Draft guidance for the digital markets competition regime

Consultation response of RBB Economics

RBB Economics welcomes the CMA's public consultation on its draft guidance for the digital markets competition regime (the Draft Guidance), as established by the Digital Markets, Competition and Consumers (DMCC) Act (the Act).

The Act has the potential to deliver meaningful benefits to competition in the digital space. Moreover, the commitment in the Draft Guidance to undertaking an evidence-based assessment in a number of areas is welcome.[1] However, implementation of the Act is not without risk: it has the potential to impose a significant regulatory burden on firms and to chill competition and innovation, to the detriment of consumers. This risk is exacerbated by the considerable uncertainty created by the Draft Guidance regarding which firms and activities will be caught by the regulation. Such uncertainty has real consequences, both for firms potentially designated as having Strategic Market Status (SMS) and those relying on their products and services.

Against this backdrop it is, in our view, imperative that the final guidance (the Guidance) meets the following two criteria:

- First, the Guidance should provide a far clearer steer as regards not only which firms are likely to be captured (and in respect of which products) but also, crucially, where the CMA is *unlikely* to designate firms with SMS status or otherwise intervene. Greater certainty provides stronger incentives for firms to undertake normal course of business activities in digital markets which may benefit customers without fearing regulation or fines.
- Second, the Guidance should promote a balanced and evidenced-based approach at *all* stages. In particular, the Guidance should go further to explain how the CMA will use economic evidence to address the difficult balance of (i) avoiding the risk that pro-competitive activities are outlawed and (ii) focusing interventions on those situations where competition problems truly exist. This approach should apply to each stage of the CMA's assessment: SMS designation; identification of areas that should be regulated; and, ultimately, remedy discussions.

Achieving these goals requires, inter alia, better guidance in respect of the following:

- the approach to defining markets and designating firms with SMS; and
- the approach to imposing Pro-Competitive Interventions (PCIs) or Conduct Requirements (CRs).

The approach to market definition and SMS designation

The Draft Guidance indicates that the Act will apply in circumstances where a firm benefits from "*substantial*" and "*entrenched*" market power.[2]

With respect to market definition, the Draft Guidance notes that "*assessing substantial and entrenched market power does not require the CMA to undertake a formal market definition exercise which often involves drawing arbitrary bright lines indicating which products are 'in' and which products are 'out'.*"[3]

1. It is welcome, for example, that the Draft Guidance explains that, when assessing the Countervailing Benefit Exemption, the CMA will consider "*evidence of benefits arising from the conduct to a substantial number, or significant category, of users or potential users of the digital activity*" and that this may include, for example "*a report by an independent expert verifying the existence and/or extent of the claimed benefits*" (para 7.65).
2. Draft Guidance, para 2.35.
3. Draft Guidance, para 2.43.

We disagree. Irrespective of whether the CMA has scope (as a matter of law) to avoid defining the market formally, from a substantive perspective it should do. Substantive market definition is an important initial step in determining whether firms have market power. When undertaken soundly, it provides an effective framework for the appraisal of the extent of demand-side and supply-side constraints and, hence, the degree of market power which firms may have (as the CMA itself would acknowledge).[4] A coherent assessment of "substantial and entrenched *market* power" requires a formal assessment of the relevant *market* in which such power is held.

The Draft Guidance goes on to state that "*[s]ubstantial and entrenched market power is a distinct legal concept from that of 'dominance' used in competition law enforcement cases"* and that *"[a]s a result, the CMA will not typically seek to draw on case law relating to the assessment of dominance when undertaking an SMS assessment."*[5]

While the legal test may differ, the Guidance should acknowledge that the CMA has already set out a clear definition of market power and a well-established process for determining its existence.[6] According to that framework, a firm will not be dominant unless it has substantial market power.[7] If (in economic terms) dominance means substantial market power, it then follows that the need for such market power to be "entrenched" represents an *additional* requirement over and above dominance. This should mean that the Act applies only to a subset of dominant firms.

The Guidance should address this point head-on setting out clearly when intervention is unlikely. It should, inter alia, provide examples of evidence that would speak *against* a finding of SMS designation. Such a steer is particularly important if the CMA is to distance itself from precedent on dominance, which firms might otherwise have used to self-assess their market positions. The Guidance should answer the question: could a non-dominant firm be designated and, if so, under what circumstances? In our view, given that they do not have substantial market power, there is no basis for intervention when firms are not dominant.

The Draft Guidance indicates that the CMA will undertake a forward-looking assessment of market power when assessing the threshold for SMS designation.[8] We agree that it makes sense to consider whether what may appear to be a strong current position is (i) likely to endure without challenge or (ii) subject to the threat of disruption over the medium-term.

However, in our view, when a firm has only recently obtained a leading position in a digital market, that position is less likely to be "entrenched". It is concerning, therefore, that the Draft Guidance states that "[*a] position of market power that has been acquired more recently may also be entrenched if the sources of that market power are likely to endure*".[9] This statement, in essence, refers to an expectation of entrenchment, as opposed to its existence. It thereby leaves open the potential for SMS designation to be applied too easily to firms that have recently brought a successful innovation to market. The Guidance should therefore revisit this position or, at least, make clear that the evidentiary standard for such a finding would be very high.

The approach to imposing PCIs and CRs

With respect to pro-competition interventions (PCIs), the Draft Guidance sets out that the standard for intervention is the identification of an adverse effect on competition (AEC) arising from a factor or combination of factors.[10] Notably, the Draft Guidance states that "*The Act does not specify a theoretical benchmark against which to measure an AEC. In assessing whether there is an AEC, the CMA will in practice focus on whether the factor or combination of factors prevents, restricts, or distorts <u>in some way</u> the effective interaction of demand and supply or if there are ways in which it considers current competition <u>could work more effectively</u> absent the factor(s).*"[11]

We do not understand this test. Taken literally, almost any feature of a market or firms' conduct could be said to impact the interaction of supply and demand "*in some way*". On its face, therefore, the test provides no limit on circumstances in which the CMA may intervene.

4. See, for example, Market Definition, December 2004, OFT Competition Act Guideline, para 2.1. This guideline has been retained by the CMA. https://assets.publishing.service.gov.uk/media/5a7cbf4ced915d68223624dc/oft403.pdf.
5. Draft Guidance, para 2.45.
6. Assessment of Market Power, December 2004, OFT Competition Act Guideline. This guideline has been retained by the CMA. https://assets.publishing.service.gov.uk/media/5a7c8c02e5274a7b7e3212ae/oft415.pdf
7. *Ibid.* para 2.9.
8. Draft Guidance, para 2.46-2.52.
9. Draft Guidance para 2.51, emphasis added.
10. These factors may relate to an SMS firm's conduct or structural characteristics of a market (Draft Guidance, para 4.6).
11. Draft Guidance para 4.10, emphasis added.

Moreover, the test as described does not provide any reassurance that the CMA will undertake an evidence-based assessment of whether markets are currently working sufficiently well for consumers (and/or whether there is material consumer detriment arising from weak competition to be remedied). Instead, the test suggests that the CMA will seek to ascertain if competition could work *more* effectively. Once again, the Draft Guidance leaves the door wide open for intervention without evidence that a competition problem exists. Competition *could* work more effectively in almost all markets. For example, in many markets barriers to entry could be a little lower or firms could compete slightly more aggressively – but that possibility does not provide a sound basis for intrusive regulation.

A further concern is that first on the list of the CMA's indicators of an AEC is whether "*SMS firms' profits reflect a reasonable rate of return based on the nature of competition*".[12] The Draft Guidance makes no mention of the fact that assessing profitability in digital markets is highly challenging because firms' asset bases are largely intangible and so particularly difficult to measure reliably. Neither does the Draft Guidance mention that high profits may simply reflect a fair return on successful innovation.

On the plus side, we welcome the CMA's commitment to assessing the competition-enhancing efficiencies that have resulted, or may be expected to result, from factors which may give rise to an AEC.[13] This is an important statement and we encourage the CMA to give as much weight to competition-enhancing features as it places on competition-reducing factors, when balancing any potential pro- and anti-competitive effects.

As regards CRs, it is not obvious from the Draft Guidance that prior to their imposition an AEC needs to be established (or even that there is a clear threshold test for when such regulatory requirements can be imposed). The main check on the CMA seems to be the need for such interventions to be proportionate and to deliver benefits to customers. While important, this is not the same as intervening only when there is a demonstrable consumer harm, arising from a failure of competition, that needs to be addressed.[14]

In our view, before imposing wide-reaching PCIs or CRs, the CMA should commit to first proving to a high-standard, through evidence-based analysis, that markets are not working sufficiently well due to weak competition and that there are insufficient countervailing consumer benefits. Without doing so, the Draft Guidance puts forward no obvious limiting principle on intervention (other than the need to consider proportionality). This provides little reassurance that truly pro-competitive conduct is protected from regulation.

Conclusion

In summary, the Draft Guidance sets out a broad set of scenarios in which the CMA may intervene with intrusive remedies without providing a clear steer on when it is *likely* to intervene and, critically, when intervention is less likely. This uncertainty creates a real risk of business chilling effects, not only for firms with limited market power but also for firms possessing SMS that are, nevertheless, engaging in truly procompetitive behaviour. The Draft Guidance also risks the inconsistent application of economic principles by failing to acknowledge that there is a well-established process for assessing substantial market power that can and should apply in respect of digital markets. We urge the CMA to provide more clarity in its Guidance to resolve these issues.

12. Draft Guidance, para 4.12.

13. Draft Guidance, para 4.13-4.14.

14. Section 3 of the Draft Guidance indicates that the CMA will only impose a CR when it is proportionate to do so and that the CMA must have regard to the benefits for consumers that it considers would likely result (directly or indirectly) from the CR. It does not, as far as we can see, set out a commitment to identifying a significant competition problem when deciding if a CR should be applied.