This note is submitted by the Australian Delegation to the Committee on Competition Law and Policy FOR DISCUSSION at its forthcoming meeting on 24-25 October 2000.
Introduction

1. Electronic commerce has the potential to enhance competition in many industries. The development of B2C websites offering online shopping facilities may generate new entrants into existing markets (from both domestic and international sources). Further, the potential reforms to supply chain management made possible through the development of B2B exchanges may enable businesses to compete more effectively in domestic and international markets.

2. However, a number of competition issues may emerge, especially if the current trend towards participant-owned B2B exchanges continues – particularly if regional exchanges develop in small economies such as Australia.

3. Given that e-commerce is still a developing area, the following views are necessarily of a preliminary nature. Australia welcomes this process as an opportunity to share views and enhance understanding of potential issues.

Key Issues

4. The Secretariat’s paper raises a wide range of issues, covering both specific competition issues arising in the conduct of e-commerce transactions, as well as the impact e-commerce may have on the analysis of competitive structures of traditional markets. In the Australian context, the key issues appear to be:

- Whether the competitive impact of B2B exchanges will be greater within a small economy such as Australia. As Australian industry is already relatively concentrated by international standards, there may be greater potential for concentrated buying or selling groups to develop through B2B exchanges. This may encourage collusion between participants, raise barriers to entry and enable participants to exert market power against trading partners (particularly on smaller, fragmented suppliers or buyers). The creation of market power may be more likely to be an issue in assessing indirect supply hubs within Australia than in larger jurisdictions. This is because the small size of the Australian economy may not afford opportunities for the diversity of exchanges for indirect goods and services which would be expected to develop in larger economies.

- Whether such ‘small economy’ effects will be mitigated by the potential for Australian businesses to participate as buyers or sellers in international exchanges.

- Monitoring changes in the nature and size of B2B exchanges over time, and to see if exchanges become more concentrated over time due to network effects.

- Dealing with issues of jurisdictional overlap when cross-border e-commerce is at issue.

- The impact of B2B and B2C operations on traditional markets and whether there is potential for anti-competitive behaviour to stymie competitive growth.
Electronic Commerce in Australia

5. While Australia is currently one of the leading countries in terms of Internet usage, only 0.4 per cent of Australian retail sales are transacted over the Internet and no measures are currently available quantifying the level of B2B activity in Australia. Approximately 43 per cent of Australian adults used the Internet in the year ended February 2000, placing Australia behind only Norway, the United States, Iceland and Sweden. It was anticipated that approximately 36 per cent of households would be online by February 2000 and 37 per cent of all businesses are connected to the Internet.

6. Survey information indicates that security issues are the greatest concern of both customers and businesses in engaging in e-commerce.¹

7. The national competition enforcement and regulatory agency – the Australian Competition and Consumer Commission (ACCC) - has not made many determinations in relation to competition issues arising from the transactional e-commerce sector (although it is handling increasing numbers of consumer protection and e-commerce infrastructure issues which are beyond the scope of this paper). In recent months the ACCC has noted a growing number of proposals to establish participant-owned B2B exchanges within Australia, and to participate in offshore exchanges. The ACCC is still in the process of developing its understanding of these arrangements before forming any views on such proposals. Two significant examples of B2B and B2C arrangements that have been proposed.

Airline Ticketing B2B and B2C Joint Venture

8. A number of airlines have proposed the establishment of a joint venture which will operate a B2B site to link airline ticket inventory and other services such as car hire and hotel reservation to one electronic exchange. This site will be linked to a B2C site owned by the joint venturers, but will also be available to travel agents and others wishing to establish a competing B2C. The airlines will provide independently priced products to the venture.

B2B Indirect Supplies Exchange

9. A number of major Australian businesses have formed an alliance, corProcure, to operate a B2B exchange for the procurement of indirect goods and services. The owners are not direct competitors and include both buyers and sellers of indirect products. The proposal envisages that both suppliers and buyers may use other procurement channels if they wish to do so.

Infrastructure Related to Electronic Commerce

10. Since the focus of the discussion is to be on ‘transaction e-commerce’ issues no comment will be made on infrastructure issues in this contribution. Nevertheless, it is recognised that infrastructure issues are relevant to the potential for development of transaction e-commerce, the competitive structure and the conduct of e-commerce industry participants.

1. Market Definition, Price Discrimination and Predation

Issue 1: What are the important factors determining whether or not e-commerce and traditional outlets (mainly wholesalers and retailers) are in the same market?
11. Given that e-commerce is still in the early stages of development, the ACCC’s approach to date has been to assess this question on a case-by-case basis.

12. The ACCC may be expected to utilise the ‘small but significant and non-transitory increase in price’ (SSNIP) test to assess whether online businesses are in the same market as traditional outlets. In determining whether a SSNIP from a hypothetical monopolist traditional outlet would result in significant customer swing towards online distribution channels, key underlying considerations will include consumer confidence in relation to privacy and security issues, the comparative cost structures of online businesses against traditional outlets, and access to infrastructure within Australia.

13. Industry-specific issues also need to be assessed, including:
   • Demand preferences to purchase particular types of goods through traditional outlets.
   • Access to suppliers and inventory, and consideration of the impact of vertically integrated distribution chains on the potential for independent online competitors to enter a market.
   • Delivery costs, including whether import costs may fall as a result of the potential development of global logistics capabilities.

14. The presence of e-commerce competitors may also impact upon the methodology used to determine markets. Supply side substitution may become a more prominent characteristic of retail markets, as online environments may add different types of products more efficiently than physical outlets. Greater levels of price and product differentiation will need to be dealt with in applying the SSNIP test.

15. Also, benchmark competition analysis may become more relevant, because although actual online sales may not be large, the greater amount of information available to consumers may increase ability to benchmark prices. Nevertheless, it remains to be seen to what extent prices posted on Internet sites will impact upon prices offered by traditional outlets. For example, within Australia, the ACCC has observed in the recent case of the entry of Impulse Airlines into major domestic routes that the advertising of a limited number of highly discounted airfares on Impulse’s own website had a direct impact on prices offered by other airlines – but only, it appears at this stage, on tickets sold over the Internet.

Issue 2: Since the Internet knows no boundaries, one might expect that e-commerce has or will considerably increase the size of geographic markets with subsequent benefits to competition. To what extent is this natural tendency being restricted because of various regulatory barriers, including regulations preserving inefficient delivery systems (both in telecommunications and in physical delivery)?

16. The view is supported that e-commerce outlets have the potential ability to overcome some of the issues of geographic isolation – particularly in substantially lowering the costs involved in identification of potential trading partners, relationship-building, transaction negotiation and logistics management. However, physical delivery costs may continue to form barriers to entry to some Australian markets. This may vary on a case-by-case basis.

Issue 3: Some studies have shown that price dispersion in B2C, even for roughly homogeneous goods, is equal to or greater than in traditional distribution. This seems odd given that e-commerce is supposed to reduce search and comparison costs. Why is a significant degree of price dispersion sometimes found in e-commerce and does it indicate a lack of competition? If so, what can or should competition agencies do about it?

17. Australian competition laws do not prohibit price dispersion, or price discrimination as such, except in relation to specific infrastructure services which are subject to an access regime. In other cases, price dispersion will only be prohibited if the conduct is carried out by a person who has market power,
and has taken advantage of that market power (to engage in price discrimination) for the purpose of preventing or hindering competition in a market – i.e. predatory pricing by a firm that has existing market power.  

18. The ability of firms to charge different prices to different customers, and prices different from other on-line or traditional competitors may be enhanced in online environments. This could be due to a range of factors, including greater scope for product and service differentiation in on-line environments, and higher search costs involved in ‘surfing’ the Internet than initially anticipated.

19. Such behaviour is unlikely to justify a regulatory response unless it arises due to the misuse of market power. In the absence of such conditions, the ability to price discriminate is likely to be pro-competitive, and reflective of the ability of online service providers to tailor offers to the individual tastes and requirements of customers and accordingly may increase rather than restrict output.

20. There have not yet been any cases in Australia where significant market power concerns or predatory pricing have been raised in relation to the conduct of online services. Potential issues which may need to be considered in determining whether some B2C operations could acquire market power may include:

- Whether established ‘brands’ in old economy businesses will have a significant competitive advantage over ‘pure plays’ in online ventures because of established trust relationships with customers, ability to provide recourse to physical outlets and potentially lower search costs associated with recognised brand names;
- The effectiveness of ‘infomediaries’ to perform low cost search and price comparison services for consumers and provide trust/security assurance for customers dealing with new or unknown brands (including whether consumers will trust the infomediary itself);
- Whether proprietary rights may subsist in key technology components (for example, the ‘one click’ debate) or particular e-commerce standards;
- Whether traditional outlets will still constrain pricing of online services.

Issue 4: Why might less well known brands or generic goods likely be better or poorer substitutes for well-known brands in B2C? Why might B2C sellers have more or less negotiating power over suppliers than their bricks and mortar cousins?

21. While having no concluded view on these issues, the following preliminary comments are made:

- Well-known brands may have a competitive advantage in the online world as a brand name search is an effective technique used to locate sites. However, online operators which do not have the advantage of a brand name to attract consumers to their site may employ other techniques such as positioning their site on search engines, effective utilisation of metatags and keywords on their websites, and building their own brand name to overcome such difficulties.
- Branded products may also be more acceptable to online consumers as the use of a known brand may lend an air of credibility to a website.
- Nevertheless, in particular industries, B2C’s appear to be developing ‘niche’ markets (for example, last minute cheap airfares). In these areas, lower priced less well known or generic goods may have a competitive advantage over more expensive, branded products.
- Relative negotiating power between B2C and bricks and mortar competitors will depend on the level of consumer acceptance of B2C sites and will need to be assessed on a case-by-case basis.
**Issue 5:** If price discrimination is being used anti-competitively, why might one expect it to be easier or harder to apply competition law against it in e-commerce compared with traditional markets?

22. While there have been no cases in Australia of anti-competitive pricing policies in B2C or B2B operations, the following preliminary comments are offered:

- The relative ease of communication across the Internet may provide greater transparency in transactions, and therefore make anti-competitive practices easier to detect.
- However, as discussed previously, it appears that the sheer volume of information available over the Internet may increase search costs (for both complainants and competition authorities seeking to compare price offers), which may create new challenges in detecting anti-competitive price discrimination.
- In B2B operations, where network externalities and regional issues may limit the number of competing ‘hubs’, transparency of exchanges may be an issue for users. Instances of anti-competitive behaviour by particular participants or owners may be more difficult to detect due to the geographic disparity between users, and the lack of competing hubs to form a benchmark for comparison.
- Investigation of on-line anti-competitive pricing may require new investigative and evidence gathering skills to be developed to deal with issues such as retrieval and analysis of information held in electronic format.

**Issue 6:** Are traditional distributors using anti-competitive means to protect themselves against e-commerce rivals? If so, what special difficulties, if any, have been encountered in bringing competition law to bear against such practices?

23. In relation to the delivery of telecommunications services, the ACCC has received a growing number of complaints concerning the conduct of existing network operators and retailers against new entrant Internet Service Providers (ISPs). These matters are dealt with under industry-specific telecommunications access and competition laws.

24. In other areas of e-commerce this has not yet been a substantive issue, however the ACCC takes the view that as the e-commerce sector continues to grow, competition issues may arise including:

- Exclusive dealing arrangements or Most Favoured Nation (MFN) clauses between traditional distributors and suppliers to constrain entry of e-commerce competitors. This issue is more likely to arise in markets where there are a small number of participants and existing ownership links between suppliers and distributors.
- Exclusive territorial licences may be used to restrict the ability of suppliers or new e-commerce participants to establish online distribution outlets in competition with existing distributors.
- Primary boycott activity against suppliers who deal with e-commerce competitors.
- Establishment of ‘closed’ B2B exchanges and joint B2C operations between traditional distributors, which could be used to tie suppliers to traditional distributors’ e-commerce sites.

25. These issues will need to be assessed on a case-by-case basis to determine whether the national competition statute, the Trade Practices Act 1974, has been contravened. Where such activities occur on a global scale, jurisdictional issues are likely to be complex.

**Issue 7:** Have there been many instances of suppliers using both traditional distributors but simultaneously employing B2C and B2B exchanges in which they have an ownership interest? From the
competition policy point of view, what new wrinkles, if any, does e-commerce introduce into such tapered vertical integration?

26. A number of suppliers have expressed interest in participating in the ownership of B2C and B2B operations, particularly in relation to airline ticketing and indirect supply procurement hubs. These proposals are still in the early stages of development and the ACCC has not as yet formed a view on the competitive effects of such ventures. Such proposals appear to envisage buyers and sellers on B2B exchanges continuing to use other procurement channels and supplying other B2C operations.

- As in any industry, suppliers with vertical links into other areas (in this case B2B and/or B2C operations) may have an economic incentive to discriminate against traditional distributors or on-line competitors. This may occur, for example, through refusals to deal, allocation of exclusive inventory to its own operations, or the implementation of Most Favoured Nation (MFN) clauses.
- There is a risk that a supplier will gain access to commercially sensitive information about its competitors.
- Suppliers may use supply policies to control the potential for traditional and e-commerce distribution outlets to compete on a full range of products in order to prevent the heavy price discounting that can occur when a new distribution channel develops. This may result in e-commerce becoming a complementary rather than competitive outlet.
- However, supplier involvement in e-commerce initiatives may also have competitive benefits, particularly if such ventures are considered ‘too risky’ to proceed without the guaranteed throughput of a particular supplier.

27. Such issues may need to be assessed on a case-by-case basis, and are more likely to arise where a supplier has a significant degree of market power.

Issue 8: Producers sometimes share the costs of distributor web-sites and thereby obtain some control over distributors’ prices. In addition, e-commerce outlets potentially compete with sellers located anywhere in the world. How, if at all, do these phenomena create a potential for laws against resale price maintenance and price discrimination to be applied differently in e-commerce compared to traditional markets? Has this potential actually materialised in your jurisdiction? If so, has competition law itself produced a competitive distortion, and if so, what steps should be taken to eliminate that possibility?

28. Resale price maintenance (RPM) is prohibited and courts have applied significant penalties for contraventions. However, the ACCC may authorise RPM conduct where it is satisfied that in all the circumstances the conduct is likely to result in such a benefit to the public that it should be allowed. It is open to the ACCC to grant authorisation, where appropriate, to reduce the likelihood of competitive distortions that might otherwise arise from the application of the prohibition on RPM to e-commerce outlets.

29. As discussed above, Australia’s competition law only prohibits price discrimination in certain circumstances. Accordingly, if an e-commerce outlet were to price discriminate between different jurisdictions on the basis of local market conditions (possibly cross subsidising prices in one region from profits in another), this would only be likely to raise issues under Australian law if the conduct constitutes a misuse of market power.
2. **Network Dominance**

**Issue 1:** What steps, including proprietary standard setting and other measures that might reduce interoperability, are being taken by e-commerce networks to increase the potential of network effects and first mover advantages to create and/or strengthen dominant positions? What are the arguments for and against competition offices taking action against such strategies? Do you have the legal tools to take such actions or is your agency basically powerless until after a dominant position, or something analogous, has been created?

30. No B2B proposals have been examined in such detail to identify whether such issues are arising in practice. The adoption of business models which limit interoperability in order to achieve the benefits of network effects may have some public benefits in terms of increasing the attractiveness and viability of exchanges. However, in some circumstances this may lead to the creation of dominant positions, or reduce the potential number of competing exchanges. It is possible that the ACCC may take into consideration whether proprietary standards and restrictions on interoperability are likely to lead to the creation of market power in assessing whether a proposed arrangement or joint venture to create an exchange may result in a substantial lessening of competition in a market and therefore contravention of s 45 of the Trade Practices Act.

**Issue 2:** Should competition agencies seek to influence the breadth of IPR protection being granted in relation to e-commerce? If yes, where does such intervention appear to be most warranted and how do you go about doing it?

31. While Australian law provides greater protection to holders of IP rights against the operation of competition laws than to other persons, this exemption for IP rights under the Trade Practices Act is currently under review. The ACCC has submitted to the review that IP rights do not warrant an exemption because if IP was made fully subject to the Trade Practices Act, the normal authorisation and notification procedures would enable the public benefits and detriments of arrangements to be assessed on a case-by-case basis. The ACCC considers that under these procedures, a proper balance could be struck between rewarding innovation and protecting the competitiveness of markets. In the context of e-commerce transactions, adopting either too wide or too narrow an approach to IP protection would have critical implications for the development of a competitive infrastructure and transactional e-commerce industry.

**Issue 3:** To what extent can B2B exchanges justifiably insist on exclusive dealing in order to protect themselves against freeriding? How does the competition analysis of such exclusive dealing change, if at all, when ownership of a B2B exchange is restricted to its major participants?

32. Under the Trade Practices Act, exclusive dealing arrangements will only be prohibited in limited situations. Generally, such arrangements will only be prohibited if they are likely to result in such a degree of foreclosure of a particular market that it will result in a substantial lessening of competition in that or another market. Also, such an arrangement may be prohibited if it constitutes the misuse of market power for the purpose of deterring or preventing competition (i.e. if a supplier has used its market power to require a buyer to enter into an arrangement to buy exclusively through a particular hub which is closed to potential competitors of that supplier).

33. If a group of competitors agree not to accept goods or services unless the supplier puts those goods and services through a nominated exchange, this could be considered under the primary boycott or third line forcing provisions.
34. Many exclusive dealing arrangements will not fall into these categories, and in fact may be considered to be part of healthy competition between B2B exchanges to attract buyers and sellers. It may be that exchanges are developed as ‘closed’ models in order to achieve critical mass, and gradually opened up to increase usage once the exchange is established.

35. Where competition issues arise, the arrangement may still be permitted under the Trade Practices Act if the parties obtain authorisation from the ACCC. Authorisation may be granted if the ACCC is satisfied that such a restraint on competition is necessary and not excessive in protecting them from freeriding, and the net public benefits of allowing such protection outweigh the competitive detriment.

36. If the ownership of a B2B exchange is restricted to its major participants, there may be a greater likelihood of competition issues arising, as such owners have greater incentives to use exclusive arrangements to ‘lock out’ competitors. Participant-owned exchanges may be less likely to ‘open’ their exchange to attract more customers once critical mass is achieved, and are more likely to be able to sustain exclusive arrangements over time due to the benefits they obtain in their primary markets from engaging in such conduct. Nevertheless, if the owners do not have significant market share, it is unlikely that exclusive dealing arrangements will have a large impact on competition, and are unlikely to be commercially sustainable.

Issue 4: Under what circumstances might B2B exchanges owned or controlled by their major participants be used to exclude or disadvantage rival sellers or buyers? etc.

37. The likelihood of owners of B2B exchanges discriminating against or excluding rivals (buyers or sellers) will depend largely on weighing up the potential costs of exclusion or discrimination (in terms of loss of exchange revenues) against the potential gains in other markets. The fewer available substitutes, the greater the gains to owners in participating in such conduct. Issues which may be taken into account include:

- The strategic significance of the goods and services distributed via the exchange.
- Competitiveness of traditional distribution channels (in particular, taking into account the efficiency gains associated with paperless transactions in a specific industry) to support rivals.
- Degree of ‘buyer/seller stickiness’ and critical mass necessary to operate an exchange. That is, if a large proportion of buyers or sellers in a market are committed to a particular exchange through ownership participation, and/or critical mass is high it becomes more difficult for a competing exchange to attract sufficient throughput to offer viable alternatives to rivals.
- Structure of ownership, taking into consideration potential counter-balancing interests which may arise if the ownership structure includes both buyers and sellers.
- To what extent the rules of an exchange are transparent and guard against discrimination.

38. Nevertheless, there may be some benefits in participant ownership in a B2B exchange, as this may provide a guarantee of volume necessary to attract investment and achieve economies of scope and scale.

39. At the same time, in a comparatively small economy such as Australia, this may result in a more concentrated market structure developing with a small number of participant-owned exchanges in each industry sector. Accordingly, the ACCC is particularly interested in discussing the issue of what critical mass is necessary for the viability of an exchange, and whether restrictive measures considered necessary to guarantee throughput in start up phases could be removed once an exchange is established.
In principle, while recognising the difficulties in determining the competitive implications of B2B exchanges, the ACCC believes that it is preferable to find structural solutions to these issues, rather than rely on the operation of anti-competitive conduct rules as and when complaints arise.

**Issue 5:** Many, if not most, B2B exchanges and B2C retailers appear to be losing money. Has this resulted in complaints of predatory pricing and, if so, were prosecutions launched? Where there have been predatory pricing cases, was it particularly difficult to prove that predation was occurring?

Predatory pricing does not yet appear to have arisen to a significant extent in Australia.

### 3. Enhanced Opportunities for Co-ordinated Effects

**Issue 1:** Under what circumstances, if any, should restrictions be placed on B2B and B2C exchanges to reduce the chances they will be associated with a higher incidence of co-ordinated effects?

Restrictions are more likely to be appropriate where the underlying market characteristics indicate that there is an economic incentive for parties to engage in co-ordinated conduct and there is a substantial risk of competitive harm.

This is more likely to occur when:

- Participants/owners are direct competitors in end product markets and have a significant combined market share in those markets (i.e. vertical exchanges).
- Participants/owners are significant buyers in input markets with significant combined buyer power.
- Goods and services exchanged via an exchange are of strategic significance, are not readily substitutable with other products, and/or involve a significant proportion of input costs.
- There is no independent management to handle data flow and administer confidentiality policies.
- The exchange involves express collective buying or selling rather than independent negotiations or auction mechanisms. Although auction rules would still need to be assessed to identify if there is any potential for ‘manipulation of bids’.
- Alternative distribution channels are not available, or are not price competitive (this reduces the ability for parties to ‘break out’ of a collusive arrangement).

**Issue 2:** What are the pros and cons of seeking to reduce any e-commerce enhanced co-ordinated effects by applying any or all of the following measures: requiring independent third party management for participant owned exchanges; putting a time limit on participant ownership of B2B exchanges; suppressing chat rooms; otherwise restricting or forbidding direct information exchange within the buyer or seller groups; and erecting Chinese walls to prevent participants learning in a timely fashion about each other’s activities.

The following initial reactions are given regarding the measures suggested above:

- Independent Third Party Management may alleviate a number of concerns, but the effectiveness of such a measure is ultimately determined by the degree of independence of management, and its ability to ensure that owners, including participant-appointed Directors, are not in a position to exchange sensitive information.
• Putting a time limit on participant ownership may limit co-ordinated conduct in the future, whilst allowing sufficient commitment from participants in the early stages of the development of an exchange to support initial capital investment. However, in practice it may be difficult to agree on an appropriate time limit on participant ownership and to find new investors at that time.

• Suppressing chatrooms may reduce the attractiveness of exchanges, and where the incentives of owners are to coordinate behaviour, other channels of communication may already be available – for example signalling through auctions, board meetings etc.

• Otherwise restricting flows of information or erecting Chinese walls are only effective as long as the parties adhere to the rules, and they can be adequately monitored to ensure compliance.
NOTES


5. For example, a penalty of $A500,000 was imposed on a bread manufacturer for contravening the prohibition on resale price maintenance: ACCC v Australian Safeway Stores Pty Ltd (1997) 145 ALR 36. The maximum penalty for each offence by a corporation is $A 10 million.

6. See s 88(8A) and s 90(8) of the Trade Practices Act 1974.

7. In particular, s 51(3) of the Trade Practices Act exempts conditions of licenses and assignments of intellectual property from the operation of s 45 (agreements that substantially lessen competition), s 47 (exclusive dealing) and s 50 (mergers that substantially lessen competition) to the extent that they relate to the subject matter of the relevant intellectual property.


9. Third line forcing is prohibited per se, but may be notified or authorised.
