

MARKET INTERVENTIONS

Investigating the UK Digital Markets Regime: Is the DMCC Bill Fit for purpose?

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About Leeds Policy Institute

Leeds Policy Institute (LPI) is the first student-run policy unit and think tank located at the University of Leeds. Founded in April of 2023, LPI has united over 60 students across the University of Leeds from a large range of undergraduate and postgraduate degrees to tackle and research both local and national issues that are encapsulated within our six policy divisions of Macro Policy, Social Policy, Urban Planning and Transport, Energy and Environment, Financial Regulation, and Market Interventions.

LPI is dedicated to producing data-driven research from an initial non-partisan position to attract a wide range of talent with varying political beliefs and backgrounds from the University. Through this, we generate organic research conclusions while extending opportunities to all students across the University of Leeds. LPI's research is reviewed by our academic advisory council consisting of lecturers and researchers from the University of Leeds and through this, LPI ensures that all published research conclusions have undergone their respective review process.

The core mission of LPI is to create opportunity and to develop the professional academic, research, and interpersonal skills of students at the University of Leeds. In this year alone, LPI has created opportunities with members presenting at LSE's British Conference of Undergraduate Research while being published in external newspapers such as the Financial Times. LPI is a testament and example to the resilient and innovative spirit that is fostered and shared by all students at the University of Leeds, and we hope that our newly published research will reflect the values and mission of Leeds Policy Institute.

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Abstract

The UK's new 'Digital Market Regime' is a controversial proposal that includes the creation of the Digital Markets Unit (DMU) under the Competition Markets Authority (CMA), as well as the formation of the Digital Markets, Competition and Consumers Bill (DMCC) which aims to ensure "Free and rigorous competition amongst businesses." While this bill sounds like a good step towards ensuring healthy competition within a rapidly growing and dynamic industry, its language and guiding principles for identifying anticompetitive behaviour create three concerns that we address. The first of these relates to *Ex Ante* regulation which, while useful in preventing market misconduct from occurring, we find problematic when applied to digital markets, as the regulatory strategy is likely to become outdated within such a dynamic industry. Our second concern arises from a closer inspection of the bill itself as its over-expansive definitions of digital activity and market power create a climate of ambiguity, both for the DMU and prospective firms vying for eligibility. Thirdly, we find that a lack of procedural safeguards and accountability measures in place could undermine existing laws and the rights of SME firms which, given the loose regulatory definitions, can happen. Yet, despite these faults, the bill can be fixed, and as such, we conduct a comparative study of both the Digital Markets Regime and the EU's Digital Markets Act (DMA) to suggest how the proposed legislation can be adapted to limit government failure when intervening in digital markets.



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Recommendations

1. **While we welcome the creation of the DMU, we find that *ex-ante* regulation is unlikely to serve as an effective method of regulation for the digital markets industry.** This is due to the highly dynamic nature of the industry, which would require an incredible level of expertise to anticipate market misconduct. It would be more optimal if the DMU embraced 'tried-and-tested' regulatory methods which the body is more familiar with
2. **Interoperability may serve as an effective non-monetised benefit from the bill, the extensive constraints of DMCC may stifle innovation in the industry.** The DMU may struggle with regulatory work due to the vague eligibility criteria required to assign a firm 'Strategic Market Status'. This vagueness, along with discrepancies in the wording of the legislation, leads to challenges for both the DMU and firms seeking eligibility.
3. **Investment in Public transport:** Investing in the current bus infrastructure would reduce emissions and individuals' reliance on cars. Leeds is the largest city in Western Europe without a tube/tram system, making the bus system vital for the city's functionality. Introducing more frequent, interconnected, and reliable services would make bus routes a more attractive option as currently 80% of Leeds buses are late. The possibility of reintroducing a CAZ in Leeds is a more feasible option once the current public transport system has evolved.
4. **The DMCC bill should take inspiration from its EU counterpart, the DMA, which provides a more thorough and robust definitional approach.** We thus conclude that the DMCC should include a quantitative value to define 'Strategic Market Status' and that it should abandon *ex-ante* regulation in favour of *ex-post* regulation. We are confident that such an amendment would help to avoid market failure, the stifling of innovation, and administrative issues while promoting healthy market conduct and competition.



1 Introduction

1.1 The Digital Markets Regime

In the contemporary economic environment, the rapid ascension of digital markets has been transformative. With the emergence of such a novel and complex industry, governments are confronted with the arduous task of formulating regulatory frameworks and market interventionist policies to keep the industry competitive and dynamic. This report studies the UK's new 'Digital Markets Regime'. This includes the creation of the Digital Markets Unit (DMU) under the Competition Markets Authority (CMA), and the proposal of the Digital Markets, Competition and Consumers Bill (DMCC), a bill which aims to ensure "Free and rigorous competition amongst businesses" (GOV.UK, 2023). This report investigates the effectiveness of such a regime, speculating as to whether it will achieve its goals of promoting free and fair competition in digital markets. Such a study is vital due to the transformative and novel nature of the digital market industry, which many have called upon for an innovative market intervention policy to ensure healthy competition. While various bodies have analysed the regime from several ideological standpoints, this report aims to offer a non-partisan, qualitative evaluation.

1.2 The DMU

The DMU is a regulatory body that has been created within the CMA to promote greater competition within the digital markets industry. This move decentralises decision-making and facilitates more specific insights for the CMA into market misconduct. When determining the efficacy of the DMU, it is important to note that the committee is yet to be established and the department is thus yet to begin its operations in earnest. This means that while the positions are filled and the upper leadership has been identified, knowledge of the main core of the staff as well as the efficacy of their efforts thus far is unfortunately either non-existent or unavailable to the public. That being said, our investigation into the DMU's announced upper management has revealed commonalities between the CMA and other



technological regulatory bodies. In its current form, the CMA is the closest entity to the DMU and as such, we are confident to work with the assumption that the DMU management is skilled and possesses the necessary personnel for the general implementation of digital markets regulation.

1.3 *Ex Ante* Regulation

The DMU aims to operate its market interventions through *ex-ante* regulation. This decision converges with other Western governments, with both the EU and the US sharing inclinations to adopt an *ex-ante* approach towards digital market competition (Tombal, 2022). A somewhat novel economic strategy, *ex-ante* regulation prevents market misconduct from initially occurring, rather than treating misconduct retrospectively. Intuitively, *ex-ante* regulation appears to be a rather cost-efficient and proactive approach to market competition. It could serve as an antidote to the lag time and slowness of traditional competition law enforcement (Thiemann & Lapenta, 2021).

However, *ex-ante* regulation is prone to a certain rigidity. As observed by Narayan et al. (2020), *ex-post* regulation possesses the advantage of being based on sufficient information, which can be used to analyse and repair market failures accordingly. In contrast, *ex-ante* regulations can become quickly outdated and rely on certain market conditions with specific market outcomes. This point is particularly pertinent for the industry of digital markets; *ex-ante* regulation may need help to keep pace with such a dynamic, evolving industry. Here, we run into a problem: An effective *ex-ante* method of operation would require a remarkable level of expertise, market study, and economic analysis to minimise the risk of either under or overregulation.

The Institute of Economic Affairs (IEA) think tank expresses concern that adopting the *ex-ante* system will “fundamentally alter the nature and modus operandi of the CMA” (IEA, 2022). This is because the proposals “embed within the CMA a regulatory function which is largely alien to the way competition law operates” (p. 21) There is a certain truth to this argument. It seems ambitious to integrate a subdivided new method of operation into an organisation that has, until recently, followed only



traditional and tested practices. If the IEA's warnings are actualised, the digital market industry could run into unintended consequences. The industry's inherent complexity could lead to underregulation and the overlooking of harmful market behaviour. The industry could become easily overregulated for the same reasons, leading to a stifling of innovation and higher barriers to entry. It is undeniable that the incredibly dynamic nature of digital markets calls for new and innovative methods of regulating the industry and that maintaining the status quo will not be enough. Yet, a study of the *ex-ante* method of regulation shows that it comes with many difficulties, not to mention the astronomic costs of administration and resources needed to implement the scheme. The DMU should proceed with caution if they are to embrace *ex-ante* regulation.

1.4 Strategic Market Status

The forward-looking approach adopted by the CMA in its designation criteria for firms with Strategic Market Status (SMS) raises notable concerns. Chapter 2 of the bill empowers the CMA to designate companies with SMS for specific digital activities, contingent upon the fulfilment of prerequisites encompassing substantial market power, strategic significance within the chosen digital domain, and financial thresholds related to turnover. However, a critical examination of the definitions underpinning these criteria reveals their inherent vagueness and logical inconsistencies, posing multifaceted challenges. Firstly, the scope of "digital activity" itself appears to be overly expansive, potentially precipitating regulatory overreach and thereby exposing the regulatory framework to legal challenges and disputes (IEA, 2023). The lack of precision in delineating specific activities engenders a climate of ambiguity, both for the DMU and prospective firms vying for eligibility. Such a lack of clarity runs counter to the recommended objective of achieving "clarity for targeted firms, concerned parties, and other market participants on the SMS designation setup and process." (Godel we al, 2022).



Secondly, the provision in Section 5 of the legislation, which deals with "substantial and entrenched market power," poses significant challenges. It requires the CMA to conduct a forward-looking assessment over five years, considering hypothetical developments that might occur if an undertaking were not designated as having Strategic Market Status (SMS). This task is particularly difficult in the fast-paced and ever-changing digital market landscape, where technological advancements and shifts in consumer behaviour happen swiftly. The wording of this requirement appears contradictory because it demands a forward-looking assessment to establish that an undertaking is already "entrenched" in its market power. This contrasts with the more flexible and easily demonstrable requirement in Section 6, which concerns the "position of strategic significance." Interestingly, if a firm meets the criteria in Section 6, alongside other relevant requirements, it effectively attains "substantial and entrenched market power." This discrepancy in the rigour of requirements between Section 5 and Section 6 raises questions about the legislation's consistency. It emphasizes the need for a more balanced approach in the legislation to ensure that the designation criteria align with the realities of the digital market.

2 Impact on Firms

2.1 Innovation

The DMCC Bill, while designed with the best intentions, could inadvertently hinder innovation within the UK's digital sector. By furnishing the CMA with extensive powers to regulate digital markets, it introduces a degree of regulatory uncertainty that could dissuade investment. This is particularly concerning for firms identified as having strategic market status, who may become cautious about innovating due to potential regulatory costs and risks. (Auer, Lesh and Radic, 2023). The limited procedural safeguards and accountability measures in place could potentially undermine the rule of law and the rights of SMS firms. The fact that the CMA's decisions are only open to judicial review, and



not a full merits review, could restrict the ability of SMS firms to effectively challenge decisions (Auer, Lesh and Radic, 2023). To escape the regulatory regime's prohibitions and obligations, the firms must justify how their conduct and product changes would benefit consumers. As a result, companies are essentially prohibited from changing the design of their products unless they can demonstrate that such changes are both "indispensable and proportionate" to realising the claimed consumer benefits (Radic, 2023).

Moreover, *ex-ante* regulations could impose added constraints on innovative outputs within the economy, thereby undermining its capacity to keep pace with international competitors (Lee-Makiyama and Gopalakrishnan, 2020). Such regulations might quash the emergence of novel technologies, resulting in the UK lagging behind its global counterparts (Quintavalla and Reins, 2023). In its aim to foster competition, the DMCC Bill could inadvertently impede product design, business strategy, and consumer choice within the digital sector. Consequently, it may stifle the very innovation it aims to promote. Policymakers must address this conflict to ensure a balance between regulation and innovation.

2.2 Interoperability

The Bill aims to address a key non-monetised benefit: 'greater interoperability across platforms.' This requirement implies that SMS firms may be obligated to integrate their products with those of competitors. In context, the open integration of a social network with other services and apps means that mobile operating systems (such as Google, Android and Apple iOS) are operable with one another. In a similar vein, 'data portability' allows the movement of data from one supplier to another, promoting an 'open access' means of use. This allows users to switch between providers, which in turn boosts competition and facilitates entry into the market. However, by enforcing an 'open' ecosystem philosophy upon companies, the opportunity for a potentially bespoke user experience could be eroded, overriding consumer choices. Considering the risks associated with data privacy and security



standards, interoperability between services could threaten the “pro-consumer” objective that the Bill intends to achieve. Businesses face the potential risk of augmented cyberattacks, although, with the right practices, they can be offset.

While the interoperability of technology services may present outcomes which are questionable for consumers, the drive for efficiency and benefits of collaboration makes the integration of digital solutions a worthwhile pursuit for businesses. The use cases are multi-fold, but interoperability is especially valuable for businesses that transfer information between various solutions daily. For instance, data portability is vital in the healthcare market, where updating electronic health records (EHRs) depends upon transferring information between healthcare organisations. Interoperability removes the need for excessive administrative labour, due to the ease of information access between networks. In this way, the DMCC Bill pays heed to the future of business operations, which will undoubtedly become ever more interconnected.

2.3 The EU’s Digital Markets Act: A Comparative Study

The EU Digital Markets Act (DMA) is the corresponding digital markets bill for the European Union. Produced by the European Commission, it has largely come into effect over the last two years. Being further advanced than the DMCC, analysis of its progress and effectiveness is highly relevant to the CMA. Although the CMA is working independently from the European Commission, both bills will likely target the same firms. It is therefore important that there is some agreement between the two bills on how to apply effective pressure on firms with SMS, or as the DMA titles them, “gatekeepers”. The DMA aims to prevent big platforms from “imposing unfair conditions on businesses and consumers.” Its policies aim to enhance growth and innovation in a competitive market to make the digital markets industry “fairer and more contestable” (European Commission, 2023).



Both bills recognise the need for new and evolving features of competition law to regulate digital markets effectively and employ a highly flexible interventionist approach. The discretion available to the two regulators is different; unlike the DMA, the DMCC does not distinguish between core platform services and can designate SMS for any digital activity, provided conditions are met. While strategic significance requirements are similar in both bills, the DMCC is more flexible in defining jurisdictional thresholds, requiring a significant number of UK users. (Andriychuk, 2023). The DMCC offers notable advantages over the DMA in terms of fairness, contestability, flexibility, and enforcement discretion, as highlighted by Andriychuk (2023). Unlike the DMA, the DMCC establishes separate procedures for the objectives of fairness and contestability. This approach grants the CMA increased discretion in enforcing contestability while enhancing overall flexibility. Furthermore, it will use nudges to encourage specific actions from addressees and provide enforcement discretion for imposing conduct requirements.

Yet, the DMCC exhibits issues of short-term efficiency. This is because the DMCC applies a mandatory efficiency defence to obligations surrounding fairness, but not for contestability (Andriychuk, p.16). This is an obstacle which might lead to delays and inefficiency in short-term interventionist policy. The DMCC could run more efficiently if it followed the DMA's simpler system: the DMA has not made mandatory public consultations necessary to its process and combines this simpler system with threats of substantial fines as an incentive to follow rules (Andriychuk, p. 20). Currently, the DMCC bill has lengthy investigatory requirements and makes public consultations a mandatory part of its process. These should be reduced or it will be difficult to succeed against big tech firms with unlimited resources to fight their causes.

Finally, the DMA seems to benefit from a broader scope when defining which firms are subject to competition law. To decide if a firm has strategic market status, the DMU uses designation requirements, one of which is "substantial and entrenched market power". This diverges from the



DMA which prefers an “entrenched and durable position”, assessing barriers to entry, and whether a firm has been able to retain significant user numbers for more than three years (Smith, 2023). This is less stringent than the DMCC, which requires the DMU to deploy a forward-looking assessment over at least 5 years to determine “market power”. Given digital markets’ exponential rate of growth and the constant radical shifts in unprecedented markets, these assessments that the DMCC wish to employ are arduous, if not impossible, tasks. Even since proposals for the DMCC appeared, Google’s search dominance has been challenged by the rise of OpenAI’s ChatGPT and its integration into Bing (Lesh, 2023). The five-year designation requirement of the DMCC certainly requires re-evaluation.

3 Conclusions

Our evaluation of the UK Digital Markets Regime has exposed several challenges.

First, while we welcome the creation of the DMU, we find that *ex-ante* regulation is unlikely to serve as an effective method of regulation for the digital markets industry. This is due to the highly dynamic nature of the industry, which would require an incredible level of expertise to anticipate market misconduct. It would be more optimal if the DMU embraced ‘tried-and-tested’ regulatory methods which the body is more familiar with. Second, we find that the DMU may struggle with regulatory work due to the vague eligibility criteria required to assign a firm ‘Strategic Market Status’. This vagueness, along with discrepancies in the wording of the legislation, leads to challenges for both the DMU and firms seeking eligibility. Having looked at the regime’s possible impacts on firms, we find that though interoperability may serve as an effective non-monetised benefit from the bill, the extensive constraints of DMCC may stifle innovation in the industry.

In our comparative study, we find that the DMCC bill should take inspiration from its EU counterpart, the DMA, which provides a more thorough and robust definitional approach. We thus conclude that the DMCC should include a quantitative value to define ‘Strategic Market Status’ and that it should



abandon *ex-ante* regulation in favour of *ex-post* regulation. We are confident that such an amendment would help to avoid market failure, the stifling of innovation, and administrative issues while promoting healthy market conduct and competition.



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