Buyer Power and the Horizontal Merger Guidelines: Minor Progress on an Important Issue

Peter C. Carstensen*

Abstract

The recently promulgated Horizontal Merger Guidelines explicitly recognize that mergers creating undue buyer power should be challenged under the Clayton Act’s prohibition of anticompetitive mergers. While this is an important step forward by the enforcement agencies, the relatively brief statement fails to articulate a coherent and complete framework for evaluating mergers that create buyer power. This article provides an inclusive evaluation of the competitive issues raised by such mergers. It starts by identifying the reasons why buyers with relatively modest market shares can—and often do—have substantial power. As the active force in making market decisions, buyers can have significant discretion with respect to when, what, and from whom they make purchases. Moreover, the incentives that frequently constrain exploitation of seller power are weaker or absent on the buying side. Hence, interdependent and unilateral exploitation are more likely. The article identifies the wide range of competitive harms that can arise from the exploitation of buyer power. It then fits those harms into the framework of the Guidelines to demonstrate that investigations of buyer power must take account of a large number of potential anti-competitive effects, both on the direct sellers and on their

* George H. Young-Bascom Professor of Law, University of Wisconsin. I want to thank David Balto, Warren Grimes, Jack Kirkwood, Christopher Sagers, Jeremy Sandford, Kyle Stiegert, and Robert Taylor for informative discussions and critiques of buyer power issues including merger analysis. Christopher Snyder, Class of 2011, provided invaluable research assistance. Financial support for this project, Competitive Policy Issues Raised by Buyer Power, has come from the University of Wisconsin Graduate School, the Food Systems Research Project, and the University of Wisconsin Law School. The Quarles & Brady Summer Research Fellowship through the University of Wisconsin Law School provided the support for this article.
upstream suppliers, well beyond the concerns customarily examined in seller merger cases. This analysis then examines market definition as applied to the selling side of the market to emphasize the importance of viewing markets from a seller’s perspective. The foregoing analysis leads to the conclusion that mergers creating buyer power should trigger concern at lower levels of concentration than is customary in contemporary selling side merger analysis. Finally, the article reviews some key defenses commonly seen in merger cases to show that they also need to be adapted to the economic realities of buyer side mergers.
PROLOGUE

In the fall of 2009, the Federal Trade Commission and the Antitrust Division of the Justice Department announced that they would commence a review of the Horizontal Merger Guidelines which were last comprehensively revised in 1992. One of the primary goals of the review process was to “reflect and incorporate learning and experience gained since 1992.” In light of that goal, it was striking that neither in the questions the agencies posed in their Questions for Public Comment nor, so far as I have learned, in the panels created at the various workshops, did the agencies address the analysis of mergers that affect the buying side of the market. This omission was even more striking in light of Question Twelve in their questions for comment that recognized that “large buyers” can “negotiate more favorable terms” in comparison with other, equally efficient, but smaller firms. Yet, nothing in the other questions asked whether mergers that create such buying power ought to be subject to a focused and specific analysis.

This failure was consistent with the very limited discussion of buyer-side effects in the then existing guidelines. The 1992 Guidelines only reference to buying-side merger effects was:

> The exercise of market power by buyers (“monopsony power”) has adverse effects comparable to those associated with the exercise of market power by sellers. In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines.

Since 1992, however, the agencies, in particular the DOJ, have brought several merger cases with major or even exclusive buying side orientation. The market analysis and competitive effects analysis implicit

---

2. Id.
4. Id.
6. For recent merger cases brought by the Antitrust Division of the Justice Department, see United States v. George’s Foods, Case 5:11-cv-00043-gec (W.D. Va. 2011) (reviewing chicken processor acquisition of competing facility, which increased monopsony power without any allegation of increased power in the market for processed chickens); United States v. JBS Swift, No. l:08-cv-05992 (N.D. Ill. 2008) (challenging acquisition of National Beef, which was ultimately abandoned); United States v. Cargill, No. Civ.A.
in those cases reflects different metrics and standards for evaluating such mergers. In addition, three major Court of Appeals decisions, including an FTC case, have highlighted the scope of buyer power, and its capacity to cause competitive harms at levels of concentration or involving a number of participants substantially at variance from the levels and numbers considered relevant to seller side power. In 2004, the prior administration deemed buyer power a sufficiently important topic that it included it in a workshop on merger enforcement.

Moreover, after the promulgation of the 1992 edition of the Guidelines, Roger Blair and Jeffrey Harrison published their book, *Monopsony: Antitrust Law and Economics*, in which they developed economic models reflecting the competitive analysis of buyer conduct and the implications of buyer mergers. In the first decade of the twenty-first century, the academic literature in both law and economics has produced books and articles that further enrich the analysis of the implications of buyer-side mergers for competition including the potential impacts on innovation. Several empirical studies have shown that buyer power has a...
significant effect on input prices.\textsuperscript{11}

Certainly, the revision process could have focused explicitly on those cases, and the continuing scholarship by asking how a new version of the Guidelines should elaborate on what an “analogous” framework is in practice. Some individual comments submitted in the course of the process did focus on buyer power issues.\textsuperscript{12}

While no questions were asked to frame the topic, the agencies did include a separate section of the proposed Guidelines that elaborated, slightly, on the Delphic declaration in the 1992 Guidelines. After further comment, that section, with only one modest but important clarification (shown in italics here) remained in the final Guidelines:

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called “monopsony power.”

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. \textit{In defining relevant markets, the

\textit{Auction Markets}, 72 \textit{Antitrust L.J.} 83 (2004).


Agencies focus on the alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist.

Market power on the buying side of the market is not a significant concern if suppliers have numerous attractive outlets for their goods or services. However, when that is not the case, the Agencies may conclude that the merger of competing buyers is likely to lessen competition in a manner harmful to sellers.

The Agencies distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways. A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts. Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger, as discussed in Section 10.

The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell.

Example 24: Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output.13

This declaration is an important step forward. It recognizes a couple of the major differences between the analysis of mergers that affect the buying side of the market and those traditionally used to evaluate seller-side effects. The key points are, first, the acknowledgment that even if there are no immediate effects on consumers, a merger can be unlawful solely based on its buyer-side effect (Example 24 makes this point). Second, the fact that output may remain unchanged is also not necessarily a basis to conclude that the merger has no adverse effect on competition. This declaration reflects an acceptance of the fact that “all or nothing” contracts that powerful buyers could impose in many circumstances would not eliminate illegality. Finally, efficiency gains that might excuse a

merger that has some adverse effect on competition do not include transfers of producer surplus resulting from enhanced buyer power.

What is missing from the brief section, less than a page out of the thirty-four pages constituting the revised Guidelines, is the kind of thoughtful and nuanced exposition of policy and approaches that would elevate buyer-side merger analysis to a position of parallel importance with seller side analysis. This article provides a fuller elaboration of the enforcement policy issues raised by mergers affecting the buying side of the market. The central theme of the following discussion is that different metrics and different measures are essential to the analysis of buyer power and the effect of mergers on that power.

I. OVERVIEW

Buyer power is a major source of competitive concern even though it has received relatively less consideration than seller power in the legal and economic analysis of competition policy. Blair and Harrison start their new book with the observation that “monopsony is far more prevalent than many have recognized.”

They then devote the next fourteen pages to summarizing what they call the recent examples of monopsony that include various kinds of bid rigging in auctions for things from antiques to treasury bonds, collusive practices involving financial aid to college students, salary setting for professional athletes, restrictions on college athletic scholarships and coaches, collusion to restrict competition for various kinds of technically skilled employees, and restraints in agricultural product markets.

Historically, buyer power issues were at the root of some of the earliest antitrust cases and have remained a continuous, but under-appreciated component of antitrust case law over the years. Hence, merger policy ought to take careful account of the ways in which mergers increase buyer power and have criteria for determining whether particular combinations create an undue risk of creating unnecessary and excessive buyer power.

The following discussion identifies the competitive issues that mergers affecting the buyer side of the market present and then fits them into the mold of merger analysis as set forth in the Guidelines. Part II presents the analysis of buyer power including a focus on the different incentives that buyers have as well as the ways in which they can—and do—use their power to exclude, exploit, and entrench their position as buyers and sometimes as sellers as well. This part demonstrates that there is a broader and more complex set of potential competitive harms arising

15. Id. at 1–14.
16. See, e.g., id. at 30–40 (describing various cases involving buyer power issues).
from undue buyer power than is conventionally associated with excessive seller power. 17

This survey of potential adverse competitive effects provides the basis for Part III that organizes the information around the standard competitive effects analysis used in merger law. Here too, the point of emphasis is that the competitive risks can and do arise from smaller market shares and larger numbers of market participants than seller side merger analysis now uses as its measure. Hence, Part IV addresses directly the question of market share thresholds and the inferences of competitive harm that might arise from combinations that create buyer power in excess of those thresholds.

Part V then takes up the problem of market definition to reinforce the position of the Guidelines that “the alternatives available to sellers” necessarily define both the product and geographic dimensions of the markets relevant to the analysis. Finally, Part VI considers the role of various defenses in the context of mergers creating buyer power. Of particular concern is the use of “efficiency” to describe wealth transfers from producers to buyers where there is no change in real productive efficiency.

The goal of this analysis is to demonstrate that, while the new Horizontal Merger Guidelines are a significant step forward with respect to identifying the relevant analysis of mergers creating buyer power, they remain insufficient. They do not acknowledge the ways in which buyer power differs in degree and sometimes kind from seller power. Of greatest concern, they do not take account of the fact that buyer power can and does arise at lower levels of market concentration and can involve larger numbers of competitors than would raise concerns on the selling side of the market. Further, buyer power can cause harms upstream from the immediately affected seller so that comprehensive analysis requires recognition of these more remote effects. Finally, market definition needs to focus on seller options including the ease with which sellers can find substitute markets for their output. The failure to develop more fully the analysis of mergers creating buyer power has pervasive adverse effects on the long run viability of our economy. It is particularly important for agricultural commodity markets where buyer concentration has caused substantial harm to farmers and ranchers.

Lastly, this analysis rests on a policy goal of maintaining and enhancing competition in markets. While various economic measures of consumer, producer, and aggregate welfare are not irrelevant to that policy goal, as the analysis will show at various points, the objective of

17. It is arguable that more kinds of competitive harm arise from seller-side mergers than conventional analysis recognizes, but that is an issue for another day.
competition law is to protect competition both as a means to the end of long run dynamic efficiency and as an end in itself.\textsuperscript{18}

II. BUYER POWER–DEFINED, COMPETITIVE IMPACTS, INCENTIVES OF THE POSSESSOR(S)

The observable patterns in the reported cases as well as the empirical and theoretical work of economists who have evaluated the issues associated with buyer power suggest the following salient points about buyer power and its anticompetitive exploitation. This part addresses the definition of buyer power, the incentives and disincentives to use buyer power in ways that adversely effect competition, and then provides a review of the potential adverse competitive affects that are central to an understanding and evaluation of mergers that create or expand buyer power. Some of the attributes of buyer power identified here have close analogues on the selling side, but others are qualitatively or quantitatively quite different. Ultimately, both buyers and sellers seek to increase and protect over time their profits, which in turn means that there will be a substantial correlation between the uses of buyer and seller power.

A. Buyer Power Defined

Any buyer that is not a pure price taker has some buyer power. Even an individual customer at an auto dealership can have some power as she negotiates a lower price. The power of the buyer comes from the central economic fact that the buyer is usually the “decider” with respect to whether to purchase from any particular vendor. In face-to-face transactions, the buyer decides not only whether to buy but also from whom to make the purchase. The resulting discretion is central to the potential for a buyer to have substantial bargaining power. The potential seller is put in the position of accepting the offer or waiting for another buyer to come along. The basic paradigm is that the seller seeks buyers and buyers make the key decisions. The seller does have the option to refuse to make a sale on the terms the buyer proposes. This gives the seller bargaining power in situations were buyers have relatively few options. When, however, there are costs to the seller from delay and uncertainty, the buyer has increased leverage. Thus, the sequence of decisional power differentiates the buyer from the seller and is a major explanation for why buyers in many contexts can have significant power even if they do not

\textsuperscript{18} See Frederick M. Scherer & David Ross, \textit{Industrial Market Structure and Economic Performance} 18 (3d ed. 1990) (noting that “the political arguments . . . and not the economists’ abstruse models, have tipped the balance of social consensus toward competition”).
dominate the buying side of the market in ways comparable to those associated with seller power.\textsuperscript{19} Indeed, this decisional model proceeds directly from the observation that buyer power occurs in market contexts in which the market share of the buyer or buyers is well below that which would be likely to support seller exploitation.\textsuperscript{20}

Closely related to the decisional role of the buyer is the fact that it is more difficult for a seller to engage in arbitrage in the ways that a buyer can. This facilitates the ability of buyers to engage in price discrimination among sellers. In the standard seller side context, in contrast, the favored buyer’s ability to resell the product to the disfavored buyer constrains the seller’s ability to impose different prices or other conditions on buyers. But in the case of buyer power, the capacity of a favored seller to obtain the necessary input from a disfavored seller and deliver it to the buyer is usually constrained. This is most clearly the case whenever the buyer can insist that the seller produce or provide the input.\textsuperscript{21} The buyer has the capacity to ensure that its disfavored suppliers cannot substitute sales to a favored supplier for delivery to the buyer.

But the ability to discriminate among sellers is also central to making the marginal cost of the input approximate its marginal contribution to the productive process. In contrast, if a buyer is obliged (e.g., by a labor contract or custom) to pay the same price to all input suppliers, then to raise the price at the margin to increase input supply results in a cost increase reflecting the total input purchases.\textsuperscript{22} As a result, the cost of increasing supply is much greater than the increased output resulting from the marginal addition. This insight is a common place in labor economics\textsuperscript{23} and is observed in other contexts where the buyer has committed to paying all sellers a price based on the highest price paid in some time period.\textsuperscript{24}

\textsuperscript{19} Indeed, implicit in the usual assumption that a seller must have a large market share in order to have power is the recognition that buyers make the decision to buy and can switch to other sources if they exist and are reasonable alternatives.

\textsuperscript{20} See infra Part V (discussing how buyer power can occur in situations where a purchaser has a relatively low market share).

\textsuperscript{21} The most obvious case is labor. The employee cannot substitute another worker. But the same is true in many selling contexts.

\textsuperscript{22} Such price uniformity extending to existing input suppliers is a “most favored nation” “restraint” on the freedom of the buyer that incentivizes the buyer to depress price.

\textsuperscript{23} RONALD G. EHRENBERG & ROBERT S. SMITH, MODERN LABOR ECONOMICS 133–41 (10th ed. 2009).

\textsuperscript{24} For a monopsonist, paying a uniform price to increase the number of suppliers requires increasing payments to all suppliers. The following illustrative hypothetical is drawn from Cory Capps, Buyer Power in Health Plan Mergers, 6 J. COMPETITION L. & ECON. 375, 377 (table 1) (2010).
Uniform pricing, therefore, creates its own incentives to employ buyer power either unilaterally or collectively to hold the marginal price steady or even force it down.

The remaining issue to consider is the strength of buyer power itself. In general it should be obvious as the prior paragraph points out that the options for sellers will greatly affect the capacity of a buyer to exercise power. Blair and Harrison have developed a measure of buyer power that focuses on price elasticity of supply and demand. Their central insight is that when supply elasticity is low and the marginal buyers have little capacity to expand purchases, the buyer has much more leverage because it can reduce price, even without imposing an “all or nothing” contract and obtain substantial supplies. Another factor increasing power comes from increased switching costs. The more sunk investment a supplier has, the more difficult it is to move into another line of production.\(^{25}\) Thus, buyer power problems are particularly evident in poultry, livestock and dairy production because of the substantial, specialized investments by producers. Doctors and hospitals are in a somewhat similar situation having large specialized investments such that they are vulnerable to buyer pressure.\(^{26}\) Related to these investments may be informational issues. If producers lack good information about and access to alternative outlets for their production, they are less able to resist buyer demands. The seller cannot tell how good a customer the new buyer might be. Hence, if it has

<table>
<thead>
<tr>
<th>Compensation Rate</th>
<th>Number of Doctors</th>
<th>Patient Visits per Doctor</th>
<th>Total Cost</th>
<th>Increase in Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>500</td>
<td>1,000</td>
<td>$50,000,000</td>
<td></td>
</tr>
<tr>
<td>$102</td>
<td>501</td>
<td>1,000</td>
<td>$51,102,000</td>
<td>$1,102,000</td>
</tr>
</tbody>
</table>

Thus, in order to add one doctor by offering a 2% increase in compensation, which would add one thousand additional patient visits, the health care provider would encounter a $1,102,000 increase in its costs. Unless it could collect that much in charges for the incremental one thousand patient visits, it would lose money by increasing output. The marginal doctor, herself, adds only $102,000 to the costs of the provider. The remainder of the increase is compensation to doctors who would have provided the same service for $2 less per visit.

Another example is in livestock purchases where the buyer pays contract suppliers based on the transactional market price as reported during or at the end of the day. In such a circumstance, the buyer has a strong disincentive to bid up the price of the cattle or hogs in the “cash” market because of the impact on the substantial volume of contract livestock.

26. See, e.g., W. Penn Allegheny Health Sys. v. UPMC, 627 F.3d 85, 85 (3d Cir. 2010) (finding that plaintiff plausibly alleged that the dominant regional hospital chain engaged in anticompetitive conduct by conspiring with an insurer to reduce competition); Complaint, United States v. Blue Cross Blue Shield of Mich., 2010 WL 4108490, at ¶1.1 (alleging that leading insurer’s “most favored pricing” agreements with hospitals forced hospitals to raise the prices they charged to competing insurance companies); see also, Marius Schwartz, Address at the 5th Annual Health Care Antitrust Forum, Northwestern University School of Law: Buyer Power Concerns and the Aetna-Prudential Merger 1 (Oct. 20, 1999) (describing how concerns about monopsony guide federal antitrust enforcement).
few options altogether, it may find itself subject to greater exploitation from its current customer because of the uncertainty about the output of a switch.\textsuperscript{27} The costs of switching are increased when the current buyer takes all or most of the supplier’s output. Then the switch does not involve a marginal shift in sales, but a massive change. The risks and costs of such a change are great.

A closely related source of power occurs when the seller needs access to a large number of buyers who resell the product, i.e., retail outlets. In such a situation, one buyer is not a good substitute for another. The supplier needs a large number of retail outlets in order to operate at an efficient scale. Hence, the loss of any major customer is a significant event because it is hard to replace one customer with another. A recurrent observation is that high volume retailers have significant leverage over their suppliers.\textsuperscript{28} Because of the need to have access to a large percentage of outlets in order to obtain a sufficient volume of sales, producers are put at the mercy of each of their large volume customers.\textsuperscript{29} In such a context, a retail firm with a 20\% or 15\% share of the national market in such a class of products is likely to have substantial power over its suppliers because of the threat that the supplier could lose one-sixth or one-fifth or more of its outlets. Reducing the number of outlets stocking a product line to 85\% or less of prior outlets can create a serious problem for a supplier. The central insight here is that for mass marketers to operate efficiently they need to have a very large-scale presence in geographically dispersed retail outlets. Moreover, replacing lost retail outlets in not easy if other outlets either

\textsuperscript{27} See Jeremy Sandford, \textit{Competition and Endogenous Impatience In Credence Good Markets} 5 (University of Kentucky, Working Paper, 2011) (showing that in an uncertain world with asymmetric information, customers will face serious problems if they have fewer than five choices among suppliers on the assumption that the buyer can not return to prior supplier and so face increasing risks as the number declines).

\textsuperscript{28} See Toys “R” Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000) (noting that even large toy manufacturers could not find a viable alternative to selling through Toys “R” Us, which controlled 20\% of toy sales in the U.S.). Additional support comes from Europe. See Clarke, supra note 10 (arguing that large European supermarket chains use their buyer power to impose unfair contractual terms on suppliers); see also, Charles Fishman, \textit{The Wal-Mart Effect} (2006) (describing Walmart’s dominance of the U.S. retail sector); \textit{United Food and Commercial Workers Int’l Union, Ending Walmart’s Rural Stranglehold} 1 (2010) (arguing that Walmart forced concentration among suppliers, violating federal antitrust laws).

\textsuperscript{29} See Joseph Cornwall Palamountain, Jr., \textit{The Politics of Distribution} 107–58 (1955) (noting that one potential reason why the automobile industry has so long insisted on using many independent dealers rather than chains of retailers is their fear of the potential power chains would acquire to dictate to the manufacturer). Palamountain also suggests a similar explanation for the historical experience of the gasoline industry, which initially tried ownership integration into retailing but then moved to individually-owned gas stations over which the producers still sought to exercise substantial control. \textit{Id}.
have the product lines they want or already carry the manufacturer’s line. The central point is that outlets are cumulative and not substitutes.

Producers of consumer goods can, by advertising, create consumer demand directly for their products. Such “must carry” goods (e.g., Gerber baby food) have more insulation from buyer power, but even here the retailer has substantial discretion to decide on the amount and location of shelf space to dedicate to these goods as well as how to display competitive alternatives.30

Small producers of consumer goods are, in some respects, even worse off. They may require only a regional presence, but they are likely to be more dependent on the retailers that are willing to give them an outlet. The threat by a major retailer (relative to the total volume produced by the upstream supplier) to drop or curtail its selling effort creates a serious economic problem for the manufacturer. Unless it can switch products or outlets easily, such a producer faces a bargaining situation in which the downstream retailer has the dominant position. The use of slotting allowances, advertising support, and other payments by producers to retailers confirms the relative power.

The common theme of the cases is that when an upstream producer needs to sell in volume31 and so needs access to a large number of outlets for its product, this empowers the downstream volume retailer to make demands both about price and non-price exclusionary conditions. The exclusionary conduct, such as the refusals to deal sought in Toys “R” Us, can be unilateral agreements with upstream producers.32 Retailer demands can also require coordination among producers as in Klor’s or Interstate Circuit.33 Such coordination is more likely than outright horizontal price fixing or market allocation among such firms; each participating upstream firm has a strong incentive to adhere to the scheme because its own sales are at risk if it cheats.34


31. Volume needs stem from economies of scale as well as from the efficient operating scale needed for a particular production facility. Once a firm has a facility that produces at a particular level, it often needs to maintain sales at that level because of the diseconomies that come from cutting back on output in a plant designed to produce at a substantially larger level.

32. 221 F.3d. at 934.


34. See generally Robert H. Lande & Howard P. Marvel, Three Types of Collusion: Fixing Prices, Rivals, and Rules, 2000 Wis. L. Rev. 941 (2000) (discussing incidences of collusion where one firm exerted pricing pressure to induce another firm to independently make a decision that restricted competition).
Despite the Robinson-Patman Act, some of the power of large retailers is used to obtain better price terms on the goods being purchased. Thus, the large retailer gets, directly or indirectly, lower prices than other retailers even though there is no economic justification for this difference. Law enforcers should be skeptical of the social advantage that may accrue from such selective discounts. When not cost justified, they serve primarily to disadvantage classes of buyers who lack power and thus indirectly reinforce the market power of the dominant buyer.

More generally, one observes as the justification for mergers in retailing that the combined firm will achieve lower prices. Whenever the expected lower prices are to arise from lower input prices, there are grounds for concern that what is about to occur is a kind of ratcheting effect wherein the retailer forces an intermediary to lower its price and that lower price is reflected back up the chain until it comes to rest with those lacking power to pass on the reduced price. To be sure, there are alternative explanations for such cost savings on the input side. There may well be economies of scale or scope as well as transaction cost savings that are substantial. Careful examination of the claims of the merging parties will reveal how the gains are likely to occur.

This phenomenon, which this discussion has located in the retailing end of the distribution chain, may also exist in other contexts where either buyers or sellers require access to the capacity of a substantial fraction of those on the other side of the transaction. What is important from the perspective of merger analysis is that when such a need for use or access exists, as concentration increases beyond a very competitive structure, the opportunity to exercise such power will arise. Again, the paradigm is Toys “R” Us, which had a 20% share of the toy market.

Professor Kirkwood argues that buyer power involves two distinct categories of power: monopsony, which involves exploitation of producers, and “countervailing power” which powerful buyers use to offset the market power of oligopoly producers. This is not a helpful distinction, although it mirrors in part the claims of retailers that they need

36. See infra Part II.C.1 (describing the waterbed effect).
37. In electric power, the peak load phenomenon creates a similar potential under some pricing schemes. The owner of base capacity has an incentive to acquire and withhold mid-level power production so that peak prices increase by requiring the market to call on even more expensive generation, resulting in an increased profit for the base component of the company’s system. This strategic conduct is rational because the market is taking the entire industry output as a unit and pricing all units at a single price.
38. Toys “R” Us, Inc. v. FTC, 221 F.3d 930 (7th Cir. 2000).
to combine in order to demand lower prices. Notably, producers of consumer goods respond by justifying their mergers as necessary to respond to the buyer power of the retailers. Increased concentration at the manufacturing-retailing intersection has the dual effect of creating more upstream buyer power in the manufacturers even as they face increased buyer power from retailers. The retailers in turn have increased retailing power as the number of competitors decline in the selling market. The end result of this process is that both further upstream producers and final consumers confront increased market power. Moreover, the retailers and their immediate suppliers have a shared interest in the joint exploitation of this power.

At the same time, achieving some scale in buying capacity can be important to achieving the ability to bargain effectively over price and quality. The Topco case, for example, included evidence that for a grocery chain to obtain house brands required a minimum of $250 million in total retail sales; hence a joint venture was essential to the Topco parties to have the necessary scale to obtain these products. Thus, it is important to recognize that some level of buyer consolidation, whether by merger or joint venture, can be helpful in creating the scale necessary for efficient buying. This, however, does not require that there be any bifurcation of the buyer power itself into distinct categories.

B. Incentives and Barriers to Exploiting Buyer Power

In evaluating the risk of anticompetitive consequences from a merger that increases market power on either the buying or selling side, it is important to consider the incentives of the merged firm to engage in such conduct, as well as the potential market forces that might deter such conduct. In selling markets, there is a rational basis to be skeptical about the gain to the seller from trying to raise price either through coordination or unilaterally because competitors could undercut that price. Hence, it is often said that there needs to be an alignment of interests and incentives for an oligopoly to engage in coordinated market exploitation and that unilateral efforts similarly require concern for both the barriers to new entry and to the potential for existing competitors to respond.

40. See Sexton & Zhang, supra note 10, at 59 (noting how the effects of combined upstream and downstream power result in serious allocative inefficiency).

41. See United States v. Topco, 405 U.S. 596, 613–14 n.1 (1968) (Burger, C.J., dissenting) (citing the trial record). But Topco, whose members had $2.2 billion in sales, was five to ten times larger than necessary to achieve those economies, suggesting that it may have served other goals as well. See Harry First & Peter Carstensen, Rambling Through Economic Theory: Topco’s Closer Look, in ANTITRUST STORIES 11 (Dan Crane, Eleanor Fox, eds., 2007) (discussing the possibility that Topco also facilitated naked market allocation among its members).
While in general the same considerations are relevant on the buying side, there are important differences with respect to incentives and opportunities. Exploiting buyer power results in lower input costs. This serves the interest of the firm in increasing profits regardless of its position in the downstream markets in which it sells its products. In addition, a buyer can deploy its power to cause its suppliers to refuse to deal with its competitors in either the input or output markets. Finally, a buyer in most contexts exercises discretion with respect to the identity of its supplier. This provides a further opportunity to affect upstream competition among suppliers. The implications for competition of these incentives are discussed in the next sub-section. What is important for present purposes is that there is a range of opportunities to exploit buyer power provided that the exploitation does not create undue risks of competitive responses that affect the firm.

Moreover, the incentives to exploit these opportunities are greater than those with respect to exploiting seller power because the potential deterrent effect of competitors is, in many circumstances, less likely to impose a significant constraint on powerful buyer(s). All buyers in any market have a shared interest in keeping prices for inputs down. Of course, like the selling side, if the demand for the input exceeds supply at a current price and supply is price elastic, then buyers generally have an incentive to raise prices. However, unlike a price cut on the selling side that seeks an immediate increase in sales, paying more for an input has no direct effect on the quantity of goods sold. By way of illustration, assume a buyers’ cartel has depressed the price of an input. A buyer wishing to compete with the cartel for that input must raise its price to the sellers. This raises the buyer’s costs of production and so makes its downstream products more costly. Such “cheating” by raising prices may also induce a larger input supply. Increased input purchases do not immediately increase either sales or profits of the cheater. The fact of an inherent lag allows for retaliation by the cartel against the cheating member by, for example, bidding up further the price of the input. This is most effective in markets where sales are made directly and not through public markets because the buyers can then employ selective bidding to drive up the costs of the deviant.

42. See, e.g., Klor’s, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 207 (1959) (finding in favor of a retailer who claimed that manufacturers had boycotted it in favor of a competing retailer); Toys “R” Us, 221 F.3d at 928 (finding retailer Toys “R” Us liable for coordinating an agreement among manufacturers not to deal its competitors).

43. If the downstream market is workably competitive, the seller will have a lower margin for its product and will be unable to raise its prices. In fact, by increasing its output, the only likely effect is to cause a reduction in price.

44. If the cartel can identify the specific suppliers to the deviant, it can bid up prices to those suppliers. The deviant must answer those prices if it wants to continue its supply.
buying markets are different in kind from selling markets because the buyer makes no direct profit from the purchase of inputs. They are necessary, but lagged components in the profit making products that result.

When the downstream market is also oligopolistic, there is a further incentive to keep prices of inputs down because this will increase the margins between input and output prices as well as potentially limit the supply of inputs available at the prevailing, depressed input market price. Reduced input availability in turn provides each oligopolist with increased opportunity to raise price in the downstream market with the knowledge that its competitors are unlikely to bid up input prices (lowering their margins) in order to reduce resale prices (still further lowering the total margin). Thus, there is both a general incentive to create and exploit buyer power and less capacity for any self-correction of such market distortions. This models works most obviously when the overall supply curve is upward sloping (i.e., higher prices are necessary to call forth increased production) but even if the supply curve is flat or even downward sloping, where there is information asymmetry, lower prices might discourage investment in expanding out, especially if no buyers are seeking increased supplies.

An important analogy is to the work on auctions that shows that bidder collusion is a substantial risk because of the strong incentives to participate in such conspiracies and exploit sellers. Moreover, auction cartels are rational despite revolving membership exactly because of the mutual advantages of such conduct. Further, potential bidders in an open auction do not have the same capacity to disrupt such cartels as occurs on the selling side of the market. All of this follows because the object of collusion is the bid price and not the price at which competitors will sell their products. These observations apply to many buying market contexts.

This difference in the incentives of buyers from sellers as well as the

Otherwise, it abandons those suppliers, only to find its new suppliers have similar opportunities. Since the cartel does not have to share the higher prices with other suppliers, it can focus on “raising its rivals’ costs” without undue risk of disrupting the prices of the bulk of its supplies. This strategy is analogous to involuntary base-point pricing used to discipline deviants from price-fixing cartels. See FTC v. Cement Inst., 333 U.S. 683 (1948) (sustaining an order by the FTC to prevent cement manufacturers from agreeing to price their goods on a basing point price system).

45. See, e.g., Sexton & Zhang, supra note 10 (observing this phenomenon in the context of powerful buyers of farm products).

46. The case of declining product costs, however, does generally result in weakening buying power and would counsel against significant concerns unless, as postulated above, there are significant information asymmetries or other market failures.

47. Marshall & Meurer, supra note 10 at 85–86.

48. See generally Asker, supra note 10 (stamp buyers’ cartel was durable despite changing membership).

indirect impact of buying on the ultimate profit of the business has two implications for merger analysis. First, coordinated efforts to keep input prices down can encompass more potential participants without serious risk of opportunistic defection. The Second Circuit remarked on this fact when it upheld a complaint charging a number of major employers in the oil and gas industry of conspiring to suppress wage competition among potential employees.\(^5^0\) Moreover, such efforts at price limitations would require very little coordination among buyers because the retention of low input prices is obviously in the self-interest of each buyer.\(^5^1\) Indeed, there is evidence that buyers can re-create tacit collusion after a period of disruption and that this can be done on a recurring basis.\(^5^2\) This demonstrates the potential strength of the “tit-for-tat” strategy found to be the long-run best strategy in the prisoners’ dilemma game.\(^5^3\)

Second, even in the absence of overt or even tacit coordination, a buyer with some monopsony or oligopsony power will have an obvious incentive to drive down input prices and increase the price spread between input and output markets. Moreover, its competitors in the downstream markets will have little incentive to disrupt such unilateral conduct in many situations. To be sure, raising rivals’ costs (i.e., entering the rival’s upstream market and raising the price of the input) is a plausible strategy, but the costs of bidding up a competitor’s input prices must be balanced against the potential for retaliation and the mutual harm, relative to other producers, in terms of costs for the products being sold.\(^5^4\)

Indeed, as discussed below, a better strategy, arguably unilateral, is to allocate input markets so that each major firm has its own set of suppliers as to which it can exercise buyer power. This strategy reduces input prices and avoids the kinds of competitive confrontations that could otherwise

\(^5^0\). Todd v. Exxon, 275 F.3d 191 (2d Cir. 2001).

\(^5^1\). The settlements with various Silicon Valley high tech firms that terminated a series of agreements not to raid each other’s employees by cold calling is illustrative of the kind of loose cartel arrangements that are possible. See, e.g., Final Judgment, United States v. Adobe, Case No.1:10-cv-01629 (D.D.C. 2010) (prohibiting Google, Apple, Adobe, Intel, Inuit and Pixar from agreeing not to compete for employees).


\(^5^4\). The logic arguing against such conduct explains, in part, the Supreme Court’s skeptical and restrictive standard for finding predatory buying. See e.g., Weyerhaeuser Co. v. Ross-Simmons Hardwood Co., 549 U.S. 312, 323–26 (2007) (explaining the similarities of predatory pricing and predatory bidding, noting the extreme difficulties of successfully executing such a scheme, and requiring a plaintiff to meet a substantial two-prong test to prevail under either theory).
occur if a rival wanted to compete for the same sources of inputs. It is a better long-term strategy for a buyer to have its own set of semi-captive suppliers than to be in a market where it must compete with other buyers. The incentive to pursue such a strategy is particularly strong when the cost of shipping the input, e.g., livestock, is significant, and many areas of the country are amenable to the production of the input. Furthermore, new entrants would in general find it more attractive to enter into markets where no buyer currently operates. While this requires the creation of new input suppliers, the entrant then has its own quasi-captive suppliers and does not risk a competitive confrontation with an established buyer. The end result of such confrontation is, after all, likely to be higher input prices and lower profit margins.

The incentives for buyers to disrupt an understanding that depresses prices or for a new entrant to challenge an existing buyer exploiting buyer power are limited, but in some circumstances the ability to exploit even a large position in some specific segment of the buying market is unlikely. For example, a dominant buyer will have little power if the input has multiple uses and shipping costs are low. Similarly, if supply is price elastic because producers can either increase or decrease output quickly or easily enter and exit the market, even a dominant buyer is unlikely to have significant power over such suppliers. This may be the case in some generic manufactured inputs. On the other hand, if longer term relational contracting is important, producers make significant sunk investment in relatively specialized equipment, or transportation is a significant cost factor and buyers are themselves geographically dispersed, then manufacturers of inputs will look a lot like many contemporary agricultural producers.55

Two central observations come from the foregoing analysis of incentives and barriers to using buyer power. First, buyers have strong incentives to exploit their power whenever possible. Second, the constraints that limit, in many circumstances, the capacity of sellers to use their potential power are not nearly as powerful or pervasive on the buying side.

C. The Possible Anticompetitive Uses of Buyer Power

There are a variety of ways that buyer power can be used to cause anticompetitive consequences for the market. Those will be discussed below. It merits acknowledgment, however, that the use of buyer power is not necessarily anticompetitive. The ability to discriminate in prices paid
for inputs over time or even at the same time, means that such a buyer more closely relates input cost to output prices. This can increase demand for the input since only the marginal input is paid the higher (or lower) marginal price. Second, given that in the real world price is only an approximation of cost, the capacity of a buyer to bargain in face-to-face transactions can move price closer to the seller’s costs and so make the entire market process work more efficiently. The fact that buyer power can facilitate markets as well as frustrate them will have a good deal of significance for any ultimate standard for judging the merits of mergers that create or increase buyer power.

1. Direct Price Fixing

Because of the incentives to exploit buyer power and limits on disincentives, firms with buyer power are likely to exploit that power without significant concern for immediate market reaction. The most basic way such power can be exploited, as implicitly assumed in the preceding discussion, is to lower prices for inputs. The conspiracies among blueberry buyers and tobacco buyers to hold down the prices paid for those crops are examples. Buyer cartels have existed in various employment markets. Several cases involving employees of high-tech companies, nurses, and doctors illustrate this as does the alleged conspiracy among oil and gas producers to limit wages for their technical employees.

Unilateral conduct can also produce lower input prices. A well-known example is Walmart, which has a long-standing history of compelling its suppliers to give it lower and lower prices. The end result is that a category of countervailing power.

56. For further elaboration on this topic, see Carstensen, Buyer Power, supra note 10.  
57. This is the strength of Kirkwood’s argument. See Kirkwood, supra note 39 for a category of countervailing power.  
58. See Deloach v. Philip Morris Cos., No. 1:00CV01235, 2003 WL 23094907 (M.D.N.C. Dec. 19, 2003) (determining whether attorney’s fees were reasonable in a tobacco buyer price fixing conspiracy that settled for $200 million); Nathan Assocs., Blueberries Price Fixing Class Action Finally Ends, 2 PROCEEDINGS: LITIGATION, REGULATORY, & OTHER NEWS 1 (May 13, 2005) (discussing a Maine state court case in which blueberry buyers were found to have engaged in a buyers cartel).  
60. See Todd v. Exxon, 275 F.3d 191 (2d Cir. 2001) (discussing an alleged conspiracy among fourteen integrated oil and petrochemical companies to set salaries at artificially low levels for technical employees).  
number of these suppliers were forced into bankruptcy.\textsuperscript{62} Walmart’s response was to move to another supplier.\textsuperscript{63} Its strategy, like other large buyers, is to become a leading customer of the supplier. This creates leverage to demand lower prices. More generally, empirical research has found that after horizontal mergers, the greatest impact is on the cost of inputs rather than the price of outputs.\textsuperscript{64}

In the standard economic models of monopsony the effect of lower prices is to reduce output even if supply is price inelastic. This assumes that there is an upward sloping cost curve for the producer. But, given those standard assumptions, a powerful buyer can use an “all or nothing” buying strategy to demand that the supplier provide the quantity that it would have provided at a competitive (i.e., higher) price if it wants to make any sale at all. This is also essentially the result of labor contracts as individual sellers have only their labor to sell. The price ought to approximate the average cost of producing the set quantity of goods. Given an increasing marginal cost, this means that the seller loses money on some part of the order but that loss is offset by the lower costs of the infra-marginal production. In substance, the buyer has appropriated the efficiency gains that would otherwise accrue to the producer and left it in a breakeven position.

To many economists focused on the short term, it may, nevertheless, appear that there is no adverse effect on allocative efficiency since output remains constant and the buyer has a lower cost for the input. On this view, control over the surplus only as transferred, but that is not regarded as affecting the short-run optimal production and distribution of society’s goods and services.

However, from another perspective, the result is inefficient because the cost of the marginal unit exceeds the price paid for it. Moreover, the producer surplus transferred to the buyer reflects the extent to which the specific producer has achieved lower costs of production than the market price. Thus, this part of the surplus, sometimes called Ricardian Rents, is the reward for efficient production. Subsequent discussion will consider the competitive policy implications of the use of all-or-nothing contracts. For present purposes it suffices to note that such a contract can occur only if the buyer or buyers have some power over the seller because otherwise the seller would offer a smaller output at the price offered.

Finally, one other consequence of imposing a price below the producer’s average cost on a producer selling to multiple buyers is that the


\textsuperscript{63} ROBERT A. SCHULTZ, \textit{CONTEMPORARY ISSUES IN ETHICS AND INFORMATION TECHNOLOGY} 80 (2006).

\textsuperscript{64} See generally Fee & Thomas, supra note 11.
seller may be compelled to raise its prices to its other customers. This is the waterbed effect. This will happen when the large buyer drives down the price to the seller below its average total cost for its overall production. Now it must recover, at least, that amount of money. Assuming a somewhat differentiated product, the seller can raise its price to its other customers in order to recover its losses. This is a sub-optimal result, we may assume, because otherwise those prices would have been higher already. But if at least short-run demand is relatively inelastic, it would be feasible to extract additional income from the other buyers, even if the longer run implications are negative in terms of lost sale or buyer failure. If those customers, in turn, compete with the favored buyer, they will be at a further cost disadvantage. Moreover, the favored buyer will have effectively made the other customers of its seller subsidize its own operation.

2. Manipulation of Public Market Prices

As a firm becomes a larger buyer in any specific product line for which there is a public market or a publicly reported price, it has an increased incentive to engage in manipulation of that price. This is true both when the majority of purchases are made in the public market and, even more, when the bulk of purchases are made outside the public market using the public price as a basis for the private transactional price. By manipulating the price downward the buyer gains the advantage of lower input costs. Of course, in public markets where most of the relevant commodity is traded, there are offsetting interests in upward manipulation. Hence, when the parties on both sides of such a market are substantial, there may well be a shared interest in neutrality. This interest is greater as the number of parties that may trade on both sides, i.e., as the number of both buyers and sellers, increases. Thus, market price manipulation is most likely to create problems when there are a few substantial traders consistently on one side of the transaction with a dispersed set of traders on the other side, and the market is a forum that sets a base price for a large number of off-exchange transactions.

For example, the prices for many agricultural commodities, when sold

---


66. There is an illustrative historical case study of this process. Standard Oil used its power as a buyer of rail services to require the railroads both to give it discounts and to pay it a percentage of the freight charges levied on its competitors. Thus, it both raised its rivals’ costs and got a piece of the overcharge. See Elizabeth Granitz & Benjamin Klein, Monopolization by “Raising Rivals’ Costs”: The Standard Oil Case, 39 J.L. & ECON. 1 (1996) (stating that Standard Oil collected a rebate from the railroads based on the quantity of oil shipped by its rivals).
under contract, rely on prices set in the residual public trading market. Thus, most hog contracts throughout the country use the prices from the northern Iowa–southern Minnesota market as the base for setting prices. Cheese and other dairy products rely on the prices from the Mercantile Exchange in Chicago for their base.\textsuperscript{67} Buyers (or sellers) of large quantities of such commodities have strong incentives to try to manipulate the “public” price in order to gain advantage in the great volume of goods that are traded off exchange. Such manipulative use of public market prices is an old story.\textsuperscript{68} The cheese litigation is an example of this problem.\textsuperscript{69}

A crucial question is how much of a market share makes it worthwhile for a buyer to seek to influence the public market price? How easy is it for buyers to coordinate their actions given the public character of such markets which may both facilitate transparency among the actors, but may also subject their actions to greater scrutiny? The incentive to manipulate market prices increases with the size of the buyer. Certainly, where the input is sold in a public market that handles only a small fraction of the overall sales but which is the source of prices for large numbers of off-exchange transactions, it should be incumbent upon those reviewing a merger that will change appreciably the market shares of such a buyer to evaluate carefully this risk.

Another related strategy involves forward contracts with an open price where the price is established at the time of delivery. Here, the incentive is to limit the delivery base price to ensure that the contract prices are kept lower. This is also why employers try to coordinate on wages. If the wage at the margin increases, then all wages will go up in many employment situations. The result is the employer faces a substantial increase in costs in order to achieve a marginal gain in production by adding the marginal employee. In commodities, this strategy results in lower cash market prices because of the effect on the contract supply for which the cash market sets the base price.

\textsuperscript{67} The public market price of such dairy products indirectly determines the price of milk used for such manufacturing purposes as well as affecting the price for fluid milk.


\textsuperscript{69} The basic analysis of this manipulation is found in Willard F. Mueller et al., \textit{Cheese Pricing: A Study of the National Cheese Exchange, DEP’T OF AGRIC. ECON., UNIV. OF WIS.-MADISON} (March 1996). For reported cases see \textit{Kraft Foods}, 232 F.3d at 979 (upholding a lawsuit by dairy farmers under California indirect purchaser law challenging market manipulation as antitrust violation) and \textit{Servais v. Kraft Foods, Inc.}, 631 N.W.2d 629 (Wis. Ct. App. 2001), \textit{aff’d} 643 N.W.2d 92 (Wis. 2002), \textit{cert. denied} 537 U.S. 1047 (2002) (rejecting a state antitrust challenge to this same conduct based on state law filed rate doctrine).
3. Discrimination Among Sellers

Another risk that a merger among competing input buyers creates is for direct price discrimination among sellers or other non-price exploitation. A monopsonist, like a monopolist, has a great deal of discretion with whom it will deal and on what terms. As discussed later, however, monopsony arises at lower market share and so is more pervasive. Monopsonistic discretion results in two kinds of problems. First, there can be, and is currently in livestock markets, substantial discrimination among producers with respect to the prices and other terms of trade they receive. In beef cattle, for example, favored sellers get the advantage of contractual arrangements that assure such producers of prices at or above the cash market. Disfavored sellers are compelled to sell in the cash market at whatever prices the buyers offer. Such cash sellers have not necessarily voluntarily chosen to rely on the cash market. Rather it is the capacity of the buyer to refuse to offer contracts combined with the lack of a market for the resale of such contracts that creates this effect. Reducing the number of competitors thus increases the potential for such discrimination on both price and access.

Second, monopoly buyers are often able to dictate terms and conditions that transfer risks to the producer without commensurate compensation. The poultry industry is almost entirely dominated by contracts of adhesion many of which have exploitative terms resulting in

70. For a more extended discussion of this topic, see Carstensen, Buyer Power, supra note 10.
71. See Pickett v. Tyson Fresh Meats, Inc., 315 F. Supp. 2d 1172 (M.D. Ala. 2004) aff’d, 420 F.3d 1272 (11th Cir. 2005) (finding by jury that cash market sellers had received substantially less for their cattle); see also, C. Robert Taylor, Proving Anti-Competitive Conduct in the U.S. Courtroom: Economic Issues with the Courts’ Opinions in Pickett v. Tyson Fresh Meats, Inc., 4 J. AGRIC. & FOOD INDUS. ORG. art. 9, 1–2 (2006).
72. One might contrast the unregulated nature of the market for livestock contracts with the carefully worked out procedures of the securities markets governing both the initial offering and subsequent resale of publicly traded securities. Public capital markets suffered from seller power to engage in arbitrary, manipulative and discriminatory conduct toward buyers. When that conduct was regulated by the 1933 Securities Act and the 1934 Securities Exchange Act public capital markets prospered and grew dramatically. Livestock markets present the reverse situation, buyer rather than seller power. In each case, part of the public policy response should be to regulate the uses of such power directly; but in addition, maintaining a competitive market structure on the side with power reduces the capacity to exploit that power, because the powerless side of the market will have more options.
uncompensated economic cost and risk falling on the producer.\footnote{75} By reducing input costs, the processors are more able to cover their own processing costs when facing a downstream market in which the subsequent buyer also has buyer power.

Such exploitation may be counter-productive in the longer run because it effectively consumes the capital invested in the production of the input. However, for the intermediate processor to survive in the face of powerful downstream customers that demand, on an all-or-nothing basis, lower prices, there may be a kind of economic compulsion. The downstream buyer, recognizing that its supplier has potential buyer power further upstream, impels the exploitation of the powerless input producers that have few, or usually no, choices among buyers. These producers are very vulnerable because of the combination of sunk costs and very great switching costs.\footnote{76} Hence, there is a kind of ratcheting effect in which the downstream pressures cause the processors to transfer more and more risk and cost to the producer while holding price of the input down.\footnote{77} Mergers that create increased buying power in the more distant, downstream market can, therefore, exacerbate these problems of upstream buyer power exploitation in both price and non-price terms.\footnote{78}

While some might regard such exploitative conduct as basically a matter of wealth transfer having no effect on market competition, this is not accurate. Allocative efficiency in a narrow sense is harmed whenever a producer must produce more than the optimal quantity, which is the result when the marginal price is less than the marginal cost. In regulated industry contexts, this kind of mismatch between cost and price has resulted in serious economic problems. Moreover, it is important to appreciate that the long-run incentives to participate in production markets

\footnote{75. See, e.g., \textit{Been v. O.K. Indus.}, 398 F. App’x 382 (10th Cir. 2010) (finding that chicken integrator varied supplies of chickens depending on market conditions which had the effect of forcing growers who had large fixed investments in their chicken raising facilities to absorb the risks resulting from varied output); \textit{Adams v. Pilgrim’s Pride Corp.}, No. 2:09-CV-397, 2011 WL 5330301 (E.D. Tex. Sept. 30, 2011) (finding that chicken processor engaged in various acts and practices that violated the Packers and Stockyards Act, 7 U.S.C. § 182 (2006), in an effort to reduce output and raise the prices paid for poultry).}

\footnote{76. Rogers & Sexton, \textit{supra} note 55, at 1143.}

\footnote{77. Solutions to important parts of the contract problem must come from other elements of agricultural market law. See, e.g., \textit{Been}, 398 F. App’x at 382. Antitrust is not well designed nor does it have the precedents to provide regulation over such conduct; but it can seek to reduce the risk of such conduct by its attention to the structure of markets.}

\footnote{78. Vertical integration by a monopsonist can also facilitate exploitation of latent buying power producing, under some conditions, lower input prices and higher consumer prices. See Catherine C. de Fontenay & Joshua S. Gans, \textit{Can Vertical Integration by a Monopsonist Harm Consumer Welfare?} (Melbourne Business School, University of Melbourne, Working Paper, 2004).}
are a function of the expected gains from the activity. In a dynamic analysis of incentives, it should be obvious that when others appropriate most of the wealth produced by an activity, the attractiveness of entry or innovation in that activity will be greatly reduced or eliminated. Thus, the greater appropriation of wealth created by farmers through their use of modern technology and efficient methods, the greater the disincentive for the next generation to enter farming. Moreover, as the markets for agricultural products fail, the fundamental public interest in retaining a viable agricultural sector is likely to call forth further subsidies and other market distortions intended to prop up producers. The dynamic interconnection of market practices with these longer run considerations provide another of the indirect effects of increased buyer power and consequent incentives to engage in conduct that has overall adverse implications for the competitive market even if it appears to be rational conduct for the firm.

While economic efficiency in both static and dynamic terms is an important outcome of well-crafted antitrust law, the fundamental legal policy goal has to be to facilitate the competitive process. Efficiency in all its senses is the usual and expected outcome of that process. But from a policy perspective, the interest has to be in creating and maintaining a workably competitive market process. From that process will come, over time, desirable economic results. This is not to argue that economic analyses are irrelevant to the creation and enforcement of antitrust rules. It is, however, to state as strongly as possible that economic analysis must serve the process-oriented goals of public policy and not itself be the arbiter of what is or is not competitively undesirable.


80. The recent economic crisis has led a number of employers to demand major concessions from their specialized labor forces. The threats involve moving production to another location within the country or outside it. Employees are in general vulnerable to coercive demands by employers in periods of high unemployment. But skilled and specialized labor face even more serious losses because they are less likely to find comparable employment and are therefore more likely to give up wages to avoid unemployment. Examples include companies with significant profits that nonetheless engage in these practices. See, e.g., Harley-Davidson Milwaukee Unions Accept Concession Laden Labor Contract, FOX 43 WPMT (Sept. 13, 2010, 6:05 PM), http://www.fox43.com/news/wpmt-harley-davidson-contract-vote,0,2259707.story (Harley-Davidson compelled its workers to accept major pay cuts); see also Harley-Davidson’s Fiscal Stimulus, PORTFOLIO.COM (Oct. 19, 2010, 11:42 AM), http://www.portfolio.com/views/blogs/daily-brief/2010/10/19/harley-davidson-profits-soar-as-finance-business-takes-off/ (Harley-Davidson subsequently reported record profits).
4. Geographic Buyer Discrimination and Spheres of Influence

Two other uses of buyer power can create serious competitive concerns. Each involves the use of buyer power to have a direct impact on the prices paid to sellers. First, buyers in moderately oligopsonistic markets often have the incentive and capacity to engage in geographic price discrimination among their suppliers. That is, each buyer focuses on buying from a specific geographic area. The incentives are obvious and the capacity arises whenever some set of sellers has few options. This can happen if the seller’s modest scale makes it impossible to search a larger market area. Other limits on the options available to sellers can be inherent, the result of buyer-imposed allocation of sellers precluding competing bids, or a consequence of significant switching costs. Hence, just as the merger guidelines recognize in selling markets that the capacity to separate out groups of buyers and charge them a higher price reflects a relevant market for purposes of analyzing competitive effects, so too on the buying side, the analysis has to consider whether the same potential to discriminate among classes of sellers might exist.

Second, buyers’ markets have greater potential to develop anticompetitive, linked oligopolies than is likely in seller markets. Because of the shared interest in retaining the lowest input prices possible, buyers will find it attractive to avoid competition for inputs in so far as possible. Moreover, the risk of retaliation across markets when firms compete in the purchase of multiple inputs at multiple locations provides a context in which tacit understandings become more enforceable. Each firm will have an incentive to develop its own sources of supply and not engage in vigorous competition with rival buyers. In agricultural markets such as poultry, processors tend to avoid building facilities that compete very directly.

82. See Carstensen, Horizontal Merger Guidelines, supra note 12, at 6–7 (arguing that regulators must evaluate where sellers can sell).
84. It was the risk of predatory buying (raising cattle prices) that motivated Monfort’s effort to block the merger creating Cargill’s massive, multi-market beef packing operation. Cargill, 479 U.S. at 104 (denying standing because plaintiff would not suffer an antitrust injury as result of higher prices to input suppliers). Having lost the case, Monfort sold out to another multi-regional packer. Company News: Conagra Deal for Monfort, N.Y. TIMES, Mar. 6, 1987, at D4.
85. JAMES M. MACDONALD, U.S. DEP’T OF AGRIC., THE ECONOMIC ORGANIZATION OF
competes at all, only at the geographic margins of its supply territory. One form this interaction can take is for a buyer to buy and then close plants that are “too competitive” with those of other buyers. By doing so, the new owner reduces competitive pressure on its rival within the rival’s sphere of influence and might expect that the rival would reciprocate by focusing its buying interests away from other areas of potential overlap. Again a central motivation for this ad hoc creation of spheres of influence is that each party can expect to gain to the extent that its buyer power is enhanced. Thus, unlike allocating selling markets, the buying side allocations have greater potential for self-reinforcement.

5. Exclusionary Uses of Buyer Power

Another well documented use of buyer power is to impose constraints on the seller that cause other buyers to have higher prices for or even no access to an important input. In a drug case, the buyer got all the major suppliers of the key input to agree to exclusive dealing contracts. The result was that competitors were fenced out of the market. Other examples include toy and appliance markets. Closely related is the use of buyer power to create cartels to the advantage of the buyer itself or its agents.

D. The Indirect Impact of Buyer Power (Upstream Market Impacts)

In standard merger analysis concerning seller power, the impact on the immediate downstream market is the primary focus. This is sensible because if the merger will result in higher prices to that market then the

---


88. Klor’s, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959); Toys “R” Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000).

89. See, e.g., Interstate Circuit, Inc. v. United States, 306 U.S. 208, 208 (1939) (finding that buyer used its power to induce suppliers to engage in horizontal price fixing agreement); see also Toys “R” Us, 221 F.3d at 932 (alternative holding that toy buyer induced toy producers to enter into horizontal agreement to refuse to deal with buyer’s key competitors). With respect to agent use of buyer power, the best example is in the insurance industry where major brokers used their ability to control the buying decisions of major insureds to induce insurers to engage in a cartel to raise prices and split the resulting cartel profits with the agents. See, e.g., In re Ins. Brokerage Antitrust Litig., 618 F.3d 300 (3d Cir. 2010). See generally Carstensen, Buyer Cartels, supra note 10 (explaining the differences between buyer cartels and buying groups).
effects further downstream can be predicted. While in general the same can be said of buyer power, there is more ambiguity as to the explanation for lower input prices that might result from a merger. On their face, such “cost savings” appear to promise an efficiency gain. But the capacity of the upstream supplier to provide further price discounts to a consolidated buyer may reflect only the ability of that supplier, given its increased volume of purchases resulting from the downstream merger, to exert its own increased monopsony power against its upstream input providers. Thus, the adverse effect of a consolidation in grocery retailing or the manufacture of food products may primarily impact farmers and ranchers who see the price for the basic ingredients driven down. These impacts may present themselves in the form of lower prices in public markets and contracts for supplies. This price reduction is itself a result of the fact that the downstream buyer can induce its supplier to reduce price because of the creditable threat of moving the business to another supplier. Consolidation among such downstream buyers creates more leverage over their suppliers and so has the capacity to create a new downward pressure on input prices. Further, as the downstream buyer consolidates its purchases, it endows its upstream supplier with greater buyer power derivatively.

Another example of this phenomenon is the manipulation of cheese prices. The direct goal of such manipulation was to lower the price of cheese for the advantage of major cheese buyers. By selling cheese on the old Green Bay cheese exchange, the major buyer of cheese could manipulate the price downward and retard its increase in many situations. This allowed it to buy cheese by contract based on the exchange price at lower rates than would otherwise exist. Milk converts to cheese on a relatively fixed ratio, and so when the price of their product declined, cheese makers reduced the price paid for milk. While the cheese makers may have absorbed a small amount of the price reduction, the great bulk of this buyer power was passed on to the dairy farmers. Obviously, further

---

90. E.g., Fee & Thomas, supra note 11 (finding reduced input costs as clear evidence of increased efficiency, but to the extent that the cost savings are the result of buyer power exploitation of upstream suppliers, that characterization may be incorrect); see text accompanying notes 120–25. See also 2010 GUIDELINES, supra note 13, at § 12 (excluding wealth transfers from inclusion as a part of an efficiency defense).

91. See Einer Elhauge, ANALYSIS OF PROPOSED NESTLE-RALSTON PURINA MERGER (unpublished manuscript) (on file with author) (noting that processors, especially meat packers, regularly assert that their buying practices are driven by the demands of powerful downstream customers). See generally UNITED FOOD AND COMMERCIAL WORKERS INT’L UNION, ENDING WALMART’S RURAL STRANGLEHOLD (2010) (offering evidence of the ways in which Walmart, the nation’s largest food retailer, exploits its buyer power).

92. Mueller et al., supra note 69.

93. Dairy farms are, at least in the short run, very price inelastic. A herd of cows, every day, seven days a week, produces a relatively set quantity of milk, depending on the season of the year. Until the herd is liquidated, the dairy farmer has to sell that output at whatever
concentration on the cheese buying side of the market would increase the incentive and capacity to engage in such manipulation further threatening the income of dairy farmers.

The point is that the impact of anticompetitive conduct on the buyer side of the market is often at one or two stages prior to the party bearing the immediate impact of the lower price. A full analysis of the effects of a merger that increases buying power needs to trace out the potential for such indirect impacts if it is to provide a comprehensive evaluation of the potential competitive harms from a transaction.

Such pressures also need to be carefully distinguished from transformations in the technology of production or the methods of transaction that generate both real cost savings and may result in significant changes in demand for inputs. As discussed below, to obtain overall static allocative efficiency gains from mergers creating both some productive efficiency and increased buyer power, the productive efficiency gains must outweigh the losses. But from a dynamic perspective, it is essential to consider the impact of wealth transfers as well. Hence, in most cases, the combined static and dynamic adverse effects on immediate or more distant parts of the supply chain will not be offset by any modest gain to productive efficiency.

E. Summary about Competitive Effects of Buyer Power

The foregoing discussion illustrates the myriad ways that buyer power, directly and indirectly, can affect the competitive process adversely. One might argue that the range of these impacts substantially exceeds the range of potential adverse effects that seller power can cause. On the other hand, a critic of current enforcement criteria might respond that the analysis of buyer power’s effects might in fact suggest the poverty of current conceptions of the harms that seller power can cause. This analysis need not resolve that issue because, regardless of the implications for seller power, the fact is that buyer power can cause a wide range of adverse competitive effects that go beyond the limited set recognized in seller-oriented analyses.

III. FITTING THE COMPETITIVE EFFECTS OF BUYER POWER TO MERGER ANALYSIS

Before considering the structural thresholds that should trigger more focused inquiry concerning a merger or acquisition involving buyer power issues, it will be helpful to organize the competitive effects discussed in

price the market provides.
Part II into the categories used in the merger guidelines to determine whether a merger “may . . . substantially . . . lessen competition, or . . . tend to create a monopoly . . . .” As with seller-side mergers, buyer-side mergers involving significant change in the structure of the buying side can result in both unilateral and coordinated anticompetitive effects.

A. Coordinated Effects

As suggested previously, the nature of buying inputs in contrast to selling outputs creates a different set of incentives with respect to cheating on a tacit collusion to restrict price or allocate suppliers. Basically, the immediate effect of “cheating” is to raise input costs or even create a trade war if one buyer “poaches” on the sources of supply tacitly assigned to another buyer. Thus, the gains to the deviant can occur only after the input is converted to an output (often requiring that other costly inputs also be acquired), but the deviation is more likely to be immediately apparent to rivals. Hence, the lag in obtaining gains makes deviation more risky.

These inherent lags in the system of production differentiate buyer collusion from seller collusion in terms of retaliation. Hence, buyer collusion can be more effective because of the lags. The deviant’s input prices can be driven up even more by selection bidding, and its downstream prices can be undermined by similarly selective selling. This is possible because most goods are not sold in anonymous open markets, but rather involve direct transactions. Hence, those firms wishing to enforce a tacit understanding can target the specific suppliers of the deviant. This is akin to the “involuntary baseline” pricing system used to enforce delivered pricing schemes.

Various scholarly studies provide further support for this conclusion. Marshall and Meurer present a model of bidding auctions in which it is not possible to disrupt the conspiracy. Asker’s study of a postal buyers’ cartel found that it was possible to sustain the cartel even when there was turnover among the participants. Finally, Hunnicutt and others found that there was very substantial stability in the identity of the buyer from cattle feedlots. This is consistent with a form of tacit allocation among cattle buyers.

Thus, the probability of tacit collusion is significant whenever there are relatively few buyers. This is especially likely when there are

98. Hunnicutt et al., supra note 81.
99. Cai et al., supra note 52.
numerous sellers, which makes it more feasible to allocate suppliers and make each highly dependent on its continued relationship with the specific buyer. In this way, the coordinated effect of allocation is a prelude to the use of unilateral power to further exploit the upstream supplier. Moreover, the coordination can take the form of standardizing input elements or even contract terms in ways that increase the relative gain to the coordinating buyers. Again because of the costs of deviating from such collective conduct, the risks of harm to competition are greater than they would be in seller side contexts and can occur even with moderately large numbers of buyers relative to what standard theory predicts on the selling side.

The fundamental implication is that where the merged buyer reduces the number of competing buyers in any relevant input market to a modest number (but one substantially larger than appears used in seller mergers) there is a cognizable risk of coordinated conduct. Only if the sellers can convert their productive capacity to other product lines easily and with a reasonable prospect of selling the resulting output is there likely to be a significant constraint on the incentive of such buyers to coordinate their buying actions.

B. Unilateral Effects

A central element of efficient product markets is the capacity of buyers to pay different prices for inputs as their demand increases or decreases. The alternative in the context of rising prices is that all prior inputs must be re-priced to the new, higher price. Hence, the incremental unit drives up the cost of all units. This is a particularly challenging issue in labor markets where uniform pay levels are more common. But for other inputs, purchased in a sequential way, the price will vary over time. This smooths out demand and encourages the marginal purchase.

But this same capacity to pay different prices is central to the unilateral risks that merged buyers will present to the competitive process. In consequence the analysis of potential unilateral effects is complex and contingent on the options available to both buyers and sellers. The greater the price elasticity of supply, the less likely are the effects to be significantly adverse. Thus, the focus is on the ability of sellers to adjust output in the face of lower prices.

100. This fact may explain why price fixing and other coordination are recurring issues in labor markets as illustrated in Todd v. Exxon, 275 F.3d 191 (2d Cir. 2001).

101. Another unilateral effect analysis would focus on the potential impact on suppliers if the merging firms were leading buyers of different inputs where each type of input was the closest alternative product line for suppliers to offer in the event that their primary line was subject to monopsony or oligopsony effects. In such a case, by having substantial stakes in the two input lines, the merged firm would be more able to impose its will on its
One strategy that can limit the flexibility of sellers is the use of an all-or-nothing contract. There, the buyer has appropriated the efficiency gains of the producer. Moreover, there are adverse implications for the competitive process because marginal cost of the last unit sold exceeds the marginal price paid for it. From the perspective of the competitive process, therefore, the more appropriate analysis is that this transfer has a long run negative effect since it denies to the efficient producer the opportunity to receive the reward for its effort. Ultimately, this will discourage investment and innovation in a market subject to such appropriation. Thus, when sellers are vulnerable to all-or-nothing contracts (e.g., when the buyer tends to take most or all of a seller’s output as in employment contracts or sales from cattle feed lots), the potential for such adverse effects from mergers creating an enhanced capacity either to impose such contracts or to limit the options of sellers to move among potential buyers demands careful assessment of the degree of risk created. In the long run, it is likely that the exploited producers will gradually exit the market, as farmers, for example, are doing. At some point, either government subsidies or imports from distant sources will become necessary.

Another unilateral effect that is a function of mergers creating buyer power is an upstream impact stemming from the consolidation of buying resulting from the merger. The consolidated firm can centralize its buying, reducing the number of suppliers. In doing so, it can generate substantial competition among its potential suppliers. The winner is now a much more significant buyer of upstream inputs to its product. As a result it now has more buyer power and an obvious incentive to exploit that power. It can do so by driving down input prices through exercise of buyer power in those input markets where it has sufficient dominance to impose its will while making up the lost volume from purchases in other more competitive markets as described above. Alternatively, it can employ all-or-nothing contracts to retain the same volume of inputs, but reducing the total price suppliers given the combined domination of the purchases of the next best alternative output for the producers.


103. One of the often overlooked points is that buyers can exploit producers where some producers have higher and some have lower cost even if that results in shrinking the supply substantially so long as there are other sources from which the growing deficit can be filled. This appears to be what is happening in agriculture with increased imports of dairy and meat products to fill the gaps created by the exit from domestic production. Even if the average cost of the imports exceeds the price that would have been paid for similar domestic production, if the gain from exploitation exceeds the extra costs, it will be rational for the buyer to engage in such exploitation.
paid per unit from what would have been required in a competitive market.104

A buyer may as a result of a merger be able, unilaterally, to use its power, as Broadway-Hale and Toys “R” Us did, to demand other kinds of exclusionary favors from its suppliers.105 In these situations, price may be less important to the buyer than is the protection of its position in the retail market from competition. Hence, the buyer uses its power to demand either coordinated or unilateral refusals to deal with its competitors as the price of its continued patronage. From the perspective of a rational seller, there is a manifest trade-off between the gains from a continued course of dealing with the large volume buyer and the potential to develop other markets. The most likely result of that balancing is to support the incumbent buyer’s demands to exclude new or marginal competitors.

Finally, increased buying power can result in the “waterbed” effect.106 The buyer forces down the prices it has to pay for inputs below the long run average cost of the seller. The volume of sales is such that the seller cannot effectively transfer this volume of sales to other outlets. Hence, it must either reduce its overall operating expenses or increase its prices to its other customers in order to achieve a revenue stream that is equal to its long run costs. Such an impact can occur whether or not the upstream supplier has the ability to exploit its own suppliers. The point is that the buyer is getting an advantage that is not cost-justified.

The waterbed case is distinguishable from the context in which the supplier has been charging supra-competitive prices and now is charging a more competitive, but above average total cost, price to a large buyer. Here the seller continues to exploit its power over its other customers by raising prices to restore its overall margin of profit. In such a case, the implications are very conflicted. The merger has increased exploitation of other customers of the supplier, but has at the same time reduced the prices paid by the merged entity. If the downstream market is workably competitive, it is possible that the price increases will not hold because the upstream supplier will lose such a volume of sales as a result of raising the prices of the competitors of the buyer. On the other hand, the merged buyer may see this as another benefit of the merger because it indirectly raises rivals’ costs.

104. An illustration of this kind of secondary effect is the history of cheese price manipulation, where the immediate effect was to drive down the price of cheese paid to cheese makers, but dairy farmers bore the ultimate burden as cheese companies reduced the price they paid for milk. See generally Mueller et al., supra note 69.
106. See supra notes 65–66 and accompanying text (explaining the “waterbed” effect).
C. A Framework for Analysis of the Likely Adverse Competitive Effects of Increased Buyer Power

One test for whether a merger may create undue buyer power is a close and critical analysis of the expectations of the merged enterprise with respect to cost savings on the buying side. If there are no readily apparent transactional gains or economies of scale, then the most likely explanation is that the merged enterprise expects to use buyer power to force down input prices directly. In any such case, the analysis then needs to look critically at the basis on which the sellers can reduce price. The recent Bhattacharyya and Nain article, for example, reports that where sellers are concentrated, buyers are able to force down prices without any evidence of reduced input costs for the sellers.\textsuperscript{107} Thus, the implication is that in such contexts the increased buyer power resulted in countervailing bargaining power that moved prices closer to a competitive level without significant upstream impacts. But within that sample there was a good deal of heterogeneity reflected in the relatively low power of the equations to explain observed variances.\textsuperscript{108} Hence, further transaction specific inquiry is relevant in such cases to ascertain whether the change in downstream buyer power will affect the buyer power of the upstream supplier with respect to its input suppliers. It is in this situation that the indirect competitive effects of a merger take on greater significance in examining the merits of the transaction. It is conceivable that the expected gains of the downstream buyer could come largely or exclusively from creating more buyer power in its suppliers and compelling them to exploit further their upstream input sources.

D. Summary on Competitive Effects

Central to the analysis of the competitive impact of buyer power is the capacity of the buyer to be the decision-maker about purchases. This insight demands that those evaluating the likely effects of mergers where the resulting firm will be a substantial buyer of any type of input must consider the risks associated with such discretionary actions. Both the

\textsuperscript{107} Bhattacharyya & Nain, supra note 11, at 108.
\textsuperscript{108} Id. at 108–10 tbls. 5 & 6 (stating that the \(R^2\) for the overall equations ranged from .19 to .45 which indicates that much of the observed variance was unexplained). Moreover, when examined for other characteristics affecting input prices, there were statistically significant negative changes in wages for workers in the supply industry in six of the ten variations in the equations. Wage reduction is a classic example of upstream input suppliers being forced to accept lower prices as a result of indirect buyer power. This is not the only explanation for reduced wages as it is also possible that some cartel or oligopoly profits had been distributed to employees and the buyer pressure created the need to reduce such “excessive” wages.
probability of coordinated effects and the potential for unilateral effects having significant capacity to distort the efficient and dynamic operation of upstream input markets exist whenever the merger will result in even a moderate increase in concentration in buying markets. Such effects are not, of course, necessarily probable. Other market characteristics, as discussed earlier, may modify or even make impractical the use of buyer power to achieve any anticompetitive effect. But, the central point is that such effects require careful examination. But such an examination is not recognized or defined in the current Guidelines.

One important practical implication of buyer side mergers is that sellers may be more reluctant to complain, because of the risks of adverse reactions from the parties to the merger. If the merger is consummated despite a complaint, the merged firm may well refuse to buy at all or impose onerous conditions on its purchases. Even if the merger is stopped, the two firms may still refuse to deal or deal on harsher terms with a complainant. The central difference is that in the case where buyer power is a concern, the buyer retains, post-merger, the discretion to buy or not to buy. This is different from the seller side merger where the customer is the party with discretion in any situation short of monopoly. This fact about future relationships means that evaluation should rest more on presumptions arising from market position and other objective criteria, and less on whether there are complaints from sellers of inputs.

IV. MARKET DEFINITION

Market definition is a useful first step in assessing the probability that undue buyer power might result from a merger of two firms that are competitors in some input market. By identifying the likely product and geographic dimensions of the market it is possible to estimate the increase in concentration of buying that will result. Indeed, as the prior analysis has shown, there is a more consistent inference of risks of anticompetitive consequences when buyer power is examined than current thinking would suggest in the case of increased concentration of seller power.

The new Guidelines correctly focus market definition on the buying side of the merged firm. Indeed, competing buyers might not compete at all in the downstream selling markets, either because they use the inputs in different outputs or because they sell their outputs in different geographic markets. Alternatively, the merged entities’ outputs may be sold in

109. As an anecdotal matter, I can report that I have had sellers tell me that they would not discuss their concerns with antitrust enforcers because of fear of such retaliation.

110. See 2010 GUIDELINES, supra note 13 at § 12 (“In defining relevant markets, the Agencies focus on the alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist.”)
sufficiently competitive downstream markets that post-merger there is no concern on the selling side. This, however, does not affect their interest or potential ability to exercise buyer power. Rather, the focus has to be on the role of merging firms as buyers; if they buy a significant quantity of the same or related inputs, then in combination they are likely to have at least some buyer power. Hence, both the product and geographic dimensions of the buying market must be investigated from the perspective of where a seller might look for alternative buyers.

In defining selling markets, merger analysis has often relied on a test that focuses on whether a firm controlling a set of products in a geographic market could raise prices by a small but significant and non-transitory amount. This is the SSNIP test, but it needs to be adapted to the buying side process. For example, if a buyer can obtain some necessary part of its input from some out-of-market source and that source has relatively good price elasticity of production, then it is feasible for the buyer to exercise power over a set of sellers, even if the sellers would reduce output substantially. This is the kind of response that would, on the selling side, suggest that some larger market must exist. But on the buying side, even such responses might still indicate buyer power, as the buyer need only consider the trade-off of the input cost savings from reducing prices, even if it results in a much lower volume in the captive market and replacing lost input by reference to the price of the other source. In short, the buying side market must be carefully defined in terms of the economic realities facing producers. The question then becomes what product and geographic dimensions must exist for a buyer to have market power over the relevant group of sellers?

A. Product Market Definition

When defining buyer product markets, the crucial question ought to be what alternatives are open to the producer of the inputs used by the merging buyers. In some cases, the producers may have a great deal of flexibility to adapt their production to yield different products useful as inputs by various other buyers. If, in addition, entry by these producers into those alternative outlet markets is relatively easy, then either such related markets should be included in the basic product market or other appropriate account of such seller flexibility should be taken. But it is likely often to be the case that the producer is relatively specialized in a line or lines of products and shifting production will not be feasible.

The potential inflexibility of output is illustrated in agriculture where a chicken operation cannot easily convert to turkeys and would be totally useless for dairy cattle or hogs. In contrast, a crop farmer can switch from soybeans to corn or related crops within a season based on predictions of
relative prices and costs. However, when there is consolidation among grain buyers, such that the same small set of buyers are taking the soybeans, corn, wheat, and sorghum, the flexibility to switch among crops is of little relevance.

Milk illustrates another product market definition concern. Milk has a number of uses including cheese, ice cream, butter, and fluid milk. By virtue of government regulation, fluid milk use earns a higher price. Hence, dairy farmers want to share in that price. In such a context, the relevant product market is limited to milk used for fluid sales. This is an example of discrimination in a product market definition. Here, the differentiation is a result of government policies. In other circumstances, institutional or market characteristics may well cause similar segmentation of apparently homogenous product markets.

B. Geographic Market Definition

As in the case of product market definition, the challenge in geographic market definition is to understand where sellers can realistically look for alternative outlets for their goods. In refusing to challenge a merger between the only two major hog processors in the Southeast, the DOJ claimed that there was no risk to hog raisers because mature hogs could be shipped over 400 miles to a slaughter facility in central Tennessee. Those knowledgeable of the business regarded this claim as highly questionable. In the long run, the risks of weight loss and death, as well as the high cost of long distance shipping of live animals, made this an impractical option for large-scale hog producers in the region.

111. The pricing of milk is a complex and convoluted process. See generally BOB CROPP & ED JESSE, BASIC MILK PRICING CONCEPTS FOR DAIRY FARMERS (2008) (discussing pricing structures for sale and production of milk). For present purposes it suffices that the farmer can share in the premium for fluid use only if the farmer’s milk is pooled in some way that makes it available for use as fluid milk. Hence, those with access to fluid processing plants have significant capacity to control the milk supplies. See generally In re Se. Milk Antitrust Litig., 555 F. Supp. 2d 934 (E.D. Tenn. 2008) (upholding plaintiff milk farmers’ antitrust claims against a 12(b)(6) motion by milk buyer defendants).


113. I interviewed a number of economists who were experts on the hog and pork markets. While some did not see serious competitive issues with respect to the Midwest (the other region where the two firms competed as buyers), there was substantial consensus that hog producers in the Southeast would be adversely affected. Because of its traditional secrecy, the DOJ did not reveal the basis on which it reached its conclusion that hogs could be shipped long distances. Moreover, a contemporaneous economic study of the hog-pork industry found that prior to the merger, nationally, there was clear evidence of buyer power. See RTI INT’L, VOL. 4: HOG AND PORK INDUSTRIES FINAL REPORT, GIPSA LIVESTOCK AND
Logistical considerations may also make it important that other inputs be produced close to the place of consumption. Recent experience with weather and other disruptions has reinforced recognition of the risks associated with long-distance supply chains in many situations. On the other hand, some products, as the recent problems with melamine from China illustrate, can move vast distances. In general, the primary characteristic of products having a global market is that they are, relative to their value, of low weight and consumed in relatively low volume. Hence, their transportation in a global market is feasible.

Government inspection and certification requirements can introduce another level of complication in defining geographic markets. For example, genetically modified crops and animals cannot be sold in some countries, and even when saleable, they often must be registered and approved for sale in the consuming country. The cost, burden, and delay in such registration may effectively limit the market in which inputs can be sold even if there are no physical barriers.

C. Conclusions about Market Definition

In sum, buyer side market definition is roughly “analogous” to that on the seller side. But both the product and geographic dimensions can be and often are quite different from the downstream selling side markets in which the parties are involved. As a result, the evaluation of the merger must focus on input rather than output markets, but even more importantly, must focus on where sellers can sell and not where buyers might buy. Finally, the SSNIP test needs to be modified to take account of input substitution by buyers. Nothing less will permit objectively reliable evaluation of the merits of mergers affecting buying power.

V. LEVELS OF PRESUMPTIVE HARM

Every buyer of any size has some power, especially in a face-to-face market context, to bargain over prices and other conditions with its input suppliers. Moreover, increased size at some modest levels may well result in a buyer more able to bargain both because the increased total cost of the input now makes bargaining more rational in terms of expected gains and because, as a larger entity, it may well pay for the buyer to invest in better information about available sources and prices of inputs. Hence, the question for consideration is when the increased buyer power is so concentrated that it “may substantially” lessen competition.

Meat Marketing Study (2007) (describing various alternative marketing arrangements and uses). Thus, the merger increased concentration both regionally and nationally, and so would exacerbate the problems of buyer power.
The essential first step is to realize that this capacity to choose among potential suppliers can create a great deal of power even when the buyer’s market share is modest by seller side measures. Indeed, the reason that fairly high market shares are used in assessing when seller combinations create risks of competitive harm is because buyers have the discretion to switch suppliers and thus destabilize the potential market power effects of a selling side merger.

In the UK, single firm market shares of less than 10% of all of some class of groceries purchased in the country have produced significant unilateral buyer power effects. In Toys “R” Us, the market share that allowed the firm to impose anticompetitive restraints on its suppliers was about 20% of the national market for toys. While no market share is reported in the Klor’s case, it is unlikely that Broadway-Hale dominated the retail appliance market in California or nationally, but it still had the power to coerce its suppliers into agreeing to cut off Klor’s. These cases suggest that unilateral effects are possible from mergers resulting in control of 10% to 20% of the buying market.

Economies and diseconomies in production affect the unilateral market power of buyers. A plausible reason for the power of a 10% buyer in the retail grocery business is that a threatened reduction in volume of 10% could cause a firm significant diseconomies of scale, especially if it will be difficult to find an alternative outlet for that quantity of production. If a supplier serves a group of buyers where none takes a

114. A buyer able to affect 10% or more of producer’s output assuming any kind of economies of scale has the potential for considerable leverage over that seller. Another relevant condition is whether there is another outlet for this production that is easily accessible. The Blair-Harrison Index of Buyer Power predicts that under some conditions, i.e., elasticity of supply and fringe demand equal to one, such a firm can impose a 5% decrease on its suppliers prices. BLAIR & HARRISON, MONOPSONY IN LAW AND ECONOMICS, supra note 9, at 59. Manifestly, in most industrial situations, a change in output for a producer in the 10% or greater range is likely to result in significant short-term impact at the very least. With longer-term impact uncertain, under such circumstances every major buyer has significant leverage over such a producer. When the buyer takes a much higher percentage of a specific sellers output, the dislocation resulting from the lost sales opportunity will be even greater assuming the seller has relatively few alternative outlets readily available.

115. See Paul W. Dobson, Exploiting Buyer Power: Lessons from the British Grocery Trade, 72 ANTITRUST L. J. 529, 535 (2005) (discussing the typical British consumer’s loyalty towards their favorite retailer). One might question whether there is any reason to think that smaller markets in terms of total sales volume may result in buyer power at smaller market shares than would be the case in markets with larger total volumes. This is the kind of question that ought to be under consideration in rethinking the merger guidelines, but to date has received no noticeable attention.

116. Toys “R” Us, Inc. v. FTC, 221 F.3d 930 (7th Cir. 2000).


118. The potential lack of alternative outlets either in the market as a whole or in a regional segment important to achieving efficient use of national advertising makes retail
very large volume, the total volume of purchases can allow the supplier to achieve scale economies. However if two of those buyers combine so that after their combination their combined purchases would significantly affect the volume of sales for the producer, then the producer will become dependent on the merged buyer’s continued patronage. This in turn can confer on such a buyer a great deal of buyer power with respect to that seller. The extent of that power will be a function of the diseconomies that might result from reduction in output, as well as the potential that the producer can find other outlets for its products. This is the converse of the committed and uncommitted entrant analysis, but now it must be framed in terms of committed and uncommitted buyers. This raises a host of questions specific to the likely impact of the merged firm as a larger volume buyer of an input.

A second context where buyer power may arise at relatively low market shares occurs when the buyer takes all or most of the output of the seller and the merger eliminates the next best alternative outlet for such a seller. Switching totally from one buyer to another involves greater transition costs and risks. If the switch does not work out, the seller may now be without any market for its output. Cattle feedlots are a potential example. No one feedlot is essential to the packer’s volume, but each feedlot needs to make sales regularly. Hence, the ability of a regular customer to refuse to deal or impose lower prices is quite substantial as the number of alternative outlets decline. Thus, in such contexts, mergers among such buyers will be likely to have significant effect on the power of all buyers in the market because of the reduction in alternative outlets.

The implication of these studies and examples is that mergers that create buyer control over 15% to 20% of an input market merit a focused review with respect to potential unilateral effects. As Blair and Harrison have shown, the relative levels of elasticity on both the supply and demand side very much affect the level of power that will result. Supply side buyer power analysis an especially important focal point.

119. This effect is most likely in contexts such as grocery retailing where the seller already is selling to other major outlets. Hence, the lost sales cannot easily or readily be recouped by adding other outlets.

120. See Carstensen, Horizontal Merger Guidelines, supra note 12, at 15–16, 27–29 (discussing “rapid entrants” and entry conditions).

121. This is in part the explanation for why the Antitrust Division challenged mergers among health insurers where the market shares were below the safe harbor levels that the Division’s own guidelines set for health care buying groups. See Mark J. Botti, Observations on and from the Antitrust Division’s Buyer-Side Cases: How Can “Lower” Prices Violate the Antitrust Laws? (2007) (explaining the Antitrust Division’s enforcement actions regarding competition between healthcare providers).

122. See Sandford, supra note 27.

123. Blair & Harrison, Monopsony: Antitrust Law and Economics, supra note 9, at 36–42; see also Sexton & Zhang, supra note 10.
market structure may also be relevant, as a concentrated supply side may produce countervailing power. However, such power may result in higher consumer prices, as the concentrated buyers and concentrated sellers collectively raise input prices and find ways to share the overcharge even if the downstream market appears competitive. The problem of buying side “efficiencies” is discussed below.

Secondly, as Todd teaches, it is possible for a more dispersed set of buyers to find it rational to coordinate their buying activities than would be the likely case on the selling side of the market. This occurs for a couple of interrelated reasons. Buyers generally share an interest in reducing input prices, especially when lower prices, e.g., wages, do not trigger a significant decrease in supply. Closely related, the benefit of cheating on a price-reducing understanding is minimal. The immediate effect is to increase the costs of the deviant. If that deviant is selling into a competitive output market, its costs will go up and so its margin will decrease. Only if any resulting output increase were very substantial and durable would the deviant expect to gain. Thus, input collusion is more self-policing and can accommodate many more parties than would output collusion. Hence, lower levels of concentration can create risks of coordinated effects. This also provides a reason for looking at mergers involving competing buyers even when the overall market for inputs would not appear concentrated from the perspective of conventional seller-side analysis. Put in somewhat different terms, a reduction from six to five substantial buyers should be a cause for concern. Even greater concern should exist when the reduction in buyers results in a universe of major buyers that is four or fewer. Thus, when the post-merger Herfindahl-Hirschman Index (“HHI”) calculation approaches 2000, there should be careful review of any merger that increases the HHI by 100 points or more.

This is not to say that all mergers resulting in a 15% or 20% control of an input market should be illegal. It is to urge that such mergers need more inquiry than they now receive and that if the post-merger HHI exceeds 2000, there should be a rebuttable presumption that the merger is illegal. The central point of this section is to emphasize that the standard for triggering further review of the merits of a merger where there is demonstrable increase in concentration on the buyer side should be substantially lower than the comparable measure on the selling side.


125. See Marshall & Meurer, supra note 10, for an in-depth analysis of bidder collusion.
VI. DEFENSES AND JUSTIFICATIONS FOR MERGERS CREATING BUYER POWER

A. Economies Resulting from the Merger

Contemporary merger policy assumes that most mergers result in real efficiency gains for the parties. This premise is empirically questionable. But given its significance in actual enforcement decisions, it is important to define carefully the kinds of efficiencies that buying-side mergers might legitimately claim. These efficiencies can arise from transactional cost savings or, in some circumstances, economies of scale or scope that upstream suppliers might achieve and share given a large assured volume of business.

The new guidelines make the point that transferring producer surplus to buyers is not an efficiency gain. This point is important because the most likely source of “efficiency” on the buying side is a lower price for inputs. The guideline position requires that the gains be disaggregated to identify the functional cause for a lower price. A transfer based on enhanced buyer power does not change any of the production or transaction costs involved in producing or supplying the input. However, when the “transfer” reflects a reduction in a heretofore supra-competitive price charged by the supplier, the fact that in some sense this is only a wealth transfer should not necessarily trigger a negative view of the merger. As discussed above, such mergers raise complex questions because of the need to focus on the likely impact of such price reductions on the suppliers of the seller and on the prices to be charged to other customers of the seller.

There is, furthermore, a tension between potential economies resulting from combinations increasing buying side concentration and the risks of adverse effects. It is a commonplace of merger analysis that efficiencies are easy to claim and hard to prove. This is in substantial part because very few efficiencies are unique to a particular firm specific market organization. For the great majority there are, in the words of Mao, “many roads” to efficiency. This is especially the case when each of the combining firms is already a multi-plant operation enjoying most or all of the economies of scale. In the beef and pork industries, a rough estimate is that eight to ten firms each operating two or three plants could exist in this country and all those enterprises would be at or above minimum efficient scale. In such contexts, there is unlikely to be any appreciable real

126. See generally F.M. Scherer, Some Principles for Post-Chicago Antitrust Analysis, 52 CASE W. RES. L. REV. 5, 10–19 (2001) (pointing to data of mergers resulting in sub-optimal efficiency to rebut the premise that mergers always enhance efficiency).
127. See supra note 13 and accompanying text.
128. Peter C. Carstensen, Concentration and the Destruction of Competition in
production cost savings resulting from the combination of these firms. It is equally hard to imagine that combining such buyers would significantly reduce transaction costs of buying inputs. Hence, any significant reduction in costs from such a merger is likely to arise only from driving down the price of inputs. But absent evidence of seller cartelization or other market power on the selling side, there is no reason to believe that seller prices are excessive. Therefore, the most likely explanation for the putative “efficiency” gains is that they represent the potential for exploitation of monopsony power. It bears emphasis that a monopsonist has no incentive to share any of those gains with downstream customers unless the downstream buyer itself has power that drives the upstream market exploitation.

This is not to deny that there could not be some efficiency gain combined with the increased monopsony power that a merger generates. The questions are whether such a combination will advance static allocative efficiency and the long run need for dynamic efficiency in the market. The famous Williamson tradeoff argument suggests that there is a real possibility of a gain. There are those who are critical of Williamson’s model, but more importantly, for our purposes, it focuses on the downstream markets in which goods are sold. Richard Sexton and Mingxia Zhang have examined the trade off between increased monopsony power and increased efficiency in production. Their conclusions are that the balance tips strongly against a net allocative efficiency gain from such combinations if the firm has both buyer and seller power unless the productive efficiency gain is very large. Indeed, both consumers and producers are at risk of exploitation. Hence, the use of combined market power is likely to overwhelm the incentives to lower price and increase output arising from some productive efficiencies. This again suggests the need for a more complete analysis of mergers where there are increases in power in both buying and selling markets. In combination the adverse effects can be much more significant than would appear if the investigation focused on only one side or the other.


130. Sexton & Zhang, supra note 10. See also Rogers & Sexton, supra note 55 (noting the potential efficiency gains in oligopsony of agricultural markets).

131. Sexton & Zhang, supra note 10. See also de Fontenay & Gans, supra note 78 (arguing that vertical integration by a monopsonist may harm consumers).
If the firm has only buyer power, the Sexton-Zhang model shows that the static trade-offs require less productive efficiency gains to offset the deadweight loss resulting from increased monopsony power. But the model also shows that there is a very substantial wealth transfer from sellers to such a buyer. In dynamic terms, such a transfer would create a strong disincentive to enter or innovate in the selling side of such a market. Thus, the exploitation of buyer power in this way creates a long run adverse competitive effect.

Real efficiency gains need to be carefully distinguished from the wealth transfers that result from the exercise of monopsony power. Such power can force down the price of inputs transferring upstream producer wealth to the downstream buyer. The gain to the buyer is at best a pecuniary gain and does not involve change in the social costs of production. It is likely, however, that much of the gain that merging parties claim to arise from their combination upon careful examination will be merely a wealth transfer. As such it should not be accepted as an efficiency justification for the merger. In fact, such gains provide direct evidence that such a merger will result in buyer power that the merged entity intends to exploit.

B. Failing Firm Analysis

In reviewing claims that a target is a failing firm, one of the considerations is whether alternative buyers exist for the firm that would not create the same competitive risks. Here again, any such transaction should be examined from a buyer’s as well as seller’s perspective. For example, Smithfield was allowed to buy the Farmland’s pork processing operations following Farmland’s bankruptcy.\footnote{Press Release, Smithfield Foods, Inc., Smithfield Foods Agrees to Purchase Farmland Foods Business (July 15, 2003) (on file with author), available at http://investors.smithfieldfoods.com/releasedetail.cfm?releaseid=296755.} In allowing the transaction, the Antitrust Division focused on the downstream effects in pork markets.\footnote{Chris Flores, \textit{Smithfield Foods to Acquire Farmland Outbids Ribal Cargill with $367M Offer}, \textit{Daily Press}, Oct. 14, 2003, at C8.} It failed to consider the upstream implications for regional hog producers, especially lower volume producers who had limited geographic mobility. If the adverse impact on those sellers had been considered, the alternative bidder for the assets that had no other hog processing operations would have been clearly more desirable from a competitive perspective.
C. Power Sellers

One final defense that might be relevant is that of “power sellers” to which the buyer merger would create “countervailing power” in the sense that Galbraith used the term. As the foregoing analysis has shown, this is a tenuous claim. Buyers, as deciders, have the capacity to induce new entry and otherwise stimulate competition in supply markets. On the other hand, increased concentration on the buying side is reflected upstream by increased concentration often extending further up the input chain. There is some empirical data that would support the contention that increased buyer power can ameliorate the potential of seller power in concentrated markets, but the more pro-competitive strategy is to compel existing buyers to find other means to induce increased supplier competition. Only if the concentration in the input market is driven by some inherent technological factors, would such offsetting buyer power seem plausible. Even then the dynamic cost is the loss of competition in innovation that would otherwise come from having a workably-competitive market structure.

CONCLUSION

The review and workshop process for reconsidering the Horizontal Merger Guidelines was an important step in reviving and focusing merger enforcement. The all-but-exclusive focus on the selling side of the market, in which the only role conceived for buyers is their possible ameliorating effect on anticompetitive seller mergers, reflects a narrow and conventional vision held by those defining the questions to be considered. The ongoing revision process did produce a somewhat more open and nuanced view of the potential adverse competitive effects that mergers affecting buyer power can create. However, the resulting section on mergers creating

134. Bhattacharyya & Nain, supra note 11.
135. There was a debate between Tom Campbell and several economists on the merits of merger to monopoly on the selling side as a response to a buyer monopoly. The responses seem the more persuasive. Compare Tom Campbell, Bilateral Monopoly in Mergers, 74 ANTITRUST L.J. 521 (2007) (arguing that allowing producers to merge when there is only one or a small number of purchasers leads to increased economic efficiency), with Jonathan B. Baker et al., Merger to Monopoly to Serve a Single Buyer: Comment, 75 ANTITRUST L.J. 637 (2008) (rebuitting Campbell’s Bilateral Monopoly thesis by arguing output is likely to increase when buyers have more than one seller with whom to negotiate). But see Tom Campbell, Bilateral Monopoly: Further Comment, 75 ANTITRUST L.J. 647 (2008) (responding to Baker et. al., criticisms).
136. In general, power buyer defenses seem to justify mergers that only marginally increase concentration on the selling side. A similar restrained acceptance of such a defense would be the most that ought to be acceptable on the buyer side with respect to seller power. Basically, some modest increase in concentration might produce the incentives and resources to overcome a supply oligopoly.
buyer power, while acknowledging the risks such mergers can create and recognizing in part the unique aspects of such mergers, has not sufficiently explicated the framework necessary to evaluate the potential anticompetitive consequences of such mergers.

This article provides one view of the scope and nature of the competitive issues and suggests how such mergers should be examined on their merits. A well-informed merger review process will develop these issues further and provide guidance to potential merger partners, their lawyers, and the agency staff.