Ex-ante and Ex-post Control of Buyer Power

Stefan Thomas*
Eberhard Karls University Tübingen

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*Professor of Law, Chair of private law, business law, competition and insurance law, Faculty of Law, Eberhard Karls University, Tübingen, Germany, Email: thomas@jura.uni-tuebingen.de

Abstract

This paper considers the effects of buyer power under the antitrust laws. It focuses on EU antitrust law, namely Article 102 TFEU and the EU Merger Control Regulation, while taking into account the stance of US antitrust law. Recent investigations of several European antitrust authorities in the grocery sector have expressed concerns that concentration on the demand side can result in market foreclosure or anticompetitive exploitation of market participants. Also, in the US there is an ongoing debate about the anticompetitive and procompetitive effects of buyer power, which is inter alia reflected in the landmark decision of the US Supreme Court in *Weyerhaeuser* and in the merger control policies of the DOJ and the FTC. Against this background, the present paper starts with the definition of buyer power. It underscores the necessity to distinguish between single price monopsony on the one hand and individual bargaining power on the other hand, since the economic effects of these two types of buyer power deviate significantly. In subsequent steps, the paper analyses different theories of harm that can be raised with respect to buyer power. It discusses the effects of buyer power on allocative efficiency, dynamic efficiency as well as consumer welfare and draws conclusions from that for the enforcement of the antitrust laws.

Keywords: *buyer power; monopsony; abuse of dominance; merger control; waterbed effect; spiral effect; allocative efficiency; dynamic efficiency; consumer welfare*.

JEL-Codes: K21, L41

Content

I. Introduction

The notion of markets implies that there is at least one seller and one buyer. Since competition law aims at keeping markets open in order to protect the competitive process and ultimately serve the benefits of consumers it is therefore acknowledged that both the supply and the demand side of markets are subject to the antitrust laws. Already in 1905 the US Supreme Court applied the Sherman Act in cases involving buyer power created through conspiracies, which aimed at suppressing input prices.[1] Although Section 2 of the Sherman Act only talks about monopolisation and makes no mention of monopsony, the US Supreme Court has acknowledged that it comprises both, monopoly and buyer power, the latter often referred to as monopsony power.[2] The reason for Section 2 not using both terms is of a historic nature since in the economic models being discussed around 1890 monopsony did not play a prominent role.[3] Nonetheless, in the debates in both houses of the US Congress in 1890 concern was expressed towards both market power on the demand and on the supply side.[4] Also Article 102 TFEU relates to both. That becomes obvious in its Sentence 2 lit. a, which prohibits in equal measure the imposition of "unfair purchase or selling prices". The merger control laws of the Clayton Act and the European Merger Control Regulation (EUMR) similarly relate to lessenings/impediments of/to (effective) competition in supply or demand markets.

The problem with the application of the antitrust laws on the buyer side is that the effects of high market concentration are much more complex than on the supply side.[5] While monopoly

[1] Swift & Co. v. United States, 196 U.S. 375, 391 (1905); Warren Grimes, *Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller*, 72 ANTITRUST L.J., 563, 564 (2005).

[2] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312, 321 (2007) ("[M]onopsony pricing … is analytically the same as monopoly or cartel pricing and [is] so treated by the law") (quoting Khan v. State Oil Co., 93 F.3d 1358, 1361 (7th Cir. 1996), *vacated and remanded on other grounds*, 522 U. S. 3 (1997).

[3] See Grimes, *supra* note 1 making reference to the OXFORD ENGLISH DICTIONARY (2d ed. 1989), according to which the first usage of "monopsony" was made in JOAN ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION (1933).

[4] *See* 21 CONG. REC. 2461 (1890) (statement of Sen. John Sherman: "These trusts and combinations…operate as a double-edged sword. They increase beyond reason the cost of necessaries of life and business, and they decrease the cost of raw material, the farm products of the country. They regulate prices at will, depress the price of what they buy and increase the price of what they sell.")

[5] See Bundeskartellamt, Buyer Power in Competition Law – Status and Perspectives, Meeting of the Working Group on Competition Law on 18 September 2008, Background Paper, p. 12 ("Detriment to suppliers caused by the exercise of buyer power does not necessarily go hand in hand with the detriment caused to end consumers downstream of the relevant market.") *available at* http://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Fachartikel/Buyer%20Power%20in%20Competition%20Law.pdf?__blob=publicationFile&v=3.

power generally gives rise to unilateral price increases directly, the impact of buyer power is ambiguous: A position of strength in a demand market can reduce the prices for an input good. Such a cost reduction can then result in lower prices in a downstream market and therefore ultimately benefit consumers. At the same time a cost reduction achieved by a dominant purchaser may also serve as an instrument to rise rivals costs and thereby foreclose an input market. This can create a position of strength on a downstream distribution market, which might ultimately result in price increases. These initial thoughts already demonstrate that it is hardly possible to condemn buyer power as per se anticompetitive on the one hand or praise it as per se efficient on the other.

The analysis of buyer power is not only challenging from an economic perspective. Moreover, this particular subject raises legal questions with respect to the objectives of antitrust law. Is it the purpose of the antitrust laws to protect social welfare or is it tailored more narrowly to safeguard the welfare of end-consumers? Are suppliers protected in the same way against monopsony as are consumers against monopoly? Is there such a thing as “supplier welfare”?

Several European antitrust authorities have started to look more closely at the concentration of demand markets, especially in the grocery sector. Investigations in the grocery sector were undertaken inter alia by the antitrust authorities in Portugal in 2006[6] and 2010[7], in Austria in 2004[8], in Scandinavia (Denmark, Faroe Islands, Finland, Greenland, Iceland Norway and Sweden) in 2005[9], in Romania in 2009[10], in Spain[11], in Sweden[12], in Italy[13], in Finland[14], in the UK[15], and in Germany[16].

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[6] Jorge Rodrigues, (2006): *Buyer Power and Pass-Through of the Large Retailing Groups in the Portuguese Food Sector*, Autoridade da Concorrência Working Paper 14, *available at* http://www.concorrencia.pt/vPT/Estudos_e_Publicacoes/Working_Papers/Documents/WP14_Food_Retailing_Rodrigues_2006.pdf.

[7] Autoridade da Concorrência (2010): Final Report on Commercial Relations Between the Large Retail Groups and their Suppliers, *available at* http://www.concorrencia.pt/vEN/Estudos_e_Publicacoes/Estudos_Economicos/Outros/Paginas/Final-Report-Commercial-Relations-Between-Large-Retail-Groups-and-Suppliers.aspx?lst=1.

[8] Bundeswettbewerbsbehörde (2007): Allgemeine Untersuchung des österreichischen Lebensmittelhandels unter besonderer Berücksichtigung des Aspekts der Nachfragemacht, *available at* http://www.bwb.gv.at/Untersuchungen/Lebensmittelhandel/Documents/Lebensmittelhandel%20Endbericht.pdf.

[9] Nordic Competition Authorities (2005): Nordic Food Markets. A Taste for Competition, *available at* http://www.kfst.dk/en/service-menu/publications/publication-file/publikationer-2005/nordic-food-markets-a-taste-for-competition/.

[10] No English report published. Romanian Version: Consilul Concurenţei (2009): Asupra Investigaţiei Declanşate Pentru Analizarea SectoruluiI ComerciaIzării Produselor Alimentare, *available at* http://www.consiliulconcurentei.ro/uploads/docs/items/id2968/raport.pdf. For an English summary see European

Some of the enforcers are afraid that a high concentration on the demand side can result in market foreclosure or anticompetitive exploitation of market participants. In this context, attention should inter alia be paid to the grocery-sector inquiries by the UK Competition Commission of 2008 and the German Bundeskartellamt of 2014. The authorities have found reasons to be concerned with a high concentration of buyer power among large food retail companies. It was alleged that despite resulting in lower input prices for groceries, the high concentration on the demand side could ultimately harm consumers or at least the suppliers. Buyer power could hamper innovation on the supply side[17] or increase market power in downstream markets.[18]

Against this background it is the purpose of the present article and to determine in which way the antitrust laws should react to the different economic effects that can arise from buyer power. As to the legal side, the focus will rest on the EU law of abuses against dominance (Article 102 TFEU) and EU merger control, while references will be made to the US decisional practice concerning the Clayton Act and Section 2 of the Sherman Act.[19] The cartel prohibition will not be part of this analysis.

Competition Network (ECN) (2010): ECN Brief 01/2010, 28, *available at* http://ec.europa.eu/competition/ecn/brief/01_2010/brief_01_2010.pdf.

11 Comisión National de la Competencia (CNC) (2011): Report on the Relations Between Manufacturers and Retailers in the Food Sector, *available at* http://www.cncompetencia.es/Inicio/GestionDocumental/tabid/76/Default.aspx?EntryId=122260&Command=Core_Download&Method=attachment.

12 An English summary is given: Konkurrensverket (2011): Mat och marknad-från bonde till bord, *available at* http://www.kkv.se/upload/Filer/Trycksaker/Rapporter/rapport_2011-3.pdf.

13 European Competition Network (ECN), Subgroup Food (2012): ECN Activities in the Food Sector. Report on competition law enforcement and market monitoring activities by European competition authorities in the food sector, *available at* http://ec.europa.eu/competition/ecn/food_report_en.pdf [25/07/2012] and (2011): ECN Brief 05/011, 47/8, *available at* http://ec.europa.eu/competition/ecn/brief/05_2011/it_food.pdf.

14 European Competition Network (2011): ECN Brief 05/2011, 42, *available at* http://ec.europa.eu/competition/ecn/brief/05_2011/brief_05_2011.pdf.

15 UK Competition Commission, The supply of groceries in the UK market investigation, 30 April 2008, *available at* http://webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/538.pdf.

16 Bundeskartellamt, Sektoruntersuchung Lebensmitteleinzelhandel – Darstellung und Analyse der Strukturen und des Beschaffungsverhaltens auf den Märkten des Lebensmitteleinzelhandels in Deutschland, Bericht gemäß § 32 e GWB - September 2014, *available at* http://www.bundeskartellamt.de/Sektoruntersuchung_LEH.pdf?__blob=publicationFile&v=7.

17 UK Competition Commission, The supply of groceries in the UK, *supra* note 15 at 10.5.

18 Bundeskartellamt, Sektoruntersuchung Lebensmitteleinzelhandel, *supra* note 16, p. 407.

19 The Robinson-Patman Act must also be mentioned for the sake of completeness since it prohibits anticompetitive price discrimination. Yet it does not seem to have a huge relevance in US antitrust practice these

When dealing with buyer power under the antitrust laws from a legal perspective, it is appropriate to distinguish between the definition of buyer power on the one hand and its effects on the other. The article therefore starts with the definitional issue (under Section II.). The procompetitive and anticompetitive effects potentially arising from buyer power will be discussed subsequently. Here, it will be necessary to draw further distinctions. Buyer power in an input market can serve as an instrument to exclude competitors from the downstream distribution market. From this angle, buyer power is merely part of the analysis of supplier power in the downstream market. The issues arising in this context form the second part of this article (under Section III.). Moreover, buyer power can be examined for other negative effects beyond simply the opportunity to exclude downstream rivals. This namely concerns the question whether the antitrust laws should protect suppliers as such against the extraction of price reductions through powerful buyers (under Section IV.).

II. The definition of buyer power

A variety of definitions of buyer power exist. Some describe it as the ability to significantly influence the terms of a purchase for reasons other than efficiency.[20] Blair and Harrison have suggested a "buying power index" in order to measure the degree of buyer power. The index shall be based on the market share of the buyer; the elasticity of supply; and the elasticity of fringe demand.[21] This index, however, is considered by some not to be an ideal tool for practical case analysis, since it is held to be very difficult to precisely measure elasticity of supply and of fringe demand.[22] The OECD has considered buyer power to be tantamount to "the ability of a buyer to negotiate a favorable price that is nevertheless above the competitive level."[23] The problem of such definitions is that they aim at describing one single phenomenon. There is not one type of buyer power, though. There are in fact two types which

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days. Private plaintiffs sometimes bring suits alleging illegal price discrimination. For example, volume discounts offered by a seller (or demanded by a buyer) could be deemed illegal if the defendant does not offer similar terms to other buyers and is unable to establish that it satisfies one of the affirmative defenses under the Robinson-Patman Act.

[20] Grimes, *supra* note 1, at 565.

[21] ROGER D. BLAIR & JEFFREY L. HARRISON, MONOPSONY IN LAW AND ECONOMICS, 52-67 (2010).

[22] Grimes, *supra* note 1, at 566.

[23] OECD, Roundtable on Monopsony and Buyer Power, Note by the United States, 13 October 2008, DAF/COMP/WD (2008) 79, para. 7.

are different in their prerequisites as well as in their effects on economy: (1) the classical single price monopsony, and (2) buyer power that is based on bargaining power.

In the classical monopsony theory, all purchasers in the relevant market pay the same price. If a full monopsony exists, there is by definition only one buyer. Consequently, buyer power means that the monopsonist can obtain a lower price by a reduction in purchase quantity.[24] In this model, monopsony power is simply the mirror image of monopoly power.[25] A monopolist increases market price by restricting output, while the monopsonist reduces market price by reducing demand.[26] Yet, this model can even work where smaller rivals exist alongside a strong buyer. They would act as price takers and profit from a lower market price achieved by the de-facto monopsonist through a reduction in quantity.[27]

However, modern antitrust economics, as well as real world economics, show that price reductions in input markets often do not follow the classical single-price monopsony model.[28] Supply can be so inelastic that a powerful buyer can extract discounts not justified by cost without reducing the quantity of its purchases at all.[29] In these cases the competitive process in the market takes place in bilateral negotiations in which supplier and buyer negotiate individually over prices and quantities. Through these negotiations, the buyer and supplier agree on individual prices and conditions that differ from those offered to other parties.[30] Each contract implies a joint profit for supplier and buyer, and the split of the profit depends on the bargaining power of each side. Buyers with market power can make "all or nothing" offers for the same or even a larger quantity at a lower price per unit or – as the alternative – threaten with the termination of any purchases from the particular seller.[31] Such conduct can often be

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[24] Zhiqi Chen, *Defining Buyer Power*, 53 ANTITRUST BULL.241, 243 (Summer 2008).

[25] *See* Vogel v. Am. Soc'y of Appraisers, 744 F.2d 598, 601 (7th Cir. 1984) ("monopoly and monopsony are symmetrical distortions of competition") (quoted in Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312, 321 (2007)).

[26] OECD, Roundtable on Monopsony and Buyer Power, Note by the United States, 13 October 2008, DAF/COMP/WD (2008) 79, para. 4.

[27] This is an upside-down version of the umbrella effect which takes place in a supply market where a strong seller increases prices through a reduction of his output. In this scenario the smaller rivals will profit from the price increase on the market.

[28] Bundeskartellamt, Buyer Power in Competition Law, *supra* note 5, p. 2.

[29] Grimes, *supra* note 1, at 567.

[30] Bundeskartellamt, Buyer Power in Competition Law, *supra* note 5, p. 2.

[31] Roger Noll, *"Buyer Power" and Economic Policy*, 72 ANTITRUST L.J. 589, 603 (2005); OECD, Roundtable on Monopsony and Buyer Power, Note by the United States, 13 October 2008, DAF/COMP/WD (2008) 79, para. 4.

found where the buyer is involved in fierce downstream competition, since this will not allow an output reduction in the downstream market. Therefore, the purchase quantity cannot be reduced. The intensity of the bargaining power is determined by the hypothetical profits to be realised if the contract were made with an alternative supplier or buyer. The less attractive such outside options are for a seller or buyer, the stronger the bargaining power of the opposite party is and vice versa.[32] A supplier will have to make a price concession if there is no sufficiently substitutable outside option for the event that the contractual negotiations with the strong buyer fail. What is more, bargaining power can be used to influence factors other than prices. A powerful buyer can impose certain contractual terms favourable to him, such as listing fees, most favoured customer clauses, or exclusivity requirements.[33] Bargaining power can therefore be defined as the power to influence prices and conditions for reasons other than efficiency.

The decisive functional difference between the classical monopsony model on the one hand and a model of bilateral negotiations on the other is the following: In the monopsony model a price reduction is achieved through a reduction in quantity, which actually takes place. The monopsonist must buy less in order to get better prices. The price then changes uniformly with respect to the whole market. In the model of bilateral negotiations, however, bargaining power is exercised via the mere threat of reducing the quantity of purchase.[34] This threat suffices for the powerful buyer to extract a price reduction without actually realising this threat, i.e., without reducing the purchase quantity. Therefore, in a model of bilateral negotiations, quantity and price are not interlinked. The purchaser can negotiate more favourable conditions isolated from the quantity he purchases. Moreover, only a model of bilateral negotiations allows for upstream price discrimination. Price is only reduced in the respective business relationship with the powerful purchaser. The setting of prices does not take place uniformly but individually.

Some argue that bargaining power in the latter sense can only exist in cases where the equilibrium price in the absence of the alleged bargaining power would have been above the

[32] *See* Roman Inderst & Nicola Mazzarotto, *Buyer Power in Distribution, in* AM. BAR ASS'N, ISSUES IN COMPETITION LAW AND POLICY 1953, 1978 (W.D. Collins ed., 2009).

[33] Chen, *Defining Buyer Power*, *supra* note 24, at 246.

[34] *Id.* at 244.

supplier's marginal costs.[35] They argue, therefore, that competition among the suppliers must be imperfect for bargaining power to arise. In fact, this can be found in many if not the most real world markets, since often both sides are to some extent concentrated.[36]

Bargaining power is often found to exist at significantly lower market shares than it is generally assumed with respect to market power on the seller side. As to the market shares on the demand side, the EU-Commission has decided that in procurement markets for grocery stores an average share of 22% of the turnover with a given buyer suffices to make him indispensable for a supplier.[37] Others argue that even powerful brand owners may depend on a retail chain with 10% market share.[38] Scholarship teaches that large size in terms of market shares is neither necessary nor sufficient for bargaining power to exist.[39]

Some authors point out that the functional differences between single-price monopsony on the one hand and bargaining power on the other are so fundamental that this should also be reflected in the terminology. The notion of "monopsony" or "monopsony power" should only be used for the classical single-price monopsony. In contrast, a position of strength based on bargaining power should exclusively be referred to as "buyer power".[40] Many other authors, however, use the words monopsony and buyer power synonymously.[41] The terminological approach in this article will be the following: "Buyer power" shall be the generic term for

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[35] *See, e.g.*, Chen, *Defining Buyer Power*, *supra* note 24, 244 et seq.

[36] See Bundeskartellamt, Buyer Power in Competition Law, *supra* note 5, p. 2.

[37] In Commission, Case IV/M.1221, 3 February 1999, *REWE/Meinl*, para. 101 the Commission applied the 22% threshold on the "*turnover with a given customer*" of the supplier. In *REWE/ADEGK* the Commission stated with reference to *REWE/Meinl* that the 22% figure had to be understood as to relate to the market share, Commission, Case COMP/M.5047, 23 June 2008, *REWE/ADEGK*, para. 93 et seq.

[38] Grimes, *supra* note 1, at 580.

[39] *See, e.g.*, Zhiqi Chen, *Buyer Power: Economic Theory and Antitrust Policy*, *in* 22 RESEARCH IN LAW AND ECONOMICS17, 31 (Richard O. Zerbe & John B. Kirkwood eds., 2007); OECD, Roundtable on Monopsony and Buyer Power, Note by the United States, 13 October 2008, DAF/COMP/WD (2008) 79, para. 27; UK Competition Commission, The supply of groceries in the UK market investigation, *supra* note 15, at 9.7 et seqq. It is even deemed to be possible that larger buyers end up paying higher prices than their smaller rivals under certain conditions, OECD, Roundtable on Monopsony and Buyer Power, Note by the United States, 13 October 2008, DAF/COMP/WD (2008) 79, para. 27, with reference to Tasneem Chipty & Christopher M. Snyder, *The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry*, 81 REV. ECON & STAT. 326 (1999).

[40] Chen, *Defining Buyer Power*, *supra* note 24, at 242 et seq.

[41] Using the term monopsonist with respect to buyer power in the context of bilateral negotiations: OECD, Roundtable on Monopsony and Buyer Power, Note by the United States, 13 October 2008, DAF/COMP/WD (2008) 79, para. 4.

both types.[42] Monopsony is used exclusively for the classical single price monopsony, while bargaining power only means the second type of buyer power based on the model of bilateral negotiations.

Moreover, it must be considered that both bargaining power and monopsony power are phenomena that vary in their intensities just as it is the case with market power on the supply side. Consequently, it would be an unwise effort to try to define certain market share thresholds that justify in themselves an antitrust intervention.[43] Rather, an economic approach to buyer power must assess the effects that buyer power can have on upstream or downstream competition and ultimately the consumer. The finding of market dominance in the meaning of Article 102 TFEU or Article 2 EUMR should consequently depend on whether the particular degree of buyer power gives rise to competitive harm. The analysis of buyer power therefore must not be detached from the assessment of the effects of such power.

III. Exclusionary effect on a downstream market

1. Preliminary remarks

As to the effects that buyer power can have on competition, this article will first focus on the potential for excluding rivals in a downstream market. Bargaining power can give the opportunity to achieve competitive advantages over smaller rivals in the input market which can pay out as an increase in strength downstream through a foreclosure of the input market.[44] Increased buyer power can reduce the powerful purchaser's input costs so that in relation to him his rival's costs are higher. This can allow the purchaser to transfer buyer power to

[42] In line with the writings of Albert A. Foer it can therefore be said that the notion of buyer power "includes both monopsony power and its kissing cousin, bargaining power." Foer, *Mr. Magoo Visits Wal-Mart: Finding the Right Lens for Antitrust* 7 (Amer. Antitrust Inst., Working Paper No. 06-07, 2006). The EU Commission also uses the notion of buyer power to comprise both, monopolistic behaviour in the classical sense as well as bargaining power, in its horizontal merger guidelines, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, Official Journal C 031 , 05/02/2004 P. 5, para. 61.

[43] Rightly emphasizing the limited value of pure market share analysis ROGER D. BLAIR & JEFFREY L. HARRISON, MONOPSONY IN LAW AND ECONOMICS, 60 (2010).

[44] EU Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, Official Journal C 031 , 05/02/2004 P. 5, para. 61 ("Competition in the downstream markets could also be adversely affected if, in particular, the merged entity were likely to use its buyer power vis-à-vis its suppliers to foreclose its rivals") (footnote omitted).

subsequent supply markets. Such an effect can give rise to competitive concerns since it increases market power in the subsequent supply market and can therefore ultimately harm consumers through increased prices. Such an outcome reduces social welfare as well as end-consumer welfare so that there is a basic consensus in the antitrust orders of the European Union and the United States that the laws against abusive unilateral conduct/monopolisation conduct as well as merger control laws must be concerned with such implications of buyer power. The question is, however, under which circumstances a concentration on the demand side might have such an effect on the downstream market. Different constellations must be distinguished.

2. Rising rivals' costs

a) Waterbed and spiral-effect

If the market share of a particular player on the demand side is higher than that of its rivals, this can result in better prices and conditions in the upstream market.[45] Actually, many horizontal mergers aim at achieving improvements on the supply side through economies of scope and scale[46] rendering the merged entity more efficient than its competitors. Is such an effect anticompetitive? Does it impede downstream competition or is it only a matter of creating efficiencies that ultimately benefit consumers?

At the outset, it must be analyzed to what extent competitors may be affected by price discrimination on an upstream level. Modern antitrust economy has developed the idea that the price cuts requested by a strong buyer can result in corresponding price increases vis-à-vis its competitors in the upstream demand market. Such is called the "waterbed effect".[47] In its simplest form it means that a reduction of prices in one customer relationship can be compensated for by price increases by the same supplier in the relationship to another

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[45] UK Competition Commission, The supply of groceries in the UK market investigation, *supra* note 15, at 5.24.

[46] *See* UK Competition Commission, The supply of groceries in the UK market investigation, *supra* note, 15 at 5.23.

[47] Paul Dobson & Roman Inderst, *Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers?*, 28 EUR. COMPETITION L. REV. 393 (2007); Roman Inderst & Tommaso Valletti, Buyer Power and the "Waterbed Effect", 59 J. Indus. Econ. 1 (2011); Jeffrey Church, *Monopsony and Buyer Power, Background Note, OECD-Policy-Roundtable on Monopsony and Buyer Power*, 31 (2008); Ioannis Kokkoris & Howard Shelanski, *EU Merger Control* (2014), para. 11.37 et seqq.

customer.[48] It could possibly be argued that a supplier facing price reductions in relation to a particular strong purchaser can try to compensate for the losses by increasing prices with respect to smaller buyers of the relevant input. If such an effect actually took place, an increase in buyer power could directly rise rivals' costs. It is questionable, though, whether a waterbed effect of this simple form is a realistic scenario. If a supplier has the power to increase prices vis-à-vis smaller buyers, it remains unclear why such power should only be used after a dominant buyer has exacted a price reduction. Rather, the supplier should have tried to achieve the highest possible price from smaller purchasers independent of the outcome of the negotiations with the powerful buyer.[49] However, buyer power can result in upstream price discrimination due to a decrease in demand of smaller rivals. The larger the quantity that a buyer purchases from a certain input, the lower the price will often be. This is due to economies of scale on the supply side. Smaller rivals in the input market therefore face relatively higher costs. If the strong purchaser passes on such cost reduction to subsequent consumers, he can increase his output in the downstream market. Since his competitor's output reduces, the smaller rivals will have a lower demand in the supply market. That can further worsen their conditions compared to those offered to the mighty buyer namely due to the loss of economies of scale and through a decrease of bargaining power, the latter being based on the fact that they become less viable outside options for the supplier.[50] This type of waterbed effect can therefore be explained by a so called "spiral effect". The EU Commission has acknowledged in its merger control decision practice that such spiral effect can take place.[51] The increase of a firm's share on the demand side will increase its downward output due to lower input costs, which will in turn further boost its demand in the input market etc. So, how should the antitrust laws deal with it?

[48] The UK Competition Commission uses the following definition with respect to groceries: "A waterbed effect occurs when, as a result of large grocery retailers obtaining lower prices from their suppliers, these suppliers increase prices for other grocery retailers and wholesalers.", UK Competition Commission, The supply of groceries in the UK market investigation, *supra* note 15, at 5.19 footnote 1.

[49] Dobson & Inderst, *supra* note 47, at 393.

[50] See UK Competition Commission, The supply of groceries in the UK market investigation, *supra* note 15, at 5.27. The UK Competition Commission, however, did not find evidence for such a waterbed effect taking place in the grocery sector, UK Competition Commission, loc. cit. at 5.42.

[51] Commission, Case IV-N.1221, 3 February 1999, *REWE/Meinl*, para. 54 et seq., 115, where the Commission outlined that an increase in buyer power will strengthen the position on the downstream distribution market, while the latter further increases the buyer power on the upstream input market.

b) Implications for merger control

As far as merger control law is concerned, the relevant question is whether such a spiral effect can amount to a significant impediment to effective competition, namely by creating or strengthening a position that gives rise to unilateral price increases in the downstream market[52] and which would have to be considered a loss of social and end-consumer welfare.[53] If the merged entity already holds a strong position in the downstream market, an increase in buyer power can reinforce this. Therefore, the European Commission has for example in the *REWE/Meinl* merger held that the dominant position to which the operation would give rise in the procurement market for grocery goods would award the merged entity with a considerable competitive advantage in the downstream distribution market. The Commission only cleared the merger subject to remedies and inter alia relied on the argument that the operation would place the merged entity in a dominant position in the food-retail market in Austria.[54]

The theory of harm based on the aforementioned arguments relies on efficiencies. By reducing his own input cost the powerful buyer has a lever to reduce purchase quantity of his rivals and thereby increase their input costs in relation to him. This leads to the well-known question of whether efficiencies created through a merger can be invoked against the transaction. Such a view might ultimately lead to a so-called “efficiency offense”. It is not the purpose of this article to enter into the fundamental debate of whether and to what extent efficiencies must be considered in the field of merger control and whether an efficiency offense is a bad thing or not. For the present context it suffices to say that, in the first instance, upstream efficiencies in the form of lower input costs can have an effect on downstream markets and that, secondly, the quality of such effects is a matter of proximity and degree: Although a spiral effect can take place, it cannot be said that superior bargaining power in an input market always leads to foreclosure and downstream monopolisation. Rather, this depends on the competitive environment in both the upstream and the downstream market. A powerful buyer can face serious competition in a downstream market.[55] That can be the case e.g. where the geographic scope of the input market is narrower than that of the downstream

[52] Potential effects on the upstream input market will be dealt with later under IV.

[53] Bundeskartellamt, Buyer Power in Competition Law, *supra* note 5, p. 3.

[54] Commission, Case IV-N.1221, 3 February 1999, *REWE/Meinl*, para. 54, 70.

[55] Thomas Rosch, Former Comm’r, Fed. Trade Comm’n, Speech Before the 2006 Milton Handler Annual Antitrust Review: Monopsony and the Meaning of “Consumer Welfare” – A Closer Look at Weyerhaeuser, p..13, *available at* https://www.ftc.gov/public-statements/2006/12/monopsony-and-meaning-consumer-welfare-closer-look-weyerhaeuser.

market or where the powerful buyer uses a different technology relying on different inputs compared to his output market rivals.[56]

Nonetheless, it would be wrong to assume that absent such scenarios buyer power will generally translate into the equivalent degree of seller power in a downstream market. Such an effect depends on several other factors. At the outset, it should be taken into consideration whether the creation or strengthening of buyer power will only result in cost reductions for the powerful buyer due to economies of scale or whether it will actually rise rivals' costs due to the waterbed effect. If the latter is not the case, the merger will render the merged entity more efficient, yet without increasing rivals' costs if compared to the status quo ante. That could be the case where the major downstream competitors are (or could become) vertically integrated and therefore immune against a waterbed effect taking place upstream. In such a scenario, an increase in upstream concentration can even boost downstream competition. Even if smaller non-vertically integrated competitors will be forced out of the market, such an effect would not be anticompetitive, since downstream competition would prevail and the antitrust laws protect competition but not individual competitors. Moreover, it must be considered whether a concentration of or cooperation between currently smaller rivals could outbalance the prominent position of the merged entity in the input market on a mid- or long-term basis. What is more, the risk of downstream monopolisation depends on the barriers of entry. If they are high, downstream monopolisation will be more difficult to tackle in the future. The grocery sector, for example, has traditionally been[57] linked to significant entry barriers, e.g. in the form of investments in infrastructure, advertising sunk costs and so on. The risks of a long-lasting downstream monopolisation might therefore be higher in this sector than it could be, for example, where virtual market platforms are at stake – like on internet sales websites – so that new competitors can gain market shares more easily by way of innovation and better service quality. However, even in virtual markets can barriers to entry exist, namely where two sided markets and network externalities play a role.

The risk of downstream monopolisation does not only depend on barriers of entry but also on the extent to which the concentration in the demand market gives rise to cost reductions. In order to have a price chilling effect it is not necessary that the merger leads to the new entity

[56] OECD, Roundtable on Monopsony and Buyer Power, Note by the United States, 13 October 2008, DAF/COMP/WD (2008) 79, para. 5.

[57] Although even grocery markets have started to face some competition from online entrants in some locations.

becoming the strongest player in the demand market in terms of a dominant purchaser, as this was the case in *REWE/Meinl*. Rather, a competitive advantage for the downstream market can also occur in situations where the merged entity is not or does not become the market leader in the demand side. In this context, it must be borne in mind that a combination of two close substitutes can give leeway for unilateral conduct even if the merger does not create or strengthen the market leader. This is true for supply markets[58], but also concerns the demand side. If – from a supplier's perspective – two buyers form very close substitutes as distribution alternatives, their merger will leave the supply side with less viable outside options than a combination of distant substitutes. A merger between two grocery companies which each focus on upscale food products will create more pressure on input suppliers than a combination of an upscale retailer with a low-cost grocery company.

c) Implications for abuse of dominance cases

A position of strength in a demand market cannot only be achieved by merger but also come from organic growth. If buyer power exists, the question comes up whether price discrimination in the aforementioned sense can be objectionable under the laws against abuses of dominance or against monopolisation. Such a view was for example taken by the US government many years ago in the *A&P* case. *A&P* and its officers were held to have violated the antitrust laws "by oppressing competitors through the abuse of the defendants' mass buying and selling power"[59]. The government asserted that the lower input prices achieved by *A&P* had enabled it to charge lower retail prices in the downstream market so that competitors were driven out of business which had increased *A&P*'s market share. The *A&P* case, however, has received much criticism.[60] Most antitrust scholars have taken the view that the decision was wrong.[61] Critics of the decision argue that achieving lower input prices were to be considered an element of free competition and created efficiencies that ultimately benefitted consumers. Again, as in the context of merger control, the question comes up as to

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[58] *See* Stefan Thomas, *Close Competitors in Merger Review, in* JOURNAL OF EUROPEAN COMPETITION LAW & PRACTICE 391(2013).

[59] United States v. N.Y. Great Atl. & Pac. Tea Co., 67 F. Supp. 626 (E.D. Ill. 1946), *aff'd*, 173 F.2d 79 (7th Cir. 1949).

[60] *See* Morris Adelman, *The A&P Case: A Study in Applied Economic Theory*, 63 Q. J. ECON. 238, 247–57 (1949); Joel Dirlam & Alfred Kahn, *Antitrust Law and the Big Buyer: Another Look at the A&P Case*, 60 J. POL. ECON. 118 (1952).

[61] *See* Noll, *supra* note 31, at 622.

whether upstream price discrimination is beneficial or detrimental, and whether it should be protected or condemned under the antitrust laws.

If any request for price reductions by a dominant purchaser were per se abusive, price competition in the upstream market would be eliminated. That would hardly make sense. Therefore, price reductions vis-à-vis a large-scale purchaser must be possible as long as they mirror efficiencies created on the supply side. If a large purchaser with bargaining power buys huge quantities, this can create economies of scale for the seller which justify rebates that are not granted to smaller rivals of this purchaser. If this buyer increases its upstream demand due to an increase in downstream output, this might justify further price reductions. To that end, any price discrimination on an upstream level is objectively justified and cannot be considered abusive in the context of Article 102 TFEU. This reflects the common understanding in European antitrust law that the achievement of a position of dominance by organic growth as such is not illegal and that dominant companies may enter into fierce competition to smaller rivals as long as it remains competition on the merits by making use of efficiencies. As the former European Competition Commissioner Neelie Kroes put it[62]: "I like aggressive competition – including by dominant companies - and I don't care if it may hurt competitors – as long as it ultimately benefits consumers."

Does this mean, however, that any exercise of buyer power resulting in lower prices should be fine? If that were the case, a dominant purchaser with sufficient bargaining power could request price concessions that go beyond what is justified by cost.[63] Some authors are of the view that such "take it or leave it-offers" extracting greater price concessions than were justified by cost should not be banned.[64] They assert that such an exertion of buyer power does not create anticompetitive effects that lessen social- or consumer-welfare. Making a "take it or leave it-offer" implied that the dominant purchaser offered to buy the same or even larger quantity, only at a lower price.[65] Based on that assumption, the exertion of buyer power only made for a rent shifting from the supplier to the purchaser without any output reduction.

[62] Neelie Kroes, Member of the European Commission in charge of Competition Policy, *Preliminary Thoughts on Policy Review of Article 82*, Speech SPEECH/05/537, held at the Fordham Corporate Law Institute, New York, 23rd September 2005, *available at* http://europa.eu/rapid/press-release_SPEECH-05-537_en.htm.

[63] This relates to more than, for example, cost reductions created by economies of scale due to larger purchase volumes would justify.

[64] Noll, *supra* note 31, at 622 et seq.

[65] Grimes, *supra* note 1, at 567.

Buying the same quantity at a lower price only meant that the supplier's margins were reduced to the benefit of the direct purchaser, while the latter received the same for paying less. A mere rent shifting, however, should not be an issue of the antitrust laws, so that there were no reasons to object such a conduct according to this view.[66]

Yet, although the direct effect of such "take it or leave it offers" is only a rent shifting without any output reduction, it is questionable whether this means that the economic effects of such conduct are actually neutral with respect to social or end-consumer welfare. It might be used as an instrument to foreclose downstream markets. However, European and US antitrust law do not consider it illegal to have a position of strength and to use superior internal efficiencies in competition with smaller downstream rivals. Extracting price concessions that are justified by cost should therefore not be objectionable under Article 102 TFEU, as was outlined above. That must be true even if such cost advantages might bear the risk of downstream monopolisation. Such monopolisation will then be efficiency related and therefore unobjectionable under Article 102 TFEU. Will that mean, though, that the use of bargaining power is per se abusive where this borderline is crossed and the price reductions go beyond what is reflected by cost? That would be problematic, too. The use of bargaining power can be an important element of dynamic competition and is therefore not per se inefficient. Bargaining power reflects a reduction in viable outside options for a supplier. The reason for a decrease in outside options can be a reduction in quality or a lack of innovation by a particular supplier.[67] In such a case it must be objectively justified for a dominant purchaser to make use of superior bargaining power created by the conduct of the supplier and pay lower prices, since lower input quality will decrease his performance in the downstream distribution market. Moreover, an increase in bargaining power of the buyer can be a result of downstream investments of this buyer. Such could be the case where the purchaser has invested heavily in advertising in the downstream market so that he becomes a more attractive sales partner for the suppliers. In such a scenario it would not be convincing to consider any reduction in price abusive if it does not merely reflect economies of scale created upstream. Such an antitrust policy could eliminate incentives for downstream innovation. Any finding of abusively low prices therefore requires an in depth analysis of the reasons for the creation of the bargaining power that is exerted. Only if bargaining power is used to rise rival's cost without any

[66] Noll, *supra* note 31, at 622 et seq.

[67] See with reference to the ambiguous relationship between innovation and bargaining power IV.3.b).

justification of the kind mentioned above, this can be qualified as being part of a strategy of inefficient exclusion and therefore abusive.

3. Other types of exclusionary conduct

It goes without saying that a position of dominance in a demand market can give rise to other types of exclusionary abuses aimed at an increase of market power on downstream supply markets. That would be the case, for example, when a dominant purchaser imposed on its suppliers the contractual restriction not to do business with its downstream competitors. For example, in the *Toys'R'Us* case, the US Federal Trade Commission successfully challenged such agreements between *Toys'R'Us* and its suppliers.[68] Again, such a conduct of a dominant purchaser is not merely a reflection of superior efficiencies but an abuse of market power to exclude downstream rivals.

IV. Welfare losses absent downstream exclusion

1. Preliminary remarks

As we have just seen, because buyer power can strengthen the position in a subsequent distribution market, interventions under merger control laws and the prohibitions of abuses of dominance/monopolisation can be justified. However, it should also have become clear that such an effect depends on the competitive environment in the downstream market. As was outlined above[69], there can be situations where vigorous competition takes place in a downstream market, so that even a position of dominance in the upstream (demand) market will not have a negative effect on the former. It will often even have a positive effect on it since lower input costs can increase the competitive pressure on the distribution level. If that is the case, the question arises whether the mere position of strength in the demand market can result in welfare losses rendering antitrust interventions necessary, irrespective of any downstream effects. One might argue that the question of welfare losses plays a less important role in EU merger control than it does under the Clayton Act, since Article 2 EUMR has

[68] Toys "R" Us v. FTC, 221 F.3d 928 (7th Cir. 2000); *see also* Noll, *supra* note 31, at 623 (agreeing with this decision).

[69] See Section III.2.b of this article.

retained the old market dominance criterion as a legal indication for a significant impediment to effective competition. Thus, one could take the view that any creation or strengthening of demand-side dominance would suffice in itself for a merger to be blocked irrespective of whether a loss of welfare were at stake. Nonetheless, it would be incorrect to assume that welfare issues are irrelevant under EU merger control for that reason. Firstly, the Commission considers welfare implications even if dominance is created or strengthened. A significant impediment to effective competition may have to be denied if the merger creates efficiencies without doing harm to social or consumer welfare.[70] Secondly, under the law of Article 2 EUMR mergers can be blocked even if the transaction will significantly impede effective competition without creating or strengthening dominance. Until today the only measure for the finding of such an impediment to effective competition in the absence of market dominance is a finding of potential harm to social or consumer welfare.

Even with respect to the law against abuses of dominance, welfare issues are not irrelevant. There can be constellations in which it is unclear whether a particular conduct is exclusionary or exploitative in terms of Article 102 TFEU. In order to exemplify that, we might think of a powerful buyer that is exposed to fierce downstream competition. Price concessions extracted from the suppliers would be passed on to consumers. Can the exertion of buyer power nonetheless be considered abusive in terms of Article 102 TFEU? The answer to this question should also be guided by the analysis of welfare gains and losses created through such a conduct.

2. Allocative efficiency (deadweight loss)

Monopsony pricing in the single-price monopsony model as described in section II of this article can create a deadweight loss and therefore result in allocative inefficiency.[71] A lower price in the monopsonised market is achieved by reducing the demand so that the prices fall. Since in this constellation the output is reduced below the competitive level, the outcome is a deadweight loss, as the equilibrium for the monopsonised good is not achieved. As a net

[70] This concerns for example mergers which create or strengthen dominance but at the same time give rise to a downward pricing pressure as a result of the elimination of double mark ups (vertical merger) or a Cournot complements effect (conglomerate merger), see Michael Rosenthal & Stefan Thomas, *European Merger Control*, Chapter C paras. 496 et seq. (2010). Such efficiencies can also play a role as a defence where dominance on the demand side is at issue.

[71] Noll, *supra* note 31, at 594.

effect on society the monopsony creates a loss of efficiency and welfare, because wealth is redistributed to the buyers of the monopsonised good.

If it were the purpose of the antitrust laws to maximize welfare in terms of allocative efficiency, it could be argued that such an effect should be prohibited. Robert Bork is the most prominent antitrust writer claiming in his book "The Antitrust Paradox" from 1978 that allocative efficiency should be a goal of any antitrust policy. He wrote[72]: "...productive efficiency, the single most important factor contributing to that welfare must be given due weight along with allocative efficiency." In a single-price monopsony case, the creation or strengthening of monopsony power would therefore have to be considered anticompetitive irrespective of whether the transaction has a potential for an input foreclosure to the detriment of downstream rivals or not. The output reduction would result in a deadweight loss, creating a lessening of allocative efficiency which would justify an antitrust intervention in itself.

Some argue, however, that allocative efficiency – or more generally speaking: social or aggregate welfare – is not an appropriate standard for antitrust law application.[73] They put forward that the antitrust laws should rather be concerned with "consumer welfare". According to them, consumer harm should be interpreted as to relate only to the end user of the particular good. The notion of allocative efficiency/social welfare/total welfare is considered by them to be rather a theoretical matter yet impractical as a theory for real world application of antirust law.[74] End-Consumer welfare as the focus of the antitrust laws would hence be defined as the welfare of those who are confronted by actual or threatened exercises of market power in a subsequent output market.[75] According to this view, monopsony power should only be objectionable as far as it creates welfare losses to end consumers.

So, what is the relevant standard for the assessment of *buyer* power: Social welfare/allocative efficiency or consumer welfare? In fact it is questionable whether the distinction between

[72] ROBERT BORK, THE ANTITRUST PARADOX 405 (1978).

[73] Sceptical about social welfare as the benchmark for competition law application see Bundeskartellamt, Buyer Power in Competition Law, *supra* note 5, p. 13 ("One of the questions raised here is whether the term *consumer* means only the end consumer on the downstream market or whether ultimately the long-term well-being of all is at stake (*aggregated welfare*). Understood in the latter meaning the term *consumer welfare* attains such a level of abstraction that it can well be used as an overall concept but not as a standard for deciding specific cases.") (emphasis original); Rosch, *supra* note 55, at 2.

[74] Rosch, *supra* note 55, at 6.

[75] *Id.* at 7.

allocative efficiency and consumer welfare would actually be decisive for the antitrust assessment of the above mentioned single-price monopsony case.[76] Since the exercise of monopsony power would result in a reduction of output on a level less than the societal optimum, the conduct would create a capacity restriction also with respect to subsequent downstream markets. This can in turn have a price increasing effect and therefore ultimately – also – harm end consumers. Such reference to consumer harm created by output restrictions is exactly the approach of the EU-Commission in its Horizontal Merger Guidelines with respect to monopsony cases.[77]

However, buyer power cases are generally not that easy to evaluate. The reason is that markets very often do not work according to the single price monopsony model. The competitive process takes place in bilateral negotiations based on the each party's own bargaining power. As shown above, in such a scenario price reductions can be achieved by making "all or nothing offers" without any reduction of purchase quantity. Yet, if the purchase quantity is not reduced or if it is even increased, the price reduction creates no allocative inefficiency.[78] Against this background, the question comes up as to whether bargaining power on the buyer side and its use vis-à-vis suppliers is by definition without any detrimental effect to competition as long as it does not exclude downstream rivals. Might an increase in bargaining power even be considered procompetitive? For an answer it must be clarified whether a reduction of the revenues of the suppliers can in itself be considered a welfare loss that could justify an intervention.

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[76] Several authors argue generally, that a differentiation between consumer welfare and social welfare rarely has an effect on the practical application of the antitrust laws. *See* Thomas O. Barnett, *2004 Milton Handler Annual Antitrust Review: Substantial Lessoning of Competition – the Section 7 Standard*, 2005 COLUM. BUS. L. REV. 293, 297 (2005) ("[T]he consumer welfare and total welfare standards can diverge, although I think it is a rare case in practice.").

[77] EU Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, Official Journal C 031 , 05/02/2004 P. 5, para. 61 ("The merged firm may be in a position to obtain lower prices by reducing its purchase of inputs. This may, in turn, lead it also to lower its level of output in the final product market, and thus harm consumer welfare") (footnote omitted).

[78] Bundeskartellamt, Buyer Power in Competition Law, *supra* note 5, p. 3.

3. Effects on suppliers' revenues

a) Protection of suppliers' revenues as a goal of antitrust policy?

Buyer power reduces input prices, while monopoly power increases output prices. This symmetry could be seen as a reason to treat both phenomena in an analogous way. In supply markets, the creation of an upward pricing pressure is deemed to constitute a significant impediment to effective competition[79], and an exploitation of customers is considered illegal under Article 102 TFEU.[80] Hence, the same might be true for a "downward pricing pressure" in a demand market depriving suppliers of a portion of their revenues. In both contexts the exertion of market power creates losses for the other party. Such an equation of seller power and buyer power would make sense if it could be assumed that buyers and sellers are protected equally by the antitrust laws. If that were found to be true, the mere threat of a price cut to the detriment of sellers would suffice to block a merger and the mere extraction of a significantly lower price through a dominant buyer might be considered an exploitative abuse of dominance, without the need to demonstrate any foreclosure effect or any loss of social or consumer welfare. From this perspective, the antitrust laws would grant to the sellers a legitimate interest in prices which shall not be "artificially" low.

Until today, the highest courts in Europe and the United States[81] have left open as to whether the antitrust laws recognize and protect such an interest of suppliers in decent, fair and sufficiently high prices for their products. In *CICCE*[82] the ECJ dismissed an action concerning an allegedly abusive conduct but recognized that the extraction of excessively low prices could in principle amount to an abuse. The Court made a few incidental observations in this respect indicating that the "economic value" of the particular good might be relevant to determine whether the purchase price was excessively low. The ECJ, though, did not provide with a comprehensive theory on the rationale behind such a potential abuse of buyer power. In

[79] *See* Thomas, *supra* note 58, at 391 (with respect to the EUMR); U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 6.1 (2010) (with respect to the Clayton Act).

[80] ECJ of 14 Feb. 1978 Case 27/76 *United Brands/Chiquita* [1978] ECR 207 para. 248/257; Commission, Case COMP/A.36.570/D3, 23 July 2004, *Sundbusserne/Port of Helsingborg*, para. 84.

[81] The same is true for Germany, Here, the Bundesgerichtshof has explicitly left open whether the law against abuses of dominance has the purpose to protect suppliers in their own right if it is invoked against a dominant buyer, BGH of 24 September 2002, WuW/E DE-R 984, 990 *Konditionenanpassung*.

[82] ECJ of 28 March 1985 Case 298/83 *CICCE v. Commission* [1985] ECR 1105. *See also* Robert O'Donoghue Jorge Padilla, The Law and Economics of Art. 102 TFEU, para. 16.2.2. (2013).

the *Weyerhaeuser* case the US Supreme Court had to decide on the illegality of a so called predatory buying scheme.[83] The Supreme Court rejected the claim.[84] While the Court judged that predatory buying can under certain circumstances affect competition on the input market, it was not explicitly acknowledged that the suppliers could claim in their own right to have an interest in sufficiently high prices under the antitrust laws.[85]

However, in its complaint filed in the *George's Foods/Tyson Foods* merger the US Justice Department appeared to be open minded towards such a view. The transaction concerned the merger of two large scale chicken processing companies. The US Department of Justice ("DOJ") was afraid that the combination would eliminate substantial competition between merging parties for the procurement of chicken grower services in the Shenandoah Valley area.[86] For its theory of harm the government relied on the argument that the merger would result in lower input prices and therefore deprive the suppliers of a portion of their revenues. The DOJ did not, however, argue further that this outcome would do harm to social or consumer welfare. In its complaint, the government merely stated that the transaction would "likely result in reduced competition, with likely effects including depressed prices paid and less attractive contract terms offered to farmers."[87] Moreover, it was argued in the complaint that in the past farmers had benefitted from competition between the merging parties as purchasers.[88] Since the transaction would reduce outside options for the farmers, they could not switch or threaten to switch to another buyer "when any of the terms of his or her contract deteriorate" so that "he or she would likely chose to accept inferior terms rather than to have no contract at all."[89] The DOJ therefore found the transaction likely to "force growers to

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[83] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007).

[84] Details below at IV.4.

[85] *See* John D. Shively, *When Does Buyer Power Become Monopsony Pricing?*, ANTITRUST, Fall 2012, at 87, 88; Roger Blair & John Lopatka, *Predatory Buying and the Antitrust Laws*, 2008-2 UTAH L. REV. 415, 445; for a more detailed analysis see at IV.4. The same is true for Germany. Here, the Bundesgerichtshof has explicitly left open whether the law against abuses of dominance has the purpose to protect suppliers in their own right if it is invoked against a dominant buyer, BGH of 24 September 2002, KVR 8/01, WuW/E DE-R 984, 990 *Konditionenanpassung*.

[86] Press Release, U.S. Dep't of Justice, Justice Department Files Antitrust Lawsuit Challenging George's Inc.'s Acquisition of Tyson Foods Inc.'s Harrisonburg, Va., Poultry Processing Complex (May 10, 2011), *available at* http://www.justice.gov/opa/pr/justice-department-files-antitrust-lawsuit-challenging-george-s-inc-s-acquisition-tyson-foods.

[87] Complaint at 9, U.S. v. George's Foods, LLC, et al., No. 5:11-cv-00043-GEC (W.D. Va. May 10, 2011).

[88] *Id.* at 10.

[89] *Id.* at 11-12.

accept lower prices and less favourable contractual terms for grower services."[90] The government argued that the disadvantages suffered by the farmers as a result of the merger should be sufficient on its own to justify blocking the transaction.[91] The case was finally settled, but the approach followed by the DOJ in the complaint implicitly considered "supplier harm" as a justification in itself for an antitrust intervention against the accumulation of buyer power. This view might find further support in the US Horizontal Merger Guidelines where the agencies state that they will analyze whether "the merger of competing buyers is likely to lessen competition in a manner harmful to *sellers*."[92] Other statements made by DOJ lawyers have reiterated this line of argumentation, namely by Sharis Pozen who was acting head of the DOJ's antitrust division.[93] Also, the official report from an industry workshop about agricultural markets issued by the DOJ in 2012[94] indicated that the DOJ might consider the mere power to extract price reductions from suppliers as a sufficient theory of harm in buyer power cases, since the report concentrates on negative effects on suppliers and fails to make any mention of consumer welfare issues.[95] In a similar way, Justice Breyer of the US Supreme Court remarked in the oral hearing concerning the *Weyerhaeuser* antitrust litigation that the antitrust laws: "are just as concerned about a group of small farmers or a group of small growers or a group of small fishermen faced with a monopsony buyer as they are with a group of consumers having to fight off a monopoly seller." [96] He added "I mean that's pretty well established, isn't it?" Also, some statements of the EU-Commission potentially underpin this understanding. The EU-Commission issued a decision in *Sovion/Südfleisch* regarding the merger between two large slaughterhouses. As to the potential competitive effects of an increase in buyer power, the Commission analyzed whether the combination would cause

[90] *Id.*

[91] *Id.*

[92] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 12 (2010) (emphasis added).

[93] Making such a statement in her individual capacity („Specifically, the antitrust laws proscribe mergers that reduce buy-side competition, agreements among buyers that unreasonably restrain competition, and exclusionary conduct enabling the acquisition or maintenance of monopsony power (*without being limited by a requirement of showing downstream effects*).)" Sharis A. Pozen, *Agriculture and Antitrust: Dispatches and Learning from the Workshops on Competition in Agriculture*, ANTITRUST, Spring 2012, at 8, 9. For a detailed analysis, see Shively, *supra* note 85, at 90.

[94] U.S. DEP'T OF JUSTICE, COMPETITION AND AGRICULTURE: VOICES FROM THE WORKSHOPS ON AGRICULTURE AND ANTITRUST ENFORCEMENT IN OUR 21ST CENTURY ECONOMY AND THOUGHTS ON THE WAY FORWARD (May 2012), *available at* http://www.justice.gov/atr/public/reports/283291.pdf.

[95] *See* Shively, *supra* note 85, at 90.

[96] Transcript of Oral Argument at *29, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069 (2007) (No. 05-381), 2006 WL 3422209.

farmers to "suffer from increased buyer power with resulting depressed pricing".[97] Even though the Commission did not find reasons for such a concern in the case at hand, this statement can be read as to be in line with the approach followed by the DOJ in the *George's Foods/Tyson Foods* merger.

Some authors point out that this approach might further be corroborated by an analogy to the cartel prohibition.[98] This view was taken by the counsel representing the plaintiffs in the *Weyerhaueser* antitrust litigation in 2007.[99] Section 1 of the Sherman Act and Article 101 TFEU prohibit any agreement between undertakings irrespective of whether this concerns the seller or the buyer side. An agreement between several purchasers on lower input prices could therefore be illegal.[100] This might lead to the assumption that any downward modification of prices for reasons other than a reduction of costs should be condemned under the antitrust laws irrespective of potential welfare losses.

However, it is questionable whether this analogy to the cartel prohibition is convincing. Section 1 of the Sherman Act and Art. 101 TFEU prohibit explicit collusion because such is by law considered to be a threat to the competitive process and economic efficiency so that is shall be ipso iure illegal as a general rule.[101] A merger or unilateral conduct, on the other hand, requires a different analysis. A merger creates a new entity, so that competition between the merging parties will be eliminated by definition. Merger analysis therefore cannot rely on the mere fact that competition is eliminated between the merging parties. It is necessary to analyse the effects that this elimination will have on competition. Moreover, as regards unilateral conduct, there is no explicit coordination taking place that can be qualified as a loss of efficiency. It would therefore be wrong to assume that unilateral conduct by a dominant undertaking will always be abusive if it were illegal under the cartel prohibition to agree on such a conduct between independent competitors. Hence, an analogy to the cartel prohibitions

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[97] Commission, Case COMP/M.3968, 21 December 2005, *Sovion/Südfleisch*, para. 44 et seq.

[98] Presenting this argument without committing to it, Shively, *supra* note 85, at 90.

[99] Transcript of Oral Argument at *8, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069 (2007) (No. 05-381), 2006 WL 3422209, citing Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co., 334 U.S. 219 (1948). *See* Blair & Lopatka, *supra* note 85, at 444 (analysis of the statements from the oral hearing).

[100] The Supreme Court has decided that agreements limiting prices between competitors on the buyer can come under Section 1 of the Sherman Act in *Mandeville Island Farms* already in 1948. Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co., 334 U.S. 219 (1948).

[101] That is without prejudice to efficiencies created through a cooperation, such as a joint purchasing agreement, that could justify an exemption under Article 101 § 3 TFEU.

of Section 1 of the Sherman Act and Art. 101 TFEU is hardly suitable to answer the question of whether it is the purpose of the antitrust laws to prohibit such a thing as "supplier harm".

Moreover, the antitrust laws lack any standard for the definition of "supplier harm". It is unclear how the price of a certain good can be determined to be appropriate, just, fair, or sufficiently high in order not to "harm" the supplier.[102] Under perfect competition on the supply side the price would equal marginal costs. Generally, a purchaser would not have an interest in extracting prices below marginal costs on a long-term basis since that would mean that no supplier could survive. An adequate or appropriate price would therefore have to be above marginal costs, but it would be impossible to define the extent to which the price must exceed this threshold. This problem is well known from the discussion of the iustum pretium-idea. From an economic perspective there is no such thing as a "just" or adequate/appropriate price that can be defined on its own terms. The same is true for the notion of "economic value" that was referred to by the ECJ in *CICCE* as a potentially relevant factor for determining an excessively low price under Art. 102 TFEU.[103] The economic value is not a fixed data but depends on the respective outside options available to the negotiating parties in the particular moment.

While the prevention of consumer harm can legitimately be considered as at least one of the goals of antitrust law, it would not be convincing to say the same about "supplier harm". Awarding to each supplier an individual right to claim for prices above marginal costs would be antithetical to competition as an institution.[104] The process of competition is a model of selection between substitutes.[105] This assumption implies that customers are free to pay less than the seller of a certain good wants, and that if the parties do not agree upon a certain price, the customer has the freedom to refuse to purchase the good at all. Competition as a process requires the possibility that companies are excluded from the market and – ultimately – that markets may disappear as a whole if customers have found better substitutes for a particular

[102] Rosch, *supra* note 55, at 14.

[103] ECJ of 28 March 1985 Case 298/83 *CICCE v. Commission* [1985] ECR 1105, para 22.

[104] O'Donoghue & Padilla, *supra* note 82, para. 16.2.1 point out that buyer power cannot be considered illegal as long as the reduction of prices does not involve a reduction in output so that allocative efficiency would be negatively affected.

[105] According to the traditional ordo-liberal thinking that still plays a prominent role in the German (and to some extent: European) antitrust application, that is actually the essence of the aims of antitrust law: the protection of the freedom to chose on the relevant market, see Bundeskartellamt, Buyer Power in Competition Law, *supra* note 5, p. 12.

good. If that were different, there would still be horse-drawn coaches instead of taxis (or Uber cars) waiting at the railway stations. Hence, the antitrust laws should not be interpreted as protecting suppliers' revenues as such against powerful buyers. Where no efficiency losses are created, the mere rent shifting should not be considered anticompetitive in itself.

In fact, even the seemingly opposite view taken by the DOJ in the *George's Foods/Tyson* merger might not express the official stance of US antitrust law towards the problem. Because the DOJ and the parties agreed to settle the case, it is unclear if the courts would have fully endorsed the position taken by the DOJ. Moreover, the Federal Trade Commission still undertakes a full-fledged welfare analysis in buyer power cases. This could recently be seen in the *Express Scripts/Medco* merger.[106] The transaction was about the acquisition of *Medco* by *Express Scripts*, two of the nation's three biggest pharmacy benefit managers (PBMs). A pharmacy benefit manager buys prescription drugs from retail pharmacies and sells services to health care benefit plants, employers and unions. With respect to the concentration of buyer power in this case, the FTC analysed the combined market share in the upstream (buyer) market as an initial step, and determined that the merged entity had a share of 29% of the retail pharmacies' sales. Although such a share is not per se insignificant, the FTC found no evidence for the likelihood of a reduction in output.[107] Hence, losses of allocative efficiency were unlikely. Moreover, the FTC had evidence that competition in downstream markets would force the merged entity to pass-on any cost savings achieved in the upstream market from the pharmacies on to consumers. The FTC therefore decided not to challenge the merger. The FTC's reasoning is rightly held to be an example for an effects-based (or rule of reason) analysis of buyer power.[108] There are also statements made by the EU-Commission that go into the same direction. In a Staff Working Document of 28 October 2009 on Competition in the Food Supply Chain the Commission made clear that European antitrust law "is not concerned with particular outcomes of contractual negotiations between parties unless such terms would have negative effects on the competitive process and ultimately reduce consumer welfare".[109]

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[106] Statement of the Federal Trade Commission Concerning the Proposed Acquisition of Medco Health Solutions by Express Scripts, Inc., FTC File No. 111-0210 (Apr. 2, 2012), *available at* http://www.ftc.gov/speeches/rosch/120402expressmedcostatement.pdf.

[107] *See id*. at 7-8.

[108] Shively, *supra* note 85, at 90.

[109] Commission Staff Working Document 28 October 2009, SEC(2009) 1449 Competition in the Food Supply Chain, para. 4.1 ("Abuses of buyer power are contrary to EC competition law where there is a proven detriment to downstream consumers. … EC antitrust law is not concerned with particular outcomes of contractual

b) Effects on dynamic efficiency

aa) Dynamic efficiency and Innovation

However, the fact that there is no such thing as "supplier welfare" under the antitrust laws should not mislead to the conclusion that the extraction of lower prices from suppliers through strong buyers were per se efficient, or at least neutral, with respect to social or consumer welfare. It was outlined above that price reductions initiated by a dominant purchaser via bilateral negotiations will generally not be detrimental to *allocative* efficiency or consumer welfare as long as they do not increase downstream monopolisation. Yet, such price cuts could lessen social welfare by reducing *dynamic* efficiency, namely result in a reduction in quality, in consumer choice, and in investment incentives for upstream suppliers.[110]

bb) Reduction of incentives for innovation

Price cuts reduce the sellers' income. While the antitrust laws do not protect any seller against losses in income, they have the purpose to protect competition as an institution by ensuring that dynamic efficiency is not hampered. A reduction in income might reduce dynamic efficiency and thereby social welfare: The reduction of income on the supply side can lessen the resources that are available for research and development. Very often, research and development are an important form of fixed cost leading to product differentiation in the input supply market. Consequently, buyer power might reduce product variety and technological progress.[111] That is a loss of consumer welfare. The EU Commission rightly states that consumer welfare "encompasses prices, diversity and quality."[112]

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negotiations between parties unless such terms would have negative effects on the competitive process and ultimately reduce consumer welfare.").

[110] Grimes, *supra* note 1, at 569 (furthermore referring to an inefficient externalisation of a firm's costs to society).

[111] Noll, *supra* note 31, at 612; OFT, The Welfare Consequences of the Exercise of Buyer Power, September 1998, Research Paper No. 16, OFT 239, available on the webpage of the British OFT, para. 4.15.

[112] Commission Staff Working Document 28 October 2009, SEC(2009) 1449. Competition in the Food Supply Chain, para. 4.1.

Price cuts initiated by a powerful buyer may reduce the incentives to engage in innovation.[113] The extraction of a price reduction implies that the current price is above marginal costs. Some even argue that the exertion of bargaining power presupposes that the supplier's upstream pricing is above the competitive level.[114] Otherwise there would be no rent that could be shifted to the powerful buyer as a result of the exertion of buyer power. The reason for such a rent being enjoyed by a supplier, though, can be successful innovation. Actually, the opportunity for a supplier to charge prices above the competitive level for at least a certain period is often a prerequisite for this undertaking to engage in innovation at all. Therefore, the anticipation of supracompetitive prices is an important element of dynamic competition. Monopolistic prices are a spur to innovation, as the US Supreme Court has explicitly stated in *Verizon v. Law Offices of Curtis V. Trinko*[115] with respect to Sec. 2 Sherman Act:

> "The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices–at least for a short period–is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct*."

That is the reason why patent law grants to the innovator exclusivity and therefore the possibility of monopolistic rents for a certain period of time. This opportunity to harvest the fruits of innovation can be restricted if the supplier faces the risk that the additional rents of innovation will be shifted to a powerful buyer.

The reduction of incentives for innovation can be amplified by a hold-up problem. If the supplier has made efforts in innovation he might be in a weaker position since the investments are sunk costs. A powerful buyer could exploit such a previous financial commitment for an extraction of further price concessions. Suppliers might anticipate post-contractual opportunistic behaviour of powerful buyers and abstain from investments in innovation. In this respect, buyer power might not only reduce incentives for innovation, it also can create incentives not to innovate.

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[113] Zhiqi Chen, *Monopoly and Product Diversity: The Role of Retailer Countervailing Power*, (Carleton Univ., Carleton Economic Papers 04-19, 2004).

[114] Where monopolisitic or oligopolistic power exists on the supply side, the normal selling price will be above the competitive price. Chen, *Buyer Power*, *supra* note 39, at 20.

[115] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

These concerns about negative effects of buyer power on upstream innovation are corroborated by several empirical studies. The UK Competition Commission has raised such concerns in its grocery sector enquiry of 2008. The Competition Commission found that buyer power could hamper supplier innovation in the future.[116] Further empirical studies have found interrelations between an increase in buyer power and a reduction of innovation on the supply side.[117,118] The EU Commission emphasized in its Staff Working Document on Competition in the Food Supply Chain that "if the exercise of buyer power is found to lead to a lower profitability for suppliers (e.g. suppliers' sale price being below their costs), this may, in specific circumstances, induce suppliers to invest less in new products and may lead to a loss in product diversity and quality for end consumers."[119] The Commission states that this aspect "is also taken into account by EC competition policy when assessing the impact of the exercise of buyer power on consumers".

More recent work has shown that the negative effects of buyer power on the incentives for innovation can be even greater if powerful buyers, such as large retailers, enter into direct downstream competition with manufacturers in certain product segments.[120] The authors observe that large food retailers have increasingly taken over more of the functions in the vertical chain, such as distribution and marketing. Moreover, these retailers have stepped into

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[116] UK Competition Commission, The supply of groceries in the UK, *supra* note 15, at 10.5 ("However, we found that when, in the hope of gaining competitive advantage, grocery retailers transfer excessive risks or unexpected costs to their suppliers, this is likely to lessen suppliers' incentives to invest in new capacity, products and production processes. If unchecked, we conclude that this will ultimately have a detrimental effect on consumers, by leading to lower-quality goods, less choice of goods, or less product innovation.").

[117] *See, inter alia*, Stephen Farber, *Buyer Market Structure and R&D Effort: A Simultaneous Equations Model*, 63-3 REV. ECON. & STAT. 336–345 (1981); Jürgen Peters, *Buyer Market Power and Innovative Activities*, REV. INDUS. ORG., February 2000, at 13-38 (where the author comes to the conclusion that a highly concentrated buyer industry coincides with a lower level of innovation on the supply side); Christoph Weiss & Antje Wittkopp, *Buyer Power and Innovation of Quality Products: Empirical Evidence from the German Food Sector* (Dep't of Food Econ. & Consumption Studies, Univ. of Kiel, Working Paper FE 0307 & FE 0303, 2003) (where the authors find out that suppliers facing significant pricing pressure from monopsonistic buyers tend to release less new products).

[118] Some authors make further distinctions. While they agree from an empirical perspective that buyer power generally negatively affects the intensity of research and development investments, they argue that a countervailing effect appears for suppliers facing powerful buyers if the latter operate under strong price competition, Christian Köhler & Christian Rammer, Buyer Power and Suppliers' Incentives to Innovate, ZEW, Discussion Paper No. 12-058, p. 16. Such a countervailing effect is not found to exist, however, where powerful buyers are faced with intense technology competition on the downstream market, Köhler & Rammer loc. cit.

[119] Commission Staff Working Document 28 October 2009, SEC(2009) 1449. Competition in the Food Supply Chain, para. 4.1.

[120] Roman Inderst & Zlata Jakubovic & Dragan Jovanovic, Buyer Power and Functional Competition for Innovation, Munich Personal RePEc Archive, MPRA, January 2015, MPRA Paper No.61214, posted 13 January 2015 (http://mpra.ub.uni-muenchen.de/61214/1/MPRA_paper_61214.pdf).

direct competition by promoting so-called private labels that are offered as substitutes to the branded goods in supermarkets. The retailers have meanwhile even stepped into the upmarket segment with these products. In such a competitive environment the retailers become major innovators in the respective product segments. Under these preconditions their buyer power can further decrease incentives for innovations in the supply market, because it aggravates the above mentioned hold-up problem. If the purchaser starts with his own research and development activities ultimately leading to a direct competition with his supplier, there comes up a risk of copying and imitation. The suppliers can be afraid that their efforts will be exploited. The risk of such a hold-up effect and its intensity will depend on the size of the retailer in the subsequent downstream market. The larger the size is, the greater the incentive to undertake own private label production, because such activities will only be profitable if a sufficiently large number of units of these products can be distributed.[121]

However, such negative effects on upstream innovation are not a per se consequence of buyer power. Rather, some authors have highlighted recently that buyer power can also create incentives to engage in upstream innovation.[122] It is argued that the suppliers faced less risks and uncertainty over the future demand where the buyer side is highly concentrated.[123] The risk of free rider behaviour is deemed to be lower with large buyers than with smaller ones.[124] This could give an incentive for innovation. Yet, this argument does not necessarily rule out any negative effect on innovation linked with buyer power. Firstly, the existence of a strong buyer will not always imply greater certainty for the supplier on the demand side. If the buyer has attractive outside options, the uncertainty might be significant. Secondly, the superior bargaining power of a strong buyer will nonetheless often result in a rent shifting to the detriment of the supplier, so that the return on innovation investments is negatively affected.

There is another argument that can be put forward for an innovation enhancing effect of buyer power.[125] It is based on the model of individual bilateral negotiations and refers to the

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[121] Inderst & Jakubovic & Jovanovic, *supra* note 120, p.2.

[122] See Section III.2.c of this article.

[123] Steven Klepper, *Entry, Exit, Growth and Innovation over the Product Life Cycle*, 86-3 AM. ECON. REV. 562-83; *see also* Peters, *supra* note 117, at 13-38.

[124] Bundeskartellamt, Buyer Power in Competition Law, *supra* note 5, p. 4.

[125] Roman Inderst & Christian Wey, *Buyer Power and Supplier Incentives*, European Economic Review 51 (3), 647 – 667 (2007); Roman Inderst & Christian Wey, *Countervailing Power and Dynamic Efficiency*, Journal of the European Economic Association 9 (4), 702 – 720 (2011).

importance of viable outside options.[126] Innovation on the supply side is assumed to render higher revenues in the future if compared to the hypothetical scenario without innovation. Successful innovation is deemed to make a contract with the particularly innovative supplier more attractive for the powerful buyer and at the same time render the outside options available to him less attractive. In a model of bilateral negotiations this outcome can increase the bargaining power of the supplier, which will allow him to gain a larger share of the joint profit. Yet, although this theory is intuitively plausible, this does not necessarily mean that such an effect will always offset any detriments that buyer power can have on the incentives to innovate. Even if successful innovation might increase bargaining power of the supplier vis-à-vis its powerful purchaser, the competitive scenario still implies the possibility that parts of the additional rents achieved through innovation might have to be transferred to the buyer. The potential return on investments in research and development can therefore still be lower than it were in a competitive scenario without buyer power. Moreover, it must be considered that the seller might have other business activities concerning supply markets where dominant purchasers are absent. Any supplier will therefore compare potential revenues achievable through increased research and development efforts in those markets with the opportunities existing in the market where a powerful buyer is present. It is thus still possible, that superior bargaining power on the buyer side will gradually reduce the incentives for innovation. However, it is also possible that innovation increases bargaining power of the supplier to such an extent, that a rent shifting to the benefit of the purchaser becomes unlikely or even takes place in the opposite direction. That could happen where the supplier creates a „must have" innovative product that he could sell through multiple channels. The effects of buyer power on incentives to innovate therefore require a case by case analysis.

cc) Reduction of product variety

In addition to having negative effects on resources and incentives for research and development, buyer power can reduce product variety.[127] This can have different reasons. The EU-Commission has emphasised that buyer power can give a trader considerable influence over the choice of products which come to market and which are ultimately obtainable by

[126] See Section III.2.c of this article.

[127] OECD (1998) Buyer Power of Large Scale Multiproduct Retailers. Background Paper by the Secretariat for Roundtable on Buying Power, *available at* http://www.oecd.org/competition/abuse/2379299.pdf; Roman Inderst & Greg Shaffer, *Retail Mergers, Buyer Power and Product Variety*, ECON. J., January 2007, 45–67; Chen, *Monopoly and Product Diversity, supra* note 113.

consumers.[128] Multi-brand retailers often control access to the retail market as "gatekeepers".[129] The producer of a relevant input will seek to meet the special requirements of the particular strong buyer for him to have a chance on downstream product markets.

What is more, the exercise of buyer power can sustain a process of concentration on the supply side which ultimately can reduce product variety as well.[130] The more that rents are shifted from the supplier to the powerful purchaser, the greater the likelihood that suppliers will rather exit the market than reinvest. The remaining players on the supply side will finally gain market power and might ultimately form a monopoly vis-à-vis a powerful purchaser. The outcome would be a bilateral monopoly,[131] which is not a desirable competitive structure. Although the supplier has now become an unavoidable training partner for the buyer so that the latter has an interest in keeping the former in business[132] and might not extract further price cuts, the monopolisation of the supply side reduces product variety and thereby negatively affects consumer welfare.[133]

Besides these negative impacts on innovation, buyer power can also reduce further incentives for product differentiation. Large scale buyers might create efficiencies if they switch to a single sourcing strategy stocking goods from only one supplier or at least very few suppliers.[134] The suppliers will seek to meet the special product requirements of the powerful buyer so that they will be considered a viable outside option for the latter. Such a repositioning on the supply side can decrease product differentiation[135] in the long run.[136]

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[128] Commission of 3 February 1999, Case IV-N.1221, *REWE/Meinl*, para. 74.

[129] See Commission of 20 November 1996 Case No. IV/M.784, *Kesko/Tuko*, para. 150 ("As an indication of the magnitude of the buying power of Kesko and Tuko, the majority of the suppliers (including several major multinationals) who replied to the Commission's investigation indicated that they depend on Kesko and Tuko for approximately 50-75% of their total sales in Finland. The dependency of different suppliers will differ according to the nature and size of their business and consumer perception regarding their products. Thus, although some very large size producers of highly regarded brand products may have some countervailing power vis-à-vis Kesko, it will be of vital importance for most small and medium sized producers to maintain sales through Kesko at the present level."); Grimes, *supra* note 1, at 579; John Curtin, Daniel Goldberg & Daniel Savrin, *The EC's Rejection of the Kesko/Tuko Merger: Leading the Way to the Application of a "Gatekeeper" Analysis of Retailer Market Power Under U.S. Antitrust Laws*, 40 B.C. L. REV. 537 (1999).

[130] Noll, *supra* note 31, at 611.

[131] *Id.*.

[132] See with reference to this issue Commission of 25 November 1998 Case IV/M.1225, *Enso/Stora*, para. 64.

[133] *See* Noll, *supra* note 31, at 611.

[134] Köhler & Rammer, *supra* note 118, p. 3.

[135] In *WPP/Grey*, a merger between two advertising and marketing services companies, some market participants had expressed some concerns that the transaction could lead to lower quality in media buying, whereby media

c) An effects-based analysis of a reduction in dynamic efficiency

If one concludes that buyer power may harm dynamic efficiency by reducing incentives for innovation and product variety, this allows one to draw the following conclusions: Buyer power can be harmful even if superior bargaining power will not result in an exclusion of downstream rivals. This has relevance in cases where fierce downstream competition is at stake and where the downstream rivals might not be affected by upstream price discrimination since they have sources of supply in other geographical areas than the concentrated input demand market. Even in such a scenario, buyer power can harm social welfare by reducing dynamic efficiency. If this effect results in lower product quality or a decline in product variety, consumer welfare is negatively affected, too.

Thus, for a theory of harm in a merger context, it is not necessary to show that the increase in buyer power has lead to single-firm dominance (on the demand side). Rather, in a concentrated demand market each further increase of buyer power has to be controlled for the creation of such detrimental effects.

Moreover, the extraction of price reductions by a dominant firm can be abusive in terms of Article 102 Sentence 1 lit. a TFEU where such negative effects on dynamic efficiency and ultimately consumer welfare are demonstrated. This finding is a contradiction to the thesis that the payment of too low a price for an input by a dominant purchaser should only be considered abusive under Article 102 TFEU where it coincides with a reduction in demand/output.[137] However, since there is no such thing as "supplier harm" it cannot suffice for a breach of article 102 TFEU that buyer power is exerted as such. Rather, where downstream exclusion is not an issue, a reduction of suppliers' revenues should only be

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buyers would not chose the media which are optimal for the advertiser but those which offer the highest rebates. However, the Commission found no evidence that these potential quality problems would be created or increased as a result of the proposed transaction. Furthermore, the Commission was of the view that due to the increasing importance of media auditors, which many advertisers use to evaluate the media buying services provided by their agency, the quality of media buying could be controlled; Commission, Case COMP/M.3579, 24 January 2005, para. 70.

[136] *See* Inderst & Shaffer, *supra* note 127; *see also* Christodoulos Stefanadis, *Downstream Vertical Foreclosure and Upstream Innovation*, 45-4 J. INDUS. ECON. 445-56 (1997).

[137] O'Donoghue & Padilla, *supra* note 82, para. 16.2.1 ("Thus, a key component of the anticompetitive exercise of buyer power to pay too low a price for inputs is that it should also involve a *reduction in output*.") (emphasis original).

considered relevant if it can be demonstrated that this harms dynamic efficiency. Moreover, the above analysis has shown that the finding of harm to dynamic efficiency does not follow a form based (or per se) approach. Rather, several factors have to be accounted for so that all potentially relevant negative and also positive effects that buyer power might have on upstream innovation and product variety can be considered. This makes clear that, at least with respect to the analysis of buyer power, only an effects based (or rule of reason) approach will be appropriate in the fields of merger control as well as in abuse of dominance cases.

4. Predatory buying

The observations that have been made with respect to exclusion and harm to social and consumer welfare finally allow to set the focus on a special type of exclusionary abuse/monopolization which is hard to put in a certain category. That is the so-called "predatory buying" theory of harm. It is the counterpart to predatory pricing, only that it takes place in a buyer market. Predatory buying means that a strong purchaser of a certain good pays prices higher than they would be under normal demand competition in order to tie the suppliers to him. This shall exclude its rivals in the demand market from access to this good. In the first phase of such a predatory buying scheme the purchaser incurs losses through this overpayment. These losses have to be recouped in a second phase when the exclusion of rivals has resulted in a position of strength in the demand market. In this second recoupment phase the dominant purchaser will charge supracompetitively low prices from the suppliers. The cost reductions achieved by the purchaser can subsequently exclude rivals in the downstream market.

Predatory buying has received much attention thanks to the prominent *Weyerhaeuser*[138] US antitrust litigation in 2007. In this case, a sawmill was accused under Section 2 of the Sherman Act of bidding up the prices for sawlogs. The plaintiff was of the view that the sawmill sought to monopolize the input market in order to force the downstream rivals out of the market for finished hardwood lumber. The US Supreme Court ultimately rejected the claim. The Court held that in order to establish a predatory buying case the plaintiff had to prove not only that the defendant caused the price to rise, but also that the defendant was likely to recoup the costs incurred in such a scheme during a subsequent recoupment phase. In fact, the Supreme Court applied a "buy-side version" of the monopoly predatory pricing test

[138] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007).

as established in the *Brooke Group* case[139]. The antitrust concern was thus based on the danger that the dominant purchaser would recoup losses made in Phase 1 by underpricing the logs it purchased during Phase 2.

No similar predatory buying case has been reported under Article 102 TFEU yet. Nonetheless, there is no reason to assume that such a set of facts could not be considered an abuse under EU-law where it is committed by a dominant purchaser. Article 102 TFEU prohibits in a similar way as Section 2 of the Sherman Act any conduct of a dominant firm that is targeted at excluding rivals from the market for reasons other than efficiency. While there are slight differences in the jurisprudence in the EU vs. the US in predatory pricing (i.e. *selling*) cases with respect to the recoupment test, there is no indication in the law of Article 102 TFEU that exclusionary conduct on the demand side would be exempt from the competition rules. Therefore, Lars Hendrik Röller, then chief economist of DG Comp, was rightly of the view that predatory bidding could as well become an issue under Article 102 TFEU.[140]

However, despite the US and the European laws covering predatory buying cases in principle, the standards applicable to find a particular conduct to be illegal are still not perfectly clear, even in light of the Supreme Court judgment in *Weyerhaeuser*. The core question is whether it suffices for overpaying to be anticompetitive that it will likely result in a concentration of the input demand market or whether it is also necessary that the conduct has an exclusionary effect on the downstream supply market. In *Weyerhaeuser* it was not necessary for the Supreme Court to decide on this question since the claim was already rejected on grounds of the recoupment test. But what if the recoupment test had been fulfilled? Would it suffice for an infringement of Section 2 Sherman Act or Article 102 TFEU if the dominant purchaser excluded its rivals in the *demand* market for sawlogs or would it furthermore be necessary to demonstrate that this position of buyer power could subsequently result in a monopolisation of the *distribution* market for finished hardwood lumber?

The search for an answer leads back into the heart of the discussion on the welfare effects of buyer power: predatory buying can be anticompetitive where the powerful buyer holds a

[139] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

[140] Lars-Hendrik Röller, *Buyer Power in the EU*, Presentation at the American Antitrust Institute Conference on „Buyer Power and Antitrust“, Washington D.C., June 22nd, 2004, *available at* http://ec.europa.eu/dgs/competition/economist/buyer_power.pdf; see also O'Donoghue & Padilla, *supra* note 82, para. 16.2.1.

powerful position in the downstream distribution market. This would facilitate an increase in monopoly power and thereby make it unlikely that cost savings in the input market are passed on consumers.[141] However, it is possible that a predatory buying scheme could be successful and exclude rivals in the input demand market without any monopolisation of the downstream distribution market. This can be possible where important rivals in the downstream market buy their input on other geographical markets which are not affected by the predatory buying strategy. Will the increase in buyer power in such a scenario suffice in itself for the conduct to come under Article 102 TFEU (or Section 2 of the Sherman Act)?

The answer should be positive if the powerful buyer reduces its output in phase 2 of the predatory buying strategy in order to reduce input prices. Yet, as was shown above, often the market mechanisms will not follow this model of single-price monopsony. Rather, contractual negotiations take place in bilateral relationships based on individual bargaining power. The powerful buyer will make "take it leave it offers" and aim to cut prices down without reducing purchase demand. This is especially likely where the powerful buyer faces severe downstream competition.[142] In such an environment, a predatory buying strategy might be successful in the input demand market by excluding *demand* rivals and ultimately succeed in reducing its input price, without any reduction of output and without *downstream* monopolisation. Moreover, fierce competition in the downstream market will force the powerful buyer to pass cost reductions on the consumers. Hence, no price increases in the downstream market will be an issue and losses to allocative efficiency are absent, too. Would predatory bidding nonetheless be considered anticompetitive? The US Supreme Court has not made a definitive statement on this question. While the Court has pointed out that predatory buying can do harm to suppliers even if consumer harm is not an issue[143], it remains unclear

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[141] A reduction in input costs will not be passed on to consumers where the undertaking has oligopolistic or monopolistic power in the downstream market, see Grimes, *supra* note 1, at 576.

[142] See Section II of this article.

[143] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007) ("In addition, predatory bidding presents less of a direct threat of consumer harm than predatory pricing. A predatory-pricing scheme ultimately achieves success by charging higher prices to consumers. By contrast, a predatory-bidding scheme could succeed with little or no effect on consumer prices because a predatory bidder does not necessarily rely on raising prices in the output market to recoup its losses. Salop 676. Even if output prices remain constant, a predatory bidder can use its power as the predominant buyer of inputs to force down input prices and capture monopsony profits.") (citing Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 ANTITRUST L.J. 669, 672 (2005).

whether this means any welfare losses are irrelevant for such a conduct to be found anticompetitive.[144]

Based on the conclusion drawn in the above sections, a differentiated approach must be appropriate. It was outlined that the mere reduction of prices can cause harm to dynamic efficiency and ultimately consumers as far as it reduces incentives for innovation and product differentiation. A predatory buying strategy is targeted at increasing bargaining power by excluding rivals in the demand market. This reduces outside options for the suppliers and provides the buyer with the opportunity to extract further price reductions. It is therefore persuasive to find predatory buying potentially anticompetitive even if downstream monopolisation is not a realistic threat. Again, this brings up the question for the legal standards for a breach of the law. Not the mere overpayment as such can suffice for the assumption that such harm will finally occur. Rather, it is necessary to develop a standard indicating that overpayment might cause these negative effects with some probability. This test must have two elements: (1) the probability of an increase in demand power in the input demand market, and (2) the probability that such an (assumed) increase in demand power will *either* likely exclude downstream rivals, and thereby increase monopolisation, *or* at least reduce incentives for innovation and product differentiation upstream, and thereby cause harm to dynamic efficiency.

As to the first question, the US Supreme Court has required in *Weyerhaeuser* a recoupment test to be fulfilled. It must be likely that the powerful buyer will make use of its increased bargaining power in phase 2 of his strategy to extract prices below the competitive level. From the perspective of EU-competition law, however, there is no ground for such a requirement. The ECJ has decided in *France Télécom* with respect to predatory *selling* that no recoupment test is necessary.[145] This European jurisprudence is based on the assumption that for the integrity of the competitive order the mere attempt to predate must be condemned. Therefore, for a predatory conduct to come under Article 102 TFEU, it is sufficient that the facts of the case indicate the mere potential for an exclusion to take place. The ECJ has developed the respective criteria in its *AKZO*-judgement, basically differentiating between

[144] Shively, *supra* note 85, at 88 ("*Weyerhaeuser* simply did not address the requirement for proof of harm to competition, allocative efficiency, or consumer welfare.") (emphasis in original). This analysis of the Supreme Court Judgment is shared by Blair and Lopatka, *supra* note 85, at 445.

[145] ECJ of 2 April 2009 C-202/07 P *France Télécom* [2009] ECR I-2369 para. 113.

prices below average total cost and average variable cost.[146] If one transfers the rationale behind the *AKZO*-jurisprudence, which concerned predatory selling, to predatory buying cases, the relevant question must be how to determine whether a price is so high that it can only be explained as being part of a predatory buying-strategy.

Academic literature has persuasively pointed out that it is hardly possible to describe the relevant threshold for the input-price by applying normative criteria such as “artificially” high. Such terminology is rightly being criticised as “speculative at best”.[147] The US Supreme Court therefore chose another approach and referred to the price in the downstream supply market. An overbidding in the upstream market should be found to have taken place where the downstream price subsequently was *below cost*. The Supreme Court did not provide with a certain formula for the calculation of cost, though.[148] Some suggest, the relevant threshold for below cost selling should be “a conventional measure of marginal, or incremental, cost”.[149] Actually, the price level can serve as an indication for the finding of an abuse, if it can economically be explained only as being part of an exclusionary strategy. That is the case if the price paid for the input is higher than the economic value of the purchased good for the downstream activities of the dominant company. The relevant threshold for the definition of such an overpayment should therefore be the *marginal revenue product*, i.e., the change in revenue which will result from the purchase of one additional unit, all other factors remaining equal. If the price for an input is in excess of the marginal revenue product, this indicates that the purchase of this good serves purposes other than increasing revenue.[150]

Once the potential for an increase in buyer power has been identified (be it by an additional recoupment test or without) another test should cumulatively have to be fulfilled. By analogy to what was found in regard to price reductions in general, it must be determined with respect to any predatory bidding strategy whether it is likely to result in downstream monopolisation or at least reduce incentives for innovation and product differentiation thereby reducing

[146] ECJ of 3 July 1991 C-62/86 *AKZO* [1991] ECR I-3359.

[147] Rosch, *supra* note 55; *see also* O’Donoghue & Padilla, *supra* note 80, para. 16.2.1. (“But implementing a clear test for identifying abusively high purchase prices, without at the same time reducing competition in procurement, is very difficult.”).

[148] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007) (“Consequently, only higher bidding that leads to below-cost pricing in the relevant output market will suffice as a basis for liability for predatory bidding.”)

[149] Blair & Lopatka, *supra* note 85, at 463.

[150] Röller, *supra* note 140, p. 10.

dynamic efficiency. In that context, the same effects analysis must take place as was outlined above. On the other hand, a mere threat of "supplier harm" as a long term consequence[151] of a predatory bidding strategy should not be considered sufficient in itself to justify an intervention.

V. Conclusions

Buyer power is neither per se procompetitive nor is it per se anticompetitive. The effects depend on several factors. It is essential to distinguish between single price monopsony and bargaining power. While the former will reduce output and create a deadweight loss, this is not the case with demand-side bargaining power. The latter can serve as an instrument to exclude rivals from a downstream market. If a merger or exclusionary conduct gives rise to such effects, an intervention is justified. Yet, even in the absence of downstream monopolisation, an increase in buyer power can be objectionable. The key issues are potential negative effects on incentives for innovation and product variety which ultimately reduce dynamic efficiency and consumer welfare. The finding of such potentially harmful effects, though, requires an in depth effects analysis. Neither in the field of merger control nor with respect to Section 2 of the Sherman Act or Art. 102 TFEU will a form-based (or per se) approach address the issues linked to buyer power adequately.

[151] Under Section 2 of the Sherman Act the probability of such an effect would already have to be proven under the recoupment test.