

*Chapter Three****The New Kid on the Block: Buyer Power***

Any serious effort to set a new antitrust agenda must devote significant attention to buyer power. While the antitrust laws have long condemned abuses of buyer power, cases against buyers have been much less common than cases against sellers.¹ It is time to reexamine this priority. Large buyers are now a prominent feature of many sectors of the economy, including the packing of meat,² the processing of chicken,³ the harvesting of hardwood timber in the Pacific Northwest,⁴ the employment of professional athletes,⁵ the provision of health insurance,⁶ and the retailing of toys and games,⁷ groceries,⁸ and

¹ See ROGER D. BLAIR & JEFFREY L. HARRISON, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993) (collecting and analyzing the relatively small number of cases involving buyers); Albert A. Foer, *Introduction to Symposium on Buyer Power and Antitrust*, 72 ANTITRUST L.J. 505, 505 (2005) (“Antitrust has much more typically focused on the market power of sellers rather than buyers.”).

² Tyson, the nation’s largest meat packer, accounts for about 40% of the cattle purchased and slaughtered by meat-packing plants in this country. *Pickett v. Tyson Fresh Meats, Inc.*, 420 F.3d 1272, 1276 – 77 (2005), *cert. denied*, 547 U.S. 1040 (2006).

³ See Robert Taylor, *Buyer Power Litigation in Agriculture*, 53 ANTITRUST BULL. (forthcoming 2008) (manuscript on file with the Buyer Power Committee) (“pure monopsony best describes the economic power integrators have over growers,” since in some areas, there is only one integrator, and even “when another integrator is in the same area, very few growers switch integrators, in part because the integrators normally require expensive upgrades of the house and equipment before allowing the switch [and] highly specialized poultry houses have essentially no salvage value”); Warren S. Grimes, *Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller*, 72 ANTITRUST L.J. 563, 569 (2005) (describing the constraints on a “farmer who contracts to supply chickens for a large poultry processor” and concluding that “the poultry firm has both the power and the incentive to drive the farmer’s profits down to the minimum sustainable level”).

⁴ In 2001, Weyerhaeuser, the leading operator of hardwood sawmills in the Pacific Northwest, purchased approximately 65% of the alder sawlogs sold in the region. *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069, 1072 (2007). Alder is the predominant hardwood species in the area.

⁵ See Roger G. Noll, “*Buyer Power*” and *Economic Policy*, 72 ANTITRUST L.J. 589, 604 – 05, 618 (2005) (characterizing professional sports leagues as both monopolies and monopsonies, and noting that their common use of “player reservation systems” has limited competition among teams for professional athletes).

⁶ See *Competition in the Unhealthy Health Sector* in this volume (“Practically every market is dominated by one or two firms and four health insurers dominate the national marketplace.”). The market for pharmacy benefit management services is also highly concentrated. *Id.* (“the three major [pharmacy benefit managers] have approximately 80 percent of the market”).

⁷ In 2001, Wal-Mart, the world’s largest retailer, accounted for 28% of the retail sales of toys and games in the United States. Toys ‘R’ Us was responsible for 23%. *Current Conditions: SIC 5092, Toys and Hobby Goods and Supplies*, available at <http://www.referenceforbusiness.com/industries/Wholesale-Trade/Toys-Hobby-Goods-Supplies>.

books.⁹ Wal-Mart alone purchases a sizeable share of the output of several leading suppliers.¹⁰ Encouraged by the American Antitrust Institute, moreover, antitrust and business scholars have been developing more sophisticated ways of analyzing buyer power and the conduct that may create or maintain it.¹¹

In this chapter, we combine this new analysis of buyer power with well-established principles of economics and law to set forth an enforcement and legislative agenda. In Part I, we provide a comprehensive definition of buyer power, one that is broad enough to encompass both the price and nonprice dimensions of buyer power and its positive as well as its negative effects. In Part II, we summarize those effects, distinguishing between classic monopsony power, which generally harms suppliers, consumers, and economic efficiency, and countervailing power, which tends to reduce supplier profits but can either benefit or harm consumers and efficiency. In Part III, we turn from the exercise of buyer power – which does not itself violate the antitrust laws – to conduct that may warrant enforcement action. In this part, we describe different types of potentially anticompetitive conduct by buyers, ranging from price fixing to inducing price discrimination, and propose an enforcement agenda. In Part IV, we discuss the

⁸ Wal-Mart is also the nation's largest seller of groceries. *Wal-Mart: Impact of a Retail Giant*, PBS Online NewsHour, Aug. 20, 2004, available at <http://www.pbs.org/newshour/bb/business/wal-mart/unique/html>. The industry also has other large buyers, including Kroger, Safeway, and SuperValu.

⁹ Barnes & Noble, the world's largest bookseller, accounts for roughly 18% of the sales of trade books in the United States. See Barnes & Noble Form 8-K, Jan. 10, 2008; Barnes & Noble, *For Investors*, http://www.barnesandnobleinc.com/for_investors/for_investor.html; Austan Goolsbee & Judith Chevalier, *Measuring Prices and Price Competition Online: Amazon and Barnes and Noble* 3 – 4 (Yale ICF Working Paper No. 02-23, June 2002). See also *B&N Touts Benefit of Mature Market*, PUB. WEEKLY, Nov. 19, 2007, available at <http://www.publishersweekly.com/article/CA6503743.html?industryid=4715> (Barnes & Noble CFO "estimated that B&N holds an 18% market share"). Borders Books accounts for approximately 15% of U.S. trade book sales. See Borders Stores, *About Us*, http://beta.bordersstores.com/online/Store/BGIView_aboutus; Goolsbee & Chevalier, *supra*. Trade books are hard cover books, high quality paperbacks, and pocket-size paperbacks marketed to a general audience.

¹⁰ Emek Basker, *The Causes and Consequences of Wal-Mart's Growth* 1 (Working Paper), available at <http://web.missouri.edu/~baskere/papers> ("Wal-Mart currently accounts for 28 percent of Playtex's sales, 25 percent of Clorox's, 21 percent of Revlon's, 13 percent of Kimberly-Clark's, and 17 percent of Kellogg's"). In 2005, Wal-Mart's total sales were greater than the combined sales of the next five largest retailers – Home Depot, Kroger, Sears Holding Company (which includes Kmart), Costco, and Target. *Id.* at 1; *Wal-Mart: Impact of a Retail Giant*, *supra* note 8.

¹¹ AAI has recently sponsored two major symposia on buyer power. See *Symposium on Buyer Power and Antitrust*, 72 ANTITRUST L.J. 505 (2005) and *AAI Invitational Symposium on Buyer Power*, 53 ANTITRUST BULL. (forthcoming 2008). See also Albert A. Foer, *Mr. Magoo Visits Wal-Mart: Finding the Right Lens for Antitrust*, 39 CONN. L. REV. 3107 (2007).

Robinson-Patman Act, the antitrust statute targeted most directly at powerful buyers. Unlike the Antitrust Modernization Commission (AMC), we do not support repeal of the Act. Instead, if Congress is interested in reform, we identify several changes in the Act that would reduce its undesirable effects while preserving its ability to combat discrimination that poses a substantial threat to small business and consumers. Finally, we summarize the main points of this chapter and call for further research.

MAJOR RECOMMENDATIONS

Antitrust Enforcement

Naked Collusion

- Criminal prosecution of cartels and other naked collusion by buyers should remain a high priority of the Department of Justice.

Mergers

- The enforcement agencies should continue to review mergers of competing buyers to determine whether the combination is likely, without offsetting justification, to create or enhance classic monopsony power. Indeed, because the agencies have historically challenged few mergers on this ground, they should be especially vigilant in the future to ensure that they do not allow acquisitions that subject small sellers like farmers or fishermen to monopsonistic exploitation.
- Since the exercise of classic monopsony power can cause harm even when it does not reduce output, in evaluating mergers of buyers the agencies should consider whether the transaction is likely to cause adverse effects beyond an immediate reduction in output, such as a transfer of wealth from suppliers to the merged firm.

Exclusionary Behavior

- The enforcement agencies should continue to bring cases like *Toys “R” Us* in which a firm, without justification, uses its buying power to raise rivals’ costs, increase its market power, and injure consumers.

- The agencies should also challenge behavior like predatory bidding, overbuying, or exclusive dealing that enables a buyer, without justification, to create, maintain, or increase classic monopsony power.

Downstream Effects in a Monopsony Case

- In any case in which an enforcement agency shows that the conduct of one or more buyers was likely to create, maintain, or increase classic monopsony power, the agency should take the position (1) that it need not show that such conduct was likely to harm consumers; and (2) that the defendant(s) cannot justify the conduct on the ground that the lower prices extracted from suppliers would be passed on to consumers.

Price and Promotional Discrimination

- The Federal Trade Commission (FTC) should look for and, if warranted, bring a Robinson-Patman case in which the challenged discrimination both favors a powerful buyer over its smaller rivals and threatens to harm consumers.

The Robinson-Patman Act

Congress should not repeal the Robinson-Patman Act. If Congress is interested in limiting its adverse effects, it should adopt the following reforms, which would reduce the number of anticompetitive Robinson-Patman cases while preserving the Act's ability to reach discrimination that poses a substantial threat to small business and consumers.

Power Requirement in Price Discrimination Cases

- In a challenge to price discrimination among customers, the plaintiff should be required to prove either that the discriminating seller had market power or that the favored customer had buyer power. If neither type of power is present, the market is competitive and the challenged discrimination is likely to be cost justified. This change would not entail a showing that the discriminating seller had monopoly power or that the favored customer had a large degree of buyer power. All that would be required is proof that competition was sufficiently imperfect that a seller had the incentive and ability to undertake significant, persistent, unjustified favoritism.

Reasonable Relationship Test for Cost Justification

- A defendant should be allowed to establish the cost justification defense if it can show that its discriminatory price was reasonably related to cost savings generated by the favored buyer. The defense should not be denied simply because of minor defects in the defendant’s cost study.

Competitive Injury Requirement in Promotional Discrimination Cases

- In a challenge to promotional discrimination, a plaintiff should be required to prove that the discrimination is likely to cause competitive injury. At present, plaintiffs challenging price discrimination must show competitive injury, but plaintiffs challenging favoritism in promotional allowances or services need not. This disparity is unwarranted and counterproductive.

Criminal Penalties

- Section 3 of the Act, which makes it a crime to engage in certain types of price discrimination, should be eliminated. This section is no longer enforced and should not be.

I. Definition of Buyer Power

In our view, buyer power is best defined as the ability of a buyer to depress the price it pays a supplier or to induce a supplier to provide more favorable nonprice terms.¹² This definition differs from the classic definition of “monopsony” power, historically the conventional definition of buyer power, in two important ways. First, unlike classic monopsony power – the power to profitably reduce the price of an input below the competitive level¹³ – our definition recognizes that powerful buyers may seek not only price reductions from their suppliers but significant nonprice concessions as well. As we

¹² Cf. Zhiqi Chen, *Buyer Power: Economic Theory and Antitrust Policy*, 22 RES. L. ECON. 17, 19 (2007) (defining buyer power as “the ability of a buyer to reduce the price profitably below a supplier’s normal selling price, or more generally the ability to obtain trade terms more favourable than a supplier’s normal trade terms”).

¹³ See DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 108 (4th ed. 2005). See also Noll, *supra* note 5, at 589 (“A buyer has market power if the buyer can force sellers to reduce price below the level that would emerge in a competitive market. Thus, buyer power arises from monopsony (one buyer) or oligopsony (a few buyers), and is the mirror image of monopoly or oligopoly”). As we note below, the Horizontal Merger Guidelines use this definition of monopsony power to identify which mergers of buyers are likely to present an enforcement concern. See *infra* note 70 and accompanying text.

explain below, these nonprice concessions may play a substantial role in insulating the firm from new entry by other buyers. They may also enhance its market power as a seller.

Second, our definition acknowledges that powerful buyers do not always, or perhaps even commonly, reduce input prices *below* the competitive level, as the classic definition of monopsony requires. Instead, they may induce suppliers with market power to lower their prices to the competitive level, or at least closer to that level. Such “countervailing power” is frequently exercised by big buyers like Wal-Mart and Costco, and no definition of buying power should exclude Wal-Mart. As we indicate later, however, the exercise of countervailing power is not always benign. By bringing prices closer to the competitive level, it can benefit consumers and improve efficiency. In other cases, though, countervailing power can create unjustified advantages over smaller buyers, reduce total competition as a result, and ultimately harm both consumer welfare and total welfare. In contrast, the exercise of classic monopsony power generally harms consumers as well as suppliers and economic efficiency.¹⁴

II. Effects of the Exercise of Buyer Power

This Part explores the effects of the exercise of buying power in more detail. We include this section not because the exercise of buyer power itself violates the antitrust laws, but because its effects help determine whether and when the enforcement agencies should challenge conduct that creates or preserves such power. In section A, we address classic monopsony power, the mirror image of monopoly power, whose effects are comparable to those of monopoly power, though directed upstream at input suppliers rather than downstream toward consumers. In section B, we turn to countervailing power, whose effects are more mixed. We describe its positive and negative consequences and briefly assess their empirical significance. In section C, we broaden our focus from the price effects of buyer power to its nonprice consequences, emphasizing the ways in which nonprice terms may advance efficiency or instead protect a large buyer from rivals. Finally, in section D, we enlarge the focus still further by discussing “vertical

¹⁴ As this discussion indicates, our definition of buyer power does not equate buyer power with undesirable effects. We distinguish the existence of buyer power from its consequences. For the same reason, our definition of buyer power is not limited to cases in which a buyer has the ability to induce a concession that is not cost justified. In some cases, it make take the leverage of a powerful buyer to force a seller with substantial market power to grant a price cut that is cost justified.

competition,” the competition to capture the profits in the vertical chain of production and distribution. By becoming more successful at vertical competition, a firm can enhance both its buying power and its selling power, reducing horizontal competition.

A. *Monopsony Power*

In the classic monopsony model, a single buyer faces a large number of suppliers, each too small to affect the market price and each operating on an upward-sloping marginal cost curve. Purchasing from such powerless suppliers, the monopsonist has an incentive, as any textbook treatment shows, to purchase less than the competitive quantity – the quantity that a competitive group of buyers would purchase – because each additional unit purchased raises the market price.¹⁵ As a result, the monopsonist will buy fewer units and pay less for them than would a group of buyers without monopsony power.

In the classic case, the exercise of monopsony power harms suppliers by reducing their revenues and profits and transferring their wealth to the monopsonist. This decline in their fortunes is likely to reduce their investment in the industry and drive some of them out of business altogether. In addition, the reduction in the quantity they produce depresses economic efficiency, since inputs that would have been produced by a fully competitive market are no longer supplied, causing a deadweight loss. Moreover, this decrease in input supply is likely to harm downstream consumers, at least to some degree. By purchasing fewer inputs the monopsonist is likely to produce fewer units of output, which is likely to cause some increase in the price that consumers pay. While the size of this effect depends mainly on the amount of market power the monopsonist has in the output market, even if the monopsonist has relatively little downstream power, a reduction in its output will tend to reduce output in the downstream market, causing some upward pressure on prices.¹⁶ Where a buyer exercises classic monopsony power, in

¹⁵ In a perfectly competitive market, no buyer has an incentive to reduce its purchases because each buyer is too small, by definition, to depress the market price by reducing its purchases. In the classic monopsony model, moreover, the monopsonist cannot discriminate in price among its suppliers, paying some less than it pays others. As we note below, such price discrimination may mute a monopsonist’s incentive to curtail purchases.

¹⁶ In fairly common circumstances, moreover, the exercise of monopsony power will harm consumers regardless of the monopsonist’s power in the downstream market. *See* Noll, *supra* note 5, at 596, 599 – 600. A firm may have monopsony power upstream but little or no market power downstream if the upstream market is much narrower than the downstream market. A meat packer, for example, may purchase its principal input (cattle) in a local or regional market where it is the dominant buyer, but sell its finished product (packaged beef) in a national market where it faces intense competition.

short, consumers tend to be hurt, not helped. In the traditional case, the monopsonist does not pass on its lower input prices in the form of lower output prices.¹⁷

In sum, the exercise of classic monopsony power reduces the welfare of suppliers, total welfare, and quite likely the welfare of consumers. Though its greatest effects are upstream rather than downstream, monopsony has negative consequences comparable to those of monopoly.¹⁸

These negative consequences may be offset when the monopsony power was acquired through superior efficiency or innovation. In such cases, the gains to the economy from a cheaper production process or a more valuable product may outweigh the costs of monopsony power. Indeed, the gains to the economy might not have occurred at all had the firm not expected to achieve monopsony profits through its innovation.¹⁹ In any event, the antitrust laws do not prohibit the exercise of monopsony power without regard to how it was acquired, maintained, or enlarged. What the antitrust laws do, in essence, is bar conduct by buyers that, without offsetting justification, increases or maintains monopsony power beyond what it otherwise would have been. When conduct enlarges or preserves monopsony power without justification, it is anticompetitive: it reduces competition among buyers, injures suppliers, and is likely to diminish economic efficiency. We discuss the principal categories of anticompetitive conduct by buyers in Part III.

In evaluating conduct that may unjustifiably aggrandize monopsony power, the enforcement agencies should recognize that a large buyer may not treat all its suppliers the same. Instead, the buyer may discriminate among them, either by paying them different prices or by engaging in all-or-nothing contracting, in which the buyer specifies the particular price and quantity that it will accept from each supplier. To the extent such

¹⁷ *Id.* at 606 (“The standard justification for the desirability of buyer power is that the input monopsonist will ‘pass on’ lower costs to consumers. This argument has no support from the standard monopsony model.”).

¹⁸ By reducing output and raising price, a monopolist harms consumers and economic efficiency. Furthermore, by restricting output, a monopolist tends to harm its suppliers, who are likely to sell fewer units of their own output.

¹⁹ See Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 ANTITRUST L.J. 575, 580 (2007) (“firms that expect to face more . . . competition after innovation have less incentive to invest in R&D”).

price discrimination is successful, the impact of monopsony power may change. On the one hand, the buyer may purchase a larger total quantity than a nondiscriminating monopsonist would, reducing or even eliminating the adverse effects on economic efficiency and consumers. On the other hand, the price discrimination, by increasing the buyer's profits, will increase the transfer of wealth from suppliers to the monopsonist. If the monopsony was acquired without justification, the exploitation of suppliers will be worsened. In short, price discrimination by a monopsonist may mitigate the adverse efficiency effects of monopsony while compounding its wealth transfer effects.²⁰

As this brief discussion indicates, the consequences of the exercise of monopsony power are generally negative, at least for suppliers and usually for efficiency and consumers. In contrast, the effects of countervailing power – the other type of buyer power – are more mixed.

B. Countervailing Power

As noted above, the classic monopsonist faces an atomistically competitive group of input suppliers, each with an insignificant market share and each operating on an upward-sloping marginal cost curve. If, instead, there are only a few input suppliers, each with significant market power and each able to increase output without a significant increase in marginal costs, the consequences of the exercise of buying power are more complex.²¹ In this situation, a substantial buyer may be able to exert countervailing power against monopolistic or oligopolistic suppliers, forcing their prices closer to the competitive level and benefiting both efficiency and consumers. It is also quite possible, however, for the exercise of countervailing power to result in sustained, significant, and unjustified discrimination in favor of the powerful buyer, injuring smaller buyers and ultimately harming both overall welfare and consumer welfare.²²

²⁰ This form of price discrimination – price discrimination by a monopsonist among its suppliers – should be distinguished from price discrimination by a seller among its customers, which may have quite different consequences and is analyzed below in Parts II.B, III.D & IV.

²¹ As Professor Chen notes, “the competition effects of buyer power are quite different depending on whether it is monopsony power against powerless suppliers or countervailing power against large suppliers with market power.” Chen, *supra* note 12, at 18. Like Professor Chen, we distinguish two types of buyer power – classic monopsony power and countervailing power. Unlike some commentators, we do not equate monopsony power with all forms of buyer power, including countervailing power.

²² Whatever the impact on consumers, countervailing power is likely to harm suppliers, since they are likely to earn profits lower than those they would have earned had the buyers been unable to exert such power. This

Countervailing power also differs from classic monopsony power in the degree of dominance required to exercise it. Since classic monopsony power is the mirror image of monopoly power – a large degree of market power – classic monopsony power is normally associated with a large share of the relevant market, approximately 70% or more. In contrast, both theory and evidence suggest that a firm can exercise countervailing power in many market settings with a substantial but nondominant share, perhaps as little as 10 – 20%.²³ Countervailing power, therefore, is likely to be exercised more frequently than classic monopsony power and its effects, whether beneficial or harmful, are likely to be more widespread.

Countervailing power is also exercised differently from classic monopsony power. In the standard, single-price model, the monopsonist does not engage in individual negotiations with its atomistic suppliers, bargaining with each of them over price and quantity. Instead, it simply posts the price it is willing to pay or reduces the total quantity it is willing to purchase. In contrast, when a large buyer exerts countervailing power, it typically sets the price it will pay through bargaining with individual suppliers, threatening to withhold purchases or offering to increase purchases in order to induce a concession. In this process, the buyer often plays one significant supplier off against another. It may indicate, for example, that it will shift the bulk of its business to the supplier that offers

reduction in profits may be desirable, of course, if the suppliers would otherwise have earned excess returns. It may not be desirable if it would prevent some suppliers from earning sufficient profits to develop or produce valuable products. Countervailing power may *benefit* a supplier if it causes the supplier to reduce price, increase market share, and capture economies of scale it had not anticipated.

²³ See John B. Kirkwood, *Buyer Power and Exclusionary Conduct: Should Brooke Group Set the Standards for Buyer-Induced Price Discrimination and Predatory Bidding?* 72 ANTITRUST L.J. 625, 637 – 44 (2005) (explaining why large but nondominant buyers may have the bargaining power to obtain non-cost-justified concessions from sellers with market power and recounting examples from the automobile industry, the salt industry, and several retail trades); Chen, *supra* note 12, at 31 (“a very large share of purchases is not a necessary condition for the existence of buyer power”); Grimes, *supra* note 3, at 563 – 64 (a 10% share may be enough if the buyer is a multibrand retailer who serves as a “gatekeeper” for its customers); Paul W. Dobson, *Exploiting Buyer Power: Lessons from the British Grocery Trade*, 72 ANTITRUST L.J. 529, 535 (2005) (“the UK Competition Commission is correct in arguing that retail buyer power can be very significant (to the extent of distorting competition) even if the retailer controls as little as 8 percent of the total market”); Peter C. Carstensen, *Buyer Power and Merger Analysis – The Need for Different Metrics* 12 (Paper Prepared for Workshop on Merger Enforcement, Antitrust Division and Federal Trade Commission, Feb. 17, 2004), available at <http://www.usdoj.gov/atr/public/workshops/docs/202606/pdf> (where suppliers need to achieve a “sufficient volume of sales, . . . a firm with 20% 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-fifth or more of its outlets”).

the best price. Through this pulling and hauling, the buyer forces suppliers with market power to compete more vigorously with each other, and consumers may benefit.²⁴

1. Beneficial Effects

Countervailing power most clearly benefits consumers when it causes the collapse of an oligopolistic pricing structure. When a large buyer induces a price cut from one oligopolistic supplier, and reactions from other suppliers cause that price reduction to spread to other suppliers and other buyers, the general price level falls, benefiting consumers, buyers of all sizes, and efficiency. Because of this increase in competition, the suppliers lose market power, but everyone else is better off.

Even if the price reduction does not spread to small buyers, consumers may benefit if the large buyer passes on the price cut. That could happen because the large buyer faces competition from other large buyers who have also obtained a price cut, or because the buyer calculates that it would make more money, given the reduction in its input costs, if it increased output, or for both reasons. But in any event, if the price cut is passed on, there is a benefit to consumers. To be sure, there may also be costs, since smaller buyers are disadvantaged by the discriminatory price cuts, and that may prevent them from supplying valuable options such as superior service or selection. On the whole, however, the gains to consumers may outweigh these costs, increasing consumer welfare and total welfare.²⁵

²⁴ See Kirkwood, *supra* note 23, at 637 – 47.

²⁵ Countervailing power may also benefit consumers when supply is monopolized. Suppose, for example, that a monopsonist buys from a monopolist. In that case (“bilateral monopoly”), the monopsonist is likely to bargain with the monopolist to induce it to produce more and charge less than it would if it were facing a group of powerless buyers. This exercise of countervailing power may even achieve the perfectly competitive level of output. Indeed, in the absence of any information asymmetries or other transaction costs, the bargaining would result in the efficient level of output, since that level would maximize the parties’ joint profits. See Tom Campbell, *Bilateral Monopoly in Mergers*, 74 ANTITRUST L.J. 521, 521 – 22 (2007). In the more realistic case, though, where the parties do not possess full information about each other’s costs and alternatives, the bargaining may not reach the efficient outcome. See Jonathan Baker & Carl Shapiro, *Reinvigorating Horizontal Merger Enforcement*, in *WHERE THE CHICAGO SCHOOL OVERSHOT THE MARK: EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST 31* (Robert Pitofsky ed.) (forthcoming 2008) (manuscript on file with the Buyer Power Committee) (Campbell’s view that bargaining between a monopolist and a monopsonist will produce the efficient result is “inconsistent with the modern economic understanding that bargaining with asymmetric information typically leads to inefficient outcomes”); Noll, *supra* note 5, at 607 (“Whether bilateral monopoly *will* improve welfare is uncertain.”). As Professor Noll recognizes, the question for antitrust policy is not whether the creation of countervailing power is likely to produce the ideal outcome, but whether it is likely to improve the situation.

2. Harmful Effects

It is also possible for the exercise of countervailing power to reduce the welfare of consumers. This may occur when a large buyer forces suppliers to discriminate in its favor and the result is a substantial, persistent, and non-cost-justified advantage over smaller buyers. As the AAI Working Group on the Robinson-Patman Act explained to the AMC, such a sustained and unjustified differential can harm consumers in five situations:

First, it can allow the favored buyer to take business or profits from disfavored buyers, reducing their number or vigor and depriving consumers of the convenient locations, distinctive services, superior selection, or other attractive features they would have offered. If consumers who value those features lose more than other consumers gain from the lower prices (or other enhanced offerings) offered by the favored firm, non-cost-justified discrimination has reduced consumer welfare.

Second, a lower price induced by a large buyer may lead to *higher* consumer prices if the large buyer uses its unjustified advantage to gain so much market share that it acquires market power as a seller. It can then raise prices to consumers, so long as its unjustified advantage or other circumstances create a barrier to entry and expansion. The same result can occur if several buyers exact unjustified concessions and use them to acquire shared market power. In short, [non-cost-justified differentials] may produce higher prices if they increase concentration in product markets and enable the favored buyers to exercise market power, either individually or collectively.

Third, buyer-induced non-cost-justified discrimination may result in higher prices to consumers when a powerful buyer induces sellers to discriminate not by *lowering* their prices to the favored buyer, but by *raising* them to other buyers. By forcing up its rivals' costs, the favored buyer can, in the presence of entry barriers, acquire market power as a seller and raise its own prices.

Fourth, buyer-induced discrimination may harm consumers by allowing the favored buyer to become less efficient. Because an unjustified concession confers a competitive advantage on the favored buyer, it can use that concession to shelter itself from competition, permitting it to survive when its costs are excessive. These inflated costs not only waste resources but tend to make the favored firm less innovative and less responsive to changing consumer tastes.

Fifth, unjustified discrimination induced by large buyers may harm consumer welfare by reducing the profitability of suppliers and causing them to curtail their investment in the industry. This is most likely to harm consumers if the suppliers were not making excess profits prior to the unjustified discrimination. In that case, future investment may be less than optimal and consumers may eventually pay higher prices or have fewer choices.²⁶

3. Empirical Evidence

Almost two decades ago, Professors Scherer and Ross reviewed the evidence on the impact of buyer power and concluded that it had, “in at least some cases,” disciplined oligopolistic sellers and benefited consumers.²⁷ Recent evidence provides a more encouraging picture. It now appears that when large retailers like Wal-Mart reduce their invoice costs, whether through the exercise of countervailing power or the achievement of efficiencies, they frequently pass on a substantial part of their cost savings to consumers. Indeed, in several of the examples described below, the pass-on rate exceeded 100%.²⁸

²⁶ AMERICAN ANTITRUST INSTITUTE, THE ROBINSON-PATMAN ACT SHOULD BE REFORMED, NOT REPEALED, COMMENTS OF THE AMERICAN ANTITRUST WORKING GROUP ON THE ROBINSON-PATMAN ACT 13 – 14 (2005), available at <http://www.antitrustinstitute.org/recent2/425.pdf>.

²⁷ F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 535 – 36 (3d ed. 1990) (“By bringing their bargaining power to bear, strong buyers are in at least some cases able to restrain the price-raising proclivities of oligopolistic sellers. If the buyers in turn face significant competition as resellers, consumers benefit.”).

²⁸ For an analysis of the pass-on issue that explains why the pass-on rate can be greater than 100%, see Michael P. Lynch, *Why Economists are Wrong to Neglect Retailing and How Steiner’s Theory Provides an Explanation of Important Regularities*, 49 ANTITRUST BULL. 911 (2004).

A particularly striking example occurred after Wal-Mart's 1997 acquisition of a Mexican retailer that it renamed Walmex. Wal-Mart installed the information technologies, warehousing procedures, and inventory management systems it had developed in the United States, and Walmex soon became Mexico's largest retailer with over 1,000 stores. At the same time, Walmex exerted its growing buying power in its negotiations with detergent and soap suppliers, a handful of relatively backward producers who had evidently colluded to set prices. Through a combination of incentives and threats, Walmex caused these producers to cut costs, reduce prices, improve quality, and even introduce their own innovations. Since Walmex was a far more efficient retailer than its predecessor, it could add a smaller markup to the reduced factory prices than its predecessor would have. The result was a pass through to Mexican detergent and soap consumers that exceeded 100%.²⁹

Basker and Van found that Wal-Mart also passed through more than 100% of the savings it realized when its cost of importing products from China fell. From 1984 through 2004, the authors estimate, Wal-Mart's invoice costs on Chinese imports (including tariffs, transportation charges, and wholesale margins) declined by 23%. At the same

²⁹ Beata Javorcik, Wolfgang Keller & James Typout, *Openness and Industrial Response in a Wal-Mart World: A Case Study of Mexican Soaps, Detergents and Surfactant Producers* (World Bank Policy Research Working Paper No. 3899, Aug. 25, 2006).

Robert Steiner, a former toy industry executive, uncovered another instance in which Wal-Mart passed through more than 100% of a concession it obtained through countervailing power. In a statement to the Buyer Power Committee, he reported:

Wal-Mart has taken a few of the best known toys and promoted them at severely cut prices prior to Christmas. In one instance of which I have information, the retailer featured a long-time favorite toy at \$8.88 in newspaper ads in October 2003. This was an item that had been selling about 1 million units a year nationwide at all retailers combined. Wal-Mart bought 450,000 units from its Asian supplier(s) at a price of \$7.50 per unit. It took possession overseas and incurred freight and duty charges that brought the landed, duty-paid cost to about \$8.25. Since Wal-Mart was advertising the toy for \$8.88, it made only a 7% gross margin on this huge promotion.

I do not have the cost Wal-Mart had been paying prior to the promotion nor its everyday retail price then. I am told that in most outlets the toy was retailing for around \$19.99, and it is probable that Wal-Mart's everyday retail price was somewhat less. I am reliably informed that Wal-Mart had been making a 15% gross margin prior to the promotion. Since Wal-Mart chopped its gross margin in half during the promotion, it passed through to consumers a saving that far exceeded the reduction in its cost.

Statement of Robert Steiner, Feb. 16, 2008 (on file with the Buyer Power Committee).

time, Wal-Mart's retail prices on these products dropped by 57%.³⁰ In this period, in other words, Wal-Mart passed through more than double the cost savings and price reductions it obtained. The authors conclude that Wal-Mart could accomplish this because its lower invoice costs enabled it to expand its store base and capture greater economies of scale, allowing it to trim its markups.

In the U.K., the Competition Commission (CC) found that the largest supermarket chains typically passed through most of the savings they achieved on private label products. The CC obtained invoice costs and retail prices on the national brands and private label counterparts sold by the five biggest British supermarket chains in five popular product lines. The CC concluded: "On average [the chains] retain one-third of their own-label savings, passing through two-thirds to consumers."³¹

This evidence indicates that whether large buyers obtain cost savings by exercising countervailing power or inducing suppliers to become more efficient, they frequently pass on a substantial proportion of their savings to consumers, sometimes more than 100%. As we now note, however, there is also some evidence of a darker side to countervailing power. This evidence suggests that when large buyers force suppliers to grant them substantial, persistent, and unjustified concessions, overall competition may sometimes be reduced, harming consumers and economic efficiency.

In his classic study of the Great Atlantic and Pacific Tea Company, Professor Adelman found that most of the concessions A&P had obtained from its suppliers were cost justified. He also concluded, however, that A&P had induced a significant number of non-cost-justified concessions and these concessions were anticompetitive. They cushioned the company from its own inefficiency and diminished its incentive to increase output and lower prices:

[P]ressure on the pocket-book nerve, which should have shaken A&P out of its lethargy, was dulled; the company was anesthetized by the

³⁰ Emek Basker & Pham Hoang Van, *Wal-Mart as Catalyst to U.S. China Trade* 32, Table 5 (Univ. of Missouri Department of Economics Working Paper 07-10, 2007), available at <http://web.missouri.edu/~baskere/papers>.

³¹ COMPETITION COMM'N, SUPERMARKETS: A REPORT ON THE SUPPLY OF GROCERIES FROM MULTIPLE STORES IN THE UNITED KINGDOM 180 (2000), available at http://www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm#full.

concessions made to it Hence, if our criterion for public policy is the promotion of competition to increase output and lower prices, then our public policy should largely condemn the discriminations in favor of A&P.³²

There is evidence, moreover, that Barnes & Noble and Borders, the nation's largest bookstore chains, obtained discriminatory prices and other terms for many years,³³ and that this persistent favoritism contributed to the demise of hundreds, if not thousands, of independent bookstores.³⁴ The resulting weakening of retail competition may have made it easier for the big chains to reduce the discounts they offered consumers.³⁵ But even if retail prices did not increase, the destruction of numerous independent bookstores deprived many consumers of nonprice options they enjoyed. Had this discrimination not declined as a result of lawsuits filed by the American Booksellers Association, the FTC, and others, the overall effect on consumer welfare might have been adverse.³⁶

Finally, citizens in many communities have passed zoning laws to exclude Wal-Mart and other large retailers, evidently judging that the entry of these firms would ultimately cause more harm than good.³⁷ Although retail prices would decline, making many consumers

³² M.A. Adelman, A&P: A STUDY IN PRICE-COST BEHAVIOR AND PUBLIC POLICY 242 – 43 (1959).

³³ See BRUCE V. SPIVA, COMMENTS OF THE AMERICAN BOOKSELLERS ASSOCIATION TO THE ANITRUST MODERNIZATION COMMISSION ROBINSON-PATMAN ACT PANEL 4 – 10 (2005), available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Spiva_Revised%20.pdf.

³⁴ See *id.* at 3 – 4 (membership in the American Booksellers Association fell from a “high of 5,200 in 1991 to 1,791 today, a 65% decline in less than fifteen years”).

³⁵ See *id.* at 14 – 15 (citing David D. Kirkpatrick, *Quietly, Booksellers Are Putting an End to the Discount Era*, N.Y. TIMES, Oct. 9, 2000). Spiva contends that the chains' exertion of buying power caused an increase in the retail price of books. See *id.* at 15 (“in response to the chains' demand for ever larger discounts, publishers have gradually raised the average list prices of new books, particularly hardcovers, in order to maintain their own profitability. Rising list prices combined with disappearing discounts to consumers has meant that the chains have actually ultimately driven *higher* prices to consumers”).

³⁶ As we explain below, the growth of the big chains and the decline of the independents does not prove that consumers as a whole preferred chains to independents. Consumers in this situation are subject to a collective action problem, which may prevent them from acting together to preserve the independents, even though they would be willing to pay to do so if they could act as a group. See *infra* note 93.

³⁷ See *The Hometown Advantage: Reviving Locally Owned Business*, <http://www.newrules.org/retail/size.html> (identifying 28 cities and 5 counties that have “enacted zoning rules that prohibit stores over a certain size”); *Wal-Mart: Impact of a Retail Giant*, *supra* note 8 (in 2003 alone, “between 15 and 20 Wal-Mart projects were halted due to residents' opposition, according to Wal-Mart spokesman Keith Morris”); *id.*

better off, the entry of these firms would also destroy local businesses,³⁸ which would not only harm their owners – and other consumers – but eliminate high paying jobs³⁹ and sap the vitality of the downtown area.⁴⁰ Since these major retailers can charge low prices partly because of their countervailing power, this evidence suggests that the exercise of such power may sometimes be harmful. In certain situations, its direct benefits – lower retail prices – would be outweighed by negative externalities.⁴¹

(“According to Sprawl Busters, an organization that monitors communities opposed to ‘urban sprawl,’ some 221 communities have fought the opening of large-scale retail developments in their neighborhoods and have won.”).

³⁸ See, e.g., *id.*, (communities have passed store size caps because they recognize “that their local economies can absorb only so much new retail without causing numerous existing businesses to close”); *Is Wal-Mart Good for America? One, Two, Three, Four . . . We Don’t Want Your Superstore*, FRONTLINE, Nov. 16, 2004, available at <http://www.pbs.org/wgbh/pages/frontline/shows/walmart/transform/protest.html> (“In Bakersfield, homeowners and union workers successfully fought Wal-Mart’s building plans by arguing that the superstore would destroy local business.”).

³⁹ See, e.g., *Is Wal-Mart Good for America?*, *supra* note 38 (“Citing independent studies by the Orange County Business Council and the San Diego Taxpayers Association, Inglewood activists argued that if Wal-Mart entered its community, good-paying union jobs would be replaced by low-wage, low-benefit Wal-Mart jobs.”); Abigail Goldman & Nancy Cleland, *The Wal-Mart Effect*, LOS ANGELES TIMES, Nov. 23, 2003 (“Every one of the giant [Wal-Mart] stores sucks away about 200 [union] jobs, said retail consultant Burt P. Flickinger III, who runs Strategic Resource Group in New York On average, Flickinger says, Wal-Mart’s wage-and-benefit package is about \$10 an hour less than those offered by unionized supermarkets Wal-Mart’s move into groceries has led 25 regional supermarket chains around the nation to close or file for bankruptcy protection, eliminating 12,000 mostly union jobs, Flickinger said.”).

⁴⁰ See, e.g., *The Hometown Advantage*, *supra* note 37 (“Store size caps help to sustain the vitality of small-scale, pedestrian-oriented business districts [and] protect the character of the community by ensuring that new development is at a scale in keeping with existing buildings.”); *Is Wal-Mart Good for America?*, *supra* note 38 (“Wal-Mart has come under attack in Vermont, where preservationists say the character, culture and economy of the entire state is under threat from an influx of superstores [T]he National Trust for Historic Preservation put Vermont on its ‘endangered’ list [, and its president stated,] ‘We know the effects that these superstores have. They tend to suck the economic and social life out of these downtowns, many of which whither [sic] and die as a result.’”).

⁴¹ These instances do not show that countervailing power is normally harmful, since most communities have not voted to ban Wal-Mart or other powerful buyers. Nor do they show that countervailing power is responsible for the bulk of the negative effects described, for much of a big chain’s ability to charge low prices is due to its economies of scale and its superior information technology. See Basker, *supra* note 10, at 4 (“By all accounts, technology and scale are at the core of Wal-Mart’s advantages over its rivals. Across the retail sector, stores that belong to retail chains tend to be more efficient than single-store retailers, and chains tend to invest more in information technology.”).

Professor Noll cites evidence of another adverse effect of countervailing power. See Noll, *supra* note 5, at 612 (“Weiss and Wittkopp provide empirical evidence that in some cases innovation in food products has been adversely affected in markets in which food retailers have oligopsony power,” citing Cristoph R. Weiss & Antje Wittkopp, *Buyer Power and Innovation of Quality Produce: Empirical Evidence from the German Food Sector*

Overall, then, countervailing power frequently appears to be desirable: it reduces the market power of suppliers and increases the welfare of consumers and society. In a significant number of cases, however, such power may be harmful, ultimately injuring both consumers and efficiency. When a buyer obtains *nonprice* concessions from its suppliers, the impact on competition may also be positive or negative. While most nonprice terms can enhance efficiency, some may insulate a large buyer from challenge, giving it greater power over suppliers or consumers.

C. *Nonprice Terms*

Buyer power represents more than just the ability to extract lower prices from suppliers. Buyer power may also manifest itself in the non-price terms that buyers secure from their suppliers. Specifically, powerful business customers may use their leverage to negotiate or impose restrictions on suppliers of goods and services that extend beyond unit price and amount to what may be termed *buyer-led vertical restraints*.⁴²

These additional terms of trade beyond the unit price of the supplied good or service may be aimed at providing the buyer with a direct financial benefit, such as requirements on suppliers to make lump-sum payments to initiate or continue trading with the buyer. Alternatively, they could be used as a means of securing more indirect benefits. For example, most-favored-customer clauses, which obligate the supplier not to sell to another buyer at a lower price, guarantee that the buyer will not be placed at a purchase cost disadvantage relative to another buyer. Similarly, exclusive dealing arrangements deny other buyers access to the supplier's product, which may allow the buyer to gain a product differentiation advantage over its rivals in downstream markets. Other terms and conditions demanded by a powerful buyer may be designed to shift the burden of financial risk squarely on to suppliers. For instance, the buyer may require the supplier to accept the return of unused or unsold supplies or tolerate long delays in payment. If supply disruptions may occur, a powerful buyer may insist that it receive supplies ahead of other buyers, thereby shifting the risk of nonavailability onto its rivals.

(University of Kiel, Department of Food Economics and Consumption Studies Working Paper FE 0307, 2003)).

⁴² See Paul W. Dobson, *Buyer-Led Vertical Restraints*, in *ISSUES IN COMPETITION LAW AND POLICY* (Wayne Dale Collins ed.) (forthcoming 2008) (manuscript on file with the Buyer Power Committee).

As with demands to grant price discounts, suppliers may be under considerable pressure to agree to such nonprice restraints when they are economically dependent on major buyers.⁴³ A single buyer need not command a large degree of countervailing power, however, for its suppliers to be willing to accept vertical restraints. First, these restraints may arise through mutual consent between broadly matched trading parties. For example, a supplier may agree to a restraint because it gains something in return, such as financial recompense, a reciprocal restraint placed on the buyer, or additional service.⁴⁴ Second, these restraints may be standard arrangements that have emerged in the industry over time and are used by most or all buyers, perhaps to ensure a level playing field.⁴⁵ Third, the restraints may arise because the buyer is facilitating a suppliers' cartel, through agreements on resale price maintenance, for example, or on exclusive supply.⁴⁶ Finally, such restraints may be associated with a group of buyers acting in unison, seeking, for instance, to thwart a more efficient retail operation from capturing their customers.⁴⁷

For the most part, though, the kind of buyer-led vertical restraints that are likely to occur are those in which the buyer holds some bargaining advantage over suppliers that ensures their compliance or consent. These practices can be wide-ranging and quite diverse in

⁴³ Consider, for example, the economic dependence of consumer goods suppliers on their major retail customers. With retail consolidation, there are fewer alternatives available for suppliers to gain access to shelf-space, which strengthens the major retailers' position as gatekeepers to consumers. As a result, suppliers operating under high fixed costs simply cannot afford to lose contracts with major retailers, as they have little or no prospect of picking up the lost business through additional orders placed elsewhere (especially when consumers are more store loyal than brand loyal). While it may be thought that economic dependency works both ways, this is not necessarily the case. A major retailer may have other suppliers that it can readily turn to if it chooses to delist a supplier, each of which may be only too willing to increase supply and replace a rival. Also, the retailer may be in a position where it can reallocate shelf space in favor of other product lines. *See* Dobson, *supra* note 23.

⁴⁴ In the U.K., for instance, newspaper wholesalers are granted exclusive territories by national newspaper publishers in return for providing "universal service" to all available retail outlets (subject to some minimum order size) in the territory. *See* MONOPOLIES AND MERGERS COMM'N, SUPPLY OF NATIONAL NEWSPAPERS (1993).

⁴⁵This might include commonly employed payment terms or rules regarding sharing of promotional expenditures between buyers and sellers.

⁴⁶ *See e.g.*, Toys "R" Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000) (major retailer coordinates agreement among manufacturers to restrict supply to warehouse clubs).

⁴⁷*See* Debra A. Valentine, *Retail Buyer Power: Abusive Behavior and Mergers/Acquisitions*, in INTERNATIONAL ANTITRUST LAW & POLICY: FORDHAM CORPORATE LAW 2000 at 513 (Barry Hawk ed., 2001).

nature. To illustrate the point, Table 1 divides buyer-led restraints into six categories, summarizing the nature of each category and providing various examples.⁴⁸

Table 1

Types of Buyer-Led Vertical Restraints⁴⁹

<i>Category</i>	<i>Nature</i>	<i>Examples</i>
1. Conditional Purchase Requirements	Supplier required to provide significant concessions in respect of whom else it may trade with or what it (uniquely) provides the buyer as a condition of purchase	<ul style="list-style-type: none"> • Insistence on exclusive supply • Minimum supply obligations • Exclusive distribution • Reciprocal dealing • Tying purchases
2. Additional Payment Requirements	Supplier required to provide lump-sum payments or special discounts for gaining/retaining access to a key distribution system or to ensure that the buyer is rewarded for its efforts and compensated for any failings on the part of the supplier	<ul style="list-style-type: none"> • Listing fees • Slotting allowances • Retroactive (overriding) discounts • Joint marketing contributions • Special payments (e.g., buyer merger “wedding gift”)
3. Non-Discrimination Clauses	Requirements placed on a supplier either to ensure that it does not offer (significantly) better terms or products to other purchasers or to assist in helping the purchaser compete on effective terms against other purchasers (e.g., in its downstream markets)	<ul style="list-style-type: none"> • Most favored customer clause • Requirement to provide best or matching product/service quality • Margin support guarantee • Open book accounting requirement
4. Refusal to Buy	Purchaser boycotts a supplier or limits its purchases in such a way as to weaken its	<ul style="list-style-type: none"> • Refusal to initiate trading • Terminating long-standing trading

⁴⁸ There are other ways of classifying buyer-led practices, particularly in the area of retailing, where a wide variety of such practices may exist. See, e.g., PAUL W. DOBSON, MICHAEL WATERSON & ALEX CHU, *THE WELFARE CONSEQUENCES OF THE EXERCISE OF BUYER POWER*, 16 OFT RESEARCH PAPER (1998), available at <http://www.offt.gov.uk/NR/rdonlyres/9A4F0B82-1514-4344-9C1F-39621912E9DE/0/oft239.pdf>; DOBSON CONSULTING, *BUYER POWER AND ITS IMPACT ON COMPETITION IN THE FOOD RETAIL DISTRIBUTION SECTOR OF THE EUROPEAN UNION* (European Comm’n DGIV, 1999), available at <http://europa.eu.int/comm/competition/publications/studies/bpifrs/>; COMPETITION COMM’N, *supra* note 31.

⁴⁹ Adapted from Dobson, *Buyer-Led Vertical Restraints*, *supra* note 42.

	competitive position or put it out of business (potentially distorting supplier competition and perhaps raising other purchasers' costs)	relationship at short notice <ul style="list-style-type: none"> • Delisting certain products
5. Deliberate Risk Shifting	Purchaser pushes on to its supplier the financial risk that it faces from uncertainty over its own performance and realized demand in its downstream markets	<ul style="list-style-type: none"> • Delayed payments • Enforced sale-or-return • Payments to cover product wastage on unused/unsold items • No written contracts
6. Service or Input Requirements	As part of the terms and conditions of supply, the purchaser requires a supplier to provide particular services or to use particular inputs (beyond those normally offered) to suit its own specific needs	<ul style="list-style-type: none"> • Tailored delivery terms • Customized product presentation • Obligations to use third-party contractors • Category management services

1. Beneficial Effects

As with other vertical restraints, the nonprice terms discussed in this section may generate efficiency benefits, including: (i) solving a free rider problem, (ii) encouraging new investment, (iii) facilitating new entry into markets, (iv) allowing for different promotional strategies in different markets, (v) achieving economies of scale in distribution or production, (vi) alleviating capital market imperfections, or (vii) allowing for uniformity and quality standardization.⁵⁰ For example, exclusive dealing might be enforced to prevent rival buyers from free riding on investments made by a buyer in developing new sources of supply or new product lines, while at the same time encouraging relation-specific investment by the supplier and perhaps financial support by the buyer. Reciprocal dealing or tying arrangements might be a means to enter a new market. Customized packaging might be required by a buyer to facilitate a promotional strategy in its downstream markets. Requiring suppliers to use third-party contractors for such functions as product labeling might be required to aid uniformity of the buyer's brand image, while a similar requirement for trucking might allow for economies of scale in distribution. These and other efficiency benefits typically arise from aligning buyers'

⁵⁰ See EUROPEAN COMMISSION, COMMISSION NOTICE - GUIDELINES ON VERTICAL RESTRAINTS, C291 E.C. OFFICIAL JOURNAL 1 (2000), available at http://europa.eu.int/eurlex/pri/en/oj/dat/2000/c_291/c_29120001013en00010044.pdf.

and suppliers' incentives or reducing transaction costs, both of which may yield increased output, improved product quality, and better prices for suppliers and consumers.

2. Harmful Effects

Nonprice terms induced by buyers may also restrict competition, at either the buyer's or the supplier's level of the distribution chain. Sometimes, competition can be affected in a very direct manner – such as where restraints are used to enforce a cartel or foreclose markets through naked exclusion. Often, though, the effects can be subtler, and competition is distorted rather than completely eliminated. Moreover, when the buyer uses a combination of restraints or the restraints occur in a network of buyers, then there may be a cumulative effect (with one distorting effect reinforcing or building on another).

Consumers may feel the impact of these restraints when they serve to reduce or inhibit product choice, quality, or innovation. Consumers may also face higher prices when the restraints operate in a manner that serves to consolidate supplier or buyer power at one level of the supply chain. The restraints may even reduce the number of effective competitors at each level, giving rise to the possibility of *successive* or *coalescing power*.⁵¹ In some settings, moreover, buying power might cause a “waterbed effect” in which suppliers compensate for the concessions they make to major retailers by worsening the terms they offer smaller retailers, ultimately harming consumers.⁵²

3. Empirical Evidence

The most comprehensive evidence on the effects of buyer-led vertical restraints has emerged from U.S. and U.K. sector inquiries.⁵³ In the United States, the FTC has examined the retail grocery industry's use of slotting allowances and other off-invoice fees (including listing charges, introductory fees, pay-to-stay levies, and failure or removal

⁵¹ For the circumstances that might give rise to coalescing power as opposed to countervailing power, see Paul W. Dobson, *Competing, Countervailing, and Coalescing Forces: The Economics of Intra- and Inter-Business System Competition*, 51 ANTITRUST BULL. 175 (2006).

⁵² See Paul W. Dobson & Roman Inderst, *Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers?*, 28 EUR. COMPETITION L. REV. 393 (2007); Paul W. Dobson & Roman Inderst, *The Waterbed Effect: Where Buying and Selling Power Come Together*, WISC. L. REV. (forthcoming 2008) (manuscript on file with the Buyer Power Committee).

⁵³ For a review of individual cases involving exclusive supply arrangements, see Valentine, *supra* note 47.

fees), as well as the role of category management services provided by suppliers.⁵⁴ The evidence points to a mix of procompetitive and anticompetitive effects.⁵⁵ In the U.K., the CC took a broader look at buyer-led restraints in the retail grocery sector. In its *Supermarkets* inquiry concluded in 2000, the CC identified 52 practices that could have distorting effects on supplier or retailer competition and found evidence that the major chain retailers had used 42 of them. The CC grouped these 42 practices into 8 categories and, as Table 2 shows, concluded that 30 of the practices distorted supplier competition, that 18 of these also distorted retailer competition, and that overall (after taking into account potentially offsetting efficiencies) 27 practices operated against the public interest.⁵⁶

⁵⁴See FED. TRADE COMM'N, REPORT ON THE FEDERAL TRADE COMMISSION WORKSHOP ON SLOTTING ALLOWANCES AND OTHER MARKETING PRACTICES IN THE GROCERY INDUSTRY (2001). *See also* FED. TRADE COMM'N, SLOTTING ALLOWANCES IN THE RETAIL GROCERY INDUSTRY: SELECTED CASE STUDIES IN FIVE PRODUCT CATEGORIES (2003).

⁵⁵ For summaries, see RICHARD J. SEXTON, TIMOTHY J. RICHARDS & PAUL M. PATTERSON, RETAIL CONSOLIDATION AND PRODUCE BUYING PRACTICES: A SUMMARY OF THE EVIDENCE AND POTENTIAL INDUSTRY AND PUBLIC RESPONSES, Monograph 45 (2002); Debra M. Desrochers, Gregory T. Gundlach & Albert A. Foer, *Analysis of Antitrust Challenges to Category Captain Arrangements*, 22 J. PUB. POL'Y & MARKETING 201 (2003); GREGORY T. GUNDLACH, ANTITRUST ANALYSIS OF EXCLUSIONARY ARRANGEMENTS INVOLVING SLOTTING ALLOWANCES AND FEES: ISSUES AND INSIGHTS (Am. Antitrust Inst. Working Paper 05-03, 2005).

⁵⁶ For the 30 practices found to be distorting supplier competition, the CC argued that the effect of each was to take away resources required to build brands and introduce new products, thereby reducing innovation and investment. Over the longer term, moreover, the practices were likely to induce exit (especially of smaller players) and raise barriers to entry, ultimately lowering quality and consumer choice. In terms of the 18 practices identified as distorting retailer competition, the CC concluded that major retailers with buyer power would be able to gain a significant advantage over smaller retailers, where (especially middle-ranking) suppliers facing intense buyer power would look for compensation by hardening their terms to these smaller retailers, in the process undermining their viability and also increasing barriers to entry into the secondary market for grocery shopping (e.g., convenience stores for top-up shopping). As a result, consumers would face higher costs and less choice if they wanted to shop at these smaller retailers. See COMPETITION COMM'N, *supra* note 31, ¶¶ 2.437 – 2.550, Table 2.14 and Appendix 11.3.

Table 2

U.K. Competition Commission Assessment of Supermarket Supplier Practices (2000)

<i>Category of Practices</i>	<i>No. of practices</i>	<i>No. practices distorting supplier competition</i>	<i>No. practices distorting retailer competition</i>	<i>No. practices against the public interest</i>
Payments for access to shelf space	8	6	0	4
Imposing conditions on suppliers' trade with other retailers	2	0	0	0
Applying different standards to different suppliers	1	1	1	1
Imposing an unfair imbalance of risk	12	10	10	10
Imposing retrospective changes to contractual terms	8	6	6	6
Restricting suppliers' access to the market	1	0	0	0
Imposing charges and transferring costs to suppliers	8	6	1	5
Requiring suppliers to use third party suppliers nominated by the retailer	2	1	0	1

D. Vertical Competition and Horizontal Competition

According to Robert Bork, although buyers and sellers are at different vertical stages, “their relationship is the same in economic reality as that of partners.”⁵⁷ In fact, however, in consumer goods industries, and perhaps in many others, firms typically have both a complementary and a competitive relationship with their suppliers and customers.

⁵⁷ Robert Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, Part II*, 75 YALE L.J. 373, 404 (1966).

Moreover, a firm's competitive relationship with its suppliers and customers can affect horizontal competition. If a firm is a successful vertical competitor, it can increase its market power as a seller and a buyer by creating cost advantages that raise barriers to entry and expansion.⁵⁸

In vertical upstream competition, a consumer goods manufacturer strives to reduce the selling prices of its suppliers (i.e., its invoice costs) by beating down suppliers' margins.⁵⁹ In vertical downstream competition, the manufacturer strives to beat down the margins of its retailers and thereby capture a larger share of its brands' consumer price at the retailers' expense. The reward for the manufacturer that out-competes its rivals in vertical upstream and downstream competition is that it will be buying for less and selling for more than they are. This accomplishment not only raises the firm's profits and power in the short run but has longer term competitive effects: it erects mobility and entry barriers that buffer the manufacturer's power against erosion. It is a daunting challenge to compete against a firm that can buy cheaper and sell dearer than you can.

The relationship between vertical competition and horizontal competition is also mutually reinforcing. By becoming a stronger horizontal competitor, the manufacturer can become a stronger vertical competitor, which enables it in turn to become an even more powerful horizontal competitor. When a firm gains horizontal market share, for example, it will be able to place larger orders, which is likely to enhance its vertical upstream advantage in two ways. First, larger orders often reduce a supplier's unit costs: due to scale economies, the supplier can fill the order at lower average total cost than a smaller order. In addition, in hopes of capturing the larger order, the supplier is likely to reduce its markup over cost. These factors combine to lower the manufacturer's invoice cost and strengthen its position as a horizontal competitor. A lower than average invoice cost means that, at equal factory margins, the manufacturer can reduce the factory price of its brand below the prices of competing brands, taking horizontal market share from

⁵⁸ This section is based on Robert L. Steiner, *Vertical Competition, Horizontal Competition and Market Power*, 53 ANTITRUST BULL. (forthcoming 2008) (manuscript on file with the Buyer Power Committee), which not only explains the concept of vertical competition but proposes a method for calculating "vertical market shares."

⁵⁹ In consumer goods industries, this typically involves exerting countervailing power against suppliers with some degree of market power.

them. Alternatively, at equal factory prices, the manufacturer will be more profitable than rival producers, again making the firm a more formidable horizontal competitor.

The firm can also strengthen its horizontal competitive position by becoming a more successful vertical downstream competitor. Suppose that a manufacturer introduces a new product and backs it with especially effective but not especially expensive advertising. And suppose that this advertising generates considerable product identity for the new brand, so that consumers quickly recognize that all the retailers carrying the brand are carrying the same item. If this brand identity is unusually high, competition to sell this brand is likely to be more intense than competition to sell other brands, and retailers' gross margins on this brand are likely to fall, since consumers are more likely to switch retailers if an individual retailer's price on this brand is out of line. As a result of these lower retail margins, the manufacturer's share of the profits in the vertical chain of distribution will grow and it will gain a cost advantage over rival manufacturers. If the manufacturer charges the same factory price as its rivals, the retail price of its brand will be lower than theirs. If the retail prices of the competing brands are the same, the manufacturer can charge a higher factory price and earn higher profits. In either case, the manufacturer has the ability to expand at the expense of its rivals, enabling it to become a larger buyer and, in turn, a stronger horizontal competitor.

Through vertical competition, in short, a firm with buying power can enhance its horizontal competitive position and increase its buying power. As discussed above, the impact of this increase in power may be positive or negative, depending on the effects on consumers, suppliers, and efficiency. In Part III, we turn from the effects of the exercise of buyer power to conduct by buyers that may violate the antitrust laws. Using the analysis in Part II, we examine several types of potentially anticompetitive conduct involving buyers and assess the priority of challenging each.

III. Antitrust Violations Involving Buyer Power

We begin with the type of conduct that history suggests is most likely to represent the exercise of monopsony power and thus most likely to exploit small sellers without providing benefits to consumers – price fixing. We then discuss mergers among buyers and exclusionary conduct by buyers. We conclude with discrimination by sellers that favors large buyers over their smaller competitors. Such conduct, which may violate the Robinson-Patman Act, is the most ambiguous of any we discuss, since it ordinarily

reflects the countervailing power of the favored buyers and thus may either benefit or harm consumers.

A. *Price Fixing*

Cases in which buyers conspired to suppress input prices began with the Supreme Court's 1905 decision in *Swift v. United States*⁶⁰ and extend through today. During the period from 1996 through 2007, according to Gregory Werden, "the Department of Justice brought sixty-nine criminal cases against buyer cartels, all of which involved collusion among bidders in auctions. Fifty-one of those cases involved collusion in real estate foreclosure auctions."⁶¹ Werden also notes: "Buyer cartel cases constituted 20 percent of total criminal Sherman Act cases during the period."⁶²

Buyer cartel cases often involve perishable commodities, such as agricultural produce, timber, or seafood, where small sellers are forced to take whatever price is offered because the product will quickly spoil and become worthless if not immediately marketed.⁶³ Other cases involving nonperishable goods include efforts to limit competitive bidding at auctions.⁶⁴ Even when nonperishable goods are offered at auction, sellers are vulnerable to buying cartels because of the costs involved in placing a product in an auction and, if the product is not sold, warehousing it for future sale.

The sellers in these cases – ranchers, timber owners, fisherman, farmers, and consumers

⁶⁰ *Swift v. United States*, 196 U.S. 375, 391 (1905) (defendants "refrain from bidding against each other, 'except perfunctorily and without good faith,' and by this means compelling the owners of [livestock] to sell at less prices than they would receive if the bidding really was competitive").

⁶¹ Gregory J. Werden, *Monopsony and the Sherman Act: Consumer Welfare in a New Light*, 74 ANTITRUST L.J. 707, 716 (2007).

⁶² *Id.* at 716 n.42.

⁶³ See, e.g., *Mandeville Island Farms v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235 (1948) (sugar refiners alleged to have unlawfully conspired to suppress the price of California sugar beets); *Am. Tobacco Co. v. United States*, 328 U.S. 781 (1946) (three major cigarette producers conspire to rig terms of tobacco auctions); *Eagle v. Star-Kist Foods, Inc.*, 812 F.2d 538 (9th Cir. 1987) (alleged price fixing of tuna purchased by canneries); *Reid Brothers Logging Co. v. Ketchikan Pulp Co.*, 699 F.2d 1292 (9th Cir.1983) (two logging companies refuse to bid against one another for timber).

⁶⁴ See, e.g., *United States v. Howe*, Crim. No. 87-00262 (E.D. Pa. 1987) (dealers collude at antique auction); *United States v. Perfection Machine Sales, Inc.*, Crim. No. 88-00281 (E.D. Pa. 1988) (buyers collude at auction for used commercial equipment).

with homes in foreclosure – operated in competitive markets and were largely if not completely powerless. As a result, they were highly vulnerable to exploitation by the colluding buyers. Whether or not the price fixing actually depressed output, it transferred wealth from atomistic sellers to monopsonistic buyers and thus offended one of the purposes of the Sherman Act.⁶⁵ Challenging such behavior should remain a high priority of the Antitrust Division.

Naked buyers' cartels are, of course, per se illegal. As a result, the enforcement agencies need not show that such collusion harmed consumers, and the defendants cannot claim that their conduct should be excused because it benefited consumers. We urge the agencies to take the same position in any case in which they show that buyers engaged in concerted conduct likely to create, maintain, or increase classic monopsony power. Whatever else the agencies might have to show to establish that such behavior violated the antitrust laws, the agencies should not have to prove that it was likely to harm consumers.⁶⁶ Similarly, whatever defenses or justifications the buyers might be entitled to offer, they should not be able to excuse their conduct on the ground that it was likely to benefit consumers. The agencies should maintain, in short, that downstream impact need not be assessed in a case alleging that competing buyers agreed on a practice likely to lead to the monopsonistic exploitation of small sellers.⁶⁷

The agencies should take this position for at least four reasons.⁶⁸ First, as we just noted,

⁶⁵ One congressman famously remarked that the beef trust “robs the farmer on the one hand and the consumer on the other.” 21 CONG. REC. 4098 (1890) (statement of Rep. Ezra B. Taylor). As this remark indicates, Congress passed the Sherman Act not only to protect consumers but also to stop the exploitation of small sellers by anticompetitive conduct. See Werden, *supra* note 61, at 714 (“Congress intended to protect sellers victimized by trusts and other conduct within the scope of the Sherman Act’s prohibitions.”); John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency*, 84 NOTRE DAME L. REV. (forthcoming 2008) (manuscript on file with the Buyer Power Committee) (Congress desired to protect suppliers as well as purchasers from exploitation by firms that have unfairly acquired power).

⁶⁶ In this context, we use “consumers” to refer to direct purchasers, intermediate buyers, or end users.

⁶⁷ This same principle should apply to single-firm conduct likely to create, maintain, or increase classic monopsony power. For example, if a buyer acquires monopsony power through predation rather than innovation, it should not be allowed to claim that its conduct was justified because it would use its monopsony power to obtain lower prices from suppliers and pass on those price cuts to consumers.

⁶⁸ For a more extensive discussion of the importance and appropriateness of protecting atomistic sellers, see Grimes, *supra* note 3.

Congress intended to protect small sellers from monopsonistic exploitation, regardless of the impact on consumers. Second, as we showed in Part I, the exercise of classic monopsony power generally harms suppliers and rarely, if ever, benefits consumers. As a result, there is little to be gained from litigating whether particular monopsonistic behavior was likely to benefit consumers and, if so, whether the benefits outweighed the harm to suppliers. Third, it would reduce costs and save time if this issue did not have to be litigated. Finally, most courts have ruled that downstream impact is in fact irrelevant to determining whether single-firm or joint monopsonistic behavior is illegal.⁶⁹

B. Mergers

The Merger Guidelines indicate that the enforcement agencies will review mergers of competing buyers to determine whether the combination is likely to create monopsony power:

Market power also encompasses the ability of a single buyer (a “monopsonist”), a coordinating group of buyers, or a single buyer, not a monopsonist, to depress the price paid for a product to a level that is below the competitive price and thereby depress output. 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.⁷⁰

In general, we agree with this approach. Since a merger that achieves or enlarges classic monopsony power is likely, absent offsetting efficiencies, to harm both atomistic suppliers and consumers, such transactions ought to be investigated carefully. Indeed, because the agencies have historically challenged few mergers on this ground, they should be especially vigilant in the future to ensure that they do not allow acquisitions that

⁶⁹ See Werden, *supra* note 61; Kirkwood & Lande, *supra* note 65.

⁷⁰ U.S. DEPARTMENT OF JUSTICE & FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES § 0.1 (1992, rev'd 1997), available at http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html. The Guidelines also state that, in evaluating mergers of sellers, the agencies will normally postulate a “price increase of five percent lasting for the foreseeable future” but “may use a price increase that is larger or smaller than five percent.” *Id.* at § 1.11. In evaluating mergers of buyers, we suggest that the agencies consider using a price reduction smaller than five percent when the suppliers in the relevant market are small and intensely competitive. For such powerless suppliers, even a one percent reduction may be significant.

subject small sellers like farmers or fishermen to monopsonistic exploitation.

We believe, however, that the Merger Guidelines do not go far enough. They refer only to mergers that create monopsony power and “thereby depress output,”⁷¹ but monopsony can cause harm even when it does not reduce output. Some recent investigations suggest that the agencies may not recognize or at least emphasize this possibility. In a review of Wal-Mart’s acquisition of the largest supermarket chain in Puerto Rico, and again in an investigation of the merger of two of the largest providers of prescription benefit management services, the FTC dismissed buyer power concerns because it concluded that the transactions were unlikely to result in a reduction in the quantity of inputs purchased.⁷²

Whether or not these matters were properly resolved, in future merger reviews the agencies should consider whether the transaction is likely to cause adverse effects beyond an immediate reduction in output. For example, a merged firm may exercise monopsony power by engaging in all-or-nothing contracting or other forms of discrimination among its suppliers, and such conduct may transfer wealth from the suppliers to the monopsonist without depressing output.⁷³ Alternatively, the merged firm may use its enhanced power to exploit suppliers that have made sunk investments in the industry.⁷⁴

⁷¹ *Id.*

⁷² In the Wal-Mart investigation, the FTC said that its concerns with buyer power were limited to cases in which the power buyer could “profitably reduce the purchase price below competitive levels by scaling back purchases in a relevant antitrust market.” Letters from the FTC to Honorable Anibal Acevedo-Vila and to Albert A. Foer, President of the American Antitrust Institute (Feb. 27, 2003) (explaining the FTC’s decision to accept a consent order resolving its investigation of Wal-Mart’s acquisition of Supermercados Amigo, Inc.), *available at* <http://www.ftc.gov/opa/2003/02/fyi0315.htm>.

In its investigation of Caremark Rx, Inc.’s acquisition of Advance PCS, the FTC justified its decision to close the inquiry with the statement that consumers do not suffer “when the increased bargaining power of large buyers allows them to obtain lower input prices without decreasing input purchases.” The FTC said there was no risk of a monopsony or oligopsony outcome, or “one in which overall purchases from pharmacies are reduced.” Caremark Rx, Inc./Advance PCS, FTC File No. 031 0239 (Feb. 11, 2004), *available at* <http://www.ftc.gov/os/caselist/0310239/0310239.htm>.

⁷³ *See supra* text accompanying note 20.

⁷⁴ For a vivid example of a sunk investment (based on testimony by Robert Taylor), see Grimes, *supra* note 3, at 569:

Consider a farmer who contracts to supply chickens for a large poultry processor. The farmer must acquire a sophisticated chicken coop that meets the processor’s requirement. This acquisition may entail borrowing substantial funds on time, creating

Even if the suppliers continue to produce the same quantity, their profits have fallen and that may cause them to curtail product quality, cut back capital expenditures, or take steps that impose external costs on society.⁷⁵ Further, an increase in concentration at one level of the distribution system may induce increases in concentration upstream and downstream. While the replacement of an atomistic distribution channel with one that is concentrated at each stage may increase efficiency and benefit consumers, it may also result in a series of oligopolies that engage in imperfect bargaining with each other, causing adverse effects on output and prices.⁷⁶ Finally, the exploitation of suppliers by the merged firm may ultimately drive some of them out of business, diminishing long-run diversity and choice. Consider the merger of the two large firms that sell prescription benefit management services. These firms deal with pharmacies, some of which are very large chains, but others of which may be small, family-owned businesses. As a result of the merger, there may be increased pressure on pharmacies to merge into larger entities. Diversity and consumer choice are more likely when individually owned pharmacies compete in the retail market, but many of these small pharmacies may find it difficult to survive.

A comprehensive approach to mergers of buyers must also recognize that some combinations of significant buyers may be procompetitive. One reason, already reflected in the Merger Guidelines, is that the merger would yield cognizable, transaction-specific efficiencies of such character and magnitude that even though the transaction would create monopsony power, its net impact on the welfare of suppliers, consumers, and society would be positive. Another possibility is that the merger would generate

an incentive for the farmer to continue to supply chickens until the loan is paid off. The chicken farmer, whose status has been equated with “economic serfdom,” is dependent upon the poultry firm to supply newly hatched chickens and to repurchase those chickens after they are raised. In these circumstances, the poultry firm has both the power and the incentive to drive the farmer’s profits down to the minimum sustainable level. Faced with these realities, the farmer may regret the decision to enter this line of work, but is constrained by sunk costs to continue the relationship.

⁷⁵ See *id.* at 574 (describing externalities; e.g., small suppliers may use the political process to “obtain subsidies for their products,” or pay their “employees a below subsistence wage with no health care benefits,” which may cause the employees to rely on “government or private charity to pay for food, rent, and health care”). To the extent suppliers are likely to respond to exploitation not by imposing externalities on third parties but by taking steps, such as reducing product quality, that may harm the merged firm, its incentive to engage in exploitation would be diminished.

⁷⁶ See *supra* notes 25 (discussing the effects of “bilateral monopoly”) & 51 (citing to a discussion of “successive” or “coalescing” power).

countervailing power and the exercise of such power would benefit consumers.⁷⁷ It may be difficult, however, to identify cases in which the creation of countervailing power would enhance rather than reduce competition. For this reason and others, we are not advocating a countervailing power defense to an otherwise illegal merger. To the contrary, as we indicated in section A above, if a merger is likely to result in the monopsonistic exploitation of small suppliers, the defendants should not be allowed to excuse this anticompetitive result on the ground that consumers would benefit.

C. *Exclusionary Behavior*

1. Exclusive Dealing and Other Behavior that Raises Rivals' Costs

Almost a hundred years ago, the Supreme Court decided a seminal 1911 case involving a powerful buyer's ability to raise its rivals' costs – *Standard Oil Co. v. United States*⁷⁸ As Standard Oil grew in size and dominance, it was able to command lower rail rates for shipping the refined product. More important, it helped maintain a cartel among the railroads, enabling them to charge higher rates to Standard's rivals while giving the big refiner a "drawback," a percentage of the higher rates charged the nonfavored refiners. Through such conduct, Standard Oil raised its rivals' costs and forced many of them to exit or sell out to Standard, enlarging its downstream market power.⁷⁹

More recently, the Supreme Court has confronted a series of cases in which a retailer has allegedly used its buying power to disadvantage competing retailers and thereby harm consumers. In these cases, a retailer with asserted power in one or more local markets may demand that suppliers cease selling to other retailers in these markets or sell to them only on discriminatory terms. In this way, a locally powerful retailer may raise the costs

⁷⁷ Both procompetitive possibilities may also apply to another type of combination among buyers – joint purchasing. When buyers combine into purchasing joint ventures or purchasing co-ops, consumers may benefit if the combination reduces the participants' input costs by creating efficiencies or countervailing power and the cost savings are passed on to consumers. For discussions of joint purchasing, see ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 99 – 100, 455 – 57 (6th ed. 2007); 12 HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 135 – 42 (2d ed. 2005). For yet another situation in which a combination of buyers may increase the welfare of consumers, see Robert A. Skitol, *Concerted Buying Power: Its Potential for Addressing the Patent Holdup Problem in Standard Setting*, 72 ANTITRUST L.J. 727 (2005).

⁷⁸ *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

⁷⁹ See Elizabeth Granitz & Benjamin Klein, *Monopolization by "Raising Rivals' Costs": The Standard Oil Case*, 39 J.L. & ECON. 1 (1996).

of its smaller rivals and enhance its ability to charge supracompetitive prices to consumers.⁸⁰

Bringing raising rivals' costs cases should be a significant priority for the enforcement agencies. By definition, these cases harm consumers and, by restricting output, they probably harm economic efficiency as well.⁸¹ In these cases, moreover, it does not matter whether the powerful buyer might have been able to exercise classic monopsony power or beneficial countervailing power. By using its power to raise rivals' costs, the buyer chose to exercise its power in a way that injured consumers.

2. Predatory Bidding and Other Conduct that Creates or Maintains Monopsony Power

In *Weyerhaeuser*,⁸² the Supreme Court held that predatory bidding is so similar to predatory pricing that the two practices should be governed by the same legal standards.⁸³ After *Weyerhaeuser*, therefore, predatory bidding does not violate the antitrust laws unless: (1) the buyer incurred losses (i.e., its revenues did not cover an appropriate measure of its costs), and (2) it is likely to recoup those losses. Because this standard is so demanding,⁸⁴

⁸⁰ See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988); *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). Toys "R" Us may have had more power in certain local markets than it had nationally. See *id.* at 930 (while Toys "R" Us's share of toy sales was 20% nationally, its share in some metropolitan areas ranged from 35% to 49%).

⁸¹ Behavior that raises rivals' costs might also increase economic efficiency. See *supra* Part II.C (describing efficiency benefits of buyer-led vertical restraints). When we refer to raising rivals' costs cases, we mean cases in which the behavior harms consumers, whether or not it increases aggregate welfare.

⁸² *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007).

⁸³ *Id.* at 1078. Predatory bidding occurs when a "purchaser of inputs 'bids up the market price of a critical input to such high levels that rival buyers cannot survive (or compete as vigorously) and, as a result, the predating buyer acquires (or maintains or increases its) monopsony power.'" *Id.* at 1075 (quoting Kirkwood, *supra* note 23, at 652). Predatory bidding is thus the mirror image of predatory pricing. See *id.* at 1076 ("A predatory-pricing plaintiff alleges that a predator cut prices to drive the plaintiff out of business and, thereby, to reap monopoly profits from the output market. In parallel fashion, a predatory-bidding plaintiff alleges that a predator raised prices for a key input to drive the plaintiff out of business and, thereby, to reap monopsony profits in the input market.").

⁸⁴ See Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L.J. 2239, 2258 – 60 (2000) (finding that plaintiffs have very rarely been able to meet the comparable standard for predatory pricing).

and because few successful predatory bidding cases have ever been brought,⁸⁵ it is unlikely that predatory bidding cases will make up a substantial proportion of either agency's enforcement agenda. Nevertheless, significant evidence of predatory bidding – or a closely related practice like predatory overbuying – should not be ignored. If a buyer did engage in such practices, it could acquire or maintain monopsony power and exploit small or relatively powerless suppliers like the timber owners involved in *Weyerhaeuser* and *Reid Brothers*.⁸⁶ For the same reason, the agencies should investigate and pursue cases involving other exclusionary practices, like exclusive dealing, that enable a buyer, without justification, to gain or preserve monopsony power.

D. *Robinson-Patman Violations*

In recent years, the federal agencies have not enforced the Robinson-Patman Act, the federal statute that outlaws, in certain circumstances, price and promotional discrimination. The FTC has issued no complaints since the beginning of the second Bush administration and the Department of Justice has not brought a Robinson-Patman case since 1976, when it urged that the Act be repealed. During the Clinton and first Bush administrations, however, the FTC was more active. It pursued two significant initiatives and asserted in both of them that the challenged discrimination threatened to harm not only small businesses but consumers. We recommend that the FTC look for and, if warranted, bring a comparable case during the next administration.

The FTC's most recent initiatives were distinctive because they combined the prospect of consumer harm with the Act's traditional focus on injury to small business. In *McCormick*, the FTC alleged that the respondent was discriminating among its customers in order to protect its own dominant position from challenge.⁸⁷ Specifically, McCormick

⁸⁵ For evidence that successful predatory bidding cases have been extremely rare, though not nonexistent, see John B. Kirkwood, *Controlling Above-Cost Predation: An Alternative to Weyerhaeuser and Brooke Group*, 53 ANTITRUST BULL. (forthcoming 2008) (manuscript on file with the Buyer Power Committee).

⁸⁶Of course, if the buyer did not incur losses, its bidding practices could not be challenged under the *Weyerhaeuser* standard, even if these practices harmed suppliers, consumers, and total welfare. Since the case was just decided, it is almost certainly premature to ask the Court to reexamine this standard. It should be noted, however, that it may be possible to formulate an alternative legal test that achieves a better balance of false positives and false negatives. See Kirkwood, *supra* note 85. Further, the Court is more likely to consider such an alternative in a case brought by the government. In *Weyerhaeuser*, the Court noted that the case had been brought by a competitor. See *Weyerhaeuser*, 127 S. Ct. at 1076.

⁸⁷ See *McCormick & Co.*, FTC Dkt. No. C-3939 (Apr. 27, 2000) (statement of Chairman Pitofsky & Commissioners Anthony & Thompson).

was targeting the customers of a rival spice producer, giving them more favorable prices or other terms in order to divert them from the rival and deprive it of the scale it needed to erode McCormick's market power. As a result, McCormick's discrimination threatened to injure both competitors of the favored customers and consumers. In *Harper & Row*, a more traditional Robinson-Patman case, the FTC asserted that major book publishers had been granting price and nonprice concessions to the national bookstore chains and this favoritism not only hurt independent bookstores but threatened to reduce competition in the marketplace as a whole. As we noted earlier, the subsequent demise of literally thousands of independent bookstores deprived many consumers of nonprice options they desired and may have resulted in higher retail prices.⁸⁸

We recommend that the FTC continue to pursue similar Robinson-Patman cases – cases that hold out the prospect of benefiting consumers as well as small business. This should not be a major part of the FTC's enforcement program, since most price and nonprice concessions induced by a large buyer are unlikely to harm consumers. Rather, they are likely to represent the beneficial exercise of countervailing power.⁸⁹ Further, it may require considerable resources to investigate and bring enough cases to end an industry wide pattern of discrimination.⁹⁰ Despite these reservations, the possibilities of constructive action in this area should not be disregarded. We urge the FTC, therefore, to devote significant attention to locating and pursuing procompetitive Robinson-Patman cases.

⁸⁸ See *supra* notes 33 – 36 and accompanying text. The FTC ultimately withdrew the cases, in part because the American Booksellers Association was challenging the same discrimination through actions against book publishers and the national chains. See *Harper & Row Publishers Inc.*, 122 F.T.C. 113 (1996).

⁸⁹ Moreover, even if the concessions are likely to harm consumers, they will often be protected by the meeting competition defense, since buyers frequently induce concessions by playing sellers off against each other. Because the meeting competition defense can insulate harmful discrimination from attack under the Robinson-Patman Act, the FTC might consider whether there should be no meeting competition defense under Section 5 of the FTC Act, provided the FTC finds that the challenged discrimination was substantial, persistent, not cost justified, and likely to harm consumers.

⁹⁰ It is difficult to eliminate industry wide discrimination at its root by suing the powerful buyers who induced it, since under Section 2(f) of the Robinson-Patman Act, buyer liability is limited to cases in which the seller was also violating the Act and the buyer knew, or should have known, that the seller had no defenses. See *Great Atl. & Pac. Tea Co. v. FTC*, 440 U.S. 69, 78 (1979). This is another area where the FTC Act might be used to combat harmful discrimination more effectively.

Moreover, if Congress decides to reexamine the Act itself, we urge both agencies to support the changes we recommend rather than repeal.

IV. The Robinson-Patman Act

Recently, the AMC recommended that the Robinson-Patman Act be repealed. Thirty years before, the Department of Justice also called for repeal. Yet, despite such repeated criticism, the Act has never been changed substantially, let alone eliminated. To the contrary, small business has always rallied behind the statute and Congress has left its principal provisions intact. If small business continues to support the Act and Congress continues to value fairness to small business, repeal is not a realistic option, even if it were desirable.

We oppose repeal of the Robinson-Patman Act. Instead, if Congress is interested in limiting the adverse effects of the statute, we recommend several changes that would strike a better balance between protecting small business and protecting consumers. In this section, we review the benefits and costs of the Robinson-Patman Act and summarize our proposed reforms. We also address why it would not be desirable to rely on other laws to protect small business and consumers.⁹¹

A. Benefits of the Act

Although the AMC downplayed the benefits of the Act, Robinson-Patman enforcement can in fact advance three significant goals: fairness to small business, distributional efficiency, and the welfare of consumers.

1. Fairness to Small Business

The overarching aim of the Act is to create a more level playing field for small business. By reducing discrimination between large and small purchasers, the Act makes it easier for small firms to survive in the marketplace. It also promotes fairness to small business by reducing the influence of buying power on the terms that sellers offer customers, thereby giving all firms a greater chance to succeed on the basis of merit rather than size.

⁹¹ In its comments to the AMC, the AAI Working Group on the Robinson-Patman Act described these proposed reforms in more detail and indicated that two of them might not require new legislation. Rather, courts might be able to adopt them as constructions of the existing Act. *See* AMERICAN ANTITRUST INSTITUTE, COMMENTS, *supra* note 26, at 21. The agencies should consider advocating these constructions in future cases and amicus briefs.

2. Distributional Efficiency

The Act does not require that sellers charge the same prices to large and small businesses. Instead, it contains a cost justification defense that allows a seller to offer different prices to different customers when the seller's costs of serving the customers differ. The Act's primary target, therefore, is *non-cost-justified* price discrimination. Prohibiting price discrimination not based on cost differences promotes efficiency in distribution markets, since it prevents a less efficient retailer from taking business from more efficient firms simply because the less efficient retailer is larger and can extract better terms. Likewise, the Act enhances distributional efficiency when it deters established retailers from obtaining unjustified concessions and using them to ward off innovative new entrants. In these instances, the Act's efficiency goal dovetails with its fairness goal, since it protects small firms from injury at the hands of larger but less efficient rivals. And because the Act allows sellers to reward buyers who are cheaper to serve, it encourages the creation and spread of more efficient methods of distribution, including volume purchasing that lowers costs.⁹²

3. Welfare of Consumers

Robinson-Patman enforcement can also benefit consumers. As indicated above, when substantial, persistent, and non-cost-justified discrimination reduces market competition, consumers will face higher prices, less choice, or greater inconvenience. For example, if unjustified discrimination forces up the input costs of small firms or eliminates them altogether, and barriers to entry protect the favored buyers from new competition, those favored buyers can raise prices to consumers. And even if competition among the favored buyers keeps their prices down, consumer choice will be reduced if the small firms that were eliminated offered services, selection, or locations not provided by the large buyers. Although consumers would benefit from the large buyers' lower prices, this benefit may be outweighed by the loss of consumer choice.⁹³ Moreover, consumers will

⁹² This last benefit has been undercut, however, by court and FTC decisions that make it very difficult to establish the cost justification defense. Our proposed reforms would rectify this problem.

⁹³ The AMC argues that consumers could not be hurt on balance, for if they valued the small firms' offerings more than lower prices, they would have patronized the small firms. This argument overlooks a significant market failure – the collective action problem that often prevents large numbers of individuals from coordinating their actions. In this case, the problem arises because no single consumer can keep a small firm afloat and each has an incentive to free ride on others' efforts. As a result, the option of shopping at small firms might not be preserved even if most consumers would prefer to have that choice and would be willing to pay for it if they could act together.

be hurt if large, established retailers wield their unjustified advantages to suppress more efficient new entrants.⁹⁴

B. Costs of the Act

As the AMC emphasized, the Act has substantial costs. Most important, it can inhibit big buyers from extracting price concessions that can be passed on to consumers. As we pointed out above, the exercise of such countervailing power can undermine oligopolistic coordination and eventually produce lower prices for all buyers, big and small. Absent the Robinson-Patman Act, therefore, consumers in some markets could be paying lower prices.⁹⁵ Additionally, the Act may impose significant compliance costs on sellers. Since private plaintiffs continue to bring Robinson-Patman actions, sellers must take steps to avoid liability, either by offering nondiscriminatory terms or by structuring transactions to evade the Act, and these steps may be inefficient. Finally, as everyone recognizes, the Act is an imperfect instrument, poorly drafted and replete with provisions that restrict its impact. For example, the Act applies only to the sale of goods, not the supply of services.⁹⁶ It curtails a seller's ability to discriminate in the terms it offers customers, but it does not prohibit a seller from refusing to do business altogether with small firms. And it contains a meeting competition defense, allowing one discriminating seller to escape liability if it was meeting the terms of another discriminating seller.⁹⁷

⁹⁴ As we noted earlier, buyer-induced discrimination can also injure suppliers, not only by depriving them of excess profits, which is desirable, but by denying them the profits they need to innovate or invest in the industry. When suppliers curtail R&D or capacity, consumers may be hurt as well.

⁹⁵ The Act's adverse impact on consumers is limited, however, by the considerable difficulties plaintiffs face in winning Robinson-Patman cases and by the Supreme Court's instruction that ambiguities in the Act's meaning should be resolved so as to protect competition rather than individual competitors. *See Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 126 S. Ct. 860, 872 (2006).

⁹⁶ The Act might be expanded to cover discrimination in services, but this would not be advisable unless the Act was also reformed in the ways we suggest. Even if it was reformed, coverage of services would be administratively difficult, since it is likely to be harder to determine whether discrimination occurred with professional services like law or accounting than with commodities like books or groceries. While suppliers sometimes sell the same books or groceries to competing retailers at different prices, law firms rarely sell identical services to different clients. Thus, to determine whether discrimination occurred in the provision of professional services, there would have to be a practical way of deciding whether the services provided to different clients were comparable. Moreover, since professional services are often priced on a per-hour basis, there would need to be a means of enforcement against a provider whose rate is nondiscriminatory but who misstates the actual time spent on a client. Congress would need to study these administrative questions in some depth before expanding the Act.

⁹⁷ The Act contains other defenses and jurisdictional requirements, including the "like grade and quality" requirement discussed by the AMC. Because of these limitations, and the expense of Robinson-Patman litigation, relatively few private actions are brought and even fewer result in jury verdicts. In addition, the Act

Without more empirical evidence, it is not possible to tell whether these costs are so high that repeal of the Act is the only appropriate option. Indeed, the absence of more definitive evidence, despite 70 years' experience with the Act, provides reason to proceed with caution. Accordingly, like the United States Chamber of Commerce, we do not support repeal of the Robinson-Patman Act. To the contrary, if Congress is interested in altering the statute, it should adopt the reforms we describe below. They would significantly reduce the Act's costs while preserving its ability to halt persistent non-cost-justified discrimination that poses a substantial threat to small firms and consumers.

C. Proposed Reforms

We recommend four reforms. The first two would revitalize the cost justification defense, a key element of the statute that the courts have largely nullified. By making it more difficult to challenge cost justified price discrimination, these reforms would refocus the Act on its original target and make it more likely that Robinson-Patman actions would promote distributional efficiency and consumer welfare.

1. Market Power

We would require plaintiffs in cases challenging price discrimination among customers to prove either that the discriminating seller had market power or that the favored customer had buyer power. If neither type of power is present, the market is competitive and the challenged discrimination is likely to be cost justified. As our comment emphasizes, this reform would not entail a showing that the discriminating seller had monopoly power or that the favored customer had a large degree of buyer power. All that would be required is proof that competition was sufficiently imperfect that a seller had the incentive and the ability to undertake significant, persistent, unjustified favoritism.

2. Reasonable Relationship Test

We would also allow a defendant to establish the cost justification defense if it can show that its discriminatory price was reasonably related to cost savings generated by the favored buyer. A reasonable relationship test would preclude the courts from denying the defense simply because of minor defects in a defendant's cost study.

has not prevented large chains from expanding at the expense of small firms in recent years. Citing these facts, the AMC contends that the Act appears to have generally failed to protect small business. This goes too far. Small business has consistently supported the Act, and sellers have consistently complained about the costs of complying with the Act. Both indicate that the Act continues to play a protective role.

3. Promotional Discrimination

The third reform would require a plaintiff challenging discrimination in promotional allowances or services to show that the discrimination is likely to cause competitive injury. At present, plaintiffs challenging price discrimination must show competitive injury, but plaintiffs challenging favoritism in promotional allowances or services need not. This disparity is unwarranted and counterproductive. It discourages sellers from offering promotional incentives to their customers and makes it easier for plaintiffs to attack procompetitive incentive programs.

4. Criminal Violations

Finally, we agree with the AMC that Section 3 of the Act, which makes it a crime to engage in certain types of price discrimination, should be repealed. This provision is no longer enforced and should not be.

D. Other Laws

In contrast to these limited changes, the AMC argues that the entire Act should be repealed, in part because discrimination that harms consumers assertedly can be reached under the Sherman Act. As the AMC report indicates, however, the Sherman Act would cover discrimination in only two situations. Neither situation represents the typical Robinson-Patman case challenging favoritism among customers, and neither is required for consumer harm.

In the first situation, the favored buyer obtains an agreement from a seller that the seller will discriminate against competing buyers. Few if any Robinson-Patman cases, however, involve agreements with a promise to discriminate.⁹⁸ Moreover, a powerful buyer need not obtain such an exclusionary agreement in order to cause consumer harm.⁹⁹

In the second situation, the favored buyer attempts to acquire or maintain monopoly power through below-cost pricing. That is, the favored buyer forces a seller to extend a below-cost concession or engages in below-cost pricing itself in order to exclude

⁹⁸ In the typical Robinson-Patman case, the seller simply promises to give the favored buyer a low price. Although the seller knows that some competing buyers are not receiving this price, the seller makes no commitment to maintain the discrimination.

⁹⁹ Only one of the five scenarios of consumer harm set forth in Part II.B above involves an agreement to discriminate against smaller buyers.

competing buyers and gain or preserve monopoly power. While the Sherman Act would reach such welfare-reducing behavior, it is rarely, if ever, found in a Robinson-Patman case.¹⁰⁰ In addition, neither below-cost pricing nor monopoly power is necessary for persistent, non-cost-justified discrimination to reduce consumer welfare.¹⁰¹ Most instances of harmful discrimination, therefore, would escape federal sanction if the Robinson-Patman Act were repealed.

As the AMC recognizes, state antitrust laws might fill the void, but that is not an attractive solution. Most distribution markets are regional or national in scope, and it is not desirable for suppliers to face different pricing and promotional rules in different states. Moreover, state statutes may be interpreted in ways that are at least as protectionist as the worst features of the existing Robinson-Patman Act. By reforming the Act, Congress would provide a better guidepost for state courts to use in interpreting their own statutes. Reform would also eliminate the possibility that states would react to repeal by passing new or stronger antidiscrimination laws, just as *Illinois Brick* led to state repealer laws that now apply to approximately half the population – a situation the AMC thought so problematic that it proposed a new federal law.

Unlike the AMC, therefore, we do not believe that repeal of the Robinson-Patman Act is the most constructive response to its flaws. Even if repeal were a realistic option, it would largely remove the ability of federal law to reach discrimination that threatens to cause substantial harm to small business and consumers. In contrast, reform would preserve the Act's current ability to combat undesirable favoritism while significantly reducing its adverse impact on the economy.

¹⁰⁰ In the ordinary case, the favored buyer is not a monopolist and is unlikely to acquire monopoly power through the discrimination. Instead, there may be several favored buyers, and though each may have significant buying power, none has a reasonable prospect of becoming a monopolist. Likewise, the typical case does not involve below-cost pricing by either the discriminating seller(s) or the favored buyer(s). Indeed, it is the big buyer's ability to use an unjustified concession to disadvantage smaller rivals *without pricing below its own costs* that makes the Robinson-Patman Act a potentially desirable policy instrument.

Moreover, even if the plaintiff had some evidence of below-cost pricing and monopoly power, its chances of success in a Sherman Act action are likely to be low. Since the Supreme Court required proof of both below-cost pricing and recoupment, no plaintiff has won a final judgment in a predatory pricing case and few plaintiffs have obtained settlements. See Bolton, Brodley & Riordan, *supra* note 84.

¹⁰¹ None of the five scenarios described earlier requires monopoly power or below-cost pricing.

Conclusion

In this chapter, we noted that buyer power is an important feature of the economy and proposed a framework for addressing it. First, we suggested a comprehensive definition of buyer power, one broad enough to encompass both the classic conception of buyer power – monopsony power – and the newer concept of countervailing power. Second, we explored the positive and the negative effects of both types of buyer power and their price and nonprice dimensions.

Third, we laid out an enforcement agenda to combat anticompetitive conduct by powerful buyers. Most significantly, we recommended that the agencies challenge:

- Cartels and other naked collusion by buyers;
- Mergers that are likely, without offsetting justification, to create or enhance classic monopsony power, whether or not they cause an immediate reduction in output;
- Exclusionary behavior that enables a firm, without justification, to use its buying power to raise rivals' costs, increase its market power, and injure consumers;
- Exclusionary behavior that allows a buyer, without justification, to create, maintain, or increase classic monopsony power; and
- Price or promotional discrimination that both favors a powerful buyer over its smaller rivals and threatens to harm consumers.

Fourth, we reviewed the Robinson-Patman Act, the antitrust statute most directly targeted at buyer power. Unlike the AMC, we did not support repeal, but we did identify ways the Act could be improved. We recommended:

- A power requirement in price discrimination cases;
- A reasonable relationship test for cost justification;
- A competitive injury requirement in promotional discrimination cases; and
- Elimination of the Act's criminal penalties.

All of these changes would reduce the number of anticompetitive Robinson-Patman cases while preserving the Act's ability to reach discrimination that poses a substantial threat to consumers and small business.

Finally, we support continued research into the nature and effects of buyer power. Drawing on insights from multiple disciplines, including strategic management, marketing, and economics, this research should enhance our understanding of the sources of buyer power, the ways in which it can be exercised, the types of conduct that can create or maintain it, and the consequences for competition, suppliers, and consumers.