

Antitrust Implications of B2Bs: Covisint – A Competitive Collaboration?

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(1) Introduction:

On February 25 2000, the three leading American automotive manufacturers: General Motors, Ford, and DaimlerChrysler¹ announced their joint intention to create a consortium-based online trading exchange called ‘Covisint.’² On September 11 2000, following a five-month investigation, the Federal Trade Commission provisionally cleared the venture.³ On October 3 2000, Arvin Meritor was the first company to officially use this electronic business-to-business exchange (hereinafter ‘B2B’), by holding an auction for the supply of an injection-molded plastic part.⁴ By January 1 2001, Covisint had extended its operations to any willing automotive participants.

Views remain mixed concerning the competitive impact of Covisint. The FTC seemed to adopt a cautious stance, which allowed Covisint to become operational whilst stipulating its right for later intervention. This reservation was prompted by concerns over its prospective operation in light of its founders’ collective automotive market power.⁵ Indeed, it has been argued that the automotive cyberspace consortium is “...a complex, ambitious plan that may not achieve its original stated goal – being the dominant online exchange for the global auto industry.”⁶ Covisint insists however, that it “will provide the language for manufacturers and suppliers to talk to each other in the future.”⁷ Furthermore, the Bundeskartellamt’s approval of the Covisint project was specifically due to its confidence that other B2Bs, albeit in the German market, would provide

¹ In April 2000, Renault and Nissan both became partners in the Covisint venture; *see* R.Kisiel, What's behind plan by Tier 1s? Automotive News, May 29, 2000, Vol. 74, No. 5876.

² K.Bradsher, Carmakers to Buy Parts on Internet, The New York Times, Feb. 25 2000, p 1. *See generally*, B.Robinson, Driving the Automotive Industry, iQ Magazine, Jan.-Feb. 2001, pp 48-55.

³ FTC Press Release, FTC Terminates HSR Waiting Period Covisint B2B Venture, Sept. 11 2000, available at <http://www.ftc.gov/opa/2000/09/covisint.htm> (last checked on May 1, 2001).

⁴ G.Kachadourian, Covisint is up and running, Automotive News, Oct. 9, 2000, Vol. 75, No. 5898.

⁵ FTC Press Release, FTC Terminates HSR Waiting Period Covisint B2B Venture, Sept. 11 2000, available at <http://www.ftc.gov/opa/2000/09/covisint.htm>, (last checked on May 1, 2001).

⁶ D.Sedgwick, Covisint’s rough start: The big 3’s Net exchange faces multiples challenges, Automotive News, Feb. 12, 2001, Vol.75, No. 5916.

⁷ A.Miles, President, Ford B2B ConsumerConnect and a member of the executive team that planned Covisint, Automotive Internet Exchange To Be Called “Covisint”, May 16, 2000, GM Press Release, available at http://www.generalmotors.com/cgi-bin/pr_display.pl?1376 (last checked on May 1, 2001).

ample competitive restraint on the apparent power of Covisint.⁸ As a result, it seems that a quandary arises regarding the competitive effect of Covisint: either it will primarily help optimize automotive supply-side efficiencies or the B2B will really further the market power of its founders, both online and offline.

This paper intends to explore certain possible and understated antitrust implications of incorporating electronic commerce within the automotive industry. Section 2 will briefly examine the background to Covisint and the state of B2B commerce antecedent to the commercial inauguration of the Internet. It will then explain what Covisint purports to achieve and how it may affect competition in the automotive component market and amongst automotive electronic marketplaces themselves. Next, section 3 will provide an overview of the contemporary automotive industry. Thereafter, section 4 offers an overview of the relevant antitrust analysis of joint ventures, so as to place these B2B developments in context. This is followed by an inquiry in section 5 into the potential and varied competitive effects of the demand-side economies associated with greater participation in the online trading exchange. It reveals why Covisint could become an antitrust concern by *inter alia* exclusion of B2B competition, before section 6 discusses whether a practical alternative mechanism exists, which is significantly less restrictive than Covisint's likely impact on B2B competition. Section 7 will conclude.

(2) Conceptualizing Covisint:

(i) *B2B commerce before Covisint:*

Prior to the inception of Covisint, some transactions between automotive suppliers and manufacturers for commodities, parts and other necessary inputs were already handled by computer-organized systems. Although some paper-intensive auto business processes have

⁸ *Covisint*, Bundeskartellamt decision, B5-40/00, Sept. 30, 2000 (basing its decision on the fact that Covisint will face competition from a variety of sources, including automaker private exchanges e.g. Volkswagen's exchange ['Electronic Supplier Link'], automotive suppliers e.g. SupplyOn [German suppliers Continental AG, ZF Friedrichshafen AG INA Walzlager Schaeffler] and even non-industry-specific exchanges e.g. FreeMarkets).

Cf FTC Press Release, FTC Terminates HSR Waiting Period for Covisint B2B Venture, Sept. 11 2000, (emphasizing, instead, the provisional nature of the proposed joint venture). It is interesting to note that both agency heads, R.Pitofsky and U.Böge reserved the right for continuing surveillance and future intervention.

persisted, electronic linkage in this respect is far from novel. This is important because it reveals an evolution in the use of technology within transactions for auto parts, whilst also helping to provide an objective benchmark by which to measure the alleged particular efficiency advances due to Covisint. Initially, most manufacturer purchasing requirements were tracked and recorded internally, so that components could be ordered to fulfill various production schedules.⁹ Subsequently, proprietary networks or Electronic Data Interchanges (hereinafter, 'EDI') extended these systems beyond a firm's internal procurement structure. EDI facilitated the computerized transfer of input requirements between businesses and across supply tiers. Although these mechanisms helped lower the transaction costs of procurement, they were inherently limited to establishing bilateral relationships and only then between large manufacturers who can afford their use.¹⁰ By contrast, the Internet makes multilateral exchanges like Covisint a reality,¹¹ which allows procurement to be rationalized on a wider scale in terms of its cost and duration, and thereby helps facilitate the emergence of the manufacturers' vision: 'build-to-order' cars.

(ii) *What is Covisint?*

Covisint is an Internet-based trading exchange for automotive parts. It is a paradigm of how technology is reshaping the manufacturing industry as well as its conventional modes of distribution. It has three main functions. First, by using the Covisint portal, automotive firms would be able to buy and sell car components and ancillary materials on a global scale through *inter alia* holding virtual auctions or displaying catalogs online. Second, its Internet capabilities include product development software¹² that will allow interactive product designing, testing,

⁹ The two primary processes were: the basic Materials Requirements Planning, or 'MRP,' which broadly correlates an automaker's need for parts in accordance with its production line. This is advanced by the second process known as Enterprise Resource Planning, or 'ERP,' which contemporaneously notifies the relevant internal departments, such as accounting, of transactions executed. *See further* S.DeSanti, *The Evolution Of Electronic B2B Marketplaces*, SF63 ALI-ABA 201, pp 205-6, Sept. 14, 2000.

¹⁰ G.Fromer, *New Business and Partners Solutions*, FTC Public Workshop, *Competition Policy in the World of B2B Electronic Marketplaces*, June 29, 2000, Vol. 1, pp 48-49, available at <http://www.ftc.gov/bc/b2b/index.htm> (last checked on May 1, 2001) (hereinafter 'FTC B2B Workshop').

¹¹ Morgan Stanley Dean Witter, *The B2B Internet Report – Collaborative Covisint*, p 47, (Mar. 2000), available at <http://www.morganstanley.com/techresearch/index.html>, (last checked on May 1, 2001).

¹² E.g. Virtual Project Workplace and a forthcoming virtualization tool for 3-D product development are examples of Covisint's distinguishing services meant to enhance automotive research & development, *see further* at <http://www.covisint.com/productdev/collaborative.shtml> (last checked on May 1, 2001).

and modifications, which should considerably advance the quality and rate of new car makes and manufacturing process improvements. Thirdly, it seems that the ultimate ideological mantra of Covisint is to further supply management. The industry exchange seeks to reduce lead times through rapid interaction and communication between automotive buyers and sellers over the Internet. As a result, costs are reduced and so is the overall time taken between ordering a car and its delivery. Therefore, given the current primacy of cost-cutting in the automotive industry,¹³ it seems inexorably logical to use Covisint as a means of achieving productive and allocative efficiency in manufacturing automobiles.¹⁴

In short, these functions help to explain the name, Covisint: since it was meant to provide *communication*, *connectivity* and *collaboration* within automotive supply, through applying the *vision* and *visibility* from the Internet in order to *integrate* automakers and suppliers alike.¹⁵ Furthermore, it does not seem coincidental that this moniker, *Covisint*, was used because it embodies the most positive aspects of using an electronic B2B exchange from an antitrust perspective. Since the FTC seems to have accepted the *prima facie* pro-competitive benefits that Covisint will allegedly bestow on automotive input commerce for the time being, they shall now be assessed in greater detail.¹⁶

(iii) *Pro-competitive gains from Covisint:*

The FTC decision in *Covisint* seemingly reveals the importance of affirmatively presenting the pro-competitive aspects of a B2B venture during an antitrust appraisal, rather than merely being

¹³ A.Cummins, Covisint: The only game in town, *Automotive Industries*, Sept. 1 2000, Vol. 180, Iss. 9.

¹⁴ KPMG, Transforming the Auto Industry Through B2B e-commerce, (May 2000), available at <http://www.kpmg.com/industries/content.asp?11id=40&l2id=0&cid=4> (last checked on May 1, 2001) (pointing out that, notwithstanding widespread media insistence on pervasive B2Bs, e-commerce still remained subject to “mere scattered tactical thrusts”). It is submitted that Covisint marks an exception to this proposition, as an attempt to unify the auto industry’s e-commerce strategy.

¹⁵ See the Covisint website general faq, available at http://www.covisint.com/info/faq_gen.shtml#cs2 (last checked on May 1, 2001).

¹⁶ J.McDavid, Business Rationale for the Exchange [Covisint], Distribution through B2B exchanges serving multiple buyers and sellers, ABA/Antitrust Law Section Conference, Nov. 13 2000, available at <http://www.abanet.org/cle/ecl/v00dgei/v00dgei.html>, (last checked on May 1, 2000).

used as a secondary justification.¹⁷ Indeed, Kovacic argues that it is imperative to advocate such efficiencies from the outset in order to positively shape the perceptions and level of scrutiny by antitrust authorities.¹⁸ Thus, the question arises: what are the legitimate business reasons behind Covisint? First, Covisint allows firms with different internal processing system to interface with one another.¹⁹ As a result of this connectivity on an industrial scale, Covisint avoids duplication of resources and allows smaller firms to enter the electronic marketplace for auto inputs, by utilizing Covisint's non-exclusive Internet infrastructure.²⁰ Hence, manufacturers will benefit from greater and easier comparison-shopping from more prospective suppliers of auto parts, whilst suppliers may avoid the costs of serving manufacturer-specific B2Bs.

Secondly, the Internet provides a more efficient mechanism for the exchange of data than historical modes by enabling instantaneous communication, although this heightens the risk of anticompetitive price coordination.²¹ In this way, new sales channels may become viable that

¹⁷ R.Pitofsky, FTC Press Release, FTC Terminates HSR Waiting Period Covisint B2B Venture, Sept. 11 2000, available at <http://www.ftc.gov/opa/2000/09/covisint.htm>, (last checked on May 1, 2001) (“as we learned at the FTC's workshop in June, B2B electronic marketplaces offer great promise as means through which significant cost savings can be achieved, business processes can be more efficiently organized, and competition may be enhanced”).

See also, J.McDavid, Distribution through B2B exchanges serving multiple buyers and sellers, *supra* note 16, (stating that the first question to be asked of any B2B founder should be: “what are you doing and why are you doing it?” and in the case of Covisint “the business rationale” was clear: transactions costs savings).

¹⁸ W.Kovacic, B2B exchanges Overview of Legal Issues: Efficiencies First, Importance of Efficiencies, adapted from Gavil, Kovacic & Baker (forthcoming 2001), Distribution through B2B exchanges serving multiple buyers and sellers, *supra* note 16.

¹⁹ It does this through the use of XML, a common format for business transactions, which takes advantage of the end-to-end design of the Internet i.e. data is stored at each end or nodule of a network and is transmitted by certain communications standards or protocols. On XML, *see* M.Cunningham, How to Build a profitable e-commerce strategy, 109-113, (2001), *and* on the end-to-end design of the Internet, *see* D.Reed, J.Saltzer, & D.Clark, End-to-End Arguments in System Design, ACM Transactions on Computer Systems, Nov. 1984, Vol. 2, No. 4, pp 277-88.

²⁰ C.Phillips, Morgan Stanley Dean Witter, FTC B2B Workshop, *supra* note 11, p 270.

²¹ J.Baker, Identifying Horizontal Price Fixing in the Electronic Marketplaces, 65 Antitrust L.J. 41, 44 (1996) (advocating that the swift sharing of information may assist coordination).

Cf E.Correia, Latham & Watkins, FTC B2B Workshop, *supra* note 10, June 30, 2000, Vol. 2, p 502, (arguing that the exchange of competitively sensitive information over the Internet may be less troublesome as it “might be very hard to imagine a very effective way to collude”).

were not previously cost-effective, as via using the Internet Covisint enables parts information to be gathered and disseminated at low marginal costs.²²

Thirdly, Covisint may generate significant cost savings through ‘disintermediation.’²³ This process may provoke antitrust concern to the extent that former intermediaries objects to the occurrence of vertical market foreclosure, when their role acting between supply tiers is eliminated. Yet, it seems that the fact that a firm is precluded from the market is not necessarily indicative of unlawful exclusion since there may be substantial gains from bypassing certain supply tiers.²⁴ Ultimately, the extent to which this process will produce efficiencies depends on the role of a supply level and whether it can be effectively integrated into the function of another tier supplier.²⁵

Fourthly, Covisint, like B2Bs more generally, has been heralded as potentially eliminating substantial costs associated with offline mechanisms.²⁶ Using the Internet, firms can search effortlessly and rapidly, place and modify orders instantly, with minimal administrative costs to exploit the shared underlying technology.²⁷ However, antitrust analysis should take account of the fact that this Internet-related benefit may not be specific to Covisint.²⁸ Nevertheless, it is

²² G.Teagarden, D.Donahue, C.Noser, A White Paper on B2B e-commerce Industry: A vertical and horizontal Perspective, 16, Jan. 18, 2000, Salomon Smith Barney, Written Statement to FTC B2B Workshop, available at <http://www.ftc.gov/bc/b2b/comments/index.htm>, No 22, (last checked on May 1, 2001).

²³ P.Harbour, B2B Basics and Antitrust Issues, 631 PLI/Pat 649, 675, Jan. 2001.

²⁴ H.Loevy, SGsosite.com, FTC B2B Workshop, *surpa* note 10, pp 326-7.

²⁵ Deloitte & Touche, Automotive Industry Report, A Global Manufacturing Survey, pp 22-23 (1998) (describing the trend toward greater outsourcing by auto manufacturers and integrating supply functions into fewer suppliers, using the Internet as a catalyst).

²⁶ Goldman Sachs Investment Research, B2B: 2B or not 2B, (Nov. 1999) (estimating that B2B e-commerce can bring about reductions in processing costs of about 10% to 35% and reductions in product costs in excess of 20%).

²⁷ J.Knoll, Detroit Diesel Corp., FTC B2B Workshop, *supra* note 10, p 263, (“one of the most important things for us, and why we may consider participating in an exchange is a reduction of the transaction costs”). See also A.Kim, equalFooting.com, *Id.*, pp 153-55.

²⁸ See section 2, part (iv) below.

likely that the magnitude of economies produced by an “industry-sponsored e-hub” like Covisint may reach an unparalleled level.²⁹

Fifthly, perhaps the *raison d’être* behind Covisint in the long-term is to drive automotive downstream competition by using its software to enable participants to collaborate in research and product improvement.³⁰ This applies a dynamic conception of competition through communicating ideas in ‘real time,’ and enabling the lead-time from product design to the dealer’s showroom to be shortened. In this way, Covisint is likely to change the nature of transacting between businesses. Although currently there is no uniform method of trading parts, it seems that Covisint will promote a shift from short-term, arms-length dealings to longer-term and more collaborative relationships due to its capabilities for joint research and production.³¹ This has important antitrust consequences since it means that there should be an additional emphasis to the static focus on prices and output, by recognizing the pro-competitive need for collaboration in the long run, in order to promote innovation in auto products and processes.³²

(iv) *How does Covisint make a difference?*

At this stage, it would be helpful to put these efficiency claims into context. For example, B2Bs and using the Internet more generally represent part of the evolution in automating commercial practice.³³ As noted above, B2B commerce was already automated prior to the Internet and therefore any net gains attributable to Covisint must account for pre-existing EDI processes.

²⁹ Morgan Stanley Dean Witter, The B2B Internet Report – Collaborative Covisint, *supra* note 11, pp 63-65 (discussing industry-sponsored e-hubs or exchanges, “the benefits of a centralized collaboration hub accrue more quickly – instead of each exchange hiring 500 people to build the same exact plumbing, 1,500 people can build the plumbing once,” *id.*, p 64. Hence, in terms of infrastructure cost savings, Covisint is unique).

³⁰ S.Konicki, Covisint’s Rough Road, Information Week, Aug. 11, 2000, (“Just as important, [as savings on manufacturer purchasing costs] the exchange [Covisint] could cut months from pre-production planning and do away with paperwork associated with car design ... using 3-D design collaboration tools”), available at <http://www.techweb.com/wire/story/TWB20000811S0012>, (last checked on May 1, 2001).

³¹ J.MacDuffie, Roundtable Discussion, 15 Antitrust 8, pp 8-9, Fall 2000.

³² See Antitrust Guidelines for Collaborations Among Competitors, issued by the Federal Trade Commission and the United States Department of Justice, April 2000, § 2.1, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,160, available at <http://www.usdoj.gov/atr/public/guidelines/jointindex.htm> (last checked on May 1, 2001) (hereinafter ‘Collaborations Among Competitors Guidelines’).

³³ Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces: A Report by Federal Trade Commission Staff, (Oct. 26, 2000), Part 1, p 2, available at <http://www.ftc.gov/os/2000/10/b2breport.pdf> (last checked on May 1, 2001).

Moreover, the gains from Covisint must be weighed up against the inevitable transition costs for auto producers to shift supply online, such as the costs of investing in the relevant technology to participate and linking-up ‘back-office’ systems to the exchange. On the one hand, Covisint may lead to technological progress by interlinking the B2B to firms’ internal systems. On the other hand, Covisint could stifle auto parts B2B competition online because its users may not necessarily wish to explore alternative and independent e-commerce strategies. Indeed, given the costs involved, they would have less incentive to use competing exchanges or establish their own electronic distribution, which would disfavor Covisint’s impact on B2B competition.

Finally, it should be remembered that there seems to be both a temporal and behavioral dimension shaping Covisint’s competitive impact. As to the former dimension, a decisor should account for the inherent time lag between forming Covisint and attaining its avowed gains, especially since the value of Covisint increases in proportion to the number of transactions and participants.³⁴ The latter dimension helps explain this efficiency delay, by accounting for the difference between the advancement of procurement processes compared to the inertia of adapting procurement behavior to the new technology.³⁵ The training of human capital plays a crucial role in determining the ultimate success of deploying technology and whether it will have anticompetitive effects. In this respect, it is interesting to note that as part of its commitments to the FTC, Covisint has setup an antitrust compliance program directing the propriety of employees’ conduct.³⁶ This should add to the transparency of Covisint’s competitive behavior and provide greater assurance that Covisint conforms to competition on the merits, though by no means does this confer antitrust immunity. These efficiencies combined with Covisint being operated as an independent company, without joint purchasing and in the absence of exclusive

³⁴ A.Sculley & W.Woods, B2B Exchanges The Killer Application in the Business-to-Business Internet Revolution, p 5, (1999), (discussing Metcalfe’s law explaining the dynamism of B2Bs). Hence it explains why a network of say, one auto manufacturer achieves relatively modest gains in comparison to a network of multiple automotive producers due to the role of *inter alia* network effects, see section 4 below.

³⁵ M.Walsh, VerticalNet, FTC B2B Workshop, *supra* note 10, pp 406-7.

³⁶ Covisint Antitrust Compliance Policy, available at <http://www.covisint.com/info/antitrust.shtml> (last checked on May 1, 2001)

membership,³⁷ means that it may legitimately be queried whether Covisint creates any antitrust problems.

(v) *Does Covisint pose serious antitrust risks?*

At the outset, it is important for antitrust to distinguish between two product markets at issue concerning B2Bs. The first is the ‘primary’ product market, in which the B2B commerce occurs. In the case of Covisint this will, broadly speaking, refer to trade in automotive inputs.³⁸ It may be argued that since Covisint’s “founders represent such a large share of the automobile market, [it] cannot [be said] that implementation of the Covisint venture will not cause competitive concerns.”³⁹ In fact, the FTC specifically stated that its clearance of Covisint did not mean that a “violation may not have occurred” and unusually reserved the right for future action in case Covisint develops contrary to the public interest.⁴⁰ Although Covisint’s creation valorized concerns regarding the collective primary market dominance of its founders being ‘levered’ online, it is submitted that this is misplaced for two reasons.

First, the Chicago school critique of market leverage⁴¹ has all the more reason to apply in this context because the existing collective dominances of Covisint’s parents offline does not change when e-commerce is introduced to the supply chain.⁴² *Ex hypothesi*, it will produce the same

³⁷ J.McDavid, Defining the Role of Antitrust in the High Technology Revolution, the George Mason Law Review Symposium, Oct. 27, 2000, Geo. Mason L. Rev., Vol. 9, No. 3, Spring 2001, (forthcoming).

³⁸ It is helpful to distinguish between two types of inputs: ‘direct’ or manufacturing inputs which are used in the production of the end-product and ‘indirect’ or operating inputs, which are used in the course of business and trading. As general proposition, direct inputs are better suited to vertical B2Bs such as Covisint given the industry expertise whilst indirect inputs may be efficaciously handled by horizontal generic exchanges. This means the degree of competition faced by Covisint may vary according to the type of inputs being exchanged. See S.Kaplan & M.Sawhney, E-Hubs: The New B2B Marketplaces, Harv. Bus. Rev., p 98, May-June, 2000.

³⁹ FTC Press Release, FTC closes HSR waiting period for Covisint B2B venture, Sept. 11, 2000, available at <http://www.ftc.gov/opa/2000/09/covisint.htm>, (last checked on May 1, 2001).

⁴⁰ See e.g. Covisint, File No. 001 0127, FTC Closing Letter to Counsel for General Motors Corp., Ford Motor Co., and DaimlerChrysler AG, at <http://www.ftc.gov/os/2000/09/covisintchrysler.htm>, (last checked May 1, 2001).

⁴¹ See e.g. R.Bork, the Antitrust Paradox, pp 272-74, (1978) and R.Posner, Antitrust Law: An Economic Perspective, pp 171-72, (1976).

⁴² S.Salop & R.Romanie, Preserving Monopoly: Economic Analysis, Legal Standards and Microsoft, 7 Geo. Mason L. Rev. 617, Spring 1999 (discussing the Chicago school “single monopoly theory,” and would

welfare loss, irrespective of the way it is exercised. Second, the leverage theory tends to assume a profit maximization conception of firm behavior. This diminishes the significance of alternative theories of the firm,⁴³ which instead may elucidate their e-commerce strategy and whether Covisint was conceived on the basis that parts competition should be suppressed or whether the real emphasis was on promoting a dynamic electronic marketplace. This suggests two results: first, that what has motivated the participants in Covisint should be borne in mind in ensuing B2B antitrust analysis and second, when viewed in light of the frequent alliances between automotive producers,⁴⁴ Covisint seems more innocuous for rivalry in the primary market at the time of writing.

The second relevant product market, which will be the focus of this paper, is the ‘market for exchanges.’⁴⁵ At present, inter-B2B competition is flourishing, though Covisint possesses the potential for an ominous impact on competition.⁴⁶ Section 5 will examine the likely network effects associated with Covisint that may considerably contribute to its market preeminence in automotive online procurement, which might in turn have a ‘chilling effect’ on *inter alia* entry and innovation. This probable prominent market position raises the question discussed in section 6 as to whether Covisint is really necessary for the acclaimed Internet-driven B2B efficiencies or whether an alternative mechanism could be utilized for such B2B commerce, which would better comport with automotive parts competition and achieve comparable results to Covisint.

conclude that if Covisint became a monopolist online, it could exploit its network effects “to raise barriers to competition that [could] preserve or enhance its monopoly power” in the automotive primary market).

⁴³ L.Kaplow, Extension of Monopoly Power through Leverage, 85 Colum. L. Rev. 515, p 552 (1985) (offering a critique of the assumptions underlying the single monopoly theory and arguing that “alternative managerial motivations ought to be taken seriously”).

⁴⁴ PWC, The Second Automotive Industry, Executive Summary, p 5 (Dec. 1999).

⁴⁵ Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces: A Report by Federal Trade Commission Staff, (Oct. 26, 2000), Executive Summary, pp 4-5 & Part 1, p 19, available at <http://www.ftc.gov/os/2000/10/b2breport.pdf> (last checked on May 1, 2001).

⁴⁶ *See generally*, Case No COMP/M.1969 – UTC / Honeywell / i2 / MyAircraft.com (2000) O.J. (C289), para 13, (epitomizing the importance of inter-B2B competition to competition authorities, as the clearance of the aerospace parts B2B, MyAircraft.com, was based in part on the vitality of B2B competition), available at http://www.europa.eu.int/comm/competition/mergers/cases/index/by_nr_m_19.html#m_1969, (last checked on May 1, 2001).

(vi) *Summary:*

Therefore, this consortium electronic marketplace presents opportunities and challenges for both the automotive industry and antitrust policy. However, as a threshold matter, the important inquiry into market definition will not be explored as questions relating to the extent to which offline and online distribution systems compete and whether B2Bs form a separate market would be specific to the facts of the relevant investigation. In addition, possible concerns relating to price coordination will not be addressed, since this issue has been adequately dealt with in the relevant literature⁴⁷ and was ostensibly avoided by the structure of Covisint.⁴⁸ Instead, in order to understand the effects of the Internet for antitrust evaluation, within the auspices of Covisint, it is crucial to briefly consider the nature of the auto industry to understand its implications for the market for electronic exchanges in automotive parts.

(3) Market structure of the automotive industry:

(i) *Manufacturing purchasing power:*

Market structure crucially defines the playing field on which the players interact offline and online. The automotive industry tends to congregate around five main global players: General Motors, Ford, Daimler Chrysler, Toyota, and Volkswagen, collectively forming an oligopsony vis-à-vis the more fragmented composition of input supplier.⁴⁹ This layout could mean Covisint might facilitate buyer power online and price squeeze suppliers, even though Covisint has not yet engendered such buyer collective dominance. Moreover, this concern is weakened in light of the

⁴⁷ See further T.Calvani & J.Schmidt, B2B Electronic Commerce & Antitrust, eCommerce Strategies for Success in the Digital Economy September 2000 618 PLI/Pat 285, pp295-297 Sept. 2000, FTC Report, *and* Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces: A Report by Federal Trade Commission Staff, (Oct. 26, 2000), Part 3, pp 3-13, available at <http://www.ftc.gov/os/2000/10/b2breport.pdf> (last checked on May 1, 2001).

⁴⁸ J.McDavid, Distribution through B2B exchanges serving multiple buyers and sellers, *supra* note 16, (Hogan & Hartson L.L.P Attorney representing Covisint to the FTC, arguing that there was an interesting convergence between the antitrust concern to minimize exchange of information between horizontal competitors and business need to avoid “competitively sensitive business secrets” being appropriated by competitors. Covisint’s use of encryption codes, technological firewalls and passwords was deemed sufficient to allay any fear of explicit or tacit price coordination).

⁴⁹ Automotive Industries, pp 32-49, (Apr. 2000) (discussing the market shares of the these five manufacturers in 1999: in the U.S. – GM 29.4%, Ford 24.7%, Daimler Chrysler 16.7%, Toyota 8.7%, VW 2.3% and globally – GM 14.9%, Ford 12.4%, Daimler Chrysler 8.2%, Toyota 7.7% VW 8.9%, based on production, Statistics from: Autofacts, PWC).

trend toward concentration at *all* levels of the auto industry.⁵⁰ It has meant that fewer suppliers are undertaking more supply functions, as manufacturers outsource their inefficient in-house production, with the net effect that suppliers may be able to wield greater bargaining power in Covisint ‘reverse’ auctions i.e. those concerning tenders by sellers, than originally considered.

(ii) *Automotive globalization:*

Another salient trend in the automotive industry that dovetails with the need for automotive e-commerce is the process of internationalizing auto parts and retail markets. As a result of trade liberalization and cross-border economies, “the pendulum [has swung] toward globalization and speed-to market,” streamlining the organization of input supply has become “critical to success.”⁵¹ Yet whilst Covisint epitomizes an electronic marketplace by providing such speed and organization, it is not the only B2B solution. Moreover, it is important to bear in mind that the Internet is not an all-wielding panacea for reforming the automotive B2B commerce, as organizational restructuring and internal cultural change are equally important therein.

(iii) *Overcapacity:*

Finally, Covisint must be understood in light of the deep-rooted problem of overcapacity facing manufacturers worldwide.⁵² This may be attributed to the scale of operation necessary, irrespective of demand, to maximize economies of scale; the informational deficiencies in accurately forecasting demand; and the secondary market competition in durable goods such as automobiles that increases the elasticity of final consumers. This has had a knock-on effect on B2B commerce, by compelling the priority of dynamic efficiency in inventory management and integrating automotive production. In this regard, Covisint represents a welcome step forward by

⁵⁰ U.S. Department of Commerce, U.S. Trade & Industry Outlook 2000, Motor Vehicles, Ch. 36 (noting industry consolidation as a global industry trend for both automakers and suppliers).

See also PWC, The Second Automotive Industry, Executive Summary, p 5 (Dec. 1999) (“In the Second Automotive Century, consolidation strategies will dominate much of the industry. Widely employed e-technologies will enable reliance upon fewer but more capable members of the extended enterprise to do the rest”).

⁵¹ Deloitte & Touche, Automotive Industry Report, A Global Manufacturing Survey, p 3 (1998).

⁵² PWC, The Second Automotive Industry, Executive Summary, p 4 (Dec. 1999) (estimating excess automotive production to be 24 million units worldwide in 1999. between 1990-99, volume utilized – capacity ratio deteriorated from 80% to 69%).

increasing “the velocity of inventory [and] to market.”⁵³ Still, how does antitrust approach such a joint venture?

(4) Antitrust analysis of joint ventures:

Although antitrust is an intensely fact-specific exercise, it is helpful to distill some general principles for examining B2Bs from the assessment of joint ventures.⁵⁴ Absent hardcore restrictions, the touchstone of analysis is the ‘rule of reason.’ In sum, the ‘rule of reason’ is shorthand for the evaluation of the likely anticompetitive effects of the venture, weighed up against its possible efficiency-related justifications, taking into account the market structure, discussed in section 3, where appropriate.⁵⁵ Countervailing efficiencies play an important role therefore, which is all the more important given the agencies’ view that the nature of proffered efficiencies is limitless.⁵⁶ This permissive attitude sheds light on antitrust enforcement vis-à-vis B2Bs and helps explain the favorable provisional examination of Covisint itself by the FTC in determining its initial likely competitive effect, as discussed in section 2.⁵⁷ Market share may also be relevant in determining whether a venture falls in the ‘safe harbor’ of unlikely investigation by the antitrust authorities. This seems to have influenced the FTC in allowing Covisint to become operational, given its infancy within the market for auto exchanges.⁵⁸

The interdependence of information technology means that firms must focus both on their competitors as well as take account of their collaborators, such as in Covisint itself.⁵⁹

⁵³ J.Nasser, Ford Motor President & CEO, Morgan Stanley Dean Witter, *supra* note 11, Appendix XI, p 367.

⁵⁴ Are B2Bs joint ventures? Collaborations Among Competitors Guidelines, § 1.1, *supra* note 32, defines a “competitor collaboration” as “a set of one or more agreements, other than merger agreements, between or among competitors to engage in economic activity, and the economic activity resulting therefrom.” It seems highly likely that the agencies would treat Covisint as an arrangement to conduct electronic procurement for example, conforming to this broad definition.

⁵⁵ *Id.*, § 1.2 & 3.3.

⁵⁶ *Id.*, § 3.36 (a).

⁵⁷ FTC Press Release, FTC Terminates HSR Waiting Period Covisint B2B Venture, Sept. 11 2000, available at <http://www.ftc.gov/opa/2000/09/covisint.htm> (last checked on May 1, 2001).

⁵⁸ Collaborations Among Competitors Guidelines, § 4.2, *supra* note 32, (excluding exceptional circumstances, the agencies will not challenge a competitor collaboration when the combined market shares of the collaboration and its participants account for less than 20% of the relevant market).

⁵⁹ L.Chappell, Covisint: Stay tuned for details : Questions remain on new exchange, *Automotive News*, May 22, 2000, Vol: 74, No. 5875.

Nevertheless, in principle, it seems that “antitrust doctrine is supple enough, and its commitment to economic rationality strong enough,”⁶⁰ for competition online to be protected. The following sections now examine certain antitrust implications of Covisint, within the specific context of the automotive industry and the Internet-sponsored networks, to which we now turn.

(5) Network Effects of Covisint:

*(i) Characterizing network effects:*⁶¹

Network effects represent one aspect of B2B electronic commerce that is potentially inimical to flourishing inter-B2B competition. Scale economies and network effects are important characteristics of a network such as Covisint,⁶² where over a significant range of output and use, per transaction costs decline as the number of transactions and the number of participants increase.⁶³ In other words, the value of Covisint to its users increases as the number of its members increases. Such network effects create a competitive dilemma. On the one hand, they embody the fact that the more technology is utilized, the more valuable the venture becomes whilst on the other hand, they may add inertia to supplanting the increasingly favored network.⁶⁴ Therefore, network effects might have practical significance for antitrust analysis, since they can generate substantial efficiencies and may heavily influence the viability and use of an electronic marketplace.

⁶⁰ R.Posner, Antitrust in the New Economy, Paper delivered to ALI-ABA Committee on Continuing Professional Education, 68 Antitrust L.J., Sept. 14, 2000.

⁶¹ *See generally*, M.Katz & C.Shapiro, Systems Competition and Network Effects, J. Econ. Persp., Spring 1994, p 93.

⁶² How is Covisint like a network? The online automotive trading exchange comprises a plurality of market participants who are able to interact and communicate using a common Internet standard or protocol. Akin to a network, the scale and demand economies derived from participation in Covisint increase as the number of participants and transactions increase.

⁶³ H.Hovenkamp, Written Statement for FTC Hi-Tech, Global Report, available at <http://www.ftc.gov/opp/global/hovenkmp.htm>. *See also* C.Shapiro & R.Willig, On the Antitrust Treatment of Production Joint Ventures, 4 J. L. Econ. & Org. 113 (1990).

⁶⁴ FTC Report, Anticipating the 21st Century: Competition Policy in the Hi-Tech, Global Marketplace (1996), Vol. 1, Ch. 9, p 8, available at <http://www.ftc.gov/opp/global.htm>, (last checked on May 1, 2001), (hereinafter ‘FTC Hi-Tech, Global Report’).

It has been suggested that network effects will be relatively unimportant in the context of B2Bs⁶⁵ or that network ventures are so likely to be pro-competitive that they should be treated as if a single economic unit.⁶⁶ These perspectives seem to underestimate the relevance and significance of network effects in this context. Instead, there seem to be 5 competition-related aspects of network effects: raising barriers to entry, the role of switching costs, providing an incentive to engage in anticompetitive maintenance of the dominant position achieved due to network effects, the impact on innovation and the influence of countervailing efficiencies.

(ii) *Barriers to entry:*⁶⁷

First, network effects shift the emphasis within a market power inquiry as to the competitive impact of Covisint, from market share to whether barriers to entry become more impervious.⁶⁸ The barriers may not necessarily be technological but rather may be established by the demand-side economies associated with Covisint. Network effects may hinder the ability of rival exchanges and other modes of distribution that may vie for customer preference, by favoring a coalition of its members to interchange transactions *inter se*.⁶⁹ Thus, the exchange members may

⁶⁵ D.Evans, Policing B2B Exchanges: Synchronicity or Ghosts in the Machine? George Mason Law Review Symposium Defining the Role of Antitrust in the High Technology Revolution, Oct. 27, 2000. (“I don’t think, however, that network effects theory plays a particularly important role in the analysis of B2Bs”). It is true however, that the network effects will not arise with respect to the primary industry, since by its very nature, the value of a car make does not vary according to the number of owners.

⁶⁶ D.Baker, Compulsory Access to Network Joint Ventures Under the Sherman Act: Rules or Roulette, 1993 Utah L. Rev. 999 (1993).

⁶⁷ Frontier Economics Group for U.K. Office of Fair Trading, E-Commerce and its Implications for Competition Policy, Discussion Paper 1, Aug. 2000, OFT 308, Executive Summary, para 1.14.

⁶⁸ S.Salop & R.Romaine. Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft, 7 Geo. Mason L. Rev. 617, Part II.D (recognizing that “monopoly power in those markets [characterized by network effects] tends to be more durable because it is more immune from erosion by natural marketplace forces”).

Cf R.Cass & K.Hylton, Preserving Competition: Economic Analysis, Legal Standards and Microsoft, 8 Geo. Mason L. Rev. 1 (“if there is greater durability to returns from investment because of greater insulation from the erosion of successes in network markets ... that describes the basic structure thought to encourage innovation”).

⁶⁹ C.Shapiro, Exclusivity in Network Industries, 7 Geo. Mason L. Rev. 673, (1999), (providing an analogous scenario: the absence of entry into the branded ATM network).

tend to adopt an inward perspective and thereby sacrifice competitive opportunities outside the exchange.⁷⁰

Conversely, although network effects could impair instant and durable entry, they do not necessarily preclude effective potential competition for two reasons. First, there is the competitive discipline of ‘perceived’ potential competition, which should remain unaffected by any prospective network effect-driven market power of Covisint. This argument draws force from the fact that some automakers have paused before deploying e-commerce and their perceived future entry could provide a competitive spur for Covisint.⁷¹ Second, network effects do not inevitably lead to impenetrable barriers to entry, according to a dynamic conception of online automotive procurement⁷² because network effects may encourage rivaling Covisint. The incentive for market penetration depends on two main factors: the probability of successful entry and the magnitude of ultimate returns.⁷³ Given the probable appeal of Covisint’s potential voluminous cost-savings for all tiers of supply in the automotive industry,⁷⁴ its B2B market share should expand exponentially as it is propelled by the ‘swelling effect’ of network effects or ‘positive feedback.’⁷⁵ This diminishes the prospect of lasting new B2B entry. By contrast, the eventual rewards of challenging and displacing Covisint could be argued to promote enduring entry given the prospect of higher profitability in the long-term, especially if the new entrant can harness comparable network effects to the previous incumbent.

⁷⁰ D.Evans, Policing B2B Exchanges: Synchronicity or Ghosts in the Machine? George Mason Law Review Symposium Defining the Role of Antitrust in the High Technology Revolution, Oct. 27, 2000, (switching costs may play a role in the future).

⁷¹ See C.Whitbread, Covisint still favored to be dominant force, Automotive News, Dec. 4 2000, Vol. 75, No. 5906.

⁷² See p 22 below and R.Schmalensee, *Antitrust issues in Schumpeterian industries*, 90 Am. Econ. Rev. Papers and Proc. 192, p 193, May 2000, (claiming that traditional tests for monopoly power do no measure the “fragility of market dominance in the software industry”).

⁷³ R.Cass & K.Hylton, Preserving Competition: Economic Analysis, Legal Standards and Microsoft, 8 Geo. Mason L. Rev. 1, p 37.

⁷⁴ Covisint Press Release, Blue-Chip Suppliers Turning to Covisint Letters of Intent Indicate Desire to Participate in Global Trading Exchange, July 17, 2000, available at <http://www.covisint.com/info/pr/07.17.00.shtml>, (last checked on May 1, 2001).

⁷⁵ See generally, C.Shapiro & H.Varian, Information Rules, (1999), pp 175-79 (describing this key characteristic of network effects that can lead to “a winner-takes-all market,” *Id.* 177, whereby the very popularity of Covisint for example fuels demand to take part, so more transactions occur on that B2B, which in turn makes the system even more attractive for further participation).

Overall, market foreclosure has not occurred during the first year of Covisint's existence, as producers have gradually embraced e-commerce. Thus, network effects have not stifled inter-B2B competition appreciably in this respect and do not yet pose a serious antitrust risk. This may be explained by the time lag for network effects to be fully triggered, inherent in their cyclical nature because Covisint's utility is intrinsically linked to its popularity. Still, antitrust should account for the presence and size of network effects arising from B2Bs as a factor in entry analysis in case of market foreclosure.⁷⁶

(iii) *Role of switching costs:*

The aforementioned possibility of Covisint raising the barriers to entry for alternative auto exchange may be compounded by the significant switching costs from Covisint that also may emerge over time. It is necessary to distinguish between two pairs of switching costs: individual and collective and those that are 'internal' and 'external' to Covisint. Internal switching costs refer to the interchangeability between products dealt with on the exchange and their external counterparts relate to the substitutability of the B2B itself. In this respect, the ability to change suppliers intra-B2B may actually improve, given the improved rate and amount of information available enhancing feasible comparison shopping of inputs, and accordingly adds to the pro-competitive value of Covisint.

On the other hand, as Covisint attracts more members, external switching costs from Covisint to another B2B seems more troublesome. "Network effects make it virtually impossible for a small network to thrive."⁷⁷ This can be explained by the imperative to build a B2B with sufficient liquidity, or transaction volume, which means a would-be entrant would have to overcome collective switching costs.⁷⁸ This market inertia may be understood in terms of an intractable

⁷⁶ S.Salop & R.Romaine. Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft, 7 Geo. Mason L. Rev. 617 (opting for a new legal standard: the unnecessarily restrictive conduct test over the sole purpose and effect test).

⁷⁷ C.Shapiro & H.Varian, Information Rules, (1999), at p 184.

⁷⁸ M.Katz & C.Shapiro, Systems Competition and Network Effects, J. Econ. Persp., Spring 1994, at 93, pp 109-13 (assessing compatibility choices and costs).

‘chicken-and-egg problem.’⁷⁹ The co-dependence of automakers desiring an electronic marketplace with various procurement and car design capabilities with technology-providers, for example, who are keen to innovate such online resources for a B2B with numerous members. Hence, once a B2B becomes popular, users will tend to be ‘locked-in’ to the underlying technology, whilst rival exchanges will tend to be ‘locked out’ by prohibitive switching costs.

As a result, Covisint might generate both individual and collective switching costs. As to the former, auto producers must be prepared to incur the costs of transition, such as securing Covisint-compatible technology and training human capital for its use. This means that rival B2Bs must overcome an additional hurdle: as they must attune their technology with Covisint’s infrastructure in order to persuade its existing users to use their suite of software products. Indeed, one of the proffered advantages of a consortium B2B is to provide a uniform standard for the industry, and thus eschew such intersystem adjustment costs. The latter costs revolve around a collective action problem. As Shapiro and Varian point out,⁸⁰ there are likely to be difficulties in coordinating defection to a rival exchange, since a competitor would only effectively rival Covisint if it could attract a sufficient number of users to sustain its own existence. Therefore, the prospects and viability of would-be entry are shaped in part by network effects and the apparent ‘first-mover advantage’ derived therefrom.

Examining network effects from this perspective means that antitrust could adopt one of two vantage points. It could either insist that any rival hindered by costs of substitution was not sufficiently superior to supplant the incumbent and therefore favor the status quo or it could recognize an impediment to ‘actual’ potential competition created by network effects due to the various switching costs. Evans has argued that switching costs should not be a major problem concerning B2Bs yet, though this seems to play down the incompatibility of technology and

⁷⁹ H.Shelanski & J.G.Sidak, *Antitrust Divestiture in Network Industries*, 68 U. Chi. L. Rev. 1 Winter 2001, p 59. An analogous situation might be a venture capitalist who is unable to obtain finance until his reputation is established for undertaking impressive investments but his reputation is contingent on making those very investments.

⁸⁰ C.Shapiro & H.Varian, *Information Rules*, pp 185-6, (1999), (using the example of the collective coordination costs associated with the QWERTY keyboard).

collective action difficulties.⁸¹ Still, this does not solve the possible adverse effect on the incentives to setup a competing online exchange created by these difficulties and the potential difficulty and reluctance to regress to non-Internet-based B2B commerce due to higher transaction costs and information deficits.

Furthermore, Evans stresses the availability of alternative distribution channels,⁸² so that a non-member of Covisint would not be precluded from dealing. This raises the question regarding the necessity of Covisint and its importance to automotive upstream competition. Clearly, it would not be impossible to conduct B2B commerce since it would already have existing supply relationships and could even incorporate the Internet to its own ERP system.⁸³ Nevertheless, it seems that an outsider would sacrifice possible cost savings in the short-term, whose magnitude is contingent on the number of firms participating in the consortium exchange. Moreover, the opportunity cost of Covisint in maintaining current distribution systems may also include lower dynamic efficiencies. For example, non-participants would be unable to use Covisint-specific technology for product design such as *inter alia* its Virtual Project Workspace,⁸⁴ which would otherwise involve heavy, individual investment costs.

Therefore, from the perspective of B2B competition, offline distribution systems will remain as an alternative to Covisint, but whether they would be considered as a competitive restraint thereon remains to be seen. Network effects do not necessarily preclude competition. Nonetheless, the intention of Covisint's parents to channel their purchases through Covisint may mean that firms distributing offline will become increasingly marginalized. Yet, antitrust protects competition, rather than competitors,⁸⁵ and Covisint would only give rise to a problem in this respect if it conducted exclusionary conduct in order to buttress its market position.

⁸¹ D.Evans, Policing B2B Exchanges: Synchronicity or Ghosts in the Machine? George Mason Law Review Symposium Defining the Role of Antitrust in the High Technology Revolution, Oct. 27, 2000.

⁸² *Id.*

⁸³ *See supra* note 9.

⁸⁴ Virtual Project Workspace provided a mechanism for Covisint members to interact and share research data as well as hold online meetings, *see further* <http://www.covisint.com/productdev/collaborative.shtml> (last checked on May 1, 2001).

⁸⁵ *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962).

(iv) *Impact on innovation:*

The relationship between network effects and innovation may be examined in the way in which network effects contribute to establishing market power. In turn, this might diminish dynamic competition by discouraging would-be entrants from trying to lure Covisint's users through superior but inoperable technology.⁸⁶ Assuming that Covisint attains a dominant position, which is not inevitable as discussed below, it is by no means a foregone conclusion that innovation will be inhibited. Although market power may be more resilient as a result of network effects, equally this may sharpen the incentive to be creative so as to attract supposedly 'locked-in' users from the incumbent, Covisint, because of the considerable eventual returns from conquering the B2B market.⁸⁷

It is important to remember that exchanges are not hermetically sealed, and as such Covisint is inextricably linked to the automotive industry itself. One consequence of network effects insulating Covisint from potential competition could be that certain diseconomies of scale such as organizational slack may crystallize, which perversely could perpetuate inefficiencies within the automotive supply chain. Given that the automotive market is oligopsonistic and that other means of distribution are not likely to be equally effective alternatives, in terms of speed and information, then 'lock-in' may occur in a way distinct from the inertia due to switching costs. The net result would be a diminished incentive for Covisint to innovate as well as lower efficiencies than anticipated therefrom, which would tilt the balance toward prohibition under antitrust scrutiny.

⁸⁶ In contrast to the static model of competition, there seems to be a shift in emphasis under dynamic B2B competition, in addition to the role played by and interpretation of abnormal profits, with the focus not on how to oversee the existing structure but focus on how it has evolved. Thus it would seem that consumer welfare depends less on price and output and more on technological innovation.

⁸⁷ Declaration of K.Arrow, Memorandum of the U.S.A in Support of Motion to Enter Early Final Judgment and in Opposition to the Positions of I.D.E. Corp. and Amici, United States v Microsoft Corp., Civil Action No. 94-1564, 5-6, D.D.C. filed Jan. 18 1995, ("a rule penalizing market successes that are not the result of anticompetitive practices will ... have the effect of taxing technological improvements and is unlikely to improve welfare in the long run") *Id.*, 10.

Thus, the promise of technological benefits might be thought to become a general policy justification for B2Bs.⁸⁸ Acting *ex ante* to Covisint's operation however, the FTC's clearance seemed to be reserved. In part, this caution may be attributable to the concern over market power leverage, examined in section 2 and in part it might reflect the uncertain extent to which B2B development and innovation within the automotive supply chain process will flourish or dwindle under Covisint. Antitrust should take cognition of the effect of Covisint on the market for innovation. An apt contemporary example of Covisint's willingness to advance automotive electronic B2B commerce is provided by its recent announcement as the sole provider of 'i-Supply Service', which is an Internet-based software program by SupplySolution.⁸⁹ This unique tool enables suppliers to take a real-time inspection of automakers' inventory.⁹⁰ "This may be the tipping point for Covisint, from being a novelty to a place where you really need to go to do business in the automotive industry, it gives users a real business reason to go and use Covisint."⁹¹ Arguably, this may be attributed to the stimulus of B2B competition though it remains to be seen whether Covisint will continue to be the forerunner of B2B commerce and achieve market preeminence, which is explored next.

(vi) *Prospective market dominance:*

Another result of Covisint's likely network effects may be its attainment of a 'critical mass,'⁹² especially in light of Covisint's open, non-exclusive membership being conducive to more and more firms joining Covisint. The market for auto exchanges could 'tip' in favor of a Covisint

⁸⁸ S.DeSanti, The Evolution of Electronic B2B Marketplaces, SF63 ALI-ABA 201, p 204, American Law Institute - American Bar Association Continuing Legal Education, Sept. 14 2000, ("what is new here? The answer is: the technology").

⁸⁹ Covisint Press Release, Covisint Selects SupplySolution for Supply Chain Execution Applications, Mar. 15, 2001, available at <http://www.covisint.com/info/pr/supplysolution.shtml>, (last checked on May 1, 2001). The significance of using SupplySolution should not be underestimated, as 750 auto suppliers already use its software, adding to the connectivity and liquidity within Covisint and making its B2B hegemony more likely.

⁹⁰ R.Kisiel, Software could help Covisint into fast lane, Automotive News, Mar. 26, 2001 Vol: 75 No. 5922.

⁹¹ *Id.* K.Prouty, Senior Research Analyst, AMR Research (specializing in research on e-business strategies and technology), available at <http://www.amrresearch.com>, (last checked on May 1, 2001), (adding that "The deal could be a turning point for the online marketplace [Covisint] that has been struggling for greater acceptance among suppliers").

⁹² P.Harbour, B2B Basics and Antitrust Issues, Jan. 2001, 631 PLI/Pat 649, at p 674. *See also*, H.Shelanski & J.G.Sidak, Antitrust Divestiture in Network Industries, 68 U. Chi. L. Rev. 1 Winter 2001, p 9.

monopoly.⁹³ Although dominance is not unlawful in itself,⁹⁴ it may still be an antitrust concern to the extent that it motivates anticompetitive conduct to sustain the collective market power achieved.⁹⁵ Evans and Schmalensee argue however, that any market power attributable to network effects should only be “ephemeral” due to the scope for technological advancement to “leap-frog” competition.⁹⁶ This argument favoring the innocuous nature of market power may be buttressed by the availability of niche markets,⁹⁷ which may exert competitive pressure on Covisint, by serving automakers’ needs individualized requirements. On the other hand, it seems that the very fact that Covisint’s market power might be fleeting in this way,⁹⁸ could encourage Covisint to act anti-competitively in order to decelerate the usurping of Covisint’s potential dominant position. Furthermore, the extent to which niche markets can exert competitive discipline on Covisint may be doubted since they serve particular demand and cannot offer the scale of economies available using Covisint.

Alternatively, applying a theory from the Collaboration Among Competitors Guidelines may allay the fears over the exercise of collective buyer power within Covisint.⁹⁹ If the founding manufacturers of Covisint decided to restrict their purchases in an attempt to lower parts prices,

⁹³ Frontier Economics Group for U.K. Office of Fair Trading, E-Commerce and its Implications for Competition Policy, Discussion Paper 1, Aug. 2000, OFT 308, § 5, paras 5.33-4, (analyzing the ‘tippiness’ of markets in terms of liquidity of online marketplaces or the scale of operation, “and just as there is a minimum efficient scale there will be some amount of liquidity that is sufficient for buyers and sellers,” *Id.* para 5.34).

⁹⁴ United States v. Grinnell Corp., 384 U.S. 563, 16 L.Ed.2d 778, 86 S.Ct. 1698 (1966).

⁹⁵ United States v. Microsoft Corp., 87 F. Supp. 2d 30, 39 (D.D.C. 2000) (finding a violation of § 2 of the Sherman Act 15 U.S.C. 2. through unlawful maintenance of its operating system monopoly).

See also, D.Carlton & A.Frankel, The Antitrust Economics of Credit Card Networks, 63 Antitrust L.J. 643, 655 (1995) (“The antitrust inquiry should focus on the joint venture's collective market share and collective market power. Otherwise, any joint venture ... would enjoy immunity under the antitrust laws”).

⁹⁶ D.Evans & R.Schmalensee, A Guide to the Antitrust Economics of Networks, Antitrust, Spring 1996, p 36.

⁹⁷ *See e.g.* ChoiceParts, a network for automotive retailer and collision repairers available at <http://www.choiceparts.com> (last checked on May 1, 2001).

⁹⁸ Automotive suppliers may constrain the power of Covisint attributable to network effects at least by keeping their technology options open, as J.Kalina, BorgWarner Automotive's Chief Information Officer put it: “Joining Covisint is *one* of several steps we are taking to leverage potentially valuable forms of information technology across our organization.” *See* C.Whitbread, Covisint still favored to be dominant force, Automotive News, Dec. 4 2000, Vol. 75, No. 5906.

⁹⁹ Collaborations Among Competitors Guidelines, § 3.35, note 50, *supra* note 32.

then a market opportunity might be opened for a would-be entrant¹⁰⁰ to procure parts without ‘driving’ the price of inputs above the original price. This notion is supported by Covisint’s non-exclusive nature i.e. members retain the right to use other exchanges and thereby lends weight to its competitive legitimacy at present.¹⁰¹ Still, it neglects the cumulative costs of successful entry in order to attract sufficient demand and afford sunken investment costs. Therefore, the most likely effective entrants under this theory would be the primary market rivals of the Covisint founders, such as VW who is setting up its own exchange, as they have an established demand and market reputation to attract suppliers from Covisint.

Network effects may also give rise to Covisint’s market leadership in auto electronic marketplaces. This may be attributed to the barrier-raising result of network effects described above, which could tilt the market in favor of Covisint due to its pioneering of auto B2B e-commerce. This ‘first-mover advantage’ creates an antitrust suspicion if prodigious market power is sustained over time.¹⁰² Still, this concern may be allayed to the extent that this advantage is not necessarily unassailable for two reasons.

First, there could be a ‘second-mover advantage’ with respect to incorporating e-commerce within the automotive industry. For example, those automakers that remain on the periphery of B2B developments can avoid the uncertainties and risks inherent in investing in new technology. Conversely, one plausible rationale behind Covisint was to defray the risks associated with developing an e-commerce strategy in order to procure pro-competitive economies. On the other hand, cautious firms may be able to ‘cherry-pick’ the optimal technology selected by the most efficient and popular B2B. Furthermore, the value of not joining Covisint is reinforced by the likely time lag in the take-off of network effects, precisely because firms tend to await others to

¹⁰⁰ *Id.* E.g. committed purchasing entry would be analyzed similarly to § 3 *Horizontal Merger Guidelines*, issued by the U.S. Department of Justice and the Federal Trade Commission, April 1992, revised April 1997, available at http://www.usdoj.gov/atr/public/guidelines/horiz_book/toc.html (last checked on May 1, 2001).

¹⁰¹ *CBS v. ASCAP*, 620 F.2d 930, 936 (2d Cir. 1980), cert. Denied, 450 U.S. 970 (1981), (holding a music composition blanket licence not to be a restraint of trade, relying on a single factor, that the individual composers retained the right to negotiate their own composition fees outside the licence).

¹⁰² Note, *Antitrust and the Information Age: section 2 Monopolization Analyses in the New Economy*, 114 *Harv. L. Rev.* 1623, 1631, 1634-5, Mar. 2001.

join in order for the venture to be more valuable upon their participation.¹⁰³ This compounds the existing uncertainty regarding the eventual locus of the most efficient exchange, benefiting from the greatest network effects. Nevertheless, probably one of the most likely candidates for successful establishment as the market leader will be Covisint, in light of the scale and scope of such an industrial consortium exchange.

Second, Covisint may be conceived within a dynamic model of competition. Contrary to the prediction of market dominance by network economics, Covisint may spawn a “perennial gale of creative destruction”¹⁰⁴ as its potential profitability, due to its estimated transaction value,¹⁰⁵ would elicit other manufacturers and third parties to instigate their own rival exchanges to transact B2B commerce in auto parts. Instead, there might be a “perennial lull”¹⁰⁶ in B2B rivalry, depending on the potency of the barrier-raising effect described above, though current market permeability, technological progress coupled with countervailing efficiencies could merit justification of any anticompetitive effects of Covisint, to which we now turn.

(vii) Countervailing efficiencies of network effects:

Finally, of course, any rule of reason assessment of Covisint should take account of the economies derived from participation in the exchange on both supply- and demand-side. Their relative importance will depend on their magnitude, which in turn will partly be a function of the scale of operation of Covisint. Herein lies a key advantage of an industrial consortium exchange, as firms benefit from a uniform standard for the industry, which allows seamless interoperability. By contrast, for example, the auto industry’s experience with differentiated computer-added systems incurred substantial intersystem adjustment costs and restricted the level of input across

¹⁰³ R.Kisiel, New tech, old realities: Coordination, supplier wariness are thorny issues for Covisint, *Automotive News* June 26, 2000 (revealing that “some suppliers believe Covisint is nothing more than a high-tech tool to further squeeze their margins, created under the guise of moving the industry forward into the world of e-business”).

¹⁰⁴ J.Schumpeter, *Capitalism, Socialism and Democracy*, p 84, (3d ed. 1950).

¹⁰⁵ R.Kisiel, Software could help Covisint into fast lane, *Automotive News*, Mar. 26, 2001 Vol: 75 No. 5922, (reporting that Covisint claims to have transacted approximately \$1 billion worth of trade since becoming operational in October 2000).

¹⁰⁶ D.Evans, *Antitrust and the New Economy*, SF63 ALI-ABA 41, p 64, American Law Institute - American Bar Association Continuing Legal Education Sept. 14 2000, (citing J.Schumpeter, *Capitalism, Socialism and Democracy*, pp 83-4, (3d ed. 1950)).

the supply chain. In practice, the exponential growths of demand-side economies will emerge over time and must be verifiable and specifically attributable to Covisint to determine the likely competitive impact of the exchange.

(viii) *Summary:*

Network effects are one distinguishing characteristic of e-commerce in general and B2Bs in particular. The success of Covisint will depend on the extent to which it can attract sufficient volume of transactions and if it does so, whether its market power becomes more durable, and entry more difficult in markets. The mere existence of network effects and their consequences however, does not confer sufficiently distinctive characteristics for Covisint to warrant distinct antitrust analysis. The most likely source of enforcement should be private law suits, as shown by the *ChoiceParts* case, the first antitrust case against an electronic marketplace and involving the founders of Covisint.¹⁰⁷ This may be an example of the incentives to behave anticompetitively to take advantage of network effects in the emerging market. Thus, it reinforces the notion that antitrust must pay careful attention to the objectives and behavior of Covisint so as to recognize the strategic importance of building and maintaining an installed base of users, whilst preserving dynamic competition and technological innovation.¹⁰⁸

Therefore, antitrust enforcement, as a behavior-shaping norm, should be vigilant in contesting market power built on network effects, especially when exclusionary market foreclosure has occurred.¹⁰⁹ Nevertheless, “[t]he successful competitor, having been urged to compete should not be turned upon when he wins.”¹¹⁰

¹⁰⁷ ChoiceParts v. General Motors Corp., Ford Motors Corp., & DaimlerChrysler AG, (2001), ChoiceParts, *see supra* note 96, has argued that the ‘Big 3’ manufacturers have sought to protect Covisint’s recent sibling, the ‘Big 3’s’ B2B serving the repair parts aftermarket, from competition by denying essential pricing information to it, brief available at <http://www.choiceparts.com/> (Media Room) (last checked on May 1, 2001).

¹⁰⁸ C.Shapiro, Antitrust in Network Industries, Speech at ALI/ABA, July 3, 1996, (“The single most important goal of antitrust in network industries is to ensure that competition from new products and new technologies is not stifled”), available at http://www.usdoj.gov/atr/public/speeches/speech_shapiro.htm (last checked on May 1, 2001).

¹⁰⁹ R.Pitofsky, Antitrust Analysis in high-Tech Industries: A 19th Century Discipline addresses 21st Century Problems, remarks at ABSA Antitrust Section’s Antitrust Issues in High-Tech Industries Workshop, Feb. 1999, available at <http://www.ftc.gov/speeches/pitofsky/hitch.htm> (last checked on May 1, 2001).

¹¹⁰ United States v. Aluminum Co. of Am., 148 F. 2d 416, 430 (L.Hand, J.), (2d Cir. 1945).

(5) Less restrictive measures than Covisint?¹¹¹*(i) Introduction:*

In the context of joint ventures, proportionality provides an important and understated doctrine to understand the hermeneutics of the antitrust authorities, especially with respect to e-commerce, where the possibilities are seemingly endless. The Collaborations Among Competitor Guidelines promulgate that a joint venture may be an efficiency-enhancing integration only when it cannot be achieved by a practically equivalent and significantly less restrictive measure.¹¹² This section will focus only on the integration itself, since other anticompetitive restrictions in Covisint remain to be seen.¹¹³

Correia has argued, in the context of discussing B2Bs, that this doctrine is not substantiated by the case law, that courts are skeptical of its value and that it is really a mere “enforcement tool.”¹¹⁴ However, there is ample evidence to plausibly suggest that proportionality is a *sine qua non* of competitive evaluation of B2Bs.¹¹⁵ For example, if the relevant market for Covisint was B2B commerce and was found to be less competitive following its operation, then when it advances the business justifications described above in section 2, the proportionality inquiry would crucially focus on whether the anticompetitive effects are commensurate with the asserted legitimate rationale of the venture.¹¹⁶ A prerequisite for an investigation into whether there is a

¹¹¹ Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces: A Report by Federal Trade Commission Staff, (Oct. 26, 2000), Part 3, pp 11-13, available at <http://www.ftc.gov/os/2000/10/b2breport.pdf> (last checked on May 1, 2001) (considering less restrictive alternatives with respect to protecting sensitive business information).

¹¹² Collaborations Among Competitors Guidelines, § 3.36 (b), *supra* note 32.

¹¹³ *See supra* note 37.

¹¹⁴ E. Correia, Antitrust Issues in Creating – Joining e-commerce “B2B” exchanges, Latham & Watkins, Aug. 4 2000, available at <http://www.lw.com/pubs/articles.htm> (last checked on May 1, 2001).

¹¹⁵ R. Pitofsky, Joint Venture Guidelines: Views from One of the Drafters, Remarks to the ABA / Section of Antitrust Law Workshop: Joint Ventures and Strategic Alliances: The New Federal Antitrust Competitor Collaboration Guidelines, Nov. 11-12 1999, Section B 3, available at <http://www.ftc.gov/speeches/pitofsky/jvg991111.htm>. *See further*, Collaborations Among Competitors Guidelines, § 3.2, note 19, *supra* note 32.

¹¹⁶ *See e.g.* United States v. Brown University, 5 F.3d 658, (3d Cir. 1993) (applying the rule of reason to an agreement between several universities concerning the quantum and method of distribution of financial aid, and holding that a restraint only survives “if it is reasonably necessary to achieve the legitimate objective proffered by the defendant”) *Id.* pp 678-9.

less restrictive measure than Covisint is a finding that it has a *prima facie* anticompetitive aim or effect.

(ii) *Should the inquiry even be commenced?*

On its face, the automotive electronic marketplace does not feature any hardcore restrictions and still faces virulent competition,¹¹⁷ so that its potential anticompetitive impact has yet to arise. It is crucial to recognize that without any threat to competition, then it is irrelevant whether there are alternatives that better comport with effective competition.¹¹⁸

Thus far, Covisint has allegedly fallen short of its initial promise to deliver “connectivity and visibility” to the automotive supply chain.¹¹⁹ One salient reason for this shortcoming, and the innocuous impact of Covisint so far, could be the very nature of Covisint itself. The industrial exchange may be classified as an ‘experience’ good, which means that users would initially be disinclined to use Covisint without trying it first. The running of various pilot schemes however, has addressed accustomization to an extent.¹²⁰ Apart from liquidity, the success of electronic B2B commerce rests on market reputation and goodwill, which helps to trigger the critical tipping point, whereby network effects induce greater market power.¹²¹ Hence, it might be potentially misleading to rely on substitutability from price changes in electronic procurement of auto parts, for example, as consumers will only become fully informed and accustomed to Covisint over time. Consequently, possible network effects will occur only gradually as incremental experience with Covisint services and technology grows. This outcome seems to be

¹¹⁷ *Covisint*, Bundeskartellamt decision, B5-40/00, Sept. 30, 2000.

¹¹⁸ See e.g. *Rothery Storage and Van Co. v. Atlas Van Lines*, 792 F.2d 210, (D.C.Cir. 1986), cert. Denied, 479 U.S. 1033 (1987), Judge Bork opined that it was “unnecessary to calibrate degrees of reasonable necessity,” *Id.* at 227 as a reflection as the defendants possessed only 6% of the market *Id.* at 217 and the restrictions on agents for moving and storage company were only ancillary, *Id.* at 214, so there was no threat to competition and no need to inquire into proportionality.

¹¹⁹ D.Sedgwick, *Covisint’s rough start: The Big 3’s Net exchange faces multiple challenges*, *Automotive News*, Feb. 12, 2001, Vol: 75 No. 5916, (discussing a number of challenges that were still facing Covisint, both internal such as selecting a CEO, or external such as B2B rivalry from Free Markets, which are hindering its expected rate of progress). It should be noted that, on April 18 2001, Covisint’s Board of Directors selected a CEO: K.English, *Covisint Press Release*, at <http://www.covisint.com/info/pr/ceo.shtml>, (last checked on May 1, 2001).

¹²⁰ R.Kisiel, *Suppliers are warming up to online buying*, *Automotive News*, Mar. 26, 2001, Vol. 75, No. 5922.

¹²¹ M.Cunningham, *How to Build A Profitable E-Commerce Strategy*, pp 30-31, (2001).

compounded by the hedging strategy by auto companies as they seek to keep their options open in the as yet uncertain and embryonic e-commerce environment.¹²²

In light of the risks to competition due to illegitimate exploitation of market power through exclusionary behavior, it is submitted that the doctrine would act as one factor within the rule of reason, helping to shed light on the defendant's intentions and in turn help determine the level of scrutiny applied by the agencies. The onus would be on the complainant to establish the practically available and less restrictive substitute B2Bs. So what are the plausible alternatives to Covisint?

(iii) *Private network without an Internet infrastructure:*

Given that B2B commerce was automated prior to Covisint, its immediate alternative is the traditional offline mechanism of distribution. The use of EDI¹²³ within larger automotive producers, who can afford the substantial costs of implementation and maintenance of the technology, depends on whether it can achieve comparable results as Covisint or whether it reveals the costs of joining Covisint are disproportionate to its proffered benefits.¹²⁴ In making this comparison, the costs and challenge of backward integrating the technology used by Covisint with internal systems disfavors the consortium model.¹²⁵ By contrast, EDI connections still form the backbone of B2B commerce and have the advantages of internal system operability and maintaining the security of firms' competitive sensitive data. Presently, PSA/Peugeot-Citroen SA has opted for this EDI route, by creating an EDI interface between Peugeot's 'Ingenum' engineering system and its suppliers, whilst its Internet strategy remains to be

¹²² G.Kachadourian, Dana's Magliochetti says connectivity is crucial *Automotive News* Vol: 75 No. 5913, Jan. 22, 2001, (describing J.Magliochetti's, chairman of Dana Corp., intention to use a combination of trade exchanges and not use Covisint exclusively).

¹²³ *See supra* note 9.

¹²⁴ J.Parker, A (Virtual) Reality Check, *Traffic World*, Sept. 4 2000, Vol. 263, p 20, (citing a Deutsche Bank / Berger study, which questioned 150 B2B experts from automotive and information technology industries in the U.S., E.U., and Asia and concluded that the benefits of global Internet communications and online exchanges will be "incremental [and] evolutionary rather than revolutionary." [emphasis added]).

¹²⁵ *Cf* Brodley, Boston University Law School, FTC B2B Workshop, *supra* note 10, June 30, 2000, Vol. 2, p 542, "to the extent that ...dominant factor of the industry have ownership in the exchange, [such as in Covisint's case] then they're going to be less interested in participating in another exchange ... [which] could restrain the ability for other exchanges to develop."

crystallized.¹²⁶ In this way, EDI may provide a readily available means of transacting B2B commerce but its market range does not match that of electronic marketplaces. Moreover, as mentioned in section 2, beyond its wider scope, the Internet can actually enlarge the scope of the auto parts market through making distribution possible that was not previously cost-effective.

Hence, to what extent is EDI practically equivalent or less restrictive than Covisint? On the one hand, EDI serves the same business strategies as those driving Covisint i.e. input cost reduction. Whilst Covisint carries with it the risk of market power due to its scale and demand economies, EDI cannot replicate the market creation associated with Internet-based transactions. In this sense, Covisint, aside from its possible network effects, moves the auto parts market closer to perfect contestability, where since a “particular transaction of entry is costless, the rule of antitrust law does not matter.”¹²⁷ Therefore, Covisint’s use of the Internet colors the competitive comparison between EDI and B2Bs, in terms of greater information available and higher speed of processing transactions, which points away from EDI’s purported equivalence in transacting B2B commerce.

In making this comparison however, it is crucial to remember that, although proportionality purports to be an objective and predictable standard, value judgments inevitably inhere in its application. This seemingly flexible standard will make it imperative for firms to liaise with competition authorities in advance in order to meet their concerns regarding excessive effect on B2B competition. It seems that Covisint provides a paradigmatic example of the evolution of ‘co-regulation’ between authorities and private enterprise, as the FTC learned about the efficiencies and dynamics of the venture, whilst Covisint allayed concerns through commitments

¹²⁶ J.Folz, Peugeot Chairman declared that it was “looking at the possibility of becoming a partner in Covisint,” Geneva Motor Show 2001, D.Barlas, Line56.com Magazine, Mar. 1 2001. *See also*, C.Whitbread, Covisint still favored to be dominant force, Automotive News, Dec. 4 2000, Vol. 75, No. 5906.

¹²⁷ F.Easterbrook, Information and Antitrust, U. Chi. Legal F. 1, (2000) (explaining Baumol’s contestability theory, [broadly, a perfectly contestable market arises when entry into and exit from the market incurs no sunk costs], as a subset of Coase’s general theory of transactions costs that when transaction costs are zero, then rule of law becomes immaterial).

See further, W.Baumol, J.Panzar & R,Willig, Contestable Markets and the Theory of Industry Structure, (Revised edn, 1988) and R.Coase, The Problem of Social Cost, 3 J.L. & Econ. 1 (1960)).

inter alia for its nonexclusive membership and instigating an internal antitrust compliance policy.¹²⁸

To conclude, Covisint overcomes the inherent limitation of EDI to the trading range of that particular firm.¹²⁹ As a result, EDI lacks the equivalent capacity to generate new products and relationships and explains why it has been suggested that firms can automate B2B commerce without using Covisint but they “will not be part of the global supply chain, since Covisint is not an option, it’s a necessity.”¹³⁰ It appears that opting for EDI would be unnecessarily regressive for procurement and supply management, and detrimental to dynamic competition. Therefore, it is not a preferable alternative for B2B competition.¹³¹

(iv) *Private Internet-based network:*¹³²

A second alternative would be to extend a firm’s EDI connections by interfacing them with the Internet and create a private B2B exchange. This advance would allow comparable, i.e. informed and swift, transactions to those carried out on Covisint. GM’s TradeXchange and Ford’s AutoXchange,¹³³ which preceded and were integrated into Covisint, provide classic examples of

¹²⁸ FTC Press Release, FTC Terminates HSR Waiting Period Covisint B2B Venture, Sept. 11 2000, available at <http://www.ftc.gov/opa/2000/09/covisint.htm> (last checked on May 1, 2001). This may be an alleged virtue of the HSR waiting period to allow private, agreed resolution.

¹²⁹ Cf Collaborations Among Competitors Guidelines § 3.34 (d), *supra* note 32, (considering the “extent to which [Covisint’s] governance structure enables [it] to act as an independent decision maker”). Thus, contrary to the stated advantage of Covisint, moving beyond one-to-one EDI may involve two competitive concerns: anticompetitive tacit coordination of purchasing and higher probability of illicit information sharing, *id.* § 3.34 (e).

¹³⁰ A.Cummins, Covisint – The Only Game in Town, *Automotive Industry*, Sept. 2000, Vol. 180, p 7.

¹³¹ E.Brown, Is the Internet Stronger Than Steel?, *Fortune*, May 15, 2000, p 166. (considering B2Bs to be the “Holy Grail” of inventory control).

¹³² PWC, E-procurement: automation and collaboration, *Fortune*, Nov. 13, 2000, p 5, available at <http://www.pwcglobal.com/extweb/pwcpublishations.nsf/docid/21BD209C5EF94806852569EE006E8EA2?OpenDocument> (last checked on May 1, 2001).

¹³³ In November 1999, Ford setup AutoXchange as a joint venture with Oracle, whilst GM established TradeXchange together with CommerceOne. See J.Couretas & A.Robinson, *Automotive News GM, Ford to do Purchasing On Web*, *Automotive News*, Nov. 8, 1999. Both technology providers currently hold 2% equity in Covisint, with Commerce One providing the software for Covisint’s services whilst Oracle organizes its internal infrastructure.

the single B2B substitute for an industrial consortium.¹³⁴ Therefore, the private exchange seems to be a lesser constraint on competitive parts procurement because there is less opportunity for coordination between horizontal competitors. Still, the parents of Covisint avowedly collaborated on the basis of the potential network effects, the imperative for fashioning a uniform industrial standard¹³⁵ and avoiding myopia by using Covisint for a broader range of design capabilities in the long-term production.

Nevertheless, Volkswagen now currently provides direct competition to Covisint via its own ‘Electronic Supplier Link’ (hereinafter, ‘ESL’).¹³⁶ From a practical perspective, ESL should be better suited to existing supplier relationships and avoids possible internal governance conflicts, together with fewer transition costs. A common difficulty faced by many fledgling B2Bs though, especially in the face of Covisint, is a lack of liquidity. VW on the other hand, seems ideally placed to pose a sustainable and potent challenge to Covisint, with respect to the competition between exchanges and the ultimate efficiency gains delivered.¹³⁷ Furthermore, ESL helps ensure the confidentiality of proprietary information through using only VW’s own suppliers, whilst Covisint carries a higher risk that information could be deliberately disclosed or inadvertently leaked to horizontal competitors, with concomitant risks of price coordination. Alice Miles, President of Ford B2B ConsumerConnect and a member of the executive team that planned Covisint, stated that the FTC specifically focused on whether Covisint transactions

¹³⁴ Gentlemen ... Start your browsers, Automotive Engineering International, July 1 2000, p 58, (pointing out that during the first two operative months of GM’s TradeXchange, GM has purchased in excess of \$1.7 million in operating materials from online catalogs). On the one hand, this casts doubt on the necessity of Covisint. On the other hand, the risks associated with e-investment, the benefits of standardizing automotive e-commerce and the maximization of the scale and demand-side economies would comport with such a joint venture.

¹³⁵ R.Johnson, Delphi seeks standards for Web purchasing: e-commerce needs common language, Automotive News, Mar. 13 2000, Vol. 74, No. 5865, (J.Alapont, President of Delphi Europe stating that many suppliers “would very much like the industry to standardize in the best possible way, and not end up with another CAD [Computer Aided Design] type of situation when later you need to have translators between one another”). This suggests that the adjustment costs of serving different OEM design systems limited supplier competition and perpetuated supply inefficiencies, which may be avoided by using Covisint concerning procurement and product design.

¹³⁶ R.Kisiel, VW going its own way on e-auctions, Automotive News, Dec 11 2000, Vol. 75, No. 5907 and C.Whitbread, Covisint still favored to be dominant force, Automotive News, Dec. 4 2000

¹³⁷ *Id.*, F.Sanz, VW Head of Purchasing, “With total group procurement volumes of some \$43.8 billion distributed principally across the regions and nine different brands, we represent a powerful market potential in our own right.”

would be confidential¹³⁸ as well as whether the Internet joint venture would be sufficiently independent, discussed below.¹³⁹ In fact, despite the FTC's clearance, precisely this concern has deterred some of the leading European car manufacturers from using Covisint.¹⁴⁰ Notwithstanding these advantages, is ESL a significantly less restrictive option for competition or merely a rival mode of e-commerce?

One major drawback of bilateral procurement exchanges vis-à-vis Covisint is their confinement to the manufacturer's own suppliers. This becomes important for the dynamic view of B2B competition since Covisint's multilateral capacity has the potential for moving toward optimal efficiency through improved products and relationships.¹⁴¹ Moreover, there seems to be a tension between the private B2B solution and the primacy of establishing a global automotive network. Two approaches seem tenable. First, a uniform technology standard could be promulgated for the industry, such as a *de facto* norm implicitly laid down by Covisint. Alternatively, the private exchanges could be made interoperable *inter se*.¹⁴² Is there any greater threat to competition by channeling purchases, for example, through a single B2B like Covisint rather than linking up a series of independent exchanges?

It seems that one competition concern from channeling purchases through Covisint only, would be the greater likelihood of parental coordination downstream.¹⁴³ This prospect would be

¹³⁸ R.Kisiel, Covisint to launch as more than auction: Web exchange still needs FTC approval, *Automotive News*, Aug. 21, 2000, Vol. 74, No. 5889.

¹³⁹ See p 35 below.

¹⁴⁰ M.Catterall & E.Chew, Europeans seeking alternative: Covisint too much influenced by U.S. companies, critics say, *Automotive News*, June 26, 2000, (reporting BMW's further reason for refraining from joining Covisint as it has been perceived to be an American-oriented venture).

¹⁴¹ See Collaborations Among Competitors Guidelines, § 3.36 (a), *supra* note 32, (requiring such dynamic efficiency claims to be sufficiently precise or "verifiable by reasonable means").

¹⁴² FTC, Public Workshop: Emerging Issues for Competition Policy in the World of E-Commerce, Mar. 22, 2001, available at <http://www.ftc.gov/os/2001/03/ecommmfrn.htm>, (last checked on May 1, 2001) (May 7th session will specifically address issues of interoperability and B2Bs).

¹⁴³ See e.g. Article 2.4, the European Community Merger Regulation, Regulation 4064/89, O.J. [1989] L395/1, O.J. [1997] L180/1, (addressing the co-ordination of the competitive behavior of undertakings that remain independent). In fact, the European Commission is currently reviewing Covisint as a joint venture under Article 81 EC, on restrictive trade practices rather than the merger provisions, see C.Rule, Covington & Burling, B2Bs: Their Antitrust Future, Distribution through B2B exchanges serving multiple buyers and sellers, *supra* note 16.

lessened to the extent that overcapacity remains in the industry and manufacturers must contest for consumer loyalty in an increasingly saturated retail market. Moreover, since automobiles are durable goods, then the secondary market should add to competitive forces constraining any tacit coordination that might be facilitated by Covisint. In addition, when Covisint is understood in dynamic terms, then closer and collaborative relationships permitted through Covisint's online software may be a preferable means to valorize innovation. Through combining resources and spreading risks, cumulative innovation in car manufacturing may be enhanced. Then, within the rule of reason balancing, the Covisint integration would be more necessary to secure the scale of consortium-type and dynamic economies, which should outweigh the more *de minimis*-like risk of coordinating final output.

Ultimately, agencies should be careful to avoid favoring a particular e-commerce solution unless the likely anticompetitive impact could be substantially lessened by another option. Thus, although private exchanges should provide vigorous 'perceived' potential competition, by threatening to lure suppliers from Covisint,¹⁴⁴ it seems that they have yet to become unequivocally equivalent to Covisint.¹⁴⁵ Moreover, there are potential dangers associated with interoperability between several private exchanges, since the associated standardization could quell incipient diversity of technology behind electronic marketplaces. Furthermore, the potential for certain auto producers to be marginalized if they are not afforded access or cannot afford access to the chosen standard protocol could lead to unlawful exclusion of competition. Perhaps, an independently owned exchange could avoid such problems of standardization and the collective market power of Covisint, which will now be examined.

¹⁴⁴ See Collaborations Among Competitors Guidelines § 3.35, *supra* note 32, (expressly consider potent potential competition that could impose competitive discipline on Covisint).

¹⁴⁵ See Covisint Connector Newsletter, Vol. 1, Iss. 1, Jan.-Mar. 2001, (elucidating the benefits of consortium-base exchanges) available at http://www.covisint.com/info/downloads/newsletters/Connector_Q101.pdf (last checked on May 1, 2001).

(v) *Independent B2Bs:*

An independent exchange is generally owned by third parties to the exchange and either may operate across industries or may be industry-specific.¹⁴⁶ In particular, these exchanges raise the question over the role of equity ownership in analyzing collaborations. Does the equity interest possessed by the founders of Covisint mean that it could have a disproportionate effect on competition when compared to those exchange owned by a non-automotive company? In other words, will Covisint's ownership by *inter alia* five leading auto manufacturers bias the exchange in favor of their requirements?¹⁴⁷

Section 3.34 (c), Collaboration Among Competitors Guidelines specifically addresses this problem, by inquiring into the effect of the financial interest on the firms' ability and incentive to compete independently of Covisint. Kinney has queried why manufacturers would need to work in an exchange like Covisint, "that's ... explicitly co-owned with you and some of your horizontal competitors, in order to do what you've been able to do privately for years?"¹⁴⁸ It may be argued that there is a need for the manufacturers to own Covisint in order to oversee the development of its software packages, tailored to their needs, and so as to ensure that they maximize supply efficiencies. On the other hand, although the manufacturers have avowedly declared that they intend to retain autonomous e-commerce strategies,¹⁴⁹ it nevertheless seems that their equity in Covisint may diminish the incentive to compete therewith. Thus, a horizontal

¹⁴⁶ Morgan Stanley Dean Witter, The B2B Internet Report: Collaborative Commerce, *supra* note 11, p 57. There are two types of independent B2B, which are *horizontal* i.e. cross-industry exchanges such as FreeMarkets, which provides Internet auction services for generic commodities and parts, available at <http://www.freemarkets.com/corpinfo> and *vertical* i.e. industry-specific marketplaces such as SupplyOn, founded by Robert Bosch Corp., the third largest automotive supplier, available at http://www.supplyon.com/f_home_en.html. In fact, GM was initially a member of FreeMarkets, until its original rival exchange: TradeXchange, which is not part of Covisint, *see* S.Gupta, Roundtable Discussion, 15 Antitrust 8, p 10, Fall 2000.

¹⁴⁷ The technology providers, Commerce One and Oracle also possess an equity stake in Covisint, *see further* http://www.covisint.com/info/partners_technology.shtml, (last checked on May 1, 2001).

¹⁴⁸ S.Kinney, FreeMarkets, FTC B2B Workshop, *supra* note 10, pp 211-12.

¹⁴⁹ J.McDavid, Governance, Independence Is Core to Covisint's Strategy, Distribution through B2B exchanges serving multiple buyers and sellers, *supra* note 16, (arguing that the Covisint's credibility to investors and appeal to auto producers depends on its independent governance, as typified by the majority of the Board of Directors are not representatives of the founders, *see further* Covisint Press Release, at http://www.covisint.com/info/pr/board_of_directors.shtml (last checked on May 1, 2001).

and independently owned exchange would provide a lesser restraint on inter-B2B competition since the incentives of its users should be unaffected by the exchange.

“The Agencies [will] also assess direct equity investments between or among the participants.”¹⁵⁰ Interestingly, in addition to their direct ownership of Covisint, Ford and GM have structured Covisint’s control as a means to acquire equity in one of the technology partners.¹⁵¹ This raises a novel problem for B2B-competition regarding the possible impact on the ability of the Ford, GM and Commerce One to compete outside Covisint in electronic automotive B2B commerce, when the former have a proprietary interest in the latter. Whilst a distinguishing feature of electronic B2Bs is the necessity of a collaborative working relationship between technology and automotive interests,¹⁵² this does not necessarily require equity interests. Indeed, the financial interest may amount to a lockout for members of Covisint from using another exchange for procurement due to the specificity of technology and suppliers’ dependence on its founders for most of their trade. Market foreclosure would be more likely. At present however, this seems to be a remote prospect because e-commerce has spawned a pluralism of distribution mechanisms so far and in turn, interoperability has not yet become essential to operate online.¹⁵³ Nonetheless, the agencies should pay close attention to the influence of Covisint’s ownership structure concerning its operation in practice, since vested financial interests in the joint venture could become the nucleus for anticompetitive collusion.

With these competitive concerns in mind, are independent B2Bs a superior choice from the perspective of exchange rivalry? FreeMarkets, for example, has 14 automotive users¹⁵⁴ and between 1998-2000 was used by Delphi, the automotive parts supplier, for online reverse

¹⁵⁰ See Collaborations Among Competitors Guidelines § 3.34 (c), *supra* note 32.

¹⁵¹ In December 2000, Commerce One opted for a 10-year revenue-sharing agreement with Covisint in exchange for Ford and GM’s aggregate 14% share in it, whilst Oracle simply charges for its software. See R.Kisiel, 2 roads to Covisint; Commerce One, Oracle choose different strategies, *Automotive News*, Jan 1 2001, Vol. 75, No. 5910.

¹⁵² J.Banerjee, e for Enterprise: Firms that make friends at the touch of a button, *The Independent*, Feb. 11 2001.

¹⁵³ *Covisint*, Bundeskartellamt decision, B5-40/00, Sept. 30, 2000. See *supra* note 8.

¹⁵⁴ R.Kisiel, Covisint faces established competition: Rival exchange lures Visteon and others, *Automotive News*, Nov. 20, 2000, Vol. 75, No. 5004.

auctions worth \$800 million.¹⁵⁵ FreeMarkets' experience suggests that such B2Bs provide an effective choice for automotive companies at least with respect to their need for commodities. Notwithstanding this competitive pressure, independent B2Bs may not even provide a commensurate comparison for the purposes of proportionality. For example, by their nature, such B2Bs do not serve the same functions as those offered by Covisint owing to their lack of domain knowledge. Hence, FreeMarkets does not compete nor emulate Covisint's online facilities enabling collaboration in product design and testing, which means that Covisint could be construed to possess unique functions, which should not be displaced by a non-equivalent exchange.

Alternatively, a better view would be to recognize that competition varies between what functions Covisint performs and that proportionality could be applied in a more tailored way therein. Therefore, antitrust scrutiny should be heightened with respect to transacting indirect inputs¹⁵⁶ since horizontal, independent exchanges act as less restrictive equals to Covisint, whilst more deference could be owed concerning Covisint's long-term design capabilities. However, these varying levels of scrutiny should help determine the overall assessment of Covisint's effect on competition and whether relief is necessary or not.

(vi) *Summary:*

Overall, this section has found that although Covisint is not necessarily the least restrictive measure with respect to B2B competition, it does not currently pose a sufficiently grave threat to such competition so as to necessitate prohibition of the integration. This view accounts for the willingness of automotive producers in all supply tiers to utilize various means to introduce e-commerce to the supply chain. *Ceteris paribus*, it seems likely that there will not be one dominant auto B2B; rather there will be pivotal online trading exchanges. Covisint should be

¹⁵⁵ R.Kisiel, Covisint gives on-site help to clients, *Automotive News*, Oct. 2, 2000, Vol. 75, No. 5897.

¹⁵⁶ *See supra* note 38.

among the forerunning electronic marketplaces, though how it achieves and sustains this market leadership may trigger a proportionality inquiry and varying antitrust scrutiny.¹⁵⁷

(6) Conclusion:

Therefore, it cannot be doubted that Covisint will radically change automotive supply in terms of efficiency, relationships and function. It seems that in any future antitrust analysis of Covisint, special cognition should be taken of the magnitude of its network effects, the particular use of any resulting market power as well as the breadth and speed of its transactions. These characteristics have been shown to distinguish Covisint from other online exchanges, in terms of both its efficiencies and market power risks. Furthermore, the experience of Covisint so far demonstrates that antitrust policy needs to understand the underlying business strategies behind an Internet joint venture and the significance of whether the integration is disproportionate to those aims, in order to preserve the incentives for automakers to be efficient and innovative in the long run.¹⁵⁸

The precise competitive effect of Covisint cannot yet be predicted since its own future remains uncertain. For example, DaimlerChrysler has yet to integrate its private Internet-based exchange ‘FastCar’ into Covisint and thus could provide a potential source of unforeseen competition.¹⁵⁹ Currently, there seems to be no less restrictive alternative to such a consortium exchange though much will depend on the extent to which Covisint’s proffered efficiencies are realized and how the auto industry and other B2Bs react. In any event, proportionality should be influential in determining Covisint’s online competitive impact. In this respect, the ongoing dialogue between competition authorities and private enterprise, such as the second FTC B2B Workshop on May

¹⁵⁷ B.Baer & M.Hansen, B2B Marketplaces and Common-sense Antitrust Precautions, 17 Computer & Internet Law. 2, p 2, Sept. 2000, (opining that “antitrust implications of [B2B operating and governing] rules can change as circumstances change” and so require ongoing observation).

¹⁵⁸ R.Pitofsky, Antitrust and Intellectual Property: Unresolved Issues at the Heart of the New Economy, Speech to the Berkeley Center for Law and Technology at Berkeley University, Mar. 2, 2001, available at <http://www.ftc.gov/speeches/pit1.htm>, (last checked on May 1, 2001), (“While much remains to be done, my contention is that antitrust has made significant progress in understanding the “New Economy,” and adjusting its policies to take more fully into account the need to protect both incentives and opportunities to innovate”).

¹⁵⁹ S.Konicki, Covisint Strives To Beat The Odds, Information Week, Apr. 9, 2000, (moreover, Ford is exploring the use of electronic product design tools in addition to its use of Covisint) available at <http://www.techweb.com/wire/story/TWB20010409S0007>, (last checked on May 1, 2001).

7-8 2001,¹⁶⁰ will help inform subsequent analysis of whether the Covisint venture is compatible with or even improves automotive parts and electronic B2B competition.

¹⁶⁰ FTC Press Release, FTC to Host Workshop on Emerging Issues for Competition Policy in the E-Commerce Environment, Mar. 22, 2001, available at <http://www.ftc.gov/opa/2001/03/ecommerce.htm>, (last checked on May 1, 2001).