Antitrust Analysis of B2B Ventures

David A. Balto

This is part two of a two-part article analyzing antitrust concerns of B2B ventures. Part one, which appeared in the July 2001 issue of E-Commerce Law, *discussed issues concerning the size of the venture and the potential for coordination and collusion among rivals. This article discusses the issues of monopsony power, exclusion, and exclusivity.*

Potential Competitive Effects: Monopsony Concerns

Monopsony concerns may arise in situations in which there is joint buying through a Business-to-Business (B2B) exchange. A monopsonist is a firm with tremendous buying power, such that it can force prices down to a suboptimal level, leading to a reduction of output.[1] Monopsony can be a difficult issue because a monopsonist is forcing prices lower instead of higher, and one might intuitively think that consumers would benefit from these lower prices. Supreme Court Justice Stephen Breyer articulated this concern when he noted that

> the Congress that enacted the Sherman Act saw it as a way of protecting consumers against prices that were too high, not too low. [Courts] should be cautious—reluctant to condemn too speedily—an arrangement that on its face appears to bring low price benefits to the consumer.[2]

A complete antitrust analysis, however, looks beyond the effect on input prices. The consumer may never see the lower prices extracted from suppliers by monopsony power, particularly if the monopsonist also possesses market power in its selling market. Professor Herbert Hovenkamp notes in his recent treatise that a monopsony price may harm consumers where it results in a reduction in output by the suppliers to the monopsonist. He concludes that "monopsony is an important antitrust concern and is just as inconsistent with consumer welfare as monopoly is."[3] In theory, a monopsonist can wield as much market power as a monopolist. The monopsonist can force the price away from the price that would prevail in a competitive market, and the seller that deals with a monopsonist can be just as injured as the buyer that deals with a monopolist.

David A. Balto is with White & Case in Washington, DC as a partner in the firm's Antitrust Group. His practice focuses on mergers, joint ventures, and e-commerce. Mr. Balto was the Policy Director of the Bureau of Competition of the Federal Trade Commission.

Recognizing the monopsony concern, however, and distinguishing between exercising monopsony power and increasing the efficiency of the purchasing process may be practically difficult. Professor Hovenkamp notes:

> A principal difficulty of antitrust policy toward monopsony is distinguishing between the efficient low purchase prices that result from reduced transaction costs or elimination of upstream monopsony. Perhaps the most problematic area is joint purchasing arrangements, which create a significant potential for cost savings but may also facilitate buyer price fixing. In such a case the decision maker would try to determine whether the defendants' managers are encouraging members to purchase as much as possible, which is generally inconsistent with buyer price-fixing; or encouraging them to suppress their buying, which is highly suspicious.[4]

The difficulty of making this distinction has serious operational implications for enforcement agencies, and emphasizes the need to keep Justice Breyer's admonition in mind.[5]

The antitrust agencies have brought several important merger cases in recent years that have included significant monopsony issues. The Department of Justice (DOJ) challenged the Continental/Cargill and Aetna/Prudential mergers based on the potential exercise of monopsony power.[6] The Federal Trade Commission (FTC) considered the issue of potential concentrated buying of Alaska North Slope oil in the British Petroleum/Amoco merger.[7] The FTC also considered the issue of misuse of buyer market power in *In re Toys R Us, Inc.*[8] In that case, the FTC alleged that the nation's largest toy retailer used its monopsony power to coerce manufacturers not to supply desirable merchandise to warehouse club stores, the new and innovative entrants into the toy retailing market.

One example of the exercise of monopsony power in a network context involved an effort by the PULSE ATM

network to reduce the fees paid for ATM transactions.[9] In *In re arbitration between First Texas and Financial Interchange, Inc.,* one member of the ATM network, First Texas Savings Association, had decided to deploy a large number of ATMs, primarily in convenience stores. ATM owners are primarily compensated by an interchange fee paid from the card-issuing bank to the ATM owner bank. When the joint venture network attempted to lower the interchange fee to make the network more attractive to card-issuing banks, First Texas sued, alleging that the network was acting as a buyers' cartel and exercising monopsony power. First Texas alleged that the reduction of the interchange fee could harm consumers by reducing the number of ATMs and diminishing consumer choice. The arbitrator agreed in part with First Texas' argument: "Simply put, the ATM owner is in the best position to identify and respond to consumer demand. Consumer choice is generally enhanced through a maximization of price/quality/convenience options."[10] He struck down the decrease in interchange fees in part because it would lead to a decrease in the deployment of ATMs.

Sometimes when network joint ventures, such as B2B exchanges, establish standards, those standards may raise monopsony concerns. This issue is illustrated by *Addamax Corp. v. Open Software Foundation.* This case involved a monopsony price fixing claim against the Open Software Foundation (OSF), a nonprofit joint venture consisting of large computer manufacturers (including HP, IBM, and Digital). OSF was formed to establish an operating system that could compete against an AT&T/Sun Microsystems product in an alleged market for UNIX operating systems. The venture wanted a security product within its operating system, and it put out a "request for technology" to Addamax and SecureWare to bid on an exclusive right to sell to OSF. OSF selected SecureWare, and within two years Addamax had begun to phase out its own product to concentrate on products for other markets. Addamax sued OSF, HP, and Digital, alleging that the defendants had engaged in horizontal price fixing by conspiring to force the price for security software below the competitive price. The District Court granted the defendants' motion for summary judgment on the plaintiff's *per se* claim, but the court found triable issues under the rule of reason. In a subsequent trial on damages alone, the court found that the plaintiff's injuries were self-inflicted and were not antitrust injuries.[11] Although the defendants prevailed, this case demonstrates some of the potential monopsony concerns that arise when joint ventures establish standards that might tip the market to an individual product.

The monopsony problem in joint buying arrangements is tied to the problem of overinclusiveness. If the buyers participating in any one B2B exchange are a significant percentage of the total market for the inputs they are purchasing, then they may have monopsony power over sellers into the site. (Note that, although site participants in many cases may dominate a particular *output* market or markets, this does not necessarily mean that they have market power as buyers for particular inputs.) The depth of concern over any individual site will depend on a number of circumstances. The agreement itself is important. Are the buyers purchasing jointly or do sellers bid on the business of each individual buyer? Would any part of the agreement limit nonprice competition between the buyers? For example, would certain terms be standardized for all auctions on the exchange or would each buyer set its auction terms? And can (and do) buyers participate in rival buying arrangements?

The central factor is what share the buyers have in the input market. As noted in the discussion of overinclusiveness, the Competitor Collaboration Guidelines provide a safe harbor "when the market shares of the collaboration and its participants collectively account for no more than twenty percent of each relevant market in which competition may be affected."[12] Although the safe harbor is relatively modest, the courts and antitrust agencies have approved joint buying arrangements with much higher market shares.

Although the safe harbors are the same on both the buying and selling side of the market, monopsony power may be less likely to occur in practice than monopoly power. Monopsony power typically requires high levels of buyer concentration, and, in most markets, buyers are far less concentrated than sellers.[13] Most products have a variety of uses and are thus bought by firms competing in a broad range of output markets; monopsony is likely to occur only when resources are specialized for just a few uses.[14] That typically will occur in relatively few markets outside of agricultural products and labor. Realistically, monopsony power can be exercised to lower input prices only if marginal costs are increasing, since sellers' marginal costs would drop under that condition if output were diminished by the monopsonist's reduction of its purchases. In industries in which marginal costs are roughly constant, however, the reduction of purchases by a monopsonist does not lower the marginal costs and therefore does not result in lower prices.[15]

Potential Competitive Effects: Restraints on Membership

A joint venture may impose many types of restraints, and restraints on membership are just one example of a matter of dispute in this context. Joint ventures often adopt membership eligibility standards that result in one or more competitors of the venture's members being excluded (or expelled) from participation. Exclusion claims frequently arise in both the exchange and network settings. In fact, one of the seminal cases on joint venture membership, *Silver v. New York Stock Exchange,*[16] involved the exclusion of a broker from membership in a stock exchange. Many of the antitrust conflicts that arose in the last electronic commerce revolution (the emergence of credit card and ATM networks) involved membership or access disputes.[17]

Since the Supreme Court's 1985 decision in *Northwest Wholesale Stationers v. Pacific Stationary & Printing Company,* the focus in access/membership claims has been on whether the venture possesses "market power or exclusive access to an element essential to effective competition."[18] *Northwest Wholesale Stationers* involved the expulsion of a stationery store from a wholesale purchasing cooperative in the Pacific Northwest. The Ninth Circuit held this expulsion to be improper because of a lack of procedural due process. The Supreme Court reversed, holding that the rule of reason should be applied because the cooperative lacked market power.

The critical question under the *Northwest Wholesale Stationers* standard is whether membership confers a significant competitive benefit. If competing networks exist and there is no significant competitive benefit from belonging to any particular one, denial of access to one network may not create an antitrust problem.[19]

The *New England Fish Exchange* case illustrates what could be a significant competitive impediment. As noted in the July issue of *E-Commerce Law,* the vast majority of the fish sales in Boston were transacted through that exchange. Forming an alternative exchange would have been a daunting, if not impossible, task. One would need to secure a sufficient number of buyers and sellers to achieve a viable scale and a sufficient level of the economies of agglomeration. Moreover, creating an alternative exchange would have posed coordination problems, since both dealers and fishermen would not defect unless they were assured a sufficient number of other firms would defect to the new exchange. In more contemporary terms, one might characterize the exchange as an essential facility.

The Internet may make a world of difference, however. On the Internet, a seller can conceivably transact business with any number of buying sites, even doing so simultaneously. Multiple sites serving the same industry may therefore arise. In theory, the marginal cost of participating in additional online exchanges may be small.

If multiple sites serving a given industry become typical, competitive concerns about exclusion from an auction site are obviously unlikely. For example, in discussing the exclusion of participants from joint buying arrangements in the health care industry, the Healthcare Guidelines instruct that, because of the industry's "large number and variety of purchasing groups . . . , it is not necessary to open a joint purchasing arrangement to all competitors in the market."[20] The Healthcare Guidelines add that "[t]he exclusion from the arrangement of some competitors will raise antitrust concerns only if those who are excluded are put at a significant competitive disadvantage in competing with the participants."[21] The point is that exclusion from a joint purchasing arrangement rarely raises antitrust concerns because most health care purchasers are capable of forming alternative arrangements.

In a context in which there is concern about exclusion from an industry exchange site, the balancing consideration is whether the venture had a legitimate basis for restricting membership or access. As the Supreme Court observed in *Northwest Wholesale Stationers,* membership restrictions will be upheld if they are "substantially related to the efficiency enhancing or procompetitive purposes that otherwise justify the [venture's] practices."[22] Membership restrictions often can be justified by the need for joint ventures to ensure that participants are financially sound, can make valuable contributions to the collaboration, and will share fully in the risks of the venture, rather than "free ride" on it. Membership restrictions have been struck down most often when they lack a legitimate business justification.[23]

There can be a variety of legitimate reasons to restrict membership. It may very well be valid to prevent members of rival exchanges from participating, particularly in situations in which competitive concerns arise from their participation. Ventures also can impose restrictions to assure that participants are financially sound enough to fulfill their undertakings and capable of providing the necessary services.

FTC Chairman Robert Pitofsky addressed access issues in the emerging world of electronic commerce:

> Although some may seek to restrict access to the new world of electronic commerce, those restrictions should be imposed only where necessary to protect a well defined interest. For example, regulators or private networks can impose restrictions to assure that participants are financially sound or capable of providing the necessary services. Those restrictions should not be overbroad. In some cases, groups of competitors have imposed restrictions on rivals to deter or delay competition. The antitrust laws disfavor the creation of artificial barriers to entry. Thus, the presumption should be that access is available to all who seek to compete for consumers business, and therefore that a general prohibition based on the class of competitor should be carefully scrutinized.[24]

The FTC Staff Report poses several questions for the analysis of exclusion claims, which parallel the issues addressed in the case law.[25]

1. Is the B2B exchange the only way the product (or adequate substitutes) can be bought or sold at comparable prices? Will the denial of access increase the costs of rivals significantly or diminish their ability to compete?
2. Can the effects of the exclusion be counteracted or deterred by alternatives, such as the entry of other exchanges, or other means of buying or selling products?
3. If the B2B exchange were in fact the only way the product or adequate substitutes could be bought or sold at comparable prices, would denial or limitation of access give the B2B exchange's participants the power to raise or maintain price above a competitive level?
4. What are the efficiencies of the exclusion?

Potential Competitive Concerns: Exclusivity

Another type of restraint that may raise some concerns involves exclusivity. Often when a new venture or network is created, it is important to guarantee the commitment of its members by restricting them from participating in rival exchanges or networks. The venture seeks to restrict competition through an absolute ban on competition with the venture, restricting the form of that competition or limiting its scope. Exclusivity can be justified as necessary to establish a new product; that is, without exclusivity, the venture could not be created. These restrictions may be necessary when participants have an opportunity to free ride on investments made by the venture or co-venturers.[26]

When a venture grows and achieves prominence, exclusivity arrangements can raise competitive concerns. As William Blumenthal observes, "[A] collateral restraint that is lawful when the venture is a fledgling might ripen into illegality as the venture matures into a position of strength."[27] Restrictions on competition among co-venturers are particularly likely to face close scrutiny when the venture brings together competitors with a substantial market share in concentrated markets. Exclusivity arrangements in established ventures often amplify concerns over the potential exercise of market power, since firms are committed to dealing solely through the venture. As indicated earlier, the lack of exclusivity requirements (when supported by evidence of nonexclusivity in practice) often can reduce competitive concerns when the venture otherwise appears to have market power.

The National Bank of Canada

Exclusivity arrangements can be pro-competitive, especially at the inception of a venture to assure the commitment of venture members and deter free-riding. This is illustrated by the challenge to MasterCard's exclusivity rule in Canada.[28] MasterCard was a late entrant into the Canadian credit card scene, and like VISA in Canada, it had an exclusivity rule prohibiting its members from issuing the rival network's cards. When one of its members merged with a VISA member, MasterCard exercised the rule and gave the bank a choice: Either withdraw from VISA or cease being a member of MasterCard. MasterCard terminated the bank, and litigation followed. The District Court ruled against the plaintiff on jurisdictional grounds, but noted that the "underlying purpose of the exclusivity provision was to enhance competition in the Canadian credit card market by introducing a new product, MasterCard."[29] It also noted that the rule had a limited duration and focused on assuring that the new network would get off the ground.

Exclusivity and the MAC ATM Network

A critical issue in evaluating exclusivity is whether the venture has the potential to exercise market power. This issue is illustrated by the treatment of an exclusivity rule adopted by the MAC ATM network. MAC is a

large proprietary network that grew by acquiring rival networks. It prohibited its bank members from belonging to other networks. Its exclusivity rule survived a private antitrust challenge in 1988. The court gave two reasons. First, the network did not possess any market power because it was a relatively small player in a larger technology market. Second, the rules were intended to assure the commitment of members and prevent free-riding."[30]

Six years later, the DOJ challenged similar exclusivity rules of MAC as illegal tying and monopolization under §§ 1 and 2 of the Sherman Act.[31] At that time, MAC had approximately a 90 percent market share in Pennsylvania and a strong position in adjacent mid-Atlantic states. The DOJ alleged that MAC had barred banks that belonged to its network from buying data processing services from third parties and had used its control over ATM processing to prevent network-member banks from connecting with competing networks. The DOJ contended that the rule effectively made it impossible for smaller banks to belong to rival networks while belonging to MAC. The case was settled, and MAC opened its network on a nondiscriminatory basis.[32]

B2B Exchanges and Exclusivity

Even in the case of a very inclusive B2B exchange, competitive concerns can be reduced if it is nonexclusive, that is, if the participants in the joint B2B "have the ability and incentive to compete independently" by participating in other sites as well.[33] The agencies consider whether, to what extent, and in what manner the relevant agreement permits participants to continue to compete against each other and their collaboration, either through separate, independent business operations or through membership in other collaborations. The ability of venture members to compete against the venture is known as "insider competition."[34]

The inquiry goes beyond the face of the parties' agreement to determine whether a collaboration is nonexclusive in fact as well as in name, and considers any costs or other impediments to competing with the collaboration. In assessing exclusivity when an agreement already is in operation, the agencies examine whether, to what extent, and in what manner participants actually have continued to compete against each other and the collaboration.[35]

Some of the factors considered are: the duration of the exclusivity agreement; the type of incentives members have to use the B2B site (*e.g.*, are there rebates, rights of first refusal, special discounts, penalties for using alternative sites, or most favored nations provisions?); the ownership structure and whether it creates incentives to use the site exclusively; any viable alternative sites; whether members use alternative sites to a significant extent; and whether there are penalties for withdrawing from the venture.

The lack of a written exclusivity provision in a joint venture agreement is not dispositive. When a venture is overinclusive to the point that no alternative exists, exclusivity is a serious concern. Courts may give undue weight to the lack of a written exclusivity provision without considering the incentives of members pushing them toward exclusive use of the venture.[36]

Because of the network efficiencies involved, analysis of exclusivity arrangements involves some difficult trade-offs between potential economies and anticompetitive effects. The FTC Staff Report presents three inquiries to address these trade-offs:

1. How strong and pervasive are the network efficiencies in a particular industry context?
2. Are the exclusivity practices reasonably necessary for achieving the network efficiencies?
3. Will interoperability between competing B2B marketplaces permit achievement of comparable network efficiencies without sacrificing competition? Will open access to the marketplace interfaces serve as a "practical, significantly less restrictive" alternative?

Ultimately, the FTC Staff Report observes that competitive concerns are magnified along with (i) the greater the market share of the B2B owners; (ii) the greater the restraints on participation outside the B2B; and (iii) the less the interoperability with other B2Bs.[37] The FTC Staff Report observes that this does not mean that "industry consortia B2Bs are presumptively unlawful or that minimum volume commitments cannot be imposed. It does suggest that high levels of industry ownership or substantial minimum purchase requirements will likely draw a closer look."[38]

Conclusion

Antitrust plays a vital role in making sure that markets are competitive and that consumers receive the benefits of a competitive marketplace. B2B arrangements offer

the potential for substantial efficiencies and with prudent antitrust counseling, participants should be able to structure these endeavors to avoid antitrust risks.

Notes

1. For a description of the differences between monopsony and buyer power, see *Report on the Federal Trade Commission Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry* (Feb. 2001).
2. Kartell v. Blue Shield, 749 F.2d 922, 931 (1st Cir. 1984), *cert. denied*, 471 U.S. 1029 (1985).
3. Herbert Hovenkamp, Federal Antitrust Policy 14-16 (1999).
4. Hovenkamp, *supra*, n.3 at 16.
5. For an exhaustive discussion of the pros and cons of strict federal antitrust enforcement against monopsony power, *see* Blair & Harrison, Monopsony: Antitrust Law and Economics (1993); Blair & Harrison, "The Measurement of Monopsony Power," 37 *Antitrust Bull.* 133 (1992); Jacobson & Dorman, "Monopsony Revisited: A Comment on Blair & Harrison," 37 *Antitrust Bull.* 1 (1992); Jacobson & Dorman, "Joint Purchasing, Monopsony and Antitrust," 36 *Antitrust Bull.* 1 (1991).
6. United States v. Aetna Inc., 1999 U.S. Dist. LEXIS 19691 (revised final consent judgment entered, Dec. 7, 1999).
7. In re BP Amoco p.l.c. & Atlantic Richfield Company, FTC Docket No. C-3938 (consent order issued April 13, 2000), 2000 FTC LEXIS 56.
8. In re Toys "R" Us, Inc., FTC Docket No. 9278 (Oct. 13, 1998), 1998 FTC LEXIS 119, *affirmed*, 221 F.3d 928 (7th Cir. Aug. 1, 2000).
9. In re Arbitration between First Texas Savings Ass'n and Financial Interchange, Inc., 55 Antitrust & Trade Reg. Rep. (BNA) No. 1380, at 340 (Aug. 25, 1988). For a description of the PULSE litigation, *see* David Balto, "Regulatory, Competitive, and Antitrust Challenges of ATM Surcharges," 71 *Banking Report* (BNA) 882 (July 13, 1998).
10. *Id.* at 364.
11. Addamax Corp. v. Open Software Foundation, 964 F. Supp. 549 (D. Mass. 1997), *aff'd,* 152 F.3d 48 (1st Cir. 1998).
12. Competitor Collaboration Guidelines § 4.2.
13. 4A Phillip Areeda, Herbert Hovenkamp, & John Solow, Antitrust Law ¶ 981 (1998).
14. D. Carlton & J. Perloff, Modern Industrial Organization 117 (1989).
15. *See generally* 4A Phillip Areeda, Herbert Hovenkamp, & John Solow, Antitrust Law ¶ 98.
16. Silver v. New York Stock Exchange, 373 U.S. 341 (1963).
17. David A. Balto, "Access Demands and Payment Systems Joint Ventures," 18 *Harvard J. of Law and Public Policy* 624 (Spring 1995). Exclusionary practices can be challenged under § 5 of the FTC Act. In United Airlines, Inc. v. CAB, 766 F.2d 1107 (1985), the Seventh Circuit, in a decision by Judge Posner, upheld CAB regulations that restricted "display bias" and price discrimination in computer reservation system networks. The regulations were upheld under § 411 of the Federal Aviation Act (prohibition of "unfair or deceptive practices or unfair methods of competition in air transportation or the sale thereof"), 49 U.S.C. § 1381, which is an analogue to § 5 of the FTC Act. *Id.* at 1111-1113.
18. Northwest Wholesale Stationers Inc. v. Pacific Stationary & Printing Co., 472 U.S. 284 (1985).
19. *See* Prepared Remarks of Mary Lou Steptoe, Acting Director, Bureau of Competition, Federal Trade Commission, Before the Bar Association of the District of Columbia, "An Antitrust Enforcement Perspective on Membership Restrictions," (Feb. 16, 1994); Balto, *Access Demands and Payment Systems Joint Ventures, supra* n.17.
20. 4 Trade Reg. Rep. (CCH) ¶ 13,150 at 20,764.
21. *Id.* For example, exclusion of rivals from efficient joint arrangements can be an effective means of raising their costs without raising those of the excluder.
22. *Northwest Wholesale Stationers,* 472 U.S. at 296 n.7.
23. *See* Gamco, Inc. v. Providence Fruit & Produce Bldg., Inc., 194 F.2d 484 (1st Cir. 1952); American Federation of Tobacco Growers v. Neal, 183 F.2d 869 (4th Cir. 1950).
24. Competition and Consumer Protection Concerns in the Brave New World of Electronic Money," Remarks by Robert Pitofsky, Chairman, FTC, before the US Department of the Treasury Conference, Toward Electronic Money & Banking: the Role of Government, Washington, D.C., Sept. 19, 1996 at 12.
25. Pt. 3, at 20-21.
26. *See generally* David A. Balto, "Networks and Exclusivity: Antitrust Analysis to Promote Network Competition," 7 *George Mason L. Rev.* 523 (1999) (describing recent enforcement actions and evolution of exclusivity analysis in network environment).
27. William Blumenthal, "B2B Internet Exchanges: The Antitrust Basics," *Antitrust Report* 34, 41 (May 2000).
28. National Bank of Canada v. Interbank Card Ass'n, 507 F. Supp. 1113 (S.D.N.Y. 1980), *aff'd*, 666 F.2d 6 (2d Cir. 1981).
29. *Id.* at 1123.
30. Treasurer, Inc. v. Philadelphia National Bank, 682 F. Supp. 269, 280 (D.N.J.), *aff'd mem.*, 853 F.2d 921 (3d Cir. 1988).
31. United States v. Electronic Payments Services, Inc., No. 94-208 (D. Del. Apr. 21, 1994), 59 Fed. Reg. 24711 (May 12, 1994).
32. *See* David Balto, "The Murky World of Network Mergers: Searching for the Opportunities for Network Competition," 42 *Antitrust Bull.* 793 (Winter 1997).
33. Competitor Collaboration Guidelines § 3.3.
34. *See* Michael S. McFalls, "The Role and Assessment of Classical Market Power in Joint Venture Analysis," 66 *Antitrust L.J.* 651 (1998).
35. Competitor Collaboration Guidelines § 3.34(a).
36. *See* Balto, *Networks and Exclusivity: Antitrust Analysis to Promote Network Competition, supra* n.26, at 561-571 (1999).
37. *Id.* at 34.
38. *Id.*