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As Internet technology sweeps over business-to-business sales, it brings the potential of radical transformation through the use of B2B exchanges in procurement or sales. Such exchanges could potentially allow businesses to take advantage of greatly reduced transaction costs, enhanced competition among suppliers and economies of scale. Because a certain amount of collaboration among competitors is needed in order to achieve those potential benefits, however, federal antitrust agencies must review these collaborative exchanges for potential antitrust issues.

In that review, the Federal Trade Commission and Antitrust Division of the Department of Justice are likely to structure their analysis around the *Antitrust Guidelines for Collaboration Among Competitors*, which was published in April 2000. This article examines a number of issues raised in the government's collaboration guidelines as they apply to B2B exchanges. The article then provides suggestions for assisting clients in avoiding the pitfalls that such exchanges can create if not properly planned and implemented.

The structure of an industry can be key

An industry's structure often sets the stage for the antitrust analysis of a proposed B2B exchange. For instance, some industries involve transactions between a mass of scattered suppliers on one side and a few buyers on the other. This "pyramid" structure exists, for instance, in the aerospace industry (which has publicly announced a proposed exchange) in which four contractors—Boeing, Lockheed Martin, BAE and Raytheon—deal with more than 37,000 suppliers.

There also can be inverse pyramid exchanges established by sellers. At the other extreme, there are industries, including office supplies and food processing, that involve fragmented players on both sides. B2B exchanges in pyramid-shaped markets are likely to be owned by a consortium of buyers or sellers, all of which probably have enough of a stake in the outcome (individually or collectively) to want to create an exchange. In a market in which players are highly fragmented, B2B sites are more likely to be created by "neutral" third parties (such as the companies Free Markets or Ariba), because the players themselves may not derive enough benefits to make investing in an exchange worthwhile.

B2B exchanges in different markets can be radically different in character. Although the existence of a particular industry structure in which a B2B exchange operates does not, by itself, raise antitrust issues, the characteristics of the industry form the backdrop to and influence the antitrust analysis.

Broadly speaking, antitrust concerns in pyramid-shaped industries center on the potential market power wielded by the buyers or sellers; in fragmented markets, the issue is often the potential market power of the exchange itself.

The first, and most critical, step in antitrust analysis is ascertaining the nature of the transaction, the antitrust issues it raises and what economic benefits it might promise. One commentator has suggested that most B2B exchanges are nothing more than press releases. Thus, it is critically important that the firms involved clearly define the nature of the business to be conducted on the exchange because that will drive the analyses of the antitrust risks and the likely benefits. Indeed, the antitrust analysis may focus on the question of why a business would choose to use or create an exchange rather than using its existing procurement process or sales channel. As a result, antitrust analysis often includes a determination of the benefits that will be derived from the exchange. In fact, the government's collaboration guidelines recognize that consumers “may benefit from competitor collaborations” and encourage procompetitive exchanges.

In that context, it is important to note that exchanges can decrease transaction costs in a number of ways, including using Web sites instead of hardcopy blueprints for product descriptions and cutting down on search times, paper processing costs and contracting costs among suppliers and buyers. Another potential benefit of an exchange is that its auction function can result in lower prices by enhancing competition for a buyer’s contract.

Such competition forces suppliers to deliver their products at the lowest competitive prices. Those decreased prices lower the cost to the buyer and should, in turn, lead to lower prices for consumers. An exchange can also reduce costs by achieving certain economies of scale for its users. In other words, in allowing aggregated volume purchases, a B2B exchange can result in lower per-product prices by giving the companies combining their purchases greater negotiating power.

Although a B2B exchange can achieve all of these benefits, it may still raise antitrust concerns. In fact, the collaboration guidelines specifically list these types of “buying collaborations” as potentially harming competition. In order to assess the potential antitrust concerns, a detailed business plan that defines the business must be developed. Antitrust counsel should pay particular attention to the nature and structure of the business, as defined in that plan, and the efficiencies potentially created by the exchange, and should work closely with the business people to develop a structure and safeguards that minimize potential anti-competitive consequences.

Potential antitrust issues: monopsony power

Any collaborative venture involving competitors raises issues of whether it will be able to exercise market power over the price or output of goods or services. Although monopsony power is more likely to be a concern in a concentrated market, agreements between multiple competitors can raise the same issue even if the market is diffuse.

Interestingly, monopsony power involves lowering the cost of goods sold, which is generally considered beneficial to consumers. However, if this decrease is forced by a group of buyers using their buying power to drive prices below the level a competitive market would bear, it can be accompanied by certain negative results, including a likely decline in the output of the suppliers, which can result in lower production of end goods by the buyer and fewer goods available to the consumer. Thus, under these limited circumstances, consumers could be harmed by the exercise of monopsony power, and the federal enforcement agencies will examine this issue.

In order to determine whether a B2B exchange creates or facilitates monopsony power, counsel should look at the nature and scope of the agreements between members and potential members of the exchange, and whether they intend to buy jointly. A joint purchasing agreement between buyers with large market shares will raise greater antitrust concerns than agreements that bring together companies that, even collectively, do not have market power. But even large firms can jointly purchase generic commodity products if they do not account for a significant share of sales. Indeed, the collaboration guidelines establish safe harbors for agreements under which the market share of the collaborators is no more than 20% of the relevant market.

Attempting to avoid an 'overinclusive' B2B

Antitrust enforcers will also want to ensure that the terms of the exchange's agreements allow members to form freely, trade on or use competing exchanges. If not, then the exchange may be deemed overinclusive. This could create competitive problems if the exchange requires suppliers to participate in it through exclusive agreements, which can pose challenges to other competitive exchanges, especially after one exchange has achieved enough critical mass that suppliers feel they must do business on that exchange.

The absence of exclusivity, however, can eliminate or minimize these concerns. For instance, without exclusivity, multiple exchanges in an industry are likely to compete actively against one another. In addition, B2B sites operated by neutral third parties will offer many competing services that compete with industry exchanges.

Another potential concern of antitrust regulators is whether the membership list of the exchange is underinclusive, which could become a concern when an exchange becomes successful and achieves a critical mass of buyers and sellers. In such an instance—even without exclusive agreements—an exchange may become an important site used by buyers and sellers because they are assured of the presence of others who will do business with them. As a result, buyers and sellers that are not members of the exchange and are not permitted to use it are foreclosed from using an "essential facility."

Similar issues could be posed by discriminatory access terms and conditions. These restrictions can harm competition by creating a disadvantage for companies not allowed to participate in the exchange, but these concerns can be minimized by offering open access on nondiscriminatory terms.

Another potential issue for an exchange is whether it will facilitate access by competitors to sensitive information, such as future pricing or plans for future models, and become an electronic "smoke-filled room." An exchange can allow companies to gauge their competitors' production plans, new products, prices or other competitive information. Obviously, such dissemination of information can raise huge antitrust concerns, and protections should be included in planning the exchange.

Another concern about exchanges is their potential impact on innovation. One of the ways manufacturers (and parts suppliers) compete is by innovating and building better products. Exchanges have the potential to dampen this innovation by facilitating information flow about the products that competitors offer.

This can harm innovation by giving companies incentives to decrease research and development because they know they may be able to access their competitors' research and development (and thus get a free ride). They also know that any research and development they perform will benefit their competitors because those competitors may also have access to the exchange.

Define, decide, consider and establish

Despite the many potential antitrust concerns that a B2B exchange creates, such an exchange should be able to avoid agency intervention by abiding by the following suggestions:

- The parties must carefully define their business objectives at the earliest possible time, identify precisely how business will be conducted on the exchange and carefully analyze and build in protection against potential antitrust risks in advance.
- The parties should decide whether the exchange will allow aggregated buying. If so, they should limit the types of products that can be purchased through

such buying to products that are unlikely to raise concerns. Aggregated buys for products like paper clips, computers or pens will not likely raise any antitrust concerns (unless the buyers have combined market power in one of those areas). In addition, the aggregated buyers can purchase other commodities in which they do not have combined market power.

- The exchange should consider whether it will require or encourage exclusivity by any buyers or sellers. Each participant to the exchange should make unilateral decisions about how much of its business should pass through it.
- The exchange should establish objective, specific criteria for admission and should allow all companies meeting those criteria to participate on nondiscriminatory terms.
- The exchange should establish strong firewalls that prevent information leakage between users of the exchange. These firewalls should prevent all users of the exchange from seeing *any* competitively sensitive information about or from any competitor.

B2B exchanges—like other joint activities among competitors—involve genuine antitrust issues. But, if a B2B exchange is well planned and well structured, it should be able to resolve these issues with minimal interference by the antitrust authorities.

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