This is in part due to a feature of digital markets that is usually disregarded by those who favour government intervention: it is very common for users to have multiple social media and messaging accounts and use them in different contexts (known as 'multihoming'). This is neglected in the government's account of 'unprecedented concentration' in this market.

Under most competition laws, including the UK and EU competition regimes, it is not monopoly or dominance that is illegal but its abuse. Those firms that have won their dominant position through competition in the market on their own merits should generally be allowed to enjoy the fruits of their superior performance where this is based on producing and selling their goods and services more cheaply than any alternative producer. The returns from a monopoly position incentivise others to enter the market, often by innovating, which in turn maintains pressure on the incumbent to innovate and improve to maintain its position. This increases consumer welfare and is not harmful unless the monopoly provider seeks to foreclose its actual and potential rivals from entering the market. This is not to belittle the possibility of abuses, only that such abuses are not proven simply by listing potential concerns, many of which lack empirical support and remain hypothetical.

In the case of digital platforms most likely to be subject to the new regime, it is their often overwhelming success in serving consumers better that is the source of much criticism and lobbying from their actual or potential rivals. Yet it must be stressed that even if rivals have been harmed, which is the essence of competition, this does not necessarily mean that the competitive process has been harmed in the sense that consumers would have been better off under some, realistic and feasible, more competitive market structure.

Neither the CMA nor the government have set out their vision of a well-functioning digital market that does not include these features. Nor have they identified one where the features have been optimally calibrated by the interventions of an expert regulator to deliver a different market structure and outcome. Consequently, the case for regulation lacks balance and a recognition that many of the sources of concern have countervailing beneficial aspects. Companies such as Google and Meta have generated massive benefits not just for their users but for their competitors and future competitors as they create new markets and generate positive externalities through investment in research and development. In addition, the advantages that they can accrue from network effects and the use of customer data can be easily overstated or confused with larger online platforms and apps simply having developed superior algorithms.

The issues surrounding so-called 'big data' are more nuanced than generally presented in the debate. Summarising the empirical findings on the effects of the use of customer data on competition, Professor Catherine Tucker (2019), Sloan Distinguished Professor of Management at MIT and an acknowledged expert on digital data issues, has concluded that 'empirically there is little evidence of economies of scale and scope in digital data in the instances where one would expect to find them'. User data is often not a barrier to entry as much of this data is not unique, essential, exclusive or rivalrous – user data can be created, obtained or synthesised; incumbents started life without it and accumulated it in the course of business. There is evidence that the benefits established players gain from the use of their accumulated data are short lived and spill over to benefit rivals, and often their success is due to other factors such as superior algorithms. Furthermore, data accumulation results from innovative, entrepreneurial efforts. Data accumulation therefore amounts to evidence of competitive innovation rather than evidence of anticompetitive conduct. At the same time, data sharing with rivals may not only violate data privacy rules but could also stifle innovation and undermine the competitive process, so mandatory data sharing (which is proposed to counter the claimed anticompetitive effects of unequal access to data) could conflict with the objectives of the proposals.

Nevertheless, the government proposes to establish and empower the DMU to address this perceived problem. In effect, the proposed framework seeks to diminish the features listed above, to reconstruct markets on the basis of a more traditional view of competition, with multiple operators competing to offer similar services, a vision of 'perfect competition' criticised by Hayek and Schumpeter for its static approach, and unattainability (Veljanovski 2021b).

### *What are the proposed new rules?*

*The creation and definition of 'Strategic Market Status'*

Under the (current) proposals, the DMU will have the power to regulate the conduct of the business of large, successful tech firms, and such firms will have additional reporting requirements on their proposed mergers.

The government wants the new regime to be 'proportionate and targeted towards the firms and activities where the risk of harm is the greatest'. It is proposed that the DMU will then have the power to designate firms with SMS after an 'evidence-based assessment' to 'identify those firms with substantial and entrenched market power, *in at least one digital activity*, providing them with a strategic position' (DCMS and BEIS 2021a; our emphasis).

The criteria for SMS designation have yet to be set out in legislation. However, it is currently proposed to apply them to firms whose products and services have digital technologies as a 'core component'. This is intended to exclude firms which have a digital aspect but are otherwise essentially non-digital, while also preserving the DMU's ability to 'respond to new digital business models where firms with SMS could emerge' (DCMS and BEIS 2021a). 'Core component' means more than just a material part, but is an open-ended definition, which will give the DMU very wide discretion to decide which businesses it wishes to regulate.

The government has conceded that more detail is needed, and it has committed to providing 'a definition of the activities in scope which is clear and easy to apply.' The list of criteria used to assess whether a firm has a strategic position will be exhaustive and set out in legislation and will include a revenue threshold, the level which remains to be set (DCMS and BEIS 2022).

Evidently, crafting the definition and the list of criteria will be challenging, but will be a useful exercise, and an opportunity to revisit the evidence base for the proposed regime. It may transpire that it is preferable to designate specific activities or lines of business, rather than firms. This was the approach adopted by the EU's New Regulatory Framework (NRF) for telecoms regulation developed initially in the 1990s (discussed further below). The DMU proposals appear to have been loosely based on similar concepts, so it may be beneficial to rethink the designation framework in light of the experience from the NRF. It designated a number of specified markets as potentially raising competition concerns and required the regulator to carry out a market study of each to determine whether a telecoms network operator had Significant Market Power (SMP) in it. SMP firms were regulated in the designated markets but free to compete elsewhere.

A number of those responding to the consultations raised concerns that designating an entire digital platform, rather than some of its activities, as having SMS will be over-inclusive. This over-inclusivity could reduce the potential for platforms in one 'market' to challenge those in other markets. The government agrees that this so-called 'leveraging' by digital platforms – that is, the use of advantages from their market position in one 'market' to enter another – is 'not inherently problematic or anticompetitive, and that firms with a strong position in one market may present a healthy disruptive force to an adjacent market in which a different incumbent has market power'. It therefore proposes to exempt such conduct by SMS firms 'to ensure that conduct which brings about net consumer benefits will not breach conduct requirements' (DCMS and BEIS 2022). However, to gain such an exemption, an SMS firm will be required to demonstrate to the DMU that the proposed conduct is 'indispensable to achieving the benefits and that the benefits outweigh the potential harm'. This is not only a heavy evidential burden on the firm but raises questions that are inherently speculative (will the firm's entry into adjacent markets be successful, will it generate effective competition, will it generate significant consumer benefits, and so on). The danger is that this requirement creates a barrier to entry, stultifying competition and distorting competitive pressures, given the burden of proof on the firm and the limited understanding and forecasting ability of the DMU. The proposal, while well intentioned, underestimates the uncertainty that innovative firms (even extremely large ones) operate under when developing products or entering new markets.

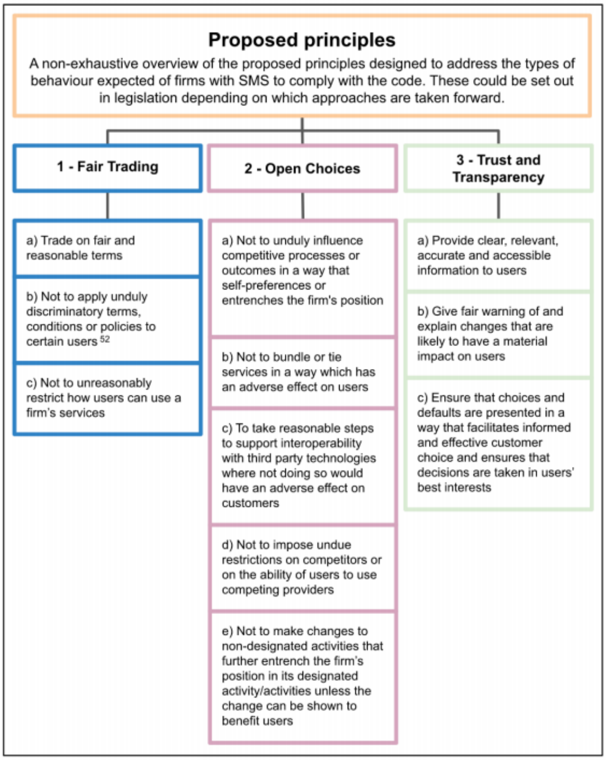
### *Codes of conduct*

SMS firms will be subject to legally binding codes of conduct in respect of those of its activities which the DMU have designated as strategically important. The codes will set out rules for the conduct of business by platforms based on a set of principles (see Figure 1).

The government decided after consultation that the core obligations should be set out in legislation, with the DMU expanding on them with legally binding requirements and guidance. This will lead to a high level of intervention in the business decisions and strategies of private firms. The government also decided that codes of conduct should be specific to and designed in cooperation with the SMS firms. Having a specific set of legally binding rules setting out business practices at individual firm level is extreme, even for an *ex ante* regime and challenges aspects of the rule of law such as generality and non-discrimination. It risks the DMU being captured by those it regulates and leaves it susceptible to lobbying from interest groups across the digital sector, as evidenced already by the heavy influence of press and media interests in the response to the consultation on the proposals.

This is highlighted by the proposal to include mandatory arbitration of pricing complaints by publishers against platforms under the heading of 'fair trading' (DCMS and BEIS 2022). An analysis of the final offer arbitration model that is proposed is beyond the scope of this paper but, on the face of it, this will undermine freedom of contract; the assumption that there is an objectively determinable fair price for services that are acknowledged to be complex and dynamic is concerning. Implementing this could be counterproductive, and further entrench the dominance of large firms by formalising their positions as unavoidable trading partners at fair prices. This approach is again reminiscent of public utilities regulation where prices and investment were regulated to reduce market power, often at the expense of encouraging competitive entry and disruptive innovation.

**Figure 1: Proposed principles for the conduct of business of SMS firms**




Source: DCMS and BEIS (2021a).

### *Pro-competitive interventions*

The DMU is to have additional powers to pursue so-called 'pro-competitive interventions' (PCIs). These PCIs will be applied to specific SMS firms with the aim of opening markets to greater competition by overcoming network effects and barriers to entry/expansion. It is intended that they do this by mandating interoperability, third-party access to data, increased consumer control over data and 'ownership separation', the latter being the draconian step of breaking up large firms. The PCIs are expected to have the potential 'to fundamentally shift the structure of digital markets', and the government intends that they should be available to the DMU where it can prove 'an adverse effect on competition' (DCMS and BEIS 2021a). Such measures go further than the CMA's established activities in consumer protection and represent, in effect, a planning model for the digital economy.

# Ex ante regulation

The proposed framework credits the DMU with an implausible level of expertise and foresight in how digital markets and large digital firms can and should be operated in the best interests of consumers. Competition authorities have been criticised for relying on static analyses in their enforcement activities, but the DMU will be expected to make, and act on, ambitious forecasts and predictions on the potential different futures of fast-moving and dynamic markets with and without regulatory intervention. If the DMU is based on a correct premise that the development of digital markets is largely irreversible; then this entrenchment is likely to apply to decisions made by the DMU that alter the business plans of an SMS firm. While the CMA now pays greater attention to dynamic competition issues (CMA 2021a) its framework is general and, given the CMA's recent pessimistic view of the digital sector, has been described as the codification of its more interventionist approach (Batchelor et al. 2021). This has been confirmed by its recent blocking of Meta's acquisition of Giphy where the CMA (2021b) adopted a very pessimistic narrow view of dynamic competition and which, as the Competition Appeal Tribunal noted,[1] failed to consider the adverse effects of its intervention. The approach is likely to remain largely static focusing on past and short-term (about three years) future potential competitive pressures.

The DMU's proposed new objectives and powers will increase the budget, power and profile of the CMA. The CMA's strong support for the proposals is therefore unsurprising. However, there is little evidence that the government has fully accounted for the institutional risks of its proposed approach, which includes giving the CMA *ex ante* regulatory powers

1 Meta Platforms Inc v competition and Markets Authority [2022] CAT 26 (https://www.catribunal.org.uk/sites/default/files/2022-06/20220614_1429_Judgment_FINAL%20%5B2022%5D%20CAT%2026.pdf).

coupled with weak judicial oversight and no provision for dedicated Parliamentary scrutiny (discussed further below).

A major concern is that the proposals fundamentally alter the nature and modus operandi of the CMA. Competition law is an *ex post* system of industry control. Firms are allowed to freely compete provided they do not engage in exclusionary and anticompetitive behaviour. Where they do, the CMA has powers to investigate and sanction those that have been found to have breached the law. It is a fairly non-prescriptive system. Further, the same competition law applies to all firms and industries and does not single out a specific type of firm. The proposals for the DMU, however, embed within the CMA a regulatory function which is largely alien to the way competition law operates. In the past, the model for specific, prescriptive and *ex ante* regulation has been to ring-fence it within a specialist regulatory body. In this case, the closest regulatory body is the Office of Communications (Ofcom). While it is desirable that industry regulation be governed by competition principles, requiring a unit within the CMA to adopt a different method of intervention can be questioned, especially since there is a dedicated industry regulator, and the CMA will in any case have to coordinate with Ofcom, the Information Commissioner's Office (ICO) and other regulators and bodies where their fields overlap. Such overlaps are likely to arise where, for example, content regulation or privacy law matters are affected by questions of fairness in terms of business, or interoperability mandates.

A related concern is that the CMA has not put forward a well-grounded, coherent theory of dynamic competition and innovation. Nor has it substantiated that the digital sector is rife with anticompetitive practices that can only be remedied by the DMU. There are constant references in the government's proposals to the theories of network effects and two-sided markets but they remain just that: tentative theories that struggle to reconcile pro-consumer and efficiency benefits with the prospect of monopoly abuses.

The approach is also presented as a direct attack on the business models of online digital platforms. Some online platforms such as Google and Facebook are data-driven, advertiser-supported businesses. This model was chosen as the best, and perhaps only, way of getting these online services up and running, and delivering massive benefits to consumers. While the take-up issues plaguing online platforms may have been resolved for some of the large digital platforms, it is not apparent that they and competitors would flourish if forced to share data, move to paywalls and/or pay users for their data. Enforced changes to the underlying business model may ultimately backfire against end-users.

Where they require prior approval from the DMU for changes to their business models and technology (a rather extreme form of what Adam Thierer (2014) described as 'permissioned' innovation), the proposed codes of conduct could stifle innovation. The codes of conduct risk second-guessing and replacing business decisions with those of the DMU (such as to prioritise preservation of legacy media outlets and privacy over convenience[2]). The proposals underestimate the intensity of work that goes into developing digital products and services, and the amount of trial and error involved. Successful innovations are unpredictable, and success often only determined by live testing in the market.

The DMU will no doubt attract qualified specialists, but it is hard to see how they could have the knowledge and foresight to determine the conditions for successful innovation and how dynamic and fast-moving markets should be steered. Since the DMU is premised on the proposition that large digital platforms pose a competitive threat, it will naturally focus on the downside risks and take a precautionary approach.

The proposed principles for the codes of conduct are also duplicative as they include areas already subject to regulation, as noted above. Although the CMA intends to cooperate with the ICO, the Financial Conduct Authority (FCA) and Ofcom, there is a clear risk of legal uncertainty from inconsistent regimes, an issue raised by respondents to the government's consultation. In response, the government has indicated that it will establish operating arrangements to prevent this (DCMS and BEIS 2022).

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2 As argued by then CMA Chief Executive Alex Chisholm in a 2015 speech (https://www.gov.uk/government/speeches/alex-chisholm-speaks-about-online-platform-regulation).

# Effects on innovation and security

The envisaged codes of conduct and PCIs will seek to control practices that do not harm competition, but are essential to providing secure, efficient digital services that are valued by consumers. For example, imposing a legal duty on SMS firms to make their core services interoperable with third parties could introduce security risks, such as increased opportunities for ‘phishing’ and ‘sock puppetry’, and friction in updating security measures (which would have to be standardised across all actors with access). Mandatory, non-discriminatory use of APIs with third parties may lead to users inadvertently sharing data in ways they do not expect. Privacy laws that mandate safeguards against such risks are not enough:

> If the service providers are placed under a broad interoperability mandate with nondiscrimination provisions (preventing effective vetting of third parties, unilateral denials of access and so on), then the burden placed on law enforcement will be mammoth. It could take just one bad actor, perhaps working from Russia or North Korea, taking advantage of interoperability mandates to exfiltrate user data or to execute a hacking (e.g., phishing) campaign, to cause immense damage. (Barczentewicz 2022)

In its response to the consultation, the government emphasised the importance it attaches to the DMU mandating interoperability, for example in online advertising intermediation (another claimed benefit to press publishers) or between competing platforms and services. While it is far from clear that there is meaningful consumer demand for such interoperability, consumers would certainly notice if such product designs mandated by the regulator compromised the security of messaging services. The departmental impact assessment (IA) accompanying the DMU proposals does not consider these practical risks. These interventions could conceivably lead to not only security breaches but an ever expanding legal and regulatory regime to try to legislate and enforce the new risks away.[3]

The government has confirmed its intention to empower the DMU to monitor, review and update its codes and the PCIs it imposes over time to ensure that the regime remains proportionate and responsive to rapidly evolving digital markets. Although the government claims support for this from consultation respondents, such an arrangement seems more likely to make the regime uncertain and unpredictable, features which are very damaging to investment and innovation.

It is proposed that the DMU will have the power to impose ‘code orders’ to specify behavioural changes required of SMS firms where a breach of the relevant code has been found. Such orders could include ‘requiring suspension, total cessation or reversing of harmful behaviour’. The government also proposes that code orders could be imposed on an interim basis without any harm being proven, to address ‘potential code breaches that may cause immediate harm’ (DCMS and BEIS 2021a). Interim measures are generally available in competition law to address the risk that a dominant firm could cause considerable harm before the regulator has had time to act, following a full process. Although such orders at the disposal of the DMU would be restricted to ‘pausing or reversing behaviour only’, this could still have a serious chilling effect, out of proportion to any risk of irreversible damage. Platforms and developers will not wish to risk the legal and operational costs of having to pause or reverse a project if the DMU considers, possibly without due process, that a development or activity potentially violates a code of conduct. The government has acknowledged that safeguards will be required in respect of interim measures, but these are likely to fall well short of what would be required to address the risk to investment and innovation from the threat of an order to pause or reverse work before due process has been completed.

3 Barczentewicz suggests that the only way for interoperability mandates to work securely would be through a heavily regulated, centralised framework like the Open Banking system in the UK, which would defeat the government’s pro-competitive objectives as by definition only a limited number of authorized operators could participate.

# Organisational design

The institutional architecture set out in the proposals seems to echo the European Commission's NRF for telecommunications of 2002[4] and its successive reforms, which created an *ex ante* regulatory system based on competition law principles. The NRF regulations were administered not by competition authorities but national regulatory authorities, such as Ofcom in the UK. Under the NRF, Ofcom had the power to designate telecom operators with SMP, which imposed obligations regarding access and price regulation in designated markets from a list of potential markets, which was periodically reviewed (EU 2002, Oftel 2002). It was for each national regulatory authority to determine which operators in which market had SMP. It is not clear whether the government considered giving Ofcom the task of enforcing the proposed digital regulation alongside its existing powers. Ofcom has historically had the concurrent power to enforce UK competition law in the communications sector and the new role in content regulation under the Online Safety Bill, which will apply to at least some firms likely to be designated with SMS. It is possible that many firms in the wider economy, such as estate agents and food delivery businesses, could be in scope of the proposed DMU regime, a concerning matter in itself, which could explain why Ofcom was not considered the appropriate regulator.

Moreover, the CMA already has significant powers to act before a specific violation has been identified, including one of the powers that the European Commission is seeking – the ability to undertake a market study. The EU Commission calls this the New Competition Tool. In a market study, the CMA can undertake a sector review without the need to identify, in advance,

4 Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive).

specific competition abuses. It has already used this power to examine the digital advertising sector (CMA 2020b). It has advanced tools for proactive investigations, which can lead to remedies being applied if abuses are found. Rather than being given greater *ex ante* powers, the DMU could make better use of this competition tool, which is being 'exported' to Europe as a key regulatory innovation.

# Merger control

SMS firms will not, as originally proposed, be subject to a tougher regime on merger control (DCMS and BEIS 2022). A ‘bespoke’ merger regime for SMS firms which included mandatory ‘phase 1 reviews’ and a lower standard of proof for a transaction to be blocked (a ‘realistic prospect’ rather than ‘more likely than not’) had been put forward (DCMS and BEIS 2021a). Following consultation, the government decided not to pursue this. The SMS merger requirements will now be limited to mandatory reporting of ‘their most significant transactions’ prior to completion, so that the CMA can undertake an initial investigation of the merger and decide whether it should take action under its general powers (DCMS and BEIS 2022). The government intends to bring in changes to the CMA’s powers to review mergers as part of its broader reforms to competition law. These include a new, acquirer-focused threshold that aims to provide ‘a more comprehensive and effective jurisdictional basis for certain vertical and conglomerate mergers, in particular so-called “killer acquisitions” that risk the development of new products or services’ (BEIS 2022). Merger reviews will be triggered when the acquirer has both an existing share of supply of goods or services of 33 per cent in the UK or a substantial part of the UK; and a UK turnover of £350 million.

While the change in course on a specific regime on SMS mergers is welcome, there are still concerns about the proposed use of the CMA’s general merger control jurisdiction, enhanced by mandatory reporting requirements for SMS firms, to target mergers involving SMS firms.

### *Basis for change*

The main basis for reforms proposed for digital markets, now to be partially addressed with the new reporting requirements and review threshold, arises mainly from the claim that the large online platforms have in the past made ‘killer acquisitions’. This has been defined by the OECD (2020) ‘as the acquisition of an innovative firm to preempt future competition’. The chief executive of the CMA (Coscelli, 2019) expressed concern about such killer acquisitions:

> Over the last decade, Amazon, Apple, Facebook, Google, and Microsoft combined – the so-called GAFAM quintet – have made over 400 acquisitions globally, with more than half of these – close to 250 – just in the most recent 5 years. Some of these acquisitions have had exceptionally high valuations. However only a handful of these mergers have been scrutinized by competition authorities, and none have been blocked. As an economist, these statistics naturally lead me to question whether we as competition authorities have got the balance right. Is it right that across all 400 of these acquisitions, there has not been a single prohibition? On this basis, is it possible to argue that we’ve correctly balanced the risks of under- and over-enforcement?

This observation has morphed into a pseudo-empirical claim that large online platforms have systematically gobbled-up small innovative firms which would have grown to become future effective competitors. These acquisitions are said to have avoided being blocked under the existing merger laws because they fall below the thresholds for investigation and/or were not considered under the then prevailing approach to constitute a competition concern.

### *Killer acquisitions*

The empirical evidence on killer acquisitions is weak. The Furman Review (2019) endorsed the concept while acknowledging that there was little evidence. It extrapolated from one academic study of acquisitions by large pharmaceutical companies where the authors found that 6 per cent of acquisitions were of firms that posed a competitive threat to the acquirer (Cunningham et al. 2021). The Furman Review acknowledged that the study has little direct relevance to the digital sector. But the study’s limited relevance runs deeper for two straightforward reasons. The first is that Big Pharma can tell from the publicly available drug trials of smaller firms which drugs are likely to compete with their proprietary drugs. Secondly, drugs have legally protected patents that give them monopoly rights. Neither of these factors are present in the digital sector.

Nor is there any evidence that the CMA has been systematically waving through otherwise anticompetitive digital acquisitions. While there have been criticisms of the clearance of the Facebook/WhatsApp, Facebook/Instagram, and Google/DoubleClick mergers, these do not amount to the general ‘failure’ of merger regulation. Indeed, several studies of the M&A activity of large online platforms struggle to find an example of a ‘killer acquisition’. The Lear Report (2019), commissioned by the CMA to undertake an *ex post* assessment of the CMA’s clearance of digital mergers, found that most large online platform acquisition targets supplied complementary products (which has an efficiency justification), and most were young firms with a median age of four years. For example, when Instagram was purchased by Facebook it was two years old, had no revenues and had 12 employees. Other studies have found that there is limited evidence supporting the killer acquisition claim (Gautier and Lamesch 2020, Latham et al. 2020).

There is also the difficulty of determining whether a nascent firm will be effective competitor in the future. This requires an impossible degree of foresight especially if framed into a general condition for merger clearance. There are numerous examples where large communications conglomerates made what were regarded at the time as commercially important acquisitions that subsequently failed, such as the AOL/TimeWarner and MySpace/News Corp mergers, and Yahoo’s acquisitions. While they would not fall into the category of killer acquisitions by any definition, these examples show how difficult it is to predict success or failure; here the companies involved misjudged their chances of success badly. It is not clear how the CMA can be expected to do better.

Without necessarily accepting that the bespoke regime would have amounted to ‘a de facto ban on acquisitions by Big Tech firms in the UK’ (as argued by Bowman and Dumitriu 2021), it would have had a chilling effect on investment and innovation in the UK, both for the firms directly affected and for the broader financial and professional services ecosystem. This could come about by closing off one of the main exit paths for investment in innovation and digital technologies. The potential to be bought out by a larger player is an important incentive for entrepreneurs to create and develop new products and services, and for venture capital to invest in them. On the other hand, if the regime is too permissive then entrepreneurial activities will be skewed to developing products that cater to the large online platforms as this represents the main exit for investors. If it is less permissive then it will direct investment into types of innovations that compete with and challenge existing digital platforms. The issue is the incentives that any new merger laws give to entrepreneurial innovation. The risk of overenforcement, and the anticompetitive effects that flow from it, seems to have been seriously underestimated in the original 2021 proposals and it is to the government's credit that it has acted in response to consultation responses to that effect.

The risk to UK competitiveness, if investors and entrepreneurs are attracted to friendlier jurisdictions, and tech giants cut the UK out of expansion plans, must not be neglected as the wider reforms to the CMA's merger powers progress. Even without the bespoke merger regime for SMS firms originally put forward, the CMA has several margins at which it can base a decision by evolving novel theories of harm, different counterfactuals, and varying speculation about future outcomes. It has in recent years adopted a more interventionist approach, evidenced by its increased tendency to block mergers. It was, for example, the first competition regulator to require Meta to divest itself of the completed acquisition of Giphy (CMA 2021b).

The CMA may yet be able to pursue its objective of being more interventionist in tech mergers under its general merger powers, in particular in light of proposals to allow greater use of interim remedies and lower the standard of review in appeals against such interim measures set out in in BEIS's *Reforming Competition and Consumer Policy* (BEIS 2022). Minsters and parliamentarians should pay particular attention that the use of these powers does not bring about the potential adverse effects that caused the abandonment of the proposed bespoke regime for digital mergers.

# How will success be measured?

DCMS and BEIS claim that the proposed

> pro-competition regime will drive competition between digital firms and open opportunities for innovative start-ups to compete with incumbents. This will result in better quality services, greater choice, and lower prices. Its design and implementation will minimise burdens on business, spurring investment and economic growth (DCMS and BEIS 2021a).

These are ambitious claims – how will they be tested and when should we expect to know if the regime has indeed delivered these benefits?

***Cost benefit analysis***

The IA (DCMS and BEIS 2021b) accompanying the original proposals is not a serious effort to quantify the costs and benefits of the proposed regime. It estimates the costs of running the DMU at between £5 million and £25 million per annum, and £1.25 million per SMS firm per year. It expects SMS firms to have reduced profits (due to 'transfer to consumers') but does not quantify wider impacts on innovation or other dynamic effects (DCMS and BEIS 2021b). This is disappointing and leaves us with little to go on in the coming years to objectively measure whether the DMU meets its objectives.

The IA does not look at any of the real costs of intervention and lack of intervention. It is based on the assumption that DMU intervention will be proportionate and generate net benefits. The chilling effect on innovation, possible DMU errors and disproportionate interventions are ignored.

The ‘costings’ put forward are neither adequate nor realistic when compared to the government’s own figures for the costs of merger reviews. According to BEIS in an impact assessment for its separate review of merger control in general, the estimated average cost to a firm of a Phase 2 merger review is £2.3 million in legal fees alone. The average cost to the CMA is £400,000 (BEIS 2021). In both cases, the costs associated with larger, more complex interventions and appeals envisaged under the proposals for digital markets would be far greater than these average costings.

One can see the inadequacy from the statistics used to support the need for a new merger regime. As noted in the Coscelli quote earlier there were over 400 acquisitions by big tech platforms, but just a few were required to undergo formal clearance by the CMA (or European Commission). Had the proposed regime been in operation during this period the DMU would have had to review all 400, under its premise that its prior assessments had been too lax. The costs to the CMA of this greater level of enforcement together with the legal costs of the merging parties and third parties making representation to the CMA (and lobbying) would have been significant. The full merger regime envisaged in the proposals will not now proceed, but there may be an increase in digital merger activity under the CMA’s general merger jurisdiction. A new cost estimate should be produced before legislation proceeds.

The IA should have also examined the strategic use of regulation by competitors and the high likelihood that the new regime would be used to protect competitors rather than competition and consumers. Competition agencies are driven by complaints of rival firms, which for all their genuine concerns are, at the bottom, self-serving. Often these complaints seek to achieve in the ‘regulatory marketplace’ what could not be achieved by direct competition.

### *Evaluation metrics*

Figure 2 sets out a summary of the desired outcomes or impacts of the new framework and associated ‘indicators of success’ from the IA.

### Figure 2: Desired outcomes and indicators of success

| Outcome / Impact | Indicators of success |
|---|---|
| Greater understanding of competition and consumer issues in digital markets; and of activities by firms with SMS | Regime is able to perform expert monitoring, and deliver up-to-date trend reporting and market intelligence on digital markets. |
| More timely identification of competition issues and harmful behaviour | Competition issues and harmful behaviours are identified prior to consumers experiencing significant prolonged harms. |
| More timely interventions in digital markets where competition issues exist | Interventions in digital markets occur swiftly after harms are identified, and before negative market outcomes are irreversible. |
| Implement effective remedies to improve market outcomes | Specific and targeted interventions lead to marked and measurable improvements in market outcomes without unintended consequences. |
| Greater agility to react to evolving markets, including changes in market dynamics, business model innovation and technological advances | The effectiveness of interventions is reviewed and interventions are subject to revision in light of changes to market conditions. |
| An effective organisation that provides good value for money | The DMU's activities have a greater positive impact on businesses and end consumers than the cost associated with operation (net positive welfare impact). |
| An organisation that is coherent with the wider regulatory landscape both domestically and internationally | The regime minimises regulatory burden on businesses in the long term, where possible. |
| Increased growth in digital and adjacent markets | Increased number of users, providers and overall GVA growth in digital markets and markets reliant on digital platforms. |
| Greater dynamic competition in digital markets, including increased entry | Increased number of new entrants in digital markets, and greater rivalry for market share (e.g. higher 'churn' in market positions). |
| Increased innovation in digital markets | For example: Increases in R&D expenditure by incumbent firms, increased rate of change in product offerings in digital markets, greater number of successful and disruptive new entrants. |
| Lower prices for end and business users of digital markets, and for consumers in the economy more widely via 'pass through'. | Decreases in price and non-price costs for digital market users, which are also passed through as lower consumer prices in industries reliant on digital markets. |
| Greater choice of digital products and services | Increase in number and variety of product offerings available to consumers. |
| Improved quality of digital products and services | Improved quality of services/features in digital markets leading to increases in consumer satisfaction. |

Source: DCMS and BEIS (2021b).

Many of the indicators are bureaucratic (delivery of reporting is the top indicator), which jars with the large claims made for the transformational impact of the DMU. Others are platitudinous, without quantification and unmeasurable (how will the number of new entrants in digital markets be measured when there is no definition of a digital market?), or susceptible to credit being claimed for developments that would have happened anyway (increases in R&D expenditure, increase in number of users and available products).

The government's new regulatory principle 'recognising what works' undertakes to 'thoroughly analyse our interventions based on the outcomes they produce in the real world and where regulation does not achieve its objectives or does so at unacceptable cost, we will ensure it is revised or removed' (HM Government 2022). Adherence to this principle would surely require more rigorously defined metrics for success of the proposed regime. The section of the IA that described the 'evidence of harm' is one sided and cites, for example, complaints of app developers (not consumers) concerning app store terms. The IA asserts that '*It is likely* that increased advertising costs are passed through to households in the form of higher prices in sectors that make heavy use of digital advertising' (our emphasis), citing a report on pass through of advertising costs prepared for the now defunct Office of Fair Trading (OFT) in 2014. This is weak evidence, especially given the positive effects that online advertising is likely to have in reducing search costs, expanding sales and reducing price dispersion. The IA simply accepts qualitative statements that advertising increases prices when there are myriad reasons why it may not.

The original proposals acknowledged that there will be trade-offs between various principles but assured us that ‘the government will ensure effective action that minimises and removes unnecessary burden on businesses’. Notable tensions are the desire for proposed digital regulation to be agile and equipped to act swiftly, but also to be evidence based and accountable; and the need for coherence between regulatory regimes designed to ensure that digital technologies are ‘safe’ while promoting innovation. There is also an inconsistency between the desire to protect ‘press sustainability’ for legacy media, while creating a level playing field for competitive markets. The IA cites ‘increased advertising revenue to the press sector’ as a ‘positive externality’, which is based on the questionable assumption that the advertising-supported print media is beneficial, while that of the digital platforms is harmful to consumers. However, responses from the legacy media and press featured strongly in the responses to the government’s consultation and specific offers to publishers, such as incorporating binding arbitration in pricing related disputes were included in the government’s response (DCMS and BEIS 2022). This shows that special pleading by interest groups, highlighted above as a risk, is already in play and may be overriding consumer welfare considerations.

The IA asserts that ‘It is the CMA’s expectation that increased innovation would be the greatest benefit of a new regulatory regime for these markets.’ But it admits that this is not based on any evidence, noting that the relationship between competition and innovation in digital markets is not always straightforward: ‘Empirical evidence is relatively limited, and the impacts of pro-competitive regulation on innovation may depend on complex, market-specific factors.’ As a result,

> the multiple complex incentives at play, and limited evidence of the impacts these – mostly novel – pro-competition remedies would have on innovation in digital markets, mean unintended or unforeseen consequences are a potential risk. (DCMS and BEIS 2021b).

Unfortunately, there has been little consideration of the acknowledged ‘countervailing risks’ in the design of the proposals. The government’s response to its consultation did not address these and it is recommended that further work be carried out on this before legislation proceeds.

# Private action and enforcement

The government has decided, for now, not to provide for private redress by empowering the DMU to require compensation for the ‘harm resulting from breaches of obligations imposed through the SMS regime’ (DCMS and BEIS 2021a). This was broadly supported in the responses to the consultation, although consumer groups supported the inclusion of statutory redress. Experience from consumer financial services shows that statutory redress mechanisms can become extremely costly and result in a shadow rulebook and a secondary industry in claims management. It has had anticompetitive effects in a number of fields where providers were forced to exit the market or cease service provision to less affluent consumers in response to unpredictable and unlimited liabilities in redress (Hewson 2021). Such additional risk is unlikely to encourage growth by new entrants into digital markets and would be contrary to stated pro-competitive aims. Even without a new statutory regime, a breach of competition law already gives rise to a potential claim in damages from those who have been harmed. If they result in more enforcement actions, the activities of the DMU will increase the likelihood of private damages actions. This should have been addressed in the proposals, with respect to both the parties claiming compensation and the SMS defendants.

The emerging concern about the actions of online platforms has already led to unusual claims. A case in point is the Collective Proceeding Order (CPO) application to bring a class action against Meta before the Competition Appeal Tribunal (CAT, which is a specialist court dealing with competition litigation).[5] If granted it would allow a claim on behalf of all users of Meta services for damages for the monetising of their data based on the proposition that they were undercompensated. The ‘novel’ theory of harm

5 Dr Liza Lovdahl Gormsen v Meta Platforms, Meta Platforms Ireland, Facebook UK.

being advanced by the class representative's lawyers is that while users received free social networking services, they should have received a share of the proceeds from the monetisation of data by Facebook by way of advertising revenue.

This turns on its head the theory of two-sided markets. Taking a step back, it is as if daily newspapers were being sued not for charging their readers but for failing to give them a share of the classified and display advertising revenues which enabled the readers to receive a lower-priced newspaper. This is putting it graphically but indicates the potential explosion in claims that will arise from the shift in the regulatory presumptions underlying competition law contained in the DMU regime.

More fundamentally, this shows that the theories which form basis for the government's proposals are still in their formative stages and provide weak guidance as to the nature of digital markets. At a conceptual (and practical) level the basis for the Facebook business model is a two-sided market. This inherently results in a situation where one side is paying over the odds (advertisers and merchants) while the other is paying nothing or in kind (social media users). This model was seen as beneficial to consumers, efficient and the basis for tremendous innovation. But applying standard one-sided analysis portrays it as engaging in a perverse mixture of predation and competition on the money side of the market.

# Rule of law and accountability

### *Judicial oversight and appeals*

The proposals include significant powers of investigation and enforcement for the DMU, such as to search premises, interview individuals, and to impose court orders, fines and senior management liability. This could leave the DMU in the position of setting the rules, deciding to whom they apply and then investigating and enforcing them.

The proposals envisage that the DMU will combine 'a participative approach with the use of formal powers… resolving issues through advice and informal engagement' (DCMS and BEIS 2021a). This is held out as reducing the burden on businesses, but similar selective approaches by other regulators have led to a lack of transparency and consistency, as compliance with and enforcement of the law become matters for negotiation (see, for example, Hewson and Tumbridge 2020).

According to the original proposals, 'procedural fairness will be embedded within the regime, with clear processes for holding the Digital Markets Unit to account for its decisions'. The transparency requirements outlined for decision making, such as publication of reasoned final decisions (which are standard in regulatory and CMA proceedings in any case) are welcome but still fall short of rigorous rules of evidence and procedure that should underpin such weighty decisions with legal effects.

Fines in line with those currently available for antitrust violations are proposed, up to a limit of 10 per cent of an organisation's global turnover for serious breaches. Fines of up to 5 per cent of turnover are proposed just for failure to provide information. These are potentially extremely large amounts and experience with other *ex ante* regimes such as the General Data Protection Regulation suggests that fines can be imposed that are out of proportion to any harm caused. This is both unjust and incentivises undesirable outcomes such as overcompliance.

The government has confirmed that it will not allow ‘on the merits’ appeals against key findings by the DMU. A firm that disputes its proposed SMS status, or that it had violated a requirement of a code of conduct, would not be able to appeal on the basis that the DMU had misapplied the law or made an incorrect finding of fact. Only judicial review grounds, which are broadly limited to procedural propriety and irrationality will be available as the basis for challenge to a decision by the DMU.[6] This makes appeals much less likely to succeed, and therefore less likely to be pursued at all. The government justifies this on the basis that, in line with the CMA Task Force’s recommendation, ‘the DMU will need discretion to exercise its expertise and judgement to shape the new digital markets regime’ (DCMS and BEIS 2021). While no doubt convenient for the DMU, and certainly conducive to its exercise of discretion, this is not aligned with the interests of accountability and the rule of law, which economic freedoms depend on. It also differs from the rights of firms prosecuted by the CMA for infringing competition law, which have the right to challenge the CMA’s decisions.

The CMA and other sectoral regulators do not like merits reviews for obvious reasons – they question and frequently overturn their decisions. However, denying the right to appeal is also unattractive as it denies those affected by a DMU decision the right to challenge a decision. This not only affects the SMS platforms, but also rivals who may be unhappy with the DMU’s decision. It reduces the pressures on the DMU to do its job properly. Regulators argue that appeals on the merits draw out investigations and stall decision making, not to mention the costs involved. Such appeals can take years.

That the CAT could not efficiently oversee the DMU’s actions is not credible though. It would ensure that the principles are adhered to and offer a more detached and objective review that balances the interests of the parties. As an illustration, in the 2016 case of Streetmap v Google,[7] the court considered innovation well before the current debate on digital markets had begun, showing a high quality of review that led to useful precedent being developed.

6 Meaning the appeal body would only consider whether the Unit had acted within its powers, applied proper reasoning, and followed due process in coming to its decision, rather than re-hearing the case afresh to ensure that the DMU had made the right decision on facts and law.

7 Streetmap.EU v Google Inc., Google Ireland Limited and Google UK Limited [2016] EWHC 253 (Ch).

The exercise of the extraordinary powers proposed for the DMU should be fully testable in court or before the CAT to establish reliable precedent and encourage high quality decision making. Judicial review does not facilitate this and involves excessive deference to the regulator.

In our opinion the government has not drawn the right balance here and instead of simply blocking merit appeals there is a case for streamlining, which should have been considered. Appeals on the merits should be available for SMS designation, all findings of code violations and all impositions of PCIs – and in particular those that involve ‘ownership separation’ or are imposed on an interim basis before any violation has been proven.

Unfortunately, the government is going in the opposite direction and, in its consultation response on the CMA’s general competition powers, proposes rolling back the availability of on the merits reviews (BEIS 2022).

### *Democratic accountability*

Under the proposals, the DMU would have certain transparency obligations but there are only vague references to Parliamentary accountability and scrutiny.

In tacit acknowledgement of the vague and unmeasurable ‘outcomes’ and ‘indicators of success’ described above, the IA promises more detailed proposals for monitoring and evaluating the DMU in the final stage impact assessment before legislation is passed. The proposals are to include ‘appropriate thresholds/metrics’ for the indicators of success and ‘additional proposals for monitoring and evaluation than is typical in a post-implementation review’ [sic]. Such a technical and powerful regulator will need well-resourced scrutiny by relevant Parliamentary committees. MPs will need to be prepared to put aside intuitions about big tech and seek objective, empirical evidence of success by the DMU against its objectives and responsibilities as eventually legislated.

# Conclusion

The proposals for the DMU are ambitious and wide ranging and significantly expand the rulemaking powers of the CMA. They are also built on weak factual, theoretical and organisational assumptions. There is no coherent theory of harm to explain why the identified market features and practices lead to consumer harm, and significant costs and risks of the proposals have been disregarded or underestimated.

It is paradoxical that the underlying reason that the DMU is considered necessary is that the CMA's existing powers cannot deal with this dynamic and fast-evolving market, and yet the same markets are believed to be dominated by firms with unassailable incumbency that is reducing dynamism. Further, despite this complexity and dynamism, officials in the DMU are expected to be able to identify who these firms are and how to manage their strategically risky activities.

The new regime would be a marked shift from the CMA's current role as an *ex post* investigator and enforcer of competition laws. It would become a regulator imposing intrusive controls which will need constant monitoring. The implications of this shift have not been fully assessed by BEIS and DCMS. Far from encouraging innovation and delivering improved outcomes for consumers, the regime could have a stifling effect by prescribing how firms can act, causing them to cluster to cautious standards.

Some areas covered by the proposals are already subject to law and regulation, such as consumer rights and data protection laws, which are arguably already unduly restrictive of economic freedoms. These proposals further undermine the principles of freedom of contract and freedom of association that free and competitive markets depend upon.

The CMA's (2020b) market study into digital advertising is relied on for evidence in support of the proposals. It has been criticised as 'policy-based evidence making'[8] but made some useful findings in respect of the anticompetitive effects of privacy and data protection laws. However, rather than addressing these effects and calling for reforms to the UK GDPR and associated regulation, the CMA recommended, and the government is pursuing, yet more regulation, to try and offset the negative effects of existing laws. New measures like the Online Safety Bill seem likely to further entrench the position of the current large players, acting in opposition to the present policy of pursuing pro-competitive measures (Keller 2021).

There is a great danger that the proposed regime will distort the discovery process of free markets and replace the price mechanism and decisions of millions of consumers and thousands of businesses with codes of conduct issued by a small group of officials. The government argues that the new regime will only apply to a relatively small number of the largest players, who are distorting competition, but the largest players are the source of much dynamism and innovation and, moreover, SMS is an elastic term. With the increasing digitisation of the economy, the DMU could find itself promulgating codes of conduct for an ever expanding range of activities.

The proposed regime will be a formidable powerbase for the CMA. Through the DMU, it will be able to intervene proactively to promote consumer welfare, innovation and media plurality. These are generally seen as incontestably good things, so, given the widespread propensity to judge policies and programmes by their intentions rather than their results, there is a danger that the DMU will be insulated from challenge across the political spectrum, other than perhaps by those calling for it to go further and intervene more.

8 'The UK has badly missed the mark on how to regulate Big Tech', Sam Bowman, *Daily Telegraph*, 3 July 2020 (https://www.telegraph.co.uk/technology/2020/07/03/uk-has-badly-missed-mark-regulate-big-tech/).

# Recommendations

The legislation should not be progressed until a more rigorous impact assessment has been carried out, with a more complete and realistic analysis of costs and risks and a more developed theory of harm. The production of each of these presents considerable challenges.

Expertise in digital markets within the CMA is welcome but the case has not been made as to why the DMU needs to have such unprecedented new powers. Improving the application of existing *ex post* powers and the use of existing tools such as market studies would allow for more targeted and proportionate enforcement that does not seek to micromanage and constrain tech firms. We note that, using its existing competition powers, the CMA has taken a much more interventionist approach and initiated extensive investigations into the digital market, establishing that it already has extensive powers to intervene. The claim that an *ex post* competition approach takes too much time can be remedied by giving the CMA more resources and requiring it to act faster.

While we primarily recommend that the CMA does not have new *ex ante* powers, if the government is to pursue such a policy, it is essential that DMU decisions can be appealed on their merits to ensure accountability and the consistent application of any new law based on precedent. This will ensure legal certainty, without which innovation and investment will be deterred and distorted.

In the absence of a definition of ‘digital markets’ and given the increasing digitisation of commercial and private activities, the powers envisaged for the DMU could extend across the entire economy, from real estate to food delivery. Clear parameters for the scope of any new powers are required. The scope of controls on SMS firms should be narrowed to specific activities to allow them to compete in areas where they are not dominant without needing seek an exemption from the DMU.

Code of conduct provisions that dictate technical matters such as interoperability should be applied with caution in light of the security risks that they could introduce to platforms and the drag on innovation that they could cause. Provisions that require SMS firms to seek advance approval for commercial or technical matters should also be excluded.

The proposals for the DMU follow EU reforms contained in the proposed Digital Markets Act and the Digital Services Act, which have been criticised for unduly interfering in free markets, including from an international trade perspective.[9] These are designed to curb the power of digital platforms with the added agenda of creating a European digital sector. The UK has an opportunity to differentiate itself and attract innovators and entrepreneurs to the country.

The government could better adhere to its own, new 'proportionality principle' by addressing existing regulations that act as barriers to entry, such as the UK GDPR. It should not be introducing yet more layers of regulation that carry an acknowledged risk of distorting the market and impairing investment and innovation.

9 'US pushes to change EU's digital gatekeeper rules', Politico, 31 January 2022 (https://www.politico.eu/article/us-government-in-bid-to-change-eu-digital-markets-act/).

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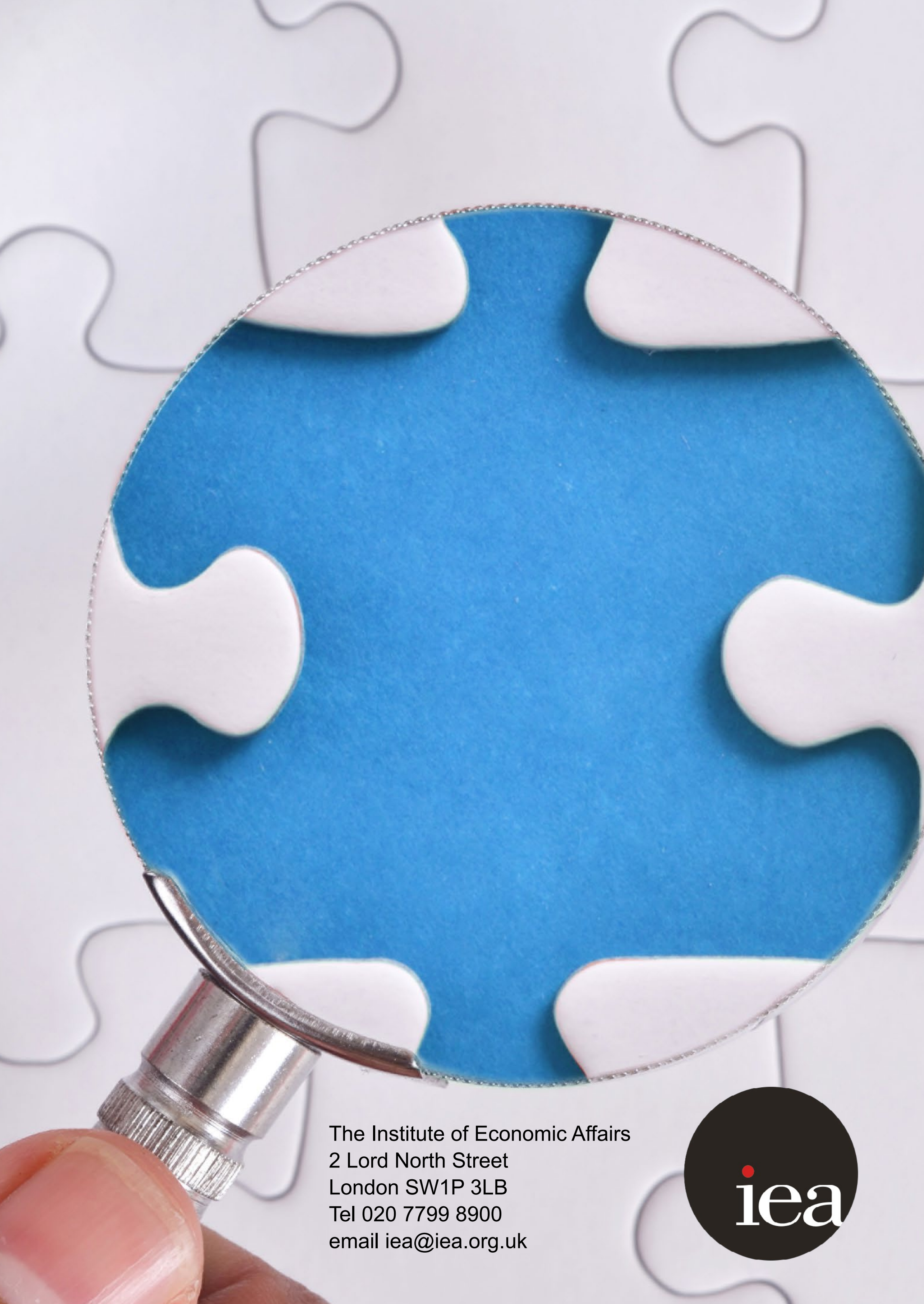

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