

Microsoft Response to Digital Services Act Consultation
Proposal for Ex Ante Regulation of Gatekeeper Platforms
(8 September 2020)

We appreciate the opportunity afforded to the public by the European Commission to provide input and evidence in the Digital Services Act (“**DSA**”) Consultation as it considers what ex ante regulation, 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 by certain large online platforms operating as “gatekeepers”.

As the Commission recognizes in the DSA Consultation, online 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 broad range 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, while digital advances bring us daily benefits they also raise a host of complex questions, including what steps should be taken to ensure healthy and vibrant competition and innovation in digital markets and to guarantee that consumers reap the potential benefits of those platforms.

As noted in our response to the Inception Impact Assessment, Microsoft supports the development of an appropriate ex ante regulation to address certain practices of online platforms acting as “gatekeepers.” It is critical, however, that any such regulation carefully balance the competing interests at stake. It should avoid interventions that could quash or stall innovation and harm consumer welfare, and it should include procedural and substantive safeguards that protect the rights of defense of those impacted. Below we provide our comments on three areas of relevance to such regulation: (1) identifying online platforms that qualify as gatekeeper online platforms; (2) the approach to obligations and prohibitions under the regulation; and (3) enforcement of the regulation.

A. Identifying Gatekeeper Platforms

As the European Commission states, the proposed ex ante regulation is intended to “ensure that markets characterized by large platforms with significant network effects acting as gatekeepers, remain fair and contestable for innovators, businesses and new market entrants.”¹ Microsoft believes that the regulation should set an exacting and high threshold that only a few platforms likely meet,² encompassing those that are outstanding in size and have an enduring position of control over the access of other parties to the EU single market. As Executive Vice President Vestager noted, “Not every platform is one of those huge gatekeepers, with the power to make or break the businesses that rely on it. And the kind of behaviour

¹ See Digital Services Act Package: Open Public Consultation at pg. 1 (available at <https://ec.europa.eu/digital-single-market/en/news/consultation-digital-services-act-package>).

² Compare Report of the Digital Competition Expert Panel, *Unlocking Digital Competition* at para. 2.116 (March 2019) (“Furman Review”) (concluding that “only a small number of companies” should qualify for strategic market status and be subject to platform regulation) (available at <https://www.gov.uk/government/publications/unlocking-digital-competition-report-of-the-digital-competition-expert-panel>).

that’s harmful when a big gatekeeper does it, can be entirely innocuous when it’s done by a less powerful platform. So, it would make sense to focus the rules on the actions of the gatekeepers that pose the most serious threat to fair digital markets.”³

The term “online 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 multi-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:

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

(b) *Ad-supported Consumer Platforms* – These online platforms aim to build audiences and drive engagement. They aggregate users by offering a free or low-cost service and earn revenue primarily by charging advertisers to advertise to those users. These online 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 online platforms enable an ecosystem of developers to build hardware and/or applications and software solutions which are purchased and used by users with the respective platform. These platforms may be open or closed. For example, Microsoft Windows and the Linux operating systems are open. Developers have access to a variety of channels through which they can effectively and efficiently sell and deploy applications and software solutions running on these operating systems 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 is sold integrated with hardware devices and requires that applications be distributed via an integrated “app store” controlled by Apple. Apple earns revenue from the sale of devices, and through charging fees to developers regarding app sales made through its App Store and subsequent in-app transactions relating to those apps.

A firm may provide an online platform that falls into only one of these categories, or it may provide an online platform that includes a variety of services, each of which fall into different of these categories.

In Microsoft’s view, determining whether any of the online platforms in these categories qualify as a gatekeeper should involve a two-pronged test: does the platform (a) enjoy market power protected by significant and very strong barriers to entry and (b) control access to a unique set of users and/or other

³ https://ec.europa.eu/commission/commissioners/2019-2024/vestager/announcements/competition-digital-age-changing-enforcement-changing-times_en.

platform participants because those users or platform participants lack the incentive and/or ability to go around the platform to connect directly and largely single-home on the platform.

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

- *Network effects.* Network effects occur where the value of a service grows for individual users 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 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, such that they cannot effectively compete for users.
- *Economies of scale.* These economies occur when costs do not increase proportionately with, 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 of supplying to each additional users. Getting an online 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 a platform that has economies of scale.
- *Economies of scope due to the role of data.* These economies occur if unique data is a significant input to the online platform product or service, and access to this unique data creates hurdles that competitors cannot overcome. Digital markets tend to be data-driven and, as such, 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 access to 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 an online 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 without abandoning content and services only available within the walled garden. 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" online 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."

These barriers may be present in different combinations and to varying degrees. But to qualify as a gatekeeper, the net effect of these barriers should be such that the platform is able – through its conduct – to deny a non-trivial number of users to (or move a non-trivial number of users away from) potential or

actual rivals or move those users into adjacent markets. The effect of such conduct would be to deny scale essential to entry and competition by rivals and enable exploitation of complements.

That being said, when distinguishing between an online platform that may have market power that can be addressed by existing competition rules as compared to a gatekeeper that presents unique problems, the Commission should consider whether the platform is nonetheless constrained because suppliers and users can “go around” the platform. If both sides can disintermediate the platform in sufficient numbers, then the platform may not be a gatekeeper because it may not be in a position to control access to users or other platform participants. For example, drivers and passengers can easily switch between ride sharing platforms, depending on who offers the best rates or availability, and after initial contact may even exchange information so as to connect directly and on better terms off the platform going forward. 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.

In other cases, 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, making disintermediation of the platform difficult if not impossible. 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. Obligations and Prohibitions

Among the Commission’s stated options for the ex-ante regulation is a set of generally applicable obligations and prohibitions and/or case by case identification and analysis of harms posed by large online platforms that qualify as gatekeepers.⁴ In that regard, Microsoft recommends combining both broad principles that set forth the objectives of the regulation and the types of behavior required for all gatekeeper platforms, and then specific backlisted practices by platform type. This approach will delineate the bounds of the regulation, ensure consistency across gatekeeper platforms while enabling greater predictability for gatekeeper platforms and ensuring that the regulation is proportionate.

In considering the former, Microsoft supports following the recommendations of the Online Advertising and Digital Platforms Market Study by the UK Competition and Markets Authority. That study identified three high-level objectives to guide a code of conduct applied to online platforms with “strategic market status” or “SMS” a concept similar to “gatekeepers.” It stated in relevant part:

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

⁴ See, European Commission: PLATFORMS WITH SIGNIFICANT NETWORK EFFECTS ACTING AS GATEKEEPER IMPACT ASSESSMENT SUPPORT STUDY, VIGIE 2020/0630, under Framework contract SMART 2019/0024 Lot 1, Terms of Reference.

*that SMS platform provides sufficient information to users, so that they are able to make informed decisions.*⁵

Microsoft believes that the regulation should have as its broad principles the objectives of fair trading, open choices, and trust and transparency. The blacklisted practices identified and implemented should aim to achieve these objectives. And their success, relevance and proportionality should be measured against these objectives.

Furthermore, any “blacklist” of practices should not apply to *all* platforms identified as gatekeepers. Rather it should set forth obligations and prohibitions specific to the type of platform, as defined by business model and market. Indeed, different types of platforms are likely to employ different behaviors and practices to build, protect, or extend their economic power:

- *Gatekeeper Matchmakers, Marketplaces, and Exchanges* may limit multi-homing by using exclusive contracts and self-preferencing policies and practices that force buyers and sellers to use vertically-integrated tools and services in order to reach an important (likely single-homed) audience or product.
- *Gatekeeper Ad-Supported Consumer Platforms* may acquire nascent competitors and rely on user defaults, vertical integration, excessive rents and scale effects to deny their competitors critical scale with respect to users or advertisers.
- *Gatekeeper Software Platforms* may extract excessive rents from developers or other complementors (through excessive charges for access to the platform) or block or otherwise competitively disadvantage complementors who might develop a relationship with users and compete by taking those users off the platform.

Given these differences, applying a single set of obligations and prohibitions uniformly across all gatekeepers may inadvertently thwart competition. For example, ad-funded consumer platforms are data-driven, such that an obligation to share data *might* be appropriate approach to facilitate entry and competition. But data sharing is not likely to be relevant to enabling competition regarding app stores that operate as gatekeepers on closed software platforms. The regulation must be flexible enough to account for and address these differences between types of platforms.

C. Enforcement

Microsoft believes that enforcement of an ex ante regulation should be vested in a specific regulatory authority at the EU level. Digital markets are EU-wide if not global. If enforcement is left to national regulatory authorities at the Member State level, there is a danger of inconsistency in application and enforcement of the regulation leading to fragmentation.

Regardless of the agency ultimately chosen, mechanisms for coordination with relevant sectoral regulators as well as DG Competition and national competition authorities will be essential to ensure that the right “tool” is deployed to tackle identified problems and practices. In addition, such coordination will be essential to avoid inconsistent outcomes and to ensure the benefit of the experiences, perspectives,

⁵ See UK Competition and Markets Authority, *Online Platforms and Digital Advertising Market Study Final Report*, paras. 80-81 (1 July 2020) (available at <https://www.gov.uk/cma-cases/online-platforms-and-digital-advertising-market-study>).

and expertise that such agencies have with respect to digital markets and the competitive impacts of online platform business models and business practices are deployed for efficient regulation.

Microsoft also believes that the regulation should define a process to determine which firms qualify as a gatekeeper. Platforms should not be left to determine on their own whether or not they are gatekeepers, particularly in the absence of any guiding precedent or experience. Doing so will create uncertainty in digital markets and may lead to inefficient outcomes, i.e., over compliance by some firms and under compliance by others. That will only hamper growth in digital markets and online platform innovation or otherwise reduce consumer welfare.

In making the initial gatekeeper determination, a platform must have the right to participate in the work determining whether it is a gatekeeper. The process of determining gatekeeper status should be subject to strict but reasonable timelines, include rigorous procedural safeguards to protect the interests of stakeholders (e.g., rights of defence and independent judicial review). Because of the consequences that flow from gatekeeper designation, the burden of proving gatekeeper status should remain with the regulatory authority.

Finally, some mechanism for periodic review needs to be included in the regulation. This review would consider both whether the platform continues to qualify as a gatekeeper. It should also consider whether the blacklisted practices are achieving 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.