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The emerging international criteria for the regulation of B2B exchanges

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Legislation: Article 4 of Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, as last amended by regulation (EC) No 1310/97; the New Regulatory Framework for Electronic Communications.

It is our intention in this paper to examine recent developments in relation to approvals given to various electronic B2B trading platforms under European competition law and the new regulatory framework directive that is proposed by the European Commission for electronic communications networks and services. There are themes common to both. The framework directive is concerned with whether operators have significant market power (Article 13), how markets should be analysed (Article 14) and standardisation (Article15). The B2B exchanges have raised familiar concerns for EU competition law: agreements between undertakings and concerted practices which have as their object or effect the prevention, restriction or distortion of competition within the common market (Article 81); and abuse by one or more undertakings of a dominant position (Article 82). Our main aim is to consider to what extent regulatory principles that arise under `old economy' models are adequate to deal with the global phenomenon of electronic B2B commerce on electronic exchanges. On the one hand there are regulatory steps being taken for the infrastructure of the web, and on the other, there is a case-by-case development of the criteria for compatibility with European competition law of the virtual trading sites that are being created in the `virtual world'. There are recurring themes. To what extent are regulatory measures for the infrastructure, and the applicability of competition law for what takes place on the infrastructure, consonant with each other, and consonant with the economics of virtual trading on what is a global modality for trade?

It may be thought to be hyperbole to speak of B2B commerce as a phenomenon: it may be that the development of B2B commerce cannot be over stated. Now, alongside traditional market structures, we can see bi-lateral trading via e-business web sites and trading on e-marketplaces. It is the creation of these B2B e-marketplaces by joint ventures to facilitate trade in the virtual world, whilst at the same time the joint venture partners are all major players in the real world, which raises concerns about what might be called `virtual' dominance and its relationship to the `old' economy. The point of these virtual markets is that are supposed to create efficiencies improving on traditional markets in their geographical scope, processing of information, and, of course, in driving down prices and in efficiency gains.

Market types

In the most recent revision of the Commission's XXXth Report on Competition Policy, the Commission identified four general market types.[1]

"There are four general market types, all with numerous variations: buyer-managed exchanges are set up by large buyers, often in conjunction with technology partners. Supplier-managed exchanges are set up by suppliers. Market-makers are independent exchanges not controlled by buyers or sellers. They tend to be backed by venture capital and were often early innovators. Content aggregators are sites that go beyond setting up a mere exchange. Instead they build and maintain multi-vendor catalogues which allow customers to access the offerings of several suppliers using a common search structure."

It might be added to this that markets can be horizontal or vertical; where vertical markets are concerned with the supply chain in one or more sectors, and horizontal markets are cross-sectoral.

According to Total Romtec, as at April 2001 there were 2,000 marketplaces worldwide, 650 of which (a third) are in Europe. They estimate that the number of worldwide marketplaces by the end of 2002 will be 10,500, with 2,700 of those being in Europe.[2] However, as at December 2001, the Commission has given `comfort letters'or negative clearance to four B2B e-marketplaces to the effect that they did not currently restrict competition under Article 81: Covisint, Volbroker[3] (foreign currency options); Eutilia[4] (services in electricity sector); and Endorsia (manufacturers of machines and industry components).[5] It appears that only these four e-market places saw fit to apply for negative clearance[6], as it is a voluntary matter to apply for such clearance when a joint venture does not amount to a merger and the joint venture is not jointly controlled by its parents. It appears in practice that the small number of notifications seems to indicate that B2B exchanges are setting themselves up to stay well clear of EU investigation and penalties, rather than even seeking comfort or clearance to assuage any doubts that they were sailing close to the anti-competitive wind. [7]

Covisint

On the 31st July 2001, having been notified on 19 January 2001[8], the European Commission issued a press release that Covisint did not restrict competition in the sense of Article 81(1).[9] This was the Commission's most significant decision under Article 81(1), as most of its decisions until then had been in relation to joint ventures under the EC Merger Regulation 4064/89 dealing with concentrations

The first decision of any kind on such B2Bs was given on 25 September 2000 by the rule-making branch of the German Federal Cartel Office, which handed down a 17-page decision on Covisint. An Englis h translation has been made available on the web by Baker MacKenzie[10]

Covisint notified the German Cartel Office of its intention to develop an Internet B2B platform for the motor industry. Share capital on setting up the venture was as follows:

DaimlerChrysler	27%
Ford Motor Co.	27%
General Motors Corp	27%
Renault/Nissan	5%
CommerceOne Inc	2%
Oracle Corp.	2%
Others incl. Employees and non-car producers	10%

The sales figures for the three big players were impressive.

	1999 World Sales	1999 Euro Sales	German sales
DaimlerChrysler	293.3 bn DM 149,985 bn Euros	97.7 bn DM	55.5 bn DM
Ford Motor Co.	298.3 bn DM US$ 162.558 bn	57.7 bn DM	32 bn DM

More than 50% of worldwide car production can be attributed to them, and one third of European car production. The German decision was that the project was not expected to give rise to the establishment or strengthening of a dominant position. The arrangements for Covisint are therefore instructive.

Covisint intended to operate an Internet platform to which the entire motor industry should have access. Three sectors were identified within the motor industry. The notification to the Cartel Office referred to the following perceived benefits.

- management supply

- Information and communication systems should improve harmonising production plans between producers and suppliers;

- To optimise storage of goods and facilitate market-efficient capacity planning concerning demand for goods, product supply, planning of supply chains, management and transport of materials, logistics and customs duty.

- Product supply

- Improvements by Internet auctions, purchasing by catalogue, outsourcing purchasing; possibilities of automation and shortening intra-company operations.

- Common product development

- Common standards provided on the basis of which plans and product designs can be made accessible.

- To create the opportunity for co-operation over the Internet by exchange of information as to product development, inter-active development, and tools for product design used on a partnership basis.

- Integration of supplier chains and synchronisation of car and component planning was expected to cut the period of car development from 12-18 months.

Fee Model

The fee model had different charges for different product packets; a standard packet for a monthly fee; and transaction fees for auctions on percentage of sale price.

Articles of Association

These provided DC, Ford and GM could not have a majority on the board. Also, that the majority on board would not be affiliated to the car producer's market, and would include supplier's

representatives.

Memorandum of Understanding

There was a lengthy Memorandum of Understanding signed by the DC, Ford, GM and Renault/Nissan. This created binding rules regarding external purchasing, data protection, and commitments to open and non-discriminating access to Covisint. Relevant points were as follows.

- It would be possible to make amendment of the Articles after 18 months, if there is a two-thirds majority of the Board, as well as a majority amongst non-car producing shareholders.
- The car producers shall not operate concerted purchasing amongst each other in relation to car specific products. Covisint will only be used as a vehicle for purchasing non-car-specific products. Joint purchasing amongst car producers shall not be possible.
- The conditions of business shall be open and non-discriminatory, and shall not provide that a user be a shareholder.
- Preference shall not be given to car producers or to a certain group of suppliers.
- There shall be no agreements to bind suppliers to exclusively or mainly use Covisint.
- A supplier shall not be prevented from acquiring shares in another B2B platform, or using another, or to use Covisint for more than 18 months, but may exclude a supplier who holds shares in another platform from acting on the Board.
- Firewalls, encoding and identification techniques are to be used to guarantee data security and confidentiality of information so that it only reaches target users.
- An open software interface shall be maintained at all times.
- A product workspace accessible over the Internet will make it possible for product development teams to have access to project data, drafts and specifications, as well as to hold virtual meetings.

Benefits

The Cartel office identified that (i) speeding up the production and sale process will go hand in hand with decreasing costs of supply, storage, personnel and information and (ii) a shorter product cycle and innovation process.

Competition

The Cartel Office noted that there were 28 B2B market places worldwide in 1995; 332 in 1999; and 1090 in July 2,000. The market was characterised by `dynamic development', but "at this early stage the dynamics of Internet markets do not yet show any clear-cut contours out of which relevant markets might crystallise in future...and [consideration] does not provide any clues to supposing that dominant positions have or are being gained on the market of Internet platforms". As a result the cartel office did not see any ground to intervene, but reserved their right to do so.

In the European Commission's press release of 31 July 2001 it stated that:

"After carrying out a thorough investigation, the Commission has concluded that the notified agreements contain adequate provisions to eliminate these potential competition concerns, and has sent the parties a "comfort" letter to this effect. In particular, the agreements show that Covisint is open to all firms in the industry on a non-discriminatory basis, is based on open standards, allows both shareholders and other users to participate in other B2B exchanges, does not allow joint purchasing between car manufacturers or for automotive-specific products, and provides for adequate data protection, including firewalls and security rules."

Volbroker.com

- The six banks that set up Volbroker as a joint venture offering an electronic brokerage service for trading foreign currency options also received clearance under Article 81. The primary concerns related to access to confidential information of the parent companies. The Commission was satisfied with assurances that `Chinese walls' would be created between the parent companies and the Joint Venture. These assurances included:
- None of Volbroker.com's staff or management would have any contractual or other obligation towards any of the parents and vice versa.
- Volbroker.com's staff and management would be in a geographically distinct location from that of the parents.
- The representatives of the parents on Volbroker.com's Board of Directors would not have access to commercially sensitive information relating to each other or to third parties.
- The parents would not have access to the information technology and communication systems of Volbroker.com.
- The parents will also ensure that the staff and management of all the parties understand and appreciate the importance of maintaining the confidentiality of sensitive commercial information and that sanctions for breach are spelled out.[11]

Eutilia and Endorsia

Negative clearance for both of these was announced on the same day[12]. It was noted that Eutilia `will provide business to business (B2B) services in the field of the procurement of goods and services to utilities in the electricity sector including auctions, e-catalogue purchasing, off catalogue purchasing, buy/sell enquiries, supplier database services and hosting of individual buy sites.'

Endorsia `will support the buying and selling requirements of various manufacturers, distributors and end-users for branded industrial goods and services. Suppliers will be able to connect to customers and customers to their suppliers by using one single electronic interface. Endorsia itself does not engage in any buying or selling activities. Each of the sellers will maintain their own separate "storefronts", deciding, for example, their own selling and customer access rules, terms and conditions of sale, shipping policy and pricing. Thus, Endorsia will serve as a conduit between individual sellers and their customers'.

MyAircraft.com

The European Commission had come to a similar decision in Case No. COMP/M.196 9 issued on 4th August 2000 [13], concerning a joint venture between United Technologies Corp. and Honeywell International to set up a B2B market place called Myaircraft.com. This case was a notification of a proposed concentration. The market place would be a "one-stop shop" for aerospace parts and services, and to offer supply chain management functions, and auction capabilities. Myaircraft.com would only provide software tools, and would not sell or take title to any parts or services transacted across its web site. They had an aggregate turnover world wide of 5 billion euros, with a quarter of that in Europe. The combined market share was between 15 and 25 %. It was noted by the European Commission that if 50% of their combined sales took place through MyAircraft.com, this would correspond to between 5 and 15% of the worldwide sale of aerospace parts and services.

Specific clauses of the agreement were as follows.

- UTC and Honeywell not to use the services of any competitor of MyAircraft.com for the purchase and sale of aftermarket parts and the performance of aftermarket services for a period (which the Commission kept confidential).
- UTC and Honeywell are not to make any of their consulting resources or services available to competing aerospace Internet platforms.
- UTC and Honeywell not to promote any competitor of MyAircraft .com, or acquire an equity

interest if either's equity in MyAircraft.com drops below a certain level.
- These obligations would expire after the initial public offering of MyAircraft.com.

The Commission said these clauses were necessary to ensure that the joint venture is established on a solid base.

Competition law and cyberspace.

When we see how few B2B marketplaces have voluntarily applied for negative clearance or exemption under Article 81, and when we realise from the decision in Myaircraft.com that it is crucial in assessing a concentration as strengthening or creating a dominant position to have a proper definition of the relevant market as a precondition, that there may be a significant element of self-assessment by these joint ventures that they are exempted from EU competition law, or that it has not caught up with such e-commerce developments in cyber space. Competition law is complex, and a legalistic analysis might focus on such issues as whether to create a market place in which any of the parents has control directly or indirectly, as this would start off a series of legal questions about the applicability of the Merger Regulation[14], such as to whether there is a community dimension, whether thresholds are met, what are the markets, and what happens during the suspension of business when a phase 1 decision has to be taken within 4-6 weeks, and also if there is a second phase investigation, which may take up to 4 months, if the concentration raises serious doubts. And all the while there are the problems of market definition and dominance issues. There is no shortage of precedents for market definition, but what is especially interesting about B2B exchanges is whether the electronic market place will itself be a market that is in competition with other markets in cyberspace. This was the question which was left unanswered in Myaircraft.com, but the decision reached was that trading on an electronic market place was one of several business modalities, which could co-exist with business carried out in old economy ways. As far as dominance is concerned, the Merger Regulation's language is reminiscent of Article 82, with its applicability to the unilateral actings of one or more undertakings, rather than the language of Article 81 and its applicability to agreements and concerted practices. With Article 82 it was provided that it was not dominance as such which attracted recrimination (reproche)[15], but rather the abuse of a dominant position. Article 81 is concerned with the prevention, restriction or distortion of competition, but the Merger Regulation is concerned with whether the concentration is compatible or incompatible with the common market. The question for the Merger Regulation is dominance itself, then whether the dominance is anti-competitive, and hence incompatible. Technical or economic progress, as such, is not a matter of exemption from the Regulations, merely matters to be taken into account. Articles 81, 82 and the Merger Regulations are distinct and used in differing circumstances. Also, there have been important decisions about the application of the Merger Regulations to a collective dominant position in an oligpolistic market, where each undertaking may be aware of common interests without having to resort to an agreement or resort to overt collusion. In short, it is clearly a challenging question to identify from the beginning which sort of application to make to achieve approval, and how to identify precedents.

There is then the question of the difference in the interplay between the Merger Regulation and the basic antitrust Regulation 17. It may be one thing to obtain clearance under the Merger Regulation for the formation of the exchange, but the operation of it may also give rise to issues under Articles 81 and 82, so that Regulation 17 procedure may still happen even where merger clearance has been obtained.

Having taken what can be taken from the existing precedents, there is then the legalistic task of differentiating those from the circumstances of an electronic exchange existing on a global network.

In the first place, networks themselves display characteristics of growth based on connectivity that increase exponentially with each new user. Most B2Bs will follow a network dynamic and are designed to produce increased connectivity between parties to the exchange. None of the models of

business have been on exchanges like a stock exchange, but rather like market places. The network dynamic itself will apply to e-marketplaces, so that the market with the most users will have a `tipping' effect'. A single electronic market may achieve the largest slice of the `cyberspace' market, which may supersede or co-exist with the national, European and global markets in the real world. Indeed, as we have seen, complex `tie-in' agreements in order to establish marketplaces have been approved in Myaircraft.com for an unspecified period. Also, in the *emaro* case[16] a B2B electronic market for office furniture and equipment, the Commission accepted that 68% of joint purchases of both parent companies would go through the exchange. As the activities of the parents did not overlap in the office furniture sector, the Commission's horizontal guidelines that create a safe have for joint purchasing by companies with a combined market share of less than 15% on both the purchasing and selling market were not exceeded. But the Commission has ruled that a Belgian postal operator De Post la Post, which made a preferential tariff in its monopoly area of general letter mail service subject to subscription to its new B2B service, had abused its dominant position, where there was a private undertaking that could not then compete on a level playing field.

How then should the `cyberspace market' be regulated? It might even be asked if regulation is appropriate for now. The Competition Commissioner, Mario Monti, stated on 2 March 2001:

" We will therefore need to analyse carefully the workings of any proposed Business to Business trading system and its effects on the market without jeopardising the important pro-competitive effects that these systems will undoubtedly have."

The Commissioner therefore recognises that an important precedent, not to say *ab ante* regulation, may itself have an anti competitive effect in Europe, in what is a global matter.

There is likely to be a shakeout phase, where liquidity will determine the continuation of many electronic marketplaces. It remains to be seen whether `first mover' advantage will actually be a significant factor. Then there will be the question of standardisation of software and protocols, which themselves may race ahead, or be restricted by property rights in patented software in particular jurisdictions. Indeed it was software for a network model of doing business that was first awarded a patent by the American Supreme Court in *State Street Bank and Trust Co v. Signature Financial Group Inc.*[17], and which has raised the dimension of monopolistic intellectual property rights being themselves construed as barriers to competition.

Market exclusion and foreclosure is an issue that has relevance. However there is not as yet any guidance or decision of the European Court of Justice which is directly in point for cyberspace. In the *Oscar Bronner* case the question of abuse of a dominant position by not granting access was construed narrowly, so that access must be indispensable and incapable of being objectively justified.[18] Nevertheless the example of *Covisint* makes it clear that open access on a non-discriminatory basis was a feature of that marketplace.

On any anti-trust analysis, it is clear that the most immediate concerns will be the abuse of information to collude in pricing. Here we have the double-edged sword of greater transparency in price information not necessarily having the effect of downward pressure on prices; whereas market price transparency is good, price transparency among competitors is generally thought bad. And yet, all the while there is the possibility that greater transparency in B2B marketplaces has the potential to produce the perfect market place. Nevertheless, we can see from the approvals that have been granted already that the protection of price sensitive information amongst competitors has been regarded as of as much importance as it normally does. Hence the importance of firewalls for security, and the `Chinese walls' for separation of management between joint ventures and their parents. In the information age it may be that the dynamics of the transparency of information and the ways it can be electronically managed will require a re-examination of our existing notions of how competition is best supported across sectors. Electronic selling software may be programmed to search and respond to electronic buying software. It may be that the quality of information itself

becomes the defining material of competition in any market.

In the USA the Federal Trade Commission issued a report in relation to B2B arrangements in October 2000.[19] The FTC Report identified the four major B2B antitrust issues as: (1) "information sharing agreements that could facilitate coordination;" (2) "the exercise of monopsony power by large buying groups;" (3) "agreements among competitors to exclude or discriminate against rivals of a B2B's participant-owners;" and (4) "competition among marketplaces themselves which might be affected by exclusivity, either de facto through over-inclusive ownership structures or through rules or incentives that keep a B2B's participants from using or supporting a rival exchange." Clearly these are similar concerns to those of the European Commission, and, similarly, the FTC gave clearance at an early stage to Covisint [20].

Conclusion

It is tempting to look at the proposed directive for a common regulatory framework for communications networks and services and to argue that the commerce that is being carried out on such infrastructure should be capable of *ab ante* regulation also. However the issues are different. Infra structure is old economy and what takes place on it is new economy. It is far easier to identify existing competition law with the former than the latter. Just as the new economy presents alternatives to the old economy, it would appear to require alternatives to the regulatory features of the old economy.

It is clear that much work is still to be done by academics and regulators in assessing B2B exchanges. They are what we would describe as neoteric markets, because of their features of network externality and global positioning in cyberspace, so that an electronic marketplace might itself constitute a market in the competition law sense, to be considered in competition with other B2B exchanges.

The question is how these should be regulated by law. It might be that calls are made for regulation by the WTO. The followers of a more pragmatic school of jurisprudence might ask, with Oliver Wendell Holmes, what the bad man needs to know: "under what circumstances and how far they will run the risk of coming against what is much stronger than themselves ?"[21] There is a danger in acting and a danger in not acting for regulators. A close look at the cases we have considered shows the first tentative steps to evaluate the potential benefits and threats such neoteric markets might present. Whilst standard historical market measurement techniques are very difficult to apply, and there may be a raft of economic advantages, there lurks the fear that anti-competitive and collusive forces might emerge in fact in the *uberhinterland* of cyberspace.

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[1] SEC (2001) 694 FINAL- updated 15/02/02 -

[2] http://www.total-romtec.com/downloads/pdf/E-MarketPlaces.pdf

[3] COMP/ 38.866- Volbroker (Deutsche Bank/UBS/Goldman Scachs/Citibank/JP Morgan/Natwest

[4] COMP/38.091 - Electrabel/EDF/Endesa/Enel/Iberdrola/National Grid/Nuon/RWE/Scottish Power/United Utilities/Vattenfall

[5] : Aktiebolaget SKF (Sweden), Reliance Electric Industrial Company (USA), The Timken Corporation (USA), Industriewerk Schaeffler INA-Ingenieurdienst GmbH (Germany) and Sandvik Finance B.V. (Sweden).

[6] On 21st December there has been another, Centradia, Case COMP/38.327, concerning a market

place for foreign exchange services, involving The Royal bank of Scotland plc. Societe General SA, Banco Santander Central Hispano SA and Sampaolo IMI SpA.

[7] The Commission has already assessed and cleared a number of such marketplaces in a wide variety of industries. Examples include electronic markets for aircraft components *(MyAircraft.com -- UTC/Honeywell/i2),* services to the chemical industry *(Chemplorer.com -- Bayer/DT/Infraserv Hoechst),* office equipment *(emaro.com -- Deutsche Bank/SAP),* public administration services *(Governet.com -- SAP/Siemens),* foreign currency options *(Volbroker.com -- Deutsche Bank/UBS/Goldman Sachs/Citibank/JP Morgan/Natwest),* and mutual funds *(Cofunds.com -- Newhouse/Jupiter/Scudder/M&G).*

[8] http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/c_049/c_04920010215en00040004.pdf

[9] http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/01/1155|0|RAPID&lg=EN

[10] http://www.bmck.com/ecommerce/germandecision.doc

[11] `Commission approves the Volbroker.com electronic brokerage joint venture between six major banks,' Commission Press release IP/00/896 of 31 July 2000

[12] 10 December 2001- http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/01/1775|0|RAPID&lg=EN&display=

[13] http://europa.eu.int/comm/competition/mergers/cases/decisions/m1969_en.pdf

[14] Regulation 4064/89 (as amended by regulation 1310/97)

[15] Case 322/81 *Michelin v. Commission* [1983] ECR 3461 at 3511

[16] Case M.2067 - Deutsche bank/SAP/JV, Article 6(1)b - decision of 13.07.2000

[17] 149 F. 3d 1368 (1998).

[18] Case C-7/97 *Oscar Bronner GmbH & Co v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co KG* [1998} ECR I-7797, 41

[19] http://www.ftc.gov/os/2000/10/b2breport.pdf

[20] File No. 0010127 (Sept 11, 2000). Closing letter to General Motors, Corp., Ford Motor Co., and DaimlerChrysler AG may be seen at www. ftc.gov/os/2000/09/covisintchrysler.htm

[21] Holmes *The Path of the Law* (1897) 10 Harv. LR pp. 460-461