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P R O C E E D I N G S

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CHAIRMAN PITOFSKY: Good morning, everyone, welcome to the FTC and to this workshop on emerging issues, on competition policy and electronic commerce. This is just the latest and most recent of a series of hearings and workshops designed by Susan DeSanti and her group.

We started out a long time ago with our 1995 hearings on global competition and high-tech competition. We have had sessions on privacy, slotting allowances, profiling and so forth, and the goal has been to detect trends in the economy before they occur and then work with knowledgeable people, the business community, the consumer sector, public interest organizations, and academics, to try to put our heads together and think about what is coming down the road and how a regulatory agency should deal or not deal with it, to anticipate problems.

That's what Congress had in mind in 1914, not just an agency that would enforce the law, but an agency that would take a look at the law and make sure the rules they are enforcing made sense.

Last year we did a substantial program on the electronic marketplace, and the emphasis was on trying

Tomorrow, we will have a panel on distribution and marketing, and then we will see that B2B, business-to-business joint ventures, begin to shade almost imperceptibly into B2C, business-to-consumer joint ventures, and we will examine problems that could arise in that context.

So, let me initiate the program by thanking all of you who are here and who are willing to lend your time and your intelligence and your experience to this project. These programs in my view have been immensely valuable. They are some of the very best things the Commission has done in the last six years, and as I've said on other occasions, the law enforcement side of the agency is not here looking for enforcement targets. We are here to learn from you, to learn from each other and to try to take the measure of what I think is, in general, an immensely promising new form of business organization.

So, with that, let me turn the program over to Susan DeSanti, director of our policy planning office and the architect of this program.

MS. DESANTI: Thank you very much, Mr. Chairman. I can hardly claim to be the architect of this program. That accolade goes to my staff, Bill Cohen, Gail Levine, Hillary Greene, Michael Wroblewski, and Angela Wilson, who worked so hard to put this all together.

I just want to take a couple of minutes to add a little bit more detail to the picture that the Chairman has given you.

the B2Bs will play in the future business environment lies somewhere between all the hype and the gloom and the doom, like much else in life.

On the one hand, it certainly seems to be the case that some of the initial business models for B2Bs may not pan out, and those who entered into B2Bs with visions of high-tech IPO valuations dancing in their heads have had their dreams dashed, but on the other hand, we do hear from antitrust counselors that they are working with plenty of B2B clients who are diligently figuring out how best to make a B2B to work and add significant business value, and this does seem consistent with what we heard from the old-timers at the workshop last June, those people who had actually been running B2Bs since August of 1998, and what they said is it takes a lot of time and work to figure out how best to structure a B2B and to produce value from a B2B.

Moreover, it's the rare analyst who predicts the complete demise of B2Bs. Rather, most predict a period of consolidation and perhaps some reevaluation of the business models that underlie B2Bs. So, just as B2Bs themselves are working on a more complete understanding of how best to structure them, how best to get value from them and how best to operate, so we thought it would be appropriate to dig deeper into areas relevant to B2B antitrust issues that were not fully explored last June.

To do this, as the Chairman noted, we're going to be using hypotheticals, and our hope is that the fact-based patterns of the hypotheticals will help us delve deeper into the nitty-gritty issues so that we can really enhance our understanding of how B2Bs operate in the real world.

What I'd like, rather than identifying them en masse at the beginning, if you would briefly identify yourselves and your firm the first time you respond to a question, that would help us.

To go through the panel, when you have an answer that you'd like to suggest, if you could just try to attract my attention. I understand your name tents are taped to the table, so you can't turn them up, so just raise a hand and I'll try to spot you.

As has been mentioned, we're working from some hypotheticals today, and the text of them is in the handout, in the blue-bound volume that you have. What I'm going to do is just very briefly go through some of the initial facts, the basic facts. I'm not going to give all the details that are in that handout, and here we go.

Case study one involves evaluation of a B2B merger. In essence, there are three B2Bs, A, B, and C, that are coming together and propose to merge, forming -- they don't have a lot of creativity here, they are forming ABC. The B2Bs are used for buying and selling a product called widgets. There are numerous producers of widgets and numerous buyers of the widgets. The widgets are purchased through four B2Bs and through two offline wholesalers.

Our little chart here shows the basic facts for the industry, 25 sellers. Sellers one through five came together to found B2B A. Sellers six through ten founded B2B B and 11 through 15 created B2B C. B2B D was not founded by any particular group of sellers. It's used by the other sellers in the market. All 25 also make some sales through X and Y, the two wholesalers.

Market shares for the widgets are depicted down below with A and B each at 10 percent of the buying volume, C also at 10 percent, D at 20 percent, and X and Y, each 25 percent.

Looking at the four B2Bs who are among the principal players here, A, B and C, who are forming the merger, have all developed catalog operations. D is a little bit different, it's a little bit specialized. It has a catalog operation like A, B and C, but it has also put together an auction system for malformed widgets, seconds, excess inventory and discontinued items.

The B2Bs differ in their rates of error, they differ a little bit in their speed of delivery, they differ in the packages of ancillary services that they offer.

Looking over at the two wholesalers, X and Y, we find that in general they're slower than the B2Bs in fulfilling orders, they have somewhat higher rates of error, and they're a bit more expensive. The hypothetical says that they have a 10 percent markup over the price that they pay and that this is a little bit -- this is more than what the B2Bs mark up. It doesn't give you an actual percentage, a point of comparison, for the B2Bs. We can discuss the implications.

Now, the parties have come forward with this merger. They basically offer two reasons for it. One, they point to supply-side scale economies. They say that coming together will allow them to spread the expense of their software and their hardware over a greater volume.

They also tell us that buyers want access to a wider range of sellers than any one B2B is offering them right now, and in effect, it's setting up some sort of network effects here.

So, this is the chart you've already seen, I'll leave it up there as we talk, and we can start to delve into the hypo.

I thought probably a good starting place would be to begin to discuss relevant market issues, and perhaps what I would like to do is throw out to the panel the question of the wholesalers, which is an obvious one in the relevant market. We have got a merger of online B2Bs. What about the wholesalers, the off-line sellers, would they likely be in the same market? What do you think?

Meg?

MS. GUERIN-CALVERT: I think the starting point for figuring out whether or not they're in the market is to focus on how one would go about finding out what the candidate market or the narrowest market would be and using the standard that is in the guidelines as looking at what's the group of sellers that if they acted collectively could raise and maintain prices without losing sufficient sales to someone else.

So, if all of the exchanges were to get together, in essence, could they raise and maintain the price of their services without causing enough people to switch to wholesalers? If the answer is yes, then the narrowest market, the appropriate market, is the exchanges.

As you had mentioned, there's a lot of information that's in the hypothetical. Some of the things I think one would want to look at to distinguish whether wholesalers are in is that according to the hypothetical, this is a world that started out with all of the business going through wholesalers. There were no direct sales at all, which suggests that the B2Bs that have entered and now acquired about 50 percent of the services must be engaged in offering some services that have a lot of cost savings. And I think the inquiry should really focus on a couple of basic themes.

One is what is the nature of the products and services that are really offered by these B2Bs? Is it just the ability to complete the transaction? Is there something in the catalog services that sufficiently differentiates those services from what's offered by the wholesalers?

What I'm thinking of is an example like computer reservation systems that collect a lot of information, manage it and process it and comes up with a different product than simply reducing transactions costs and search costs.

I think the other things I would look for to try to distinguish it is are the consumers right now, the buyers that are buying from all of these sellers, tending at current prices to switch between the exchanges and the wholesalers, or is it the case that the 50 percent of purchases that are still sitting at the wholesalers belong to buyers who for whatever reasons only can purchase through wholesalers?

So, I think we would want to look at whether or not there's switching, going back and forth, or whether in the event there was a modest increase in the price of the exchange services, whether or nt to loost3lbrice between the exchanges on the purchaser side and the providing and perhaps more just-in-time delivery service.

So, I think you need to know more about the services being provided by the wholesalers as compared with the B2B exchanges to find out whether the difference in markup reflects a difference in the value of the services provided.

MR. COHEN: I saw Janusz signaling. Before I throw it to you, let me add a little bit more complexity to this.

If we were thinking about how to apply our standard 5 to 10 percent price increase test, would there be particular problems here given that the B2B market really has not quite settled out yet and people may not have yet reached the price level at which they are going to be operating to be able to sustain profits?

MR. ORDOVER: That, of course, is a complication. Actually I wanted to start with a different complication, because all the easy things were said very well and all the hard things were said very well, as well, so I have to put in another hard thing, and that is that we have a vertically integrated situation here, which that has put a bit of an analytical spin on how you decide what the relevant market is and whether the simple and profound application of the guidelines that Meg talked about is going to give us all the answers that we need.

In fact, it would seem that one issue that one may want to ask one's self in asking what will happen in the event of hypothetical price increase, I presume a price increase for the transaction cost, will be whether or not the sellers would be willing to abandon their vertically integrated exchanges and provide the product to the competing wholesalers, who in principle are an alternative venue.

So, I would be thinking that whereas in the guidelines the market definition analysis is correctly focused o

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B (Koc Tky pochanss-uj Ton a T*j T 8 whether1rticaablT*j Tysi fallacy of trying to define markets off of prices that somehow have been driven too close to collusive levels by the actions of the participants, but here possibly the prices may be too low, because the service is new, there could be promotional selling, trying to attract customers to the B2Bs away from the wholesalers. There could be an attempt to actually discover what the market will be willing to pay for the services provided by the B2Bs.

So, again, this is a correct complication and the one that guidelines do not really have that much to say, but it's conceivable that one may want to look at what's happened perhaps in some other B2B exchanges, whether, in fact, the initial pricing strategies, such as penetration pricing and the discounting in order to get people accustomed to these new services, or whether the traditional pricing is that of looking for the highest possible price and then continually discounting off of it.

So, whether or not the price is too low or too high, I mean, it's very difficult to say. It's quite clear, just if we are allowed to come back to the reality of these B2Bs, that whatever the price they charge, the services which they deliver do not seem to be that attractive to that many customers, and that is obviously an issue that suggests that either they will have to improve the services or they will have to change their pricing model or both in order to make them sustainable and viable.

So, I think that we have a lot of issues on how to define these markets for both dynamic and vertical integration reasons.

MR. COHEN: Bill?

MR. BAER: Thanks.

You know, just to follow up really on Bill and Janusz' point, practically looking at this, you'd really want to be dynamic in your view, because what you have is an unusual situation in the B2B environment where there's already been about 50 percent penetration. That makes this a very unusual fact pattern in terms of what I've seen, and you'd want to look very closely at the documents, in particular of X and Y, to see what their responsive strategy is.

It would be instructive as well to find out -- and this would go to the question of uncommitted or committed entry by X or Y -- if they have already given up 50 percent market share and don't have an alternative electronic site of their own, what the heck is going on in this marketplace? And you really may end up concluding that -- somewhat unusually -- this is all one way pull away from the traditional wholesale chain, and they may have no way of getting it back.

One other efficiency that may explain it is I think this assumption of a dramatically reduced error rate over what the traditional wholesalers would do.

MR. COHEN: I am going to have to be the mean guy in this and move us on to additional topics as we try to get through all the issues that we want to discuss in the merger.

Let's move on to the issue of trying to identify market participants and relevant market shares here, and I guess I'd start you out with a question of -- and it's been touched on already -- whether there are likely to be uncommitted entrants here. X and Y are already wholesaling here. What would it require for them to move into the online sector?

What about the possibility that private internet-based networks might be turned to constrain price? Are these likely to be uncommitted entrants? How do we think about who should be, if not in the market right now, who's almost there?

Deb?

MS. GARZA: Well, I -- is this on? Okay.

I think that's right, that -- your question or hypothetical went only to the wholesalers, and it would seem to me that wholesalers, at least in the way the scenario was printed out, are at great risk of either having to exit the market or being completely marginalized to just a warehousing or shipping function, which was suggested, that a particular company performing an aggregation service and they're already allowing buyers and customers to manage their inventory costs, and presuming they're providing some comparable ancillary services that the online marketplace is providing.

In addition, there is, as you mentioned, the private internet trade networks, and then there are the other B2Bs that are out there presumably that are developing their own platforms through which training can occur and value-added services can be added, which I would think would also be uncommitted entrants, because it would be fairly easy I would think to expand from whatever they were doing to -- from -- you know, gidgets to widgets or whatever.

So, I would think that there actually would be, besides the wholesalers, a whole range of other -- of potential uncommitted entrants.

MR. COHEN: Yes, Mark?

MR. POPOFSKY: Well, I think one of the interesting issues is sellers 16 through 25. We see here three B2Bs which are industry sponsored in A through C, then we see D which has apparently no industry sponsor, which has a somewhat differentiated business model, and the question I proposed is what happens if A through C collectively raise price?

One interesting issue I think is whether you could have 16 through 20, 21 through 25 themselves be considered uncommitted entrants. We would have to know a lot more about what it really takes to enter this market.

Certainly the fact that they have some interaction with D suggests maybe they should somehow take an ownership interest in D and turn D into more what A through C are doing if that's necessary to proceed because the infrastructure apparently is already there, and in my experience with my clients, that's one of the key issues, is how long does it take to get one of these B2Bs off the ground.

Even if they are industry sponsored, at least I've seen, it's not that easy, and if the standard in the guidelines is coming close to triviality for an uncommitted entrant, it doesn't seem to me that necessarily fits the bill unless you can somehow take advantage of existing infrastructure like D provides.

MR. COHEN: Thank you.

Just a note for all the speakers, try to speak directly into the microphone. As I said that or suggested that, I turned away from the microphone. It's easy to do.

Yes, Roxann?

MS. HENRY: Well, one point that nobody's actually touched on right now is this issue of the exclusivity. Currently, according to the hypothetical, there is no mandatory exclusivity, but everybody is exclusive, and that's clearly a factor that you need to understand why, because maybe there are some real benefits to the suppliers that are coming through. I mean, obviously the suppliers' goals here are to sell as much of their product as possible and to increase their own profitability as much as possible.

Rarely, I think, does it turn out that the seller's motivation is primarily the B2B or to get fees from the B2B. The supplier is usually out there because they want to sell more product, and they're trying to increase their own penetration into the base. So, the reasons for these exclusivity, I think, really need to be probed considerably to get an understanding why, because if there's no mandatory exclusivity, there's something else going on here.

MR. COHEN: Okay, Jon?

MR. EKONIAK: One of the interesting dynamics here is the fact that with X and Y, they're actually wholesalers. They buy from the sellers and -- or buy from the manufacturers and resell to the sellers. They actually own the relationship in between.

Now, with the B2Bs, they're actually facilitating direct trade. They're not taking ownership, they're not playing a role there, they're enabling a buyer to talk directly to the seller. So, they're actually taking less of a role and less of an ownership stake in the transaction, which is actually providing better information from buyer directly to seller.

In the old world, with X and Y, there was actually -- it benefitted both X and Y to maintain that information themselves and not let anyone else get at it. That way, they could take the extra fee and the extra profit because of imperfect information.

I think with the B2Bs, they're providing more perfect information out there. So, what we'll see is it's obviously moving, and with the market share going up so fast, it's obviously moving to more perfect information.

So, the challenge is can other players actually come in and capture some market share from the existing

B2Bs? And I think we have to look at it from where the widgets play in the overall scheme of a product. There's obviously an opportunity for other players to come in that might have set standards, might have set trading rules that could actually circumvent where the widgets are playing.

So, for example, if the widget is a small piece of an overall product, somebody with more market power can actually come in from outside the widget industry and impose their own rules, and the widget makers would have to conform to these.

A great example would be in the marketplace for automotive products. If somebody is making an engine, well, they might actually have very little control versus the OEMs who are actually manufacturing the entire cars themselves. So, if the widget is just a small participant in there, other players can easily come in if they have more market power.

MR. COHEN: Before turning to theories of anticompetitive effects here, let's just take one more question about some of these market shares that you see up there. We wrote these nice little boxes, 10 percent, 10 percent, 10 percent, et cetera. I'm wondering, should we regard this as having any great meaning right now given the early stage of the industry and the transitions that are going on, or should we more or less be counting heads or using something like a bid model in this type of setting?

Any reactions?

Meg?

MS. GUERIN-CALVERT: I think in general it's worth it to look beyond the market shares, because if we're looking at it as if it were a wholesaler plus B2B market, it would be pretty important to ascertain whether or not that 50 percent that X and Y have is relatively stable or still in the process of flux. At most it looks at what the volume has been that has been won rather than the capacity.

Once again, one of the things that, again, many of the comments have touched on that would be worthwhile to try to identify is the extent to which sellers, particularly 16 through 25 that are sitting on D, have sufficient widget capacity that they could expand to have essentially all of the buyers' needs met over D.

I think kind of implicit in all of the comments so far has maybe been both a capacity constraint on the part of the sellers and also some sort of possible dedications, as Roxann's point, between the B2B and the seller and the buyer. To the extent both of those things don't exist, then it would be much more appropriate to look at counting heads rather than shares.

MR. COHEN: Yes, Joe?

MR. WINTERSCHEID: And I think a lot of it bears on Roxann's point, as well, on ease of switching; that is, explaining why there does seem to be de facto exclusivity and how easy it is to switch. I think that would be very telling as to the significance of the market shares if they have any significance at all.

MR. COHEN: Okay, Alex?

MR. GIBBONS: Yeah, I'd like to just build on what Joe said before, because I think it's extremely important to look at the fungible nature of the widget or the -- I'd really look at it as three very specific scenarios that can be looked at with this particular hypothetical, and then based on these three possibilities: Is a widget something that's completely fungible, therefore a commodity of basically the same quality, a commodity in this marketplace, or is it differentiated by the product itself, or thirdly, is it differentiated by services attached to that product, outside that product?

If we look at the first, and I think the best assumption for this hypothetical is starting off with the commoditized widget, then to me the market shares don't matter as much, but also the pricing is something

Janusz?

MR. ORDOVER: Well, I think that obviously there are serious scale and scope economies and the merger may marginalize D, although D seems to have a somewhat specific business plan that does not necessarily relate so much to the way you described A, B and C in your hypothetical.

I am not quite sure why or whether or not a -- this tipping to A, B and C as being the most leading B2B necessarily creates competitive concerns, as long as one buys into the rest of the story that has been going on, which is that there are all these other forces operating on the B2B marketplace that enable, in this particular case, the buyers to I presume get around the B2B bottleneck and procure widgets from the sellers.

Now, on the other hand, if the sellers are not willing to participate in these alternative venues, then the constraint will be lessened, but I think that would go back to our old market definition. It seems to me that if at least the first unilateral effect that one would want to be concerned about is whether or not the sellers, who seem to be many -- 25 sellers is a market that one rarely encounters nowadays -- whether or not they might be willing to use the B2B in a way that I guess Krattenmaker & Salop called the "cartelmeister."

There is a way possibly to lessen horizontal competition amongst the suppliers of these widgets to the buyers which cannot be accomplished if they deal either directly with each other or through these wholesalers perhaps, but there might be a way to do so if the sellers have an interest in these B2Bs and, in fact, are willing to take their profits through transaction prices at the level of the B2B.

I would view that as a possible source of concern, setting aside whatever the collusive, facilitating availability of information exchange and so on may arise on the B2B, but I would focus at least as a step one to get around the question of whether or not the transaction price, actually the fees that would be charged for selling and buying, whether those would be possibly elevated, even though in some sense it hurts the sellers, because they would be paying some portion of it and the buyers may be paying another portion, but whether or not that would enable them to lessen horizontal competition at the widget manufacturing and selling level.

MR. COHEN: Bill?

MR. KOLASKY: Yeah, I want to follow up on a couple of points. One, on the last point that Janusz made, that is really one of the key facts here, that A, B and C were all founded by widget manufacturers themselves, and I would think that in thinking about unilateral effects, you start with the premise from GTE-Sylvania that in terms of the cost of distribution, the manufacturers' interests are generally aligned with those of the consumer, and you would have to ask why would it be in the interests of the widget manufacturers who founded A, B and C to merge the three together.

I would at least start out with a very strong presumption that their interest is in trying to make distribution more efficient, not in terms of capturing market power and raising the cost of distribution. There is, of course, the possibility that it's designed to facilitate collusion at the manufacturing level, but that seems on the facts of this hypothetical somewhat implausible given that 40 percent of the widget capacity, at least, is in the hands -- is not involved in A, B and C. That's the first point that I would want to make about this.

Second, in thinking about unilateral effects, I think it's very difficult and artificial to talk about anticompetitive effects without at the same time talking about efficiencies. The hypothetical breaks those two questions apart, and I think you really have to bring them together somewhat.

I think one of the most interesting facts in this hypothetical is that before the advent of the B2B exchanges, there were only two wholesalers who accounted for 100 percent of the distribution market. That suggests that there are, in fact, very strong economies of scale here that perhaps show that the aggregation function is a very important one and that buyers very much value having access to a large number of sellers through a small number of wholesalers.

That, again, to me reinforces the argument that the likely explanation for this merger is an efficiency explanation rather than a market power explanation.

MR. COHEN: Deb?

MS. GARZA: Yes, I agree with Bill, and it kind of of feeds off of what Roxann has said, as well. It seems to me that the way the scenario was laid out, there have to be really strong efficiencies associated with enlarging the network, and presumably the sellers are participating in, as are the buyers, because of those efficiencies and because of the distribution efficiencies which the hypothetical indicate are fairly strong given that the cost is lower than the distributors' costs, X and Y.

But in addition, as Roxann said, I would think that the sellers' primary motivator would be to drive sales to themselves, to increase their volume of widget sales. It's hard to believe, unless there is something unusual about the way they are structuring their distribution fees, their transaction fees, that they are really going to be motivated by being able to impose a high transaction fee cost on the buyers and try to make it up there.

It would seem to me that what you're really going to find with 25 sellers is a lot of competition that is going to basically compete away, within the price of the widgets, any kind of excessively high transaction fee you have anyway. So, I would be cynical at the outset that the purpose of the merger would be to allow the parties to exercise unilateral market power with a transaction fee.

MR. COHEN: Yes?

MS. HENRY: Let me also point out that part of your notion on the network effects is that there's going to be -- because of the increased volume, there is obviously a lot of scale efficiencies to be gotten, but when we're talking distribution, you don't necessarily have to talk about widgets. What's to prevent D from simply expanding the products that he serves through his network? He can expand his B2B to provide other products to the same buyers and possibly get some of those scale efficiencies as well. There's a lot of ways to get scale efficiencies that are not just scale efficiencies from distributing more widgets.

MR. COHEN: Yes, Joe?

MR. WINTERSCHEID: Just on the -- first, I guess just on the assumption that there's a potential for tip here, I mean we don't really know that. It's not even suggested in the facts. And what we know is from the facts or what seems to be assumed is that a 10 percent isn't enough, but we don't know what would be needed to even give rise to a possible concern.

Second, even assuming that there's a potential for network effect or tip, that really doesn't in and of itself raise an issue either unless there is some lock-in effect. Again, network effect in and of itself shouldn't be a concern. In this environment it's usually a benefit, unless something else is going on that gives rise to that concern.

MR. COHEN: We have got a variant coming which is going to add a lock-in issue.

Meg?

MS. GUERIN-CALVERT: One thing that suggests that there isn't a lock-in at the buyer level is that the facts seem to indicate that right now anyway all the buyers can freely float among the four networks, as well, it seems possibly, with the wholesalers as well, and so it doesn't seem that we have a starting point factual situation where the buyers in general to make some widget purchases have to be just on one network.

I mean, that obviously is where it goes next, and there is some suggestion that the sellers, as Roxann pointed out, may be dedicated, but I think you'd really want to look for it at both levels to have a real concern about tipping for the reasons that Joe said.

MR. O'BRIEN: I wanted to pursue just a little bit further this point about how the B2B feeds back onto incentives of the suppliers, which was the point that Janusz raised. And Bill, you indicated there were probably strong economies of scale in the wholesaling function or the intermediate level between the suppliers and the purchasers. And if it were the case that this new technology that's being used in B2Bs created some kind of seismic shift, which some folks alluded to earlier might mean X and Y would be out of the picture, the alternative wholesalers, I would suggest that it becomes probably even more important the more concentrated that wholesale level is to pay attention to the kinds of incentives that Janusz raised.

In particular I'm interested in whether or not we're concerned about, you know, the nature, the structure of the B2Bs in terms of the decisions they make, how the decisions are made and how profits are divided and how that feeds back into the suppliers' incentive. So, I just wanted to ask a few questions related to these issues.

First, with respect to the scope of the B2Bs' decision making, I assume all at the table here are assuming that pricing decisions continue to be made independently by the sellers in this scenario.

Okay, so then if that assumption is fair, let's go and ask, well, what decisions does the B2B make and should we be concerned if, for example, through this merger certain decisions that were previously made by sellers or certain investment decisions or what have you are now going to be made by the B2B?

efficiencies, and I would agree with many of the points, that one should not jump to conclusions there will be any unilateral effect, that's merely trying to understand what might be the unilateral effect, i.e., of the sort that if we do define electronic marketplace or B2B to be the relevant market, that in every market there are fees or prices, and the concern is that in such a market increased concentration may raise the fee or the price.

In this case, those are going to be prices for executing transactions, for many other services that these B2Bs can provide. So, for example, one may be concerned along the lines of Dan O'Brien who started asking whether or not historically a request for proposals or request for quotes were crafted unilaterally by a buyer or offered by a seller. So, there was competition not only in price perhaps but also in the whole slew of terms, which may have mattered to the buyer or which may enable the seller to wade through 500 different comparable bids, they are stated in ways that are hard to differentiate, but at the same time there's something that may be lost in terms of the value of product differentiation.

We assume that the widgets may be more or less similar, but there is -- I don't think that's necessarily a component of the hypothetical. There may be much more to it, that the kind of homogenization may, in fact, stymie or stifle or lessen some sort of competition that previously existed on other dimensions than price.

So, indeed, I would want to look into how these transactions are to be designed, how to be executed. I little bit from economics perhaps a little bit to the legal issues. I think raised in Janusz' comments is a deeper issue once you get beyond the merger as to how the antitrust laws are going to regulate the decisions of the B2B. Are we going to in essence have, considering a lock-in conspiracy of all those who hold equity in it, which I guess perhaps is 15 sellers, the notion that somehow the antitrust laws are going to regulate on the balancing test every decision a B2B makes, or are we going to treat ne ccg 10 makes, or are 1

And so it seems to me when you're considering how the B2B will be treated after the merger, it seems to me that might auger for a single entity treatment. And then when you consider that, you might consider that that might change how you would view the merger. Knowing that we're going to regulate the B2B only under Section 2 of the Sherman Act following the merger, that might or might not require a more careful scrutiny of the possible sources of harm, possible benefits at the time the merger occurs, because this is when the antitrust laws would apply principally to a lot of those decisions.

MR. KOLASKY: Following up on that, two points: One, I think I certainly was assuming, and I suspect most of us were assuming, that the B2B itself had put in place the kinds of safeguards that antitrust counselors generally recommend in terms of assuring that the B2B does not facilitate collusion as to the pricing of widgets among the manufacturers. If that were not the case, I think the analysis would be different.

The second point I wanted to make is following up on Mark's. One of the things that you have to arrangements that have been put in place by the participants designed to solve the inherent principal/agent problem that always exists? I thought that whoever wrote this hypothetical had thought about that very hard and had been very clever in designing a set of governance principles for these joint ventures that were designed to solve that principal/agent problem.

The fact that all of the -- that there is no exclusivity, so that the members of each of these exchanges is free to sell through a competing exchange or to sell through the wholesalers, means that it's very easy for the widget manufacturers to discipline any kind of a price increase by any of the exchanges. And I think that a transparency as to the fees that are being charged by the B2B exchanges would further facilitate the solution of the principal/agent problem, and so that's something that we should not be opposed to but should actually welcome.

MR. COHEN: Bill, let me jump ahead slightly to take you up on one of your assumptions. You assumed that they had -- that the B2Bs had in place the proper firewalls and proper arrangements to avoid facilitating together 15 sellers, would it be appropriate or would it be important for us to inquire into what mechanisms they do have there?

MR. KOLASKY: Oh, absolutely.

MR. COHEN: Yes.

MR. O'BRIEN: Just one more along this line. You know, if we were to assume that this merger took place and that network effects were strong and that entry was difficult, so that some of the factors you identified, Bill, as strong constraints may not be there, then what we're left with is two B2B exchanges if we were to assume that the wholesalers are less effective constraints.

Would it ever be appropriate for us as a condition of the merger to place any kinds of constraints on, for example, the way in which the B2B shares its revenues with the seller/owners and the mechanism by which the B2B prices its services and so on?

MR. BAER: You know, I suppose in theory it could, Dan. I would be more interested in assuming that we had difficulty of entry, that entry was not timely, likely and sufficient; about conditions under which other people could get in, that is, that in terms of relief, one easy thing to do would be to guarantee that it wouldn't be -- that it would be open to all nondiscriminatory and nonexclusives, so that if those conditions weren't in place with specific terms of how these guys operated before, given the point Roxann made earlier about how people seem to have focused on one or another, that you probably want to make sure that this thing wouldn't be a device that would basically leave a whole bunch of sellers out in the cold.

MR. WINTERSCHEID: And as to how the profits are distributed, it seems to me in one sense that whatever concerns might be raised there, they are somewhat dissipated to the extent that the group is becoming larger, in that their equity interest is diluted as the group becomes larger and there becomes less of an anticompetitive incentive or mechanism built into the equity structure.

MS. GUERIN-CALVERT: I would also say you want to look real carefully at D. In most cases, most industries, you are only going to have A, B, C, you are not going to have a D, and D is almost as big currently, it's a third party, so it's neither driven by sellers nor buyers, and it's been -- it seems like, anyway -- more successful in attracting volumes than have A and B put together or B and C put together.

So, one of the things before imposing such conditions, I'd want to look really, really carefully at what is the likelihood that D would be able to respond, you know, if, for example, ABC constrain their catalog in a particular place, get into excessive standardization, raise fees, engage in a bunch of hypothetical anticompetitive behavior, what's the likelihood that D is going to have the incentive to respond?

And again, one of the things is what's the likelihood that its sellers, 16 to 25 who do not have an ownership stake in the other, have got the ability to induce buyers to switch en masse to them?

MR. COHEN: Before leaving anticompetitive effects, let's take you up on raising D there. What about possibilities of collusion, of coordinated interaction, between ABC and D or between the onlines and the wholesalers? Are things going to be too heterogenous? Is it going to work?

MR. ORDOVER: Well, that's one thing to talk about, but let me say -- on the basis of the hypothetical, let me say that the likelihood of coordinated interaction here amongst these four remaining firms is very complicated and very difficult, in part because there may be a lot of stuff that will not be visible to the outside world, so the ability to actually deviate from whatever course of coordination they may attempt to set, quite difficult, especially if we believe that the wholesalers, for example, provide a whole different set of services on top of the services that the B2B provides, which may be no more than an electronic board on which quotes are posted, that in such a case what it is that one should coordinate with with the wholesalers who are providing shipping services, perhaps, and so on and so forth.

So, I am really skeptical sort of as a general principle that even among B2Bs there is a large possibility of being able to engage in coordinated interactions, given the monitoring problems, given the inability to actually detect cheating that easily, and I think that to the extent there are any kind of problems are those which are more likely to fall in the unilateral rubric than in the coordinated rubric.

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may make a difference, especially in the nascent stage of the B2B where investments and commitments are very important in order to create the kind of credibility that the marketplace needs in order to become viable.

So, I would want to caution against applying sort of very strict governance tests towards these newer and emerging organizations, in part because we just really don't know yet how efficient arrangements are going to be, what are the set of efficient arrangements that get around the principal/agent problem and that, in fact, enable these organizations to gain efficient scale and deliver the efficient scope of services.

MR. COHEN: I think I saw Mark Warner's hand up.

MR. WARNER: Yes, I wanted to come back to your some coordinated interaction between the merged firm, ABC, and D, where ABC says, look, you can have our excess inventory, our discontinued lines, our discontinued widgets, you specialize in that part of the market, and we will specialize on the new stuff, the ones that people really want. And I think that could have some effect to real world consumers.

I think we need to know a little more about this business of the only malfunctioning widgets are from sellers 16 to 20, yet those are the ones that give it the largest market share. So, I think that's something else that we would want to look at.

MR. COHEN: Okay, one more, then we will have to move on. Jon?

MR. EKONIAK: I think what we have to look at here is two separate businesses. One is the business of selling widgets, and the other is the business of information, and that's where the B2Bs come in.

Now, those selling the information, the B2Bs, apply the same fee to everyone that's selling through their system, whether it's a subscription fee, a transaction fee or a percentage transaction fee. Underlying that, the widget companies, those sellers, are still going to be as competitive as they ever were before. They don't have the ability to actually compete and sell information. They are still competing underlying whether they are providing better quality, better products, better delivery, better return policies, whatever it may be.

I still think that underlying there's a completely competitive atmosphere with the widget manufacturers, and B2Bs are providing the information to who offers the best product that matches what the buyer wants.

MR. KOLASKY: Bill, I know you want to move on, but I think there's one important point that hasn't been brought out that needs to be on coordinated interaction.

In addition to all the problems that Janusz identified, you also have very different incentives. A, B and C are owned by the widget manufacturers. D is not. That means that the owners of D and the owners of A, B and C have very different incentives. That is going to make coordination very difficult.

To the extent, for example, that D cooperates in a price increase for transaction prices and that ends up in the pockets of A, B and C, that in effect is going to reduce the distribution costs of A, B and C while raising the distribution costs of D's members, and that's not something that's going to be in the interests of D long term. So, I think coordination is not a real danger here.

MR. COHEN: Let's turn briefly to entry, and what I'll throw out is one point. The hypo posits that capital in this area has been drying up for forming new B2Bs, and if you were to combine that fact with what we've been reading in the newspapers about all the need to consolidate a little bit, need to retrench in the area, should we be expecting entry here to solve any problem that might emerge? Is entry a likelihood right now? Nobody would argue that their client is protected by entry?

Oh, Meg?

MS. GUERIN-CALVERT: I would say the thing that would give pause, and this is just building on the comments that Bill made earlier, that the likely candidates seem to be X and Y. They have got the knowledge and the know-how. One of the things that I think would have to be looked at is if it's the case and so on whether that's a sufficient volume to be able to make a go of it. And I think that would be pretty critical in terms of looking at the likelihood that down the road you'd see an entrant. And you'd have to go back in and see what kind, if any, of first mover advantages, network effects, had there been for A, B, C and D that X or Y would have to kind of deal with.

MR. ORDOVER: How would the Commission view the joint venture by a large number of buyers who would say we are sick and tired of these guys, A, B and C, charging us 10 cents markup per widget, and we want to set up our own buyer-centric exchange and exercise some mild buying power in order to break the lock on the supplier-centric exchange?

Meg pointed out correctly that while entry may not be a problem given the capacity of capital -- access to capital and may not be a problem given the access to IT technologies or something like that for people who are in the widget business, but if they can't get widgets to sell, the whole enterprise has no business viability. So, I think that the situation that we have here offers a challenge as to what would be the appropriate countervailing arrangement that might get around whatever barriers there might be from availability of supply.

Now, it could be that those who are no longer, who are not selling through A, B and C but D and X and Y, that they may provide enough scale and scope. At the same time, we are saying that there's efficiencies from consolidating A, B and C, the usual tension. So, I think that there might be ways of getting around the problem, but they may create their own potential antitrust concerns through formation, for example, of buyer-centric exchange.

MR. COHEN: I think we'll turn to efficiencies, which are a big topic we need to touch upon. Just to start out, it's come up several times throughout the discussion already, is there anyone who would want to try to state the case for this merger from the standpoint of efficiency? What are the key efficiencies you see out here?

Yes, someone wants to summarize it? Yes?

MR. GIBBONS: Obviously the incentives at the beginning for all of these sellers to go into the separate exchanges were not having to do with price fixing or -- they're more how do I extend my own electronic portal out to my own buyers, and with this, the expenses that the individual companies were seeing were enormous for what they could handle on their own. So, therefore, almost in all cases we see these exchanges bubbling up because of consortia effect or an independent seeing an opportunity to jump into the space, to lay out the cash, to lay out the capital to do this.

What we have seen in the past year, and I know this through personal experience, is that it's not an easy thing to just go out there and grab the software off the shelf and grab the infrastructure and make this happen. So, as was said at the podium earlier, the hype at the beginning and then the realities a year later have shown that that capital infrastructure cost was something that needs to be shared, and that's what I think we're seeing right now.

MR. COHEN: You know, if scale economies and network effects are really important here, how would you respond to the counter-argument that, well, won't they eventually be realized by natural growth and sort

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So, you really would need to look at whether or not, in fact, competition is producing the economic conditions that make this merger justifiable and that there are real efficiencies or savings to be gained from it, particularly you need to be of a certain scale in order to have a real shot at it.

What's tough, and this is a tough policy

MR. GIBBONS: Also, there is another dynamic here that I think is important. And that is since these changes, there has been a transformation in thinking that the exchange will do all of the work and all the sellers have to do is plug into it. And what's going on now is a recognition that the bulk of the work is a transformation, not in that type of thinking, or in that type of thinking towards what the individual supplier or seller has to do to be able to be part of an exchange.

When this work gets done, to actually make it so that they're enabled to be on a network, to be able be into an exchange, there's also the recognition that it opens up tremendous competitive paths that are not just A, B, C, D, X, Y, but all the private exchanges from all the different sellers, because the work that's done to be able to hook up to an exchange is exactly the same work that needs to be done to make it so you

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important when you're asking the question about whether efficiencies are merger-specific to recognize that that question is most relevant when you're treating efficiencies as a defense to an otherwise anticompetitive merger. When you integrate efficiencies into the competitive effects analysis, then the question you really ought to be asking is whether the merger is the most efficient way to capture the efficiencies.

That's a very different question, and I think, you know, here, yes, if there were clear anticompetitive effects, you would be worried about whether the efficiencies are merger-specific or not, but if the case for anticompetitive effects is a relatively weak one, you also ought to be asking is the merger the most efficient way to capture the efficiencies.

MR. COHEN: Okay, for purposes of the next question, let's assume that there are some anticompetitive effects and that we are concerned about whether it's merger-specific, whether the efficiencies are merger-specific.

Let me ask, would interoperability be another way of capturing some of these efficiencies? And I don't here want to get into the benefits and flaws of interoperability, we'll touch on some of that in the next -- in the first variation, but rather, what are the barriers to achieving interoperability, what are the costs? Is it likely to be accomplished as an alternative?

MR. WINTERSCHEID: It's certainly possible that it might be an alternative, but I think the facts as presented suggest at least provisionally that it might not be, and whatever what's driving the merger of one of the parties is the volume that would flow through a different exchange. Mere interoperability will not achieve that, certainly not achieve that objective.

MR. COHEN: Right. What about the bringing together of a larger field of buyers and sellers?

MS. GUERIN-CALVERT: Again, it depends on just the way it was set up, is that there's a possibility for more connections, but if where the true efficiencies, the cost savings are just moving a larger number of transactions over a single computer, it sounds like the way interoperability is suggested is that you would have three mainframes or two mainframes running and then an interface between the two of them, a bridge of some sort to facilitate possibly some incremental transactions, but again, you would really want to look into the technologies to see if the efficiency in having a single, enhanced, very, very large catalog that has a lot of additional features, a single online auction with a lot of depth and richness to it, or is it simply providing more possibilities for a connection between buyers and sellers?

MR. COHEN: Let me turn us to the last big subject area here, and that's the financial issue, and the hypo adds another fact at this point, and that's the fact that none of the B2Bs has yet shown a profit, and I guess what I want to ask is, do we have a failing firm argument here, or if not, how should we take account of the flailing firm possibilities?

In particular, how do we judge this given that this is still a startup period for the indus1otEW1Te11Tj T* is

ying mnot,2Bs has Iw sta ? H In padge this given that independent that quickly or, you know, maybe in years to come, sure, that could happen, but at this point, it's not a question of trying to make the exchange profitable. It's trying to make their own membership have a channel that is better than they could do on their own.

Therefore, I think that's an extremely important point for people to be realizing, and it's a reason why the independent exchanges are falling faster than the consortia-based exchanges, flailing more than the consortia, and it's yet to be seen exactly how the consortia-based ones may become independent and profitable, but that's years to come, I believe.

MR. ORDOVER: That's not predation. I was just wondering whether that would create problems given that consortia is able to finance these losses, whereas the independents can't, whether that in itself creates a competitive concern. I don't think it does, but I think it is an issue as to the viability of the whole sector as being financing itself by virtue of the fees or whether there is a need to have that financed through some ex ante contributions into the setup, which I think that creates benefits of a number of people getting together and sharing the risk.

Given the failure rate of these operations, it makes perfect sense to spread the risk, which is very difficult, at least at the early stages, to diversify through the marketplace for the reasons that the marketplace does not often like that kind of risk get to the next level, to make it viable, it might affect the incentive of sellers 11 through 15, for example, to participate elsewhere as opposed to continuing to pump money into the losing proposition.

But at the same time, you know, I'm just not sure how the failing firm doctrine literally applies here, because where do you really have the exit of the productive assets. And yet in a sense the exchange is going to go away, but sellers 11 through 15 are going start looking back to X and Y. It makes it very, very hard to argue that the B2Bs are somehow their own little marketplace.

MR. COHEN: We're up to the time where we are scheduled to take a break. What I'd like to do is to give you -- if anybody has any summary comment they want to make, something they really wanted to get out as to how you'd advise a client on whether it is likely to be an anticompetitive problem here or whether the enforcement agencies, if you were advising them, whether you think we should be concerned about this, is there anything I haven't been able to get to anybody on?

Let's start with Mark.

MR. POPOFSKY: It's a different perspective than we've been focusing on, because there is more than the United States to worry about. Many of the exchanges we all work with are operating worldwide, and they have to worry about competition rules not only in America but also in Europe. They have to worry about filings in jurisdictions such as Brazil and Taiwan. And when you're setting rules for how your B2B is going to operate and contemplating transactions, it's not necessarily the economic analysis we are applying here or the analysis applied by the Commission that's going to govern --

MR. WINTERSCHEID: Or at all.

the way to do that, I think, is to take a look at the often looked at New York Stock Exchange analogy and to look it from the point of view of, yeah, that's not making a lot of profit. It's basically a nonprofit organization, SIAC, that's running that, and it's specialists working on the side of that exchange that make the money.

When you look at A, B, C and D in that fashion, that the eventual end point for exchanges may be just simply an electronic exchange where specialist type of activities may or may not be added into the exchange itself, maybe with the companies, the sellers or with the X and Y distributors' logistics, but not necessarily finding that it has to be in the A, B, C, D space, you have a different view of what the exchange actually is at that point, and I think it's important to keep that in mind.

MR. COHEN: Okay, let's go to break, and we will come back at 11:00.

(A brief recess was taken.)

MR. COHEN: What we're going to talk about now will be a couple variations on the fact pattern that we had started with. Variation 1 introduces interoperability into the fact pattern, and it tells us that instead of merging, A, B and C have decided to implement an interoperability plan. Under the plan, the buyers become able -- a buyer who turns to any of them, A, B or C, is able to access sellers 1 through 15. The transaction fees are split when a buyer uses one B2B to buy from a seller that's been listed on another.

The buyer-accessed B2B receives 75 percent of the fees, and the seller-accessed B2B receives 25 percent. And we've simplified things by speaking just in terms of transaction fees. We are talking about the compensation, and for shorthand we'll call it transaction fees, that are being split in this fashion.

Finally, A, B and C enter into some agreements to facilitate the interoperability. They agree that they're going to use the same shipping service, and they agree to provide a common minimum set of value-added services.

What I'd like to do is reverse the usual order of discussion because of the very obvious potentials for pro-competitive benefits here. I'd like somebody, if they wish, to comment briefly on what they see as the likely pro-competitive aspects of this to begin with, maybe identify and describe what you would put forward as the leading points if an agency were to start reviewing an interoperability plan like this, and to tell us how we might go about gauging the likely significance of any of the benefits.

Anybody want to start off? Meg?

MS. GUERIN-CALVERT: One of the things, this is in principle how you set it up, very similar to shared ATM networks, where in essence you have an interface between one shared ATM network and another. Some of the pro-competitive benefits would be that with one simple log-on to network A, you are able to get not only the full functionality of A, but again, if there's a common set of standards, you can at very low cost, presumably with -- it might even be not obvious to you, the purchaser, at all as to what has gone on, not only to get you into A but easily into B and into C.

So, from the buyer's perspective, there is the ability, perhaps at very low cost, to look first on A among purchasers one through five, if the service is not available there similar to -- if you're on travel and you don't see your own bank's ATM there, you could get the advantage of buying from the next five or then the following five. So, that would be one of the features.

It could also be that in terms of having the same shipping service, there might be -- by combining the volumes of all of the sellers, 1 through 15, and all the purchases that would be made by the buyers, perhaps a lower shipping fee that could be attained than any one network could attain on its own. That, if it gets passed on, you know, is again a potential cost savings. And, you know, particularly as compared to a buyer having to have three separate interfaces, again, depending on how much time is involved, there may be some significant cost savings on the side of the buyer where they can more quickly go do other things.

One of the things to making it happen would be this minimum set of value-added services. It's, again, the idea that the services that the buyers most readily demand would be available on any one of the networks but accessing the other two.

MR. COHEN: Okay, I wanted to start with the pro-competitive benefits just to stress here that we do see a lot of good in these arrangements. But now as an antitrust enforcement agency, I am going to turn us to some of the potential harms, and we may spend a little bit more time on those.

Let's talk to begin with about some of the effects on the ability and incentive to compete of these participants, and particularly the effects of the revenue sharing on incentives to compete. What I'm getting at here is that B2B A, for example, knows that if it loses a buyer to B2B B or C, it may still earn 25 percent of the fee, and that even if it retains the buyer, it may well lose 25 percent of the fee. Could interoperability in this type of arrangement reduce any one firm's incentives to lower its prices to win more business?

Janusz?

MR. ORDOVER: Well, I mean, it depends on whether you are thinking at the level of introductory microeconomics, where the answer would be yes, or whether you are trying to think hard and make sense out of this whole arrangement as a package.

MR. COHEN: Help us to think hard, please.

MR. ORDOVER: Okay. Well, you know, the first sort of answer that I gave was a theory of economics, that optimization says that if you have this equity share, or here it's just a revenue share, that will lessen the incentive, but I think at the same time the real point has to be that through that kind of an arrangement, there is, in fact, an incentive to engage in interoperability.

What would be -- you may have a bill and keep type of arrangement, which perhaps might help, but I doubt that it would get you as far as a situation in which the firms are at least partly integrated and have some incentive in aligning their incentives to invest in the software that will, in fact, implement interoperability.

Would A then have to continue interoperability with B and C? It seems to me that would become a very, very important question and perhaps a very difficult one. So, I think when we're looking at the possible anticompetitive consequences and the possible efficiencies of interoperability, we also have to ask in relation to what, instead of what? Is this something the parties are doing because they are doing it affirmatively and that's been the plan?

That suggests to me perhaps there are great efficiencies from doing so. Or is it that they're doing it because they think it's somehow a regulatory second best, if you will, in which case I might be a little more skeptical that the virtues of interoperability are those that are articulated by Janusz.

MR. COHEN: Alex?

MR. GIBBONS: I would like to comment following that. Well, first of all, I agree with what Jon said earlier, that we have to differentiate between physical and -- physical movement of a product and the information, and then after we've done that, we have to look at what the actual B2B exchange's product is, and the product is information about all of the widgets, all the widgets from the 25 different companies if they can get it. So, it's not in their best interests in any case to make it so that they're giving less than the maximum amount of information.

Interoperability -- merger will accomplish it, and interoperability also accomplishes it, but to back off by saying we are not going to do a piece of the catalogs, the information about widgets, would not be in their best interests.

Now, having said that, I think the real problem from an antitrust point of view is, is there an exclusive nature of holding onto that information? And my opinion is no, there's definitely not. The ubiquitous nature of information flow these days makes it so that even if A, B, C, D come together in an interoperability plan, it still allows each of the sellers to be able to give the same information or better information about any product that they're selling at the same exact time, that can be compared or contrasted.

MR. COHEN: Bill?

MR. KOLASKY: Yeah, just a couple of points. I think let me use this one. For some reason I'm more comfortable looking to my right than to my left.

Following up on Mark's point, I think that one of the things that we really need to focus on is that interoperability is not a panacea. It is not necessarily a more desirable alternative to merger, because there are two inherent problems with interoperability agreements.

Number one is in terms of innovation, coordination is much more difficult than it is in a single firm. Secondly, to the extent that because of an interoperability agreement you have to share your innovations with others, there is less incentive to innovate than there would be in a single firm. So, I think we need to start out with the premise that interoperability ought not to be viewed in every situation as a less restrictive alternative that is superior to merger.

Having said that, I think Janusz is exactly right in terms of the incentives. Obviously any kind of revenue-sharing arrangement does alter the incentives somewhat. The one that's posited here seems to do so in a manner that maintains the incentive to innovate, because if you generate the business yourself, you keep 75 percent of the revenues rather than only 25 percent.

And second, if you generate it for one of your own sellers, you do even better, you keep 100 percent of the revenues. Part of the antitrust analysis it therefore follows is focusing on what are the revenue-sharing arrangements. This would look very different, I would suggest, if it were a 50/50 revenue-sharing arrangement, because then I think the incentives would be materially altered in a way that would reduce the incentive to compete.

MR. COHEN: Joe?

MR. WINTERSCHEID: Yeah, just to agree with that, again, looking at the incentives, I agree with Bill, that here it seems to be structured in a way that does promote continued competition between A and C.

The other dynamic that you'd also want to keep in mind is the effect of the other external competitors on the incentive of each of A and B and C to continue to innovate and compete. That is, if any of them is threatened with the loss of business or all three of them to the other competing exchange or to X and Y, that likewise is going to have a continued disciplining effect.

MS. GUERIN-CALVERT: If I could just add to that, I think the other point that would come in is you would want to look particularly carefully at the common minimum set of value-added services, because I think all of this is assuming that A could, if it chose to, add on many new enhanced services above and beyond the common set -- this goes to Mark's point -- assuming that it wouldn't affect the ability to continue to interoperate, would be a way -- and that's a verb -- would be a way in which A could get the 75 percent transaction fee or the hundred percent. And that, again, in a lot of network industries is how volumes have been switched from network to network, is competition above some minimum level.

MR. COHEN: I think I saw Bill Baer over here.

MR. BAER: No, I'm fine. Meg made my point.

MR. COHEN: Okay.

MR. ORDOVER: I just want to get a quick point in, and that is that interoperability is a perhaps static point. And Mark made what I think is the most important point along the way here, and that is that this is a dynamic industry and a very quickly changing set of IT technologies, and the innovation power of each of those exchanges will have to be driven by new sets of services that it's going to offer. And the question whether or not this is a stable situation in which every firm would be willing to share all of its technology and maintain anything but the minimum level of interoperability after a while I think is a critical one.

In my view, again, I don't see the

interoperability as a way to solve or to deliver most of the benefits that potentially would be delivered from a merger, and I don't think that we should come away from this conversation suggesting that these are substitutable arrangements. They may be an inevitable arrangement, but they are not necessarily substitutable arrangements.

MR. COHEN: Yes?

MS. HENRY: Let me just also note that when we're talking about interoperability here, we've almost assumed that the costs for interoperability are the same for each of A, B and C, and in the real world, that's not necessarily true. The costs may, in fact, differ to do the interoperability for each one of them, and there may be differences in the platforms such that there are more costs for one than for others.

have you had to agree extensively on your technology in a way that may interfere with improving other aspects of your system on down the line? Is there a technological issue here as well as an incentives issue?

Anyone?

MR. BAER: The answer is yes. That is -- you know, this is not an antitrust issue, but in terms of forming these things, how technology will be shared, you know, what -- how it will work, what will happen to future innovation, when does it have to be contributed to the venture or not, can it be used independently by participants in the venture, those are big issues, and they come up all the time, and they bog down a number of B2Bs that I've been involved with. So, it's a big issue.

And the point that sometimes interoperability as opposed to merger becomes a barrier to folks getting TS and being able to be more effective, which I think is very well taken.

MR. ORDOVER: Let me just add one point, and that is that we completely forgot in this picture the people who actually do the IT part in these deals, the Aribas, the CommerceOne, these folks, and they have a lot of proprietary knowledge which they may not be willing to share with their rivals, who may have, for example, begun helping the B2B number B or number C and now they are supposed to somehow combine themselves into an interoperable platform.

I think there are a lot of issues in terms of implementing it that do not necessarily stem from the conflicting interests of the buyers and the sellers of the widget, who absolutely have zero expertise in what it is that it takes to set this thing up as a technology, as a platform, but in fact bringing together the IT experts, these folks around the servers, that run the software and on and on, and make sure that they, in fact, interoperate with each other, where they are engaged in industries in which competition is actually fierce on a day-to-day basis, and their interests are hardly that of necessarily cooperating to a significant extent.

So, I think there's another element in that mix, and just speaking from experience in trying to work on the Covisint joint venture, I noted that that was actually a substantial issue among the people who were initially aligned with the GM B2B and with the Ford B2B. They could not get together in any reasonable way and agree as to exactly what those technological platforms ought to look like.

MR. COHEN: Alex?

MR. GIBBONS: Having a technical background, I can say that yes, there is definitely a technology component to this, but I would also add that there's a tremendous standards component to this, and it's probably larger than the IT side of it. In order to have the interoperability and be successful, the major stumbling block for the IT professionals would be to get to -- get through that standards issue, and on the question of whether a merger or interoperability might be better in getting to the technological infrastructure, I'd like to introduce the fact that the widgets are only one component in some other industry.

There are cross-industry issues that have to take place. So, interoperability is extremely important to address even if you've solved the widget problem with, you know, if we say widgets are carburetors for cars, for example, Covisent still has the problem of dealing with every other part and interoperability and standards for all of those other automotive parts. Or when you're dealing with retail outlets, they sell consumer goods and food products and also automotive supplies.

So, there's a cross-industry, cross-widget to widget to midget to gidget and everything else that you have to interoperate with also.

MR. COHEN: A further aspect of this is the question of if you're interoperating and sharing in your revenues, to what degree does that permit you to continue to offer unique services, compete on other countervailing incentives that may not exist in some of the other worlds.

In general what has happened in the ATM arrangement is that the name of the game is moving as much in the way of volumes as possible over the switch but where volume can be transactions involving just taking out money, or in a more local area, making deposits in some areas and being able to move monies among accounts. So, one of the things that has happened there is that there has been a focus on having increasing standardization so that technology suppliers can have machines that work with the network but where in general there has not been a kind of common look and feel as to what the individual ATM's functionality can be. There's still quite a bit of diversity.

The thing where, again, I just want to be cautious about extrapolating that into another world is that there's an independent incentive on the part of the ATM deployer to try to get as much business to it as possible either by putting them in convenient locations, by having a lot of services or the bank itself in terms of being able to serve its own customers as well as to track others. But at least in that context when you look at third parties who aren't banks coming in, they have competed in part by having an agreement with basic functionality but to go above and beyond it.

MR. COHEN: Yes, Roxann?

MS. HENRY: Well, there is the issue of the interoperability, then there is these issues of all of the separate bells and whistles which everybody wants for their own product. But I think there's also a cooperative agreement that sometimes is built into these interoperability plans where certain upgrades, certain system upgrades and development can also be done on a joint basis as well. And it may be that it's on a sort of contribution open basis where you may decide to make a proposal to upgrade the system in a certain way, and folks, you have got how many sellers now in this, you can say, okay, I can't afford to do this upgrade on my own, but I'm putting it out there as a possibility that I think would be beneficial out there in the marketplace.

How many of you want to contribute in terms of cost to join in on the development of that upgrade? That is something which is in place in some of these areas, and it is actually quite pro-competitive, because it allows enough people to get together to actually do the financing who all have an interest in it, but not everybody is required to either.

MR. COHEN: Bill?

MR. KOLASKY: I'm not sure exactly where we are in the discussion, but if we are going to turn to potential anticompetitive effects of this kind of interoperability plan --

MR. COHEN: That's correct.

MR. KOLASKY: -- there is actually at least one piece of litigation that involved an interoperability plan on facts very similar to that, and that was the joint venture among the Regional Bell Operating Companies to create interoperability for their internet yellow pages. It was a B2C exchange, if you will, rather than B2B, and what's significant about that case -- and Roxann's firm was involved on the other side of it on behalf of GTE -- is that the obvious potential anticompetitive effect that you might run into is to have the exchange that's left out here, D, arguing that because of network effects, there will be a tipping effect, and then all of the business will go to the exchanges that are part of the interoperability agreement and that poor D has been left out in the cold.

MR. COHEN: More broadly, what would interoperability do to questions of entry in the market? Are there concerns that you could view this as something exclusionary? Anything to contribute on that?

Yes, Bill?

MR. KOLASKY: Just to follow up, just as the incumbent D would argue that they are not going to be able to survive as the odd man out, potential entrants would argue that to the extent that critical mass and network effects are operative, this is going to be -- make it much more difficult for a new exchange to get started, especially in an environment as posited in the first hypothetical where capital for B2Bs is drying up generally.

MR. WINTERSCHEID: But just one counter to that, because there is I think an argument that could also be made, depending on how the facts pan out, that having the common standard, a ubiquitous standard, might promote entry. Number one, it could be that it would promote switching between A and C, and beyond that, by having the common standard that's more ubiquitous might facilitate new entry, because you know you have a common base, depending on the proprietary protections that might attend the common technology.

MR. COHEN: You know, those comments seem like an ideal segue to our last variation, unless somebody wants to add anything.

think that's a clue that we can really eliminate a lot of anticompetitive scenarios up front.

MR. COHEN: Okay, let's turn to our second variation. With variation 2 we return to the idea of a B2B merger. A, B and C are again proposing to merge. The industry participants and market sharers are the same as in the original merger with four B2Bs and two wholesalers, but what we're adding to the mix now is an integration technology. And let's talk a little bit about that one.

A, it's assumed, has implemented a patented integration technology that allows buyers to integrate their internal processes with A's and to seamlessly connect with sellers one to five, and the hypo tells us that this yields considerable savings.

B and C have jointly developed a similar but unpatented technology and they are about to introduce it. But now along comes the merger of A, B and C, and the internal documents reveal that ABC intends to use A's patented technology to permit these connections. It would have the benefit, since they would have joined together, the three firms would have the benefit of offering seamless connections with sellers 1 to 15, but it's A's technology, the patented one, rather than the B-C technology, which would have been unpatented.

Once A's technology has been implemented, the hypo assumes, installing a different system would be very costly.

I'll put up the overall board again. We can have it behind us as we talk. It's largely the types of fact patterns that we had assumed for our first merger. Let's move into variation 2. And perhaps we'd start, in talking about the merger with this integration technology added, we could start by asking, does this do anything to our market definition issues or our selection of market participants?

We seem to have at least one more alternative here, and that would be B2B e-marketplaces for widgets with an integration technology.

Anybody want to talk about market issues given the new fact here? Well, then, I am going to volunteer someone. Let's volunteer Roxann.

MS. HENRY: Well, I think clearly one of the questions becomes what are the switching costs and just how great they are, and that's really where you have to focus your attention and energy. If the switching costs are really phenomenal, perhaps there's some sort competition with the other people anyway, so why are you worried?

So, in essence, A isn't in competition with B and C right now, I suppose, if you go to that extreme. On the other hand, what are those hundred buyers buying from A doing? Are they really just substituting between -- among sellers one through five or are they benchmarking their prices also by taking a look at what's available elsewhere?

I mean, it seems hard to imagine in this market for widgets that the distribution costs are just so great that they're locking people in. It's not very real world, but it's conceivable that the switching costs are that great.

MR. COHEN: Could it at the margin be an argument that this added advantage of integration tilts the balance against including the wholesalers?

that Roxann put in the first panel. Why is it that the buyers are now segregated? What's going on in the marketplace to cause that self-selection?

And you really need to understand a lot more about that also to assess the overall competitive

But back to the point, I don't think this is a real world situation simply because there's no way the sellers are going to be able to say you will have this proprietary integration tool, and that's what you will use to the exclusion of any other. It has to be an open integration technique or tool, otherwise they wouldn't accept it to begin with.

MR. O'BRIEN: Of course, the hypothetical indicated that there was large cost savings due to the proprietary technology, and if those cost savings are passed on to B and C when they're integrated, those cost savings are huge, the merger goes through, huge cost savings, proprietary technology, D is sort of out in the cold. X and Y are kind of out in the cold. Now I want to come back to the question that I asked in the first scenario, which is, the merged firms raise the price of the B2B services. Should we care about how the merged firm distributes revenues among the sellers, or should we be concerned about how the means by which profits are divided affect the sellers' individual incentives?

Let me be more specific. If we were to assume that the profits of the B2B -- it has become a profit center now -- that the profits of the B2B were distributed in proportion to the sellers' market shares, I could imagine how that wouldn't distort their incentives at all; however, if they had a different means of dividing the profits, I could believe that the concern that Janusz raised right at the beginning, of the B2B becoming a profit center, is a real concern.

I'd just like anybody to elaborate on that.

MS. GUERIN-CALVERT: I guess it would seem that the essence of what you've done with this hypothetical is to switch the nature of the game. And one of the things, before addressing the question, that I think would be important to understand is whether what is going on is that once -- that there are very few incremental buyers coming into the marketplace.

In other words, once A has a hundred installed, that they're kind of fully integrated and there's such substantial cost savings that the hypothesis is that it would never be worth their while, even with a substantial price increase, to switch to X or Y to do wholesale transactions, would I think, you know, potentially put X and Y not in the market.

But again, where one of the things that could market.

fully integrated A, B and C, there is still opportunity to be adding new customers on to get the volumes.

Again, I think to answer your question, so much is going to depend on whether or not sellers 16 to 25 are constrained. If they are unconstrained, even with profit sharing agreements that would provide more of an anticompetitive incentive on the part of sellers 1 through 15 to distort the downstream competition, then D still has an ability to try to add -- move substantial amounts of widgets into the buyers' hands that are connected to it.

MR. ORDOVER: Right. So, the example is an unstable story, because if dealing with A exchange, mediating between sellers and buyers, gives both sellers and the buyers incredible cost savings, then they should kill off everybody else upstream and downstream relatively quickly, or you would have sellers -- you know, buyers from B and C naturally trying to gravitate to exchange A, or you would likely see sellers who are perhaps not able to sell through B -- through A trying to get in.

So, I think that looking at the market shares and this diagram is interesting, but I don't think it's indicative of the situation that at all forecasts what expect if there were some mechanism that delivers huge efficiencies, that people who play with that mechanism are going to gain huge advantage in some relevant market, upstream or downstream. And therefore I would (a) pay no attention to these market shares; (b), I would view the attempt by B and C to join up with A as almost a life-saving attempt given that they are not capable possibly of delivering equal efficiency gains. If they are, the dynamics changes again, but assuming that they are not, then they are disadvantaged, and then the market itself would beat out inefficient trading arrangements.

MR. COHEN: Well, given that you're stressing the dynamics of this, should we be expecting a tipping effect here? Should -- is D going to erode and have its sellers join with ABC ultimately? Is that where we're heading -- for one B2B?

MR. POPOFSKY: Let me take a first shot at that. I think not on the facts posited for the following reasons: Despite the fact that A's technology is somewhat superior, it only has a hundred buyers. Now, assuming there are not other special characteristics that lock the buyers into A, other than the fact that it has this whiz-bang technology, and that B and C have developed one that they are willing to give away, if you will, in the hopes of building an installed base, it strikes me that in the other relevant market here, which might be a technology developed market or an innovation market even, depending on how you want to view it, barriers to entry seem low.

As Alex said, it's the buyers who are going to take a tool and force it on the B2B, and thus it seems to me it makes sense 16 to 25 could be a constraint. After all, there is no reason to believe that the technology B and C have developed will exit the market somehow after the merger, even though it's not going to be used, or that you can't develop a comparable tool. After all, if A's were so great, you might see it having a much higher present share than it already has, and I think that's an important clue.

MR. COHEN: How would we assess the difficulty of another technology emerging and the strength of the intellectual property if we were faced with a merger right at this point, where A has developed its technology and put it into effect, B and C have something which has not yet gone into effect, and nothing else is out there?

What do we do with the merger when it comes before us in that setting?

MR. KOLASKY: Well, I think one of the things you want to do is find out more about what it costs and how long it took B and C to develop their, quote unquote, open technology, and you'd want to know more about that open technology as to whether or not it was truly competitive with A's technology.

If it turns out that, you know, B and C were able to develop this open technology relatively cheaply over a relatively short period of time, as Mark said, little bit deeper, because it may not just be the cost of innovation but the fact that A's out there, the buyers are familiar with it, that creates the advantage, not just the cost of innovating itself, but the reputation that A has for that innovation that it made.

MR. COHEN: Yes, Jon?

MR. EKONIAK: One of the things we have to look at is if we do see a standard start to evolve, and whether it's a proprietary standard or an open standard over time, because one offers a better product or has more market presence out there, how is that standard used in the market? If a B2B is able to extract value based on the fact that they have a standard, then that can be termed or deemed anticompetitive versus actually allowing the underlyer sellers to compete based on service, delivery, et cetera.

So, if the standard is a form of actually creating value, it could be seen as if it is somewhat anticompetitive, versus having an open standard out there that everyone can use, everyone can participate in. And then it really comes down to what are the products or services that we're actually buying and selling here.

MR. COHEN: Yes?

MR. GIBBONS: I'd like to bring up a nasty word in here, and that is bundling of services, because I think it's an easy trap for us to fall into and talk and think just on e-procurement through the exchanges all the way through. And from an e-procurement point of view, this scenario is a relatively simple one, because the technologies that would be proprietary are relatively simple to -- switching costs would be relatively small. But if we get over to the transportation and logistics side and supply chain optimization, where exchanges over the next few years are going to become more and more sophisticated, that's where the integration of companies with the exchanges will make it so that switching costs will be very high.

If we start bundling services in exchanges at that point in the sense of saying if you are in with my supply chain proprietary solutions, and because of that you're only going to be able to buy through me to take care of -- to take advantage of those services, then there's a serious problem.

MS. GUERIN-CALVERT: I also think that B and C might have accomplished something very different than what A accomplished, if A's buyers are different from B buyers and are different from C buyers. What B and C have come up with is a technology that allows, maybe to push it somewhat, seamless integration with all of the B buyers with B and potentially those same ones with C, and so that that might have had a real prospect for lowering switching costs such that any network that had it could have interacted with all of A, B, C and D's buyers.

So, that would be worth looking at to see if they have really done something that has reduced costs as opposed to creating what we've been talking about, which is a little bit more of a lock-in or an incentive to deal with only one network.

MR. WINTERSCHEID: You could simplify it, Bill, by positing that B and C's alternative technology would have infringed A's patent and the merger was in settlement.

MR. COHEN: No.

MR. WINTERSCHEID: No?

MR. COHEN: We are not going to simplify it that much.

MR. WINTERSCHEID: One point, though, not to -- but we're focusing on the ability of B to develop an alternative, but don't lose sight of X and Y and the total available population out there. I mean, it's not just the B buyers, but there are technology houses that are out there that if this is, you know, a better solution, undoubtedly they will be looking at alternative ways to solve the problem, and there is still a 700 -- you know, 70 percent of the marketplace still out there available for capture in that connection.

MR. COHEN: Let me throw out one last question with a couple parts to it, and it sort of wraps it all together. Let's say that in defending the merger and in discussing this part of the merger in particular the parties point to the fact that this integration package will be available. It will allow 300 buyers to integrate fully with their sellers.

Could we question whether there's a less restrictive alternative of using the B-C open technology rather than the A technology in that setting? That's part one of the question.

Part two would be, taking it a step further, would it be appropriate -- or perhaps maybe what I'm asking is what are the considerations pro and con for looking at this issue not so much as a less restrictive alternative but as a fundamental problem with the merger, questioning whether we should intervene to try to require the adoption of the open technology rather than the proprietary technology?

Yes, Mark.

MR. POPOFSKY: Just an initial comment, this was raised as an issue Bill Kolasky raised in the first panel, which is what is our framework for analyzing the merger? Is our baseline, does the merger make the world worse, is there first anticompetitive effect, and then you consider efficiencies and whether they can be achieved in a less restrictive way, or is the question we ask had the joint venture or the merger participants done the most good for the world that they should have done. And unless you think the merger is first going to cause an anticompetitive effect, I don't see the real basis for asking whether they should have achieved even more efficiencies than they have through the scheme.

Now, ironically it might be a different question if it weren't a merger but a joint venture. Then you might be asking about the internal restraints of the joint venture, and because it's not competition that's been created only by the joint venture but it's affecting existing competition, you might say, well, you know, adopting this restraint here has eliminated a pro-competitive effect and caused other anticompetitive effects.

But in a merger situation, I first think you have to ask have the parties created a potential, at least, for anticompetitive harm, and then and only then do you get into the details of, if you will, re-engineering their solution to it.

MR. BAER: I think that's fair, Mark, but at the same time, the way that Bill posited the question, there is a sense in which having this technology involved in the merger and that being the chosen technology, it potentially has an exclusionary effect, and so it may well be choice of technology drives competitive analysis.

I mean, you know, and so, you know, even though there may be some efficiencies, some cost savings, is there a corresponding anticompetitive effect to it? And so one I think would be fair in -- from an antitrust enforcer's perspective -- saying, well, if you go this way, your stated plan is to use A's technology, what will the exclusionary effect be, and is there a way to get there in a less restrictive fashion? So, I think it's fair gd orom T* (19 a question whether the right result or even the preliminary thought on the result should be to require the merged parties to adopt the unpatented technology. You might be thinking about something more like that that will be available for license in the marketplace or that there will be no requirement of the merged firm that their customers can only use the patented technology.

MS. HENRY: Another real issue is just looking real quickly at buyer welfare here, and one point that is immediately going to become apparent is that A's current buyers are going to start screaming. They're not going to be real happy if they've made this tremendous investment that you've told me is so incredibly cost-prohibitive to switch, you're going to have 100 very angry buyers there, and then the question is, well, what benefit has been given overall?

If what you've ultimately done is somehow you've got 300 buyers who now have 15 suppliers, it's real hard to go from there to suggest that there's some real big anticompetitive significance here.

MR. ORDOVER: Anyway, as Joe pointed out, if we make a commitment, the merged firm makes a commitment to maintain the nonproprietary standard, it actually does require some maintenance. I think it does not exist in a vacuum. I think we have talked about this as being nonproprietary, meaning it's going to be out there for the taking. That is just false, and I think if there is a divestiture, for example, to D, together with whatever know-how has been developed to bring that standard up to the speed and the level it's in or if it's divested to X and Y or something of that sort, I think that will ameliorate a lot of problems and also will not expropriate whatever investments that A's buyers have made in the past.

I think here the fix is easy, and I don't see any competitive constraints to begin with, but assuming --

MR. BAER: Right.

MR. ORDOVER: -- that you want to think there is something like that, then --

I think that probably is the only practicable remedy. I doubt that anyone will pay for it.

MR. WARNER: Well, what I would like to do is pick up what Mark had said at the end of the first session. And that just brings us back to some of the international implications, because it does seem to me that that really complicates it, where people are situated. We're sort of positing here A, B, C and D, X and Y are all in the United States. But it seems to me if D or someone like that is in another country and that's the party that is going to be hurt, if the standard that's in effect adopted is the patented standard of A and B, that you're probably going to get something more likely D would get a more favorable sort of reception from its own, its home country antitrust authorities, and that maybe, and this is a pragmatic world, D might have to think of -- there might be a different answer.

There might be -- we might all agree here that there is no need to require as a remedy that they -- that the parties adopt the unpatented technology, but there might be another jurisdiction where the harm is more likely to be localized, more likely to be felt, where the competition authorities would see that differently. And I'm thinking specifically of Europe or something, where they would also be aided by doctrines of competition and all that might help them to do that.

So, I think, as we think of not just the antitrust and technology interface but also add the international gloss on it, that it becomes a little bit more complicated.

MR. COHEN: We're about at the time where we are going to shift over to some closing remarks from Commissioner Thompson, but before that, does anybody have anything they want to add to wrap up the discussion? Are we all set?

Okay, Commissioner Thompson is going to give us a few closing remarks for this morning's session.

COMMISSIONER THOMPSON: Well, good morning, thank you for coming this morning, and thank you all for participating. I know that the one thing more dangerous than standing between a lawyer and a fee is standing between a lawyer and lunch, but I join the Chairman in welcoming you and all of you to the FTC's second workshop on competition policy in the world of e-commerce and electronic B2B marketplaces.

Now, I see some familiar faces from last year's workshop, survivors, and to you I welcome you back and thank you for joining us again. I also want to thank

Susan DeSanti and her staff for their excellent work in organizing this event.

Now, I hope you have enjoyed the panels as much as I have this morning. I was downstairs listening to you, and I think we all have to reflect that a great deal has happened in the world of B2B marketplaces since we held our last workshop in June, and I think we're in an interesting juncture in the world of e-commerce generally and B2B marketplaces specifically.

Since June, we've witnessed a shake-out of the dot com players, and while that shake-out's effect in the business-to-consumer sector has been well publicized, the shake-out's impact on the B2B sector is no less significant. Here, too, companies that predicted revolutionary changes on how companies buy from each other have found themselves scrambling to stay in business, but this shake-out does not signal the wholesale demise of e-commerce.

It does demonstrate a needed market focusing on the issue of value, how it's generated and to whom it belongs. So, while we might not yet have heard the sounding of the dot com death knell, I think what we are hearing is a warning bell, perhaps one that asks businesses to place their customers at the center of their value proposition by spending a little less attention on the E and a little more time on the commerce.

That's where I remain optimistic, for although many e-commerce B2B entities have not been successful thus far in the marketplace, there is still value in internet-based technology and the promise it holds for consumers and businesses alike.

Now, while recent figures from Forrester Research predicted e-marketplaces will capture 53 percent of all online business trade by 2004, totaling over $1 trillion in annual transactions, it will be interesting to see if reality meets these time and dollar projections.

Furthermore, it would be interesting to see how the dot com shake-out has affected whether the success of B2B models will come from the collective accretion of buying or selling power and how much of that is attributable to the development of new and innovative products such as inventory and customer relationship management tools.

Now, my guess would be that the latter will be more significant. I would also hazard a guess that private proprietary e-marketplaces will comprise a significant portion of that total.

So, what can companies do to reduce the risk of being voted off e-commerce island? While many New Economy stars have flared out of existence in recent months, those who remain in the industry by necessity are becoming more sophisticated in their consideration of the integration of issues relating to e-commerce. Included in this evaluation process is both the analysis of market competitiveness of the business model and compliance with antitrust laws.

Now, whether or not a proposed exchange or the behavior in which it engages run afoul of the antitrust laws remains a fact-based inquiry. While the business form is new, the applicable law is not. So, for relevant guidance, we will refer you to the FTC-DOJ Guidelines for Collaborations Among Competitors.

When we convened last year, we observed that the B2B model was in its nascent stage, full of possibilities as well as potential pitfalls. B2B in its adolescent stage can still be likened to an orchestral work in progress. For the most part, what we've heard so far sounds pretty good, but the question remains whether each finished piece will be in harmony or in discord with the antitrust laws.

We will, when appropriate, use our baton to gently shape the process and when necessary direct the players to consonance, but it's up to all of you in this room to be sure that it finds an audience.

Thanks very much for coming.

(Applause.)

MS. DESANTI: Thank you. Now I have the practical information that you all need, which is where can you get lunch around here? We do have a cafeteria up on the 7th floor. There's also a cafeteria over at the National Gallery of Art, and there are some other places around. You can ask Gail, Hillary, myself, Michael Wroblewski, we will be happy to direct you to some other shops in the area.

We will see you all when we convene again at 2:00.

(Whereupon, at 12:00 p.m., a lunch recess was taken.)

AFTERNOON SESSION

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MS. DESANTI: If you could please take your seats, I think we will get started with our panel for this afternoon, and we are very pleased to have opening remarks for this panel by Commissioner Swindle.

COMMISSIONER SWINDLE: Thank you very much, Susan. I look at this distinguished panel, and I see at least some acquaintances and some friends. I see my friend, Jan McDavid. I'll ruin her reputation by mentioning she's a friend.

I'm not a lawyer, and I see my friend, Bill Kovacic, who is always telling people that in his

Last summer we had this enormous euphoria, which both the chairman and I think Commissioner Thompson and others have spoken of what we thought this was going to happen, as the Wall Street Journal put it, that B2B commerce was going to change the way the business world functioned or words to that effect.

That's somewhat paled in the reality of the marketplace as some would like to remind us. I was looking at a Wall Street Journal story back in early April, and it quoted Ariba as going bust -- the current price of Ariba on that particular day, I think around April 4th, was $4.44 as compared to its 52 week high of 173.

I looked on Yahoo just a few minutes ago. For those of you who hold a stock, it's at 8.74. That's a boom. It's doubled inside of a month but where are we going from here with B2B?

I would suggest that we probably are going to go forward with it. Just like most good ideas and technology, there's a lot of spill over. A lot of it comes from an over estimation of our expectations and a lot of hyperbole and we build up these expectations, and things don't turn out exactly the way we thought they would.

But, I suspect just as in other ventures and new ideas, there will be fall out, and it will all settle down into being something that if we do it right, we'll all benefit enormously from it.

I said last summer that for B2B to be successful, it was going to take a lot of things, but first and foremost it had to generate a concept or a belief that there's something to be trusted, and no trust and no business. More than just words and expectation, B2B has got to deliver a value, as with most of the dot coms, while fulfilling its promise of greater efficiency and cost savings.

History tells us that undoubtedly like with all new ideas, there can be a lot of honest mistakes, and there's also going to be a lot of people in business, in B2B, who are going to try to get out there for various and sundry reasons, not the least of which is the competitive zeal in trying to get ahead of the competition.

They're going to go right to the limits of allowable conduct. Some of you perhaps have heard me use the analogy of an airplane and flying it to its maximum performance -- and fighter airplanes, not Piper Cubs and things like that. You take it out to the edge of its envelope as we call it in aerodynamics. If you go a step beyond you're in uncertain, unchartered

a very wise man, and anybody who looks under the hood of a car as much as he does, he knows what details are and what the devil is. So that's what the purpose of this meeting is for you to help us dig down to understand the complications and to sort of see how they measure up against the principles that we try to run this agency by, and in doing so, try to help us have the most competitive economy that we can possibly have.

This panel is going to consider the specifics of B2B operating rules, our structure, information sharing, compliance and emerging issues related to standard setting. It will be a brainstorming session. I would ask those of you in the audience, if you haven't had a chance to interrupt and challenge, please do so.

We've got a very distinguished panel here who are capable of keeping us entertained for hours and hours and hours. I've been around Bobby Willig on a number of occasions, and I kid you not, he moves the lawyers aside when he starts talking. He's full of information, lots of good ideas, enormous experience as has this panel here. It's a good time to do a lot of brainstorming and help us be better at what we do, and hopefully in doing better ourselves, you can benefit by it. Certainly the consumers will.

I was in Russia a number of years ago with three friends. We were all former Marines, and we were over there dabbling around trying to figure out how to set up a business before Communism fell, and we were sitting over on the side after having a meeting with our interpreter and several supposedly business people in their government, and we were debating something. We were arguing with each other, and the interpreter came over to me and said, Everyone is worried and concerned, why are you fussing? (Obviously she didn't use that word because I don't think it's in their vocabulary.) Why are you arguing, you seem to be ready to hit each other.

And I looked up and said, "What are you talking about?" We're just brainstorming, and that idea just -- her eyes just glazed over when I said that, but we know what brainstorming is. It's using good intellectual power to discuss something in detail and see if we can find better ways of looking at it and perhaps of implementing the things that we should be doing.

Thank you for your participation, those of you in the audience in particular, those of you on the panel. Have fun, thank you very much.

MS. LEVINE: Thanks. Thank you, Commissioner Swindle, and I think that your characterization of our sessions is very apt. I think this will be, I hope this will be a brainstorming session. We've got an incredible array of panelists here today.

Let me just take a moment to introduce the FTC staffers at the table. I'm Gail Levine. This is my colleague Michael Wroblewski, and with us today is Rick Dagen. He's the assistant director for anti-competitive practices for the Bureau of Competition here at the FTC.

Now I would like to introduce people who are doing the work on this panel, our panelists. We have Joel Mitnick of Sidley Austin Brown & Wood, David Evans from Jones, Day. From Kaye Scholer, we have Pamela Jones Harbour.

We have a pair of very distinguished economists with us this morning, Ruth Given from Deaieoitt

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Ernst & Young. Ernst & Young has some experience in auditing B2Bs, and we're hoping that Paul can shed some light on this for us today.

We have Michael Rickman from Goodyear Tire, Jeff Smith from Transora, he's their chief legal officer, and Mary Schoonmaker, who's an executive with RosettaNet, also from California. Thank you for coming in.

I guess to give a quick overview of what this panel will be up to today, let me just say that we're going to talk about two major things, operating rules and standard setting.

Last year at our B2B workshop, there was a lot of discussion about operating rules, the rules that govern how B2Bs work from day to day, and in particular there was a lot of discussion last year about firewalls and how they could solve a lot of the potentially improper information chain, to the extent that that risk existed at all.

Today we would like to drill down a little bit and ask our panel to apply that learning to some tricky situations. For example, what's the role of policies versus firewalls. If there's a gap in the firewall, can we fill it with a strong enforcement rule, a strong policy, or is the only answer really to build a stronger technological firewall?

What about peer-to-peer networking? If a business to business e-marketplace adopts a peer-to-peer technology, what kind of efficiencies can that bring? What kind of information sharing risks can that also bring?

We also want to ask some questions about B2B auditing practices. B2Bs have started to seek auditing of their compliance with their internal practices. We would like to ask what kind of views we, as an enforcement agency and as the public, should have of those auditor's reports.

Now, we're not limiting ourselves to questions about firewalls. We're also going to be discussing monopsony, exclusion, the intersection between the two. We're going to be talking about questions of B2B responsibility.

We're going to be taking a 20-minute break around 3:45, and then when we come back, we're going to jump into the question of standard setting, and we'll be asking questions about how standard setting initiatives that impact B2Bs, the efficiencies they can raise and the exclusion possibilities, their effect on innovation and their intersection with intellectual property rights.

But let me just give a quick overview of the format we'll be using today. I'm going to turn it over to Michael Wrobelewski in just a second to give the exposition of the basic facts of the hypotheticals that we'll be discussing today. We're going take up the questions after that one by one, and either Michael or myself or Rick is going to throw the question out to our panel.

We'll spend about 10 minutes on each one of the questions, and what we'll do at the beginning of those 10 minutes is call on the one or two people on the panel that may have some expertise on that question and then throw it open to the rest of the panel.

If you panelists are interested in answering the question, please just turn your table tent up like this. You may have to hold it, make sure it doesn't fall down, and then we'll do our very best to see your interest and call upon you.

So without further ado, let me turn it over to Michael to present the basic facts.

MR. WROBLEWSKI: Thank you, Gail. The B2Bs in this case study are organized among the buyers as opposed to this morning the case study, the B2Bs were organized among the wholesaler level.

In this particular case study, the product is

X. X is a non-differeniated commodity with few close substitutes, and it's used in the manufacture of commercial goods. There are several tiers of buyers of X. We have the four largest, Acme, Apogee, Bottom and Base. You have some smaller buyers, Zenith, Center, Core and Cross. Then there's some of the smallest buyers, and there are about six of those, each with about 1 percent of the market.

There are three B2Bs in this particular case study. The first one actually in terms of development is IndyX, and it was formed without the backing of any particular buyer, and when IndyX got up and running, XMarket was formed, which was formed by Acme and Apogee which are the two largest buyers in this market, each with 28 and 23 percent respectively, and they formed XMarket. Zenith joined them along with another smaller buyer, so they now handle about 57 percent of the purchases in this market.

The second or the third B2B that was formed was ECommX, and it was formed principally by Bottom and Base, which comprise about 30 percent of the total purchases in the market and five smaller buyers, so the ECommX handles about 35 percent of the total purchases in this market.

And now because of the formation of these two particular B2Bs, IndyX is now only left with 8 percent market share. It still has Center and Cross and Core, and where we are right now is all the purchases of X are made on one of these three B2B marketplaces.

The first question that I would like to get to deals with information sharing, and it's really a question dealing with the board of directors for XMarket, which was our first B2B. The board has seven members. Two of them are representatives of Acme, and two are representatives of Apogee, Acme and Apogee being the owners. The other three members are non-industry participants. The board makes broad management decisions but leaves the day-to-day decisions to senior management.

The question that I would like to address to Jan McDavid based on your experience and counseling B2Bs is: Is this split between leaving the broader decisions to the board and the day-to-day decisions to senior management effective or sufficient to deal with any proper risk or harm due to information sharing?

MS. MCDAVID: Well, I would think that you would probably want to add one additional rule for the operation of the board, and that is the kind of data that are given to the board about transactions taking place on the exchange.

Even if their authority to manage the company is limited to broad management decisions, if they got detailed information about the transactions taking place among the persons using the exchange, then you might have a risk of inappropriate information sharing.

What we have done in the B2Bs that we're counseling is recommending that basically they get aggregated data. They get nonspecific transactional data. They get perhaps the kind of data that might be necessary to regulate the agreements among themselves and incentivizing them to use the exchange, but that that be extremely nonspecific about the kinds of transactions that are taking place in order to avoid problems of access to inappropriate competitively sensitive information.

MR. WROBLEWSKI: What is the harm for just kind of -- if we take a step back, what is the harm that the policies that you just espoused going at trying to prevent?

MS. MCDAVID: Well, for example, you would not want Acme to know what Apogee is buying at what prices, what kinds of transactions that it's using the exchange for, and the same would be true of any other user of the exchange because that might provide an opportunity for some sort of coordination.

MS. LEVINE: I was going to ask one follow up question on that.

I just wanted to ask, you said that it's important to sort of take an eye toward what kind of

MR. MITNICK: I just want to emphasize something that I think is implicit in what Jan is saying which is that people should be clear that there's no specific rule as to what the board can and can't do in terms of management decisions.

The issue really is just what kind of information, competitively sensitive and non public, they have access to.

MS. MCDAVID: I think that's right. And the analogy I would use here for -- the basic standard goes back to the 1930s. We're talking about Maple Flooring, for example, and the kinds of cases that decided issues

MR. NIGRO: This is one of those rare instances where I think the antitrust needs are actually in many cases consistent with the business needs as so often they're not, and so I tend to agree with Jan that having some sort of guidelines or safeguards with respect to the content of the information that potentially could flow up to the board is important.

I think having a general policy may be useful but it's not -- the generality of it makes it subject to different interpretations, and I think it can be practical to implement if you're a member of the board because it's general.

And so I think it's often more efficient and more practical to focus on the specific types of information that shouldn't be shared between Acme and Apogee and, in making that judgment, evaluating or taking into consideration factors such as the structure of the market, the market shares of Acme and Apogee in the downstream market, the extent to which -- is X a good that's just resold in competition between Acme and Apogee, or is it just a very minor input that really has no significance in the downstream market.

And I think you need to take all those considerations -- all those factors into consideration and make sure that the rules that you're imposing on the members don't unduly restrict the board from doing what it needs to do, but takes into consideration the antitrust risk that applies in that particular market.

MR. WROBLEWSKI: Okay.

MS. MCDAVID: Let me just add one additional thought, which is we have put into place antitrust compliance programs in B2Bs that we've set up in which we've spelled these kind of things out, and we also encourage the attendance of counsel at the board meetings vetting in advance -- not necessarily us, the vetting in advance of the agenda and materials have been prepared for the board in order to make this compliance easier.

MR. WROBLEWSKI: Bobby?

MR. WILLIG: Thank you. It's all very well and good to say that ordinarily the business interests of the architecture of a venture coincide with meeting the antitrust concerns, but I think this hypothetical has been set up deliberately to go the other way through FTCers. This is Apogee and Acme. Together they have 51 percent of the buying.

And if this acquisition of the input X is one to one with the output that all of these different buyers are putting into the market, then the two of them roughly correspond to 50 some odd percent of the output market as well.

Now, maybe businesses ordinarily would like to keep their activities secret from that of their rivals, but here Apogee and Acme certainly have an interest in saying, I'll show you yours if you'll show me -- no, wait a minute, how does it go again? I'll show you mine if you show me yours, right. We've all played games like that. Acme and Apogee may, in fact, have those incentives, so we can't just blow this off on the grounds of, Oh, ordinary business secrecy will take care of the public here.

My concern, this is really a question to both the FTC and you, Jan, in your experience, these are board members, and Apogee and Acme together have a majority of the board. Is there something in procedure that would make it especially dangerous for them after the FTC has gone away, after the inception of the B2B organization, it's now 18 months later, the heat is off, the journalists are no longer attending the meetings? Now, the board has a quiet session where they change the rules and actually start permitting some peeks at one another's information on a systematic basis. The fact that this is the board seems to me raises certain dangers like that.

How did you cover that when you set things up, Jan?

MS. MCDAVID: Well, in at least one instance we posted the compliance policy on the web site, which means that to the extent it were to be revised, it's available for all to see.

It's also been our expectation, even for the ventures that have been fully investigated by the agency, that they would keep their eye on them. The way they put it is, The folks who are were worried about this know our phone number.

MR. WROBLEWSKI: Do you want to move on to question number 2? Thank you.

MR. DAGEN: Thank you. The next question involves basically assuming that the B2B has put into place Jan's suggestions with respect to the board, but now we have the issue of what happens with respect to the employees that are actually running the day-to-day operations, the senior management.

As part of this hypothetical fact situation, we have employees of Acme and Apogee who are part of the senior management that are on loan. We have former employees of those two companies that currently have no plans to return, and then we have independent new hires through the want ads, the burgeoning B2B job seekers out there.

So the question is: What issues get raised by the composition of the senior management having the current employees on loan and the former employees, and how does -- even with respect to the new non affiliated employees, and I would like to first turn this to Mike Rickman.

MR. RICKMAN: First of all, thank you. It's a pleasure and honor to be here this afternoon.

I think the first thing you have to look at is the seconded employees in terms of level of difficulty of the handling the issue. I start with the seconded employees, how long are they going to be there, in what positions will they be holding and in what types of information will they be receiving? If you start with that series of questions, then you can start to analyze the question more precisely.

If they're in positions that are going to be handling the cost and price information and they're seconded employees and they're not going to be there for a long period of time, I think you create some serious issues about what happens when they reenter and they go back to the home companies.

If they are there for an extended period of time, I think you can begin to add some confidentiality agreements, some nondisclosure-type documents that begin to put into place some protections against information that would be coming back to the home companies and that could have some antitrust implications if shared in those companies.

Now, some of the information will get old very fast if it's a commodity type market, but I think confidentiality agreements and nondisclosures start to aid you in preventing any potential issues.

If they're in a sales marketing or a business development role, some of those issues may go away. If they're in a technology type role, they even go away I think more, but that's my view on the different levels of demarkation among the positions.

I will say this, that if you're in the transition period, you formed your B2B last week, and now it's going to operate, and then it will be up in full gear in three or six months, seconded employees for that short-term may never see any of the important information that would give concerns that Janet talked about or that were talked about here in question number 1, that pricing and cost information that would be shared.

I think whether it is a seconded employee, a former seconded employee who is now full time with the B2B or a business person who has had no ties previously with any of the forming companies, you have to treat them like you would treat any other kind of employee in a setting where there is confidential information that is being shared within the company, that there's confidential information that you're concerned about.

In everyday practice, we have employee confidentiality and nondisclosure agreements, non-competes, and some of those documents now become important that you look at those and whether they're important for your particular business.

I would raise as an issue buyer/seller agreements where you might put a non-compete or -- not a non-compete, but a non-raiding function into the buyer/seller agreement. Do you want your employees who are holding all of this cost and pricing information to now run off and go to a seller or a buyer?

And that's a question that I think is going to be a struggle here as we go forward because those particular employees become very valuable to the sellers and the buyers of the world, and how do you protect them from leaving and taking information with them, and so one option is a non-raiding function, a non-raiding feature in your agreements.

You may want to have a provision in your definitive agreements that says if you're going to second people in to the operation, they have to stay there for awhile. They just can't come back, and they can't go back and forth at will, however you structure enter and exit features.

I think any time you get a polluted employee, you're going to have an issue, whether it's in this type of joint venture or any type of joint venture, so I think the more precautions you put in place up front and think about the issues up front, you can now begin to come up with solutions.

But I think on its face, you have to look at the level of information that they have access to and what kind of firewalls prevent them from the other information that is the dangerous information contained in the B2B.

MR. DAGEN: Bill?

MR. KOVACIC: I was going to ask Mike if the kinds of restrictions that you're talking about imposing on the person, especially who's going to have long-term exposure to the organization's operations, make it difficult to get people to take those assignments, if they wanted to contemplate coming back to the company; that is, if they become radioactive because they've had exposure to this host of information and then in a sense you're going to wall them off when they come back, career advancement possibilities, mobility in the organization might decline, does it become hard to get good people to go to the new organization to assist in the start-up and management?

people there and attract people if it's going to be a successful B2B.

MR. DAGEN: One question that the non-raiding issue seems to bring up is how you would -- how you deal with that if say somebody from Goodyear was a member and then returned back to Goodyear and had information about Michelin or somebody else, some sort of supply relationship, presumably you would wall that person off because there would be antitrust concerns if at the competitor level there was an agreement obviously not to go after the Michelin business and vice versa.

So I don't know how you would handle those -- handle that aspect of it. I just throw that out there.

MR. RICKMAN: No. I think that's another excellent question when you look at this. As you go through the thought process of how you handle a seconded employee or any employee that you're going to want to hire, if you, Goodyear, and you, Michelin, agree outside that you're not going to rate each other as former employees, I think you have an issue.

If it's the B2B that you're agreeing with not to take their employees as part of an efficiency enhancing situation, then I think you have less issues, but if it's done outside the B2B, the board members get together outside the room without the counsel present, without, in earshot of the compliance policies. They make agreements outside. Then you have more issues.

MR. DAGEN: I'm going to turn this over to Pamela. I guess just to follow up, one of the issues I was trying to raise there was if someone came back to the company and you wanted to wall them off because they now have information from the B2B that's going to allow say Goodyear or some other company to go after customers more efficiently.

On the one hand, that would seem to be a good thing. On the other hand, that would seem to limit competition, and it would be interesting to figure out what sort of enforceable rule there would be from the companies that are running the B2B, the owners of the B2B. But Pamela, I think you have something to say.

MS. LEVINE: Can we get you to speak into the microphone?

MS. JONES HARBOUR: I was saying I had an observation to make. Here I think there is a particular concern regarding the jobs that give seconded employees access to competitively sensitive information.

For example, a seconded employee who is a programmer probably would be more likely to obtain competitively sensitive hard data than say a participant owner on the board of directors of a B2B.

I think a seconded employee programmer could perhaps insert a few lines of code, let's say, to instruct the computer to send proprietary information back to Acme or Apogee, or they could insert a few lines of code to give them back door access.

Is that a particular problem that you could foresee as well?

MR. RICKMAN: I think again that's an excellent observation because the technology people can do things that I know I can't even think of, but I think one of the things that is a theme that comes from question number 1 and is especially important for question number 2, and it is whether you are a founding member of that company or whether it is the B2B company itself, compliance has to be a number 1 feature of everything that is done.

Janet talked about posting them on the web site. Are they posted on all the cubicles? Have they been handed out to every employee? Have the founding company's antitrust counsel talked to the people who have gone down and have been the seconded employees? How far-reaching is your compliance program?

And I think that's as important a consideration

construct firewalls that could prevent the sellers of Y from learning about their rivals' prices, that's the seller at Y level, but also look at the question from the point of view of Acme, a buyer of Y, and how will the fact that Acme -- the fact that Acme owns Yellow impact the effectiveness of those firewalls you've set up on the seller level?

Joel?

MR. MITNICK: Gail, in your introduction earlier, you said we were going to be drilling down today beyond where we were at the last session, but I would actually like to just step back for a minute and do a little bit of an overview before we get into the answer, because the question is, Should firewalls be constructed?

I think we need to stand back a little bit and think about why we sometimes have firewalls, and remember that there is no antitrust law that mentions the word firewall. There is no statutory requirement anywhere that I'm aware of for firewalls.

Information exchanges, as you know, are judged under the rule of reason, not per se, so the question is when should, as a matter of prudence and policy, firewalls be recommended? When should the enforcement community look for them?

And it seems to me that firewalls should be constructed in those situations where the facts give rise to a heightened risk of liability. I think there's kind of just a practical way to think about when there's a heightened risk of liability.

You're sitting with some people who are thinking about putting together a B2B in day one and kind of as Bobby suggested before, think about what happens down the road, 18 months down the road, you're thinking about it on day one, you're thinking that 18 months down the road, you're sitting in depositions with the FTC or you're sitting before a jury in a courtroom.

And the question is, How are you going to feel when the enforcers or the jury hears the kind of information that you're sharing amongst yourselves? And I think when you think of it in that way, the business people fairly easily are able to come to a sense of whether there's a heightened risk of liability.

So can we answer the questions here? You have to say to yourself, Do the facts that we've talked about in the hypothetical, do those give rise to a heightened risk of liability, and with respect to Y, we're talking about catalog prices being posted, and the buyer of X, who also owns a Y seller, is able to see the prices of the Y competitors. Does that give rise to a heightened risk of liability?

time options going on, and there was a lot of different prices and the opportunity for sellers to really see how their rivals were pricing in lots and lots of different specific instances, and if there was some sort of an off line agreement, it provides a nice opportunity possibly to police that.

But even in that situation, you would probably want to know a few more facts, such as what's the market share of the players might make a difference, what's the market share of XMarket in terms of how much Y is going through it, and what's the market share of Acme in terms of the Y product.

The second question that Gail posed is one that goes more to the vertical issue, but here again, the question is, Is there a heightened risk from Acme selling -- being a buyer of X and a seller of Y?

To me the fact that this is on a B2B doesn't add that much more from the typical vertical situation, and I think you would need to know many more facts than we have here to be able to determine whether there is any possibility of exclusion that could go on, which is the typical vertical concern.

I think if you change the hypothetical slightly you have something that's perhaps more unique to an risk, and that would be if you have not really X and Y, but you have the same participants on both sides of the

It was, therefore, impossible to separate out the X and Y buying and selling functions, and we literally told those people that in order to reduce liability risk they needed to operate at only one level, but not both.

MS. LEVINE: Let me ask, Paul, if you can comment on the ecommerce twist that Joel's given in this question, very briefly before we move on to question 4, just in the interest of time.

MR. PENLER: Sure. Just an observation from kind of real world perspective on firewalls. When we look at firewalls, we categorize them in two buckets. One is a technical feasibility or accuracy of the firewall, does it work the way it's supposed to from the perspective of code, can someone hack into it, et cetera, and secondly, and what we see is definitely the real issue, is the user administration of that firewall, who has exception to the firewall, who still has access to certain data, even though it might be firewall protected.

And what we've seen is these user administration is where the security office of the exchanges and a lot of the concerns of exchanges and the participants are focused on as opposed to the technical code, if you will, of the firewall.

MR. WROBLEWSKI: Paul, that leads nicely into our question number 4 dealing with what we call an e-paper trail, just to give a few more facts for this question. Assume in this fact scenario that the B2B has a policy that forbids sellers from reviewing other seller's offers and forbids buyers from reviewing other buyer's purchases, but as a practical matter, the B2B firewalls don't make it technology impossible to review this information.

The B2B maintains an e-paper trail, that is, a listing of all activity off screen hits that occur on the B2B, and this paper trail or e-paper trail is maintained for six months.

First question I would like to ask Jeff Schmidt, from your experience with Transora, are these types of e-paper trails prevalent in the industry, and is the threat of being detected, say in terms of violating a policy, sufficient to deter that conduct?

MR. SCHMIDT: When I read this hypothetical, I kept stumbling over the part where it says firewalls with depend on liquidity.

That means attracting other buyers into the marketplace, and there is no way in the world that they would attract other buyers in that marketplace if the buyers were concerned with the security that was present.

You can certainly -- I think that these policies do the best or try to make due the best you can, but I don't think -- I think probably the key question there is going to be, Do technological firewalls exist in other marketplaces, and I can't imagine the buyers would opt for the one if there were alternatives where they were sufficient somewhere else.

MS. LEVINE: So are you saying that buyers are going to insist on the technological safeguards that actually prevent any of this information sharing, or will they be satisfied with policies that urge or that require the participants not to share the information?

MR. SCHMIDT: I think in my experience the buyers think nothing is more important than the propriety of their information, the confidentiality of their information, and if there is any doubt about the marketplace's ability to keep that confidential, they won't come to you.

And so if there is -- I think the assumption is if the marketplace is doing what it ought to be doing, technological safeguards are present, are able to be present and the marketplace better have them or there are way too many other places for that buyer to go, and the policies just are -- the policies are helpful as safeguards with the technological security in place, but I think by and large, they would not be sufficient to most buyers, again so long as the technological safeguards existed in the industry.

MR. WROBLEWSKI: If we put a wrinkle -- and I want to follow up with Barry and with Bobby with this. If the policies say one thing and the technology, as we've heard Paul said, says as long as the system administrator is doing certain things and following certain things or following the policies, that the information won't be shared, but what happens if, by chance, the policy is violated?

You don't want it to happen, but say it does happen because in these particulars, at least in the hypo that we set up, they're not necessarily trying to attract additional buyers. You have maybe one that has 57 percent of the buyers already, so you're not necessarily trying to attract additional buyers.

But if there is a violation going on, what do the antitrust officials then do if there's a violation of the policy? Would that possibility be a violation of Section 5 of the FTC Act? Barry, I'm going to turn to you.

MR. NIGRO: I don't think a violation of the policy necessarily equates to a violation of the antitrust laws. I think a separate evaluation needs to be undertaken, and you need to evaluate the extent to which the access to that information is likely to have an anti competitive effect.

And actually what I wanted to do is ask Bobby Willig a question. The focus seems to be on limiting the sharing of sensitive information, and my question is -- and we don't know how concentrated the market is for the sale or manufacture of X, and my question is: Are there markets where transparency or the sharing of this sort of information like in a stock exchange actually can make the market intensely competitive, and are there situations where the market would actually benefit from that type of transparency?

MR. WILLIG: That's a great question. It's actually very surprising I think but absolutely correct as a matter of relatively recent economics including economists, research results by people who are staffers here in this wonderful organization, that outside of the circumstances of the collusion bugaboo, the theory of the grand collusive cabal, outside of those circumstances, information sharing can be very pro-competitive.

This is not surprising to Adam Smith.

And the concern is that the information exchange or the technology of the B2B will somehow help these potential cartel mates to solve their problem with keeping track of one another. What I wanted to add to this conversation in answer to this and partly the next question as well, that as a matter of economics, if that's the issue, if that's the problem and if the environment is relatively stable, not a highly volatile environment, and the other conditions, all of the guidelines are present for potential collusive concerns, then the parties don't need a lot of monitoring to solve their problem. They don't need to keep track of each other all the time.

The only time they need to peek through the imperfect firewall is when they feel like they have been denied sales or denied the opportunity to price in a comfortable way because of the possibly maverick behavior of their rivals.

You only need to take a peek when those concerns arise, and if it's a stable environment that doesn't come up very often, if at all, and what really works for them is knowing that if you go maverick, your rival has the opportunity to take a peek at that time, find out that you've undermined the cabal and then go ahead into the price war or the punishment regime.

So this audit, the frequency is not all that important. It's just the occasional violation that is really the danger, and the question is whether the audit can take the pointed look at the penetrations of the firewall and correlate it with the times where the collusion may have broken down. Just a simple count of episodes where the firewall has been breached is really not sufficient. I'm worried about these questions a lot from that perspective.

MR. DAGEN: Bobby has started to answer the next question. To avoid his monopolization, we'll start it officially now.

XMarket B2B, and they're available to others at a substantial fee, and I would like to turn this over to Pamela for her assessment of what the possible effects on competition are at this stage.

MS. JONES HARBOUR: I think a key issue here is the age of XMarket's information contained in the monthly transaction reports. The joint venture guides state that sharing current pricing and operating information is more likely to raise competitive concerns than sharing historical information.

So the question posited by this hypo is whether two to six week old price and quantity information is sufficiently historical and therefore less likely to raise competitive concerns.

I guess I'm not too troubled about the dissemination of this information as proposed by Bobby Willig. I too think of the stock exchange, and if you think of the dynamic pricing, pricing two to six weeks later would be ancient. More contemporaneous data might cause concern given the level of concentration on the buyer side and the assumed lack of concentration on the seller side.

There is one fact that does cause concern, and that is the substantial fee that is charged to the non-participants. XMarket, controlled by the dominant

to raise concerns. What type of information is being shared, we touched on that. Information relating of course to price, output, cost or strategic planning is more likely to raise concerns, but then of course it's offset by the two to six week time lag which would make it I think historical information.

And another factor to add into the mix is the direct versus indirect goods. I think we're dealing with a direct good here since it is part of the manufacturing process.

MR. DAGEN: Just a quick follow up on that just on the two to six weeks, just an item of note, in the recent baby food decision, the Court of Appeals noted that a four to eight week lag was not extraordinary and did not see a distinction between that and other industries, at least in terms of being able to police and monitor cartel conduct.

Of course there we would have only had two players, and I think as you've noted here, we have potentially a much greater number of anonymous players here, so there's that issue.

The other question I would like to put forward before moving to the next question is unlike in the original question where we were talking about the board getting aggregate data, here we're talking about specific quantity and price data and given that Acme has 28 percent and Apogee has 23 percent, do you think that raises a problem in terms of the members being relatively -- it being relatively easy for the members of this B2B to determine who's actually making those purchases because Zenith and small buyer, if these are lumpy purchases, probably aren't making those purchases, so the nature of the specificity of data might enable at least Acme and Apogee to more easily monitor the purchases because of their size.

I guess that was convincing, okay.

We'll move on to the -- yes, Bill?

MR. KOVACIC: Jan mentioned before the usefulness of looking at Maple Flooring and American Column and Lumber, and I think a very useful way to look at this problem indeed is to map out all of the variables that are spelled out there.

I think what's striking, especially about Maple Flooring, which is the 1921 decision that does find liability, is no single factor in isolation but not merely the information exchange and the transaction report but the famous Mr. Gadd who provided commentary that helped individual members interpret the significance of the data, but also the Court's emphasis on the broad base of exchanges and discussions among industry participants which really implicates each of the other questions we've seen to this point, as well as a detailed discussion of actual competitive effects, that is, the Court went through a detailed competitive effects story using historical data that tried to link individual information exchange episodes to actual market effects.

So in looking at each discrete compartment, I would simply suggest that in thinking about the effect of any one provision, in isolation, perhaps not that important, if you have effective responses to the other items on the list, but as soon as you have perhaps two or more weaknesses in the monitoring and oversight regime, it's easy to have a critical mass that is troublesome.

And I just add that in Maple Flooring, the share of the participants was well under the market shares that we're talking about here. The danger threshold was identified at about 35, 40 percent.

MR. DAGEN: I would like to move on to part 2, kind of following up with what Bill was talking about, change one of the variables. Previously we were seeing price and quantity data reported for each transaction. Now there is going to be -- that would be reported monthly.

Here there's going to be reports that reflect the amount of inventory that each seller using XMarket

MR. DAGEN: Thank you. I just note that some of the issues that Pamela was talking about are discussed in a consent involving Stone Container Corporation that we had a few years ago involving inventory which is not in the B2B context.

So now we will move on to the next question, question 6, which switches letters from B2B to P2P, and that is the shorthand for peer-to-peer networks, and I would like to first turn this over to Chris Compton to explain exactly what a P2P is and why do we care.

MR. COMPTON: I guess I'm being asked that because of a short paper I wrote for the Spring Meeting, but you must never confuse the authorship of a paper with expertise, particularly for an antitrust lawyer.

With that caveat, in general terms a P2P here aggravates potentially all of the issues that we've been talking about. What peer-to-peer technology involves essentially is the enabling of direct connection across whatever the network is between every user on that network without the need for a client server relationship, without the need for a server that becomes the repository of all the data.

So it involves a number of different models for P2P, but in its basic architecture, it involves the ability of anyone connected to the Internet or to the network -- not Internet, the network to get access in any other platform to ubiquitous platform technology, it could be Macs, it could be PDAs, it could be PCs, it could be mobile telephones or servers, access to any of those other devices and the ability to call down or exchange information with any of those real time.

Now, in its simplest form that we've all familiar with, it's things like Instant Messaging and Napster, but the predictions before the tech rack have been that P2P was going to be a killer technology, if you will at the enterprise level because it would enable the entire world of information that might be out there of other enterprises, other companies that choose to be in the network, to be instantly and completely available to every one at your company, for example, so essentially every computer on this network therefore is both the client and the server.

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In a P2P network, it's available immediately, needs for X, not pricing, so I suppose arguably it's not quite as bad as it might be, but clearly even the guidelines, the Competitor Collaboration Guidelines anticipated the problem on a buyer collaboration under 3.31(a) of an exchange of information of this kind enhancing the ability to project the needs and production schedules of your competitors where these are key inputs to your product.

So clearly one of the important questions here is the extent to which X is an important input to the commercial products being manufactured and sold by the various buyers.

With that, let me stop, and we can take the rest of the questions from there.

MR. DAGEN: It seems one of the issues, as I start to think about this, is that you may be eliminating, as Chris was saying, that central repository of data, and to some degree that may remove it from the competitor aspect of it.

So I don't know to what extent factually that accurately describes the potential for P2Ps where it's strictly vertical between buyers and sellers or that doesn't accurately reflect anything.

David, could you address that and anything else you had?

MR. EVANS: Sure. I think to a certain extent technologically speaking you have to have some centralization. You have to have some way of identifying the participants out there, whether or not it's an e-mail address or a TCP/IP address or something else. There has to be some way of identifying who those people are, and I think in addition -- well, I guess there are two ways probably of accomplishing that. One would be having some sort of centralization --

MS. LEVINE: Can I ask you to move closer to the mike? Sorry about that.

MR. EVANS: That's okay. Is this on? One way of accomplishing that is through a centralized server here that provides just sort of minimal functionality. They aggregate inventories, production schedules and projected needs information.

You can also do that through the actual software. Napster, for example, you download software, and that helps you format the information in the way that's -- that it can be shared amongst the other participants.

I think because some centralization, at least in my opinion, is necessary, you can use the same or similar firewalls and other prophylactic measures you employ in a B2B context obviously with some tweaking in a P2P context. The P2P can -- well, in this hypothetical the P2P could put up access barriers to that information based on a log in, and a more decentralized P2P where the network is created using that software, you can include certain features within that software that can sort of mimic the firewalls or other prophylactic measures.

For example, you could assign the software a unique serial code, Microsoft is doing this now, license that software to a known company, tie the serial ne fired y serst 12 0 0 12 36 746.34 Tqone e Del a monitor the exchange of the information, and therefore a heightened antitrust risk, and in that sense I completely agree with Chris.

I think though if you look at-- you would really have to look at the specific transaction that are contemplated over this P2P, and if the transaction contemplated is bilateral and unobservable, only the two parties to the transaction can observe those and observe the information being exchanged, I think the antitrust risks are much, much less.

MR. WROBLEWSKI: Thank you. We'll move on to question number 7, and actually it's our last one on information -- I'm sorry, go ahead.

MS. GIVEN: Can I make one comment just before we go on?

MR. WROBLEWSKI: Certainly.

MS. GIVEN: Just before we leave the whole issue of concerted action and collusion and things like that, I wanted to bring kind of a real world check into this hypothetical based on my experience being an economist and also working for a consulting firm that puts these things together or, as I might say, is trying to put these things together because it's very difficult to get competitors to work together.

And so even though there's a lot of discussion about collusion, these people that are trying to develop these things are rivals for a reason. They are fierce competitors, long periods of time, and I think that one of my first reactions when I saw this was, I don't care there's anything else that really exists out there.

Maybe there is something in financial services or energy or something where you totally got everybody moved on to an online situation, but I don't think so, and I think part of the reason that it's hard to get these people to work together, these firms to work together, is partly the confidentiality issue. There's a lot of sensitive stuff that they don't really want to share. Maybe there's some stuff that they can benefit from having auctions and stuff.

A lot of the design issues, it's better actually to have private marketplaces that eventually will plug into B2Bs maybe years in the future. That seems to be the direction that we're going in terms of consulting.

And so that's -- I think that I understand the issues here, but it looks like you sort of jumped a couple of years ahead and sort of skipped the hard part about how do these things get formed.

Anyways, I wanted to kind of raise that before we moved on.

MR. WROBLEWSKI: Thank you. This last question on information sharing deals with auditing and compliance. We touched on this topic earlier, and in our hypo, we assume that the two largest participants of XMarket, in order to provide some more confidence to

more than just looking at policies and procedures. It's similar, and in fact the auditing standards are identical to those of a financial audit. The rules are regulated by the ICP, the other standard setting rules, financials, that make up auditing and test standards.

These reports are actually issued. These are test reports, so these are issued under the same set of standards that the financial statements are issued, so they do look at more than what the policies are. They look at what is actually done, which includes looking at, reviewing actual transactions, looking at control logs, looking at design and things along those lines.

Then lastly, you asked about reliance. Reliance, it's kind of like beauty, it needs to be viewed from the eyes of the beholder. The most important thing from a reliance perspective for people to match, Does the report address what the area of concern is.

For example, there might be a report that has system reliability, but in those standards, especially something like Systrust the ICP puts out, there's really nothing specific on confidentiality of data, so if your concern is confidentiality of data, Systrust report will not affect necessarily your needs and your issues, so that's the first thing.

A couple other things that would need to be considered would be the timing of the report, what period did it look at, how long ago was it done, and specifically what was looked at, and then some of these areas, unfortunately very few of them, there are standards that are starting to be accepted by the r like to add a couple of points because when I see the words fair and neutral marketplace and I hear your, What should the regulators do about the audit, I get a little concerned as an inside counsel or even in my past life as an outside counsel because now you have an audit.

Who ordered the audit? What is it measuring, and what is your responsibilities in light of Care Mark and other more recent cases to report that any violation of the antitrust law versus any violations, as Barry said earlier, of policy.

As a tool of compliance, the audit is important but it should retain some control under the inside counsel like Mr. Schmidt or under the outside counsel who is representing that B2B. There's a real concern I have for an audit of fair and neutral marketplace if it's not -- if the guidelines of how that audit is going to be conducted are not set out at the beginning.

To do an audit just to do one could raise a lot of issues down the road for that particular audit, what is the disclosurability of that audit, et cetera, so I just raise that issue.

MR. WROBLEWSKI: Thank you.

MS. LEVINE: Let me just ask a follow up question on that. What if the auditor discovers that the parties that commissioned the audit, in this case it's Acme and Apogee, the owners of the B2B, have done some practice that may discriminate against a minority member, Zenith say or that other small buyer, what kind of position does that put the auditor in, and is that information going to be disclosed in the auditing report?

MR. RICKMAN: Well, since I raised the issue, I'll take a stab at it first.

MS. LEVINE: Thanks.

MR. RICKMAN: I think the question is when you look at Acme and Apogee doing the audit, I have some questions about that. I think it's best that the audit economists on our panel to help us answer these questions. Let's spend a short amount of time on part 1 before moving on to part 2.

Part 1 asks for the dividing line between monopsony and joint buying. Suppose that ECommX provides services to facilitate joint buying, that 90 percent of the purchases on ECommX involve joint purchasing and that as a result the buyers get a really good deal when they buy through ECommX.

Here's my question to you, economists: Tell us, is this efficient joint buying, or is this monopsony, and what kind of facts do we need to add to the mix to know?

MR. WILLIG: What a good question.

MS. GIVEN: Why don't I go first, and then you can disagree with me.

MR. WILLIG: I'd love to.

MS. GIVEN: Because that's what economists do. The first thing I would like to point out is this is not really a monopsony. It's an oligopsony, and I think that's significant to think about, and I'll get to that towards the end of my little comment here.

My first reaction was monopsonies usually happen or happen in a situation where you have a single buyer and a competitive seller in a market, and you don't really have that quite here. You actually have a number of online exchanges, and you don't have necessarily a really competitive seller market. Maybe it's competitive, who knows. It's kind of borderline, so you don't necessarily think there's going to be a problem.

Let's see. I think another thing you might look at, after getting to the market structure, is were there rules in place that sort of predispose something like this to happening, like not allowing people to sell off the exchange, and actually I'm trying to remember if these are exclusive exchanges. Are they? I'm trying to remember.

MS. LEVINE: I don't think it's --

MS. GIVEN: Maybe it wasn't specified. To the extent you can allow someone to purchase off the exchange then you don't have the cartel situation.

The other thing is you might have a situation where buyers are sort of linked to particular exchanges -- I mean, sellers are linked to particular exchanges. I don't think that's the case. There was -- actually a lot of monopsony economics have been done in the labor market, and the real famous case that people might be familiar with if you're familiar with anything is on professional athletes, and baseball in fact I think until 1976 did have an exclusive arrangement between players and teams.

But in terms of -- so those are kind of theoretical things that you might see that might raise problems. I think in terms of empirical requirements that you might see, there's been -- I would say first, are there any complaints? Basically are the sellers complaining that they're being forced to get paid low prices? And then the next thing would be to go ahead and try to test them to see if there are any particular results.

And I think in labor, as I said labor is the key thing that we actually see monopsony because this is where you actually do see large single purchasers, firms in particular geographic areas, and then you see large fragmented labor markets, and you've seen a lot of empirical studies on for example, nurses and teachers, athletes, coal miners.

And I think one example that's not labor is actually agriculture and meat processing, and then

You can actually look at concentration and wage rates, which is a little bit problematic, and you can look at price and quantity, and just to -- I want to mention one case that I'm familiar with on monopsony and was a big issue recently, and I don't know if people are familiar with this there are probably people in this room who are more familiar with it than I am, and that was the Aetna Prudential merger that the Justice Department required Aetna to divest some of its HMO plans in Texas.

And that case, from that what I understand, seemed to be mainly made on the fact that the physicians who contracted with Aetna claimed it would have monopsony power, so that's one example.

Then I just want to make kind of one other comment that feeds back to my initial comment about oligopsony, is if this was really a monopsony situation, the purchaser would really have power, but what we really have are a number of purchasers on a particular exchange, and as I mentioned earlier, I don't think it's really easy to get them to cooperate together to -- in this, just kind of based on my own experience.

MS. LEVINE: Bobby?

MR. WILLIG: Well, I totally disagree, just as we knew would happen. I put it in a complimentary way I think. The question is, What factors are relevant, and I came up with two groupings of the factors, which I think you did also.

The first grouping would be whether the aggregation enables supply efficiencies. The aggregation that the question is about involves some of these buyers, through the B2B exchanges, bundling together their purchases and presenting them jointly to the sellers probably in a take it or leave it fashion. I think that's kind of what the aggregation is all about, We're offering you a deal, we want you to supply our joint needs, and that's what the deal is, and we want such and such a price and if you don't give us that price, you don't get any of our volume. I think that's what the aggregation is about.

MS. LEVINE: Why does it have to be a take it or leave it situation?

MR. WILLIG: Well, that's where you stop to get some advantages I think, both efficiency advantage as well as commercial advantage, but I think the kind of efficiencies that can arise from this kind of aggregation come up with their scale economies of course on the supply side, so here's a big bundle of demand for you, seller, to meet where you can exploit the scale economies in your production, come up with lower cost as a result, and we want to share the benefits, so that's what's in it for us, but from the social point of view there's an efficiency there.

Also the risk reduction, even without scale economies, if you, seller, were out there facing the uncertain fragmented world that you would otherwise be facing, you've got certain inventory costs, certain planning costs, but we can alleviate that for you by giving us our aggregated bundle, that provides some savings to you in those categories, and again we want to share that.

So those are all efficiencies. Those are all good reasons. We can and should applaud those kinds of aggregations.

The other side, the other set of factors is whether or not the aggregation raises or lowers the quantity that's transacted in the XMarket and presumably in the downstream market as well, and here we get to the monopsony theory. When we aggregate, are we agreeing among ourselves to limit the amount that each of us is buying?

When we come up with the aggregation package there is the agreement, the agreement to aggregate, and within the agreement there may be limitations on what we are permitting one another to present to the market. If so, this is plainly dangerous raising monopsony and downstream monopoly or oligopsony kinds of issues.

And I think you mentioned this very well, that if the agreement so-called to agglomerate allows bypass, allows people to go outside the agglomeration for additional volume, that very much mitigates that risk I think.

The final factor is if you don't give us our deal, says the agglomeration, what is the implicit threat? Is the implicit threat that we're just not going to be buying that amount of X at all, thereby curtailing our downstream production, in which case this sounds like an anti-competitive cabal masquerading as a joint buy, or instead is the threat, Look, we'll just go elsewhere as individuals or go elsewhere as an agglomeration to make the deal, in which case it sounds more like commercial muscle, which may be an issue, but it's probably not an antitrust issue.

MS. LEVINE: Any thoughts on that, panelists?

If not, I'm going to leap ahead to the next question, and I'm going to start out with Bobby and see if I can ask for an economist's view on it. Part 2 of question 8 asks you to balance a claim of exclusion against a monopsony concern. Here's the situation.

real. I think it is in my experience.

Second, I think free riding can very well be a real issue of concern when it comes to new ventures of this kind that require real investment, real planning, real risk taking, and the idea of spreading those benefits out willy-nilly without the ability to get compensation for the sharing of those benefits is a very real set of business concerns.

On the exclusion side, an 8 percent bunch of folks is not going to make somebody's day as a monopoly or as a shared monopoly or oligopsony, so 8 percent is a pretty small number, so let's entertain as a hypothesis that there is the exclusion story here.

If so, it seems to me likely that it arises because the 9 percent players could, under the right circumstances, with good access to the inputs X, be feared to grow a lot beyond their 8 percent. They must be really expandable to make the exclusionary story make sense.

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So if they're real expandable, why can't they use that in their joint buying to good advantage, which to me makes the whole exclusion story kind of fall apart on its own bottom, so here I'm kind of coming down the other way.

MS. LEVINE: Jan, do you have any thoughts on this?

MS. MCDAVID: I don't think I have any problems with it.

MS. LEVINE: Anybody else want to take a stab at Bobby? It's a tough thing to do.

MS. MCDAVID: Let me just make one comment on the free riding point. Couldn't they charge the new entrants some reasonable fee and as Judge Posner has said, therefore if pay is possible, the ride is no longer free?

MR. WILLIG: No doubt they would probably extract the fee in the purchase price of X which would drive the enforcers crazy, charging your rivals a surcharge on their input purchasing.

MS. MCDAVID: If you're charging for all transactions taking place on the exchange.

MR. WILLIG: Not yourself because you were the original investor.

MS. MCDAVID: Most of them do.

MS. LEVINE: Most of them do what?

MS. MCDAVID: Most of them charge for transactions.

MS. LEVINE: Do they charge their incumbent members and the new members the same fee?

MS. MCDAVID: The ones that are encouraging participation by a broader range than their original members who want to achieve some scale in order to do the transaction costs are.

MS. LEVINE: Paul?

MR. PENLER: We have seen next to no variance in fees if someone is a member or a non-member or founder or non-founder. If there is any variance in fees, it has to be for very good economic reasons., the amount of purchases they do through the exchange or things along those lines.

MS. RICKMAN: I have two questions. One was, the first is on this 35 percent number, how does that compare to the 20 percent sant sa 9P zis aer, hoat

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percentage level that is so high that it is an important ingredient.

So I was just wondering if there was any reaction to those two issues.

MR. DAGEN: We have Bill Cohen back there, but I won't ask him to jump up here. I think one short differential would be the fact that we don't have an integration really here that is contemplated in the Collaboration Guidelines to some degree, risk sharing, et cetera, by the buyers.

MR. WILLIG: Which way does that cut? Does that make the percentage guideline more or less?

MR. DAGEN: The more integration, the more lenient, so what do we have here? We have less integration here.

MR. WILLIG: Right, we get 35 percent on the hypo. Is that 20?

MR. DAGEN: So that makes it worse here because there's no integration.

MR. WILLIG: There's more concern.

MR. DAGEN: Right, more concern. The guidelines are consistent -- we could have a smaller percent. It just makes it a more obvious question.

MS. LEVINE: Before we take our break in another five or so minutes, let's jump to the last question in this series. It's question 9 about B2B responsibility. Rick, do you want to do the exposition?

MR. DAGEN: Sure. In this question we are in kind of antitrust enforcer heaven because we have evidence that ecommerce X, or we could be using XMarket here, have reached an agreement to use their buyer power to depress output and lower the price they pay for X, and we have that both on the telephone and written agreement, and they've actually hired Bobby to do the econometrics that demonstrate the anti-competitive effects here.

So we have that violation of the antitrust laws, and the question that's posed by this hypothetical is whether the B2B also would be liable here, even permitting the joint buying but they provide no services that facilitate it, all they do is permit the joint buying, and we turn this over to Paul Penler from Ernst & Young to give his thoughts on this.

MS. hcsTVINE Suwd we 5/rticannd thoR thoR-ccFs that de is challenged, the trade association is inevitably also effective ways to shed responsibility and that one would have to assume ultimately that they're brought into the morass.

MR. DAGEN: So would it be the panelists' general view or, Bill, your general view that they could not easily get off by saying, We are essentially a common carrier and therefore we just provide the means of transacting but we're not a guilty party here?

MR. KOVACIC: I think at some point it's conceivable that if you demonstrate in a rigorous way, based upon contemporaneous records that show you who you've designed and limited your role, that it's conceivable that you might, but it strikes me that it's going to be a long, labor and unpleasant journey to reach that destination.

Again going back to other f i4sponation T* (

relationships involving members' individual firms, here again the association -- the B2B exchange itself perhaps is implicated.

MS. LEVINE: Jeff?

MR. DAGEN: I think --

MS. LEVINE: Go ahead.

MR. DAGEN: Paul?

MS. LEVINE: Paul, if you would like to --

MR. PENLER: I'll make a brief comment.

MS. LEVINE: Sure, go ahead.

MR. PENLER: One reason I hesitate not wanting to be a Philadelphia attorney here since I'm one of the few that don't have a law degree, but I will say based on our experience working with exchanges, they're very concerned about this. A lot of exchanges are, that they could be inadvertently pulled into something that they did not -- they were not a party to or that they had no interest of occurring.

So what I've seen a lot of exchanges do is try to set up policies and procedures and try to protect themselves so they can show some level of due diligence and trying to prevent something like this from occurring.

MS. LEVINE: Let me see if I can ask Jeff if he can give us the last word since he's general counsel of

Transora, one of the B2Bs that Bill is telling us will be in the hot seat if this sort of thing happens, and then we'll go to our break.

MR. SCHMIDT: Just to echo in part what was said, I think this is a real challenge for the marketplaces, and you have to distinguish between the possibility of being sued versus doing everything you possibly can to do what's right, and I think having policies in place where you make it as clear as possible to your participants what the rules are for joint buying and then have consequences of some sort if you find that they've violated it, which is likely to implicate some sort of auditing process, although recognizing as a practical matter it can't be in every transaction audit process but something that gives you the opportunity to discover a violation of your policies and then again enforcing, having consequences in the event of a violation of those policies.

I think that's the best marketplace to be.

MR. KOVACIC: Gail, could I add I think the real danger here might be less from a discriminating assessment by a public enforcement policy than the prospect that once the arrangement is made known, you have a long parade from here to eternity of the troubled damage claimants, and that's where staying away from a jury becomes difficult.

And I think Paul's right, that if you put in place ruthless safeguards that keep people out, once you've identified difficulties, that helps, but I think the cases suggest recently that a somewhat antiseptic and absolutely consistent application of the standard is important or you start bumping in to Kodak/Aspen problems with kicking people out, especially the more successful your venture is.

given us that exposition.

Here are the facts for the standard setting hypo. Traditionally, in the old days, buyers and sellers used to meet face to face or on the phone or in a fax and decide between them the kind of X they wanted to trade, its weight, its color, its size, whatever.

But on B2Bs you have to be very precise, and there's not the opportunity for this more informal communication and more informal way of coming to an understanding. You have to use a very precise way of describing the X that you want to buy or the X that you want to sell. The taxonomies sometimes differ among B2Bs, and sellers have found themselves in the very unpleasant position of having to customize their online catalogs for each taxonomy developed by each of the varying B2Bs.

To solve that problem, 15 of the 16 sellers in this market, these are sellers of Xs, have gotten together and they're going to try collectively to set a standard to define grades and qualities and the like of

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B2B world, can you tell us something about the efficiencies that these statlD1 so forth.

So the question, I enjoyed Commissioner Swindle's opening remarks because that is the quest of some of the standards. Standards are an enabler to B2B. They are the tools that help B2B, so that's one of the tools. There are many tools.

So in this particular group, let's just set up an example of these competitors working together with a couple of sellers. If each of them has a separate process, that sets a tremendous cost for everyone to have their own purchase order taxonomy, their own

I would expect that they would go through would be the process, what they call the choreography of going back and forth, I need to order this, I've got X of this, and it's a dialogue that sort of goes back and forth, same efficiencies, just not only what you call it but then how the servers are talking back and forth to each other.

I'll stop there because I can go on to the next question, but we should let the tent cards go up.

MS. LEVINE: Any tent cards interested in going up? Well, then let's move on to the next question. Michael?

MR. WROBLEWSKI: The hypothetical Gail set up said that in the variation that 15 of the sellers had come together to form this standard, and the 16th, which was by far the largest, hadn't participated.

The question is, is -- the variation that we put for this question is whether that 16th seller was actually excluded, say the 15 joined together and excluded that 16th seller. The question that we have is, one, how would this situation come up in the real world or would it ever come up in the real world?

Mary, I'll turn to you, and then I want to turn to Pam for a second too.

MS. SCHOONMAKER: Well, in most standard

setting processes, back to where we were in the earlier part of the discussion before the break, typically there's a board of directors in a standards firm typically that helps set the road map, what are the standards we're going to cover, what are the priorities.

But when it comes to developing the standard, that is putting the standard together, the processes, the taxonomies, as I said earlier, you want to make sure that every member of the standards body is open, every member is able to help develop the standard, every member is able to vote on the standard, to ratify it and adopt it and is not inhibited in any way.

So from a standard setting perspective, I would say it's a no-no, make sure everybody is there in the open process, development part of the standard.

Priority, that might be a little bit different. Somebody has got to help set the priorities, but when it comes to developing the standard and putting the effort into it, you need to have everybody openly invited to the table to say, Here is how the public taxonomies and the public processes should and could work.

And typically also sometimes people come to the table and say, I found a dictionary or a process that works well, and let's just adopt that. Harkening back to I guess the second part of the earlier question too is things that would prevent things from becoming adopted would be, it's not universally developed, openly developed or something that could be implementable, and the things that impact the barriers to getting it implemented are all the chain processes and the back end things have to get worked, but, no, no, have to make sure it's open and openly developed.

MS. LEVINE: I gather what you're saying is that we're not going to see in the real world, at least right now the 16th seller being excluded. The 15 really, as a practical matter, want to have the 16th at the table.

You did mention in the course of saying that -- I think I heard you say that the question of setting priorities within the standard setting organization was a different matter and that I gather one or two or some subset of the let's say 16 now invited to the table might be in the privileged position to present -- to present the agenda, to set the priorities; is that correct?

MS. SCHOONMAKER: Yes, typically in the standards world, let's just give a hypothetical example, there might be a hundred processes from the cataloging, pricing, inventory, all the collaborative design efforts, collaborative forecasting efforts. We can go on and on and on.

Typically there's a group in most standards organizations that gets together and says, We want to focus on order management course or we want to focus on cataloging first, we're going to put our energies around that and put the on loan resource -- it's just like the seconded group that we were talking about earlier, put our resources and efforts into developing and implementing that.

That's typically what happens. It's more setting the priorities but not developing the standard. That's again how it works out.

MS. LEVINE: Well, Pam, if that's the real world scenario, if that's the view from the real world, that exclusion, now it's pretty unlikely, but that the holding of these important privileged positions is more likely, a smaller number of the standards members might be in that privileged position, does that raise exclusion concerns for you?

MS. JONES HARBOUR: It actually could. I want to take another stab at this from an antitrust perspective, and I think the answer to the question involves an analysis of the justifications that are offered by the 15 sellers for the standard setting effort.

Now, the 15 sellers have offered the full array of pro-competitive justifications for their standard setting. In essence they assert standardizing the descriptions of X will facilitate competition among the sellers of X by reducing confusion, for example, among buyers about whether one seller's industrial size X is the same thing or a different thing than another seller's extra large X.

I think this justification indeed is a valid one, but if it is valid, then there can be little justification I think for preventing seller 16 from participating in the standard setting effort, and the exclusion, in my opinion, clearly takes the guise of a group boycott, and it seems like there are no countervailing pro-competitive justifications that were at least offered in the hypothetical.

Taking another look at this, I think denying seller 16 access to the standard setting process and its outcome may even invoke the essential facilities doctrine. If access to the process and the standard is necessary for seller 16 to compete and if seller 16 can't replicate it or adhere to it without participation, and if sellers 1 through 15 collectively exercise monopoly power, then I think the standard might be evoked in this hypothetical.

MR. WROBLEWSKI: Barry?

MR. NIGRO: While I think it's prudent to counsel our clients to have an open standard setting

So I'm not sure that I would necessarily agree that excluding one participant from the setting of the standards is automatically a problem.

MS. LEVINE: What about the facts as Mary has presented them. Imagine that the 16th seller hasn't been excluded. Rather the 16th seller and sellers 15, 14, 13 down to 10, they've all been -- they've all been told, You can come in but you can't play that privileged agenda setting role, that's for a subset of us to play. What kind of issues does that raise?

MR. NIGRO: I think it's the same issue because it's just being excluded to a lesser degree, and so you really have to look at whether that has an anti-competitive effect, and based on the hypo, it's hard to say without assuming more facts, but I can envision a situation or circumstances where excluding or limiting participation some of the members in the setting of the standards isn't necessarily a bad thing.

MS. LEVINE: Bob, did you want to add something? I'm sorry, I didn't see your tent. The water is blocking my view. All right. Thank you.

MR. WILLIG: Again I'm agreeing with your latest remarks, but it seems to me there's two standard forces that are very important in the area of products, which is what I took a lot of this hypothetical to be about.

One is it's clearly pro-competitive to have good product standards out there. It brings people in we'll stay with the more mediocre ones, and the complaint was that was one of the ways that the players were actually keeping better products off the table, was refusing to certify the new standard.

So my conclusion is that openness is really what this is all about. Standard setting is good, but allowing for new products to come and notwithstanding the standards is all important, and here's where allowing the 16th to use the standard, but in a sense pushing the biggest player to also entertain the idea of coming up with its own design, can be quite pro-competitive.

MS. LEVINE: Jeff?

MR. SCHMIDT: I just have a brief comment, and that was in prioritizing the importance of some of the subjects we're talking about, at least in the Transora experience, the importance of standards really can't be overstated as to what's driving the participants to actually want to have a marketplace.

We can spend a lot of time talking about group purchase setting and how we're buying and things like that, but at least when you're dealing with -- perhaps when you're dealing with larger companies such as participating with Transora, that is not what's driving their participation both because they think they were already getting about the best price that they're going to be able to get or in some cases their individual market shares preclude them from really getting together for any group purchasing in any event.

But it is the ability to get through and develop some standards that they are -- I think if we had the business people here at least from the Transora side, they would say this is not an antitrust problem, we don't care what standard is adopted, we just want a the X will break early or late in its life. The group members who sell the really good Xs from the breakage perspective, you know, the ones that break late in their life if at all, are upset because the standard doesn't display that good quality of theirs.

So the question becomes: What is the competitive impact of that standard, the standard that doesn't really display the superior qualities of some members of the group? So that's the first level of question, and the second level of question is: Would it make a difference if we included buyers, if you imagine that buyers sat on the standard setting organization as well?

Bill, do you feel like taking an opening crack at this one?

MR. KOVACIC: I think one general issue is that any standard setting process is going to confront a trade-off about the level of completeness that it wants to achieve, much as parties writing a contract have to face a basic question in deciding how complete a contract one wants.

It's a standard theme in the contracting literature that the perfectly complete contingent contract is perfectly unattainable because it fills the size of this room.

So any standard setting process is necessarily going to have to make discriminating judgments about that -- about the degree of detail, trade-offs concerning detail versus clarity, which means choices have to be made, so I think in evaluating the competitive significance of a specific standard, one wants to ask a process question about how it was developed; that is, what considerations went into the selection of the specific test.

And it seems to me that an organization, in setting a standard, gets itself a long way around the specific competitive hurdles by demonstrating that the trade-offs, a need to make the trade-offs in part, govern the specific selection of information to be disclosed, and second, that the choices were made in a neutral way with the kind of open process that Mary referred to before.

One can think back to the FTC's own experience with the octane rating. One of the basic complaints about posting the octane rating was, Does this give consumers the right information? Same issues come up in presenting nutritional labels too. Are you giving them information that is really important or are you leaving out variables that are less important?

So the first thing I would focus on would be the process and methodology by which the standard itself is established, and to ask, Is it a process that is ultimately likely to be consistent with demand side user needs in the long-term?

The second interrogatory in this question asks, Would the analysis change if some buyers were among the members of the standard-setting group? My intuition would be absolutely, that is, to have some buyer representation on the standard setting group would provide some measure of assurance that the choices' made and the trade-offs made are made in a way that is ultimately compatible with purchaser interest.

MS. LEVINE: Well, let me ask the panel then, is buyer participation dispositive? You've got buyers in your standard setting organization. Does that make all the difference? Go ahead.

MR. RICKMAN: Well, I would like to raise one point about Bill's comments. I think when you're talking about standard setting, the question I ask myself is, Is it a restriction on output or price or the product's characteristics, and in this case -- and it's hard to tell from a hypothetical, let's say breakage rate is a part of the product, and if you have an agreement on what goes into that product or what it's going to have, then I think you get into a very dangerous area of a conspiracy to restrain output.

One case that comes to mind, I was trying to think of the name of it, I think it was the FTC's investigation of the Detroit area car sellers where they had an agreement on being closed on Sundays. So there was a restriction on output done by a quote, unquote, standard setting organization one might say.

So I think that's one of the questions I ask when I see that the standards are restricting the potential output part of it.

MS. LEVINE: Ruth?

MS. GIVEN: Yes. I have a somewhat different perspective on this whole question. I think it's partly because I come from the supplier side, and I have an example that I think is really good. I see this as a situation that is sort of driving the suppliers to commoditization, and that is really scary.

If they've got differences in quality, they want to be able to compete based on those and not be forced into something that some of them think is an unfair quality standard.

And the example that I have is actually when I was working at Kaiser Permanente a few years ago, I don't know if you know about a benefits management company called Hewitt Associates, which started three or four years ago something called the HMO auction, where they were going to have this virtual auction for HMO services in a few large metropolitan markets.

HMO and Kaiser and its competitors kind of had to participate, and there was a real concern that the competition would be based purely on price and not on product differentiation, and Kaiser, as people know, is pretty different in lots of ways. Some ways people don't necessarily think are great, and other ways maybe we do have better quality standards because we're vertically integrated. We were vertically integrated.

But that is one thing that I think there was a real concern was if we participate in these auctions that Hewitt Associates was holding, which is strong -- that has a strong effect on what they do find valuable as long as they understand.

MS. LEVINE: Pamela?

MS. JONES HARBOUR: Another concern that I see here is potentially the lock-in effect, that the sellers will get really comfortable with the lower breakage rate and not improve quality to make the product more durable, and I guess briefly the lock-in effect occurs when an industry group adopts a particular standard and then becomes an arm for the sellers in the industry.

And a final observation that I would make is that if the group gradually upgrades its standards and receives regular input from the buying class, then I think it probably withstands scrutiny.

MS. LEVINE: Bill, do you agree?

MR. KOVACIC: I think one question that's suggested in a number of the comments is to what extent individual suppliers that want to provide a superior level of quality can distinguish themselves in the marketplace by saying, I offered the standard plus something else, and without knowing what kind of success individual suppliers have had in different circumstances, and perhaps the health care example is one that shows that this is a sticky process, I would simply wonder whether over time if you exceed the standard dramatically, if that doesn't become an important part of your marketing and sales presentation, that is to go to significant buyers and say you can work through the B2B, but I can beat the standard all the time.

So I would want to know more about who are the purchasers and to what extent can sellers differentiate themselves by offering this additional increment of quality.

I think it also suggests the possible benefits of having at least at different stages, multiple paths for standard setting or at least more than one. Suppose you're dissatisfied with the approach that the incumbent dominant group is providing, and they're setting the bar too low, you want to set yourself apart, you can create a focal point by saying, I'm going to be part of the superior quality standard setting group and we set higher standards, we hit higher targets, we certify ourselves, we in effect brand our coalition that way.

That would seem to provide another safety valve against the possibility that you get trapped for a long period of time in an inferior rut.

MS. LEVINE: Let me ask Mary if we see that in the real world, at least in your particular corner of it. Do you find that, as Bill's hypothesizing, that a standard setting organization is constrained by the fear that another rival experienced organization setting better standards will come out there and come out with a rival standard?

MS. SCHOONMAKER: No. Actually the standards world it's a little bit different. It's kind of what Bobby was saying, is that if somebody sees a need or a weakness in the existing standard, they go off and form another standard that works on an area that perhaps the group is not working on, and they tend to come together again so it kind of works in different ways.

The standards group it has an altruistic vision of looking at the whole B2B spectrum, trying to involve the whole community, and with that you could get into a stalemate, so you have to pick off what do you want to work on.

So all the comments I think are right on in terms of getting the community and then having healthy competitiveness in the standards community on what to work on and how to market itself.

MS. LEVINE: Any other comments before we move on to the fourth question? Excuse me, Paul, I didn't see that, sorry.

MR. PENLER: I think one thing to keep in mind here is when we talk about standards if you want to talk about standards is the type of standards. RosettaNet for example is a technology standard. This case is focused on what I'll call an industry standard, related to a given industry type of product, and then I think a third category that we see a lot of are operational standards.

Just one observation I want to make, since so many of the exchanges out there focus in a given vertical industry, I think there's kind of a unique opportunity here to have standards that could apply across the different exchanges without having a lot of additional competitive issues because they are in different industries, so you don't have necessarily, then, a Transora being concerned about what a Covisint doing because they're two totally different industries.

But as they start dealing with a lot of companies and different parts of the supply chain of moving data, they could all benefit from operational standards as well as technology standards.

MS. LEVINE: What kind of standards do you have in mind that go across non-competing B2Bs?

MR. PENLER: For example, on the technology side is an area of XML that RosettaNet focused on, and there are several other standard setting bodies for different elements, if you would, of the XML world so a code can be read.

On the operational side, for example, we see many exchanges interested in having conversations among one another of setting similar standards of the way they perform, the way policies are issued out on the web, the way compliance with those policies might be monitored or attested to, that then would give the different participants in the marketplace confidence that if a certain standard is followed, that that market is like -- it can put some level of confidence from one industry to another.

MS. LEVINE: Janet?

MS. MCDAVID: I wanted to make some of the same points that Mary was really describing, I think technological standards, and it seems to me we should be very interested in allowing these exchanges to talk to one another, and so that if you are a user of an exchange, you can use it to access another exchange without having to write different kinds of code and things that I don't know anything about in order to do so.

And the same is true on the operability side. The more intercommunication you've got between these, probably the better, as opposed to what are really product standards that may have much more competitive implications. It's in everyone's interest that these things be able to talk to one another without having to write.

Even for XML, I understand there are different kinds of XML that don't necessarily speak to one another.

MS. LEVINE: You're envisioning a kind of standard that would allow someone to access one B2B for one part, another B2B for another part, both of which go in to the same product; is that the idea?

MS. MCDAVID: Absolutely, and I think there's a good deal of that going on.

MR. SCHMIDT: Or you would access through one B2B to another B2B.

MS. MCDAVID: Right.

MS. LEVINE: Going through it, yet using the same standard. Is that what UDDI and other organizations like it are seeking to establish as standards? Mary?

and say, What language do you speak of XML, what processes do you speak, okay, let's run this, and we'll optimize on it, which is kind of back to Janet's comment of this B2B all the way from raw materials, let's talk high technology, semiconductor all the way to a finished product and think of the information flow, and its interesting like the FTC, the information flow going through that in a nanosecond.

That's kind of interesting. That's a perfect information world where they are actually seeing all the information on inventory instantly. A customer orders something. It goes all the back to the sand in silicon, if the whole thread worked. It doesn't at the present time, but if the whole thread works, that's the holy grail of B2B.

MS. LEVINE: How far do you think we're away from that as a technological matter?

MS. SCHOONMAKER: Quite a ways.

MR. WILLIG: What about a world where various B2B marketplaces are wonderfully interoperable and agree to become that way, but thereby also create a danger for themselves of losing business, one to the next, so part of their agreement to interoperate is to separate what they're handling?

I'll take the washes, you take the chips, and we'll interoperate on the same set of codes but without that side agreement that you stay away from my washers, I'm not going to be willing to interoperate with you.

MS. SCHOONMAKER: That sounds like a frightening world, but at the same time I think you're embarking upon what happens when we all have this information, what business models do we go to, what value do you operate under, do the rules dynamically change as everybody has all the information at their fingertips? Do we go off to our corners or do we create new business models?

MR. WILLIG: Lawyers, are we in trouble with that agreement?

MS. MCDAVID: Hopefully some lawyer might identify that.

MS. LEVINE: What's the answer?

MS. MCDAVID: I would advise against the horizontal market allocation arrangement. That's orange jump suit territory.

MR. WILLIG: But it's market allocation to create a new market, then with the interoperability of this whole family of B2Bs.

MS. MCDAVID: That's a little stretch.

MR. WILLIG: Is this a grocery story thing? I think there's a special set of brands of food stocks at a bunch of grocery stores, and they had some agreement to stay out of each other's territory because they were all handling those overlap brands. Someone said that case was dead. Never mind.

MS. LEVINE: Let's jump to the fourth question in this series. The question now is how many handles the standard established by the B2B is going to accommodate. In the past these hypothetical Xs have had five handles. Buyers now decided they would prefer six handled Xs. They would last longer, and so in the long run they're cheaper.

They're frustrated though because they find that they can't order that six handled X through the B2B from the group's members because the standard does not accommodate them. You can't click on a six handled B2B.

I gather -- instead I gather that had this happened in the real world, if this scenario arose, you would have to get on the phone and order or something like that, fax machine, whatever, and order that six handled B2B the old way. You can't do it through the B2B.

The buyers suspect that the standard setting group, which back to the basic facts of our variation is established only by the sellers. That seller group is really not interested in establishing a standard for the six handled B2B -- six handled X because in the long run they don't really want to be selling six handled Xs.

The group, for its part, responds that they are trying to change the standard, but establishing standards and changing standards takes time.

The questions that come out of this series of facts is just the competitive impact. Mary, can I ask you whether this is a fact pattern we might see in the real world?

MS. SCHOONMAKER: Yes. I was trying to stretch -- in the real world five to six handles would probably hopefully have been accounted for by taxonomies, so I kind of have to stretch it more, Do they want a whole new process.

And standards do take time to get developed. Most standards take -- when you're working fast in a standards organization, it's six to nine months. That's about as fast as a standard process can go.

So I'll kind of try to respond from it that way, and that could be open, making sure you have a sense of community, making sure you have continuous improvements in your standards is a must or your standard -- what happens is it starts to get put on the shelf and another standard arises and gets merged or prevails.

MS. LEVINE: How does that other standard arise?

MS. SCHOONMAKER: From the sense of community where the buyers are not getting what they want. And again that's the sense of communities or the natural balances that happen within the trading company.

MS. LEVINE: So you're saying the buyers are going to insist that the sellers start doing this?

MS. SCHOONMAKER: Typically in the real world the sense of community takes over, and the standard grows or another standard arises.

MS. LEVINE: Bill?

MR. KOVACIC: I would just wonder, Mary, if it wouldn't be true that if the facts as they're suggested here where the buyers are significant participants -- let's imagine it's the most important of the buyers, I would expect that that strong expression of distaste perhaps backed up by either a threat to buy one of these and integrate it into one's own organization, to peel off members of the existing B2B and to support them in developing an alternative would be a strong motivation to change quickly.

MS. SCHOONMAKER: It would be a very strong motivation. In the real world, in many ways, something like this, with all due respect to people who wrote the case, probably hopefully would not have happened because the sense of community would have set the foundation, and here is sort of the various shoots in which we will go, but sometimes there's that oops.

Also in the real world -- and again I'm getting more into technology rather than fair trade practices. In the real world they typically develop what kind of exists today, and then they start to see what happens on XML B2B environment, quick information, and all of a sudden they go, Oh, we need to change because it's starting to change all our back end processes, so we need to evolve and get more into a true 21st century sort of way of doing business.

That's kind of an interesting dynamic that happens technologically. I don't know how that relates back to fair trade practices, but perhaps maybe we can help battle that in another round.

MS. LEVINE: Chris?

MR. COMPTON: You know, to my mind there are a couple of different analytical looks at this one. If you assume for purposes of analysis that this was a deliberate decision and agreement by the members of this group to delay the standard as distinct from it taking from six to nine months and we're doing the best we can, then you bring in the whole rule of reason analysis that the collaboration guidelines lay out.

You start with that first question of whether this is likely to effect competition. Are we going to have competitive harm? And I think you have to think there is likely to be competitive harm here because you're going to probably delay the introduction of a better product into the market and hurt consumer welfare.

But the big issue we don't know, of course, is number 16. What kind of capability does the largest see here. Why would there be some efficiency or pro-competitive benefit to deliberately deciding not to promptly introduce the new six handled standard? There might be some arguments.

It could be that it would distract the focus of the standards group from more productive activities. It could be that they've got other standards that are far more important to get out there, and they can't do it all at once. There might be arguments to be made there, but it seems a bit of a stretch under these facts.

So I think the only other point I would make is independent of the rule of reason analysis, you have the Allied Tube issues. In the worse case -- and it's not necessarily part of this fact pattern, the worse case you've got the sellers abusing the standard

MS. LEVINE: Thanks. I think now we should probably turn to our final question of the day. Rick?

MR. DAGEN: Thank you. The last question moves toward discussion of the intersection of intellectual property and standard setting and B2Bs. The Commission has been somewhat involved in IP and standard setting, been involved in those previously in the Dell case and some other areas, but now this is kind of expanding the question to see whether the B2B aspect or the ecommerce aspect adds anything to this discussion.

So we're going to suppose the standard setting group claims intellectual property rights in the standards. Does that alter the analysis of how the group's activities are likely to affect competition and if so, how? I think there was some earlier discussion I guess about different standards. One could be the industry standard, the operational standards and the technical standards.

And why don't I start with Mary, and maybe you can -- if it makes a difference as to which one of those standards we're talking about, and in fact do -- has a B2B group ever claimed intellectual property rights or patent right or copyright in the standard?

MS. SCHOONMAKER: Well, certainly most -- B2B being distinguished as a firm or a marketplace and standards as a dot org, I haven't -- there are certainly firms that contribute to the intellectual property and have copyrights on that intellectual property, and they open source it to a standards firm.

So in the case of most standard firms they have a royalty free license to use the standard, but it doesn't allow their uses of that standard to have rights to the intellectual property of others, so that's kind of from a technical standpoint how it works.

I probably couldn't comment much about operationally or any other fact, but it's typically royalty free, and contribution from technically other dot org corporations we have yet to see -- oh, no,

and contribughts too

patents have come into play in a number of instances, so you could have a Covisint or others come up with a way of doing business, a business method process that involves the Internet or software or something like that that could become patentable and licensable, and it could be an industry standard.

The Amazon.com one-click case comes to mind with a shopping cart. They came up with the shopping cart. It's a neat feature. Now a lot of others are using a similar, is it a violation of the business method, so there are situations where it is coming into play.

MR. DAGEN: Go ahead, Mary.

MS. SCHOONMAKER: Actually I'm thinking of a few right now. What we have seen in a couple standards groups is a one-time technical donation of proprietary content, so it goes over, and then it gets merged and maintained by the standards organization, so the rights are transferred over, and then it becomes part of the standards so I have seen that in two instances.

MR. DAGEN: That's done as part of the up front part of the process.

MS. SCHOONMAKER: Up front or ongoing improvement, where all of a sudden it comes five to six handles, and someone says, How can we do that in less than six months, let's get a technical donation. And a firm has approached the consortium, could purchase the proprietary standard, again one time transfer of knowledge, and then it becomes part of the consortium likely. That I have seen.

MR. DAGEN: What do you think the implications would be if, in fact, somebody in the standards setting group encouraged adoption of a standard that said, Here's the way we should do the six handle technology and then did not disclose that they had patent rights and subsequently asserted them?

MS. SCHOONMAKER: I'm waiting for the other cards to come up.

MS. LEVINE: That is a good question for our lawyers. David, did you have any thoughts on that?

MR. EVANS: The submarining issue? Dell is a Section 5 case, correct?

MR. DAGEN: Correct, everything we do is Section 5.

MS. LEVINE: You have to use your microphone.

MR. EVANS: Well, obviously I think that's a problem. I don't think as a practical matter --

MR. DAGEN: You're still not coming through.

MR. EVANS: Well, I'm not really saying much. Obviously I think that's a problem. From a private plaintiff's side, probably won't have that many options unless it's CSU v. Xerox, which under sort of the Alexandrian federal circuit rules are now basically sham, Walker Process, or tying.

The really interesting question I think is the effect on the market, what is the market and how does this particular patent affect the market. If you look at -- we'll take one-click for example and Amazon suing Barnes & Noble.

They can't have this -- well, assuming that the patent is valid, Barnes & Noble.com couldn't use the shopping cart feature. Well, how does that affect them competitively? Does that mean that they can no longer sell books online? Is that the only way they can sell books?

Can you have a two-step shopping cart where instead of clicking a button once, you click a button, two buttons and then it's automatically sent to you?

That may not violate the patent. It may add an extra step to the whole process, but are you really harmed competitively for it? That I think is the more interesting and difficult question in these cases.

MR. DAGEN: Bobby?

MR. WILLIG: The image that keeps going through my mind is instead of the shopping cart here in the B2B world, it's the shopping trailer truck. That's all.

MS. MCDAVID: Demonstrating the truth of what Orson said as he opened.

MR. WILLIG: He gives me all those compliments, then he votes against all my cases. I just don't get it.

If we think about the product standard again instead of the process standard, it seems to me that there is something to IP protection of the product standard because if we're worried about their integrity or about people either using that same B2B or using other channels, weakening the integrity of the standard by pretending to be adhering to it but actually not, intellectual property behind the standard could help the standard be an effective tool for pumping up competition through the B2B that has the intellectual property protection on the standard.

It helps to make the standard real, helps to make it more enforceable if there is no actual property behind it, it seems to me.

The danger is that someone is going to use some sort of restrictive licensing to that IP to first push the standard on the market and then create some sort of a monopoly, some sort of exclusivity to the site by using the intellectual property that way whether it fits that three part test or not.

I'll let the court do that in a few years, I won't opine on that, but it seems to me as long as the IP is licensed openly and freely and yet still enforced or on anything else we've talked about so far? Who wants the last word?

MR. WILLIG: It doesn't have to be the last word. This has been bothering me all day because I think it's actually very important. One of the main things that the enforcement community gets into is worrying about the information exchange, and I think at the very core of those issues is the question of the timeliness of the information, what is competitively sensitive information and what is not.

And my friends who have been involved in the counseling and the interactions with the Commission on these issues have said that the devil is in those details, one of the nastiest areas, and I wanted to just opine that in our earlier discussion about what is the timing of stale enough information to make it non-sensitive competitively and the court opining in the baby food case seems to me that the economic standard is not four weeks or two weeks or a year, but rather it's a duration of time which has to be related to the ordinary frequency of commerce in the relevant market where the concern actually resides.

So, for example, if we're talking about automobile B2B, and car companies are acquiring auto quality glass, and suppose the ordinary big deals there get made no more frequently than once a month, which is

But the Commission's merger study based on documents obtained in the Exxon case showed to a striking extent how the rule of Container which even limited exchanges of information involving relatively recent transactions in the recent past, it underscored the extent to which exchanges involving past transactions could play a useful role in coordinating cartel behavior on feature transactions.

And it was simply a very useful way of documenting in an industry context in which the Commission had done a lot of work about how certain types of information exchanges, even those a bit older, could serve as a mechanism for coordinating feature behavior.

MS. LEVINE: Thank you. That puts a nice gloss on these comments as well, and it really does bring us back to a lot of the points that have permeated the whole discussion today.

So I wanted to thank you all. You've been excellent panelists on a long and difficult afternoon of questions. I really greatly appreciate it.

I want to thank you the audience too and remind you that we'll be adjourning and beginning tomorrow at ten o'clock for a session on online distribution and marketing.

Thank you again, panelists.

(Time noted: 5:02 p.m.)

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C E R T I F I C A T I O N O F R E P O R T E R S

CASE TITLE: WORKSHOP ON EMERGING ISSUES FOR COMPETITION POLICY IN THE WORLD OF E-COMMERCE

HEARING DATE: MAY 7, 2001

We HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by us at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of our knowledge and belief.

DATED: MAY 21, 2001

SUSANNE BERGLING

DEBRA L. MAHEUX

C E R T I F I C A T I O N O F P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

DIANE QUADE