

# A new pro-competition regime for digital markets

Advice of the Digital Markets Taskforce

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## Overview

1. In March 2020, the CMA was asked to lead a Digital Markets Taskforce, working closely with the Office of Communications (Ofcom) and the Information Commissioner's Office (ICO), to provide advice to the government on the design and implementation of a pro-competition regime for digital markets. The government was clear when commissioning this work that it should complement and build on the outputs of the Furman Review,<sup>1</sup> as well as drawing evidence from the CMA's market study into online platforms and digital advertising.<sup>2</sup> This report sets out our advice.
2. Digital markets play a fundamental role in modern life, delivering substantial benefits for consumers, businesses and the economy more widely. The online services available to so many of us at the touch of a button have transformed the way we go about our daily lives. For businesses they have opened up new markets and audiences. And in the process, these developments have boosted innovation, lowered prices, and created jobs throughout our economy.
3. However, the dynamics of digital markets have changed hugely, and what were once the 'scrappy, underdog startups'<sup>3</sup> are now amongst the most powerful global firms. The lack of effective competition in the activities of these firms is often the result of specific market features like network effects, economies of scale or unequal access to data. Mergers and acquisitions are also an important part of the business model of these firms, with strategic acquisitions being used to build-up a strong position and to reinforce it, for example by building 'ecosystems' of complementary products and services around their core service, insulating it from competition.
4. The accumulation and strengthening of market power by a small number of digital firms has the potential to cause significant harm to consumers and businesses that rely on them, to innovative competitors and to the economy and society more widely:
  - **A poor deal for consumers and businesses who rely on them.** These firms can exploit their powerful positions. For consumers this can mean they get a worse deal than they would in a more competitive market, for example having less protection or control of their data. For businesses this can mean they are, for example, charged higher listing fees or higher

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<sup>1</sup> Furman Review (2019), [Unlocking Digital Competition](#).

<sup>2</sup> CMA's market study into online platforms and digital advertising, July 2020, [final report](#)

<sup>3</sup> [US Antitrust House Subcommittee Investigation of Competition in Digital Markets](#), 2020.

prices for advertising online. These higher prices for businesses can then feed through into higher prices for consumers for a wide range of products and services across the economy.

- **Innovative competitors face an unfair disadvantage.** A powerful digital firm can extend its strong position in one market into other markets, ultimately giving itself an unfair advantage over its rivals. This means innovative competitors, even if they have a good idea, are likely to find it much harder to compete and grow their businesses. This can result in long-term harmful effects on innovation and the dynamism of UK markets.
  - **A less vibrant digital economy.** If powerful digital firms act to unfairly disadvantage their innovative competitors, these innovative firms will find it harder to enter and expand in new markets, meaning the ‘unicorns’ of tomorrow that will support jobs and the future digital economy will not emerge.
5. It is imperative that digital markets continue to thrive and deliver the benefits we all value so highly. Without effective competition, we will not unlock the full potential for these digital services to contribute to economic growth and the UK’s recovery from COVID-19. That is why we can no longer ignore the significant harms caused by powerful digital firms which are now increasingly evident. As has now been recognised in many prominent reports,<sup>4</sup> existing competition laws are not, by themselves, sufficient to address these challenges. Given the substantial and entrenched market power of these firms, an *ex ante* regime is needed to prevent them from exploiting their powerful positions as well as to drive vibrant competition and innovation.

## Our proposals

### *The DMU*

6. We recommend that the government establish a Digital Markets Unit (DMU) to further the interests of consumers and citizens in digital markets, by promoting competition and innovation. The DMU should be a centre of expertise for digital markets, with the capability to understand the business models of digital firms, including the role of data and the incentives driving how these firms operate.

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<sup>4</sup> Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition for the digital era, final report for the European Commission](#); Stigler Center (2019), ; US House Judiciary Subcommittee on Antitrust, Commercial and Administrative Law (2020), [Investigation of Competition in Digital Markets](#).

7. To that end, government should put in place a regulatory framework for the most powerful digital firms, alongside strengthening existing competition and consumer laws. In considering the design of this regulatory framework we have sought to strike the right balance between the following key principles:
- **Evidence driven and effective** – regulation must be effective, and that means ensuring it is evidence based, but also that it can react swiftly enough to prevent and address harms. The activities undertaken by the most powerful digital firms are diverse and a ‘one size fits all’ approach could have damaging results.
  - **Proportionate and targeted** – regulation must be proportionate and targeted at addressing a particular problem, minimising the risk of any possible unintended consequences.
  - **Open, transparent and accountable** – across all its work the DMU should operate in an open and transparent manner. In reaching decisions it should consult a wide range of parties. It should clearly articulate why it has reached decisions and be held accountable for them.
  - **Proactive and forward-looking** – the DMU should be focused on preventing harm from occurring, rather than enforcing *ex post*. It should seek to understand how digital markets might evolve, the risks this poses to competition and innovation, and act proactively to assess and manage those risks.
  - **Coherent** – the DMU should seek to promote coherence with other regulatory regimes both domestically and internationally, in particular by working through the Digital Regulation Cooperation Forum which is already working to deliver a step change in coordination and cooperation between regulators in digital markets.<sup>5</sup>
8. These factors are not always aligned and there are trade-offs between them. Our recommendations strike what we consider to be the most appropriate balance between these different factors.

### ***The proposed new regime***

9. The DMU should have strong powers to drive vibrant competition and innovation across digital markets. In particular, we are recommending the DMU should oversee a regulatory framework for the most powerful digital

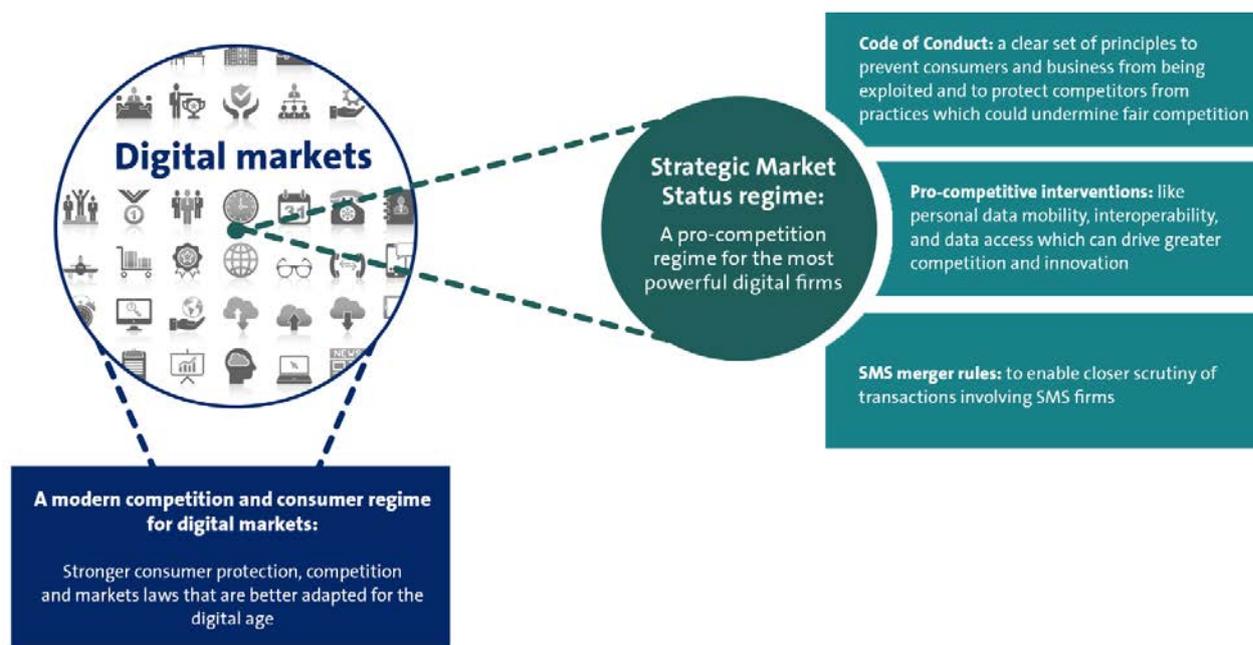
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<sup>5</sup> [The Digital Regulation Cooperation Forum](#) comprises the CMA, Ofcom and the ICO and has been established to support regulatory coordination in digital markets, and cooperation on areas of mutual importance.

firms – ‘the Strategic Market Status (SMS) regime’, with SMS merger rules overseen by the CMA.

10. We are also proposing existing competition and consumer protection laws are strengthened so they are better adapted for the digital age.

**Figure 1: Overview of the proposed new pro-competition regulatory regime**



### ***The SMS regime***

11. The majority of our recommendations relate to the design of a regulatory regime to address the market power of the most powerful digital firms.
12. The entry point to the SMS regime is an assessment of whether a firm has ‘strategic market status’. This should be an evidence-based economic assessment as to whether a firm has substantial, entrenched market power in at least one digital activity, providing the firm with a strategic position (meaning the effects of its market power are likely to be particularly widespread and/or significant). It is focused on assessing the very factors which may give rise to harm, and which motivate the need for regulatory intervention.
13. Those firms that are designated with SMS should be subject to the following three pillars of the regime:
  - **An enforceable code of conduct** that sets out clearly how an SMS firm is expected to behave in relation to the activity motivating its SMS designation. The aim of the code is to manage the effects of market power,

for example by preventing practices which exploit consumers and businesses or exclude innovative competitors.

- **Pro-competitive interventions** like personal data mobility, interoperability and data access which can be used to address the factors which are the source of an SMS firm's market power in a particular activity. These interventions seek to drive longer-term dynamic changes in these activities, opening up opportunities for greater competition and innovation.
  - **SMS merger rules** to ensure closer scrutiny of transactions involving SMS firms, given the particular risks and potential consumer harm arising from these transactions.
14. The SMS regime should be an *ex ante* regime, focused on proactively preventing harm. Fostering a compliance culture within SMS firms will be crucial to its overall success. However, a key part of fostering compliance is credible deterrence and the DMU will need to be able to take tough action where harm does occur, requiring firms to change their behaviour, and with the ability to impose substantial penalties. The ability to take tough action sits alongside enabling resolution through a participative approach, whereby the DMU seeks to engage constructively with all affected parties to achieve fast and effective results.

### ***A modern competition and consumer regime for digital markets***

15. Alongside the SMS regime, it is essential the right tools are available across digital markets more widely to drive competition and innovation and address harm.
16. The core focus of the taskforce advice has been on the design of a pro-competition regulatory regime for digital firms with SMS. We have therefore not considered the challenges across digital markets more widely at the same level of detail. Our key proposal is therefore to establish the DMU such that it is able to take on a proactive role as a centre of expertise in relation to competition across digital markets, making it well-placed to advise on whether further reforms are needed.
17. Many of the CMA's reform proposals<sup>6</sup> will be key in ensuring existing laws are best able to address the challenges of the digital age. In particular, reforms to

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<sup>6</sup> In February 2019, the CMA published a letter to the Secretary of State for Business Energy and Industrial Strategy, setting out [proposals for a series of reforms to the CMA's competition, consumer protection, markets and mergers tools](#).

the markets regime<sup>7</sup> to ensure it can be most effectively utilised to promote competition and innovation in digital markets, for example by pursuing measures like data mobility and interoperability.

18. In addition to these, we highlight recommendations in a few key areas where, based on existing evidence and experience we believe action is necessary. These are as follows:

- **action to address unlawful or illegal content**, such as fake online reviews and scam advertisements, hosted on platforms which could result in economic detriment to consumers and businesses;
- **action to enable effective consumer choice** in digital markets, including by addressing instances where choice architecture leads to consumer harm; and
- **stronger enforcement of the Platform to Business Regulation.**<sup>8</sup>

### ***A coherent regulatory landscape***

19. Whilst a new pro-competition framework is needed to promote competition and protect consumers and businesses in digital markets, this framework cannot operate in isolation. It will need to be joined-up and coherent with the wider regulatory landscape, in particular with sectoral regulation, data protection regulation<sup>9</sup> and with the government's new regime for harmful online content.<sup>10</sup>

20. As part of the taskforce work, we have given initial consideration as to what mechanisms might be needed to support enhanced regulatory coherence across these regimes. Our proposals cover information sharing between regulators, and enabling the DMU's powers in relation to the SMS regime to be shared with Ofcom and the Financial Conduct Authority (FCA).

21. The CMA, Ofcom and the ICO have already established the Digital Regulation Cooperation Forum (DRCF) to deliver a step change in coordination and

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<sup>7</sup> Under the Enterprise Act 2002.

<sup>8</sup> The [EU platform-to-business relations](#) (P2B regulation), which entered into force in July 2019, contains a set of rules intended to create a fair, transparent and predictable business environment for smaller businesses and traders on online platforms.

<sup>9</sup> Data Protection Law – the General Data Protection Regulation and Data Protection Act 2018 provide the general framework for the protection of personal data that applies in the UK.

<sup>10</sup> DCMS, [Online Harms White Paper](#) – the government has consulted on a new regulatory framework intended to improve citizens' online safety by setting clear expectations of companies, with robust action to counter illegal and unacceptable online content and activity.

cooperation between regulators in digital markets.<sup>11</sup> The DRCF is now working with government to consider the steps that should be taken to ensure adequate coordination, capability and clarity across the digital regulation landscape.<sup>12</sup> Proposals in this area will therefore be developed and explored further by the DRCF.

22. The most powerful digital firms operate across multiple jurisdictions globally. Regulators in many jurisdictions are investigating and addressing very similar challenges. We therefore also propose measures to better enable regulators active in different jurisdictions to work together, both to understand the issues and to consider solutions. Our proposals cover information-sharing and establishing a network of agencies to work together to tackle the conduct of the most powerful digital firms, modelled on the 'colleges' which currently exist for supervising the largest global banks.

## Next steps

23. We believe the case for an *ex ante* regime in digital markets has been made. We therefore welcome the government's response to the CMA's online platforms and digital advertising market study,<sup>13</sup> and its commitment to establishing a DMU from April 2021 within the CMA. We also welcome government's commitment to consult on proposals for a new pro-competition regime in early 2021 and to legislate to put the DMU on a statutory footing when parliamentary time allows. We urge government to move quickly in taking this legislation forward. As government rightly acknowledges, similar action is being pursued across the globe and there is a clear opportunity for the UK to lead the way in championing a modern pro-competition, pro-innovation regime.
24. We stand ready to assist government in establishing the DMU and in undertaking work to operationalise key elements of the regime. Our advice provides government with the information it needs to form the basis of this legislation and it is now for government and Parliament to decide on. Subject to decisions on key elements of the regime being taken by government, we will undertake the preliminary work needed to best enable the DMU to be fully operational as soon as any legislation comes into effect.

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<sup>11</sup> [Digital Regulation Cooperation Forum](#).

<sup>12</sup> [Government response to the CMA's market study into online platforms and digital advertising](#), November 2020.

<sup>13</sup> *Ibid.*

# 1. Introduction

- 1.1 In this chapter, we provide an overview of the Digital Markets Taskforce, including background on the commission from government, how we have gone about developing our advice, including the evidence underpinning it, and the wider domestic and international context for our work.

## Background

- 1.2 In March 2020, the government commissioned the CMA to lead a Digital Markets Taskforce ('the taskforce'), working closely with Ofcom and the ICO, to provide advice on the design and implementation of pro-competition measures for digital markets. This report sets out our advice.
- 1.3 The taskforce was asked to base its advice around the proposals put forward by the Digital Competition Expert Panel, led by Professor Jason Furman ('the Furman Review'), which published its findings in March 2019.<sup>14</sup> The Furman Review recommended the establishment of a digital markets unit (DMU), tasked with securing competition, innovation, and beneficial outcomes for consumers and businesses. The Furman Review recommended the DMU have three core functions:
- establishing and overseeing an enforceable code of conduct for firms that are designated as having strategic market status;
  - pursuing personal data mobility and systems with open standards; and
  - using data openness to promote competition.
- 1.4 The Furman Review also recommended strengthening the merger control regime, including requiring that digital firms with SMS make the CMA aware of their intended acquisitions to enable the CMA to determine in a timely manner which cases warrant more detailed scrutiny.
- 1.5 Subsequently, the CMA undertook a 12-month market study<sup>15</sup> into online platforms and digital advertising, publishing its report in July 2020. The narrower focus on ad-funded platforms, coupled with a longer time frame and strong evidence gathering powers, enabled the market study to reach much more detailed and company-specific findings, supported by a robust evidence

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<sup>14</sup> Furman Review (2019), [Unlocking Digital Competition](#).

<sup>15</sup> CMA's market study into online platforms and digital advertising, [final report](#).

base. This also enabled the market study to further develop the high-level proposals of the Furman Review for a new pro-competition regime.

- 1.6 The market study conducted a detailed assessment of the market position of Google and Facebook in relation to digital advertising, and in doing so further supported the case for a new pro-competition regime that is *ex ante* in nature. Moreover, it was able to provide ‘proof of concept’ for the high-level proposals of the Furman Review. The market study made practical and applicable proposals for the design and implementation of a code of conduct for these firms, to manage harmful effects of their market power. It also identified more granular, firm and market-specific pro-competitive interventions that would open up competition by targeting the sources of Google’s and Facebook’s entrenched market position.
- 1.7 In March 2020, the government formally accepted the six strategic recommendations of the Furman Review.<sup>16</sup> Simultaneously, it also commissioned the taskforce. In November 2020, the government responded to the CMA’s online platforms and digital advertising market study.<sup>17</sup> In particular, the government committed to establishing and resourcing a new DMU from April 2021, to consulting on proposals for the new pro-competition regime in early 2021, and to legislating to put the DMU on a statutory footing when parliamentary time allows.

## The wider context

### *Other UK initiatives*

- 1.8 Work to develop a pro-competition regime for digital markets sits as one part of a number of wider initiatives in relation to digital markets. Other key initiatives and work include:
  - **The online harms regime**<sup>18</sup> – the government has consulted on a new regulatory framework for online safety to make clear companies’ responsibilities to keep UK users safer online with robust action to counter illegal and unacceptable content and activity.
  - **The Cairncross Review**<sup>19</sup> – this review looked into the sustainability of high-quality journalism in the UK and as part of that investigated the role

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<sup>16</sup> HM Treasury, [Budget 2020](#).

<sup>17</sup> [Government response to the CMA's market study into online platforms and digital advertising](#), November 2020.

<sup>18</sup> DCMS, [Online Harms White Paper](#).

<sup>19</sup> The Cairncross Review (2019), [A sustainable future for journalism](#).

and impact of digital search engines and social media platforms. It recommended a number of proposals including new codes of conduct to rebalance the relationship between platforms and publishers.

- **The House of Lords Communications and Digital Committee report on the Future of Journalism**<sup>20</sup> – this report considers the future of journalism including the imbalances of power between news publishers and platforms.
- **Digital Strategy**<sup>21</sup> – the government has announced its intention to publish a new Digital Strategy, which will give consideration as to the regulatory regime for digital.
- **National Data Strategy**<sup>22</sup> – the government is consulting on its National Data Strategy in relation to its framework for considering how it best supports the use of data in the UK.
- **Smart Data initiatives**<sup>23</sup> – in June 2019 the government consulted on proposals to enable data driven innovation in consumer markets, use data and technology to help vulnerable consumers, and to ensure consumers and their data are protected. Since then government has launched the Smart Data Working Group to coordinate and accelerate existing smart data initiatives across regulators and government.

### ***International initiatives***

1.9 Furthermore, work to consider the challenges that digital markets pose and how best to address these challenges is underway across the globe. It is promising that there has recently been increasing consensus between a number of jurisdictions on these challenges, and on the need to develop a new pro-competition approach. In particular:

- **In the US**, there have been recommendations made by both the Stigler Center<sup>24</sup> and the House Judiciary Antitrust Subcommittee<sup>25</sup> relating to digital platforms, both emphasising that tougher action is needed to

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<sup>20</sup> House of Lords, Communications and Digital Committee (2020), [Breaking News? The Future of UK Journalism](#).

<sup>21</sup> [Digital Secretary Oliver Dowden's closing speech at the UK Tech Cluster Group's Road to Recovery summit, June 2020](#).

<sup>22</sup> [UK National Data Strategy](#).

<sup>23</sup> HMG, [Smart data: Putting consumers in control of their data and enabling innovation](#).

<sup>24</sup> Stigler Center (2019), [Committee on Digital Platforms Final Report](#).

<sup>25</sup> US House Judiciary Subcommittee on Antitrust, Commercial and Administrative Law (2020), [Investigation of Competition in Digital Markets](#).

address competition concerns. The recommendations made by the Antitrust Subcommittee include a number of interventions to restore competition ranging from structural separations to data remedies such as interoperability and data portability.

- **In Europe**, the European Commission has consulted on proposals for the introduction of a new Digital Markets Act, which includes *ex ante* rules covering large online platforms acting as gatekeepers, as well as plans to potentially increase the responsibility of platforms through the Digital Services Act proposals.<sup>26</sup>
- **In Germany**, the German Federal Government has endorsed a draft legislation introducing the concept of ‘undertakings with paramount significance for competition across markets’ and establishing that the Bundeskartellamt have powers to prohibit them engaging in a range of conduct.<sup>27</sup>
- **In Australia** the government has established a special unit within the Australian Competition and Consumer Commission (ACCC) to proactively enforce, monitor and investigate competition and consumer protection in digital platform markets, and asked the ACCC to create a mandatory code of conduct to govern the commercial relationship between digital platforms and media companies.<sup>28</sup>
- **In Japan**, the government has established a ‘Headquarters for Digital Market Competition’ in September 2019 with an aim to facilitate discussions on the transparency of the dealings with digital platform businesses and the protection of privacy. In June 2020, it released an interim report proposing that *ex ante* regulation be applied to digital platforms.<sup>29</sup>

1.10 Throughout our work we have engaged frequently with our counterparts in these and many other jurisdictions, holding bilateral meetings and workshops to better understand their approach. We have had regard to their approach in

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<sup>26</sup> The European Commission, [The Digital Services Act package](#).

<sup>27</sup> Press release: [Bundeskartellamt welcomes Economic Affairs Ministry’s plans to modernise competition law](#). The German Federal Ministry for Economic Affairs and Energy officially presented its draft bill for the 10th amendment to the ‘German Act against Restraints on Competition’ on 24 January 2020.

<sup>28</sup> ACCC (2019). [Digital Platforms Inquiry](#), p30. Australian Government (2019), [Regulating in a Digital Age](#).

<sup>29</sup> [List of publications from the Headquarters of Digital Markets Competition including establishment notice and Report on Medium-Term Vision on Competition in the Digital Market](#); JFTC (2019), [Guidelines Concerning Abuse of a Superior Bargaining Position in Transactions between Digital Platform Operators and Consumers that Provide Personal Information](#).

developing our own proposals for a regulatory framework to promote competition in digital markets in the UK.

## **The role of the Digital Markets Taskforce**

- 1.11 The taskforce is led by the CMA and has worked closely with officials from Ofcom, the ICO and the FCA. The taskforce's purpose is to provide government with expert advice on the functions, processes, and powers needed to deliver greater competition and innovation in digital markets in a proportionate and efficient way.
- 1.12 The government was clear when commissioning this work that it should complement and build on the outputs of the Furman Review, as well as drawing evidence from the CMA's market study. The government asked the taskforce to answer a broad range of practical questions around how the regime should be implemented and administered in practice. These include advice on an appropriate methodology for designating firms with SMS, the form and scope of a code of conduct, how such a code might interact with other relevant regulations, and the associated powers and processes required to operate and enforce the full range of proposed regulatory functions.<sup>30</sup>

## **Our approach**

### ***Evidence gathering***

- 1.13 In developing our advice, we have sought information on:
- the types of concerns our proposals need to be capable of addressing; and
  - how a regulatory regime could best be designed to address these concerns.
- 1.14 We have gathered this information from a wide range of sources. These are set out in more detail in Appendix A and summarised in Figure 1.1. Our sources include:
- Responses to our call for information, launched in July 2020, alongside extensive stakeholder engagement through a mix of bilateral and roundtable discussions involving a wide range of digital firms, investors,

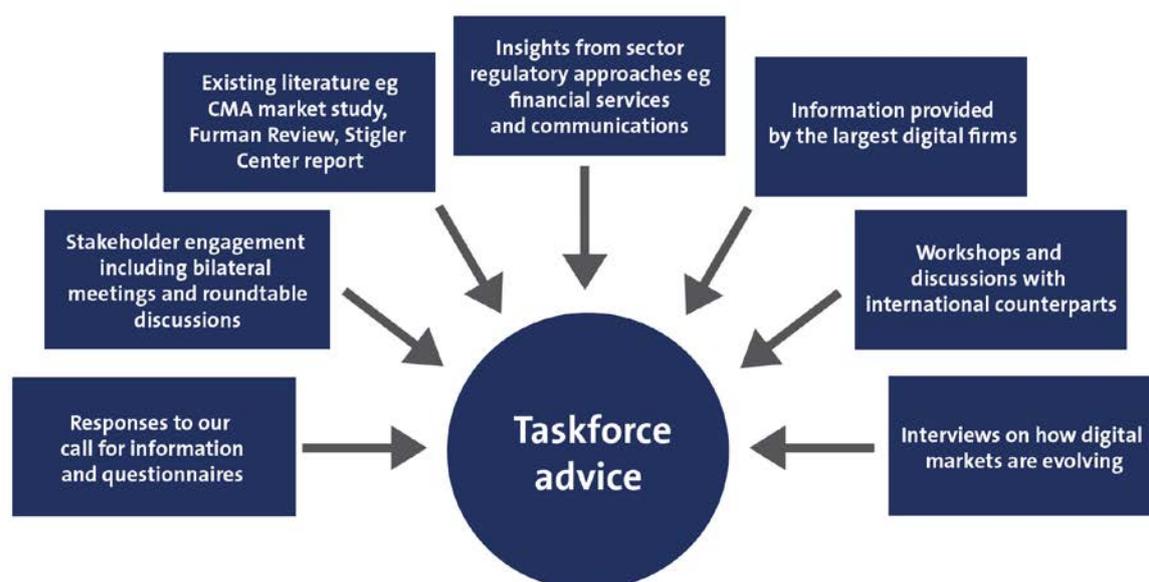
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<sup>30</sup> See our [terms of reference](#) for full details of the government's request for advice.

consumer and businesses representatives and academics. Responses to our call for information have been published alongside this advice.

- Existing reports on the challenges posed by the most powerful digital firms, including the CMA's market study on online platforms and digital advertising as well as numerous expert reports on this subject.<sup>31</sup>
- Engaging with existing regulators to learn from existing regulatory approaches, in particular in relation to the communications, financial services and groceries sectors.
- Information provided to us by the largest digital platforms.
- Workshops and discussions with international counterparts.
- Interviewing experts, as well as undertaking our own research, to better understand how digital markets might evolve.

**Figure 1.1: summary of the key sources informing our advice**



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<sup>31</sup> Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition for the digital era, final report for the European Commission](#); Stigler Center (2019) [Committee on Digital Platforms Final Report](#); US Antitrust House Subcommittee Investigation of Competition in Digital Markets, 2020.

## **Our advice**

1.15 The remainder of this report sets out the main elements of our key proposals. To meet the government's request for proposals that can be readily implemented, we have gone into some detail on specific aspects of the framework. This can be found in the supporting appendices which provide far more detail on the evidence and rationale behind our proposals and alternative approaches considered.

1.16 Our advice is organised as follows:

- Chapter 2 provides an overview of the benefits and challenges of digital markets and why we believe it is crucial the government acts to ensure they remain competitive.
- Chapter 3 provides an overview of the role to be played by the DMU.
- Chapter 4 sets out recommendations in relation to the SMS regime. This is supported by further detail in Appendices B, C, D, E and F.
- Chapter 5 sets our recommendations for reform of competition and consumer laws. This is supported by further detail in Appendix G.
- Chapter 6 sets out how the DMU will work with other regulators, at home and abroad.
- Chapter 7 sets out what we expect our proposed regulatory framework will deliver and next steps.

## 2. The case for change

2.1 In this chapter, we briefly outline the huge importance of digital markets, both to consumers, businesses and the economy. We then set out why it is crucial government takes action to ensure digital markets are competitive and continue to deliver the innovative products and services which are now so fundamental to our daily lives.

### The benefits of digital markets

2.2 Digital markets have revolutionised our lives with rapid and profound changes for consumers and businesses, the economy and society:

- For consumers, digital has provided easy access to a world of information, as well as the ability to connect and interact with friends and family all over the world, to consume music or video content when and wherever, and to buy products online and have them delivered the same day.
- For businesses, digital has opened up new markets and audiences, provided new revenue streams and revolutionised business models. The ongoing global COVID-19 pandemic has only served to emphasise the important role digital markets can play.
- For the UK economy, the digital sector contributed nearly £150 billion to the UK economy in 2018.<sup>32</sup> The sector's economic contribution has grown rapidly, increasing by 30% since 2010, outpacing most other sectors.
- For society, digital markets can have an important role in supporting wider values such as democracy and free speech.

### Powerful digital firms and the risks to competition

2.3 The dynamics of digital markets have changed, and those firms which once competed so vigorously to gain a foothold in their markets are in many cases now amongst the largest and most powerful global firms, and have been for a number of years.

2.4 There is an increasing body of evidence that the lack of effective competition in activities dominated by powerful digital firms is often the result of specific market features, that lead to entrenched market power, inhibiting the ability of rivals to enter and expand and undermining effective competition. This was borne

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<sup>32</sup> DCMS, [Sectors Economic Estimates 2018: Gross Value Added](#), 2020.

out in the CMA's market study of online platforms and digital advertising. These mark features include:

- **Network effects and economies of scale** – network effects occur when the value of a service to its users increases as the total number of users increases. While sometimes a natural feature of the market, network effects can also be the result of technological design decisions. Economies of scale arise where average costs decrease with increasing scale. These features mean that once a firm reaches a certain size, it can be extremely difficult for smaller new entrants to challenge it effectively.
- **Consumer decision making and the power of defaults** – rapid increases in the availability of information and services online, coupled with a reduced tolerance for delays, has encouraged 'default behaviour' on the part of consumers – a propensity to avoid wasting time by immediately accepting whatever default option is presented.<sup>33</sup>
- **Unequal access to user data** – data about users is highly valuable for developing and providing digital services, such as targeting advertising and personalised timelines with relevant suggested content. The scale of data available to powerful digital firms acts as a competitive advantage, while creating a barrier to entry and expansion to smaller potential rivals.
- **Lack of transparency** – a common attribute amongst the large online platforms is that they rely on sophisticated algorithms to make a large volume of decisions in real-time. One of the consequences of this reliance on 'black box' decision-making is that consumers and businesses that interact with them find it difficult to understand or challenge how decisions are made and may find it harder to exercise choice effectively.
- **The importance of ecosystems** – the companies behind the most powerful digital firms have built large 'ecosystems' of complementary products and services around their core service. While this type of integration can deliver efficiency savings and improve the consumer experience overall, it can also insulate these core services from competition, making it harder for rivals to compete.
- **Vertical integration, and resultant conflicts of interest** – the large digital firms are increasingly present at multiple stages of the supply chains in which they operate. This can give rise to conflicts of interest, and

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<sup>33</sup> CMA market study into online platforms and digital advertising, [Appendix L: summary of research on consumers' attitudes and behaviour](#)

the potential to use their power in their main activity to undermine competition in other stages of the chain.

- 2.5 Together, these market features mean a small number of digital firms have been able to develop particularly strong and entrenched market positions, which they may seek to leverage into other markets.<sup>34</sup>
- 2.6 Mergers and acquisitions are an important part of the business model of these firms, with strategic acquisitions being used to reinforce an existing strong position or expand that position into adjacent markets. Large digital firms can also use acquisitions to build and strengthen their ‘ecosystems’ of complementary products and services around their core service, insulating the core service from competition. Acquisition targets are often at an early stage of their development, making it difficult for competition authorities to assess whether the target firm is likely to develop into a competitor.
- 2.7 The accumulation and strengthening of market power by a small number of digital firms has the potential to cause significant harm to consumers and businesses that rely on them, to innovative competitors and to the economy and society more widely.
- 2.8 Harms to consumers and business users of large digital firms include:
- **A poor deal for consumers** – although consumers do not pay money for many online services, there is still an exchange that takes place. In exchange for searching the internet, watching videos, or communicating with friends, consumers provide their attention and data about themselves. In a more competitive market, consumers might not need to provide so much data in exchange for the services they value, may be provided with greater protection and control of their data or alternatively they may be rewarded, financially or otherwise, for continuing to use the services.
  - **A poor deal for business users** - digital firms with market power may be able to exploit the business users reliant upon them, such as marketplace sellers, app developers and advertisers (the vast majority of which are likely to be SMEs), through charging high prices. This can include through charging higher fees, higher commissions or higher prices for advertising than would be expected in a more competitive market. A lack of competition can lead to them being offered worse terms by powerful digital firms than would otherwise be the case – for example restrictions in

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<sup>34</sup> See for example the CMA’s market study into online platforms and digital advertising, [final report](#), paragraph 58, and, in the case of Google, from paragraph 5.261.

relation to the design and pricing of their goods and services or on the other digital firms they can form relationships with.

- **Higher prices of goods and services across the economy** – higher prices charged by powerful digital firms to business users like marketplace sellers, app developers and advertisers can be expected to feed through into higher prices paid by consumers for goods and services across the economy.
- **Reduced innovation and choice** – as barriers to entry and expansion weaken the incentives of new entrants and challenger businesses to come forward with disruptive innovation – these dynamics also limit the incentives of the large digital firms to innovate themselves. This leads to less innovation and choice for consumers and businesses – meaning they are less likely to benefit from the next ‘big idea’ to revolutionise their lives in the way advances in technology have done to date.

2.9 Harms to innovators include:

- **A competitive disadvantage** – a powerful platform can use its powerful position to further entrench its market power, for example by raising barriers to entry (such as access to data) or by extending its strong position in one market into other adjacent markets, ultimately giving itself an unfair advantage over its rivals. This can include for example by promoting or directing consumers to its own services, over those of competitors. This means innovative competitors, even if they have a good idea, are likely to find it much harder to compete and grow their businesses. Importantly, this could act as a handbrake on innovation right across digital markets.

2.10 Lastly, harms to the economy and society include:

- **A less vibrant digital economy** – if powerful digital firms act to unfairly disadvantage their innovative competitors, these innovative firms will find it harder to enter and expand in new markets, meaning the ‘unicorns’ of tomorrow that will support jobs and the future digital economy will not emerge.
- **Harm to society** – the actions of these firms can also have wider consequences on society, with impacts on issues of mental health, media plurality, accuracy of news, and democracy.

2.11 As recognised in the Furman Review, in the CMA’s market study, and in other prominent reports,<sup>35</sup> existing competition laws are not, by themselves, sufficient to address these challenges. The most powerful digital firms have such entrenched market power that existing laws, which allow enforcement against individual practices and concerns, are not sufficient to protect competition. Further, digital markets are fast-moving, and the issues arising within them are wide-ranging, complex and rapidly evolving. Tackling such issues requires an ongoing focus, and the ability to monitor and amend interventions as required. An *ex ante* regulatory approach is therefore needed to proactively shape the behaviour of digital firms with substantial and entrenched market power, and to prevent harm arising. Our proposals for this regime are outlined in Chapter 4.

## Wider competition and consumer concerns in digital markets

2.12 There are widely held concerns in relation to a broad range of digital markets. These concerns are not solely confined to a small number of the most powerful digital firms, and as such not all will be addressed through our proposals for an SMS regime. Our work has focused on four particular concerns, which are set out in more detail in Appendix G:

- **Barriers to effective and informed consumer decision-making** – there are a range of factors which can lead to barriers to consumers making effective and informed decisions. These can include the information consumers are provided with (which may be too much, too little, misleading, hidden, or presented at an ineffective time). However, the way in which choices are presented and the defaults that are selected can also be used both to support, but also to impair consumers’ decisions, for example to nudge or push consumers into choices which may not be in their interests.
- **Activity or content which could lead to economic detriment for consumers and businesses** – activity or material hosted on platforms which can result in economic detriment to consumers and businesses includes fake and misleading online reviews, scam advertisements (such as for high-risk financial schemes) and the sale of counterfeit goods. Such

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<sup>35</sup> For example: Stigler Center (2019), [Committee on Digital Platforms Final Report](#); Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition for the digital era, final report for the European Commission](#).

practices can damage consumer confidence online, undermine effective competition and damage businesses.

- **Barriers to switching and multi-homing**<sup>36</sup> – barriers to switching and multi-homing include factors such as loss of customers data (such as chat history, photos or tracked activities) or loss of reputation (such as customer reviews) which may mean a consumer or business is less likely to switch providers. Similarly, technical barriers like a lack of interoperability between providers may make it harder for consumers to switch and multi-home.<sup>37</sup>
- **Coordination failures** – in some circumstances it would be beneficial for customers if market participants coordinated their actions. For example, coordination on standards for the world wide web has made it possible for webpages to be developed so they are compatible with a wide choice of browsers. However, beneficial coordination may sometimes fail to arise where individual firms do not account for the benefits such coordination would provide customers, either in the short or long term, and/or do not have incentives to reach the same outcome (in fact, in many cases companies have strong incentives to build ‘moats’ around their services to protect future revenues).

2.13 Our experience has demonstrated the need for reform of existing competition and consumer laws to address these challenges. Much of the existing legislative framework pre-dates modern digital markets and our experience has demonstrated particular challenges in applying this to these issues. Strengthening the existing toolkit is vital to safeguarding the vibrance and dynamism of digital markets more widely. Our proposals in this regard are set out in Chapter 5.

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<sup>36</sup> Multi-homing refers to customers using similar services provided by different providers simultaneously.

<sup>37</sup> For example, if users of an instant messaging app are ‘locked in’ to that app, because their contacts also use it and they cannot message their contacts through an alternative messaging app.

### 3. The role of the DMU

3.1 In this chapter, we provide a brief overview of the DMU, including its overarching aims and objectives.

**Recommendation 1: The government should set up a DMU which should seek to further the interests of consumers and citizens in digital markets, by promoting competition and innovation.**

3.2 In its responses to both the Furman Review, and the CMA's market study into online platforms and digital advertising, the government has already accepted the recommendation that a DMU be established.<sup>38</sup>

3.3 The principal duties of the DMU will be the lynchpin of the regulatory framework, framing how and to what aim the DMU uses its powers. We recommend the DMU's primary duty should be '***to further the interests of consumers and citizens in digital markets by promoting competition and innovation.***'

3.4 We believe it is essential that the consumer interest underpins the regime. Furthermore, we also believe it is important that digital markets support the interests of UK citizens, respecting wider rights such as privacy, data protection, and free speech. Framing the DMU's duties in this way should ensure the DMU is focused on outcomes which support the overarching interests of consumers and citizens while using competition to deliver these. Across its work we would expect the DMU to make digital markets work well in the interests of consumers, businesses and the economy.

3.5 The DMU should seek to deliver these outcomes through regulation that promotes effective competition. Promoting more effective competition in digital markets will have a number of important benefits, including:

- **greater innovation and more choice**, for example new features or adaptations to existing popular services, or the emergence of transformative new products and services;
- **lower prices** for a wide range of goods and services across the economy, both directly to consumers, but also where businesses pass the costs of lower commissions, or advertising prices through to consumers;

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<sup>38</sup> [Government response to the CMA's market study into online platforms and digital advertising](#), November 2020.

- improvements on multiple aspects of **quality**, as firms face greater pressure to meet consumer expectations on issues such as control over data and privacy;
- **predictable, consistent, and fair operating conditions for smaller firms** who rely on powerful digital firms;
- **greater certainty for innovative businesses** who compete with powerful digital firms, increasing **confidence to invest and expand**; and
- a **boost to productivity and growth**, leading to **job creation** in new firms and emerging markets, and the retention and attraction of highly skilled workers in the UK.

3.6 We recommend the DMU should also have an explicit focus on promoting beneficial innovation. A full assessment of competition should focus not only on the situation that currently presents itself (a 'static assessment') but must also build a view of possible harms to future consumers through reduced innovation (sometimes referred to as 'dynamic competition'). This is especially important in digital markets, where often the greatest harm to arise from a lack of effective competition is foregone innovation. Dynamic harms are, by their nature, difficult to quantify and can be underweighted in competition assessment. An explicit duty should focus the DMU on considering the relative impact an intervention has on innovation that promotes consumer interests. It should lead the DMU to explicitly favour remedies which support dynamic competition.

### **Recommendation 1a: The DMU should be a centre of expertise and knowledge in relation to competition in digital markets.**

3.7 To be able to operate the regulatory framework we are proposing most effectively, the DMU will need to build up a great deal of expertise and knowledge. This should include the capability to understand:

- the business models of digital businesses, including the role of data and the incentives driving how they operate; and
- the role of algorithms and artificial intelligence.

3.8 This is essential if the DMU is to be successful in intervening effectively to drive greater competition and innovation in these markets. Not only would such expertise enable better and swifter identification of potential problems as or even before they emerge, it should also support better remedy design, ensuring interventions address a particular harm, without unnecessarily restricting how these digital firms operate.

- 3.9 In acting as a centre of expertise in relation to competition in digital markets, the DMU will need to work closely with other regulators with responsibilities for digital markets, most notably Ofcom, the ICO and the FCA. In particular, it will need to work closely with other regulators where the practices of digital firms have effects on wider policy objectives such as data protection, media plurality, and public service broadcasting.
- 3.10 The DMU should also maximise opportunities to work effectively and efficiently with these regulators, recognising that many of the same skills and processes will be necessary to support wider regulation of digital markets. We expect the DMU would work with the DCRF to consider how expertise and analytical capabilities are best developed and shared across regulators. Further information on how the DMU would work with other regulators and the DCRF is set out in Chapter 6.

**Recommendation 1b: The DMU should be proactive, seeking to foster compliance with regulatory requirements and taking swift action to prevent harm from occurring.**

- 3.11 The DMU should be a proactive regulator, focused on preventing harm and shaping markets to deliver greater competition and innovation.
- 3.12 In relation to the SMS regime, we expect the DMU would focus on supporting SMS firms to comply with the code. The primary motivation for establishing a new *ex ante* regime is the ability to proactively shape the behaviour of SMS firms in advance before harm occurs. We expect it would do this in a range of ways, including through establishing open and productive relationships with SMS firms, and being clear about what is expected. This is explored further under recommendation 5 below and in Appendix C.
- 3.13 The DMU would also undertake monitoring in relation to SMS firms, enabling it to take swift proactive action where it identifies risks of potential problems occurring, as well as where those risks have crystallised and problems now exist. The DMU would monitor the conduct of SMS firms to ensure it is compliant with the code. Where it finds problems, it should have a range of tools available to address them. This includes using a participative approach reliant on engagement with all affected parties, as well as tough powers where a participative approach is inappropriate or insufficient. This is further explored under recommendation 7 below as well as in Appendix C.
- 3.14 We expect the DMU would also undertake monitoring in relation to digital markets more widely, including in relation to firms and activities not covered by the SMS regime. This monitoring role would provide for swifter intervention to promote greater competition and innovation, both by spotting problems earlier and by providing greater expertise enabling them to be addressed

more quickly. It would also enable the DMU to spot opportunities where intervention could better support competition and innovation, for example where regulatory requirements act as a barrier to innovation, or where remedies like personal data mobility and interoperability could be most beneficial.

- 3.15 In order to support this, we would expect the DMU to engage regularly with a diverse range of participants in digital markets, undertake research and gather information to ensure it kept abreast of how digital markets are evolving and any risks to and opportunities for competition and innovation. The DMU's role in relation to digital markets more widely is explored under recommendation 12 below and in Appendix G.

## 4. A pro-competition framework for the most powerful digital firms

4.1 This chapter provides an overview of our proposed regulatory framework for the most powerful digital firms. The chapter covers:

- an overview of the proposed regime;
- how SMS should be assessed and firms designated;
- the code of conduct;
- pro-competitive interventions;
- monitoring and enforcement;
- the DMU's processes and decisions; and
- SMS merger rules.

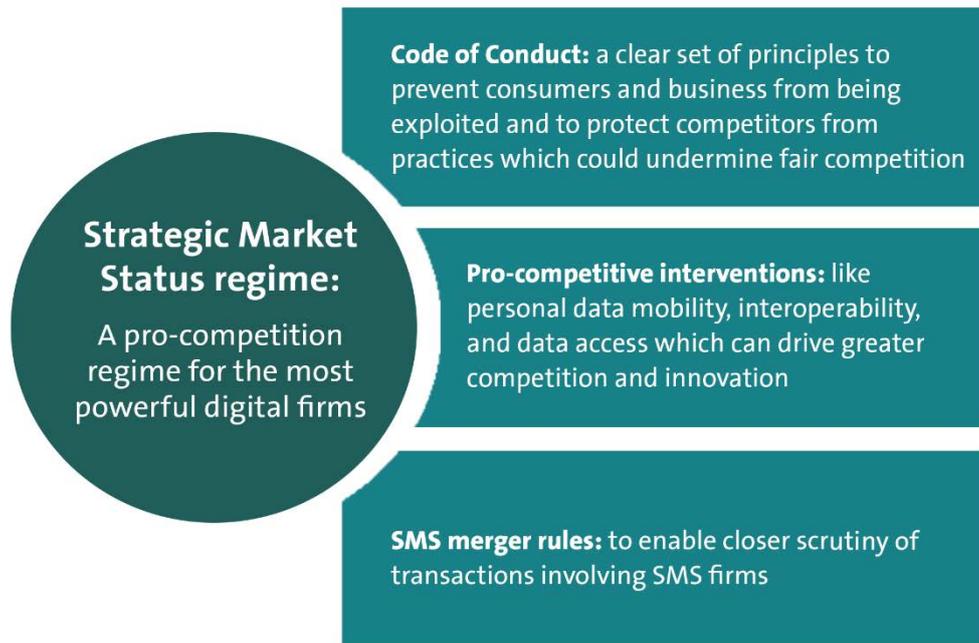
4.2 Further detail on the evidence and rationale supporting our recommendations, as well as alternative approaches considered, can be found in the accompanying appendices B, C, D, E, and F.

### Overview of the regime

**Recommendation 2: The government should establish a pro-competition framework, to be overseen by the DMU, to pursue measures in relation to SMS firms which further the interests of consumers and citizens, by promoting competition and innovation.**

4.3 The purpose of the SMS regime is to address harm arising from the market power and strategic position of the most powerful digital firms that have extensive reach and influence over many aspects of our lives, as well as driving vibrant competition and dynamic innovation in the markets in which these firms operate.

Figure 4.1: overview of the SMS regime



- 4.4 The entry point to the regime is a test as to whether a firm has ‘strategic market status’. This should be an evidence-based assessment as to whether a firm has substantial, entrenched market power in a particular digital activity, providing the firm with a strategic position (meaning the effects of its market power are likely to be particularly widespread and/or significant). It is focused on assessing the very factors which may give rise to harm, and which motivate the need for regulatory intervention.
- 4.5 When the SMS test is met by a firm, it should be subject to the following three pillars of the regime:
- **An enforceable code of conduct** which sets out clearly how the firm is expected to behave in relation to the activity motivating its SMS designation. The code seeks to set clear ‘rules of the game’ up-front, preventing the firm taking advantage of its powerful position, such as through exploiting consumers and businesses or excluding innovative competitors.
  - **Pro-competitive interventions** that seek to address the sources of market power and drive longer-term dynamic changes in these activities, opening up opportunities for greater competition and innovation. For example, interventions relating to personal data mobility, interoperability,

and data access, which can be used to address the factors which lead to the firm holding such a powerful position.

- **SMS merger rules** to ensure closer scrutiny of transactions involving SMS firms, given the particular risks and potential consumer harm arising from these transactions.

4.6 This chapter provides a brief overview of the SMS regime including our key recommendations in relation to SMS designation and in relation to the design of these three pillars of the regime.

## Designating SMS firms

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

4.7 The entry point to the regime is a test as to whether a firm has ‘strategic market status’ in relation to a particular activity.

4.8 The DMU should decide whether a firm meets the SMS test in a particular activity. We believe it is important this decision is made by an independent regulator and that it is an expert regulatory judgement, both as to whether the criteria for designation are met and whether it is appropriate to designate a firm.

**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.**

4.9 The SMS test should, at least, involve an assessment of whether a firm has substantial, entrenched market power in an activity. In our view it should also involve an assessment of whether the firm’s market power in that activity provides the firm with a strategic position. We now provide an overview of these elements.

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

4.10 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 and/or reduce quality and innovation since a significant number of users are 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.

- 4.11 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.
- 4.12 However, there are significant concerns about instances in which market power has become entrenched – that it is not merely transitory and likely to be competed away in the short term. Once a firm’s position becomes entrenched, the likelihood of a rival emerging and taking a substantial share of the market is low. In such circumstances, it is likely that prices will be persistently higher, while quality, investment and innovation will be persistently lower than would otherwise be the case, to the long-term detriment of consumers.
- 4.13 Market power assessments are a common feature of existing competition law and can be conducted relatively swiftly and with confidence, subject to having access to the relevant evidence. Such a test should focus on direct evidence of market power, such as whether consumers or businesses could credibly switch to an alternative service offered by another company without losing out, and the ease with which other firms could enter and expand.
- 4.14 The approach taken to assessing competition would be consistent with that taken by the CMA in its markets work and with the CMA’s proposed revisions to the Merger Assessment Guidelines.<sup>39</sup> The market power assessment should not require a formal market definition exercise, which results in a binary judgement of whether firms fall inside or outside of the market. Such a rigid approach would fail to recognise the nuanced and interconnected nature of digital products and services and underemphasise the importance of dynamic competition.
- 4.15 In order to retain a targeted, practical and proportionate approach, we do not consider that the entire SMS firm should be assessed when considering SMS designation. Rather we propose the assessment should be applied with respect to a specific activity. By activity we mean a collection of products and

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<sup>39</sup> [Draft revised guidance: Merger assessment guidelines](#) (2020, currently under consultation, section 9).

services supplied by a firm that have a similar function or which, in combination, fulfil a specific function. For example, Google offers a set of products (Google Open Display) which, in combination, manage the buying, selling and selection of advertisements for display on websites. A focus on activities encourages a focus on how a specific firm operates and how the products and services offered by the firm interact. This is appropriate given that the SMS regime is firm-specific.

- 4.16 The SMS test should also be formed so that only a 'digital' activity is relevant for an SMS assessment. We recommend that, for the purposes of the SMS regime, the term 'digital' is interpreted to cover any situation where digital technologies are material to the products and services provided as part of the activity. This approach will give the regime appropriate focus without creating an inflexible regime. For example, by providing clarity to businesses 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 while an online marketplace would clearly be within scope even though it might sell physical goods.

*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*

- 4.17 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 in an activity can be particularly widespread or significant. 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 and distinguishing it from existing law.
- 4.18 Therefore, the SMS test should involve not only an assessment of market power, but also an assessment of whether a firm's market power in an activity provides it with a strategic position. A firm will have a strategic position when the effects of its market power are particularly widespread or significant.
- 4.19 A variety of factors could indicate that a firm has a strategic position and the precise relevance of these factors could differ from case to case. The factors we have identified, and circumstances in which the effects of a firm's market power might be particularly widespread and/or significant, are:
- a firm has achieved **very significant size or scale** in an activity, for example where certain products are regularly used by a very high

proportion of the population or where the value of transactions facilitated by a specific product is large;

- 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;
- the firm can use the activity to **extend market power** from one activity into a range of other activities<sup>40</sup> and/or has developed an ‘ecosystem’ of products which protects a firm’s market power;
- 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
- the activity has significant impacts on markets that may have **broader social or cultural importance**.

4.20 We would not expect all of these factors to be relevant for every SMS designation (eg in one case effects on markets of broader social or cultural importance may be central to the assessment, in another case it could be irrelevant). We would expect the DMU to produce guidance on its approach to SMS assessment.

4.21 As we have noted above, 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 that 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 strategic market status.

4.22 We refer to an activity that satisfies the SMS test 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. We return to designated activities later on when we discuss the scope of the code of conduct and pro-competitive interventions.

**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**

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<sup>40</sup> The extension of market power to other activities has been referred to in various ways including leveraging, self-preferencing and envelopment.

**and a consideration of whether a sector regulator is better placed to address the issues of concern.**

- 4.23 Our expectation is that only a small number of digital firms are likely to meet the SMS test set out above. However, to help provide clarity to the vast majority of firms that are not expected to meet this test, we believe the DMU should set out clearly in formal guidance those factors it would expect to consider when prioritising potential firms for designation. Key factors are:
- **The firm's revenue** – we recommend the DMU prioritises firms of a certain size (we suggest focussing on firms with annual UK revenue in excess of £1 billion, and particularly those which also have annual global revenue in excess of £25 billion).
  - **The activity undertaken by the firm** – we recommend the DMU initially prioritises firms active in particular activities (we suggest relevant sectors could include online marketplaces, app stores, social networks, web browsers, online search engines, operating systems and cloud computing services).
  - **Whether a sector regulator is better placed to address the issues of concern** – we recommend that the DMU considers whether a sector regulator (working with the DMU) is better placed to address the issues of concern before prioritising a designation assessment.
- 4.24 These factors should not be included as hard and fast rules within the test itself. Having them in guidance will ensure the regime is **forward-looking** and the DMU retains some flexibility to apply the test as needed within a complex and evolving set of firms and activities. Through issuing formal guidance that can be updated as digital markets evolve, the DMU will be able to balance the need to be forward-looking with being transparent and clear.

**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.**

- 4.25 The DMU should also be required to publish guidance on how it will operate its designation process, and on how it expects to conduct its assessments. We expect these assessments to be undertaken in an open and transparent way, with SMS firms and the public able to provide input and comment. We recommend the DMU is required to complete designation within a statutory

deadline and suggest 12 months is likely to be appropriate.<sup>41</sup> Further information on how we expect these decisions to be undertaken is set out under recommendation 9 and in Appendix B.

- 4.26 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 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.
- 4.27 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. For example, the DMU may assess whether Google has SMS in relation to Search separately to considering whether it has SMS in relation to the Play Store and, were they to meet the test, apply different codes.

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

- 4.28 We recommend that designation in relation to a particular activity be set for a fixed period. A fixed designation period provides certainty for the SMS firm, whilst the duration reflects the 'entrenched' nature of the market power underpinning the designation. We suggest a period of five years balances sufficient time for the effect of regulation to be observed, with the need to ensure the designation remains appropriate. The regulation the firm is subject to could however be considered and reviewed within the designation period to ensure it remained effective.
- 4.29 Within the fixed period, the DMU could receive applications from firms to remove designation in relation to an activity where there had been a material change in circumstances which made the designation no longer appropriate. We recommend that the DMU should be able to decide whether to review designation within the designation period in light of such applications. Re-designation assessments would follow the same assessment and process as the original designation.

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<sup>41</sup> As we set out later and in Appendix C, we recommend that development of the code of conduct is undertaken alongside the designation assessment.

**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.**

- 4.30 When a firm meets the SMS test in relation to a particular activity the associated remedies should only apply to a subset of the firm’s activities. As set out below, the code and pro-competitive interventions would apply in relation to those activities for which the firm has been designated as having SMS. The merger rules would apply to all transactions entered into by an SMS firm, with mandatory notification of those that meet certain clear-cut threshold tests.
- 4.31 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.
- 4.32 More detail on the evidence and rationale supporting all our recommendations in relation to SMS designation, as well as alternative approaches considered, is set out in Appendix B.

## **The code of conduct**

**Recommendation 4: The government should establish the SMS regime such that when the SMS test is met, the DMU can establish an enforceable code of conduct for the firm in relation to its designated activities to prevent it from taking advantage of its power and position.**

- 4.33 The purpose of the code is to prevent SMS firms from taking advantage of their powerful positions. It will provide a set of clear *ex ante* principles for SMS firms to follow, with the aim of preventing consumers and businesses from being exploited, and to prevent practices by the firm which could undermine fair competition.
- 4.34 Setting the ‘rules of the game’ in advance will influence firms’ decision-making upfront, helping to avoid the emergence of concerns in the first place. It will also enable behaviour by SMS firms to be challenged and changed much more rapidly than is possible through existing laws, with the aim of preventing significant harm from materialising.

## Recommendation 4a: A code should comprise high-level objectives supported by principles and guidance.

4.35 The form of each code should comprise three elements:

- **Objectives** – these set out the objectives the code seeks to deliver. An example of such an objective is ‘fair trading’.
- **Principles** – these set the standards as to how the SMS firm should behave, in order to achieve the objective that they relate to. They provide a more detailed articulation of what a firm must or must not do. An example of such a principle is ‘to trade on fair and reasonable contractual terms’.
- **Guidance** – this provides greater clarity to the SMS firm on how the principles should be interpreted, with specific examples of what conduct would be expected to breach the principles. An example of such guidance is ‘in trading with small advertisers, a term may be unfair if it is applied by default and benefits the SMS firm by imposing costs on the advertiser by comparison to alternatives, unless there are offsetting benefits to advertisers from the default option’.

4.36 We believe this framework for the code strikes the right balance between providing certainty for firms, whilst retaining a degree of flexibility for the DMU. In particular:

- The objectives provide certainty to SMS firms on what can be addressed through the code. They provide clarity that wider issues are not within scope and ensure clear focus.
- The principles provide flexibility to address the changing behaviour of firms. The practices of digital firms evolve quickly and the DMU will not be able to anticipate every practice it wants to cover within the code.
- The principles also provide flexibility to address a wide range of practices, with exceptions where such conduct might deliver efficiencies. Such conduct could be difficult to capture within a narrow ‘blacklist’ of restrictions.
- The guidance provides additional clarity on the context and circumstances in which a practice might breach the code. The guidance should not be taken to be exhaustive, and the examples it includes will necessarily be case-specific.

**Recommendation 4b: The objectives of the code should be set out in legislation, with the remainder of the content of each code to be determined by the DMU, tailored to the activity, conduct and harms it is intended to address.**

4.37 We recommend the overarching objectives of the code are set out in legislation. Since the legislation will determine the shape and purpose of the regime, we believe it makes sense for it to specify what the code should be seeking to achieve. Setting the objectives in legislation would mean they were much harder to change than if the DMU developed them, but for that reason would provide greater predictability at the outset of the new regime as to its scope.

4.38 Our proposed objectives build on those put forward by the CMA's market study. Our analysis across wider digital markets suggests these objectives capture what a pro-competitive code should be seeking to deliver. The proposed objectives are:

- **Fair trading:** users are treated fairly and are able to trade on reasonable commercial terms with the SMS firm.
- **Open choices:** users face no barriers to choosing freely and easily between services provided by SMS firms and other firms.
- **Trust and transparency:** users have clear and relevant information to understand what services SMS firms are providing, and to make informed decisions about how they interact with the SMS firm.

4.39 The DMU should then have appropriate discretion to design the principles and associated guidance necessary to deliver on these objectives. Enabling the DMU to have discretion to implement this layer of detail itself will ensure the principles are **evidence-based and targeted** at the particular activity, conduct, and harms they are intended to address. Providing discretion to the DMU to set the principles and guidance also allows the code to be **forward-looking** and where necessary, adjusted over time such that it remains fit-for-purpose. In designing the principles, the DMU should work with other regulators where appropriate, to ensure alignment with other regimes such as data protection and e-privacy law and support a **coherent** regulatory landscape.

4.40 In setting principles, the DMU should be able to allow for 'exemptions' to principles. This would mean it has the power to adopt principles which prohibit SMS firms from prescribed conduct, except where specified conditions apply - for example that the conduct is necessary, or objectively justified, based on the efficiency, innovation, or other competition benefits it brings. This is

important as we recognise that conduct which may in some circumstances be harmful, in others may be permissible or desirable as it produces sufficient countervailing benefits.

- 4.41 We expect many principles could be common across the codes of SMS firms and activities. There is value in standard principles, such that action can have wider precedential value and to provide for greater consistency and clarity for firms on what is expected. It will also help to avoid the codes creating an unlevel playing field between SMS firms, and thus unduly distorting competition. However, the DMU should also be able to set principles which are bespoke to particular SMS firms or activities where necessary to address particular conduct or harms which are unique to that activity or firm.

**Recommendation 4c: The DMU should ensure the code addresses the concerns about the effect of the power and position of SMS firms when dealing with publishers, as identified by the Cairncross Review.**

- 4.42 The Cairncross Review,<sup>42</sup> which reported in February 2019, proposed there should be new codes of conduct to rebalance the relationship between platforms and publishers. It proposed that these should be developed by the platforms themselves with guidance from a regulator and with the potential for that regulator to develop a statutory code if it did not consider those proposed by the platforms were sufficient. Similar initiatives are being taken forward in other countries, including in France<sup>43</sup> and in Australia.<sup>44</sup>
- 4.43 Our view is that the measures put forward to be included within the codes of conduct proposed in the Cairncross Review should be captured within codes for relevant activities of SMS firms. The Cairncross Review proposed commitments from platforms in respect of certain practices where the news media have alleged that they are required to comply with unfair trading terms.<sup>45</sup> Our proposals for an enforceable code for SMS firms in relation to digital advertising covering, in particular, the objectives of fair trading and trust and transparency, would also be likely to cover these practices.
- 4.44 The DMU could set out in guidance how the code principles should apply to trading between SMS firms and publishers. Under our proposed approach to the code, the terms on which publishers trade with SMS firms could be

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<sup>42</sup> The Cairncross Review (2019), [A sustainable future for journalism](#).

<sup>43</sup> The Autorite de la concurrence, [Related rights: the Autorité has granted requests for urgent interim measures presented by press publishers and the news agency AFP](#). It has required Google to negotiate with publishers and news agencies on the remuneration for the re-use of their protected contents.

<sup>44</sup> ACCC(2020), [News media bargaining code](#).

<sup>45</sup> The Cairncross Review (2019), [A sustainable future for journalism](#), page 93.

assessed through a principle under the objective of fair trading. For example, the DMU could consider the extent to which it is reasonable for platforms to republish 'snippets' of content, and whether the terms on which they do this are fair.

- 4.45 We agree with the Cairncross Review's view that establishing what is a fair value exchange between two commercial parties would be difficult for a DMU or arbitrator to establish. The remedy powers associated with the code that we are recommending in this report do not include direct outcome regulation and would not enable the DMU to set prices. However, the code could allow the DMU to determine whether terms are fair and reasonable, taking into consideration the volume of content published, the price paid, and the service provided.
- 4.46 If the DMU had concerns that a term might breach the code and was not fair and reasonable it would have a range of tools available to address this (set out under recommendation 7 below).

**Recommendation 4d: The code of conduct should always apply to the activity or activities which are the focus of the SMS designation.**

- 4.47 The code of conduct should be focused on the activity or activities which underpin the SMS designation – ie in those designated activities in which the firm has substantial, entrenched market power, providing the firm with a strategic position.
- 4.48 It is important the entire code does not apply to a wide range of activities beyond a firm's designated activities to ensure it is applied in an **evidence-based** and **proportionate** way. A broad application of the code could have significant adverse effects, for example, an SMS firm may be a disruptive entrant into areas outside of its designated activities. It is important that such disruptive and beneficial entry continues to be feasible.
- 4.49 A key concern motivating the SMS regime is the ability of an SMS firm to use its position in a designated activity to extend its market power into other activities. These concerns arise not merely due to the entry of a firm into a new area, as noted above such entry could be disruptive and beneficial. Rather, concerns arise when a firm uses its position in one activity (its designated activity) to unfairly 'tip' competition in its favour to the long-term detriment of customers. In our view this conduct can be adequately addressed

by applying the code of conduct to designated activity since it is conduct in the designated activity which is the source of the concern.<sup>46</sup>

4.50 Another important concern motivating the SMS regime is when a firm engages in conduct in its wider ecosystem which further entrenches the position of its designated activity. For example, if a firm were to remove or significantly alter a product relied on by competitors to its designated activity. While such conduct may affect competition in the designated activity, an action outside of the designated activity would be needed to address the conduct. Therefore, to address this conduct the code (or an element of it) must apply outside of the designated activity.

4.51 We have considered how this conduct could be covered effectively and proportionately by the code, given our view that the entire code should not apply to a wide range of activities beyond a firm's designated activities. Our preferred approach is the use of a single standalone principle ensuring that a firm cannot make changes to non-designated activities that further entrench the position of its designated activity unless the change can be shown to benefit customers.<sup>47</sup> Unlike the other code principles, this principle would apply to the conduct of the entire firm. However, it is tightly focused on a specific concern and we would expect it to be relevant to a minority of actions in non-designated activities. Therefore, we consider this approach to be proportionate.

**Recommendation 4e: The DMU should consult on and establish a code as part of the designation assessment. The DMU should be able to vary the code outside the designation review cycle.**

4.52 We believe a code should be developed as part of the designation assessment. A decision as to whether a firm has SMS in relation to a particular activity is closely linked to the decision as to the code which should apply to that activity. The SMS test is a decision as to whether a firm has substantial and entrenched market power, providing the firm with a strategic position. The code aims to manage the effects of this market power. Therefore, in assessing the market power, its significance and effects, the DMU should also consider how best to address this through the code.

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<sup>46</sup> For example, it might be claimed that an online marketplace is unfairly favouring its own products in product search results. The concern is therefore about how the firm's products are presented on the marketplace which can be addressed with a code of conduct applied only to the online marketplace.

<sup>47</sup> It is unlikely that a firm would engage in clearly anti-competitive conduct in a non-designated activity where the sole effect is to further entrench the firm's position in a designated activity. Therefore, in practice when applying this principle, the DMU will need to consider whether there are countervailing benefits for customers that are sufficient to offset any negative effects on competition in the firm's designated activity.

- 4.53 Developing the code alongside the designation assessment enables the DMU to carry out information gathering, analysis, design and consultation in a more coherent and effective way. It also means there is greater certainty for all parties more quickly than if there was a two-stage process.
- 4.54 The content of the code should be revisited when designation is reviewed. However, there should also be scope for the DMU to make alterations to the code outside of this designation cycle. The ability to vary the code outside the designation cycle is important to ensure it can keep pace with changes in the technologies being used or the conduct or business model of firms. Such changes would however require appropriate consultation and rights of appeal. More information on the DMU's processes and decisions is set out under recommendation 9 and in Appendix C.

**Recommendation 5: SMS firms should have a legal obligation to ensure their conduct is compliant with the requirements of the code at all times and put in place measures to foster compliance.**

- 4.55 SMS firms should have a legal obligation to ensure their conduct is consistent with the requirements of the code at all times. The primary motivation for establishing a new *ex ante* regime is the ability to shape proactively the behaviour of SMS firms in advance before harm occurs. This legal obligation should support the DMU in delivering this aim.
- 4.56 Although the obligation to comply with the requirements of the regime rests with the SMS firm, the DMU's approach will be important in encouraging and supporting compliance. Getting this right will be essential to the success of the regime. We believe the following approaches should support the establishment of a strong compliance culture within SMS firms:
- **Clarity of expectations from the DMU** will be critical. Clear guidance will play an important role, explaining how to interpret particular elements of the code, as well as potentially setting out past relevant decisions.
  - **Establishing positive and productive relationships** between dedicated UK-based resource on either side will allow for more frequent, open, and constructive discussions. The SMS firm should have a legal obligation to cooperate with the DMU.
  - **Clear accountability** will help to foster compliance within the firm 'from the top'. We recommend that SMS firms are required by law to identify appropriate individuals – senior staff members with authority over the UK business – to take responsibility for compliance.

- **Embedding a compliance culture** throughout an SMS firm, such that when taking decisions, compliance with the code is considered from the outset, not just as an after-thought will support in delivering greater success. Compliance with the code should not be side-lined to a function but should be embedded through the firm's decisions.
- 4.57 **The ability to take tough action when firms don't comply** will also be essential in driving credible deterrence. The actions available to the DMU when the code is breached are set out later in this chapter.
- 4.58 Finally, the DMU should seek to **learn lessons from other regulators** where relevant, such as the FCA, which have implemented initiatives to instil compliance within the entities that they regulate.
- 4.59 The more that the DMU can achieve pro-actively to avoid harms occurring in the first place, the more successful the regime will be.

## The pro-competitive interventions

**Recommendation 6: The government should establish the SMS regime such that the DMU can impose pro-competitive interventions on an SMS firm to drive dynamic change as well as to address harms related to the designated activities.**

- 4.60 Pro-competitive interventions (PCIs) are an important tool to enable the DMU to intervene in markets to promote dynamic competition and innovation. Whilst the code will seek to prevent SMS firms being able to take advantage of their powerful positions in the activities that give rise to their SMS designation, PCIs will seek to address the root cause of market power. Remedies like personal data mobility and interoperability cannot be achieved via the code but are critical in addressing features, such as barriers to entry, which prevent innovative new competitors driving greater competition and innovation. Powers to implement these types of remedies are essential if the DMU is to be able to drive long-term dynamic changes in markets, opening up opportunities for innovation to the benefit of consumers, businesses and the economy more widely.
- 4.61 The purpose of the PCIs is to **promote** competition – to create the conditions such that dynamic competition and innovation can flourish – and to further the interests of consumers. While the code seeks to prevent SMS firms from taking advantage of their powerful positions, for example by exploiting users or excluding competitors, it will not address the reasons why the firm has this powerful position in the first place, ie it will not address the root causes of the firm's market power. Without action, even with the code, there will continue to

be a lack of effective competition. This matters; without effective competition, an SMS firm will face too little incentive to invest, to innovate, to offer lower prices or to improve quality, since there is little risk of it losing its position to a rival if it does not do so.

- 4.62 PCIs are not a new concept. Interventions of this sort have been used to great effect in markets like communications for many years. The closest parallel in economic regulation is Ofcom which, through the Significant Market Power regime, has undertaken (and continues to undertake) a series of interventions to promote greater competition in communications.<sup>48</sup>
- 4.63 We distinguish PCIs from remedies available under the code, since code remedies will be more limited and can only require firms to change their behaviour such that they are no longer in breach of the code. Code remedies cannot be used to implement specific remedies to address underlying competition problems – for example to address the sources of a firm’s market power. Whilst a code breach could take action against an SMS firm who cut API access to a competitor, it generally could not require an SMS firm to proactively make a new service interoperable.
- 4.64 There are also likely to be circumstances where the DMU identifies a specific remedy to a code breach which might go beyond the minimum required to meet the code, but would bring a greater level of benefits. Similarly, in some circumstances the PCI could enable a more pro-competitive remedy than is possible under the code. Examples of such circumstances are explored further in Appendix D.
- 4.65 PCIs could involve significant interventions to create new forms of competition and would therefore be more transformational in nature. They must result from a detailed assessment and understanding of competition concerns in a particular activity, and for this assessment to consider the potential effectiveness and proportionality of any intervention as well as any risks and possible unintended consequences. The proposed PCI tool we are proposing is grounded in the need for such assessment. We provide an overview of these interventions in this section, with detailed proposals outlined in Appendix D.

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<sup>48</sup> Ofcom, [Telecoms regulation](#).

**Recommendation 6a: With the exception of ownership separation, the DMU should not be limited in the types of remedies it is able to apply.**

***The types of remedies available to the DMU***

- 4.66 The DMU should be able to develop a PCI which is **evidence-based** and **targeted** to the particular harm to be addressed, as well as being **proportionate**.
- 4.67 With the exception of full ownership separation (discussed further below), the DMU should not be limited in the type of PCI remedies it can implement. Such a rigid approach would carry substantial risk in digital markets, where emerging technology could open up new challenges and also potential solutions. Limiting PCIs to a prescribed set of interventions would therefore risk the DMU not being able to pursue the most effective remedies in future, but rather the remedy it has the power to implement. In choosing its PCI, the DMU should have regard to the reasonableness, effectiveness, practicability and proportionality of a proposed intervention.
- 4.68 We would expect the DMU to be required to provide guidance on the types of PCIs it would consider. This would be likely to include:
- **data-related interventions** – including interventions to support greater consumer control over data, mandating third-party access to data and mandating data separation/data silos;
  - **interoperability and common standards** – these can be important in data-related remedies, for example to support personal data mobility, but can also be used to ensure software compatibility or enable systems to work together;
  - **consumer choice and defaults interventions** – these remedies can be used to address concerns regarding the power of defaults and in relation to the design of choice architecture which influences consumer decision making;
  - **obligations to provide access** on fair and reasonable terms – for example obligations to provide access to an operating system or online marketplace; and
  - **separation remedies** – limited to operational and functional separation – for example where different units within an SMS firm are operated independently of each other.

### **Full ownership separation**

- 4.69 We have carefully considered the need for different forms of separation remedies in these markets, which could range from operational and functional separation through to full ownership separation. We found a strong *prima facie* case for separation remedies in our online platforms and digital advertising market study, to address Google's vertical integration and conflicts of interest in open display advertising and to address the competition effects of the joint ownership of Facebook and Instagram.
- 4.70 We consider that the ability to impose separation remedies will be important in addressing concerns in relation to the activities of SMS firms. Whilst we consider that the DMU should be able to pursue operational and functional separation, it should not be able to impose full ownership separation. Instead, this power should remain available to the CMA, following a market investigation. This recommendation recognises the significance of a decision to pursue a divestiture remedy, given the costs associated with this remedy, the fact it interferes to a greater extent with a company's property rights, and that the decision cannot be reversed.
- 4.71 In the event the DMU considered that full ownership separation was likely to be the only effective solution, the DMU should possess the right to make or recommend a market investigation reference.

### **Recommendation 6b: The DMU should be able to implement PCIs anywhere within an SMS firm in order to address a concern related to its substantial entrenched market power and strategic position in a designated activity.**

- 4.72 We consider that the justification for the DMU having the power to implement PCIs stems from the need to tackle the sources and effects of an SMS firm's substantial entrenched market power and strategic position in a designated activity. The use of PCIs by the DMU should be in line with this aim.
- 4.73 Therefore, whilst we recommend that the DMU should be able to implement PCIs anywhere within an SMS firm, we consider that the competition or consumer concern they are being used to address should be related to a designated activity. Using PCIs to intervene in relation to the SMS firms' activities more widely cannot be justified by the SMS assessment. Limiting the scope for PCIs ensures these interventions are **targeted** at the particular activity which motivates the need for regulation.
- 4.74 The following examples demonstrate the scope for which PCIs could be applied:

- A PCI could be used to address conduct, behaviour or a market feature in the designated activity which leads to an adverse effect on competition or consumers elsewhere within the SMS firm. For example, a data silo remedy could be imposed to prevent data collected in a designated activity being used to provide an advantage in the firm's other activities.
- A PCI could be used to address conduct, behaviour or a market feature anywhere within the SMS firm which leads to an adverse effect on competition or consumers in the designated activity. For example, a remedy could be implemented to prevent defaults being used in a firm's other products, which automatically direct consumers to the firm's designated activity.

4.75 The DMU should be able to use PCIs in either of these scenarios.

**Recommendation 6c: In implementing a PCI the DMU should demonstrate that it is an effective and proportionate remedy to an adverse effect on competition or consumers. A PCI investigation should be completed within a fixed statutory deadline.**

4.76 We recommend the legal test the DMU must meet in order to implement a PCI would be to rectify an adverse effect on competition or consumers, in activities in which the SMS firm operates, which relate to the firm's market power and strategic position in a core activity. This legal test is intended to ensure a PCI is **targeted** at addressing a particular conduct, behaviour or market feature.

4.77 We expect the DMU would announce when it is initiating a PCI investigation and for these to be conducted in an **open and transparent** manner. It is particularly important that the SMS firm and third parties more widely are consulted on remedy design, to ensure the PCI is likely to be **effective and proportionate**, without causing significant adverse consequences for the firm's wider business. The DMU should consult with the ICO to ensure that interventions that involve personal data align with data protection law.

4.78 A PCI investigation could be run in the course of or shortly after a designation assessment. It is likely that the SMS designation process will be an important source of evidence for the DMU in determining whether there are reasonable grounds for concern that an adverse effect on competition or consumers exists, and that therefore it should initiate a PCI investigation. However, we recommend nothing should preclude the DMU from initiating a PCI investigation at any other time. For example, a PCI investigation could follow a scoping assessment, or be initiated off the back of a complaint or own-initiative monitoring.

- 4.79 We recommend a PCI investigation is completed within a statutory deadline. We suggest that 12 months is likely to provide sufficient time for the DMU to collect evidence to understand the competition or consumer problem it is looking to address and to design and consult on an appropriate remedy. The statutory deadline could cover the point up to which a final decision on the need for a remedy is made, with the DMU able to undertake testing and/or trials during a subsequent implementation phase, where necessary, to fine-tune remedy design to ensure it is most **effective**.
- 4.80 Further information on the process we would expect the DMU to follow when imposing PCIs is set out under recommendation 9 and in Appendix D.

**Recommendation 6d: PCIs should be implemented for a limited duration and should be regularly reviewed.**

- 4.81 We recommend PCIs should be implemented for a limited duration, with the DMU able to set this at the point of making a final PCI decision. This would enable the DMU, for example, to implement a PCI for a shorter period and review its effectiveness before deciding whether to continue with the remedy, amend it and/or consider the need for additional measures. The ability of the DMU to ‘layer’ PCIs over time, starting with smaller interventions and considering their effectiveness before considering more interventionist remedies is a key advantage to having this tool incorporated within an ongoing regulatory regime. The DMU should actively monitor the effectiveness of its PCIs, and could consider reviewing outside of the fixed period, subject to a material change in circumstances, or in line with a change to designation.

## **Monitoring and enforcement**

**Recommendation 7: The government should establish the SMS regime such that the DMU can undertake monitoring in relation to the conduct of SMS firms and has a range of tools available to resolve concerns.**

- 4.82 For the DMU to be able to act swiftly in relation to the conduct of SMS firms, before serious harm occurs, it will need to be able to identify where there are risks of potential problems, as well as where these risks have crystallised and problems now exist.
- 4.83 We would expect the DMU to monitor the activities of firms to identify breaches of the code as well as breaches of remedies imposed under code orders or PCIs. The DMU’s monitoring might also inform future priorities for designation assessments, updates to the code, as well as where future PCI investigations may be needed.

4.84 The DMU should be **forward-looking** and have a range of tools to help it understand emerging issues and to monitor compliance with the SMS regime. It should deploy these in a **proportionate** and **targeted** manner. This should include through:

- gathering periodic and *ad hoc* information from SMS firms and other parties;
- requiring SMS firms to report particular information to the DMU as well as produce compliance reports, which the DMU could publish;
- conducting its own checks of conduct or carrying out reviews on practices across SMS firms;
- holding confidential discussions with stakeholders, and establishing a secure whistleblower channel for employees of SMS firms; and
- reviewing complaints made to the DMU.

4.85 More information on the powers required by the DMU to gather such information is set out under recommendation 8 below and in Appendix E. A monitoring role for the DMU across digital markets more widely, including non-SMS firms, is outlined under recommendation 12.

4.86 Where the DMU identifies a potential problem, it should have a range of tools available to address that problem, combining a participative approach with use of formal powers. We now provide an overview of these covering:

- a participative approach;
- formal investigations;
- imposing penalties;
- interim measures; and
- scoping assessments.

**Recommendation 7a: Where appropriate, the DMU should seek to resolve concerns using a participative approach, engaging with parties to deliver fast and effective resolution.**

- 4.87 In many circumstances, it is likely that a participative approach,<sup>49</sup> whereby the DMU seeks to engage constructively with all affected parties, will achieve fast and effective resolutions.
- 4.88 We recognise that in some cases affected parties may be better placed to identify an appropriate resolution than the DMU itself. The DMU could support parties in coming to a resolution. In supporting a resolution being reached, the DMU could ensure it delivered benefits to competition more widely and was not just in the interests of the parties. We would expect the DMU to draw on experiences from regulatory bodies in other sectors, such as the Groceries Code Adjudicator and Ofcom, to iteratively develop its approach. We would expect the DMU to be as transparent (to the public and wider stakeholders) as possible in relation to its participative approach to resolving concerns, and also to ensure that it has appropriate safeguards in place to ensure the independence of its processes.
- 4.89 It should be up to the DMU to decide when it is appropriate to rely on engagement, balancing the wider compliance and deterrence effect an investigation may have, with the potential efficiency benefits of informal resolution. Engagement may also be less appropriate where a large number of parties are involved and where those involved have concerns about their identity being known (for fear of retribution from SMS firms).

**Recommendation 7b: The DMU should be able to open formal investigations into breaches of the code and where a breach is found, require an SMS firm to change its behaviour. These investigations should be completed within a fixed statutory deadline.**

- 4.90 The main purpose of a code breach investigation is to establish whether there has been a breach, and if so, to bring the SMS firm's conduct back into line with the code. As such, the DMU would be able to order the SMS firm to change its conduct to comply, and, if necessary, specify the steps it must take. This focus on remedying the conduct rather than punishing the firm is an important distinction from enforcement under the Competition Act 1998.

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<sup>49</sup> In a 2018 interview with Quartz on how to regulate tech monopolies, Jean Tirole proposed a form of 'participative antitrust'.

- 4.91 We would expect the DMU to operate code breach investigations in an **open and transparent way** and publish guidance on its expected approach.
- 4.92 The DMU should be able to require a remedy which directly addresses the breach. It should be able to consult on an effective remedy, but the remedy should be **proportionate** and the DMU should not be able to impose a more intrusive alternative than that required to address the breach.
- 4.93 We recommend the DMU should conduct code breach investigations quickly, within a fixed statutory deadline to prevent material damage to competing businesses. Our initial assessment is that six months would be appropriate and achievable in most circumstances, balancing the need for quick resolution with appropriate rigour, but this will require further testing and consideration by government. We recognise this would be a compressed timeframe compared to existing competition and regulatory enforcement. However, we believe it is critical to achieve quick resolution to code breaches in these fast-moving markets, avoiding protracted processes that leave users of SMS firms, like small businesses, in limbo. As set out in the next section, we recommend the process for imposing penalties is operated separately from the process for investigating potential breaches of the code and is not included within this statutory deadline.
- 4.94 Further information on the process the DMU should follow in relation to these investigations is set out under recommendation 9 as well as in Appendix C. We recommend the DMU follow a similar process where it finds an SMS firm has breached a remedy order, for example a remedy imposed as a result of a PCI.

**Recommendation 7c: The DMU should be able to impose substantial penalties for breaches of the code and for breaches of code and PCI orders.**

- 4.95 While we do not propose that breaching the code should automatically lead to a penalty, the potential for substantial penalties would have a significant deterrent effect. The legal test should require that the breach is committed intentionally or negligently for a penalty to be imposed. The DMU should set out in guidance that the imposition of a financial penalty for a breach of the code would be most likely for a serious breach that causes significant harm. This would be more comparable to the approach followed by the ICO when deciding whether to impose penalties for breaches of data protection legislation than the CMA in its approach to competition law enforcement.
- 4.96 We propose the DMU is able to impose penalties up to a maximum of 10% of worldwide turnover. We believe this level of penalty is sufficient to lead to deterrence and commensurate with fines available in antitrust cases and to

other regulators.<sup>50</sup> It also reflects the size of the firms likely to be designated with SMS. The DMU will need to adopt penalties which are proportionate to the breach it has found and should publish guidance on how it will determine penalties.

- 4.97 As we think it is important that the potential for penalties does not unnecessarily complicate the routine operation of the code, the process for adopting penalties should be operated separately from the process of investigating potential breaches of the code, and outside of a tight statutory deadline.<sup>51</sup> Further information on the process we would expect the DMU to follow when imposing penalties is set out under recommendation 9 and in Appendix C. We recommend the DMU follow the same process where it considers it is appropriate to impose a financial penalty as a result of an SMS firm not complying with a remedy, for example a code remedy or PCI.

**Recommendation 7d: The DMU should be able to take action quickly on an interim basis where it suspects the code has been breached.**

- 4.98 The DMU should have the ability to act quickly on an interim basis where it has reason to suspect the code may have been breached and it is desirable to act on an interim basis to prevent significant harm. We consider this is essential in fast-moving digital markets where a change by an SMS firm to terms and conditions, algorithms, or an API can have immediate material consequences. Further information on the process we would expect the DMU to follow when imposing interim measures is set out under recommendation 9 and in Appendix C.

**Recommendation 7e: The DMU should be able to undertake scoping assessments where it is concerned there is an adverse effect on competition or consumers in relation to a designated activity. The outcome of such assessments could include a code breach investigation, a pro-competitive intervention investigation, or variation to a code principle or guidance.**

- 4.99 The purpose of a scoping assessment is to consider whether particular conduct or behaviour by an SMS firm has an adverse effect on competition or consumers. It could be used where:

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<sup>50</sup> In the case of the Competition Act 1998 the maximum penalty is set at 10%. This can be contrasted with the FCA where for certain breaches it may impose an unlimited penalty, with the ICO where a cap of 4% is adopted in respect of the GDPR, and Ofcom where certain Communications Act breaches are capped at 5% of the qualifying revenue.

<sup>51</sup> It may be appropriate for the DMU to be able to indicate at the outset of a code enforcement case that it is deprioritising penalties, and running an investigation in a non-penalty track, for example where a code breach investigation is opened as a result of genuine ambiguity as to how the code applies to the set of facts.

- Conduct is covered by the code, but further assessment is necessary to consider whether the code has been breached, for example because the conduct also delivers efficiencies or benefits to other policy objectives like privacy.
- Conduct is not covered by the code but is still suspected to be harmful and where there may be a need for DMU intervention.

4.100 It is important the DMU has this tool available, to ensure it is able to consider wider conduct that may not be covered by the code. As set out above, the DMU will not be able to anticipate every practice it wants to cover within the code when setting it. The scoping assessment provides the DMU with a tool to be able to consider wider practices which may be harmful and take appropriate action through its other tools.

4.101 We would expect scoping assessments to be completed within six months, including a decision on next steps. Scoping assessments could result in no further action, the DMU opening a code breach investigation, an investigation in relation to a pro-competitive intervention, or the updating of code principles or guidance.

## The DMU's powers, processes and decisions

**Recommendation 8: The government should establish the SMS regime such that the DMU can draw information from a wide range of sources, including by using formal information gathering powers, to gather the evidence it needs to inform its work.**

4.102 To ensure its work in relation to the SMS regime is **evidence-driven and effective**, the DMU should be able to gather information from a wide range of sources. To do this, it will need to use a combination of: proactive powers to require information; and information volunteered by stakeholders.

4.103 The DMU will need strong information gathering powers to support its work in relation to the SMS regime – including to inform designation assessments spot and investigate potential breaches of the code and to undertake PCI investigations. These powers will need to account for the way information is obtained, used and stored in the modern world (for example data in the cloud). They will also need to be accompanied with penalties for non-compliance, or for the provision of false or misleading information. The DMU should use its information gathering powers in a **proportionate** and **targeted** manner. Information gathering powers for the DMU's wider work in relation to non-SMS firms are outlined under recommendation 12.

4.104 Stakeholders will also be an essential source of information to the DMU and the DMU should seek to encourage stakeholders to provide information, for example in relation to potential code breaches, voluntarily. A challenge in achieving this is that some stakeholders may have reservations about coming forward for fear of retribution, especially where they are dependent on the SMS firm.

4.105 Complainants should be protected as far as is reasonably possible, and they may have to be anonymised. However, the DMU may need to weigh the risks of harm to the complainant against the necessity to disclose, if anonymisation limits the ability of the DMU to act to address the harm.

**Recommendation 9: The government should ensure the DMU's decisions are made in an open and transparent manner and that it is held accountable for them.**

4.106 In considering the design of the steps the DMU should follow across its work, we have sought to ensure this process is **open and transparent**. These are significant decisions which should rightly be open to scrutiny, with the DMU held **accountable**.

**Recommendation 9a: The DMU's decisions should allow for appropriate internal scrutiny.**

4.107 The DMU will be empowered to make important decisions and it is essential that these are made in a way which allows for appropriate internal scrutiny.

4.108 Our recommendation is that, following the passing of the necessary legislation, all decisions within the SMS regime are for the DMU<sup>52</sup> and should be viewed as independent expert regulatory judgements. This includes decisions in relation to designation, the code of conduct, code breach investigations and penalties and to implement PCIs. This allows for decisions to be made independently and on the basis of robust evidence and analysis.

4.109 We have not specified how and at what level within the DMU decisions should be made, since we believe this is best considered in line with wider decisions on the DMU's institutional design. However, given the importance of these decisions, the DMU's decision-making model must allow for sufficient internal

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<sup>52</sup> Ofcom and the FCA could also make relevant decisions if the DMU's powers are shared between regulators where the designated activity is in a regulated sector. This would include 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. See recommendation 14b below. This does not change the proposal that all decisions should be viewed as independent expert regulatory judgements. Decisions in relation to the SMS merger regime would remain for the CMA.

scrutiny to ensure robust and objective decision-making. There are a range of ways this could be achieved and a variety of models which could be explored taking lessons from existing regulatory regimes. The approach taken to decision-making should balance the need for independence, with the need to ensure decisions can be made swiftly, and reviewed and adjusted as part of an *ex ante* framework.

**Recommendation 9b: The DMU should consult on its decisions.**

4.110 We expect the DMU would conduct its work in an **open and transparent** way. This is important to ensure the DMU's decisions are **effective**, taking into account appropriate evidence and a diversity of perspectives. For example, we would expect the DMU to publicly announce when it opens a designation assessment, code breach investigation or PCI investigation and provide an opportunity for the SMS firm and third parties to provide input. Similarly, we would expect the DMU to consult when establishing or making changes to the code. We would also expect the DMU to be as transparent (to the public and wider stakeholders) as possible in relation to its participative approach to resolving concerns, and also to ensure that it has appropriate safeguards in place to ensure the independence of its processes.

4.111 We would expect the DMU to set out its provisional decisions and provide an opportunity for those affected to make representations. In relation to designation assessments, we would expect the DMU to publicly consult on a provisional designation decision and provisional code of conduct. Similarly, we would expect the DMU to publicly consult on provisional decisions in relation to PCIs. In relation to decisions on code breach investigations and code remedies, interim measures and penalties, we would expect the SMS firm (and where appropriate third parties) to be able to make representations.

4.112 Further detail on the DMU's processes in relation to designation assessments, making and varying the code, code breach investigations, interim measures, scoping assessments and PCI investigations is set out in the respective appendices.

**Recommendation 9c: The DMU's decisions should be timely, with statutory deadlines used to set expectations and deliver speedy outcomes.**

4.113 We are recommending that many of the DMU's decisions be subject to a statutory deadline, in particular, designation decisions, decisions in relation to code breach investigations, and decisions in relation to PCIs. Our recommendation for timeframes to be set out in statute reflects the need for faster decision making in these markets and aims to deliver greater certainty, both to SMS firms and those that use or rely on their services, including

consumers and small businesses. We believe setting deadlines firmly in legislation provides a clear instruction to the parties, the DMU, and the courts on appropriate process, timeframes, and evidence required to support decisions. However, deadlines should be of an appropriate length to ensure that quality of investigation, analysis and decision making is not compromised.

**Recommendation 9d: The DMU’s decisions should be judicially reviewable on ordinary judicial review principles and the appeals process should deliver robust outcomes at pace.**

4.114 We recommend that the DMU should be held **accountable** for its decisions and that these decisions should be judicially reviewable, on ordinary judicial review principles.<sup>53</sup>

4.115 This will mean that an appeal will 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. This is consistent with the DMU’s decision on designation being an expert regulatory decision where the DMU is exercising a discretionary judgment.<sup>54</sup>

4.116 Adopting a judicial review standard for a regulator’s decision is consistent with the government’s recent approach to other similar regimes. In 2017, the standard of review for appeal to the Competition Appeal Tribunal (CAT) from Ofcom’s communications appeals was changed from being an appeal ‘on the merits’ to one applying the principles of judicial review.<sup>55</sup>

4.117 The application of judicial review standards by courts and specialist tribunals like the CAT provides detailed scrutiny of decisions while allowing the administrative body an appropriate level of discretion in making its expert decisions.

4.118 Where the DMU’s decision is found to be flawed we would expect the normal discretionary judicial review remedies to be available to the appeal body, including mandatory prohibiting and quashing of decisions. Where this is the

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<sup>53</sup> We would expect this to cover all judicial challenges to the DMU actions, including challenges made to the legality or fairness of the process.

<sup>54</sup> Our consistent recommendations on appeals against code enforcement decisions are covered in Appendix E.

<sup>55</sup> ‘The Tribunal must decide the appeal, by reference to the grounds of appeal set out in the notice of appeal, by applying the same principles as would be applied by a court on an application for judicial review,’ , new section 194A(2) of the Communications Act 2003, introduced by section 87 of the Digital Economy Act 2017.

case, we expect the DMU to reach a fresh decision on the matter having regard to the court's judgment.

4.119 We recommend that appeals are made to a judicial body with capacity to deal with what are likely to be large and complex appeals expeditiously and where procedural rules can be made to facilitate active case management to deliver appeals at pace.

## Merger control for SMS firms

### A distinct merger control regime for SMS firms

**Recommendation 10: The government should establish the SMS regime such that SMS firms are subject to additional merger control requirements.**

4.120 The purpose of the SMS merger regime is to ensure that acquisitions entered into by SMS firms receive additional scrutiny in light of the powerful positions of these firms and the potential harms that such transactions might raise.

4.121 There are widely-held concerns about historic underenforcement against digital mergers in the UK and around the world.<sup>56</sup> For example, the Furman Review stated that over the last ten years the five largest digital firms have made over 400 acquisitions globally with none of these being blocked by competition authorities, leading the review to call for a 'reset' in digital merger assessment and 'more frequent and firmer action to challenge mergers'.<sup>57</sup> The Stigler Report similarly concludes that authorities have permitted too many digital mergers, in particular 'rarely' challenging vertical mergers,<sup>58</sup> and explains that the most powerful digital firms use their existing positions to 'derive superior insights into what firms they should block, which they should buy, and how they should grow strategically.'<sup>59</sup> The evidence from these reports, as well as previous competition investigations by the CMA and other competition authorities, also shows that acquisitions by the most powerful digital firms are likely to hold particular risks for consumers, given the particularly widespread and significant effects of the market power that they

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<sup>56</sup> These concerns are discussed in: Furman Review (2019), [Unlocking digital competition](#); Lear's (2019) [Ex-post Assessment of Merger Control Decisions in Digital Markets](#); Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition for the digital era, final report for the European Commission](#); Stigler Center (2019), [Committee on Digital Platforms Final Report](#); and [US Antitrust House Subcommittee Investigation of Competition in Digital Markets](#), 2020.

<sup>57</sup> Furman Review, [Unlocking Digital Competition](#), paragraph 3.44 and recommendation at paragraph 3.54.

<sup>58</sup> Stigler Center (2019), [Committee on Digital Platforms Final Report](#), page 63.

<sup>59</sup> Stigler Center (2019), [Committee on Digital Platforms Final Report](#), page 50.

already hold, and therefore give rise to particularly acute risks in the event of regulatory underenforcement.

- 4.122 As set out in Chapter 2, there is also an increasing body of evidence that the lack of competition in activities dominated by the most powerful digital firms, often as a result of specific market features such as network effects and economies of scale, makes it hard for rivals to enter and compete. The most powerful digital firms have been able to develop particularly strong and entrenched market positions, which they may seek to leverage into adjacent markets.<sup>60</sup> This limits sources of potential entry and challenge by new entrants, which is particularly important in digital markets in which incumbents hold a strong position.
- 4.123 Mergers and acquisitions activity is an important part of the business model of these firms, with strategic acquisitions being used to reinforce an existing strong position or expand that position into adjacent markets. The most powerful digital firms can also use acquisitions to build and strengthen their 'ecosystems' of complementary products and services around their core service, insulating it from competition. Acquisition targets are often at an early stage of their development, making it difficult for competition authorities to assess whether the acquired firm is likely to develop into a competitor.
- 4.124 The accumulation and strengthening of market power by the most powerful digital firms through mergers and acquisitions activity therefore has the potential to cause significant harm. Mergers involving digital firms often raise issues around the deeper entrenchment of existing market power as well as the loss of dynamic or potential competition, where either the target or the acquirer could have developed products and services in competition with the other. These harms to innovation can result in potentially very large losses to consumers.<sup>61</sup>
- 4.125 While, in our view, the UK merger control regime remains broadly fit for purpose, there are risks that certain limits to the existing primary regime could restrict the CMA's ability to enforce effectively in digital markets.
- 4.126 The CMA only has the power to investigate a merger (and, ultimately, where that merger raises competition concerns, to prohibit it or allow it to proceed

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<sup>60</sup> See for example the CMA's market study into online platforms and digital advertising, [final report](#), paragraph 58, and, in the case of Google, from paragraph 5.261.

<sup>61</sup> Loss of innovation is discussed frequently in the Furman Review (2019), [Unlocking Digital Competition](#), for example at paragraphs 1.157 and 3.30.

only subject to conditions) where the merger meets one of the specified jurisdictional tests – known as the ‘turnover’ test and the ‘share of supply’ test.

- 4.127 The turnover test (which requires the business being acquired to generate annual revenues of at least £70 million in the UK) is intended to capture acquisitions of targets with an established market presence. There is a risk, however, that this test fails to capture many transactions entered into by the most powerful digital firms, which often involve the acquisition of nascent, potential competitors or firms whose early stage business model is to initially offer ‘free’ services to consumers, which may be generating little or no revenue in the UK.
- 4.128 The share of supply test captures transactions where the merging businesses overlap in the supply of a particular type of goods or services and the merger creates or increases a combined ‘share of supply’ of at least 25% in the UK. This test has, in practice, previously captured acquisitions of nascent competitors (such as Google’s acquisition of Waze and Facebook’s acquisition of Instagram). There is, however, again a risk that this test fails to capture many transactions entered into by the most powerful digital firms, which often involve moving into adjacent markets, because it cannot capture mergers where the relationship between the merging parties is purely vertical in nature (ie they do not overlap).
- 4.129 Even when the CMA has the power to investigate a merger, difficulties can arise in establishing that there is a sufficient likelihood of consumer harm to justify intervening in that merger, even if the potential harm is very large.
- 4.130 While the most powerful digital firms already hold significant market power, and underenforcement carries particularly acute risks for consumers, the threshold to establish that a transaction raises competition concerns remains high. The CMA can ultimately only intervene in a merger where it establishes that the merger gives rise to a substantial lessening of competition (**SLC**) on a ‘more likely than not’ basis (ie on the balance of probabilities). This can be particularly challenging in digital mergers, where there is often significant uncertainty about how the market, or the business that is being acquired, is likely to develop in future. At present, a merger can only be blocked where consumer harm (in the form of an SLC) is the likely outcome. As a result, there is a serious risk that mergers that have considerable potential to cause significant harm to UK consumers, but where this cannot be considered as the likely outcome at the time that the decision is taken, would be cleared. This risk was highlighted in recent expert reports, such as the Furman Review, which noted that the current framework for assessment can ‘make it hard to demonstrate that a substantial lessening of competition is more likely than not,

despite the potentially very large scale of lost benefit if the merger prevents competition from emerging in that digital market'.<sup>62</sup>

4.131 In addition, we also consider that the voluntary nature of UK merger control raises particular risks with regard to transactions by SMS firms. As UK merger control is voluntary, merging parties are able to complete (or 'close') transactions prior to clearance. In practice, the CMA often begins its investigation after an acquisition has already completed and integration has begun. In these circumstances, the CMA will typically impose a 'hold separate' order, known as an initial enforcement order, requiring the merging parties to operate their businesses independently of each other and not to integrate further. But, given the complex and interconnected nature of the most powerful digital firms, there can be particular difficulties in unwinding integration that has already taken place. These difficulties raise significant risks around whether effective remedies can be put in place in the event that competition concerns are ultimately found, as well as giving rise to significant cost and uncertainty for both the CMA and the merging parties.

4.132 There are some disadvantages to additional merger control scrutiny for SMS firms, as well as potential unintended consequences. These have to be considered carefully (as set out in Appendix F) and factored into the detailed design of the regime. However, in light of the widespread and significant risks that arise from acquisitions by firms with SMS, we consider that there should be additional merger control requirements for these acquisitions, in the form of a distinct merger control regime.

### **The key features of the SMS merger control regime**

**Recommendation 11: The government should establish the SMS merger control regime such that SMS firms are required to report all transactions to the CMA. In addition, transactions that meet clear-cut thresholds should be subject to mandatory notification, with completion prohibited prior to clearance. Competition concerns should be assessed using the existing substantive test but a lower and more cautious standard of proof.**

4.133 The SMS merger control regime would need to be designed carefully, to ensure that it can achieve its objectives while minimising any unintended adverse consequences. While this will require further detailed consideration, our current proposals for the key features of such a regime are set out below.

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<sup>62</sup> Furman Review (2019), [Unlocking Digital Competition](#), paragraph 3.82.

*The SMS merger control regime would be operated by the CMA*

4.134 We propose that the SMS merger control regime would be operated by the CMA alongside the wider merger control regime. The CMA is the UK's specialist competition authority and operates the UK's existing merger control regime across all industries, including those regulated by other sectoral competition regulators. Many of the tests and theories of harm applied across the two regimes will be the same and there is therefore a strong incentive to minimise the risk of inconsistent approaches. Splitting the UK's merger control responsibilities between two different bodies would also likely result in the duplication and dilution of expertise and resources across two regulators.

*A reporting obligation would apply to all transactions entered into by SMS firms*

4.135 We propose that SMS firms would be required to make the CMA aware of all transactions that they enter into within a short period after signing. This would allow the CMA to verify whether the jurisdictional tests that govern whether transactions are subject to mandatory notification are being applied appropriately, as well as supporting the CMA's monitoring of transactions that fall outside the thresholds for mandatory notification.

*Transactions that meet certain clear-cut thresholds would be subject to mandatory notification*

4.136 We propose that certain transactions entered into by SMS firms that meet bright-line threshold tests would be subject to mandatory merger control notification. Our preferred option would be that these threshold tests are designed to establish a transaction's materiality and connection to the UK, although further consideration is necessary to assess how these design needs might be achieved in practice.

4.137 The SMS merger control regime would result in qualifying transactions being subject to mandatory notification, with penalties (in the form of fines) imposed where SMS firms fail to comply with this requirement. It is therefore particularly important that the thresholds that determine whether a transaction is subject to mandatory notification are clear-cut in nature and straightforward to apply in practice.

4.138 We propose that the mandatory notification regime would apply only to clear-cut acquisitions of control (including both 'de jure' control and 'de facto' control). In designing the SMS merger control regime, further consideration should be given to the types of transactions that would be caught by the definition of 'control'. However, we propose at this stage that acquiring the

ability to exercise ‘material influence,’ which is a less clear-cut standard, would not trigger a mandatory notification.

- 4.139 We also propose the use of bright-line threshold tests, in order to ensure that the mandatory notification regime is properly targeted. These thresholds would be intended to ensure that transactions that appear to be most likely to have a substantial impact on competition in the UK are subject to mandatory merger notification. This would also ensure that transactions that appear to have no material impact in the UK are not subject to the requirements of mandatory (and suspensory) notification (although, as described further below, consideration should be given to what kind of ‘safety net’ should exist for transactions that are not subject to mandatory notification but could nevertheless raise competition concerns).
- 4.140 Our preferred option would be to assess the materiality of a transaction by reference to its transaction value (similar to the tests used in merger control regimes such as the USA, Canada and Japan). The connection that a transaction has to the UK (the ‘UK nexus’) could be assessed by reference to certain clearly defined criteria relating to the activities of the target business in the UK, such as revenues, assets, or end-users. Further analysis is required, however, to assess whether it is possible to design a UK-focussed test that is clearly defined but also capable of capturing transactions that raise concerns around potential competition (the loss of which, as noted above, is one of the key concerns liable to be raised by acquisitions by SMS firms).
- 4.141 As set out above, the proposed code of conduct would primarily apply to a subset of the SMS firm’s activities, centred around those activities that are the focus of the SMS designation process. We do not, however, propose to limit the SMS merger control regime (including both the reporting and mandatory notification requirements) to acquisitions that relate to those core activities.
- 4.142 A key concern motivating the SMS regime is the ability of an SMS firm to use its position in a designated activity to extend its market power into other activities. As set out above, we consider that such conduct would be covered by the code (given that the SMS firm’s conduct in the designated activity is the source of concern in that circumstance). We also consider it is important that the SMS regime should be able to address the concerns that might arise when a firm seeks to further entrench the position of its designated activity through actions taken in its wider ecosystem. For that reason, the code can apply outside the designated activity where such conduct may affect competition in the designated activity.
- 4.143 The same principles apply to the acquisitions entered into by an SMS firm. It can, however, often be difficult to determine, in a clear-cut manner, how a

target business's activities might relate to the designated activities of an SMS firm. Given the importance of bright-line threshold tests for SMS firms to be able to assess when mandatory notification is required, we think that this kind of assessment is not suited to a jurisdictional test. We therefore propose that the SMS merger regime should apply to all transactions entered into by the SMS firm and that the connection between the target business's activities and the core activities of the SMS firm should be considered in the substantive assessment of the merger.

- 4.144 Where it can readily be established that there is no competitive interaction between the activities of an SMS firm and the activities of the target firm, it may be appropriate to operate a simplified notification process to eliminate competition concerns.
- 4.145 While the mandatory notification regime would be designed to capture the transactions that appear most likely to raise concerns, we propose that there should be some form of 'safety net' that would enable the CMA to review acquisitions by firms with SMS that did not trigger mandatory notification (such as acquisitions of material influence) but could nevertheless raise competition concerns. More detailed consideration will have to be given to the design of this mechanism (including, for example, whether such transactions may be subject to the existing merger control regime or whether some other form of 'call-in' would be a more appropriate way of achieving this aim). In any case, other than the requirement to make the CMA aware of these transactions (as described above), they would not be subject to the prohibition on closing prior to clearance.

*Transactions qualifying for mandatory notification would be subject to a prohibition on closing*

- 4.146 At present, the UK merger regime does not prevent merging parties from 'closing' (ie implementing) a transaction before receiving merger control clearance. As explained above, we consider that the closing of transactions involving SMS firms before or during a CMA investigation gives rise to significant risks, particularly in relation to the availability of effective remedies in the event that a transaction is ultimately found to raise competition concerns.
- 4.147 We therefore propose that the transactions that qualify for mandatory merger control notification under the SMS merger regime would be subject to a prohibition on closing prior to obtaining merger control clearance (whether unconditionally or subject to conditions).

4.148 The prohibition on closing would be intended to protect against any action that might prejudice the outcome of the CMA's investigation or impede the putting in place of remedies (if the merger is ultimately found to raise competition concerns).

*Competition concerns would be assessed using the existing substantive SLC test, but to a lower and more cautious standard of proof*

4.149 In order to block a merger, or to allow it to proceed only subject to conditions, the CMA is required to consider whether a merger might be potentially harmful to consumers. In order to conduct this assessment, a merger must be assessed against a specified substantive test (ie that the merger is expected to harm competition) to a specified standard of proof (ie the strength of evidence needed to show this).

4.150 We propose that competition concerns would be assessed using the existing substantive test – the Substantial Lessening of Competition (SLC) test – under the SMS merger regime. The economic principles that underpin merger assessments and the competition concerns that mergers can raise (ie unilateral, coordinated or non-horizontal effects) apply equally to acquisitions by SMS firms and acquisitions under the existing primary merger regime. Within this context, the SLC test provides a well-understood yet sufficiently flexible framework to assess the competition concerns that might be raised by acquisitions by SMS firms.

4.151 In principle, the final decision in relation to whether a merger can proceed is taken after an in-depth 'phase 2' investigation.<sup>63</sup> At that stage, the CMA can, at present, only intervene in a merger that is likely to result in an SLC (ie on the balance of probabilities). However, in order to address the serious risk that acquisitions by firms with SMS that have considerable potential to cause significant harm to UK consumers could be cleared, we support the use of a lower and more cautious standard of proof in the final decision on these mergers.

4.152 This would enable the CMA to intervene in mergers in circumstances where there is a material risk that the merger would result in an SLC but it may not be possible to prove this on a 'more likely than not' basis, particularly given the forward-looking analysis that is often required when assessing digital mergers. This would be consistent with the central principles underpinning the

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<sup>63</sup> Merging parties are also able to offer remedies to address competition concerns identified following an initial phase 1 investigation to avoid a reference to a phase 2 investigation.

recommendations in the Furman Review, namely that both the likelihood and potential scale of harm should be taken into account in the assessment of digital mergers, and that authorities should be able to intervene in transactions even where harm is not the likely outcome.<sup>64</sup>

4.153 We therefore propose that a phase 2 investigation under the SMS merger regime would assess whether the merger will give rise to an SLC by applying a threshold that is lower than the ‘more likely than not’ test. Our recommendation at this point is to assess whether there is a ‘realistic prospect’ that a merger gives rise to an SLC. This would, critically, enable the CMA to intervene in mergers that have the potential to cause significant harm to UK consumers, even where it cannot be established that this outcome is more likely than not. The ‘realistic prospect’ standard is already used in UK merger control, as a ‘lower and more cautious threshold’ than the balance of probabilities standard, to assess whether competition concerns arise in phase 1 investigations. While the purpose of using this threshold in a phase 1 investigation – ie to ‘screen’ whether a transaction should be referred to an in-depth investigation – is different to that envisaged in phase 2 investigations under the SMS regime, there would be conceptual consistency in using the same test where a cautious approach is merited for other reasons (ie because of more acute risks of underenforcement in relation to acquisitions by firms with SMS).

4.154 For the avoidance of doubt, the proposed introduction of the ‘realistic prospect’ standard would not reduce the rigour of an in-depth phase 2 investigation. The legislation and guidance would ‘lock in’ key aspects of the phase 2 process, including the appointment of a new and independent set of decision-makers to consider the applicable statutory questions and the applicable statutory timeline for investigation. The longer timeline of a phase 2 investigation would allow for additional evidence-gathering and further analysis to take place, meaning that the decision at phase 2 would typically be informed by a significantly more developed evidence base than that used during phase 1.

4.155 Some of the recent reports on competition in digital markets have suggested other ways in which mergers could be assessed in order to address the risk of underenforcement. The Furman Review, for example, proposed an alternative

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<sup>64</sup> Furman Review (2019), [Unlocking digital competition](#), paragraphs 3.88 and 3.89. This is also consistent with the recommendation in Lear’s (2019) [Ex-post Assessment of Merger Control Decisions in Digital Markets](#). (page xiv), which recommends that the CMA should be willing to accept more uncertainty in order to address potential gaps in merger enforcement. A few respondents to the call for information were also supportive of changing the standard of proof.

substantive test based on a 'balance of harms' approach. While we agree that this test would, in theory, be an attractive way of weighing whether a merger is expected to do more harm than good for consumers, we do not currently believe that it is possible, in practice, to apply the test in a transparent and robust way. Similarly, while some commentators have suggested reversing the burden of proof (such that merging parties would be required to show that a merger was not anti-competitive), we currently believe that it would be difficult, in practice, for merging parties to meet this burden in the vast majority of cases (including transactions that do not have a material risk of harming consumers). We therefore currently consider that the use of a lower and more cautious standard of proof would be the best way of addressing the particular concerns that may arise from acquisitions by firms with SMS in a proportionate manner, but suggest that further consideration could also be given to these alternative options if there is some basis to suggest that these significant practical concerns could be overcome.

*Non-competition concerns in mergers would continue to be assessed by other regulators under existing frameworks, including intervention on public interest grounds, with cooperation mechanisms being strengthened. Further consideration is needed on how to address media plurality concerns not covered by existing public interest frameworks.*

- 4.156 The public policy concerns that are raised by acquisitions by SMS firms are not always limited to competition issues. For example, mergers could have privacy implications or wider public interest concerns similar to those in media mergers.
- 4.157 The ICO considers that it already has the powers required to be able to enforce data protection and e-privacy concerns in the context of mergers once it is aware of the proposed transaction. As such, we propose that non-competition concerns relating to privacy or data protection should not be considered within the SMS merger control regime. This will allow the CMA and the ICO to assess the competition and e-privacy and data protection aspects of a merger respectively.
- 4.158 Mergers involving firms with SMS may also give rise to concerns that may not be capable of being addressed within the existing bases for public interest interventions in merger cases. More work is needed to establish whether such concerns are better addressed by updating the media plurality framework, or as part of the SMS merger control regime. In the meantime, we consider that there is likely to be value in applying the existing public interest intervention regime to the SMS merger control regime, allowing the Secretary of State to intervene in these mergers on public interest grounds where the relevant

statutory tests are met in the same way as under the existing primary UK merger control regime.

4.159 Further to the recommendations on working with other regulators in Chapter 6, it will be important to ensure that the SMS merger control regime enables sufficient cooperation between the different regulators that may be considering the different implications of the same transaction. The regime should therefore explicitly provide for the sharing of information between the CMA and other authorities where appropriate, and the CMA, Ofcom and the ICO should cooperate on individual cases through information exchange, consultation, and other forms of close cooperation.

## 5. A modern competition and consumer regime for digital markets

5.1 In this chapter, we outline proposals for powers to drive greater competition and innovation across digital markets more widely, beyond those activities where a firm is designated as having SMS. The chapter covers:

- a proposed role for the DMU in monitoring digital markets to enable earlier and swifter intervention when problems are identified; and
- proposals to strengthen competition and consumer laws to ensure they are better adapted for the digital age.

5.2 Further information on our proposals, including on the rationale and justification is set out in Appendix G.

### The DMU's role in relation to all digital markets

**Recommendation 12: The government should provide the DMU with a duty to monitor digital markets to enable it to build a detailed understanding of how digital businesses operate, and to provide the basis for swifter action to drive competition and innovation and prevent harm.**

5.3 As set out in Chapter 3, we recommend the DMU's duty should be to further the interests of consumers and citizens in digital markets by promoting competition and innovation and that it should act as a centre of expertise in relation to competition in digital markets.

5.4 In order to fulfil this duty, we recommend the DMU is given a duty to monitor digital markets. This monitoring role would provide for swifter intervention to promote greater competition and innovation, both by spotting problems earlier and by providing greater expertise enabling them to be addressed more quickly. It would also enable the DMU to spot opportunities where intervention could better support competition and innovation, for example by pursuing remedies like personal data mobility and interoperability.

5.5 We have earlier recommended that the DMU have a monitoring role in relation to the conduct of firms designated with SMS (see recommendation 7). This would necessarily involve the DMU developing its knowledge across many digital markets. A wider monitoring role, beyond SMS firms, could therefore be done in conjunction with this work.

5.6 In line with these aims, we propose the DMU should have a range of tools to enable it to carry out this function:

- **Engaging regularly with a diverse range of participants in digital markets.** This could include through establishing a group of expert advisers or fellows who could support the DMU for short fixed periods when it is working on particular issues. The DMU could also consider establishing an ‘Innovation Hub’ to provide an access point within the DMU for innovative businesses to raise concerns when they face regulatory barriers to developing these services.
- **Undertaking research and gathering market intelligence.** This could include undertaking research on its own or in partnership with other organisations, academics or universities to better understand the impact of new technologies on consumers’ and citizens’ interests.
- **Gathering information through calls for information and market studies.** We recommend that the DMU is able to gather information in relation to digital markets through calls for information and market studies under the Enterprise Act 2002.
- **Broader information gathering powers.** We also consider that the DMU should have a general power to require information outside a formal market study. This is important because imbalances of information between regulators and business is particularly acute in digital markets and it is essential that regulators are equipped with powers to enable them to understand markets at a sufficiently early stage to spot problems and be able to intervene quickly. We recognise that these powers would need to be used in a **proportionate and targeted** way.

5.7 If the DMU did identify a need for intervention to further the interests of consumers or citizens, it should have a range of possible approaches available to it. These could include:

- **Supporting industry initiatives to promote competition and innovation** – the DMU could have an important role in supporting industry initiatives which seek to open up opportunities for competition and innovation, for example by ensuring these promote the interests of the wider market.
- **Considering the use of regulatory sandboxes** – the DMU could consider whether there might be value in establishing a ‘regulatory sandbox’<sup>65</sup> within the DMU, to support firms in trialling propositions where

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<sup>65</sup> A regulatory sandbox enables a firm to test new business models whilst still ensuring consumer outcomes are safeguarded.

competition or consumer protection laws act as a barrier to their development.

- **Publishing guidance and recommendations to industry** – the DMU could, working closely with other regulators, publish guidance and recommendations on conduct which is likely to support consumer and citizen interests in digital markets, as well as practices which are likely to lead to harm.
- **Putting advice or recommendations to government** – the DMU could put forward advice or recommendations to government where it considers that action is needed to further the interests of consumers and citizens in digital markets.
- **Identifying a matter for enforcement** – in the course of its work, the DMU may come across concerns which are likely to breach existing laws. Where potential breaches are in relation to competition or consumer protection law, these could be dealt with by the CMA, or by a concurrent regulator such as Ofcom or the FCA. In addition, potential breaches of data protection or e-privacy laws could be referred to the ICO.
- **Making or recommending a Market Investigation Reference (MIR)** – We consider that the DMU should be able to make or recommend (depending on the institutional design of the DMU) an MIR where it considers there are concerns in relation to competition or consumers in digital markets which require intervention to address. This would include where intervention is likely to be required in relation to non-SMS firms, or to non-designated activities of SMS firms.<sup>66</sup>

5.8 As part of its monitoring role, the DMU would need to be cognisant of the broader impact that digital markets may have on issues outside of its primary remit, such as data protection and eprivacy. As detailed in the following chapter, it would need to work closely with experts, industry and regulators in a range of different fields to ensure cooperation, coherence and alignment.

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<sup>66</sup> The DMU could also make or recommend an MIR to undertake full ownership separation remedies in relation to the designated activities of SMS firms.

## A modern set of competition and consumer laws

**Recommendation 13: The government should strengthen competition and consumer protection laws and processes to ensure they are better adapted for the digital age.**

- 5.9 Alongside the SMS regime, it is essential the right powers are available across digital markets more widely to drive competition and innovation and address harm.
- 5.10 In February 2019, the CMA published a letter to the then Secretary of State for Business Energy and Industrial Strategy, setting out proposals for a series of reforms to the CMA's competition, consumer protection, markets and mergers laws (referred to as the 'reform proposals').<sup>67</sup> Many of these reforms will be key in ensuring existing laws are best able to address the challenges of the digital age. We do not repeat all the reform proposals set out in that letter here, but rather draw out those particularly relevant to digital markets. In particular, we draw out proposed reforms to the markets regime<sup>68</sup> to ensure it can be most effectively utilised to promote competition and innovation in digital markets, for example by pursuing measures like data mobility and interoperability.
- 5.11 In addition to this, we highlight recommendations in a few key areas where, based on existing evidence and experience we believe action is necessary. These are as follows:
- **action to address unlawful or illegal content**, such as fake online reviews and scam advertisements, hosted on platforms which could result in economic detriment to consumers and businesses;
  - **action to enable effective consumer choice** in digital markets, including by addressing instances where choice architecture leads to consumer harm; and
  - **stronger enforcement of the Platform to Business Regulation.**
- 5.12 Given the dynamic nature of digital markets, we recognise that these proposals are unlikely to be an exhaustive solution for the long-term. Rather, we consider it is important the DMU is set up to take on a proactive role as a

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<sup>67</sup> [Letter from Andrew Tyrie to the Secretary of State for Business, Energy and Industrial Strategy](#), February 2019.

<sup>68</sup> Enterprise Act 2002.

centre of expertise in relation to competition across digital markets, making it well-placed to advise on whether further reforms are needed in future.

**Recommendation 13a: The government should pursue significant reforms to the markets regime to ensure it can be most effectively utilised to promote competition and innovation across digital markets, for example by pursuing measures like data mobility and interoperability.**

- 5.13 We set out above that, as part of its monitoring role, the DMU could identify opportunities to support greater competition and innovation, for example where interventions like personal data mobility could be used to overcome barriers to switching. When the DMU identifies such an opportunity, it could make or recommend a Market Investigation Reference for action in this area.
- 5.14 We have looked at whether such interventions in digital markets could be implemented through the markets regime, or whether new powers are needed. We consider that the markets regime is not designed to deliver ongoing interventions like data mobility and interoperability. In particular, market studies and market investigations are designed to be one-off exercises, with remedies based on a snapshot of the market at a point in time. In addition, under the markets regime it is difficult to re-open, review and amend remedies as markets change and remedies evolve. This is particularly important in relation to remedies like data mobility where the scope of data covered, or the technology utilised to deliver the remedy is likely to need to evolve.
- 5.15 This is an area we have been considering for some time and proposed reforms to the markets regime were highlighted in our reform proposals, and in our response to the European Commission's proposed New Competition Tool.<sup>69</sup> We consider that these reforms proposals would be likely to address, at least partially, some of these challenges.<sup>70</sup> For example, a key part of our proposed reforms to the markets regime is the ability to have greater flexibility to amend or adjust remedies as markets evolve. This would better ensure remedies arising from a market investigation are effective on an on-going

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<sup>69</sup> [The CMA's response to the European Commission's consultations in relation to the Digital Services Act package and New Competition Tool.](#)

<sup>70</sup> Other proposed reforms include the ability to: intervene through a market investigation in relation to an adverse effect on consumers, not just an adverse effect on competition; impose interim measures; accept partial undertakings; and impose stronger enforcement powers for non-compliance with remedies arising from a market study, as well as for failure to comply with information requests.

basis, providing the opportunity to review their effectiveness and to update them as markets change.

- 5.16 However, we recognise that even these reforms may not be sufficient to enable market-wide transformational remedies like interoperability to be effectively pursued. We will continue to work with government, including in its work on Smart Data,<sup>71</sup> to consider the appropriate framework for these market-shaping measures.

**Recommendation 13b: The government should strengthen powers to tackle unlawful or illegal activity or content on digital platforms which could result in economic detriment to consumers and businesses.**

- 5.17 We recommend government take action to address unlawful or illegal activity or content hosted on platforms which could result in economic detriment to consumers and businesses. Such content includes fake and misleading online reviews, scam advertisements (eg for high-risk financial schemes) and the sale of counterfeit goods. This content can undermine consumer trust in digital markets and damage businesses. It is therefore vital that more is done to address such material.
- 5.18 The CMA's work on fake online reviews<sup>72</sup> has demonstrated the harm such material can cause, and demonstrated the limitations of consumer law to address such practices. For example, we found that more than three-quarters of people are influenced by reviews when they shop online,<sup>73</sup> and that billions of pounds are spent every year based on write-ups of products or services. When businesses purchase fake online reviews it can mean consumers are misled into buying something which isn't right for them. It can mean businesses who compete fairly miss out on these customers.
- 5.19 We consider that powers are needed to require online platforms to take appropriate steps on an ongoing basis to effectively tackle unlawful or illegal activity or content which could result in economic detriment to consumers and businesses when it occurs on, or is facilitated through, their platform. While there is not 'one size fits all' set of measures, we envisage that they would need to take proactive steps to identify and, where appropriate, remove unlawful/illegal content and prevent its reappearance.

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<sup>71</sup> [Next steps for Smart Data](#), Sept 2020.

<sup>72</sup> CMA, [Fake and misleading online reviews trading](#).

<sup>73</sup> Ofcom, [Adults media use and attitudes](#), 2017.

- 5.20 Government could strengthen powers in this area through reforms of existing consumer protection law. For example, this could be facilitated through a new duty of care on firms, and/or through updates to the Consumer Protection from Unfair Trading Regulations. This would complement the proposed new regime for harmful online content.<sup>74</sup>
- 5.21 Given the significant economic detriment to consumers and businesses which can result from unlawful or illegal activity or content hosted on platforms we consider it vital that government takes swift action to address this issue.

**Recommendation 13c: The government should take action to strengthen powers to enable effective consumer choice in digital markets, including by addressing instances where choice architecture leads to consumer harm.**

- 5.22 As set out in Chapter 2, a range of factors can create barriers to consumers making effective and informed decisions. These can include the information consumers are provided with (which may be too much, too little, misleading, hidden, or presented at an ineffective time). However, the way in which choices are presented and the defaults that are selected can also be used both to support, but also to impair consumers' decisions, for example to nudge or push consumers into choices which may not be in their interests.
- 5.23 We believe it is important government takes action to ensure consumers can make effective choices in digital markets. This would strengthen consumer trust when interacting with digital products and services and support more effective competition.
- 5.24 In healthy competitive markets, we would expect firms to design their choice architecture in ways which benefit consumers' interests. However, our existing work across many digital markets has found evidence of firms using choice architecture which seeks to influence consumer choice. Examples include:
- In the CMA's market study into online platforms and digital advertising<sup>75</sup> it found evidence of the use of '**dark patterns**' which utilise insights into consumer behaviour to influence choice. We also found evidence of **use of defaults** which are not in consumers' interests – for example in the

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<sup>74</sup> DCMS, [Online Harms White Paper](#) set out the intention to improve protections for users online through the introduction of a new duty of care on companies and an independent regulator responsible for overseeing this framework.

<sup>75</sup> CMA market study into online platforms and digital advertising final report, [Appendix G: the role of tracking in digital advertising](#).

consent framework used to obtain users' consent in relation to cookies and tracking.

- In its work on cloud storage<sup>76</sup> the CMA found evidence of **subscriptions which automatically renew**, leading to financial loss for consumers where they no longer want or need the service, and discouraging consumers from considering alternative options.
- In its work in the hotel online booking sector,<sup>77</sup> the CMA found evidence of **scarcity claims and pressure selling**, with online booking platforms making claims as to how many people are looking at a room, how many rooms may be left or how long a price is available, creating a false impression of room availability to rush customers into making a booking decision.

- 5.25 Our experience has demonstrated that existing consumer protection laws do not achieve sufficient protection to enable consumers to make effective choices and that reform is needed.
- 5.26 One way to address the issue and promote effective consumer choice is through reforms to the consumer protection regime, for example by imposing a more explicit duty on firms to take reasonable and proportionate steps to reflect consumers' interests in the design of their products and services.
- 5.27 A duty of care to enable more effective consumer choice would complement the 'fairness by design' duty proposed in the market study final report,<sup>78</sup> which focused on consumer choice in relation to the collection of data. Any such duty would also complement the existing data protection by design requirement under the GDPR, as well as the government's proposals for a safety by design framework within its Online Harms White Paper.<sup>79</sup>
- 5.28 Government could also consider reforms to the Consumer Protection from Unfair Trading Regulations, for example by 'blacklisting' certain manipulative design practices, such as the use of subscription traps.

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<sup>76</sup> CMA, [Consumer law compliance review: cloud storage, Findings Report](#).

<sup>77</sup> CMA, [Online hotel booking case page](#).

<sup>78</sup> CMA market study into online platforms and digital advertising at , paragraphs 8.123-8.151 and [Appendix Y: choice architecture and Fairness by Design](#). We initially proposed this requirement would only apply to SMS firms, but could be extended to firms more widely following a review of its implementation and effectiveness, in particular to consider how such a duty could be implemented in a proportionate way.

<sup>79</sup> DCMS, [Online Harms White Paper](#).

**Recommendation 13d: The government should provide for stronger enforcement of the Platform to Business Regulation.**

- 5.29 We recommend the government provides for stronger enforcement of the Platform to Business Regulation, by establishing a nominated enforcer, rather than relying on the existing court-based model. We believe this would drive greater compliance with the regulation, by providing credible deterrence.
- 5.30 The Platform to Business Regulation provides a set of rules in relation to a wide range of consumer-facing online platforms. It seeks to provide a targeted set of mandatory rules to ensure a fair, predictable, sustainable and trusted environment for the business users of such platforms. In particular, it focuses on providing business users with appropriate transparency in areas such as terms and conditions, parameters used for determining search rankings, restrictions on selling elsewhere and data use. It also requires platforms to have complaints handling systems for business users.
- 5.31 We believe that the substance of the Platform to Business Regulation, if enforced effectively, could better protect business users who rely on online intermediaries and search engines and encourage greater competition.
- 5.32 However, the current enforcement model only allows for court-based enforcement, relying on certain representative organisations, as well as individual businesses, to bring cases to court. In many cases these businesses are likely to be in a weak position relative to the platforms, and may be unlikely to risk taking a breach of the regulations to court, for fear of retaliation by the platforms.
- 5.33 Instead we recommend an enforcement model in which a nominated enforcer has powers to investigate breaches of the Regulation, and to ensure compliance. We believe this is likely to lead to more effective enforcement of this regulation, providing greater incentives to platforms to comply. This role could be combined with the monitoring role proposed for the DMU at the beginning of this chapter.

## 6. A coherent regulatory landscape

6.1 This chapter sets out recommendations to promote a coherent regulatory landscape for digital markets. It covers:

- how the DMU should work with UK regulators with responsibility for competition and consumer protection, as well as with responsibility for other policy objectives such as data protection and e-privacy; and
- how the DMU should work with other competition and consumer protection regulators internationally with responsibility for digital markets.

### Working with other regulators

**Recommendation 14: The government should ensure the DMU is able to work closely with other regulators with responsibility for digital markets, in particular Ofcom, the ICO and the FCA.**

6.2 'Digital' is not a sector but rather refers to a wide range of technologies which can be applied to the production and delivery of products and services across the economy. Whilst a new pro-competition framework is needed to promote competition and protect consumers and businesses in digital markets, this framework cannot operate in isolation, but will need to be joined-up and **coherent** with the wider regulatory landscape.

6.3 Key bodies and regulatory regimes we expect the DMU and the new digital markets regime to interact with include:

- **Ofcom** – sectoral regulator responsible for communications, including telecoms, broadcasting and video-sharing platforms. Ofcom also has concurrent powers with the CMA for enforcing competition law in relation to communications matters, and is a dedicated enforcer of consumer law. The government has also announced it is minded to appoint Ofcom as the regulator responsible for the new regulatory regime for harmful online content.<sup>80</sup>
- **The ICO** – responsible for data protection and eprivacy.
- **The FCA** – responsible for enforcing competition law within financial services, as well as regulating the conduct of financial services firms.

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<sup>80</sup> DCMS, [Online Harms White Paper](#).

- 6.4 As part of the taskforce work we have given initial consideration as to what mechanisms might be needed to support enhanced regulatory coherence across these regimes. These ideas will be explored further by the Digital Regulation Cooperation Forum (DRCF).<sup>81</sup>
- 6.5 The DCRF comprises the CMA, Ofcom and the ICO and was established to support greater coordination and cooperation in the regulation of online services. The DRCF is now working with government to consider the steps that should be taken to ensure adequate coordination, capability and clarity across the digital regulation landscape.<sup>82</sup>
- 6.6 The work by the DRCF will consider:
- the challenges existing regulators have to coordinating effectively, for example, managing trade-offs between conflicting policy objectives, coordinating on cross-cutting digital issues or interventions, and in identifying and addressing regulatory overlap/ underlap; and
  - what coordination mechanisms (for example, duties to consult, concurrency arrangements, MOUs, joint action plans or shared objectives) might be needed to address these challenges.
- 6.7 The recommendations below highlight what we believe to be important elements in any coordination arrangements in the regulation of digital markets. We expect these will be considered and developed further through the DRCF work.

**Recommendation 14a: The DMU should be able to share information with other regulators and seek reciprocal arrangements.**

- 6.8 Subject to appropriate safeguards, the DMU should be able to share information (including confidential information) with other regulators, and other regulators should be able to share information with the DMU. Given there is significant overlap in regulatory responsibilities when it comes to digital markets, regulators will be most effective the more they can take advantage of efficiencies, for example in working together to understand and address cross-cutting regulatory challenges. Enabling information sharing is a vital part to enabling such cooperation.

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<sup>81</sup> The CMA, the ICO and Ofcom have together formed the Digital Regulation Cooperation Forum (DRCF) to support regulatory coordination in online services, and cooperation on areas of mutual importance.

<sup>82</sup> [Government response to the CMA's market study into online platforms and digital advertising](#), November 2020.

- 6.9 Information sharing will enable the DMU to share information with another regulator where it is relevant to that regulator's duties and objectives. For example, if in its work, the DMU uncovered an issue with wider implications for data protection it should be able to share this with the ICO. Similarly, we would expect the ICO to be able to share an issue with wider implications for competition with the DMU.
- 6.10 Information sharing will also enable the DMU to be able to seek sectoral expertise in relation to an issue, and for other regulators to be able seek expertise from the DMU where relevant. For example, the DMU may wish to share information with Ofcom to inform a regulatory response to an issue in relation to instant messaging or video-sharing platforms.
- 6.11 We expect the DRCF to consider further the sorts of information which regulators should be able to share and any limitations to existing information sharing arrangements.

**Recommendation 14b: The government should consider, in consultation with Ofcom and the FCA, empowering these agencies with joint powers with the DMU in relation to the SMS regime, with the DMU being the primary authority.**

- 6.12 We consider that there is a strong case for giving Ofcom and the FCA powers, alongside the DMU, to designate an activity within 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. We therefore recommend that the government considers, in consultation with Ofcom and the FCA, sharing these powers amongst regulators, which would enable these activities to be considered in a coherent way, in line with the wider sectoral approach and utilising sectoral expertise.
- 6.13 We expect the SMS regime to apply to only a limited number of the most powerful digital firms, and suggest that government consider whether the power to 'first' designate a firm is reserved for the DMU.<sup>83</sup> However we recognise that SMS firms could be designated in relation to activities covered by existing sector regulators, most notably communications and financial services.<sup>84</sup> It would be important for these activities to be regulated in a

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<sup>83</sup> For example, the first time a firm is designated with SMS in relation to an activity, this designation should be done by the DMU. Once a firm is designated in relation to at least one designated activity, any subsequent activities of the SMS firm can be designated by the DMU, Ofcom or the FCA. There is no difference in the SMS test or the process for applying it for a first or subsequent SMS designation.

<sup>84</sup> For example, Ofcom in relation to personal communication services such as WhatsApp, television operating systems, cloud services or internet of things support services, or the FCA in relation to payment services, cryptocurrencies, insurance or banking.

coherent way alongside wider sectoral regulation. Enabling the respective sectoral regulator to lead in relation to regulation of these activities would better enable coherent regulation.

- 6.14 We recommend the DMU should have ‘primacy’ in relation to these powers. This is important to ensure one regulator has the final decision on which regulator leads in relation to a particular activity, reducing the risk of overlap and duplication. The DMU will be best able to take on this role, ensuring it has oversight of regulation across all activities of SMS firms and that this regulation is developed in a coherent way.
- 6.15 There are analogies between any such sharing of powers for the SMS regime and the existing coordination mechanisms in place between concurrent regulators under the competition regime. However, there are also important differences, most notably that existing concurrency arrangements relate to *ex post* regulation, where the decision is who leads any enforcement. In contrast, the SMS regime is an *ex ante* regime and regulators will need to divide up who leads on proactive engagement and monitoring in respect of particular activities. Coordination arrangements will therefore need to be very carefully considered to ensure shared powers maximise the benefits of utilising sectoral expertise and coherence, whilst adequately addressing the potential challenges multiple regulators may bring. How shared powers could work in practice could be further explored through the DRCF work.

## Working with international counterparts

**Recommendation 15: The government should enable the DMU to work closely with regulators in other jurisdictions to promote a coherent regulatory landscape.**

- 6.16 The most powerful digital firms operate across multiple jurisdictions globally. This means that regulators in many jurisdictions are investigating and addressing very similar challenges. And there are likely to be significant efficiencies from regulators working together, both to understand the issues and in devising solutions.
- 6.17 The DMU should take account of equivalent regulatory requirements in other jurisdictions and maximise opportunities to promote greater regulatory coherence across the international landscape. It should seek to work with other agencies to try and develop common principles which guide the approach to regulation of digital firms, seeking to achieve alignment in approach across jurisdictions where possible. For example, in developing codes of conduct, the DMU should take advantage of opportunities for

alignment where evidence suggests similar problems exist and a comparable solution is an effective and proportionate response.

- 6.18 The mechanisms by which the DMU cooperates with counterparts internationally will need to be considered in line with the final institutional design for the DMU. As set out in the introduction, many jurisdictions around the globe are establishing regimes for dealing with the challenges posed by the most powerful digital firms. In many cases these regimes are to be overseen by the competition authority. Any mechanisms the DMU has for cooperating with these counterparts will need to build on the existing relationships the CMA and other regulators have with these authorities.

**Recommendation 15a: The DMU should be able to share information with regulators in other jurisdictions and should seek reciprocal arrangements.**

- 6.19 In order to maximise the benefit from cooperation arrangements with regulators in other jurisdictions, it is critical that the DMU can share confidential information with, and receive confidential information from, other authorities overseas. This will mean creating information sharing arrangements between the DMU and other agencies. Such information sharing arrangements are at the heart of comprehensive international cooperation arrangements such as those between Australia and New Zealand and between the Nordic competition agencies.<sup>85</sup>
- 6.20 To enable these arrangements, the DMU should be able to sign agreements with other agencies. This should include the power to share confidential information to assist its functions and the functions of concurrent regulators (ie Ofcom and the FCA), and the power to collect and share evidence on behalf of other regulators where a mutual provision is in place.

**Recommendation 15b: The DMU should explore establishing a network of international competition and consumer agencies to facilitate better monitoring and action in relation to the conduct of SMS firms.**

- 6.21 The DMU should explore establishing a network of international competition and consumer agencies who meet periodically to consider and set key strategic priorities to tackle in respect of the conduct of the most powerful digital firms.
- 6.22 Providing a structure and framework for regulators working on individual firms would facilitate more **effective** regulation. It would go beyond regulators in different jurisdictions all pursuing their own individual priorities, and sharing

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<sup>85</sup> ACCC, [Competition agencies welcome International Cooperation Act](#), 2012.

information to support these on an ad-hoc basis as needed. In addition to this, it would also involve regulators agreeing some strategic global priorities and using these to inform their own cases and work. It should not preclude regulators continuing to have their own national priorities, but recognises that a combined effort and focus is likely to deliver more effective results than regulators each pursuing particular issues individually.

- 6.23 This approach is modelled on the ‘regulatory colleges’ which exist in financial services for large global banks. Each network could comprise a small group of agencies and provide a framework for ongoing cooperation and information sharing in a range of areas. This might include key strategic areas of focus within an SMS firm – for example where there is likely to be harmful conduct or risks to competition as well as where it sees the areas of opportunity to promote greater competition and innovation. The network could also support closer working in respect of particular cases – for example assisting in gathering and interrogating intelligence and even taking parallel actions.
- 6.24 The DMU would need to work closely with existing international networks such as the International Competition Network, and the Organisation for Economic Cooperation and Development (OECD), and with other competition and consumer agencies internationally to draw up formal plans for the networks, including for which firms networks are formed, which international agencies participate in the networks, the role and relationship with the firms who are the subject of discussion through a network and how frequently meetings are held.

## 7. Next steps

7.1 In this section we set out work which could be undertaken, alongside the progression of legislation, to support in setting-up the SMS regime. We also provide an overview of what our proposals will deliver, for consumers, businesses, innovators and the economy.

### Establishing the SMS regime

7.2 We believe the case for a new ex ante regime in relation to the most powerful digital firms has been clearly made, not only in our own market study of online platforms and digital advertising, but also by numerous reports and reviews around the world.<sup>86</sup> We are seeing a growing consensus amongst governments, regulators, and commentators alike that the current situation cannot continue unabated.

7.3 We therefore welcome the government's response to the CMA's online platforms and digital advertising market study.<sup>87</sup> In its response, government has committed to:

- establishing and resourcing a new Digital Markets Unit (DMU) from April 2021, housed in the CMA, to build on the work of the Taskforce and begin to operationalise the key elements of the regime;
- consulting on proposals for the new pro-competition regime in early 2021; and
- legislating to put the DMU on a statutory footing when parliamentary time allows.

7.4 We urge government to move quickly in taking this legislation forward. As government rightly acknowledges, similar action is being pursued across the globe and there is a clear opportunity for the UK to lead the way in championing a modern pro-competition, pro-innovation regime.

7.5 We stand ready to assist government in the legislative process towards establishing the DMU. Our advice provides government with the information it needs to form the basis of this legislation and it is now for government and Parliament to decide on. Subject to decisions on key elements of the regime

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<sup>86</sup> For example: Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), [Competition for the digital era, final report for the European Commission](#); Stigler Center (2019), [Committee on Digital Platforms Final Report](#); US Antitrust House Subcommittee Investigation of Competition in Digital Markets, 2020.

<sup>87</sup> [Government response to the CMA's market study into online platforms and digital advertising](#), November 2020.

being taken by government, we will undertake the preliminary work needed to best enable the DMU to be operational as soon as any legislation comes into effect.

- 7.6 The CMA stands ready to assist with work in order to support in operationalising elements of the regime. This could include beginning to develop guidance on how the DMU will carry out its work, for example guidance on its approach to undertaking designation assessments, and its approach to code breach investigations. Developing such guidance would be subject to government having taken key decisions on the regulatory framework in these areas.
- 7.7 The CMA could also begin to undertake designation assessments to assess which firms should be designated with SMS and in relation to which activities. Any such work would be subject to government having taken key decisions on the regulatory framework for designation and the SMS test. We consider that designation assessments for Google and Facebook, in relation to their activities in digital advertising should be prioritised, given the work of the CMA's online platforms and digital advertising market study. Progressing this work in advance should help to minimise any period between the regime coming into effect and the DMU being able to enforce against harmful conduct.
- 7.8 Further to this aim, we ask Government to consider what other steps could be taken to swiftly establish the regime. This could include making designations as part of the legislative process, assuming designation assessments could be completed in time. The quicker the regime can take effect, the faster we will start to see its benefits in terms of protecting consumers and businesses from harm and driving greater competition and innovation across digital markets.

## What will this deliver?

- 7.9 Taking action to drive greater competition in digital markets will deliver significant benefits to consumers, businesses, innovators and the economy.
- **For consumers and businesses reliant on powerful digital firms** we expect a stronger regulatory approach will deliver greater innovation and more choice, for example new features or adaptations to existing popular services, or the emergence of transformative new products and services. We would also expect it to result in lower prices for a wide range of goods and services across the economy, both directly to consumers, but also where businesses pass the costs of lower commissions, or advertising prices through to consumers. Lastly, improvements on multiple aspects of

quality, as firms face greater pressure to meet consumer expectations on issues such as control over data and privacy.

- **For innovators** we expect a stronger regulatory approach will better enable them to expand and grow their businesses, including to compete with powerful digital firms, delivering innovative new products and services and contributing to a vibrant digital ecosystem.
- **For the economy** we expect that taking action to strengthen the regulatory framework will deliver a boost to productivity and growth, leading to job creation in new firms and emerging markets, and the retention and attraction of highly skilled workers in the UK.

7.10 We urge government to act on our recommendations and enable these benefits to be realised. This will ensure digital markets in the UK continue to flourish, delivering vibrant competition and innovation.

## Annex A: Our recommendations to government

### *A Digital Markets Unit*

**Recommendation 1:** The government should set up a DMU which should seek to further the interests of consumers and citizens in digital markets, by promoting competition and innovation.

- Recommendation 1a: The DMU should be a centre of expertise and knowledge in relation to competition in digital markets.
- Recommendation 1b: The DMU should be proactive, seeking to foster compliance with regulatory requirements and taking swift action to prevent harm from occurring.

### *A pro-competition regime for the most powerful digital firms*

**Recommendation 2:** The government should establish a pro-competition framework, to be overseen by the DMU, to pursue measures in relation to SMS firms which further the interests of consumers and citizens, by promoting competition and innovation.

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

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

**Recommendation 4:** The government should establish the SMS regime such that when the SMS test is met, the DMU can establish an enforceable code of conduct for the firm in relation to its designated activities to prevent it from taking advantage of its power and position.

- Recommendation 4a: A code should comprise high-level objectives supported by principles and guidance.

- Recommendation 4b: The objectives of the code should be set out in legislation, with the remainder of the content of each code to be determined by the DMU, tailored to the activity, conduct and harms it is intended to address.
- Recommendation 4c: The DMU should ensure the code addresses the concerns about the effect of the power and position of SMS firms when dealing with publishers, as identified by the Cairncross Review.
- Recommendation 4d: The code of conduct should always apply to the activity or activities which are the focus of the SMS designation.
- Recommendation 4e: The DMU should consult on and establish a code as part of the designation assessment. The DMU should be able to vary the code outside the designation review cycle.

**Recommendation 5:** SMS firms should have a legal obligation to ensure their conduct is compliant with the requirements of the code at all times and put in place measures to foster compliance.

**Recommendation 6:** The government should establish the SMS regime such that the DMU can impose pro-competitive interventions on an SMS firm to drive dynamic change as well as to address harms related to the designated activities.

- Recommendation 6a: With the exception of ownership separation, the DMU should not be limited in the types of remedies it is able to apply.
- Recommendation 6b: The DMU should be able to implement PCIs anywhere within an SMS firm in order to address a concern related to its substantial entrenched market power and strategic position in a designated activity.
- Recommendation 6c: In implementing a PCI the DMU should demonstrate that it is an effective and proportionate remedy to an adverse effect on competition or consumers. A PCI investigation should be completed within a fixed statutory deadline.
- Recommendation 6d: PCIs should be implemented for a limited duration and should be regularly reviewed.

**Recommendation 7:** The government should establish the SMS regime such that the DMU can undertake monitoring in relation to the conduct of SMS firms and has a range of tools available to resolve concerns.

- Recommendation 7a: Where appropriate, the DMU should seek to resolve concerns using a participative approach, engaging with parties to deliver fast and effective resolution.
- Recommendation 7b: The DMU should be able to open formal investigations into breaches of the code and where a breach is found, require an SMS firm to change its behaviour. These investigations should be completed within a fixed statutory deadline.
- Recommendation 7c: The DMU should be able to impose substantial penalties for breaches of the code and for breaches of code and PCI orders.

- Recommendation 7d: The DMU should be able to take action quickly on an interim basis where it suspects the code has been breached.
- Recommendation 7e: The DMU should be able to undertake scoping assessments where it is concerned there is an adverse effect on competition or consumers in relation to a designated activity. The outcome of such assessments could include a code breach investigation, a pro-competitive intervention investigation, or variation to a code principle or guidance.

**Recommendation 8:** The government should establish the SMS regime such that the DMU can draw information from a wide range of sources, including by using formal information gathering powers, to gather the evidence it needs to inform its work.

**Recommendation 9:** The government should ensure the DMU's decisions are made in an open and transparent manner and that it is held accountable for them.

- Recommendation 9a: The DMU's decisions should allow for appropriate internal scrutiny.
- Recommendation 9b: The DMU should consult on its decisions.
- Recommendation 9c: The DMU's decisions should be timely, with statutory deadlines used to set expectations and deliver speedy outcomes.
- Recommendation 9d: The DMU's decisions should be judicially reviewable on ordinary judicial review principles and the appeals process should deliver robust outcomes at pace.

**Recommendation 10:** The government should establish the SMS regime such that SMS firms are subject to additional merger control requirements.

**Recommendation 11:** The government should establish the SMS merger control regime such that SMS firms are required to report all transactions to the CMA. In addition, transactions that meet clear-cut thresholds should be subject to mandatory notification, with completion prohibited prior to clearance. Competition concerns should be assessed using the existing substantive test but a lower and more cautious standard of proof.

*A modern competition and consumer regime for digital markets*

**Recommendation 12:** The government should provide the DMU with a duty to monitor digital markets to enable it to build a detailed understanding of how digital businesses operate, and to provide the basis for swifter action to drive competition and innovation and prevent harm.

**Recommendation 13:** The government should strengthen competition and consumer protection laws and processes to ensure they are better adapted for the digital age.

- Recommendation 13a: The government should pursue significant reforms to the markets regime to ensure it can be most effectively utilised to promote competition and innovation across digital markets, for example by pursuing measures like data mobility and interoperability.

- Recommendation 13b: The government should strengthen powers to tackle unlawful or illegal activity or content on digital platforms which could result in economic detriment to consumers and businesses.
- Recommendation 13c: The government should take action to strengthen powers to enable effective consumer choice in digital markets, including by addressing instances where choice architecture leads to consumer harm.
- Recommendation 13d: The government should provide for stronger enforcement of the Platform to Business Regulation.

*A coherent regulatory landscape*

**Recommendation 14:** The government should ensure the DMU is able to work closely with other regulators with responsibility for digital markets, in particular Ofcom, the ICO and the FCA.

- Recommendation 14a: The DMU should be able to share information with other regulators and seek reciprocal arrangements.
- Recommendation 14b: The government should consider, in consultation with Ofcom and the FCA, empowering these agencies with joint powers with the DMU in relation to the SMS regime, with the DMU being the primary authority.

**Recommendation 15:** The government should enable the DMU to work closely with regulators in other jurisdictions to promote a coherent regulatory landscape.

- Recommendation 15a: The DMU should be able to share information with regulators in other jurisdictions and should seek reciprocal arrangements.
- Recommendation 15b: The DMU should explore establishing a network of international competition and consumer agencies to facilitate better monitoring and action in relation to the conduct of SMS firms.