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## LAWFLASH

# UK COMPETITION AND MARKETS AUTHORITY RELEASES UPDATE ON POTENTIAL RISKS OF AI FOUNDATION MODELS

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## AUTHORS

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The UK Competition and Markets Authority (CMA) recently published an update paper outlining its concerns with AI foundation models (FMs). The CMA's September 2023 initial Report on FMs set out its early views on how FMs should be developed and deployed as well as potential future regulatory interventions. The update paper (FM Update) cites three key risks to competition of FMs and suggests mitigation measures.

For further background on the CMA's initial Report on AI Foundation Models, see our previous LawFlash.

The FM Update notes that the largest technology firms can contribute a wealth of resources, expertise, and innovation to FM development. However, the CMA states that this small number of incumbent technology firms already hold market power in many of today's digital markets. As a result, they may be empowered to "profoundly shape" FM-related markets as they develop, to the detriment of competition. The CMA cites a reduction in quality and higher prices as examples of the potential harms to competition within the FM sector.

The CMA notes that businesses and consumers are increasingly using generative AI, with more than 120 FMs released since the publication of the CMA's initial report in September 2023 and with the total number of known FMs globally exceeding 330.

The FM Update sets out some initial comments on the current development of the FM industry:

- Market development still depends on the availability of "compute, data, and expertise"
- FMs are released on a range of platforms and are increasingly integrated in a number of digital products and services
- The FM value chain is becoming more interconnected through vertical integration, partnerships, and strategic agreements between firms

## KEY RISKS ASSOCIATED WITH FM-RELATED MARKET DEVELOPMENT

The FM Update sets out three interwoven key risks that the CMA has identified to fair, open, and effective competition arising from the developing FM ecosystem:

*1. Firms that control critical inputs for developing FMs may restrict access to them to shield themselves from competition.*

Critical inputs, namely compute, data, or expertise, are inputs that have been deemed essential to developing FMs by the CMA. Firms that control these key inputs could implement restrictions to protect their market position, disadvantage market entrants, and prevent such entrants from building competing, capable FMs. Ultimately, the CMA considers that this could result in reduced quality and consumer choice in addition to increased prices.

The CMA notes that the FM sector is “more likely to flourish” when data, compute, and expertise is accessible and partnerships and integrated firms do not reduce the sector’s ability to compete. Further, there can be diversity in the types of FMs available only if key inputs are accessible.

The CMA is currently conducting three investigations into the cloud and AI accelerator chip sectors to assess, among other things, FMs’ potential impact on the ecosystem. The CMA notes that it will also take into account developments in FM-related markets when considering which digital activities to investigate under the upcoming Digital Markets, Competition and Consumers Bill.

*2. Powerful incumbents could exploit their positions in consumer- or business-facing markets to distort choice in FM services and restrict competition in FM deployment.*

The CMA expressed concerns that business and consumer choice could be impacted for existing digital products as FMs are or become integrated with such products. For example, technology firms with existing market power could integrate FMs into their existing product lines. The CMA states that this is happening “rapidly” and that such firms could confer their own FM services or those of their partners an advantage through “pre-installation, technical bundling, accessibility, integration, and compatibility.” The CMA claims that integration could result in firms that control routes to market, thus gaining significant influence over the deployment of FMs.

Such integration could entrench market power. The CMA notes that the plurality of FMs developed and deployed is crucial for user choice and that free choice and user determination to engage with the best products should not be restricted by anti-competitive bundling, tying, or self-preferencing.

*3. Partnerships involving key players could reinforce or extend existing positions of market power through the value chain.*

The FM Update also discusses how, in addition to increasing levels of vertical integration in the value chain, an increasing number of partnerships with FM developers and deployers and strategic investments (such as key talent hires) have been seen among the largest technology firms. The CMA notes that access to key inputs of such firms is likely to give them significant leverage when agreeing to such partnerships.

While the CMA recognizes certain pro-competitive benefits of such partnerships, it recommends vigilance against such partnerships being used to disadvantage new market entrants. The CMA highlights that

partnerships in the FM sector should not diminish consumer choice or diversity of business and that vertical integration and partnerships should not be used to foreclose competitors. The CMA will monitor existing and emerging partnerships and “step up” its review of partnerships that may fall within the UK merger control rules.

## **IMPACT ON COMPETITION**

The extent of the aforementioned risks will depend on the structure of the FM-related market at play. For example, a market characterized by “high returns to scale of data, high levels of personalisation, or network effects” could see one FM provider or a small number of providers gain entrenched market power.

According to the CMA, FMs may create higher-quality and potentially more personalized products and services at reduced prices. However, FMs may also result in unfair consumer practices such as “subscription traps, hidden advertising, or fake reviews.” The CMA also considers that “hallucinations” arising from or flaws embedded in FMs may produce outputs that in turn “mislead consumers and prevent them from making informed choices.”

## **TAKEAWAYS**

The CMA highlights that its principles are intended to complement the UK government’s approach to AI regulation and endorsed the House of Lords Communications and Digital Committee’s recommendation that “‘market competition’ should be an explicit policy objective of the UK Government’s work on AI.” The CMA will continue to deploy existing powers at its disposal, such as market investigations and merger control reviews, to assess the FM sector.

CMA Chief Executive Officer Sarah Cardell recently commented that, “[n]ow, with a deeper understanding and watching developments very closely, we have real concerns.” The potential “paradigm shift” that FMs could bring to economies and users was also flagged, with Cardell stating that the fast-moving nature of the FM sector has sparked an increase in the agency’s apprehension.

Market players in this space should remain mindful of the CMA’s growing interest, especially regarding vertical integration and partnerships. The CMA could use its powers to review partnerships (that are not subject to UK merger control) through investigations into whether such partnerships are anticompetitive agreements or give rise to abuses of market dominant positions or through broader market investigations.

While helpful in highlighting the CMA’s concerns surrounding the rapid advancements in the FM sector at this early stage, both the initial Report and FM Update leave open the definitions of “FM market” and “FM-relevant market.” This is likely due in part to the fact that this technology, its use, and the players associated with the same are in a state of growth and flux. That said, the CMA’s approach to enforcement in the coming months and future CMA updates in this space will prove crucial as regards clarification of market definition.

The CMA also acknowledges the UK government’s position on “striking a balance” between the potential benefits of open-source FM models (including “innovation, transparency, and accountability”) and the potential risks. In turn, the CMA has called for “effective technical and policy mitigations” around risks arising from open-source (and proprietary) FM models to help ensure that the market “sustain[s] a range of FMs, including open-source models.”

The CMA intends to continue its dedicated program to consider the impact of FMs on markets throughout 2024, with a further update anticipated in August. Further publications expected from the CMA include (1) a paper on AI accelerator chips (considering their role in the FM value chain), (2) joint research in the Digital Regulation Cooperation Forum on consumers' understanding and use of FMs, and (3) a joint statement with the Information Commissioner's Office (the UK's data protection regulator) on the interaction between competition, consumer protection, and data protection in FMs.

## **HOW WE CAN HELP**

Morgan Lewis continues in its commitment to staying abreast of these developments to support our clients operating within the AI FM space. Notably, we are actively advising clients on the upcoming EU AI Act, including in relation to general-purpose AI models, which is expected to be regulated under such law.

Morgan Lewis will continue to provide legal advice, risk assessment, compliance support, representation in investigations, and strategic guidance in response to opportunities, risks, and challenges posed by AI.

## **CONTACTS**

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following:

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