The Digital Markets Act: Precaution over Innovation

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On 15 December 2020, the EU Commission released a proposal for a Regulation on Contestable and Fair Markets in the Digital Sector – referred as the "Digital Markets Act" (hereinafter "DMA"). The DMA intends to further materialize the European "techlash" on large U.S. tech companies referred as "digital gatekeepers". These digital gatekeepers (i.e., Google, Amazon, Facebook, Apple and Microsoft) allegedly engage in unfair practices and enjoy uncontestable market positions. The DMA ambitions to regulate the digital gatekeepers with stringent obligations and prohibitions. The European Commission justifies the DMA by the need to avoid regulatory fragmentation with Member States' regulations at the national level.

This policy paper argues that not only does the DMA fail to fulfill its stated objectives, thereby lacking the necessary legal basis, but also that the DMA epitomises the prevalence of precaution over innovation in the digital economy. The DMA's unintended consequences will result, among others, in a transatlantic divide whereas such partnership becomes urgent.

Why The DMA Is Probably Illegal

To justify a regulatory proposal, the European Commission always needs to ground it on a legal basis. Absent a proper legal basis, the regulatory proposal is illegal under EU treaties. But it is probable that the DMA is illegal under these treaties. Indeed, the European Commission chose Article 114 of the Treaty of the Functioning of the European Union (TFEU) to justify the DMA proposal. Article 114 TFEU is a convenient legal pathway for the European Commission since regulations adopted under this Article do not require unanimity among Member States – a mere qualified majority is sufficient. But regulations adopted under Article 114 TFEU need to fulfil the purpose of that Article. Article 114 TFEU justifies "measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market". In other words, the European Commission can only use Article 114 TFEU to harmonise national regulations: with this article, EU institutions pre-empt national regulations in order to both avoid regulatory fragmentations and to complete the European Single Market. The objective is laudable and is precisely the DMA's stated objective.

Indeed, on page 4 of the DMA, the European Commission states that "Member States apply or are considering applying divergent national rules to address the problems arising from the significant degree of dependency of business users on core platform services provided by gatekeepers and the consequent problems arising from their unfair conduct vis-à-vis their business users. That situation creates regulatory fragmentation […]." The European Commission thus justifies EU regulatory intervention by the need to harmonise national rules and to avoid regulatory fragmentation: "Without action at the EU level, this will be further aggravated with the adoption of new initiative pending in several Member States […] Given the intrinsic cross-border nature of the core platform services provided by gatekeepers, regulatory fragmentation will seriously undermine the functioning of the Single Market for digital services as well as the function of the digital markets at large." Consequently, the European Commission asserts in the DMA proposal that "harmonization at EU level is necessary and Article 114 [TFEU] is the relevant legal basis for this initiative." The Commission further writes that "there is an emerging fragmentation of the regulatory landscape and oversight in the Union, as Member States address platform related problems at national level. This is suboptimal […] Divergent fragmentation could create legal uncertainty and higher regulatory burdens for participants in the platform economy. Such fragmentation puts at risk the scaling-up of start-ups and smaller businesses and their ability to thrive in digital markets." (DMA, p.60).

But does the DMA avoid regulatory fragmentation and effectively harmonise national regulations on digital competition? The answer is clear: no. Not only does the DMA do nothing to avoid regulatory fragmentation and to harmonise national regulations, but rather, it incentivises further regulatory fragmentations. Consequently, because the DMA lacks a sound legal basis, it may well be illegal (Lamadrid de Pablo & Bayon Fernandez 2021).

Indeed, the DMA proposal does nothing to fulfil its stated objective of preventing regulatory fragmentation. It recognises that "a fragmentation of the internal market can only be effectively averted if Member States are prevented from applying national rules which are specific to the types of undertakings and services covered by this Regulation" (Recital 9). However, the DMA merely lays down obligations and prohibitions on (American) tech companies with no obligations on Member States as promised in the DMA's stated objectives. According to Commissioner Vestager, the DMA allows Member States to "do more" at the national level with more stringent obligations than those included in the DMA (Vestager & Breton 2020, 39'). Germany has already issued its own competition rules applicable to digital markets – thereby already leading to further fragmentation (Franck & Peitz 2021). Also, the French, German, and Dutch governments, self-proclaimed "friends of an effective Digital Markets Act," publicly

considered that “Member States should therefore remain able to set and enforce national rules including national competition law applicable to gatekeepers’ unilateral conduct” (France, Germany & Netherlands, 2021). Virtually every Member State would soon have its own “national DMA”–thereby contradicting the DMA’s stated objective to have “the same rules” (Vestager & Breton 2020, 43’50). It is obvious that different national legislations increase regulatory fragmentation and compliance costs (Meyring 2021).

> The DMA likely violates the EU principle of proportionality with excessively stringent obligations and absolute prohibitions, with neither evidence of harm of the targeted practices nor the chance to consider different interests with a balancing exercise. Because the DMA may violate fundamental rights, it may to violate the EU principle of proportionality, itself enshrined in the Article 114 TFEU (Lamadrid de Pablo & Bayon Fernandez 2021).

Because the DMA further fragments the Digital Single Market rather than avoids such fragmentation, the legality of the DMA under Article 114 TFEU is highly “questionable” (Lamadrid de Pablo & Bayon Fernandez 2021). The Impact Assessment accompanying the DMA identifies sources of regulatory fragmentation. But “strikingly, or rather tellingly, none of the examples of existing or likely regulatory fragmentation identified by the Impact Assessment would be affected by the DMA” (Lamadrid de Pablo & Bayon Fernandez 2021). This obvious “mismatch” between the DMA’s stated objectives and its actual content will lead to scrutiny as part of the judicial review of the legality of the DMA under EU Treaties rules (Lamadrid de Pablo & Bayon Fernandez 2021). The DMA’s goal is to preclude Member States from imposing further obligations on gatekeepers, but it clearly is possible for them to do precisely that (Article 1(5) & Article 1(6) of the DMA). Since the DMA frustrates the purpose of Article 114 TFEU as its legal basis, it may lack a valid legal basis – thereby leading to a risk of illegality under EU Treaties rules.

Why The DMA Is Precautionary

Even if the DMA is legally valid, it will be economically detrimental to European digital entrepreneurs and consumers (not to mention American consumers). Indeed, the DMA represents a paradigm shift from ex-post antitrust enforcement to ex-ante rules of competition. Traditional antitrust analysis requires evidence of harmful practices in order to sanction companies on a case-by-case basis. The DMA imposes obligations and prohibitions without evidence of harm, without possibility for a balancing exercise to take place with pro- and anti-competitive effects of the targeted practices, and without a proper assessment of the innovation deterrence these unconditional obligations generate. In fact, the DMA epitomises the logic of the precautionary principle in antitrust matters–or “precautionary antitrust” (Portuese 2021). Precautionary antitrust was already looming (Portuese 2020; 2021b). With the DMA, it is now a reality – at the expense of innovation, market dynamism, and entrepreneurial risk-taking attitudes.

The precautionary principle is a regulatory principle which prescribes regulatory interventions amid uncertainties, despite absence of harm, for the sake of avoiding a hypothetical risk which may lead to irreversible situations. The precautionary principle reverses the burden of proof so that it is no longer for the enforcer to demonstrate the need for intervention, but it is for the company to demonstrate the need for enforcers not to intervene. The DMA applies this precautionary logic to digital competition. It imposes obligations and prohibitions, absent evidence of harm, for undefined “risks” – namely “structural risks for competition” and a risk of “lack of competition” (Portuese 2021). The assumptions underlying the DMA’s justifications for early interventions revert to the belief that “markets tip” so that if enforcers wait for too long, the markets may “irreversibly” tip for few winners. The Commission believes that market tipping justifies urgent interventions, with a set of obligations and prohibitions, but also with interim measures decided in emergency cases. The DMA’s precautionary measures not only impinge on fundamental rights to property and to conduct business in a legitimate manner, but it would also considerably deter innovation with rigid regulation in a dynamic market environment characterised by disruptive innovation.

The chilling effect of the DMA’s precautionary measures on innovation is predictably substantial. European digital entrepreneurs will experience downgraded digital ecosystems: so-called gatekeepers may not be able to improve their products and services since such improvements may violate one of the prohibitions listed in the DMA. European digital entrepreneurs may also see that those digital gatekeepers would have to share their data with rivals if the digital gatekeeper collected such data and is under one of the DMA’s obligations to disclose such data. Also, European digital entrepreneurs may find it harder to reach consumers as sign-ons and saving users’ passwords will be prohibited. Also, the DMA will greatly harm small European digital entrepreneurs as it prohibits price discrimination in favour of digital gatekeepers. In other words, the digital gatekeeper will have to treat a small business user with no financial resource exactly the same way it would treat a multi-billion business user. This equality in treatment is inherently unfair as it precludes the digital gatekeeper from discriminating between business users according to their financial capabilities. For instance, should all business users be charged the same way on app stores, many small digital entrepreneurs who are present on app stores for free because the digital gatekeeper exempt them from any charge, would suddenly be subject to the same fee applied to a very lucrative business user. Digital entrepreneurs’ innovation and ability to grow will stall.

The DMA prevents digital gatekeepers’ innovation because new innovative products and services may presumably be considered as leveraging practices prohibited under the DMA. If a digital gatekeeper wants to enter a market in order to disrupt incumbents, it may face the DMA’s prohibitions – at the expense of innovation and of consumer benefits. Consumers will experience higher search costs, higher transaction costs, and higher prices. Indeed, they may less easily find relevant products

and information because of a twisted ranking. They may have to sign-on and memorise passwords because of lack of interoperability. They may experience higher prices as digital advertising may no longer be a viable business model for digital companies to provide consumers with cheap (or zero) prices.

The DMA's precautionary logic reverses the burden of proof so that the digital gatekeeper may attempt to justify a targeted practice – but the likelihood a convincing the European Commission not to enforce one of the DMA's obligations is incredibly low. Obligations and prohibitions will apply irrespective of their unintended consequences on consumers and on innovation.

> Characteristics of the precautionary principle are present in the DMA. With the precautionary principle, innovation deterrence is expected. With the DMA's precatunionary antitrust, digital innovation deterrence is expected too.

Three years after the passing of the GDPR (General Data Protection Regulation), its main author, MEP Axel Voss recognised the considerable unintended consequences of the Regulation. He acknowledged that the GDPR "abridges other fundamental rights, leads to a compliance costs explosion and severely hampers Europe's digital transformation" (Voss 2021). The DMA is the GDPR applied to digital competition: massive unintended consequences, compliance costs explosion, and barriers to European digital entrepreneurs' growth at the expense of consumers. European innovation will suffer because European business users will be subject to a wide range of side-effects because of their gatekeepers' new obligations and prohibitions. European consumers will suffer because innovative products and services (be they European or non-European) will be prohibited or deployed at a lower speed or at a higher price in Europe as opposed to other continents.

Why The DMA Is Divisive

Not only is the DMA legally flawed and economically harmful, it also is a politically divisive tool at a time of calls for transatlantic unity. In light of the growing power of Chinese tech platforms associated with undemocratic values, a transatlantic partnership is necessary to bolster an alliance of likely-minded democracies on the challenges of digital transformation. The DMA divides, rather than build, such transatlantic alliance.

The EU has repeatedly called for a Transatlantic Tech Partnership (Zubascu 2021). The European Commission called for a new "EU-US agenda for global change" within which the European Commission wishes to set a "joint EU-US tech agenda" (European Commission 2020). The Commission considers that "the EU and the US need to join forces as tech-allies to shape technologies, their use and their regulatory environment" (European Commission 2020). Among many wishful plans, the Commission specifically considers that "the EU will propose a new transatlantic dialogue on the responsibility of online platforms, which would set the blueprint for other democracies facing the same challenges. We should also work closer together to further strengthen cooperation between competent authorities for antitrust enforcement in digital markets" (European Commission 2020).

However, for many reasons, the EU proposal is regrettably not credible given the European techlash on American companies (Portuese 2021c). Does the DMA solve this issue of credibility? It actually worsens the prospect of a transatlantic tech partnership. Admittedly, the DMA initially targeted U.S. and Chinese companies, with potential large European companies potentially falling within the ambit of the DMA (Espinoza, Khan, and Hancock 2020). However, recent amendments from the European Parliament now clearly reveal that European lawmakers intend the DMA to only targets five U.S. tech companies. European Parliament lawmaker Andreas Schwab who leads the DMA amendments confessed that "the DMA should be clearly targeted to those platforms that play an unquestionable role as gatekeepers due to their size and their impact on the internal market" (Chee 2021). Therefore, in order to designate "gatekeepers," Schwab proposed to "increase the quantitative thresholds and to add…that they are provided of not only one but, at least, two core platform services" (Chee 2021). The higher the thresholds, the lower the number of companies targeted by the DMA, the more U.S. tech companies can be singled out from European rivals who are thus exempt from the DMA' obligations. And this is exactly what is happening: the DMA would "focus on top 5 tech companies"– namely, Google, Facebook, Apple, Amazon, and Microsoft (Espinoza 2021). Raising financial thresholds and increasing the requirement for the gatekeeper to provide at least two core platform services are both strategic amendments ensuring that none of the European tech companies will be subject to the DMA while targeting an extraordinarily small group of American companies.

This surely is a not the way to kick off a healthy transatlantic tech partnership. Not only is the DMA so trade-restrictive that the European Union may be liable under World Trade Organization rules, but it sends an unhelpful message to Americans – a message of digital protectionism under the veil of the moniker "digital sovereignty" (Siebert 2021). Rather than teaming up with the U.S. in addressing the challenges of Chinese tech companies and in shaping digital collaborations with American entrepreneurs, the EU further reinforces its pervasive techlash. Yet the EU hopes to create an alliance with Americans while avoiding regulatory fragmentation within the EU. These wishful intentions will likely not materialise as long as the EU sticks to the DMA. The DMA does nothing to preclude regulatory fragmentation which hampers European tech entrepreneurs' growth but does a lot to weaken the prospect of a much-needed transatlantic tech partnership. With another obscure regulation such as the DMA, Europe will lead by precaution, not by innovation.

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