Response to CMA consultation: Draft digital markets competition regime guidance

A submission by Frontier Economics[1]

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Frontier Economics (**"Frontier"**) is an economic consultancy which regularly advises clients operating in digital markets, as well as clients operating in other sectors subject to ex ante regulatory regimes.

We welcome the CMA's Draft Digital Markets Competition Regime Guidance (the **"Guidance"**) which we consider provides helpful information on how the CMA plans to administer the DMCC Act in practice. The purpose of this response is not to comment comprehensively on all aspects of the Guidance. Rather this response focuses on specific parts of the Guidance that we believe are important to highlight and/or can be clarified or improved to support the proper and effective functioning of the new regime.

Approach to designating firms as having SMS

The role of evidence on multi-homing in assessing substantial and entrenched market power should be clarified

1 Evidence on multi-homing (i.e. the use of multiple substitutable services in parallel) is currently not mentioned in the Guidance as relevant for the assessment of whether a firm has "substantial and entrenched" market power.

2 There is consensus in the economic literature that multi-homing is an important driver of competition and that its presence attenuates market power, particularly for digital firms. The presence of multi-homing, all else equal, suggests low switching costs and low barriers to entry and expansion (as acknowledged by the CMA itself in previous reports).[2] A panel of economic experts in 2021 noted that *"[i]n the platform economics literature, entrenched market power is often measured by the extent and cost of multi-*

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[2] See for example, [1] CMA, Online Platforms and Digital Advertising – Market study final report, 2020, paragraph 3.214; [2] The Evolving Concept of Market Power in the Digital Economy – Note by the United Kingdom (2022). [3] Frank and Peitz (2019). 'Market Definition and Market Power in the Platform Economy'.

homing. More competition and substitution on one side of the platform market can reduce its market power on that side".[3] Similarly, Scott Morton and Athey (2022) note that *"[a]vailable and vibrant multi-homing is therefore a strong signal that there is competition between platforms in a market and that consumers have choices".*[4]

3 The CMA may consider that evidence on multi-homing is included implicitly/indirectly in the Guidance via references to evidence on *"switching costs"*[5] and *"barriers to entry and expansion"*[6]. However, we consider that it would be helpful to clarify explicitly (e.g. in para 2.41 of the Guidance) that evidence on multi-homing is considered relevant evidence for the assessment of *"substantial and entrenched"* market power.[7]

Evidence gathered from historic cases will generally need updating before incorporating in an SMS assessment

4 Digital markets are often described as dynamic and fast-moving,[8] reflecting that fact that they are often characterised by a high degree of innovation, are materially influenced by technology advantages and consumer preference shifts, and provide the potential for new products and services to achieve scale rapidly.

5 This should impact how the CMA interprets evidence and analysis from previous cases and the weight that such historic evidence is given in SMS assessments. We therefore agree with the CMA that, in relation to evidence and analysis from previous cases, the CMA should *"be mindful of when and for what purpose the evidence was initially gathered and consider the weight it should be given and the extent to which it should be updated or corroborated".*[9]

6 By way of example, the CMA Online Platforms and Digital Advertising Final Report was published in July 2020 and largely relied on data and evidence from 2019. Since then, significant competitive changes have occurred that were not a focus for the market study. For example, technology and consumer preference shifts have led to

[3] Cabral, L., Haucap, J., Parker, G., Petropoulos, G., Valletti, T. and Van Alstyne, M. (2021) 'The EU Digital Markets Act', Publications Office of the European Union, Luxembourg. Available at: https://publications.jrc.ec.europa.eu/repository/handle/JRC122910.

[4] Scott Morton, Fiona M. and Athey, Susan (2022) 'Platform Annexation'. Available at: https://www.americanbar.org/content/dam/aba/publications/antitrust/journal/84/3/platform-annexation.pdf.

[5] Para 2.41.

[6] Para 2.43.

[7] The European Commission's Digital Markets Act which explicitly mentions multi-homing as a relevant factor to take into account for "gatekeeper" designation. See Digital Markets Act, Art 3.8 e). (May 2022).

[8] See for example, Sarah Cardell's observations on page 2 of Trends in Digital Markets: A CMA Horizon Scanning Report. Available at : https://assets.publishing.service.gov.uk/media/657ad2ab254aaa0010050d0c/__Trends_in_Digital_Markets__.pdf.

[9] Para 2.65.

a rapid increase in the popularity of online video content and new competitors such as TikTok (only briefly discussed in the market study[10]) have achieved significant success in attracting user attention and advertising expenditure.[11] Similarly, Amazon advertising (also barely mentioned in the market study) has seen global revenues more than treble between 2019 and 2023, reaching $47bn in 2023.[12] Assessments of market power in relation to competition for attention and online advertising should be taking into account these developments.

The relationship between "dominance" and "substantial and entrenched" market power should be clarified

7 Para 2.45 of the Guidance notes that *"Substantial and entrenched market power is a distinct legal concept from that of 'dominance' used in competition law enforcement cases."* As a result, the CMA *"will not typically seek to draw on case law relating to the assessment of dominance when undertaking an SMS assessment".*

8 From an economic perspective, there is a close relationship between the concept of "dominance" in competition law and the DMCC concept of "substantial and entrenched market power". Both concepts are fundamentally about an assessment of market power, and the evidence required for these assessments appears to be effectively identical in both cases. This raises the question as to whether the threshold for "substantial and entrenched market power" is higher or lower than the market power threshold for dominance.[13] It would be helpful this could be clarified in the Guidelines. In addition, any examples that the CMA can provide, real or hypothetical, whereby a firm could be considered dominant but not having *"substantial and entrenched market power"* (or vice versa) would be helpful.

9 Furthermore, dominance case law has generated a number of rules-of-thumb that help increase business certainty. For example, the OFT (2004) abuse of a dominant position guidelines state that the *"OFT considers it unlikely that an undertaking will be individually dominant if its share of the relevant market is below 40 per cent."*[14] Whilst shares are supply are not always an appropriate metric for assessing market power in digital markets, it would be helpful for the Guidelines to provide similar

[10] The market study describes TikTok is referred to as a *"small platform"* (Figure 2.3) that *"seems to compete most closely with 'Facebook Watch'"* (para 3.191).

[11] https://www.businessofapps.com/data/tik-tok-statistics/.

[12] Statista (2024), Global Amazon advertising revenue 2019-2023. Available at : https://www.statista.com/statistics/259814/amazons-worldwide-advertising-revenue-development/.

[13] Indeed, the OFT (2004) guidelines on a dominant position have referred to "substantial market power". state that "*An undertaking will not be dominant unless it has substantial market power."*

[14] OFT (2004), Abuse of a dominant position: Understanding competition law. Available at : https://assets.publishing.service.gov.uk/media/5a74c497ed915d4d83b5ecd7/oft402.pdf.

rebuttable rules-of-thumb to increase regulatory certainty for potential SMS firms (particularly in relation to their smaller products/services).

10 Finally, para 2.64 of the Guidance states that the CMA *"will decide the weight it is appropriate to place on a particular piece of evidence, taking into account, for example, its relative quality. There is no set hierarchy between quantitative evidence, such as consumer surveys or econometric analysis, and qualitative evidence, such as internal documents or statements of relevant firms."*

11 Given that there is no hierarchy of evidence, the CMA should provide further guidance on how it will assess the *"relative quality"* of evidence when making designation decisions (i.e. provide guidance on the likely pros and cons of common types of evidence). The European Commission's Market Definition Notice (**"MDN"**) provides insights into how the Commission views the quality of different types of evidence (e.g. the MDN explains that evidence on past substitution is particularly informative *"when the substitution is caused by an exogenous shift in relative supply conditions"* but is less informative when *"customers are shifting away from a product as a result of factors unrelated to changes in relative supply conditions, such as a change in preferences or consumption patterns over time"*).[15] Similar guidance from the CMA covering the most common types evidence would be helpful.

Ensuring that the digital markets competition regime creates a stable and predictable platform for investment

12 Ex ante regulation differs fundamentally to ex post enforcement. In particular, an ex ante approach risks preventing firms from engaging in activities (e.g. developing new products; entering new markets) that could benefit consumers, a risk not present in the same way with ex post enforcement. The Digital Markets Competition Regime must guard against these risks.

13 These risks are particularly significant in rapidly evolving digital markets, which are fundamentally different to traditional regulated utilities that have historically been subject to ex ante economic regulation. As a result, the aim to deliver observable regulatory outcomes in today's market may unintentionally restrict innovation pathways.[16] These negative effects may be hidden, as unrealised innovations

[15] Commission Notice on the definition of the relevant market for the purposes of Union competition Law. Para 51 and 52. Available at : https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C_202401645.

[16] As explained in Frontier Economics (2022) "The Limits on Leveraging": "*Many organisations foster a culture of experimentation. A combination of curiosity and an exploration of the unknown through research and testing means that everyone is encouraged to experiment, learn from failure and put forward new ideas to make the customer offering more*

typically are impossible to identify. This creates the risk that any ex post evaluation of the Digital Markets Competition Regime may understate the costs.

14 UK consumers could face substantial economic harms from such unintended consequences. For example:

(a) Digital markets thrive on experimentation and trial and error, with firms often unaware in advance of what customers will like.[17] Conduct Requirements in particular must be designed in a way that supports this innovation and does not impede of rapid evolution of products and features in response to customer feedback. Imposing a regulatory "brake" risks slowing development.

(b) This issue is compounded by the global nature of digital product development, which means that rules requiring UK-specific product builds could have a wider effect on the innovation landscape. This CMA should consider this when assessing the proportionality of its interventions.

(c) Digital firms often innovate by integrating and complementing existing features and services, enhancing the customer experience. Regulatory interventions that aim to facilitate competition, but that undermine the customer experience – for example by forcing customers to navigate a fragmented landscape of services when they would prefer to use one joined-up service – risk causing more harm than benefit.

15 All regulatory rules run the risk of being open to rent-seeking behaviour, and any process needs to guard against misuse of the rules by third parties to expropriate the returns of an innovator, rather than appropriately rewarding legitimate third party innovations in the digital ecosystem.

16 To mitigate the risk, the regime should aim to create a stable and predictable platform for investment and innovation for all firms, including SMS firms. That means ensuring that:

(a) designation decisions, Conduct Requirements and Pro-Competitive Interventions are based on sound evidence;

(b) the CMA takes seriously the impact of its interventions on longer-term incentives to develop new and improved products; and

(c) requirements for digital firms are not frequently added to and amended on a ongoing basis.

appealing. Practically, it would be very difficult to maintain a culture of devolved, continual innovation if each initiative required regulatory review and support."

[17] Because innovation is a process of discovery, it is a serious error to assume that synergies or customer responses are or can be always known in advance. As explained by Amazon to its shareholders: *"To invent, you have to experiment, and if you know in advance that it's going to work, it's not an experiment."*

17 Finally, we note the importance placed on evidence obtained from trials and experiments in the draft guidance. Broadly we welcome the role of evidence from trials and experiments in the regime, as these can be a valuable source of evidence in digital markets. This is particularly the case where digital firms are well set up to carry out A/B testing or field experiments in the ordinary course of business. However, it is important that this approach is well focused, and does not become a means by which remedies imposed through the regime are subject to continuous field evaluation, and thereby subject to ongoing tweaking and updating. There should, within a reasonable timeframe, come a point at which the evidence base is settled and the final form of any remedy stabilises for a reasonable period of time. Likewise, and with regard to the helpful guidance published separately ("*Experiments at the CMA*")[18], it is important that all evidence is assessed on its merits. In particular, the CMA should have particular regard to methodologies that are used in the ordinary course of business to evaluate user behaviour, even where one could imagine specifying a more scientifically precise experiment when designing from scratch.

The risk of regulatory capture

18 As a final consideration, we would invite the CMA to take seriously how it guards against the risk of regulatory capture in the implementation of the new regime. Since the pioneering work of Stigler (1971) and Laffont and Tirole (1993), economists have concerned themselves with how institutional frameworks best create incentives for high quality decision making that reflects economic reality, rather than the narrow interests of the fallible humans charged with managing the regulatory process.

19 The CMA as an organisation has, to date, been very effective at remaining an independent evidence-led organisation. The CMA undoubtedly has a strong organisational culture which supports this, and that is to be commended. But it is important to recognise that culture does not exist in a vacuum and, if it is to endure, it must be supported by more concrete elements of organisational design and guidelines for decision making. In its role as an ex post enforcer of competition law, three features of CMA structure and practice have helped mitigate against the risk of regulatory capture. In particular, CMA investigations under its Competition Act and Enterprise Act powers:

[18] https://www.gov.uk/government/publications/experiments-at-the-cma-how-and-when-the-cma-uses-field-and-online-experiments/experiments-at-the-cma-how-and-when-the-cma-uses-field-and-online-experiments#executive-summary

(a) are typically one-off, or where there is repeated interaction this is infrequent and not necessarily inevitable or predictable;

(b) involve the investigation of specific alleged "problems" as defined against relatively clear statutory tests; and

(c) typically involve working towards a discrete, high stakes decision (e.g. imposing a large fine, or a decision to clear or block a merger).

20 These features add up to create a situation where there is inevitably a healthy adversarial nature to the interactions between regulator and regulated. Parties are largely fighting to win each individual case, and the CMA has a healthy natural scepticism to the arguments they advance. If Parties are to be successful, they must do so on the merits of the factual and legal evidence, and their incentive is to invest in the evidence and not in softer forms of influence. The CMA, for its part, must also listen carefully to robust factual and economic evidence, knowing that its decisions can be tested on their merits in court (in the case of the Competition Act) or are subject to scrutiny by an independent panel (in the case of the Enterprise Act).

21 The DMCC as described in the draft guidance is an entirely different beast when seen through the lens of regulatory capture. This is because it is a major departure for the CMA on each of the key elements described above:

(a) it appears to envisage a process of continuous dialogue between regulator and regulated – potentially meaning that the regulatory process is broken up into a repeated series of small incremental decisions, each of which is relatively low stakes on both sides;

(b) the statutory tests have been left deliberately vague in order to maximise the CMA's discretion, and the guidance does little to add further specification to the objective tests that interventions will have to meet; and

(c) the regime is not subject to merits review in the courts, nor does it involve an independent panel process.

22 The institutional setup is one in which new risks emerge, namely that:

(a) relationships matter more than evidence – because both sides are willing to compromise over regulatory outcomes today rather than fight on the evidence (because to do so could compromise relationships in the future); and

(b) wide discretion creates a "black box" decision making process where there is much to be gained from influencing the decision makers as individuals, rather than arguing the case on its merits.

23 The CMA, regulated firms, and consumers all stand to gain when the outcomes are decided principally on the factual and economic evidence, not on the whims of the

individual decision maker. The danger is that firms will direct their resources to whatever channels seem best for obtaining the best commercial outcome, and evidence generation can easily give way to more cynical lobbying efforts, and to a revolving door of CMA employees being hired into regulated firms on the basis of their personal relationships and 'inside knowledge' rather than their skills and experience.

24 These type of concerns have long been a feature of regulated industries in other sectors where, since the privatisation of utilities in the 1990s, issues of regulatory capture have been taken seriously. The CMA should engage with this debate and think actively now about how – notwithstanding its track record to date – it can remain an evidence based organisation as it transitions from being solely an ex-post enforcer to also becoming an ex-ante regulator.

25 In our view, four things could help guard against the risks described above:

(a) aim to develop over time (and in the guidance where possible) greater precision over the evidential tests that will be applied by the regime;

(b) seek ways to ensure that high quality evidence is not only paramount in decision making, but that it is also *seen* to be paramount;

(c) create independent checks and balances inside the organisation (in particular where crucial board level decisions are involved) to ensure that evidence behind decisions is properly tested outside the ongoing relationships of the team holding the regulatory relationship day-to-day; and

(d) aim to avoid frequent repeated decision making, but rather (in line with other sector regulators) to put in place rules that provide stability over a sustained period.

26 Not all this can necessarily be achieved through wording changes in the draft guidance, but we believe the CMA should nonetheless consider more broadly how the implementation of the new regime can be set up so that the institutional arrangements continue to protect its important reputation as an independent evidence-led organisation.