E-commerce and competition issues under the Trade Practices Act: discussion paper

Australian Competition & Consumer Commission

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Discussion paper

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Disclaimer

This paper is a guide only and should not be taken as legal advice. It is not possible here to explain many of the qualifications that may apply to the provisions of the Trade Practices Act, or to identify all the possible categories of e-commerce activities and the application of the Trade Practices Act to those activities.

Contents

1. Introduction

Technological innovation and the rapid growth of the information economy are key trends in today's economy. The development of digital technology has paved the way for the emergence of a broad range of new communications channels including Internet services, mobile phones, email, video conferencing, and webcasting.

Technological change has far reaching implications for commercial activities within Australia and globally. In particular, it has provided significant growth opportunities for the Australian information technology sector and for the development of e-commerce services.

Some important changes brought about by e-commerce include the development of new online businesses to compete against traditional 'bricks and mortar' retailers and the development of new distribution channels for traditional products and services including online banking and online airline ticketing services. Another key development is the emergence of new business-to-business services including B2B electronic marketplaces and e-procurement services.

Approximately 56 per cent of employing businesses are now connected to the Internet, of which 36 per cent use it for banking, 28 per cent use it for selling related activities, and 24 per cent for procurement.[1] The value of B2B e-commerce in Australia at June 2000 was $US 2.3 billion, placing it the second best performer in the Asia-Pacific region, after Japan.[2]

These changes have the potential to significantly increase competition by increasing consumers' choice of products and traders. They also enable business to achieve significant efficiencies in their commercial operations as they move from high cost paper-based transactions to faster, lower cost electronic transactions.

At the same time, care must be taken to ensure that the opportunities for competition in this dynamic new area of economic activity are not stifled by anti-competitive conduct. While it is true that in rapidly changing high technology markets competition may be fierce, cases such as the ongoing Microsoft litigation indicate that in some instances businesses may achieve significant market power, and use their position to stifle further competition. From a consumer protection perspective, there have also been a number of cases where unscrupulous traders have taken advantage of the Internet as a medium to propagate old-fashioned scams. An example of this is the recent Skybiz matter which arose in relation to an Internet-based pyramid selling scheme.[3]

A theme which emerges in this area of competition policy is whether new technology alters the way in which market power issues should be analysed. Another important

1 NOIE, *State of Play*, June 2001 p 7–8.

2 NOIE, *State of Play*, June 2001 p. 64.

3 See ACCC, '*ACCC Institutes Against Skybiz.com Inc (USA)*', Media Release, MR230/01, 18 September 2001.

consideration is how the development of new Internet-based services and distribution channels will affect the definition of markets. Specifically, will markets become more global in nature or in fact promote the development of a larger number of smaller niche product markets? These are important considerations in assessing competition issues in existing markets as well as new technology markets.

The purpose of this paper is to stimulate industry discussion on what may or may not be unique about e-commerce and high technology industries in terms of competitive analysis. Attention is focused on the types of issues that may arise for Australia under the *Trade Practices Act (Cth) 1974* (the TPA) and how well the TPA can deal with those issues.

This is not intended to be an exhaustive guide to all the issues that may arise in e-commerce, or to provide a definite view on the ACCC's position on the matters covered in this paper. No doubt new issues will emerge as e-commerce matures and the regulator's views may also change to reflect its increased industry knowledge.

The ACCC welcomes industry comment on the issues raised, and to generate discussion identifies specific issues for consideration. Industry participants are also welcome to raise with the ACCC any other issues they believe to be relevant.

Further, the ACCC will be hosting a public conference on e-commerce issues on 19–20 November 2001. Day 2 of this conference will be used as a forum for the public, industry, legal and economic experts to comment on the issues.

2. Summary

The emphasis of this discussion paper is directed towards identifying types of e-commerce activities emerging within Australia, how these initiatives are assisting business to compete better and where potential competition issues may arise. It is also aimed towards generating a wider discussion of the way in which laws may apply to best serve the welfare of Australians.

Key themes that emerge throughout this paper include the following.

- Generally, e-commerce has the potential to increase competition by enabling the development of new services, new distribution channels, and greater efficiency in business activities.
- Competition policy issues may arise in relation to joint ventures to develop B2B electronic marketplaces (eHubs), particularly when they are developed by existing market participants with a significant combined market share (as buyers and sellers) in underlying wholesale markets.
- Competition policy issues may arise in relation to eHubs on an ongoing basis if they appear to have developed sustainable market power resulting from network effects and other factors, and/or engage in strategic acts to preserve or maintain their market power. Potential issues would include evidence of price fixing or tacit collusion, or anti-competitive discrimination against, or refusal of access to third parties.
- Issues will not arise in all cases, and this will depend on the details in each case. In many situations there will be pro-competitive and other public benefit issues that should be taken into account. A recent Federal Trade Commission report identified a range of potential efficiency gains that may accrue from the use of eHubs. They include reductions in administrative costs, reductions in search costs when accessing appropriate trading partners, creating new markets (e.g. markets for surplus stock), economies of scale in joint purchasing, and more effective supply chain management.[4] An important area for further consideration is whether the current authorisation structure is the appropriate forum to deal with these issues. This includes assessing how the authorisation procedures will operate in relation to dynamic services that may change as they develop.
- Issues may differ in other jurisdictions depending on the underlying level of concentration in wholesale markets in those regions. In this regard Australia may see more trade practices activity because of the small size of the economy and the level of market concentration in some industries. At the same time, Australian regulators should not ignore the global picture and how B2B can assist in the development of global competition.

4 See FTC, *Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces*, A report by the Federal Trade Commission Staff, October 2000, Part 2.

- E-commerce may raise issues in relation to the formation of standard setting arrangements, how businesses manage competition between distribution chains, and how they manage online information. These will be assessed under existing trade practices laws which could require further consideration of issues such as the adequacy of the existing 'purpose' test under s. 46 or whether an effects test should also be applied.

- The balance between developing copyright laws (which respond to the needs of the online environment) and the competitive implications of introducing new forms of copyright protection (such as the prohibition on circumvention devices) may need to be monitored.

- Small business may benefit substantially from e-commerce. At the same time it may face challenges in gaining access to eHubs and dealing with the impact of online retailing in areas such as franchise arrangements.

3. Overview of e-commerce activities

Given that e-commerce is still in the early stages of development, it is not possible to identify every type of e-commerce activity which may evolve. It is likely that there will be an online component of many if not all business activities in the future. Many different applications will develop, some of which will be successful, while others may not.

E-commerce activities may fall within the following very broad categories.

Development of and participation in procurement eHubs[5]

eHubs are essentially a single point of reference for multiple users to perform a particular function via the Internet (or other relevant electronic networks). An eHub may be designed to provide a variety of functions ranging from providing information about products and services of a particular type, to providing the means for transactions between buyers and sellers to occur and associated fulfilment services. Some users may also outsource some of their internal activities to an eHub. For example, an eHub may provide transaction services together with logistics or stock control services.

eHubs may be owned and operated by industry participants (either as a private consortium or via an industry association), or by independent third parties. They may be vertical (i.e. industry specific), or horizontal (indirect supplies) in nature. The trading mechanism adopted by an eHub (if in fact it is designed to support trading functions) may involve private negotiation, collective negotiations, one-to-many auctions, or a fully operational exchange (e.g. a continuous spot market similar to a stock exchange).

Examples of developing eHubs relevant to Australia include the following.

PeCC: A proposal to develop an eHub for the pharmaceutical industry.[6]

CorProcure: A horizontal eHub trading indirect supplies developed by 14 large Australian businesses including Telstra, Coles Myer, Australia Post and National Australia Bank.

Cyberlynx: A horizontal eHub trading indirect supplies developed by businesses including Woolworths, Commonwealth Bank of Australia, and Lion Nathan.

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5 For ease of reference, this document uses the term ‘eHub’ to cover a range of models for many-to-many procurement services. It may include a portal service that does nothing more than provide hyperlinks to different users to full B2B exchanges which operate sophisticated continuous spot markets online.

6 See *US mistrust of B2B not a leader*, AFR 12 May 2000, p. 81.

Zuji: A proposal for an online airline ticketing service and B2B platform for travel agents developed by Qantas, Ansett, Air New Zealand and other airlines in the Asian region.[7]

Ausmarkets: A proposal for an eHub to trade wholesale over-the-counter financial products developed by ANZ, National Australia Bank, Westpac and Commonwealth Bank of Australia.[8]

Individual e-procurement

Generally, this involves a market participant transferring existing relationships with business customers and suppliers to an online environment — a one-to-one or one-to-many application. The actual operations may be outsourced or performed internally. For example, Corporate Express has established its own B2B business to supply stationary and related products to business customers.[9]

Development of online retailing and information services

Broadly, these activities may be described as Business-to-Consumer (B2C) services. Examples include online shopping and information services. These may be new services such as Amazon and eBay, or new business to consumer distribution channels for existing businesses such as online airline ticket services.

Development of standards for e-commerce transactions

Standards for communication over the Internet including public key infrastructure (PKI), electronic payments systems and industry specific standards for electronic trading are also an important component of e-commerce activities. In some cases, standards may be developed by trade associations, separate standard setting bodies, or as part of the development of an eHub. An example of this is the SuperEC project which is developing electronic standards for communications within the superannuation industry.

Government transactions

Governments will also be involved in transforming appropriate activities from the offline to the online world. For example, the Victorian Government has initiated the development of an Electronic Commerce for Procurement Panel to assist government departments to put purchasing and payment activities online. Also, the National Office

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7 See Zuji, press release 15 August 2001, at <http://www.zuji.com/zuji/en_pr_consumer.html>.

8 See *Banks take Wholesale Financial Markets Online with AusMarkets.com*, press release 6 November 2000.

9 See http://www.corporate-express.com.au.

for the Information Economies (NOIE) is involved in the development of the Gatekeeper Project to provide for the accreditation of digital certificates for authentication and security of transactions for government transactions.

Provision of B2B and B2C products and services

This would include the business of Internet service providers (ISPs), software vendors and application service providers (ASPs) in supplying infrastructure to support online transactions.

Issues to consider:

3.1 What other types of e-commerce activities are being developed?

3.2 Which types of B2Bs are proving to be successful for Australian business? Why?

3.3 Are B2Bs delivering significant benefits to Australian business?

3.4 Have B2Bs changed, or are they likely to change the way business is conducted, or do they merely perform the same business activities electronically?

3.5 Which types of B2Cs have been successful in Australia? Why?

3.6 Does e-commerce development in Australia differ substantially from international developments?

4. Application of Trade Practices Act to eHubs

Considerable thought has been given to the competitive implications of eHubs, both within Australia and internationally.

In the United States the development of eHubs has attracted considerable attention from anti-trust authorities. Covisint — a joint venture between General Motors, Ford, DaimlerChrysler, Renault and Nissan to develop an eHub for trading auto components (and associated services) — was investigated by the US Federal Trade Commission (FTC) in 2000. While the FTC decided not to take action at that time, given the venture was still in the early stages of development, it could not say that implementation of the Covisint eHub would not cause later competitive concern.[10] The FTC has also held two workshops to discuss the potential issues arising in B2B.[11]

The following outlines some of the key trade practices issues arising for eHub owners, operators, and users in Australia.

Relevant provisions of the Trade Practices Act

In the Australian context eHubs could raise issues for owners, operators and users under the TPA. Issues may arise in relation to:

- joint venture arrangements to establish eHubs; and/or
- agreements to participate in, or enforce ongoing membership and operating rules of both participant-owned and independent eHubs.

Section 45A – price fixing arrangements between competitors

Provisions within arrangements between competing participants in an eHub which are likely to fix, control or maintain prices between them may be prohibited pursuant to s. 45 and s. 45A of the TPA. Such provisions may be contained within joint venture agreements to establish an eHub or within the ongoing membership and operating rules of an eHub.

For example, if a trading eHub enables participants to jointly sell goods or services over the eHub, this may constitute price fixing. The collective acquisition of goods and services by buying groups via an eHub may be exempt from s. 45A if they fall within the scope of the exemption for collective acquisition contained in s. 45A(3) of the TPA, but may still be assessed under other provisions of the TPA. However, a group of small

10 FTC, *FTC Terminates HSR Waiting Period for Covisint B2B Venture*, media release, September 11, 2000.

11 FTC, *Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces*, A report by the Federal Trade Commission staff, October 2000; Federal Trade Commission Public Workshop on Emerging Issues for Competition Policy in the World of E-Commerce, *Transcripts*, 7-8 May 2001 available at http:www.ftc.gov/opp/ecommerce.

suppliers will not have the advantage of this exemption. Where fees are set by a joint venture between competitors to jointly supply eHub services, this may be exempt from s. 45A if it falls within the scope of the joint venture exemption contained in s. 45A(2) of the TPA. However, the joint venture may still be assessed under other competition rules within the Act.

An eHub that does not expressly operate as a mechanism for joint pricing could also raise issues under s. 45A if, for example it:

- imposes rules that standardise trading terms that constrain the separate negotiation of particular types of discounts, allowances, credits or rebates;[12] or
- facilitates price fixing in downstream markets. For example, an eHub which enables a buying group to acquire key strategic inputs at a collectively negotiated price (which may of itself be exempt from s. 45A by virtue of the collective acquisition exemption) could result in price fixing in downstream markets in which the buyers compete.

eHubs could also become involved in price fixing arrangements (as either a principal or as a person knowingly concerned with an offence) if the eHub does the following.

- Enables participants in a price fixing arrangement to 'signal' to each other via the eHub — for example, if a trading eHub allows suppliers to see each other's catalogues, this may provide them with an opportunity to communicate intended price increases to each other. This is similar to concerns that sometimes arise in relation to traditional auctions or information exchanges being used as a mechanism for signalling to achieve price coordination.[13]
- Enables participants to coordinate price fixing arrangements automatically using encrypted software.

12 For example, see *Catalano, Inc v Target Sales, Inc* 446 US 643 (1980) where an arrangement among competing wholesalers to standardise credit terms was held to constitute an illegal price restraint. Also see Blumenthal, W, *B2B Internet Exchanges: The Antitrust Basics*, Antitrust Report May 2000 34-55 at 47 which queries whether such issues should be assessed under a rule of reason test in the United States.

13 For example, see *United States v Airline Tariff Publishing Co* 1994-2 Trade Cas. (CCH) 70,687 in which the US Department of Justice took action in relation to a computer network established by airlines to provide route and fare information on a number of issues, including allegations that footnote designators were used to signal price intentions.

Issues to consider:

4.1 What if any difficulties arise in applying the collective acquisitions exemption to eHubs? Why should small supplier groups not have the same level of protection as small buyer groups?

4.2 To what extent may owners and operators of eHubs be implicated in price fixing arrangements pursued by users of their facilities?

4.3 What steps should owners and operators of eHubs take to prevent illegal price fixing arrangements? For example, what steps can owners and operators take to reduce the likelihood of signalling occurring?

4.4 What guarantees or evidence can owners and operators of eHubs offer to ensure that such price fixing mechanisms are not 'buried' in computer programs or hardware?

Section 4D – primary boycotts

An eHub that includes rules or provisions which constitute an agreement between competing buyers or sellers not to trade with certain persons in relation to the goods and services in which they compete may constitute a breach of the primary boycott provisions of the TPA.

For example, if suppliers agree not to supply goods or services in which they compete to any buyer outside the eHub in which those suppliers participate, this may constitute a primary boycott arrangement. Equally, an agreement between competitors not to deal with traders via a particular eHub may constitute a primary boycott.

Some uncertainty may arise as to the scope of the application of primary boycott provisions to eHubs.

Uncertainty can arise in assessing whether participants are in competition with each other, particularly in relation to buyers in horizontal or 'indirect supply' eHubs which trade a variety of products to buyers in various industries. In a strict economic sense it may be arguable that buyers, irrespective of the value of the input to their different manufacturing processes, compete against each other for supply and organised boycotts pursued by such buyers can have a significant economic impact on suppliers. However, in practice it appears that buyers who do not compete against each other in downstream markets, or are buying low value, non-strategic items may not engage in rivalry against each other in any real sense and on this basis, could be argued not to be competitors.

Issues to consider:

4.5 When should members of an eHub be considered to be 'competitive with each other'? If members who buy the same products are not considered to be competitors, will this result in suppliers having less protection under the TPA against primary boycott activities by buyers than buyers would against suppliers?

4.6 Is it likely that primary boycott issues may arise in retaliation for perceived exercise of market power by an eHub? If so, how should these cases be treated?

Section 47 – third line forcing

Third line forcing occurs when a supplier either supplies the goods or services on condition that the purchaser buys goods or services from a particular third party, or refuses to supply because the purchaser will not agree to that condition. It is a special category of exclusive dealing which is prohibited outright, without having to prove that it would substantially damage competition.

If an eHub creates or enforces rules which make access conditional on participants agreeing to buy goods and services from another person not related to the eHub, this may raise third line forcing issues. This could raise issues in relation to mandating the use of a particular brand of public key infrastructure (PKI), computer software or hardware, electronic payment services, delivery services etc.

Issues to consider:

4.7 To what extent do eHubs require participants to acquire goods and services from third parties in order to operate? What types of goods and services are likely to fall within this category?

4.8 To what extent does mandating the use of particular third party goods and services enhance the efficiency of eHubs?

4.9 Is it arguable that certain types of goods and services should be considered as part of a bundle of services provided by an eHub and should not be considered to be separate third party goods or services?

Section 46 – misuse of market power

A firm with a substantial degree of market power in a particular market cannot take advantage of that power for the purpose of damaging other businesses.

Owners and operators of eHubs will need to be aware that their conduct in developing, administering and enforcing membership and operating rules may raise issues under s. 46 if the eHub has achieved a position of substantial market power.

An issue will be to determine whether or not a particular eHub has substantial market power. This will be discussed in more detail in the following section.

Examples of conduct which may raise issues under s. 46 include:

- refusals to provide access to an eHub to certain industry participants or the imposition of onerous admission qualifications;
- discrimination in relation to the level of access given to particular buyers or suppliers;
- imposing additional costs or infrastructure investment to ‘lock in’ participants to a particular eHub; or
- restricting use of proprietary intellectual property rights (IPRs).

Complex issues may arise in assessing whether an eHub has taken advantage of its market power in pursuing a particular course of action. It may be that rules which restrict entry to an eHub, or otherwise appear to disadvantage particular businesses occur irrespective of whether an eHub has market power or not. Complex issues may also arise in assessing whether an eHub operator has acted for a proscribed purpose. For example, if an eHub operator decides to restrict access to the exchange by requiring participants to use a particular type of catalogue software which is too sophisticated and expensive for some, it could be argued that the purpose was not to restrict competition, but rather offer trading partners the best available technology solution. Nevertheless, such acts may have a substantive effect on competition, particularly for small competitors or potential new entrants.

Issues to consider:

4.10 What kinds of conduct could eHubs engage in that may raise issues of misuse of market power?

4.11 Should an 'effects' test be applied to allegations of misuse of market power?

Sections 45 and 47 – Contracts, arrangements and understandings which are likely to result in a substantial lessening of competition in a market and exclusive dealing that is likely to result in a substantial lessening of competition

Arrangements to establish an eHub, or provisions within agreements between participants, eHub operators and each other to abide by certain membership or operating rules may breach the TPA if they have the purpose or likely effect of substantially lessening competition in a market. Exclusive dealing issues may arise, for example if an eHub requires members to agree not to supply or acquire goods or services from a competing eHub and this is likely to have a substantial impact on competition between eHubs. Analysis of the competitive impact of eHubs is discussed in detail in the following section.

Section 50 – mergers between eHubs

Where eHubs begin to consolidate as the industry matures, it can be expected that certain mergers, strategic alliances or interoperability arrangements between eHubs may raise issues under s. 50 or s. 45 of the TPA. In assessing these issues it is necessary to consider what the likely effect on competition will be.

Part IIIA – access arrangements for services provided by means of infrastructure facilities

Part IIIA provides for the regulation of services provided by means of infrastructure facilities which are of national significance and uneconomic to duplicate. It is feasible that a particular eHub may be of national significance and uneconomic to duplicate, in which case Part IIIA could apply. However, in the majority of cases this approach to and application of the act appears uncertain.

Equally, Part XIC which provides for access regulation of certain telecommunications services would only apply if the eHub itself falls within the definition of a telecommunications service.

Issue to consider:

4.12 In what circumstances should eHubs be regulated under Part IIIA or Part XIC of the TPA?

Market definition issues

In many cases the assessment of eHubs under the TPA will depend on whether the eHub is likely to result in a substantial lessening of competition in a market, or have substantial market power. In both cases it is necessary to identify the boundaries of the relevant markets.

The ACCC's approach to market definition is comprehensively set out in its *Merger Guidelines*[14] and this issues paper does not revisit those principles. However, complex issues may arise in applying those principles to e-commerce situations, and in particular to eHubs.

Substitution possibilities

In assessing the scope of the relevant market in which eHubs participate, potential substitution possibilities may need to be considered carefully. Again, this will depend on the actual nature of the eHub itself — whether it involves the full scope of procurement functions including information, negotiation, trade, fulfilment and settlement services, or a subset of these categories of activity.

Possible substitutes include procurement via traditional means, individual rather than collaborative e-procurement (demand-side substitutes), or eHubs in other industries that could introduce new services to compete against another eHub.

Demand-side substitution will depend on the extent to which those alternative services can offer a comparable range of services at a comparable price. One of the 'selling points' of multi-participant eHubs is the potential cost saving for both buyers and sellers and the economies of scale associated with the use of eHubs.[15] The existence of such efficiencies may reduce the potential for substitution from other procurement mechanisms. However, this may vary on a case-by-case basis. For example, where procurement costs in relation to the inputs in question do not represent a significant component of the buyer's overall production costs, the buyer may be more willing to

14 ACCC, *Merger guidelines*, June 1999, paras 5.34–5.42.

15 See FTC, *Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces*, Part 2 which outlines in some detail the efficiencies identified in B2B. Identified savings include reductions in administrative costs, search costs, enabling economies of scale in joint purchasing.

use other procurement mechanisms. It may be that in some industries, face to face contact is important and eHubs will in fact be of limited value against traditional procurement mechanisms, or only really compete in relation to the more routine components of the procurement process. This will need to be assessed in each case.

Supplyside substitution will also depend on a range of factors, including the level of industry expertise necessary. It may be that while a wide range of technology service providers may have the ability to supply the infrastructure necessary to develop an eHub, a certain degree of industry specific expertise may be necessary to develop an eHub with the functionality to cater for the industry in question. Also, there may be some additional costs involved in developing industry specific computer languages to cater for specific industry needs.[16]

Analysis of price information

One factor in assessing the scope of a market is to look at the pricing behaviour of the relevant parties. In assessing established product markets, similar pricing policies may indicate that firms offer close substitutes (though this is not always the case). The traditional approach to testing substitution possibilities is to apply the SSNIP test.[17]

However, when identifying the substitution possibilities in markets involving eHubs, SSNIP analysis may be deceptive. Because the e-commerce activity is new, it may be that there are other short term considerations which drive the price of eHub services which will become less important over time when such services have an established market position. Accordingly, during the initial developmental stage prices for the usage of eHub services may be quite low to encourage uptake of the new service. This does not necessarily indicate that eHubs prices will be constrained by other procurement methods in the medium to long term.[18]

Geographic scope of the market and globalisation issues

While s. 4E of the TPA defines a market as 'a market in Australia', the ACCC takes the view that the market does not need to be defined wholly within Australia, only that at least some part of it be in Australia. In some cases, the relevant market has been found to be a world market.[19]

As the Internet is essentially borderless, it is feasible that eHubs physically hosted from servers located anywhere in the world may compete against each other. However, the

16 See Peter O'Shea *Open Standards may become critical*, e-Commerce Today, May 2001, p. 5 which suggests that interoperability between eHubs is dependent on how open the standards used are.

17 The test is to ask whether a hypothetical monopolist would be able to impose a small but significant and non-transitory increase in prices without losing significant sales to a substitute product or service. See ACCC, *Merger guidelines*, June 1999, para 5.44.

18 This is a usual characteristic of services which exhibit network effects, where owners will initially keep prices low to gain the benefits of attracting more customers which, in a network market, will in turn increase the value of the service to other users. See McKenzie & Lee, *How Digital Economies Revises Antitrust Thinking*, The Antitrust Bulletin, Summer 2001, pp 253–298.

19 See ACCC, *Exports and the Trade Practices Act*, October 1997, p. 14–15.

actual procurement services that are offered by an eHub may be targeted to certain geographic regions. It will be a question of fact in each case to determine whether a market for procurement services is global or of a more limited geographic scope. Relevant factors to take into consideration will include the nature of the products traded via the eHub. If the underlying supply market is of a global nature, then the eHub's market is more likely to be classified as global. The existence of eHubs may encourage global trade by facilitating more effective international communication, but will not necessarily overcome structural and other trade barriers that may exist in relation to particular products. Any factual evidence of significant competition from global eHubs will also be relevant.

Issues to consider:

4.13 What other issues may arise from analysing market definition in relation to eHubs?

4.14 To what extent are developing eHubs of a global nature?

Competition analysis

As outlined above, the competitive implications of eHubs may need to be considered to determine whether:

- a joint venture or other form of collaboration between competitors to establish an eHub may result in a substantial lessening of competition and therefore breach s. 45 of the TPA;
- a merger or interoperability arrangement between eHubs may result in a substantial lessening of competition and therefore breach s. 45 or s. 50 of the TPA; and
- the ongoing activities of an eHub operator and users may breach one of the provisions of Part IV of the TPA because it is likely to substantially lessen competition or involves a misuse of substantial market power.

The ACCC engaged CoRE Research to provide an economic analysis of the competition implications of eHubs. The resulting report, entitled *Competition Issues Associated with B2B E-Commerce*, by Joshua Gans and Stephen King (the Gans & King Report) is available on the ACCC website at <http//:www.accc.gov.au>.

The ACCC has not issued guidelines or policy principles in relation to this area and considers that it may be premature to adopt a specific set of rules at this time. Nevertheless, Gans & King's report provides a useful basis for identification of the relevant issues in assessing the competitive effects of eHubs. Accordingly, this section considers the issues raised by Gans & King and seeks industry views on those issues or additional considerations they believe should be taken into account.

Summary of findings

From a policy perspective, key findings of the Gans & King report are summarised as follows and will be considered in more detail in the following paragraphs. Key points are these.

- eHubs may be pro competitive and enable the achievement of efficiencies. They may also provide wider gains to society by encouraging innovation.
- Competitive concerns are more likely to arise when a B2B exchange allows a number of firms on one side of a wholesale market to coordinate transactions and those firms jointly represent a significant part of the market. Whether those firms may jointly exercise market power should be assessed under the usual tests to identify market power. Such tests are identified in the *ACCC Merger guidelines*.
- The key question is whether the B2B exchange enables an exercise of market power not previously available to participants.
- Those participants must be locked into the B2B in some way. While Gans & King suggest that contractual exclusivity is the key to this, the following discussion suggests that other factors such as ownership and other incentives to participate may also be relevant.
- Main issues include the potential for participants to engage in tacit collusion, exercise of monopsony power or exclusion of third parties. This may affect competition in the relevant wholesale markets, and in some cases associated retail markets. In considering whether issues of tacit collusion are likely to arise it is important to assess if the eHub in question really changes the underlying nature of transactions occurring. In some instances it may not, and each case should be considered individually.
- It is a fallacy to assume that the exertion of monopsony power to reduce supplier costs will always benefit consumers. Monospony power issues should be considered in the same way as monopoly power issues.
- eHubs may exhibit network effects, a factor which suggests that a market will favour one eHub being used. This is a fact of life in such industries. What is relevant is to assess whether certain firms can prevent serial competition over time between new entrant eHubs. This behaviour is more likely from firms which have significant market presence in underlying wholesale markets.
- The question is what to do about it. There may be value in allowing an incumbent to invest in an eHub, as this may assist in developing such proposals. However, they should not be allowed to use market power to affect the competitive process.

Market power and eHubs

Gans & King state that:

> The critical issue when examining any anti-competitive consequences of a B2B exchange is whether the establishment and nature of that venture is likely to make the exercise of market power easier.[20]

In one sense an eHub may provide participants with better opportunities to coordinate transactions and to exercise market power which, individually, they would not have been able to do. They may have better access to each other's prices and other competitively sensitive information. They may be able to act jointly to exclude or discriminate against third party competitors seeking access to the eHub. However, to make the exercise of market power in underlying wholesale markets easier, Gans & King's analysis suggests that there must be something about the eHub to which participants are bound that reduces their desire and ability to look for substitutes (i.e. whether they will engage in off exchange transactions). In effect, there needs to be some incentive towards stability within a collusive arrangement for it to be likely to result in competitive damage over a significant time period.

As previously discussed, market power is assessed by identifying the market in which a business operates, and considering whether, in all the circumstances, it is likely to have market power having regard to substitution possibilities and other relevant factors.

The following identifies some of the factors that may be relevant in assessing market power in relation to eHubs and, in particular, the incentive and ability for participants to engage in off exchange transactions.

(a) Combined market position of participants in the markets for goods traded over the eHub (as either buyers or sellers)

The ability to use a B2B in an anti-competitive way may be closely linked to the combined market power of the participants in wholesale markets. If the participants do not initially have significant market power, then it is unlikely that they would be in any position to use their eHub to disadvantage trading partners or competitors.[21] If they tried to increase the cost of user fees, collude on prices, refuse access to or otherwise discriminate against competitors' use of the eHub, then trading partners and competitors would go elsewhere.

Issues which Gans & King identify as being relevant here are the usual tests for market power adopted in other areas such as merger or joint venture analysis. These would include whether it is likely that other firms could enter that market, level of fragmentation and countervailing power, and import substitution.[22]

(b) Impact of ownership on incentive to engage in off exchange transactions

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20 Gans & King Report, p. 13.

21 Subject to further discussion regarding the impact of network effects on market power which will be discussed below.

22 For a comprehensive discussion of the elements of market power, see the *ACCC Merger guidelines*.

Where an eHub is owned by participants who have a significant market share in the relevant wholesale markets it is arguable that this may raise greater concerns about the potential creation of market power. Ownership may have an impact on the incentive of owner-participants to engage in off exchange transactions as determined by:

- the level of investment they have made in establishing the eHub; and
- balancing the profit foregone in not directing volumes through the eHub against the potential gains of dealing off exchange.

However, it may also be relevant to consider the potential for countervailing power to be exercised within a joint venture structure if both buyers and sellers are members of the consortium. To determine whether the presence of both buyers and sellers within a consortium structure will effectively constrain the exercise of market power, it is necessary to consider a range of factors including:

- proportionate level of representation of buyers and sellers;
- whether the ownership structure is concentrated or fragmented;
- whether buyers and sellers have equal access to information;
- board representation of buyers and sellers; and
- vertical integration.

(c) Impact of exclusivity clauses on ability to engage in off exchange transactions

As Gans & King's Rule 4 states, an eHub is more likely to raise issues where it involves some form of exclusivity which prevents participants trading outside the exchange,[23] or from operating in a non-cooperative fashion within the exchange. This would involve a careful analysis of the rules of participation in an eHub.

(d) Efficiencies and the 'essential facility' doctrine

Gans & King suggest that:

> Market power and access are only a concern if the B2B exchange is so successful in lowering transaction costs that membership of this exchange becomes a pre-requisite …[24]

Where an eHub delivers such a higher degree of efficiency that participants or potential participants cannot find alternative modes of transacting at a comparable price, (that is reducing the practical ability of participants to trade off exchange) it is more likely that the eHub may encourage the use market power.

This factor may need to be assessed on a case-by-case basis, as various types of eHubs may deliver different quantities of benefits. Also, where an eHub is still in the

23 In fact, in some circumstances this may amount to a primary boycott.

24 Gans & King, op cit., p. 25.

formative stages, it may be difficult to accurately assess the level of efficiency it will deliver.

(e) Technical innovation

It is often argued, particularly in new economy markets, that innovation will ensure that networks that appear to be dominant will quickly disappear when a new technology overtakes it. Arguably, this may mitigate the dangers of exercising market power.

However, whether this is relevant in assessing eHubs may depend on a number of factors, including:

- access to minimum scale volumes;
- likelihood of new technology remaining independent, or being 'bought out' by the incumbent;
- ability of incumbents to maintain market position because of switching costs and other tying mechanisms such as integration with complementary products or services;[25]
- length of time for a new technology to get to market; and
- access to underlying patents and other information necessary to develop 'migrating' technologies rather than having to reinvent existing technology in order to innovate.

(f) Technical integration and switching costs

Arguably, a new eHub may not attempt to make participants invest significantly in modification of their existing IT systems in order to use the service. Such a factor could compromise the initial attractiveness of the eHub. However, in some cases it may be a technical necessity. Furthermore where the eHub is owned by incumbents they may have sufficient initial market power to require users to invest in making their systems compatible with the eHub and incompatible with others.

In some circumstances, by increasing exit costs, this could magnify the incentives for participants to continue using a particular eHub rather than engaging in off exchange sales, and assisting the owners to consolidate market power in this area.

(g) Alternative eHubs

As discussed above, whether there is room for one or more than one hub within a particular area of competition may be debatable. However, in the initial stages of development it may be relevant to identify whether there are other viable competing eHub competitors in the area.

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25 See R Posner, *Antitrust in the New Economy*, Antitrust Law Journal, Vol 68 2001, p. 930 also notes the relevance of network effects: 'If network externalities are large, they may give the monopolist a cost advantage that exceeds the benefit of a superior new technology. This is an issue of path dependence: an industry may be stuck with an inferior technology because of the cost advantage of the existing network.'

(h) Network effects

Network effects, sometimes also called network externalities or demand side economies of scale, occur when the value of a product to users increases when another user joins the network.[26] Where network effects are strong, this may lead to the development of high barriers to entry for potential competing networks — as they face the task of having to persuade substantial numbers of users to simultaneously switch services in order to offer similar benefits to the incumbent network.

eHubs may exhibit network effects, particularly where an eHub encourages liquidity in markets. As the volume of trade increases, the more attractive it may become to participants and the greater the pull of network effects.

In each case it may be necessary to consider whether or not, given the nature of a particular eHub, it is likely to exhibit strong network effects.

Generally, it would be expected that network effects will not raise issues of market power as it is sometimes argued that networks may unravel as quickly as they develop when a new technology or product emerges.[27]

However, in each case it will be relevant to consider the likelihood of the particular network being in a position to exert market power over a significant period of time. This may depend on a range of factors.

As Gans & King note, incumbents have greater incentive to

> use their existing dominant position to ensure that their own-sponsored or owned exchanges were to achieve the necessary network effects to drive independently owned exchanges out…[28]

Accordingly, where elements such as exclusivity clauses and ownership incentives tend towards the development of market power, network effects may nevertheless assist in increasing barriers to entry. Other elements which may be important in establishing and maintaining network effects include interoperability and switching costs. If an eHub is not interoperable with other eHubs in the same area of competition, or switching costs for users are high, then the eHub is more likely to be in a position to exercise market power.

The strength of network effects could discourage participants from engaging in off exchange transactions if they may lose the benefits of transacting via the network. However, this may depend on the facts in each case.

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26 C Shapiro & H R Varian, *Information Rules – A Strategic Guide to the Network Economy*, Harvard Business School Press, 1998; J Tirole, *The Theory of Industrial Organisation*, MIT Press, 1989.

27 See Dr Cento Veljanovski, *EC Antitrust & The New Economy, Is the EC Commission's View of the network economy right?* Eurpean Competition Law Review, 2001 Vol 9; McKenzie and Lee, *How Digital Economics Revises antitrust thinking*, The Antitrust Bulletin/Summer 2001 253- 298 at 270 discusses the relationship between dominance and consumer expectation – they argue that as consumers will be expected to move to a low priced network they would expect that network to gain popularity, which is in effect a self fulfilling prophecy.

28 Gans & King, op cit., p. 27.

When may market power develop?

Part IV provisions of the TPA will not generally apply to prevent the establishment of an eHub which is owned and operated by one party rather than a collaborative venture. However, where an eHub develops market power over time, its conduct, including the adoption of membership and operating rules, may fall within the scope of the anti-competitive provisions of the TPA.

This may be relevant where an eHub that does not initially enjoy significant market power in wholesale markets nevertheless grows into such a position due to the status afforded by its business success and the demise of competing eHubs due to network effects. During the 'growing stage' it is unlikely to be able to exercise market power and the TPA would not prevent a successful venture from developing. When it has reached a critical mass level, it may however be able to then exercise market power and its conduct may fall within the scope of the TPA. To determine whether market power is significant at a particular point in time it will be necessary to consider the likelihood of sustaining such a position over a significant period of time. Issues such as likelihood of independent technical innovation and switching costs will be relevant in this case, just as they are relevant in assessing whether an initial eHub development is likely to raise market power issues.

Issues to consider:

4.15 To what extent do you consider that the combined market power of consortium members in wholesale markets effects the competitive analysis of eHub joint ventures?

4.16 In what circumstances are eHubs likely to exhibit strong network effects?

4.17 Are participants in an eHub likely to engage in a significant number of off-exchange transactions if there are strong network effects? What factors will determine this?

4.18 What other factors should be taken into account in assessing the market power of an eHub?

Forms of exercising market power

The major categories of concern, once market power has been established include:

- exercise of monopsony power;
- tacit collusion;
- discrimination against third parties; and
- impact on market in which the eHub operates.

Monopsony power

Gans & King suggest that monopsony power issues can be analysed in the same way as monopoly power issues (and, in fact, develop their analysis on the basis of a buyer-driven eHub).

It is sometimes suggested that the exercise of monopsony power is good for industry, because it will result in price decreases. However, as Gans & King point out, an economic analysis of monopsony power issues suggest that even if prices fall, the exercise of monopsony power will result in a loss of allocative efficiency and a deadweight loss to society.[29] This is because the exercise of such power results in suppliers reducing the level of output below the optimum level.

It is also relevant to note that monopsony power may be exercised in other ways – including predatory buying (i.e. buying at such a low cost to drive competing buyers out of the market) or placing pressure on suppliers to supply competing buyers on less favourable terms.

Gans & King note that the exercise of monopsony power may be muted where there are a relatively small number of sophisticated participants on both sides of the market. However, eHubs would appear to be designed for situations where there is a high degree of market fragmentation, at least on one side of the market, as these are the circumstances when the most benefit can be gained from developing an electronic marketplace.

Gans & King also suggest that where there is an ability to offer flexible pricing schemes (i.e. price discrimination), the market impact may be that the distribution of benefits between each side of a market changes but there is no dead weight loss. Nevertheless, this may not cover situations where monopsony power is used to damage competitors, rather than to squeeze supplier's prices. These distributive effects may have other social and political policy implications for the Australian economy which will need to be considered.[30]

Issues to consider:

4.19 What other factors should be taken into account in assessing the competitive effects of the exercise of monopsony power?

4.20 Should wealth distribution effects be taken into account in assessing eHubs? To what extent is this possible under current laws, other than when an eHub seeks authorisation?

Likelihood of sharing competitively sensitive information

An agreement to exchange information or one that facilitates such an exchange (even when there is no express agreement to fix prices) may raise competition issues if it provides competitors with sufficient certainty regarding their competitors behaviour that they will no longer need to compete vigorously. The impact on competition may be seen in a variety of ways including reduction in price competition, reduction in

29 Gans & King, p. 9.

30 See Louis Vogel, *Competition Law and Buying Power: The Case for a New Approach in Europe*, [1998] ECLR 19(1) p. 4–11.

discounting or promotional activities, or reduced innovation and product differentiation.[31]

However, in respect to eHubs, tacit collusion may only be likely to raise issues in certain types of circumstances. Although increased price transparency could potentially raise issues of collusion, it may equally offer considerable competitive gains as the other side of the market will benefit from being able to compare and contrast different price offerings. Determining whether the overall effect is likely to be competitively detrimental requires a careful assessment of various factors including the following.

(a) Has the eHub significantly increased the degree of information transparency in a market?

The Gans & King report suggests that tacit collusion is only likely to be a serious concern where the underlying preconditions for collusion exist and the eHub increases the likelihood of such collusion occurring.[32] A key issue will be to determine whether the level of price transparency between competitors is increased as a result of the establishment of the eHub.

eHubs may be developed to replicate existing trading processes in an online environment to make processes more efficient for buyers and sellers. As such there may be no increase in the level of transparency. It may still be necessary to consider carefully whether electronic marketplaces have introduced more subtle, but important changes to a market which may increase the likelihood of tacit collusion. One such change could be the increased ability of participants to analyse price movements and respond more quickly because of the increased automation of these processes. Also, if eHubs drive a greater degree of liquidity (for example if they enable the introduction of spot markets or repeat auctions) this will increase the frequency of transactions which may increase the level of transparency between competitors.

(b) What type of information is exchanged, and are ring fencing and confidentiality rules sufficient to prevent owner participants accessing strategic information?

The potential for coordinated conduct to occur will depend on the nature of information which is available via the eHub.

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31 See Federal Trade Commission, *Antitrust Guidelines for Collaborations Among Competitors*, April 2000 para 3.31(b): 'the sharing of information related to a market in which the collaboration operates or in which the participants are actual or potential competitors may increase the likelihood of collusion on matters such as price, output, or other competitively sensitive variables.' In the Australian context, the ACCC has raised concerns about the competitive implications of information sharing in a number of instances. See for example, ACCC *Application for Authorisation of Interhospital agreement between Friendly Society Private Hospital Bundaberg, St Stephen's Private Hospital Maryborough, St Andrew's Private Hospital Toowommba, St Andrews War Memorial Hospital Brisbane and the Wesley Hospital Brisbane*, September 1999.

32 For a more detailed description of the market characteristics conducive to tacit collusion, see *ACCC Merger guidelines*, p. 58. As a general rule, a market must be relatively concentrated for tacit collusion to occur: see DeSanti, S, Nagata, E, *Competitor Communications: Facilitating Practices or Invitations to Collude? An Application of Theories to Proposed Horizontal Agreements Submitted for Antitrust Review*, Antitrust Law Journal, Vol 63 (1994) p. 93.

Where the information is of little strategic value — possibly where the products and services traded are of small proportionate value, have many other substitutes, or are not used as a manufacturing input or resold — then tacit collusion is unlikely to have a significant impact on competition. However, this must be assessed from both the buyer and seller side of the market. It may be that items of little strategic value to buyers may be of significant value to sellers.

In some eHubs the nature of the design may prevent competitors obtaining any knowledge of trade occurring via the eHub that does not involve themselves. At the most they may obtain aggregated information. In these circumstances, the occurrence of tacit collusion will depend on the level of security used by the eHub. However, if the eHub is owned by some or all market participants, they may still have access to this information. In assessing this issue, consideration will need to be given to any existing confidentiality or ring fencing rules that regulate information access.

(c) Are significant off exchange transactions likely to occur?

Gans & King suggest that the success of a tacit arrangement is determined by the level of confidence each participant holds in the quality of shared information. In the absence of exclusivity clauses, Gans & King suggest that firms can easily engage in off exchange sales, and the likelihood of tacit collusion may be reduced. Even where a particular eHub does not prescribe full exclusivity by participants, the potential for tacit collusion still exists if, in all the circumstances, it is likely that there will be a significant proportion of trade occurring via the eHub.[33] It is arguable that if competitors are unlikely to move a substantial proportion of sales 'off line' then minor 'chiselling' is unlikely to have a substantial destabilising effect.

Factors which may be taken into account in determining whether participants in a tacit collusion are likely to break away from the arrangement may include:

- whether the development of an eHub creates market power to the extent that it significantly constrains even the participants that created it from engaging in off exchange transactions. In particular, ownership interests, efficiencies and network effects may provide disincentives to trade off exchange;
- whether there are any minimum volume requirement clauses;
- whether there are most favoured nation clauses[34], as such clauses may prevent firms from offering lower prices outside an eHub undetected;
- inter-dependency in other areas of operations; and
- industry history of collusive activities.

33 See Federal Trade Commission, *Antitrust Guidelines for Collaborations Among Competitors*, April 2000, p. 19.

34 For discussion of the use of most favoured nation clauses to facilitate tacit collusion, see Steven C Salop, (1986) 'Practices that (Credibly) Facilitate Oligopoly Co-ordination', Ch 9 of Joesph Stiglitz and F Mathewson, (eds), *New Developments in the Analysis of Market Structure*, Cambridge: MIT Press pp. 265–290.

Issues to consider:

4.21 To what extent are eHubs likely to increase the amount and frequency of information provided to competitors about each other?

4.22 What factors should be taken into account in determining the incentive and ability for participants in an eHub to engage in off exchange sales?

4.23 To what extent are technical firewall measures and ring fencing arrangements likely to prevent the danger of participant owners acquiring a higher degree of information about competitors and trading partners?

Likelihood of discrimination against 3rd parties

In assessing joint ventures to establish eHubs, both Gans & King's report and the Federal Trade Commission report consider whether, as a result of the development of the eHub, market power is likely to be used against competitors.

Gans & King note that arrangements which restrict the participation of either the buyer or seller may raise competition issues. If an eHub is open access in nature it is unlikely to raise such issues.[35] Most eHubs will, however, contain some form of entry requirements and are unlikely to be fully open.

Many B2Bs may need to put in place admission rules to ensure the bona fides of participants. Admission requirements may vary depending on the nature of the B2B and the nature of the products and services to be traded. For example, the admission rules for a foreign exchange currency dealer may be quite different to the admission rules for an office supplier. Similarly, discriminatory fee structures may reflect a fear by investors that others will 'free ride' off their innovation.

When open access is initially provided, it may still be relevant to consider if the joint venture participants have the ability and incentive to later exercise market power and introduce such rules.

Issues to consider:

4.24 What types of rules (both membership/admission and operating rules) may restrict access to an eHub?

4.25 What measures can be taken to limit the use of restrictive rules in order to prevent a substantial lessening of competition?

4.26 How can the conflicting competitive interests in allowing open access and protecting investors from free riding be dealt with?

Competition between marketplaces

As discussed above, the potential for competition to occur between eHubs is an important element in considering whether an eHub may be used by participants, and in

35 Gans & King, op cit., p. 24.

particular owner-participants, to exercise market power to effect competition in markets for the goods and services traded.

It is also important in the context of whether market power can be used to prevent entry into the market for providing eHub services itself. Lack of competition at this level may raise issues, particularly where it appears that this may stifle the development of innovative, efficient e-commerce services or result in higher prices.

Whether this is likely to occur depends on the factors outlined previously.

Pro-competitive and public benefit issues

A re-occurring theme in the Gans & King report is that many of the elements of an eHub may also facilitate competition in a market. If administered correctly, an eHub may allow small businesses greater access to big business, increased efficiencies and timesavings. This will enable businesses to focus on their core operations and facilitate more flexible, transparent pricing arrangements.[36] In some cases, there may be additional benefits in stimulating infrastructure investment and facilitating Australian business access to global marketplaces. A recent FTC report identified a range of potential efficiency gains that may accrue from the use of eHubs, including reductions in administrative costs, reductions in search costs in accessing appropriate trading partners, creating new markets (e.g. markets for surplus stock), economies of scale in joint purchasing, and more effective supply chain management.[37]

At the same time, it is these specific characteristics of an exchange which provide incentives for incumbents to take control of these activities to protect themselves from competition.

In most cases, it would be expected that unless an eHub is owned by market participants with significant market power, the pro-competitive benefits of an eHub are likely to outweigh the potential for anti-competitive conduct. However, this does not necessarily mean that over time, if an eHub gains some market power in its own right, that the conduct of the eHub will not need to be scrutinised.

Where a proposal to establish an eHub raises competition issues under s. 45 or s. 50 of the TPA, or its rules or conduct raise issues under ss. 45, 47 or 46 of the TPA, efficiency arguments may to some extent be taken into account in assessing whether the proposal or conduct falls within the scope of the relevant provision of the TPA. For example, if a proposal by participants in a market to establish an eHub were to give rise to efficiency gains which result in lower, or not significantly higher prices, increased output or higher quality goods or services, this would be a relevant factor as such gains could increase competition. The treatment of pro-competitive efficiencies is discussed

36 See NOIE, *E-commerce Beyond 2000*, 2000 p. 16; ACCC, *B2B E-Commerce and the Trade Practices Act* ACCC Update, Issue 8, February 2001.

37 See FTC, *Entering the 21st Centure: Competition Policy in the World of B2B Electronic Marketplaces*, A report by the Federal Trade Commission Staff, October 2000, Part 2.

in the ACCC *Merger guidelines*. To accept such efficiency claims, the ACCC requires strong and creditable evidence that such efficiencies are likely to accrue.[38]

In contrast to the above, there will be some cases where efficiency claims may not necessarily lead to greater competition. For example, where two firms merge to create a monopoly, this may result in a more efficient allocation of resources, but it is unlikely to lead to a greater level of competition.

In those cases, and when other broader public benefit considerations arise, matters are typically dealt with under the authorisation process of the TPA. Details of the authorisation process are contained in the ACCC *Guide to authorisations and notifications*, November 1995.

In the e-commerce area, while there are many studies undertaken on the likely efficiency gains associated with B2B, the industry is still in the early stages of development, and it may be difficult to obtain reliable evidence until the market matures.[39] Care must be taken to differentiate between efficiency gains which could eventuate through the development of an eHub, and the efficiency gains that a firm would obtain from other, non-collaborative B2B activities. It is also relevant to consider how the efficiency benefits will be distributed. It may be that an eHub will provide a greater efficiency to some businesses than to others. For example, large businesses which have the resources to integrate their legacy systems with an eHub may be able to reduce the amount of information rekeying in comparison to small businesses (although small business may not need to process the same volume of transactions).

In assessing whether to apply for authorisation, there may need to be some consideration of what the parties specifically seek to have authorised. If parties seek authorisation of a joint venture agreement to establish an eHub, consideration will need to be given to whether they also need to have authorisation protection for the initial membership and operating rules. These are a critical component in assessing the potential nature and scope of an eHub and its implications under competition laws. In fact, authorisation may be meaningless unless issues such as operating rules are covered.

Where authorisation is sought in relation to a specific set of rules and underlying structure, issues may equally arise if the parties seek to change those rules, as may be expected in the on-going operation of an eHub. This raises issues of whether the parties would need to seek further authorisation of rule changes which raises administrative and resource implications.

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38 See *Merger guidelines*, para 5.171–5.174.

39 See FTC, Ibid. Part 2, p. 1: 'The full nature and extent of efficiencies that B2Bs will create has yet to be determined. Although some B2Bs are up and running and have so far created certain kinds of efficiencies, many more B2Bs are still in the planning stages, with the potential to realise more, fewer, or different kinds of efficiencies.'

Issues to consider:

4.27 What are the key pro competitive elements of eHubs?

4.28 How can industry provide creditable evidence that such competitive elements will outweigh potential anti-competitive elements in an immature market?

4.29 Is the authorisation process an effective way to deal with such issues?

4.30 What kind of arrangements would need authorisation – joint venture arrangements? Specific membership and operating rules? What kinds of issues does this raise for eHub operators?

Cross jurisdictional considerations

In some cases eHubs will be domestic in character, but in other cases eHubs will bring together buyers and sellers in many jurisdictions.

If an eHub accepts members or transactions from Australia, or targets Australian businesses in some form, it could be considered to be carrying on a business in Australia, even if it does not have a physical presence within the jurisdiction. This would technically place it within the scope of the TPA. At the same time, eHubs may be subject to competition laws in several other jurisdictions. One potential concern is that if regulators do not harmonise their approach towards competition issues, B2B will be subject to uncertainty and high regulatory costs which may stifle the development of such ventures. Equally, if an eHub could not develop in Australia, but is allowed to flourish internationally, it raises the question of whether Australian businesses could be disadvantaged against the rest of the world. Australian businesses should nevertheless have the right to certain statutory protections under the TPA if it appears that an eHub raises significant competition issues in this jurisdiction.

In assessing arguments that suggest eHubs in Australia should be treated in the same way as other jurisdictions, it should be noted that Australia's economic situation is different and may require action which would be inappropriate in another jurisdiction. Because of Australia's size, geographic location and population, there is a greater level of market concentration present than occurs in other jurisdictions. Accordingly, B2B issues may be of more concern in Australia than in other jurisdictions.

All these issues may need to be considered when assessing eHub ventures that have a global aspect.

Issues may also arise regarding the treatment of Australian businesses at the hands of a global eHub. Where global networks develop, perhaps owned and controlled by large multi-nationals, the interests of smaller Australian businesses may not necessarily be taken into account, or situations of market power abuse may arise. In some cases domestic trade practices laws may not apply, or would be extremely difficult to enforce. This may be particularly relevant to small business.

Administrative issues

The preceding discussion raises important implications for administering the TPA in relation to eHubs. The main issues that emerge follow.

When to scrutinise eHubs

eHubs could be assessed at the formation stage in the same way that mergers and some joint ventures are treated under s. 45 and s. 50 of the TPA. That is, parties seeking to establish an eHub that may raise some issues can approach the ACCC for an informal opinion on whether the ACCC is likely to take action under the TPA to prevent that eHub from developing. Such views could be provided on a qualified basis, subject to the potential for the nature and rules of an eHub to change over time. Alternatively, eHubs may only be assessed if there is a specific complaint about the conduct of an eHub or its participants.

The Gans & King report suggests some justification for assessing the formation of eHubs, particularly when the ownership is dominated by participants on one side of the market, as this may facilitate the exercise or creation of market power. However, the report also notes that participant-ownership does have benefits and can potentially achieve efficiencies sooner than would be the case if incumbents were precluded from investing in eHubs.[40]

The development of an eHub is costly for the parties and can result in significant structural change to an industry. Therefore, it may be preferable to provide parties with some degree of certainty by assessing certain types of eHubs during the formation stage, rather than attempting to 'undo' an arrangement at a later date.

Not all eHub ventures would need to be investigated at the formation stage. This should only need to occur in relation to the formation of an eHub via a joint venture or other form of collaboration between market participants in wholesale markets that have significant combined market power in those wholesale markets. In making this assessment, it would be relevant to consider the ownership structure, membership and operating rules, and likely conduct that may occur under those conditions. It may be that the factors within the *Merger guidelines* are the appropriate tests to apply to determine if incumbents are likely to have significant combined market power.

Clearly, per se offences would raise issues for investigation.

In cases where it is argued that the efficiencies and other public benefits of an eHub could not be achieved without participant-ownership, the parties may need to consider the appropriateness of seeking an authorisation for the proposal. In some cases, such arguments may be valid. However, claims that an eHub will never get off the ground without industry investment need to be assessed carefully. Clearly there are a number of independent eHubs developing, and although they may not have the guaranteed throughput of a participant-owned eHub, if they are efficient, is it difficult to understand why they would not obtain sufficient critical mass to be successful. It may also eventuate that while participant-ownership is important in the initial stages of

40 *Gans & King Report*, p. 28.

development, this may no longer be necessary to assure viability once the service is established.

How to ensure compliance with the TPA following an initial assessment

Initial investigation can help identify circumstances where an eHub appears to have the ability to exercise market power. The fact that some eHubs may exhibit network characteristics indicates that although an eHub may not initially raise concerns, it may in the future.

As outlined above, it is sometimes argued that in markets utilising new technologies this is not an area of concern as a new technology may quickly overtake the dominant player. Competition, it is argued, will be maintained through a series of battles between incumbents and new competitors over time.

Theoretically, network effects can unravel as quickly as they are created. However, in practice, an incumbent, once entrenched, may be in a position to act strategically to prevent this from occurring. For example, it may try to consolidate its position by creating exit barriers such as requiring participants to invest in non-compatible systems, use of intellectual property rights in standards to prevent third party innovation, or embark on a campaign of acquisition of potential competing research and development ventures.

Requiring eHubs to consult the ACCC on all rule changes and activities to ensure that they are not creating or exercising market power would impose a significant administrative burden on industry. However, where an eHub has been authorised, it may be that to preserve the protection of authorisation, changes in circumstances would need to be submitted to the ACCC.

There are a number of different options to address this administrative issue. The ACCC may decide not to become involved unless a complaint is received, or it may develop a monitoring/compliance program with the parties where there is some risk of competition issues arising.

Issues to consider:

4.31 What administrative issues may arise in assessing eHub issues at the formation stage?

4.32 What administrative issues may arise in assessing ongoing issues once an eHub is established?

5. Other competition issues arising in e-commerce

While much of the attention in e-commerce has focused on potential issues arising in B2B electronic trading exchanges, e-commerce may also raise different types of competitive conduct issues and have an impact on the way in which competition issues are assessed in the offline world.

This section of the issues paper will briefly consider other issues that may emerge in the future.

Market definition and globalisation issues

Generally, it is accepted that the development of eHubs at the wholesale level may improve the ability of businesses to negotiate supply arrangements with international trading partners – thus increasing the potential for import and export competition to develop. Similarly, independently owned business-to-consumer (B2C) retailing portals and individual sites may increase the level of competition in a market.

Such developments will need to be integrated into general competitive analysis in defining the geographic scope of markets in Australia, particularly in relation to mergers, joint ventures and misuse of market power cases.

The traditional tools for identifying relevant markets may be applied to determine whether online traders (either regional or global focus services) should be included in the same wholesale and retail markets as offline traders. Online services will not always be significant new entrants into all markets, nor will they necessarily trigger a significant increase in import competition in all sectors of the economy. This will depend on a range of factors including product substitutability, taste and consumer acceptance which will need to be assessed on an case-by-case basis.

In each case it will be important to consider, as it is in the offline world, whether online services are likely to arise as independent new entrants, or merely a new distribution channel for existing market participants.

Some studies have suggested that the application of traditional tools such as price comparison to determine market boundaries may become more complex as online distribution channels proliferate.[41] It is argued that online sales enable a higher degree of price discrimination, and thus product differentiation, which may lead to narrower market definitions.[42] Alternatively, it is also possible that online environments may be

41 See David A Balto, *Emerging Antitrust Issues in Electronic Commerce*, Speech delivered at 1999 Antitrust Institute, Columbus, Ohio, November 12, 1999 at p. 9: 'A hypothetical monopolist may be able to charge a nontransitory 5 percent price increase to some customers and not others. Relevant product markets have often been defined by the ability to price discriminate and this issue will receive serious consideration in future investigations in these markets.'

42 Frontier Economics Group, *E Commerce and Its Implications for Competition Policy*, A report for the Office of Fair Trading, UK, 2000 p. 32.

characterised by higher levels of customer arbitrage because of a reduction in search transaction costs which could lead to the development of broader markets.[43]

Issues to consider:

5.1 Are online services likely to afford significant opportunities for new entry, or a new distribution channel for existing market participants?

5.2 To what extent do transportation costs and other factors continue to restrict import competition from international online services?

5.3 To what extent may online services lead to narrower niche markets?

5.4 Are existing tests for defining markets adequate when dealing with e-commerce issues?

Back room integration and market power

One of the efficiencies associated with electronic transactions, particularly B2B transactions, is the ability to integrate back room operations between a buyer and a seller so that routine activities can occur automatically. For example, systems are developing where a large wholesale buyer may integrate its IT systems with particular suppliers to such a degree that when goods leave the warehouse, the system automatically raises a purchase order with the supplier. The supplier's system automatically arranges for the delivery of the goods, adjusts its own stock records and sends an invoice.

The attraction of the Internet over electronic data interchange (EDI) in such applications was that because it occurs over an open platform, the investment costs associated with such integration are reduced, and will be capable of being used with a number of different buyers and suppliers.

In monitoring the development of B2B ventures, the anecdotal evidence received by the ACCC suggests that such integration is more complex than anticipated and may require substantial investment. This may raise questions regarding whether such integration could increase switching costs for trading partners, which in turn has implications for assessing market power in Australian markets.

Issues to consider:

5.5 Is back room integration expensive?

5.6 Are back room integration systems generally interoperable with all other buyers and sellers in a market?

5.7 How do participants prevent getting locked in by such arrangements?

43 Whether consumers face higher or lower search costs in online environments in somewhat debateable. The experience of consumers with services such as person-to-person Internet auction sites to date suggests that such mechanisms are not without risk as evidenced by the number of consumer protection related complaints in the area and that use of search engines and portals still may be time consuming, particularly for users with only the basic computer skills.

Standard setting arrangements

The Internet enables any-to-any connectivity for those who have access to a computer or other Internet connection device and a browser program. The development and adoption of e-commerce requires the corresponding development of standard practices on issues including the type of computer software to be used and compatibility standards, electronic payments standards, and proforma electronic documents for purchase and order forms and other electronic messages.[44]

Some e-commerce projects may involve a group of competitors, customers and/or industry associations deciding on the underlying standards to be adopted by participants in a particular eHub or by an industry as a whole.

Competition issues may arise if the owners of a standard (and any associated intellectual property rights) are in a position to raise rivals costs through controlling access to a standard. Other more subtle advantages may be obtained through participation in committees that assess changes to standards. Committee participants may have advance knowledge of changes that will allow them to tool up their internal operations or market in advance of their competitors. In some cases, the link with the standard-making body will enable a firm to advocate the inclusion of a particular process or technology which gives them a cost advantage resulting from their internal structure that is not available to competitors.[45] Also, standards could be used to restrict or control competition between the users of the standard.

An example of this arose in the case of *Dell Computer Corp*.[46] where the FTC alleged that Dell had abused market power while it was a member of the Video Electronics Standards Association, by failing to disclose its patent rights used within the design standard for a computer part and then threatening to enforce those rights against others. Another current example is the concerns that DVD standards contain technical elements which restrict competition between different global regions.[47] In other areas of e-commerce such as public key infrastructure (PKI) schemes, technical and legal standards may need to be monitored to ensure that similar issues do not arise.[48]

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44 Examples of 'standards' projects include SuperEC (electronic communications standards in the superannuation industry); Identrus (online security and payments standards); and RosettaNet (development of open Internet-based business standards).

45 See Anton & Yao, *Standard Setting Consortia, Antitrust and High Technology Industries*, Antitrust Law Journal 64 (1995) 247–265.

46 121 FTC 616 (1996). As a result of the action, Dell entered into a consent order agreeing not to enforce its patent right against computer manufacturers incorporating that design. Recently, it was announced that the FTC is investigating Sun Microsystems and others for whether they illegally kept patents secret while helping set industry standards (reported at <http://news.findlaw.com/legalnews/s/20010910/n10252182.html>).

47 See ACCC, *Consumers in Dark About DVD Imports*, media release, 21 December 2000.

48 Public key infrastructure is a system by which digital certificates may be used to secure communications and verify the identity of parties to a transaction over the Internet. For example, the global venture Identrus is a venture between banking organisations to develop standards for public key infrastructure and electronic payments. Banks will then offer their own individual PKI services to customers based on those standards.

Within Australia, s. 45 of the TPA may apply to arrangements between competitors to establish a standard setting body. Potentially, s. 45A could apply where the standard used dictates such a large proportion of the final product costs that the result is competitors agree to fix, maintain or control the cost of final products. Also, s. 46 could apply to participants who use their position within a standard setting body for the purpose of damaging competition.

Factors which may be taken into account in determining whether a standard setting body is likely to have the potential to harm competition relate to the strength of the parties involved and the potential for competing standards to emerge. These include:

- vertical integration between owners of the standard setting body and final products, relevant manufacturing processes, or complementary products;
- balance of buyer and seller representation;
- reputation and brand name;
- how proscriptive the standard is and how it may limit the ability of users to act independent of each other in markets for final products;
- switching costs and other 'lock in' mechanisms such as technical incompatibility, and
- ability to obtain rights to develop interoperable standards which may be part of a migration strategy to a new standard.

If standards are open and available on non-discriminatory terms, they are less likely to result in competitive detriment.[49] Difficulties may arise when standards which initially appear to be open and transparent, change, once the standard becomes dominant in a market. The *Dell Computer Corp* case illustrates this point.

It may be appropriate for parties to seek authorisation for the development of a new standard so that they can outline the public benefits anticipated from the venture.

A standard may have a social and competitive benefit by assisting the development of complementary products. For example, the development of standard levels of interoperability may enable a wider range of products to be developed, and consumers will have the benefit of knowing that certain products will be compatible with others. This may be of particular relevance within the computer software and hardware industry.

Issue to consider:

5.8 What measures can be taken under the TPA to prevent anti-competitive use of standard setting bodies, while preserving the potential benefits of the development of standards?

49 For further discussion see David A Balto, *Standard Setting in a Network Economy*, Cutting Edge Antitrust Seminars International, February 17, 2000, available at http://www.ftc.gov/speeches/other/standardsetting.htm>.

Distribution channel management

As the development of online services creates another potential distribution channel for goods and services, tension may arise between competing outlets – particularly when some outlets are independently owned and operated but others have vertical links with manufacturers. Some wholesale operations could be squeezed out or replaced by Internet intermediaries.

Potential issues may include:

- suppliers refusing to deal with independent offline or online distributors because they have developed their own online retail websites;
- suppliers refusing to deal with independent online distributors; and
- suppliers discriminating between price and quality or quantity of goods distributed via online and offline distribution channels.

In many ways these issues are not unique and also arise in relation to supplier decisions to deal with one or many offline distributors. Relevant provisions of the TPA would include s. 45 (arrangements which are likely to result in a substantial lessening of competition), s. 46 (refusals to deal by a person with substantial market power for a proscribed purpose), and s. 47 (exclusive dealing). In most cases, refusals to deal or discrimination will only fall within the scope of the TPA if the supplier has substantial market power and there is a likelihood of substantial competitive damage.

While any complaints regarding conduct which does not favour certain distributors or categories of distributors may be similar to those occurring in the offline environment, there will still be some challenges involved in assessing such conduct under the TPA.

First, in relation to conduct which appears to threaten the development of online competition, particularly during the initial stages, it may be difficult to accurately assess the level of competitive damage that is likely to occur.[50] It is possible that in assessing such matters it is necessary not only to consider the quantitative aspects (i.e. whether there is a loss in numbers of potential competitors) but also whether there is a loss in quality of competition. A competitive on-line sector may, because of the different nature of the distribution service, provide greater opportunities for the creation of niche markets, product differentiation, flexible pricing structures and override territorial restrictions on distribution.

Second, when the matter falls within the scope of s. 46 of the TPA, it will be important to understand the purpose of the conduct. As demonstrated in the recent *Melway* case,[51] identifying the relevant purpose may be complex, and often the purpose of conduct may appear ambiguous. For example, in the Melway case there was considerable

50 Note that the test of substantially lessening competition also includes preventing or hindering competition (s. 4G) which provides some basis for considering of the impact on future competition when applying the test.

51 [2001] HCA 13.

debate as to whether there is any legitimate justification for protecting a territorial distribution system,[52] Another example in relation to online sales is whether a supplier refuses to supply on the basis that the online sales may not project the image that the supplier wants for its products.

Thirdly, cross border jurisdictional issues may arise where Australian distributors are dealing with suppliers based in other jurisdictions.

Issues to consider:

5.9 Do the current laws sufficiently address issues of distribution channel management in relation to the treatment of online services?

5.10 What other issues may arise in dealing with suppliers in other jurisdictions?

Bundling or tying arrangements

One of the key characteristics of online products and services is the ability to easily bundle several products together. This is particularly relevant in relation to information products. For example, it is a common practice of computer software companies to offer several different software applications in one package or preload their software onto computer hardware for sale. Equally, B2B services may offer a package of trading, information, logistics and supply chain management services.

The bundling of such products and/or services may provide a sensible and convenient solution for purchasers, and a way in which competing service providers can differentiate their offerings to attract more customers. In some cases it may also be a more efficient and economical way to provide both products and/or services, resulting in lower prices and promoting the development of a new competitive product or service.

This is an area that has been considered in the *Microsoft* case.[53] One of the issues raised in that matter was whether imposing technology ties which, through control of intellectual property rights, made it technically illegal for users to unbundle Internet Explorer from Windows constituted monopolisation. Similar issues may arise in relation to the sale of computer hardware with software.

If purchasers are forced to acquire goods or services from a third party provider, this may raise third line forcing issues which is a per se offence under the TPA.

Where a supplier bundles its own goods or services together, this could also raise issues under s. 47 (exclusive dealing) or s. 46 (misuse of market power) if, as a result of

52 This was the issue addressed in the recent High Court decision in *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd*, [2001] HCA 13. In that case it was found on the facts that in refusing supply Melway was acting for the purpose of preventing competition between its distributors. Ultimately, the High Court upheld Melway's appeal on other grounds.

53 US v Microsoft Corporation, 87 F. Supp. 2d 30 (DDC 2000) (appeal pending).

bundling, the supplier is able to restrict competition in the supply of any or all of the bundled items.

In relation to technology products it is relevant to consider whether the user has been forced to accept the bundle or not. If products can readily be 'unbundled' without the user incurring significant costs, it is arguable that bundling products is unlikely to cause competitive damage.

In dealing with such matters, issues may arise in determining whether the potential efficiency gains associated with bundling could outweigh any potential anti-competitive effects. With the exception of matters involving a breach of s. 46, authorisation or notification may be sought for the bundling of products.

Issue to consider:

5.11 Do current laws adequately deal with the issues associated with balancing the benefits of bundling against the potential anti-competitive outcomes?

Information aggregation

Aggregation services – access to competitors information

Another area where transferral of operations from offline to online environments may create competition issues is in the area of information collection, analysis, and in some cases, resale of information.

Firstly, the way in which businesses relate to their customers may change as they obtain more information about the customer in a digitalised format. By enabling business to keep records of customers preferences, it is argued that a business may 'profile' that customer to increase the efficiency of their dealings and target marketing campaigns, subject to the customer's privacy rights. This in itself may increase the competitiveness of markets, and in most circumstances would not fall within the scope of the TPA, except where fair trading issues may arise.[54]

Some businesses are also moving into the area of providing customised information aggregation services to individuals and businesses, which provide the intermediary with information about the whole pattern of the user's commercial or consumer activities. For example, account aggregation services aggregate the customer's financial accounts from a number of different financial institutions.[55] If the aggregation service is vertically integrated with a particular institution, this may provide it with competitively sensitive information about its competitor's relationship with that customer. Also, in B2B relationships, it may be that the aggregator integrates the business customer's back

54 Part V of the TPA may be relevant in considering whether a business has failed to adequately disclose to the customer its privacy policy. Customers may also obtain some protection over the use of their information under the forthcoming privacy laws.

55 See ASIC, *Account Aggregation in the financial services sector*, issues paper, May 2001.

room operations with its own systems. This could increase switching costs for customers and provide a disincentive to shop around.

It is important to ensure that the TPA correctly balances the opportunities associated with access against possible competitive damage. Currently the TPA will only constrain information flow in limited circumstances.

Mergers or a strategic alliance between an aggregator and a market participant may be assessed in terms of the competitive effects of such arrangements under ss. 45 and 50 of the TPA. If a firm attempts to compel users to use a particular service (or not to use a competitor's aggregation service) this may raise issues under s. 46 as a possible misuse of market power, exclusive dealing under s. 47 or anti-competitive arrangement under s. 45. These would only be applicable in limited circumstances where it can be shown that the firm has market power, or the act will result in a substantial lessening of competition.

Copyright and the ability to integrate competitor's online information on own website

The potential ease of access to information over the Internet may also give rise to free rider concerns. Should a firm be able to use information from a competitor's site to enhance its own site without 'paying' for that information?[56] For example, in the United States there have been cases where competing auction sites have taken action to prevent competitors searching their sites for auction information.[57] Another example is the practice of 'screen scraping' by which one firm offers to 'scrape' information from another's screen to present to the end user in a repackaged format. Such activities may have a commercial impact, particularly on the advertising revenues generated by each website. While enhanced access to information may increase competition and enable the creation of new services such as aggregators it may also dull the incentive to invest in online services.

Under existing competition laws in Australia, it is unlikely that obtaining and using a competitor's information in this way would be prohibited. Firms may, however, seek to protect the use of information posted online through copyright, technological 'locks' and contractual arrangements. This in itself could raise competition issues.

Recent amendments to copyright legislation may in some circumstances outlaw the marketing of devices that facilitate the circumvention of technology locks.[58] In this regard, it would appear that the balance of power is swinging towards the protection of information. However, this has raised some concerns that these measures may provide copyright holders a higher level of protection than envisaged under the copyright itself, if it enables copyright holders to prevent users taking advantage of exemptions such as

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56 For example, the practice of framing or using shopbots to transfer information from one website to another is a common method used to combined information from a number of independent sites.

57 See 'eBay Wins Round in Bidder's Edge Dispute,, *E-Commerce Times*, 26 May 2000 at <http://www.ecommercetimes.com/perl/story/3419.html>.

58 Copyright Amendment (Digital Agenda) Act 2000. L Gamertsfelder, 'Digitalising Copyright Law – An Australian Perspective Part 1', *Intellectual Property Law Bulletin*, Vol 13 No 10.

fair dealing.[59] Also, it may arguably stifle innovative products such as music file swapping programs which assist in the development of online music distribution.[60] The TPA is only likely to be relevant where it can be shown that imposing technical locking devices constitutes a misuse of market power.

Issues to consider:

5.12 In what circumstances should firms be able to use information posted on other websites without compensating the owner of the website?

5.13 Is the use of technology locks likely to stifle legitimate access to information beyond the scope of copyright protection and what impact could this have on competition?

Global issues

In many instances the competitive shape of technology industries and Internet applications will be determined at an international level. For example, while the activities complained of in the *Microsoft* case took place offshore, the results are still felt within Australia as it is part of the global Internet community which relies on these products. Australia's role in these matters many vary, depending on the facts in each case. However, this is not to say that Australia does not participate in global issues in appropriate matters. For example, as was seen in the Vitamins matter, the ACCC took enforcement action in relation to an international cartel.[61]

Issue to consider:

5.14 What challenges will arise in applying competition laws in relation to e-commerce matters which have cross-jurisdictional aspects?

59 See Intellectual Property and Competition Review Committee, Review of Intellectual Property Legislation under the Competition Principles Agreement (the 'Ergas Report'), September 2000 p. 99–101.

60 See Henry Ergas, 'Copyrights and Wrongs', *Business Review Weekly*, 21 July 2001 p. 26.

61 See ACCC, *Federal Court Imposes Record $26M Penalties Against Vitamin Suppliers*, media release MR 37/01, 28 February 2001.

6. Small business

From a theoretical perspective, small business and rural enterprise have been identified as two areas where e-commerce could provide significant industry benefits. Access to the Internet as a distribution mechanism should enable small businesses to reach more customers (even internationally) and deal more equally with larger competitors in B2B transactions.[62] The Internet does not distinguish businesses in terms of size or geographic location. Equally, where the Internet promises to deliver greater internal efficiencies it may also give small businesses a better chance of survival against their larger rivals.

However, recent studies indicate that the uptake of e-commerce by small business (as either a buyer or supplier in B2B and/or B2C environments) has not been as rapid as would be anticipated.[63] Reasons cited for this include the cost involved in getting across the technology and 'what's in it for me' issues.

Further, the Internet may in itself present some barriers to participation by small business which need to be considered in terms of the competitive outcomes.

Access to eHubs and Internet portals

As discussed above, not all eHubs may be freely open and available to all businesses. Some qualification rules or access requirements may give large business an advantage over small business in gaining access to, and trading over an eHub. Particular issues for small business may include the following.

Upfront joining fees and transactions costs. If fees are too expensive for small business, small-to-medium enterprises (SMEs) may face greater disadvantages than in the offline world. While it may be the case that fees are initially set at a low level to encourage participation, it may be that once an eHub is well established it could increase prices beyond the level feasible for small business.

*Investment in technology.*To fully utilise the benefits of eHubs, small businesses may need to make significant investment in technology. For example sellers may need to establish electronic catalogues. In some cases, eHubs may offer what is known as 'host' services (usually through a known application service provider or ASP) so that small business does not need to undertake significant infrastructure investment. However, the fees for such services may still be significant. Also, when such services are used they

62 It may be somewhat optimistic to suggest that small business would be placed on a completely level playing field with larger competitors. A small business may, however, obtain greater opportunities for its products to be seen by large customers, which is particularly important when a small business introduces innovative products which may otherwise never reach the market. Also, use of an eHub may encourage large business to deal with small business more often because, through use of an eHub the larger trading partner can see that efficient trading mechanisms are in place which reduces its risk in dealing with a smaller firm.

63 NOIE, *Taking the Plunge 2000, Sink or Swim*, 2000.

may not be capable of providing the full degree of efficiencies that are available to large businesses that have integrated their legacy systems with an eHub.

Prudential and quality standards. An eHub may consider that to protect the integrity of its marketplace, members must meet certain prudential and quality standards. This may be a legitimate issue for eHub operators. What if a small business posts a very competitive price on an eHub and is flooded with requests that it cannot fulfil? This may have adverse consequences for both the small trader and the eHub. At the same time, if standards are set too high, this may disadvantage small business.

Access to information. eHubs are likely to generate revenue streams from a range of sources including membership and transaction fees, advertising, and selling individual and aggregated trading information back to participants and other parties. As information becomes a commodity in its own right the cost of access may become an issue for small business.

Care will also need to be taken to ensure that eHub operators do not impose unconscionable terms of trade on small business.

Franchising arrangements

The development of online trading may have an impact on existing franchising arrangements, particularly where contractual terms provide for territorial limits.

Small businesses may have entered into franchising arrangements on the understanding that they would have exclusive territorial rights. Where the terms of such contracts do not clearly state whether an exclusive territory extends to online advertising, this places franchisees in an uncertain position.

On the other hand, franchisees may raise concerns that if a franchisor excludes them from participating in online trading this takes potential business away from them (within their own exclusive territories as well as externally). In some cases this may need to be considered under the unconscionable conduct provisions of the TPA.

Restricting the ability of franchisees to engage in online activities, or developing a single site for online trading controlled by the franchisor, could also have competitive implications. As previously discussed, one of the key issues in the recent High Court decision in *Melway* was whether the conduct of a supplier in restricting inter-territorial sales between wholesalers may constitute an anti-competitive purpose pursuant to s 46 of the Act. This could equally be applied to a decision by a franchisor to restrict a franchisee's ability to engage in online advertising and trading. This would need to be considered on a case-by-case basis, and would depend on whether a franchise product faces competition from a number of different products within the market as a whole.

Fair dealing and technology

In deciding whether to join an eHub, make arrangements to have their own B2C websites developed, or invest in new IT systems, small businesses may need to carefully consider any technical jargon used and high flown descriptions of the capabilities and advantages of a particular product or service. This can be daunting and fears that systems may not live up to expectations can dissuade businesses from participating in e-commerce altogether.

Businesses should check carefully to ensure that they obtain information not only about the technical specifications of a product or service they are buying, but also a clear understanding of the expected performance capabilities. Equally, suppliers will need to provide clear and concise information and all material details of the performance capabilities and limitations of their products One potential issue is the security of online transactions. Current industry views are that PKI is the best form of security protection available for online transactions at present. PKI certificates can verify the identity of trading parties, security and non-repudiation of transactions. The value of the certificate will, however, depend on the type of certificate used, who issues it, and what liability limits are put in place.[64] It may be that certain PKI certificates only provide one or two of the potential PKI functions. Businesses and parties that buy and rely on PKI will need to be aware of such limitations. Also, as certificates are issued as a part of a package to participate in a particular online service, businesses may need to investigate in detail the true security of the system.

Enforcement issues

It is likely that as more SMEs become involved in e-commerce, particularly cross border transactions (as either a buyer or a seller), this may create issues in relation to:

- understanding of applicable jurisdiction in transactions; and
- cost of enforcement activities.

Issues to consider:

6.1 What are the potential benefits and dangers of e-commerce for small business?

6.2 To what extent are existing laws adequate to protect small business in the developing online environment?

6.3 What further steps can be taken to increase small business confidence in e-commerce?

64 See Mark Sneddon, *Legal Liability and E-Transactions*, Report to the National Electronic Authentication Council (NEAC), 2000.