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POWERFUL BUYERS AND MERGER ENFORCEMENT

JOHN B. KIRKWOOD*

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Although large buyers like Wal-Mart and Tyson Foods occupy important positions in the American economy, antitrust law remains focused on the conduct of sellers. Moreover, when mergers of buyers have been challenged, the cases have been based on a single theory – that the merger would create a dominant buyer (or group of buyers) that would exploit small, powerless suppliers. Most powerful buyers, however, face suppliers with power of their own, and in such cases, the buyers exert “countervailing power,” which can also be anticompetitive. Yet buyer mergers that reduce competition through the exercise of countervailing power are not addressed by the government’s guidelines, the leading treatises, or the case law.

This Article provides a comprehensive analysis of the role of buyer power in merger enforcement. It defines the types of buyer power, describes their competitive effects, and reviews an array of evidence. It also discusses the traditional approach to buyer mergers, suggesting modifications to better reflect the true dynamics of buyer power. Most important, it recommends that courts and enforcement agencies halt mergers that enhance anticompetitive countervailing power. Because many buyer combinations that increase such power are beneficial, the Article identifies ten situations in which a merger that augments countervailing power would reduce competition and diminish the welfare of consumers, suppliers, or society.

INTRODUCTION

Large buyers play a major role in the American economy. They occupy prominent positions in the packing of meat,¹ the processing of chicken,² the harvesting of hardwood timber in the Pacific Northwest,³ the employment of professional athletes,⁴ the provision of health insurance,⁵ and the retailing of toys and games,⁶ groceries,⁷ and books.⁸ The largest buyer of all, Wal-Mart,

¹ Tyson Foods, one of the world's largest processors of chicken, beef, and pork, accounted for forty percent of the cattle purchased and slaughtered by U.S. meat-packing plants at the time of the *Pickett v. Tyson Fresh Meats, Inc.*, 420 F.3d 1272, 1276-77 (11th Cir. 2005).

² See 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").

³ In 2001, Weyerhaeuser, the leading operator of hardwood sawmills in the Pacific Northwest, purchased approximately sixty-five percent of the alder saw logs sold in the region. *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 315 (2007). Alder is the predominant hardwood species in the area.

⁴ 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).

⁵ See *Competition in the Unhealthy Health Sector*, in AM. ANTITRUST INST., THE NEXT ANTITRUST AGENDA: THE AMERICAN ANTITRUST INSTITUTE'S TRANSITION REPORT ON COMPETITION POLICY TO THE 44TH PRESIDENT 317, 322 (Albert A. Foer ed., 2008) ("[P]ractically every major metropolitan market is highly concentrated."); *id.* at 323 ("[T]he increased consolidation has given several insurers a greater degree of monopsony power. Insurers employ this buyer power to decrease compensation to health care providers, leading to a reduced level of health care."); *id.* at 322 ("Four health insurers dominate the national marketplace, with one or two firms dominating practically every local market.").

⁶ Wal-Mart, the world's largest retailer, accounts for nearly thirty percent of toy sales and Toys "R" Us is responsible for another eighteen percent. *Biggest U.S. Toy Retailers*, EHow (May 24, 2011), http://www.ehow.com/info_8479565_biggest-toy-retailers.html. For clarity, this Article will use "Wal-Mart" for all references to Wal-Mart despite the company's use of "Walmart" as its trademark and "Wal-Mart Stores, Inc." as its legal trade name. Press Release, Wal-Mart Stores, Inc., Walmart Second Quarter Earnings Exceed Consensus Estimates (Aug. 13, 2009), available at <http://news.walmart.com/news-archive/investors/walmart-second-quarter-earnings-exceed-consensus-estimates-1320373>.

⁷ Wal-Mart is also the nation's largest seller of groceries. The industry also contains other major buyers, including Kroger, the country's biggest grocery-only retailer. See Tom Demeropolis, *Kroger Gains Market Share in Walmart Cities*, BUS. COURIER (Apr. 29, 2011, 6:00 AM), <http://www.bizjournals.com/cincinnati/print-edition/2011/04/29/kroger-gains-market-share-in-walmart.html?page=all>.

⁸ Amazon sells over twenty percent of all books sold in the United States and at least sixty percent of e-books, the fastest growing segment. See Barry C. Lynn, *Killing the*

now accounts for a substantial share of the output of many well-known consumer-products firms.⁹ Because of their pivotal positions, large buyers often exert considerable leverage over their suppliers and sometimes can harm consumers as well, as the Federal Trade Commission's case against Toys "R" Us illustrated.¹⁰ The focus of antitrust law, however, has remained on sellers.

In its recent review of antitrust enforcement, the American Antitrust Institute (AAI) stated that "cases against buyers have been much less common than cases against sellers"¹¹ and declared: "It is time to reexamine this priority."¹² Professor Carstensen noted that "[a]ntitrust law has not focused

Competition: How the New Monopolies are Destroying Open Markets, HARPER'S MAG., Feb. 2012, at 27 ("Today, a single company – Amazon – accounts for more than 20 percent of the domestic book market. . . . In many key categories, it sells more than half the books purchased in the United States. And according to the company's estimates, its share of the e-book market, the fastest-growing segment of the industry, was between 70 and 80 percent in 2010. (Its share of the online sale of physical books is roughly the same.)"); Amy Martinez, *Amazon Muscles Publishing World*, SEATTLE TIMES, Apr. 2, 2012, at A7. Barnes & Noble, the nation's largest brick-and-mortar bookseller, accounted for twenty-three percent of trade book sales in 2010. Jim Milliot, *B&N is #1 in Trade Books*, PUBLISHERS WKLY., Mar. 21, 2011, at 6. Barnes & Noble also accounted for more than twenty-five percent of e-book sales. Jeffrey A. Trachtenberg, *Digital Media: B&N Puts Focus on Digital Market*, WALL ST. J., May 20, 2011, at B8.

⁹ Emek Basker, *The Causes and Consequences of Wal-Mart's Growth*, 21 J. ECON. PERSP. 177, 177 (2007) ("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.*

¹⁰ See *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000) (discussed *infra* in Parts I.C.3 and V.A.1); see also Paul W. Dobson & Roman Inderst, *The Waterbed Effect: Where Buying and Selling Power Come Together*, 2008 WIS. L. REV. 331, 332 (arguing that "the evolution of the retailing industry" has concentrated "market and bargaining power in the hands of a steadily shrinking and increasingly internationally active number of large retailers," affording them "the possibility of simultaneously enjoying both buyer power and seller power").

¹¹ *Buyer Power: The New Kid on the Block*, in AM. ANTITRUST INST., *supra* note 5, at 95) [hereinafter *Buyer Power*]; see also 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."); Robert Pitofsky, Chairman, Fed. Trade Comm'n, Thoughts on "Leveling the Playing Field" in Health Care Markets, Remarks Before the National Health Lawyers Association Twentieth Annual Program on Antitrust in the Health Care Field (Feb. 13, 1997) (transcript available at <http://www.ftc.gov/speeches/pitofsky/nhla.shtml>) ("Enforcement actions involving large buyers are relatively rare . . .").

¹² *Buyer Power*, *supra* note 11, at 95. To focus additional attention on the issue, the AAI has held two symposia on buyer power. See *AAI Invitational Symposium on Buyer Power*, 53 ANTITRUST BULL. 233 (2008); *Symposium on Buyer Power and Antitrust*, 72 ANTITRUST L.J. 505 (2005). For other recent discussions of buyer power, see Albert A. Foer, *Mr.*

very directly or in a sustained way on the analysis of buyer power and its uses,”¹³ and added: “[b]uyer power raises a number of problems requiring much more comprehensive analysis than conventional antitrust and competition policy has provided.”¹⁴ In its April 2011 issue the *Journal of European Competition Law and Practice* agreed, identifying the “next big question” in competition law as “How do we treat buyer power?”¹⁵ This Article confronts that question in the context of one of the most important areas of antitrust policy: merger enforcement. It defines the two types of buyer power, describes their anticompetitive and procompetitive effects, reviews an array of evidence, and sets forth a methodology, much of it new, for evaluating mergers of buyers.

Buyer power is not a unitary concept. Some buyers are powerful because they deal with suppliers who are numerous and small, like many farmers, timber owners, or doctors, and the buyers represent the sole or the principal channel through which the suppliers can sell their output. These buyers exercise *monopsony power*, the buy-side analogue to the familiar sell-side concept of monopoly power, and can exploit their suppliers by reducing purchases and depressing the prices they pay, transferring wealth from the suppliers to themselves. Downstream consumers may be harmed as well, because the monopsonist’s reduction in output may drive up final product prices.¹⁶

Other buyers are powerful not because they face fragmented and largely powerless suppliers, but because they deal with suppliers with significant market power and can play them against one another, obtaining lower prices or other concessions which can benefit them and frequently consumers as well. When Wal-Mart, Costco, and Barnes & Noble bargain with suppliers of popular, brand-name products – products that possess market power because they are differentiated from other brands – these buyers do not exercise monopsony power. They exercise *countervailing power*, a type of buyer power that often results in *increased* output and lower prices to consumers, beneficial effects that have been recognized by commentators¹⁷ and

Magoo Visits Wal-Mart: Finding the Right Lens for Antitrust, 39 CONN. L. REV. 1307, 1309 (2007); Gregory J. Werden, *Monopsony and the Sherman Act: Consumer Welfare in a New Light*, 74 ANTITRUST L.J. 707 (2007).

¹³ Peter Carstensen, *Buyer Power, Competition Policy, and Antitrust: The Competitive Effects of Discrimination Among Suppliers*, 53 ANTITRUST BULL. 271, 272 (2008).

¹⁴ *Id.* at 330.

¹⁵ Paul Nihoul & Thomas Lübbig, *The Next Big Question in Competition Law: How Do We Treat Buyer Power?*, 2 J. EUR. COMP. L. & PRAC. 107 (2011).

¹⁶ See *infra* Part I.B.

¹⁷ See *infra* Part I.C; see also Carstensen, *supra* note 13, at 330-31 (“Larger volumes can create economies of scale, oligopolistic pricing can be disrupted, and downstream price competition can be advanced when the buyer uses the lower price it has received to compete.”); John B. Kirkwood, *Buyer Power and Exclusionary Conduct: Should Brooke Group Set the Standards for Buyer-Induced Price Discrimination and Predatory Bidding?*,

demonstrated in formal economic models.¹⁸ But the impact of countervailing power is not uniformly benign. As Parts I and V explain in detail, buyers can exert their power in ways that reduce competition upstream or downstream, harming suppliers, consumers, or society.¹⁹

Traditionally, antitrust policy has placed much more emphasis on monopsony power than countervailing power, even though countervailing power is more common.²⁰ Moreover, one area of antitrust law – merger policy – has overlooked the undesirable effects of countervailing power altogether. Buy-side merger policy has concentrated exclusively on a single anticompetitive possibility: that a transaction would create, enhance, or preserve monopsony power. Mergers that are likely to reduce competition through the resulting exercise of countervailing power are not addressed by the

72 ANTITRUST L.J. 625, 646 (2005) (“[C]onsumers may benefit when a substantial buyer induces a discriminatory price from oligopolistic sellers, even if the discrimination is not cost-justified. In one scenario, additional buyers find out about the concession and demand similar treatment, causing the concession to spread to other sellers and other buyers. Eventually, a price war ensues and the entire oligopolistic price structure collapses, benefiting both consumers and smaller buyers.”).

¹⁸ See *infra* Part IV.C (explaining that bilateral monopoly models show that when a monopoly seller faces a single buyer with countervailing power, rather than a group of competing buyers, and the buyer does not have downstream monopoly power, the outcome is usually greater output and lower downstream prices); see also Zhiqi Chen, *Buyer Power: Economic Theory and Antitrust Policy*, 22 RES. L. & ECON. 17 (2007) (summarizing several models of beneficial countervailing power); Özlem Bedre-Defolie & Stephane Caprice, *Merger Efficiency and Welfare Implications of Buyer Power* (Eur. Sch. of Mgmt. & Tech., Working Paper No. 11-07, 2011), available at <http://ssrn.com/abstract=1888293> (reviewing additional models).

¹⁹ See also Dobson & Inderst, *supra* note 10, at 355 (“[E]quating buyer power with lower retail prices and higher consumer surplus should not be automatic.”); Kirkwood, *supra* note 17, at 647-51 (describing five scenarios in which persistent, non-cost-justified discrimination induced by a large buyer can reduce consumer welfare). Given the anticompetitive effects of countervailing power, the following statement is overbroad: “If seller prices are above the competitive level, buyer conduct that reduces prices toward the competitive level will have an unambiguously positive effect on consumer welfare.” Jonathan M. Jacobson & Gary J. Dorman, *Joint Purchasing, Monopsony and Antitrust*, 36 ANTITRUST BULL. 1, 56 (1991).

²⁰ See *infra* Parts I.B & I.C; see also AM. ANTITRUST INST., VIEWS OF THE AMERICAN ANTITRUST INSTITUTE ON THE PROPOSED HORIZONTAL MERGER GUIDELINES 9 n.11 (2010), available at <http://www.antitrustinstitute.org/content/aai-submits-comments-ftc-and-doj-proposed-horizontal-merger-guidelines> [hereinafter AAI Views] (“[M]onopsony power is rare in the economy because it tends to occur only in markets in which a dominant buyer (or group of coordinating buyers) obtains inputs from small, competitive sellers. While those conditions may be present in agricultural or labor markets, they do not often appear elsewhere in the economy. In most other markets, sellers have some market power, and large buyers ordinarily exercise countervailing power rather than monopsony power.”).

Merger Guidelines,²¹ the leading treatises,²² or the case law.²³ Competition authorities in other countries have recognized that a merger of buyers may produce anticompetitive countervailing power.²⁴ But in the United States, the risk that a merger would produce such undesirable consequences has not resulted in a single enforcement action or court decision. Given the power of large buyers in the United States and the evidence that such power has been used in the past to reduce competition,²⁵ American antitrust policymakers need to reevaluate their position.

²¹ The new Guidelines state that the enforcement agencies may challenge a merger of buyers if it may “enhance market power on the buying side of the market,” which the Guidelines equate with “monopsony power.” See U.S. DEP’T OF JUSTICE & FTC, HORIZONTAL MERGER GUIDELINES § 12 (2010), available at <http://www.ftc.gov/os/2010/08/100819hmg.pdf> [hereinafter 2010 GUIDELINES]. The Guidelines do not mention countervailing power in section 12 (“Mergers of Competing Buyers”) or elsewhere, although they recognize the concept in section 8 (“Powerful Buyers”). Nowhere do the Guidelines indicate that the agencies would challenge a merger of buyers that is likely to create countervailing power, even if the merger would increase the probability of anticompetitive conduct.

In its comments on the proposed new Guidelines, the AAI had urged the agencies to address mergers that may enhance countervailing power: “The new Guidelines allude to countervailing power in Section 8, where they state that powerful buyers ‘may constrain the ability of [a firm] to raise prices,’ but they do not explain how the Agencies would analyze a merger that creates countervailing power rather than monopsony power. We recommend that the Guidelines note that, while most mergers that create or enhance countervailing power are likely to be procompetitive, in some cases such mergers may reduce competition.” AAI Views, *supra* note 20, at 9.

²² See 4A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶¶ 980-82 (3d ed. 2006) (focusing exclusively on mergers that may create monopsony power); ROGER D. BLAIR & JEFFREY L. HARRISON, MONOPSONY: ANTITRUST LAW AND ECONOMICS 81-84 (1993) (same).

²³ There are no judicial decisions addressing the issue. For discussions of other cases, see *infra* Parts II-V.

²⁴ See James Mellsop & Kevin Counsell, *Antitrust Insights: Assessing the Implications of Upstream Buyer Power on Downstream Consumers*, ANTITRUST INSIGHTS, Summer 2009, at 1, 6-7 (discussing the merger of two bookstore chains in Australia and New Zealand and the review of this transaction by the competition authorities in both countries). As Mellsop and Counsell explain, the issue the agencies faced was whether the merger would create anticompetitive countervailing power, not whether it would produce monopsony power. *Id.* Since “the evidence suggests that publishers are likely to have some market power of their own, . . . the appropriate model of price determination is not the textbook monopsony model, but the bilateral bargaining model.” *Id.* at 6; see also *id.* (citing agency findings that publishers have market power over particular titles). The competition agencies ultimately concluded that the merger would not be anticompetitive because it would not significantly enhance the merged firm’s buying power and thus was unlikely to reduce the number of titles published or raise the retail price of books. See *id.* at 6-7.

²⁵ See *infra* Part I.C.3.

To assist that process, this Article provides a comprehensive analysis of the role of buyer power in merger analysis. It addresses the traditional approach to buyer mergers, buyer power as a mitigating factor in seller mergers, and mergers that enhance countervailing power, and sets forth policy recommendations in each area. In addition, it aims to stimulate further research in an emerging but long-neglected aspect of antitrust policy.²⁶

The discussion proceeds as follows. Part I defines buyer power and its two components, outlines their effects, and summarizes evidence on the impact of countervailing power. Part II addresses mergers that may enhance monopsony power.²⁷ Part III moves to countervailing power and discusses its customary role in merger law – as a factor that may mitigate the competitive harm from a merger of sellers. Part IV considers buyer mergers that may enhance countervailing power in a procompetitive way, and Part V describes the potential anticompetitive effects of a merger that enhances countervailing power. The Article concludes with a review of its most important contributions.

The Article identifies, for the first time, ten situations in which a merger that creates countervailing power would ultimately reduce competition and harm consumers, suppliers, or society. Each situation is described in detail along with the evidence necessary to establish it. A greater appreciation of the dynamics of buyer power also warrants reconsidering other elements of current merger analysis. The Article points out that the Guidelines' traditional methodology – treating a merger of buyers as analogous to a merger of sellers²⁸ – may lead to significant errors. It recommends, contrary to the leading treatise, that agencies and courts should continue to examine, on a case-by-case basis, whether the presence of buyer power is likely to mitigate the anticompetitive effects of a merger of sellers. The Article also provides a simple, comprehensible discussion of bilateral monopoly. It concludes that when two buyers face a single supplier, a merger of those buyers is likely to be

²⁶ Although John Kenneth Galbraith coined the term countervailing power in the early 1950s, see JOHN K. GALBRAITH, *AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER* (1952), the idea was “largely ignored for a long time,” Chen, *supra* note 18, at 23. In fact, “until [the] late 1990s[,] little theoretical analysis had been done on this subject.” *Id.*

²⁷ A merger of buyers, like a merger of sellers, may enhance the power of the merging parties in three different ways. It may create power that did not exist prior to the merger, it may increase the power that each merging party had before the transaction, or it may protect that power from erosion. To avoid continually repeating these alternatives, I will follow the new Guidelines and simply refer to them all as “enhancing” the power of the merging firms. I will also refer to downstream purchasers from the merged firm as “consumers” even though these customers will sometimes be wholesalers, retailers, or other types of intermediate entities.

²⁸ See 2010 GUIDELINES, *supra* note 21, § 12 (“To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market.”).

procompetitive if the merged firm could not restrict output downstream. The merger is likely to be anticompetitive, however, if the single buyer would thereby attain a downstream monopoly. Moreover, the Article explains why it makes sense to allow buyers to merge to exercise procompetitive countervailing power even though it would be illegal for buyers to fix prices when they face suppliers with power. Finally, it suggests a general method, consistent with the Guidelines and the leading treatise, for analyzing a merger that may create both countervailing power upstream and market power downstream.

I. BUYER POWER, MONOPSONY POWER, AND COUNTERVAILING POWER

This Part provides the framework for what follows. It defines buyer power, describes its two principal forms (monopsony power and countervailing power), and summarizes the major consequences of each.

A. Buyer Power

Powerful buyers may exert their power in different ways and with varying effects, depending on their strength, the strength of their suppliers, and other factors. In order to capture these variations, buyer power should be defined as *the ability of a buyer to depress the price it pays a supplier or obtain more favorable nonprice terms*.²⁹

This definition differs from the textbook definition of monopsony power – historically the standard definition of buyer power and still the most common understanding – in two important ways. First, unlike the textbook definition of monopsony power – the power of a purchaser to profitably reduce the price of an input below the competitive level³⁰ – this definition recognizes that powerful buyers may seek not only price reductions from their suppliers but significant nonprice concessions as well.³¹ These nonprice concessions may

²⁹ Cf. Chen, *supra* note 18, at 19 (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”).

³⁰ See DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 108 (4th ed. 2005); Roger D. Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 CORNELL L. REV. 297, 306 (1991); Jacobson & Dorman, *supra* note 19, at 5; Noll, *supra* note 4, 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.”).

³¹ See Paul W. Dobson, *Exploiting Buyer Power: Lessons from the British Grocery Trade*, 72 ANTITRUST L.J. 529, 532 (2005) (“Buyer power gives retailers more than just the ability to extract discounts and obtain low prices from suppliers; buyer power also may manifest itself in the contractual obligations that retailers may be able to place on suppliers.”).

play a substantial role in insulating the large buyer from the competitive threat posed by smaller buyers, thereby enhancing its market power as a seller.³²

Second, this definition acknowledges that powerful buyers do not always, or even commonly, force suppliers to reduce input prices *below* the competitive level, as the classic definition of monopsony requires. Instead, they often induce suppliers with market power to lower their prices *toward* the competitive level, benefiting themselves and frequently consumers as well. Such countervailing power is typically exercised by big buyers like Wal-Mart, and no definition of buying power should exclude Wal-Mart.³³ The exercise of countervailing power, however, is not always benign. By bringing prices closer to the competitive level, it can benefit consumers and improve efficiency. In some cases, though, it can result in a reduction in competition, upstream or downstream, and harm consumer welfare, social welfare, and supplier welfare. In contrast, the exercise of monopsony power (unless warranted by efficiencies) ordinarily harms suppliers and social welfare and often harms consumers as well.³⁴

³² See, e.g., *id.* at 533 (“[E]xclusive supply arrangements deny other retailers access to the supplier’s product, which may allow the retailer to gain a product differentiation advantage over its rivals.”).

³³ Robert Steiner has noted the irony here: if buyer power is limited to monopsony power, then the largest buyer in the world would not have buyer power when it deals with manufacturers of branded goods. See Robert L. Steiner, *Vertical Competition, Horizontal Competition, and Market Power*, 53 ANTITRUST BULL. 251, 265 (2008) (criticizing the enforcement agencies for defining buyer power as monopsony power in their horizontal collaboration guidelines: “The clear but remarkable take-away is that except for the very rare condition of monopsony, power buyers such as Wal-Mart and Home Depot have no market power in their dealings with manufacturers. The concept of everyday vertical upstream competition, in which downstream firms depress the margins of upstream firms but not below the perfectly competitive level and without reducing output, is missing.”). In some markets, of course, Wal-Mart may exercise monopsony power. When it purchases produce for its grocery stores and supercenters, for example, it may deal with small, competitive suppliers and may be able to exploit them in various ways. See Peter C. Carstensen, *Buyer Power and the Horizontal Merger Guidelines: Minor Progress on an Important Issue*, 14 PENN. BUS. L. REV. 775, 803 (2012). But when it buys from suppliers with market power, it normally exercises countervailing power and engages in what Steiner calls “vertical upstream competition.” Steiner, *supra*, at 265.

³⁴ As this discussion indicates, the definition of buyer power I propose does not equate buyer power with undesirable effects. Instead, it distinguishes the existence of buyer power from its consequences. Professor Chen’s definition makes the same distinction: a buyer has power under his definition so long as it has the ability to “reduce the price profitably below a supplier’s normal selling price,” whether that reduction is procompetitive or anticompetitive. See Chen, *supra* note 18, at 19. In a later article, he explains:

The normal selling price . . . is defined as the supplier’s profit-maximizing price in the absence of buyer power. In the case where there is perfect competition among suppliers, the normal selling price of a supplier is the competitive price, and the buyer power is *monopsony power*. On the other hand, in the case where competition among suppliers is imperfect, the normal selling price is above the competitive price, and the

This dichotomy between monopsony power and countervailing power, elaborated in the next two Sections, may not always capture reality. There may be instances in which suppliers have a small amount of market power and it is not clear whether the monopsony model or the countervailing power model fits best. In most cases, however, the appropriate model will be apparent. And even when it is not, it will be useful to consider both models in evaluating whether a merger of buyers is likely to be anticompetitive. Both models provide tools for addressing such pivotal issues as whether the post-merger exercise of buyer power is likely to cause suppliers to increase or reduce output, whether it is likely to place smaller buyers at a competitive disadvantage, and whether it is likely to reduce suppliers' incentives to invest or innovate.

B. Monopsony Power

1. Concept

In the textbook 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.³⁵ Purchasing from such competitive and powerless suppliers, the monopsonist has an incentive, as any textbook treatment shows, to buy less than the competitive quantity – the quantity that a competitive group of buyers would purchase – because each additional unit purchased raises the market price. As a result, the monopsonist will acquire fewer units and pay less for them than would a group of buyers without monopsony power.³⁶

buyer power is *countervailing power*.

Zhiqi Chen, *Defining Buyer Power*, 53 ANTITRUST BULL. 241, 247 (2008). Thus, the “effects of buyer power are quite different depending on whether it is monopsony power against competitive suppliers or it is countervailing power against suppliers with market power.” *Id.*

Likewise, my definition does not conceive of buyer power as the “mirror image” of seller market power. Cf. Noll, *supra* note 4, at 589 (“[B]uyer power . . . is the mirror image of monopoly or oligopoly.”). While my definition has a “mirror image” component – monopsony power is in theory the mirror image of monopoly power – it also includes a distinct component: countervailing power.

³⁵ For the importance of a rising supply curve, see Jonathan B. Baker, Joseph Farrell & Carl Shapiro, *Merger to Monopoly to Serve a Single Buyer: Comment*, 75 ANTITRUST L.J. 637, 641 (2008) (explaining that the monopsony “model is only coherent if each supplier experiences higher marginal costs as its output expands”); Jonathan M. Jacobson & Gary J. Dorman, *Monopsony Revisited: A Comment on Blair & Harrison*, 37 ANTITRUST BULL. 151, 154 (1992) (“[M]onopsony power can be exercised only in an industry having an upward-sloping supply curve.”).

³⁶ 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 curtailing the quantity it buys. In the textbook monopsony model, moreover, the monopsonist cannot

In this Article, monopsony power refers to the textbook concept. It is not restricted, as some textbook models are, to the case of a single purchaser. Monopsony power, like seller market power, is a matter of degree, and a buyer may possess such power when its share of purchases is less than 100%. But monopsony power is limited to cases in which two central characteristics of the textbook model are satisfied, at least approximately: (1) the buyer purchases from a competitive tier of sellers, who lack significant market power and who face rising supply costs, and (2) the buyer has sufficient power over these suppliers that it can profitably induce them to supply their output at a market price below the competitive level.³⁷ These features distinguish monopsony power from the usual case of countervailing power, where suppliers have significant market power and the buyer negotiates a price that is closer to – but not below – the competitive level.

2. Prevalence

Given its essential features, monopsony power is unlikely to be a common condition in the American economy.³⁸ There are not many markets in which a dominant buyer (or small group of coordinating buyers) faces a fragmented set of suppliers with rising marginal or incremental costs.³⁹ These features are

discriminate in price among its suppliers, paying some less than it pays others. As I note at the end of this Part, such price discrimination may mute a monopsonist's incentive to reduce purchases. For readable treatments of the basic economics of monopsony, see Blair & Harrison, *supra* note 30, at 301-06; Jacobson & Dorman, *supra* note 19, at 5-18.

³⁷ In one circumstance, the first characteristic may not be necessary: if the government is auctioning off a resource that is increasingly costly for the government to supply, collusion by the bidders will lower the winning bid and reduce the amount the government supplies. A monopsonistic output reduction occurs even though the upstream market structure is not competitive. What drives this result is that the government does not attempt to limit the quantity it supplies in order to obtain a supracompetitive price. Instead, it acts like a group of competitive producers, supplying as much as it can so long as its marginal costs are covered. Claes Bengtsson, and attorney with the Competition Directorate of the European Commission, suggested this possibility to me at the conference on Buyer Power in Competition Law at Oxford University, May 15, 2012.

³⁸ Jacobson & Dorman, *supra* note 35, at 154 (“[M]onopsonistic restriction of purchases below the competitive level is quite rare . . .”). See also AAI Views, *supra* note 20, at 9 n.11.

³⁹ To the contrary, in many, if not most, manufacturing industries, supply curves do not rise at higher outputs. See CARLTON & PERLOFF, *supra* note 30, at 40 (“Empirical studies of manufacturing firms often find that cost curves are L-shaped: As output rises, the average cost curve slopes down sharply, slopes down more slowly, and finally is flat.”); Jacobson & Dorman, *supra* note 35, at 157 (stating that “monopsony problems in manufacturing are likely to be unusual” because “supply curves are generally flat in manufacturing industries”). Chen notes, however, that in an “empirical study of 26 manufacturing industries,” John Shea “found significantly upward sloping short-run supply curves for 16 of the 26 sample industries.” Chen, *supra* note 34, at 248 (citing John Shea, *Do Supply Curves Slope Up?*, 108 Q.J. ECON. 1, 1 (1993)).

most likely to exist in agricultural markets, such as the purchasing of cattle⁴⁰ or the processing of chicken;⁴¹ natural resource markets, such as the acquisition of hardwood timber in the Pacific Northwest;⁴² or labor markets, such as the hiring and retention of professional athletes.⁴³ The enforcement picture is consistent. The federal government has seldom challenged a merger on the ground that it would enhance monopsony power, and the cases that have been brought have all involved agricultural markets, natural resource markets, or labor markets.⁴⁴

3. Effects

Although relatively rare, monopsony power, like monopoly power, has multiple adverse effects if it is not justified by static or dynamic efficiencies. Most obviously, the exercise of monopsony power harms upstream suppliers by reducing their revenues and profits and transferring their wealth to the monopsonist. Because this group is fragmented and its members lack significant market power, this transfer of wealth raises serious fairness issues – issues that were partly responsible for the passage of the Sherman Act.⁴⁵ The exercise of monopsony power unjustified by efficiencies also has undesirable economic effects. The decline in suppliers' fortunes is likely to reduce their aggregate investment in the industry and drive some of them out of business altogether.⁴⁶ The reduction in the quantity they produce also depresses

⁴⁰ See *supra* note 1.

⁴¹ See *supra* note 2.

⁴² See *supra* note 3.

⁴³ See *supra* note 4.

⁴⁴ See *infra* Part II.A.1; see also Carstensen, *supra* note 13, at 271 (“Historically the visible problems have come in labor and agricultural commodity markets.”); Jacobson & Dorman, *supra* note 35, at 157 (“Not surprisingly, a large proportion of the reported cases finding joint buyer conduct unlawful under the antitrust laws involve labor markets or agricultural markets.”).

⁴⁵ See John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency*, 84 NOTRE DAME L. REV. 191, 207-08 (2008) (referencing legislative history indicating a “congressional desire to help protect sellers from being forced to sell at prices below the competitive level,” including a statement by one representative that the beef trust “robs the farmer on the one hand and the consumer on the other.” (quoting 21 CONG. REC. 4,098 (1890)); *id.* at 234-35 (“Just as Congress wanted to prevent sellers from using unfair means to acquire monopoly power (because they could then raise output prices and transfer wealth from consumers to themselves), Congress wanted to prevent buyers from using unfair means to acquire monopsony power (because they could then lower input prices and transfer wealth from suppliers to themselves). The desire to stop the transfer of wealth by firms who had unfairly gained power is the same in both instances.”).

⁴⁶ It may also reduce their development of new products. See Noll, *supra* note 4, at 612 (citing Cristoph R. Weiss & Antje Wittkopp, *Buyer Power and Innovation of Quality Products: Empirical Evidence from the German Food Sector* (Univ. of Kiel, Dep’t of Food

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.⁴⁷ Where a buyer exercises monopsony power, in short, consumers tend to be hurt, not helped: the monopsonist does not pass on its lower input prices in the form of lower output prices.⁴⁸

In sum, the exercise of monopsony power that is not warranted by efficiencies reduces the welfare of suppliers, total welfare, and quite likely the welfare of consumers. Though its greatest effects are upstream rather than

Econ. and Consumption Stud., Working Paper FE 0307, 2003)) (“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.”).

⁴⁷ Peter C. Carstensen, *Buyer Cartels Versus Buying Groups: Legal Distinctions, Competitive Realities, and Antitrust Policy*, 1 WM. & MARY BUS. L. REV. 1, 10 (2010) (stating that if monopsony “cause[s] a sufficient reduction in output, this can affect the downstream market by increasing scarcity of the product made with that input, resulting in higher prices for the remaining production”). 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.

Professor Noll maintains that even if the monopsonist has *no* market power downstream, the exercise of its power upstream will harm consumers. See Noll, *supra* note 4, at 596 (“[B]ecause output of the monopsonized good is less than the social optimum and other inputs are not perfect substitutes for this input, final goods will be under-supplied as well, causing real final goods prices to be higher than would be the case in the absence of monopsony. . . . Although some have claimed otherwise, these fundamental results about the effects of single-price monopsony do not depend on either the extent of competition or the cost structure of other firms in the downstream market.”).

⁴⁸ See Blair & Harrison, *supra* note 30, at 339 (“[L]ower input prices resulting from the exercise of monopsony power do *not* ultimately translate into lower prices to the monopsonist’s customers and increased overall consumer welfare.”); Peter J. Hammer & William M. Sage, *Monopsony as an Agency and Regulatory Problem in Health Care*, 71 ANTITRUST L.J. 949, 964 (2004) (“The fact that the monopsonist pays less for supplies in the input market need not mean that the monopsonist will charge lower prices in the final product market. Indeed, the opposite is generally the case.”); Noll, *supra* note 4, 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 . . .”).

downstream, unjustified monopsony has negative consequences comparable to those of monopoly.⁴⁹ These negative consequences may be offset when a firm's monopsony power is attributable to superior static or dynamic efficiency. In such cases, the gains to the economy from lower production costs or a more valuable product may outweigh the adverse effects 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 superior performance.⁵⁰ 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, augments monopsony power beyond what it otherwise would have been. When conduct enhances or preserves monopsony power without justification, it is anticompetitive: it reduces competition among buyers, injures suppliers, and is likely to diminish economic efficiency.

The analysis of monopsony is more complicated if the monopsonist does not treat all its suppliers the same. Instead of paying a single price to all its suppliers of an input, the monopsonist may discriminate among its suppliers, either by paying them different prices or by engaging in all-or-nothing contracting, in which the monopsonist refuses to deal at all with a supplier unless the supplier agrees to furnish a specific quantity at a specified price.⁵¹ To the extent the monopsonist is successful in such price discrimination, the welfare effects of its behavior may change. On the one hand, the buyer may purchase a larger total quantity than a non-discriminating 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

⁴⁹ The exercise of unjustified monopoly power also tends to reduce consumer welfare, supplier welfare, and total welfare. Higher prices and lower output plainly injure consumers and economic efficiency. But they also tend to harm suppliers: by restricting output, the monopolist is likely to buy fewer inputs from its suppliers, who are likely to see their profits fall as a result.

⁵⁰ See, e.g., Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 ANTITRUST L.J. 575, 580 (2007) ("[F]irms that expect to face more . . . competition after innovation have less incentive to invest in R&D." (emphasis omitted)).

⁵¹ See Blair & Harrison, *supra* note 30, at 317 ("The all-or-none supply curve . . . answers the question: What is the maximum quantity suppliers will make available at each price when the alternative is to sell nothing at all? Accordingly, the all-or-none supply curve lies below the standard supply curve. Knowledge of the all-or-none supply curve enables the monopsonist to fully exploit its power by extracting all of the producer surplus.").

monopsonist may mitigate the adverse efficiency effects of monopsony while compounding its wealth transfer effects.⁵²

C. Countervailing Power

1. Concept

The nature and consequences of buyer power depend on the competitiveness of upstream supply. If a large buyer faces an atomistically competitive group of input suppliers, each of which lacks significant market power and operates on an upward-sloping supply curve, the buyer may be in a position to exercise monopsony power. And absent offsetting efficiencies, the consequences of such power are likely to be negative. But if, instead, there are relatively few input suppliers, each with significant market power and each with a constant or downward-sloping marginal cost curve, the buyer could not exert monopsony power but may be able to exert countervailing power, with procompetitive consequences.⁵³ If a substantial buyer can wield countervailing power against monopolistic, oligopolistic, or monopolistically competitive suppliers, it can force their prices closer to the competitive level and benefit both efficiency and

⁵² Note that this form of price discrimination – price discrimination by a monopsonist among its suppliers – is different from price discrimination by a seller among its customers, which may be caused by a powerful buyer. When a seller responds to the pressure of a powerful buyer and discriminates in its favor, and against smaller, competing buyers, competition may be either enhanced or diminished. *See infra* Part I.C.3.

Some have argued that the wealth transfer that results from the exercise of monopsony power is not an antitrust concern unless output is reduced. *See* 12 HERBERT HOVENKAMP, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* 131 (2d ed. 2005) (“The sellers’ loss is a mere wealth transfer that the antitrust laws were not designed to remedy.”). As Professor Lande and I have explained, however, one of the goals of the antitrust laws is to protect suppliers from exploitation by firms that have unfairly acquired monopsony power. *See* Kirkwood & Lande, *supra* note 45, at 193. Such exploitation can occur even if output is not reduced, as when a firm acquires monopoly power without justification and practices perfect price discrimination. *See id.* at 228-30. Professor Areeda agreed. He stated that he would condemn a cartel engaged in perfect price discrimination, even though it would cause no output reduction and no inefficiency, because it

is taking from some people and giving to other people more than competition would. I regard this as an anticompetitive distortion. “Consumer welfare” embraces what individual consumers are entitled to expect from a competitive economy. If the efficiency extremists insist that only their definition of consumer welfare is recognized by economists, we would answer that ours is clearly recognized by the statutes. The legislative history of the Sherman Act is not clear on much but it is clear on this.

Phillip Areeda, *Introduction to Antitrust Economics*, 52 *ANTITRUST L.J.* 523, 536 (1983).

⁵³ *See* Chen, *supra* note 18, at 18 (“[T]he competition effects of buyer power are quite different depending on whether it is monopsony power against powerless suppliers or countervailing buyer power against large suppliers with market power.”).

consumer welfare.⁵⁴ It is also quite possible, however, as this Article explains, for the exercise of countervailing power to result in anticompetitive effects, reducing overall welfare and consumer welfare.⁵⁵

Countervailing power also differs from monopsony power in the way it is exercised. In the standard, single-price case, 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.⁵⁶

⁵⁴ See, e.g., Sugato Bhattacharyya & Amrita Nain, *Horizontal Acquisitions and Buying Power: A Product Market Analysis*, 99 J. FIN. ECON. 97, 98 (2011) (“[E]nhanced buying power downstream may counteract established selling power upstream and force suppliers to charge competitive prices. . . . [B]uyer size and buyer industry concentration have long been known to be correlated with lower seller profits.”); Dobson & Inderst, *supra* note 10, at 335 (“It is common to think of powerful buyers as the consumers’ champions, using their buying muscle to negotiate discounts from suppliers and passing them on to consumers in the form of lower prices.”).

⁵⁵ In addition, whether or not consumers benefit, countervailing power is likely to harm supplier welfare, for most suppliers are likely to earn lower profits than they would have earned had the buyers been unable to exert such power. This 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 offer valuable products. These adverse effects may occur among direct suppliers to the powerful buyer or among more remote suppliers, who may experience “pass back” effects from the reactions of direct suppliers to the exertion of countervailing power. See *infra* Part V.B.3. Countervailing power may benefit a supplier if the buyer wields it by shifting the bulk of its purchases to the supplier willing to extend the lowest price, enabling that supplier to increase its output and achieve greater economies of scale.

⁵⁶ Bargaining power is “the power to obtain a concession from another party by threatening to impose a cost, or withdraw a benefit, if the party does not grant the concession.” Kirkwood, *supra* note 17, at 638-39. A “buyer might attempt to use bargaining power to obtain a discriminatory price by threatening to remove business from a supplier unless it grants the discrimination. Or it might threaten not to bring additional business to a supplier unless the favoritism is forthcoming.” *Id.* at 639. A Wal-Mart senior executive noted that in retail markets, where big buyers often exercise countervailing power, the manufacturer’s price to the retailer depends mainly on bargaining power: “The manufacturer’s price is something that’s determined largely by the negotiating power of the retailers that carry his merchandise.” S. Robson Walton, *Antitrust, RPM and the Big Brands: Discounting in Small-Town America (II)*, 25 ANTITRUST L. & ECON. REV. 11, 16 (1983); see also Roman Inderst & Christian Wey, *Buyer Power and Supplier Incentives*, 51 EUR. ECON. REV. 647, 650 n.11 (2007) (“Bilateral negotiations stand in sharp contrast to the ‘textbook’ view of monopsonistic power. Under the latter view, buyer power is exercised by withholding demand so as to reduce the (uniform) purchase price prevailing on the upstream market. In contrast, our view is that buyer power manifests itself via more favorable terms for the more powerful buyer.”).

In this process, the buyer often plays one significant supplier off against another, indicating, for example, that it will shift the bulk of its business to the supplier that offers the best price.⁵⁷ Through this pulling and hauling, the buyer forces suppliers with market power to compete more vigorously with each other,⁵⁸ and consumers may benefit.

2. Prevalence

Countervailing power is more common than monopsony power. As noted above, monopsony power occurs infrequently because it ordinarily requires both a dominant market share and a competitive tier of suppliers with rising costs. In contrast, countervailing power requires neither. So long as suppliers have significant market power, a buyer may be able to exercise countervailing power against them, particularly if their marginal costs are constant or declining. In many real-world markets, suppliers do have a significant amount of market power,⁵⁹ and when that is so, their marginal costs are often constant or falling.⁶⁰

⁵⁷ F. M. SCHERER & DAVID ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 528 (3d ed. 1990) (“[O]ligopolists are prone to cut prices in order to land an unusually large order, especially when they have excess capacity. Large buyers can exploit this weakness by concentrating their orders into big lumps, dangling the temptation before each seller, and encouraging a break from the established price structure.”); *id.* (“Large buyers . . . play one seller off against the others to elicit price concessions.”); Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 *ANTITRUST L.J.* 49, 95 (2010) (“[I]n some cases, larger buyers are better placed than small buyers . . . to shift a great portion of their business to price cutters.”); Michael E. Porter, *The Five Competitive Forces That Shape Strategy*, *HARV. BUS. REV.*, Jan. 2008, at 79, 83 (“Buyers are powerful if they have negotiating leverage relative to industry participants, especially if they are price sensitive, using their clout primarily to pressure price reductions.”).

⁵⁸ 4 AREEDA & HOVENKAMP, *supra* note 22, ¶ 943a (“[T]he large buyer is typically in a much stronger position to force sellers to compete against each other for the buyer’s trade.”).

⁵⁹ Few markets in the economy are populated by numerous sellers of homogenous products. In the typical market, the number of competing sellers is relatively small, the products offered are significantly differentiated, or both, and as a result, the suppliers have a significant degree of short-run or static market power: the ability to price above marginal cost. These suppliers may or may not possess long run or dynamic market power: the ability to earn excess economic profits by pricing above average total costs (including the risk-adjusted cost of capital). But their ability, in the absence of buyer power, to price significantly above marginal cost renders them vulnerable to the exercise of countervailing power.

⁶⁰ See Baker, Farrell & Shapiro, *supra* note 35, at 641 (“[I]n our experience, in markets with a small number of suppliers . . . marginal cost is often roughly constant, or even decreasing in the relevant ranges of output.”); *supra* note 39 (reviewing evidence that supply curves in manufacturing industries are often flat at higher outputs, indicating that marginal costs are constant in this range).

Moreover, in those circumstances, a buyer need not possess a dominant market share in order to exercise countervailing power. To the contrary, as numerous commentators have recognized, buyers may induce concessions from their suppliers when their share of the suppliers' sales is substantially below fifty percent. Chen states: "[A] very large share of purchases is not a necessary condition for the existence of buyer power"⁶¹ Dobson and Inderst agree: "[A] buyer (or a group of buyers) could wield substantial buyer power . . . at levels of size and market share considerably below those that are needed to establish seller power in the final market."⁶² In fact, where the buyer has special attributes that a supplier values – such as the ability to influence its customers' purchases or enable the supplier to achieve substantial scale economies – the buyer may be able to obtain a concession with a share in the range of ten to twenty percent. Klein and Murphy state: "In contrast to monopsony, significantly lower wholesale prices can be achieved by retailers with relatively small market shares as long as the retailer has the ability to influence the share of its customers' purchases in a product category that is obtained by a chosen manufacturer."⁶³ Grimes notes that a ten percent share may be enough if the buyer is a multibrand retailer who serves as a "gatekeeper" for its customers.⁶⁴ Dobson asserts that "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."⁶⁵ Carstensen points out that where suppliers need to achieve a "sufficient volume of sales, . . . a firm with a 20% share of the national market in such a class of products is likely to have substantial power over its suppliers because of the threat that the supplier could lose [sic] one-fifth or more of its outlets."⁶⁶ Petrovic and Hamilton observe:

⁶¹ Chen, *supra* note 18, at 31.

⁶² Dobson & Inderst, *supra* note 10, at 356.

⁶³ Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433, 449 (2008); *see also id.* ("The supermarket achieves a lower wholesale price not because it has any monopsony buying power, but because it is able to commit its consumers as a group to shift its purchases across brands."); Porter, *supra* note 57, at 84 ("Intermediate customers gain significant bargaining power when they can influence the purchasing decisions of customers downstream. Consumer electronics retailers, jewelry retailers, and agricultural-equipment distributors are examples of distribution channels that exert a strong influence on end customers.").

⁶⁴ Grimes, *supra* note 2, at 563-64; *see also id.* at 583 ("For most sellers, creation of their own retail outlets is not a satisfactory option. Sellers of less-expensive consumer products ranging from groceries to appliances to apparel will end up relying in whole or in part on the retailers that sell the bulk of these goods in a multi-brand setting. These retailers are the gatekeepers . . .").

⁶⁵ Dobson, *supra* note 31, at 535.

⁶⁶ Peter C. Carstensen, Young-Bascom Prof. of Law, Univ. of Wis. Law Sch., Buyer Power and Merger Analysis – The Need for Different Metrics, Statement Before the Workshop on Merger Enforcement held by the Antitrust Division and the Federal Trade

“Even for the biggest manufacturers of packaged consumer goods, from Procter and Gamble to Clorox and Revlon and from Del Monte to Nabisco and Sara Lee, the amount of business with Wal-Mart – typically ranging between 15 percent and 30 percent of total shipments – creates a significant dependency on the retailer’s demands.”⁶⁷

A buyer with a substantial but non-dominant share is likely to have significant leverage over a supplier pricing above marginal cost for two reasons. First, it can reward the supplier if it makes a concession by shifting a significant amount of business to it, enabling the supplier to increase its profits despite the concession.⁶⁸ Second, it can threaten to punish a supplier that refuses to make a concession with the loss of a significant portion of its sales. So long as the supplier could not make up that volume by turning to a different buyer, the supplier has an incentive to offer a concession that would avoid an even greater reduction in its profits.⁶⁹

A significant buyer may have other sources of leverage as well. Dobson highlights the multiple relationships that frequently exist between a retailer and upstream producers, relationships the retailer may be able to exploit to obtain greater concessions:

From the perspective of producers, retailers have three interlinked roles. First retailers are producers’ *customers*; they buy their products for resale to ultimate consumers. Second, they act as *competitors* when they sell “own-label” (otherwise known as “private label” or “store brand”) products in competition with producer branded goods. Third, they are *suppliers* that “sell” shelf space, either directly through listing or slotting fees or indirectly through requiring lower prices from producers as a

Commission 12 (Feb. 17, 2004) (prepared statement available at <http://www.ftc.gov/bc/mergerenforce/presentations/040217carstensen.pdf>).

⁶⁷ Misha Petrovic & Gary G. Hamilton, *Making Global Markets: Wal-Mart and Its Suppliers*, in *WAL-MART: THE FACE OF TWENTY-FIRST CENTURY CAPITALISM* 131 (Nelson Lichtenstein ed., 2006).

⁶⁸ See *supra* notes 56-58 and accompanying text; see also Kirkwood, *supra* note 17, at 637-44 (explaining why substantial but non-dominant buyers are likely to have the bargaining power to obtain concessions from suppliers with market power, citing examples from the automobile industry, the salt industry, and several retail trades).

⁶⁹ Klein and Murphy point out that suppliers cannot turn to other buyers if the buyer demanding the concession is in a position to control the purchase decisions of its customers. Klein and Murphy stress that in many product categories even relatively small retailers are in this position. See *supra* note 63 and accompanying text; see also Dobson, *supra* note 31, at 535 (“In Britain consumers have an exceptional degree of loyalty towards their favored retailer and tend not to shop around for grocery products, but instead consistently rely on one store for most or all of their needs. . . . In this setting, respective market shares mean little. A supplier with a high market share in the supply market will still be economically dependent on a retailer that commands only a modest market share of the retail market because of the supplier’s relative lack of external opportunities.”).

condition of stocking, and advertising space, such as through promotional support payments.⁷⁰

In addition, a buyer may obtain a concession by threatening to engage in “setting up [the buyer’s] own production facilities, financing another supplier that may then produce a private-label variant of the good, or searching and locating an alternative supplier.”⁷¹ A buyer need not have a dominant share of purchases to engage in any of these activities.

3. Effects

Countervailing power is not only more widespread than monopsony power but its consequences are more varied. The following Sections briefly describe the principal procompetitive and anticompetitive effects of countervailing power.⁷²

a. *Beneficial*

Countervailing power most clearly increases consumer welfare 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.⁷³

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 intense competition downstream,⁷⁴ or because the buyer calculates that it would make more money, given the reduction in its input costs, if it increased output,⁷⁵ 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

⁷⁰ Dobson, *supra* note 31, at 536. Dobson adds: “In the case of Great Britain, the large multiple retailers have appeared very adept at exploiting these three roles.” *Id.* at 537.

⁷¹ Roman Inderst, *Leveraging Buyer Power*, 25 INT’L J. INDUS. ORG. 908, 911 (2007).

⁷² For additional effects, see *infra* Parts IV & V.

⁷³ See, e.g., Kirkwood, *supra* note 17, at 646.

⁷⁴ Chen, *supra* note 18, at 28 (“[C]onsumers are more likely to benefit from countervailing power and consequently welfare is more likely to improve when there is intense competition in the downstream market.”).

⁷⁵ This is most likely to occur when the supplier uses simple per-unit pricing (“linear pricing”), because a reduction in the supplier’s price will then translate directly into a reduction in the buyer’s marginal costs. See *id.* (“With linear prices, the exercise of countervailing power will necessarily lead to lower wholesale prices, and lower wholesale prices usually translate into lower consumer prices.”); Jacobson & Dorman, *supra* note 19, at 4 (“Lower input prices generally yield lower prices and greater output of end products.”). In contrast, if a supplier uses non-linear pricing, the buyer may receive a lump-sum payment that it has no incentive to pass on. See Bedre-Defolie & Caprice, *supra* note 18, at 18.

adverse effects, 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 the costs, increasing consumer welfare and total welfare.

b. *Harmful*

It is also possible for the exercise of countervailing power to reduce competition and harm consumers, suppliers, and society. For example, a large buyer may induce its suppliers to raise the costs of its rivals, weakening them or forcing up their prices, and enabling the buyer to exercise market power downstream. Alternatively, a buyer may wield its countervailing power to obtain substantial, discriminatory discounts from its suppliers and use the resulting competitive advantage to take business or profits from its smaller rivals, shrinking their shares and driving many of them out of business. This increase in downstream concentration could lead to higher prices, but even if it does not, consumers may be hurt by the loss of retail options.⁷⁶ Consumer welfare and total welfare could also be harmed if the buyer employs its discriminatory discount not to compete more aggressively but to shield itself from competition, allowing its costs to rise and its responsiveness to consumer preferences to diminish.

The exercise of countervailing power may also harm competition upstream. It may reduce suppliers' profits and curb their incentives to engage in research or product development, curtailing innovation or product variety. By concentrating its purchases in one or a few suppliers, a large buyer may confer monopsony power on those suppliers, allowing them to exploit more remote suppliers or prefer certain types over others. The exertion of countervailing power may also cause suppliers to merge or collude in response, diminishing upstream rivalry and potentially depressing both total welfare and consumer welfare. Part V describes these and other anticompetitive effects in more depth.

c. *Evidence*

Almost two decades ago, Professors Scherer and Ross reviewed the literature on buyer power and concluded that such power had, "in at least some cases," disciplined oligopolistic sellers and benefited consumers.⁷⁷ Recent evidence provides a more compelling picture, indicating that when large

⁷⁶ When a major retailer drives smaller retailers out of business, it deprives consumers of the locations, services, and selection those retailers offered. That would diminish overall consumer welfare if the consumers who value these choices lose more than other consumers gain from the major retailer's lower prices.

⁷⁷ SCHERER & ROSS, *supra* note 57, at 536 ("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.").

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%.⁷⁸

A particularly striking example occurred after Wal-Mart's 1997 acquisition of a Mexican retailer that it renamed Walmex.⁷⁹ 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.⁸⁰ At the same time, Walmex exerted its growing buying power in its negotiations with detergent and soap suppliers, forcing them to cut prices and reduce profit margins.⁸¹ It also selected the most efficient local producers to become suppliers of its stores' brands and pushed them to become even more efficient and innovative.⁸² Because Walmex was, by all accounts, a far more efficient retailer than its predecessor,⁸³ Walmex could pass on more than 100% of the resulting price reductions. Wal-Mart's entry, in short, provided a double benefit to Mexican detergent and soap consumers – it lowered margins on both the supplier and retail tiers of the industry.

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.⁸⁴ From 1984 through 2004, the authors estimate, Wal-Mart's invoice costs on Chinese imports (including tariffs and transportation charges) declined by twenty-three percent.⁸⁵ During the same period, Wal-Mart's retail prices on these products dropped by fifty-seven percent.⁸⁶ In other words, Wal-Mart passed through more than twice the input price reductions it obtained, an

⁷⁸ For an analysis of this phenomenon, 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).

⁷⁹ See Beata Javorcik, Wolfgang Keller & James Tybout, *Openness and Industrial Response in a Wal-Mart World: A Case Study of Mexican Soaps, Detergents and Surfactant Producers*, 31 WORLD ECON. 1558, 1559 (2008).

⁸⁰ *Id.* at 1563.

⁸¹ *Id.* at 1559 ("By exercising its bargaining power, it squeezed profit margins among the major brands, offering them higher volumes in return."); *id.* at 1576 (finding that "the entry of Walmex led to . . . movement toward marginal cost pricing, even among the major brands").

⁸² *Id.*

⁸³ *Id.* at 1564 ("Even the major brand suppliers agreed that Walmex's distribution system had made retailing more efficient.").

⁸⁴ See Emek Basker & Pham Hoang Van, *Wal-Mart as Catalyst to U.S. China Trade 32* (Apr. 2008) (unpublished manuscript) (manuscript available at <http://ssrn.com/abstract=987583>).

⁸⁵ *Id.*

⁸⁶ *Id.*

accomplishment made possible by the greater scale economies it attained as it expanded.⁸⁷

In the U.K., the Competition Commission found that the largest supermarket chains typically passed through most of the savings they achieved on private label products.⁸⁸ The Competition Commission 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.⁸⁹ The Competition Commission concluded: "On average [the chains] retain one-third of their own-label savings, passing through two-thirds to consumers."⁹⁰ After Asda, the supermarket chain owned by Wal-Mart, negotiated a large price reduction on bananas, it lowered the retail price by almost thirteen percent.⁹¹

Similarly, in the health care industry, insurance companies often employ countervailing power to obtain discounts from providers with market power. To do this, insurers frequently use *selective contracting* – contracting with only those providers, or networks of providers, willing to offer substantial discounts. This practice, the health care version of a common technique employed by buyers to obtain concessions, has been "the most successful aspect of modern managed care, at least financially, because it allows direct insurer-provider bargaining over fees."⁹²

Likewise, two recent empirical studies found that mergers of buyers led, on average, to a reduction in suppliers' prices and profits.⁹³ Because the reductions were greater when the upstream market structure was more concentrated, the authors of both studies attributed the effects to countervailing

⁸⁷ *Id.* at 19 ("Because the direct effect of a tariff reduction on prices is amplified by the expansion and scale effects, consumer prices fall more than one-for-one with tariff reductions.").

⁸⁸ COMPETITION COMM'N, SUPERMARKETS: A REPORT ON THE SUPPLY OF GROCERIES FROM MULTIPLE STORES IN THE UNITED KINGDOM (2000), *available at* http://www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm#full.

⁸⁹ *Id.*

⁹⁰ *Id.* at 180.

⁹¹ Inderst, *supra* note 71, at 911 n.5 ("[F]ollowing a huge volume discount negotiated by Asda, a fully owned UK subsidiary of Wal-Mart, with Del Monte, it has been reported that Asda started a prolonged price war by cutting the price of loose bananas from 1.08 to 0.94 lb . . .").

⁹² Hammer & Sage, *supra* note 48, at 975. This is not to say that health insurers never exercise monopsony power. Where a dominant insurance company faces a fragmented tier of providers (e.g., doctors who practice individually or in small groups), the outcome may be a monopsonistic reduction in reimbursements and an adverse effect on supply, at least in the long run.

⁹³ See *infra* Part IV.A (describing the studies in more detail). As the authors of one study noted, moreover, their results are consistent with other empirical work on the impact of buyer power. See Bhattacharyya & Nain, *supra* note 54, at 98 ("[B]uyer size and buyer industry concentration have long been known to be correlated with lower seller profits.").

power, not monopsony power.⁹⁴ Moreover, the one study that investigated whether the reductions were passed on found that, on average, merged firms passed on a significant percentage of the lower prices they received, benefiting customers and economic efficiency.⁹⁵ In short, there is considerable evidence that buyers have used their bargaining power to obtain lower prices from suppliers, and whether they obtained these lower prices by inducing suppliers to reduce their margins, adopt more efficient production techniques, or both, the buyers have frequently passed on a substantial proportion of their savings to consumers, sometimes more than 100%.

At the same time, there is evidence of the anticompetitive impact of countervailing power. Large buyers have sometimes used their power to elevate the costs of their smaller rivals, diminishing competition downstream and confronting consumers with higher prices or reduced choice. The classic article on raising rivals' costs recounts a number of examples.⁹⁶ More recently, the FTC's case against Toys "R" Us provided a striking illustration of this exclusionary strategy.⁹⁷ As the Commission showed, Toys "R" Us, the largest toy store chain in the country, successfully pressured toy manufacturers to deny popular items to Costco and Sam's Club, reducing the growth of a new method of distribution and depriving their customers of the selection they desired.⁹⁸

Sometimes, large buyers use their power to shield themselves from their own inefficiency. In his major study of the Great Atlantic and Pacific Tea Company (A&P),⁹⁹ Adelman discovered that during the Great Depression, as suppliers found it more difficult to resist price cutting, A&P obtained larger discriminatory concessions.¹⁰⁰ Adelman concluded that this discrimination was anticompetitive because it diminished the chain's incentive to cut costs, 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 concessions made to it. . . .

....

⁹⁴ See *infra* notes 160, 163-167 and accompanying text.

⁹⁵ See *infra* note 165 and accompanying text.

⁹⁶ See Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209, 212-19 (1986).

⁹⁷ See *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 928 (7th Cir. 2000).

⁹⁸ See *infra* Part V.A.1.

⁹⁹ M.A. Adelman, *A&P: A Study in Price-Cost Behavior and Public Policy* (1959).

¹⁰⁰ *Id.* at 242 ("As price structures gradually buckled in the depression, . . . [p]references increased in absolute amount, and . . . [by] 1935, . . . gross discrimination [accounted for] well over a third of net profit.").

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.¹⁰¹

There is evidence, moreover, that Barnes & Noble and Borders, the nation's largest bookstore chains, obtained discriminatory prices and other terms for many years,¹⁰² and that this persistent favoritism contributed to the demise of hundreds, if not thousands, of independent bookstores.¹⁰³ The resulting weakening of retail competition may have made it easier for the big chains to reduce the discounts they offered consumers.¹⁰⁴ But even if retail prices did not increase, the destruction of numerous independent bookstores deprived many consumers of choices they may have preferred to have. 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.¹⁰⁵

In many communities, citizens have passed zoning laws to exclude Wal-Mart and other large retailers, evidently judging that the entry of these firms would cause more harm than good.¹⁰⁶ Although retail prices would decline,

¹⁰¹ *Id.* at 242-43.

¹⁰² See BRUCE V. SPIVA, COMMENTS OF THE AMERICAN BOOKSELLERS ASSOCIATION TO THE ANTITRUST MODERNIZATION COMMISSION ROBINSON-PATMAN ACT PANEL 4-10 (2005), available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Spiva_Revised%20.pdf.

¹⁰³ See *id.* at 3-4 (reporting that membership in the American Booksellers Association fell from a "high of 5,200 in 1991 to 1,791 members today, a 65% decline in less than fifteen years").

¹⁰⁴ 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), <http://www.nytimes.com/2000/10/09/business/quietly-booksellers-are-putting-an-end-to-the-discount-era.html?pagewanted=all&src=pm>). Spiva contends that the chains' exertion of buying power caused an increase in the retail price of books. See *id.* at 15 ("[I]n response to the chains' demands 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.").

¹⁰⁵ The growth of the national chains and the decline of the independents does not prove that consumers as a whole preferred chains to independents. As explained below, consumers in this situation are subject to a collective action problem. If it is sufficiently widespread and difficult to overcome, it would prevent consumers 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* Part V.A.4. Today, of course, the greatest threat to the independents does not arise from the bookstore chains but from e-books and online retailers like Amazon. See Richard A. Posner, *Can Bookstores Survive? Prospects and Consequences* – Posner, BECKER-POSNER BLOG (Jan. 9, 2011, 3:15 PM), <http://www.becker-posner-blog.com/2011/01/can-bookstores-survive-prospects-and-consequencesposner.html>.

¹⁰⁶ See *Store Size Caps*, INST. FOR LOC. SELF-RELIANCE (Mar. 15, 2012),

making many consumers better off, the entry of these firms would also destroy local businesses,¹⁰⁷ which would not only harm their owners – and other consumers – but eliminate high paying jobs¹⁰⁸ and reduce the vibrancy of central shopping areas.¹⁰⁹ 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.¹¹⁰

<http://www.ilsr.org/rule/store-size-caps/> (identifying twenty-eight cities and five counties that have “enacted zoning rules that prohibit stores over a certain size”). In addition, community protests have stopped Wal-Mart from opening hundreds of stores. See Paul Ingram, Lori Qingyuan Yue & Hayagreeva Rao, *Trouble in Store: Probes, Protests, and Store Openings by Wal-Mart, 1998–2007*, 116 AM. J. SOC. 53, 53 (2010) (“[T]he principal obstacle to the expansion of Wal-Mart has been protests by local activists. During the period starting from 1998 and ending in 2005, Wal-Mart floated 1,599 proposals to open new stores. Wal-Mart successfully opened 1,040 stores. Protests arose on 563 occasions, and in 65% of the cases in which protests arose, Wal-Mart did not open a store.”).

¹⁰⁷ See, e.g., *One, Two, Three, Four . . . We Don't Want Your Superstore*, FRONTLINE (Nov. 16, 2004), <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.”); *Store Size Caps*, *supra* note 106 (stating that 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”).

¹⁰⁸ See, e.g., Abigail Goldman & Nancy Cleeland, *The Wal-Mart Effect*, L.A. TIMES, Nov. 23, 2003, at A1 (“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.”); *One, Two, Three, Four . . . We Don't Want Your Superstore*, *supra* note 107 (“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.”).

¹⁰⁹ See, e.g., *One, Two, Three, Four . . . We Don't Want Your Superstore*, *supra* note 107 (“[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 wither [sic] and die as a result.’”); *Store Size Caps*, *supra* note 106 (“Store size caps help to sustain the vitality of small-scale, pedestrian-oriented business districts . . . and they protect the character of the community by ensuring that new development is at a scale in keeping with existing buildings.”).

¹¹⁰ These instances do not show that countervailing power is normally harmful, since most communities have not prevented Wal-Mart or other large retailers from opening stores.

Overall, then, countervailing power appears to be desirable in most instances: it reduces the market power of suppliers and increases the welfare of consumers and society.¹¹¹ In a significant number of cases, however, such power may be harmful, ultimately injuring both consumers and efficiency. In contrast, the exercise of monopsony power, if that power is acquired or maintained without justification, is invariably harmful, to the suppliers it exploits, to economic efficiency, and frequently to consumers as well. As a result, mergers that threaten to enhance monopsony power without a compensating justification have long been considered an appropriate target for federal enforcement and judicial condemnation – and should remain so. Antitrust analysis of these mergers, however, may lead to mistaken results if it is not linked to the defining characteristics of monopsony power.

II. MERGERS THAT MAY ENHANCE MONOPSONY POWER

When the enforcement agencies and the courts analyze a merger that may enhance monopsony power, they traditionally approach it from two perspectives, sometimes singly, sometimes in combination. Section A describes these two perspectives and Section B identifies potential problems with the second perspective.

A. *The Two Perspectives of the Traditional Approach*

Several commentators and cases rely on the textbook monopsony model to identify the kinds of buy-side mergers that ought to be blocked. They determine whether a merger of buyers is likely to be anticompetitive by asking, in essence, whether the post-merger market structure would approximate the monopsony model (or its close kin, the oligopsony model). In contrast, the enforcement agencies employ what Carstensen calls the “unfortunate mantra”

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 9, at 179 (“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 . . .”).

¹¹¹ Thus, despite growing concentration in the U.K. supermarket sector, and evidence that the largest chains have been able to exercise countervailing power, the CC’s studies of the sector have not found substantial negative effects. See Paul W. Dobson & Ratula Chakraborty, *Buyer Power in the U.K. Groceries Market*, 53 ANTITRUST BULL. 333, 366 (2008) (“At a broad level, the continued profitability and viability of wholesalers, manufacturers, and primary goods producers indicate that buyer power is not fundamentally undermining supply chains – with only a few apparent exceptions Moreover, little evidence has emerged to show that consumers have so far been harmed in respect of product choice/innovation and prices . . .”). Instead, “real prices have consistently fallen in recent years.” *Id.*

that “buyer power is the mirror image of seller power.”¹¹² While “mirror image” analysis is generally useful – pure monopsony is, after all, the mirror image of pure monopoly – this approach can be misleading, as Carstensen suggests, if it is applied without regard to the distinctive features of buyer power analysis.¹¹³

1. Textbook Monopsony Analysis

In the textbook monopsony model, described earlier, 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. Some commentators rely on this model, or a modest variation of it (a dominant buyer with a competitive fringe), to describe the kinds of mergers of buyers that most warrant antitrust scrutiny. In their book-length analysis of monopsony, for example, Professors Blair and Harrison begin their brief discussion of horizontal mergers by observing that a “series of horizontal mergers among firms that buy the same inputs can lead to a case of pure monopsony. In other instances, the merger may result in a dominant firm in a market with several smaller or fringe buyers.”¹¹⁴ Similarly, in their analysis of joint buyer activity, Jacobson and Dorman state: “Proof of [buy-side market power] will normally require (1) evidence of a significant market share and (2) proof that the input product industry has an upward-sloping supply curve.”¹¹⁵

The federal court decisions to date also reflect the monopsony model, albeit implicitly rather than expressly. There have been just two cases resolving a litigated federal challenge to a merger of buyers,¹¹⁶ and both involved mergers that likely would have created a market structure approximating the monopsony model: a dominant buyer facing a fragmented tier of suppliers with upward-sloping supply curves. In *United States v. Rice Growers Ass’n*,¹¹⁷ the court enjoined a merger that would have created a dominant buyer of California rice, a rice milling firm with sixty-four percent of the market.¹¹⁸

¹¹² Carstensen, *supra* note 13, at 273 (quoting *Monopsony Issues in Agriculture: Buying Power of Processors in our Nation’s Agricultural Markets: Hearing Before the S. Comm. on the Judiciary*, 108th Cong. 11 (2003) (testimony of R. Hewitt Pate, Assistant Att’y Gen., U.S. Dep’t of Justice)).

¹¹³ *Id.*

¹¹⁴ BLAIR & HARRISON, *supra* note 22, at 82.

¹¹⁵ Jacobson & Dorman, *supra* note 19, at 53-54.

¹¹⁶ See *id.* at 23-24 (stating that as of 1991, “there appear[ed] to be only two reported decisions evaluating the legality of a horizontal acquisition from the buying side”). Since 1991, there have been no additional litigated buy-side cases. See John B. Kirkwood & Richard O. Zerbe, Jr., *The Path to Profitability: Reinvigorating the Neglected Phase of Merger Analysis*, 17 GEO. MASON L. REV. 39 (2009) (analyzing the entry issue based on a review of every litigated federal merger decision since April 1992).

¹¹⁷ 1986-2 Trade Cas. (CCH) ¶ 67,287 (E.D. Cal. 1986).

¹¹⁸ *Id.* at 61,457-59.

Moreover, the suppliers of that rice – numerous California farmers – likely operated in a competitive market with rising costs of supply. The other case, *United States v. Pennzoil Co.*,¹¹⁹ challenged the combination of two of the three largest refiners of Penn Grade crude oil, a commodity produced by “more than 2,000 independent producers operating approximately 100,000 wells with an average daily output of less than one-third barrel per day.”¹²⁰ Since most of these wells were marginal, the supply curve of Penn Grade crude oil was almost certainly upward sloping. Moreover, after the merger, the producers would have faced a dominant buyer: a combined firm with fifty-four percent of refining capacity.¹²¹

In addition to these court decisions, there have been a small number of cases in which the agencies challenged a merger on the ground that it would create monopsony power, and the case was settled or the merger dropped. Two of these cases appear to fit the oligopsony model, in which a small number of buyers, rather than a single dominant buyer, exercise monopsony power through coordinated action, but where the other characteristics of the monopsony model are present. In *United States v. JBS S.A.*, the complaint alleged that the “acquisition would increase JBS’s share of fed cattle packing capacity from close to 20% to approximately 35% and eliminate one of three large packers that compete with JBS. Post merger, over 80% of the nation’s fed cattle packing capacity would be controlled by a three-firm oligopoly”¹²² Since these three large packers purchase cattle from numerous ranchers, who likely operate in a competitive industry with an upward-sloping supply curve, this case approximates the oligopsony model.¹²³ Similarly, in *United States v. Cargill, Inc.*,¹²⁴ the Justice Department alleged that the acquisition would have given Cargill “the power to artificially depress prices paid to U.S. farmers”¹²⁵ because “Cargill and one other company would hold approximately 80% of the authorized delivery services (various types of grain elevators) in the local or regional markets in question.”¹²⁶ Like *JSA*, the case involved fragmented suppliers with little or no market power, whose supply costs likely rose with output.

¹¹⁹ 252 F. Supp. 962 (W.D. Pa. 1965).

¹²⁰ *Id.* at 968.

¹²¹ *Id.* at 969.

¹²² Complaint at 3, *United States v. JBS S.A.*, No. 08CV5992 (N.D. Ill. Oct. 20, 2008).

¹²³ The proposed acquisition was ultimately abandoned. See Press Release, U.S. Dep’t of Justice, Department of Justice Statement on the Abandonment of the JBS/National Beef Transaction (Feb. 20, 2009), available at http://www.justice.gov/atr/public/press_releases/2009/242857.pdf.

¹²⁴ 2000-2 Trade Cas. (CCH) ¶ 72,966, at 88,206 (D.D.C. 2000) (accepting consent judgment).

¹²⁵ *Id.*

¹²⁶ *Id.* at 88,207.

In these four cases, in short, there was evidence of both a dominant buyer (or a small group of buyers with a dominant share) and a supply tier that was fragmented and competitive.¹²⁷ The presence of a competitive supply tier – populated by essentially powerless suppliers with rising costs – is important in distinguishing a monopsony case from a case of countervailing power. Yet mirror image analysis, the other traditional approach, does not explicitly require this distinction.

2. Mirror Image Analysis

Because the monopsony model is the mirror image of the monopoly model, it is natural to analyze a merger of buyers as if it were symmetric to a merger of sellers. The federal government's merger guidelines have taken this approach for at least the last two decades. In 1992, the Horizontal Merger Guidelines stated: "In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines."¹²⁸ The 2010 Guidelines reiterate this approach: "To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market."¹²⁹

In many respects, mirror image analysis is a sound approach. Even Professor Carstensen, no fan of mirror image analysis, has stated: "In [input markets] typified by farmers, ranchers, and doctors . . . the measurement of buyer power . . . is roughly similar to that in seller markets."¹³⁰ But mirror

¹²⁷ Likewise, the Department of Justice's recent challenge to a combination of two chicken processing plants in Virginia fits the oligopsony model. See *Complaint, United States v. George's Foods, LLC*, No. 5:11-cv-00043-gec (W.D. Va. May 10, 2011). Post-merger, the buy side of the market would be highly concentrated. The government alleged that George's Foods' acquisition of the Tyson plant in the Shenandoah Valley would reduce from three to two the number of processors to whom chicken growers in this area could sell their services. *Id.* at 7. At the same time, the sell side would be atomistically competitive. The government asserted that there are "nearly 500 broiler growers in the Virginia portion of the Shenandoah Valley alone." *Id.* at 4. The Department withdrew the case after George's agreed to "make capital improvements to [its] Harrisonburg chicken processing plant that will lead to a significant increase in the number of chickens that will be processed at the facility." Press Release, U.S. Dep't of Justice, Justice Department Reaches Settlement with George's Inc., (Jun. 23, 2011), available at http://www.justice.gov/atr/public/press_releases/2011/272510.pdf.

For two other cases involving mergers that may have enhanced monopsony power, see Pitofsky, *supra* note 11, at n.17 ("The Commission has brought cases challenging mergers which would have enabled buyers to exercise monopsony power." (citing Phillips Petroleum Co., 120 F.T.C. 1129 (1995); InterNorth, Inc., 106 F.T.C. 312 (1985))).

¹²⁸ Horizontal Merger Guidelines, 57 Fed. Reg. 41,552 (Apr. 2, 1992).

¹²⁹ 2010 GUIDELINES, *supra* note 21, § 12.

¹³⁰ Carstensen, *supra* note 13, at 275.

image analysis, if not applied carefully, may produce two errors. It may misstate the concentration thresholds that are appropriate for a merger of buyers, and it may fail to distinguish mergers that may enhance countervailing power from mergers that may enhance monopsony power.

B. *Potential Drawbacks of Mirror Image Analysis*

1. Concentration Thresholds

Mirror image analysis implies that the concentration thresholds used to determine whether a merger of buyers is presumptively illegal should be the same as those used for mergers of sellers. Several commentators, however, question that notion, arguing that the appropriate thresholds should be either higher or lower in the case of buy-side mergers.

Areeda and Hovenkamp assert that “concentration thresholds should be higher for horizontal mergers whose only significant anticompetitive threat arises from the post-merger firm’s participation in the market as buyer rather than seller.”¹³¹ The treatise takes this position because price fixing by buyers has been observed much less frequently than price fixing by sellers.¹³² That fact, though, may not mean that buyers have more difficulty colluding than sellers. Indeed, the treatise acknowledges that “no principle of traditional economic price theory explains why buyer collusion to depress prices is less common than seller collusion.”¹³³ Buyers probably collude less frequently than sellers for two reasons, neither rooted in the difficulty of buyer coordination. First, hard-core collusion to depress input prices below the competitive level is unlikely to be successful unless the upstream market structure is conducive to the exercise of monopsony power, and that is uncommon.¹³⁴ Second, if buyers want to get together to influence input prices, they can easily do so, without hard-core collusion, by forming a group buying organization.¹³⁵ In short, buyer price fixing may be less common than seller price fixing, not because it is harder for buyers to engage in anticompetitive collusion when the upstream market structure is conducive to the exercise of monopsony power, but because (1) the upstream market structure is not often conducive, and (2) when it is conducive to the exercise of countervailing power rather than monopsony power, buyers can usually induce lower input prices either on their own or through buying groups. Thus, the observed

¹³¹ 4A AREEDA & HOVENKAMP, *supra* note 22, ¶ 982.

¹³² *Id.* ¶ 981b (“While seller price-fixing agreements have been a common occurrence . . . buyer agreements are much less common.”).

¹³³ *Id.*

¹³⁴ See *supra* Part I.B.2.

¹³⁵ See Carstensen, *supra* note 47, at 15 (“[M]any groups of competitors that desire to coordinate their buying activities can with only modest planning create an entity that has the appearance of being a buying group”); *id.* at 37 (“[C]urrent antitrust law provides a broad tolerance for any enterprise that holds itself out as a buying group”).

infrequency of buyer price fixing does not support higher concentration thresholds where the upstream market structure is conducive to the exercise of monopsony power.

In contrast to the Areeda-Hovenkamp treatise, Carstensen suggests that the concentration thresholds should be *lower* in the case of a buy-side merger:

[T]he incentives to create and adhere to a buyer cartel are significantly different from those in a seller cartel. Defection by a seller from a price fixing or market allocating cartel results in a direct and immediate increase in sales and revenue. . . . In contrast, a defecting buyer faces basically higher prices as it bids up input prices in order to achieve a large volume of production. Larger production, however, means that the volume in the market into which the product will resell will also increase. Hence, the product faces higher input prices and constant or lower resale prices. Even so, it is possible that the marginal increase in costs will be more than offset by the opportunity to make more sales at slightly lower prices. This two step process of gaining from defection, however, means that there are greater incentives to remain loyal to the conspiracy.¹³⁶

This analysis identifies several possible reasons why buyers may be less likely than sellers to defect from a cartel or other form of coordinated anticompetitive pricing. One reason – that buyers must engage in a “two step process” to gain from defection – may not be enough, by itself, to establish the difference. It is true that a buyer must undertake a two-step process when defecting: it must raise the input price it pays, and it must increase the volume it sells, which may depress its selling price. But a defecting seller must also undergo a two-step process: it must lower its selling price, and it must increase the volume it sells, which may require it to purchase more inputs at a higher price.

A second reason may be more important. Carstensen points out that a defecting buyer “faces basically higher prices as it bids up input prices.” Those higher prices would place the defecting buyer at a competitive disadvantage, at least for a short period of time. In contrast, a defecting seller is less likely to have to pay higher input prices and less likely, as a result, to suffer a competitive disadvantage. This asymmetry arises because a defecting buyer must incur higher input costs than its rivals when it departs from the coordinated input price. A defecting seller, however, need not do so and indeed would frequently not do so since, outside the monopsony setting, input suppliers can often expand their own output without incurring higher marginal costs.¹³⁷ A defecting seller, in short, is less likely to be placed at a competitive disadvantage by rising supply costs than a defecting buyer. While the buyer’s disadvantage is unlikely to last long – other buyers are likely to bid up input

¹³⁶ *Id.* at 35-36.

¹³⁷ *See supra* note 39.

prices in response to the defection – this asymmetry may provide a reason why buyers are less likely to cheat on coordinated pricing than sellers.¹³⁸

If this reasoning is correct, coordinated monopsony pricing may occur at lower concentration levels, or be easier to sustain at moderate concentration levels, than coordinated supracompetitive pricing. It may be appropriate, therefore, for courts and enforcement agencies to lower the concentration thresholds they use to determine whether a merger creates a reasonable probability of coordinated monopsony pricing.

2. Type of Buyer Power

Mirror image analysis is also subject to a second objection. Unlike the textbook monopsony model, which focuses explicitly on the structure of input supply, mirror image analysis focuses on concentration in the buying market, entry, and efficiencies, not the state of competition among suppliers. As a result, mirror image analysis, if applied woodenly, could result in serious errors, condemning mergers of buyers that resulted in highly concentrated buying markets, even if the type of buyer power that ensued was countervailing power, not monopsony power, and the outcome was a procompetitive reduction in input prices.

This error can easily be avoided. Mirror image analysis can address the state of upstream supply when it considers whether a merger poses a significant risk of anticompetitive effects. A merger that enhanced countervailing power in a procompetitive way, reducing supplier market power and raising consumer welfare, would not produce anticompetitive effects, even if it would result in a large increase in buy-side concentration. Mirror image analysis can go astray, in other words, if it focuses on the concentration-increasing impact of a merger to the exclusion of its competitive effects.

The Guidelines do not discuss this issue, but they contain language that suggests the agencies are aware of it. The “Mergers of Competing Buyers” section states that the agencies “distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways.”¹³⁹ While the Guidelines do not identify a concession induced by countervailing power as one of those “effects arising in other ways,” the language is broad enough to allow the agencies to treat procompetitive price reductions obtained by the

¹³⁸ Carstensen has suggested yet another reason: defecting sellers profit from their cheating more quickly than defecting buyers do. A defecting seller realizes an immediate gain when it makes a sale by cutting prices below the consensus level. A defecting buyer, however, realizes no gain when it purchases inputs at a price higher than the consensus price. It profits only when it resells those inputs or converts them into a product that it then sells. This difference in timing may reinforce the competitive disadvantage mentioned in this Part and increase buyers’ reluctance to cheat on a coordinated price. See Carstensen, *supra* note 33, at 805 (explaining that buyers experience “inherent lags” in realizing gains from cheating).

¹³⁹ 2010 GUIDELINES, *supra* note 21, § 12.

exercise of countervailing power differently from anticompetitive price reductions occasioned by the exercise of monopsony power. It would be clearer, however, if the Guidelines expressly distinguished countervailing power from monopsony power and made plain that the agencies would not challenge a merger of buyers on the ground that it posed a risk of monopsony power unless the upstream market structure was conducive to the exercise of monopsony power.

In one area of merger policy, in contrast, there is widespread recognition of the existence and potential procompetitive effects of countervailing power. The Merger Guidelines, the Areeda-Hovenkamp treatise, and the case law all embrace the notion that the anticompetitive effects of a merger of sellers may be lessened, if not eliminated, when the merged firm must deal with powerful buyers.

III. COUNTERVAILING POWER AS A MITIGATING FACTOR IN A MERGER OF SELLERS

The Guidelines recognize the procompetitive effects of countervailing power in their section on buyer power as a mitigating factor in a sell-side merger.¹⁴⁰ Though they do not mention countervailing power, the Guidelines state that “powerful buyers” can induce price cuts from sellers with market power and that such buyer power may prevent sellers from raising prices after a merger.¹⁴¹ Similarly, the Areeda-Hovenkamp treatise notes that large buyers can limit the market power of merging sellers by playing them off against each other or by threatening to integrate backward into the sellers’ market.¹⁴²

Several court decisions have referenced this benefit of buyer power. The best known is *United States v. Archer-Daniels-Midland Co.*,¹⁴³ where the judge held that ADM’s lease of two corn wet milling plants from Nabisco did not violate section 7, in part because the purchase of the relevant product, high-fructose corn syrup, is “dominated by a few large, sophisticated and powerful buyers, such as Coca-Cola and Pepsi-Cola.”¹⁴⁴ The opinion contains a detailed

¹⁴⁰ *Id.* § 8.

¹⁴¹ *Id.* (“Powerful buyers are often able to negotiate favorable terms with their suppliers. . . . The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices.”).

¹⁴² 4 AREEDA & HOVENKAMP, *supra* note 22, ¶ 943a (“[T]he large buyer is typically in a much stronger position to force sellers to compete against each other for the buyer’s trade.”); *see also id.* (“Such a buyer may also be in a position to make all-or-nothing offers or to threaten backward vertical integration in the event prices are maintained.”); Bhattacharyya & Nain, *supra* note 54, at 101 (“[T]he notion that large buyers have an advantage in obtaining price concessions from sellers has been verified by a number of empirical studies.”).

¹⁴³ 781 F. Supp. 1400 (S.D. Iowa 1991).

¹⁴⁴ *Id.* at 1416.

description of the tactics those buyers use to keep syrup prices low.¹⁴⁵ Other cases have also relied on the size and sophistication of buyers in concluding that a merger of sellers would not pose a significant risk of anticompetitive effects.¹⁴⁶

Buyer power is no guarantee, however, that a sell-side merger will be harmless. Even if a large buyer has enough leverage to prevent the merged firm from charging it a higher price, smaller buyers may be exposed to a price hike. As noted earlier, big buyers often seek concessions in order to obtain a competitive advantage over smaller buyers.¹⁴⁷ This means that the merged firm may well discriminate in favor of its larger customers and against its smaller ones.¹⁴⁸ For this reason, several courts have blocked mergers of sellers, despite the presence of large buyers, because small customers could be injured.¹⁴⁹ The Guidelines endorse this approach: “[E]ven if some powerful

¹⁴⁵ The court explained:

The power buyers and other large buyers use numerous tactics to obtain low prices for HFCS, including:

- (a) Refusal to reveal the prices quoted by other suppliers and the price which a supplier must meet to obtain or retain business, creating uncertainty among suppliers.
- (b) Swinging large volume back and forth among suppliers to show each supplier that it better quote a lower price to obtain and keep large volume sales.
- (c) Delaying agreement to a contract and refusing to purchase product until a supplier accedes to acceptable terms.
- (d) Holding out the threat of inducing a new entrant into HFCS production and assuring the new entrant adequate volume and returns.

Id. at 1417-18. The court also found that buyers “continually play suppliers off against one another, cutting back or discontinuing purchases from sellers as a means of obtaining the lowest possible prices. As a result, purchaser-supplier relationships are highly unstable, with suppliers, including ADM, frequently losing business, regaining it, and losing it again on price grounds – sometimes within the same quarter.” *Id.* at 1419.

¹⁴⁶ See, e.g., *United States v. Baker Hughes Inc.*, 908 F.2d 981, 986 (D.C. Cir. 1990); *United States v. Country Lake Foods, Inc.*, 754 F. Supp. 669, 679 (D. Minn. 1990).

¹⁴⁷ See *supra* Part I.C.3.

¹⁴⁸ See, e.g., Shapiro, *supra* note 57, at 93 (“The majority of [Department of Justice] mergers involve intermediate goods and services. In these markets, prices typically are negotiated and price discrimination is common. For example, manufacturers may negotiate lower prices with larger customers than with smaller customers . . .”).

¹⁴⁹ See *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 59-61 (D.D.C. 1998); *United States v. United Tote*, 768 F. Supp. 1064, 1085 (D. De. 1991). Similarly, Judge Posner ruled, in a price fixing case involving high fructose corn syrup (HFCS), that the large buyers in this market did not eliminate the danger to small buyers:

[T]here are some very large buyers of HFCS, notably Coca-Cola and Pepsi-Cola, and, as theory predicts, they drove hard bargains and obtained large discounts from the list price of HFCS 55. But it does not follow that the defendants could not and did not fix the price of HFCS 55. There is a difference between a market in which all or virtually all the buyers are large and one in which there are some large and some small buyers. Suppose the buying side of the HFCS market were as concentrated as the selling side, meaning that five firms bought 90 percent of all the HFCS sold. They would be able to

buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.”¹⁵⁰

The Areeda-Hovenkamp treatise would restrict the role of buyer power even further. Even if there are no small, vulnerable customers, the treatise recommends that courts and enforcement agencies ignore buyer power as a mitigating factor in a merger of sellers unless the circumstances are exceptional.¹⁵¹ But the first argument the treatise makes – “[m]easurement imposes intractable problems except in the clearest case where buyer power is so significant that sellers clearly are forced to behave competitively”¹⁵² – is overstated. The measurement issue is whether buyers would have sufficient leverage post-merger to prevent a significant price increase or other anticompetitive effects. That can be addressed by examining each of the tactics a buyer might use to exert leverage over its suppliers and asking whether those tactics would be available and effective post-merger. Several cases have had no trouble doing this. In *United States v. Archer-Daniels-Midland Co.*,¹⁵³ the court concluded that big buyers could continue to protect themselves after the challenged transaction by using the same tactics they had wielded in the past.¹⁵⁴ Conversely, in *Chicago Bridge & Iron Co. v. FTC*,¹⁵⁵ the court reviewed these same tactics and concluded that they had become *unavailable* to the buyers as a result of the merger.¹⁵⁶ There will, of course, be

whipsaw the sellers into granting large discounts, and probably therefore any effort at fixing prices would quickly collapse. When instead there are some large and some small buyers, which is the situation here, this need not prevent price fixing; it may simply cause the price fixers to engage in price discrimination, giving large discounts to the big buyers and no (or small) discounts to the small ones.

In re High Fructose Corn Syrup Antitrust Litig., 295 F.3d 651, 658 (7th Cir. 2002). Moreover, when an input represents a small proportion of a buyer’s total purchases, the sellers may be able to fix its price, despite the presence of large buyers, because the buyers are unwilling to devote the effort to detect and break a cartel in a minor input. See, e.g., Sharis A. Pozen, Acting Assistant Attorney General, U.S. Dep’t of Justice, Remarks at the Briefing on Department’s Enforcement Action in Auto Parts Industry (Jan. 30, 2012) (transcript available at http://www.justice.gov/atr/public/press_releases/2012/279740.pdf) (describing price fixing and bid rigging of wire harnesses, instrument panel clusters, fuel senders, and other small parts sold to auto manufacturers). Professor John Connor pointed out to me that his research on global cartels indicates that effective collusion is much less likely on major inputs. E-mail from John Connor, Professor of Indus. Econ., Purdue Univ., to author (Jan. 31, 2012) (on file with author).

¹⁵⁰ 2010 GUIDELINES, *supra* note 21, § 8.

¹⁵¹ 4 AREEDA & HOVENKAMP, *supra* note 22, ¶ 943b (“We conclude that it would be inappropriate to give formal recognition to buyer concentration and related factors in the ordinary run of merger cases.”).

¹⁵² *Id.*

¹⁵³ 781 F. Supp. 1400 (S.D. Iowa 1991).

¹⁵⁴ See *id.* at 1417-18; see also *supra* note 145.

¹⁵⁵ 534 F.3d 410 (5th Cir. 2008).

¹⁵⁶ See *id.* at 440. In particular, the Fifth Circuit stated:

close cases where the impact of buyer power will be hard to assess. After all, any merger of sellers will reduce the ability of buyers to play sellers against each other, since there will be one fewer seller post-merger. But in most cases, agencies and courts can look at how many other sellers remain, and what other tactics are still available to the large buyers, and make a reasoned judgment. The phenomenon of countervailing power is sufficiently pervasive, and its impact sufficiently well understood, that it should not be routinely excluded from merger analysis.

The same conclusion applies to the treatise's second argument – that “powerful buyers might find it more profitable to share in their suppliers’ excess profits rather than trying to get supply prices down to competitive levels.”¹⁵⁷ That may be true in some instances,¹⁵⁸ but both my experience at the FTC and the theory and evidence set forth above¹⁵⁹ indicate that buyers commonly exert countervailing power in order to obtain lower input prices or other benefits that they pass on (at least in part) to increase their market share at the expense of smaller rivals. Large buyers, in other words, normally seek discriminatory advantages, and while those advantages weaken smaller buyers and may ultimately harm consumers, in the short run they usually lead to higher output and lower prices. In most cases, then, the exertion of countervailing power tends to limit or remove the adverse effects of a merger on consumers, not to simply capture a share of the merging firms’ profits.

In short, the proper approach to buyer power in sell-side merger cases is to examine the facts of each case, looking at whether and to what extent large buyers are likely to be able to exercise significant leverage post-merger, neither presuming that their efforts will be successful nor presuming that they will fail. On this issue, the method set forth in the Guidelines is exactly right.¹⁶⁰

(b) As we noted earlier, the market has had only two dominant players, PDM and CB&I [whose assets were combined in the challenged transaction], so buyers cannot now swing back and forth between competitors to lower bids *post-acquisition*; (c) Instances of CB&I pressuring customers to offer sole-source contracts by withdrawing its bid and CB&I’s success at obtaining sole-source contracts undermine any argument that buyers have the ability to pressure CB&I in contract negotiations; and (d) No buyer can assure that a new entrant has “adequate volume and returns” for meaningful entry into the market as there is no evidence that buying power is sufficiently concentrated.

Id.

¹⁵⁷ 4 AREEDA & HOVENKAMP, *supra* note 22, ¶ 943b.

¹⁵⁸ See *infra* Part IV.C.2 (discussing bilateral monopoly).

¹⁵⁹ See *supra* Part I.C.

¹⁶⁰ See 2010 GUIDELINES, *supra* note 21, § 8 (“However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer’s negotiating

IV. MERGERS THAT MAY ENHANCE PROCOMPETITIVE COUNTERVAILING POWER

In *Archer-Daniels-Midland Co.*, the court not only endorsed the notion that countervailing power can eliminate the anticompetitive effects of a merger of sellers; it also suggested that mergers of buyers may be desirable because “increasing concentration on the buying side . . . is an effective means of counteracting any potential market power that might be exercised by sellers.”¹⁶¹ Section A shows that this view has empirical support – that many mergers of buyers do indeed restrain supplier margins and produce benefits for customers and consumers. It also notes that neither courts nor enforcement agencies have ever objected to a buy-side merger on the ground that it would create countervailing power. Section B addresses whether this permissive approach is tantamount to recognizing a countervailing power defense to a presumptively illegal buy-side merger. Section C confronts the extreme case – bilateral monopoly – and concludes that when it occurs as a result of a merger of buyers, the outcome depends on whether the merger would also give the merged firm monopoly power as a seller. Finally, Section D outlines a more general process for evaluating a merger of buyers that is likely to enhance both upstream countervailing power and downstream market power.

A. *Evidence and Enforcement*

Mergers of buyers can be procompetitive when they allow the merging firms to achieve economies of scale, reduce transactions costs, or avoid duplication of facilities. A merger of buyers may also be desirable when it allows the merged firm to exercise countervailing power in a procompetitive way, reducing the market power of suppliers and lowering their input prices. As Hovenkamp notes in his discussion of a related form of integration, when smaller buyers form purchasing groups, they “can force concentrated sellers to behave more competitively toward the smaller buyers, thus making the market more competitive.”¹⁶²

Two recent studies indicate that mergers of buyers often have these procompetitive effects. Edward Fee and Shawn Thomas examined 391 horizontal mergers that occurred in the last two decades of the twentieth century and concluded that an important source of the gains from these mergers was the reduction in suppliers’ margins that followed the mergers, a reduction that reflected the procompetitive impact of buying power.¹⁶³ Fee and

leverage will harm that buyer.”).

¹⁶¹ *United States v. Archer-Daniels-Midland Co.*, 781 F. Supp. 1400, 1422 (S.D. Iowa 1991).

¹⁶² 12 HOVENKAMP, *supra* note 52, ¶ 2015b.

¹⁶³ See C. Edward Fee & Shawn Thomas, Sources of Gains in Horizontal Mergers: Evidence from Customer, Supplier, and Rival Firms, 74 J. Fin. Econ. 423, 425 (2004) (“We find that, on average, suppliers experience significant declines in cash-flow margins immediately subsequent to downstream mergers. This result suggests that some form of

Thomas found that supplier margins fell more where the supplying industry was more concentrated, just what one would expect if the mergers enhanced countervailing power.¹⁶⁴ The authors also determined that the merged firms kept only part of the resulting gains for themselves, passing on most of them to ultimate consumers.¹⁶⁵

In a more recent study, Sugato Bhattacharyya and Amrita Nain reach the same result: mergers of buyers tend to increase the exercise of countervailing power against upstream suppliers. Looking at hundreds of mergers over a two-decade period, the authors find that suppliers who sold a greater portion of their output to an industry in which a merger occurred experienced lower profits post-merger.¹⁶⁶ Profits fell because the suppliers' prices declined in response to the merger,¹⁶⁷ a result that Bhattacharyya and Nain assign to countervailing power. The authors reason that buyers with countervailing power are likely to target suppliers with market power,¹⁶⁸ and find evidence

buying power is an important source of gains in horizontal mergers."). Fee and Thomas categorize the type of buying power at work as efficiency-enhancing buyer power (i.e., countervailing power), not monopsony power. If it were monopsony power, they reason, then all suppliers would suffer reduced margins post-merger, but that is not the case: the losses are borne by the suppliers who are terminated post-merger. Suppliers who are retained increase their market share and maintain their profits. See *id.* ("These results suggest that merging firms could realize gains by pitting their preexisting suppliers against one another in a price competition to remain suppliers post-merger. Given that winning suppliers do not appear to suffer, we interpret these results as more consistent with efficiency-increasing buying power than monopsonistic collusion . . ."). Fee and Thomas do not explore whether retained suppliers use their increased size for anticompetitive ends: raising the costs of rivals, for example, or exploiting their own suppliers.

¹⁶⁴ *Id.* at 451 ("[S]uppliers seem to suffer more when they operate in relatively concentrated industries; e.g., when there are greater initial supplier rents for the merging firms to capture."); see also *id.* at 458 ("This result is consistent with an efficient form of countervailing power lowering rents in the supplier industries.").

¹⁶⁵ See *id.* at 453 (concluding that merged firms do not realize large gains in their operating performance; instead, "buying power savings are largely passed along to ultimate consumers"). The one caveat is that Fee and Thomas did not find persistent changes in either the merged firms' margins or their suppliers' margins. To the contrary, the changes at both levels tended to decline as time passed, perhaps because suppliers consolidated in order to better resist the enhanced power of their customers. See *id.* at 425. The authors did not investigate whether suppliers actually merged, however, or what other factors might have accounted for the "somewhat temporary . . . nature" of the initial margin changes, leaving this result and its interpretation uncertain. See *id.* at 458.

¹⁶⁶ Bhattacharyya & Nain, *supra* note 54, at 98 ("We find that supplier industries selling a larger fraction of their output to the downstream consolidating industry have lower cash-flow margins following downstream consolidation.").

¹⁶⁷ *Id.* ("[T]he decline in supplier selling prices may . . . be attributed to consolidation downstream.").

¹⁶⁸ *Id.* at 108 ("Countervailing power theory suggests that suppliers with prior pricing power would be the natural targets of buyer power generated by consolidation

that prices declined more when suppliers had greater market power. In particular, supplier prices fell to a greater degree when the upstream industry was more concentrated,¹⁶⁹ had higher barriers to entry,¹⁷⁰ or had experienced a larger number of horizontal mergers.¹⁷¹ Thus, they conclude, their study provides “direct evidence that horizontal mergers countervail upstream market power.”¹⁷²

In accord with these studies, no court decision has ever condemned a merger of buyers on the ground that it would enhance countervailing power. Instead, all the litigated cases are consistent with the monopsony (or oligopsony) model.¹⁷³ This record creates a problem for mergers that pose a threat of *anticompetitive* countervailing power: there is no precedent for condemning these consolidations. At the same time, there is no precedent for blocking mergers that would create procompetitive countervailing power, even though those mergers would raise buy-side concentration.

Likewise, the federal government has never challenged a merger on the ground that it would enlarge countervailing power. To the contrary, in a statement explaining the closing of the Caremark/Advance PCS investigation, the FTC maintained that the merger, if it created buying power at all, would have created procompetitive bargaining power (i.e., countervailing power).¹⁷⁴

downstream.”).

¹⁶⁹ *Id.* at 99 (“We find that supplier industries with a higher Herfindahl index or a higher four-firm concentration ratio prior to consolidation downstream experience larger price declines post-consolidation.”).

¹⁷⁰ *Id.* (“A similar result obtains when we use capital intensity and capital expenditures to proxy for higher barriers to entry upstream.”).

¹⁷¹ *Id.* (“[S]uppliers experiencing increased horizontal merger activity prior to downstream consolidation suffer larger price declines post-consolidation.”).

¹⁷² *Id.* at 114; *see also id.* at 99 (“These results are all consistent with the creation of buyer power through downstream consolidation to countervail upstream market power.”). Bhattacharyya and Nain do not address whether the merged firms passed on the lower prices they induced. While they find no evidence that the mergers resulted in *higher* downstream prices, *see id.* at 108, they do not ask whether the mergers produced *lower* downstream prices. One might infer that the buy-side mergers had this effect because they led to lower input prices without increasing downstream market power, a combination that would tend to cause a firm exercising countervailing power to expand output and reduce downstream prices. But the authors do not investigate this. The second caveat is that Bhattacharyya and Nain discover that when buyers merge, suppliers tend to merge in response, just as Fee and Thomas had suspected. *See id.* at 99 (“We find that suppliers’ horizontal merger activity in a given year is positively related to consolidation activity in main customer industries over the prior four years.”). As noted, however, the authors find no evidence of higher upstream or downstream prices in the period they examine, suggesting that the supplier combinations had no anticompetitive effects. But again, the authors do not study this directly.

¹⁷³ *See supra* Part III.

¹⁷⁴ FTC, FTC FILE NO. 031 0239, STATEMENT: *IN THE MATTER OF CAREMARK RX, INC./ADVANCE PCS 3* (2004), available at <http://www.ftc.gov/os/caselist/0310239/040211ftcstatement0310239.pdf>.

The merger combined two prescription benefit management (PBM) services and the Commission considered not only whether it would create downstream market power but whether it would “confer monopsony (or oligopsony) power on PBMs when they negotiate dispensing fees with retail pharmacies.”¹⁷⁵ The agency thought that monopsony power was unlikely because the merged firm’s buying share would be too low.¹⁷⁶ Instead, the merger would likely enhance the parties’ bargaining power, which would benefit consumers, a point the Commission emphasized at length:

It is important not to equate market concentration on the buyer side with [monopsony (or oligopsony)] power. For example, a shift in purchases from an existing source to a *lower-cost, more efficient* source is not an exercise of monopsony power. Nor do competition and consumers suffer when the increased bargaining power of large buyers allows them to obtain lower input prices without decreasing overall input purchases. This bargaining power is procompetitive when it allows the buyer to reduce its costs and decrease prices to its customers.

....

... It is likely some of the PBM’s [gains from increased bargaining power] would be passed through to PBM clients. Although retail pharmacies might be concerned about this outcome, a reduction in dispensing fees following the merger could benefit consumers.¹⁷⁷

If the agency’s analysis of the facts is correct, this merger would enhance procompetitive countervailing power rather than monopsony or oligopsony power.¹⁷⁸ Some might object to the agency’s decision, however, on the ground

¹⁷⁵ *Id.* at 2.

¹⁷⁶ *Id.* at 3 (“[T]he post-acquisition share of the merged firm for all purchases of prescription dispensing services would be below the level at which an exercise of monopsony power is likely to be profitable.”). In addition, PBMs engage in individual negotiations with pharmacies rather than announcing a single price at which they will deal with all pharmacies. *See id.* As noted, this factor tends to differentiate the exercise of countervailing power from the exercise of monopsony power. *See supra* Part I.C.

¹⁷⁷ *Id.* (footnote omitted).

¹⁷⁸ It is not entirely clear that the Commission’s analysis is correct. The most critical factor in distinguishing countervailing power from monopsony power is the structure of the upstream supply market. If the upstream market is atomistically competitive rather than oligopolistic or monopolistically competitive, a reduction in input prices would represent the exercise of monopsony (or oligopsony) power rather than countervailing power. The Commission’s statement did not address the upstream market structure.

In a subsequent investigation of another PBM merger, the Commission again concluded that the transaction was unlikely to enhance monopsony power without addressing the competitiveness of upstream supply. *See* FTC, FTC FILE NO. 111-0210, STATEMENT CONCERNING THE PROPOSED ACQUISITION OF MEDCO HEALTH SOLUTIONS BY EXPRESS SCRIPTS, INC. (2012), available at <http://www.ftc.gov/os/2012/04/120402expressmedcostatement.pdf>. In explaining its decision, the Commission noted that the merged firm would not

that it appears to recognize a countervailing power defense to a merger that significantly increased buy-side concentration. Since antitrust law does not permit a countervailing power defense to buyer price fixing, why should it permit a countervailing power defense to a presumptively illegal merger of buyers?

B. *Countervailing Power Defense*

If the agencies and courts do not ask whether a merger would create countervailing power rather than monopsony power, and whether the countervailing power would be likely to increase rather than reduce competition, they would substantially increase the risk of erroneous decisions. They would be much more likely to condemn procompetitive mergers and exonerate anticompetitive transactions. As a matter of policy, therefore, it makes considerable sense to look at the actual expected effects of a merger. Given the state of the law, moreover, it is easier to do so in the merger context than in a price fixing case, since price fixing is per se illegal and mergers are evaluated under the rule of reason. Under the rule of reason, many factors need to be considered in determining whether a merger is anticompetitive, including countervailing power. Thus, none of these factors is actually a “defense” to an anticompetitive merger. All are relevant to determining whether the merger is in fact anticompetitive.

Hard-core price fixing is per se illegal, whether by buyers or by sellers.¹⁷⁹ A merger, in contrast, is judged under the rule of reason, since it involves an integration of the parties’ operations that can increase efficiency and promote competition. As the Guidelines put it, a merger may “generate significant efficiencies and thus enhance the merged firm’s ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products.”¹⁸⁰ The Guidelines also indicate that one of the

have a dominant share of pharmacy business and that pharmacy reimbursement rates are only weakly correlated with PBM size. These factors would not be dispositive, however, if most pharmacies operate in competitive markets and the merger would reduce their reimbursement rates. The Commission responded to this possibility by stating that “even if the transaction enables the merged firm to reduce the reimbursement it offers to network pharmacies, there is no evidence that this would result in reduced output or curtailment of pharmacy services generally.” *Id.* at 8. But the Food Marketing Institute, whose members operate almost 22,000 pharmacies, argued in a detailed letter that supermarket pharmacy margins are very thin, that the merger would depress reimbursements below competitive levels, and that this could cause pharmacies to cut an array of services consumers value. See Letter from Food Mktg. Inst. to Jon Leibowitz, Chairman, Fed. Trade Comm’n (Feb. 2, 2012), available at <http://www.fmi.org/docs/newsletters-comments/fmi-letter-to-ftc-concerns-regarding-the-proposed-acquisition-of-medco-health-solutions-by-express-scripts-inc-.pdf?sfvrsn=2>.

¹⁷⁹ See *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 213 (1940); Carstensen, *supra* note 47, at 4-5.

¹⁸⁰ 2010 GUIDELINES, *supra* note 21, § 10.

potential efficiency benefits of a merger is the ability of the merged firm to obtain lower input prices through the exertion of countervailing power. The Guidelines state: "Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger"¹⁸¹ Likewise, the case law recognizes the procompetitive effects of countervailing power. It considers countervailing power to be a mitigating factor in a sell-side merger case, and it has never condemned a buy-side merger because it would create countervailing power.¹⁸² In sum, it is sensible and consistent with existing law to examine countervailing power in a merger case, even if it is not considered in a price fixing case.¹⁸³

In this respect, a merger is like a buying co-op, a joint venture that integrates the members' purchasing activities. Like a merger, the legality of a buying group is determined under the rule of reason,¹⁸⁴ and like a merger of buyers, one of the standard justifications for a buying co-op is that it can lower purchasing costs through the exercise of countervailing power.¹⁸⁵ No one suggests, however, that this factor should be ignored in evaluating a buying co-op because it would create a countervailing power defense to an otherwise illegal horizontal restraint. Moreover, it is relatively easy for buyers to form purchasing co-ops.¹⁸⁶ As a result, buyers rarely need to engage in hard-core collusion in order to lower their input prices in a procompetitive way. Given the availability of this less restrictive alternative, and the absence of other efficiencies, there is ample reason to hold buyer price fixing to be per se illegal.

¹⁸¹ *Id.* § 12. When the Guidelines refer to "market power" here, they are referring to "market power on the buying side of the market," i.e., monopsony power. *See id.*

¹⁸² *See supra* Part III.

¹⁸³ *See* Warren S. Grimes, *The Sherman Act's Unintended Bias Against Lilliputians: Small Players' Collective Action as a Counter to Relational Market Power*, 69 ANTITRUST L.J. 195, 207 (2001) ("[T]here is an obvious reason for antitrust's relative tolerance of mergers and joint ventures and intolerance for [unintegrated] collective action intended to create countervailing power. Mergers and joint ventures among rivals can create economies of scale, generate distributional gains, or create new products or services. The collective action of small rival sellers and buyers designed solely or primarily to create offsetting power is an unlikely source for most readily recognized efficiencies.").

¹⁸⁴ *See* Carstensen, *supra* note 47, at 5.

¹⁸⁵ *See, e.g.,* 12 HOVENKAMP, *supra* note 52, ¶ 2015b (purchasing co-ops "can force concentrated sellers to behave more competitively toward the smaller buyers, thus making the market more competitive"); Jacobson & Dorman, *supra* note 19, at 20 ("There are several potential sources of efficiency gains from joint purchasing. Perhaps most importantly, when the sellers of a product are able to charge excessive prices, joint purchasing can allow the buyers the bargaining strength to push prices back down to competitive levels.").

¹⁸⁶ *See supra* note 135.

To be sure, a merger that enhances countervailing power would raise concentration on the buying side of the market, and if the increase is great enough, the merger would trigger a presumption of illegality.¹⁸⁷ But if the defendants introduce substantial evidence of a mitigating factor, as they almost always do, the presumption would be rebutted and the government would have to introduce additional evidence of the merger's anticompetitive effects.¹⁸⁸ In the resulting clash of evidence, the overarching question would be the probable impact of the merger on competition. A claim that the merger would enhance procompetitive countervailing power would be relevant to that question, just as a claim that the merger would promote competition because it would reduce operating costs. Neither of these claims amounts to a "defense" to an anticompetitive merger if defense means a basis for excusing or permitting an anticompetitive merger. Instead, both need to be examined to determine whether the merger is actually anticompetitive.

Countervailing power, in short, is an element in the ultimate empirical inquiry. If it is excluded, it ought to be because it is generally too difficult to litigate, as the Areeda-Hovenkamp treatise has argued,¹⁸⁹ or because it would steer antitrust enforcement in the wrong direction. Some have contended, for instance, that buyer power is procompetitive only when upstream suppliers have market power and antitrust law should focus on getting rid of the upstream market power, not allow buyers to bulk up to combat such power.¹⁹⁰ This makes sense where antitrust enforcement can eliminate the upstream market power, but that is frequently not the case. Upstream market power is usually caused by a cost structure that permits only a few large firms to survive in a market (the typical source of monopoly, duopoly, or oligopoly) or by consumer preferences for an array of differentiated products (the typical explanation for monopolistically competitive markets). Antitrust law cannot remove either of these sources of market power. When that is the case, a merger that would enhance procompetitive countervailing power is likely to be the most constructive response. In some instances, to be sure, there will be a reasonable prospect that the upstream market power would dissipate in the near future. If that is so, and if the upstream market would then become vulnerable

¹⁸⁷ See *United States v. Baker Hughes Inc.*, 908 F.2d 981, 982 (D.C. Cir. 1990) ("By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition." (citing *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 120-22 (1975); *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 363 (1963))).

¹⁸⁸ See *Baker Hughes*, 908 F.2d at 983 ("If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.").

¹⁸⁹ 4 AREEDA & HOVENKAMP, *supra* note 22, ¶ 943b.

¹⁹⁰ See EINER ELHAUGE & DAMIEN GERADIN, *GLOBAL ANTITRUST LAW AND ECONOMICS* 244-46 (2007).

to the exercise of monopsony power, the merger could be challenged on that ground, as discussed in Part V. But such cases of temporary supplier power are unlikely to be common.¹⁹¹

Suppose, however, that the source of upstream market power is neither scale economies nor consumer preferences but a cartel. In that instance, antitrust policy should indeed attempt to eliminate the cartel instead of allowing buyers to merge to combat it. In fact, there would be reason to suspect a cartel when the merger would likely enhance monopsony power if the cartel were eliminated. In that circumstance, the upstream market structure would have to be vulnerable to the exercise of monopsony power – that is, it would have to contain many sellers of similar products operating on upward-sloping supply curves – and the only plausible source of market power in such a market is a cartel. In this context, the very assertion of countervailing power as a mitigating factor would give the government ground to investigate. Similarly, the government could deal with the concern that a merger of buyers might provoke suppliers to collude in reaction, and as a result, upstream prices might rise rather than fall, causing downstream consumers to pay more for the final product.¹⁹² If this were a genuine threat, the government could simply

¹⁹¹ One way that supplier market power might be eroded relatively quickly is through new entry. But new entry is unlikely to convert an upstream market characterized by substantial scale economies or significant product differentiation into one vulnerable to the exercise of monopsony power: a market populated by numerous small sellers of relatively homogenous products. Even if new entry were likely, in other words, it may not change a merger that would enhance countervailing power into one that would result in monopsonistic exploitation and thus be subject to challenge. Moreover, if scale economies or product differentiation are very large, entry would be unlikely. See Kirkwood & Zerbe, *supra* note 116, at 55-56 (stating that both the structure-conduct-performance literature and the entry-and-exit literature indicate that market power is “more likely to endure when barriers such as scale economies, product differentiation, and capital requirements are very high”).

Of course, de novo entry is not the only possibility; in the absence of the merger, one of the merging buyers might sponsor entry. If that occurred and the entry were substantial, it would reduce upstream market power and the rationale for greater buyer power. But again, it may not turn the merger into one that is actually anticompetitive. Also, entry sponsorship is unlikely to occur unless (1) entry itself would be profitable, which depends on the height of the barriers upstream, and (2) entry sponsorship would be profitable, which depends on the benefits and costs of the effort. See *id.* at 94 (explaining that buyers are more likely to sponsor entry “when the input price reductions or other benefits they would enjoy as a result of new entry exceed the costs they would incur in locating and supporting a new entrant”). In short, while the prospect of upstream entry may supply a basis for challenging a merger that would otherwise enhance procompetitive countervailing power, the necessary circumstances are unlikely to be present in many cases.

¹⁹² See 4 AREEDA & HOVENKAMP, *supra* note 22, ¶ 943b (“[T]he presence of large buyers may simply stimulate or formalize seller collusion [W]hile such agreements are plainly unlawful, they may be hard to detect, and they may go on for considerable periods of time without detection.”); Grimes, *supra* note 183, at 200 (“[C]ountervailing power created by

challenge the merger of buyers, arguing that its ultimate effect would be anticompetitive rather than procompetitive, as Part V explains.

A related concern has an even easier solution. It is sometimes suggested that a merger of buyers might cause sellers to merge in response, raising concentration on both sides of the market and producing a serial oligopoly.¹⁹³ But if a merger of buyers is likely to be procompetitive, there is no reason to allow sellers to merge in response. And if the merger of buyers is anticompetitive (either because it would produce monopsony power or because it would create anticompetitive countervailing power), it can be challenged directly, obviating any need for sellers to merge in response.

This kind of case-by-case analysis can also be applied to the most extreme form of upstream and downstream concentration. Suppose sales are concentrated in a single firm, a supplier who would have monopoly power if it were facing numerous small buyers. And suppose purchases are also concentrated in a single firm, a buyer who would have monopsony power if it were facing fragmented suppliers. In this setting, neither the supplier nor the buyer would face a competitive set of counterparties; instead, they would face each other, in a confrontation called “bilateral monopoly.”

C. *Bilateral Monopoly*

A merger of buyers that results in bilateral monopoly could be either procompetitive or anticompetitive. The outcome depends crucially on the extent of downstream market power. Suppose two buyers face a single supplier and the buyers merge. If the merged buyer would have no downstream market power, economic analysis indicates that the merger is likely to increase output, benefiting consumers and enhancing efficiency, although this outcome is not assured. If, however, the merger would create downstream market power – giving the merged firm monopoly power in the sale of the supplier’s product – the combination is likely to be anticompetitive.

1. No Downstream Market Power

A merger of buyers would not create downstream market power, even when the supplier has exclusive control of a key input, if the merged buyer would compete downstream with other products made from other inputs. Suppose, for example, that the supplier is the sole source of an input used by two buyers to manufacture a particular product. And suppose that those buyers not only compete with each other in selling that product but also compete with many

collective action may act as a virus that quickly permeates the economy, leaving a structure in which all players are either oligopolists or acting collectively to create oligopoly power. . . . [For example,] a group of steel producers [might] agree to coordinate price and output because they face powerful buyers in the automobile industry . . .”).

¹⁹³ This is a realistic fear. Bhattacharyya and Nain found evidence that mergers of buyers triggered upstream consolidations, though they did not report any adverse effects from the greater upstream concentration. See Bhattacharyya & Nain, *supra* note 54, at 114.

other products made from other inputs. In this case, even if the two buyers merged, they would have no downstream market power. The relevant product market would consist of their product and numerous other products, all of them close substitutes. Even so, the supplier would have an incentive to restrict output premerger, not because it can raise the final product price to any significant degree – it cannot – but because it can make more money by producing less of the input and charging the buyers more for it.¹⁹⁴

Premerger, then, the supplier would restrict output, and the quantity of the product produced by the two buyers would be less than the efficient quantity. Once the buyers merged, however, they could use their enhanced countervailing power to force the supplier to increase its output, which would reduce the deadweight loss, raise the parties' joint profits, and enhance economic efficiency.¹⁹⁵ Citing a formal proof, Mellsop and Counsell explain:

[I]t can be shown that the monopolist supplier and monopsonist buyer will have an incentive to negotiate the quantity that maximizes their joint profits, with the result being a level of market output that is closer to the competitive outcome and greater than that which would be achieved absent buyer power. The monopoly supplier and the monopsonist buyer would not want to set a quantity different from this, as to do otherwise would not maximize the total amount of the profits that can be split between them.¹⁹⁶

Baker, Farrell, and Shapiro concur: "We agree . . . that two parties engaged in bargaining – such as a single buyer negotiating with a single seller – have an *incentive* to trade the quantity that will maximize their joint profits. Modern economic analysis of bilateral bargaining recognizes this joint incentive to achieve bilateral efficiency"¹⁹⁷

Despite this incentive, the supplier and buyer may not agree on the efficient quantity. Each one would try to maximize its own profits, and given transactions costs, information asymmetries, and other impediments to successful bargaining, the result may be bargaining breakdowns or production of an inefficient quantity. Baker, Farrell, and Shapiro observe:

Major impediments arise from the pervasive presence of private information and incomplete contracts.

¹⁹⁴ The supplier's incentive to restrict output would exist so long as the buyers' demand for the input is downward sloping. This would be the case if the buyers would tend to substitute other inputs or curtail production if the price of the input rose.

¹⁹⁵ This analysis assumes that the supplier was not engaging in perfect price discrimination premerger. If it had been, it would already have been producing the efficient quantity and capturing all the surplus in the input market.

¹⁹⁶ Mellsop & Counsell, *supra* note 24, at 3 (citing Roger D. Blair, David L. Kaserman & Richard E. Romano, *A Pedagogical Treatment of Bilateral Monopoly*, 55 S. ECON. J. 831, 831-41 (1989)).

¹⁹⁷ Baker, Farrell & Shapiro, *supra* note 35, at 638.

... In widespread circumstances, a buyer will limit its quantity so as to influence the seller's perception of its willingness to pay for the product. As a result, inefficiently low quantities routinely result from bilateral bargaining under asymmetric information.¹⁹⁸

Mellsop and Counsell agree: "In practice, ... the ability to maximize joint profits may be constrained by, for example, private information, incomplete contracts, and breakdown in bargaining."¹⁹⁹

A merger of two buyers that creates a bilateral monopoly, however, would tend to reduce these bargaining impediments. It would diminish the number of buyers involved in the negotiations from two to one, and this reduction may lower transactions costs, reduce the number of information issues, and simplify the process. In other words, the merger would not only increase the buyer's bargaining power; it would also tend to lower the obstacles to a successful negotiation. From both a bargaining power and a bargaining process perspective, therefore, a merger of buyers that creates a bilateral monopoly – but no downstream market power – is likely to be procompetitive. Mellsop and Counsell state that as long as "the buyer has some bargaining power, it can extract some of the monopolist's surplus, and to do so generally results in a higher quantity of input purchased than in the pure monopoly case, even if this is not necessarily the joint profit maximizing quantity."²⁰⁰ Jacobson and Dorman concur, explaining that theory tells us that bilateral monopoly "is almost never worse than the simple monopoly outcome ... and is generally better for downstream consumers since the bargaining war will tend to push prices and output in the direction of the competitive level."²⁰¹

In sum, in the face of a monopoly input supplier, a merger that produces a single buyer – but no downstream market power – is likely to be procompetitive. While it may not produce the efficient outcome, it is likely to increase output and thereby lower downstream prices to some degree, raising both total welfare and consumer welfare. This result is of course not guaranteed. The upstream market power may dissipate in the near future and, as a result, the merged firm might be able to exercise monopsony power against upstream suppliers. If this is a substantial possibility, however, the government would be in a position to block the merger. Likewise, if the merger would be anticompetitive for any of the other reasons described in Part

¹⁹⁸ *Id.*; see also *id.* at 640 ("Most litigated cases settle, but the frequency with which cases instead go to trial illustrates that bilateral bargaining need not reach any resolution, let alone an efficient one.").

¹⁹⁹ Mellsop & Counsell, *supra* note 24, at 3.

²⁰⁰ *Id.*

²⁰¹ Jacobson & Dorman, *supra* note 19, at 19; see also Jacobson & Dorman, *supra* note 35, at 155 ("Faced with a monopsony buyer, ... the monopolist's power will be constrained and market price and output will move toward the competitive level – improving economic welfare."); Noll, *supra* note 4, at 607 ("[B]ilateral monopoly can produce a more efficient outcome and lower prices in the final product market, thereby benefiting consumers.").

V, it should be stopped. But a merger of buyers should not be halted simply because it would produce a bilateral monopoly. Absent downstream market power, the additional power it would create is likely to be procompetitive countervailing power.

Baker, Farrell, and Shapiro raise a statutory objection. In their article on bilateral monopoly, which addresses mergers of sellers rather than mergers of buyers, they suggest that the language of section 7 of the Clayton Act makes it very difficult to approve a merger of sellers that would result in a single seller facing a single buyer: “[I]t would be more than passing strange if a statute that explicitly prohibits mergers that substantially reduce competition or tend to create a monopoly could be interpreted to accept in all cases the total elimination of competition merely because there is a single buyer.”²⁰² They are correct that the government and the courts should not “accept in all cases” a merger of buyers that creates a bilateral monopoly. Some of those mergers may be anticompetitive, and where that is so, they should be stopped. But where the merger would instead create beneficial countervailing power, lowering upstream prices and increasing output, the language of section 7 does not require condemnation. A merger that would cause the merged firm to increase output would *enhance competition* in the downstream market. And although the merger would eliminate rivalry on the buying side of the upstream market, it would have no anticompetitive effects in that market.

In such a case, therefore, the defendants could rebut the presumption of anticompetitive effects that flow from the increase in upstream concentration by introducing evidence that the merger would actually raise output, lower prices, increase downstream competition, and enhance consumer and total welfare. And the government could produce no counter evidence. It could argue that an increase in competition in one market (the downstream market) does not offset a reduction in rivalry in another (the upstream market).²⁰³ But here the markets are vertically connected rather than separate, and all the evidence of effects is procompetitive, in both markets.

2. Downstream Market Power

The outcome would be very different if the merger would confer downstream market power on the merged firm. Suppose that a supplier has monopoly power because it manufactures a product so distinctive that consumers are willing to pay a high price for it, a price that substantially exceeds the costs of production and distribution. And suppose that two buyers

²⁰² Baker, Farrell & Shapiro, *supra* note 35, at 645.

²⁰³ See *United States v. Phila. Nat’l Bank*, 374 U.S. 321, 370-71 (1963) (holding that a merger that would create anticompetitive effects in one market cannot be justified by showing that it would produce greater procompetitive effects in another market, for a merger whose effect “may be substantially to lessen competition is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial” (internal quotation marks omitted)).

compete intensely in reselling this product to consumers, earning only a competitive margin. In this setting, the retail price would be at the monopoly level but the supplier would capture all the monopoly profits.

If the two buyers merged, the result would be bilateral monopoly upstream and monopoly power downstream, since the merged firm would be the only retailer of the distinctive product. But here, in contrast to the prior scenario, the merged firm would *not* have an incentive to force the supplier to increase its output. Instead, the buyer's incentive would be to maintain output at the monopoly level and transfer all the monopoly profits to itself, which it could achieve if the supplier lowered its price to a level that just covered its costs while holding its output constant. The supplier, of course, would have no interest in surrendering its monopoly profits, so once again, the two parties must turn to bargaining in an attempt to resolve their conflict.

In this case, however, the outcome is unlikely to be procompetitive. As emphasized above, bargaining can lead to impasse and temporary interruptions of production. Moreover, if the two firms cannot agree on a division of the monopoly profits and each tries to earn a supracompetitive margin, the result of such "double marginalization" would be a downstream price that exceeded the monopoly level. If the two firms did agree to preserve the retail price at the monopoly level and divide up the monopoly profits, the outcome would be no worse than the premerger outcome, but no better. It is difficult to envision a scenario in which the merger would result in higher output and a lower retail price. While the merger would enhance the buyers' countervailing power, the lowest price the merged firm is likely to obtain from the supplier is a price that just covers its costs, and the merged firm would have no incentive to pass that price on.

In short, where a merger of buyers results in both bilateral monopoly upstream and monopoly power downstream, the outcome is likely to be anticompetitive, not procompetitive. The retail price is likely to be no lower than the premerger level, and could easily be higher, and nonprice rivalry at the retail level would be eliminated, potentially reducing innovation and choice.

D. Mergers That Also Enhance Downstream Market Power

Except in the last Section, the discussion to this point has assumed that the merger of buyers had no direct effect on downstream competition. If that is not the case – if the merger is likely to enhance the merged firm's market power as a seller as well as its countervailing power as a buyer – how should the transaction be analyzed? Both the Areeda-Hovenkamp treatise and the Horizontal Merger Guidelines indicate the correct approach: appraise the merger first from a sell-side perspective and then consider its effect on buy-side countervailing power as either an efficiency benefit of the transaction or an additional ground for condemnation.

The treatise does not address mergers that may enhance countervailing power. But in analyzing mergers that may enhance monopsony power, it states that where such a merger also involves "a significant threat of increased

market power on the selling side of the market,” then “the ordinary rules governing mergers by sellers would apply.”²⁰⁴ The treatise does not spell out how those ordinary rules would apply to a transaction with both upstream and downstream effects; the Guidelines take the analysis further. They recognize that a merger of sellers may enable the merged firm to exercise greater countervailing power as a buyer, and they indicate they will treat this as a potential efficiency benefit of the merger, to be evaluated along with the other asserted efficiency benefits of the transaction:

The Agencies distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways. A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts. Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger, as discussed in Section 10.²⁰⁵

Thus, if a merger of sellers presents both downstream market power issues and upstream countervailing power claims, the government will consider the upstream claims as a possible offset to the downstream anticompetitive effects, subject to the same proof requirements as for other efficiency claims, such as whether the asserted cost savings are substantiated, whether they are merger specific, and whether they are likely to be passed on.²⁰⁶

And of course, if the countervailing power created or enhanced by the merger is likely to have anticompetitive effects, those effects should also be included in the ultimate evaluation of the transaction. Part V addresses those potential anticompetitive effects.

V. MERGERS THAT MAY ENHANCE ANTICOMPETITIVE COUNTERVAILING POWER

Mergers that enhance countervailing power may be anticompetitive when the merged firm is likely to exercise its augmented buyer power in a manner that reduces rather than intensifies competition. In this Part, I set forth ten ways in which this could happen. Five would result in harm to downstream competition: competition in the market or markets in which the merged firm and its downstream rivals sell their products or services to customers. The other five anticompetitive effects would occur upstream: in the market(s) in which suppliers sell inputs to the merged firm and other buyers.

²⁰⁴ 4A AREEDA & HOVENKAMP, *supra* note 22, ¶ 980.

²⁰⁵ 2010 GUIDELINES, *supra* note 21, § 12.

²⁰⁶ *See id.* § 10.

A. Harm to Downstream Competition

A large buyer may use the countervailing power it acquires through the acquisition of a rival to harm competition in the downstream sale of its products or services, diminishing the welfare of consumers. In particular: (1) the merged firm may coerce or induce its suppliers to raise the costs of its remaining rivals, enabling the merged firm to increase prices in downstream markets; (2) the merged firm may extract price cuts or other concessions from its suppliers and they may react by increasing prices to other buyers, allowing the merged firm to raise its own prices;²⁰⁷ (3) the merged firm may obtain discriminatory concessions that are so large and long-lasting that they enable the merged firm to drive out or greatly diminish the market share of smaller buyers, increasing downstream concentration and making tacit or explicit collusion more likely; (4) even if downstream prices fall as the merged firm takes share from its smaller rivals, their destruction may deprive consumers of choices they preferred and depress overall consumer welfare; and (5) the concessions obtained by the merged firm may allow it to become less efficient, less dynamic, and less responsive to changing consumer preferences.

1. Raising Rivals' Costs

Almost thirty years ago, in a much-celebrated article, Thomas Krattenmaker and Steven Salop showed that a large buyer can gain downstream market power by inducing suppliers of a key input to refuse to sell it to rival buyers – or to sell it to them only at higher prices – thereby raising their costs, weakening them as competitors, and allowing the large buyer to raise its own downstream prices.²⁰⁸ Since then, “raising rivals’ costs” has become a widely accepted explanation of exclusionary behavior,²⁰⁹ forming the basis for a number of court decisions and government actions. In the best-known instance, the Seventh Circuit sustained the FTC’s ruling that Toys “R” Us, one

²⁰⁷ Dobson and Inderst call this theory the “waterbed effect” because the suppliers’ reactions resemble the movements of a waterbed, which if pushed down in one area will pop up in another. See Dobson & Inderst, *supra* note 10, at 333 (exploring “the possibility that through a ‘waterbed effect’ better supply terms for powerful buyers can lead to a worsening of the terms of supply for smaller or otherwise-less-powerful buyers”).

²⁰⁸ See Krattenmaker & Salop, *supra* note 96, at 211-14; see also Steven C. Salop, *Economic Analysis of Exclusionary Vertical Conduct: Where Chicago Has Overshot the Mark*, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST* 141, 143 (Robert Pitofsky ed., 2008) (“[Raising rivals’ costs] generally involves conduct to raise the costs of competitors with the purpose and effect of causing them to raise their prices or reduce their output, thereby allowing the excluding firm to profit by setting a supracompetitive price.”).

²⁰⁹ See, e.g., Carstensen, *supra* note 13, at 307 (accepting without qualification the notion that powerful buyers can raise their rivals’ costs by insisting that “their suppliers enter into exclusive supply contracts”); Salop, *supra* note 208, at 143 (“Analysis consistent with the [raising rivals’ costs] paradigm is commonly applied to exclusivity arrangements that have the effect of raising rivals’ distribution costs.”).

of the largest toy retailers in the country and thus one of the largest toy buyers, had disadvantaged its new and rapidly growing rivals, Costco and Sam's Club, by successfully pressuring manufacturers to deny popular products to them.²¹⁰ Likewise, the Department of Justice has sued several health plans for using most favored nations clauses in their contracts with providers. Such clauses prohibit providers from giving discounts to competing health plans unless they give equal or better discounts to the health plans themselves. Where the smaller health plans would have been able to secure bigger discounts absent the clauses, the clauses raise their costs and thus permit the larger health plans to increase the premiums they charge.²¹¹

If a large buyer can harm downstream competition by raising its rivals' costs, a merger that creates a large buyer could increase the probability of such exclusionary conduct. If so, the government's ultimate burden would be to show that in the circumstances that would exist post-merger, it is reasonably likely that the merged firm would engage in conduct that would raise its rivals' costs and thereby enable it, without justification, to increase downstream prices or otherwise harm customers. As Krattenmaker and Salop indicate, the circumstances that must exist for this behavior to be both profitable and effective are limited.²¹² But as the cases cited in their article and this one

²¹⁰ See *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 930 (7th Cir. 2000).

²¹¹ A smaller health plan may be able to obtain greater discounts than a large plan if it can successfully differentiate itself. For example, it might use a less inclusive provider network, demanding bigger discounts from the relatively few producers it includes. For a discussion, see Mark J. Botti, *Observations on and from the Antitrust Division's Buyer-Side Cases: How Can "Lower" Prices Violate the Antitrust Laws?*, Remarks to the Antitrust Section of the ABA 15-16 (Apr. 19, 2007) (prepared remarks available at <http://apps.americanbar.org/antitrust/at-committees/at-hcic/pdf/program-papers/Botti-Paper.pdf>).

Recently, the Department of Justice sued Blue Cross Blue Shield of Michigan on this theory, alleging that the large health plan used most favored nations clauses in its contracts with the majority of Michigan's general acute-care hospitals. See *United States v. Blue Cross Blue Shield of Michigan*, 809 F. Supp. 2d 665, 668 (E.D. Mich. 2011). In some instances, moreover, Blue Cross allegedly required hospitals to charge competing health plans between thirty and forty percent more than they charge Blue Cross. See *id.* at 669; Press Release, U.S. Dep't of Justice, Justice Department Files Antitrust Lawsuit Against Blue Cross Blue Shield of Michigan (Oct. 18, 2010), available at http://www.justice.gov/atr/public/press_releases/2010/263227.htm.

²¹² They explained:

[T]wo conditions must be satisfied before the purchase of exclusionary rights can have an anticompetitive effect. First, conditions in the input market must enable the purchaser to raise its competitors' costs by purchasing exclusionary rights. These exclusionary rights contracts must significantly raise the competitors' costs. Second, conditions in the output market must enable the purchaser, after its competitors' costs increase, to increase its price. It will acquire this power only if unexcluded rivals lack the ability or incentive to expand their output in response to the purchaser's price increase and if potential entrants cannot take up the slack.

indicate, these circumstances do occur and large buyers do exploit the opportunities they afford. It is not surprising, therefore, that the new Guidelines state that the enforcement agencies may investigate whether a merger will lead to exclusionary conduct.²¹³

Some may object that it is too difficult to predict whether a large buyer will engage in anticompetitive exclusionary conduct post-merger. After all, it can be challenging to determine, even after a firm has actually engaged in exclusionary conduct, whether that conduct was anticompetitive. As a result, it could be argued that the government should never challenge – and the courts should never block – an otherwise procompetitive merger on the ground that it poses a threat of future harmful exclusionary conduct. Instead, agencies and judges should always wait to see if the merged firm employs exclusionary conduct and then evaluate it after the fact.²¹⁴

That approach would not make sense, however, if the other antitrust laws – the Sherman Act and the Federal Trade Commission Act – could not reach the anticompetitive exclusionary conduct when it did occur. The ordinary statutory weapon against exclusionary conduct is section 2 of the Sherman Act, and it applies only if the defendant has monopoly power or its conduct has created a dangerous probability of monopoly power.²¹⁵ The courts have rarely found such power, however, when the defendant's share of the relevant market

....

If these two basic conditions are met, the strategy can succeed. For the strategy to succeed, however, the firm seeking an exclusionary right also must be able to purchase that right profitably, and its rivals must lack effective counterstrategies. Finally, one must consider whether some apparently anticompetitive exclusionary rights deals should be shielded from antitrust attack because they do or may generate overriding cost efficiencies.

Krattenmaker & Salop, *supra* note 96, at 250-52.

²¹³ See 2010 GUIDELINES, *supra* note 21, § 1 (“Enhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct.”); *id.* § 2.2.3 (“[R]ival firms may provide relevant facts, and even their overall views may be instructive, especially in cases where the Agencies are concerned that the merged entity may engage in exclusionary conduct.”).

²¹⁴ See D. Bruce Hoffman & Daniel Francis, *Including Exclusion in the 2010 Horizontal Merger Guidelines*, ANTITRUST SOURCE, Oct. 2010, at 4 (“[I]f the merged firm were to behave anticompetitively in the future, there is no reason to think that the existing Section 2 and FTC Act Section 5 toolkit would not be up to the task. While litigating exclusionary conduct is difficult, much of that difficulty lies in determining the merits of the claims – a difficulty that is exacerbated, not reduced, when the analysis is conducted *ex ante* rather than *ex post*.”).

²¹⁵ See *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 459 (1993); *Colo. Interstate Gas Co. v. Natural Gas Pipeline Co. of Am.*, 885 F.2d 683, 694 (10th Cir. 1989) (stating that section 2 requires a “dangerous probability that the defendant’s conduct would propel it from a non-monopolistic share of the market to a share that would be large enough to constitute a monopoly for purposes of the monopolization offense”).

was less than seventy percent,²¹⁶ and have apparently never found it when the defendant's share was below fifty percent.²¹⁷ As a result, a buyer with a substantial but non-dominant share would not be covered by section 2 if its behavior simply raised the costs of its smaller rivals but did not greatly enlarge its own market share.

Toys "R" Us shows how this can happen. The big retailer was able to raise the costs of its emerging rivals – and curb their growth – without possessing a monopoly market share or creating a dangerous risk that it would acquire such a share. To the contrary, its share of national toy sales was just twenty percent and its share of local toy sales did not exceed forty-nine percent in any metropolitan area.²¹⁸ Similarly, its share of toy purchases was substantially below monopsony levels. Like many other large buyers, Toys "R" Us had a substantial but non-dominant buying share, accounting for less than a third of its suppliers' total sales.²¹⁹ Moreover, its goal was to stunt the growth of its emerging rivals, not to weaken or destroy so many of its traditional competitors that it would capture the great bulk of toy sales. In this iconic raising-rivals'-costs case, in short, section 2 was not a viable option.

The FTC was able to reach the retailer's exclusionary conduct because it violated section 1 of the Sherman Act.²²⁰ Section 1 was available because the retailer had secured both horizontal and vertical agreements to effectuate its

²¹⁶ *Exxon Corp. v. Berwick Bay Real Estate Partners*, 748 F.2d 937, 940 (5th Cir. 1984) ("[M]onopolization is rarely found when the defendant's share of the relevant market is below 70%."); *see also* *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 187 (3d Cir. 2005) ("[A] share significantly larger than 55% has been required to establish prima facie market power."); *Colo. Interstate Gas Co.*, 885 F.2d at 694 n.18 (observing that to establish "monopoly power, lower courts generally require a minimum market share of between 70% and 80%").

²¹⁷ *See* U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 22 (2008), *available at* <http://www.usdoj.gov/atr/public/reports/236681.htm> ("The Department is not aware . . . of any court that has found that a defendant possessed monopoly power when its market share was less than fifty percent."). The Obama Administration withdrew this report because of disagreements with its enforcement approach. *See* Press Release, U.S. Dep't of Justice, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009), *available at* http://www.justice.gov/atr/public/press_releases/2009/245710.htm ("[T]he Section 2 report will no longer be Department of Justice policy [because the report] raised too many hurdles to government antitrust enforcement and favored extreme caution and the development of safe harbors for certain conduct within reach of Section 2.").

²¹⁸ *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 930 (7th Cir. 2000) ("The Commission found that [Toys "R" Us] sells approximately 20% of all the toys sold in the United States, and that in some metropolitan areas its share of toy sales ranges between 35% and 49%.").

²¹⁹ *See id.* ("[Toys "R" Us] buys about 30% of the large, traditional toy companies' total output and it is usually their most important customer.").

²²⁰ Under section 5 of the Federal Trade Commission Act, the Commission can enforce section 1 of the Sherman Act. *See id.* at 933 (stating that "for present purposes [section 5] tracks the prohibitions of the Sherman and Clayton Acts").

exclusionary strategy. Neither type of agreement, however, is a necessary feature of a raising-rivals'-costs case. Toys "R" Us had to orchestrate a horizontal agreement among the toy manufacturers because none of them was willing on its own to accede to the firm's demands and deny product to Costco and Sam's Club. But if Toys "R" Us had possessed greater buying power, its threat to cut off any manufacturer who sold product to a warehouse club would have been sufficient to secure unilateral compliance with its demands. The loss of sales to the big retailer could not have been made up by greater sales to the clubs.²²¹ But the big retailer was not so overwhelming. Not only was its share of purchases substantially less than fifty percent, but the clubs were a new, rapidly growing, and very promising method of distribution. No toy manufacturer was comfortable, under these circumstances, in knuckling under to Toys "R" Us without an assurance that other manufacturers would do the same.²²² If the circumstances had been more favorable to Toys "R" Us, however, the retailer could have raised its rivals' costs without a horizontal agreement among its suppliers.

Likewise, if Toys "R" Us had had a somewhat larger market share and its emerging rivals had been less attractive, it may have been able to secure manufacturer compliance without vertical agreements. In *United States v. Colgate & Co.* and *Monsanto Co. v. Spray-Rite Service Corp.*, the Supreme Court ruled that a vertical agreement requires an exchange of commitments between a supplier and a buyer. Section 1 is not violated if one of the parties simply threatens to cut the other off.²²³ Thus, if Toys "R" Us had been able to bring the toy makers into line through threats of termination rather than

²²¹ Indeed, Toys "R" Us took this very position in the litigation. It argued that it had so much buying power that each manufacturer had independently decided to deny product to the warehouse clubs. According to the Seventh Circuit, Toys "R" Us contended that each supplier simply asked itself: "Why gain a few sales at the clubs[] . . . when [we] would have much more to gain by maintaining a good relationship with the 100-pound gorilla of the industry[] . . . and make far more sales?" *Id.* at 935.

²²² See *id.* at 932 ("[T]he biggest hindrance [Toys "R" Us] had to overcome was the major toy companies reluctance to give up a new, fast-growing, and profitable channel of distribution. The manufacturers were also concerned that any of their rivals who broke ranks and sold to the clubs might gain sales at their expense, given the widespread and increasing popularity of the club format." (citation and internal quotation marks omitted)).

²²³ See *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762-64 (1984) (ruling that an agreement to maintain resale prices cannot be established without showing that the manufacturer sought an assurance from a dealer that the dealer would comply with the manufacturer's specified resale prices, and the dealer gave that assurance); *United States v. Colgate & Co.*, 250 U.S. 300, 307-08 (1919) (declaring that no agreement is created when a manufacturer simply announces that it will refuse to sell to dealers who do not adhere to its specified resale prices, even if the dealers thereafter adhere to those prices). These principles are not limited to refusals to deal by manufacturers; buyers also have *Colgate* rights. See *infra* note 224.

through negotiations and an ultimate exchange of commitments, there would have been no vertical agreements.²²⁴

It is easy to imagine a case, in short, in which a merged buyer successfully raises its rivals' costs and harms consumers without violating section 1 or section 2 of the Sherman Act. In such a case, the only antitrust law that might reach the conduct is section 5 of the Federal Trade Commission Act. Since it does not explicitly require an agreement, monopoly power, or even a dangerous probability of monopoly power, it is broad enough in principle to do the job. But there are two problems with relying on section 5 to reach unilateral exclusionary conduct by a substantial but non-dominant buyer. First, only the FTC can enforce it. Thus, if the FTC lacks the relevant industry expertise or is distracted by other priorities, there may be no remedial action. Neither private parties nor the Department of Justice can attack exclusionary conduct under section 5. Second, even if the FTC is available, it may not prevail. It lost three major cases in the early 1980s,²²⁵ and since then has rarely brought pure section 5 cases.²²⁶ In 1984, moreover, it announced it would not use section 5 to attack exclusionary conduct that is not prohibited by section 2.²²⁷ While it no longer adheres to that Reagan-era view, the FTC has filed

²²⁴ See *Toys "R" Us*, 221 F.3d at 932 (indicating that Toys "R" Us was not satisfied simply announcing its new policy; instead, it wanted to find out how each manufacturer would respond, which led to negotiations and ultimately explicit agreements). In contrast, if the retailer had simply threatened to refuse to deal with non-complying manufacturers, it would have been within its *Colgate* rights. See *id.* at 939 ("*Colgate* indicates that the retailer would . . . be within its rights to tell the manufacturer that it will no longer stock the manufacturer's product, if it is unhappy with the company it is keeping (*i.e.*, if the manufacturer is sending too many goods to discounters . . .)."). Other courts have upheld the same principle. See *Garment Dist., Inc. v. Belk Stores Servs.*, 799 F.2d 905, 911 (4th Cir. 1986); *Burlington Coat Factory Warehouse Corp. v. Esprit de Corp.*, 769 F.2d 919, 923-25 (2d Cir. 1985).

²²⁵ See *E.I. Du Pont De Nemours & Co. v. FTC*, 729 F.2d 128, 136-42 (2d Cir. 1984) (reversing the FTC's condemnation of several parallel but non-collusive facilitating practices, ruling that the agency's legal standards were too vague and its findings of anticompetitive effect inadequately supported); *Official Airline Guides, Inc. v. FTC*, 630 F.2d 920, 925-28 (2d Cir. 1980) (reversing the FTC's holding that a monopolist cannot arbitrarily discriminate among competing firms in another industry, asserting that this gives the Commission too much power to substitute its own judgment for that of the monopolist); *Boise Cascade Corp. v. FTC*, 637 F.2d 573, 582 (9th Cir. 1980) (overturning the FTC's prohibition of a delivered pricing scheme, indicating that the Commission must find either collusion or an actual effect on competition to ban such a practice).

²²⁶ See ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 652-56 (6th ed. 2007).

²²⁷ See *In re Gen. Foods Corp.*, 103 F.T.C. 204, 365-66 (1984) ("The proscription against attempted monopolization in Section 2 of the Sherman Act does not require a showing of monopoly power or injury to competition – a dangerous probability is sufficient. We do not believe this standard should be changed when a case is brought under Section 5. . . . If the conduct at issue here cannot reach the early threshold of doubt under the Sherman Act, we

only one pure section 5 case against exclusionary conduct since,²²⁸ and it hedged its bet by filing a supplemental challenge alleging that the conduct also violated section 2.²²⁹ It is not clear, in short, that section 5 is a reliable tool for halting exclusionary conduct not covered by the Sherman Act.

In contrast, the Supreme Court has made plain that section 7 of the Clayton Act prohibits mergers that pose a significant threat of post-merger exclusionary conduct.²³⁰ In fact, this is the principal basis for vertical merger enforcement – the fear that the merged firm would exclude unintegrated competitors by foreclosing them from access to its downstream or upstream facilities.²³¹ While section 7 has not been used to block a horizontal merger on this ground,²³² it has been used to halt a number of vertical mergers. Thus, if the evidence indicates that a combination of buyers is reasonably likely to result in behavior that raises rivals' costs and harms consumers, a pre-merger challenge under section 7 may be a more effective way of addressing the problem than a post-merger challenge under section 5.

will not condemn it under the Federal Trade Commission Act.”).

²²⁸ See Complaint, *In re Intel Corp.*, F.T.C. File No. 061 0247 (Fed. Trade Comm’n 2009) (No. 9341) 2009 WL 4999728, at *1.

²²⁹ See Daniel A. Crane, *Reflections on Section 5 of the FTC Act and the FTC’s Case Against Intel*, CPI ANTITRUST J., Feb. 2010, at 1, 13 (referring to “the Commission’s decision (strongly objected to by Commissioner Rosch) to bring a supplemental Sherman Act Section 2 challenge concerning the same conduct as the Commission challenges in its Section 5 allegations”).

²³⁰ In *Cargill, Inc. v. Montfort of Colorado, Inc.*, 479 U.S. 104 (1986), the plaintiff challenged an acquisition on the ground that the merged firm would engage in various forms of exclusionary conduct post-merger. *Id.* at 106-07. While the Court dismissed the suit because the plaintiff’s allegations were inadequate, the Court had no trouble with the notion that a merger that threatened genuine anticompetitive exclusionary behavior would violate section 7. *Id.* at 122. Indeed, the Court rejected the government’s attempt to preclude plaintiffs from ever challenging mergers on the ground that they would result in predatory pricing, stating that “nothing in the language or legislative history of the Clayton Act suggests that Congress intended this Court to ignore injuries caused by such anticompetitive practices as predatory pricing.” *Id.* at 121-22.

²³¹ See 4A AREEDA & HOVENKAMP, *supra* note 22, ¶ 1004a (“In striking down customer-supplier mergers, courts have relied principally on the fact that such mergers can foreclose the customer firm as a market for the supplier’s rivals or the supplier firm as a source of supply for the customer’s rivals.”); Salop, *supra* note 208, at 148 (“[V]ertical mergers can lead to real foreclosure that creates market power in either the upstream or downstream market under certain identifiable circumstances.”).

²³² Cf. Hoffman & Francis, *supra* note 214, at 2 (“[T]o the best of our knowledge the Agencies have never challenged a horizontal merger that was otherwise unobjectionable on the ground that the firm, post-merger, might be more likely or better able to engage in exclusionary conduct in violation of Section 2.”).

2. Waterbed Effects

Suppose that the merged firm does not pressure its suppliers to raise the costs of its rivals. Instead, it simply demands price or other concessions from those suppliers. But suppose that those concessions nevertheless cause the suppliers to increase prices to smaller buyers or otherwise worsen their terms. If that happens, the merger has produced what Dobson and Inderst call “waterbed effects” – responses of suppliers to the exertion of buyer power that disadvantage smaller buyers by increasing their costs.²³³ Those higher costs may cause the smaller buyers to lose market share or even exit the business, enabling the merged firm to raise prices, or the increase in costs may instead, as in the prior scenario, lead directly and without major shifts in shares to higher retail prices.²³⁴

The waterbed theory, however, has a puzzling aspect. If suppliers are profit-maximizing firms, wouldn’t they already be charging the profit-maximizing price to smaller buyers? How would their incentive or their ability to raise prices to smaller buyers be increased by lowering prices to a large buyer? Dobson and Inderst are aware of the issue: “Put bluntly, just because a supplier gives a discount or other concession to one retailer does not mean it will be in a stronger position to extract better terms from other retailers.”²³⁵

They offer three possible explanations. First, waterbed effects may occur if the discounts that buyers receive depend on their size.²³⁶ If that is so, a large buyer is likely to obtain greater discounts than a small buyer, and if the large buyer uses its cost advantage to take sales from smaller buyers, the discounts they will be able to negotiate will be reduced.²³⁷ Dobson and Inderst note that recent theoretical work has demonstrated that this size-based dynamic can be derived from formal modeling.²³⁸ They also point out that a Competition Commission study of the U.K. supermarkets industry found that larger supermarket chains do in fact obtain greater discounts.²³⁹

²³³ See generally Dobson & Inderst, *supra* note 10, at 341-52.

²³⁴ See *id.* at 333 (“Buyers who find themselves on the wrong side of this mechanism may be caught in a vicious circle of seeing their business shrink, their purchasing prices increase, and their margins erode, which may ultimately cause them to exit the market. What is more, if a waterbed effect were sufficiently strong, it may, at least in principle, also lead to lower consumer welfare, even in the short run, through an increase in retail prices.”).

²³⁵ *Id.* at 342.

²³⁶ *Id.* at 347.

²³⁷ *Id.* at 347-48.

²³⁸ See *id.* at 347 n.29; see also Mellsop & Counsell, *supra* note 24, at 5 (“The formal theoretical foundations of this effect have . . . recently been developed”); Bedre-Defolie & Caprice, *supra* note 18, at 4 (deriving a waterbed effect in a model where the supplier’s cost function is convex (i.e., its marginal costs are increasing at an increasing rate), but not where the supplier’s cost function is concave).

²³⁹ See Dobson & Inderst, *supra* note 10, at 349-50.

The second possible basis for a waterbed effect rests on the behavioralist notion that firms may not always or systematically maximize profits.²⁴⁰ Suppose that suppliers are principally concerned with securing an adequate margin and do not attempt to squeeze all the profit they can from their smaller customers. If suppliers engage in such satisficing behavior, they may have the ability – and would have the incentive – to raise prices to smaller buyers if they are forced to grant a concession to a large buyer that causes their overall profits to fall below their target margin.²⁴¹ This explanation runs counter, of course, to the assumption deeply embedded in antitrust policy that firms generally maximize their profits.²⁴² But it does draw support from the “cost shifting” that has occurred in the health care industry. While the evidence is not uniform and the shifting is often not complete, a number of studies have concluded that hospitals, both for-profit and not-for-profit, have reacted to lower Medicare or Medicaid payments by increasing the charges they levy on private payers.²⁴³

The third possible source of a waterbed effect is a reduction in the number of suppliers caused by the exercise of countervailing power.²⁴⁴ Dobson and Inderst note that “there will be a point at which, as suppliers’ margins are squeezed even further through the exercise of buyer power, continuing operations may no longer be profitable for all suppliers.”²⁴⁵ If this occurs, and

²⁴⁰ *Id.* at 342.

²⁴¹ *See id.* (indicating a waterbed effect may occur if a supplier is “wedded to obtaining a set average margin or is desperate to cover its existing fixed costs”).

²⁴² *See, e.g., id.* at 343.

²⁴³ *See* MEDPAC, REPORT TO THE CONGRESS: MEDICARE PAYMENT POLICY § 2A, at 62-63 (2009), available at www.medpac.gov/chapters/Mar09_Ch02A.pdf (“The academic literature on ‘cost shifting’ is mixed. Some argue that cost shifting is minimal because of competition. Others argue that past reductions in Medicare and Medicaid payments have been partially offset by increases in private-payer rates (cost shifting) and partially offset by reduced cost growth.” (citations omitted)); David M. Cutler, *Cost Shifting or Cost Cutting?: The Incidence in Reduction of Medicare Payments*, 12 TAX POL’Y & ECON. 1, 18 (1998) (finding that for the period 1985-90, hospitals engaged in dollar-for-dollar cost shifting to private payers as Medicare payments decreased, but for the period 1990-1995, in conjunction with the growth of HMOs and PPOs, hospitals switched to cost-cutting instead of cost-shifting); Austin Frakt, *How Much Do Hospitals Cost Shift? A Review of the Evidence*, 89 MILBANK QUART. 90, 92 (indicating that cost shifting occurs, though far below dollar-for-dollar levels); Vivian Y. Wu, *Hospital Cost Shifting Revisited: New Evidence from the Balanced Budget Act of 1997*, 10 INT’L J. HEALTH CARE FIN. & ECON. 61 (2010) (finding that cost shifting from Medicare to private payers is lower in markets with a greater proportion of for-profit hospitals, but overall about twenty-one percent of Medicare payment reductions are shifted to private payers); John F. Cogan, R. Glenn Hubbard & Daniel Kessler, *ObamaCare and the Truth About ‘Cost Shifting,’* WALL ST. J., Mar. 11, 2011, at A15 (“[A] long line of academic research shows that low rates of Medicaid reimbursement translate into higher prices for the privately insured.”).

²⁴⁴ Dobson & Inderst, *supra* note 10, at 345.

²⁴⁵ *Id.*

the supplying market becomes more concentrated, the remaining firms may take advantage of the increased concentration to raise prices to smaller buyers. This explanation, though, presents another puzzle. Why would a large buyer pressure its suppliers so hard that some of them go out of business? Dobson and Inderst suggest two possible answers: "First, the buyer might not believe the supplier's claims that the concession would cause dire consequences (i.e., an information asymmetry explanation). Second, the buyer might demand the concession anyway because, if it did not, its large rivals would do so (i.e., a prisoners' dilemma explanation)."²⁴⁶

Of the three possible explanations for a waterbed effect, the first is the least subject to objections and the most supported by theoretical modeling and empirical evidence. Thus, if a merger challenge were to be grounded on fear of a waterbed effect, this basis appears to be the strongest. It would require evidence that in the market in question: (1) smaller buyers negotiate prices with their suppliers; (2) that these buyers are less successful in this process than larger buyers; (3) that this disparity has begun to shrink the shares of – or otherwise disadvantage – the smaller buyers; and (4) that the concessions they have been able to negotiate have diminished. If evidence of such a dynamic were found, a challenge to a merger of buyers that would worsen the problem may be warranted, assuming the government could establish a significant threat to competition and consumer welfare. In the short run, the concessions induced by the larger buyers benefit consumers because the larger buyers pass them on, at least in part, in order to gain share at the expense of smaller buyers. To establish a threat to competition, therefore, the government would have to show that it is reasonably probable that these benefits would be outweighed by the higher prices or other harms consumers would suffer in the long run.

If that is the case, an attack on the merger, rather than on the conduct that would follow the merger, would be the only remedy. The conduct itself would violate neither the Sherman Act nor the Federal Trade Commission Act. In the waterbed scenario, suppliers grant non-predatory price cuts to the merged firm, and then decide on their own – unilaterally rather than collusively, and not in response to any exclusionary demand from the merged firm – to raise prices to smaller buyers.²⁴⁷

3. Higher Downstream Concentration

This anticompetitive mechanism is simpler, less controversial, and more familiar than the waterbed effect. In this scenario, the merged firm uses its enhanced buying power to obtain a substantial, discriminatory concession from its suppliers and uses that advantage to drive out or weaken enough of its smaller rivals that downstream concentration increases significantly, giving it

²⁴⁶ *Id.* at 345 n.25 (citing Kirkwood, *supra* note 17, at 650 n.75).

²⁴⁷ Nor would such conduct violate the Robinson-Patman Act if the suppliers could invoke its meeting competition defense, as they might well be able to do. See *infra* note 252 and accompanying text.

market power as a seller and enabling it to raise prices or otherwise harm consumers in the long run, either unilaterally or in coordination with other large rivals.²⁴⁸

Unlike the waterbed effect, this theory is not subject to multiple theoretical objections. It is one of the well-recognized ways in which price discrimination induced by a powerful buyer could reduce the welfare of consumers. Moreover, the harm it describes may have occurred in the retail sale of books, where, as pointed out above, hundreds, if not thousands, of independent bookstores were driven out of business by the national bookstore chains.²⁴⁹ These large buyers had obtained substantial discriminatory concessions from book publishers and later, after retail concentration increased, may have raised prices to consumers.²⁵⁰

This theory is more likely to be valid where the downstream market is already experiencing a trend toward concentration. If so, the countervailing power created by the merger would provide a reason to fear an acceleration in concentration. Of course, the merger might itself increase concentration to such a degree that the transaction could be challenged as a merger of sellers, making buyer power analysis unnecessary. But if not, and if there is a serious risk of future market consolidation, a merger challenge may be the only remedy. Smaller buyers are excluded because the merged firm obtains and passes on price cuts from its suppliers. So long as those price cuts are not below cost, the suppliers who grant them would not be engaged in illegal predatory pricing, and neither would the merged firm, even if it passes on all of them.²⁵¹ Moreover, an action under the Robinson-Patman Act would not be available if the merged firm had induced the price cuts by playing several suppliers off against each other, giving each of them a meeting competition defense.²⁵²

4. Reduced Choice

A powerful buyer may harm competition and reduce consumer welfare by restricting consumer choice as well as by causing consumer prices to increase.

²⁴⁸ For a fuller description of this theory, see Kirkwood, *supra* note 17, at 648-49. See also Chen, *supra* note 18, at 36 ("If . . . buyer power is concentrated in the hands of one or two dominant retailers, competition problems may arise in the long run when a significant number of smaller retailers are forced out of the downstream market and, as a result, the dominant retailers acquire significant seller power in the downstream market.").

²⁴⁹ See *supra* note 103 and accompanying text.

²⁵⁰ See *supra* notes 100-102-04 and accompanying text.

²⁵¹ See Kirkwood, *supra* note 17, at 649.

²⁵² Where each supplier is aware that it is competing against other suppliers, and knows that it can only win the buyer's business by outbidding the other suppliers, each supplier would have a meeting competition defense. Moreover, if the winning suppliers have a meeting competition defense, the merged firm would not be liable for inducing discriminatory price cuts. See *Great Atl. & Pac. Tea Co. v. FTC*, 440 U.S. 69, 83 (1978).

Suppose, as in the prior scenario, that the merged firm uses its enhanced countervailing power to induce substantial and sustained concessions from its suppliers and then passes on those concessions to consumers in the form of lower prices. And suppose that those lower prices undercut its smaller competitors and force many of them to curtail their offerings or close altogether. But suppose, in contrast to the prior scenario, that the merged firm never raises its downstream prices. Competition and consumer welfare may nevertheless be harmed if the consumers who preferred the offerings of the smaller firms lose more than other consumers gain from the merged firm's lower prices.

When a large chain like Wal-Mart or Barnes & Noble grows at the expense of small, independent retailers, it can deprive consumers of the distinctive benefits that these small firms provide: more convenient locations, better service, a wider selection of merchandise, a focus on local tastes, or a more appealing place to meet neighbors and friends. The opening of a big box store can also decimate the shopping area of a small town, replacing familiar local firms with dark, vacant storefronts. As Robert Reich puts it, Wal-Mart turns "main streets into ghost towns by sucking business away from small retailers."²⁵³ Likewise, Peter Applebome writes: "A store shutting down these days isn't exactly startling news. You drive around any suburban downtown these days, and you see the yawning, empty storefronts: ghosts of better days."²⁵⁴ In their study of the impact of Wal-Mart's expansion on Mom and Pop stores, Russell Sobel and Andrea Dean declare: "The instant Wal-Mart moves into town, all small businesses are destroyed in its path, leaving downtowns barren and empty."²⁵⁵

To be sure, the elimination of small firms by large buyers like Wal-Mart and Barnes & Noble may represent economic progress. Consumers could be better off when large, low-priced chains replace small, high-priced independents. After all, the chains are able to grow because many consumers prefer what they offer to the features of their smaller rivals. But the overall impact on consumer welfare may not be positive. Consumers in this scenario are subject to a collective action problem, a multi-person prisoners' dilemma that may prevent the market from reaching the optimal solution. Suppose that many consumers are willing to pay a significant amount to keep their local bookstore in business. In particular, they may be willing to buy a number of books at full price at the local independent bookstore rather than purchase them at a substantial discount from Barnes & Noble or Amazon in order to preserve the

²⁵³ Robert B. Reich, *Don't Blame Wal-Mart*, N.Y. TIMES, Feb. 28, 2005, at A1.

²⁵⁴ Peter Applebome, *Who Killed This Little Bookstore? There Are Enough Suspects to Go Around*, N.Y. TIMES, Mar. 22, 2009, at A24.

²⁵⁵ Russell S. Sobel & Andrea M. Dean, *Has Wal-Mart Buried Mom and Pop?: The Impact of Wal-Mart on Self-Employment and Small Establishments in the United States*, REG. MAG., Spring 2008, at 39. Sobel and Dean find, however, that Wal-Mart has had little negative impact on the overall size of the small business sector. *Id.*

option of shopping at the independent. But without some assurance that other consumers are following the same strategy, many individual consumers will not adopt it. No single consumer can preserve an independent bookstore on her own. To ensure the survival of independents, consumers have to act collectively, and that is difficult to accomplish.

Consumers can coalesce around a preserve-local-business strategy when that strategy is put to a vote in a local election, or when community activists organize a protest, as has often occurred in connection with the proposed opening of a Wal-Mart or other big box store.²⁵⁶ Moreover, the success of many of these initiatives indicates that in a nontrivial number of cases, consumers as a whole may in fact prefer greater choice to lower prices.²⁵⁷ But without a community vote, it is difficult to tell whether the collective action problem affects most consumers or only a few: whether, in other words, consumer welfare in the aggregate has been diminished or enhanced by the growth of a large buyer and the elimination of many of its smaller but distinctive rivals.

To resolve that issue, it would be necessary to determine the views of a representative sample of consumers, a process that would be costly. The effort may be worthwhile, however, where downstream markets have traditionally included highly differentiated local merchants, where many of them have already gone out of business, and where the merger threatens to accelerate their demise. In such a case, consumers may be in a position, because of their own experiences, to provide reliable evidence that they have lost more than they have gained as their options have diminished. Such evidence could be buttressed by company documents or independent marketing studies that stress the weight consumers have put on the distinctive attributes of smaller retailers. If the necessary evidence is available, a merger challenge may be the only viable enforcement option. The other antitrust laws are no more likely to reach this scenario than the prior scenario.

5. Increased Slack

As we have seen repeatedly, a merger of buyers that enhances countervailing power is likely to enable the merged firm to gain a significant competitive advantage over its smaller rivals. In the four previous theories, this competitive advantage led, directly or indirectly, to adverse effects on those smaller rivals and, because of those adverse effects, to diminished competition and harm to consumers. In this last downstream theory, the anticompetitive effects occur not because smaller rivals are hurt, but because the merged firm uses its competitive advantage as a shield, protecting itself from competition while its own costs rise. The resulting productive inefficiency not only wastes resources but threatens to reduce consumer

²⁵⁶ See Ingram, Yue & Rao, *supra* note 106.

²⁵⁷ See *supra* notes 106-110 and accompanying text.

welfare, since it makes the firm less dynamic and less responsive to changes in consumer tastes.

There is one documented instance in which buyer power resulted in inefficiency and slack.²⁵⁸ But it is not clear there are many others. Most big retailers have lower costs than their smaller competitors because they realize greater economies of scale and invest more heavily in information technology.²⁵⁹ At the same time, there is no doubt that the exertion of buying power can distort productive efficiency. If a merger enhances the countervailing power of the merged firm, and it uses that power to take business from its rivals, more output would be produced by the merged firm, but not because it is more efficient. It would have secured that business because of the competitive advantages it had obtained through its buying power. In short, mergers that enhance countervailing power may shift business from more efficient to less efficient firms.²⁶⁰

A merger challenge on this theory is most likely to be plausible where there is compelling evidence that the merging parties used their countervailing power before the merger to obtain significant concessions but did not pass on those concessions to consumers. Instead, they allowed their costs to rise. With such a track record, the merging firms may be even less innovative and less responsive to consumer preferences post-merger, since they would no longer face any prospect of losing business to each other. If there is enough evidence to support a case based on this theory, a merger challenge would be the only route. Neither the Sherman Act nor the Federal Trade Commission Act prohibits firms from dissipating the concessions they have obtained from suppliers in higher costs.

B. *Harm to Upstream Competition*

A merger of buyers that enhances countervailing power could also reduce competition upstream: (1) the merged firm's exercise of countervailing power could diminish the returns that suppliers earn from research and development, curbing their incentive to innovate; (2) alternately, by depressing suppliers' profits, the exertion of countervailing power may cause suppliers to restrict the variety of products they offer; (3) if the merged firm concentrates all its purchases in a single supplier, it could give that supplier monopsony power over atomistic suppliers further upstream; (4) a merger that appears to create countervailing power may actually result in monopsony power if the structure

²⁵⁸ See *supra* note 101 and accompanying text.

²⁵⁹ See *supra* note 110.

²⁶⁰ See Chen, *supra* note 18, at 35 (“[I]ncreased retailer countervailing power . . . can cause efficient [sic] loss on the production side. The reason is that exercise of buyer power by one retailer will typically cause redistribution of retailing business in the downstream market. Given that this redistribution of business is based on the retailer's buyer power (or the lack of) in the upstream market rather than on their productive efficiency in the downstream market, it tends to result in distortions in downstream production.”).

of the supplying tier changes and suppliers lose their market power; and (5) the merged firm's exercise of countervailing power may cause suppliers to collude in response, worsening consumer welfare.

1. Diminished Innovation

There is a well-known link between the expected profitability of an innovation and a firm's willingness to invest resources in developing it:

If a monopoly arises from a competitive process, such as a race to produce a superior technology, the excess profit of the winner in the technology race is the carrot that induces firms to participate in the race. A systematic policy to cut back or eliminate this ex post reward would reduce the intensity of technological competition and thereby could reduce efficiency in the long run.²⁶¹

This link also matters for merger policy. If the reward to innovation is reduced not by government policy but by the exercise of countervailing power, a merger that enhances countervailing power could diminish the incentive to innovate, as Carstensen has written: "[T]here is a real question of whether the long run interest in an efficient, dynamic, and equitable market process is well served when buyers use their power to extract all the producer surplus of their suppliers."²⁶² Mellsop and Counsell agree: "It is often argued that because buyer power reduces upstream suppliers' profits, it can harm upstream sellers' incentive for investment and innovation."²⁶³ As Noll explains, this concern is also applicable to mergers that create monopsony power: "[M]onopsony can reduce technological progress because suppliers will anticipate that if their R&D efforts are successful, the monopsonist nevertheless will be able to extract the quasi-rents that recover the R&D costs."²⁶⁴

The innovation area is complex, however, and greater buyer power may not always have an adverse effect on dynamic efficiency. A merger of buyers could increase innovation, even if it put more pressure on suppliers' margins, because it might cause suppliers to develop more differentiated products in order to better resist this pressure.²⁶⁵ In winner-take-all markets, moreover, the

²⁶¹ Noll, *supra* note 4, at 608-09. The Guidelines also rely on the link between profits and innovation when they explain why high margins are not in themselves an antitrust concern: "High margins commonly arise for products that are significantly differentiated. Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs." 2010 GUIDELINES, *supra* note 21, § 2.2.1, at 4 n.3.

²⁶² Carstensen, *supra* note 47, at 21.

²⁶³ Mellsop & Counsell, *supra* note 24, at 5. Both the New Zealand Commerce Commission and the UK Competition Commission have expressed concern over buyer power because it may depress sellers' incentives for investment and innovation. *See id.*

²⁶⁴ Noll, *supra* note 4, at 612. For supporting evidence, see *supra* note 46.

²⁶⁵ *See* Mellsop & Counsell, *supra* note 24, at 5-6 ("[I]nnovation can improve the bargaining position of a supplier against a strong buyer By investing to make its

prospect of very high profits from an innovation may cause too many firms to invest in research and development, raising the total costs of discovery and reducing economic efficiency.²⁶⁶ Where that is a serious risk, a merger that enhances buying power and reduces the gains to innovation might actually improve dynamic efficiency. Moreover, buyers have an interest in promoting supplier innovation,²⁶⁷ and that interest may temper a buyer's willingness to demand concessions from its suppliers.²⁶⁸

Given these conflicting considerations, a challenge to a merger of buyers based on the threat to innovation would need to be carefully developed. It might require evidence showing that prior to the merger, the rate of innovation among suppliers had slowed and that this decline was attributable to the growth of powerful buyers. If such evidence were available, however, a merger challenge would be a more prudent strategy than a post-merger attack on the merged firm's behavior. No case has concluded that the Sherman Act or the Federal Trade Commission Act was violated because a buyer obtained a concession from a supplier that reduced its incentive to innovate. In contrast, the government has frequently challenged mergers of sellers on the ground that the transactions would slow the rate of innovation.²⁶⁹

product more attractive or by lowering its costs, a supplier can improve its bargaining position and make it more difficult for a strong buyer to switch suppliers." (citing Inderst & Wey, *supra* note 56)).

²⁶⁶ See Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 HARV. L. REV. 397, 440 (2009) ("[T]he patent race literature proves that firms will make socially excessive (and often duplicative) investments if they capture all the total surplus created by their innovations. . . . For example, a firm would invest \$1 million to be the hundredth research team with a 1/100 chance of becoming the first discoverer of an innovation that will generate \$100 million in profits, even if having a hundredth team does not meaningfully increase the marginal odds that someone will discover the innovation."). According to Elhauge, this problem arises when the winning firm would capture the entire total surplus created by its invention. If that is the only circumstance in which the problem would occur, it is likely to be rare. To capture all (or nearly all) the surplus generated by a new product, a firm would have to engage in perfect (or near perfect) price discrimination.

²⁶⁷ Mellsoy & Counsell, *supra* note 24, at 6.

²⁶⁸ Buyers also have an interest in not driving suppliers out of business, yet as noted earlier, that can nevertheless occur. See *supra* note 246 and accompanying text. It is not clear, therefore, how often buyers will soften their short-run demands in order to achieve long-run gains in dynamism among their suppliers.

²⁶⁹ See, e.g., *Lockheed Corp.*, 119 F.T.C. 618, 623 (1995); Agreement Containing Consent Order, *In re Illinois Tool Works*, F.T.C. File No. 951 0091 (Fed. Trade Comm'n 1996) 1996 WL 49283, at *9; Agreement Containing Consent Order, *In re Hoechst AG*, F.T.C. File No. 951 0090 (Fed. Trade Comm'n 1995) 1995 WL 556286, at *14; Agreement Containing Consent Order, *In re The Scotts Co.*, F.T.C. File No. 951 0056 (Fed. Trade Comm'n 1995) 1995 WL 317118, at *19; Complaint, *In re Danaher Corp.*, F.T.C. File No. 091 0159 (Fed. Trade Comm'n 2010) (No. C-4283) 2010 WL 387913, at *1; Complaint, *In re AEA Investors 2006 Fund, L.P.*, F.T.C. File No. 081 0245 (Fed. Trade Comm'n 2010) (No. C-4297) 2010 WL 3511502, at *3; Complaint, *In re Getinge AB*, F.T.C. File No. 091

2. Lower Variety

The exercise of countervailing power can affect the range of products offered to consumers in another way. Instead of diminishing the development of new products, it could cause suppliers to drop some of the products they already produce, diminishing product variety and restricting consumer choice. This potential adverse effect of buyer power has been recognized repeatedly,²⁷⁰ and formally modeled by Inderst and Shaffer.²⁷¹ They show that in a market in which two suppliers, each with a differentiated product, sell to two retailers, each of which carries one of the suppliers' products, the merger of the two retailers will result in the elimination of one of the products, since it is more profitable for the merged retailer to carry a single product than two. While this model is narrow, it does capture one significant potential dynamic effect of countervailing power. After a merger, the merged firm "may want to enhance its buyer power vis-à-vis [its] suppliers by delisting a product [and] committing to a 'single-sourcing' purchasing strategy."²⁷² Moreover, anticipating this dynamic, suppliers may "strategically choose to produce less differentiated products, which further reduces product diversity."²⁷³

A case based on this theory would require a detailed analysis of the incentives facing the merged firm and its suppliers post-merger. The government would ultimately have to establish that the merged firm is reasonably likely to find it profitable to reduce the number of products it carries post-merger or that one or more suppliers would find it profitable to reduce the number of products they produce. Both showings would require a game-theoretic modeling of the bargaining that would take place after the merger. As with other anticompetitive theories, moreover, both would be helped by evidence that the predicted anticompetitive effects had already begun to occur pre-merger as the merging firms grew in size and power. It might also be necessary to address the issue of excessive product variety. Because monopolistically competitive markets can sometimes produce too much product variety,²⁷⁴ the government might have to rebut the claim that the merger would actually benefit consumers by diminishing the number of

0000 (Fed. Trade Comm'n 2009) 2009 WL 285503, at *1. See also 2010 GUIDELINES, *supra* note 21, § 6.4 ("The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts.").

²⁷⁰ See Grimes, *supra* note 183, at 238; Kirkwood, *supra* note 17, at 650-51; Noll, *supra* note 4, at 611.

²⁷¹ See Roman Inderst & Greg Shaffer, *Retail Mergers, Buyer Power and Product Variety*, 111 ECON. J. 45 (2007).

²⁷² Chen, *supra* note 18, at 26.

²⁷³ *Id.*

²⁷⁴ In cases of excessive product variety, consumers benefit from the extra choices they receive, but are hurt by the higher prices they have to pay. A larger array of products may cost more, on a per unit basis, than a smaller array, because producers may achieve greater economies of scale on a smaller array.

products offered and lowering average prices.²⁷⁵ Once again, however, if the necessary evidence and theoretical support are available, a merger challenge is likely to be the only way to forestall an anticompetitive reduction in consumer choice.

3. Upstream Monopsony

A merger that enhances countervailing power may affect upstream suppliers at multiple levels. It is most likely, of course, to affect the prices or terms of the suppliers that deal directly with the merged firm. But it may also affect the prices and terms of suppliers further upstream, as the direct suppliers change their production volumes, product lines, or other strategies in response to the concessions they make to the merged firm. More remote suppliers, in short, may experience “pass back” effects from the reactions of direct suppliers.

Some of these effects will be positive for the remote suppliers. For example, if the merger leads to the procompetitive exercise of countervailing power, the merged firm is likely to increase its purchases from the suppliers it continues to patronize, taking advantage of the lower prices or other better terms they offer and expanding its output in response. In turn, more remote suppliers to these direct suppliers are also likely to benefit. In contrast, if the merger causes direct suppliers to reduce the number of products they offer, suppliers of inputs for these products would suffer. But the harm to these more remote suppliers would not amount to an anticompetitive effect unless the reduction in product variety is itself anticompetitive. If, instead, the reduction is procompetitive, a possibility noted in the prior subsection, the consequences for the remote suppliers may be unfortunate, but they are not anticompetitive. Similarly, remote suppliers would not suffer anticompetitive effects if they can respond to a direct supplier’s demand for lower prices by adopting more efficient production techniques. If the ultimate result is the supply of inputs at lower costs, output is likely to increase, direct suppliers and consumers are likely to benefit, and remote suppliers can preserve their positions and profits.

Remote suppliers would experience anticompetitive effects in the following scenario. Suppose that the merged firm decides to obtain a lower price for an input by purchasing exclusively from the supplier that offers the best price. And suppose that this exclusive arrangement means that producers further upstream now have only one outlet for their own output: the exclusive supplier

²⁷⁵ Chen, *supra* note 18, at 26-27 (explaining a Mathewson and Winter model that explores the impact of buyer power on product variety and consumer welfare). According to Chen, the authors

start with the proposition that a monopolistically competitive equilibrium can lead to an excessive number of firms or product variety, selling at excessive prices. They demonstrate that this property . . . is enough to generate the incentive for buyers collectively (or for a large subset of buyers) to offer a subset of sellers the right to their exclusive business in exchange for lower prices.

Id. at 26-27 (citing G. F. Mathewson & R. A. Winter, *Buyer Groups*, 15 INT’L J. IND. ORG. 137 (1997)).

to the merged firm. If those remote suppliers are atomistically competitive, the exclusive supplier can exercise monopsony power over them, obtaining the output it needs from each of them through all-or-nothing contracting and forcing them to sell at a monopsony price rather than a competitive price. Even in this scenario, though, consumers are likely to benefit. If the merged firm obtains a lower input price by purchasing exclusively through a single supplier, the merged firm is likely to increase its output as a result, and that higher output is likely to lower downstream prices, benefiting consumers. But remote suppliers would not benefit, since they have to surrender any rents they would have made from the higher output to the exclusive supplier. Because Congress wanted to protect atomistic suppliers from monopsonistic exploitation, this transfer of wealth is itself a reason to condemn the merger, despite the consumer benefit.²⁷⁶ Moreover, the reduction in the supplier's profits may reduce their incentive to innovate, depressing dynamic efficiency and harming long-run consumer welfare.

An instance of pass back was described in *Knevelbaard Dairies v. Kraft Foods, Inc.*²⁷⁷ A group of cheese processors had manipulated the price of cheese on the National Cheese Exchange, injuring bulk cheese producers.²⁷⁸ The court concluded that upstream dairies were also hurt because the price of milk was linked by a state agricultural department formula to the price of cheese on the Exchange.²⁷⁹ As a result, when cheese prices fell, milk prices also dropped.²⁸⁰ Two features, however, may distinguish the case from a merger that enhances countervailing power. In *Knevelbaard*, the initial price reduction was the product of collusive market manipulation, not unilateral countervailing power. Moreover, if the court was correct, the pass back occurred through government regulation, not through the reactions of suppliers to the exercise of countervailing power.²⁸¹

²⁷⁶ See Kirkwood & Lande, *supra* note 45, at 235-36 (showing that the most recent decisions have rejected defendants' attempts to justify alleged buying cartels by claiming they resulted in lower prices to consumers).

²⁷⁷ 232 F.3d 979 (9th Cir. 2000).

²⁷⁸ *Id.* at 980-82.

²⁷⁹ *Id.* at 1000.

²⁸⁰ *Id.*

²⁸¹ The court explained:

The alleged price fix among buyers was accomplished in an unusual way: through a now-defunct auction agency called the National Cheese Exchange ("NCE"), the cheese makers are said to have rigged the price for bulk cheese in order to depress their acquisition costs both for that commodity and for milk. California milk prices were targeted and restrained in that the NCE bulk cheese price "determined the cost of fluid milk." That allegation, as the parties' briefs confirm, means that the California Department of Food & Agriculture ("CDFA") used the reported NCE bulk cheese prices in its formula for setting the "support" (i.e., minimum) price for milk produced in that state.

See *id.* at 982.

In a comment to me, Carstensen disagreed with the court's characterization of the pass

A merger of buyers that enhances countervailing power could produce an anticompetitive pass back if suppliers had monopsony power over input producers further upstream but had not exercised it to the maximum extent possible. In that situation, in other words, direct suppliers pursue a target margin, and the exercise of countervailing power by the merged firm deprives them of that margin. To restore it, they exert the full extent of their monopsony power over their own input suppliers, depressing their income and profits. If these remote suppliers were poor farmers or textile workers in a developing country, the adverse effects on equity would be compounded. Moreover, if the result were a decline in downstream output, consumers would be harmed as well. Of course, this scenario is unlikely to occur with great frequency: it assumes that suppliers are satisficers rather than profit maximizers, and that the exertion of countervailing power leads to a reduction rather than an increase in output. But if those conditions are fulfilled, it is not surprising that commentators have identified the resulting impact on remote suppliers as an adverse consequence of buyer power.²⁸²

The concentration of the merged firm's purchases in a single supplier could also have effects on choice. If that supplier decides to deal with only certain more remote suppliers, the impact on downstream consumers could be positive or negative, depending on how the supplier exercises its discretion. For example, the supplier might contract only with remote suppliers who promise to pay their workers a living wage. Despite the higher costs entailed, this choice might have considerable appeal for consumers, as Starbucks has found with its "Fair Trade" coffee purchase program.²⁸³ Alternatively, the supplier might select remote suppliers whose products or processes turn out to be unattractive or excessively costly, diminishing downstream sales. Since the supplier has no incentive to reduce its own sales, adverse effects on consumers

back mechanism. He stated that the state regulatory scheme actually had little or nothing to do with the transmission of lower cheese prices upstream. Rather, producers of bulk cheese demanded lower milk prices when they saw that cheese prices had declined.

²⁸² See Carstensen, *supra* note 13, at 287 ("[R]educing the price of branded goods can induce the producer to lower its prices to those of its suppliers over which it has buyer power. . . . [In this setting] the affected producer has an increased incentive to look for ways to reduce its costs by exercising its power in any component market in which it can exercise leverage."); Grimes, *supra* note 2, at 569-70 ("If a retailer is able to exercise buyer power in purchasing chickens, the costs of that power may be passed up the supply chain until reaching relatively powerless atomistic sellers. Thus, low prices paid by food retailers for poultry products may have little effect on the large poultry processors who simply pressure their contract suppliers to supply poultry at lower prices.").

²⁸³ Starbucks recently noted on its paper cups that it "bought 65% of [its] coffee . . . last year . . . from farmers who are good to their workers, community and planet." The company added: "It's using our size for good" Sarah Gilbert, *Starbucks Is Trashing Its Green Image*, DAILY FIN. (Apr. 22, 2010, 9:00 AM), <http://www.dailyfinance.com/2010/04/22/starbucks-is-trashing-its-green-image/>.

are unlikely to be common, but given the inherent uncertainties, they are a potential consequence of this scenario.

4. Temporary Supplier Power

As noted earlier,²⁸⁴ a merger that enhances countervailing power would not be procompetitive in the long run if (1) the market power of the merged firm's suppliers is temporary and (2) once it disappears, the merged firm would be able to exercise monopsony power against those suppliers, reducing their welfare as well as the welfare of consumers and society over the long run. Suppose, for example, that there are many suppliers but they have market power because they have formed a cartel or because government regulation has artificially limited entry. And suppose there is good reason to predict that antitrust enforcement would break up the cartel or that the regulations would be revoked. If so, and if the merged firm would then be in a position to exert monopsony power over those suppliers, the merger would be anticompetitive rather than procompetitive (assuming no efficiency justification) and should be blocked.

5. Supplier Collusion

The final anticompetitive theory is a complement to the previous one. Instead of focusing on the disappearance of upstream market power, this theory highlights the possibility that supplier power may increase in response to the merger. Areeda and Hovenkamp explain: "[T]he presence of large buyers may simply stimulate or formalize seller collusion [W]hile such agreements are plainly unlawful, they may be hard to detect, and they may go on for considerable periods of time without detection."²⁸⁵ Of course, a merger that enhances countervailing power might weaken and eventually undermine such collusion. But it might also cause suppliers to coalesce in ways they would not otherwise, causing a net increase in upstream prices that leads to higher downstream prices.

This theory assumes that suppliers would not collude, or collude as effectively, in the absence of the threat to their profits posed by the merged firm. In effect, the theory assumes that the suppliers are loss averse, more willing to collude post-merger to avoid losses than to collude pre-merger to achieve gains. It seems clear that loss aversion is a characteristic of many individuals.²⁸⁶ It is less clear that many firms exhibit this preference, although it is plausible in the case of large, bet-the-firm investments and when firms are

²⁸⁴ See *supra* Part IV.B.

²⁸⁵ 4 AREEDA & HOVENKAMP, *supra* note 22, ¶ 943b.

²⁸⁶ See RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* 33 (2008) ("People hate losses Roughly speaking, losing something makes you twice as miserable as gaining the same thing makes you happy. In more technical language, people are 'loss averse.'").

satisficers rather than profit-maximizers. In these cases, firms may well care more about avoiding substantial losses than achieving comparable gains.

A case based on this theory would have to show that conditions in the upstream market are favorable to collusion, even though there would be a more powerful buyer post-merger, and that the presence of this buyer would provoke the suppliers to collude, even though that option is currently available to them. Neither showing, however, is impossible. The factors relevant to the likelihood of collusion are well known,²⁸⁷ and the government may have evidence that the suppliers colluded in the past in reaction to a substantial threat to their profits.

CONCLUSION

It is no longer appropriate to view buyer power as simply the mirror image of seller power, and oppose mergers of buyers only when they pose a threat of monopsony power. To be sure, it is important to protect small, competitive sellers from monopsonistic exploitation, and there is reason to believe that coordinated monopsony pricing is more stable than coordinated supracompetitive pricing. Antitrust enforcement should therefore maintain, if not intensify, its focus on mergers that may enhance monopsony power. But this should not be the sole concern of buy-side merger policy.

When Wal-Mart purchases detergent from Proctor & Gamble, there is no danger that the retailer will exercise monopsony power over the manufacturer. Instead, Wal-Mart is likely to obtain price and other concessions that a smaller buyer could not extract, and those concessions are likely to reduce the market power that Proctor & Gamble could otherwise exercise. In most instances, those concessions are likely to be procompetitive. But as this Article has demonstrated, there are many ways in which a large buyer's exercise of countervailing power could reduce competition and harm consumers, suppliers, and economic efficiency.

The implications for merger policy are fourfold. First, courts and enforcement agencies should expand the scope of their analysis, looking not just at whether a merger of buyers is likely to enhance monopsony power, but also at whether the merger is likely to augment countervailing power. Second, if a merger is likely to enhance countervailing power, agencies and courts should consider whether that power may produce anticompetitive effects as well as procompetitive effects. Third, if the theory and supporting evidence are adequate, an agency should bring, and a court should sustain, a challenge to a merger of buyers on the ground that it would create anticompetitive countervailing power. Fourth, agencies and scholars should continue to refine the ways in which a merger is likely to enhance buying power – whether monopsony power or countervailing power – using the standard tools of policy development: theoretical analysis, economic modeling, studies of past mergers,

²⁸⁷ See, e.g., 2010 GUIDELINES, *supra* note 21, § 7.2 (“Evidence a Market is Vulnerable to Coordinated Conduct”).

and continuing experience with cases and investigations. And the resulting developments should be incorporated, when appropriate, in the Merger Guidelines.

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