

**Electronic Commerce and Competition  
(October 2000)**

**1. Introduction**

The competition policy approach towards electronic commerce - as the market is in continuous change - is still developing in Hungary, and therefore it is only possible to give a general overview of the present situation.

Although e-commerce falls under the category of content providing, almost all of the access providers in Hungary are also concerned in e-commerce. It is important to note this, because the rules relating to content providing and access providing are different.

According to the Hungarian telecommunications legislation, content providing is not regarded as a telecom service. Consequently, this service can be provided without licensing. Providing internet access is, on the contrary, a telecom service and can only be provided with a licence. The Hungarian Communications Authority issued about 40 licences, but there is a significant number of access providers who had started their activity before the system of licensing was introduced and who drive their businesses without a licence. Hence, there is intense competition on the Hungarian market of internet access providers.

With regard to electronic commerce between undertakings and consumers (B2C e-commerce), two decrees are to be applied: a government decree<sup>1</sup> concerning distance selling and a ministry decree<sup>2</sup> concerning - among others - the commercial activity of mail ordering. The distance selling decree contains rules corresponding to the rules of the relevant EU directive. Furthermore, the act on electronic signature has been drafted, and - according to a resolution of the government<sup>3</sup> - it will assist the transactions concluded through the internet. Thereby, internet commerce in general could be escalated, too.

Regarding - inter alia - the above mentioned facts, it is obvious that e-commerce is still evolving in Hungary, although significant legal barriers to entry do not exist. Consumers substantially mistrust electronic payment, and only a few banks offer services that make electronic payment possible.

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<sup>1</sup> 17/1999. (II.5.) government decree on distance selling

<sup>2</sup> 15/1989. (IX.7.) decree of the Ministry of Commerce on certain commercial activities

<sup>3</sup> 1075/2000. (IX.13.) government resolution on the regulatory principles for the act on electronic signature and on the actions to be taken related to it

Regarding electronic commerce between undertakings (B2B e-commerce), the new forms of internet based business, which may face antitrust challenge in the future (i.e. Joint ventures, B2B exchanges), are also in an evolutionary stage. In Hungary, B2B e-commerce substantially takes place through the EDI (Electronic Data Interchange) system which is not based on internet protocol. Since the appearance of the EDI systems in 1996, the number of its users has dynamically increased.<sup>4</sup> Nevertheless, internet based arrangements for B2B e-commerce may become prevailing by 2002. The most significant arrangements can be Web-EDI systems. Currently, there are two providers of Web-EDI services in Hungary, but there has not been any experience accumulated about their operation.

Concomitantly, the Office of Economic Competition (OEC) has not yet decided in cases related directly to electronic commerce (the only such case so far concerned the registration of domain names - Vj-135/1999.). However, since the competition policy approach towards e-commerce highly resembles the approach towards traditional businesses, the general practice of the OEC is used as a basis for the presentation of those principles that would be applied in future cases.

## **2. Market definition, price discrimination and predation**

Until September 2000, the OEC has neither received any notifications or complaints concerning directly e-commerce markets, nor has it taken action ex officio. Some cases can be mentioned where the OEC assessed the deceptive nature of advertisements shown on the internet, but in these cases the definition of the relevant market had no practical significance, since market definition and the assessment of market position only have an important role in antitrust procedures.

Regarding the lack of experience in the field of e-commerce, the former practice of the OEC is summarised here, remarking the issues that may emerge in the market of electronic commerce:

OEC's general practice of market definition will also be applied in the cases concerning e-commerce. The Hungarian competition act<sup>5</sup> contains some categories to be taken into account while defining the relevant market: "The relevant market shall be defined by taking into account the goods which are subject to the agreement and the geographical area concerned."

With regard to electronic commerce, the relevant product (the "goods" that can be subject to an agreement) is a special service which shows both the characteristics of internet services and of traditional trade services. In 1999, the OEC investigated a supposed cartel in the market of internet services. In this case, the market of the registration of the '.hu' top level domain was concerned from the viewpoint of supply

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<sup>4</sup> According to last year data, the number of undertakings using the EDI in Hungary was about 400.

<sup>5</sup> Act No LVII of 1996 on the Prohibition of Unfair Competition and Restrictive Market Practices

substitutability. When defining the market, the OEC made a distinction between access providing and content providing. Furthermore, it identified several market segments with regard to content providing, and the market of the domain name registration was defined as one of these independent market segments.

In traditional market analysis, the OEC used to differentiate between retail trade markets and wholesale markets. According to us, this separation is not identical in e-commerce, since B2B e-commerce is not necessarily based on the traditional manufacturer-distributor relationship. (However, separating C2C markets from B2C ones is not apparently necessary.)

With regard to market definition and concerning the current practice of the OEC, the following must be kept in mind:

According to the Hungarian competition act, "In addition to goods which are subject to the agreement, any goods that can be reasonably substitute for them shall also be taken into account. When doing so, the intended use, price, quality and terms and conditions of fulfilment shall be taken into consideration."

While implementing this article, the OEC assesses firstly the trend of prices and, secondly, the conditions under which consumers can acquire the relevant product. Price dispersion might be different in relation to the different products or product groups, but the OEC has not so far received complaints making a grievance of price discrimination. With regard to the term 'same conditions', the legal and customary rules relating to mail ordering and distance selling services must be applied, since sales on the internet must be also regarded as distance selling.

According to the Hungarian competition act, "The term 'geographical area' means the territory outside which:

- a) a consumer is unable to procure the goods or is able to procure them only under considerably less favourable conditions; or
- b) the seller of goods is unable to sell the goods or is able to sell them only under considerably less favourable conditions."

In the case of internet, the extension of the relevant geographical market depends upon the interpretation of the term 'considerably less favourable'. In this way, the extension of the market must be assessed on a case-to-case basis, analysing the particular circumstances in each case. In general, the geographical market can be defined as 'global' when the relating customs and duties and the transaction (delivery) costs do not constitute a significant excess compared to the cost of purchase at home. Software and low weight products (i.e. books, CDs) typically fall under this category. With regard to these products and to the delivery costs, it is assumable that the geographical market can be extended to the neighbouring countries. Concerning other products and services, it may be justified to define the geographical market as 'national'.

### 3. Network dominance

As mentioned above, the OEC has not issued decisions concerning directly e-commerce, so the former experience of the office can be referred to when contributing to this issue, but some early progress is already perceivable in the market, and these can be taken into account as well.

According to international experience, the establishment of electronic market places - typically B2B portals - needs relatively large investment, and the barriers to entry stemming from network effects are high. Typically, only determinant actors of the traditional markets may be able to win the large number of customers adequate to operate the market place economically. Therefore, in many cases, larger undertakings likely have significant advantages in competition. This general statement may, however, not always be true, but - while evaluating a given case - the assessment of the referred entry barriers would be regarded as particularly important. Maybe one example is ought to be mentioned in so far as regards barriers to entry: the small number of businesses that possess the adequate infrastructure to operate an internet portal. In the present situation, it could be expected that smaller undertakings will disappear either because they lack capital, or through acquisitions, and in this way the market will be more concentrated. (Nevertheless, these transactions might fall under the M&A rules.)

The establishment of B2B market places may lead to dominant position because of the network effects and the high barriers to entry (these latter might also be created artificially by applying the company's own standard). If the market place is to be established by more than one undertakings, the OEC can observe the formation of the market place ex ante and in that way it can prevent the evolving of dominant position. Should the undertakings have the intention to operate the electronic market place in the form of a full function joint venture, the OEC investigates the cases according to the rules relating to mergers. A merger procedure can only be started if the transaction needs approval, that is if the aggregate net turnover of the undertakings concerned exceeds the thresholds defined by the competition act. In order to carry out this evaluation, the activities integrated in the joint venture must be determined. The problem arises that it is attached to market definition, since it is necessary to assess whether the performing of a traditional activity could substitute the performing of this activity on-line.

If the new undertaking is not a full function joint venture, but two or more independent undertakings establish the portal by agreement, the OEC applies the rules relating to agreements restricting competition. This kind of agreement must be notified for exemption if the market share of the undertakings concerned exceeds 10%. In this case, the definition of the market is a significant requirement for further investigation. (OEC's approach toward market definition has been discussed under the previous subtitle.)

Both in the cases of mergers and agreements restricting competition, the OEC analyses the relevant market and the effects on competition. Under circumstances qualified by law, the OEC can approve the merger or exempt the agreement even if dominant position exists or there is some restriction of competition, respectively. In this case, the OEC assesses the advantages and disadvantages stemming from the merger or the agreement. While doing this, the OEC takes only those advantages into account, that could not be reached without the merger or the restriction of competition. These benefits refer basically to efficiencies including not only allocative and productive but also dynamic efficiency. This attitude guarantees that the practice of the office would not detain innovation, and that the office would only intervene in the formation of electronic market places in a reasonable extent.

The OEC can impose conditions and obligations upon the undertakings in order to prevent the possible restrictive effects. When applying this alternative, measures that could deter undertakings from investment must be avoided, but it must be also secured that none of the B2B electronic market places restricts other competitors in market action. Consequently, it cannot be stated in general that the operator and participants of a B2B market place must be separated, though the eventual exclusive clauses would face close scrutiny. By assuring transparent operation and reducing exclusive clauses to the necessary level, the possibility of abuse may probably become limited. In other cases, by the application of rules relating to the abuse of dominant position, the OEC might be able to restrict the practices distorting competition.

The situation is completely different when a B2B portal is established by undertakings that are not independent from each other. In this case, the OEC has only limited means for ex ante control, since it can apply only the rules relating to the abuse of dominant position. It is theoretically possible to control ex ante the practice of leveraging, although the competition act does not specify it expressly as an abuse.

Regarding the fact, that electronic market places in the Hungarian geographical market are still in an early stage of their development, any experience related to predatory pricing cannot be presented.

#### **4. Enhanced opportunities for co-ordinated effects**

Since there has not been sufficient practical experience gained, only a theoretical approach can be presented, again. Nonetheless, it is held, that it would not be reasonable - at the current level of development - to regulate an emerging and still evolving phenomenon which is based on openness, free access and innovation.

The collusive conduct of the participants of B2B e-commerce will be difficult to prove, since through the use of internet the exchange of information becomes easier. In that way, it will also be more difficult to collect direct evidence, so the significance of indirect evidence will rise. The exchange of information between businesses can only be restricted by the competition authority if the collusion is highly probable, that is,

only in a later stage when the competition act will have been infringed by the operation of B2B market places.

In order to reduce the foreseeable challenges (entry barriers for smaller firms, agreement on the fees of access to the market place, agreement on selling/purchase prices etc.), it would be helpful to elaborate a system for monitoring the market (it could be a special responsibility of the task force to be formed shortly to investigate hard core cartels). Instead of the prohibition of chatrooms - which can play a decisive role in collusive practices - it is more reasonable to determine the frames of their operation. The characteristics of the internet - and thereby that of e-commerce - let prognosticate that self-regulation will retain its importance also in the future. A code of conduct drawn up by the internet service providers may constitute an important element of this self-regulation.