

Submission of Electronic Frontiers Australia to the Australian Competition and Consumer Commission on eBay International AG Exclusive Dealing Notification.

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I ABOUT EFA

Electronic Frontiers Australia Inc. (EFA) is a non-profit national organisation representing Internet users concerned with on-line freedoms and rights. EFA was established in January 1994 and incorporated under the *Associations Incorporation Act* (SA) in May 1994.

EFA is independent of government and commerce and is funded by membership subscriptions and donations from individuals and organisations with an altruistic interest in promoting online civil liberties.

Our major objectives are to protect and promote the civil liberties of users and operators of computer based communications systems such as the Internet, to advocate the amendment of laws and regulations in Australia and elsewhere (both current and proposed) which restrict free speech and to educate the community at large about the social, political, and civil liberties issues involved in the use of computer based communications systems.

II INTRODUCTION

Although competition policy is not per se an issue which is within EFA's purview, the promotion of competition and therefore the availability of alternative products and services in technology markets is an issue with implications for the civil liberties of online users.

Companies which facilitate online trade and communication are often in a position to impose their own moral viewpoint upon their users. Similarly, they can impose restrictions upon the lawful trading activities of their users. Where, due to anti-competitive activity, competitors are damaged or foreclosed from entry to these markets, consumers may be unable to 'vote with their feet' and discipline the dominant suppliers by taking their business elsewhere, and a morally and commercially conservative viewpoint could be imposed upon those users.

III MARKET DEFINITION

As the Commission is no doubt aware, issues of market definition are critical in determining whether conduct has contravened Pt IV of the *Trade Practices Act 1974* (Cth) ('TPA').

EFA's submissions on the issue of market definition have been hampered by the fact that the Commission has, at eBay's request, withheld from the public register the report from NERA Economic Consulting which was Annexure B to their notification. Similarly, parts of Annexure A to the notification which discuss the NERA report have been excluded from the public register.

Although NERA apparently concluded that it is 'not possible to form a definitive view of the likely markets in which eBay and PayPal respectively operate',¹ the public is not even permitted to know which possible markets NERA considered may or may not exist.

While we acknowledge that parts of the NERA report may well contain commercially sensitive information which eBay would not wish to publically disclose, we consider that level of secrecy afforded to the NERA report is excessive and goes beyond what is reasonably required to protect eBay's legitimate commercial interests. At a minimum, the possible markets which NERA considered should have been disclosed so that EFA and others could offer their opinions on whether those markets did or did not exist, and whether NERA's ultimate conclusion – or lack of a conclusion – was sustainable.

¹ PayPal notification at 4.3.

A eBay's market

The first and most obvious market in which eBay might operate is a market for the supply of online auction services ('**the Auction market**'). eBay would likely argue that they compete in a much broader market, in which they face competition from substitutable services such as online classifieds,² online retail stores, and perhaps even offline classifieds.³

EFA submits that these alternatives are not substitutable for online auction services of the type provided by eBay, for a number of reasons including:

- Online auction services result in a concluded contract for the sale of the items listed. Australian and overseas authority holds that the listing of an item on eBay or a similar site constitutes an offer to sell, which is accepted by the 'bidder' upon placing a bid and creates a legally binding contract between buyer and seller.⁴ By contrast, listings in online or offline classifieds are regarded merely as an invitation to treat – that is, a solicitation for offers. A buyer using a classified service has no certainty that, if theirs is the highest offer, they will 'win' the item.
- Online retail stores are distinguishable from online auction services, as the former involve a relatively limited number of suppliers, usually only supplying a limited range of new merchandise, at non-negotiable prices.
- By eBay's own words, the service which they offer is unique. In an interview published by itwire.com, an eBay spokesperson described eBay as 'a site that has over 200 million plus members globally, a marketplace that just can't be compared to anything in the offline or online space for the volume of buyers that it could bring to you for a relatively low cost.'⁵
- Many submissions by individual consumers to the ACCC on this issue express a belief that there are no alternatives, or no viable alternatives, to using eBay.⁶ If this accurately reflects community opinion, then alternatives such as classifieds are unlikely to be substitutable in economic terms for online auction services.

If it is the case that consumers acquire the services of eBay solely or predominantly in reliance on its brand, rather than the qualities of eBay's services, it is also possible that a single-brand market could exist.⁷ Although Australian courts have not yet found that a single-brand market existed in a particular case, they have accepted that they can exist.⁸

² E.g. the Trading Post online website at <http://www.tradingpost.com.au>; the Craigslist website at <http://www.craigslist.org>, etc.

³ E.g. the physical Trading Post publication, specialist publications such as Australian Motorcycle Trader, and classified services provided by most newspapers.

⁴ See, e.g. *Smythe v Thomas* [2007] NSWSC 844 and the overseas authorities cited therein.

⁵ <http://www.itwire.com/content/view/17800/53/1/1/>

⁶ E.g. 'If there was a viable alternative to eBay [sic], I would use it, but there is not.', submission of Jennifer Hughes; 'there are no good alternatives to eBay', submission of Richard Nichols.

⁷ Stephen Corones, *Competition Law in Australia* (2004, 3rd ed) at [2.55].

⁸ *Regents Pty Ltd v Subaru (Australia) Pty Ltd* (1998) 84 FCR 218 at 228.

B PayPal's market

EFA believes that PayPal currently competes in a market for 'payment services for online auctions' ('the **Payment market**'), in competition with:

- Online services such as Qpay and Paymate;
- EFT services provided by banks and building societies;
- Credit-card services provided by banks, building societies, and card issuers; and
- Other payment methods such as postal orders.

C A possible cluster market?

It could be argued that a cluster market exists, comprising online auction services and services for payment for online auctions. EFA submits that such a market does not exist. The Wallis Committee in its Financial System Inquiry Report held that a cluster market approach to similar services is only appropriate when *most* customers purchase *all* the products [here, services] from a single supplier because the transaction costs of purchasing them separately would be too onerous.

Here, the direct financial transaction costs of using PayPal are higher than the costs of most of the alternative products. Many submissions from individual sellers demonstrate that they elect not to use PayPal because of those transaction costs.

Ergas writes that to say a cluster market for products A and B exists is to imply that a firm selling only A or only B would not be able to compete with one selling both A and B; either because the cost of producing A and B jointly is substantially below that of producing them separately, and/or because consumers incur additional costs when they purchase A and B separately as against purchasing them jointly.⁹ EFA submits that Ergas' definition is not satisfied here.

IV ASSESSMENT OF EBAY'S NOTIFICATION

eBay's proposed conduct would clearly constitute exclusive dealing within the meaning of s 47(2) of the TPA, in that eBay will supply or offer to supply services on the condition that the people (eBay users) [to] whom they supply will not, or will not to a limited extent, acquire services or services of a particular kind or description from a competitor (such as Paymate, banks, etc) of a body corporate related to eBay (PayPal).

⁹ Henry Ergas, *Cluster Markets: What They Are and How To Test For Them* (2002) The Wayback Machine
<<http://web.archive.org/web/20050623113852/http://necg.com.au/pappub/papers-ergas-cluster.PDF>> at 2 May 2008.

EFA submits that eBay's proposed conduct has the purpose,¹⁰ or would have or be likely to have the effect, of substantially lessening competition in the Payment market.

EFA further submits that eBay's proposed conduct would not result or be likely to result in a benefit to the public, or that any public benefit which might result would be outweighed by the detriment to the public constituted by resulting lessening of competition.

A Public benefits claimed by eBay

1 Avoidance of 'bad buyer experiences'

eBay claims that their proposed conduct will have 'direct and immediate benefits' to eBay buyers who would otherwise have had a 'bad buyer experience'¹¹ – that is, buyers who, if not for eBay's proposed conduct, would have chosen to use a payment method other than PayPal.

eBay states that such 'bad buyer experiences' are one of the two biggest reasons that eBay buyers decide not to continue using eBay.¹² While customer retention and brand protection are no doubt commercial concerns of eBay, they can not be properly characterised as public benefits. EFA rejects eBay's attempt to equate customer retention with public benefit by relying on the benefits to eBay sellers of increased numbers of eBay buyers.¹³

To the extent that compelling the use of PayPal may provide some direct benefits to eBay users who are defrauded, and would otherwise have paid by a different payment method, we submit that any such benefits should be weighed against the detriments that may occur to the broader class of users who are compelled to use PayPal, including those who are or would not be defrauded.

2 Security, and avoidance of fraud and identity theft

eBay claims that PayPal is a more secure method of payment than competing services, for reasons including that:

- Buyers and sellers do not have to disclose to each other credit card or account details;¹⁴
- Sellers are therefore not subject to the risk of identity theft;¹⁵ and
- Users must link at least one bank or credit account to their PayPal account.¹⁶

EFA takes issue with the characterisation of PayPal as a more secure alternative. A PayPal account, once linked to a user's bank accounts or credit cards, provides an

¹⁰ It need not be eBay's sole purpose, so long as it is one of eBay's purposes, and is a substantial purpose: *Trade Practices Act 1974* (Cth) s 4F.

¹¹ As described in Annexure A to eBay's notification at [5.2].

¹² *Ibid.*

¹³ *Ibid* at [5.13].

¹⁴ *Ibid* at [5.5(1)].

¹⁵ *Ibid* at [5.6(3)].

¹⁶ *Ibid* at [5.5(2)].

avenue of attack by which money can be stolen from those other accounts and transferred elsewhere. Many users are uneasy with giving PayPal unrestricted access to withdraw money from their bank accounts or credit cards, and choose not to use PayPal for this reason.¹⁷

3 Strengthening the Australian economy

eBay claims that eBay's contribution to the Australian economy is estimated to be \$2.6 billion annually.¹⁸ This figure is said to be the result of an economic model that 'estimates eBay's impacts on the Australian economy as a result of its demonstrated effects in reducing prices and stimulating competition.'

EFA believes it is ironic that eBay rely on the alleged benefits of their stimulating effect on competition, while at the same time they seek to restrict competition in the Payment market to their own financial benefit.

EFA also observes that the effect of the proposed conduct on eBay's alleged contribution to the economy, or to the level of competition in the eBay marketplace, have not been addressed by their notification.

B Public detriments which are likely to result

1 Substantial lessening of competition in the Payment market

eBay's proposed conduct will undoubtedly lead to a substantial lessening of competition in the Payment market. eBay have a monopoly or near-monopoly in the Auction market, and a contractual prohibition on using services which compete with PayPal in the payment market will damage PayPal's competitors (such as Qpay and PayMate) and likely prevent future entries into the Payment market.

2 Prevailing prices on eBay will increase

PayPal impose various fees and commissions on users receiving payment through PayPal. eBay's proposed conduct would impose these additional direct costs on eBay sellers who do not use PayPal, or who do not exclusively use Paypal. The direct per-transaction fees alone could cause affected eBay sellers to raise their fees by up to 5% to compensate.

Because the proposed conduct only – at this stage – relates to Australian buyers and sellers, Australian sellers will likely become less competitive in the global eBay marketplace as against overseas sellers who are not required to use PayPal, and who are not subject to consequential additional costs.

3 eBay and PayPal's 'protection policies' facilitate fraud against sellers

There is, at least, a perception amongst many eBay sellers that eBay and PayPal's 'protection policies' are weighted in favour of the purchaser, to the extent that they facilitate fraud by unscrupulous purchasers. If an eBay purchaser claims they did not receive a purchased item, unless the seller can *prove* that it was received by the purchaser – which requires the use of registered post or a courier service – it is

¹⁷ For just one first-hand report of being defrauded via a compromised PayPal account, see <http://www.jimkarpen.com/paypalfraud1.html>

¹⁸ Ibid at [5.15].

presumed that the purchaser did not receive the item, and eBay/PayPal will take funds from the seller's PayPal account and refund the purchaser.

The proposed conduct will indirectly increase prices because, to avoid this risk of being fraud, sellers must use traceable delivery methods which provide proof of delivery, and are significantly more expensive than ordinary postal services. For domestic deliveries, this would require the use of Registered Post with a Proof of Delivery option, or courier service. For international deliveries, an international courier service would be required in most cases.¹⁹

The cost of these services may be as much as 10 times higher than the cost of ordinary postal service, and would in many cases be higher than the cost of the item purchased. These costs will be passed onto the eBay purchasers.

Many eBay sellers, after being defrauded in this way, have elected to stop using PayPal. eBay's proposed conduct would deprive those sellers of the opportunity to protect themselves in this way.

The alternative is for sellers to abandon eBay in favour of a competing service, to the extent there are any such services which are sufficiently close substitutes.

4 eBay and PayPal's notoriously poor customer service record

Many websites on the Internet are devoted to criticism of eBay and PayPal's customer service, policies, and actions. Some examples include www.nopaypal.com and www.paypalwarning.com. A frequent criticism of eBay and PayPal's customer service is that they are 'faceless' corporations, who to the greatest extent possible try to 'hide behind' email communication, typically conducted with boilerplate 'form' emails, and that they do not make available, or do not sufficiently make available other contact methods such as telephone.

If eBay proceed with their proposed conduct, PayPal will in effect have a largely 'captive market' and will have no incentives to provide better levels of customer support, or a better service generally. In short, PayPal will be free to give less and charge more.

5 PayPal's 'user agreement'

Australian users of PayPal's services are required to accept the terms of a contractual 'user agreement', which is posted on the PayPal website.²⁰ Many of the terms of this 'user agreement' are potentially misleading, unconscionable, unfair, or unenforceable. Some specific criticisms of the PayPal 'user agreement' include:

- The user agreement is in reality, not one agreement but constitutes more than a dozen separate documents. The 'user agreement' incorporates the terms of 13 other 'policies' by reference, including a 'Privacy Policy', 'Closing Accounts and Limiting Account Access' policy, 'Buyer Complaint Policy and PayPal Buyer Protection Policy', 'Fees Policy', 'Acceptable Use Policy', etc;

¹⁹ Although Australia Post offers a Registered Post International service, it is available only for letters and not parcels.

²⁰ <https://www.paypal.com/au/cgi-bin/webscr?cmd=p/gen/ua/ua-outside>

- PayPal reserve the right to amend the user agreement and policies at any time;
- The user agreement allows PayPal to place a 'hold' on any funds in a user's account for up to 180 days and to 'fine' the user up to \$3000 for contraventions of the Acceptable Use Policy.²¹ At common law, this 'fine' is likely a penalty and would be unenforceable for that reason; and
- The user agreement (and associated polices) contain many terms which may be 'unfair terms' within the meaning of Part 2B of the *Fair Trading Act 1999* (Vic), including terms which:
 - Permit PayPal but not the user to avoid or limit performance of the contract;
 - Penalise the user but not PayPal for a breach or termination of the contract;
 - Permit PayPal but not the user to vary the terms of the contract;
 - Permit PayPal unilaterally to vary the characteristics of the services supplied to the user;
 - Limit PayPal's vicarious liability for its agents; and
 - Limit the user's right to sue PayPal.

The effect of eBay's proposed conduct will be to force eBay users who currently exercise an informed choice *not* to deal with PayPal to accept the current and future terms of PayPal's user agreements and policies.

C Balancing the benefits and detriments

EFA submits that the public benefits claimed to result from the proposed conduct do *not* outweigh the public detriments which would result. In particular, many of the claimed public benefits are *already available* to consumers who *elect* to use PayPal to make payments. EFA submits that the ACCC ought to take into account that these alleged benefits are already available to consumers who choose to accept them.

EFA submits that the ACCC should revoke the notification made by eBay.

²¹ PayPal User Agreement, para 2.8.

V EBAY'S PROPOSED CONDUCT AS A MISUSE OF MARKET POWER

Although not strictly relevant to the assessment of eBay's notification, EFA is concerned that eBay's proposed conduct may constitute a misuse of market power in contravention of s 46(1) of the *TPA*.

A Substantial market power

As a threshold issue, eBay must have a substantial degree of market power for a contravention of s 46 to be established. Correct identification of the market or markets in which eBay operates is critical to an assessment of whether eBay possess substantial market power. We understand that the NERA report was unable to form a view as to whether eBay has substantial market power in any market because it was unable to define the markets in which eBay may operate or determine the strengths of any network effects enjoyed by eBay in that market.²²

EFA submits that if the existence of the Auction market is established,²³ eBay clearly possess substantial market power in that market. That market power is caused by factors including:

1 Barriers to entry

There are substantial barriers to entry into the Auction market. Not only would entry into the Auction market require a significant investment of capital, eBay holds a significant portfolio of so-called 'business method' patents both in Australia and internationally.²⁴ While the validity of some of these patents may be doubtful, the existence of patents such as 'system and method for submitting an offer to purchase over a network-based commerce facility'²⁵ poses a significant barrier to entry into the Auction market.

2 Network effects

A network effect exists when, all other things being equal, a consumer would prefer to join a larger, rather than a smaller network.²⁶ In the context of online auctions, it seems self-evident that consumers would, other things being equal, prefer to join a larger network, which makes available a larger variety of products and services from a larger number of suppliers, rather than a smaller network. The ability of any new entrants to enter the Auction market will be constrained by the network effects enjoyed by eBay by virtue of its existing 200 million plus membership base.

3 Imperfect information

Although alternatives to eBay evidently exist in the Auction market, many if not most Internet users are not aware of those alternatives. Indeed, the individual authors of

²² eBay notification, Annexure A at [4.4(1)].

²³ As discussed above at IIIA).

²⁴ See, e.g. <http://tinyurl.com/3m9von> for a listing of patents held and patent applications made by eBay.

²⁵ US patent number 7,222,092.

²⁶ See generally Henry Ergas, 'The (Uneasy and Somewhat Messy) Interaction of the IP Laws and the Competition Laws' (Paper presented at the Trade Practices and Consumer Law Conference, Sydney, 27 May 2000) 7; Carl Shapiro and Hal R Varian, *Information Rules: A Strategic Guide to the Network Economy* (1999).

this submission, who consider themselves avid users of the Internet and well-informed consumers, were not aware of the existence of some small competitors of eBay in the Auction market, until they came to prepare this submission.

The fact that consumers, because of imperfect information, are not aware of competing services in the Auction market contributes to eBay's market power in that market.

B Taking advantage

EFA submits that eBay's proposed conduct involves a 'taking advantage' of their substantial market power in the Auction market, in the sense that a rational firm without substantial market power would be unable to engage in that conduct.

Even if one accepts that eBay competes in a broader market than the Auction market as we define it, and competes with services such as the Trading Post or newspaper classifieds, it is highly implausible that a competitor such as the Trading Post would be able to dictate that all payments made for goods listed in the Trading Post must be channelled through a subsidiary company without losing an amount of business sufficient to make the move unprofitable.

C Proscribed purpose

eBay's taking advantage of its substantial degree of market power must also be for one of the three purposes enumerated in s 46(1). EFA submits that it may be inferred²⁷ that eBay's proposed conduct has, at least, a significant purpose of eliminating or damaging competitors to PayPal in the Payment market,²⁸ or preventing new market entry in the Payment market.²⁹

VI CONCLUSION

On the whole, eBay appears to be arguing that:

- eBay customers are incapable of *choosing* the 'best' payment option, according to eBay's definition of what the 'best' option is;
- For those customers' own good, eBay must *force* them to use the 'best' payment option;
- It is impliedly irrelevant to eBay's decision-making that the 'best' payment option is provided by a wholly-owned subsidiary of eBay, and will result in a significant financial benefit to eBay.

eBay's argument is condescending and paternalistic at best, and ignores the fact that eBay users are capable of making rational choices about what *they* view the best payment method to be.

²⁷ TPA, s 46(7).

²⁸ TPA, s 46(1)(a).

²⁹ TPA, s 46(1)(b).

eBay users who want the benefits of PayPal's dispute resolution facilities are free to choose to use PayPal to pay for their purchases. This may mean in some cases they withhold their business from eBay sellers who do not accept payment via PayPal.

Those eBay sellers may choose not to accept PayPal because of the additional fees and commissions which PayPal charge, or because they have been defrauded in the past or are aware that the risk of such fraud exists. If the fact that they do not accept PayPal causes them to lose a significant amount of business to sellers who *do* accept PayPal, then the benefits of accepting PayPal may outweigh the costs (monetary or otherwise). In those cases, rational sellers will be disciplined by the preferences of buyers in the market and will make the *choice* to accept PayPal.

Most if not all of the benefits claimed to result from eBay's proposed conduct are *already available to buyers and sellers who want those benefits*. The only change in those benefits which eBay's proposed conduct would cause would be to *force* those benefits upon people who *currently choose not to receive them because they view the associated costs as too high*. EFA submits that this cannot properly be characterised as a public benefit.

EFA submits that the ACCC should revoke the notification lodged by eBay.