THE ORIGINAL EQUIPMENT SUPPLIERS ASSOCIATION

Comments Prepared for the Federal Trade Commission
In Connection With Its Workshop on Competition Policy
in the World of B2B Electronic Marketplaces

June 29, 2000

FTC File No. 6750-01P

Neil De Koker
Managing Director
Original Equipment Suppliers Association
2950 West Square Lake
Suite 101
Troy, Michigan 48098-5724

Of Counsel

Marc L. Fleischaker, Esq.
D. Reed Freeman, Jr., Esq.
David H. Evans, Esq.
Arent Fox Kintner Plotkin & Kahn, PLLC
1050 Connecticut Avenue, NW
Washington, DC 20036

Introduction

The Original Equipment Suppliers Association ("OESA")[1] submits these comments ("Comments") to the Federal Trade Commission (the "Commission") pursuant to the Commission's *Federal Register* Notice dated May 4, 2000, regarding the application of competition policy to business-to-business ("b2b") electronic marketplaces ("emarketplaces").

The automotive and other derivative and related markets are seeing an explosion of interest in emarketplaces.[2] OESA supports the development of these exchanges.[3] Among other things, the exponential increase in real time communications and information flow will allow emarketplaces to reduce costs, improve efficiencies in design, manufacturing and distribution and generally make the industry more competitive in the global economy.[4] Nonetheless, the structure and operation of these exchanges, at least without proper failsafe mechanisms, may raise competition issues. OESA submits these Comments to underscore some

---

[1]OESA represents approximately 202 companies involved in the supply of components, modules, systems, equipment, materials and services used in and by the original equipment automotive industry and the aftermarket for the maintenance and repair of automobiles.

[2]For example, on Friday, February 25, 2000, Ford Motor Company, General Motors Corporation, and DaimlerChrysler AG announced a plan to combine efforts to create what they later named "Covisint," a b2b portal for ecommerce with their automotive suppliers. According to Commerce One, one of the technology partners involved in Covisint, the purpose of Covisint is to "eliminate redundancies and burden from suppliers by integration and collaboration, [resulting in] lower cost, easier business practices, and marked increase in efficiencies for the entire industry." Covisint is the most significant automotive b2b exchange to emerge. Covisint is still in a very formative stage, and OESA understands that Covisint has yet to conduct actual business pending the results of the Commission's review.

[3]Generally, OESA supports the development of Covisint. Covisint has the potential to help create momentum toward an industry-wide effort to harmonize ecommerce approaches. This will ensure that all segments of our industry – including suppliers, original equipment manufacturers, and other industry participants at every level – can reap the benefits of the ecommerce, business-to-business revolution.

[4] General Motors estimates its "e-structuring" has generated $800 million in cost savings over $1.6 billion in costs. These costs include initiatives like Covisint. http://www.wired.com/news/business/0,1367,37155,00.html

of the issues that can arise, and to suggest some safeguards that might be helpful in achieving these ends.

OESA hopes that these Comments will assist the Commission in developing an analytical approach to b2b electronic commerce ("ecommerce"). OESA believes that if the safeguards it suggests are put in place, b2b exchanges will be a valuable tool for, and materially reduce costs and improve efficiency of, the markets in which they operate.

B2B and Competition

B2B exchanges can materially increase the efficiency and competitiveness of many industries. They also have the ability to reduce competition as well if proper safeguards are not put in place.

Within a direct market, an exchange may facilitate the exercise of monopsony power or anticompetitive exclusionary practices; facilitate oligopolistic or perhaps collusive downstream activity; stabilize downstream prices through a harmonization of input costs; and reduce innovation. Within the market for the provision of ecommerce services, an exchange may attempt to or monopolize the market; establish and maintain supracompetitive transaction pricing; and establish and maintain anticompetitive non-price restraints that may stifle the ability of participants and potential entrants to develop alternative business methods and emarketplaces.

On the other hand, exchanges can facilitate the standardization of communication protocols across broad groups of participants with otherwise incompatible systems. Participants will be able to transact business without paper, without the need for redundant data entry and with less error. Information about transactions will be available in real time – details about the terms and conditions of the transaction, its status and delivery information will all be accessible instantaneously not only over Web interfaces but potentially within a participant's own back office systems. These innovations will reduce transaction costs, increase efficiency and result in higher quality products and services. The challenge is to implement just enough safeguards to prevent potential anticompetitive behavior while not needlessly hampering the ability of the exchange to reap these benefits.

These Comments address potential problems associated with, and suggested remedies for, competition issues raised by information perfection, monopsony power, exclusive dealing and other non-price restraints. The Comments conclude with a brief discussion on behavioral issues.

Information Perfection

The tremendous value (and danger) of the Internet is in its ability to facilitate the aggregation and analysis of massive quantities of information. Information is no longer a resource each participant develops and uses independently. Its aggregation and analysis are no longer laborious, time consuming and costly exercises that only a few of the most sophisticated participants can achieve. Each transaction on the Internet can be tracked in great detail. Participants in an electronic exchange can know, among other things, the identities of the purchaser and the seller, the quantity purchased, the date and time of the transaction, and the number of times the specific purchaser looked at the product before making her decision. And as computing power increases, the ability of participants to acquire and process information will only increase.

There may be problems with a marketplace that is this transparent. For example, if all purchasers in a market know the precise costs of their competitors, they will be able to predict their competitors' future pricing habits. While differing cost structures may limit the ability of sellers to collude on downstream price (which is still a real possibility), it is possible that the information may facilitate a tacit form of market allocation. If a company knows precisely the lines in which it is most and least competitive comparatively, that company may shift resources away from the less competitive lines to its more competitive ones. The companies with the least marginal cost for a particular product line may become the *de facto* monopolist when the less competitive participants exit those lines.

To a large extent, this is the competitive process that antitrust law aspires to create. Firms may continue to compete (perhaps more vigorously) on products they share similar cost structures with their competitors. They may also innovate in order to differentiate their less competitive products. The difference between this process taking place outside of and within an entirely transparent collaborative venture is in the level of uncertainty. Without complete transparency, a company may be able to "guess" at its competitors' strengths and weaknesses, but it will never know with real-time accuracy what those strengths and weaknesses are. That uncertainty will lead the company to make the competitively optimal choices. Eliminate the uncertainty, and participants will tend to move away from individual profit maximizing models to a collusive one.[5] Since the competitors would be reacting to the activities of their competitors

---

[5]Market concentration plays a role in determining whether a given information exchange will facilitate this (and other) forms of oligopolistic behavior. In atomistic markets, the presence of perfect transactional information about competitors will not necessarily eliminate the competitively-necessary uncertainty about their behavior. One should realize, however, that in markets where transactional information is perfect, "oligopoly" occurs at much higher numbers, and that merely because a market has 100 or so participants, it no longer necessarily means that the market will behave atomistically. The most common response to suggestions that information perfection cannot be illegal is look at the stock market. The stock market, however, operates on

rather than the demands of the market, participant welfare will maximize at the expense of consumer welfare.

When information is perfect among only one group of participants at the same functional level in an electronic exchange (for example, buyers), antitrust concerns are heightened. The informational asymmetry will tip the competitive balance toward the group that possesses the greater information, increasing its welfare at the expense of the uninformed groups. If an informational advantage is gained by virtue of the business acumen of the participant, the participant should be allowed to reap the profits of its endeavor. If, however, the informational advantage is gained by virtue of an agreement between competitors, the competitive effects of such an agreement should be viewed more closely. In the context of a b2b exchange, because this advantage results from an express agreement to share the information necessary to achieve it, it can be challenged under Section One of the Sherman Act[6] as a combination in restraint of trade or under Section Five of the Federal Trade Commission Act[7] as a facilitating practice.

In assessing information flows, then, one should be wary of how much information is shared horizontally. Are the efficiencies to be gained by the purchasers through sharing their bid information outweighed by the potential that they could harmonize their purchasing, allocate downstream markets or ultimately stabilize prices both to their customers and from their suppliers? Ideally, information would be contained within "vertical paths" in the exchange. Purchasers could only see those bids unique to them. Input sellers could see the prices the purchasers wanted to pay for the goods. Purchasers would not see the prices at which their competitors purchase, and sellers would not see the prices at which their competitors sell. To the extent more visibility is necessary, "anonymization" of specific transaction data – the reduction or elimination of the ability of competitors to attribute specific transaction data to individual participants – might limit the potential anticompetitive effect.

An important component of this analysis is who will own the information. If the exchange is controlled by all the participants in a specific level of the supply chain, they will be incentivized to share specific information across that level and to mask the information with regard to participants at different levels. The cleanest solution is to give equity and management interests to all participants — not just those on a specific level. A second solution is to preclude equity and management interests by any participant, thereby making the exchange a third party.

---

a theory of informational symmetry. Individuals are prohibited from making trades on inside information, for example.

[6]15 U.S.C § 1 (Supp. 2000)(prohibiting contracts, combinations and conspiracies in restraint of trade).

[7]15 U.S.C § 45 (Supp. 2000).

In that case, the exchange is incentivized to protect against inappropriate information dissemination, and is shielded from the influence of the participants who want greater disclosure. If ownership is a prerequisite, firewalls, data anonymization and management independence or isolation become necessary.

Monopsony

Monopsony power is the ability to reduce the price of a good or service below competitive levels. The exercise of monopsony power is illegal when accomplished by virtue of an agreement between two or more competitors. If purchasers constituting a substantial portion of an input supply market act in concert to acquire goods and services, they could force the prices of the goods and services below competitive levels.[8] Because the additional "purchasing power" of such buyers would be derived from their combination rather than their individual business acumen, their aggregated purchasing power could raise serious anticompetitive concerns.

In the context of an electronic b2b exchange, the ability of purchasers to act collectively turns largely on how much information they have about the others' activities. The most obvious solution would be to limit access to that information by creating vertical-pathways-based firewalls, anonymizing the information, isolating or making management independent and limiting (or extending) equity ownership in the exchange. If these solutions prove impractical given the efficiencies the parties wish to realize, an exchange may need closer scrutiny. While this may add to the transactional costs associated with establishing and operating the exchange, the potential welfare costs of collusive activity outweigh, in OESA's opinion, the costs of added scrutiny.

If the parties insist on complete transactional transparency across horizontal levels, the first step of the antitrust analysis should be to identify the product markets most affected by such transparency. If the number of product markets is too great to identify and address individually, the parties should be willing to accept general guidelines for their activity within those markets. Moreover, if the parties wish to exceed the safe harbors provided in the *Revised Federal Trade Commission, Justice Department Policy Statements on Health Care Antitrust Enforcement* or the *Antitrust Guidelines for Collaborations Among Competitors*, they should be prepared to justify their activities and accept solutions. For example, if their shares in a relevant market are sufficiently high, and they insist on sharing bid information regarding purchases made within those markets, they should be prepared to justify their desire and explain how their collective buying will not negatively affect competition.

---

[8]The flipside of monopsony action is standardization of input costs. If, by virtue of their concerted action, the costs of their inputs stabilize, the purchasers could stabilize the prices of the goods they sell.

Exclusive Dealing

If all the purchasers in a market require that in order to do business with them (or to get the purchasers' most favorable prices) a seller must participate on an exchange, they have in effect created an "essential facility." Under these circumstances, exclusive dealing arrangements can become illegal under Section One of the Sherman Act.

Most obviously, if the parties exclude a potential participant for reasons other than objectively valid business justification, the exclusion may be a form of group boycott. A variation on this group boycott can take the form of a manipulation of transaction or electronic interchange standards. For example, if the "language of the exchange" is a proprietary XML, denial of access to that language could preclude certain parties from participating. If there is an agreed-upon standard, denial of access to the relevant "how-to-use" information could also form the basis of a group boycott claim. For example, the exchange coders will most likely establish a uniform set of variables and Internet locations to which the back office systems of each of the participants must read and write. Without access to those variables and locations, the potential participant will not be able to use the system maximally. Even if there is a browser interface, the participants would have to key in information manually without access to those variables and locations. This would reduce the efficiency (and accuracy) of the exchange. If it is done deliberately, the effect would be to raise the costs of the potential participant and perhaps end their ability to participate in the market. If the exclusionary behavior is achieved through agreement of the participants, it would also violate Section One. Another variation is forced intermediation – purchasers forcing not only their immediate suppliers to participate with full transparency, but those suppliers' suppliers. While some efficiencies can be gained by virtue of complete market participation, if potential participants are forced to join and disclose information by virtue of the market power of the purchasers, the effort could be a form of group boycott or concerted refusal to deal.

The Commission should also be concerned with the ability of the exchange itself to innovate. While it is up to the parties to determine the most efficient way in which to do business, limiting the ability of the exchange to adapt to new business methods may be anticompetitive. If the parties agree to a specific method of doing business and the exchange is the exclusive means of doing business in the market, the selection may have the effect of entrenching the exchange. If a newer, more efficient business system is developed but is excluded from competing with the exchange for the business of the participants, the exchange could violate Section Two of the Sherman Act.[9] The participants could violate Section One by agreeing to engage in exclusive dealing to the detriment of the competing exchange.[10]

For this reason, the exchange should establish an independent body to evaluate admission to the exchange, the establishment of standards on the exchange and exchange's technical operations. While its absence is not illegal in itself, it could indicate a potential for anticompetitive behavior that should be monitored more closely in the future. If the exchange insists on full horizontal informational transparency, the exchange should accept an evaluating board.

Other Non-Price Restraints

The Commission should also consider non-price restraints. Uniform product catalogues imposed on all participants in the exchange could hinder innovation by defining a complete set of products. If the procedures required to add a new product are sufficiently onerous, participants would be unlikely to invest in developing new products because there would effectively be no market for them.

Transaction terms and methods may also be standardized. The parties may insist on standardizing contract terms including payment options, payment dates, financing terms, and perhaps even warranties. The parties may also insist on standardizing common data fields and transmission protocols. While standardization of data fields and transmission protocols is beneficial when accomplished in an open non-proprietary manner, standardization of transaction terms is not necessary. For example, it may be an efficiency to create a "warranty" tag in an XML. (*E.g.*, <WARRANTY></WARRANTY>.) This does not mean that it is an efficiency to

[9]15 U.S.C. § 2 (Supp. 2000)(prohibiting illegal monopolies).

[10]Network effects would have to be taken into account in this analysis. The principal value of an exchange is that it offers a standardized communication protocol for participants. If the exchange were based on HTML only, the value of the "standardization process" would be minimal. In effect, only variables and Web locations would need to be standardized; each participant would have to create Web modules for their back office systems to achieve compatibility. If the exchange were based on an industry-specific XML, however, the standardization process becomes more difficult. Participants would not only have to agree on "Web basics" but also on the tags themselves. In this situation, the network effects (and value) of a single exchange increase. The exclusion of alternative exchanges here would not necessarily represent anticompetitive behavior, but may actually be necessary to create an industry-wide exchange in the first instance. The process by which the participants agreed to create an inaccessible XML might have to be examined, however, to ascertain whether the participants acted anticompetitively.

standardize the contents of that tag. Absent a compelling reason (other than technology) to create such "content" standards, efforts to promulgate them should be viewed skeptically.

Behavioral Issues

One of the greatest benefits of these exchanges is in their ability to facilitate and enhance communication. Communications can be increased; cost of communications can be lowered. But while the efficiencies increase, so too does the potential for anticompetitive collusion.

Obviously the Commission cannot and should not monitor every communication accomplished over the exchange. The Commission should be concerned, however, with the presence or absence of an oversight group or mechanism designed to monitor the content of the communications. The exchange should insure that the rules regarding competitor discussions are clearly posted, and that all participants are aware of the exchange's policy regarding the antitrust laws. To the extent the exchange creates any online chat rooms or boards, the moderators of those channels should be advised on what sort of issues to look for.

In addition, the Commission should consider whether operational transparency is necessary. If the individual participants do not all have ownership interests in the exchange, they should at least be able to audit the activity of the exchange so that potential problems can be identified and contained early on, or brought to the attention of the relevant authorities if necessary.

Conclusion

The biggest threat to competition posed by b2b exchanges is the aggregation of the purchasing power of purchasers in any given market segment. This can be accomplished through an express agreement, or by virtue of selected information exchanges. This can be cured by isolating information exchanges within select vertical pathways; insuring that management is independent; anonymizing information; and precluding collective purchasing where shares are too high. The administrative operations of the exchange should be fully transparent.

OESA supports establishing properly structured b2b exchanges within our industry. They are an important step in the development of the next generation of business. The efficiencies are tremendous. The issues OESA raises above are only potential problems that might arise. OESA raises them to highlight some of its concerns in the hope that the Commission will find them beneficial as it develops a methodology for analyzing these types of exchanges.

Respectfully Submitted,

Neil De Koker

Neil De Koker D.R.F.
Managing Director
Original Equipment Suppliers Association
2950 West Square Lake
Suite 101
Troy, Michigan 48098-5724

Of Counsel:

Marc L. Fleischaker

Marc L. Fleischaker, Esq. DRF.
D. Reed Freeman, Jr. Esq.
David H. Evans, Esq.
Arent Fox Kintner Plotkin & Kahn, PLLC
1050 Connecticut Avenue, NW
Washington, DC 20036
Counsel for OESA