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A Free-Market Guide to Navigating Tech Issues in the 107th Congress

B2B Exchanges and Antitrust Regulations

by
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Most transactions in the United States are between one business and another. The Internet holds promise of saving consumers billions of dollars by making these inter-business dealings more efficient. But achieving the savings requires creation of websites that share information among competitors and foster other forms of cooperation. Such cooperative dealings make antitrust authorities nervous, and application of outmoded antitrust doctrines may impede development of B2B and harm consumers.

Background. "B2B," for "Business-to-Business," is the term used for Internet-based exchanges used by businesses to post information about goods and services they provide or need, and to integrate information systems with suppliers and customers. The term has come to stand for exchanges that serve multiple businesses, not for the thousands of websites established by individual businesses for the use of their customers.

Interbusiness activity represents about 70 percent of all transactions in the US.[1] With GDP closing in on $10 trillion per year, any technique that reduces the costs of these dealings will bring consumers immense savings. For example, each major US automobile company (Ford, GM, DCX) spends $80 billion to $90 billion annually buying from 30,000 different suppliers. Investment bankers estimate B2B exchanges could reduce the price of a $19,000 vehicle by $2,000 to $3,000.[2] The value of B2B exchanges, worldwide, may reach the neighborhood of $2.5 trillion by 2003.[3]

B2B savings take many forms. They can reduce paperwork costs, allow for instant correction of errors,[4] and sometimes eliminate in-person sales calls.[5] They allow purchasers to obtain price quotations from multiple suppliers, and sellers to obtain bids from multiple buyers. By speeding up transactions, they reduce costs of financing inventory. They allow for aggregation of orders and thus increase the availability of quantity discounts. They create markets for the sale of excess materials, capital goods, and services. B2B exchanges expand the geographic reach of markets, facilitate the creation of futures markets, and encourage arbitrage across time and space. By improving companies' forecasting abilities, they reduce waste by matching supply and demand for goods and services.

For all of these reasons, writes Erick Schonfeld in *eCompany*, "The Web's infiltration into every pore of the economy is proceeding with the force of pure logic. No company can resist it. None can afford to."[6]

Development of B2B. One type of B2B exchange is "vertical," which means the exchange services a single industry. It can include all the levels within that industry, from raw-materials suppliers through component and finished-goods production to customers. For example, the steel industry has a B2B, as does the building industry. Another type is "horizontal," which means that the exchange is multi-industry. These are useful when several industries have a common need for particular kinds of inputs, or share particular problems.[7] Other variations exist—B2Bs supporting a specific type of buyer in dealing with many industries that produce inputs for such buyers, for example, or B2Bs with regional specializations.

Numerous entrepreneurs are rushing to convert the promise of Internet-based savings into reality, and in the process to levy handling fees on trillions-of-dollars-worth of transactions.

At the onset of the B2B movement, consultants and software vendors, who saw a market opportunity to establish industry B2Bs and charge firms for the privilege of joining, took the initiative. Over the past year, the impetus has shifted. Much of the necessary software and technical expertise can now be supplied off-the-shelf rather than built from scratch; several software firms are competing for business; and industry members came to realize they provide most of the value, and concluded they should collect more of the loot.[8] As a result of these forces, B2B is shifting to a model whereby a group of industry players establishes an exchange, with themselves as major equity owners. Firms with technical expertise may be brought in as partners; the automobile industry B2B Covisint is owned not just by auto companies but by Oracle and CommerceOne.

The software is getting cheaper, but still "building a quality trading exchange involves significant effort and is an extremely complex undertaking."[9] Covisint has 200 people engaged in planning, and the World Wide Retail Exchange, a joint project of 53 major retailers, expects to spend $100 million for start-up during its first two years.[10]

Because of the commitment involved, "most electronic marketplaces are minimally functional and not much more than a press release announcing strategic partnerships."[11] It is difficult to sort the serious efforts out from those that are just a hope and a press release, but *eCommerce Business* recently counted "the exchanges that sport a name and an announcement, and show some signs of life," and came up with 62.[12]

Competitive concerns. Only one B2B exchange has been formally reviewed by the antitrust authorities. The Federal Trade Commission mulled over the plan for Covisint for three months before deciding that the formation of the organization was not an *automatic* violation of the antitrust laws, but that the Commission reserved the right to decide at any time if its actual operation violated those laws. The FTC chairman stated:

> B2B electronic marketplaces offer great promise as means through which significant cost savings can be achieved, business processes can be more efficiently organized, and competition may be enhanced....Of course,…B2Bs should be organized and implemented in ways that maintain competition. The antitrust analysis of an individual B2B will be specific to its mission, its structure, its particular market circumstances, procedures and rules for organization and operation, and actual operations and market performance.[13]

Soon thereafter, the Commission released a staff report on B2B marketplaces, reinforcing its conclusion on Covisint: For competitors to establish a B2B exchange does not violate antitrust laws, but actual operations might do so. Actions that the trustbusters regard as potentially anticompetitive are:[14] (1) Exchanges of information about prices, quantities, and plans might facilitate price-fixing. (2) If several companies aggregate purchases or sales, they might create monopolistic market power. (3) Exchange members might exclude competitors from participation, or impose discriminatory operating or access rules, which "leave rivals with reduced functionality or higher costs." (4) Exchange rules limiting members' freedom to deal off the exchange or to belong to other exchanges could lessen competition in what FTC calls "the market place for exchanges."

Each B2B exchange is to be judged according to whether it is, on balance, "pro-competitive" or "anti-competitive," and this is to be judged under the “rule of reason” on the basis of a large number of factors tossed onto the scale and weighed according to largely unarticulated standards.[15] Some familiar rules of thumb apply: Exchange of information about future prices is very suspect, whereas information about past prices is probably all right. Some parts of the *FTC Report* are almost surreal. How should a practicing lawyer advise a B2B client to respond to the report’s conclusion that exclusion of some firms raises deep concerns, but it is “an antitrust problem only when it harms competition, not merely competitors,” EXCEPT that some forms of exclusion might be classified as group boycotts, which are illegal *per se*, BUT, “legal principles delineating *per se* unlawful exclusion are beyond the scope of [this report]”?[16]

In essence, FTC regards B2B exchanges as jazzed-up versions of trade-association activities, standard-setting organizations, and other extant intra-industry interactions. It assumes the antitrust doctrines developed over the past century are readily applicable to the Internet era. And in this frame of reference, all cooperation among competitors is suspect.

Policy recommendation. Whether the 107th Congress will be forced to deal with antitrust and B2B depends on actions by the antitrust enforcers. Clearly, these need no added authority on the topic, and will not seek legislation. But if they begin assaulting B2Bs, threatening to forestall their immense potential consumer benefits, then industry may well knock down congressional doors seeking help.

Such over-reaching by the government is distinctly possible. Antitrust doctrine is in sad intellectual shape. “The most basic terms used in the field, concepts crucial to great issues of industrial structure, billions of dollars in treble damages, and years of jail time, have no certain meanings. As used by the enforcers, analysts, and judges, their definitions are varying and often contradictory.”[17] The late Professor Phillip Areeda, the nation’s most illustrious antitrust expositor, called the “essential facilities doctrine”—which is crucial to discussion of B2B exclusion issues—a mere “epithet” that lacked any “limiting principles.”[18]

In particular, the dervishes of antitrust enforcement have never understood or accepted the importance of “partial integrations” among the operations of legally separate firms, and the immense consumer benefits that can result from these, even when the firms are competitive. The enforcers tend to tag such deals as “anti-competitive,” and thus illegal.[19] Since partial integration is the soul of B2B, this negative preconception will lead the government astray. State attorneys general, having tasted blood in the Microsoft trial, and bearing simplistic views about antitrust, are likely to be the worst offenders.[20]

Contrary to the assumptions of the *FTC Report*, this currently incoherent body of antitrust law is not adequate for dealing with the Old Economy of bricks and mortar, let alone the New Economy of clicks and the Internet. If the antitrust enforcers do not recognize the need to rethink their premises, Congress will be forced to step in.[21]

~ James V. DeLong

[1] Erick Schonfeld, "Corporations of the World, Unite! You Have Nothing to Lose but Your Supply Chains," *eCompany* (June 2000); available at www.ecompany.com/articles/mag/print/0,1643,6637,00.html.
[2] *General faqs about covisint*, www.covisint.com/info/faq_gen.html. Covisint is a B2B exchange owned by Ford, DaimlerChrysler, General Motors, Renault, Nissan, CommerceOne, and Oracle. The name derives from Co (connectivity, collaboration, and communication), Vis (visibility and vision), Int (integration and international).
[3] Schonfeld, "Corporations of the World, Unite!"; Paul Larson, "Business to Business E-Commerce," *Motley Fool Internet Report*, 14 March 2000; available at www.motleyfool.com (charge).
[4] The National Association of Purchasing Agents estimates the average manual purchase order costs $79 to process. Larson, "Business to Business E-Commerce."
[5] A panelist at an FTC workshop estimated that a sales call in the chemical and pharmaceuticals industry costs $575; the same transaction via B2B would cost $10. However, this is a high estimate; most calculations of savings are more prosaic. Federal Trade Commission, *Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces*, report by FTC staff (October 2000), part 2, p. 3; available at www.ftc.gov/os/2000/10/index.htm#26 (hereafter "FTC Report").
[6] Schonfeld, "Corporations of the World, Unite!"
[7] Larson, "Business to Business E-Commerce."
[8] Rob Spiegel, "Gotcha! Traditional industries stole the e-marketplace initiative from dot-coms. Now what?" *eCommerce Business*, 15 January 2001; available at www.ecommercebusinessdaily.com.
[9] *An Independent Global Electronic Trading Company: The Universal Foundation for B2B Electronic Commerce*, UCCnet White Paper (October 2000); available at www.uccnet.com.
[10] *General faqs about covisint*; World Wide Retail Exchange, *Frequently Asked Questions*, www.worldwideretailexchange.org.
[11] UCCnet White Paper.
[12] Spiegel, "Gotcha!" provides the list.
[13] *FTC Terminates HSR Waiting Period for Covisint B2B Venture*, press release, 11 September 2000; available at www.ftc.gov/opa/2000/09/covisint.htm.
[14] FTC Report; Federal Trade Commission and US Department of Justice, *Antitrust Guidelines for Collaboration Among Competitors* (April 2000); available at www.ftc.gov/bc/guidelin.htm. Interestingly, the report does not express concern over vertical issues, the possibility that powerful players might use a B2B exchange to impose restraints on other levels of the supply chain.

[15] FTC Report, part 3.
[16] Ibid., p. 18.
[17] James V. DeLong, "Antitrust Law for Dummies," *TechCentralStation*, 17 April 2000; available at www.cei.org/sthml/.
[18] Phillip Areeda, "Essential Facilities: An Epithet in Need of Limiting Principles," 58 *Antitrust Law Journal* 841 (1989/1990).
[19] Fred Smith, "The Case for Reforming the Antitrust Regulations (If Repeal Is Not an Option)," 23 *Harvard Journal of Law & Public Policy* 23 (Fall 1999); Robert Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York: Free Press, 1978).
[20] See, *e.g.*, John R. Wilke, "Twenty States Oppose Airlines' Proposal for Joint Venture in Online Reservations," *The Wall Street Journal*, 11 January 2001.
[21] Other recent CEI works on antitrust include *The Antitrust Reader* (1997); James V. DeLong, *Intellectual Property and Antitrust Enforcement*, Statement Before the Committee on the Judiciary, US House of Representatives, Oversight Hearing on the Antitrust Enforcement Agencies, 12 April 2000; James V. DeLong, "The New Trust-busters," *Reason* (March 1999), p. 36; James V. DeLong, "The Microsoft Case and the Intellectual Property Defense," *Federalist Society Intellectual Property News* (Fall 2000). All are available at www.cei.org/shtml.