

# Microsoft Response to the UK CMA Digital Markets Taskforce Call for Information

(31 July 2020)

We appreciate the opportunity afforded to the public by the United Kingdom Competition and Markets Authority (**CMA**) to provide input and evidence to the Digital Markets Taskforce (**DMT**) as it considers what intervention, if any, is necessary to protect and promote competition and innovation in digital markets and to address the anti-competitive effects that can arise from the exercise of market power in those markets.

As the DMT recognizes in its Call for Information, digital platforms are transforming the way we live and work. They have changed the way we communicate with one another, created new channels for expression and creativity, and enabled almost instantaneous access to a multitude of information. They have expanded the reach of commerce, transformed commercial relationships, and created new opportunities for businesses big and small. And this is just the beginning. But as digital advances bring us daily benefits they also raise a host of complex questions, including what steps should the government take to ensure healthy and vibrant competition and innovation in digital markets and to guarantee that consumers reap the full benefits of those platforms.

As the DMT considers this question, it is critical that any new approach carefully balance the competing interests at stake. It must include procedural and substantive safeguards that ensure both the rights of defense for those impacted and that avoid interventions that could quash or stall innovation and harm consumer welfare. Below we provide Microsoft's comments on each of the three areas identified in the Call for Information: (1) the scope of a new approach to promote competition and innovation; (2) the range of potential types of remedies that should be available under that approach; and (3) designing the procedure for that approach.

## **A. The Scope of a New Approach.**

As the Digital Markets Taskforce states, the proposed new approach is intended to cover those digital platforms with "strategic market status" (**SMS**). Microsoft agrees with the assessment of the "Furman Review"<sup>1</sup> that SMS should be an exacting and high standard for which only a few platforms likely qualify, encompassing those that have an enduring position of control over the market access of other parties. Accordingly, as the Digital Markets Taskforce recognizes, the first step is to determine scope: which digital platforms qualify for SMS.<sup>2</sup>

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<sup>1</sup> See Report of the Digital Competition Expert Panel, *Unlocking Digital Competition* at para. 2.116 (March 2019) ("Furman Review") ("Only a small number of companies should be within the definition of a well-defined test that matches the characteristics of the sector.").

<sup>2</sup> See Digital Markets Taskforce, *Call for Information* at para. 2.3 (available at <https://www.gov.uk/cma-cases/digital-markets-taskforce>).

The term “digital platform” encompasses a diverse set of businesses, including ecommerce marketplaces, app stores, search engines, social networks, ride-sharing services, infrastructure-as-a-service, operating systems and more. But, all platforms, by definition, operate in two-sided markets, facilitating interactions between suppliers – e.g. sellers, developers, and advertisers – on the one side and users on the other. For simplicity, they can be sorted into three different categories (although a digital platform might bring together different services that fall within different categories):

(a) *Matchmakers, marketplaces, and exchanges* – These digital platforms match buyers and sellers or consumers and providers, intermediating the relationship between both sides. Typically, the digital platform earns revenue by charging a fee when a sale or transaction between the two sides is made. Examples of such platforms include Amazon, eBay, AirBnB, Uber, Steam and Angie’s List.

(b) *Ad-supported consumer platforms* – These digital platforms aggregate users by offering a free or low-cost service and earn revenue primarily by charging advertisers to advertise to those users. These digital platforms intermediate the relationship between advertisers and their users. They typically leverage user data – whether volunteered, observed, or inferred through use of the platform service – to optimize advertising. Examples of ad-supported consumer platforms include Microsoft Bing, Google Search, Snapchat, Twitter, and Facebook.

(c) *Software platforms* – These digital platforms enable an ecosystem of developers to build applications and software solutions which are purchased and used by users on the respective platform. These platforms may be open or closed. For example, Microsoft Windows and Linux operating systems as well as cloud platforms such as Amazon Web Services and Google Cloud Platform are open. Developers have access to a variety of channels through which they can effectively and efficiently sell applications and software solutions directly to users. These platforms are primarily monetized by charging users a fee (whether one-time, on a subscription basis, or on a consumption basis) to use the platform or for related support services. In contrast, Apple iOS is closed. It requires that applications be distributed via an integrated “app store” controlled by Apple. Apple earns revenue from the sale of its platform (integrated in mobile devices) as well as charging fees for sales made by developers via its App Store.

In Microsoft’s view determining which of the different platforms in these categories qualify for SMS should involve a two-pronged test. SMS should only be found for digital platforms (a) with market power protected by significant and very strong barriers to entry and (b) that control access to a unique set of users and/or other platform participants because those users or platform participants lack the incentive and/or ability to go around the platform to connect directly.

In considering market power and barriers, the most likely relevant barriers would be:

- *Network effects.* Network effects occur where the value of a service grows as the total number of users increases. Network effects can be direct, flowing from interactions with other users, or indirect, arising from a complement to the network (e.g. apps). The reinforcing nature of network effects and the positive feedback loop that makes the platform stronger as more users join. Absent equivalent scale, rival platforms cannot match the value provided by the network effects of the incumbent and effectively compete for users.

- *Economies of scale.* These economies occur when costs do not increase proportionately and/or the quality of the platform increases as the number of users or other participants on the platform increase. They are prevalent in digital markets where production typically requires a significant investment in fixed costs but no or little variable costs. Getting a digital platform to scale is challenging and if important aspects of the platform, such as service quality, monetization options, or other factors require scale, then rivals or potential rivals will be hard pressed to compete for users with the incumbent.
- *Economies of scope due to the role of data.* These economies occur if data is a significant input to the digital platform product or service and access to this unique data creates hurdles that other competitors cannot overcome. Digital markets tend to be data-driven and, as such, also tend toward tipping. Where machine learning is important to product quality or monetization and a data source is unique, necessary and not replicable, then that data serves not only as a barrier, but the incumbent's advantage grows over time through the positive feedback loop associated with the data. Again, rivals – who lack an equivalent data set or stream – will be disadvantaged against the incumbent in competing for users.
- *Limited offsetting from multi-homing and differentiation.* If a digital platform's user base single-homes all or most of the time, then the platform will enjoy significant control over its users. This can occur when, for example, switching costs are high, behavioral nudges such as defaults discourage switching, or the platform is part of an ecosystem's walled garden that prevents users from accessing other services. In addition, the tendency to offer platform services for free to users along with information asymmetries can limit the ability of rivals to differentiate themselves. Indeed, users often have limited ability and information to determine the true cost of a "free" digital platform service; they do not understand how much data is collected, how it is used, and what the platform charges other parties for platform access and whether service quality and value is sufficient relative to the "price paid."

Indeed, these platforms are ones that should be able – through their conduct – to deny a non-trivial number of users (or move a non-trivial number of users away from) potential or actual rivals or into adjacent markets. The effect of such conduct would be to deny scale essential to entry and competition by rivals.

That being said when distinguishing between platforms that may have market power that can be addressed by existing competition rules as compared to platforms with SMS that present unique problems, the DMT should consider whether the platforms are nonetheless somewhat constrained because suppliers and users can "go around" the platform. If both sides can go around the platform in sufficient numbers, then the platform may not have SMS because it may not be in a position to control access to users or other platform participants. This lack of control makes it more likely that eventual entry and competition by rivals could arise, but it also limits the platform's ability to harm overall consumer welfare even in the absence of new competition. For example, private vacation rental services can match renters and property owners, but the two sides of the platform are eventually connected together and can come to private arrangements circumventing the platform in the future. If the platform's terms are too onerous, then one or both sides will have the incentive and ability to go to the trouble of connecting directly to circumvent the platform either then or in the future. Thus, there is some limit on the platform's

practices even if a new competitor is unlikely to enter the rental service platform market because of barriers to entry. On the other hand, in situations where the platform controls and mediates engagement between the two sides of the platform and technically or otherwise limits the ability to connect absent intermediation by the platform, then going around the platform in the future could be difficult. Similarly, if the user does not have the incentive to go around the platform, such is the case with many free services or when the user does not have visibility into other options beyond what is presented by the platform, which is often the case in aggregation markets where aggregation and discovery is the primary benefit of the platform, then users will not go around the platform even if better options might exist.

## **B. Remedies for Addressing Harms.**

Once a firm with SMS for a digital platform is identified, it will be important that substantive obligations are created with care to preserve the consumer benefits that the platforms provide, while addressing the problematic aspects of the specific platform. Microsoft believes that the Online Platforms and Digital Advertising Study provides an appropriate framework that could be applied to other types of digital platforms for which a firm is found to have SMS. That study states:

*We propose that the code should be based around three high-level objectives (fair trading, open choices, trust and transparency), with principles within each objective, providing greater specificity as to the behaviour required by the code. The fair trading principles are intended to address concerns around the potential for exploitative behaviour on the part of the SMS platform, the open choices principles are intended to address the potential for exclusionary behaviour, while the trust and transparency principles are designed to ensure that SMS platform provides sufficient information to users, so that they are able to make informed decisions. Each SMS platform **would have its own tailored code**. Published guidance for each SMS platform would provide more detail on practical application of the principles to the markets within which the SMS platform would operate.<sup>3</sup>*

Combining both broad level principles that determine the type of behavior required for all platforms with SMS and then including more detailed and platform-specific codes of conduct enables greater predictability for specific platforms while also ensuring that the high level principled approach is the same for all SMS digital platforms.

Microsoft also agrees that in addition to creating enforceable codes of conduct, a future Digital Markets Unit (**DMU**) should have the power to implement specific remedies focused on conduct by the SMS platform. These remedies may take a variety of forms, but they should be proportionate. To the extent possible, remedies should be coordinated with other relevant agencies domestically (e.g. U.K. Information Commissioner's Office and U.K. Office of Communications) as well as internationally. Otherwise remedies may have unintended consequences in other areas of regulatory concern and may conflict with obligations imposed by other jurisdictions. Coordination may also open up opportunities to drive greater effectiveness across multiple dimensions and potentially at a broader scale. Ultimately, however, the key consideration in Microsoft's view, is that substantive obligations be created for each SMS platform,

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<sup>3</sup> See UK Competition and Markets Authority, *Online Platforms and Digital Advertising Market Study Final Report*, paras. 80-81 (1 July 2020).

reflecting the unique competitive dynamics and business models of each, instead of adopting a one size fits all approach.

### **C. Designing the Procedure of a new pro-competition approach.**

As is clear from the discussion above, the powers of a future DMU will be significant and there will be significant risks that over regulation harms digital platform innovation or otherwise reduces consumer welfare. Moreover, the interventions can have significant impacts on private companies and individual rights. As such, it is critical that there be robust procedure and checks and balances put in place both within a future DMU and from other institutions, most especially the courts. These procedures must balance the need for speed and flexibility against the concerns associated with due process, rights of defense, and avoiding misplaced interventions that harm consumer welfare. In this regard, Microsoft believes the following two-step approach is appropriate:

- (i) A detailed and careful review should be conducted with the DMU bearing the burden of proof as to whether any particular firm qualifies for SMS and providing for the rights of defense, including judicial review, for market participants impacted.
- (ii) Once SMS is established, the DMU should have broad intervention powers subject to concepts like proportionality but for which the SMS firm has the burden of establishing that the code of conduct or intervention is not proportional or is otherwise unreasonable.

First, in making the initial SMS determination, firms must have complete rights to participate in the work determining whether the firm has SMS with respect to any digital platform. The work involved and the rigor should be similar to the approach to market investigations undertaken by the CMA. The process of determining SMS should include rigorous procedural safeguards to ensure that issues are fully investigated without prejudging remedies that may be imposed (e.g., separation of investigative and remedial phases) and to protect the interests of stakeholders (e.g., rights of defence and independent judicial review). Because of the extraordinary powers of the DMU to intervene once SMS is established, the burden of proving SMS should remain with the DMU.

Once SMS is established and to enable more timely and effective intervention, however, the burden should shift so that the SMS digital platform owner must carry the burden of establishing that any element of the code of conduct or specific intervention is not warranted in the specific case. The code or specific intervention may not be justified because it is not proportionate, will actually harm competition, or otherwise will not benefit consumer welfare. This burden shifting can strike a reasonable balance between ensuring interventions only occur when warranted but providing the flexibility to the DMU to arrive at reasonable and timely solutions once SMS has been established. Both the determination of SMS as well as codes of conduct and other interventions should be subject to independent judicial review.

Finally, some mechanism for periodic review needs to be included in the process. This review would consider both whether the firm continues to have SMS and/or whether the code and other obligations can be eliminated. It should also consider whether interventions are having their intended purpose and whether they should be kept, modified, or eliminated, based on the extent to which they achieve the

following: predictability, entry, innovation, consumer benefits, and lower prices. These reviews should occur reasonably often, perhaps every three to five years.