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UK taskforce recommendations map out new regulatory regime for digital firms

Just ten days after the UK Government announced it would take forward calls by the Competition and Markets Authority (**CMA**) for a new regulatory regime for online platforms and other digital firms with market power (see our alert), the Digital Markets Taskforce (**Taskforce**) – a unit led by the CMA, working with Ofcom, the Information Commissioner's Office (**ICO**) and the Financial Conduct Authority **(FCA**) – has made recommendations on the design and implementation of that regime. The Taskforce advises that the regime should apply to the most powerful digital firms (those having "Strategic Market Status" (**SMS**)). It should include a tailored code of conduct for each SMS firm, setting out clear principles for the firm to follow. The codes will be enforceable by a new Digital Markets Unit (**DMU**) to be set up within the CMA ready to begin work in April 2021.

And the DMU should be able to make ex ante "pro-competition interventions" to drive greater competition and innovation in digital markets. This is all familiar – the Taskforce is building on the CMA's findings in its market study into online platforms and digital advertising markets and the Furman Report before that. But there is a lot in the report that is new. Significantly, and building on an idea floated by the CMA's CEO in October, the Taskforce adds a third pillar to the proposed SMS regime: "SMS merger rules". This would entail a wholly separate mandatory and suspensory merger control regime for the scrutiny of transactions involving SMS firms. And more generally the Taskforce makes detailed recommendations on which firms should fall within the scope of the SMS regime, and how the whole package should work in practice.

The SMS test: "substantial, entrenched market power in at least one digital activity, providing the firm with a strategic position"

The Taskforce expects only a small number of digital firms are likely to meet the SMS test. It recommends that the DMU, as an independent regulator, should have the power to designate a firm with SMS. The DMU should publish clear formal guidance (to be updated as markets evolve) on its approach to assessing the test as well as how it will prioritise firms for designation. The Taskforce proposes that the DMU prioritises the following:

– Firms with annual **UK revenue exceeding GBP1 billion** – in particular those that also have annual global revenue of over GBP25bn.

– Firms active in **particular activities**: online marketplaces, app stores, social networks, web browsers, online search engines, operating systems and cloud computing services.

Where a sector regulator is better placed to address the issues, the DMU should take this into consideration before prioritising a designation assessment.

The application of the SMS test would require the DMU to assess whether a firm has:

– **Substantial market power:** the DMU would assess whether users of a firm's product or service lack good alternatives to that product or service and there is a limited threat of entry or expansion by other suppliers – the approach should be consistent with that taken by the CMA in its markets work and under its revised merger assessment guidelines (currently under consultation – see our alert).

– **Which is entrenched**, ie not transitory or likely to be competed away in the short term.

– **Relating to at least one digital activity:** in order to ensure a targeted and proportionate approach, the Taskforce recommends that the assessment should be **applied only in relation to a specific activity**, and not the entire firm. The DMU would therefore look at collections of products/services that have a similar function or fulfil a specific function. Only digital activities are relevant to the SMS assessment – the Taskforce proposes that 'digital' is interpreted to cover "any situation where digital technologies are material to the products and services provided as part of the activity". This has the potential to be extremely broad. The Taskforce clarifies that a high-street retailer deciding to launch an online store is unlikely to fall within the regime, whereas an online marketplace would clearly be within scope. But there are likely to be many areas where this is not clear-cut.

– **And which provides the firm with a strategic position**, ie where the effects of its market power are particularly widespread or significant. The Taskforce recommends various factors to be taken into account in this assessment, including whether: (i) a firm has achieved a very significant size or scale; (ii) a firm is an important access point (a "gateway") to customers for a diverse range of other businesses or the activity is an important input for such businesses; (iii) a firm can use the activity to extend market power into other activities; (iv) a firm can use the activity to "determine the rules of the game" within its own ecosystem and for a range of market participants; and (v) the activity has impacts on markets that may have broader social or cultural importance.

It would be possible for a single firm to have multiple SMS-designated activities. In terms of process, the Taskforce recommends that the DMU have a deadline of 12 months to complete a designation process (including to design the tailored code of conduct that will apply to the firm upon its designation). It could choose whether to undertake multiple designation assessments in relation to a single firm either in parallel, or separately. Any designations should be set for a fixed period – the Taskforce suggests five years. Within that period, firms could apply for removal of their designation in relation to an activity where there has been a material change in circumstances.

Where a firm meets the SMS test in relation to one or more activities, the Taskforce recommends that the SMS status applies to the entire corporate group. However, crucially, the associated remedies (as set out below in relation to the first two pillars of the regime) should only apply to those specific activities.

Three pillar regime for SMS firms

Once a firm is designated as having SMS, the Taskforce recommends that it should be subject to three key measures: a tailored code of conduct, ex ante "pro-competitive interventions" and specific merger control rules. While the Taskforce recommends significant enforcement powers to underpin each of these pillars, it emphasises that the purpose of this regime is to proactively prevent harm so it will be important to foster a compliance culture within SMS firms and enable resolutions through a participative approach, working constructively with all affected parties. The Taskforce recognises that, of course, the affected parties may well be better placed to identify an appropriate resolution to some issues than the DMU itself.

Pillar 1: A new, legally binding code of conduct, to be tailored to each firm

Recognising that "the activities undertaken by the most powerful digital firms are diverse and a 'one size fits all' approach could have damaging results", the Taskforce recommends that this code is **tailored** to each SMS firm and to the activity and conduct where the evidence demonstrates problems might occur. The aim of the code is to manage the effects of the market power held by each SMS and so to avoid the emergence of concerns in the first place. The Taskforce anticipates that these 'rules of the game' would clearly set out how the firms are expected to behave, governing elements of how they do business and treat their users, up front, for example by preventing practices which exploit consumers and businesses or exclude innovative competitors. High-level **objectives** (fair trading, open choices, and trust and transparency) would be set out in legislation. These objectives would then be supported by **principles** (both standard and bespoke, and including 'exemptions') and **guidance**, the detailed content of which the Taskforce recommends should be designed (at the same time as a firm's SMS designation assessment) and overseen by the DMU (allowing for flexibility and adjustment over time).

Importantly, the Taskforce expects the DMU to monitor SMS firms to identify breaches of the code and remedies. It suggests that the DMU should be able to take "action quickly on an interim basis" where it suspects the code has been breached and should undertake scoping assessments (expected to be completed within six months). The Taskforce recommends that the DMU should be able to impose "substantial penalties" for breaches of the code – up to a maximum of 10% of worldwide turnover is proposed. However, the Taskforce would like the DMU to focus on remedying the conduct – bringing the SMS firm's conduct back into line with the code – rather than punishing the firm. To prevent material damage to competing business, the DMU would also need to conduct code breach investigations quickly, within a fixed statutory deadline (six months is mooted, not including the process for adopting penalties).

The Taskforce has specific recommendations on how the DMU could use the code for relevant SMS firms to address concerns about the balance of power between SMS platforms and news publishers, as identified previously in the Cairncross Review and in keeping with themes looked at recently by a number of other antitrust regulators (including in Australia, where the ACCC has been working to legislate a 'News Media Bargaining Code'). The Taskforce considers that its proposals could capture key elements of the Cairncross Review's substantive proposals for a rebalanced relationship between SMS firms and publishers, albeit the Cairncross Review envisaged the platforms being required to draw up their own codes of conduct, rather than having an enforceable code imposed upon them. The Taskforce does not recommend that the DMU directly regulate pricing set by SMS platforms for publishers, but notes the code could allow the DMU to determine whether SMS firms' terms and prices are fair and reasonable.

Pillar 2: Pro-competitive interventions (PCIs)

The Taskforce recommends that the DMU should have the ability to intervene to address the "root causes" of market power and to drive longer-term dynamic changes in the particular activities in which SMS firms have market power, in order to open up opportunities for greater competition and innovation. Intervention has the potential to be extremely far-reaching:

– First, the Taskforce recommends that, with the exception of ownership separation, the DMU should not be limited in the types of remedies it is able to apply. The Taskforce expects the DMU to provide guidance on the types of PCIs it would consider. These could include data-related interventions (eg mandating third party access or data separation/silos), interoperability measures (eg to support personal data mobility), interventions to address concerns over consumer choice and defaults, and obligations to provide access on fair and reasonable terms. Notably, the Taskforce considers that separation remedies should be **limited to operational and functional separation**, for example where different units within an SMS firm are operated independently of each other. It believes that the power to impose full ownership separation should only remain available to the CMA following a market investigation, and that the DMU should possess the right to make or recommend a market investigation reference should it consider full ownership separation to be the only effective solution. It will be interesting to see whether this clarification appeases the Government, which in its response to the CMA's market study findings was unconvinced of the scope of the PCIs contemplated, and suggested that further work on this front was needed.

– Second, the Taskforce suggests that "the DMU should be able to implement PCIs anywhere within an SMS firm in order to address a concern related to its substantial entrenched market power and strategic position in a designated activity". So, for example, a data silo remedy could be imposed to prevent data collected in a designated activity being used to provide an advantage in the firm's other activities. Or a remedy could be implemented to prevent defaults being used in a firm's other products, which automatically direct consumers to the firm's designated activity.

There are, however, proposed checks on the DMU's powers. A PCI investigation should be completed within a fixed statutory deadline (12 months is suggested). The legal test for implementing a PCI should ensure it is targeted at addressing a particular conduct, behaviour or market feature, and remedies should be effective and proportionate to the adverse effect on competition or consumers. And PCIs should be implemented for a limited duration and regularly reviewed. But, while the Taskforce encourages the DMU to take a "participative approach, engaging with parties to deliver fast and effective resolution", again, the Taskforce would like to see the DMU armed with the ability to impose substantial penalties for breaches of PCI orders.

More generally, in order to fulfil its duties under the first two pillars, the Taskforce recommends that the DMU have strong information gathering powers. In what will be welcome news for firms, the Taskforce is also keen for processes to be open and transparent: the DMU should be obliged to announce when it opens a designation assessment, code breach investigation or PCI investigation and should provide an opportunity for input from the SMS firm and third parties. It should also consult on its provisional decisions as well as any proposed changes to the codes. The DMU's decisions should be subject to appeal on judicial review grounds.

Pillar 3: Enhanced distinct merger rules

In order to address concerns about historic under-enforcement of mergers involving big tech firms under the UK's existing voluntary merger control regime, the Taskforce recommends that there should be closer scrutiny of transactions involving SMS firms. This should be carried out by the CMA, not the DMU, to avoid duplication and dilution of expertise – this, at least, is good news for firms. However, despite the Taskforce noting that the regime must be designed carefully to minimise any unintended adverse consequences, it is clear that the proposals if implemented will result in significant burden for SMS firms. Crucially the Taskforce does not believe that the SMS merger control regime should be limited to the activities that are the focus of the SMS designation process – it could apply to any acquisition by an SMS firm. The proposed SMS merger regime has several layers:

– First, the Taskforce suggests that SMS firms be required to report **all** transactions to the CMA within a short period after signing.

– Second, it recommends an additional **mandatory suspensory** merger control process for transactions (i) amounting to "clear-cut" acquisitions of control (including both 'de jure' and 'de facto' control, but not the ability to exercise 'material influence') and (ii) meeting "bright-line threshold tests" (preferably a UK-focused transaction value test). A possible simplified notification process is mooted for transactions where it can be readily established that there is no competitive interaction between the activities of an SMS firm and those of the target. In terms of the CMA's assessment of the transaction, the Taskforce calls for a lower, more cautious standard of proof (recommending a 'realistic prospect' standard) when assessing the likelihood of harm to consumers on the basis of the existing – substantial lessening of competition – substantive test. Interestingly it rejected the "balance of harms" approach proposed in the Furman Review on the basis that it would not be possible to apply in a transparent and robust way. Similarly, it rejected a reversal in the burden of proof on the basis that it would be difficult in practice for merging parties to meet that burden, including in non-problematic cases.

– Third, the Taskforce proposes that there should be some form of '**safety net**' that would enable the CMA to review acquisitions by SMS firms that did not trigger mandatory notification (such as acquisitions of material influence) but could nevertheless raise competition concerns.

– Finally, the Taskforce suggests that for now the **existing public interest intervention regime** should be applied to the SMS merger control regime, allowing the Secretary of State to intervene in these mergers on public interest grounds where the relevant statutory tests are met.

It is interesting that the Taskforce's recommendations for the new SMS merger regime are more heavily caveated than its other proposals. In a number of areas (including the appropriate thresholds) it notes that further consideration should be given. It is perhaps in relation to this pillar, therefore, that we might see the greatest movement between the recommendations put forward and the draft regime ultimately consulted on by the Government.

Beyond the SMS regime: a wider role for the DMU?

The Taskforce advises that the DMU should have a duty to monitor digital markets more generally. This would, says the Taskforce, enable the DMU to spot potential issues earlier, enabling swifter action and intervention. It should have a range of tools to do this, including broad information gathering powers. Where the DMU identifies a need for intervention, it should have a range of possible actions, including a role in supporting industry initiatives, considering the use of regulatory sandboxes, publishing guidance, making recommendations to Government and identifying matters for enforcement (which it could refer to the CMA or appropriate regulator). Importantly, the report indicates that the DMU should be able to **carry out market studies** under the existing UK markets regime, and (as noted above) to make or recommend in-depth market investigation references.

Calls for a "modern set of competition and consumer rules"

More broadly the Taskforce recommends that the Government should strengthen competition and consumer regimes to ensure they are "better adapted to the digital age". To this end, the Taskforce refers to the letter sent to the Secretary of State by the CMA in February 2019, setting out various reform proposals, and hones in on a number of these. For example, it recommends that the Government pursues significant reforms to the markets regime, so that there is greater flexibility to amend or adjust remedies as markets evolve, in particular where interventions such as data mobility and interoperability – which are of an ongoing nature – are involved.

A coherent regulatory approach

As we have noted in previous alerts, ensuring that the UK regulatory landscape for digital markets is coherent will be crucial to the success of any new regime. The Taskforce agrees – it is clear that the new framework cannot operate in isolation. It must sit alongside sector regulation, data protection rules and the new regime on harmful online content. The DMU will need to work closely with other regulators – specifically Ofcom, the ICO and the FCA. The Digital Regulation Cooperation Forum (**DRCF**), a body comprising the CMA, Ofcom and the ICO, is already considering these points and working with the Government to ensure a joined-up approach.

And going even further than this, the Taskforce advises the Government to consider whether Ofcom and the FCA should also have powers to designate activities within an SMS firm, to set and enforce a code of conduct and to implement pro-competitive interventions. This would be significant, and it gives clear scope for inconsistent approaches and duplication. The Taskforce gets around this by suggesting the DMU would have 'primacy' in relation to these powers. It will be interesting to see what the Government makes of this recommendation.

Looking internationally, the Taskforce believes it is important that the DMU can share information, and work closely with regulators in other jurisdictions – particularly given that the most powerful digital firms operate multi-nationally. Indeed, the Taskforce recommends that the DMU should explore establishing a network of international agencies to facilitate better monitoring and action in relation to the conduct of SMS firms. This would involve the setting of "strategic global priorities" to inform cases and work (modelled on the 'regulatory colleges' that exist in the financial services sector for large banks). As more proposals for regulation of digital markets are unveiled (the European Commission is, for example, due to announce its package of measures on 15 December), it is clear that international cooperation will become ever more important.

The road to the new regime

The Taskforce's recommendations are intended to give the Government the information it needs to form the basis of the legislation setting out the new regime. We expect it to take many of the Taskforce's recommendations on board. But there are likely to be some areas of controversy and debate – prime candidates are the scope of the PCIs and the parameters of the SMS merger control regime. The DMU is keen to assist the Government in progressing the initiative as quickly as possible. And the Taskforce notes that even ahead of the establishment of the DMU, the CMA could begin to undertake designation assessments, particularly in relation to Google and Facebook's activities in digital advertising. Progress towards the implementation of the new regime therefore looks set to be rapid. All eyes will be on the Government's public consultation on the rules, due for early 2021, closely followed by the establishment of the DMU in April. Watch this space.