

# CMA online platforms and digital advertising market study BT response to interim report

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# 1. Executive Summary

- 1.1. The CMA's interim report is an important milestone in its strategy for tackling the challenges posed by the digital economy. Facebook and Google have brought innovative and valuable services to customers but their hyper-scale, profitability and importance to consumers' everyday lives, requires a new flexible regulatory approach that maintains incentives to innovate, but protects customers and businesses from unfair practices.
- 1.2. The CMA has lifted the lid on digital advertising, an important source of market power for both Facebook and Google. However, effective regulation will need to reach beyond these markets into adjacent markets where market power can be used unfairly to the detriment of consumers. Google and Facebook are deeply vertically integrated, providing end user services, devices and sometimes connectivity (amongst other things). This brings benefits to consumers and drives innovation, however entry into adjacent markets can reinforce market power, for instance through insights and monetisation opportunities from a wider set of data.
- 1.3. Rival firms in adjacent markets may not be able to compete effectively without the same opportunity to leverage from strong positions in other markets. A code of conduct ('Code') with appropriate enforcement measures should ensure that the conduct of firms with strategic market status ('SMS') in adjacent markets is fair by limiting leveraging behaviour which threatens competition and innovation to the detriment of consumers.
- 1.4. These are not abstract or theoretical concerns. The European Commission's investigations have found harm to competition in certain adjacent markets. The Commission's Android investigation, for example, found that Google had used its mobile operating system to illegally reinforce its dominance in search and that it had unfairly prevented other versions of the Android operating system from competing. Google was fined €4.3 billion.
- 1.5. The competition law regime is a vital tool for discouraging egregious behaviour and will remain so. But where firms do cross that line, ex-post enforcement can, in some cases, be too late to prevent serious harm arising. A flexible and transparent ex-ante regime would complement existing competition tools in protecting consumers and businesses from unfair practices, in both core and adjacent relevant markets, which undermine competition and innovation. Such a regime should be informed by existing competition and data privacy law principles. The UK, a world leader in effective regulation, has a real opportunity to shape the global debate on how best to tackle these challenging issues.
- 1.6. We expect that SMS will only apply to a small number of companies. This reflects the intention to target intervention at powerful digital platforms that enjoy enduring market power. These platforms are typically global, hyperscale, and enjoy network effects which make them essential for consumers and businesses.
- 1.7. As the Furman Review observed, interventions should avoid creating new burdens or barriers for smaller firms seeking to challenge the established players through innovation and new business models. These new challengers may be rapid growth start-ups but also established companies including those in the telco sector. Where

challenger companies are already subject to ex-ante regulatory regimes, duplication should be avoided.

- 1.8. We welcome the CMA's proposal of a Code for online platforms with SMS, in line with the Furman Review. Adopting a principles-based, ex ante approach is desirable, as it allows the regulated firms some flexibility to determine best practice compliance, but ensures that unfair behaviour can be tackled swiftly.
- 1.9. The CMA has focussed narrowly (understandably in the context of this market study) on the digital advertising aspects of Google and Facebook's activities. However, for the Code to be meaningful it must be capable of covering designated firms' interactions with customers, competitors and partners across the numerous adjacent markets in which they do, or will, operate in the future. Their position of market power and their importance to consumers' daily lives gives rise to a responsibility to act fairly vis- a- vis partners, competitors and consumers. The CMA should consider further how this should be best achieved, recognising the trade-offs that over and under regulation can bring to incentives to innovate.
- 1.10. Not all issues can be addressed through the Code, for instance the CMA discusses structural remedies and requirements to provide rival firms with key inputs that aim to drive competition and reduce market power. The power to impose these remedies is a necessary complement to the Code but should only bite on firms designated with SMS. They should apply in relevant and adjacent markets where there is evidence that market power is being leveraged.
- 1.11. We agree with the CMA that, at this stage, the CMA should support Government in exploring the type of regulatory regime that is needed, and how to bring a Code to life, rather than move to a market investigation.

## 2. Designation of strategic market status

- 2.1. The CMA proposes a Code for online platforms with SMS, in line with the Furman Review.
- 2.2. The criteria for designation of SMS – which will trigger the application of the Code – will be considered further in the Government's response to the Furman Review. We welcome the CMA's views on the possible criteria for designation and the opportunity that provides for industry to comment.
- 2.3. Its initial view (6.30) is that "the following criteria provide a useful starting point for assessing whether a digital platform should be considered to have SMS and hence be subject to the code of conduct:
  - the platform has enduring market power over a relevant market;
  - the platform acts as an important gateway for businesses to access a significant portion of consumers; and
  - businesses depend on the platform to access users on the 'other' side of the market."
- 2.4. We agree that the CMA's cumulative three stage test is an appropriate starting point. We also note that typically these firms benefit from network effects and are global hyperscale operators.
- 2.5. The CMA indicates an initial view that Google and Facebook would likely be considered to have SMS and that "other platforms may be considered to have SMS when considering their role in other markets"<sup>1</sup>. We agree with the CMA's initial view that Google and Facebook would likely be considered to have SMS. We consider that designation of other digital platforms that are not funded through digital advertising will require a detailed assessment of their activities including a finding of enduring market power in respect of their digital platform activities.
- 2.6. We also consider it critical that market power is found to be enduring for a firm to be designated with SMS. High and persistent market shares are a reasonable indicator<sup>2</sup> but should be assessed alongside market features which might underpin the persistence of dominance relating to control of bottlenecks, data advantages, irreversible network effects, strategic investments and customer behaviour and biases which may reinforce a position of market power.
- 2.7. We expect that SMS will only apply to a small number of companies with characteristics that satisfy the test. This reflects the intention to target intervention at powerful digital platforms that enjoy enduring market power. As the Furman Review

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<sup>1</sup> Paragraph 68 of the Interim Report.

<sup>2</sup> Such an approach is consistent with UK and EU competition law where dominance is unlikely where the entities' market share is less than 40% (footnote 55, European Commission Guidelines on market analysis and the assessment of significant market power under the EU regulatory framework for electronic communications networks and services (OJEU C159/1, 7.5.2018)).



observed<sup>3</sup>, interventions should avoid creating new burdens or barriers for smaller firms.

- 2.8. There would be no sense in capturing firms which seek to challenge the digital platforms with SMS (through innovation and new business models) and which do not have established market positions.<sup>4</sup> Designating such firms too early would undermine the benefits of innovation and competition that these newer players may bring and their role in constraining the behaviour of firms with SMS. The conduct of firms without SMS may raise societal (e.g. online harms) or other issues (exploitation of behavioural biases) however such issues should be considered outside of the ex-ante SMS regime.
- 2.9. The CMA's second and third criteria for designating SMS (namely, platforms which act as a gateway to customers and/or to users on the 'other side' of the market) is drafted broadly and could give rise to unintended consequences. We note that this leaves room for firms in other sectors to be captured, for example, some publishers and telecoms firms act as important gateways that businesses depend on to access a significant portion of consumers. However they do not operate digital platforms of the type being considered, and where they do, they do not enjoy hyperscale characteristics or 'strategic' status.
- 2.10. To avoid duplicative ex-ante regimes, firms that are already subject to sector specific regulatory regimes which address market power issues should not be designated as having SMS on the basis of their activities in those regulated markets. For example, communications markets are already heavily regulated on an ex-ante basis to ensure vigorous retail competition. BT is subject to General Conditions of Entitlement, SMP Conditions, Our Commitments, in addition to wider ex post competition, consumer and data protection law regimes that apply to all sectors.<sup>5</sup> It is the vibrant retail competition in broadband brought about by the ex-ante communications regulatory regime that has underpinned the growth of the digital economy through enabling the digital platforms to grow rapidly. We believe these markets are not the intended focus of the SMS regime, and so should be excluded or the test should be amended to avoid it inadvertently capturing firms with market power which is addressed through existing regulation.

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<sup>3</sup> Unlocking digital competition Report of the Digital Competition Expert Panel, page 5.

<sup>4</sup> In the CMA's paper on "Competition and Regulation" published on 10 January 2020, it assessed the impact of regulation on innovation and competition. One of its key recommendations was to ensure that regulation does not disproportionately harm smaller scale services and new entrants (7.9).

<sup>5</sup> In the UK, the Privacy and Electronic Communications Regulations (PECR) also requires CSPs to collect consent to process traffic and location data. Digital firms are not currently subject to these rules. There are ongoing discussions about encrypting domain name system (DNS) resolution, which is the process by which individuals are connected to the webpage s/he requested. Google and Mozilla have proposed that the DNS function be handled by encrypted versions of their Chrome and Firefox browsers respectively. However, this would also mean that Google would have access to a further category of sensitive data (e.g. location data, details of URL requested) which is currently processed by CSPs. Google and Microsoft Windows have stated they will only automatically upgrade customers to encrypted DNS if their existing provider (ordinarily a CSP) supports it. Mozilla is currently only applying encrypted DNS by default in the US.

2.11. SMS designation should be the tool for determining those firms to which the new regime will apply. These entities will likely already operate across numerous adjacent markets outside of the core market(s) in which they have market power and already have a demonstrated ability to move quickly into new markets and to behave anticompetitively.<sup>6</sup> Figure 1 demonstrates the high degree of vertical integration of Google and Facebook. Taking Google as an example, it operates across much of the value chain and its presence in adjacent markets further strengthens its market power in digital advertising for instance by providing access to additional customer data which can be monetised.

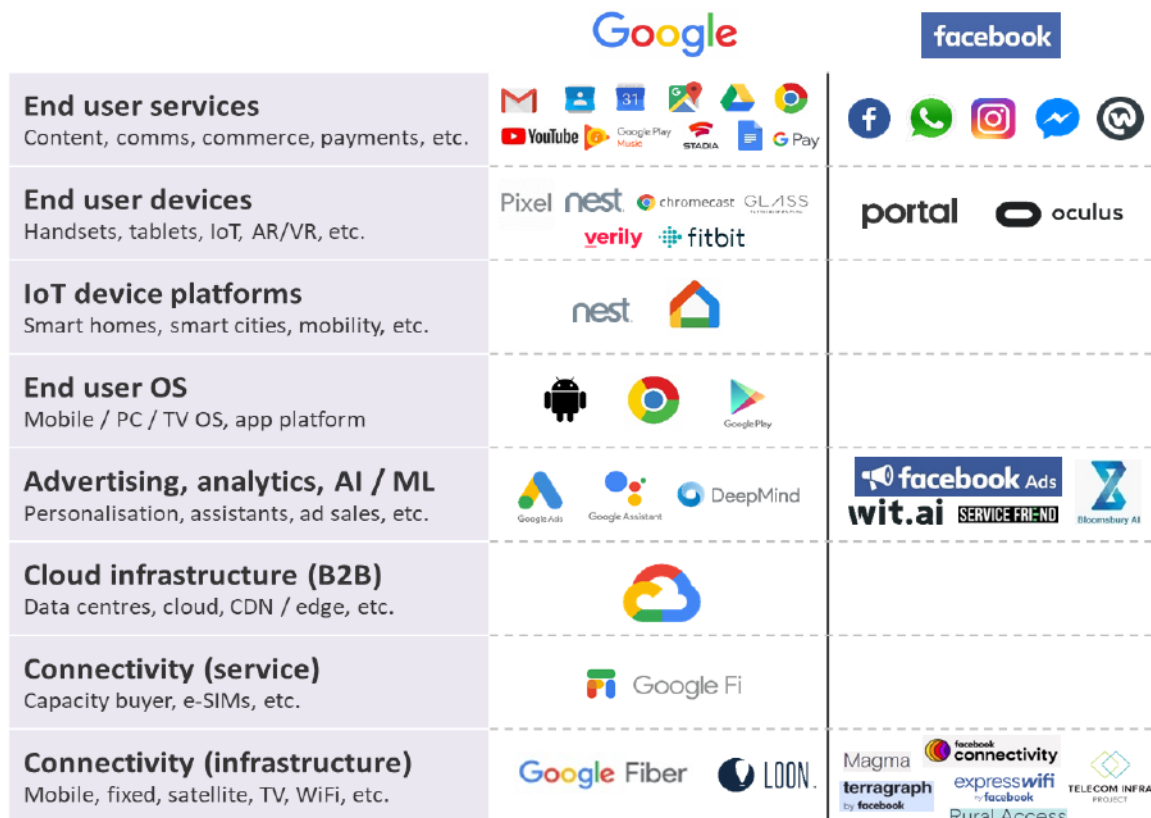


FIGURE 1, BT overview of vertical integration

2.12. For firms designated as having SMS, the Code should therefore be capable of application across activities where market power is (or could be) leveraged to the detriment of consumers. This should take into account the rationale for entry and expansion, including those which are less obvious. For example, the value of entry may not be the product being sold but the data being derived from use of the product or service which may reinforce persistent market power.

2.13. Designations should be made in a timely fashion to protect consumers and competition as soon as practically possible (and building on the CMA's extensive study). We agree that designations should periodically be reviewed to ensure that regulation remains appropriate.

<sup>6</sup> See for instance EU Commission decision in case 40099 Google Android where the European Commission fined Google €4.34 billion for breaching EU antitrust rules by imposing illegal restrictions on Android device manufacturers and mobile network operators to cement its dominant position in general internet search.

- 2.14. We urge the CMA to consider further how such a regime would apply in practice to ensure that designated firms remain encouraged to invest and innovate but also to ensure fair conduct.



## 3. Interventions

### (a) Code of Conduct

- 3.1. We are, in principle, supportive of a Code which could be a flexible tool allowing swift intervention in dynamic markets (as the CMA says). For the Code to be effective, a regulator will need to move quickly to remedy breaches and may need to update or amend the Code to meet changing circumstances.
- 3.2. The CMA's initial view is that "the code should take the form of high-level principles rather than detailed and prescriptive rules" (6.37), which for platforms funded by digital advertising, would be: 'fair trading', 'open choices' and 'trust and transparency' (6.39). As the CMA notes, the Code would require (6.19) "them to act in a way that ensures that consumers and businesses dealing with them are fairly treated and vigorous competition can take place."
- 3.3. We broadly agree with this approach which is not dissimilar to the principle-based regulation applicable to financial services, where the onus is on the regulated firm to demonstrate how it complies with the required principles. These broad principles should be capable of application to all of the firms' activities in relevant and adjacent markets including their relations with consumers, competitors and partners. The Code could also provide specific requirements on top of the general principles; firms would still, however, need to comply with the general principles.
- 3.4. The regulator should also pay close attention to the culture within companies such that doing the right thing is the expected norm. In fast moving digital markets there may be delay in regulatory action catching up with developments, but having the right culture in place should help limit egregious behaviour and swiftly remedy it once uncovered.
- 3.5. The CMA is right to highlight that the Code needs to be accompanied by powers to render it effective (6.49-6.52). All of the measures the CMA proposes should be adopted including fines, mandatory orders, powers to determine disputes and information gathering powers. Although financial penalties are a useful tool, the CMA should consider how the regulator would best ensure that required changes in behaviour occur given that financial penalties would need to be very large to deter entities with very high turnover. The power to impose other interventions may act as further deterrent (see below). We agree with the CMA that SMS firms (and other materially-affected persons) should have the right to appeal the regulator's decisions.

### (b) Further interventions

- 3.6. Not all issues can be addressed through the Code, for instance the CMA discusses structural remedies and requirements to provide rival firms with key inputs that aim to drive competition and reduce market power. The power to impose these remedies is a necessary complement to the Code but should only bite on firms designated with SMS. They should, however, be capable of application to their activities in relevant and adjacent markets. We note that the CMA already has powers to impose a range of remedies under the Enterprise Act, where processes and evidential requirements are set out, and these could be adapted to apply to digital platforms.

- 3.7. Firms that are not designated with SMS will remain regulated by competition law, other sector specific regulation and any other generally applicable law such as data and consumer protection.
- 3.8. The CMA (6.56) notes that the interventions designed to address sources of market power could be designed with reference to SMS but the CMA also asks whether some of the remedies, such as interoperability, should apply more broadly. We consider that all remedies under discussion should only be imposed on digital platforms with SMS as the ex-ante regime should only apply to those firms holding SMS.
- 3.9. In relation to digital platforms with SMS in digital advertising, we welcome remedies which will improve transparency within digital trading, increase customer data portability (in a safe and compliant way), increase competition in digital advertising and promote adoption of common standards on verification, viewability and measurement. Application of the Code would enable proportionate interventions to protect the consumer interest by protecting the process of competition.
- 3.10. As we note in section 2 above, the CMA has considered adjacency in the context of the digital advertising value chain, however adjacency needs to be considered in a wider sense, and cover leveraging into any adjacent markets. By way of example:
- Certain bundling and tying of distinct products.
  - Firms with enduring market power may use excess profits generated in their core business to expand into adjacent competitive markets by offering services at a price below the cost of an efficient standalone operator in that adjacent market.

This may potentially weaken competition in the adjacent market(s) and/or strengthen their market position in the former market(s).

- 3.11. In both examples above, a rival firm in the adjacent market cannot necessarily replicate the propositions of the firm with SMS, because it does not have the same opportunity to leverage from strong positions in other markets. In order to ensure a level playing field in that adjacent market (thereby promoting dynamic competition and innovation), in addition to the Code, the CMA should consider remedies which constrain the leveraging behaviour of firms with SMS.

## **(c) Timing and next steps**

- 3.12. The new ex-ante regime should be established as soon as possible, with SMS designations made quickly and the Code implemented.
- 3.13. In addition, the CMA proposes a set of interventions to directly address the market power of Facebook and Google. These interventions should be assessed by the relevant regulator once established using evidence collected as part of, and since, the market study. However, the CMA should substantially develop its thinking on these interventions such that the future regulator is well placed to act quickly, and with information gathering powers commensurate with those enjoyed by the CMA and Ofcom, once established.
- 3.14. We agree with the CMA that, at this stage, the CMA should support Government in exploring the type of regulatory regime that is needed, and how to bring a Code to life, rather than move to a market investigation.