



7-12-2004

Beware Buyer Power

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Recommended Citation

Beware Buyer Power, *Legal Times*, July 12, 2004

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LegalTimes

Legal Times

July 12, 2004 Monday

SECTION: Vol. 27 No. 28

LENGTH: 1849 words

HEADLINE: BEWARE BUYER POWER

BYLINE: Robert H. Lande

BODY:

Antitrust Law: A Practice Focus

WHEN COMPANIES CAN DICTATE PRICES THEY PAY, IT CREATES ANTITRUST CONCERNS TOO

Antitrust usually focuses on seller-side market power. By contrast, the conventional wisdom is that buyer-side market power is so unusual and so rarely anti-competitive that it barely merits more than a scholarly afterthought pointing out that, in theory, it too can be harmful.

Moreover, these brief mentions usually say either that monopsony is essentially the mirror image of monopoly or that, while seller-side power is suspect since it leads to higher consumer prices, buyer-side power is usually benign, except in rare circumstances. Why should the public care which layer of a distribution channel gets the potential savings that can arise when one large buyer buys inexpensively--even if it buys too inexpensively? Indeed, monopsony is often thought to be pro-competitive because it usually leads to lower buyer costs, which will usually be passed on to consumers.

For these reasons, many commentators believe that buying power should be treated more leniently than selling power, and recent government prosecutions of monopsony cases have been rare.

But there are also reasons to suspect that conventional wisdom doesn't tell the whole story. Among these are (1) the emergence of power at the buyer level beyond anything previously experienced (think Wal-Mart); (2) the recognition that antitrust enforcers regularly permit mergers that increase buyer power and thereby change industry dynamics, often leading to countervailing consolidation; (3) the growing political debate over possible negative effects of monopsony in agriculture, health care, and retailing; and (4) the relative lack of either an empirical or a theoretical basis for determining when buyer power may be of antitrust concern.

On June 22, the American Antitrust Institute devoted its fifth annual conference to the topic of buyer power. While the AAI conference showed that there is indeed much truth to the conventional wisdom, it also revealed that contrary considerations may be underappreciated by the antitrust community.

LOW-LEVEL POWER

At the outset, it should be stressed that there is a fundamental reason why buyer power may have more potential to harm competition than seller power does: Buyer power can occur at much lower market share levels.

There is, of course, no clear market share line above or below which either monopoly or monopsony power always arises or cannot arise. But the standard promulgated by 2nd Circuit Judge Learned Hand in (1945) has stood the test of time. Hand famously wrote that for monopoly power to exist, a 90 percent market share is enough, 60 percent or 64 percent is doubtful, and 33 percent certainly is not enough.

By contrast, buyers sometimes have enough power to obtain lower prices or other discriminatory terms with much lower market shares. The 7th Circuit's decision in (2000) held that a buyer with an approximately 20 percent market share can sometimes have the power to extract significant concessions from sellers--although that case had horizontal complications that make it arguably ambiguous precedent.

A better example probably is provided by a recent careful analysis of the Supreme Court's 1948 decision in by conservative economist John L. Peterman. Peterman has concluded that buyers of salt were able to obtain non-cost-justified discounts even where they had market shares of less than 20 percent. The crucial unanswered question, which requires more empirical investigation, is just small a market share may, under various circumstances, enable a buyer to exert monopsony power.

How does a company that purchases, say, 20 percent of toys or table salt exercise buyer power? That company can threaten to take its business elsewhere if it does not receive lower prices from particular sellers. If there are other significant suppliers of toys or salt, its threat may well be credible. Even if the sellers are perfectly competitive with each other, they may all agree to lower their prices if the buyer can convince them that getting a small profit is better than getting no profit at all.

After all, the company that buys 20 percent of the goods available is making a relatively large purchase. This purchase can provide suppliers with crucial economies of scale and become a key part of their business strategy. So they may be willing to make this sale at only slightly above average variable cost and to cover their overhead from the profits on sales to their other customers, who end up paying more.

There is, of course, a big difference between the power to affect price and the power to restrain or destroy competition. But, at a minimum, our sensitivities to possible abuses should become heightened at much lower market share levels of buyer power than when we are examining potential abuses from seller-side power.

EUROPEAN VIEW

The European Union has more heightened sensitivities on this issue. The EU addresses buyer power much more explicitly in its merger guidelines than does the United States and has been more aggressive in its antitrust policies in this regard.

For instance, the EU recognizes that a merger of retailers can sometimes lead to or increase monopsony power. This can enable the merged company to achieve so much savings that it gets a significant cost advantage over other retailers. The company may then be able to use this cost advantage to raise its rivals' costs or restrict its rivals' revenue through predation.

According to Hendrick Rller, chief economist of the EU's Directorate General for Competition (and a keynote speaker at the AAI conference), the EU has so far concluded that these anti-competitive outcomes can only occur under certain conditions involving appropriate market shares, elasticities, and the excess capacity of fringe firms.

SELLER BEWARE

Another situation in which an anti-competitive monopsony might arise is where buyers may try to squeeze certain sellers in ways that lead to undesirable inefficiencies regardless of whether consumer prices rise as a result.

As an oversimplified example, Stanford professor Roger Noll analyzes the following type of scenario: Suppose that it costs 30 cents to produce a barrel of oil in Field A and \$30 to produce a barrel in Field B. The market price received by both fields is \$30 a barrel. But then the only two pipelines leading into the general area merge. The resulting monopsonist oil buyer could offer to pay the owner of Field A just slightly more than 30 cents a barrel.

Often the owner of Field A will sell at this price since there is no other way to get its oil to market. But other times, negotiations will break down, and the 30-cent oil will not be produced. In its place, more expensive oil will be produced, and this is inefficient by definition. Nevertheless, the buyer will not be able to raise prices to consumers unless it also has monopoly power in the downstream market.

Professor Noll points out that this situation highlights a difficult policy question: Should the antitrust laws protect sellers from buyers who acquire monopsony power where that power does not result in higher consumer prices? (One might call that the Wal-Mart scenario.)

I would argue that the antitrust laws give sellers as much right to sell into a competitive market as consumers have to buy from one. After all, the Sherman Act prohibits [e]very contact, combination . . . or conspiracy, in restraint of trade with no exception for restraints caused by buyer power. Moreover, the Sherman Act debates, back in 1890, did not suggest an exception. One congressman notably complained that the beef trust robs the farmer on the one hand and the consumer on the other.

HOW DO WE JUDGE?

Yet another question raised at the AAI conference was this: Should efforts by buyers to drive other buyers out of the market be judged under the same standards as efforts by sellers to exclude other sellers? That is, should the standard be that set forth by the Supreme Court in (1993)?

Seattle University professor Jack Kirkwood argues that different standards should apply--for several reasons. First, unlike the sellers in predatory buyers need not sacrifice profits to harm their competitors, so there is no purpose to evaluating their behavior on the basis of whether it allows them to recoup their investment in the long term.

Second, price discrimination by buyers usually arises in cases alleging violations of the Robinson-Patman Act. A purpose of this law (although not of the Sherman Act) was to protect small businesses. So preserving small businesses in situations where predatory behavior does not drive up consumer prices might be appropriate in Robinson-Patman Act cases, but not in Sherman Act cases.

Third, much less economic power is required for a buyer to have the power to detrimentally affect competition. Therefore, the requirement that the seller possess the dangerous probability of acquiring monopoly power does not make sense in a buyer context.

Fourth, and simply put, the effects are different. While seller market power almost always harms consumers, buyer power can have different types of effects on consumers. It can be positive because the lower prices can be passed on to the consumers.

Nonetheless, Kirkwood describes five instances where buyer power can harm consumers: (1) where the discounts demanded will help the large buyer so much that its rivals will go bankrupt, depriving consumers of some choices they desire; (2) where the favored buyer or buyers will, as a result, be able to turn around and become an oligopoly or monopoly and raise prices; (3) where the powerful buyer will force sellers to raise the costs to the buyer's rivals, which in turn will cause consumer prices to rise; (4) where the buyer will be protected from the rigors of competition so much that it will allow its costs to rise; and (5) where investors will become reluctant to invest in the industry, which will harm consumers in the long run.

Are these anti-competitive scenarios just theoretical? Is buyer power so rare and the likelihood of actual harm so small that, despite these possibilities, we can safely relegate it back to footnote status? We don't know.

Several of the conference's speakers did discuss the legally and politically complicated buyer power issues involving the nation's largest retailer and private employer, Wal-Mart. These speakers included the retailing giant's chairman, Rob Walton. But conclusions as to whether any of Wal-Mart's activities violate the antitrust laws await another day.

The proper analysis of buyer power will require an increased emphasis on strategic behavior and the subtleties of power relationships. But observers looking at agriculture, health care, and retailing--not to mention sports, natural resources, and the labor market in general--are already raising some pertinent questions.

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LOAD-DATE: April 17, 2011