



LAUNCHWORKS

Launchworks & Co | Kings House | 174 Hammersmith Rd
Hammersmith | London W6 7JP | United Kingdom
Tel: +44 207 160 63 21 | E: info@launchworks.co
www.launchworks.co

Principles for the governance and regulation of digital platforms¹

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Abstract: Digital platforms now orchestrate vast ecosystems underpinning the innovative development and distribution of products, services and contents globally. It is generally in the platforms' interest to follow good governance principles to ensure the healthy growth of their ecosystems. Yet at times platforms' incentives may not be aligned with its participants or with society as a whole. This paper discusses platform governance principles, when the introduction of various forms of regulations may be warranted and how principles of good regulation developed in other sectors can be adapted and used for platform regulation. In particular, we believe there is an opportunity for platforms, regulators and ecosystem participants to co-develop new principles to address competition concerns and avoid adversarial outcomes.

Keywords: digital platforms, regulation, competition, antitrust, ecosystem governance.

¹ This paper was co-authored by Benoit Reillier, Dr Richard Cadman and Justin Coutts, respectively Managing Director, Senior Advisor and Platform Architect at [Launchworks & Co](http://www.launchworks.co) where they help policy makers and organisations of all sizes harness the power of innovative ecosystems and platform based business models. This paper draws on the advisory work that the authors are currently doing for Google. Launchworks & Co has advised a wide range of organisations and digital platforms in a variety of sectors, for more information see <https://www.launchworks.co/>.

*“Simple, clear purpose and principles give rise to complex intelligent behaviour.
Complex rules and regulations give rise to simple stupid behaviour.”*
Dee Hock, Founder, Visa Inc

It is increasingly common for policy makers and politicians to start their speeches on digital markets by highlighting the incredible contribution that innovative digital platforms have made to the global economy. Yet such praise is almost invariably followed by suggestions that these very platforms, now too big and powerful, need to be regulated. While the exact shape these new regulations will take is still unclear, experience in other regulated sectors – such as telecoms – are often mentioned as a key source of inspiration. However the regulation of dynamic, innovative, fast moving and global platform markets poses unique challenges that make it difficult to follow traditional approaches. Some clear and established economic tests can be useful as starting points but new flexible approaches to regulation and competition enforcement will need to emerge to respond to the challenge.

One promising avenue is the development of high level platform governance principles – that can be enshrined into codes of conduct – to guide the behaviour of digital platforms and help address some of the emerging competition concerns and public policy objectives identified². We note that platform businesses already have governance frameworks to balance the interests of different ecosystem participants and that these could form the basis of individual or collective codes of conduct.

Policy makers also need clear intervention principles to decide when, what and how to regulate in order to address perceived market failures and achieve desirable outcomes. Many of the principles of good regulation are well established, and in some ways quite similar to the principles that platforms themselves need to follow to regulate their markets, for example when they seek to protect participants and foster trust. These principles are key to ensuring the emergence of a data driven, proportionate and forward looking framework that will address anti-competitive concerns and foster innovation. Finally, regulatory alignment across jurisdictions will be crucial to delivering the benefits we expect from the development of these digital markets and avoid fragmented and inconsistent interventions that would undermine the development of future digital products.

This paper discusses the following issues concerning the governance and regulation of digital platforms:

- I. Why principles-based regulation is more flexible than rules:** examines the reasons why principles are often better suited than detailed rules to regulate services in the digital sector;
- II. How platform governance can be a starting point for principles-based regulation:** reviews the sets of governance principles that are currently used by digital platforms, including their strengths and weaknesses as a basis for regulation;
- III. When is economic regulation needed in the first place:** considers how regulatory gaps can be identified and the conditions that ought to be met before competition and competition law gives way to regulation; and
- IV. What are the features of a digital regulatory regime:** discusses which features would facilitate regulation of digital markets to meet the desired regulatory goals while minimizing any adverse or unintended consequences.

² Concerns mentioned by the Commission in the context of digital platforms include self-preferencing, leveraging, access to data, interoperability, management of ID services, killer acquisitions, and asymmetry of information.

I – Why principles-based regulation is more flexible than rules³?

Platforms as ecosystem orchestrators

Platforms are not new⁴. The Grand Bazaar in Istanbul, set up in 1461, is probably the largest physical marketplace in the world and operates thanks to unique governance principles surprisingly similar to the ones adopted by today's digital platforms⁵. In essence, the Grand Bazaar attracts buyers and sellers and matches them so that they can connect and transact securely, the very definition of a platform business⁶.

Today's digital platforms typically operate in online multi-sided markets and attract complements to their ecosystems. They are different from linear manufacturing businesses and traditional value chains in that instead of simply offering products and services they create value by enabling, enhancing and balancing participants' contributions to their ecosystem. In that sense platforms need to design principles that ensure the healthy development of their ecosystems. Ultimately, these principles need to create trust amongst ecosystem participants in order to enable successful transactions. Conversely, a lack of effective governance principles may lead to the collapse of the platform, as the game industry found out in the early 80's when it realised, too late, that without 'gatekeepers' to regulate the ecosystem nobody was able to prevent the market from being flooded by low quality titles⁷.

This governance role is complicated in circumstances where the platform is competing with some of its participants. This may be the case with an app store platform that also offers its own apps. In such cases platforms may have incentives to favour their own services in ways that may be deemed anti-competitive. In other cases, however, the perceived biases that the platform may have towards certain participants are in fact fully justified by the need to maintain the health of the entire ecosystem, for example by excluding buggy or unsafe apps. Concerns about the need to prevent platforms favouring their own apps or services in an anti-competitive way have led to recent calls for regulation.

From internal management principles to external regulation

Regulation can take many different forms. In some sectors, regulations comprise prescriptive rules that specify in detail how industry participants should act in almost any given situation.⁸

³ In developing these principles we have drawn on our experience working with and advising a number of digital platforms and regulatory bodies across a range of countries and sectors. We have also reviewed relevant regulatory and economic reports and academic research discussing the development of good governance principles in the context of digital markets.

⁴ In the Middle Ages, the French fairs of Champagne were the "fulcrum of European trade". These events attracted the best traders, financiers and customers from all over Europe and operated as multi-sided platforms with their own governance frameworks. See Fisman R., Sullivan T., *The Inner Lives of Markets: How People Shape Them-And They Shape Us*, Public Affairs (2016).

⁵ See Launchworks Platform Model in Istanbul's Grand Bazaar, Launchworks & Co Insights, Dec 2017, available at: <https://www.launchworks.co/insights/launchworks-platform-model-istanbuls-grand-bazaar/>.

⁶ We define platform businesses as businesses creating significant value through the acquisition, matching and connection of two or more customer groups to enable them to transact. For a discussion of platform see, Chapter 3, *What is a platform business*, in *Platform Strategy, How to unlock the power of communities and network to grow your business*, Reillier B. & Reillier L.C., Routledge (2017).

⁷ The 1983 collapse of the gaming market, that led to the bankruptcy of 90% of US game developers, including iconic firms like Atari, is widely attributed to the lack of 'gatekeepers' able to design governance principles to ensure that poor games could not crowd out good ones and destroy the entire gaming ecosystem. Today's app store governance rules are at least partly aimed at avoiding such systemic market failures. See Boudreau K. J. & Hagiu A., "Platform Rules: Multi-Sided Platforms As Regulators". In "Platforms, Markets and Innovation", edited by Gawer A., Cheltenham, UK: Edward Elgar Publishing, 2009.

⁸ For example, the Wholesale-Retail Code describes in minute detail how participants in the UK water sector should operate almost all aspects of their businesses: available at: <https://www.mosl.co.uk/market-codes/codes>.

But regulation can also take a principles-based form, setting high level standards for regulated businesses to incorporate, while leaving companies to work out how to translate these principles into concrete action.

Principles- vs rules-based regulatory approaches – Taxi industry illustration

Principles-based	Rules-based
Available taxis should be clearly identifiable so passengers can find one easily.	Taxis must signal their availability with an illuminated light on the roof of the taxi.
Passengers can be confident that the driver will get them to their destination.	Only drivers who have passed a 'knowledge exam' can operate a taxi.
Customers need to know the price they will pay.	Only cars with a meter may operate taxi services.

In the context of the digital sector, principles-based regulation offers several advantages:

- **Digital markets are fast-moving.** Rules-based regulations are particularly suited to stable environments where it is important to prevent predictable issues from arising. Yet, detailed rules are often ill-suited for innovative and fast moving market environments as illustrated in the table above. Going further back, original rules-based regulations for cars in the UK required the driver to notify a village constable of his arrival, so that officials could walk in front of the car waving two red warning flags while the driver followed slowly behind⁹. Needless to say the principle of safe driving has lasted longer than the initial rules.
- **Digital markets entail complex, iteratively developed, technologies and business models.** If stable business environments lend themselves to rule-based regulations, innovative digital markets do not. This is because specific rules, rooted in or assuming a specific technology choice or business model design, are particularly difficult to set, let alone comply with, in a world where innovative platform-based firms continually flex and iterate on these parameters. Clear sets of principles can however be used to ensure that the best technology and business decisions are made to converge towards desirable outcomes.
- **Platforms have experience administering principles-based codes.** Digital platforms already use high-level principles to guide their decision-making, including to balance the interests of different stakeholders. Accordingly, platforms have experience of translating high-level principles into the day-to-day operations of their businesses.

That said, principles-based regulation has disadvantages too.

- **Risk of circumvention.** If the principles are too vague firms may have incentives to choose interpretations that effectively result in circumvention. Vague principles would also be difficult for regulators to enforce.

⁹ For more information on US and UK 'Red flag laws' see: https://en.wikipedia.org/wiki/Red_flag_traffic_laws

- **Legal uncertainty.** Regulatory authorities may have different interpretations of the principles and this may lead to a lack of legal certainty that will be detrimental for market participants. Depending on the sanction regime and cost of compliance, firms may adopt an overly risk taking or risk averse approach to abiding by the principles. Significant costs may occur where firms need to constantly seek legal and expert advice on whether their actions are compliant. Enforcement costs for the regulator may also be high.
- **Subjectivity.** Principles can be subjectively interpreted by different stakeholders which may lead to different outcomes irrespective of their incentives to circumvent or not the principles themselves. Constant effort to reduce subjectivity of principles within and across organisations may be costly.

On balance, however, principles-based regulation may still be a better starting point than rule-based regulations in the context of digital platforms. This is because principles provide market participants with flexibility to reach desirable outcomes while prescriptive rules, once in place, shift the focus to narrow compliance. In digital markets, technologies and business models change so quickly that prescriptive rules risk becoming obsolete the moment they are issued. It is also generally simpler to move from a principles-based approach to a rules-based approach than it is to attempt the reverse.

At the same time, regulators should consider what steps could be taken to mitigate the risks of circumvention and legal uncertainty arising from principles-based regulation. Principles may need to be supplemented with guidance notes contextualising them for relevant settings. For example, a non-discrimination principle applicable to all digital platforms may mean different things in the context of an app store, a market place, a social network or a dating website. Companies might achieve greater certainty if they have the option to engage in voluntary, non-binding, consultations with regulators concerning forthcoming product changes. And regulators could explain what objectives they aim to achieve.

Possible objectives might include:

- Ensuring competition on the merits
- Transparency of actions, agreements and relationships
- Empowering and protecting platform participants
- Spreading the benefits of the platform and recognising diversity of needs
- Maintaining vibrant communities
- Staying true to previous commitments
- Promoting understanding and openness

II - How platform governance can be a starting point for principles-based regulation

Digital platforms have all developed governance principles to foster the long-term sustainable development of the ecosystems they orchestrate. These principles are often at the heart of the way platform businesses operate. They determine who can join, who is allowed to do what, how participants are matched and connected and for what type of transactions. As such marketplaces, app stores, financial networks, social networks and search engines are all platforms with their own, unique, set of governance principles. Ultimately these principles need

to be internally consistent so that the platform can create trust for its participants to enable successful transactions.

Today, most platforms have high level governance principles, covering different stakeholders and ecosystem activities. The table below illustrates some of the principles developed by digital platforms to manage their operations and balance the interests of their stakeholders.

Google’s 10 things we know to be true (2020)¹⁰	Apple’s Principles of Business Conduct¹¹
<ul style="list-style-type: none"> ● Focus on the user. ● It’s best to do one thing really, really, really well. ● Better fast than slow. ● Democracy on the web works. ● You don’t need to be at your desk to need an answer. ● You can make money without doing evil. ● There is always more information out there. ● The need for information crosses all borders. ● You can be serious without a suit. ● Great just isn’t good enough. 	<ul style="list-style-type: none"> ● Honesty. Demonstrate honesty and high ethical standards in all business dealings. ● Respect. Treat customers, suppliers, employees, and others with respect and courtesy. ● Confidentiality. Protect the confidentiality of Apple’s information and the information of our customers, suppliers and employees. ● Compliance. Ensure that business decisions comply with applicable laws and regulations.
Amazon’s Leadership Principles¹²	Facebook: “Our Principles”¹³
<ul style="list-style-type: none"> ● Customer Obsession. Leaders start with the customer and work backwards. ● Ownership. Leaders think long-term. ● Invent and Simplify. Leaders expect and require innovation and find ways to simplify. ● Are Right, A Lot. Leaders have strong business judgement. ● Hire and Develop the Best. Leaders raise the performance bar with every hire and promotion. ● Insist on the Highest Standards. Leaders have relentlessly high standards. ● Think Big. Thinking small is self-fulfilling. ● Bias for Action. Speed matters in business. ● Frugality. Accomplish more with less. ● Learn and Be Curious. Leaders always learn. ● Earn Trust. Listen attentively, speak candidly and respect others. ● Dive Deep. Leaders operate at all levels. ● Have Backbone; Disagree and Commit. Respectfully challenge decisions when necessary. ● Deliver Results. Deliver the key inputs with the right quality and in a timely fashion. 	<ul style="list-style-type: none"> ● Give People a Voice. People deserve to be heard and to have a voice — even when that means defending the right of people we disagree with. ● Build Connection and Community. Our services help people connect, and when they’re at their best, they bring people closer together. ● Serve Everyone. We work to make technology accessible to everyone, and our business model is ads so our services can be free. ● Keep People Safe and Protect Privacy. We have a responsibility to promote the best of what people can do together by keeping people safe and preventing harm. ● Promote Economic Opportunity. Our tools level the playing field so businesses grow, create jobs and strengthen the economy.

¹⁰ See <https://www.google.com/about/philosophy.html>.

¹¹ See https://s2.q4cdn.com/470004039/files/doc_downloads/gov_docs/business_conduct_policy.pdf.

¹² Adapted from: <https://www.aboutamazon.co.uk/working-at-amazon/our-culture/our-leadership-principles>.

¹³ See <https://about.fb.com/company-info/>.

With these statements, companies have signalled an appreciation of the benefits of principled decision-making. Some of these principles may be relevant to the balanced development of a platform ecosystem. For example, under its ‘you can make money without doing evil’ principle, Google states some of the guiding principles that are governing its advertising programmes:

- *We don’t allow ads to be displayed on our results pages unless they are relevant where they are shown. And we firmly believe that ads can provide useful information if, and only if, they are relevant to what you wish to find – so it’s possible that certain searches won’t lead to any ads at all.*
- *We believe that advertising can be effective without being flashy. We don’t accept pop-up advertising, which interferes with your ability to see the content that you’ve requested. We’ve found that text ads that are relevant to the person reading them draw much higher click-through rates than ads appearing randomly. Any advertiser, whether small or large, can take advantage of this highly targeted medium.*
- *Advertising on Google is always clearly identified as a ‘Sponsored Link’, so it does not compromise the integrity of our search results. We never manipulate rankings to put our partners higher in our search results and no one can buy better PageRank. Our users trust our objectivity and no short-term gain could ever justify breaching that trust.*

These platform governance principles permeate many strategic decisions made by platforms as part of their development. These principles help answer questions about the role of the platform, who should join, the incentives it provides, the information it gathers, the way it matches participants, how it builds trust, how conflicts are resolved, how payments are made, etc. Some of these principles are company-wide, for example Facebook’s principles, while others are specific to a particular field such as Google’s AI principles¹⁴, or a specific business unit in the case of AppStores’ code of conduct¹⁵. In some cases the principles developed by digital platforms cover a range of stakeholders.

For example, Airbnb recently announced its stakeholder principles as set out below:

Airbnb stakeholder principles (2020)¹⁶
<ul style="list-style-type: none"> ● Guests <ul style="list-style-type: none"> ○ We prioritize the safety of our community. ○ We make guests feel like they belong. ○ We enable the creation of billions of personal connections. ● Hosts <ul style="list-style-type: none"> ○ We treat our hosts as partners. ○ We enable the creation of millions of entrepreneurs. ● Communities <ul style="list-style-type: none"> ○ We strengthen the communities we serve. ○ We diversify the types of communities guests visit. ○ We set a new standard for sustainable travel. ● Shareholders <ul style="list-style-type: none"> ○ We will build a highly valuable business. ○ We will make long-term strategic decisions. ● Employees <ul style="list-style-type: none"> ○ We champion diversity and belonging. ○ We live our Core Values every day. ○ We enable long-term growth and career opportunities.

¹⁴ See “Artificial Intelligence at Google: Our Principles”, <https://ai.google/principles/>.

¹⁵ See <https://www.apple.com/ios/app-store/principles-practices/> and <https://support.google.com/googleplay/android-developer/answer/9914283?hl=en>.

¹⁶ See <https://news.airbnb.com/serving-all-stakeholders/>.

Ultimately, it is these principles that have made platforms, and their ecosystems, so successful and valuable¹⁷ for their users.

This is not to say that platforms' pre-existing statements of principles are sufficient to address the concerns raised in relation to alleged anti-competitive practices. Some of these principles are too vague to be testable. Many, or even most, were not conceived with current competition-related concerns in mind, rather they may be focused on ensuring internal efficiency or creating a specific type of work culture. And it is not always clear that these principles can be enforced. For example, is it verifiable that a platform's personnel "*listen attentively*"? What are the sanctions for failing to "*demonstrate honesty*"? And who decides whether a platform has achieved its goal to "*serve everyone*"?

In order to be effective, principles cannot merely be stated; they need to be mapped onto metrics that can be measured, regularly tracked and embedded in the governance structure of the firm, starting with board level leadership¹⁸. They also require some form of enforcement to address circumstances where regulated firms fail to adhere to these principles.

Recent experience confirms that industry codes can achieve regulatory objectives through sufficiently clear and verifiable principles, while resisting the development of highly prescriptive rules¹⁹.

Ultimately, we believe a shared set of good governance principles could be co-developed by digital platforms and their regulators in order to identify and commit to acceptable behaviours, objectives and rules associated with good ecosystem governance, high trust levels and positive market outcomes.

One for all and all for one

While some principles are generic enough to apply to all market participants, others may only be applicable in specific circumstances, for example if a firm has significant market power.

This symmetric vs asymmetric distinction will require careful economic tests to ensure that all firms exhibiting market power in a relevant market are treated the same. Targeting regulations at individual firms, *irrespective of their position in a given product/market*, would be a significant departure from accepted principles of good economic regulation. It is well established that firms do not have market power in a vacuum, and/or at the holding level, but only in a specific context where their products and services are subject to specific competitive constraints in a given relevant market and point in time.

¹⁷ In a seminal study on the economic value contributed by platforms Prof. Erik Brynjolfsson of MIT and his colleagues famously estimated that a search engine, an email account and online maps were respectively worth \$17,530, \$8,414 and \$3,648 per year to their users. See <http://ide.mit.edu/sites/default/files/publications/1815663116.full%20gdp.pdf>.

¹⁸ Airbnb has mapped key principles to specific sets of metrics that are regularly reviewed. These "stakeholder principles" metrics, such as guest safety, are also used to determine employee bonuses. The platform has set up an official Stakeholder Committee on Airbnb's Board of Directors. The Committee will be chaired by Belinda Johnson after she transitions from her current role as Chief Operating Officer to become a member of the Airbnb Board in 2020.

¹⁹ In that context useful precedents include the UK Groceries Code (Groceries Supply Code of Practice - GOV.UK) and the UK Advertising Codes (Marketing and advertising: the law: Advertising codes of practice) that have followed a similar approach.

A first step in this direction is the Platform to Business Regulations²⁰ focused on “*Promoting fairness and transparency for business users of online intermediation services.*” These symmetric regulations, that apply to all digital platforms operating in the EU, address some of the principles mentioned above²¹.

In the context of digital platforms a range of regulations aimed primarily at consumer protections, such as fee transparency or privacy standards, seems relevant to all digital platforms. Additional obligations could apply only to organisations with market power to ensure that specific competition concerns are addressed, for example behaviours that only firms with market power could profitably engage in. It is this latter category of obligations that we focus on in the next section.

III - When is economic regulation needed in the first place?

When should regulation be introduced?

While each sector is different, the process of introducing, sometimes far reaching, new *ex ante* regulations and remedies, should follow some well-established economic and legal principles. Sectors like telecommunications, that have been liberalised and regulated for more than a quarter of a century, have established helpful precedents for deciding what should be subject to *ex ante* regulations and what should remain the domain of competition law²².

“First, do no harm” is often cited as the first principle of good regulation. This is easier said than done and regulators need to ensure that the right type of regulatory intervention is done in the right way and at the right time. Of course, the regulatory process should only regulate things that should be regulated. Yet, since no process is perfect, regulatory errors will emerge. The question then becomes what type of error has the most detrimental impact on market developments. So-called Type II errors, not regulating things that should be regulated, are often considered less damaging to competition than Type I errors, regulating something that should not be regulated. This is because Type II errors can either be corrected by the market or can easily be corrected at a later date by regulation. Type I errors, however, tend to be less visible, more difficult to roll back and may therefore have a longer negative market impact.

This is especially the case in high innovation markets²³. The figure below shows where regulation and antitrust law are applied correctly or erroneously.

²⁰ See Regulation (EU) 2019/1150.

²¹ In fact, the various articles of the regulations can be mapped onto the high level platform governance principles set out in this paper. For example Art.3 of the regulations is concerned with terms and conditions used by the platform, and mandating the use of plain and intelligible language, availability of information, clarity of grounds for termination, disclosure of affiliation and clarification of IP, minimum notice period, etc. These provisions are clearly improving the Transparency of actions, agreements and relationships on the platform. Art.4. of the regulations, focused on restrictions, suspensions and terminations conditions, is clearly aligned with the principles of Protection and empowerment of participants while also Promoting openness and understanding, etc.

²² In fact, a successfully regulated market often tends to revert back to competition law. While the first ‘fully fledged’ New Regulatory Framework (NRF) for electronic communications introduced in 2003 included 18 product-markets susceptible to *ex ante* regulations, that number was progressively reduced from 18 in 2003 to 7 in 2009 and to 5 in 2014. There are only two markets left in the latest draft recommendation dated August 25th 2020 (<https://ec.europa.eu/digital-single-market/en/news/recommendation-relevant-markets>).

²³ See Bauer, J. M., & Bohlin, E. (2008), From static to dynamic regulation. *Intereconomics*, 43(1), 38-50. See also McChesney, F. S. (2003), Talking 'Bout My Antitrust Generation Competition for and in the Field of Competition Law. *Emory LJ*, 52, 1401.

Regulation	Is workable competition possible?	
	Yes, workable competition is possible <u>Shouldn't be regulated</u>	No, workable competition is not possible <u>Should be regulated</u>
<u>No ex ante regulations introduced</u>	Good outcome	Type II error
<u>Ex ante regulation introduced</u>	Type I error	Good outcome

Source: adapted from Bauer and Bohlin

Innovation markets are particularly prone to Type I errors largely because economists know less about the relationship between competition and innovation than they do about standard price competition²⁴. As was famously pointed out by Ronald Coase, where economists do not understand something, they look for a monopoly explanation²⁵.

Manne and Wright suggest that the European Microsoft case is an example of a Type I error. The European Commission, acting as the competition authority found that the non-interoperability of Microsoft's server operating software amounted to an anti-competitive refusal to deal. However, according to Manne and Wright, later economic analysis shows that imposing a duty to deal on a monopolist creates suboptimal incentives to innovate²⁶.

An example of a Type II error is the initial lack of regulation of mobile termination rates (MTRs) in Europe, where the calling party pays for the whole call. Each mobile network has a monopoly on calls terminating on that network and so was able to set the monopoly price for call termination, resulting in excessively high prices for calls between networks. Eventually this problem was addressed via regulation, first by the Competition Commission in the UK, the predecessor of the CMA, and later by the European Commission setting maximum MTRs each operator could charge the others²⁷.

What economic tests should be satisfied for ex ante regulatory intervention?

A number of relevant precedents in other sectors can shed light on the way policy makers have tried to balance the need for effective regulations and the risks of introducing market distortions and disincentivising investments.

²⁴ Manne, G. A., & Wright, J. D. (2009), *The Limits of Antitrust in the New Economy*. George Mason University School of Law.

²⁵ Coase, R.H. (1972), *Industrial Policy: a proposal for research* Economic Research: Retrospect and Prospect Vol. 3 Policy Issues and Research Opportunities in Industrial Organisation, NBER 1972, 59 - 73

²⁶ Danne and Wright op. cit. footnote 24, Table 1. For a description of the European Microsoft case, see Kuhn, K. U., & Van Reenen, J. *Interoperability and market foreclosure in the European Microsoft case* in Lyons, B (ed) "Cases in European Competition Policy: The Economic Analysis" Cambridge University Press, 2009.

²⁷ For a full description of this case, see Armstrong, M., & Wright, J. (2009). Mobile call termination in the UK: a competitive bottleneck?. *Cases in European Competition Policy: The Economic Analysis*, Cambridge: CUP.

EU Three criteria test for the Electronic Communication Market

All criteria must be met, in sequence:

- The market is subject to high and non-transitory barriers to entry;
- The market is not trending towards effective competition; and
- Competition law alone would not adequately address the market failures concerned.

The European Commission developed the “three criteria test” in electronic communications markets to identify markets where the introduction of *ex ante* regulations may be justified. The three criteria are:

1. The market is subject to high and enduring barriers to entry. In telecommunications markets these arise from the high economies of scale, scope and density of a communications network and from legal barriers, such as the need for a spectrum licence. In digital markets, network effects are often mentioned in the context of barriers to entry.
2. The market is not trending towards effective competition. This is a dynamic criterion and examines how market shares and the behaviour firms in the market have changed over time: specifically, whether market shares are stable/concentrating and whether firms are behaving as one would expect in a competitive market.
3. Competition law alone would not adequately address the market failures concerned. Competition law may be inadequate if compliance requirements are extensive, intrusive and/or where anticipatory intervention is necessary²⁸.

The test must be conducted in the order set out above and all three criteria must be fulfilled for the market to be deemed “susceptible to *ex ante* regulation”. The first two criteria respectively cover conditions of market entry –that may limit the number of competitors– and the prospects for effective competition between firms in the market. Even if a market fulfils the first two criteria, competition law remains the default option for correcting such problems and *ex ante* regulation is only required if competition law is inadequate.

A market’s conditions may change over time. For example, in telecommunications, the European Commission found in 2003 that the market for “call origination and access from a fixed location” was susceptible to *ex ante* regulation. However, by 2007 the market had been removed from the list as technical and market developments had eliminated those barriers to entry. Similarly, the market for mobile call origination and access was on the 2003 list but removed in 2007 as, whilst legal and regulatory barriers remained high (test 1), the market was trending towards effective competition (test 2).

If a “three criteria test” can be usefully applied in electronic communications, would it be feasible to adapt the test for digital platform markets?

²⁸ Cave, M., Stumpf, U., & Valletti, T. (2006), A Review of certain markets included in the Commission's Recommendation on Relevant Markets subject to *ex ante* Regulation. *An independent report to the DG Information Society, European Commission*.

We will assume here that the Hypothetical Monopolist Test (HMT)²⁹ or some other methodology is used to define markets and that a test for whether *ex ante* regulation is needed is only applied once a market is defined.

High and enduring barriers to entry

Users generally prefer larger networks so that they can communicate/transact with more participants. Therefore, the larger the number of participants transacting on a given platform, the higher its ‘utility’. As a result, successful platforms often become large. They generate network effects that benefit all participants as they scale and reach a critical mass. This process can generate barriers to entry that may make it difficult for new entrants to replace existing platforms. Yet, competition for becoming the largest platform in a given market (“competition for the market”) can be fierce since in such “winner takes all” markets only a handful of participants can reach the required scale. However, even an established platform is not expected to maintain its position forever since new innovative substitutes can quickly emerge. For example TikTok, that only launched globally in August 2018, now has in excess of 1 billions users³⁰. Also each technology wave, for example from fixed to mobile, will result in new competitive dynamics allowing new entrants to overcome barriers to entry established during the previous round. When there is the prospect of such changes within a relevant time horizon, the introduction of *ex ante* regulations may not be warranted.

Trending towards effective competition

Competition *in* the market is likely to be effective if market participants have choice and are free to switch to other providers. In a platform context this is the case when both sides of the market are able to select other services/platforms or ‘multi-home’. If even one side single-homes then the other side must connect to the platform to access those customers, which is unlikely to result in effective competition. When multihoming is difficult, the platform may control access to its participants on one side and, if these are critically important to other businesses and if no substitute exists, they may be considered ‘gatekeepers’. Alternatively consistent and/or increasing levels of expenditures in R&D in a sector may suggest increasing levels of competition.

Sufficiency of Competition Law

Whether competition law is sufficient or not to deal with this structural criteria is likely to be the same as for telecommunications, i.e. only needed if remedies are likely to be extensive, intrusive or anticipatory. This point is well made by Alexiadis and de Streel who states:

“Any new regulation, however, should be proportionate and should not exceed what is necessary to achieve its objectives. In this regard, it is anticipated that ex ante regulation would only address the sorts of issues which competition policy cannot address effectively.” (emphasis in original)³¹

²⁹ See European Commission (1997) “*Commission notice on the definition of relevant market for the purposes of Community competition law*” 9/12/1997. Note that the potential for amending this Notice is currently being consulted upon by the European Commission (<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12325-Evaluation-of-the-Commission-Notice-on-market-definition-in-EU-competition-law/public-consultation>). See also Motta, M. (2004), *Competition policy: theory and practice*. Cambridge University Press. p102 for an explanation of the HMT.

³⁰ See <https://en.wikipedia.org/wiki/TikTok>.

³¹ Alexiadis, P., & de Streel, A. (2020), Designing an EU intervention standard for digital platforms. *Robert Schuman Centre for Advanced Studies Research Paper*, (2020/14). P.35.

We believe that the current three criteria test, already well known to the European Commission and National Regulatory Authorities (NRAs) responsible for electronic communications, can usefully be adapted to relevant platform markets candidates for regulatory intervention.

Who should be regulated?

We are quite surprised to see that some policy makers seem to be proposing the regulation of individual platforms *per se* rather than the regulation of relevant markets that give rise to competition concerns. Using names of established platforms like Google, Facebook, Amazon and Apple may well be a convenient semantic shortcut, but the analysis of the underlying relevant markets concerned should not be forgotten.

Regulating individual firms, rather than the markets in which they operate, would be a significant departure from established economic precedents, and risk resulting in both Type I and Type II errors. Large firms with a small presence in new markets could end up being regulated (Type I errors) while smaller firms with market powers in specific vertical segments, such as travel, etc., may end up not being regulated (Type II error).

The economic cost of these errors would not only impact the property rights of shareholders³² but also reduce choice, quality and innovation that contribute to overall consumer welfare. Therefore, it is essential that regulatory authorities properly identify which markets could have conditions that make them susceptible to *ex ante* regulation³³.

The New Competition Tool – an alternative approach?

An alternative to both the formal *ex ante* regulatory process and the *ex post* competition law based investigation is the proposal by the European Commission of a “new competition tool” (NCT), broadly modelled on the Market Investigation powers given to the UK Competition and Markets Authority (CMA) under the Enterprise Act 2002. Market investigations allow the CMA, and would presumably allow the European Commission, wide discretion to intervene in markets outside the normal regulatory or competition law processes.

A Market Investigation allows the CMA to investigate a wider set of competition concerns than just abuse of dominance or explicit collusion. According to a recent report³⁴ they are “*well designed to carry out the holistic analysis of markets where problems are market-wide and there are a variety of interwoven factors – structural and behavioural – creating competition concerns*”.

Market investigations allow the CMA to impose both structural and behavioural remedies. For example, BAA, the operator of UK airports, was required to divest itself of London Gatwick and Edinburgh airports following a market investigation. A similar investigation into UK banking resulted in a behaviour remedy to provide data portability between banks.

While a market investigation can explore market issues more freely, since it is not bound by regulatory or antitrust legal processes, such freedom may also be a weakness. Safeguards would need to be introduced to ensure that such investigations are not unduly influenced by political

³² Motta, M. (2004), “*Competition Policy: Theory and Practice*”. Cambridge University Press. pp 265- 266.

³³ For the avoidance of doubt, here we are talking about asymmetric economic regulations, aimed at firms with market power, rather than consumer protection regulation that may apply to all firms.

³⁴ Fletcher, A. (2020), “*Market Investigations for Digital Platforms: Panacea or Complement?*”
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3668289.

considerations. For example, the CMA is structured to avoid such concerns as the investigation is commissioned by the CMA Board but undertaken by an independent panel³⁵.

Were a similar approach to be adopted by the Commission, it would be important that any investigation should be based on sound principles of good regulation. This would ensure that there is a strong methodological basis for market intervention built on well-established economic and legal foundations. A poorly designed NCT would risk the introduction of *ex ante* regulations without adequate checks and balances and result in Type I and Type II regulatory errors.

IV - What are the features of a digital regulatory regime?

The decision to introduce economic regulations in a specific market on an *ex ante* basis is usually just a starting point. The regulator typically needs to carry out an analysis of the relevant markets to identify the participants that may have significant market power and determine the appropriate remedy for addressing the specific competition concern identified. Irrespective of the process chosen for introducing regulation, a number of well-established features of good regulation can help achieve regulators’ objectives, whatever they may be, whilst minimizing adverse or unintended consequences. Like the platform governance principles we discussed in section II, these features of regulatory regimes aim to ensure that the underlying market can operate as efficiently as possible while, in some cases, also meeting other desirable public policy objectives.

Features associated with ‘good governance and regulation’

The Commission and associated European regulatory bodies have set out what the features of ‘good governance and regulation’ may look like in a range of different contexts. Good regulation starts with good governance because the processes, balances and mindset of regulatory bodies clearly influences the regulatory options identified and the final judgements made.

European Governance: A White Paper (EU)³⁶	EU “Promoting Good Governance”³⁷
<p>Principles of Good Governance</p> <ul style="list-style-type: none"> ● Openness (outreach & and accessible communication) ● Participation ● Accountability (responsibility and communication of roles) ● Effectiveness (timely, clear objective, evaluation & proportionate) ● Coherence (internally and externally consistent) 	<p>Principles of Excellence</p> <ul style="list-style-type: none"> ● Results orientation ● Citizen/Customer focus ● Leadership and constancy of purpose ● Management of processes and facts ● People development and involvement ● Continuous innovation and improvement ● Partnership development ● Social responsibility

In the same way, a number of bodies with legislative and regulatory powers in the UK, including the House of Lords, the UK Government and the Competition and Market Authority (CMA) have highlighted a number of regulatory principles with particular relevance in the context of platform regulation.

³⁵ We note in that context the importance of having truly independent panel members acting as ‘quasi judges’.

³⁶ See https://ec.europa.eu/commission/presscorner/detail/en/DOC_01_10.

³⁷ See <https://ec.europa.eu/esf/BlobServlet?docId=444&langId=en>.

Better Regulation: Principles of Good Regulation³⁸	UK House of Lords Regulatory Principles³⁹
<ul style="list-style-type: none"> ● Proportionality (proportionate to problem and justify compliance costs, all options considered, light-handed options preferred first) ● Accountability (consultation, explanation of decision rationale, evaluative criteria, accessible complaints and appeal procedures) ● Consistency (internally & externally, predictable, consistently enforced) ● Transparency (clear definition & communication of policy need, plain language, distinguish between law and recommended practice, guidance on compliance, clear on non-compliance consequences) ● Targeting (focused on a specific problem, goals based with flexibility on how to comply, adapted guidance and support, focus on most serious risks, systematically reviewed and removed as appropriate) 	<ul style="list-style-type: none"> ● Parity ● Accountability ● Transparency ● Openness ● Privacy ● Ethical design ● Recognition of childhood ● Respect for human rights and equality ● Education and awareness raising ● Democratic accountability, proportionality and evidence based
UK Govt: Principles for technology⁴⁰	CMA: Online platforms and digital advertising⁴¹
<ul style="list-style-type: none"> ● Pro-technology government ● Sharing the benefits of technology widely and fairly. Technology as an engine for social mobility ● Pro-innovation regulation ● Protecting the vulnerable and ensuring safety and security ● A free and open internet. Multi-stakeholder internet governance, protection of human rights & fundamental freedoms 	<ul style="list-style-type: none"> ● Fair trading (prevent exploitative behaviour) ● Open choices (prevent exclusionary behaviour) ● Trust and transparency (provide sufficient information to users so they can make informed decisions)

While we have used the UK to illustrate the range of regulatory principles that should be considered in the context of good regulation, many other countries have developed and are following similar approaches⁴².

Governments are acutely aware that some market structures result in market failures that harm consumers and citizens and distort economic outcomes. Sectors that are subject to a market failure will tend to be less efficient and result in a transfer of welfare from consumers to producers (and their shareholders). Economic regulation is designed to prevent such suboptimal outcomes.

³⁸ See UK Government’s Better Regulation Task Force, “Principles of Good Regulation”, <https://www.rqia.org.uk/RQIA/media/RQIA/Resources/Better-Regulation-Task-Force-Principles-of-Good-Regulation.pdf>.

³⁹ See UK House of Lords, “Regulating in a digital world”, Chapter 2: Principles for regulation, <https://publications.parliament.uk/pa/ld201719/ldselect/ldcomuni/299/29902.htm>.

⁴⁰ See Baroness Morgan speech, January 2020, <https://www.gov.uk/government/speeches/baroness-morgan-speaking-on-how-we-can-make-technology-work-for-everyone>.

⁴¹ See CMA “Online platforms and digital advertising: Market study final report”, 1 July 2020 https://assets.publishing.service.gov.uk/media/5efc57ed3a6f4023d242ed56/Final_report_1_July_2020_.pdf

⁴² See, for example, regulatory profiles of OECD countries at <https://www.oecd.org/gov/regulatory-policy/by-country.htm>.

However, there is a trade-off as excessive regulation of a market, or a firm within the market, may damage or even destroy incentives to invest and innovate. If the regulator signals that it will expropriate the profits of an investment through regulatory intervention, then firms may not make the investment in the first place⁴³. Such a regulatory failure could be as damaging as a market failure arising from one firm's dominant position in the market.

Regulation is also an intrusion by the State into the property rights of shareholders in private companies. The State, via the regulatory authority, sets controls on the behaviour of the undertaking or may even affect the ownership structure of the organisation⁴⁴. Unlike a firm found to be in breach of competition law *ex post* by abusing a dominant position, a regulated firm may not have infringed any law but is regulated *ex ante* to prevent it from abusing a dominant position.

It is, therefore, important that regulation is subject to a set of principles that strikes the right balance between the interests of both consumers and regulated platform firms and that the regulator does not abuse its power by imposing regulations that are neither justified nor proportionate. These principles are applicable to both new regulatory bodies that would be specifically tasked with oversight of digital markets as well as existing regulators that may need to intervene in such markets.

Good regulation principles

To that end, we propose below a set of ten principles that a prospective regulator of digital platform businesses should adhere to in their conduct.

- **Defining the goals.** The regulator should articulate clearly what objectives or goals new regulation is intended to achieve. This is important because it affects how any principles should be interpreted and understood. Clear goal setting is, therefore, key to reaching desirable outcomes.
- **Forward looking:** Regulatory decisions should be forward looking and take account of foreseeable market conditions, to the extent possible. And regulators should not, therefore, take actions that embed current technologies at the expense of possible future technologies that may compete with today's incumbents. Otherwise, regulations may chill, rather than promote, innovation.
- **Evidence based:** When identifying a market problem that needs correcting, the regulator should produce empirical evidence that supports the finding of a structural weakness in the market and, therefore, the need for regulation. Regulators should also be required to produce an impact assessment of any proposed regulation setting out why the proposal is both appropriate and proportionate. And all such evidence should be presented to stakeholders to challenge. This type of evidence-based process can help ensure that regulations achieve their stated objectives and support, rather than undermine, consumer welfare, while avoiding unnecessary regulatory burdens.

⁴³ See Newberry, D. M. (2002), *Privatization, restructuring, and regulation of network utilities* (Vol2). MIT press. Ch. 2.

⁴⁴ Motta, M. (2004) "*Competition Policy: Theory and Practice*". Cambridge University Press. pp 265- 266.

- **Predictability and transparency:** The regulator should follow a predictable and transparent process that allows all relevant stakeholders, whether directly or indirectly affected by a proposed regulation, to comment on and influence its decisions. To this end the regulator should be required to follow a consultation process by which all proposed regulations are subject to public consultation before being put in place. Predictable rules and processes contribute to legal certainty, thereby creating conditions that are conducive to investment.
- **Neutrality:** Regulators should not favour or discriminate against any business, business model or technology. They should recognise that platform participants are more concerned with the functionality and utility of the platform than its business model or technology. When considering markets this means that any platform or other undertaking that participants use for the same purpose need to be included. Moreover, regulators should not implement any regulation that benefits one group of platforms or platform participants whilst unduly harming the interests of another group. Otherwise, regulation risks distorting competition, rather than promoting it.
- **Accountability:** The regulator should be accountable to the legislature and should report regularly and publicly on its objectives and demonstrate that it is efficiently and effectively discharging its responsibilities with integrity. Regulatory decisions should be subject to independent review when relevant. Right of appeal, on the merits of the case, should be given to regulated entities. These rights ensure appropriate protection for technologies and products that result from legitimate private investment, while promoting high quality regulatory practices.
- **Appropriateness and Proportionality:** Any regulation proposed by a regulator should be appropriate to the problem it identifies. This means that the regulator needs to adopt and follow a clear process of identifying market problems and the scale of those problems so that appropriate regulation can be used to correct them. Regulations should also be proportionate to the effect of the problem so that there is neither excessive nor too little regulation. Where possible, regulators should seek to collaborate with industry on solutions, thereby reducing the need for longer and more uncertain adversarial settings.
- **Transition to competition law:** The regulator's primary function is to create conditions in which markets can be effectively competitive without the need for *ex ante* economic regulation. Regulations, therefore, need to be reviewed on a regular basis to ensure that they are still relevant and required. The introduction of sunset conditions is a good way of ensuring that regulations are regularly assessed and can be effectively withdrawn when no longer required.
- **International alignment:** Many digital markets are global in nature and regulators, therefore, need to take into account relevant international regulatory precedents and activity when formulating their regulatory proposals. Beyond the social waste associated with duplication of regulatory efforts, lack of international alignment would potentially result in fragmented, potentially mutually exclusive, sets of interventions generating market distortions negatively impacting welfare.

- **Systemic engagement:** We believe that there are significant opportunities for regulators, regulated firms and other relevant stakeholders to work together towards the development of innovative principles, desirable market outcomes and even remedies as part of a systemic approach that considers all ecosystem participants. Where possible such constructive engagement at the ecosystem level should help develop a shared understanding of issues and concerns and may reduce the need for longer and more uncertain adversarial settings.

Like the governance principles of platforms, that help balance the interests of their ecosystem participants, these high level regulatory features would help regulators create trust and visibility to facilitate a constructive dialogue with the many stakeholders that will be impacted by potential future regulations. In the same way as an internal code of conduct would need to be enforced by companies, these regulatory principles would need to be followed. In both cases this would require a credible commitment to the principles. In the case of regulators, it is expected that enforcement powers will ensure that platforms follow regulations that embed good governance principles. For platforms, this means that they should expect good regulations principles to be followed by the regulator and be able to appeal decisions when this is not the case.

Conclusion

High level principles for the governance and regulation of platform businesses are likely to be key to the long-term development of effective competition. Platform businesses are, to a large extent, regulators of their own ‘marketplaces’. They set the rules and incentives for participants and have an interest in the healthy long-term development of the ecosystems they are co-creating. Regulators and policy makers are also at a crossroad and need to develop new capabilities to intervene quickly, flexibly and provide clarity and legal certainty to market participants. We believe there is an opportunity for such new forms of principles-based interventions to emerge in collaboration with ecosystem participants. Platforms will have to constructively engage in the policy debate, share data and develop guiding principles to address emerging competition concerns. Policy makers will need to develop new analytical capabilities and sector expertise to effectively engage with platform businesses and co-develop new rules of the game.