FEDERAL TRADE COMMISSION

I N D E X

FEDERAL TRADE COMMISSION

PUBLIC WORKSHOP: )
EMERGING ISSUES FOR )
COMPETITION POLICY IN THE )
WORLD OF E-COMMERCE. )
------------------------------)

MAY 8, 2001

Room 432
Federal Trade Commission
6th Street and Pennsylvania Ave., NW
Washington, D.C. 20580

The above-entitled workshop resumed, pursuant to notice, at 10:00 a.m.

APPEARANCES:

MODERATORS:

SUSAN DeSANTI, Director, FTC Policy Planning

HILLARY GREENE, Attorney, FTC Policy Planning

MICHAEL E. ANTALICS, Deputy Director, FTC Bureau of Competition

**PANEL 3: ONLINE DISTRIBUTION AND MARKETING**

PANELISTS:

WILLIAM BLUMENTHAL, King & Spalding

STEVE BOLERJACK, Ford Motor Company

BARBARA O. BRUCKMANN, Howrey Simon Arnold & White

RANDY COVILL, AMR Research Inc.

ADAM J. FEIN, Pembroke Consulting Inc.

BOB GEISTMAN, Ingram Entertainment, Inc.

JULIA KLEIN, C.H. Briggs Hardware Co.

JAMES LANGENFELD, LECG, LLC

MARK E. PLOTKIN, Covington & Burling

SANFORD M. PASTROFF, Sonnenshein Nath & Rosenthal

STEVEN C. SALOP, Georgetown University Law Center

MARY LOU STEPTOE, Skadden, Arps, Slate, Meagher & Flom LLP

RICHARD M. STEUER, Kaye Scholer, LLP

WILLARD K. TOM, Morgan, Lewis & Bockius, LLP

**P R O C E E D I N G S**

\- - - - - -

COMMISSIONER LEARY: My name is Tom Leary, and I am happy to greet you for this morning's session.

As far as I'm concerned, these workshops are immensely valuable, and my hat is off to Bob Pitofsky frankly, our retiring chairman, because he has really revived what was originally the mission of the Federal Trade Commission.

I don't know whether many of you know that, but the FTC, when it was started in 1914, was not supposed to be a law enforcement body. It was supposed to be a body that did exactly what it's done in these workshops; that is a body that acts in consultation with interested people in the private sector in order to try to determine what is or what is not unfair.

You may remember, it's no coincidence, the FTC was started in 1914, three years after the Supreme Court decided the Standard Oil case. The Standard Oil case, of course, is famous to a lot of people because it broke up the then Standard Oil Company. But for competition lawyers, the significance of the Standard Oil case is that it laid out the so-called rule of reason, which requires that the determination of what is competitive and what is not competitive depends upon a reasonable review of the facts in each case.

And an awful lot of people said, we need more guidance than that, we better put an agency in place to give guidance, and that's what gave birth to the Federal Trade Commission. The FTC evolved away from that role over the years. But under Bob's leadership, we are circling back with these workshops on a variety of issues, and that's what this is all about.

It's a mutual education process. Probably most of you either know about or were here when we had the first workshop on these issues last year. It was enormous. We had to rent a hall at the Department of Agriculture. Hundreds of people were there, and I think that was tremendously informative.

That was the first course, if you will. That was B2B 101, and we learned a lot from you, and I think you learned something in return. I think most notably we were able to convey at least some feeling of reassurance that we were not about to jump in and try to make rules on issues that we really didn't know too much about.

This is B2B, 201 or 102 or whatever it is academically, this is the advanced course, but the issues are still there.

Now, I'm aware of the fact that B2B marketplaces, in many areas, have not exploded quite as rapidly as a lot of people thought they might, for business reasons. My perception is that at least one of those business reasons is the persistence of very fierce independent competitive spirit on the part of American businesses. It makes it hard for them to get together and organize these things and agree on how they should work.

That may be frustrating to people who are interested in a particular web site and who see the enormous potential efficiencies, but it's not generally a bad thing.

I think one of the glories of capitalism in the United States has been that we tend to be the most fiercely competitive people in the world, and I think in the long run there have been massive contributions to consumer welfare arising from that vigorous competitive spirit.

The Commission's job, as I see it, is not to favor one method of doing business over another. Our job is not really to affirmatively promote what we may think are efficient business methods.

Our job is to make sure that efficient businesses are not stifled, either by anti-competitive practices or, equally important, by unfounded fears of government regulation. This workshop and the participation of people like you is, in my mind, a critical element in achieving that balance, and I want to thank you for being here.

**(Discussion off the record.)**

MS. DESANTI: Thank you very much Commissioner Leary. I want to share with the audience that when Commissioner Leary says he's going to read transcript, he's going to read the transcript, and he sometimes reads it before we do.

I also want to give an introduction to the topic of this workshop, a few procedural things about how we're going to run the session this morning, and then we will dive right in.

This workshop this morning is a little bit different from what we did yesterday. Yesterday we were digging deeper into some B2B issues that had been raised at least tangentially in the B2B workshop last June and that we wanted to learn more about.

The workshop today is going to add in some B2C issues and focus on vertical issues in the supply chain that we really haven't gotten into to any great extent before, so we can look at this as sort of our initial version of last June's workshop for these issues.

I want to emphasize that, as always, we're very much in a listening and learning mode. We're not trying to send any signals here that we think that there are terribly exciting enforcement issues in this area.

To the contrary, we're really seeking to learn about the business realities of what happens when manufacturers and distributors and retailers think about getting into online distribution of goods and services and what antitrust counselors are confronting in their daily practices.

So we have a variety of experts who are here to share with us their experience and wisdom and time this morning. We very much appreciate all of you making the time to come and help educate us in these areas.

I think first I'll go around and introduce people. We'll just go around the table. Bill Blumenthal is with King & Spalding. Steve -- no, Steve Bolerjack over here is with the office of general counsel of the Ford Motor Company. Bob Geistman, who is next to Bill Blumenthal, is with Ingram Entertainment where his duties include responsibilities for Ingram's Internet properties.

Next we have Steve Salop of Georgetown University Law Center, a very well known economist who has helped us on many occasions. Next we have Adam Fein, who is president of Pembroke Consulting which provides strategic management consulting about wholesale distribution channels and B2B strategies.

Next to Adam we have Will Tom, a very familiar face at the FTC having held a variety of positions here and at DOJ. Will is now with Morgan, Lewis & Bockius.

Coming around the corner, we have Sandy Pastroff, who has an extensive antitrust practice at Sonnenshein, in the Chicago law firm. Next to him is Mary Lou Steptoe, a former

FTC bureau director with many long years at the FTC before she joined Skadden Arps.

Next to me is Hillary Greene, my trusty staff person in Policy Planning, without whom these workshops would not happen. On my right is Mike Antalics, who is the deputy director of the Bureau of Competition.

Next to him is Mark Plotkin who has an ecommerce practice at Covington & Burling. Steve Bolerjack, I'll just introduce him again, from the Office of General Counsel at Ford Motor Company. Then we have Randy Covill from AMR Research. He is a senior analyst for retail e-business strategies; Barbara Bruckmann from Howrey Simon Arnold & White, who also has an extensive antitrust practice.

Jim Langenfeld, you may think that this is old home week, but in fact there are just many people who have made many contributions at the FTC. Jim has been an economist who has had very senior positions in the Bureau of Economics and is now with LECG.

Next to him is Julia Klein, who is also going to bring us some real world perspective on this. She is president and CEO of C.H. Briggs Hardware Company, which is a wholesale distributor to woodworking, countertop, kitchen, bath and furniture industries.

Last, but scarcely least, is Dick Steuer from Kaye Scholer, and no one could begin to be speaking about distribution and marketing issues without having Dick Steuer on the panel.

With that, we will get started. What I would like to do is outline some of the ground rules. I was lucky enough to speak to almost everybody on the panel last Wednesday. It took all day, and there was very little overlap in what people were saying.

Everybody seemed to be bringing up new and interesting issues, so it is quite clear to me that we have more material here than we can possibly cover in the amount of time that we have. So I will ask that you please keep your remarks to three or four minutes and focus on the highlights of what you want to make sure that the agency understands on these issues.

We're also going to have sort of a free for all in the sense of please raise your hand and contribute where you want. We're looking for a relatively unstructured, productive conversation and dialogue among everyone.

With that introduction, let me start by saying, we are imposing structure only in the sense that first we're going to ask the business people to give us some business perspectives on the costs and benefits of online distribution and marketing and to help us get a foundation for understanding what the business issues are when manufacturers, distributors and retailers begin to think about this.

So I will ask one of our business people to start. Adam?

MR. FEIN: I don't think this is on.

MS. DESANTI: Wait a second. Bill or Michael? I should also say, one way to get my attention, tilt your table tent. Then I'll know that you have something you want to contribute. Yesterday's workshop went too perfectly. There had to be some issues that come up here.

MR. FEIN: Thank you. I thought after our conversations, I would just start off and just make a couple of comments about what we've been seeing about in the world of online distribution and its relationship to what's happening in distribution and supply chains.

The way we think of it is that most supply chains or distribution channels are really semi-sequential sets of activities that could be performed by various players in the supply chain. A manufacturer, a distributor, a broker an online exchange or even customers can take on different functions in the supply chain.

A lot of what's happened in the last 12 to 24 months, broadly speaking, has been a number of exchanges attempting to take over certain sets of functions that had been previously performed by other intermediaries in the distribution and supply chain.

For example, a large number of these exchanges, B2B exchanges or even some B2C sites we were looking to, in some sense, avoid the logistics, physical distribution, after sale service, in some cases pre sales information functions of the supply chain and simply try to, in some sense, kind of argue siphon off the information ordering processing components of the supply chain and match buyers and sellers.

Now, there's nothing inherently wrong with that. In fact, most of my research in consulting has found that that's how distribution and supply chains evolve. Functions shift from one player to another.

Part of the problem that we saw, one of the reasons these exchanges didn't take off initially, was in some sense many of these exchanges discovered that in trying to unbundle these functions and activities, number 1, it was substantially more difficult than they initially anticipated, and, number 2, most of these exchanges discovered that their greatest competition wasn't other exchanges or other B2C sites. In fact, it was just simply the existing ways of doing business, and I'll just speak from my experience.

Most of the industries that I deal with are business customers, contractors, industrial facilities, retail stores that are purchasing, and that's what I call B2B, business buying from a business. Most of these customers were very reluctant to disrupt any systems that were working, even if those systems were acknowledged to be somewhat inefficient and maybe even not completely economic, particularly when the stakes were high from a procurement and purchasing side.

Someone who is running a plant facility or plant is more concerned about keeping that line running than about trying to save 2 percent on the price of a hammer. So to some extent these exchanges, at least in my opinion, looked at a first mover advantage versus each other when, in fact, they should have been looking at themselves as really late entrants into an established marketplace of companies providing these functions in a channel, an in place network of distributors, brokers, suppliers.

And their success was dependent on stealing away a repeat purchase behavior, and I guess as a general framework, I like to think of these activities, and if you think about these activities and what a company should be paid for at various activities -- well, not to get too detailed, but that was another issue in terms of what is the appropriate compensation for providing this sliver of activities which had been performed one way or another in the channel.

So a big barrier here was just customers saying, I don't want to unbundle this function or I'm not sure I can, this function can be appropriately unbundled, and there were some issues regarding the pricing of that particular service relative to the overall pricing or value within a supply chain.

So that's an issue that I've seen. In terms of a conceptual framework, that's the way I analyze these situations.

MS. DESANTI: You've mentioned the functions that need to be performed, and it's a question of who in the supply chain is going to be performing them.

Could you just give us some examples of what those functions are that need to be lodged somewhere in order to get the good to the customer?

MR. FEIN: Not to be flippant, but let me give a real world example of something that I think most people in these audience might understand and appreciate, and we can generalize that to more business situations.

If you think about buying, I don't know, something like pasta sauce or paper towels for your family -- you could go to a convenience store, and you could purchase an individual roll of paper towels, and someone somewhere has taken that, has purchased a quantity, has broken it down and has allowed you to purchase it in an assortment with other products and allowed you to buy just one roll of paper towels.

Now, you could also go to a warehouse club, Sam's Club or a Costco, and you could drive up in your large vehicle, your SUV, and you could buy an entire pallet of paper towels and bring it home to your basement and store it there, so in some sense, someone is still buying inventory. Someone is managing inventory.

Consumers, in the case of a lot of these warehouse stores, are being paid in the form of a lower price to take on some building the inventory, taking some inventory risk for anybody who's ever had a basement that's flooded, taking some price risk that the price might go down or might go up, and in some sense is responsible for managing that inventory down in their basement.

Now, you could generalize that type of example. Certain things have to be done, and a general principle of marketing channels or supply chains is you can get rid of the entity doing it, but the thing -- the quantity, assortment, selection issue -- still has to be managed.

Now, we can look at a manufactured product going to a business-to-business channel, and it's the same analogy. A customer might want to just buy a certain quantity of product and a set of other products, and they may want to hold the inventory themselves. They may want to pay someone to manage the inventory on their location.

So those things have to be done, quantity and assortment and selection issues have to be managed, and who manages it could be the customer, could be an intermediary, could be the manufacturer themselves, and what we've seen in recent years is some online companies attempt to take over certain of those functions, to disengage them from where they had been bundled before. If that's clear.

MS. DESANTI: Randy, do you --

MR. COVILL: Yeah, I would like to add a few comments to that. Basically we've seen four different strategies going on in the market in this area: The first one I should mention is disintermediation, which is the strategy where a manufacturer or a company basically tries to skip over the dealers and distributors and sell directly online to the general consumer.

Now, I should point out that although that was tried a year, a year and a half ago, we regard it right now as a failed strategy. It basically doesn't work. What we're seeing in the market is a multichannel victory where multichannel retailers are prospering.

And the reason why disintermediation doesn't work is because basically consumers like their channels. They like being able to buy in the store some of the time. They like being able to order on the web some of the time and order through mail order catalogs some of the time.

So from a general consumer perspective, channels are often additive as opposed to exclusive, and generally consumers don't like the idea of giving up a channel that's convenient and worked well for them.

So with the possible exception of some companies who never had channels in the first place, the Dell Computer being the outstanding example of a company that was started selling direct over the Internet, never really had a channel organization or brick and mortar store organization, and also with the exception of some very small businesses, crafts businesses selling over the web, for most businesses, disintermediation has basically been a failed strategy that consumers have shown no liking for.

Just to give you a couple statistics on this, the latest research that we've done and also the National Retail Federation has done, the results are consistent, about two-thirds of the time consumers who go to a web site actually prefer to buy the item in a store, in a brick and mortar store.

They're basically doing product research online, so consumers often will go to a brand name web site to understand the product, look at the alternatives, see if the product has the features and functions that they want, and then based on that will actually go with a handful of printouts into the store to buy the item.

Likewise, about 4 percent of all in store traffic likes to go to a web site either to do more research or sometimes to order the product online if it's the weekend or whatever. So there's a lot of crossover use of these channels and back and forth, and to us it looks very much like there's a multichannel victory going on in the market, if that's not too dramatic, but the pure play web strategies of replacing dealers and distributors just hasn't worked. At least that's what our research has shown.

There's three other strategies. I'm going to skip over pretty much the re-intermediation one because I think Adam covered that pretty well with the idea of the exchanges and others trying to make the supply chain more efficient by picking up certain functions.

The only thing I would add to his comment is that it has proven to be technically much more challenging than I think was originally understood. Part of the problem here is that the members, potential members of a trading exchange tend to have many different computer systems, be using many different technologies, none of which are consistent.

And that becomes a substantial technology challenge and a very expensive thing to overcome, and also it's waiting for the evolution of some industry standards and technology developments too to really make it feasible in an economic sense at reasonable cost.

The two other strategies I want to briefly mention are the strategies of co-intermediation and neo-intermediation, and not to get too complicated with buzz words here, but the idea is the co-intermediation strategy is trying to firewall your web site from your other channels. Because treating it as a separate business, different business, that was very popular a year or so ago as companies tried to spin off web sites and spin off web operations.

And actually the trend today is to pull them back in-house because of the multichannel issues that I mentioned, but the idea is to firewall your web site. That too did not work all that well because again it comes down to consumer choice and consumer behavior, and consumers want to shop and buy multiple ways, so just trying to isolate a channel hasn't proven to be a terribly practical thing to do.

And then the last strategy I want to mention, neo-intermediation, is selling new products, only new products and services on the web. That has been successful in the sense of lowering the cost of new product introduction. So if you're a manufacturer or retailer, you have a new product, you would like to introduce it to the market, find out if there's demand for it, find out if people want to buy it, one relatively inexpensive way to do that is to offer it on the web first and see if it sells because that's basically a lower cost effort than stocking stores with it, shipping stuff around the country and seeing if it sells.

So in terms of lowering the cost of new product introduction, we are seeing success there. So with that, I'll stop now.

MS. DESANTI: Okay. Julia or Bob? I'm sorry, you have to --

UNIDENTIFIED AUDIENCE MEMBER: I would like to direct this to Randy. In today's issue of The Washington Post, it says an Apple Store is to open a store in Tyson's, so do you think that the consumer likes to browse the web to see what features something has that they could get and then go in to the store to purchase the item?

MR. COVILL: Yes, absolutely we're seeing a lot of that. A number of stores are adding Internet enabled kiosks to their stores. I believe Borders just did that in 335 stores, so we're seeing a lot of that, and this raises the issue, I want to just briefly mention, of shopping bots, shopping robots and so forth.

And I think a year ago or a year and a half ago, there was a concern on the part of retailers and sellers that consumers would fire up these shopping robots that would go out and scour the web for the best deals and the lowest prices and come back to the consumer with a list of options.

It hasn't turned out exactly that way for a number of reasons. First of all, consumers have not been willing to pay for that service, so there's the issue of who pays for the shopping robot, who buys the software, who installs it, who maintains it and who's basically absorbing those costs, and consumers have not shown a willingness to do that.

In fact, most of the shopping robots today are actually used by retailers and businesses who are searching each other's web sites to do competitive analysis, so they're probably more used by business to do competitive analysis than they're actually used by end consumers out there.

The other problem with them, just very briefly, was that the early ones, at least, came back with too many options. Consumers don't want a list of a thousand choices. It's too hard to sort that, understand it. There's too much search cost in it, so what we're seeing is consumers really want information on two or three real alternatives and often start with brand names that they're aware of and want to look at those two or three alternatives.

MS. DESANTI: Bob?

MR. GEISTMAN: In our world of distribution, distributors traditionally don't get a whole lot of respect.

**(Discussion off the record.)**

MR. GEISTMAN: Traditional distributors don't get a lot of respect where we sit somewheres in the middle of the manufacturer and the retailer and are kind of transparent to the consumer, and we're at the mercy of everybody in the supply chain, so in our world right now, you've got manufacturers that are pressuring us to deliver a consistent and uniform message, selling message of the features and benefits, and they're often fairly complex.

And at the same time the retailers and consumers are very, very price conscious, so they're dragging our margins, which have always been razor thin, to even be thinner than they are.

So in the B2B world, what we've tried to do is to establish a web site that hopefully will deliver the consistent message and communicate with customers, and hopefully that message will get down to the consumer of the features and benefits of products or whatever it may be and yet try to drive cost out of our business so that customers that are looking for -- first of all, you have the communication aspect, and you have the online ordering aspect.

And there is always going to be a need for a personal relationship and a one-to-one dialogue on things, but there are lots of parts of business that the customer doesn't necessarily need to speak with somebody. And it's taken over our culture. I mean, you look at self-service gasoline and people doing their own banking.

You go to the Kroger where I live in Nashville, and you can check yourself out and can provide better service, and so in a lot of aspects, the online world for B2B is just an extension of that. It actually provides better service in a lot of cases because it's available 24/7.

You don't have to wait to get the right person to answer the question, and you can go ahead and provide that uniform and consistent message that the manufacturer wants.

Now, that sounds very easy to deliver, but it's very -- in reality it's very, very difficult to deliver because you're dealing with back-end legacy systems that in many cases were delivered strictly for internal use, and your entire business is run off of these systems. Whether it's customer information, whether it's product information, content, whatever it may be was never intended, at least in most companies up until a few years ago, to have any application outside of internal use.

And now all of a sudden you want everybody to use it, to have that same view. There are no standards. Everybody has a different method of how they want to look at it, so you build this really nice interface on the front end, which is the Internet, which is a web site, and you try to tie that in with your back-end legacy systems, which brings lots and lots of problems and complications and costs to the table and things like that.

But the benefits we think will outweigh all of that in the long run. Again the cost reduction, the self-service aspect, the uniform targeted message, leveraging inventory. If I can show all retailers, which is my world, I sell to retailers -- if I can show all retailers inventory online real time, hopefully they'll come to me to tap into that inventory, whether I'm their primary or secondary or third supplier.

So we hope to leverage the inventory, the convenience, the advertising expenditures and all those types of things. But the biggest problems that we face, besides the integration with our own internal back end legacy systems, are also just integrating with the supply chains and to integrating with our customer base that receives this information in all different types of -- they have all different types of dial up connections, and we have suppliers that provide us the information in all different methods.

And so there's a huge cost on our part to kind of take all the information up and down the entire food chain and put it into a mechanism that works up and down the food chain.

MS. DESANTI: Do you have any B2C aspects of your business?

MR. GEISTMAN: Yeah, we do a bunch of different things. We actually at one time were a -- we had three online stores that we sold in 1998, and we got into it in 1996 primarily to understand what the Internet was because we had only heard -- we only heard the word Internet, but we didn't really know what it was.

And we were in the process of writing a business plan to get into consumer direct fulfillment primarily for direct marketers and infomercials and things like that, not for Internet retailers because we didn't even know what an internet retailer was at that time.

And we had learned of a small online book store that was doing this B2C distribution, and so we talked with them and long story short, we wound up partnering with them and getting into that B2C.

It was a totally different world for us. Besides all of the costs of maintaining a site, marketing a site, just the site itself, getting consumers to the site was very, very expensive, and then Randy talked about the pricing.

When the consumers are just a click away from finding the lowest price, margins are very difficult. And then the whole idea of being a distributor and selling to thousands and thousands of retail locations but also being a retailer and having to compete to get that customer and explaining the customer acquisition costs of selling products at or below cost was very difficult.

And so we got out of that business, and what we did was we got into providing support services for Internet retailers, and that support services consist of a number of different things, but primarily we provide content and online retail time access to inventory, and then we also provide the back-end fulfillment.

So if retailers go to a number of different, specific sites and go to place an order for the products that we sell with an online retailer, in many cases that order comes electronically through the Internet retailer site to our company, and we do the pick, pack and ship, and the consumer never even knows that we were there.

So just to finish that up, so for the Internet retailer, their concern is marketing their site and providing customer service, and they leave all the inventory management and all of the consumer direct fulfillment, which is obviously very, very expensive, to people that have that experience.

MS. DESANTI: Julia Klein, you're a wholesale distributor. How have you thought about these issues?

MS. KLEIN: Well, I noticed in the handout material there's a case about widgets. Well, we really do sell widgets for real.

MS. DESANTI: The first person we've met.

MS. KLEIN: Someone has to do it. What we do is add value to products from 200 different vendors, 29,000 different products to go to about 10,000 customers in a large regional area.

Companies like ours really are the backbone of the American economy, small and midsize distributors, to get people what they need to buy and to sell. We provide inventory and warehousing services. We break pallets. We provide credit, delivery service, technical assistance and marketing and selling services for these vendors moving their products through the chain.

We happen to sell to small manufacturers who build furniture for kitchens and bathrooms. There's lots of other folks just like us.

What we've done online over the past couple of years is take this very same business and move it through a different channel. So we provide pricing and availability online and direct order entry online. The same thing that we do in our off line business. In fact, it's all one integrated business.

So we market and sell 29,000 different products. we provide an electronic catalog and real time price availability checking, and we provide fulfillment services for vendors for new and non stocked product as a quick way to get some of those to market.

Some of the benefits to us, first and foremost is lower transaction cost doing what we do. It's very expensive to take a phone call, enter the order, pick, pack and ship and deliver. When a customer does their own self-service, it's less expensive for us and better margin for us.

We also have a broader reach. What you can market on the Internet is much more broad than what you can do in person and much less expensive. Finally, and surprisingly and probably most important to us, is improved customer service because our customers are able now to check their pricing and availability 24/7.

And it's actually, I'm embarrassed to say, a by-product of the other work that we've done but a very important by-product. To customers, being able to have that self-service availability is critical.

We deal with small manufacturers who often do place their orders at midnight, that kind of thing. It also gives customers easier access to new vendors and products more quickly than our real live in person sales force might be able to get them into the field.

And to our vendors, our supplying manufacturers, being online provides a way to really streamline the entire supply chain. When it works well, and I would suggest to you that it's very hard to make it work well, and it doesn't always do that, their products also get broader visibility.

So we partner with vendors for our regular business, B2B, and also to do some direct consumer fulfillment on more experimental products and services that they want to pursue.

Some of the problems as we've experienced them are first and foremost cost. We're a midsize company. This is a black hole of money in many ways. There's a lack of standards in our industry and in many others.

Integrating legacy systems from suppliers to customers is really a challenge, and there's just fundamentally an enormous amount of work that needs to go into integrating an entire channel.

Second problem for us, being a midsize company in a small city, is a difficulty in getting right skill sets into our business in a way that we can afford them.  Now, that sounds somewhat mundane, I'm sure.  For companies like Ford or for Dell, that's probably not as much an issue.

For us it's an enormous issue, and finally adoption rates I think up the chain and down the chain are much slower than we would wish or maybe that we thought about a couple years ago.

I think the biggest challenge that I foresee down the road, aside from the ones I've just mentioned, is really how are 200 supplying manufacturers to allocate business opportunities over time?

I think that the Internet is making the traditional arrangements that we've lived with for the last 30 years -- I'm a third generation business owner so a lot of these relationships have been in place for a long time.  The Internet makes them less relevant and more challenged every single day that goes by.

I think the reach that we have for the Internet and the customer choice that's available, the ease of doing business, starts to undermine some of those traditional arrangements. I would suggest to you that it's really an area worth a lot of conversation.

Industries move at different speeds. You've expressed some interest in learning more about how all industries -- how industries get together and move online. Well, in my industry it's hard enough to just move a business online, let alone the entire industry. Maybe that's coming next year, but for now, for us moving 6 percent of our business online has been a really big challenge.

Changing some of those traditional arrangements I think is the next big challenge that's around the corner.

MS. DESANTI: That seems like a good point. I know, Steve, that you have a question, but I'm hoping we'll get to it in the course of the discussion.

I would like to open up the discussion and bring in the legal issues that come up and lay some questions on the table from an antitrust perspective.

When clients come into you and say: Well, we're thinking about how to go online, what kinds of antitrust issues can arise in the formation and the structuring of that? How have relationships been structured between manufacturers or off line retailers on the one hand and online distributors on the other hand?

What factors may be relevant in determining whether the online distributor is fully or partially owned by a manufacturer or an off line retailer? What factors are relevant to determining whether an online distributor is set up as a competitor collaboration or whether the online distributor is established as a principal or an agent?

So I throw the floor open to anyone who wants to speak up on that. Will?

MR. TOM: Let me just address the joint venture competitor collaboration issue versus the independent web site retailer kind of model. I can think of at least three reasons why you see a lot of these ventures being established as joint ventures rather than as wholly independent third-party competitors.

And just reading the report last year and seeing some of the things that the antitrust agencies have said in speeches and so forth, I think there may be perhaps a little more suspicion of a joint venture model than is warranted.

Reason one is a lot of these ventures require pretty substantial sunk costs, and as we've seen over the last year, they're fairly risky. There's no guarantee in this -- as an entirely new form of business emerges, that any of these ventures are going to succeed.

And as a result, to get the kind of investments that you need and even more so today as the riskiness has been exposed, you may have to give a piece of the action to customers or suppliers. You may need some way to commit these folks, not only in terms of capital commitments, but also to some degree of at least expectation or incentive that there will be some transaction volume that will support your venture.

Secondly, there are a lot of economies of scale and scope here, and again that may push toward a joint venture model rather than an individual manufacture model.

Finally, if you believe that a lot of these businesses have strong network effects and perhaps a tendency to natural monopoly, one would expect that current industry participants will not want to expose themselves to the creation of a bottleneck monopoly at some other level of the supply chain.

And for the same reason, the antitrust enforcers may actually prefer a joint venture that is structured along reasonably open and competitive lines to one in which the ultimate entity that controls the bottleneck is a single entity. Because the result of a joint venture structured along competitive rules may well be a fairly vigorous competitive marketplace whereas, without opining on the merits of the Microsoft case, the result of the independent proprietor of the network standard may be at least what the antitrust agencies have feared is the case with Microsoft.

MS. DESANTI: Bill, you have observations?

MR. BLUMENTHAL: Susan, I do, and they're going to be somewhat I think at odds with what Will just said.

MS. DESANTI: Oh good, disagreement. Be sure to speak into the mike, please.

MR. BLUMENTHAL: Let me be clear that I agree conceptually with Will in terms of the types of efficiencies that one sees.

**(Discussion off the record.)**

MR. BLUMENTHAL: Let me observe as well, everything that the business panelists said is very broadly consistent with what I think we're seeing in the practice. I still need to get closer?

MS. DESANTI: Yes.

MR. BLUMENTHAL: I'll talk into it like that.

MS. DESANTI: Thank you very much.

MR. BLUMENTHAL: A year ago, as I think everybody knows, a joint venture approach was very much the rage. We have, over the last year, seen a steady backing away from that to the point that very, very few new ventures are being proposed. Virtually all of the distribution that we're seeing is being done unilaterally by companies, either unilaterally or in the form of a joint venture where the venture isn't predominantly a B2B venture. It's a venture undertaken for other purposes, and it simply happens to have an ecommerce component to it.

The reason for that I think goes back to the nature of information on the -- well, the role of the Internet, and I'm going to use the term disintermediation in a slightly different since than Randy Covill was using it, but fundamentally in terms of information flows, the Internet is a disintermediate in technology.

And to the extent that's the case -- and we're seeing that in lots of industries. You see it in real estate. You see it in travel agencies. To some degree you see it with regulatory lawyers, where the regulatory lawyers no longer had quite the information control that we once did.

And the other place you see it is in the context of industries trying to get their product to the marketplace. You have the question, to what extent do you do it unilaterally or to what extent instead do you add a cost burden of 10 million, 20 million, 30 million dollars a year to create a centralized hub basically to create an intermediary in what is fundamentally a disintermediate technology?

And I think what we've steadily seen is that the sunk costs are real, but people take a look and say: are the scale economies that significant? Are the network effects that significant? There is no question that there are huge efficiencies to electronic commerce.

The question is whether there are significant efficiencies at nearly the same level to acting jointly because, as we've heard, virtually everybody who has -- everybody who is going to interface with the hub, nonetheless, needs to have the electronics to achieve that interface.

The question then becomes: What value does the hub add as a hub? To what extent is there value added for going centrally as opposed to simply disintermediating around the hub you're creating and going directly to your traditional channels?

Let me add one other point on this. I think as we're thinking it through, it's important to distinguish between tangibles and intangibles. Virtually all of the discussion so far this morning has focused on tangible goods, and to the extent we're dealing with tangible goods, it adds a layer because there is a warehousing aspect, a fulfillment aspect.

I think an awful lot of what we've seen in the way of successful ecommerce so far has related to intangibles, to intellectual property. Take a look at, for example, the BNA site, the Wall Street Journal site, a lot of the information flows of that type, products that are not necessarily information products but that are services and that don't need to have the fulfillment aspect.

Once you get into fulfillment, there are pricing issue that come in to play that one simply doesn't have with intangibles in quite the same way.

MS. DESANTI: Dick, you have some thoughts.

MR. STEUER: Yeah. I think as we talk about the legal issues, it's important not to over generalize because distribution has always been a tug of war between different points along the distribution channel. You have to distinguish between whether you have products that are whole products where a lot of advertising demand creation is done by the manufacturer, or push products that are largely in the hands of retailers.

And a lot of this also depends on who owns the trademarks. There's a vast difference between manufacturer owned trademarks and something like the traditional Sears Kenmore retailer owned trademarks.

But now with the Internet we have a whole different set of dynamics, and Bill alluded to it. I really see that there are at least four different type of products that we have here. There are the products that can be digitized, and we think of software. Software you used to buy at a software store, and now most people download it. Well, depending on the generation, a lot of people don't go to record stores anymore. They download music. They're going to be downloading a lot more in the future including, depending on the technology, possibly books and on and on.

Next you've got commodities, things that you can buy off the Internet because if you bought one roll of paper towels, you've seen them all basically and can buy commodity type items off the Internet with a certain amount of assurance, and I'm talking more about commodities.

And the next level are things where you need more information. And yet when you think about the success of the catalog industry, people are willing to buy some highly differentiated products, including things that come in different sizes and colors, without actually having to go to a store and hold them and touch them. And again as partly a generational thing, I think you see that category of products that can also be sold over the Internet. And then there's the small category of products like surgery that cannot be sold over the Internet because one has to go there, but it's harder and harder to think of that category of products where it's not enough just to see a picture on a screen or possibly to visit a showroom and be able to make choices off the Internet.

With all the advantages of customization and ease of delivery and so forth that the Internet brings, there's only a small slice that doesn't lend itself to the Internet at all.

So I think when we work through the issues, particularly the legal issues, it's important to think about those distinctions.

MS. DESANTI: Let me throw in the mix: How has the per se rule against vertical price fixing figured into how people have thought about structuring their online distribution? I just throw that into the mix of the questions. Will?

MR. TOM: Okay. Before getting to that question, let me underscore something that Dick Steuer just said, which is the nature of the product really makes a difference in terms of the kind of structure.

The extent of network externalities, for example, is going to be much greater in the kinds of businesses where the customer is demanding the full array of products to be available, the ability to choose among 29,000 products, the ability to have the full range of marketable securities and on and on, whereas in markets in which that kind of range of product availability is not so important, you may find that the network effects are less important.

On the issue of the per se rule against resell pricing, I think it does potentially come about in the sense that, for example, if a third-party is operating the sites of individual manufacturers or retailers, which may well happen for scale reasons, an alternative to doing a collaborative site would be to have individual sites but have somebody else actually build it and run it and operate it and provide all of the back end.

To what extent is that operator of your site completely your agent? Does it meet all of the Simpson versus Union Oil test for a consignment arrangement, for example, and if it doesn't, do you run into a tension between legal rules that were built for an entirely different model of distribution and the problem of needing to control all of the terms of trade of something that is being offered to the public as your site?

If you are a bricks and mortar retailer and someone else is operating your site under your name, if that independent entity has full pricing authority and you aren't able to dictate the prices that will be offered on your site, you're asking for a lot of trouble with your customers who are going to walk into your store and see different prices from what they saw on your site and be very upset.

It could even raise consumer protection issues, talking about the other side of this agency, and so I would think, I would hope that the antitrust enforcers and antitrust courts would see a situation like that as posing sufficiently distinct issues just as VMI posed distinct issues that rule of reason treatment would be appropriate.

MS. DESANTI: Okay. Barbara, and I would like at this point to sort of add to the discussion to make sure that we're moving through all of the issues, also put on the table more broadly the coordination of marketing and advertising and advertised pricing issues that come up in the antitrust arena, and I will get back to you in a moment.

MS. BRUCKMANN: I just want to add another dimension to what Dick has suggested about the nature of the product, influencing the decision on strategy.

MS. DESANTI: We have another mike problem. Could you just move it closer to you? I'm sorry, the mikes are just not working.

MS. BRUCKMANN: Is that better? Sorry for my fumbling around here. Is this working better?

In addition to the nature of the product, I think it's very important to recognize, at least in my practice dealing with manufacturers, that the first item on the table is the manufacturer's rep. They are coming to the problem assuming the nature of the product that they sell, we understand that.

And they are raising a number of issues in selecting their strategy, which initially begins with an assessment of their current distribution system; how is that performing, then their own expectations about profitable growth; what is it likely to be on the Internet; their expectations about marketing; what is that going to look like on the Internet; their requirements for a goodwill image; brand considerations, is this a high end brand, is it a low end brand; what's going to happen when I have a low price or a higher price on the Internet vis-a-vis my bricks-and-mortar, and then also price. There's the pure simple issue of price.

Another layer on these business objectives that we run into right off the bat when we're giving advice as manufacturers are trying to move on to the Internet where they're in bricks-and-mortar and they're now changing their direction online, is the extent to which they need to control their distribution. And if they are a manufacturer that is not interested in a free-for-all at that level, and there are some that simply don't care. They want their products sold on every corner. They don't care what the extent of the price competition is.

There's others that care about the store location, both bricks-and-mortar and online. So issues like my ability to select my outlet, my ability to control behaviors and my ability to limit unauthorized distribution are all factors, so that is just another sort of layer on the process for the difference when they're looking at other options, and then their business objectives, in my experience, tend to drive the real strategy.

On the resell price issue, I'm going to raise an issue that is near and dear to my heart, and that is MAP. I think I have seen and counseled clients on the law governing MAP and seeing too many cautious companies back away from MAP on the Internet and then faced with Robinson-Patman problems by enforcing MAP on their bricks and mortars; in other words, a condition for co-op is X.

Well, that condition is not on the competing online retailers, so a bona fide MAP program, which presents no risk to the company or virtually no risk to the company with their bricks-and-mortar outlets, is abandoned for yet more cautious approaches to Robinson-Patman.

And I'm going to bring this home, and I'm just going to put my hat in my hands and say: the terms of the FTC's consent in the CD cases I think has contributed to a chilling effect. Because, the definition of in-store promotion by including Internet sites without regard to whether they're selling or non-selling, and companies that are -- the ones that are on the more cautious end of the spectrum are looking at that and saying, What is the FTC's view.

They were looking at Internet sites as in-store promotion, and they're not drawing a distinction about they're selling or not selling. What does that mean? Are they going to be watching what I'm doing? We know they look at web sites, and what is their enforcement action, so I would think this would -- be as vertical retail distribution increases, and I agree with Bill that we're seeing more unilateral vertical strategies than the collaborative because of this, I don't want to give my competitor my secrets, that this issue of MAP on the Internet needs to be addressed soon and needs to be addressed carefully so that companies can operate within the full stretch of the law.

MS. DESANTI: I'm a little concerned that we're all talking inside baseball here when we talk about MAP and co-op advertising. Could you just give us a little primer for the record? I know that 99 percent of the people here know what you're talking about, but just to make sure that our record is clear on those issues.

MS. BRUCKMANN: Okay. Well, one always stumbles when one goes back to basics, so if anybody wants to contribute to my definition. Cooperative advertising is a long standing concept where manufacturers will contribute into a fund a certain percentage of the value of the purchases from the customer.

If a customer buys a hundred dollars worth of goods, then the manufacturer may have a plan whereby they will put into a cooperative advertising fund, and that money will accrue over the course of the year. Now, the advertising fund, some industries retailers are required or wholesalers are required to make contributions. In most industries this is funded solely by the manufacturer, and there are usually rules on how you can spend the money.

You have to have certain kinds of ads. You have to be limited in the kinds of media where you can advertise where the supplier will pay for your ad. They're usually very stringent requirements on trademark uses. You can't have your trademark within so many centimeters of a competitor's mark and so forth.

Minimum Advertised Price Programs referred to collectively as MAP programs add a wrinkle on to cooperative advertising programs, and actually there are two strains of MAP, but the first one is linked to cooperative advertising, is the notion that the manufacturer has gone through significant or has made significant investments in his product and in his brand, and he does not want his brand to be used, for example, as a loss leader, has an idea of where his product ought to be positioned in the market against other products in terms of price point.

So the manufacturer will say to the customers, You may use the money in this advertising fund, but one of the conditions is you advertise at a certain price or you don't advertise lower than a certain price, and the logic endorsed by the Federal Trade Commission is that those kinds of programs should be evaluated under the rule of reason as non price. The notion is that the manufacturer -- it's the manufacturer's money, and the manufacturer can decide how it wishes to spend its money.

The second type of MAP program which generally creates more risk is what's called a bald MAP program, and that's simply the manufacturer saying you can't advertise below X, and I think there's important law for even that kind of program being rule of reason provided there is other opportunities for that retailer to set its own resell price.

In other words, we have to draw this distinction between the advertised price and the resell price. As advertised the resell gets closer, then the issues get more acute, but on balance, MAP has been out there a long time. Its programs have been endorsed, supported by the Federal Trade Commission, by the courts.

But MAP on the Internet is just causing problems, and consents which are obviously read and considered by counselors and by business people that define the Internet as -- an Internet site as an in store without regard initially to whether it sells or not sells can have a chilling effect.

And then also this notion that a web site -- as you page through a web site, I think it is like a bricks and mortar business, but the first few pages of a web site could very well be advertisement and then there could be sort of an interloop where the retailer can then discuss with the consumer, if you will, what its actual resell price is going to be.

So in some -- it's not true of all sites but in some sites there is this opportunity for advertising early on and selling later on in the experience with the web site, but I think where we are right now is the companies are a bit uncertain about it, and it's an opportunity for the FTC.

MS. DESANTI: Thank you, Barbara.

UNIDENTIFIED SPEAKER FROM THE AUDIENCE: I want to talk --

MS. DESANTI: Just a second, please, because I think we have a lot to cover, so I would like to ask the next question, give Steve Salop the opportunity to speak and then, Sandy, will go to you.

MR. SALOP: I want to talk about exclusion, but before I get to that, I really wanted to raise a question.

MS. DESANTI: Steve, do you have a mike? Can we get you a mike?

MR. SALOP: While we were still talking about the business stuff and the per se rule, I wanted to raise a question for the business people. Randy said something that was very interesting, which is that a lot of consumers do their research on the Internet, and then they purchase in a brick and mortar store.

And that is the reverse of the standard free-rider story that we normally hear in analyzing vertical restraints. I mean, the standard story is that the Internet retailers are free riding on the brick and mortar retailers like the old story of the discounters were free riding on the traditional department stores, and what Randy's really saying is it's very much, if anything, the opposite, so I think it would be worth it to follow up on that.

MS. DESANTI: Randy?

MR. COVILL: Sure. I think that it is the opposite in the following sense. I've looked at some statistics that say right now in New England, about 50 percent of the time when a consumer goes to buy a new car, they walk into a car dealership with printouts from the Internet about the cars that they have researched, their features and options and so forth. So I think that there is, in fact, a very significant consumer trend to do more of that type of research.

The other thing I would just add too is we're seeing the emergence of some web sites that are pretty much brand only web sites. In other words, the attempt there is to promote the brand, promote product information, share product information, but not necessarily to actually sell anything over the web, and I think that's an important trend to note here too.

MS. DESANTI: Steve, I think --

MS. STEPTOE: Can I just add to that? I think the issue is back to what they're saying --

MS. DESANTI: Could you put the mike in front of you?

MS. STEPTOE: I think the issue here on the research, the reverse research, reverse free-rider argument is, again, keep in mind the nature of the product. I think this happens most when the product at issue has a lot of functional information that you want like the cars' carburetors and all this, and the computers' drive and so forth, but ultimately also has a touchy feely aspect.

And so you go and you get your heart -- you get your information off the Internet, but then you go and make your personal choice elsewhere. I think this argument doesn't apply on the commodity products particularly, where it's just the setting of a price and you know what it looks like, and I think it doesn't apply on the purely informational sites that were discussed.

So I think the distinction, considering the nature of the product, should be kept in mind as we make these generalizations.

MR. SALOP: Can I just follow up? What's interesting about that though, normally the free-rider story is about the touchy feely goods. It's not about paper towels. It's about Sony digital cameras, and I agree with you, Mary Lou, but I think in terms of the standard controversy, it's much more about the video cameras than about the paper towels.

MS. DESANTI: And we're going to get into more on exclusive dealing in just a couple minutes. I want to give Steve Bolerjack a chance to speak, and then I would like to get back to a standard minimum advertised pricing, and, Sandy, you've had your tent up for a while, and I want to get to you. Go ahead, Steve.

MR. BOLERJACK: I was just going to respond to the free rider argument, that I don't necessarily feel that the ability to conduct research on the Internet and use the sites that may or may not be offering anything per se to get product information necessarily flips the free rider argument or eliminates it.

I understand what you're saying, but by the same token, if you've got a retailer who is probably on the Internet providing product information, you can get it from all sorts of sites that have very little to do with the manufacturer or the dealer. There are car magazines, those sorts of things, consumer reports, all sorts of things.

And going out and using the Internet to get product information and then going into the bricks and mortar store on make the purchase for either the touchy feely situation or, in our view, to set up a relationship with a retailer who can provide the sales discussion, demonstrate the features, and more importantly, the after sales support I don't think flips the free rider that the bricks and mortar stores are in fact now free riding on these web sites, so I disagree.

MS. DESANTI: All right. Well, we'll put that as a place holder to get back to the debate in a moment. Sandy, could you help on the MAP issues and maybe also are there RP, Robinson-Patman Act, issues that are raised in these kinds of situations?

MR. PASTROFF: Certainly. To follow up on Barbara's comment about there being two different types of MAP programs, I think there is some confusion because conceptually they're very different. The traditional type is, as Barbara mentioned, a cooperative advertising program where the notion is all the manufacturer is doing is saying, Look, I'm going to provide funds to you, and if you want to use my money, you have to use it in a different way, you're free to do whatever you want in terms of selling when you're not using my money or advertising when you're not using my money.

And so there is, in that sense, no type of agreement on price, but there can be an agreement on how the funds will be used.

The second type could just be a flat out restriction that might be called a MAP program where the manufacturer just says, You shall not advertise my products below a certain price. The legal basis for that is more of the Colgate doctrine which just says the manufacturer can announce the terms on which it's going to deal, and if people aren't going to abide by those terms, they won't -- they'll be terminated.

But there is no agreement, and conceptually from a legal standpoint they're different. I agree with Barbara also that MAP programs can be done lawfully with Internet selling, but there are complications.

The fundamental distinction I think that has led to MAP programs being approved is the notion that there's a difference between the advertised price and the sales price, and so you can have an agreement on money being used for advertising at a certain price, but that agreement doesn't extend to the price at which the products will be sold.

And in a bricks and mortar world the advertisement might be a newspaper or TV ad, but that's going to be separate or may be separate from the price that's paid when the person actually goes into the store.

When you're talking about Internet selling, the line between an advertised price and the actual transaction price becomes much less clear, and so the question is: What's advertising versus what is the transaction price?

And there is some concern, but the notion that taking the legal position that the first part of the site is just the advertised price but then that's not actually the transaction price, and it's also much more difficult when you're selling over a web site to actually have a different transaction price than the advertised price.

And so what some people have done to avoid that is not -- well, there are a couple position options. One is the easy way out, is just to have call for price so you don't actually have the advertised. Or you could have the advertised price being the suggested price, and then a notation on the web site that says: We offer discounts, call us, we can give you a special price; or the web site might say: Less than the MSRP. That's one way of doing it.

Another way is the transaction price might appear at checkout so you have a distinction between the advertised price and the check-out price, and I've even seen some web sites where there is an explanation to the public about what a minimum advertised price program is and why the manufacturer's participating or the retailer's participating.

And they point out that there are other ways that the retailer can provide value. They can offer different promotional prices. They can offer other types of free shipping and service and so forth, but I agree with Barbara that it can be done.

In terms of Robinson-Patman issues, the Internet certainly does complicate things because there have been some traditional ways that manufacturers have been able to offer different prices to different customers and do so lawfully. One traditional way has been to have different prices in different geographic territories.

That doesn't really work well when you're selling over the Internet because some courts have held that an Internet seller competes with every retailer in the country.

Similarly, having different prices for different distribution channels becomes more difficult when one of the people who is selling is an Internet retailer.

I think one of the most vexing issues is manufacturers who are offering promotional programs. The Robinson-Patman Act requires that promotional programs be offered on a proportionally equal basis to all people who are selling the manufacturer's product, and when you have some sellers who are selling over the Internet and some selling in a bricks and mortar environment, proportional wise in between the two becomes difficult.

Similarly, proportional wise in between different Internet sellers is difficult because there may be significant difference in value from one site versus another. Having your product displayed on the first page of Amazon.com is certainly going to be viewed as more valuable than the first page of my web site.

And the question from a manufacturer's perspective is, How do I come up with a logical basis to allow me to recognize that value? I would say from the standpoint of what the Commission can add, there still is, I think, some uncertainty in the law as to what the appropriate legal standard is for proportionalizing promotional programs.

I mean, one option is a cost standard saying that you have to pay based upon the cost to provide the promotion.

Another one is the value standard. I think a lot of counselors believe that the value standard is correct, but there's no definitive answer on that.

When the Fred Meyer Guides were last amended, there was a proposal that the value standard be adopted, and that was withdrawn. And I would suggest that, at least in addressing this issue, if there ever were interest in looking at the Fred Meyer Guides again, adopting a value standard would make it or provide a little more certainty to people who are concerned about addressing this issue of proportionality.

MS. DESANTI: Let me pick up on one of the other comments that you made, which was a discussion of the exclusive territories and how they work or don't work in this context. Let me just throw out that question: Are there circumstances where manufacturers have prohibited online distribution of their products or confined it to specific web sites or assigned exclusive territories?

How does this all work in this new world of the Internet? Bob?

MR. GEISTMAN: I can speak for our product lines, and we're in the entertainment business, and so traditionally the manufacturer, the manufacturers to us are Hollywood studios. They've managed their revenue streams worldwide by having windows, and so when a movie is opening in England, it may be coming out on video in the U.S.

And so it has been pretty easy for the manufacturers to say to a distributor like us, you can only sell in the U.S., and that was pretty easy. We just sold to retailers in the United States.

Well, now you've got Internet retailers, and there are no global -- there are no borders for them. And so somebody logging on in England can go out to a U.S. web site, whether it's CDNow or whoever it is, Amazon, and want to buy a movie that hasn't even opened up theatrically in Europe, but it's available on a video format here in the U.S.

So it puts us in a weird position because we're providing fulfillment services. So, we're not really the retailer, and we're not shipping it to the retailer, but we're shipping it on behalf of the retailer, and the retailer is a U.S. company. And yet, our agreements with our suppliers who are manufacturers tell us that we can't ship outside the United States.

And so we've kind of taken the moral route I guess and said, we're not going to ship outside the U.S. Some of our competitors do ship outside the U.S., though there are some competitive issues with that.

MS. DESANTI: Adam, and then we'll hear from Julia.

MR. FEIN: There's an interesting issue with regard to coordination and pricing and the territory issues that we're seeing in more of the business-to-business channels, and I guess I should just preface this by saying that the vast majority of industrial business products go through this network of about 400,000 distributors in the United States.

The average distributor is about $8 million in revenue, so that works out to be about $3 trillion in revenue, but the typical distributor is a fairly small company that is focused on a particular geography, and traditionally they've sold to customers in that geography.

And there's a couple of things that I've heard come up from the legal aspect, which of course I can't talk about, but I just thought it might be interesting to talk about some of the practices we are seeing which are somewhat unusual, in my opinion.

One way that a lot of distributors are reacting to ecommerce is, of course, setting up their own web sites -- and I think Julia is a great example of a company that's doing that. Typically these are password protected, customer specific accounts, so a customer, who's a known customer, who has credit, enters a particular area of the site with their customized pricing and their customized production selection in many cases.

I'm not speaking about Julia's company, but just in general. And in some sense, many distributors are very reluctant to actually post any prices because there is so much of the negotiation in the business-to-business channels depending on a wide variety of factors, which are not worth going into right now, so one way that this has not been an issue in some sense is these prices are protected behind, in some sense, a firewall.

The more troubling issue, in some sense, is the notion that these distributors can now sell outside of their quote, unquote, designated territories. And there's two types of things that are going on. In some cases manufacturers are trying to use the Internet technology to coordinate their distribution channel, for example, particularly for products that are highly technical with a lot of specifications to them or often maybe a central component of a larger set of products such as a central control system for a heating, ventilation and air conditioning system or very technical computer router.

They will actually set it up so that the product information is available on the manufacturer's web site. The customer may be encouraged by the manufacturer or sometimes by the distributor to go to the manufacturer's web site to figure out what they want and configure it. The manufacturer does not literally take the order in the sense that they don't hold a receivable. They don't actually ship the product.

It's connected electronically to the distributor's system, and the order is placed with the distributor that then configures, bundles it with other products and does the service and delivery, and they hold the receivable and are responsible for collecting it.

One thing that's interesting about this or challenging to many distributors right now, who are often smaller companies, is this provides a lot more information than they've traditionally provided about their customers to manufacturers, both in terms of what the products are being purchased, the prices or configurations that are being offered, so that's one challenge out there right now for these relatively small companies who are feeling some of this pressure.

The second challenge that they're feeling is larger customers, in many cases, will say: Well, gee, why should I order from my local distributor? Why do I have to enter my zip code? Why don't I just order from whichever distributor has the lowest price? Some manufacturers in some sense are almost most turning a blind eye to that. Others are trying to actively coordinate their channel in some sense to ensure that there's no customer leakage.

And there's a lot of -- at least from a strategy perspective -- and we work with manufacturers on business strategy issues, there's a lot of uncertainty about how to actually do that in a way that won't compromise the marketing and sales effectiveness of these channels.

Let me mention a third issue, which is also troubling to the manufacturer's side now, which is that a number of services and sites have sprung up to allow distributors to trade with each other, and you can liken this almost to Napster for inventory.

Literally, I, as a distributor, may be an authorized distributor, and I may be part of this service. And a distributor two towns over might not be an authorized distributor, and say, Well, boy, my customer really wants this other product, I'm not technically supposed to sell it, but I see on this service I belong to in this group that I can get it from that other distributor.

Now, this happens in the real world. But, it's a little harder to coordinate its relationships, its faxes, it's out the back door, but now in some sense very open and easy to do, and many manufacturers are finding that the distributors are saying a sale is a sale, and depending on the nature of the relationships, they're having difficulty trying to figure out how to prevent this channel leakage in some sense across these territories as these independent services emerge.

And so you have the distributors struggling with how they maintain their customer relationships and proprietary boundaries while wanting to cross it tending to be smaller companies. You have the larger manufacturers recognizing that in many cases the customer doesn't want to purchase direct because they want the service. They want the small quantities, whatever they want, and they don't want to hold the receivable, having trouble trying to manage it and trying a variety of strategies right now.

And, of course, I have no idea of the legality of these various initiatives. But, this is an issue that is definitely on the minds of a lot of people, manufacturers and distributors, in these channels where distributors control 90 plus percent of the product industry volume goes through these distribution channels.

So let me just mention that as sort of a practical real world, Boy, what do we do about this kind of issue that I think is underlying some of these comments. It's not a retail thing though.

MS. DESANTI: Julia and then Mark.

MS. KLEIN: Well, Adam's point that this is on people's mind is really true. This is on my mind all the time. My experience is that our manufacturers in our speciality materials construction niche are dealing with this issue mostly with a lot of fear and ignorance, a good portion of each I would say.

The concern about channel leakage is a very real one because the question is: How do you protect the brand building investment over time? And that's protected through these traditional, geographic mostly arrangements that have hundreds of thousands of dollars, millions of dollars of investment over years.

How do you protect that? I think distributor's fear is that manufacturers will coordinate across boundaries, and what will that mean for the investment that I've made?

I think that the gap is in the opportunity. What do you do when customers want to buy across boundaries, but brand building does need to be protected.

The ultimate question for me is: How do customers want to buy and how can they best be served? And the traditional arrangements that work pretty nicely in traditional channels no longer work. Those answers just are not relevant anymore.

MS. DESANTI: Thank you. Mark?

MR. PLOTKIN: In our practice, one of the things that we're seeing with companies that are on the B2B side of getting in to the Internet, companies very much like the kind that Adam was describing, manufacturers that are dealing with their distributors, fairly largely manufacturers, some of them are trying to find ways to expand the market allocations to their various distributors to, in effect, sweeten the pie to avoid channel leakage.

And in a few cases that I can think of in the last year and a half or so, we've seen some manufacturers start to allocate overseas territories, to domestic distributors and dealers -- where the manufacturer of the dealers and distributors haven't typically distributed its products outside the United States before.

And one of the sort of innovative techniques that they're using to expand their marketplace outside the United States, in some cases Canada and Mexico, is to get their distributors and dealers to take on, share some of the risk in accepting a new and perhaps unexplored territory.

And we've seen distributors and dealers, in a number of cases, respond very fairly to this if the manufacturer has gone and done some market research on a new territory. So that's one -- that's one example on the B2B side where we've seen a response to this channel leakage problem.

On the B2B side -- and this gets back to the point everybody's made -- that a lot of these issues are product specific. And one group of products that I'm familiar with, although I'm quite familiar with, although not that I buy them all the time but just that they're out there, are luxury goods of certain kinds. My wife would accuse me of me buying more luxury goods than actually I deserve.

In the luxury goods category, a number of luxury goods manufacturers have simply barred their distributors from selling on the Internet for a couple reasons. One is to avoid territory infiltration. Another is because of traditional fears that luxury goods manufacturers have about promoting the sales of gray market goods, both goods that have been reimported into the United States, that have been sold in foreign markets, that have been created to different specifications for those markets.

There's long been a fear that Internet sales of any products would facilitate generally a proliferation of products. And I'm just going to use a brand example, though I don't know anything about this brand in terms of its attitudes toward Internet sales, but let's take a brand like Cartier, for example.

Using Cartier as a proxy for other brands that I'm familiar with, and Cartier and others are examples of manufacturers that in part 2 -- and I think that they would say that the reason that they don't want to have Internet sales of their goods in addition to infiltrating sort of geographic territories for different distributors and dealers, is also because of the pre-sales information and the after-sales service requirements for their products.

I'm sure they wouldn't say that -- and I'm sure this is right too that they wouldn't want to promote price competition with respect to their products.

And to just sort of wind this down quickly, I'm not sure that all of the luxury good manufacturers that do --

that I'm aware of that do bar Internet sales for their products expect that they're going to be able to do that forever. I think that there's enough pressure from dealers and distributors, typically in foreign markets, where they would like to sell these goods, and distribution channels for customers are not as free flowing and accessible as they are in the United States.

There's a lot of pressure, particularly in Latin American markets, for example, to start to sell these products over the Internet where consumers who are located in remote parts of a territory have a better chance to acquire them.

MS. GREENE: We've been talking a lot about different distribution restrictions in terms of territory, and I want to throw another component out on to the table, which is: What are the distribution restrictions with regard to who the customers would be? That's a sort of inexact way to introduce the topic of exclusive dealing and how that plays out when there's an Internet component.

Is there anybody that would like to leap into that?

MS. DESANTI: Steve?

MR. SALOP: I don't really think it's any different than what we know about exclusive dealing in bricks-and-mortar. I don't think there's anything particularly special about ecommerce and the way in which we should analyze exclusivity.

I mean, if you look at this sort of retailing over the last 60, 70 years, every time there's an innovation in retailing, the traditional retailers have tried to resist it and tried to get the manufacturers to cut off the discounters, cut off the non-traditional retailers and maintain their position.

It's true with the discounters in the 50s.  It's true with the rise of malls.  It's true of category killers, true of club stores and now with Internet retailers.  Sometimes it involves collective action.  Sometimes it's the conduct of important, powerful, unilateral action by retailers, but you just go through the history of antitrust from Fashion Originators' Guild which was partly concerned with a new, innovative form of retailing sales in hotels, off site sales, Internet circuit, the FTC consent's decree against the May Company in the 60s, down to Toys-R-Us and venture of the Chrysler dealers in the northwest United States.

It's all pretty much the same, and the way to analyze it is the same.  You analyze market power by what rival's costs are raised, whether there is power over price, and you can look at traditional efficiency constructs and they're all -- as Randy really emphasized in his comments -- it's all the traditional free-riding concerns that we've been seeing in advertising over the last 60, 70 years.

MS. GREENE: If we look at the concerns that you address as sort of translating the existing law into the Internet exclusive dealings issue, what about the specifics of how you actually apply it? Will the efficiencies analysis shake out differently in terms of practical application?

It's the same type of analysis, but as a practical matter is it going to be different?

MR. SALOP: Well, I think Randy pointed out an important potential difference. I mean, the free-rider analysis might be quite different. Steve says, speaking specifically with respect to automobiles, it doesn't seem that way because you want to get this relationship, so you can put that in quotes, with the dealer to give some important pre-sale service.

But I think that's going to have to shake out on a case-by-case basis. The problems that an automobile manufacturer have are quite different than the problems that Cartier or Gucci have that are worried that the specifications for a European handbag are somehow different than an American handbag. That's always going to have to be looked at case-by-case.

MS. GREENE: Steve? I mean, Jim.

MR. LANGENFELD: Well, I've seldom been mistaken for Steve. And as usual I will sort of agree in part and disagree in part with Steve.

Whether you can use exactly the same tools and method of analysis for exclusivity, I guess I would disagree with Steve. And I think part of this was highlighted, although I wasn't in the session -- but some people have related to the session yesterday morning.

There are always questions about market definition, and the question here, which is, whether bricks-and-mortar competes as effectively as some have said with Internet or the other way around. That, I think, is something that is not easily grasped right now, and I think that there's a lot of work that needs to be done.

I agree with Steve that a lot of the key fundamental economic issues can be the same, but I think that the technology, the antitrust, the economics, the legal technology really needs to step up because I don't think we have a good enough handle as we have on traditional bricks-and-mortar types of businesses.

Secondly, in terms of the free-rider issue, I have a different take on the free-rider issue than Steve does, and that's the type of statistics we heard from Randy. I would agree with the other Steve that, if anything, this probably highlights the same type of free rider issues, it's not that new.

My experience looking around and the research I've done, people tend to look at the Internet for two different things, which have been described already, some Internet sites are purely information. Others you can buy on. Some you can do both, and to the extent that people are actually using the Internet to do research and then going into decide whether to buy a car or not, looking of the auto industry but not at that level, that suggests there's still a lost of pre-sale and post-sale services that are very important.

And, in fact, even some of Randy's statistics saying two-thirds of shoppers still prefer to go into the store with a lot of pre-sale service, that's critical.

Where you would get a free riding issue is whether after they've done their Internet search, they've gone in and looked at the cars, and then they want to go back and get the best price on the specific car, the specific model that they've already free ridden off of the automobile dealer. That's when you would actually get a free rider problem.

I just don't think the numbers -- more research needs to be done, but the numbers that I think Randy is suggesting is completely consistent with that, that 4 percent. People that may be going into a shop and going back and actually ordering on the Internet which is something I'm sure retailers and manufacturers are concerned about.

I guess the last point I would like to make is, and this one I'll agree with Steve, I think there's going to be a big shake up in this, in particular because it's so difficult to enforce geographic territories now, I think that on the Internet where those geographic territories are important, it's going to be very difficult to buy things off of the Internet.

And where it's important, where it's less important, you're going to see different types of restrictions, different types of firms and techniques being developed to ensure that there's pre sale service, ensure that you have a good relationship with the customers, and it's not going to be based on geography as much any more.

In fact for those of you that have done some B2C shopping, one of the things that always surprises me is you can do it online, but almost always you can call up and talk to a person.

And my own experience is frequently that if it's good B2C type of business, you get more information. You don't get to the touch product, but you get more and better service at that stage than you do in half the bricks and mortar retailers that you go to.

So I can there's going to be a significant evolution. I wish I knew exactly how that was going to work out, but I think that the geographic exclusivity is something that's going to become less important in many products, and others it will probably still remain.

MS. GREENE: Mary Lou?

MS. STEPTOE: Thank you. I have another spin on the exclusivity issue that I've encountered that I think is interesting, which is a site, let's make it an Internet site that is actually offering a multitude of products, and it wants to have the suppliers, the products it is offering -- I'm talking probably B2C but this could work on B2B as well, I've seen it both ways.

It wants to tie up its suppliers exclusively for awhile to make its site unique, to differentiate it, to offer that value added, and the problem is, the question as we all know in exclusivity, judged on the rule of reason, the question is, the big one, is it of reasonable duration and how much foreclosure is there, how much market power does the company have.

And now we have Internet time where this site initially, and I drafted these things, has zero market power, it isn't up yet, and then it's a phenomenal success, and captures let us say 60 percent of the Internet market going back to the question, is that the correct market.

All of a sudden somebody's annoyed by this exclusivity. Either someone wants to do a copycat site and can't get to suppliers or the suppliers themselves who realize that they've bound themselves to this one site and now they would like to move elsewhere, it's a difficult counseling problem because you really don't have time to see what's happening until it's happened.

And for what it's worth, I'll just say what I have been tending to do, and if anything thinks this is dangerous I would love to know it, is to try to tie the exclusivity provisions to some objective business measure going back almost to Will's point about joint venture and sharing the risk and the like, is to try to and tie it to something that we all have to build together to created this attractive site.

We would like to create an exclusive arrangement for a period of years that comports with our projections on when our first break even point would be plus a little extra to do more than break even and try to paper the good intentions behind this. It's not to foreclose competitors. It is not to limit business opportunities of our supplier, but it is to create the joint venture.

But I also always have to caveat you have to be ready to let go of this. If you're successful beyond your wildest dreams and what seemed a reasonable five-year exclusivity provision is becoming very tight after two and a half years, you may want to rethink it.

MS. GREENE: Steve, you wanted back in?

MR. SALOP: I was just going to pick up with something that Jim said. I think what Mary Lou said is right.

MS. DESANTI: Can you speak into the mike, please?

MS. STEPTOE: Particularly where you said I was right.

MR. SALOP: Mary Lou is always right. I think really Julia said it all in the beginning, which is you have to satisfy the customer, and if the customers are changing the way that they want to shop, then the successful manufacturers will alter their distribution systems to satisfy consumers because they'll win. That's what Dell did and why they've been so phenomenally successful.

And, yeah, sure, there have got to be various brand investment and free-rider issues floating around. I guess I disagree with Jim that touching a product is major pre-sale service, but there are clearly free-rider issues floating around, and the manufacturers have to figure out how to intermediate them.

That seems to me to be the challenge of channel management these days. How to get the information to the consumers? How to get the various intermediaries to continue to invest? How to maintain competition among your retailers so they don't get so powerful as they might? And at the same time keep them investing.

I mean, you have to figure all that out. That's a big issue in business schools these days. It's a big issue facing manufacturers.

MS. DESANTI: I would like to throw out a couple more questions and let everybody respond to everything in the next 20 or so minutes that we have. We are, of course, running out of time. This is no surprise.

One question that I'll send your way after we hear from a few more people, Steve Bolerjack, is how do you think options when you're a manufacturer that's operating in the context of some restrictive state laws about just how you go about your distribution?

And another issue that we touched on briefly yesterday, but is obviously another issue that warrants more consideration -- what are the international aspects of this and how are counselors dealing with those issues?

With that, Bill, you've had your tent up for awhile.

MR. BLUMENTHAL: Susan, I was simply going to make the limited observation that the imposition of territorial restraints, customer restraints, exclusivity in a number of circumstances can be risk reducing. That is principally because in some circumstances what it does is convert a horizontal relationship into a conglomerative relationship.

All of this may be a little bit counterintuitive for whatever the reason I raise it. But I've been struck by how often we've seen this in the industrial B2B setting. Where it most often comes up is where a number of distributors are seeking to form a joint venture site. To the extent that they are not restrained in terms of how they distribute onwards, they're competitors, and that may well limit what that site can do or how you structure that site.

To the extent, however, that the manufacturer on its own elects to impose customer restraints or territorial restraints, it can convert those otherwise competing distributors into ones who don't hit each other in the marketplace, and that that frees them up substantially, greatly reduces the risk.

MS. DESANTI: Julia?

MS. KLEIN: Just a follow up to give us an idea of a shake out or a shake up in distribution. The methodology that I see being employed is in breaking down a margin. Whereas traditionally, in an exclusive arrangement, the distributor of record would get the entire mark-up for the transaction.

What I see developing now is more of a philosophy of whoever does the work gets the credit, and there are a lot of activities to be performed, and margin that's attached to each of those activities.

So in our world, for example, now in a geographic arrangement, if you get a product specified, you would get a percentage of the margin. If you've managed the relationship for the selling, that would be a percentage. If you do the physical fulfillment, that would be another percentage. In a traditional arrangement, that all comes in one chunk. But what we're starting to develop now is smaller pieces that kind of move around those boundaries.

MS. DESANTI: Dick?

MR. STEUER: Just a couple of quick points on exclusivity and on territories. On exclusivity, traditionally what you had was that different distributors could only carry one brand of a particular type of product, but there usually was some geographic separation that made it work.

Now, with the Internet, you have everybody in the same market suddenly and they've only got the one product to sell. So, it's hard to differentiate themselves -- one retailer from another. This agency has seen something like that in the Chrysler Buick matter.

The other thing on exclusivity that we hear of is exclusivity for a web site -- that a particular seller will be the only Internet florist on a particular web site. And, there is a fear that some web sites, whether they were portals or Internet service providers, have been so powerful that they would take over the whole market, and I don't think we've seen that develop. Consumers can find their way to alternates. I don't think that type of exclusivity is going to be a problem.

Two very quick points on the territories. Obviously it makes a big difference what kind of product it is. It's possible for a manufacturer to police territorial separation for physical goods because there's a ship to point, and even with Internet sales, there's a possibility of knowing where the product is going.

If the products are totally digitized -- music, for example -- and it's going to an Internet address, it becomes impossible to really know physically, geographically where that product is going.

I should also mention in the EU, under the new distribution guidelines, you cannot prevent retailers from selling over the Internet and cannot prevent them from selling in different parts of the EU as long as they don't in very specific ways target consumers in other territories, but by and large it's against the regulation.

MS. DESANTI: So, Dick, is that something that you see as in contrast to U.S. law -- U.S. law and EU law are inconsistent on those points?

MR. STEUER: I think there is some inconsistency there because to the extent that a manufacturer can have a geographic restriction and police it, that's generally permissible here. Whereas, in the EU, except in very specific circumstances, it is not permissible.

MS. DESANTI: Randy?

MR. COVILL: I just wanted to make two quick comments.  First of all, in terms of exclusivity around web sites, I haven't seen much of that.  If anything, I've seen it going in the other direction with all of the affiliated marketing programs where, in effect, a web site will want to become a brand for the consumer selling the best products or representing the best product somehow.

So in effect, that web site wants to carry many different products from many different manufacturers.  So at least at the web site level, I have not seen a lot of exclusivity.

The other thing I wanted to mention around value add and whether it's retailers or dealers and distributors that add value, I think it's important to recognize that the definer of that is the buyer -- the consumer ultimately -- and we've had a lot of discussion about actually touching the product.

But there are other forms of value add, and I would say the actual shopping experience, whether you think of that as the ease of doing the transaction in the B2B world or in the consumer world, just the efficiency of finding the product you want, searching for it, actually buying it, the shopping experience, if you will, those things all represent value add but different types of customers are happy to pay for.

So I just want to get that idea on the table, that value add here is a pretty broad concept, and I think at the end of the day it's defined by the person willing to pay for it.

MS. DESANTI: Steve, could you help us understand how you operate in a context where you've got some restrictions on what your distribution system can be and what options you might consider?

MR. BOLERJACK: Obviously, as the question implies, you already understand. Automobile manufacturers are typically unable to sell motor vehicles at retail in most states. There are some very limited exceptions, but Steve was talking about the wonderful success, and I agree, of Dell, and that's just not an option that's open to the autos or certain other manufacturers obviously.

Amongst the dealers, the capability of selling, their ability to use the Internet becomes a matter of either -- I think Will talked about this a little bit -- their individual use of the site versus possibly a group can band together to some extent to make these things saleable, again so long as it's permitted by state law. There are some issues in a number of states with even selling vehicles on the Internet, and that will shake out in due time.

The other thing I guess to some extent you want to be concerned about, and I don't think it's just our industry, is advertising. State laws can impose significant restrictions on advertising, particularly price advertising in a number of industries, and again you struggle to be sure that your retailers comply appropriately.

And so I guess the comment is it's there. You deal with it, and to the extent that the retailers ask come up with something that either individually or as a group can meet the customers needs, that's something that's probably going to be a winning combination.

MR. ANTALICS: Let me just ask a question of Randy. You touched on this a couple of times, talking about multichannel retailers winning out.

On the Internet site, do you see any sort of a trend in any aspects, for any group of manufacturers where they might be trending toward limited distribution over the Internet, either through just a single site or a small number of sites?

MR. COVILL: I have not seen that. What I have seen is the Internet being used for a lot of marketing experimentation and a lot of marketing innovation -- so the idea of test marketing products, trying them out on the web first before a manufacturer goes through the expense of building a lot of inventory and getting that inventory out to a lot of dealers and distributors. So I would say at the experimentation level, I think there's a lot going on. There's less at the actual roll out and implementation model.

MR. ANTALICS: Adam? Sorry.

MR. FEIN: Another issue which I guess I should bring up, in a lot of the channels I see, speaking about the customer's choice, in most businesses today the trend has been vendor reduction, not an increase in the number of suppliers, but from the automobile manufacturers to even Dell itself, Dell was direct to the consumer but anything but direct going upstream to its suppliers.

So the trend in most businesses today has been to reduce the number of companies they want to do business with or a lot of transactional simplicity and many of the exchanges and online sites in these new proliferating of sites or even manufacture direct is not of interest to many of these business customers who are saying, I deal with 800 vendors, I'm trying to figure out how to get it down to 20, why do I want to add another one.

So a lot of these exclusivity issues are playing out in a different way where it's the customer really saying, I don't want exclusive or I want to choose who I'm going to buy from, or the last thing I need is more choices, just help me figure out who are the ones who are going to help me run my business better.

And that's a little different than some of the consumers stories that we've been hearing, and I think that's an important perspective to understand in channel management.

MR. ANTALICS: Let me just ask kind of a general question and, Barbara, you had some interesting comments before on where over-enforcement or lack of clarity could chill innovative measures. I guess a two-part question: Are there other areas, particularly with respect to pricing, where we ought to be backing off or rethinking how we look at issues? And the second side, if you're going to take some enforcement away from us there, where should we be looking?

MS. BRUCKMANN: Well, I'm glad that my comments fell on fertile ground. From my standpoint, with respect to the Internet and pricing, MAP is where I would encourage some reflection because I see some real world implications for cautious manufacturers that don't want to tangle with your enforcement attempt.

I also would like to second what Sandy has suggested with respect to the value standard. I think with respect to Robinson-Patman, given the inherent cost structure of Internet sites, they can put an ad on the Internet which costs maybe two cents to put the text up, that the value standard right now is under a cloud.

And if there is an opportunity, given the jurisdictional mandate of the Commission, to address the value standard and to remove the cloud that was placed on it in 1990 because the Commission was hesitant that this is too soft, it could be abused too readily, there is a lot of resistance from small vendors, I think -- it would be a great service.

No one is naive to think this is self implicating, but if there is a way to at least remove the cloud on the value standard, I think that would be something. I second Sandy's information.

MS. DESANTI: Steve?

**(Discussion off the record.)**

MR. SALOP: I wanted to follow up on what Dick Steuer said because we really haven't talked much about the issue of exclusivity, exclusive web sites, a web site getting an exclusive for certain products. The notion that a web site or a portal might be some type of essential facility where the obvious ones that come to mind are eBay, for certain things like the payment system, and AOL and Windows Media Player would be precisely the ones that people think about now.

And there have been some cases there and some analysis. GTE brought suit against the Ameritech for having exclusives for their Yellow Pages where the claim was that they would be able to create an externality, network effects for their Yellow pages and drive GTE's Yellow Pages out of business.

Of course, in the Commission's analysis of the AOL-Time Warner merger, the issue of potential AOL exclusivity is analyzed. It was something I worked on for AOL, and there what we found is that there was really little exclusivity despite AOL's large size, and the type of exclusivity that AOL had was very short run. Like the poster child -- I probably shouldn't use the word poster child. The poster child for it was that AOL got the Sports Illustrated swimsuit issue 24 hours in advance. It was that type of exclusivity just to create some marketing buzz. But, like what Dick Steuer said, what was found was that there were lots of alternative ways for customers to reach the manufacturers or the Internet sellers.

And so the value of being on AOL's site was really not very large. AOL was clearly not an essential facility, but that's certainly an issue that should be analyzed. There's a lot of analysis now going on with Windows Media Player and what exclusivities they're going to demand, are they going to be behave in the way that they did with respect to the browser; and eBay is fairly unique in some ways that could make it an essential facility.

So it seems to me that's an issue that antitrust should continue to look at.

MS. GREENE: Will?

MR. TOM: Is this working? I've got a procedural suggestion rather than a substantive one in terms of where the agencies might want to pull back a little bit, and that is in situations where markets are clearly not well developed, where there are multiple players trying to penetrate a business, and a complainant comes into the agency, and there is always a temptation to say, Look, we don't know very much about what is going on here, let's just use some CIDs and see what's really going on and try to find out a little bit about it.

In a business in as much of an infancy as many of these businesses are, that can be a profoundly anti-competitive thing to do in and of itself, particularly if I'm right that with respect to some particular types of products, a joint venture kind of model is necessary or some degrees of limited exclusivity of the type that Mary Lou described is necessary.

The prospect of buying into a CID investigation that may cost you, oh, a hundred thousand dollars a month, let's say a small scale investigation in terms of legal feels and so on, can have a real chilling effect on potential joint venture participants or potential customers or potential vendors.

Who needs this? Why buy into it? So I think that I would strongly urge the agencies to try to spend more time up front in trying to unpack the complainant's stories, in turning their economists lose and seeing if the stories really make sense and trying to gather information and formally conducting these kinds of workshops before you let loose with a compulsory process.

MR. LANGENFELD: Responding to Mike's question, I'm going to put it a little differently and talking about economists. I think one of the problems that we have in just getting our hands around the Internet and electronic business is there really hasn't been that much research that's been done that tries to quantify the interaction between bricks-and-mortar and the different types of electronic business that's out there.

And I echo Commissioner Leary's comments that that's one of the things that I think the agency should be doing, and I think these types of panels are quite helpful, but one thing the agency should consider, similar to what it's done in the past, the eyeglass cases that supported a lot of antitrust action, is you may want to consider identifying a project in-house.

A lot of these e-businesses have been up long enough now. You can actually get data. You can get some data on market shares. In fact, I imagine there are people here, some other consultants that are here that are willing to sell that to you. I'm not suggesting anything.

But I do think that this is one of the things that will help you address some of the issues that we're talking about, the theoretical issues here. When you start talking about exclusivity, is it really exclusivity? And I think this has just been such a dynamic area and some economists thought we just haven't done the empirical basis to really have a cutting edge to decide this type of exclusivity is fine and this is not.

MS. DESANTI: Thank you. I think we're going to try to wrap up now. I would like to hear from Mark and Mary Lou. Then, Dick, you'll get the final word. Mark?

MR. PLOTKIN: I'm actually going to try to give Dick the final word even before it gets to him, which is to say that Dick flagged an issue that we have, actually back to my luxury goods segment, which is the conflict with the EU.

And it's one example of several different types of coordination issues that we see now with the international expansion of ecommerce by U.S. companies. Our clients are starting to get inquiries from antitrust enforcers in other countries, not just in the EU, about practices that we perceive are okay in the United States.

And I would be interested at some point to hear that the Commission and the Justice Department are working with and are talking to their counterparts overseas about these kinds of online distribution issues and sharing views including empirical analysis which I think is probably much more readily available in the United States than it is in a lot of these other jurisdictions.

And that brings me to the second point, which is that there really is a great deal of good empirical data now about the relationships between off line retailers and distributors and online companies.

I think that in the case of a lot of our companies that we work with, many of them have concluded that for those that are themselves off line retailers or distributors, the fact is that the selling and fulfillment and customer relationship management that's to be done on the Internet is something best left to a company other than themselves.

And so they're looking to partnerships with companies like Amazon to do that, and one sees that in the Toys-R-Us Amazon arrangement and also in the recent Borders Amazon arrangement.

There is a lot of empirical data out there.  I know our clients are happy to supply some of it anyway to the extent it's not inconsistent with their interests.  But ideally we'll have another program where we got more into the empirical side of this because I think there's a lot to learn.

I mean, if I wanted to be the whining type, I would whine now about certain kinds of practices out there based on the empirical data, but I'll save that for a private conversation.

MS. DESANTI: We'll look forward to the next session. Mary Lou?

MS. STEPTOE: My point was the EU point that has been made, so I'll yield my time.

MS. DESANTI: Dick?

MR. STEUER: I just wanted to address the pricing issue because it's a good question, and I think that it's far more complex than we might realize because of the rationale behind the rule against resale price maintenance that each seller, in it's own sovereign little area, is in the best position to make decisions on what the price should be, not the manufacturer. That's the theory.

With the Internet, this gets very complicated because suddenly there's only one territory, and with shopping bots, presumably all prices should very quickly go to the same level because we have transparency and perfect competition.

The problem is it seems not to be happening. The empirical evidence that I've seen suggests that shoppers are willing to pay more at sites that they have heard of and at least have some assurance that they're actually going to get the product that they're ordering on a timely basis, so suddenly we have that kind of distinction. And then we hear about Amazon that's able to distinguish from customer to customer and figure out how much one is willing to pay and make those kinds of distinctions.

Would it be possible to ban that under the Kahn case? I don't know, but I think the point is there's a lot more we need to learn about pricing on the Internet. It's not really as simple as what we're used to analyzing.

MS. DESANTI: Thank you, and I want to thank all of you. I think what we have in fact learned this morning is it's very, very complicated and that there is a great deal more to learn, but you have contributed mightedly to our better understanding of these issues.

So I thank all of the panelists for your participation, and now we are very fortunate to have Commissioner Anthony with us, who will close the entire workshop with a few remarks.

COMMISSIONER ANTHONY: Thank you, and in closing our workshop, I want to pick up on some of Chairman Pitofsky's remarks yesterday.

In reflecting on what I wanted to say today, it occurred to me that our mission at the Federal Trade Commission is, in fact, as you know one of protecting competition and consumers, but we really do more than just bring cases.

The agency is committed to the development and evolution of antitrust law, and one unique way we do that is to conduct these workshops and hold hearings. This helps our dialogue in ways that we rarely can achieve in prosecuting a specific case.

Many of the panelists who have spoken here in the last two days are frequent customers of the Commission, and I have seen many of you in the audience as well.

When you visit the agency to advocate on behalf of specific clients, it's hard for all of us to step back and sort of get the big picture, but in the workshop context, we are drawn together by our common interests, not our adversarial ones, so I thank all of you for participating in this workshop and for coming with your thinking caps on.

Antitrust, perhaps more than any other discipline, cannot exist with a static set of rules, and while certain antitrust principles remain constant, their application constantly must adapt to changes in the marketplace. The dynamic new world of ecommerce is certainly an example of that.

By coming together to share these ideas and to discuss actual market behavior, you help the enforcement community to get it right, which is about the bottom line for all of us who are serving in the public interest.

Speaking of dedication to the public interest, I would like to add to Commissioner Leary's comments this morning and to pay tribute to our chairman, Bob Pitofsky.

I'm sure you'll all agree that the level of scholarship has certainly increased at the Commission during his tenure. It's never been greater, and when he steps down, we, at the Commission, will lose a wonderful teacher.

However, he has instilled this agency with a true spirit of learning which I'm sure will be his enduring legacy.

I would also like to thank Susan DeSanti and her staff on the Policy Planning Committee for conducting this workshop, the former B2B workshop and other workshops and hearings, and I hope you'll join me in giving Susan and her staff a round of applause.

**(Applause.)**

COMMISSIONER ANTHONY: Thanks again for joining us.

**(Whereupon, at 12:16 p.m., the workshop was concluded.)**

**- - - - -**

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

EMERGING ISSUES FOR COMPETITION POLICY IN THE WORLD OF E-COMMERCE

WORKSHOP DATE: MAY 8, 2001

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

DATED: MAY 22, 2001

____________________________

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