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BRIEFING PAPER

CONFLICTING MISSIONS

THE RISKS OF THE DIGITAL MARKETS UNIT TO COMPETITION AND INNOVATION

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Foreword

The idea that markets and competition are human creations, and that we can set them up well or badly, seems obvious. We can organise the basic rules so it's easy for big incumbent firms and monopolists to block disruptive new challengers or breakthrough technologies that might cut prices or improve the quality of what customers can get, or we can encourage these things so consumers do better because firms have to pedal faster, becoming more efficient and productive to win and keep their business. And the digitising economy means we've got to rethink how to do this for lots of well-established industries as well, to cope with new technologies and business models. These are huge, high-stakes decisions that could shape our economy, our jobs and our lives in ways that could be right or wrong.

It isn't easy either, partly because digitisation is moving so quickly that it's hard for competition's 'rules of the road' to keep up, and partly because there are some fundamental traps that get in the way too.

The first is a rather silly caricature of competition, that misunderstands what market forces are all about. The caricature says that competition is either the same as the law of the jungle, where nature is red in tooth and claw and business leaders have to kill or be killed; or it's like the laws of physics, which are impossible to change. Either way, it says that you and I can only be protected from the devils and demons of competition by big fat bibles of extra-strong, heavy-duty rules and regulations, written by priesthoods of politicians and regulators.

The next is hubris from even the best and cleverest politicians and regulators, convinced they know what results markets ought to be producing and quiveringly-ready to brand anything which deviates from their vision as 'market failure' that demands intervention by brilliant, well-intentioned people to put it right. And they just happen to be those people.

The third is old-fashioned vested interests, because markets that are set up badly create their own industries of people who feed off keeping them that way, and who make good livings from all the high-maintenance expert reports, strategy updates, economic analyses, legal arguments and lobbying lunches that are needed to keep politicians and regulators briefed and influenced, so they use the powers in all those extra-strong, upfront rules in ways that help their clients.

So there's a premium on practical, sensible proposals that set digitising markets up properly to begin with, without all those complicated, high-maintenance interventions instead. Which say standards and rules aren't just OK, but in fact are vital and necessary building blocks to make our economy work for the benefit of consumers rather than of monopolist bosses, politicians or bureaucrats. But that instead of even more upfront, extra-strong powers for the priesthoods, the lowest-cost, most creative, freest, most entrepreneurial and commercially-successful way of delivering

them are rules that sharpen competition rather than blunting it. That accept the collective wisdom of the customer crowd, and allows businesses to try creative new ways to provide what people want, without getting in the way too much. Which create legal and institutional brakes to stop us falling into the three fundamental traps I've described here, which will otherwise lead us to the wrong answers and leave post-Brexit, post-pandemic Britain with less-competitive and less-successful companies, jobs and exports in future.

That's why the proposals in this paper are such a welcome and well-timed contribution to the debate. They start from the right place, with the right instincts. They will certainly repay your time and thought in reading them.

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Introduction

At the end of 2020, the UK government announced plans to create a Digital Markets Unit (DMU) charged with implementing an *ex ante* regulatory regime for certain digital platforms.[1] Following the recommendations of the Digital Markets Taskforce, led by the Competition and Markets Authority (CMA), this DMU would serve as the *de facto* regulator of large tech companies that had been designated as having "strategic market status" (SMS). Accordingly, the DMU was formally established within the CMA in April 2021, although Parliament will need to legislate to give it the powers proposed by the Digital Markets Taskforce. That authorization is likely to come in 2022. Until then, the DMU will prepare draft codes of conduct, and potentially conduct further analysis to add more firms to its remit (so far, only Google and Facebook have been proposed as firms to be regulated, following the CMA's Digital Advertising Market Study).[2]

This announcement followed several official reviews claiming that some digital markets are not working properly because of the dominance of a few platforms. Based on these reports, the DMU would be given powers to designate dominant platforms as having "substantial, entrenched market power in at least one digital activity, providing the firm with a strategic position", which would lead to their being given the SMS designation. This would make platforms subject to a bespoke code of conduct, potential pro-competitive interventions (PCIs), and increased scrutiny of their merger and product expansion decisions.[3]

At first glance, none of these powers may appear novel. Codes of conduct have been used in other sectors, such as groceries and energy markets, and PCIs were part of the package of remedies in the CMA's 2015 retail banking market review.[4]

But these interventions were limited to a small number of clearly delineated sectors, firms, activities, or products. By contrast, the DMU's remit will cover *all* "digital markets". This is an already large and growing proportion of the UK economy that comprises many different activities, from digital advertising and e-commerce to online search, social media, and news publishing (among others). And it increasingly encompasses markets like taxis, groceries, entertainment, and other sectors that are becoming significantly "digitalised". What may seem to be a focused mandate now is, over the coming decades, likely to grow to encompass more and more of the economy.

1 BEISC & DCMS, Response to the CMA's market study into online platforms and digital advertising (2020).

2 Kate Beioley, UK watchdog on Big Tech likely to remain powerless for a year, Financial Times (7 April 2021), available at https://www.ft.com/content/ea14274c-0857-4345-bea8-211d039de55f.

3 CMA, A new pro-competition regime for digital markets: Advice of the Digital Markets Taskforce (2020), pp. 5-6.

4 CMA, The Retail Banking Market Investigation Order 2017 (2017), p. 25.

The DMU will thus combine the powers and operating structure of a narrow sector regulator with a cross-sector purview that is much closer to the CMA's economy-wide reach. And it will do so for one of the most vitally important parts of the economy, where entrepreneurialism is central and where misguided regulation of incumbents may have systemic effects. The implications of this—creating a *de facto* regulator with goals that are often conflicting, with powers that lack many of the checks and balances that the CMA usually faces, and with a remit that could be as broad as the economy itself—have been given little scrutiny so far, with some assuming the DMU's scope is much narrower and more focused than it really is.

" What may seem to be a focused mandate now is, over the coming decades, likely to grow to encompass more and more of the economy."

Proponents might view this level of ambition as fit for the challenge presented by digital markets, where strong competition is vital and where markets may naturally gravitate toward a small number of large competitors. And given the broad variety of activities undertaken by digital platforms and the rapidity of technological change, they may argue that an effective regulator needs both a broad remit and extensive powers to act quickly. But there are also clear costs and risks in creating such a powerful new agency, and these have not yet been widely appreciated by many with an interest in economic policy in Britain.

To get the measure of those costs and risks, this paper evaluates the challenges that the DMU will face as a novel regulator tackling firms with complex and highly differentiated business models, whose actions have distinct effects in several markets and startup ecosystems. It focuses on the structure and goals of the DMU, the first pillar of its powers—the codes of conduct it is expected to write and enforce—and the checks and balances that the CMA's proposals lack. The other two pillars of its powers—pro-competitive interventions and changes to the mergers regime—are just as important substantively, but require further consideration in a future paper. We do discuss one element of the mergers proposals below, however, given its importance to startups.

Section 1 sets out the main findings of several official reviews that preceded the announcement of the DMU.

Section 2 summarises the duty and powers that the Digital Markets Taskforce proposes to give to this new regulator.

Section 3 considers the problems of operationalising the DMU's primary duty, given its vague objectives and different constituencies. Without a clear vision for what success looks like and how to manage the trade-offs involved, the DMU could easily become a hindrance to competition and innovation, instead of a positive force. The number of firms subject to SMS designation, and the consequent interventions, could steadily increase without improving consumer outcomes, because there would be no straightforward way to decide whether regulation worked.

Further, because the determinants of innovation for any given firm or in any given market are so poorly understood, the heightened scrutiny of SMS firms contemplated by the Digital Markets Taskforce's recommendations

could inadvertently chill innovation, both by SMS firms themselves, as well as by small firms and startups, whose venture capital may depend in part on their prospects of being acquired by an incumbent.

Moreover, in its current proposed form, the DMU could influence the activities of companies beyond those found to have market power. This could create major barriers to inter-platform competition — a key part of competition in platform markets, as platforms vie with each other to keep users within their ecosystem and attract new ones.[5] And, if it makes it harder for smaller firms to be acquired, it could reduce both the founding of, and investment in startups in the UK.

Because SMS firms will only be able to contest designations and the associated interventions via judicial review, there is also a bias in favour of intervention built in to the DMU's design. Lacking meaningful checks and balances, the DMU's mistakes could go uncorrected for years, further weakening innovation, competition, and startup formation in the UK to the detriment of consumers and the British economy itself.

All of these could combine to create significant unseen costs for British consumers, which go ignored and uncorrected even as they worsen consumer welfare and weaken competition and innovation in the markets the DMU is supposed to be working to improve.

Section 4 evaluates the Taskforce's proposed participative approach. We consider existing models of conduct-based regulation in the UK, finding that these precedents have generally had much narrower goals and remits than those of the DMU, and that they therefore constitute a poor template for the new regulator. Where existing conduct-based regulation has had a broader remit, such as with the Financial Conduct Authority, it has been criticised by firms as unclear and unpredictable and by other stakeholders as ineffective. We also consider in this section whether co-regulation—mixing statutory objectives with private governance—might best achieve the government's purpose for the DMU, given the need to optimise across many different margins and the difficulty of doing so from the top.

Section 5 concludes with high-level recommendations to help ensure that the DMU actually serves to promote competition and innovation in UK digital markets. Before moving forward, the government should focus the DMU on the CMA's core objective, which is to promote competition for the benefit of British consumers. And it should be clear that the codes of conduct it is charged with drafting and enforcing should be done only to promote competition, not to regulate the conduct of incumbents for the purpose of promoting other social goals that may conflict with the goal of promoting competition.

The government should also narrow the scope and extent of the DMU's powers so that it promotes competition in the specific markets in which it has determined a firm has "strategic market status", and does not grow

5 Nicolas Petit, Big Tech and the Digital Economy: The Moligopoly Scenario (2020).

into a bloated regulator of these companies' other activities in competitive markets, or of the wider economy wherever "digitalisation" is taking place. The DMU should be genuinely participative, allowing stakeholders to actively assist in decision-making instead of just offering advice. It should give special consideration to startups, and to the effects of its behaviour on entrepreneurs' and venture capitalists' incentives to start and fund a business. Finally, it should allow for appeals on the merits to allow the DMU to be held accountable by courts for its decisions.

1. Background

The government's announcement of a Digital Markets Unit came in the wake of several reviews into the performance of digital markets in the UK. Because the issues that they identified have informed plans to create a DMU, here we briefly review their findings. We then summarise recent interventions in other jurisdictions, notably the European Union and the United States, with similar aims to those of the proposed DMU.

Persistent dominance

In its report for HM Treasury, the Digital Competition Expert Panel, chaired by Professor Jason Furman (referred to below as the "Furman Review"), argued that particular economic features of digital markets, such as strong network effects and the central role of user data, were more likely to lead to 'persistent dominance and market power' than was the case in other markets.[6] The CMA's market study into online platforms funded by digital advertising added other features—economies of scale, the power of consumer defaults, unequal access to user data, and vertical integration—that 'inhibit entry and expansion by rivals and undermine effective competition'.[7] Official reports in other jurisdictions have also cited network effects and data, as well as 'extreme returns to scale', to argue that 'large incumbent digital players are very difficult to dislodge'.[8]

Evidence of consumer harm

Both the Furman Review and the CMA market study outlined several potential harms to consumers from limited competition in digital markets (Table 1). Because digital platforms typically charge a zero price to consumers, the reports often looked to measures other than prices as indirect evidence of consumer harm. The CMA cited Google and Facebook's dominant market shares and high 'excess' profit rates, as well as a finding that intermediaries capture over a third of the price charged for digital ads.[9] It also cited the increase in ads served to users on Facebook-owned platforms, although the impact of greater ad exposure on consumer welfare is ambiguous.[10]

6 Digital Competition Expert Panel, Unlocking digital competition: Report of the Digital Competition Expert Panel (2019), pp. 32-48.

7 CMA, Online platforms and digital advertising market study: Final report (2020), p. 11.

8 Jacques Crémer, Yves-Alexandre de Montjoye & Heike Schweitzer, Competition policy for the digital era, European Commission (2019), pp. 2-3.

9 Online platforms and digital advertising market study: Final report (2020), pp. 317 and 64-65.

10 Online platforms and digital advertising market study: Final report (2020), p. 313.

Table 1.
Harms to consumers from limited competition in digital markets

	Direct	Indirect
The Furman Review	– High prices for advertisers and lower returns for publishers – Abuse of user data – Lower service quality	– Pass-through of higher ad prices resulting in higher prices of goods and services to consumers – Reduced quality and choice in downstream services – Long-term reduction in innovation
CMA market study	– Reduced innovation – Lower quality – Limited control over user data	– Higher prices – Deterioration of quality/range of publisher content – Reduced innovation in new markets

A separate review by Dame Frances Cairncross considered the implications for journalism of the rapid consumer shift towards online publications.[11] It argued that digital platforms have taken on a powerful role in the market for news, and that the shift towards digital advertising had reduced revenues for traditional news publishers (reinforced by the CMA's finding that publishers capture 65 per cent of gross ad spend, with the rest going to intermediaries, including platforms).[12] The CMA also cited concerns that digital platforms are able to select what users see, and to glean valuable insight from their data.[13]

The case for a digital markets regulator

The Furman and Cairncross Reviews and the CMA market study all endorsed new interventions into digital markets, with a particular focus on addressing the market power of the largest platforms. The Furman Review called for a 'pro-competition digital markets unit, tasked with securing competition, innovation, and beneficial outcomes for consumers and businesses', in significant part through the adoption and enforcement of a code of conduct establishing 'acceptable norms of competitive conduct'.[14] Cairncross recommended establishing codes of conduct to govern the commercial arrangements between publishers and platforms in order to 'rebalance' their relationship. The CMA supported the Furman Review's proposal for a new regulator and recommended three high-level objectives that it should pursue with regard to dominant platforms: what it described as fair trading, open choices, and trust and transparency.[15]

11 Online platforms and digital advertising market study: Final report (2020), p. 274.

12 Frances Cairncross, The Cairncross Review: A sustainable future for journalism (2019), pp. 57 and 60.

13 Online platforms and digital advertising market study: Final report (2020), p. 319.

14 Unlocking digital competition: Report of the Digital Competition Expert Panel (2019), pp. 55 and 57.

15 Online platforms and digital advertising market study: Final report (2020), p. 23.

International developments

Around the time of the government's announcement, the European Commission published draft legislation for the regulation of what it calls 'gatekeeper platforms', with a significant impact on the EU's internal market.[16] In the US, the Federal Trade Commission, the Department of Justice, and groups of states have independently launched lawsuits against Google for monopolisation of its search engine and display advertising network, and against Facebook for anti-competitive acquisitions and access restrictions on its platform.[17] Staff of the Democratic majority on the House Judiciary Committee recommended regulation for large tech companies in their October 2020 report.[18] And, in February 2021, the Australian parliament passed legislation for a mandatory bargaining code between platforms and news media.[19]

16 European Commission, Proposal for a regulation of the European Parliament and of the Council on contestable and fair markets in the digital sector (Digital Markets Act), COM(2020) 842 final (15 December 2020).

17 John D. McKinnon, These are the US antitrust cases facing Google, Facebook and others, Wall Street Journal (17 December 2020), available at https://www.wsj.com/articles/these-are-the-u-s-antitrust-cases-facing-google-facebook-and-others-11608150564.

18 House Committee on the Judiciary, Investigation of Competition in Digital Markets (2020), available at https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf.

19 Treasury Laws Amendment (News Media and Digital Platforms Mandatory Bargaining Code) Bill 2021 passed both Houses on 25 February 2021.

2. The Digital Markets Unit

Following the Furman Review, the government convened a Digital Markets Taskforce to advise on the specific powers and decision-making structure of the Digital Markets Unit. The Taskforce, which published its findings in December 2020, was led by the CMA, with input from Ofcom, the Information Commissioner's Office (ICO) and the Financial Conduct Authority (FCA).

According to the Taskforce, the DMU's primary duty should be 'to further the interests of consumers and citizens in digital markets by promoting competition and innovation'. It should have the power to designate firms with strategic market status (SMS), a term the Taskforce has adopted from the Furman Review and defined as 'substantial, entrenched market power in at least one digital activity, providing the firm with a strategic position'.[20] Crucially, although the SMS designation may only arise from one activity or set of activities in which the firm was considered to have such market power (designated activities), the SMS status would apply to the firm as a whole. SMS designations would be reviewed every five years.

"Crucially, although the SMS designation may only arise from one activity or set of activities in which the firm was considered to have such market power (designated activities), the SMS status would apply to the firm as a whole."

As a result of designation, SMS firms would be subject to a bespoke code of conduct in relation to their designated activities. The DMU would draft and enforce the codes. It would also be empowered to introduce pro-competitive interventions (PCIs), such as data-related interventions, as well as interoperability and access obligations, to address the sources of SMS firms' market power.[21] In addition to its powers vis-à-vis SMS firms, the DMU would be given a broad supervisory mandate for digital markets, beyond SMS firms and activities.

20 Advice of the Digital Markets Taskforce (2020), p. 5.

21 Advice of the Digital Markets Taskforce (2020), p. 43.

3. Elusive goals and conflicting methods

The proposed DMU is meant to respond to a wide array of concerns about the impact of large digital platforms, from self-preferencing and publisher terms to data protection and user experience, to their longer-term effects on innovation and consumer choice. These are based on the findings of potential consumer harm outlined in Chapter 1, which the Taskforce thinks can only be addressed by giving the DMU an extensive range of powers.

But such broad authority runs the danger of turning the DMU into a barrier to competition and innovation instead of a positive force, especially in the absence of clear goals for the Unit, limits on its powers, and checks on errors and regulatory overreach. These guardrails appear to be lacking in the Taskforce's proposals; thus far, the government appears to have accepted the recommendations for these extensive new powers without careful scrutiny.

"lack of clear DMU objectives makes it difficult to determine whether a firm's conduct would be considered compliant"

Not knowing what success looks like

If the government follows the Taskforce's recommendations, the DMU would start life with significant powers, but little direction on what it is expected to achieve. This would not only make it more difficult for the new regulator to operate effectively, but it would also create uncertainty among digital firms about what was expected of them; lack of clear DMU objectives makes it difficult to determine whether a firm's conduct would be considered compliant. It would also complicate efforts to keep the DMU accountable, since courts, government, and Parliament would lack clear, objective standards against which to judge the DMU's decision-making.

This matters, because the proposed DMU is unlike existing regulatory bodies or other frameworks for *ex ante* regulation in an important respect: the breadth of its mission. Recent examples of *ex ante* regulation, such as the CMA retail banking market order and the Grocery Supply Code, have had relatively narrow and well-defined objectives—increased current account switching and a reduction in the risk to suppliers, respectively. Clear goals make it easier to measure performance and hold both regulated firms and the regulator itself accountable. Such clarity benefits all stakeholders by making compliance requirements more certain, and by allowing firms to undertake conduct with some confidence that it will not later be challenged or prohibited.

By contrast, the DMU's primary duty is to 'further the interests of consumers and citizens in digital markets by promoting competition and innovation'.[22]

22 Advice of the Digital Markets Taskforce (2020), p. 22.

First, this involves a broader set of success metrics than has been the case in the past. A duty to 'further the interests' of consumers could go beyond promoting consumer welfare, the statutory focus of UK competition policy and of the CMA.[23]

Including 'citizens' among DMU stakeholders suggests that even those not directly participating in digital markets would count. This implies that the DMU would be required to adjudicate in cases where conduct benefits consumers, but causes harm to other groups—for example, by laying off workers to improve efficiency and lower prices for consumers. How the DMU would weigh these interests against those of consumers and firms remains unclear.

Second, although SMS designation would be assigned on the basis of market power in relation to a specific activity or activities, it would apply to the entire firm. Activities in adjacent markets could fall within the scope (e.g., product changes in those non-designated markets could be prohibited) if they were considered to entrench the firm's position in the designated activities.

This would mean that a company with activities in many different sectors could be subject to regulatory oversight in *all* of those sectors, despite only being deemed to have 'strategic market status' in one of them. A designation limited in scope to one activity, such as Search, could in practice lead to regulation of many other activities done by the same company—such as the development of email or mapping software—if those were seen to strengthen its position in search, as well. Although this assessment is intended to take into account any potential customer benefits of changes in the non-designated activities, it is unclear how such balancing would be conducted by the DMU, particularly where there is a lack of clarity in its objectives. Despite appearing to be limited in scope, the current approach would therefore mean the DMU had quasi-regulatory powers over entire companies.

Third, *all* markets are digital to some extent, and many are rapidly becoming more so. Without a limiting principle on what qualifies as a 'digital market', the DMU's mission could encompass the entire economy, and end up with extensive, quasi-regulatory powers over sections of the economy that go well beyond the scope originally envisaged by Parliament, including groceries and other retail, entertainment and media, transport, and other sectors that may similarly become significantly 'digitalised' in the future.

Fourth, competition and — especially — innovation are inherently ambiguous. While clearly enhanced innovation is a desirable *outcome* of the CMA's work, it may be harder for the CMA to promote it consciously in an *ex ante* fashion.

23 Enterprise and Regulatory Reform Act 2013 s25(3): "The CMA must seek to promote competition, both within and outside the United Kingdom, for the benefit of consumers."

CONTRADICTORY GOALS

Even at a high level, the three objectives that the Taskforce proposes to set for the codes of conduct—fair trading, open choices, and trust and transparency—would inevitably clash in practice, both with each other and with the DMU's main objective to promote competition for the benefit of consumers.

For example, the 'trust and transparency' objective might dictate stricter consumer data protections, but this would likely favour incumbents and make it more difficult for challenger firms to break through. This effect has already been apparent with the EU's General Data Protection Regulation (GDPR), which in reducing data sharing also ended up "increasing market concentration among technology vendors that provide support services to websites."[24]

"the three objectives that the Taskforce proposes to set for the codes of conduct—fair trading, open choices, and trust and transparency—would inevitably clash in practice"

One recent working paper found that, between 2016 and 2019, the GDPR's introduction "induced the exit of about a third of available apps" on the Google Android Play Store, and "in the quarters following implementation, entry of new apps fell by over half.[25] As a barrier to user data, stricter data protections would also conflict with the desire to 'rebalance' publishers' relationships with platforms, since they would hinder publishers' ability to gain insights about users and serve them targeted ads.[26]

This problem could be particularly acute when different business models compete with one another on dimensions that make trade-offs in these areas, and/or cut across different objectives. For instance, iOS and Android devices compete in part by monetizing users in different ways: Apple's devices emphasise privacy but may end up being more expensive or less functional for users, whereas Android devices provide fewer default privacy protections but at lower prices and with better third-party app functionality (since, for example, it is easier for third-party apps to access things like user location data). Similarly, iOS devices can only load apps from the Apple App Store, whereas Android devices can carry third party app stores and apps installed by the user without going through an app store. Again, both of these decisions carry costs and benefits: Apple's devices may be more secure and provide a smoother experience for users than Android devices, and may provide higher revenues to Apple that encourage greater investment in other aspects of the product, but at a higher price and with reduced choice.

In both of these examples, the DMU's goals may be contradictory: promoting "trust and transparency" may militate against the Android approach to data to increase privacy, but at the cost of reduced choice

24 Garrett Johnson, Scott Shriver & Samuel Goldberg, Privacy & Market Concentration: Intended & Unintended Consequences of the GDPR (2021) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3477686.

25 Rebecca Janssen, Reinhold Kesler, Michael Kummer & Joel Waldfogel, GDPR and the Lost Generation of Innovative Apps (2021).

26 Online platforms and digital advertising market study: Final report (2020), pp. 318-319 and 347.

and competition; promotion of "open choices" may lead it to force Apple to adopt a more open approach to apps on iOS devices, reducing user choice and undermining a revenue stream that causes it to invest in iOS and iOS devices. In neither case is there an "optimal" business model or product design, nor do users clearly prefer one approach over another. This is not to say that any of the goals assigned to the DMU are in and of themselves undesirable, but that there is no indication how they will choose between goals that come into conflict -- a decision that is usually left to democratically elected politicians, rather than regulators.

The government-commissioned reviews that preceded the Taskforce report did not help to clarify matters. The Furman Review, for example, offered some detail on the types of interventions that might increase competition in digital markets, but it did not elaborate on how the DMU should manage the interests of its various stakeholders, nor did it consider in much detail what the costs and risks of its proposals might be. The CMA digital advertising market study, while endorsing the Furman Review's recommendation for a DMU 'tasked with securing competition, innovation, and beneficial outcomes for consumers and businesses' did not suggest ways to reconcile the distinct elements of this mission.[27]

The absence of a blueprint for how to deal with these trade-offs and conflicts is a fundamental problem, particularly when the proposed DMU will enjoy vast powers over a large and growing portion of the economy. This lack of clarity, and potential erratic and contradictory regulation, gives rise to significant economic costs in terms of lost innovation and distortions of inter-platform competition (as discussed further below). This also creates problems of accountability. The DMU will be able to set its own priorities and change these over time, write codes of conduct and interpret their application, and expand at its discretion the number of digital firms under its enhanced supervision. As shown below, given the DMU's broad remit across conflicting objectives, judicial review cannot resolve such concerns.

Practical implications of poor institutional design

It is difficult to anticipate all the practical ways in which lacking clear objectives alongside great powers could adversely affect UK digital markets. Below we sketch out some of the more obvious ones.

LOSS OF INNOVATION

SMS designations could become a barrier instead of a spur to innovation. In principle, subjecting firms with substantial market power to enhanced supervision and even codes of conduct could be pro-competitive. But it is highly likely to achieve the opposite if SMS firms are unclear about the outcomes that the DMU would like to see. Without a clear objective, such a regime would impose significant additional costs on firms without providing a positive influence on their conduct. It could end the system of

27 Unlocking digital competition: Report of the Digital Competition Expert Panel (2019) p. 13.

"permissionless innovation" that these companies currently operate in, and create a regime where they have to get permission in advance before they can innovate.

Similarly, there is a risk that the codes will just get things wrong, barring conduct that is beneficial by accident. Unlike decisions made by single firms, the DMU may impose similar provisions on many SMS firms, imposing the same "error" on all of them, and without the prospect of competition from another SMS firm to correct this.

"at a minimum, this framework would build in a box-checking bureaucracy to micromanage product changes in digital markets, leading to slower innovation and worsened outcomes for consumers."

For instance (as noted above), the Taskforce recommends a requirement for SMS firms to prove consumer benefit before making changes to *non*-designated activities, if the changes could further entrench the firm's position in its designated activities. This is a huge burden, and incompatible with how highly innovative technology companies typically work. Innovative firms rely on their ability to conduct repeated experiments through A/B testing to continually improve and/or develop new products. Imposing additional barriers to such changes, especially where this is based on vague and conflicting standards, is likely to push SMS firms to err on the side of caution when attempting to innovate.[28]

Consider a firm planning to integrate its non-designated user applications further with its designated operating system. By improving the user experience and enabling access to a wider range of services with less friction, such a change could well be pro-competitive. But it would also raise concerns among competitor firms in the non-designated market, which might see their future access to users threatened. Because of a potential clash with the fair access objective in the code, the SMS firm might abandon its plans, or face higher costs and delays in rolling them out, which consumers may bear. This could work backwards too. A firm with SMS in one market might ordinarily use that success to move into an even less competitive market, increasing competition in the adjacent market, but would be prevented from doing so by these provisions.

Far from a mere hypothetical, dilemmas of this kind are already starting to arise, as large technology firms look (for instance) at integrating their payments applications with their mobile operating software. These dilemmas would become more frequent once the firms were designated as having SMS. Moreover, the DMU could not easily resolve the uncertainty with guidance, given the range of stakeholders and the need to balance short-term competitive benefits with the potential long-term effects on innovation.

Thus, at a minimum, this framework would build in a box-checking bureaucracy to micromanage product changes in digital markets, leading to slower innovation and worsened outcomes for consumers. Worse still, without a clear sense of the tradeoffs and how to manage them, the current

28 See, eg., Adam D. Thierer, Embracing a Culture of Permissionless Innovation, Cato Institute (November 17 2014), available at https://www.cato.org/cato-online-forum/embracing-culture-permissionless-innovation

proposals would likely encourage a precautionary approach to innovation that would sacrifice beneficial new products altogether over the fear that those new products might be considered to increase SMS firms' market power.

CONSTRAINTS ON INTER-PLATFORM COMPETITION

The Taskforce devotes much of its advice to ensuring SMS firms will not use their market power in designated activities to weaken competition with non-SMS firms in non-designated activities. But a great deal of competition in digital markets involves competition *between* platforms, as each vies to make its ecosystem attractive to manufacturers, developers, and end-users by offering a growing range of services and functionality.[29] And this means that the prospect of entry into Market A by a firm with market power in Market B may constrain the power of firms already in Market A. For example, Amazon's shopping platform may be as likely, if not more likely, to face competitive constraints by Facebook's Marketplace and Instagram's Shop function than a wholly new or at least non-SMS player. Nearly 15 years ago, Microsoft's dominance of computer operating systems was significantly eroded by what were already then platforms of considerable scale—Google and Apple—when they released their own smartphone operating systems.

"a great deal of competition in digital markets involves competition between platforms as each vies to make its ecosystem attractive to manufacturers, developers, and end-users by offering a growing range of services and functionality."

Amazon, Google, Apple, and Netflix all compete with each other, and with other companies as well, in the video streaming market; Google and Facebook have faced new and rapidly-growing competition from Amazon in digital advertising that one analyst has speculated may now be as profitable for Amazon as its cloud computing service, AWS, is.[30] Facebook has entered the VR gaming market, competing with Valve, Microsoft, Sony, and others, as well as the online dating and second-hand goods markets.

All of these activities are in some way related to these firms' core products—Amazon's video streaming is bundled with Prime subscriptions and its advertising business is largely built on advertising on its marketplace, while Facebook's VR units require a Facebook account. And it is possible that the CMA considers products like these as entrenching these companies' positions in their SMS designated activities, even if they also *introduce* new competition to their markets. Anything an SMS firm does in other markets could conceivably be seen as entrenching its position in its home market, creating a risk that the SMS designation ends up being much broader than is currently suggested.

By raising the regulatory hurdles and uncertainty associated with entering and developing a new business, SMS platforms are likely to be more reluctant to enter such markets at all, including by acquisition. This could also have serious implications for startups hoping to be acquired in these markets. A platform hoping to enter the market for, say, online dating, and

29 Nicholas Petit, Big Tech and the Digital Economy: The Moligopoly Scenario (2020).

30 Benedict Evans, Does Amazon make more from ads than AWS? (14 March 2021), available at: (https://www.ben-evans.com/benedictevans/2021/3/14/do-amazon-ads-bring-in-more-cash-than-aws.

compete with current incumbents like Match Group may expect to do so by acquiring a smaller startup in that market and scaling it up. This creates an incentive for startups to enter that market even if they do not believe they can beat Match Group single-handedly. The loss of potential acquirers therefore reduces both competition *and* company formation in these markets, and so results in further (indirect) loss of innovation.

SMS firms' entry into new markets might also be constrained by other SMS firms seeking to protect 'their' turf. In this, they might be helped by non-SMS firms worried about the impact on their own ability to compete. We have recently seen this alliance of large and small incumbents in US banking, with both megabanks and small banks—their presence a legacy of decades of protectionist regulation—opposing the entry of big technology firms on the grounds that they are insufficiently regulated and would threaten financial stability.[31]

Far from promoting innovation, SMS designation could help incumbents large and small to entrench their position vis-à-vis entry by other SMS firms into new activities by providing a mechanism for hindering or even blocking such entry. Both types of firms would oppose expansion, even when it was likely to benefit consumers. And given the lack of clear vision for what sort of competition the DMU is aiming for, the DMU might often find it easier to agree with them.

THE RATCHET OF SMS DESIGNATION

The Taskforce recommends that SMS designations be reviewed every five years, but it does not offer any clear vision of facilitating markets in which SMS designation can be gradually removed. In the absence of clear end-goals, the status could become a ratchet, capturing ever more firms, yet with few firms losing their designation over time. This would catch more and more businesses in the net of regulation, with the harms to innovation which that implies.

There are several reasons for this. The DMU might lack the confidence to remove SMS designation in the face of uncertain benefits and costs. This is likely to be exacerbated by rival non-SMS firms aggressively arguing against removal, as would SMS firms in other activities for fear of an unlevel playing field. All this would reinforce a status quo bias to maintain existing designations, even as the DMU proceeded with new designations. And there is no guarantee that the DMU will remove interventions as swiftly as it says it will introduce them, allowing interventions that are now causing harm to persist over time.

How much this 'ratchet effect' could harm innovation is uncertain. It might be argued that SMS firms whose strategic position and market power is diminished would tend to be in structural decline, with little ability to innovate regardless of whether they lost their SMS designation. On the other hand, there have been examples of technology firms that experienced long-term decline for several years, only to rebound with

31 Dan Murphy, Big Tech's invasion of banking, Milken Institute Review (26 April 2019).

completely new product offerings. IBM went from dominating computer hardware to focusing mainly on software. Apple saw its share of computer operating systems dwindle for years until it became a market leader in handheld devices. And Microsoft, having been sidelined by the growth of smartphones, is now a major player in cloud computing. How they might have fared in a world of SMS designations is an open question, but it is fair to assume that SMS designation would have impaired their ability to innovate in other areas.

In addition to the deleterious effect on firms, the ratchet effect would make it difficult to check the growth and scope of the DMU itself, as it would be difficult to deny it more resources and powers as the number of firms and activities under its watch increased.

JUDICIAL REVIEW STANDARD AND THE DIFFICULTY OF CORRECTING MISTAKES

These practical concerns are compounded by the lack of effective checks on the DMU's exercise of its extensive powers. The Taskforce suggests that the DMU's decisions should be subject to judicial review, but this will provide minimal oversight regarding the DMU's actions.

Judicial review permits appeals on only very limited grounds (illegality, procedural unfairness, and/or irrationality), with no option for a review of the merits of the case. This sets a very high bar for appellants to meet. In practice, it leads to significant deference to the regulator (as demonstrated, for example, by the Competition Appeals Tribunal's (CAT) approach to judicial reviews of the CMA's merger decisions).

These narrow grounds are acceptable in the context of the CMA's merger and market investigation decisions, however, because the CMA operates under a particularly protective 'doubly independent' process in its initial decision-making. This 'double independence' is provided by: (i) the CMA itself as an independent body; and (ii) a two-phase review process where the Phase 2 panel of decision-makers is not involved in the Phase 1 review and therefore come to the inquiry with an open mind.

In contrast, there is no such two-phase process for the DMU, and therefore there is no one interrogating the DMU's decision-making. Despite this crucial difference, it is unlikely that the CAT would take a radically different approach to the DMU's decision-making where it is able only to judicially review cases.

This is likely to be a particular problem where, as discussed above, the DMU's objectives are unclear or in tension with each other. The lack of clear objective(s), or specific guidance on how the DMU is supposed to weigh competing priorities, weakens the already-limited grounds of judicial review. There is no bar to the DMU choosing among its many potential objectives to justify different decisions, even when these could be based on wholly inconsistent approaches (e.g. prioritising privacy over open choices in one case, but prioritising the latter over the former in a subsequent case)

or could result in contradictory outcomes.[32]

Without a common understanding of what the DMU is seeking to achieve, and how it is supposed to balance divergent interests of different stakeholder groups, it is difficult to see how well-founded appeals on the basis of irrationality or illegality could succeed. Instead, the deference accorded to the regulator is likely to be even greater when its purpose is so broadly defined, reinforcing the DMU's unprecedented level of discretion.

"For example, even if a deal had a 90 per cent chance of being pro-competitive, the remaining 10 per cent could still be deemed as being "greater than fanciful" and, under these proposals, be blocked."

MERGERS AND ACQUISITIONS

The CMA has also proposed to lower the burden of proof required to intervene in mergers and acquisitions done by SMS firms. Currently, it uses a "balance of probabilities" standard, which means it will block acquisitions its panel sees as having a greater than 50 per cent chance that the acquisition will lead to a substantial lessening of competition (SLC). It has proposed to move to a "realistic prospect" standard for mergers involving firms designated as having Strategic Market Status.[33] The CMA describes this as a "greater than fanciful" chance of an SLC.

This is, obviously, a much lower standard, and in many cases it would effectively ban SMS firms from acquiring smaller companies. For example, even if a deal had a 90 per cent chance of being pro-competitive, the remaining 10 per cent could still be deemed as being "greater than fanciful" and, under these proposals, be blocked.

This goes further than the Furman review, which proposed a "balance of harms" standard of proof for acquisitions involving SMS firms. Under that system, the CMA would weigh the probability of an SLC occurring by the magnitude of the potential lessening – so mergers with a lower than 50% probability of reducing competition, but with a very high reduction in competition if the reduction did occur, could be blocked. The CMA rejected these proposals as being too difficult to feasibly implement, given the amount of guesswork and predictions that merger review involves.

These proposals are troubling for several reasons.

One, they may constrain inter-platform competition by slowing or stopping platforms from extending their operations into adjacent markets by acquiring and building up a smaller firm already present in this market. Google's purchase of Android helped it build a competitor to Apple's iPhone; Apple's acquisition of Beats helped it build Apple Music, which competes with Spotify and YouTube. Most recently, Google bought Fitbit to compete with Apple on smartwatches. Smaller acquisitions have enabled entry and increased competition in cloud computing and video streaming, too.

32 Geoffrey A. Manne, Dirk Auer, Sam Bowman, Should ASEAN Antitrust Laws Emulate European Competition Policy?, Singapore Economic Review (2021), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3709730.

33 Advice of the Digital Markets Taskforce (2020), Appendix F, paragraph 113.

Even if these deals increased competition, they may still have created a "greater than fanciful" possibility that they could do the opposite. Under the proposals, even a deal with a high chance of improving competition should be blocked if there is a small risk that it might reduce competition. The goal should be to encourage deals that are likely to promote competition, not block them because of a remote chance that they do not.

Second, startups depend on acquisitions. Along with an initial public offering, being bought is the main way entrepreneurs and venture capital investors can "exit" the firms they have built. The harder it is to sell your company, the harder it is to make a return. Fifty per cent of US start-up executives said that being acquired was a long-term goal, and 90 per cent of US start-up exits in 2008-18 happened thanks to acquisitions.[34]

"The CMA dismisses the risks of over-enforcement, spending just 150 words in its 15,000-word proposal on it."

Some empirical evidence suggests investment in start-ups is sensitive to rules governing acquisitions. One working paper found venture capital activity grows by about 40-50 per cent in countries that enact pro-takeover laws, and US states that introduced anti-takeover laws saw a 27 per cent decline in VC investment deals compared with those that did not.[35]

Some founders in the UK have already complained that the existing rules hurt them.[36] And if the US does not follow the CMA, many start-ups may simply set up there instead of in Britain.

The CMA dismisses the risks of over-enforcement, spending just 150 words in its 15,000-word proposal on it. But it is already taking a more aggressive stance on M&A. Since the start of 2019, 81 per cent of deals it has referred for in-depth scrutiny have been blocked, abandoned or required remedies, compared with some 50 per cent between 2003 and 2017.[37]

Finally, the proposals would give excessive discretionary power to the CMA. By reducing the burden to such a low standard, the CMA would effectively have unlimited power to block acquisitions by SMS platforms. If it did not use this power to effectively block all mergers they did, which itself would be problematic, it would end up making decisions capriciously, undermining the rule of law and giving CMA officials an immense discretionary power over private businesses.

EFFECTS ON THE WIDER ECONOMY

Although the DMU's powers have been proposed to relate only to SMS

34 Engine, The State of the Startup Ecosystem (2021), available at: https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/60819983b7f8be1a2a99972d/1619106194054/The+State+of+the+Startup+Ecosystem.pdf

35 Gordon M. Phillips, Alexei Zhdanov, Venture Capital Investments, Mergers and Competition Laws around the World (2017), p. 33. available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3072665

36 Matthew Ahston, Is CMA watchdog savaging tiny tech start-ups?, The Times (11 April 2021), available at: https://www.thetimes.co.uk/article/is-cma-watchdog-savaging-tiny-tech-start-ups-qv7xmvvl8

37 Platypus: UK Merger Control Analysis, available at: https://www.linklaters.com/en/insights/publications/platypus/platypus-uk-merger-control-analysis/

firms, they may have more far-reaching effects than this. As described above, acquisitions by incumbents are an important way startups can deliver a return to their founders and investors. Decisions made by the DMU that rule out certain kinds of conduct by incumbents could thus effectively prohibit startups from engaging in that conduct too, by making it impossible for them to be acquired by an SMS firm prohibited from using their product. For example, a data analytics startup that legally used user data in a way that was prohibited by DMU codes of conduct could find that it could not be bought by any SMS firm, since the SMS firm would not be allowed to use it.

This effect could be felt more broadly if SMS firms found that, in practice, it was difficult to prove that design changes benefitted users (and hence found that they were barred from making such changes), and acquisitions that would involve those changes were prohibited.

Firms that have not yet been given SMS status may respond to the unequal regulatory environment in two ways. One, they may engage in what is effectively regulatory arbitrage, taking advantage of a relatively less restrictive regulatory setup. Or two, in expectation of future SMS status or acquisition by an SMS firm they may adopt conduct that complies with a code of conduct that does not yet affect them. There are risks to either approach: the first could distort the market towards less efficient firms that have adjusted their business models or conduct to avoid SMS designation, while the second could cause what are intended to be narrow codes of conduct to apply to much larger swathes of the economy that are "future proofing" their business models against expected future regulation. These distortions are risks that the Digital Markets Taskforce does not seem to have considered in its proposals.

WILL CONSUMERS BENEFIT?

Ultimately, everything the DMU does should have the goal of improving consumer welfare. But without clear measures of success, there is also no way to measure whether the codes of conduct (or other interventions) have, in fact, made consumers any better off; and hence, there is no way to test the success of the DMU. Even with clear objectives, the unseen costs of bad decisions by the DMU may be significant, especially with no mechanism put in place to identify and correct them.

Many of the dangers discussed above carry unseen costs of these kinds. If startups being unable to sell to SMS platforms leads to lower investment in them, it may be a slow and invisible effect that cannot easily be separated from other trends in the economy. Reduced inter-platform competition, or innovation by SMS firms, may similarly be difficult to measure, especially if other major jurisdictions like the EU adopt similar policies that mean these innovations do not happen at all, and not that they just do not reach UK consumers.

And given the tensions between the DMU's objectives, and the Codes of Conduct that have been proposed so far, all of which involve trade-offs and no clear measures of success, it will be extremely challenging to measure

whether any intervention is better for consumers than the counterfactual. And it will be virtually impossible to predict all the second-order effects on consumers from disrupting one side of a multi-sided market.

Publisher remuneration, which the Taskforce proposes to 'rebalance' via a standalone principle under the fair trading objective, demonstrates why seemingly pro-consumer initiatives can end up serving to support incumbent producers. More remuneration for publishers may mean higher prices for advertisers, rather than lower returns for intermediaries — higher prices that the CMA believes would feed through to higher product prices for consumers.

And given higher payments thanks to the DMU, publishers might keep just keep the extra money for themselves, instead of passing them on to users through lower prices or improved content. Furthermore, because the most powerful and influential publishers are also the largest incumbents, it is not clear that the DMU will lead to a more dynamic market for news content that encourages entry (a concern Dame Frances Cairncross voiced in her review).[38]

Thus, as an example, under the Taskforce's current proposals, SMS firms may be required to pay more to certain large publishers, nominally on the basis of the 'fair trading' principle, without any requirement or evidence that such additional payments lead to better consumer outcomes.

It is not even clear how the efficacy of such a measure would be evaluated or how the DMU would be held accountable: surely it cannot be sufficient that the SMS firms have simply been required to hand over more money to publishers (regardless of the impact on consumers)? Yet without any articulated vision of what consumer outcome the codes of conduct are intended to achieve, it is impossible to evaluate whether these interventions are working or not. As discussed below, these raise the risk of the CMA becoming more politicised and potentially a vehicle for rent-seeking by incumbents.

These sorts of problem may be insurmountable in the complex multi-sided markets the DMU is being tasked with regulating. Stronger bargaining power for Uber or Deliveroo drivers may mean higher prices for customers of those services. Card networks that charge higher prices to merchants may nevertheless be improving competition on the consumer side through rewards and other incentives, as was the conclusion of the *Ohio v. Amex* case. To imagine that the DMU can know the optimal arrangements in each of these markets, and then effectively impose them via Codes of Conduct without creating other harms, is likely to be over-optimistic. And when it gets things wrong, it is consumers who will suffer — with no clear way of fixing things.

38 The Cairncross Review (2019), p. 74.

4. A 'participative approach' is no panacea

So far, we have outlined some major concerns that the DMU could not effectively discharge its duty to promote competition and innovation, given its broad remit and the lack of real accountability and clarity for market participants. In recommending that the DMU take a 'participative approach' to regulation, the Taskforce perhaps seeks to mitigate some of these shortcomings by vowing that the new regulator will 'engage all stakeholders' in its decision-making, providing a check on overreach.[39] The Taskforce cites Professor Jean Tirole's definition of participative regulation, whereby industry proposes possible regulations and the regulator issues an opinion, creating legal certainty without statutory rules.[40]

But the Taskforce's advice offers little in the way of a participative decision-making structure beyond recommending that the DMU consult widely as it assesses firms for SMS designation and drafts the applicable codes of conduct. It is doubtful that the interests of all relevant 'stakeholders' will be represented: the consultation process would give the loudest voices to existing businesses and interest groups, but comparably little to startups, especially those that do not yet exist. This means that innovative new firms—perhaps the most important parties in digital markets, other than consumers themselves—may be left out of the process altogether. And participative approaches still need tractable procedures to ensure outcomes match intentions. It is meaningless to talk about "input from stakeholders" if there isn't even a clear (and reviewable) obligation for the DMU to follow some sort of process in doing so.

"It is possible that special interest groups may overwhelm DMU consultations with responses. This may put the unit in a difficult position where it must decide on a politically popular position, under pressure from government and vocal public groups, that is nonetheless anticompetitive in effect"

A greater reliance on 'participative approaches' may also increase the propensity of the DMU to become captured or unduly influenced by interest groups, whether representing the interests of certain companies (either SMS firms or their competitors) or campaign groups. It is possible that special interest groups may overwhelm DMU consultations with responses. This may put the unit in a difficult position where it must decide on a politically popular position, under pressure from government and vocal public groups, that is nonetheless anticompetitive in effect—for example, over unduly restrictive rules on firms' use of user data, rules about the treatment of small business suppliers that would lead to higher prices for consumers, or regulation of the relationship between news publishers and digital platforms, where the outsized influence that news publishers have on political debate gives them outsized influence over the DMU's decision-making. The CMA has an impressive record of political independence, and changes that risk that independence should be treated with extreme caution.

And while there are several examples of conduct-based regulation in the UK, they materially differ from the DMU in their scope, powers, and

39 Advice of the Digital Markets Taskforce (2020), p. 48.

40 Allison Schrager, A Nobel-winning economist's guide to taming tech monopolies, Quartz (27 June 2018), available at https://qz.com/1310266/nobel-winning-economist-jean-tirole-on-how-to-regulate-tech-monopolies/.

approach, and thus are unlikely to provide useful precedents. It is therefore unlikely that a 'participative approach' in the Taskforce's limited sense could meaningfully address the concerns we have raised.

Differences from existing code of conduct approaches

The increasing popularity of principles-based codes of conduct is based on the belief that such an approach is both more flexible and more likely to elicit good behaviour than either prescriptive regulation, self-regulation, or no regulation. Principles-based regulation can also be more participative than prescriptive regulation, as firms theoretically have greater scope for making changes to their products and operating structures, as long as they abide by the principles, than may be the case under most prescriptive regimes. Such 'participation' is also seen as resolving a crucial tension between the ability to make significant interventions and the need for appropriate checks and balances. Here, we consider two notable examples of code of conduct approaches from the UK. We look at their history, their performance to date, and compare them with the DMU as proposed by the Taskforce.

Table 2. Summary of conduct-based regulators and their structure

Name	Goal(s)	Remit	Powers	Accountability	Criticism
GCA	– Rebalance the relationship between large grocery retailers and their suppliers	– Largest UK grocery retailers	– Grocery Code of Supply enforcement (but not ownership or amendments)	– Annual surveys of retailers and suppliers	– The largest global suppliers have increased their leverage over UK retailers
FCA	– Address asymmetric information between financial firms and their customers	– Financial firms covered by the FSMA, the CCA and certain EU directives	– Authorisation and supervision – Design and enforcement of employee codes of conduct – Competition mandate – Market reviews	– Perimeter reviews – Ad hoc commissions and reviews	– Insufficient attention to regulatory arbitrage. – Regulatory creep

THE GROCERIES CODE ADJUDICATOR

In 2008, the Competition Commission (CC) found that grocery retailers were transferring 'excessive risk and unexpected costs' to their suppliers, principally through retrospective adjustments to the terms of supply. The CC believed that, if left unchecked, these practices would have 'an adverse effect on investment and innovation' in this market, and ultimately on consumers.[41] As a remedy, the CC proposed a Groceries Supply Code of Practice to cover grocery retailers with turnover above £1 billion. The code included an overarching fair-dealing provision, as well as specific bans on retrospective adjustments and other practices deemed harmful.[42]

As of July 2020, the 13 largest UK grocery retailers were subject to the Groceries Code, up from 10 when the GCA was created.[43] While the CMA—the CC's successor body—retains ownership of the Groceries Code itself, the Groceries Code Adjudicator (GCA) has since 2013 been in charge of issuing guidance, investigating Code breaches, and arbitrating disputes over the Code between retailers and suppliers. While both retailers and suppliers may raise disputes for GCA arbitration, suppliers enjoy enhanced protections and guarantees for compensation relative to those offered to retailers.[44]

41 Competition Commission, The supply of groceries in the UK market investigation, final report (2010), p. 6 and 12.

42 The supply of groceries in the UK market investigation, final report (2010), pp. 14-15.

43 Department for Business, Energy, and Industrial Strategy, Statutory Review of the Groceries Code Adjudicator: 2016-2019 (2019), pp. 28-29.

44 Statutory Review of the Groceries Code Adjudicator: 2016-2019 (2019), p. 10.

The GCA has had a positive impact on supplier-retailer relationships, according to the two statutory reviews conducted since its creation. Specifically, these reviews credited the GCA with improving retailer compliance with the Groceries Code, changing retailer practices and creating 'a strong culture of collaboration' between retailers and suppliers.[45] Both groups reported broadly positive opinions of the GCA's performance to date. On the negative side, some retailers report that the Grocery Code has weakened their negotiating hand with the largest global suppliers—which, while not the focus of the CC's order, have also benefited from its protections.

COMPARISON WITH THE DMU

Unlike the proposed DMU, the GCA's enforcement remit is clearly circumscribed to the largest grocery retailers in the UK. The GCA's objective is to address specific practices adopted by certain grocery retailers in relation to their suppliers. Any other concerns—whether about innovation or new entry at any point of the value chain, grocery retail prices or promotions, use or sharing of consumer data, food safety or quality—are beyond its scope. Furthermore, the Grocery Code remains in the hands of the CMA, leaving only its interpretation, administration, and enforcement to the GCA.

In contrast, the set of practices that the Taskforce would like the DMU to address or preempt is much broader and more complex (given the various business models, markets, stakeholders, and trade-offs involved) than those the GCA is charged with policing. The DMU would also enjoy broad discretion over the activity-specific codes of conduct it would impose on SMS firms and how these would be enforced. It is also worth noting that the Grocery Code, even with its limited scope, is not universally seen to have achieved its aim. Retailers have expressed concerns that the Grocery Code increased the bargaining strength of already powerful suppliers—an issue that has parallels with the questions raised earlier around publisher-platform bargaining.

THE FCA'S PRINCIPLES FOR BUSINESS

Since its creation in 2013, the Financial Conduct Authority has operated a principles-based model of regulation. The FCA has particularly sought to mitigate the negative consequences of asymmetric information for the relationship between financial firms and their customers. Its Principles for Business reflect this ethos, emphasising fairness, trust, and transparency, as well as financial prudence.[46] Derived from these Principles are codes of conduct for employees and senior managers of FCA-regulated firms, which in each case involve a small number of broad rules. There are potentially stiff financial and other penalties for violations of these rules, although few individuals have so far been disciplined.

While the FCA covers a wide range of financial instruments and activities

45 Statutory Review of the Groceries Code Adjudicator: 2016-2019 (2019), p. 15.

46 Financial Conduct Authority, FCA Handbook, High Level Standards, PRIN 2.1.

and enjoys expansive powers over them, its 'regulatory perimeter' is limited by statute, principally the Financial Services and Markets Act (FSMA), the Consumer Credit Act (CCA), and regulations transposed from EU directives on payments, money laundering, and other areas.[47] The Digital Markets Taskforce recommended that the FCA be granted SMS designation and code of conduct-writing powers for the activities it regulates, although it proposed that the DMU remain the primary SMS regulator.[48]

Despite its broad remit, the FCA has regularly been the target of criticism regarding supposed inaction against unregulated activities by regulated firms that led to consumer losses.[49] These criticisms have led to a steady expansion of the FCA's perimeter to new types of firms and financial products. But the FCA has also earned praise in the UK and abroad for combining effective regulation of a major global financial market with the promotion of competition. Notably, the FCA pioneered the concept of a regulatory 'sandbox' for financial startups, which the Taskforce recommends be included in the DMU's toolkit.[50]

COMPARISON WITH THE DMU

Unlike digital markets, the ones that the FCA regulates have long been characterised by statutory restrictions on entry and extensive prudential rules aimed at maintaining financial stability. Other government interventions, such as the Financial Services Compensation Scheme, mean that public authorities have a direct interest in constraining the actions of financial institutions lest moral hazard drive them to pursue excessive risks.[51] While the FCA's perimeter is broad, it has not prevented criticism for negligence with regard to abuses happening immediately outside its perimeter. The FCA is also an unusually large and powerful regulator, compared both with other UK agencies and with its international counterparts, and it continues to grow.

The conflict between interim measures and a participative approach

The DMU's proposed institutional design faces a difficult dilemma between incorporating checks and balances commensurate with its extensive powers, and allowing it to act quickly when needed. The Taskforce proposes to resolve this dilemma by combining a 'participative approach that can deliver fast and effective resolution' with 'formal enforcement where necessary', including through interim measures. But this assumes that affected parties—in particular SMS firms, with the threat (or actual cost) of interim measures hanging over them—will, in fact, seek to resolve issues quickly.

47 Financial Conduct Authority, Perimeter Report 2019/2020 (2020), pp. 5-6.

48 Advice of the Digital Markets Taskforce (2020), pp. 77-78.

49 See Financial Conduct Authority, Independent investigation into London Capital & Finance (17 December 2020).

50 Advice of the Digital Markets Taskforce (2020), pp. 67-68.

51 Though whether or not this approach succeeds in reducing risk is debatable.

There are two problems with this assumption. First, it is far from clear that SMS firms will necessarily seek to 'settle' an issue quickly—particularly where fundamental issues of product design or business models could be at stake, given the wide-ranging scope of the code proposals. Changes could require a UK-specific product redesign, or even alterations to the product internationally where it is not possible to create a country-specific version of the product. It seems implausible that Amazon, for example, would simply agree to changing a core aspect of its product in the UK or worldwide due to a dispute over the application of a broad principle of the code.

"It is far from clear that SMS firms will necessarily seek to 'settle' an issue quickly—particularly where fundamental issues of product design or business models could be at stake, given the wide-ranging scope of the code proposals."

The 'quick resolution' model doesn't seem to be borne out to date by the approach of large digital firms likely to be designated SMS. One illustration is the protracted antitrust litigation in the EU (although interim measures have not featured in European Commission investigations until recently). It is likely that SMS firms' willingness to settle quickly will depend on the type of issue in question: whether it is relatively isolated and straightforward or a broader principle of interpretation on which firms will not want to concede, due to its far-reaching implications.

INTERIM MEASURES, INNOVATION AND INTER-PLATFORM COMPETITION

In the latter case, the 'stick' of interim measures will be needed, which itself creates a problem. The Taskforce suggests that the DMU should have the same powers for interim measures as it would have for any final order—enabling a great deal of intervention before any breach of the code has even been demonstrated. This seems unduly prejudicial to SMS firms in circumstances where: (i) the code principles themselves are deliberately high-level in order to ensure flexibility; and (ii) as acknowledged by the Taskforce, these are fast-moving markets where interventions could cause the SMS firm significant harm during the interim period.

This interim harm would be aggravated if the codes were to create an uneven playing field between SMS firms if one firm were subject to a more burdensome set of provisions than another. For example, if Google were subject to an interim measure preventing it from integrating a certain feature into YouTube for a year while a code dispute was pending, but Facebook was able to make similar developments to Instagram's video-sharing capabilities, Google might find itself significantly disadvantaged even if the code dispute was eventually resolved in Google's favour. In such circumstances, the interim measures could distort inter-platform competition by unduly hampering one firm's ability to compete and effectively picking winners between the SMS firms.

Although the Taskforce proposals set out some safeguards to minimise the potential harm that can arise in the interim period,[52] they focus more on the need for the DMU to act quickly. It is not clear that sufficient consideration has been given to the potential harm to the SMS firm from imposing interim measures. For example, the Taskforce draws an analogy

52 Advice of the Digital Markets Taskforce (2020), Appendix C, paragraph 168 et seq.

to the interim orders used in the CMA's merger regime,[53] but this is an inappropriate comparator. Initial enforcement orders in a merger are intended to keep the merging parties separate and to ensure they carry on with their business-as-usual operations as if the merger was not proceeding (i.e. to prevent any difficulties in unwinding the transaction if necessary). In contrast, interim measures under the Taskforce proposals may be used to prevent the introduction of or changes to a firm's product as part of the firm's business-as-usual activities. The latter context is wholly different and potentially much more damaging to the SMS firm and competition more broadly.

Given these concerns, the suggested 'participative approach' is far from resolving any concerns regarding appropriate checks and balances on the DMU's extensive powers.

CO-REGULATION: A MORE FLEXIBLE ALTERNATIVE?

Instead, a model that may come closer to what Professor Tirole described and that would appear compatible with the Taskforce's recommendations is co-regulation, i.e., a mixture of self-regulation and statutory regulation that can 'combine the flexibility of self-regulation and the binding nature of legislation'.[54] By taking advantage of regulated firms' on-the-ground knowledge, co-regulation can lead to better regulatory outcomes and improved compliance, while guarding against regulatory capture thanks to the statutory element.[55]

A good example of this model is the legal sector, where the UK implemented co-regulation in the form of the statutory Legal Services Board, created in 2007 by the Legal Services Act. A key goal of this Act was to replace full self-regulation with a flexible statutory framework that would promote competition and innovation in legal business structures, while retaining statutory government oversight. The Board oversees nine self-regulatory bodies (such as the Bar Standards Board and the Solicitors Regulation Authority) that are formally part of, but functionally separate from, the professional associations representing the different legal professions. The Board oversees the content of self-regulatory codes, while a separate Legal Services Ombudsman adjudicates disputes between individual clients and legal professionals. Additionally, a Legal Services Consumer Panel ensures that the consumer voice is represented in policy discussion and decision-making.

Like the proposed Taskforce, the Board is charged with promoting various regulatory objectives which may sometimes conflict with each other—such as to protect and promote the interests of consumers, to improve access to justice, and to promote competition in legal services provision. However,

53 Advice of the Digital Markets Taskforce (2020), Appendix C, paragraph 174.

54 Ian Bartle & Peter Vass, Self-regulation and the regulatory state: a survey of policy and practice, Center for the Study of Regulated Industries Research Report 17 (2005), p. 13.

55 Kate McEntaggart, Julien Etienne, & Jennifer Uddin, Designing self- and co-regulation initiatives: evidence on best practices, BEIS Research Paper Number 2019/025, Department for Business, Energy and Industrial Strategy (2015), pp. 11-13.

the Board is better able to manage and provide transparency as to the trade-offs between these objectives through the co-regulatory structure. Co-regulation allows for a much more meaningful involvement of stakeholders through a process of open consultation, by allowing each of the relevant bodies to develop their self-regulatory codes (provided that these are in keeping with the pursuit of the overarching regulatory objectives), and by publishing reasoned decisions.

To date, the Board has exercised its powers through the mandatory review of any changes to self-regulatory codes, and the publication of regular reports on Regulatory Performance and the state of the market, without using or threatening to use any disciplining mechanism (i.e. assuming direct control).[56]

A recent review by the Competition and Markets Authority of the UK legal services sector found that regulation was working reasonably well, but that change in the sector was slower than expected.[57] While it is hard to tell whether the slow pace of change is a result of the regulatory structure itself, or the nature of the market and its participants, the Board very rarely misses the 28-day target for reviewing regulatory changes. This suggests that the regulatory process itself may be sufficiently nimble for faster moving digital markets.

COMPARISON WITH THE DMU

Like the Legal Services Board at the time of its creation, the DMU's starting point will be largely self-regulated markets. Proponents of the DMU have identified some of the problems they would like the new agency to address, but they have as yet done little to explain how the DMU should manage competing objectives and trade-offs. Given the uncertainty around how to operationalise the DMU's promise of participative regulation, the Board's co-regulatory model may offer a valuable precedent.

How might co-regulation work in digital markets? One approach would be to give firms greater scope for drafting their code of conduct, subject to the objectives defined in statute. The DMU's role then would be to supervise the drafting process, to mediate disagreements between SMS firms and their stakeholders, and to intervene where compliance with the codes was found to be poor or the codes themselves inadequate.

To mitigate the tendency for an SMS 'ratchet', designation could be separated from supervision, as with the Groceries Code Adjudicator. For example, an independent department or committee within the CMA could consult with stakeholders about the criteria and priorities for designation, publish them in advance, and formally give designation to SMS firms. The DMU would come in only after designation.

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56 Edward J. Balleisen & Marc Eisner, The promise and pitfalls of co-regulation: how governments can draw on private governance for public purpose, in New perspectives on regulation, Cambridge MA: The Tobin Project (2009), p. 129.

57 CMA, Review of the legal services market study in England and Wales (17 December 2020), pp. 7-8.

This approach would still not solve many of the problems outlined above, however — most fundamentally the risk of erroneous prohibitions of behaviour that is, in fact, procompetitive, with no way of identifying these occasions or correcting these errors.

5. Making the DMU a useful addition to competition policy

The Digital Markets Unit as proposed by the Taskforce risks undermining competition in digital markets and the political independence of the CMA, and has an essentially unlimited mandate that may frequently contradict the CMA's statutory objective of promoting competition for the benefit of consumers. It has excessively broad goals, which will in practice lead it to make subjective judgements about the benefits of contradictory objectives. And yet, this discretion comes with far less oversight than normal CMA processes.

Little thought has been given to how the proposals will affect the UK's startup environment, or to the wider economy, of creating a de facto regulator of firms in "digital markets", as more and more sectors evolve to become "digitalised".

It is not unusual for a regulator to want to have new powers for itself, and to want to be able to use those powers with little oversight or constraints. It is the government's job to think twice about the costs of giving those powers over. If the government goes ahead with setting up the Digital Markets Unit as it is currently proposed, it could mitigate some of the risks described in this paper with the following measures:

1. **Impose a clear competition and consumer welfare goal on all of the DMU's activities**, in line with the CMA's statutory goals., This would ensure that interventions and the rules it sets are justified in terms of increasing competition for the benefit of consumers, and not other goals, such as increasing privacy at the expense of competition or improving payments to suppliers at the expense of consumers. Every aspect of the codes of conduct should be justifiable in terms of enhancing competition, not as a form of regulation designed to emulate outcomes that the DMU imagines would happen in a more competitive market.

2. **Remove the requirement that the DMU must approve product design changes in SMS activities**, which will hold back innovation in these activities and put the DMU in an inappropriate position of having to make subjective judgements about product changes without evidence about the effects of those changes. Instead, review significant changes that may raise competition concerns after a period of real-world use, and require that the company involved collects and shares relevant data and other information to enable the DMU to review for the competition effects it has.

3. **Limit the scope of all DMU powers to the specific activity designated as giving rise to SMS**, not to any wider activities by the firm involved. This would mean the codes of conduct, pro-competitive interventions, and limits on mergers and acquisitions

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would be limited and would limit some of the regulatory creep that could otherwise lead to narrow designations of Strategic Market Status, causing entire companies to become regulated by the DMU.

4. **Allow full appeals to the Competition Appeals Tribunals, on the merits of the case, not just on points of law**. The codes of conduct and other SMS powers give the CMA significant and novel power over important sections of the economy, and there should be some checks and balances over the content of its decisions. A co-regulatory approach that allowed SMS firms and other stakeholders to participate in code-writing might help to reduce the firms' reliance on appeals. In addition, to minimise the risk of companies using legal challenges to simply slow down decision- making, the government should review the CMA and CAT's case management processes in order to speed up decisions, as recommended by John Penrose MP's *Power To the People* report.[58]

5. **Include sunset clauses in all SMS designations and DMU interventions** as standard, so that the DMU has to re-evaluate all its measures on a recurring basis., This would help to avoid certain companies and sectors from slipping into regulated status indefinitely and certain conduct becoming *de facto* prohibited for all companies through a wider chilling effect.

It should also explore the co-regulation approach outlined in section 4. But these recommendations cannot solve many of the problems identified in this paper, some of which may be inherent to the DMU and its powers as they have been proposed. If so, there are serious risks that the DMU ends up undermining competition, innovation, and startup formation in digital markets, and compromising the CMA in the process.

Indeed, it is possible that some of the proposals for the DMU cannot be tweaked to avoid harm, since the *ex ante* regulation they entail is incompatible with innovative, dynamic markets, no matter how it is designed. As John Penrose's analysis of the proposed DMU has argued, the switch to *ex ante* regulation fundamentally changes the nature of the CMA's relationship with the sector it is governing. These powers "create a high risk of 'regulatory creep' which adds red tape costs steadily over time; the huge growth in cost, time and complexity of price control decisions in the long-established sector regulators over the last 30 years shows what can happen."[59]

The ambition behind the DMU should not cloud policymakers' perspective on digital markets. While there are some concerns around their recent

58 John Penrose MP, Power to the People: Stronger Consumer Choices and Competition So Markets Work For People, Not the Other way Around (2021), pp. 18-19 available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/961665/penrose-report-final.pdf.

59 Power to the People (2021), p. 29.

evolution, they are a fast-growing and highly dynamic part of the UK economy. Regulatory interventions should, first, seek to do no harm and, second, seek to replicate models that work, instead of creating a vast new agency with a strong sense of mission but no clear sense of how to pursue it or the costs of doing so.

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