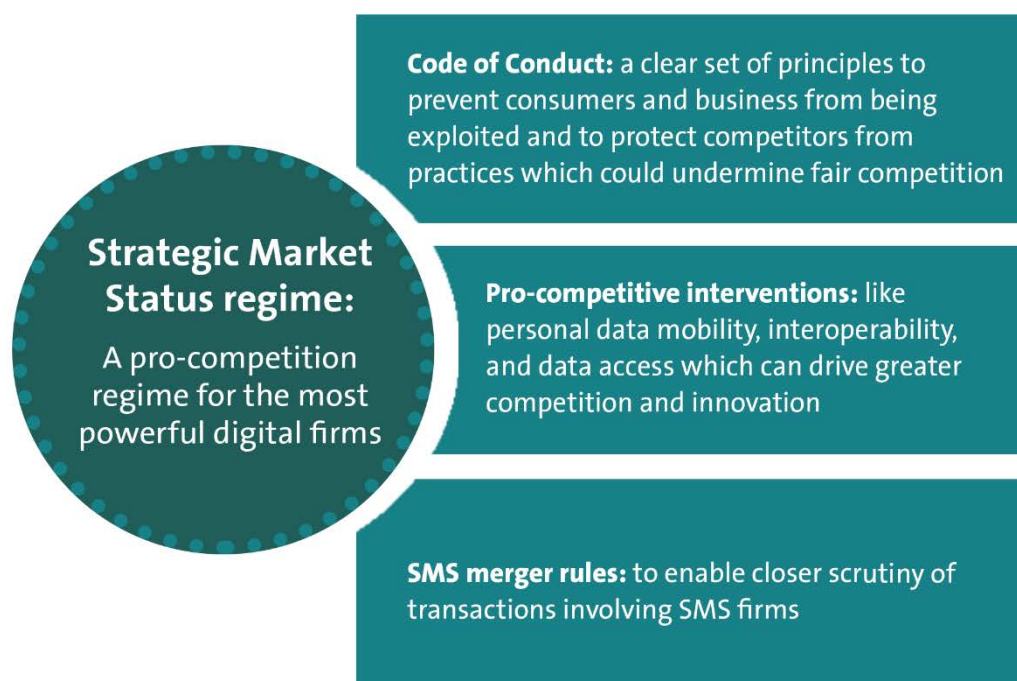


Appendix B: The SMS regime: designating SMS firms

Overview

1. This appendix sets out our proposals for designating firms with strategic market status (SMS), including the SMS test and the process involved in carrying out this assessment. Firms designated with SMS should then be subject to (1) an enforceable code of conduct; (2) potential pro-competitive interventions, and (3) SMS merger rules. Details on these tools are covered in Appendices C, D and F respectively. Appendix E sets out cross-cutting powers and procedures.

Figure B.1: overview of the SMS regime



2. The material in this appendix is presented in two parts:
 - **The test for SMS** covering (i) our approach to developing the test, (ii) our recommended test, including an explanation of the reasons underlying our recommendation, and (iii) alternative approaches to the SMS test that we do not recommend.

- **The process for designating a firm with SMS** covering (i) who the decision maker should be, (ii) how the designation process should be run and whether the designation process should be subject to a statutory deadline, (iii) the entity to which the SMS designation should apply, (iv) the appropriate length of designation and (v) the process for appealing a designation.

The test for SMS

Recommendation 3: The government should provide the DMU with the power to designate a firm with SMS.

3. In this section we describe our recommended SMS test as well as the rationale supporting our approach. After describing our recommendations, we discuss a number of alternative approaches we are not recommending.

Our approach

4. The key principle underpinning our advice is that the SMS test must provide sufficient justification for the application of an SMS regime (involving (1) a code of conduct, (2) pro-competitive interventions, and (3) SMS merger rules) to a specific firm.¹ We envisage that such a regime could only be justified for a small number of firms and the SMS test should seek to identify the relevant characteristics of such firms. Additionally, any SMS test should seek to be appropriately flexible and clear.
5. Flexibility is necessary to ensure that the SMS test can adapt to changing circumstances. This is important because the SMS regime needs to be future-proof and capable of meeting its goals as existing business models evolve and new business models emerge.²
6. Clarity will enable firms to understand whether they may be considered candidates for an SMS designation and the evidence that is likely to inform

¹ As noted in the Furman Review (2019), [Unlocking Digital Competition](#) (paragraph 2.116) '[the test] needs to be carefully designed to identify where companies operating platforms are in a position to exercise potentially enduring market power, without granting an excessively broad scope and bringing within the bounds of regulation those companies who are effectively constrained by the competitive market'.

² The need for this flexibility was emphasised in our interviews on how digital markets are evolving (see Appendix A) and has been highlighted by a number of commentators. For instance Caffarra (2019), "[Follow the Money](#)" – [Mapping issues with digital platforms into actionable theories of harm](#), states 'so-called 'digital platforms' differ profoundly in terms of key characteristics'. Many respondents to our call for information also highlighted the importance of a case-by case assessment while others indicated that the SMS criteria should be flexible.

such an assessment.³ Clarity will also contribute to an efficient process that is less likely to be subject to numerous points of dispute and where submissions from the potential SMS firm and from third parties are more likely to be targeted and relevant.

7. Therefore, the following principles, which build on the key principles for the overarching regulatory approach set out in the main advice,⁴ have guided our advice in relation to the SMS test:
 - (a) Does the test provide sufficient justification for the application of the SMS regime to a firm? In practice, this is likely to require a test that will be satisfied by relatively few firms;
 - (b) Flexibility – is the test flexible enough to adapt to changing circumstances? Will it be sufficiently future-proof?; and
 - (c) Clarity – will firms be able to understand whether they might be considered candidates for an SMS designation, will stakeholders understand what evidence is likely to be relevant to an SMS assessment and will the designation process be efficient?
8. There are inevitable trade-offs between these principles. For example, a test based solely on a jurisdictional threshold would be clear – ie once a firm exceeds a certain UK revenue threshold it is designated with SMS. However, with no analysis of the potential harms the firm could cause, this would not provide sufficient justification for the application of the SMS regime to a firm. Similarly, incorporating flexibility means providing the Digital Markets Unit (DMU) with a degree of discretion, which may reduce clarity.
9. Our recommended SMS test has sought to balance the trade-offs between these principles. In determining this, we have carefully considered the submissions we have received from stakeholders, similar international proposals⁵ and the findings of various reports considering similar issues.

³ The ability to formally self-assess is less important in this case than in traditional ex-post competition law because an SMS designation must be made prior to any remedies being introduced and this designation will be subject to consultation and will be appealable.

⁴ These key principles are: evidence driven and effective; proportionate and targeted; open, transparent and accountable; proactive and forward looking; and coherent.

⁵ See Box B.3 for a formal comparison between our proposed test and legislative initiatives in other jurisdictions.

Our recommended SMS test

Recommendation 3a: SMS should require a finding that the firm has substantial, entrenched market power in at least one digital activity, providing the firm with a strategic position.

10. As we describe below, we consider that this test will ensure that the SMS regime only applies where the evidence supports its application. Additionally, it will be sufficiently flexible so that the regime is, as far as possible, future-proof while also providing appropriate clarity (when accompanied by guidance) to firms as to the scope of the regime and the evidence which could inform an SMS designation assessment.
11. The subsequent sections provide the reasoning for our recommended SMS test by considering the following factors underlying our recommendation:
 - the SMS test should be assessed with respect to a specific activity;⁶
 - that activity should be a digital activity;
 - the SMS test should involve an assessment of whether the firm has substantial, entrenched market power in the activity; and
 - the SMS test should also involve an assessment of whether the firm's substantial, entrenched market power in an activity provides the firm with a strategic position.
12. Additionally, we are recommending that the DMU has the power rather than the duty to designate a firm with SMS. Therefore, the DMU will need to exercise its discretion prior to undertaking a designation assessment. When doing so, we consider it appropriate for the DMU to prioritise designation assessments by having regard to: (i) a firm's revenue, (ii) the nature of the activity or activities undertaken by the firm and (iii) whether a sector regulator is better placed to address the issues of concern. These prioritisation factors are also discussed below.

The SMS test should be applied with respect to an activity and not every part of the firm. An activity is a group of products and services that can be considered together.

13. Any potential SMS firm will be engaged in a range of activities, offering a wide variety of different products and services, some with very different uses and functionality. Furthermore, the concerns motivating any SMS designation are

⁶ Albeit the SMS test might be satisfied by multiple activities operated by a single firm.

likely to relate to a certain activity or to a small number of activities. In such cases, it would be inappropriate and impractical for the SMS assessment to involve a detailed assessment of every part of a firm. Therefore, the SMS assessment should focus on a specific set of products and services.^{7,8}

14. An activity is a collection of products and services. We refer to an activity that satisfies the SMS test (ie a digital activity in which the firm has substantial, entrenched market power, providing the firm with a strategic position) as a **designated activity**. The SMS test could be satisfied in relation to more than one activity provided by a firm, so that a single firm could have multiple designated activities. Additionally, as we discuss in Appendix C, our recommendation is that the code of conduct should apply to a subset of a firm's activities. It is therefore necessary to explain how products and services might be grouped together into activities.
15. We recommend that the DMU is able to group products or services supplied⁹ by a firm into a single activity when these products or services (i) can reasonably be described as having a similar function or (ii) can reasonably be described as fulfilling, in combination, a specific function. For example, based on the work of the CMA's online platforms and digital advertising market study¹⁰ (referred to as 'the market study' throughout), plausible activities for Google and Facebook might be:
 - (a) Google Search – Google's products and services providing organic and paid general search results.
 - (b) Google Open Display – the products provided by Google to manage the buying, selling and selection of advertisements for display on websites.
 - (c) Facebook's Social Media Platforms – the products provided by Facebook that allow users, advertisers and publishers to interact and communicate with each other.
16. Examples of circumstances where it may be appropriate to group products and services together into a single activity include but are not limited to:

⁷ As such, the approach will be akin to that of the [CMA's market study into online platforms and digital advertising](#), which focussed on the products and services that are part of Google Search, Google Open Display and Facebook's Social Media Platforms. Although additional products and services were considered, this was done with a focus on the interactions between these additional products and Google Search, Google Open Display and Facebook's Social Media Platforms.

⁸ Such an approach is consistent with a number of responses to our call for information which emphasised the need for the SMS test or regime to focus on specific activities or markets.

⁹ For completeness: an activity could include access to functionality – eg hardware or software functionality necessary to develop a computer program.

¹⁰ CMA, [Online platforms and digital advertising market study](#), July 2020.

- (a) products and services that are usually purchased or used in combination by a potential SMS firm's customers. For example, organic and paid search results are presented in the same webpage as a single set of search results and are likely to form part of the same activity;
 - (b) a potential SMS firm offering a number of products, possibly under different brands, that have similar functionality and as such could be described as a single activity. For example, when a social media provider offers a number of products under different brands with a common function: allowing users, advertisers and publishers to interact and communicate with each other;
 - (c) products and services that serve different customers, but which are closely connected and in combination fulfil a single function. For example, products that form part of the same supply chain, such as the different products forming part of Google Open Display which manage the buying, selling and selection of advertisements for display on websites; and
 - (d) where a firm provides a means by which businesses can access customers, the products and/or services offered to customers and to businesses are both part of the same activity. For example, the services offered to buyers and sellers by an online marketplace or an app store are likely to be part of the same activity.
17. When undertaking the SMS designation, the DMU should identify and provide a description of the activity to which the assessment relates. In doing so, we would expect the DMU to identify the key products or services that are part of this activity. The SMS assessment should then focus on this activity and therefore on these products and services.
18. An activity could consist of products and services that would be identified as belonging to separate relevant markets under a traditional competition law approach. In our view, a focus on activities has significant advantages since it encourages a focus on how a specific firm operates and how the products and services offered by the firm interact rather than a focus on narrowly and rigidly defined markets. It is also appropriate given that the SMS regime is firm-specific.¹¹
19. A focus on activities has implications for the assessment of market power and when implementing a code of conduct and pro-competitive interventions. Therefore, we discuss activities further in those parts of our advice.

¹¹ As we have noted, this approach would mirror the assessment of Google Search, Google Open Display and Facebook's Social Media Platforms in the CMA's market study into online platforms and digital advertising.

20. Finally, although the SMS assessment should focus on a specific activity we emphasise that the assessment should not view that activity in isolation and should also consider the contribution of a firm's wider ecosystem of products.¹² A firm's wider ecosystem of products could contribute to an SMS assessment in a variety of ways. Specifically, our recommended SMS test involves an assessment of whether a firm has market power in an activity. A firm's wider ecosystem of products may reinforce the firm's market position in a particular activity or set of activities, thereby entrenching a firm's market power.¹³ For example, the market study discussed how Google and Facebook's ecosystems enable 'them to cement the position and strength of their core services, and to leverage this strength into other markets'.¹⁴

That activity should be a 'digital' activity. Digital should be interpreted to cover any situation where digital technologies are material to the products or services provided as part of an activity.

21. The term 'digital' is commonly used to refer to a wide range of technologies such as the development of the Internet, improvements in computer processing power and advances in data storage and analytics capabilities.¹⁵ These technologies have led to the exaggeration of a number of market features which can contribute to market concentration, especially when they arise simultaneously.¹⁶ For example, the Internet and advances in computing have drastically lowered some distribution costs contributing to more significant economies of scale and enabling the greater exploitation of network effects. Likewise, advances in data storage and processing have enabled the exploitation of a wider range of economies of scope.

¹² This observation has been made by some stakeholders. For instance, BT submitted that 'SMS designation should reflect a platform's ability to leverage its market power across its ecosystem, which allows platforms with market power in one market to consolidate and proliferate their market power across adjacent markets, leading to worse outcomes for consumers.' (See BT's call for information response, page 13); Vodafone submitted that 'the assessment of market power or strategic market status should take into account the relevant firm's activities in connected markets which form part of a coherent value chain or ecosystem (e.g., operating system/app store).' (Vodafone's call for information response, question 1).

¹³ Our recommended test also involves a consideration of whether a firm has obtained a strategic position. This analysis could also consider a firm's wider ecosystem of products (eg whether a wider ecosystem of products increases the ability of a firm to extend market power from their designated activity).

¹⁴ The market study provided several examples to illustrate this, such as the role of Google Chrome and Google Assistant to direct consumers towards Google Search. See CMA's market study into online platforms and digital advertising, [final report](#), paragraph 2.36 and [Appendix E: ecosystems of Google and Facebook](#).

¹⁵ This was observed by Furman Review (2019), [Unlocking Digital Competition](#) (paragraph 1.24) and by a number of stakeholders. For instance, Amazon submitted that '[w]hat commentators sometimes refer to as the "digital markets" is a set of foundational technologies ...' (Amazon's call for information response, paragraphs 3.4-3.7). Other stakeholders highlighted (i) the difficulty of clearly defining 'digital markets' or a 'digital sector' and (ii) the range of businesses and business models encompassed by the term 'digital markets' and 'digital platforms'.

¹⁶ As noted by the Furman Review (2019), [Unlocking Digital Competition](#), paragraphs 1.65-1.66 and Stigler Center (2019), [Committee on Digital Platforms Final Report](#), page 34.

22. Since the term 'digital' refers to a set of technologies, a wide range of activities could be characterised as being 'digital' to some degree and this cannot be meaningfully measured. Therefore, attempts to define the term 'digital' narrowly are likely to create arbitrary and inflexible dividing lines and be a significant source of debate. For example, does the delivery of physical goods mean an online marketplace is not a digital activity? What happens if that online marketplace also allows customers to collect or purchase products in store or if the marketplace opens some bricks-and-mortar retail outlets?
23. The potential for such debates, which would be unrelated to the potential for consumer harm, would produce an inflexible regime¹⁷ and would risk creating an unclear test and an inefficient designation process.¹⁸ Therefore, for the purposes of the SMS regime, we recommend that the term 'digital' is interpreted to cover any situation where digital technologies are material to the provision of an activity.¹⁹ In our view, this approach will provide the regime with an appropriate focus whilst providing some clarity to firms, for example, by indicating that the decision of a high-street retailer to launch an online store is, in itself, unlikely to bring the retailer within scope of the regime.

The SMS test should involve an assessment of whether the firm has substantial, entrenched market power in the activity.

24. Many of the concerns motivating the introduction of the SMS regime, and similar regimes in other jurisdictions, arise from instances where a firm has substantial, entrenched market power.^{20,21}
25. Substantial market power arises when users of a firm's product or service lack good alternatives to that product or service and there is a limited threat of entry or expansion by other suppliers. This allows the firm to increase prices or reduce quality and innovation, since a significant number of users are

¹⁷ A similar point was raised during our interviews on how digital markets are evolving (see Appendix A). Some participants referred to the potential for the issues motivating the SMS regime to arise in sectors that might traditionally not be viewed as 'digital' and which might not meet a narrow definition of the term (eg the automobile or healthcare sectors).

¹⁸ Jean Tirole has cautioned against 'lengthy debates about which companies are really digital'. See Tirole (2020), [Competition and the Industrial Challenge for the Digital Age](#), page 8.

¹⁹ This is consistent with Furman Review (2019), [Unlocking Digital Competition](#) (paragraph 1.26), Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition policy for the digital era, final report for the European Commission](#) (Chapter 2) and Stigler Center (2019), [Committee on Digital Platforms Final Report](#) (page 105) which do not attempt to narrowly define the term 'digital'.

²⁰ For instance, Furman Review (2019), [Unlocking Digital Competition](#), page 10, paragraphs 1.95-1.117 and 2.10 and Stigler Center (2019), [Committee on Digital Platforms Final Report](#), page 35 and 105. Both the German draft amendment to the German Competition Act and the French Senate bill relating to 'structuring companies' include a market power assessment. See Alain Ronzano, July 2020, ['French Senate approves measures for 'structuring companies'](#) and Kris Van Hove, October 2020, ['Revising the Competition Law Rulebook for Digital Markets in Europe: A Delicate Balancing Act'](#). See also Box B.3 for further detail on these legislative proposals.

²¹ A requirement to assess market power (or something equivalent to it) was consistently emphasised by stakeholders during the course of our work.

unwilling or unable to switch away to competing products or services. As a result, substantial market power can lead to immediate harm to consumers by allowing firms to charge higher prices and offer lower quality than if there was greater competition. Substantial market power can also lead to longer-term harm to consumers where it leads to less innovation than there would be if there was greater competition. For example, the market study provided evidence of how Google and Facebook's market power in digital advertising results in a variety of harms including:²²

- (a) poor-quality services (eg seeing many adverts or having to give up lots of personal data without being adequately rewarded for it);
- (b) advertisers being overcharged by Google and Facebook leading to consumers paying higher prices for goods and services being advertised; and
- (c) a loss of innovation and the development of new, valuable services for consumers, eg the market study received concerns about restrictions on the ability of others to interoperate with Google and Facebook's products.

26. The potential to obtain a position of market power, to raise prices and to earn substantial profits provides a strong incentive for firms to invest and to innovate. Therefore, the temporary attainment of market power is necessary to provide incentives to innovate and to invest. It is a natural and beneficial aspect of competition and it would be inappropriate to introduce the SMS regime to address transitory instances of substantial market power.
27. However, there are significant concerns about instances in which market power has become entrenched – ie once a firm's market power is expected to persist over time and is unlikely to be competed away in the short term. For example, Google Search has been the most popular search engine in the UK for more than a decade, accounting for around 90% of page referrals throughout the last ten years.²³ The market study provided evidence of a variety of barriers to entry and expansion which support Google Search's position and mean that it is likely to persist.²⁴
28. It is when market power becomes entrenched that the SMS regime is justified. This is because the incentives to continue investing and innovating and to offer lower prices arise because of the fear a firm might lose its position to a

²² CMA's market study into online platforms and digital advertising, [final report](#), paragraphs 2.82-2.86 and paragraph 6.3 et seq.

²³ CMA's market study into online platforms and digital advertising, [final report](#), Figure 3.3.

²⁴ For example, substantial economies of scale in web-crawling and indexing, Google's control over access points to online search (eg Google Chrome) and the role of defaults. See CMA's market study into online platforms and digital advertising, [final report](#), paragraphs 3.4-3.152.

rival if it does not do so. Once a firm's position becomes entrenched there is little prospect of competitive entry. In such circumstances it is likely that prices will be persistently higher, and quality, investment and innovation will be persistently lower than would otherwise be the case, to the long-term detriment of consumers.

29. Additionally, the SMS regime will not involve a single, one-off intervention; the code of conduct will create a set of ongoing obligations and the firm may be subject to other pro-competitive interventions. Therefore, the regime will be an ongoing one and this can only be justified if a firm's market power is expected to persist over time.
30. Given the above, our recommendation is that the SMS test should involve an assessment of whether the firm has substantial, entrenched market power in a digital activity.
31. Market power assessments are a common feature of competition law and *ex ante* regulation (see Box B.1). As we have described at paragraphs 13-20 an activity might be a collection of products and services, some of which serve different users and where the alternatives available to different users might differ.²⁵ Therefore, when assessing whether a firm has substantial, entrenched market power in an activity, we expect the DMU to consider evidence about the alternatives available to users of each of the products or services that form an important part of the activity. We also expect the DMU to consider the interactions between those products and services.²⁶ Such an assessment would be equivalent to the market study's assessment of Google Open Display where the CMA analysed the market position of Google at different stages of the supply chain while noting that 'Google has the strongest position at each part of [the open display advertising] chain'.²⁷

Box B.1: Assessing market power

Determining the existence of market power involves assessing the quality of the alternatives available to users of a product or service and the possibilities for entry and expansion. When customers lack good alternatives and there is limited threat of entry or expansion, a firm will not face effective competitive pressure and will have substantial, entrenched market power.

²⁵ For example, the alternatives to a social network available to a consumer may differ to those available to an advertiser.

²⁶ For example, we do not expect evidence that a firm has a weaker position in one product which is part of an activity to contradict a finding that the firm has SMS in the activity as a whole if the wider evidence supports such a finding (eg if the product with the weaker position is only a small part of the activity as a whole).

²⁷ CMA's market study into online platforms and digital advertising, [final report](#), paragraph 5.213.

Market power assessments are common in competition law and in *ex ante* regulation.²⁸ They involve an assessment of both the existing competition and the potential competitive constraints faced by a firm (eg those arising from potential entry).²⁹

A wide range of evidence can be used to assess market power including:

- evidence of competitive interactions and rivalry between firms, for example internal documents discussing competition;
- evidence on customer switching and behaviour, eg from surveys;
- shares of supply or market shares; and
- evidence of barriers to entry, eg the importance of network effects, economies of scope and economies of scale.

32. Finally, consistent with the CMA's approach in market studies,³⁰ it is not necessary for the DMU to undertake a formal assessment of the relevant market. Instead, when assessing SMS, the DMU should focus on direct evidence of market power, specifically evidence of substitutability, competitive rivalry and barriers to entry and expansion.³¹
33. Formally defining the relevant market involves drawing arbitrary bright-lines indicating which products are 'in' and which products are 'out'. Attempting to draw such bright-lines is often unnecessary. The relevant evidence can be analysed and interpreted without having formally defined a relevant market. For example, internal documents discussing competitors, views from customers or competitors on substitutes and evidence of customer switching can be analysed without having defined the relevant market. Market shares

²⁸ For example, they are a fundamental component of the CMA's mergers and competition enforcement cases and many markets cases as well as of the activity of regulators such as Ofcom.

²⁹ As such, an assessment of whether a customer has countervailing buyer power is part of an assessment of market power.

³⁰ CMA's market study into online platforms and digital advertising, [final report](#), paragraphs 3.25 and 3.153. Many of the points we make here are also reflected in the CMA's [Draft revised guidance: Merger assessment guidelines](#) (2020, currently under consultation, section 9). BT (BT's call for information response, page 6), Qustodio (Qustodio's call for information response, page 6) and Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition policy for the digital era, final report for the European Commission](#) (page 3) have made similar observations about the difficulties of traditional market definition approaches.

³¹ We emphasise that our recommended approach does not mean that questions that are usually addressed as part of a formal market definition exercise should not be addressed at all. Eg it would still be necessary to consider the competitive constraint from other forms of advertising (eg television advertising) on an advertising funded social media platform.

can also be calculated on multiple different bases and interpreted without concluding on market definition.³²

34. Drawing such bright-lines also adds unnecessary complexity. For instance, it can create unnecessary duplication and inefficiency as the same evidence is considered twice: once when defining the relevant market and a second time when assessing the position of a firm within that market. Similarly, it can lead to questions being formulated in abstract and indirect ways that are poorly related to the available evidence.³³ Finally, formal market definition also encourages a narrow approach in which each product or service is allocated to a specific market making it difficult to consider important interactions within an ecosystem of products. This makes formal market definition particularly ill-suited to digital markets where firms may have developed complex ecosystems of interrelated products.

The SMS test should also involve an assessment of whether the firm's substantial, entrenched market power in an activity provides the firm with a strategic position.

35. In our view, the concerns that have been expressed and which motivate the case for a new pro-competition regime extend beyond a concern that a firm might have substantial, entrenched market power in a relatively narrow area. The case for a new regime is motivated by concerns that in certain circumstances the effects of a firm's market power can be particularly widespread or significant. In our view, it is such circumstances that are crucial in contributing to a firm having strategic market status rather than merely having substantial, entrenched market power. Therefore, this is an important aspect justifying the introduction of the SMS regime, distinguishing the SMS regime from existing law, and significantly reducing the number of firms which could satisfy the SMS test.
36. The circumstances we have identified in which the effects of a firm's market power might be particularly widespread or significant are those where:
- (a) the firm has achieved very significant size or scale in an activity, for example where a product is regularly used by a very high proportion of the population or where the value of transactions facilitated by a product is large;

³² This is illustrated by the market study's use of such evidence.

³³ For example, in an SMS assessment the focus should be on the competition faced by the potential SMS firm in a particular activity. Much of the available evidence will directly relate to this question, eg because the firm's internal documents will directly discuss the competition it faces. On the other hand, formal market definition often encourages an assessment of whether abstract groups of competitors compete with each other which is less likely to be directly reflected in the evidence.

- (b) the firm is an important access point to customers (a gateway) for a diverse range of other businesses or the activity is an important input for a diverse range of other businesses;
 - (c) the firm can use the activity to extend its market power into a range of other activities³⁴ and/or has developed an 'ecosystem' of products which protects a firm's market power;
 - (d) the firm can use the activity to determine the 'rules of the game' within the firm's own ecosystem and also in practice for a wider range of market participants; or
 - (e) the activity has significant impacts on markets that may have broader social or cultural importance.
37. These factors are varied and their precise relevance is likely to differ from case to case. Additionally, new factors could emerge over time as existing business models evolve and new businesses emerge. Therefore, it is important that a degree of flexibility is retained to future-proof the regime. Consequently, we do not propose that a 'strategic position' is precisely defined in the statutory test.
38. However, we recognise the importance of providing clarity about the DMU's approach. We consider that the best way to achieve this without compromising the flexibility of the regime is for the DMU to provide guidance describing the factors it is likely to consider relevant to its assessment. Below we elaborate on each of the factors identified in paragraph 36 and how each could be assessed to illustrate what the DMU's guidance could cover.
39. The DMU would update this guidance periodically. In doing so we expect the DMU to identify factors which are likely to indicate that the effects of a firm's market power are particularly widespread or significant. Over time decisional practice will also provide further clarity as to the precise meaning and interpretation of a 'strategic position'.
40. As we have noted, a range of different factors could inform the strategic assessment and that assessment is about the implications of a firm's market power in an activity – ie whether the firm's market power in an activity provides the firm with a strategic position. Therefore, the different factors contributing to the test, including the level of market power that the firm enjoys, cannot be considered in isolation and should be assessed together to reach an overall view on whether a firm has SMS. For example, a firm with a

³⁴ The extension of market power to other activities has been referred to by commentators and stakeholders in various ways including leveraging, self-preferencing and envelopment.

particularly high level of deeply entrenched market power that serves a high proportion of the UK population could be designated with SMS even if there is limited evidence that the other factors contributing to a firm having a strategic position apply. Similarly, a firm with a lower level of market power, or where that market power is less entrenched, might also be designated with SMS if the evidence showed that the effects of that market power were likely to be particularly significant or widespread.

41. Finally, the assessment (and therefore the evidence used) should be focussed on the potential SMS firm's operation of a specific activity. In other words, the assessment is whether the firm's position in a specific activity provides it with a strategic position, and not solely whether the activity is strategic in general.

Factors that the DMU could consider relevant to an assessment of whether a firm has a strategic position

- *Size or scale*

42. A number of stakeholders and reports have commented on the size or scale of firms in certain activities.³⁵ Consideration of such a factor is likely to focus the SMS regime on a small number of the most powerful firms where there is the greatest scope for consumer detriment.
43. Size or scale could be measured in a wide variety of ways including financial and non-financial indicators.³⁶ Examples include revenue, market capitalisation, user numbers, time spent using a product and measures of the gross value of transactions facilitated by a firm. The most appropriate metric is likely to depend on the specific context. For example, user numbers and time spent using a product may be particularly informative for an advertising funded product. Measures of the gross value of transactions facilitated will likely be more relevant for online marketplaces. The relevant metric in any particular case is likely to indicate either the value of the markets or the number of businesses or individuals affected by the market power of a potential SMS firm. Therefore, such metrics will indicate the scale of the costs associated with that market power. For example, if a substantial proportion of

³⁵ See for instance, Furman Review (2019), [Unlocking Digital Competition](#), paragraphs 1.6-1.7, 1.56-1.59 and 1.102-1.103 and EU Observatory on the Online Platform Economy, [progress report](#), Work stream on Measurement & Economic Indicators (pages 12-15). The French Senate bill relating to 'structuring companies' also identifies the number of unique users of the firm's products or services as a relevant consideration. See Alain Ronzano, July 2020, '[French Senate approves measures for 'structuring companies'](#)'. This point was also made by a number of respondents to our call for information.

³⁶ Therefore, an assessment of this factor could draw on a wider range of metrics than the revenue threshold we discuss below.

the UK population uses a firm's product, this indicates that the effects of any market power are likely to be particularly significant and widespread.

- *The firm is an important access point to customers (a gateway) for a diverse range of other businesses or the activity is an important input for a diverse range of other businesses*

44. Some firms provide a product or service that is an important means of accessing customers (ie the product or service might be described as a 'gateway')³⁷ for other businesses or is an important input for other businesses. Where a firm's activity performs this role in relation to a diverse set of other businesses (eg across many different product areas or across very different industries) then the implications of a firm's market power are likely to be felt broadly and to be more widespread and significant.
45. For example, Amazon Marketplace is an access point or gateway to customers for businesses selling a vast range of products.³⁸ Similarly, Google Search and Facebook provide an important advertising route for an enormous range of businesses.³⁹ Cloud computing infrastructure might be an example of an input that is important to a diverse range of businesses.
46. We do not expect assessing this factor to require formally identifying or precisely quantifying the number of markets or businesses concerned. However, metrics that indirectly measure the number or diversity of markets concerned could be informative. Examples could include the number of distinct products or product categories offered via a marketplace or the number of apps or categories of app offered by an app store. Comparators would help to inform whether such metrics indicate that a firm holds a particularly strategic position. For example, in understanding whether a marketplace provides access to a particularly wide range of markets, the

³⁷ We return to the term 'gateway/gatekeeper', differing interpretations of the term and whether it should be incorporated formally into the SMS test at paragraphs 81-84. Many stakeholders referred to certain firms having gatekeeper roles, involving control over market access or large customer reach. See also Furman Review (2019), [Unlocking Digital Competition](#), paragraphs 1.55-1.58 and 1.17, and Stigler Center (2019), [Committee on Digital Platforms Final Report](#), page 105. As we discuss in Box B.3, policy proposals in other jurisdictions also refer to the role of certain businesses as an access point for other businesses to customers. For example, the European Commission's proposals have been described as focussing on gatekeepers. See European Commission, [The Digital Services Act package](#). Similarly, the French Senate bill relating to 'structuring companies' and the German draft amendment to the German Competition Act, both refer to the importance of the firm's activities for third parties' access to supply and sales markets as a factor to consider. See Alain Ronzano, July 2020, [French Senate approves measures for 'structuring companies'](#) and Kris Van Hove, October 2020, [Revising the Competition Law Rulebook for Digital Markets in Europe: A Delicate Balancing Act](#).

³⁸ For example, Furman Review (2019), [Unlocking Digital Competition](#) (paragraph 1.58) states 'it is clear that for thousands of smaller independent online sellers in particular, Amazon's marketplace is a strategically important gateway to consumers'.

³⁹ As noted in the CMA's market study into online platforms and digital advertising, [final report](#), (paragraph 9) '[t]he costs of digital advertising ... are reflected in the prices of goods and services **across the economy**' (emphasis added).

number of products offered by that marketplace could be compared to figures for other marketplaces or for other retailers.

- *Enabling a firm to extend or protect its market power*

47. All of the major reports emphasise the ability of very large firms to extend market power from one activity into other, related activities.⁴⁰ Such conduct was also emphasised by many stakeholders during the course of our work and the market study noted that it had received numerous complaints about such conduct.⁴¹
48. The extension of market power into other activities is of concern not only because it may extend a firm's market power into a new area, but also because it may further enhance and protect a firm's existing market power.⁴² Therefore, the ability of a firm to extend its market power in one activity into other activities is likely to indicate that the effects of a firm's market power are particularly significant and widespread. This is especially true when the firm's designated activity is also an access point to customers for other businesses across a wide range of markets. In such circumstances, a firm is more likely to have opportunities to extend its market power across a particularly diverse range of activities.⁴³
49. The assessment of this factor should closely resemble the assessment of a firm's ability to foreclose as conducted, for example, in a merger case.⁴⁴ Such an assessment should involve understanding a firm's capabilities and the extent to which this creates opportunities for the extension of market power. We would expect a potential SMS firm to have opportunities to extend its market power that are not available to other firms. This could be because the potential SMS firm has access to richer data about consumer behaviour, perhaps because the firm offers a broader ecosystem of products. Observed

⁴⁰ Furman Review (2019), [Unlocking Digital Competition](#), paragraphs 1.64 and 3.113. See also Stigler Center (2019), [Committee on Digital Platforms Final Report](#), page 35 and Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition policy for the digital era, final report for the European Commission](#), page 7, 37 and 65-66.

⁴¹ Specific examples noted by the market study included Google and its specialised search products, Sonos' concerns regarding Google's conduct vis-à-vis smart speakers and voice assistants and the extension of Facebook's market power in display advertising into other advertising related markets (CMA's market study into online platforms and digital advertising, [final report](#), paragraphs 58, 3.135, and 5.114). Such conduct has also been a focus of a number of anti-trust cases including the Google Shopping case.

⁴² For example, by providing the ability to deny competitors the scale required to compete effectively or by creating an ecosystem of products meaning that any competitor would need to compete effectively across an entire ecosystem, thereby raising barriers to entry.

⁴³ For example, where leveraging into more loosely connected activities that do not clearly fall into the same supply chain might be possible.

⁴⁴ In merger cases the CMA uses the ability, incentive, effect framework to assess the potential for foreclosure.

behaviour, particularly past incidences of successfully extending market power across activities would also be relevant.

50. Additionally, several of the most powerful firms offer a wide range of products as part of an ecosystem. Several policy reports and stakeholders have emphasised the importance of such ecosystems of products in protecting a firm's market power in an activity.⁴⁵ Therefore, this factor may be particularly relevant where an activity plays an important role in entrenching the firm's position in another activity where an SMS finding has already been made. For example, the market study discussed how part of Google's reason for establishing a strong position in open display advertising may have been to protect Google's search advertising business.⁴⁶ If Google is designated with SMS on the basis of Google Search, then this could be a factor in contributing to an assessment of whether Google Open Display also provides Google with SMS.

- *Determining the 'rules of the game' within their own ecosystems and for a wider range of market participants*

51. The decisions of some firms can effectively determine the 'rules of the game' for others, determining norms not only within the firm's own ecosystem but also, potentially, for other market participants.⁴⁷ As a result, a decision taken by a firm has the potential to have far-reaching effects beyond the firm's direct ecosystem.

52. The market study described this as a firm having a 'quasi-regulatory' role and put forward as an example Google and Facebook's role in interpreting data protection law, especially Google's announcement that it would phase out support for third-party cookies on Chrome.⁴⁸ Other examples could include:

- (a) the influence of Google's ad server on the rules followed by other intermediaries in the advertising chain, such as rules covering the

⁴⁵ For instance: Furman Review (2019), [Unlocking Digital Competition](#), paragraph 3.113, 2.22-2.23; CMA's market study into online platforms and digital advertising, [final report](#), paragraphs 2.36-2.38; Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition policy for the digital era, final report for the European Commission](#), page 7, 65-68 and 121; Stigler Center (2019), [Committee on Digital Platforms Final Report](#), page 70. This point was also made by several respondents to our call for information. Similar considerations are also part of proposals in other jurisdictions. For example, the French Senate bill relating to 'structuring companies' and the German draft amendment to the German Competition Act, both refer to the firm's vertical integration and its activities in related markets as relevant considerations. See Alain Ronzano, July 2020, ['French Senate approves measures for 'structuring companies''](#) and Kris Van Hove, October 2020, ['Revising the Competition Law Rulebook for Digital Markets in Europe: A Delicate Balancing Act'](#).

⁴⁶ CMA's market study into online platforms and digital advertising, [final report](#), paragraph 5.301.

⁴⁷ Such effects were highlighted by several respondents to our call for information.

⁴⁸ CMA's market study into online platforms and digital advertising, [final report](#), paragraph 47.

sequencing by which different intermediaries receive information pre-auction;⁴⁹ and

(b) *de facto* requirements that publishers use certain mobile friendly formats to benefit from advantageous distribution via Google Search and Facebook's Social Media platforms. As a result, Google and Facebook have important effects on how mobile webpages are designed across the Internet.⁵⁰

53. Such a 'quasi-regulatory' role could arise for a number of different reasons. For example, if the firm offers a set of inter-related products then other firms may have a strong incentive to adopt the standard used by the potential SMS firm to ensure compatibility with the SMS firm's product offering. Alternatively, the size of a firm's designated activity may be such that it becomes a focal point, determining the norms of behaviour for other market participants.

- *Effects on socially or culturally important markets*

54. During the market study a significant number of concerns were raised about the impact of Google and Facebook on the news media and the implications for the provision of authoritative and reliable journalism.⁵¹ Similar concerns were also raised by a number of stakeholders during the course of our work. Such concerns are examples of a firm's market power having significant implications for markets that are perceived to be socially or culturally important. For example, a social media firm may influence socially or culturally important markets because of its effects on free speech, political discourse and journalism. Alternatively, a firm may be socially important because it operates, or its actions have implications for, critical infrastructure or because the firm has access to highly sensitive healthcare data.

55. The effects of a firm's market power are likely to be particularly significant if it has effects on a socially or culturally important market. However, we do not consider it appropriate for the DMU itself to determine which markets are socially or culturally important and which are not. In our view, this should be a decision taken by accountable, elected representatives – ie a judgement that should be made by government and/or Parliament. Therefore, we would expect government to advise the DMU on whether certain markets should be viewed as socially or culturally important and the reasons why.

⁴⁹ CMA's market study into online platforms and digital advertising, [Appendix U: supporting evidence for the code of conduct](#), paragraph 147.

⁵⁰ CMA's market study into online platforms and digital advertising, [final report](#), paragraph 5.365.

⁵¹ CMA's market study into online platforms and digital advertising, [Appendix S: the relationship between large digital platforms and publishers](#).

Box B.2: Assessing whether a firm has a strategic position

An assessment of whether a firm has a strategic position is an assessment of the implications of a firm's market power and whether those implications are particularly widespread or significant. Therefore, the different factors contributing to the test, including the level of market power that the firm enjoys, cannot be considered in isolation and should be assessed together to reach an overall view on whether a firm has SMS.

A variety of factors could contribute to the assessment of the implications of a firm's market power (ie to the strategic assessment). The precise relevance of each factor could vary from case to case and not all factors need be relevant to a designation assessment. The factors we have identified are:

- (a) the firm's size or scale in an activity;
- (b) a firm's role as an important access point to customers (a gateway) for a diverse range of other businesses or the fact that the activity is an important input for a diverse range of other businesses;
- (c) an activity's role in enabling a firm to extend or protect its market power;
- (d) circumstances when a firm can use an activity to determine the 'rules of the game' within its own ecosystem and also in practice for a wider range of market participants; or
- (e) the activity's effects on socially or culturally important markets.

Our recommended SMS test

56. Taken together, our recommendations lead to the following SMS test: the DMU should have the power to designate a firm with SMS when the firm has substantial, entrenched market power in at least one digital activity, providing the firm with a strategic position.⁵²
57. Box B.3 compares our recommended SMS test with legislative initiatives in other jurisdictions.

⁵² When re-designating a firm, it may be necessary to consider whether the firm would have SMS absent regulation. This is equivalent to Ofcom's 'modified greenfield' approach in the SMP regime.

Box B.3: legislative initiatives in other jurisdictions

There are a number of proposals in other jurisdictions with similarities to the SMS regime.⁵³

European Commission's Digital Markets Act proposals

The European Commission is developing proposals for *ex ante* rules for large online platforms acting as 'gatekeepers'.⁵⁴ These proposals have yet to be published but the available information refers to a desire to address the consequences of market power, the extension of market power from one activity to others and the role of certain firms in determining the 'rules of the game' and as an important access point to customers.⁵⁵

The German Competition Act draft amendment

The amendment introduces the concept of 'undertakings with paramount significance for competition across markets' and links this status to: (i) dominance in one or more markets; (ii) financial strength or access to other resources; (iii) vertical integration and activities on otherwise related markets; (iv) access to data relevant for competition; and (v) importance of the firm's activities for third parties' access to supply and sales markets, and related influence on third parties' business activities.⁵⁶

The French Senate bill

The bill relates to 'structuring companies'. 'Structuring companies' will be identified by considering a number of factors including (i) whether a firm has a dominant position in one or more markets; (ii) the number of unique users of the firm's products or services; (iii) the firm's vertical integration and activities in other related markets; and (iv) the importance of the firm's activities for third-party access to

⁵³ Other proposals not discussed in detail but with some similarities include: (i) the Japanese Fair Trade Commission's review of its guidelines on Abuse of a Superior Bargaining Position, Japan FTC (2019), [Release of the "Guidelines Concerning Abuse of a Superior Bargaining Position in Transactions between Digital Platform Operators and Consumers that Provide Personal Information, etc."](#); (ii) a Japanese proposal to create transparency and fairness obligations for 'Specified Digital Platform Providers', Japan's Ministry of Economy, Trade and Industry (2020), [Cabinet Decision on the Bill for the Act on Improvement of Transparency and Fairness in Trading on Specified Digital Platforms](#); (iii) the ACCC ongoing inquiry into markets for the supply of digital platform services, ACCC (2020), [Digital Platform Services Inquiry](#); and (iv) the ACCC's mandatory code of conduct to address bargaining power imbalances between Australian news media businesses and digital platforms, ACCC (2020), [News media bargaining code](#).

⁵⁴ European Commission, [The Digital Services Act package](#).

⁵⁵ European Commission's Brochure (2019), [How do online platforms shape our lives and businesses?](#) and Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition policy for the digital era, final report for the European Commission](#), page 7, 37 and 65-66.

⁵⁶ Kris Van Hove, October 2020, ['Revising the Competition Law Rulebook for Digital Markets in Europe: A Delicate Balancing Act'](#) and German draft amendment to the German Competition Act, [full text](#), (in German).

markets and the influence that it consequently exercises on the activities of third parties.⁵⁷

A comparison with our proposed SMS test

The German and French proposals have several similarities to our SMS proposal including:

- A market power assessment (both refer to dominance).
- A wider assessment of the potential impact of that market power. For example, both proposals refer to the importance of the firm's activities for third party access to markets, which is similar to whether a firm is an important access point to customers or is a gateway under our proposal. Similarly, both refer to vertical integration and related markets which is similar to our emphasis on a firm's wider ecosystem of products.

The available information indicates that the European Commission's proposals are also motivated by many of the factors that would be relevant to an assessment of our proposed SMS test.

Recommendation 3b: The DMU should set out in formal guidance its prioritisation rules for designation assessments. These should include the firm's revenue (globally and within the UK), the activity undertaken by the firm and a consideration of whether a sector regulator is better placed to address the issues of concern.

58. We believe that our recommended SMS test will be satisfied by only a relatively small number of firms. However, the DMU will have to exercise its discretion regarding which designation assessments to consider. The DMU should provide guidance as to the factors it will have regard to when prioritising designation assessments. This guidance will provide further clarity as to which firms may be within scope of the regime. We believe that it would be appropriate for the DMU to identify the following factors in its guidance:

- (a) a firm's revenue;
- (b) the activity concerned; and

⁵⁷ Alain Ronzano, July 2020, '[French Senate approves measures for 'structuring companies'](#)' and French Senate bill, [full text](#) (in French). Other factors include the benefit the firm derives from significant network effects, the firm's financial valuation and the firm's access to essential data for the access to a market or the development of an activity.

- (c) a consideration of whether a sector regulator is better placed to address the issues of concern.

The DMU should consider a firm's revenue before prioritising a designation assessment

59. Revenue is a simple measure which will allow firms to self-assess whether they could be within the regime's scope. It will also focus the regime on instances where the potential impacts of any interventions are likely to be greatest.⁵⁸
60. A consideration of revenue raises the following five questions:
- (a) Should it be the revenue of the corporate group or something narrower?
 - (b) Should it be UK or global revenue, either or both?
 - (c) What level should any revenue threshold be set at?
 - (d) How should any threshold be updated?
 - (e) Should a revenue threshold be part of the statutory test rather than a factor influencing prioritisation?
61. Taking each of these questions in turn. First, the DMU should consider the revenue threshold of the whole corporate group and not the revenue associated with a subset of a firm's activities. Considering the revenue of the whole corporate group limits the need to allocate revenues precisely to different activities creating a simpler, more efficient process.⁵⁹
62. Second, we suggest that the DMU should focus on UK revenue when prioritising designations, although it could also consider global revenue. A focus on UK revenue is consistent with SMS being a UK regime with a focus on issues that are important in the UK. For example, a consideration of UK revenue would exclude firms such as Tencent and Alibaba which currently have no or limited UK presence.
63. However, the intention is that the SMS regime focusses on a relatively small number of firms where any customer harm is likely to be most significant. Such considerations may be reflected in a firm's global revenue. For example,

⁵⁸ As such, there is some overlap with this prioritisation factor and the consideration of a firm's size when assessing whether a firm has a strategic position. However, the assessment of a firm's size could consider a much wider set of measures of size (eg the number of users or the gross value of transactions facilitated).

⁵⁹ Any attempt to do so would be particularly difficult in many digital firms where it is not necessarily clear to exactly which activities revenues should be allocated.

firms with a large global presence (and therefore significant global revenues) are more likely to benefit from substantial economies of scale and scope, especially where digital technologies allow economies of scale and scope to be exploited across geographic boundaries. Such economies of scale and scope are likely to help entrench a firm's market power.

64. Therefore, we recommend that, although the DMU's primary focus should be on UK revenue, it could also consider global revenue (in addition to UK revenue) when prioritising designation assessments.
65. Third, we have assessed the appropriate level of revenue using publicly reported information on revenues and confidential information provided to us. Based on this information we suggest that the DMU should focus on instances where a firm's UK revenue exceeds £1 billion and particularly those which also have annual global revenue in excess of £25 billion. In our judgement, these thresholds would provide clarity to a significant number of firms, focussing the regime on the relatively small number of firms who are likely to satisfy the SMS test, while still ensuring flexibility so the regime can adequately address significant potential problems.
66. Fourth, any revenue thresholds should be updated from time to time to remain relevant. Therefore, the DMU should keep the thresholds under review and update the thresholds when appropriate.
67. Finally, we are recommending that UK and global revenue should be a factor influencing the DMU's prioritisation of designation assessments. We are not recommending that a revenue threshold is included as part of the statutory test – ie we are not recommending that a revenue threshold is something that must be satisfied in every case. In our view, this provides an appropriate balance between clarity and flexibility. For example, it would allow the DMU to prioritise important designations where the threshold was close to being met but there was evidence of substantial harm while indicating that such cases are likely to be rare.⁶⁰

The DMU should initially prioritise designation assessments in relation to specific activities

68. Above we have explained our view that the SMS regime should focus on digital activities, which are those where digital technologies are material to the products or services provided as part of an activity. We do not propose that

⁶⁰ Having revenue as a prioritisation factor also avoids the need for a precise methodology for identifying UK revenues and the potential for lengthy debates about: (i) an appropriate methodology and (ii) the correct application of any methodology.

the scope of the regime, in terms of sectors in which it could be applied, should be more narrowly constrained, to preserve flexibility as digital markets evolve.

69. We note that other legislation is confined to specific identified sectors. For example, the Platform to Business Regulation⁶¹ applies to ‘online intermediation services’ and ‘online search engines’ and the Digital Services Tax⁶² applies to social media platforms, search engines and online marketplaces. However, in our view any attempt to limit the regime to a narrow list of sectors could quickly become outdated, given the pace at which digital markets evolve, and would need to be frequently reviewed and updated creating an inefficient process. In practice, the need to designate a new sector will be motivated by concerns surrounding a specific firm. Evidence specific to that firm would be needed to justify the inclusion of the new sector. The same evidence would then be used to undertake the SMS designation. As a result, the SMS assessment (or significant elements of it) would effectively be run twice, once to identify the sector and once to designate the firm. This would create an inefficient process.
70. Furthermore, identifying specific sectors to which the SMS regime applies would require precise definitions of those sectors. The SMS assessment would then require a formal assessment of whether the firm satisfied the definition. As we noted when discussing the term ‘digital’, such debates, which would be unrelated to the potential for consumer harm, would produce an inflexible regime and would risk creating an unclear test and an inefficient designation process.⁶³ Not confining the SMS regime to specific identified sectors would allow the DMU to apply the SMS regime in a timely manner where the evidence justified doing so.
71. However, we recognise that providing some initial guidance to firms on the sectors the DMU is likely to focus on would be valuable to provide clarity on the scope of the regime. These sectors should be those where the market features may make the accumulation of substantial, entrenched market power more likely and where the effects of any firm having SMS might be most significant. Based on the market study’s work, stakeholder responses and a range of policy reports, we consider relevant sectors could include online marketplaces, app stores, social networks, web browsers, online search engines, operating systems and cloud computing services.

⁶¹ [EU platform-to-business relations](#) (P2B regulation).

⁶² HM Treasury, [Digital Services Tax](#).

⁶³ We note that it is for this reason that we are recommending that the term ‘digital’ is interpreted broadly.

72. There is some evidence that these sectors have market features (eg economies of scale and network effects) that make it more likely that a firm will obtain substantial, entrenched market power. Furthermore, these are sectors that are either currently important, eg because firms act as an important means to accessing customers, or which are rapidly expanding and where there is good reason to believe the sector could be of significant importance in the foreseeable future.

Before prioritising a designation assessment, the DMU should consider whether a sector regulator is better placed to address the issues of concern.

73. Our expectation is that the SMS regime will only be applicable to a small number of firms. However, there may be some limited instances in which the concerns motivating a possible SMS designation could be addressed either using the SMS regime or by using the powers of a sector regulator (eg if the activity falls within the remit of Ofcom's SMP regime). In such circumstances we expect the DMU to consider whether the sector regulator (working with the DMU) is better placed to address the issues of concern before prioritising a designation assessment.

Alternative approaches to the SMS test that we are not recommending

74. In reaching our recommendation we have considered a range of alternative options. We briefly discuss three particularly notable alternatives below:
- an SMS test without an assessment of market power;
 - formally limiting the SMS regime to 'platforms' or 'online platforms'; and
 - incorporating alternative terms, such as 'gatekeeper' and 'dependence', into the statutory test.

An SMS test without an assessment of market power

75. As we have noted, most stakeholders submitted that the SMS test should involve an assessment of market power. However, some stakeholders provided a contrary view, for example submitting that the SMS regime could apply only in certain pre-identified sectors where a jurisdictional threshold is satisfied. In such an approach, any firm within those sectors satisfying the jurisdictional threshold would be designated with SMS.
76. In our view, any test without a market power assessment would be overly simplistic and would fail to ensure that SMS designations are evidence-based

and well-directed towards cases where harm is most likely to arise – ie cases in which a firm has, at a minimum, substantial, entrenched market power.

77. A key feature of the approach we are proposing is that it is based on an economic assessment and targeted at identified harms. It is this assessment which provides the justification for the application of the SMS regime to a firm. A test without any assessment of market power would not provide sufficient justification for the application of the SMS regime, nor would it assist in identifying where, within a firm, SMS interventions, such as applying the code of conduct, would be justified. Before any elements of the SMS regime are applied, we consider it necessary that, at least, an assessment of market power is undertaken to identify where those interventions are justified. It is most efficient if this assessment is incorporated into the SMS test itself so that firms to which the interventions are addressed are designated with SMS and interventions are only feasible where there is a case for doing so.

Formally limiting the SMS regime to ‘platforms’ or ‘online platforms’

78. When discussing the concerns motivating the SMS regime and similar proposals, the terms ‘platform’ or ‘online platform’ are often used.⁶⁴ While the term ‘platform’ is widely used, it is clear that there are a variety of different definitions.⁶⁵ Therefore, if the SMS regime were to be restricted to ‘platforms’ or ‘online platforms’ it would be important to clearly define these terms.
79. Some definitions of the term ‘platform’ describe an intermediary – ie a firm that links groups of users, allowing those users to ‘interact’. These ‘interactions’ could take a wide variety of different forms – eg buying and selling products or services, the provision of advertising or the exchange of data. These simplest definitions would be satisfied by a wide range of businesses – eg supermarkets enable product manufacturers to sell products to end-customers. As such, they would provide limited clarity on the scope of the regime and we consider there to be little value in complicating the SMS test by including such a definition of a platform.
80. A number of other definitions of a ‘platform’ have been suggested linking ‘platforms’ to the significance of network effects or the degree of control a firm

⁶⁴ Furman Review (2019), [Unlocking Digital Competition](#), Stigler Center (2019), [Committee on Digital Platforms Final Report](#), Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition policy for the digital era, final report for the European Commission](#), Digital Markets Taskforce, [terms of reference](#). These terms were also used by a number of respondents to our call for information.

⁶⁵ The Stigler Center (2019), [Committee on Digital Platforms Final Report](#) (page 7) states that ‘digital platform lacks a consistent definition – different companies may be characterized as a platform in different environments’. Similarly, a report by Oxera states that ‘the generic notion of ‘online platform’ does not seem fit for purpose’. See Oxera (2015), [Benefits of online platforms](#), page 1. Similar observations about the diversity of digital platforms have been made by several stakeholders.

has over the interactions between users.⁶⁶ However, these definitions are vague and relate to factors that are not readily measurable. Therefore, we do not consider such definitions to be suitable for use in a legal test.⁶⁷ Any attempt to include such a definition of a platform would risk creating an unclear and complicated SMS test with an inefficient designation process. Instead we consider that further clarity on the scope of the regime can be provided through guidance, eg identifying sectors where initial designation assessments might be prioritised as suggested above.

Alternative terms such as gatekeeper and dependence

81. The market study referred to Google's and Facebook's 'gatekeeper role and market power, which leads to a position of dependency for users'.⁶⁸ The European Commission's proposals have been referred to as rules to be applied to 'gatekeeper' platforms.⁶⁹ More generally, a wide variety of terms such as 'bottlenecks' and 'relative market power' are referred to by various authors.⁷⁰ Therefore, we have considered whether such terms should form part of the statutory test.
82. First, we have found that stakeholders interpret these terms in a variety of different ways and that the meanings of such terms are unclear.⁷¹ Therefore, if these terms are to be used, they should be clearly defined and the implications of these definitions should be carefully considered.
83. For example, at a minimum, the term 'gatekeeper' refers to a situation where a firm provides access to customers for other businesses – ie the firm is an

⁶⁶ For example, see European Commission staff working document (2016), [Online platforms](#) (page 3); Rochet, Tirole (2003), [Platform Competition in Two-Sided Markets](#); Evans, Schmalensee (2007), [The Industrial Organisation of Markets with two-sided platforms](#); Hagiu, Wright (2015), [Multi-sided platforms](#).

⁶⁷ A similar point has been made by Philip Marsden and Rupperecht Podszun. See Marsden, Podszun (2020), [Restoring Balance to Digital Competition – Sensible Rules, Effective Enforcement](#), page 17.

⁶⁸ CMA's market study into online platforms and digital advertising, [final report](#), paragraph 7.105.

⁶⁹ European Commission, [The Digital Services Act package](#).

⁷⁰ See for instance: Alexiadis, de Streel (2020), [Designing an EU Intervention Standard for Digital Platforms](#); Padilla, Perkins and Piccolo (2020), [Self-Preferencing in Markets with Vertically-Integrated Gatekeeper Platforms](#); Prat, Valletti (2019), [Attention Oligopoly](#); Furman Review (2019), [Unlocking Digital Competition](#), paragraph 2.117.

⁷¹ Eg BGL submitted that the term 'economic dependence' is 'vague and implies a lower threshold than dominance' but that 'true dependence' should capture 'not only the (very high) levels of economic reliance placed on the platform by its users for a wide variety of their key needs, but also the fact that the platform with SMS has no competitors who can realistically compete with it in terms of scale and breadth of the service it provides.' BGL also submitted that the term 'gateway' is 'too broad and risks capturing any platform that provides an important route to market for small suppliers.' (BGL's call for information response, paragraphs 1.11-1.14). In contrast, Booking.com submitted that 'what sets gatekeepers apart from other platforms (and simply dominant firms) is their ability to control not just one market but entire ecosystems of unrelated markets (e.g. an operating system and a streaming service)' (Booking.com's call for information response, pages 7-8). Other stakeholders also commented on the difficulties involved in defining such terms.

intermediary.⁷² Therefore, incorporating the term ‘gatekeeper’ would implicitly limit the scope of the regime to intermediaries. However, we have received no evidence indicating that it would be appropriate to limit the SMS regime to intermediaries. We also do not consider the issues the SMS regime is intended to address are unique to firms that can be described as intermediaries.⁷³

84. Second, in most cases these terms describe situations in which a firm has market power or where the effects of that market power are particularly significant for users.⁷⁴ As such, we consider them to be incorporated into our recommended SMS test either as part of an assessment of market power and/or a factor contributing to whether a firm has obtained a strategic position.⁷⁵ Therefore, evidence that a firm’s users are ‘dependent’ or that the firm is a ‘gatekeeper’ or ‘bottleneck’ would be evidence to support a finding that a firm has SMS. For this reason, we do not consider it necessary to introduce terms such as gatekeeper or dependence into the statutory test in their own right.

The designation process

85. In this section we develop our recommendations for the designation process considering:
- Who should be the decision maker? – We recommend that the decision to designate a firm as having SMS should be made by the DMU.⁷⁶
 - How should the designation process be run and whether there should be a deadline for the designation process? – We recommend that the designation process should be a public and transparent process with

⁷² For example, this appears to be the sense in which the term gatekeeper is used at paragraph 2.10 of Furman Review (2019), [Unlocking Digital Competition](#).

⁷³ This is supported by our interviews on how digital markets are evolving (see Appendix A) where participants referred to the potential for the issues motivating the SMS regime, such as the widespread extension of market power, to arise in areas where firms are not intermediaries eg in the future in various areas of cloud computing.

⁷⁴ For example, Alexiadis, de Stree (2020), [Designing an EU Intervention Standard for Digital Platforms](#) describes dependence as a situation where a user ‘has insufficient and unacceptable means of switching to other providers’ (page 16) and the Stigler Center (2019), [Committee on Digital Platforms Final Report](#) (page 105) defined a bottleneck as ‘where consumers primarily single-home and rely upon a single service provider, which makes obtaining access to those consumers for the relevant activity by other service providers prohibitively costly’.

⁷⁵ This observation was made by PayPal (PayPal’s response to our call for information, paragraph 8) who noted that ‘[t]o a large extent these terms overlap ... Therefore, an assessment of ‘strategic market status ... ought to evaluate these concepts as part of an overall assessment rather than interpreting them as distinct, individual criteria’.

⁷⁶ As set out in chapter 6 of the main advice, Ofcom or the FCA could have powers to make decisions in relation to designating an activity of an SMS firm.

consultation on a provisional decision prior to finalisation and the assessment completed within a statutory deadline.

- How long should a designation be for? – We recommend that designation is fixed for five years.
- To which entity should SMS status apply? – We recommend that the SMS status should apply to the firm as a whole. However, remedies should apply to only a subset of a firm’s activities.
- What should the appeals process be? – The DMU’s decisions should be judicially reviewable on ordinary judicial review principles and the appeals process should deliver outcomes quickly.

The DMU should be the decision maker

86. We recommend that once the regime is established, SMS designation and the adoption of a code is a formal process run by the DMU.⁷⁷ The decision on designation should be viewed as the exercise of an independent expert regulatory judgment by the DMU, both as to whether the criteria for designation are met and whether it is appropriate to designate a firm.
87. In discharging that decision making we recommend that the DMU bear the evidential and legal burden of establishing that a firm should be designated as having SMS and discharge that burden to the ordinary civil standard, on the balance of probabilities.
88. We recommend the DMU should develop guidance on how it will operate its designation process, and on how it expects to conduct its assessment.⁷⁸

Recommendation 3c: The designation process should be open and transparent with a consultation on the provisional decision and the assessment completed within a statutory deadline.

89. The designation process should be open and transparent. The precise details of how this should be achieved should be a matter for the DMU but we would expect it to be likely that the DMU would:

⁷⁷ As set out in chapter 6 of the main advice, Ofcom or the FCA could have powers to make decisions in relation to designating an activity of an SMS firm, to set and enforce a code of conduct in relation to that activity and to implement pro-competitive interventions in relation to that activity where the designated activity is in a regulated sector. This does not change the proposal that all decisions should be viewed as independent expert regulatory judgements.

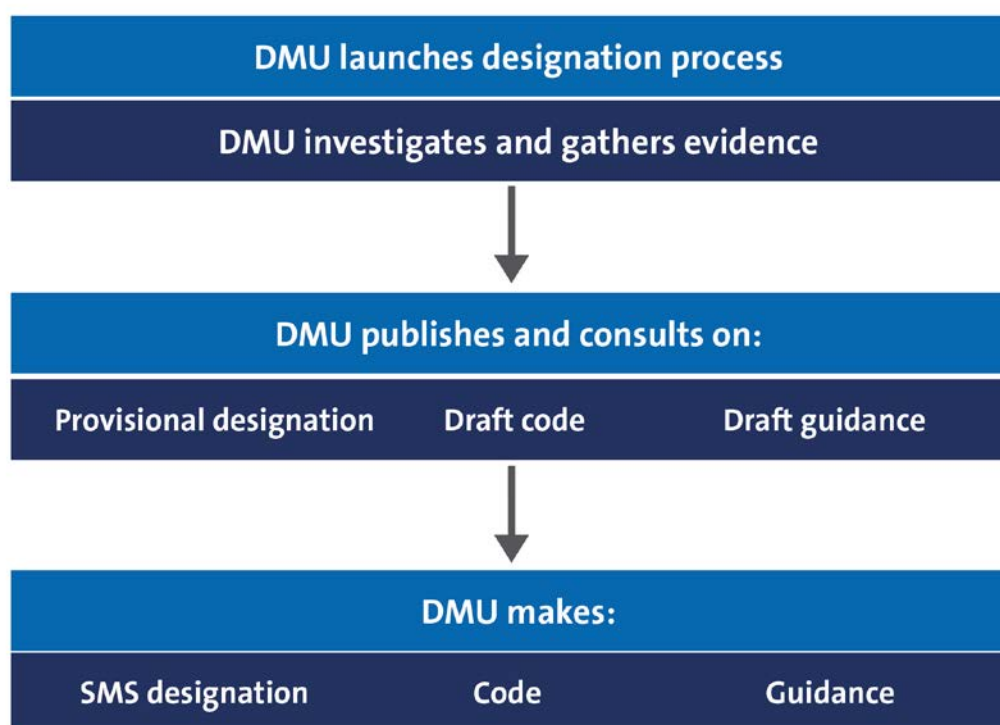
⁷⁸ Examples of issues that could be included in this guidance include the factors the DMU is likely to consider when assessing whether a firm has a strategic position and how activities will be identified.

- (a) publish a notice opening the designation process;
 - (b) publish and consult on a provisional designation, specifying the activities to be subject to regulation by the code⁷⁹ and the reasons for the decision; and
 - (c) publish a final decision on designation, specifying the activities to be subject to regulation by the code and the reasons for the decision.
90. We expect that, alongside the case opening, or soon after, the DMU will set out the issues it is investigating and invite evidence from stakeholders.
91. As set out above, the SMS test is an assessment in relation to a particular activity the firm undertakes. Where more than one of a firm's activities may meet the SMS test, and these activities are related, the DMU may choose to undertake designation assessments in parallel, for example if there are efficiencies in the evidence to be collected and the analysis to be undertaken. These activities may also be subject to the same or similar codes. For example, in relation to the digital advertising market, the DMU may assess whether Google has SMS in relation to Google Search and Google Open Display in parallel. Conversely, where more than one of a firm's activities may meet the SMS test but these activities are less closely related, the DMU could undertake these assessments separately.
92. During the designation process the DMU will need to gather information to establish if the firm has SMS and, if so, in which activity or activities. As part of that same process, it should also gather information necessary to determine what conduct should be covered by the code in those activities. We recommend the DMU be empowered to use its general information gathering powers, as described in Appendix E, to collect the necessary evidence to inform its designation decision.
93. We expect the DMU's evidence gathering would be focused on reviewing representations and gathering information and documents via notice, but it may wish to collect information via interviews or a hearing with the firm or third parties.
94. Subject to the necessary confidentiality redactions, we would expect the DMU to consult publicly on its provisional decision. We would expect the DMU to receive relevant submissions from the firm and from other stakeholders.

⁷⁹ We discuss how these activities should be identified in Appendix C.

95. As described in Appendix C, we expect the provisional code, which aims to prevent SMS firms from taking advantage of their powerful positions in the activities that give rise to their SMS designation, will be consulted on alongside the provisional decision.

Figure B.2: overview of the designation process



96. We recommend the process of designation in relation to a particular activity, and subsequent re-designation processes, should be subject to a statutory deadline. This recommendation reflects the need for faster decision making in these markets, and aims to deliver greater certainty for firms' potentially subject to designation and those that use or rely on their services.
97. We consider that, if the government, and Parliament, were to accept this recommendation, and judge that a statutory deadline is the right approach, the period they choose to adopt will provide a clear delineation of the nature of the review that the DMU is expected to undertake. This legislative choice will be clear to the parties, the DMU and the courts, and will reduce the risk that the process becomes unwieldy, with a strong justification for appropriate scoping and prioritisation of analysis by the DMU, and the DMU adopting appropriate administrative deadlines.
98. The statutory deadline should apply from the point of launching the designation process. Within that deadline we recommend the DMU have

discretion on how it schedules the compulsory consultation steps and operates its information gathering and other administrative processes.

99. We suggest that the designation process, and subsequent re-designations could be completed within 12 months.⁸⁰ In suggesting 12 months, we recognise the need to balance pace and certainty for SMS firms and other stakeholders as to the outcome of the designation assessment, with the need to ensure a decision on designation is robust and informed by evidence which will need sufficient duration to achieve. As we explain in Appendix C, the 12-month period encompasses not just the process of designation, but also the design and adoption of the code of conduct.

Recommendation 3d: A firm’s SMS designation should be set for a fixed period before being reviewed.

100. We recommend that designation be fixed for a maximum period before being reviewed.⁸¹ Adopting a fixed period reflects both the finding that the firm has entrenched market power in the relevant activities and that a threshold for establishing a period of stable regulatory intervention has been met. This defined period of regulatory action is necessary to give certainty to both the firm, competitors and users of its services to make investment decisions, in light of the provisions made in the code and in pro-competitive interventions.
101. We suggest that five years⁸² is an appropriate fixed period which balances the finding that the firm has substantial, entrenched market power in an activity providing it with a strategic position, with the need to ensure the designation remains appropriate. This element of entrenched market power as a core finding of designation, means the justification for the status is unlikely to be competed away in the short term, and requires that remedies need to be available for a sufficient period for regulation to be beneficial for potential users of the services and to allow any interventions impacting on competition to have an effect.

⁸⁰ Where a firm has been designated, we consider that the decision on whether re-designation is appropriate could, in fact, be undertaken in less than 12 months.

⁸¹ The maximum designation period should not prevent the DMU from conducting a re-designation process earlier. We would expect this might be appropriate if there are material changes in circumstances that warrant review or if the DMU judged it desirable to conduct parallel reviews so certain SMS firms initially designated at different times were on a common designation timetable track.

⁸² This has a parallel in the five-year period over which Ofcom now undertakes its forward look of telecoms markets and applies its ‘significant market power’ (SMP) regulation in a market. See the [government’s recent response](#) to the public consultation on implementing the European Electronic Communications Code, 22 July 2020 (page 26), describing the move to five years and observing ‘We welcome comments that support the role of longer market review periods in providing regulatory certainty to incentivise investment’ (page 22) and ‘We agree with the majority of responses that noted the positive impact of moving to a five year review period, bringing greater regulatory stability and certainty for industry.’

102. A consequence of a fixed period of designation is that if the DMU judges that designation may remain appropriate, we expect the DMU will need to initiate a designation review at least a year before the end of the five year cycle.⁸³ Too short a maximum period of designation, will risk the DMU, and the respective firm, being diverted into a near constant designation cycle (particularly were designation to be appealed), rather than focusing on the core purpose of the SMS regime – the application of effective regulation in the form of an SMS code, pro-competitive interventions (where appropriate) and the SMS merger rules.

The DMU should have the power to add or remove activities within a designation period

103. A firm could satisfy the SMS test in relation to multiple activities and could therefore have more than one designated activity. We recommend that the DMU have the power to add or remove individual activities from a firm's overall SMS designation where a change in circumstance makes that appropriate.
104. The DMU should apply the same process steps to make a change as it would follow in making a designation. We recommend that, as for designation, amendments should be subject to a 12-month statutory deadline, but we would not expect most variations to take that long. We also expect that where the DMU was proposing to add or remove a designated activity it would consult on the consequential changes to the code it envisioned making at the same time.
105. We expect, given the forward-looking assessment of entrenched market power, that removal of designation in relation to a designated activity would be exceptional. Nevertheless, we recommend that the power should be available to provide flexibility. We also expect, given the comprehensive exercise of designating a firm and the forward look at its activities which give it strategic market status, action by the DMU to add an activity into the scope of designation would happen rarely. Again, given the fast-moving nature of these markets and their propensity to 'tip', we do however recommend the power is available.

⁸³ To avoid the risk of regulatory uncertainty an inadvertent delay in a re-designation process may create, eg if information is not produced on time, we recommend that where the DMU has opened a subsequent designation process in good time it should have the power to extend an existing designation period until determination of that review. This might include where the whole designation, or inclusion of a specified activity, is under appeal. See by analogy Ofcom's power to make temporary arrangements in the Communications Act 2003, in sections 48A, 49A, 80, and 80A and the use of the power in [BCMR-Temporary-Conditions](#).

106. We would expect the DMU to receive applications from firms to remove an activity where there had been a material change in circumstances which made the designation no longer appropriate. We recommend, the DMU should have a discretion whether to exercise this power.⁸⁴ We do not recommend an artificial threshold test be adopted, ie requiring a formal finding that there has been a ‘material change of circumstance’; instead the DMU should exercise its discretion whether to prioritise opening a designation process.
107. In exercising that discretion, public resources should not be unduly diverted into considering frequent requests that the DMU should review designations. In addition to its general discretion, we expect the DMU would not reconsider a request to review an activity within 12 months of declining a previous request. Further, as designation is time-limited we would not expect it to be appropriate for the DMU to exercise this power in the latter years of a designation, as it is likely to be more proportionate to assess such matters as part of the scheduled designation review.

Recommendation 3e: When a firm meets the SMS test, the associated remedies should apply only to a subset of the firm’s activities, whilst the status should apply to the firm as a whole.

108. When a firm meets the SMS test in relation to a particular activity or activities, the associated remedies should only apply to a subset of the firm’s activities. In Appendices C and D we explain that the code and pro-competitive interventions should apply in relation to those activities for which the firm has been designated as having SMS. In Appendix F we explain why the SMS merger rules should apply to all transactions entered into by an SMS firm, with mandatory notification of those that meet certain clear-cut threshold tests
109. However, the ‘status’ should apply to the entire corporate group. This would: ensure the DMU has the ability to require all the information it needs from the corporate group to make the SMS assessment; ensure that parent companies procure their subsidiaries’ compliance with the regime; and prevent the possibility of corporate reorganisations frustrating the application of remedies.

Appeals against designation decisions and the activities and content covered by the code

110. If the new regime is to work effectively and to command the confidence of consumers, SMS firms and the businesses that use them, it is essential that

⁸⁴ Like all discretionary powers, the DMU’s discretion would be subject to normal administrative law principles, the DMU’s exercise of its discretion would need to be rational and reasonable.

the process is fair and transparent, with effective rights of appeal to ensure that is the case. By holding public authorities such as the DMU to account for their decisions, it ensures that high standards of procedural fairness and analytical rigour are adhered to and thereby builds confidence in the system on the part of businesses and consumers.

111. We recommend that the DMU's decisions on designation should be appealable to a court or tribunal, applying judicial review principles.⁸⁵ This is consistent with the DMU's decisions and its accompanying guidance being an expert regulatory decision where the DMU is exercising a discretionary judgment.
112. An appeal should be focused on a review of the DMU's decision, and the evidence underpinning that decision, rather than the appeal body considering afresh the merits of the DMU's decision, and substituting its own judgment for that of the DMU.
113. We set out our detailed advice on appeals against DMU decisions in Appendix E, alongside our wider detailed recommendations for the effective operation of the SMS regime, eg on information gathering powers.

⁸⁵ We would expect this to cover all judicial challenges to the DMU substantive decision, as well as challenges made to the legality or fairness of the process the DMU operates.