GOVERNING THE UNGOVERNABLE: THE MARKET, TECHNOLOGY AND YOU

Rapid changes in technology have created new opportunities and challenges for competition laws and the regulators and courts that enforce them.

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Competition is the basis of a market economy and technology is changing the face of competition. Consumers, at the touch of a screen, can access goods and services from around the world, compare prices and product reviews, and download digital services or order physical goods.

Competition and markets, however, exist within a set of institutions, laws and regulations, such as the rules of contract and laws against misleading and deceptive behaviour. In the past two decades, the rapid change in technology has created new opportunities and challenges for these laws and the regulators and courts that enforce them.

Herein, I briefly discuss some of these opportunities and challenges, focusing on competition laws and business regulation. I divide my remarks into three sections. First, I consider the areas where competition laws are adapting to technological change. Then I consider the regulatory failures: where is technological change exposing regulatory gaps? Third, I consider the issue of information and consumers. In particular, can technology be harnessed to improve competition regulation?

I want to leave you with three conclusions:

– First, while new businesses may be competing with new technologies, the old rules of competition still apply. In these areas, our old rules can adapt.

– Second, technology has changed some business models. Simplistic approaches to analyse competition that apply to the old economy may make little, if any, sense in new markets. Regulatory shortcuts that previously have been adequate, may fail. Regulators must adapt their traditional approaches or they will make errors applying old rules to new situations.

– Third, the way information moves through our economy has changed. Information technology (IT) creates opportunities for better regulation. But seizing these opportunities will require economic sophistication and a change in regulatory mindset.

Technology and traditional market regulation

For much anti-competitive behaviour, technological change just leads to ‘old wine in new bottles’. A cartel is still a cartel, even if the communication is by email rather than in smoke-filled rooms. An anticompetitive merger is still an anticompetitive merger, even if it involves two companies that trade in cyberspace.

Have the ‘old laws’ adapted to new technology? Let me start with an example of success. Earlier this year the High Court ruled that Google did not engage in misleading and deceptive conduct
when it published a number of advertisements created by its AdWords program.¹

Between 2005 and 2007, Google’s AdWords was used by a number of companies to create ‘sponsored links’ that were displayed on Google’s search pages. These advertisements were misleading and deceptive. The relevant advertisers had already been dealt with for breaching Australia’s Competition and Consumer Act 2010 (CCA).

However, the Australian Competition and Consumer Commission (ACCC) also brought a case against Google for misleading and deceptive conduct. Normally, a publisher is immune from such prosecution. Section 85(3) of the CCA provides a ‘publishers’ defence’. A publisher does not engage in illegal conduct if, in the normal course of business, it publishes a misleading or deceptive advertisement but had no reason to suspect that the advertisement was illegal. The publisher is a ‘mere conduit’.

The publishers’ exemption makes sense. If publishers had to verify the content of every advertisement, it would bring the advertising industry to a shuddering halt. Publishers would not have the information or the ability to verify all advertisements and they would either be forced to significantly limit advertising or hope and pray that advertisers were doing the right thing.

The ACCC, however, argued that Google’s AdWords technology meant that Google had a role in making or creating the sponsored links. Google did not simply ‘receive’ and ‘publish’ the advertisements. It was intimately involved in providing the program that made the misleading advertisements possible. According to this argument, Google was neither just a publisher nor an ‘innocent conduit’ but an active party to the misleading and deceptive behaviour.

The Full Federal Court agreed with the ACCC.² It stated that Google was more than a publisher because the advertisements were displayed in response to a consumer’s search request. The Court concluded, ‘Google’s conduct in response to the user’s interaction with Google’s search engine was misleading’.

Google appealed to the High Court, which reversed the Full Federal Court decision. According to the High Court, the AdWords technology ‘merely assembles information provided by others’. It ‘does not render Google the maker, author, creator or originator of the information in a sponsored link’.

As such, ‘Google is not relevantly different from other intermediaries, such as newspaper publishers (whether in print or online) or broadcasters (whether radio, television or online) …’. Google simply provides ‘a means of communication between advertisers and consumers’ (judgement paragraph 69).

So approximately five years after the case commenced we have clarity. Google and other internet intermediaries are publishers with the rights and obligations of publishers, but no more.

Why is this decision important?

– First, it makes clear that, from the perspective of competition and consumer laws, internet publishing can be handled by the same rules that hold for traditional publishing.

– Second, this case and other court rulings are providing a body of law that makes the rules of the internet clear.³

– Third, the case illustrates the flexibility and adaptability of the law. Just because we have new technology does not mean we need new competition laws.

This is not the only ‘old wine in new bottles’ case. The recent US decision regarding Apple and eBooks illustrates how the new-economy cases can clarify old-economy issues.⁴ The decision clarified the legal status of ‘most favoured nation’ clauses. These contractual conditions are used in both traditional and ‘new technology’ contracts.

Similarly, recent decisions have led to a re-examination of the laws on resale price maintenance (RPM), where a wholesaler requires a retailer not to discount its product. RPM has occurred on the internet, particularly when bricks-and-mortar retailers try to use wholesalers to limit competition from internet retailers. The ACCC has responded strongly to this anticompetitive
behaviour. But the re-emphasis placed on RPM has highlighted the limitations of this law.

In summary, while new businesses may be competing in new technologies, the old rules of competition still apply. These rules can adapt to new situations. The context may differ, but anti-competitive behaviour is still anti-competitive behaviour, whether it occurs on Main Street or the internet.

**Where is regulation failing?**

While broad competition laws have shown they can adapt to technological change, new technology is having two effects on regulation. It is exposing regulation that, while ‘good enough’ in the past, is unable to meet the complexities of change. It is also raising issues that are challenging competition regulators.

A simple example is provided by electricity regulation. Electricity prices have been rising. A significant part of this rise is due to rising charges for electricity networks – the transmission and distribution wires that bring power from generators to our places of work and our dwellings. Regulators set these network charges.

One source of high network charges is the regulatory approach that takes fixed network charges and turns them into per kilowatt-hour charges. The regulator works out how much money a network company needs then divides this by the expected volume of electricity to get a volume-based charge. Consumers pay this charge.

The problem with this approach is that networks largely involve fixed costs. An electricity network is built to a certain size depending on the prediction of peak load. But once built, the costs of operating that network do not vary greatly with the actual load.
So regulators turn a fixed cost to the network business into a variable charge to be paid by consumers.

This approach is fine so long as consumers cannot bypass the electricity network. Historically that has been the case. However, advances in solar technology together with government subsidies to install photo-voltaic systems mean many consumers and businesses now regularly bypass the network for at least some of their power consumption. Instead of predicted rises, our transmission and distribution networks are facing falling average power loads. So the fixed cost of the network is being divided over a smaller volume of power meaning the price per unit of power rises.

Rising network charges increase the incentive for consumers to install solar power systems. And this reduces the load still further, increasing per kilowatt-hour prices and so on. This cycle has been called a ‘death spiral’ for the electricity industry. That is probably going too far. But new technology has exposed an old regulatory short cut. The first rule of economic regulation is that variable costs have variable charges and fixed costs have fixed charges. But regulators have got away with ignoring that rule for 20 years.

From an economic perspective, this problem has a simple solution. Set network charges on a per customer basis that does not depend on the amount of power consumed. But this solution is more easily said than implemented.

Fixed network charges create both equity and political concerns. Is it fair that low energy users pay the same network charge as high energy users? What happens to the poorest residents who cannot afford the fixed network charge? Should a household that has invested in a solar power system now have to face higher fixed network charges?
In brief, the regulations that were satisfactory for old technology are failing with new technology.

The second area of concern is where technology transforms the market so the old rules of competition simply do not apply. The best example of this is with two-sided markets.

[A] two-sided market is a market in which a firm sells two distinct products or services to two different groups of consumers (the two ‘sides’) and knows that selling more to one group affects the demand from the other group, and possible vice versa… A firm in a two-sided market is then said to act as a platform.8

Examples include:

– Credit and debit card payments schemes. Merchants care about the number of consumers who have the relevant card and customers care about the number of merchants who will accept the card;

– A classified advertising platform such as realestate.com.au or carsales.com.au. Sellers care about the number of buyers who look at the site while buyers care about the number of sellers who list on the site; and

– A television network that provides entertainment/content for viewers but also provides space for advertisers to promote their products to viewers is a two-sided platform.

The interactions in two-sided markets can make competition analysis difficult. Consider, for example, mergers in media where outlets provide content to attract the ‘eyeballs’ of potential customers and then sell advertising space to generate revenue. From the customers’ perspective, the content is desirable but putting up with advertising is the price they pay to get the content. More advertising is a bad thing from the customers’ perspective.

Now suppose that two media platforms seek to merge. This will substantially lessen competition for advertising content but (at least in this example) consumers may still have lots of choice of alternative media. Then the merger can lead to higher advertising prices and this will benefit customers although harm advertisers.

As Jeziorski (2012) noted when looking at the merger of radio stations ‘if extra market power causes the radio station to decrease advertising, listeners benefit but advertisers are hurt’.9

Australia’s ‘black letter’ merger laws do not recognise these types of two-sided interactions. If a merger substantially lessens competition in a market then it is illegal. So if a merger of two platforms substantially lessens competition in a relevant advertising market, the fact that consumers might prefer less advertising is irrelevant.

Similarly, two-sided markets can involve ‘tipping’ – where one platform dominates because of the positive benefits that flow to each side of the market when there are more participants on the other side. In 2012, when the ACCC considered the acquisition of the Trading Post, an internet platform for classified advertising, by carsales.com.au, an internet platform specialising in advertising for automobiles, a key concern was tipping.10 Given this concern, the ACCC refused to clear the acquisition and the deal did not proceed. However, tipping need not arise in two-sided markets and critically depends on the presence or absence of multi-homing – the ability of one or other side of a market to simultaneously use more than one platform. At best, the competitive effects of the carsales.com.au acquisition of the Trading Post were ambiguous.

What are regulators to do in such ambiguous situations? In my opinion, when in doubt, regulators should limit interference, particularly in fast-changing areas. So regulators should ensure there are no artificial barriers being erected to competition, consumers are well informed (or at least not misinformed), and market participants have flexibility.

Unfortunately, as the carsales.com.au example shows, regulators are going much further.
In summary, technology has changed the nature of competition in areas such as payment instruments, energy, telecommunications, advertising and media. Simplistic approaches to analyse competition that apply to the old economy may make little if any sense in new markets. Regulators must adapt their traditional approaches when dealing with these areas or they will make errors by applying old rules to new situations.

The information revolution and competition regulation

Finally, let me turn to my third area. The changes in technology that are challenging competition regulators may also offer solutions. Regulators can use IT to improve regulation, in part, by helping consumers to have the knowledge or options to make better, more informed decisions.

A simple example is the reforms for automatic teller machines (ATMs). In 2008 the Reserve Bank of Australia (RBA) changed the way customers were billed for withdrawals at ATMs so that banks had to make the fees clear before customers withdrew their money. This simple reform used available ATM technology but it had a significant effect. The RBA estimated the reforms saved consumers $120m in fees in the first twelve months. This saving came from a mixture of changed consumer behaviour and new entry into the provision of ATMs. New ATMs have been deployed in areas that were previously not profitable so consumers have easier access to their funds. And consumers are informed and making the decisions that are best for them.

This type of reform – simply changing the way information is passed on to consumers – can be used elsewhere. If the RBA is concerned about credit card surcharging, for example, it could change the way information is provided and the fees are paid to induce greater clarity and competition.

Some of these regulatory reforms, like ATMs and credit card surcharging, depend on informing customers. In other situations the solution can
involve a change in ‘property rights’ or the ‘default option’. Australia was one of the first countries in the world to adopt mobile number portability, so when a consumer changes mobile carrier they can keep the same telephone number. Before mobile number portability the carrier owned the number, and as such, controlled a key switching cost. Simply by changing the default – so that the customer could keep the mobile number rather than the carrier keeping the number – mobile number portability reduced barriers to customers switching and increased mobile phone competition. The success of this policy is reflected in the fact that it has been copied around the world.

Regulatory solutions may involve the creation of markets. For example, while the Victorian government adopted a one-size-fits-all approach to smart electricity meters, the AEMC has recognised a better approach to this new technology might be to allow consumers choice through a ‘market’ for electricity metering.12

To exploit new technology, and design new ways to empower consumers, regulators have to change their mindset. Traditionally, regulators had a set of rules they enforced. If prices were too high, the regulators set the price. If quality was too low, the regulators set the quality. To adopt innovative solutions, however, regulators have to step back and ask a simple question: How can the regulator change the structure of market interactions to help the market function better without ongoing intervention?

Or to put it another way, how can the regulator put itself out of a job?

So this brings me to my third and final conclusion.

The way that information moves through our economy has changed. Regulators must seize the opportunities provided by IT while considering the implication of new business models for the rules of competition. They need an increased level of economic sophistication and a change of mindset. Every regulator’s aim should be to make itself redundant.

Technology means we can have better regulation. In some areas our old rules can adapt. In other areas, new rules need to be developed. But the big gains will come through a change in regulatory mindset. Just as technology has revolutionised our approach to business it needs to revolutionise our approach to business regulation.

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1 Google Inc v Australian Competition and Consumer Commission 2013, HCA 1 (6 February 2013).
3 For example see the decision of the Victorian Supreme Court in Trkulja v Google (No 5) 2012, VSC 533.
4 United States District Court, Southern District of New York, United States of America v Apple Inc, et. al. 12 Civ. 2826 (DLC).
6 See for example Australian Energy Markets Commission 2013, Strategic priorities for energy market development 2013, EMO0025, October 23.
10 See Australian Competition and Consumer Commission 2012, ‘Carsales.com Ltd – proposed acquisition of assets associated with Trading Post From Telstra Corporation Ltd.’, Statement of Issues, Canberra, 19 October.