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THE DMA AND THE ROLE OF ECONOMICS

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The Digital Markets Act (DMA) represents a significant overhaul of the European Union's approach to digital markets and is the first time that *ex ante* regulatory obligations have been imposed on digital markets.

In contrast to competition law and other regulatory settings, the DMA has removed economic considerations from its implementation. Instead, the DMA sets out a pre-defined list of services, called 'core platform services', a list of criteria to identify 'gatekeepers', and a list of obligations and prohibitions that these gatekeepers must adhere to. In this note, we discuss the pros and cons of this approach from an economic perspective.

We find that the lack of proper effects and efficiency considerations may result in two types of imperfect enforcement. First, the DMA may prohibit behaviour that benefits consumers or at least does not harm them. Second, by setting too narrow a list of prohibited conduct, the DMA may fail to capture behaviour that could have the same effects as the prohibited conduct. Finally, we explain that the lack of proper effects and efficiency considerations may result in imperfect enforcement.

GETTING RID OF ECONOMICS COMES AT A COST

While the design of the DMA quite clearly draws upon several high-profile competition cases from the digital sector that relied on economic concepts such as effects on competition, economics is not a key component in the enforcement of the DMA itself. While the omission of economics may certainly simplify enforcement procedures, this does not come without a cost.

The lack of economics increases the risk of under- and overenforcement

A core principle in economics is that markets typically deliver good outcomes for consumers except where there is a market failure. Even if there is a market failure, this does not necessarily warrant intervention unless the practice harms consumers.

Economic analysis has often played an important role in enforcement by identifying market failures and behaviours that exploit these failures to harm consumers, ultimately ensuring that intervention is limited to cases in which it is necessary.

In competition law, market failures that harm consumers are identified based on concepts such as market definition, dominance, effects-based analysis, or efficiency considerations. Without these economic mechanisms, the DMA becomes a blunter instrument.

This absence of economic considerations is deliberate and will in many cases allow the DMA to swiftly hit its intended target. However, the absence of economics also implies a risk of both under and overenforcement.

Underenforcement could occur if a gatekeeper engages in conduct covered by the list of prohibitions, but in another digital platform market than the core platform services. Another risk of underenforcement relates to a gatekeeper engaging in behaviour that is not captured by the DMA's list of prohibitions but has the same effect as prohibited conduct. By setting a limited set of rules that gatekeepers must abide by, the DMA may make it easier for gatekeepers to circumvent them.[1]

Overenforcement could occur if a firm's gatekeeper status, and consequent enforcement costs, deter the firm from aggressively competing with other established gatekeepers. Overenforcement may also occur if conduct practised in a specific context would deliver net benefits to consumers, even when practised by a gatekeeper, but the practice is prohibited by the DMA. This may be the case for several forms of leveraging conduct that the DMA prohibits. Although some of this behaviour is prevalent, it has only been sanctioned in a small number of high-profile competition cases.[2] This is the case because leveraging practices can create efficiency gains, which may be passed on to consumers. In the same way, consumers may in certain cases have preferences for "one-stop shopping".

The lack of economics limits the DMA's ability to be future proof

Even under the assumption that the combination of gatekeeper thresholds, core platform services, and 'self-executing' obligations will not lead to undue intervention today, this will not necessarily hold in the future.

The lack of economics limits the regulatory safeguard mechanisms built into the DMA. Regulatory intervention in other settings includes the rolling back of provisions when they are no longer necessary or automatically extended to reflect new developments. However, limiting the role of economics makes the DMA less future-proof.

The Commission has attempted to future-proof the DMA by allowing for the use of market investigations – but there is no built-in mechanism to determine when a market investigation should occur. Moreover, such investigations can only recommend changes to the list of services, obligations, and prohibitions. They cannot give the Commission new enforcement powers.

While it is likely that legislators will recognise the need to conduct a market investigation to expand the list of core platform services or obligations, they may not experience the same urgency to limit the list of services or obligations. This means that the likelihood of the regulation being rolled back on time is lower. Deregulation could be relevant if, for example, disruptive innovation undermines the relevance of a legacy service or if it becomes apparent that the list of obligations restricts behaviour that could benefit consumers.

Ex ante regulation need not necessarily omit economic principles

One of the key design features of the DMA is that it imposes *ex ante* rules. Employing an *ex ante* approach has clear benefits as it can ensure timely intervention, addressing issues before they arise. However, *ex ante* regulation does not have to omit the use of economic mechanisms. Instead, this is a choice of the legislator.

Ex ante regulation of telecoms markets, so-called significant market power (SMP) regulation, relies on economic principles to a large extent. Similar to the DMA, SMP regulation was designed to address concerns even before they arose, but it has several safeguards in place to protect against undue regulation, all of which build on economic principles:

1. **Market definition** is used to identify existing competitive constraints and thus cases where competitive forces may be sufficient to ensure good outcomes.
2. **An explicit safeguard against the regulation of emerging markets** protects incentives to invest in *"…new and emerging markets, in which market power may be found to exist because of "first mover" advantages […] [These markets] should not in principle be subject to ex ante regulation".*[3]

[1] The DMA allows for additional obligations to be included in the future through the market investigation mechanism. However, any such alterations would still have to go through the legislative process, which would affect the speed of enforcement, one of the main objectives of the DMA.

[2] For example, note the different conclusion of the UK High Court when assessing Google Maps and the European Commission when assessing Google Shopping.

[3] Commission Recommendation 2003/311 of 11 February 2003 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation, in accordance with Directive 2002/21/EC, para 16.]

3. **The Three Criteria Test** checks whether a market suffers from the kind of structural market failure that would warrant *ex ante* regulatory intervention by asking three questions: (i) whether a market has high barriers to entry, (ii) whether there is a tendency towards effective competition, and (iii) whether competition law is considered insufficient because market failures are 'persistent' and 'extensive' and/or whether 'timely intervention' would be difficult.
4. **A test of SMP** on the relevant market as defined in Point 1. A high market share alone is not sufficient to identify SMP. Other evidence, such as buyer power, profitability, economies of scale, and scope may also contribute to the assessment.

These safeguards have served to ensure that SMP regulation is more future proof and periodic review has led to gradual deregulation. The list of specific telecoms markets deemed most relevant for *ex ante* regulation (a list that could be considered conceptually similar to the list of core platform services of the DMA) has been shortened from 18 markets when the Commission published its first 'Recommendation' in 2003 to just two today.

THE NEW LIMITED ROLE OF ECONOMICS WITHIN THE DMA

While the DMA has largely omitted economic considerations from its text, our reading of the final version of the DMA suggests there are two areas where economic considerations will be required. The DMA states its objective is to ensure 'contestability' and 'fairness' in digital markets. Since these objectives, particularly contestability, are rooted in economic concepts, we expect that economic analysis will be required when determining whether these objectives are achieved.

Regulatory Dialogue

While the DMA largely dismisses the role of economics in determining which actions and behaviours to allow or prohibit, Article 8 of the DMA reserves a role for regulatory dialogue in the application of the obligations listed under Article 6. It states that the Commission's decisions specifying how a gatekeeper should implement obligations should ensure that these specifications '*are **effective in achieving the objectives** of this Regulation and the relevant obligation, and **proportionate in the specific circumstances** of the gatekeeper and the relevant service*'. [**emphasis added**]

We understand that the Commission will thus have an obligation to show that its specifications of obligations: (i) are best designed to achieve the stated objectives of the regulation (contestability and fairness) and the obligation, and (ii) are proportionate. Since contestability is inherently an economic concept, we would expect that the Commission and stakeholders use economic analysis in their Article 8 decisions and argumentation.

Gatekeepers will also be able to suggest how to comply with DMA obligations. If the Commission accepts a gatekeeper's request for specification, it must publish a non-confidential version of its draft decision and give 'interested third parties' the right to provide comments. We expect that the analysis provided in this context will likely include economic analysis to show how the objectives of the regulation (ensuring contestability and fairness), and the objectives of the obligation, are achieved more effectively with a particular specification.

We also expect the economic analysis to be important in determining payment and value in instances where gatekeepers can receive compensation for the services or data they have to provide under the DMA. This applies to, for example:

- Article 6, paragraph 11, mandating gatekeepers operating online search engines to provide access to its 'query, click and view data' on 'fair, reasonable and non-discriminatory' terms; and
- Article 6, paragraph 12, mandating gatekeepers to apply 'fair, reasonable, and non-discriminatory general conditions of access to non-business users' to their app stores and online search engines.

The term 'fair, reasonable, and non-discriminatory' (FRAND) is frequently used to determine payment in intellectual property litigation when a firm is mandated to share its intellectual property. While there is rarely a consensus on how to determine FRAND terms, there is extensive economic literature discussing how to calculate FRAND payments in different circumstances. Different methods include looking at value creation, appropriate margins, or looking at similar settings in other markets.

Article 8 also requires the Commission to ensure that any obligations it imposes are proportionate. While this is ultimately a legal question, from an economic perspective it could be argued that an obligation or prohibition which is detrimental to consumers, or which does not achieve the contestability and fairness objectives, would not be proportionate. If a gatekeeper uses this argument to justify a particular specification of its

obligations, we expect that it would need to use similar considerations to those that are typically used in an efficiency defence.

Anti-circumvention

Finally, the DMA also includes anti-circumvention prevention. Article 13 paragraph 4 states that a *'gatekeeper **shall not engage in any behaviour that undermines effective compliance** with the obligations of Articles 5, 6 and 7'*.

At this stage, it is unclear how these obligations will be interpreted. However, it is possible to draw a parallel with the enforcement history of Article 102. For example, 'margin squeeze' abuse is used in cases where a dominant undertaking does not outright refuse to supply access to an essential facility but still makes it impossible for downstream rivals to compete effectively with the integrated dominant firm. In that sense, a margin squeeze can be seen as a circumvention of Article 102's prohibition of outright refusals to supply or of regulatory-mandated supply (e.g. in the telecoms sector).[4]

We expect that similar considerations will apply to the application of the DMA. For example, where a gatekeeper provides access to its ranking services for its products and those of its rivals under equal conditions, the Commission may consider a situation where an independent rival cannot commercially replicate the gatekeepers' offering and cover its costs as circumvention. Such considerations generally involve economic analysis.

Feedback welcome

The views expressed reflect our own opinion on the significance of this topic for digital markets. This note is a summary of an article which is forthcoming in the Competition Law & Policy Debate journal later this year.

At CE, we advise companies in the TMT and digital sector on a broad range of economic issues. If you would like to discuss the issues in the above article or the potential impacts of the DMA on your company, please do not hesitate to get in touch with the authors.

[4] Effectively, a margin squeeze is a form of "constructive refusal to supply" according to established case law.