Response to the CMA's consultation on its new digital markets competition guidance

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Table of Contents

I Introduction

1. Thank you for the opportunity to respond to the consultation issued by the Competition and Markets Authority ("CMA") in relation to its draft digital markets competition regime guidance ("the Guidance").

2. In our response we have focused on the guidance document which outlines the proposed overall digital markets competition regime, i.e. we have not provided any comments on the merger reporting requirements. As an economic consultancy, our comments are focussed on strategic market status ("SMS") designation (including criteria and procedure), the conduct requirements ("CRs") for SMS firms and the pro-competition interventions ("PCIs") that the CMA may make to address adverse effects on competition ("AEC").

3. To summarise our view, we see a risk that the guidance in these areas (as currently drafted) could lead to significant difficulties for both the CMA and other stakeholders when it comes to implementing the digital competition regime. This is because the guidance is drafted very broadly, and so appears to provide the CMA with substantial discretion around how it implements the regulation in practice. This leaves significant uncertainty for all parties. While we can understand the CMA's desire to maintain a substantial element of discretion at this stage, we are concerned that the level of discretion provides the incentive for many stakeholders to attempt to influence the CMA in how it applies that discretion, the likelihood that any decisions made by the CMA will be appealed, and the risk that Judgments in such appeals will set rule and precedents that the CMA will have to abide by subsequently. This dynamic is likely to obstruct the CMA in its implementation of the regime and lead to delays and costs for all parties, including the CMA.

4. In addition, we make one comment on the timeframe for conducting PCI investigations and imposing remedies, which appears to be extremely challenging for the CMA to achieve in a robust manner.

5. These points are expanded below.

II Strategic market status designation

II.A Designation criteria

1. The CMA states that it will designate firms as having SMS in a "digital activity" where, following an investigation, it determines that the digital activity:

    i. has a link to the UK;

    ii. meets a minimum turnover threshold;

    iii. has "substantial and entrenched market power"; and

    iv. has a "position of strategic significance" in relation to the digital activity.[1]

2. These tests give the CMA substantial discretion in the SMS designation process, particularly with regards to the last two criteria:

    i. The process for determining whether a firm has substantial and entrenched market power ("SEMP") appears to provide the CMA with significant freedom. The CMA emphasises that SEMP is a distinct concept from dominance[2] and does not require a formal market definition exercise.[3] Rather, the CMA considers that "*Market power arises where a firm faces limited competitive pressure and individual consumers and businesses have limited alternatives to its product or service or, even if they have good ones, they face barriers to shopping around and switching*" (Guidance, para 2.40) and that "*Evidence relevant to market power may include indicators such as the level and stability of shares of supply, the number and strength of competitive constraints to incumbent firms, profitability levels and levels of customer switching*" (Guidance, para 2.41).

    ii. While we understand the desire to avoid an extensive market definition debate, it is hard to see how the CMA can operationalise the share of supply test without some reference to market definition. The share of supply test in mergers is explicitly a jurisdictional test only and does not have to have any nexus with market power. However, here the whole purpose of the use of shares of supply is to determine whether a particular firm has market power. This begs the question, in the absence of a market definition, of "shares of what?".

    iii. Moreover, the guidance does not specify any quantitative threshold(s), or a prescriptive list of evidence, for determining whether a firm has SEMP. Instead, the CMA states that it may rely on a range of qualitative and/or quantitative evidence with the balance between the two varying across investigations, reflecting the specifics of each case.[4] Again, while the CMA's desire to retain flexibility is understandable, in the absence of any firm and fixed quantitative threshold for determining whether a firm has SEMP, the CMA will be open to pressure from potential firms with SMS and their rivals in the designation process

[1] Guidance Section 2
[2] Guidance 2.45
[3] Guidance 2.3
[4] Guidance 2.63-2.67

as to how these criteria should be applied, to appeal, and to Judgments on appeal that start to proscribe the CMA's discretion in subsequent cases in a way that the CMA does not have control of, for example in the interpretation of the quantitative and qualitative evidence.

iv. The criteria for determining whether a firm has a position of strategic significance ("POSS") are similarly broad and raise similar concerns in our view. The CMA specifies four conditions of which one must for met for a firm to have a POSS,[5] but there are no clear or quantitative thresholds across any of these conditions (beyond the "gateway" revenue thresholds).

3. We suggest that it would be helpful for the CMA to provide a further level of guidance beyond that currently identified, which sets out some principles for the nature, type and strength of evidence that will be required to demonstrate SMS.

4. In addition, we note that the turnover condition,[6] the link to the UK criterion[7] and definition of a digital activity[8] could be interpreted broadly and one could see the potential for firms to be designated as having SMS who would not seem to be the CMA's focus. For example, could the largest UK supermarkets be designated under these criteria? They would meet the turnover and link to the UK criteria and, for example, provide services "by means of the internet" such as online shopping and online banking.

5. One could see how the potentially wide range of firms that could be designated as SMS could lead to significant lobbying by firms – both those who could meet the criteria and those who would not – around who the CMA designates and in what order.

II.B SMS investigations

6. The CMA states that it will undertake "SMS investigations" for the purpose of designating SMS. The CMA notes that each investigation will be in relation to an individual firm[9] and, while the Guidance is not completely clear on this point, given resource constraints one would assume that the CMA will need to stagger SMS investigations and designations. Indeed, the CMA notes that it will use its 'Prioritisation Principles' when considering which firms and digital activities to prioritise for SMS investigations.[10] [11]

7. We note that the Prioritisation Principles – and seemingly inevitable staggering of SMS investigations/designation – could mean that the CMA designates certain firms as having SMS in a given digital activity, while other potential SMS firms in that activity are yet to be investigated. For example, the Prioritisation Principles could imply that the largest firm in a given digital activity is subject to an SMS investigation/designation before the next largest firm(s), even though the next largest firm(s) may also meet the SMS criteria and should be

[5] See Guidance 2.53-2.62. The four conditions are (i) the firm has achieved a position of significant size or scale in respect of the digital activity, (ii) a significant number of other firms use the digital activity as carried out by the firm in carrying on their business, (iii) the firm's position in respect of the digital activity would allow it to extend its market power to a range of other activities, and (iv) the firm's position in respect of the digital activity allows it to determine or substantially influence the ways in which other firms conduct themselves, in respect of the digital activity or otherwise.
[6] Guidance 2.25-2.26
[7] Guidance 2.18
[8] Guidance 2.6
[9] Guidance 2.70
[10] Guidance 2.69
[11] The CMA's Prioritisation Principles are: (i) Impact: how substantial is the likely positive impact of CMA action? (ii) Is the CMA best placed to act: is there an appropriate alternative to CMA action? (iii) Resources: does the CMA have the right capacity in place to act effectively? And (iv) Risk: what types of risks are associated with CMA action, and how significant are they?

designated in principle. (A potential example could be the CMA designating Google Android – the largest mobile operating system globally[12] – as having SMS in mobile operating systems, while Apple's iOS[13] – the second largest mobile operating system globally, but also holding a very strong market position – remains undesignated, at least for a period, because it is somewhat smaller and the CMA judges "the likely positive impact" of SMS designation to be lower in the case of Apple's iOS than for Google Android.) To the extent that the CMA designates certain SMS firms before other SMS firms within a digital activity, there is a strong risk that this would lead to regulatory distortions to the competitive process and provide an unfair competitive advantage to firms that are yet to be designated as having SMS.

8. Furthermore, the Guidance could benefit from more clarity around how the CMA will treat digital activities which are in some way related to a given digital activity for which the CMA designates SMS. The CMA states that it may:

   i. "treat two or more of the potential SMS firm's digital activities and the products within those as a single digital activity where either of the following conditions is satisfied: (a) these have substantially the same or similar purposes or (b) these can be carried out in combination to fulfil a specific purpose";[14] and

   ii. in the case of a further SMS investigation, designate an undertaking "in respect of a digital activity that the CMA considers to be similar or connected to the relevant digital activity, whether instead of, or in addition to, the relevant digital activity".[15]

9. A feature of the largest digital firms (who one would expect to be the CMA's focus in SMS designation) is that they tend to offer an "ecosystem" of connected products/services. Taking Google as an example, it has an operating system (Android), web browser (Chrome), a search engine (Google Search), a shopping comparison service (Google Shopping), a maps service (Google Maps), a flight comparison service (Google Flights), an email service (Gmail), and many more products/services. All of these are, to some extent, connected. For instance, Google operates a "single sign-on" model where an individual's Gmail account details can be used to access/enhance a whole range of services, such as providing a saved search history in Google Search or Google Maps.

10. It appears possible – based on, for example, precedent from the European Commission's Digital Markets Act – that Google will be found to have SMS in at least some of its products/services, such as Google Search. However, based on the CMA's current guidance, it is unclear whether designation of Google Search as SMS would also lead to designation of Gmail and Google Maps, because they are "connected" to Google Search (e.g. through the single sign-on) and can be "carried out in combination to fulfil a specific purpose". One could see how this could lead to a situation where large parts (and potentially even all) of an undertaking become regulated via a single SMS designation, which would seem to run counter to the CMA's objective to focus on specific priority digital activities.

[12] https://gs.statcounter.com/os-market-share/mobile/worldwide (last accessed on 11 July 2024)
[13] Ibid.
[14] Guidance 2.13
[15] Guidance 2.89(d)

III Conduct requirements

1. As noted above, the Act and Guidance provide the CMA substantial discretion in how to regulate SMS firms. This is reflected in the broad principles identified in the Guidance as to how conduct requirements (CRs) may be defined and imposed. We consider that this ability to design bespoke requirements for SMS firms has the opportunity to be a strength of the regime; however, we see it as important that this discretion does not prevent the regime from being seen to be transparent, proportionate and fair.

III.A Aims of conduct requirements

2. The act provides that the CMA may impose a CR provided it meets a broadly defined set of statutory criteria. The CMA are concerned with (i) proportionality to achieve the objectives of fair dealing, user choice, and trust and transparency; (ii) the type of CR proposed; and (iii) the benefits/effects of the CR on consumer welfare.

3. It may be prudent for the CMA to consider issuing updated guidance after this consultation which provides greater certainty over how proposed CRs will be assessed against these criteria, both to provide *ex ante* certainty to stakeholders (i.e. SMS businesses, other businesses and consumers) and to reduce regulatory friction when imposing CRs (and/or other remedies).

4. **First**, it will be important to ensure the objectives of 'fair dealing', 'open choices' and 'trust and transparency' are, and are seen to be, interpreted consistently and predictably across all CRs imposed by the CMA on SMS firms.[16]

5. Therefore, we consider it may be beneficial if each of these objectives had a clearly understood meaning within the context of the DMCC regime, which may be achieved if the CMA were to expand on the definitions set out in 3.6 of the Guidance.

6. **Second**, the guidance sets out an 'exhaustive' list of permitted types of CR. We consider it is helpful for the above goals to have set out a complete list of CRs that may be imposed. However, as they are currently explained in the guidance each type is broadly defined and may in practice encompass a wide range of behaviours (or prohibitions).

7. For example, the CR requiring that an SMS firm not *'[use] data unfairly'* may be perceived to encompass a broad range of uses of data. For instance, it is unclear whether this should be interpreted to prohibit the use of data for any applications other than that for which it was gathered. If so, this may inadvertently inhibit the efficient development of innovative new products by an SMS firm in an adjacent market, with a possible adverse outcome for consumer welfare.

8. Therefore, we consider that:

    i. The CMA may wish to consider issuing more precise guidance in due course on how SMS firms may eventually be required to comply with each type of CR set out in the Act (e.g. illustrative examples of conduct/outcomes that would satisfy

[16] For example, the objective that '*users… are treated fairly'* is open to a margin of interpretation and could conceivably be applied differently across two different SMS firms.

each CR, and clearer definitions of terms used in the CR descriptions, such as 'fair' or 'interoperability'). This will allow firms that anticipate SMS designation to review their conduct earlier, and potentially engage more constructively with any CRs that are ultimately imposed.

ii. When imposing a CR, ensure that 'interpretive notes'[17] are routinely provided (absent a good reason why they cannot be), and that they clearly set out how the SMS firm is expected to / may comply with it (that is, the behavioural and market outcomes the CMA is attempting to engender through the CR). This would be likely to improve both constructive engagement with and the efficacy of any CRs imposed.

9. The CMA explains that it may consider imposing a CR on activities outside the scope of the *'relevant digital activity'* if the activity in question is designed or operated in such a way as to '*increase [the SMS firm's] substantial and entrenched market power and/or its position of strategic significance in relation to the relevant digital activity', explaining that '[t]his might occur through conduct that is likely to raise barriers to entry or expansion or prevent the lowering of such barriers'*.[18]

10. While the Guidance goes on to explain that this '*could*' be the case where an SMS firm's other products/services either steer users to relevant digital activity, or withdraw interoperability, as it is currently drafted the test for whether to impose a CR outside of the relevant digital activity may include a range of conduct which may not necessarily be harmful to consumer welfare (e.g. it could be read to apply to any and all bundling of products/services, which may be beneficial to users).

11. For example, certain types of firm compete to sign users up to an 'ecosystem' of services, which may be, but are not necessarily, complementary. Within the current framework, it could be interpreted that the launch/operation of any successful product outside of the relevant digital activity '*increase[s] [the SMS firm's] substantial and entrenched market power'* insofar as it may encourage additional users to sign up to the relevant 'ecosystem', and once there, they are incrementally more likely to use the relevant digital activity. (Rivals would likely argue that this would increase barriers to entry.) Nonetheless, in this example it is not obvious that the offering by the SMS firm of the additional service would have a deleterious effect to consumer welfare. If CRs were to be imposed on products/services such as these, it may lead to an unintended consequence of inhibiting innovation by SMS firms.

12. Therefore, we consider it may be beneficial for the CMA to provide additional guidance on the circumstances in which CRs outside of the relevant digital activity will be introduced, to improve consistency and to avoid unintended consequences. For example, it could further clarify the intentions/behaviours by SMS firms that would fall within the scope of the test set out above, and/or consider whether to set out additional tests (concerned with object / justification of the conduct) in updated guidance.

III.B Application of conduct requirements

[17] See Guidance 3.53 et seq.
[18] Guidance 3.14

13. The CMA sets out four principles for assessing the effectiveness of CRs it is intending to impose. These cover how the CMA will decide whether to impose an outcome or action-focused CR, and whether the requirements will be higher or lower level.[19]

14. Considering **Principle 1**, the CMA explains that where an outcome is measurable, and compliance is easy to assess, the CMA may be more likely to impose an outcome-focused CR. While there may be advantages in leaving it to the SMS firm to consider how to achieve compliance, we note that outcome-focused CRs should be focused on outcomes within the SMS firm's control.

15. For example, we understand that an objective of the Act is the facilitation of '*open choices'* for the users of SMS firms' services. [20] If a CR were designed to facilitate market entry, we consider it could not feasibly be designed as an outcome-focused CR measured against the number of new firms entering the market, as this variable is outside the SMS firm's control (i.e. it would be possible that after the imposition of the CR, the conduct of the SMS firm in question would be compliant with the aims of the Act, but nonetheless competing firms had not (yet) entered the market).

16. Therefore, we suggest the CMA may wish to consider clarifying in updated guidance that outcome-focused CRs will focus on outcomes within the SMS firm's control.

17. Considering **Principles 3 and 4**, the CMA sets out that for action-based CRs, it will '*typically impose higher-level requirements*', however, that it '*will be more likely to impose more detailed CRs where a firm has failed to comply effectively with higher-level requirements and/or in circumstances where the CMA has identified clear and persistent issues which need to be corrected'*.[21]

18. We make the following observations.

    i. It will be important for the CMA to impose higher or lower-level CRs consistently as between SMS firms. This mirrors the observations we make above that it will be important for the regime that SMS firms are treated consistently so as not to distort competition between them, as imposing a more directive CR on one firm may put it at a disadvantage versus firms subject to higher-level requirements. A lack of consistency may also increase the risk of challenge and regulatory friction more generally.

    ii. It is not currently clear how conduct may be deemed to constitute a '*clear and persistent issue*'. For example, the Guidance is not explicit as to (i) whether this includes conduct pre-dating the Act, such that a highly detailed action-focused CR may be imposed immediately upon SMS designation, and (ii) the thresholds above which conduct is deemed to be '*clear and persistent*'. We suggest the CMA may wish to clarify through updated and more detailed guidance the circumstances under which higher- or lower-level action-focused CRs will be imposed. This would also be likely to improve the consistency with which CRs are imposed.

[19] Guidance 3.26
[20] Guidance 3.6
[21] Guidance 3.26

19. Related to the above, the CMA explains that when choosing whether to impose CR(s), it will have regard to the proportionality of those measures, by reference to their effects on (i) the SMS firm, (ii) third parties, (iii) consumers, and (iv) other stakeholders (e.g. the CMA itself).[22] It sets out it will not try to quantify these effects, but will take a view 'in the round', having regard to the qualitative and quantitative evidence available.

20. It will be important for the CMA to consider these effects in detail so as to avoid unintended consequences on consumer welfare; however, it is not clear at the current stage how the CMA will prioritise between regulating SMS firm conduct and the possibility of inadvertent effects of that intervention, in particular given the uncertainty surrounding the eventual outcome of any proposed CRs.

21. It may be beneficial for the consistency and transparency of the regime to set out in more detail *ex ante* the principles the CMA will apply when deciding the weight to attach to (i) more certain short-term effects versus less certain (but potentially more substantial) longer term effects, and (ii) pro-competitive outcomes of CRs versus the risk of unintended consequences. For example, how would the CMA approach implementing a CR (such as one requiring open access / interoperability of an SMS firm's products) where there may be a reasonable likelihood of an increase in competition in the short-term, but with a risk of a deleterious effect on innovation (and therefore, consumer welfare) in the longer-term (e.g. via disincentivising the SMS firm from investing further in its products subject to the CR)? Alternatively, how would the CMA consider assessment of a potential CR that would lead to a reduction in consumer welfare today (through reducing an SMS firm's ability to improve its product, or to unbundle an existing product), but with the possibility of improved consumer welfare if rivals were to respond by increasing their innovative activity in the relevant area?

22. Therefore, the CMA may wish to consider clarifying in updated guidance how it will prioritise / apply weight to these competing considerations when assessing the proportionality of any proposed intervention.

[22] Guidance 3.31

IV Pro-competition interventions

1. The CMA states that it may make PCIs in relation to an undertaking designated as having SMS where, following a PCI investigation, it considers that a factor or combination of factors relating to a relevant digital activity is having an AEC. This could occur because the factor or combination of factors prevents, restricts, or distorts competition (or "the effective interaction of demand and supply")[23] in connection with the relevant digital activity in the UK,[24] and can relate to actual competition or potential competition.[25]

2. The concept of an AEC appears to have been transposed from the CMA's Market Investigation regime. If this is correct, Market Investigation precedent suggests that there is a broad scope for what can be defined as an AEC (e.g. market structure and concentration, aspects of customer behaviour, aspects of the cost structure, the regulatory regime, etc.) and the guidance suggests that the CMA will have a similarly broad scope for determining what constitutes an AEC within the digital competition regime.

3. Our view is that the CMA will need to consider carefully what is truly an AEC and merits a PCI.

4. For instance, the Guidance as drafted suggests that key market features in digital activities/markets, such as network effects, could potentially be classified as an AEC, in that network effects are a key determinant of how competition operates in digital markets and can mean, under certain conditions, that the market structures that tend to prevail are with one or a small number of firms holding most of the sales share.

5. The CMA could then take the view that network effects are an AEC and that action must be taken to reduce the prevalence of that AEC. However, network effects are driven by the user benefit arising from the number of other users of the service, on one or other side of the market. Therefore, if the CMA tries to impose PCIs to "correct" network effects and "improve" the interaction of demand and supply, then it is far from clear that end-consumers would end up better off from such interventions (whereas consumer welfare is, and should be, the CMA's ultimate objective).

6. Relatedly, the CMA states that it will consider whether there are competition-enhancing efficiencies that have resulted, or may be expected to result, from factor(s) which are giving rise to an AEC and assess whether any such efficiencies may outweigh the anti-competitive effects of the factor(s) under assessment. This assessment will be based on:[26]

    i. whether the efficiencies would strengthen competition between the SMS firm and its rivals;

    ii. whether the efficiencies would impact the same competitive process, customers and users that are being adversely affected by the specific factor(s); and

    iii. whether there are other (potentially less restrictive) ways these efficiencies could be achieved.

[23] Guidance 4.10
[24] Guidance 4.4
[25] Guidance 4.8
[26] Guidance 4.14

7. It is unclear in this aspect of the Guidance whether the CMA will consider efficiencies which strengthen the competitive offering of an SMS firm. For example, an SMS firm may combine or bundle together different services, in a manner which brings benefits to consumers and improves its competitive offer. It is unclear whether the CMA would consider this to be "an efficiency that strengthens competition between the SMS firm and its rivals" (as rivals might argue such efficiencies could be classified as reducing competition between themselves and the SMS firm). It would be helpful if the CMA could clarify its approach in this area.

8. Finally, in relation to the PCI investigation process, we note that the CMA states that PCI investigations will be subject to a nine-month statutory deadline,[27] which is half the length of its statutory deadline for Market Investigations (moreover, these are typically preceded by Market Studies of a further six months to gather information and consider how competition is functioning). In addition, we note that the remedy options that the CMA may implement following a PCI investigation (which are the same options as those available to it where it carries out a Market Investigation)[28] are potentially very far-reaching, including, example, requiring an SMS firm to divest an aspect of its business.[29]

9. In our view it is questionable whether nine months is enough time, and the process is sufficiently comprehensive, particularly given the CMA's scope to impose potentially very impactful remedies at the end of the investigation. We would encourage the CMA to consider carefully whether there is sufficient time built into this process to be sure that it would be sufficiently thorough and comprehensive to reach a clear and well-evidenced view on (a) whether there is truly an AEC, (b) whether the AEC requires a PCI by the CMA, (c) that the proposed PCI is appropriate and proportionate, and (d) whether the benefits of intervention clearly outweigh the costs/risks.

[27] Guidance 4.48
[28] Guidance 4.24
[29] Guidance 4.24(c)