

The Digital Services Act: New EU Proposal to Regulate Digital Markets

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tl;dr

Background: The European Commission has released its draft Digital Services Act (“DSA”), which seeks to make the internet safer for European citizens. If passed into law, this regulation will shape digital markets in the European Union for years to come.

But... While some provisions of the draft DSA could bring needed changes to the regulation of online markets, the law will on balance make it more costly for online firms to do business in Europe. This is particularly true for smaller platforms with less capacity to shoulder significant compliance costs. Like many other regulations, the DSA also might further entrench incumbents.

However... The draft’s principle requiring online platforms to obtain some information on business users will protect both consumers and firms from illegal online activities. This should enhance European consumers’ trust in online markets and could boost growth.

KEY TAKEAWAYS

HEAVY COMPLIANCE COSTS

The DSA would force online platforms to significantly alter the way they “police” their

ecosystems; this is especially true for very large platforms that would be subject to more stringent obligations. Only small platforms and what the draft calls “micro-enterprises” are excluded from the regulation.

The DSA also would impose significant transparency requirements, notably with regard to content-moderation decisions and online advertisements. Very large platforms would have to explain how their recommender systems (which seek to predict user preferences) work and share much of their data with authorities and researchers. These obligations entail both compliance and opportunity costs that likely will be passed on to consumers.

The DSA also creates a system of government-appointed “trusted flaggers.” Platforms would have to work with these entities in order to identify criminal activity, share information with law enforcement, and potentially remove problematic content. Unfortunately, hefty fines for noncompliance (up to 6% of the total turnover, or revenues, in the preceding financial year) could lead companies to be excessively cautious and remove even benign content. Such an outcome would threaten freedom of expression. It is also unclear whether this system will prove workable in practice, or whether it will collapse under its own weight.

These new rules could have far-reaching consequences for consumers and businesses alike. For instance, local authorities may be able to request travel accommodation websites to remove from their platforms hosts with unregistered properties or outstanding tax obligations. The same might be true for gig-economy workers who may not comply with local regulations.

KNOW YOUR BUSINESS CUSTOMER

The draft DSA would also require online platforms to verify the identity of their trading partners. This “traceability of traders” principle is sometimes referred to as “[Know Your Business Customer](#)” (KYBC).

KYBC would make it easier for victims of online crime to seek redress. The previous regime (laid out in the e-Commerce Directive) absolved so-called “passive intermediaries” of liability for illegal content so long as they agreed to remove such content when made aware of its existence. Unfortunately, this system did little to prevent illegal content from reappearing once it had been taken down from a website. For instance, infringers routinely used aliases and shell corporations to re-upload the same content and prevent aggrieved parties from taking them to court.

Knowing violators’ identities will enable victims to pursue parties actually liable for illicit content with minimal burden on either the platforms, or non-business customers. Unlike the previous regime, this will deter infringers from putting illegal content online in the first place.

REGULATORY COMPETITION AMONG EU MEMBER STATES

The draft DSA requires each member state to supervise service providers whose “main establishment” is in their territory, while also creating several mechanisms for the commission and member states to coordinate their actions. Member states will thus have

incentive to limit regulatory overreach in order to attract large tech firms.

In other words, the decentralization of enforcement will enable national authorities to interpret the DSA’s provisions in ways that maximize the growth of online markets.

THE REGULATION WILL ALSO APPLY TO OVERSEAS BASED ONLINE PLATFORMS AND INTERMEDIARIES

Additional online transparency regulations for recommender systems and online advertising will apply to all large online platforms, including those that have their main establishments outside the European Union in cases where these service providers have EU-based users. The regulation will also require foreign-based providers of intermediary services to designate a legal representative in one of the member states where the provider offers its services.

For more on this issue, see Geoffrey Manne and Dirk Auer’s recent [analysis](#) of the DSA draft.

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