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Regulatory oversight of digital markets: is a new approach required?

Speakers: Derek Holt and Mat Hughes

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Regulators in the UK, EU and US have expressed increasing concern with the state of competition in digital markets. The Furman report, commissioned by the UK government, the Crémer report, commissioned by the European Commission and the Stigler report, published by the University of Chicago, all consider the state of competition in the digital markets in their respective jurisdictions. In this CLA event, the speakers, Derek Holt and Mat Hughes, set out both sides of the argument on this topic, considering which competition issues are present in digital markets and whether a new regulatory regime is required. At the outset they were clear that their objective was to further debate, rather than setting out their personal views.

1. *What are the competition concerns in digital markets?*

Digital markets are seen to have different features to other sectors, including their multi-sided nature, commonly with zero pricing on one side of the market, strong economies of scale and their reliance on data. These features are not unique to digital markets, but their combination, prevalence and extent increases the likelihood of market-tipping and makes it difficult for competitors to make inroads, which can lead to high market shares persisting and limited dynamic competition.

Generalisations can be false however, and digital platforms are not all the same. Effects-based competition policy looks at the theory of harm, evidence gathering, diagnosis and remedies. Remedies are difficult because they need to be focused, proportionate, use a cost-benefit analysis and avoid unintended consequences. Furthermore, market share in 2019 is not necessarily a good indicator of future revenue threats. For example, a small search engine, Duck Duck Go, saw its platform's daily average usage increase from some 31 million users December 2018 to over 40 million in July 2019, which could be indicative of future change even if its market share is very small. Similarly, Facebook is undergoing a demographic shift and may not have the same market presence in the future.

The ability of digital companies to set the rules regarding how users engage with their platforms may lead to concerns, if there is insufficient competition from rival platforms. Companies in digital markets have to develop the features of their platform to be successful, which can lead to innovation. However, especially if there is limited competition from rival platforms, the ways in which these rules of competition on the platform can operate may lead to concerns. Three main theories of harm can arise, which may be summarised as follows:

- **Discrimination** – self-preferencing when providing complementary services in downstream markets, for example, Google Shopping. Another example relates to a Danish dating website, which claimed it had reduced access to Facebook once Facebook launched its own dating website.
- **Promotion of single-homing** - where a user uses a single platform rather than multiple ones which makes it challenging for new entrants to access customers. Examples of this might be hotel booking sites imposing restrictions on hotel groups offering lower prices elsewhere.
- **Exploitation of the platform** – established digital platforms may be compulsory trading partners for users resulting in an inequality in bargaining power which can lead to concern that users may be harmed. In addition, a lack of competition over consumer privacy levels can lead to unfairness and excessive terms imposed on users.

A topical example of these issues is the CMA's market study of online platforms and advertising markets. Data practices are a key theme in the CMA study with concerns raised about consumers' limited willingness to engage.

There are arguments to rebuke these theories of harm however. As a starting point, a theory of harm is not evidence of current or future harm. Vertical integration is arguably all about self-preferencing, yet can be an efficient way for businesses to operate and for a platform to innovate and evolve. Regulators should be wary of discouraging effective integration.

As regards discrimination, it is debatable whether this theory of harm is the right standard, rather than foreclosure and this debate is being tested in the Royal Mail v Ofcom case in the Competition Appeal Tribunal.

It is questionable whether the activities of digital platforms are exploitative. Many services are free of charge to users, prompting the argument, is free not cheap enough? Users are opting for the companies which offer the best service.

In the CMA's market study of online platforms and digital advertising, the case is made for the impact of network effects in digital advertising. However, an alternative view is that this argument is not compelling as advertising campaigns are designed for use across multiple different types of media.

A more tempered view of the theories of harm requires a regulator investigating the market to test the concerns against data, explore the counterpoints and strike the right balance.

2. Is a new regulatory approach required?

The Furman report makes proposals in three broad areas of competition policy. These are:

- **Merger control** – the proposals include greater scrutiny of digital mergers, using the balance of harm test and rewriting the merger assessment guidelines.
- **Competition law investigations** – the proposals include retrospectively analysing cases not taken, streamlining the interim measures process and changes to the appeals standard, using a judicial review standard rather than full merits to assess appeals.
- **A new digital markets unit** – this proposal includes increasing regulatory oversight of platforms with "strategic market status", greater data mobility and interoperability and access to data held by platforms.

A new digital regulator will confer some platforms with "strategic market status". It is likely that the digital platforms falling into this category will be those seen as a "must-have" for consumers.

Reform proposals focus on lowering barriers to entry for rival platforms. If it is accepted that there is not enough competition in digital markets, regulation is arguably preferable for market participants as it avoids the uncertainty of remedies. Nonetheless, regulators are susceptible to imposing a "one size fits all" regulation which isn't fit for purpose and different things treated in the same way can have consequences that could spill over into other markets.

The Furman report also includes proposals to increase data mobility and interoperability to enable greater ease of switching. The report proposes to extend the requirement to divulge data. Those platforms with "strategic market status" have accumulated data and have established a user base. The report includes proposals intended to lessen the impact of incumbency this has generated and make it possible for new entrants to have access to that data and enter on an even playing field.

The argument against further regulation focuses on the associated risks. It is unclear what data the writers of the report had in mind. Moreover, if remedies associated with data, lead to data becoming less valuable, then consumers may face higher prices or poorer services in other respects. Interoperability is also complex to achieve (as highlighted by the challenges Facebook has faced in achieving this across its own messaging platforms), and may make innovation complex since this might raise interoperability problems.

Regulators need to balance market and regulatory risk, a process which requires considering proportionality, the likely effectiveness of regulation and the risk of unintended consequences. Indeed, the risk of unintended consequences is increased by the Furman's report reasonable observation that it is difficult to predict how digital

markets will change. Regulators must also consider the risk that deterring bad behaviour in one market might deter good in another.

In addition, it is striking that when comparing business spending on research and development in 2018 across industry sectors, digital companies' expenditure is matched only by automotive companies and pharmaceuticals.

Finally, regulators must be alive to the consequences of regulatory failure and unintended consequences. In the fibre broadband market, European countries with relatively less regulatory intervention to enforce access to incumbents' networks, such as many Central and Eastern European countries, Spain and Portugal, have a significantly higher investment in next generation fibre-to-the-premises networks than those in jurisdictions with greater regulatory intervention, such as the UK and Germany. While correlation is not the same as causation, it is important to recognise that regulation might deter innovation and investment.