ARNOLD & PORTER UPDATE

B2B Marketplaces & Common Sense Antitrust Precautions

July 19, 2000

Business-to-business ("B2B") exchanges are drawing considerable interest among investors, but since the efficiencies promised by these ventures also mean bringing together competitors, the exchanges are also drawing the attention of antitrust regulators. The Federal Trade Commission reportedly is investigating Covisint, a procurement exchange planned by Ford Motor Corp., General Motors Corp., and Daimler Chrysler A.G. Press reports indicate that the Justice Department's Antitrust Division is investigating both a B2B venture among meatpacking firms and Orbitz, a planned business-to-consumer ("B2C") exchange among five major airlines. In addition, the Federal Trade Commission just concluded a two-day workshop designed to explore the ways in which B2B ventures operate, what efficiencies they offer, and what antitrust risks they present.

While these governmental activities have caused some to worry whether B2B collaborations are too risky, our view and the clear message from the FTC workshop is that B2B ventures are not inherently suspect under the antitrust laws and whatever risks that do exist can be minimized by paying close attention to structure, information flow and membership criteria.

What follows is a summary of some of the more common issues that have arisen in the course of Arnold & Porter's representation of a number of founders of and participants in B2B and B2C exchanges. Please note that this is an overview, not a substitute for a full analysis of the issues presented by a particular venture. Risks can be minimized by following common sense antitrust safeguards from the initial planning stages through implementation, but the risks are real and making sure they are addressed should be part of your due diligence agenda for any B2B venture. If you have questions about this memo or the antitrust implications of any B2B venture, please call us.

Arnold & Porter

www.arnoldporter.com

Thurman Arnold Building
555 Twelfth Street, NW
Washington, DC 20004
tel: 202.942.5000
fax: 202.942.5999

399 Park Avenue
34th Floor
New York, NY 10022
tel: 212.715.1000
fax: 212.715.1399

777 South Figueroa St.
44th Floor
Los Angeles, CA 90017
tel: 213.243.4000
fax: 213.243.4199

1900 Avenue of the Stars
17th Floor
Los Angeles, CA 90067
tel: 310.552.2500
fax: 310.552.1191

1700 Lincoln St.
Suite 4000
Denver, CO 80203
tel: 303.863.1000
fax: 303.832.0428

Tower 42
25 Old Broad St.
London, EC2N 1HQ
tel: 0207.786.6100
fax: 0207.786.6299

Structural Issues

- ***membership***
- ***exclusivity***
- ***de facto rules***
- ***joint buying/monopsony***
- ***HSR implications***

In creating an exchange and planning for its operations, the joint venture partners will have to establish rules about who can join and what participation, either in equity or non-equity positions, implies about participation in other similar ventures. Because the antitrust implications of those rules can change as circumstances change, and because de facto rules can sometimes emerge from other features of an exchange, this is the area in which exchanges are most likely to need antitrust counsel.

When evaluating whether certain competitors can be excluded from or can be allowed to join an exchange, companies need to be sensitive to the possibility that the exchange might be a vehicle for the exercise of market power. The business models of many B2B exchanges recognize that the exchange becomes more useful as a greater percentage of the target audience participates. In some of these "network" situations, access to the exchange's network (or the lack of access) can affect the viability of a competitor in that industry. Ventures need to be careful about membership decisions in these situations. When access to an exchange has little affect on the viability of a competitor, the exchange has far greater leeway in determining who may join.

The existence of market power is also relevant to the question of a venture's exclusivity rules. Exchanges, especially new exchanges, will often have valid business reasons for seeking commitments from participants that they will conduct all or a certain portion of their business through the exchange. But commitments by participants to use one exchange means they are not available as potential customers for the promoters of other exchanges. When the first exchange is so successful that it becomes the "dominant" exchange (with some arguable degree of market power), antitrust concerns may arise regarding exclusive dealing requirements that hamper the development of other exchanges.

In addition to explicit rules about membership and exclusivity, companies also need to be aware that other features of an exchange, for example its fee structure, can create de facto rules regarding membership and exclusivity. Fee structures could create entry barriers for start-up enterprises trying to compete against an exchange's existing members. Fee structures could also reduce incentives for current members to use competing exchanges or to compete through non-exchange methods.

Thurman Arnold Building
555 Twelfth Street, NW
Washington, DC 20004
tel: 202.942.5000
fax: 202.942.5999

399 Park Avenue
34th Floor
New York, NY 10022
tel: 212.715.1000
fax: 212.715.1399

777 South Figueroa St.
44th Floor
Los Angeles, CA 90017
tel: 213.243.4000
fax: 213.243.4199

1900 Avenue of the Stars
17th Floor
Los Angeles, CA 90067
tel: 310.552.2500
fax: 310.552.1191

1700 Lincoln St.
Suite 4000
Denver, CO 80203
tel: 303.863.1000
fax: 303.832.0428

Tower 42
25 Old Broad St.
London, EC2N 1HQ
tel: 0207.786.6100
fax: 0207.786.6299

The difficulty with all these concerns is that they normally arise only after an exchange has achieved some level of market power – until that time the practices are usually legitimate and reflect aggressive competition. However, determining whether such market power exists is a difficult, fact-intensive inquiry best undertaken with antitrust counsel. The necessary interplay between "bricks and mortar" sales channels and Internet sales has only complicated that inquiry. But given the network effects that characterize these types of businesses (the exchange is more valuable as its user base expands), companies should realize that if the start-up exchange of today is successful, it may well be the only exchange operating in a particular area.

The potential that network effects will lead to a situation where only one or a very few exchanges serve individual markets creates a heightened need for exchanges to plan for the possibility of transitioning away from membership and exclusivity rules that could raise concerns in a more mature phase of their operations. Fortunately, statements at the FTC workshop indicate the agency's awareness that the focus in analyzing conduct in this area is whether the conduct harms competition itself, not individual competitors. But if the controversy over the Microsoft litigation is any indication, the issue of if, when and how any transition needs to take place is likely to be subject to different views by the enforcement agencies and the antitrust bar.

Looking at other structural issues, exchanges that intend to aggregate the purchases of multiple buyers have been a special focus of potential antitrust concerns. The issue presented – monopsony, or buyer side market power – is not new, but it has attracted special attention because much of the talk about potential B2B efficiencies has been devoted to the enhanced opportunity that the Internet creates for buyers to aggregate their purchases in order to lower procurement costs. For many exchanges this will not be a concern; but those that do intend to aggregate purchasing power should keep in mind that antitrust enforcers will be unlikely to credit procurement cost savings that are the result of the exercise of buyer market power. Where aggregated purchases could account for more than about twenty percent of sales of a particular good or service in a relevant geographic area, exchanges need to assess whether such aggregation is appropriate from an antitrust perspective. Finally, because of concerns over the facilitation of coordinated behavior, buyer aggregation sites also need to be alert to situations where jointly purchased goods or services account for more than about twenty percent of the input costs of buyers that compete against each other downstream.

Parties also need to keep Hart-Scott-Rodino premerger notification procedures in mind when setting up a B2B venture. Decisions about the form of the entity, e.g., choosing a corporation as opposed to an LLC, can trigger the need to submit HSR filings to the FTC and Justice Department. If HSR filings are required, HSR procedures could create substantial delays in the ability of parties to move forward with their implementation plans – HSR rules would not allow parties to implement plans until the HSR review process is concluded.

Thurman Arnold Building, 555 Twelfth Street, NW, Washington, DC 20004, tel: 202.942.5000, fax: 202.942.5999
399 Park Avenue, 34th Floor, New York, NY 10022, tel: 212.715.1000, fax: 212.715.1399
777 South Figueroa St., 44th Floor, Los Angeles, CA 90017, tel: 213.243.4000, fax: 213.243.4199
1900 Avenue of the Stars, 17th Floor, Los Angeles, CA 90067, tel: 310.552.2500, fax: 310.552.1191
1700 Lincoln St., Suite 4000, Denver, CO 80203, tel: 303.863.1000, fax: 303.832.0428
Tower 42, 25 Old Broad St., London, EC2N 1HQ, tel: 0207.786.6100, fax: 0207.786.6299

Given the time pressures facing Internet-based businesses, significant HSR delays could effectively derail a proposed venture. For those ventures where HSR filings will be required, advance antitrust planning will be particularly important because it is not clear how the agencies will respond to proposed joint ventures that, while presenting no immediate antitrust problems, have not yet advanced to the point where the parties have adopted antitrust safeguards that they will need when the venture is operational.

Firewalls, Confidentiality & Information Sharing

- ***technical and non-technical firewalls***
- ***participant terms of use***
- ***formation and focus group discussions***
- ***staffing***
- ***board and investor access***
- ***data mining***
- ***compliance programs***

Managing vast amounts of information is a key to the success of B2B ventures, but that information is also the source of potential antitrust risks. Companies buying and selling through B2B ventures may be direct competitors, and in processing transactions the venture may obtain detailed information about competitive activities of those companies. This could include information about customers, suppliers, prices, costs, sales volumes and inventory. Fortunately, participants in B2B ventures seem to be aware of the need to establish firewalls and confidentiality rules to protect competitively sensitive information. The basic guidance in this area is simple – competitively sensitive information should be provided and be accessible only on a need-to-know basis for the reasonable functioning of the venture. The development of firewalls and confidentiality rules is the first step in the development of an appropriate antitrust compliance program.

When it comes to firewalls and B2B ventures, participants usually think of the technical firewalls built into the venture's software, e.g., password protecting data so only bona fide buyers can access information about goods and services offered for sale. But non-technical firewalls and other rules covering confidentiality and information sharing should also be addressed in a number of other contexts.

> *Participant Terms of Use.* The terms of use under which participants gain access to the venture's site can supplement technical firewalls by ensuring that participants take no steps to circumvent those firewalls. One area for antitrust training is to ensure that

Thurman Arnold Building
555 Twelfth Street, NW
Washington, DC 20004
tel: 202.942.5000
fax: 202.942.5999

399 Park Avenue
34th Floor
New York, NY 10022
tel: 212.715.1000
fax: 212.715.1399

777 South Figueroa St.
44th Floor
Los Angeles, CA 90017
tel: 213.243.4000
fax: 213.243.4199

1900 Avenue of the Stars
17th Floor
Los Angeles, CA 90067
tel: 310.552.2500
fax: 310.552.1191

1700 Lincoln St.
Suite 4000
Denver, CO 80203
tel: 303.863.1000
fax: 303.832.0428

Tower 42
25 Old Broad St.
London, EC2N 1HQ
tel: 0207.786.6100
fax: 0207.786.6299

sellers' field personnel do not gain access to information about other sellers through the use of customers' access rights.

Formation and Focus Group Discussions. Information concerns arise even before a site is fully designed. The creators of a B2B venture will want to discuss what services/functionality the venture should provide and will want to begin collecting information that will allow them to design the site, e.g., projected transaction volumes to help them build the proper technical infrastructure. Regardless of whether those discussions take place among the founders of the venture or among focus groups of potential customers, some basic precautions are in order. As with all meetings among competitors, agendas should be prepared in advance of the meeting, reviewed by counsel, and followed during the meeting. Participants should avoid discussing any competitively sensitive information that is not necessary to the formation or operation of the exchange. Furthermore, where the need for information sharing can reasonably be met through bilateral discussions with independent exchange employees or technology providers, rather than in settings involving multiple competitors, that format should be preferred.

Staffing. Many B2B ventures are initially staffed with seconded employees from the founding companies. Appropriate confidentiality commitments should be obtained from those employees before they are given access to confidential information of other participating companies. In addition, the employees and their employers should understand that a seconded employee's role in the venture may limit the scope of the duties he can assume upon his return to a founding company.

Board and Investor Access. Board members and investors (who in the B2B context may be competitors of companies transacting business through the venture) will occasionally need to receive reports of a venture's operations, e.g., for audit or accounting purposes; but care should be taken to prevent that access from circumventing firewall protections. In most contexts the data required can be aggregated in order to preserve confidentiality. Where data cannot be aggregated, parties should consider using a third party, such as an accountant, to review detailed data and report on its findings.

Data Mining. A B2B's business model may depend on mining and marketing the data generated by the exchange. As with accounting and audit requirements, care should be taken to prevent data mining from circumventing appropriate firewalls. As a basic guide in this area, ventures should consider the safe harbors set out for information exchanges in the FTC/DOJ Health Care Guidelines, which require aggregation of data and limit the use of current or projected data.

Thurman Arnold Building	399 Park Avenue	777 South Figueroa St.	1900 Avenue of the Stars	1700 Lincoln St.	Tower 42
555 Twelfth Street, NW	34th Floor	44th Floor	17th Floor	Suite 4000	25 Old Broad St.
Washington, DC 20004	New York, NY 10022	Los Angeles, CA 90017	Los Angeles, CA 90067	Denver, CO 80203	London, EC2N 1HQ
tel: 202.942.5000	tel: 212.715.1000	tel: 213.243.4000	tel: 310.552.2500	tel: 303.863.1000	tel: 0207.786.6100
fax: 202.942.5999	fax: 212.715.1399	fax: 213.243.4199	fax: 310.552.1191	fax: 303.832.0428	fax: 0207.786.6299

Efficiencies

Comments at the FTC Workshop made it clear that the agency does not want to be seen as stifling the tremendous potential efficiencies that could be realized through B2B ventures. In order to benefit from this deferential stance, parties should make sure to make the most of a venture's potential efficiencies. As early as the first meeting, participants should discuss and document what efficiencies they believe will result from operating a B2B exchange. In particular, they should identify the efficiencies resulting from joint arrangements that otherwise could not be realized if the companies had established their own exchanges. By documenting efficiencies early on and refining the analysis of efficiencies on an on-going basis, participants can establish a record supporting their reasons for meeting, forming the alliance, and determining that the alliance may be beneficial to consumers (e.g., creating cost savings for consumers). Those efficiencies can make the difference between agency condemnation and agency acceptance of a given venture's practices.

* * * * *

For those interested in the details of the FTC Workshop, we have a summary we would be delighted to share with you. Background information can also be found at the FTC website: www.ftc.gov.

We hope this information is helpful. If you have questions concerning B2B ventures or any other issue where we might help, please contact Bill Baer at 202.942.5936 or William_Baer@aporter.com, Doug Wald at 202.942.5112 or Douglas_Wald@aporter.com, or Myles Hansen at 202.942.5692 or Myles_Hansen@aporter.com.

Thurman Arnold Building
555 Twelfth Street, NW
Washington, DC 20004
tel: 202.942.5000
fax: 202.942.5999

399 Park Avenue
34th Floor
New York, NY 10022
tel: 212.715.1000
fax: 212.715.1399

777 South Figueroa St.
44th Floor
Los Angeles, CA 90017
tel: 213.243.4000
fax: 213.243.4199

1900 Avenue of the Stars
17th Floor
Los Angeles, CA 90067
tel: 310.552.2500
fax: 310.552.1191

1700 Lincoln St.
Suite 4000
Denver, CO 80203
tel: 303.863.1000
fax: 303.832.0428

Tower 42
25 Old Broad St.
London, EC2N 1HQ
tel: 0207.786.6100
fax: 0207.786.6299