ALERT MEMORANDUM

Unlocking Digital Competition: UK Expert Panel Publishes Report on Competition in Digital Markets

11 April 2019

On 13 March 2019, the Digital Competition Expert Panel (the "**Panel**") chaired by Professor Jason Furman issued its final report on competition in digital markets (the "**Report**"). The Report makes a series of non-binding recommendations designed to address a number of purported challenges for enforcing UK competition rules in digital markets.

Background

In 2018, the Government commissioned Professor Furman, chair of the Council of Economic Advisers in President Obama's Administration, to investigate and report on competition in digital markets. The Report's goal was to consider the potential opportunities and challenges that the digital economy may pose for competition and to suggest proposals for change.

The Report is the latest example of a growing interest – in the UK and internationally – in the regulation of digital markets. Andrew Tyrie, Chairman of the Competition & Markets Authority (the "**CMA**"), has highlighted the perceived challenge that "*the UK has an analogue system of competition and consumer law in a digital age*," and the House of Lords Select Committee on Communications recently published a report in response to concerns that if governments fail to regulate the internet adequately, "*it will evolve in ways determined by, and in the interests of,* [the largest tech] *companies.*"

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Competition policy in digital markets is also under scrutiny in other jurisdictions around the world, including in Australia, where a December 2018 preliminary report published by the Australian Competition and Consumer Commission recommended stricter regulation on the market power of Google and Facebook. In the United States, various politicians have called for large technology companies to be disciplined or even broken up. At the EU level, a panel appointed by the European Commission published a report in April 2019

on the challenges of digitisation for competition policy and, in December 2018, Japan's Fair Trade Commission opened a market study into competition and digital platforms.

The Report contends that digital markets exhibit a unique combination of features that create specific challenges for competition enforcement, and therefore merit both closer scrutiny and new tools to enable intervention. Among the features identified are: significant economies of scale and scope; network effects; barriers to entry (as a result of large, valuable data sets), technical restrictions, limited data portability and tying arrangements that increase switching costs and limit multi-homing; and, markets that "*tip […] towards a single winner.*" The Report also observes that digital markets are fast-moving and services may be offered for free, such that competition authorities applying a traditional framework lack both the means to understand them and the right tools to intervene. This is the central premise for the Report's proposals – that significant reforms are justified because "*[a]lthough many of these features are evident in non-digital markets, the combination and strength of them in digital markets is unique.*"

Analysis

The Report analyses how competition functions in digital markets and makes a series of recommendations designed to enhance market transparency, efficiency and competitiveness. The Report claims that there are several challenges for enforcing UK competition rules in digital markets and makes – wide-ranging and, in some cases, controversial – recommendations to address these challenges. These include proposals to: establish a new Digital Markets Unit to oversee digital markets; replace the UK's voluntary merger control regime with a mandatory notification system; lower the substantive thresholds for intervening in digital markets; make greater use of interim measures; and lower the standard of review applied by the UK Competition Appeal Tribunal (the "**CAT**"). The recommendations are set out in full in **Annex I** below.

The recommendations are not binding and several would require legislative reform. Nevertheless, the Report is likely to influence the CMA's enforcement policy. The most important proposals are discussed below.

1. Digital markets require a specialist regulator and code of conduct

The Report's flagship proposal is the creation of a new Digital Markets Unit ("**DMU**") – staffed by individuals with industry expertise – to sustain and promote effective competition in the sector. The Report leaves open whether the DMU would operate as a unit of the CMA or Ofcom, or would be set up as a new independent regulatory authority. This differs from the House of Lords' parallel proposal to establish a new Digital Authority that would co-ordinate with regulators in the digital world and assist their effective implementation of the law.

The DMU would work with industry stakeholders to establish a principles-led 'code of conduct' that would apply to digital platforms designated as holding 'strategic market status', *i.e.*, "*a position of control over other parties' market access*". The relevant digital platforms would need to adhere to the principles and explanations of "*fair and reasonable*" conduct set out in the code, which would facilitate *ex ante* regulation and monitoring of conduct in digital markets.

Designations of 'strategic market status' would be reviewed every three to five years. The Report envisages that only "*a small number of companies*" should be designated as holding 'strategic market status', implying that the concept would capture only the largest digital platforms (*e.g.*, Amazon, Facebook, Apple, Microsoft, and Google). The rules in the code of conduct and which companies' activities or specific business units are designated as having 'strategic market status' would need to be sufficiently clear to ensure legal certainty, proportionality, and predictability for the affected players.

The DMU under the Report's proposal would not have a mere coordinative function but would be endowed with powers to impose remedial directions and to monitor, investigate, and penalise non-compliance with the code of conduct.

In the CMA's response to the Report, the CMA's Chief Executive, Andrea Coscelli, observed that the

CMA already has considerable expertise in digital markets, a dedicated Data, Technology and Analytics ("**DaTA**") unit, and views digital markets as an enforcement priority. Creating the DMU would be another step in that direction.

2. Data mobility and open technical standards are pro-competitive and should be promoted

The Report advocates for open technical standards and greater data mobility, and cites Open Banking as an illustration of how these can increase transparency and enhance consumer choice. The Report finds that early engagement of industry and policymakers in the design of an Open Banking Standard enabled the UK's largest banks to agree a common set of standards for creating and sharing banking data well ahead of the implementation of the EU's second Payment Services Directive. The Report proposes similar measures to promote information sharing and portability of data in digital markets, whereby users could move and manage their diverse personal data across multiple platforms. The Report also recommends exploring how digital businesses could open their data to other competitors on reasonable terms to help new entrants improve their understanding of users' habits and requirements. The European Commission's expert panel report similarly focuses on the need to ensure that data are accessible and even envisages that mandatory data access may be appropriate in certain circumstances.

As the Report acknowledges, government-led standardisation is likely to be "*inflexible and ill-equipped to deal with market developments or changes in technology*." Solutions should therefore be industry led: many digital companies have already made substantial efforts to promote data mobility. These efforts include the Data Transfer Project (led by Google, Microsoft, Facebook, and Twitter) and the "Uber Movement" scheme, through which Uber has released anonymised and aggregated data to inform local authorities' infrastructure and planning decisions. Giving projects such as these formal status could help to achieve the Report's aims of facilitating user switching between services.

3. Merger review should be modified to reduce "Type II" under-enforcement errors

The Report expresses concern that major digital companies have grown and consolidated their market position largely unchecked, including by acquiring smaller companies. It attributes this to "Type II" under-enforcement errors in UK and EU merger control, *i.e.*, that the CMA and European Commission have unconditionally cleared too many digital mergers. The same theme appears in the House of Lords report, and the CMA is already conducting an *ex-post* study into prior UK merger clearances to determine whether it incorrectly authorised any digital mergers, in light of subsequent market developments. The Report suggests that the need to prove a "*substantial lessening of competition*" on the balance of probabilities at Phase 2 is too difficult to satisfy in cases involving acquisitions of smaller companies in early-stage development. Absent reforms, "*digital companies* [could] *continue to acquire innovative potential future rivals unchallenged.*" The Report makes three main proposals to address these perceived shortcomings:

— Digital companies designated as holding "*strategic market status*" should be required to make the CMA aware of all intended acquisitions, including those involving the acquisition of companies in adjacent, non-overlap markets;

— The CMA's merger assessment guidelines should be updated "*to reflect the features and dynamics of modern digital markets*"; and

— A new substantive test, based on a "*balance of harms*" should be introduced for assessing "*cases involving potential competition and harm to innovation*". The CMA could prohibit or conditionally approve a transaction that it considers "*would do more harm than good*", having regard to both the magnitude of harm and its likelihood. The Report envisages this standard as being optional in cases in which these issues arise.

As to the first proposal, the Report acknowledges (based on evidence from the CMA) that the 'share of supply' test is sufficiently flexible to enable the CMA to review high-profile, non-horizontal digital mergers when needed. (The European Commission reached a similar conclusion in respect of the EU

Merger Regulation's thresholds.) Where *prima facie* concerns have arisen – as in *Facebook/Instagram* and *Google/Waze*, for example – the 'share of supply' test provided a jurisdictional basis for review, notwithstanding the parties' differentiated service offerings and the target businesses' minimal UK turnover. The CMA's recent enforcement practice (*e.g.*, the Phase 2 reviews in *Experian/ClearScore*, *Nielsen/Ebiquity*, *TopCashback/Quidco*, and *PayPal/iZettle*, the latter of which was not originally notified but was called in for review) confirms its willingness and ability to assert jurisdiction over digital markets cases and, if necessary, proceed to an extended review.

Companies whose activities are deemed to hold 'strategic market status' in certain markets would need to be clearly identified and made aware of their obligations if they are to inform the CMA of all intended acquisitions. Updating the merger assessment guidelines to take account of how the CMA reviews mergers in the digital sector, such as examining the presence and strength of network effects and multi-homing, as well as the potential for reductions in service quality or privacy protections, could standardize and reflect the CMA's existing powers and practice.

The proposed reforms to the substantive test, however, appear controversial. The 'balance of harms' test would risk introducing an unwelcome degree of uncertainty into the merger review process, by providing the CMA with a broad margin of appreciation in deciding whether the expected harm is sufficient to warrant intervention. The CMA has commented that this test would bring about "*a fundamental shift in merger policy*" that would create difficulties in applying merger control assessments in a "*transparent*" and "*robust*" manner. The Report discusses this test in the context of digital mergers, but does not limit its application specifically to the digital sector. One could envisage such a test being considered applicable in other cases where issues of potential competition and innovation arise, such as in the pharmaceutical sector.

By contrast, the European Commission's expert panel report advocates for less extensive reform, finding the existing substantive test under EU law to form a "*sound basis*" for assessing digital mergers. It recommends instead re-designing theories of harm to capture any adverse effects (*e.g.*, through increased barriers to entry) caused by the acquisition of small start-ups by dominant players.

Under the existing legal standard – the 'balance of probabilities' – the CMA already reviews the impact of a transaction on potential competition (for example in its Phase 2 reviews of *PayPal/iZettle* and – the since abandoned – *Experian/ClearScore*). In its response to the Report's findings, the CMA stated that: "*addressing these challenges [posed by mergers in digital markets] does not require fundamental changes to the existing legislative regime at this stage*". The statement concedes that the CMA's "*predecessor organisations did not, in some cases (such as Facebook's acquisition of Instagram), fully consider important evidence that could have provided greater insight into how the markets…were likely to evolve in future*". However, these appear to be examples of incomplete analysis, or a function of the inherent difficulties in trying to predict how markets will develop in the future, rather than a defective legal test. This recommendation should therefore be approached with caution.

4. Intervention in digital markets is too slow

The Report recommends procedural changes to enhance the CMA's existing enforcement powers, including:

— *Fast-tracking antitrust cases in digital markets.* The Report considers that enforcement action in digital markets is too slow in general, and in antitrust cases in particular (between 2014-2017, CMA antitrust cases averaged 39 months in length, compared with 25 months for all cases over the same period). The Report argues that fast-moving markets demand quicker case resolution; at present, "*companies exposed to anti-competitive practices may go out of business before the case is concluded*".

— *Greater use of interim measures.* The Report also proposes that, to balance the need to accelerate the antitrust enforcement process with the rights of the affected parties, the CMA should make greater use of its existing power to award interim measures.

The CMA has broadly welcomed the Panel's recommendations. Mr Tyrie had previously expressed the view that greater use of interim measures is "*essential if the CMA is to respond to the challenges thrown up by rapidly changing markets.*" His observations and the Report's reform proposals are consistent with an emerging consensus at the European level.[1]

While it is clearly desirable for the CMA to complete its reviews quickly and efficiently, the existing rules do not preclude this. For example, despite requiring the parties to produce and the CMA to analyse substantial amounts of evidence and data, mergers are assessed to strict statutory timetables. The CMA has similarly been able to assess and close antitrust cases in short timeframes: it issued an effects-based no grounds for action decision approximately six months after opening its investigation into suspected anti-competitive conduct in relation to single-wrapped impulse ice cream in 2017.

Both interim measures and fast-track final decisions should remain grounded in the evidence. Greater confidence in exploiting existing statutory powers should not come at the expense of investigative rigour. Importantly, interim measures should be used as a means of last resort for truly exceptional circumstances and should not be a tool for 'hold-up' or 'hold-out' by opportunistic third parties.

5. The standard of judicial review should be lowered to shorten the appeal process

The Report assesses the current UK framework for judicial review in antirust and merger cases, observing that the CAT currently applies a full merits review standard, which allows it to examine the evidence afresh and to take any decision that the CMA itself could have made. The Report argues that the process is exhaustive and cumbersome and that a lighter touch standard of review – for example, judicial review rather than full merits – would accelerate case throughput, including in fast-moving (digital) markets. The proposal echoes Mr Tyrie's claims that the current framework is "*a more protracted and cumbersome appeal process than was originally intended for, and by, the CAT.*" The CMA has welcomed the Report's findings.

When the Government consulted on reforms to streamline regulatory and competition appeals in 2013, it was suggested that the full merits review standard was the primary cause of the length and complexity of appeals, and that shifting to a judicial review standard would improve economy of process. The full merits review was ultimately preserved, for several important reasons, which remain sound today. First, a "judicial review" standard does not guarantee faster process. In judicial review cases, the need to remit the case to the CMA for re-determination (a decision which may itself be appealed) can extend the end-to-end duration of a case significantly, even beyond the timeframe required for a full merits review to take its course. Second, full merits reviews may enhance procedural economy. Particularly in complex, technical cases (as the CAT observed in a 2012 judgment, *TalkTalk Telecom Group v OFCOM*) hearing the case on its merits may permit the CAT to cure otherwise determinative procedural defects that arose in the original decision. Third, a judicial review standard does not adequately protect the fundamental rights engaged by competition law decisions. A full factual and legal assessment of the merits upon appeal is often the first time that independent judicial scrutiny is applied to competition decisions.

There is little evidence, anecdotal or otherwise, that the prospect of a full merits review on appeal is chilling administrative enforcement action. The CMA has grown in sophistication and confidence over time, learning from difficulties encountered on appeal in previous cases. More recently, the CMA has demonstrated a willingness and capacity to take

[1] For example, Competition Commissioner Margrethe Vestager has reportedly stated that "*The French have been very successful in doing interim measures for quite some time and that is, of course, of interest to us.*" (Financial Times, *EU considers tougher competition powers*, July 2, 2017). *See also* Germany's Federal Ministry for Economic Affairs and Energy, *White Paper on Digital Platforms of the Economics Affairs Ministry*, March 20, 2017: "*we plan to make it easier to order injunction measures so that the authorities can eliminate the effect of restrictions to competition (provisionally) before investigation proceedings have been completed.*"

on more challenging cases, even if this may raise the risk of appeal. Given the technical complexity of some digital markets cases, the safety net of a further, full merits, review may be welcomed.

What's Next?

The Report is a diligent piece of analysis that makes a valuable contribution to the UK antitrust enforcement debate. The CMA has endorsed many of the Report's findings, praising it as providing "*invaluable insight into* [the] *challenges* [posed by digital markets] *and how they might be addressed by updating the UK competition framework*." The CMA has, however, cautioned against some of the Report's more controversial recommendations – most notably its proposal to replace the substantive mergers test with the 'balance of harms' standard – and is of the view that no "*fundamental changes to the existing legislative regime*" are required at this stage.

Nonetheless, the Report seems likely to influence the antitrust enforcement debate in the UK in the near term. As recommended by the Report, the CMA may launch a market study into digital advertising in the near future, depending to some extent on the outcome of the Brexit negotiations. Companies and investors with significant activities in digital markets in the UK should expect increased interest and potentially greater antitrust scrutiny in the sector.

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Annex I: The Report's Recommendations

1. The digital markets unit should work with industry and stakeholders to establish a digital platform code of conduct, based on a set of core principles. The code would apply to conduct by digital platforms that have been designated as having a strategic market status.
2. The digital markets unit should pursue personal data mobility and systems with open standards where these will deliver greater competition and innovation.
3. The digital markets unit should use data openness as a tool to promote competition, where it determines this is necessary and proportionate to achieve its aims.
4. The digital markets unit should co-operate with a wide range of stakeholders in fulfilling its role, but with new powers available to impose solutions and to monitor, investigate and penalise non-compliance.
5. To account for future technological change and market dynamics, the digital markets unit should be able to impose measures where a company holds a strategic market status – with enduring market power over a strategic bottleneck market.
6. Government should ensure the unit has the specialist skills, capabilities and funding needed to deliver its functions successfully.
7. The CMA should further prioritise scrutiny of mergers in digital markets and closely consider harm to innovation and impacts on potential competition in its case selection and in its assessment of such cases.
8. Digital companies that have been designated with a strategic market status should be required to make the CMA aware of all intended acquisitions.
9. The CMA's Merger Assessment Guidelines should be updated to reflect the features and dynamics of modern digital markets, to improve effectiveness and address under-enforcement in the sector.
10. A change should be made to legislation to allow the CMA to use a 'balance of harms' approach which takes into account the scale as well as the likelihood of harm in merger cases involving potential competition and harm to innovation.
11. The CMA should perform a retrospective evaluation of selected cases not brought and decisions not taken, where infringements were suspected or complaints received, to assess how markets have subsequently evolved and what impact this has had on consumer welfare.
12. To facilitate greater and quicker use of interim measures to protect rivals against significant harm, the CMA's processes should be streamlined.
13. The review applied by the Competition Appeal Tribunal to antitrust cases, including interim measures, should be changed to more limited standards and grounds.
14. The government should introduce more independent CMA decision-making structures for antitrust enforcement cases, if appeal standards are changed.
15. The government should ensure those authorities responsible for enforcing competition and consumer law have sufficient and proportionate information gathering powers to enable them to carry out their functions in the digital economy.
16. The CMA should continue to prioritise consumer enforcement work in digital markets, and alert government to any areas where the law is insufficiently robust.
17. Government should promote the UK's existing competition policy tools, including its market studies and investigation powers, as flexible tools that other countries may benefit from adopting.
18. The UK should use its voice internationally to prevent patent rights being extended into parts of the digital economy where they are not currently available.
19. Government should support closer co-operation between national competition authorities in the monitoring of potential anti-competitive practices arising from new technologies and in developing remedies to cross-border digital mergers.
20. To ensure platforms and businesses have a simple landscape in which to operate, government should encourage countries to consider using pro-competition tools in digital markets. As part of this work, government should work with industry to explore options for setting and managing common data standards.