



New UK pro-competition digital markets regime confirmed by Government

May 2022

UK competition rules are facing unprecedented levels of change. Last month we reported on the **UK Government's intentions for broad reforms to the competition and consumer law regimes**. Now, the Government has set out the framework for an entirely **new "pro-competition regime" for digital markets**.

The aim of the new regime is to tackle "the harmful effects and sources of substantial and entrenched market power" in the digital sector, including by governing the relationship between users and key digital firms.

It will be overseen by the Digital Markets Unit (DMU), which was launched within the Competition and Markets Authority (CMA) in April 2021 and is currently working in shadow form. The DMU will be responsible for designating firms as having "Strategic Market Status" (SMS), setting out how such firms should behave through conduct requirements, implementing "pro-competitive interventions" (PCIs) and enforcement.

The Government's announcement of its plans was well-timed – rumours were circulating that the new digital markets regime might have been shelved. While these have now been stamped out, there is still uncertainty around when the new rules will be adopted. A draft Digital Markets, Competition and Consumer Bill was mentioned in the Queen's speech, suggesting that the rules will be drawn up in the coming year, but not enacted. The Government simply says that legislation will be brought forward "when Parliamentary time allows".

There is also a lack of clarity over the precise detail of the regime. The Government's intentions are in many places framed in broad terms. It notes it is still considering the best way to implement a number of the proposals. The devil will therefore be in the detail of the legislation and accompanying DMU guidance.

The DMU: promoting competition and working collaboratively

The DMU's core objective will be to promote competition in digital markets within and outside the UK for the benefit of consumers.

Importantly, the Government has confirmed that the interests of citizens will not be included in the DMU's statutory duty. Many respondents to the consultation raised concerns that this could risk regulatory overreach, allowing the DMU to consider wider societal issues, and would reduce clarity. The Government agrees.

In line with a more general trend for UK regulators to coordinate their activities:

- The DMU will be required to work closely with the Financial Conduct Authority (FCA), Ofcom, the Information Commissioner's Office, the Bank of England and the Prudential Regulation Authority – it must consult with them where proportionate and relevant, and notify them when opening an SMS designation assessment.
- The FCA and Ofcom will be able to hand over any competition concerns they identify in their sectors if the DMU is best placed to address these through its new powers.
- There will be mechanisms to ensure effective information exchange between regulators.

The activities of the DMU will be funded in part by a levy imposed on firms designated as having SMS.

A more clearly defined scope

The Government recognises the need to balance the flexibility of the new regime with clarity and predictability for businesses. To this end, it intends to define the scope of the new rules more narrowly than originally proposed:

- **The regime will only apply to certain types of “digital activities”.** The Government is considering how to define these activities in a way that is clear and easy to apply. Getting this definition right will be key to providing legal certainty.
- **SMS will be applied to only a limited number of firms meeting certain evidence-driven criteria:**
 1. **A firm must have substantial and entrenched market power in at least one digital activity.** The Government does not give further details in its response. In the consultation it noted that “substantial market power arises when users of a firm's product or services lack good alternatives...and there is a limited threat of entry or expansion by other suppliers”. Entrenched market power occurs “once a firm's market power is expected to persist over time and is unlikely to be competed away in the short or medium-term”.
 2. **This market power must give the firm a strategic position.** The list of criteria to assess whether a firm has a strategic position will be exhaustive and set out in the legislation. While this will be helpful in providing certainty, it raises the question of how to adapt the criteria in fast-moving digital markets. The Government is exploring options for periodic updates. The DMU will be required to publish guidance on these issues.
 3. **A UK nexus requirement** will ensure a focus on competition in the UK.
 4. **A minimum revenue threshold** will make clear that small firms are not in scope. The Government gives no indication as to what an appropriate threshold would be.

Which firms and which of their digital activities will be targeted for a designation assessment will be at the discretion of the DMU. DMU guidance will therefore provide important details on how it will prioritise cases in practice.

The DMU will have a deadline of nine months to complete an SMS designation assessment. This is extendable by three months in exceptional circumstances.

Conduct requirements: a flexible, tailored approach

SMS firms will be subject to binding conduct requirements, setting out how they are expected to behave. These will manage the effects of their market power with a view to preventing harms before they occur.

The legislation will set out high-level objectives for SMS firm behaviour and categories of conduct requirement.

The Government is still finalising the precise wording of the objectives, which will relate to 'fair trading', 'open choices' and 'trust and transparency'. It gives examples of potential conduct requirement categories:

- Not to apply discriminatory terms, conditions or policies to certain users or categories of users, compared to equivalent transactions.
- Not to bundle or tie the provision of other products or services by making access to them conditional on the use of the relevant designated activity.
- Not to leverage other parts of the business to further entrench power in a designated activity.
- To provide clear, relevant, accurate and accessible information to users.

Crucially, these conduct requirements will not apply to every SMS firm in the same way. It will be for the DMU to develop specific binding requirements within these categories for each SMS firm, tailored to the exact circumstances of that firm. It is expected to do this in parallel with the SMS designation assessment. DMU guidance will set out how each firm's conduct requirements will operate in practice. To allow for evolving markets and associated harms, the DMU will be able to remove and amend conduct requirements.

Interestingly, the Government will introduce an exemption to ensure that conduct bringing about net consumer benefits will not breach conduct requirements. For example, SMS firms will be able to argue that leveraging conduct that would otherwise breach conduct requirements brings about benefits to consumers, is indispensable to achieving the benefits and that the benefits outweigh the potential harm. Meeting the evidence burden of this defence may prove tricky. General and informal DMU guidance on the application of the exemption will be vital to give SMS firms sufficient comfort that they will not face enforcement action.

Failure to comply with the conduct requirements could ultimately lead to final enforcement orders and financial penalties. Once it has formally opened an investigation, the DMU will also have the power to impose interim orders to pause or reverse conduct.

In addition, as a last resort for pricing-related disputes, the Government is considering a mechanism based on binding final offer arbitration.

PCIs: wide remedial powers including structural separation

The Government's intention is for PCIs to tackle the root causes of substantial and entrenched market power. The PCI regime will in many ways mimic the CMA's existing market investigations regime. In particular:

- The DMU will have broad discretion to implement a similarly wide range of remedies. Significantly, this will include the power to implement ownership separation, although only where it is appropriate and other remedies are insufficient. The CMA has used this power only rarely in market investigations – while not certain, we anticipate that the DMU will take a similar approach.
- In order to be able to implement a PCI, the DMU must prove an adverse effect on competition.
- There will be safeguards in the form of consultation requirements and rights of appeal.

The DMU's intervention approach will be iterative. It will be able to monitor, trial, review and amend PCI remedies, and accept voluntary enforceable undertakings from SMS firms during the course of an investigation.

The statutory deadline for completing a PCI investigation will be set at nine months, with an optional three-month extension in exceptional circumstances.

Controversially, the DMU will be able to implement PCIs anywhere within an SMS firm, provided the intervention relates to a competition concern in a designated activity. The Government has decided that this aspect of the regime was "needed to ensure the DMU can address any anti-competitive leveraging of a firm's market power across its ecosystem". The DMU will, however, need to demonstrate the direct relationship between any intervention and the concern.

DMU guidance will provide further insight on many of these aspects, including on the types of PCIs it will consider implementing in different circumstances and how trials will be run. In the meantime, joint **CMA/Ofcom advice** has been published, which sets out how conduct requirements could oblige big tech firms with significant bargaining power to agree fair and reasonable terms for the content they use on their platforms.

Strict powers of enforcement, including for individuals

The Government has opted to give the DMU tough enforcement powers, as a back-up to light-touch ongoing dialogue with SMS firms.

SMS firms that breach the conduct requirements or fail to comply with PCI orders face fines of up to 10% of global turnover, with additional daily penalties of up to 5% of daily global turnover for continued breaches. The DMU will be able to investigate and enforce against conduct occurring overseas where there is sufficient connection to the UK. Information offences will be penalised with a fine of up to 1% of global turnover, with further 5% daily fines available for continued non-compliance.

With the aim of embedding a culture of compliance within SMS firms, senior managers will also be on the hook. The DMU will be able to impose civil penalties on named senior managers who fail to ensure the firm complies with requests for information. "Serious misconduct" may also result in director disqualification. Civil and criminal penalties will apply to anyone knowingly or recklessly providing the DMU with false information.

In addition, the DMU will have broad powers to gather information, including the ability to conduct dawn raids, interrogate algorithms, require field trials and request compliance reports. This will extend to information stored overseas.

DMU decisions will be subject to review on judicial review principles.

Merger control proposals reined in

The merger control proposals in the consultation were ground-breaking, amounting to a whole new bespoke merger control regime for SMS firms. In welcome news, the Government has dropped many of these plans, settling for a narrower reporting mechanism.

SMS firms will be required to report certain merger transactions to the CMA prior to their completion. Rather than a requirement for SMS firms to inform the CMA of all mergers, as proposed in the consultation, the Government is minded that the reporting obligation will only apply when:

- i) the SMS firm acquires > 15% equity or voting share after the transaction;
- ii) the value of the SMS firm's holding is > GBP25m; and
- iii) the transaction meets a UK nexus test (as yet undefined).

This flagging mechanism will give the CMA basic information and the opportunity to carry out an initial assessment. It will then decide whether to request more information and/or initiate a standard merger review.

Importantly, this does not in itself expand the CMA's jurisdiction to review mergers in digital markets. The Government has dropped plans for an additional SMS-specific transaction value jurisdictional threshold.

Instead, the Government will introduce a new threshold as part of its **planned reforms to the broader competition regime**, which is in large part aimed at “killer acquisitions”, many of which involve digital markets. It will be met where a party has a share of supply of at least 33% of any goods or services in the UK (or a substantial part of it), a UK turnover of more than GBP350m, and there is a UK nexus.

The Government has also cancelled other, more interventionist measures. First, its radical proposal for a mandatory suspensory element to some SMS merger reviews. Secondly, a suggested change to the substantive test probability standard for phase 2 merger investigations. After hearing concerns about how this may negatively impact UK investment, the Government now plans to stick with the “more likely than not” balance of probabilities standard, rather than change to a lower “realistic prospect” of a substantial lessening of competition.

The UK regime in the international context

The planned UK regime sits alongside a number of initiatives from governments and regulators across the globe. In March, for example, EU institutions announced that they had reached political agreement on **proposed EU rules for “gatekeeper” digital platforms**.

Interestingly, the Government presents the new UK regime as a more flexible, targeted and proportionate regime to those emerging in other jurisdictions. Compared with the EU rules, there is certainly scope for the UK conduct requirements to be more tailored to individual firms. And the UK's proposed exemption for net consumer benefits is novel.

However, as EU **Executive Vice-President Vestager has pointed out**, digital regimes are broadly heading along the same path, and authorities will push for close cooperation to avoid enforcement gaps between jurisdictions. This in turn could help to reduce the likelihood of firms having to navigate a patchwork of regimes.

What is clear in respect of both the UK and the EU is the continuing significance of traditional antitrust enforcement. We expect it to play a complementary role, both while the regulatory legislative and implementation process progresses and beyond.

Contacts



Mark Friend
Partner - London
Tel +44 20 3088 2440
Mark.Friend@allenoverly.com



Dominic Long
Partner - London & Brussels
Tel +44 20 3088 3626
Dominic.Long@allenoverly.com



Philip Mansfield
Partner - London
Tel +44 20 3088 4414
Philip.Mansfield@allenoverly.com



Thomas Masterman
Partner - London
Tel +44 20 3088 3386
Thomas.Masterman@allenoverly.com



Kristina Nordlander
Partner - London & Brussels
Tel +44 20 3088 1280
Kristina.Nordlander@allenoverly.com



Louise Tolley
PSL Counsel - London
Tel +44 20 3088 3585
Louise.Tolley@allenoverly.com



Emily Bourne
Senior PSL - London
Tel +44 20 3088 4562
Emily.Bourne@allenoverly.com

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales. The term partner is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2022. This document is for general information purposes only and is not intended to provide legal or other professional advice. | 2008440211