FINALISATION OF THE DIGITAL MARKETS ACT

Questions, answers and some more questions...

2022

frontier economics

WWW.FRONTIER-ECONOMICS.COM

BERLIN | BRUSSELS | COLOGNE | DUBLIN | LONDON | MADRID | PARIS

FINALISATION OF THE DIGITAL MARKETS ACT

Questions, answers and some more questions...

April 2022

Following a challenging legislative process lasting well over a year, on 24 March the European Council and the European Parliament reached a provisional political agreement on the Digital Markets Act (DMA) - the set of European Union rules which aim to govern the behaviour and limit the market power of large online platforms such as Google, Apple, Meta, Amazon and Microsoft.

After a last push, the co-legislators are now expected to finalise and publish the text soon. What is clear from the press conference following the agreement and the short publications made by the Council and the Parliament is that this landmark legislation will greatly impact digital markets in the EU. It may also set a precedent further afield.

Most of the regulatory framework appears to be in line with the key building blocks of the Commission's proposal published in December 2020, albeit with some material changes. The framework now includes the principal features summarised in the table below:

THRESHOLDS	FOR A PLATFORM TO QUALIFY AS A GATEKEEPER, FIRSTLY IT MUST EITHER HAVE HAD AN ANNUAL TURNOVER OF AT LEAST €7.5BN IN THE PAST 3 YEARS (UP FROM €6.5BN IN THE COMMISSION'S PROPOSAL) OR A MARKET VALUATION OF AT LEAST €75BN (UP FROM €65BN IN THE COMMISSION'S PROPOSAL). MOREOVER, THEY MUST HAVE AT LEAST 45M MONTHLY END USERS AND AT LEAST 10K BUSINESS USERS ESTABLISHED IN THE EU.
CORE PLATFORMS	IN-SCOPE PLATFORMS ARE MARKETPLACES AND APP STORES, SEARCH ENGINES, SOCIAL NETWORKS, CLOUD SERVICES, ADVERTISING SERVICES, MESSAGING PLATFORMS, VIRTUAL ASSISTANTS AND WEB BROWSERS (THE LAST TWO HAVE BEEN ADDED RELATIVE TO THE COMMISSION'S PROPOSAL). FURTHERMORE, A NEW CATEGORY OF "EMERGING GATEKEEPER" HAS BEEN INTRODUCED, WHICH WILL ENABLE THE COMMISSION TO IMPOSE "OBLIGATIONS ON COMPANIES WHOSE COMPETITIVE POSITION IS PROVEN BUT NOT YET SUSTAINABLE".
DOS	GATEKEEPERS WILL NEED TO: (1) ENSURE THAT USERS CAN UNSUBSCRIBE FROM CORE PLATFORM SERVICES UNDER SIMILAR CONDITIONS TO SUBSCRIPTION; (2) PROVIDE CHOICE SCREENS FOR THE INSTALLATION OF CERTAIN SOFTWARE (E.G. WEB BROWSERS, SEARCH ENGINES OR VIRTUAL ASSISTANTS); (3) ENSURE THE INTEROPERABILITY OF THEIR INSTANT MESSAGING SERVICES' BASIC FUNCTIONALITIES; (4) ALLOW APP DEVELOPERS FAIR ACCESS TO THE SUPPLEMENTARY FUNCTIONALITIES OF SMARTPHONES (E.G. NFC CHIP); (5) GIVE SELLERS ACCESS TO THEIR MARKETING OR ADVERTISING PERFORMANCE DATA ON THE PLATFORM; AND (6) INFORM THE EC ABOUT PLANNED M&A ACTIVITY.
DON'TS	GATEKEEPERS MUST NOT (1) 'SELF-PREFERENCE' THEIR OWN SERVICES; (2) REUSE PERSONAL DATA COLLECTED FROM A CORE PLATFORM SERVICE FOR THE PURPOSE OF ANOTHER SERVICE; (3) ESTABLISH 'UNFAIR' CONDITIONS FOR BUSINESS USERS; (4) PRE-INSTALL CERTAIN SOFTWARE APPLICATIONS; OR (5) REQUIRE APP DEVELOPERS TO USE CERTAIN SERVICES (E.G. PAYMENT SYSTEMS OR IDENTIFICATION SERVICES) IN ORDER TO BE LISTED IN APP STORES.
PENALTIES	THE COMMISSION CAN IMPOSE FINES OF UP TO 10% OF GLOBAL TURNOVER FOR NON-COMPLIANCE BY GATEKEEPERS, WHICH INCREASES TO 20% FOR REPEATED OFFENCES. SYSTEMATIC VIOLATIONS COULD TRIGGER STRUCTURAL AND BEHAVIOURAL REMEDIES, INCLUDING A BAN ON MERGERS. FURTHERMORE, WE UNDERSTAND THAT GATEKEEPERS CAN NOW FACE COLLECTIVE ACTIONS FROM INDIVIDUALS AND COMPANIES IN NATIONAL COURTS IN CASES OF NON-COMPLIANCE WITH THE DMA OBLIGATIONS.

In the months ahead, the Commission and the potential gatekeepers will be turning their attention to implementation and compliance. Requirements as significant as those mandated in the DMA will undoubtedly raise a number of practical challenges, which both sides will need to work through. If the DMA is to be implemented in a way which maximises benefits to competition and consumers while minimising the implementation costs, careful thought needs to be given to how to carry out the required changes in a proportionate and sustainable way.

While we await the publication of the final text, we cast our minds back to our series on digital regulation last year. These articles set out our reflections on some of the most interesting aspects of the proposals in the EU (and UK) from an economic perspective, which we reconsider here in light of the current proposal.

PREFERENTIAL TREATMENT

The definition of self-preferencing has been uncertain since the Commission's Google Shopping case in 2017.

The inclusion of the ban on self-preferencing in the DMA leaves significant questions unanswered – an issue we considered when this was first proposed in the draft legislation. At this stage, important outstanding questions are:

- ***How broadly does the ban on self-preferencing apply?*** The Commission's original text suggested that the ban should just apply to rankings (preventing gatekeepers from giving their own products/services higher positions in any search results). However, the Parliament proposed that it should also apply to "other settings". This could have wide-ranging implications for gatekeepers and go to the heart of how they design their products. For example, it could limit their ability to offer additional complementary services to users if such services rely on their own proprietary product/service offerings, such as payment or other ancillary services (e.g. after a search for the best pubs, a search engine might currently show a map to the location using its own proprietary map services). Under the strictest form of a ban on self-preferencing such features could be restricted. It is unclear exactly how the self-preferencing requirement will be specified in the DMA's final text, but this will be an area that potential gatekeepers and their rivals will be paying close attention to.
- ***What does self-preferencing mean in practice?*** The ranking and positioning of products/services is often determined via complex algorithms, which are in many cases constantly updated through the use of machine learning. Designing such algorithms is one of the core skills of digital platforms and often many different factors determine ranking. If a gatekeeper's own services tend to do well in its rankings because they meet objective criteria that best match a consumer's needs, a requirement for a blanket removal could be against consumers' interests.

REGULATORY CLIFF-EDGES

The old dilemma for regulators of how (and when) to regulate fast-moving innovative markets.

Given that the DMA applies a long list of obligations to any firm that meets a range of quantitative thresholds, there is a risk that the DMA could lead to regulatory cliff-edges. For instance, there could be a large jump in the amount of regulation that a business faces as it grows, or big differences in the regulation faced by companies with quite similar market positions (e.g. one just below the thresholds and the other just above them). We previously considered the likelihood of regulatory cliff-edges under the Commission's (and the CMA's) proposals for regulating digital markets. Regulatory cliff-edges have the potential to distort competition. Large jumps in regulation (at a potentially arbitrary point) could reduce firms' incentives to capture market share from rivals and to innovate.

Even though the DMA represents a relatively mechanical approach towards regulation, the introduction of the 'emerging gatekeeper' category could go some way towards minimising regulatory cliff-edges. There may still be a number of levers that can introduce flexibility in implementation:

- Taking into account the market position of firms when the Article 6 obligations on gatekeepers are being specified or assessed in terms of compliance.
- Carefully considering the extent of the imposition of obligations for entities that are not currently in an 'entrenched or durable' position of power, i.e. "emerging gatekeepers".

It remains to be seen to what extent the finalised text will include provisions for flexibility in how regulation is applied, particularly around the boundaries of these thresholds, to safeguard against potential distortions.

ECOSYSTEMS

Balancing the benefits of ecosystems with any potential risks of leveraging market power/entry deterrence.

The DMA seeks to make markets more contestable by, among other features, imposing restrictions on combining data, tying under some circumstances, mandating access to certain inputs and limiting self-preferencing. Such obligations can also affect the incentives (or ability) of the gatekeepers to innovate in their Core Platform Service (CPS) markets but also in other 'adjacent' markets, i.e. affecting the creation or expansion of ecosystems. We previously examined two crucial questions for regulators when grappling with the competitive effects of growing business ecosystems: (1) what would need to be true for such expansion to have anti-competitive effects? and (2) what would be an appropriate regulatory response in this situation? We found that for this expansion to be anti-competitive (a) there must be a credible theory for deterrence of entry into the core market; and (b) the immediate pro-competitive and welfare effects associated with entry into the target market would need to be outweighed by longer-term anti-competitive effects. Relatedly, we argued that the UK's proposals for requiring approval before the introduction of new and improved services could throw the net of regulation over a wide range of pro-competitive innovation, putting the attendant benefits to consumers at risk.

The potential threats of such regulation to innovation may be particularly significant in digital markets, where innovation is rapid and frequently built directly into the very design of products. Some of the key questions to be considered include:

- Will firms continue to be able to offer core platform and other services together e.g. within the same app?
- Can the obligations restricting tying, data combination and self-preferencing be specified in a way that reduces the risk of unintended consequences?

FAIR, REASONABLE AND NON-DISCRIMINATORY (FRAND)

Another aspect that will require clear guidelines and more clarity for affected businesses (gatekeepers, rivals and users of the platforms).

FRAND terms are typically applied to situations where a product is an important input for certain downstream markets (e.g. standard patents relating to a technology that is essential for an industry standard). In the DMA, FRAND requirements will be imposed on search engines, social networks and app stores, although the exact interpretation of FRAND in these different contexts is still unclear.

When commenting on the Commission proposal published in December 2020 (which has been revised since), we raised a number of issues relating to the use of these types of requirements in the digital context. Among them was the need to consider in more detail how these requirements would support the achievement of improved contestability and fairness of core platform services.

With these objectives in mind, we also reflected on the lessons that economists have learnt from telecoms, where ex-ante access regulation has not been a quick fix. Effective implementation in this sector has required the commitment of significant resources by regulators and other stakeholders to specify the access offer, determine terms and conditions and monitor compliance with non-

discrimination obligations. In digital markets, designing and implementing effective access regulation would appear to be even more challenging than in telecoms. In part this reflects the complexity and dynamism of the digital sector but also the lack of experience globally in ex-ante economic regulation of these markets. In addition, regulating companies which have built strong market positions through a process of innovation in competitive markets raises knotty economic questions which did not arise when imposing access regulation on former statutory monopolies (whose market position was a legacy of previous regulatory frameworks and not the result of competitive processes). These are issues that can be taken into account as the Commission and the digital markets players move forward with the implementation of the DMA.

These are only some of the many interesting economic questions that such an important and far-reaching piece of regulation will undoubtedly raise as the focus shifts to implementation and compliance. Once the final text is published, we will follow up with further thoughts on what to look out for as the time to implement the DMA approaches.

AUTHORS

ELEANOR MONAGHAN
Manager

GREG WILKINSON
Manager

TOM OVINGTON
Manager

FEDERICO BRUNI
Consultant

WANT TO KNOW MORE?

WWW.FRONTIER-ECONOMICS.COM

HELLO@FRONTIER-ECONOMICS.COM

+44 (0) 207 031 7000