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**Working Paper:**

**BUYING POWER AND SECTION 2 OF THE SHERMAN ACT**

**- ANTITRUST RESPONSES TO UNILATERAL PRICING POLICIES OF  
BUYERS POSSESSING MARKET POWER -**

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## BUYING POWER AND SECTION 2 OF THE SHERMAN ACT

### - ANTITRUST RESPONSES TO UNILATERAL PRICING POLICIES OF BUYERS POSSESSING MARKET POWER -

#### **I. Introduction**

Traditionally, antitrust policy and research have been focused on firms exercising market power in output markets. The pertaining literature about monopolist and oligopolist conduct is hardly manageable any more. In contrast, for a long time most antitrust scholars have paid only marginal attention to power on the buying side of the market<sup>1</sup>.

A plausible reason for this neglect appears to be the traditional notion that buying power is a rare market phenomenon<sup>2</sup>. Indeed, collusive monopsony cases like *Mandeville Island Farms v. American Crystal Sugar Co.*<sup>3</sup> or the famous antitrust suit against the Great Atlantic and Pacific Tea Company, which successfully claimed the abuse of market power of a single buyer<sup>4</sup>, remained quite seldom<sup>5</sup>. In recent years, however, we have seen a

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<sup>1</sup> See Roger Blair & Jeffrey Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 1-4 (describing the treatment of monopsony in standard casebooks and antitrust treatises).

<sup>2</sup> It is wildly held that concentration levels ordinarily decrease downstream in the distribution chain. Under this assumption the “typical” vertical stage is likely to be less consolidated than the previous “upstream” stage from which it buys, and more concentrated than the next “downstream” stage to which it sells. Market power, then, appears to lie more often on the selling side. See Marius Schwartz, *SHOULD ANTITRUST ASSESS BUYER MARKET POWER DIFFERENTLY THAN SELLER MARKET POWER?*, Comments at the FTC/DOJ Joint Workshop on Merger Enforcement (Feb. 17, 2004), available at: <http://www.usdoj.gov/atr/public/workshops/docs/202607.htm>.

<sup>3</sup> 334 U.S. 835 (1947). The case deals with efforts of sugar refiners to control the price paid so sugar beet growers in California. It is probably the best known buyer-side price fixing case today.

<sup>4</sup> *United States v. New York Great Atlantic & Pacific Tea Co.*, 173 F.2d 79 (7th Cir. 1949). It was the first of a line of cases against the Great Atlantic and Pacific Tea Company brought by the federal government. The government successfully claimed a violation of antitrust laws through obtaining exclusive discounts on the wholesale purchase of food products.

<sup>5</sup> Roger Blair & Jeffrey Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 26 – 35, still compile an astonishing variety of famous monopsony cases until 1992.

strong consolidation in many previously fragmented industries. Big retailers, health insurance companies, entertainment firms, and natural resource extractors have significantly gained purchasing clout and they have used their clout to force suppliers to sell to them at below-market prices. That, in turn, has enhanced the advantage these powerful buyers enjoy vis-à-vis their own competitors. It doesn't cause surprise, then, that both suppliers and competitors of these large buyers are increasingly filing antitrust suits challenging buyers' alleged anti-competitive conduct<sup>6</sup>.

Facing this trend, the Federal Trade Commission (FTC) has issued reports that specifically discuss monopsony in the fields of e-commerce<sup>7</sup>, health care<sup>8</sup>, petroleum<sup>9</sup>, and more generally in merger enforcement<sup>10</sup>. At the same time government studies and investigations about "big-box" retailers like Wal-Mart have been carried out in the Americas and Western Europe<sup>11</sup>. Only recently the U.K. Office of fair trading published a substantive

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They conclude that monopsony has always been more important than generally realized. Similar statements, but with less emphasis on a profound economic analysis of specific types of buyer conduct, were made in Germany in the early 80ties.

<sup>6</sup> See Michael C. Naughton, BUYER POWER UNDER ATTACK: RECENT TRENDS IN MONOPSONY CASES, Antitrust, Summer 2004, at 81 ("The growing number of cases being brought alleging violations of the antitrust laws based upon abuse of buyer... power may signal a developing trend.").

<sup>7</sup> Federal Trade Commission, Entering the 21st Century: COMPETITION POLICY IN THE WORLD OF B2B ELECTRONIC MARKETPLACES (2000), available at <http://www.ftc.gov/os/2000/10/b2breport.pdf>.

<sup>8</sup> U.S. Department of Justice and Federal Trade Commission, IMPROVING HEALTH CARE: A DOSE OF COMPETITION (2004), available at [http://www.usdoj.gov/atr/public/health\\_care/204694.htm](http://www.usdoj.gov/atr/public/health_care/204694.htm).

<sup>9</sup> Federal Trade Commission, THE PETROLEUM INDUSTRY: MERGERS, STRUCTURAL CHANGE, AND ANTITRUST ENFORCEMENT (2004), available at <http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf>.

<sup>10</sup> See U.S. Department of Justice and Federal Trade Commission, FTC/DOJ JOINT WORKSHOP ON MERGER ENFORCEMENT (2004), available at <http://www.ftc.gov/bc/mergerenforce/presentations/index.html>.

<sup>11</sup> See, e.g., OECD Directorate for Financial, Fiscal and Enterprise Affairs - Committee on Competition Law and Policy, BUYING POWER OF MULTIPRODUCT RETAILERS (1999), available at <http://www.oecd.org/dataoecd/1/18/2379299.pdf>; Dobson Consulting, Buyer POWER AND ITS IMPACT ON COMPETITION IN THE FOOD RETAIL DISTRIBUTION SECTOR OF THE EUROPEAN UNION (Prepared for the European Commission-DGIV 1994), available at <http://europa.eu.int/comm/competition/publications/studies/bpifrs>.

report on the competitive effects of buyer groups<sup>12</sup>. These efforts of the FTC and of various governments and agencies provide for a better understanding of probable consumer welfare implications of buying power.

Nevertheless, Federal courts and antitrust scholars in the U.S. have not reached a common ground how to appraise and deal with market power of buyers yet<sup>13</sup>. In accordance with new economic theory some courts opined that monopsony power on the buying side can cause the same welfare losses as the exercise of monopoly power on the supply side and, therefore, should be dealt with in a similar manner<sup>14</sup>. Given the widespread notion that buying power may be in keeping with an antitrust policy oriented toward lower market prices<sup>15</sup>, however, it's not unheard of for courts<sup>16</sup> and scholars<sup>17</sup> to take a decisively

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<sup>12</sup> Adrian Majumdar, Leslie Neubecker, Ugur Akgun & Marcus Baldauf, *THE COMPETITIVE EFFECTS OF BUYER GROUPS*, available at: [http://www.oft.gov.uk/shared\\_of/economic\\_research/oft863.pdf](http://www.oft.gov.uk/shared_of/economic_research/oft863.pdf).

<sup>13</sup> The most comprehensive and still contemporary treatise on the economics of monopsony is the book by Roger Blair & Jeffrey Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993). See also Thomas A. Piraino, *A PROPOSED ANTITRUST APPROACH TO BUYERS' COMPETITIVE CONDUCT*, 56 *Hastings L.J.* 1121, 1128-1140 (2005) and Roger D. Blair & Jeffrey L. Harrison, *ANTITRUST POLICY AND MONOPSONY*, 76 *Cornell L. Rev.* 297, 298 – 299, who indicate that courts might treat buying power much more favorably than selling power under a rule of reason analysis. For an European perspective see Paul Dobson, Michael Waterson & Alex Chu, *THE WELFARE CONSEQUENCES OF THE EXERCISE OF BUYER POWER* (1998), available at [http://www.oft.gov.uk/shared\\_of/reports/comp\\_policy/oft239.pdf](http://www.oft.gov.uk/shared_of/reports/comp_policy/oft239.pdf).

<sup>14</sup> *Roberta TODD v. EXXON CORPORATION, et al.*, 275 F.3d 191, 202 (2<sup>nd</sup> Cir. 2001) as to the definition of input markets; *D. Lamar Deloach et al. v. Philip Morris Companies, Inc., et al.*, F.Supp.2d, 2001 WL 1301221 M.D.N.C. (2001). See also Roger G. Noll, “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 624 (2005).

<sup>15</sup> The Supreme Court repeatedly referred to lower consumer prices as a primary objective of anti-trust enforcement. In *State Oil Co. v. Kahn*, for example, the Court stated that “condemnation of practices resulting in lower prices to consumers is ‘especially costly’ because ‘cutting prices in order to increase business is the very essence of competition.’” 522 U.S. 3, 15 (1997) (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 [1986])

<sup>16</sup> *Kartell v. Blue Shield of Mass., Inc.*, 749 F. 2d 922 (1st Cir. 1984) (in the following: *Kartell II*): Using insurer monopsony power to reduce physicians' fees benefits consumers by lowering their price of care.

<sup>17</sup> M. Jacobson & Gary J. Dorman, *Joint Purchasing*, *MONOPSONY AND ANTITRUST* 36 *ANTITRUST BULL.* 1, 23 (1991) (pleading for a more lenient antitrust treatment of collusion among horizontal competitors to form joint-purchasing organizations: “The rare nature of harmful buying-side effects and the significant potential for efficiency gains suggest that antitrust rules should be designed to avoid interfering with most joint purchasing activities.”); James C. Lanik,

more lenient few on buying power than on market power on the selling side. Finally, there are also proponents of a more rigorous treatment of buying power in certain instances<sup>18</sup>. In this vein, the Ninth Circuit Court of Appeals in *Ross-Simmons* recently found that the rigorous standard of proof for plaintiffs alleging predatory pricing set forth in the famous *Brooke Group* decision<sup>19</sup> should not apply to predatory overbidding, the corresponding conduct of buyers<sup>20</sup>.

Against this backdrop, great significance has been attached to the fact that the Supreme Court granted certiorari. This year the Supreme Court reversed the approach of the Ninth Circuit in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*<sup>21</sup> and adopted a two prong test for predatory bidding and overbuying that appears to be the mirror image of the *Brook Group* standard for predatory pricing. The decision offers valuable clues how to deal with exclusionary conduct of a monopsonist possessing no market power in the output market. To which extent the decision provides certainty as to the general antitrust treatment of unilateral pricing decisions of large buyers, however, is questionable. The narrow set of circumstances addressed in the case, at least, suggests care in generalizing the Supreme Court's findings.

In careful consideration of the latest Supreme Court decision in *Weyerhaeuser* and the alternative approach chosen by the Ninth Circuit the following paper seeks to examine and identify overarching standards of legality for single buyer pricing decisions under

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STOPPING THE TAILSPIN: USE OF OLIGOPOLISTIC AND OLIGOPSONISTIC POWER TO PRODUCE PROFITS IN THE AIRLINE INDUSTRY, 22 *Transp. L. J.* 509, 529 (1995) (contending that oligopsonistic behavior may enhance consumer welfare in industries with high input costs); Michael K. Lindsey, JOINT PURCHASING ARRANGEMENTS, 61 *Antitrust L.J.* 401, 402 (1993) (suggesting that competitors who agree to jointly purchase resale inventory can buy at lower prices and increase efficiency).

<sup>18</sup> Peter C. Carstensen, BUYER POWER AND MERGER ANALYSIS: THE NEED FOR DIFFERENT METRICS (2004), available at <http://www.ftc.gov/bc/mergerenforce/presentations/040217carstensen.pdf>. (alleging that mergers among buyers in markets for agricultural products are more likely to engender anticompetitive results than is generally the case for mergers among sellers).

<sup>19</sup> *Brooke Group Ltd. v. Pueblo Bowl-O-Mat, Inc.*, 509 U.S.209 (1993).

<sup>20</sup> *Confederated Tribes of Siletz Indians of Or. v. Weyerhaeuser Co.*, 411 F.3d 1030 (9th Cir. 2005).

<sup>21</sup> 127 S.Ct. 1069 (2007).

antitrust. Following a precise definition of “buying power” the paper places special emphasis on the economic models of monopsony and buying power. It then addresses possible antitrust responses to unilateral pricing decisions of large buyers which aim at exploiting and gaining buying power.

The article concludes that monopsony power on the buying side causes essentially the same economic harms as monopoly pricing on the selling side. Hence, monopoly and monopsony should in principle be treated symmetrically in antitrust. That is, in reviewing unilateral pricing policies that give rise to antitrust concern when undertaken by sellers, such as monopoly pricing, predatory pricing and price discrimination, the corresponding actions by buyers should, by and large, be treated in an equivalent fashion. Nevertheless, under some circumstances market power on the buying and the selling side of the market may have different effects on consumer welfare and economic efficiency. These differences must be taken into account when applying the antitrust standards governing unilateral pricing decisions of monopolists to the equivalent conduct of powerful buyers.

## **II. Definition of “Buying Power” and scope of analysis**

The term "buyer power" is frequently used to describe two somewhat different phenomena. On the one hand it refers to what economists call "monopsony" power, i.e. the power to profitably reduce the price of an input below the competitive level through “underbuying”<sup>22</sup>. On the other hand it is used to designate the concept of bargaining in markets with a small number of buyers, typically in the retail-sector<sup>23</sup>. The OECD has adopted a definition that implicitly embraces the latter scenario when it describes buyer power broadly as "the ability of a buyer to influence the terms and conditions on which it purchases goods”<sup>24</sup>.

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<sup>22</sup> Dennis W. Carlton & Jeffrey M. Perloff, MODERN INDUSTRIAL ORGANIZATION 108 (4th ed. 2005).

<sup>23</sup> See Richard Scheelings & Joshua D. Wright, ‘SUI GENERIS’?: AN ANTITRUST ANALYSIS OF BUYING POWER IN THE UNITED STATES AND THE EUROPEAN UNION, 39 Akron L. Rev. 207, 209 (2006).

<sup>24</sup> OECD Directorate for Financial, Fiscal and Enterprise Affairs - Committee on Competition Law and Policy, BUYING POWER OF MULTIPRODUCT RETAILERS (1999), available at

This broader definition is apt to encompass situations that involve antitrust problems in which buying power is not used in a fashion suggested by the classical textbook model of monopsony. In particular, it captures cases in which firms avail themselves of their purchasing clout to suppress prices without lowering the quantity purchased. Suppose, for example, that sellers with market power restrict output and set supracompetitive prices. Countervailing bargaining power on the buyer side, then, may lead to a higher production of the input and lower prices, closer to the competitive level. Even in competitive selling markets buying power may reduce input prices while the quantity of input purchased remains constant<sup>25</sup>. Finally, a firm with buying power may seek to buy more input and raise prices in order to foreclose other buyers from the market. In order to reach these cases I will, in principle, embrace the broader OECD-definition of buyer power in this article<sup>26</sup>.

The root concern expressed by the OECD, though, is the extent to which few-agent bargaining in retail markets engenders different contractual terms for input suppliers. Another vague objection is the scope of dependency resulting from few-agent bargaining<sup>27</sup>. Arguably, both concerns are of doubtful utility in antitrust analysis and policy the primary objective of which is protecting competition, not competitors<sup>28</sup>:

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<http://www.oecd.org/dataoecd/1/18/2379299.pdf>. at 18. For a similar definition, see Margaret Bloom, *Retailer Buyer Power*, 2001 *Fordham Corp. L. Inst.* 399 (2000).

<sup>25</sup> This might happen when supply is perfectly inelastic or in so called All-Or-None Supply Cases, see below at III 3.

<sup>26</sup> The broader bargaining framework of buying power is embraced by most European agencies and scholars whereas the narrower concept of monopsony power seems to prevail in the U.S. See, for example, Adrian Majumdar, Leslie Neubecker, Ugur Akgun & Marcus Baldauf, *THE COMPETITIVE EFFECTS OF BUYER GROUPS*, at 1.12 – 1.14 (p. 4-5), available at: [http://www.oft.gov.uk/shared\\_oft/economic\\_research/oft863.pdf](http://www.oft.gov.uk/shared_oft/economic_research/oft863.pdf) as opposed to Roger Blair & Jeffrey Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993). The differentiation is blurred, however, because many commentators employ the terms “buying power” and “monopsony” synonymously.

<sup>27</sup> In the 1990s, some European nations, including Germany and France, enacted regulations specifically focused on “buyer power.” These regimes attempt at filling the alleged lacuna in the supra-national European law by specifically utilize a theory of “dependence”.

<sup>28</sup> The Second Circuit recognized the role of antitrust legislation in protecting competition in *United States v. Aluminum Co. of America*, 148 F.2d 416, 429 (2d Cir. 1945) (stating: “Throughout the history of the[ ] [antitrust] statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other.”) The

Price discrimination is not only an inevitable consequence of few-agent bargaining, where outcomes depend on relative bargaining abilities. According to economic theory price discrimination also produces negative consumer welfare effects only in some instances<sup>29</sup>. Thus, despite the numerous statutory preclusions, the sweeping objection to price discrimination does not fully square with classical price theory and its market effect requirement<sup>30</sup>. Consequently, my analysis will primarily focus on forms of price discrimination which might yield anticompetitive effects, namely price discrimination as an exclusionary device under section 2 of the Sherman Act.

As to the concern of “dependency” there is currently no widely accepted theory of economic dependence whatsoever. Hence, antitrust authorities face considerable problems when they have to apply pertaining provisions of law: Who is to say where economic dependence begins and ends? The scope is virtually unlimited. Given the doubts as to the legitimacy of any regulatory intervention, competition authorities have so far tended to

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modern trend, however, is to downplay the significance of small business protection and to concentrate on the role of competition in generating welfare gains through efficiency. See *Brunswick Corp. v. Pueblo Bowl-o-Mat, Inc.*, 429 U.S. 477, 488 (1977) (proclaiming that the antitrust laws “were enacted for the “protection of competition, not competitors”” (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962))).

<sup>29</sup> Richard Scheelings & Joshua D. Wright, ‘SUI GENERIS’?: AN ANTITRUST ANALYSIS OF BUYING POWER IN THE UNITED STATES AND THE EUROPEAN UNION, 39 *Akron L. Rev.* 207, 209 (2006).

<sup>30</sup> The broad criticism against the Robinson-Patman Act bears on this problem. See, e.g., Robert Bork, *The Antitrust Paradox: A POLICY AT WAR WITH ITSELF* 382 (1978) (describing the Robinson-Patman Act as “antitrust’s least glorious hour” and “the misshapen progeny of intolerable draftsmanship coupled to wholly mistaken economic theory”); Richard Posner, *THE ROBINSON-PATMAN ACT: FEDERAL REGULATION OF PRICE DIFFERENCES* (1976); and William Baxter, *A Parable*, 23 *Stan. L. Rev.* 973 (1971). More recently, the Antitrust Modernization Commission has announced that it will take up the question of whether the Act should be repealed. Professor Herbert Hovenkamp testified to the Antitrust Modernization Committee that “as a matter of competition policy, the Robinson-Patman Act is unnecessary and should be repealed.” *Robinson-Patman Act: Hearing Before Antitrust Modernizations Commission*, (2005) (written statement of Prof. Herbert Hovenkamp) available at [http://www.amc.gov/commission\\_hearings/pdf/Hovenkamp.pdf](http://www.amc.gov/commission_hearings/pdf/Hovenkamp.pdf).

avoid inquiring into this area<sup>31</sup>. In the following sections I will also refrain from closer scrutiny of this concern.

### **III. Economic theory of Buying Power**

For nearly its first century, distinct and broad legal categories dominated antitrust analysis in the U.S. and they are still influential today. Increasingly, however, economic concepts - such as market power, aggregate and consumer welfare, price elasticity, and ease of entry - inform and supplement the legal analyses. This trend has evolved from the law of mergers, but it has become very important in cases brought under section 2 of the Sherman Act, too<sup>32</sup>.

The rising importance of law and economics in monopolization cases appears logical: § 2 of the Sherman Act is quite loosely worded leaving its real content to judicial interpretation<sup>33</sup>. Confronted with the problem of giving a sensible and practicable meaning to the sweeping prohibitions of efforts to “monopolize, or attempt to monopolize”, the Supreme Court has construed section 2 in light of the primary goal of antitrust law: The protection of “consumer welfare”, whether defined as economic efficiency or as well-being of consumers in the relevant market<sup>34</sup>. This approach, of course, renders a sophisticated market analysis indispensable that accounts for modern economic theory.

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<sup>31</sup> See Louis Vogel, COMPETITION LAW AND BUYING POWER, 19(1) Eur. Competition L. Rev. 4, 9. Note, however, that the EC/Commission in its recent merger decisions appears to be incorporating the concept of dependency into its conditions for approval.

<sup>32</sup> The success of law and economics started in the 70ties with the most influential writer being Prof. and now Judge Richard A. Posner. See in particular ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 42-71 (1976), at 3: “The antitrust field is in need of a thorough rethinking of both its substantive and administrative aspects, and the essential intellectual tool for this process of rethinking ... is the science of economics.”

<sup>33</sup> The same is true for § 1 of the Sherman Act. The evolving judicial interpretation of these provisions caused many commentators to emphasize the common law nature of U.S. antitrust law, see for example Roger Blair and Carloyn Schafer, ANTITRUST LAW AND EVOLUTIONARY MODELS OF LEGAL CHANGE, Univ. F. L. Rev. 40 (1988), 379.

<sup>34</sup> There has been a longstanding antitrust controversy on the meaning of consumer welfare and, consequently, on the proper welfare standard in antitrust. Following Robert Bork, some commentators equate consumer welfare with economic efficiency. The principal opposing view, first established by Robert Lande, is that consumer welfare refers to the well-being of consumers in the

The following sections discuss the market conditions and economic models most commonly employed to assess and describe behavior of firms possessing buying power. In many real antitrust cases, though, somewhat different conditions of the market seem to prevail. Therefore, the discussion also contemplates the economic effects of buying power in these more realistic, but less familiar circumstances.

### **1. Classical Single-Price Monopsony**

The classical model of monopsony assumes a single intermediate firm that enjoys monopsony power in its input market and deals with atomistic sellers having no market power<sup>35</sup>. Under these circumstances a monopsony leads to a dead weight loss in quite the same fashion as a monopoly. In particular, both suppliers and consumers are likely to incur welfare losses. This becomes clear if one compares the outcome of competitive markets with the buying and selling decisions of a monopsonist that by definition has the capacity to unilaterally influence input prices.

If the monopsonist ignored its power to unilaterally influence prices and acted as if it were part of a competitive buying side of the market, then it would purchase at a price

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relevant market. According to this view, the antitrust laws do not aim at squeezing maximal wealth from a country's limited resources. Rather, they seek to protect consumers in the relevant market from exploitation.

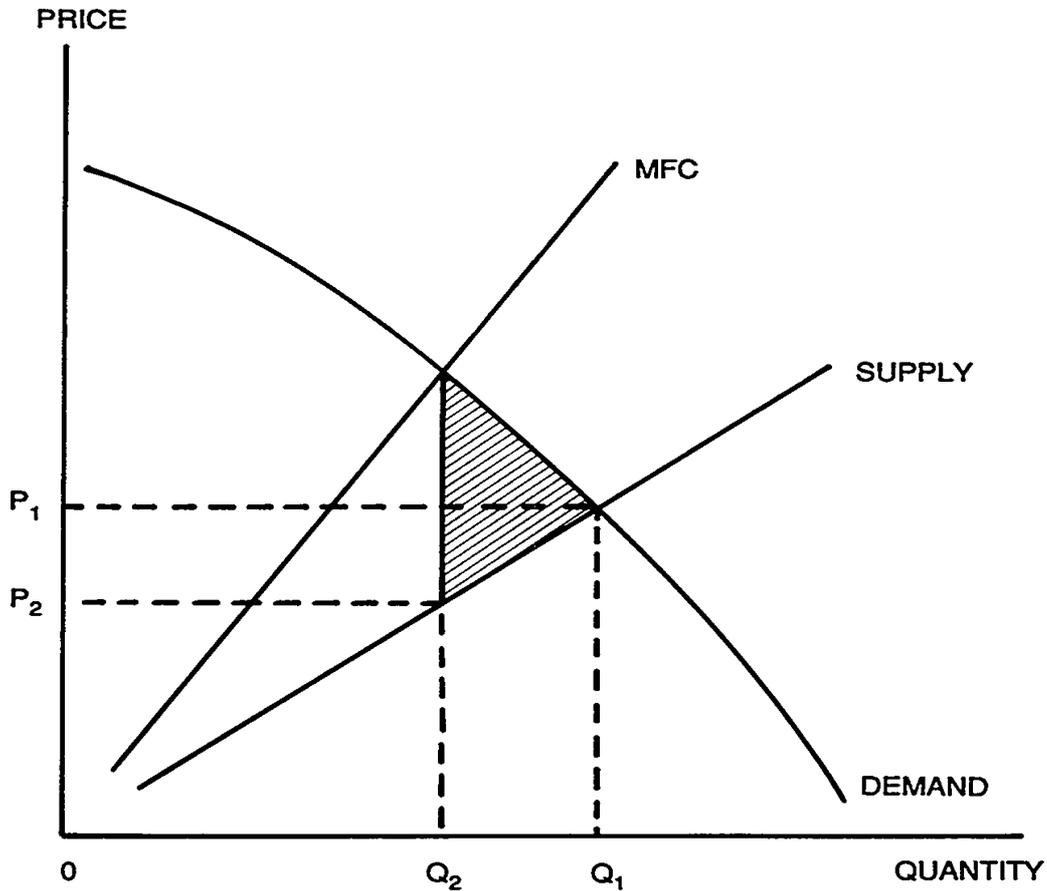
Today, most courts and professors would appear to follow the last conception, at least in the context of the Sherman Act. That is, business conduct is deemed "anticompetitive" if it reduces consumer welfare in the relevant market. In the final analysis, this view considers "competition" to be a process for advancing consumer interests.

For a review of these issues see Robert H. Lande, WEALTH TRANSFERS AS THE ORIGINAL AND PRIMARY CONCERN OF ANTITRUST: THE EFFICIENCY INTERPRETATION CHALLENGED, 34 *Hastings L.J.* 65, 74-77 (1982), John B. Kirkwood, CONSUMERS, ECONOMICS, AND ANTITRUST, in 21 *Res. L. & Econ.*, Antitrust Law and Economics, 1, 4-7 & 28-35 (John B. Kirkwood ed., 2004). In this paper, I focus on Lande's concept of consumer welfare, but also contemplate the impact of buying power on efficiency, i.e. aggregate social welfare. Specifically, I will address the impact of pricing policies of powerful buyers on supplier-surplus.

<sup>35</sup> Roger D. Blair & Jeffrey L. Harrison, MONOPSONY: ANTITRUST LAW AND ECONOMICS (1993). See also Dason, Michael Waterson & Alex Chu, THE WELFARE CONSEQUENCES OF THE EXERCISE OF BUYER POWER (1998), at. 3.1 and 4, available at [http://www.ofc.gov.uk/shared\\_ofc/reports/comp\\_policy/ofc239.pdf](http://www.ofc.gov.uk/shared_ofc/reports/comp_policy/ofc239.pdf).

determined by the point where demand equals supply. At this point social welfare, i.e. the sum of consumer surplus<sup>36</sup> and producer surplus<sup>37</sup>, is maximized<sup>38</sup>.

FIGURE I



Source: Roger D. Blair & Jeffrey L. Harrison, *Monopsony*, 76 *Cornell L. Rev.* 297, at 302.

<sup>36</sup> Consumer surplus signifies the difference between the price consumers are willing to pay for a good and the actual market price of the good. See Hal Varian, *INTERMEDIATE MICROECONOMICS*, 258-260 (1987).

<sup>37</sup> Analogous to consumer surplus, producer surplus represents the difference between what sellers are willing to accept and what they actually receive in the market. See Hal Varian, previous note, at 262-63.

<sup>38</sup> Andrew I Gavil, William E. Kovacic & Jonathan B. Baker, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* (2002), at 30.

Since a monopsonist is not constrained to a market-determined price it will not buy at this socially optimal point. Rather, a monopsonist will purchase at a price/quantity combination that maximizes its own profit. This profit maximum occurs at the point where demand equals "marginal factor cost," which is the rise in the monopsonist's total costs stemming from the purchase of one additional unit of input.<sup>39</sup> As a result, the monopsonist will purchase the lower quantity ( $Q_2$ ) of input in lieu of the competitive equilibrium quantity ( $Q_1$ ), as depicted in figure 1. And instead of paying the price  $P_1$ , which relates to the competitive equilibrium quantity  $Q_1$ , the monopsonist will pay the price  $P_2$ , which is the price consistent with the purchase of  $Q_2$ .

In terms of social welfare this decision generates a deadweight loss equal to the striped triangle. That is, the profit maximizing strategy of the monopsonist leads to unrealized gains from further trade. This loss will be born by the producers in the first place. Their surplus declines by the area between  $P_1$  and  $P_2$  above the Supply curve.

The fact that the monopsonist buys at a lower price from its suppliers may lead to the false conclusion that the monopsonist's costs will drop and consumers will benefit through lower prices on the monopsonist's output. Indeed, some Court decisions appear to be based on this notion. Careful economic analysis, however, reveals that the monopsonist does not pass on these lower input costs to its customers: The relevant costs for pricing decisions are not average costs but marginal costs. These are not lower. Thus, there will be no price cuts in downstream markets<sup>40</sup>. To the contrary, the decision to pur-

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<sup>39</sup> In order to calculate the marginal factor cost the monopsonist has to take into account two effects: if the supply-curve is positively sloped (as is usually the case) the monopsonist must pay a higher price for the extra input. In addition, the price of all other input units will also increase to the level of the last unit. See Roger Blair & Jeffrey Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 37. Theoretically, the monopsonist may escape this dilemma by means of price discrimination. That is, the monopsonist may try to pay the higher price only for the added input unit. Market constraints like arbitrage as well as legal prohibitions, however, are likely to prevent the monopsonist from successfully pursuing such a strategy. See *infra* at III 2b and IV 3.

<sup>40</sup> *D. Lamar DELOACH et al. v. PHILIP MORRIS COMPANIES, INC.*, F.Supp.2d, 2001 WL 1301221 M.D.N.C. (D.C., MD North Carolina 2001) at FN 10 citing Roger D. Blair & Jeffrey L. Harrison, *ANTITRUST POLICY AND MONOPSONY*, 76 *Cornell L. Rev.* 297, 304 (1991).

chase fewer inputs may translate into higher output prices if the monopsonist also enjoys some downstream market power.

**a) Monopsonists possessing no power in downstream markets**

First, consider an intermediary monopsonist without selling power. Typical cases involve distinct local markets for agricultural commodities and forestry products<sup>41</sup>. Weyerhaeuser Co., a sawmill company in the Pacific Northwest, is a good example. According to the facts stated by the Supreme Court in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*<sup>42</sup>, Weyerhaeuser entered the Northwestern hardwood-lumber market in 1980 by acquiring an existing sawmill. It gradually expanded the production and now owns six hardwood sawmills in the region. By 2001, these mills were purchasing approximately two thirds of the alder logs available for sale on the open bidding market in the region<sup>43</sup>. Given the barriers to entry it is fair to infer buying power on part of Weyerhaeuser from these data<sup>44</sup>. Yet, Weyerhaeuser was selling lumber in a broad output market in which it lacked market power. In fact, in the relevant hardwood lumber market Weyerhaeuser's market share was only about 3 percent<sup>45</sup>.

Assuming an upward sloping supply curve of logs<sup>46</sup> and a fixed configuration of the plant size in the short run<sup>47</sup>, the profit maximizing strategy of a monopsonist in the position of

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<sup>41</sup> See Roger G. Noll, "BUYER POWER" AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 596 (2005) (arguing that the example of local monopsonists selling food products in competitive regional or national wholesale market occurs with some regularity, particularly "when some producers of food products enjoy scale economies that are sufficient to make some localities a natural monopsony, but all food processors then compete in competitive regional or national food markets.").

<sup>42</sup> 127 S.Ct. 1069, 1072 (2007).

<sup>43</sup> The Logs represent up to 75 percent of a sawmill's total costs, see *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S.Ct. 1069, 1073 (2007).

<sup>44</sup> For a comprehensive discussion on measuring buying power see Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 47-62.

<sup>45</sup> See *Weyerhaeuser Appellate Brief*, at 10.

<sup>46</sup> In reality, the supply of logs in the Northwestern Area was quite inelastic. For the economic consequences of supply inelasticities see *infra* at III 2 a.

Weyerhaeuser would be straightforward: It will buy an additional log as long as the market value of the incremental lumber produced exceeds the incremental cost of buying the log. Furthermore, according to standard economic theory competitive firms produce at the point where the output price (P) equals the marginal cost of production<sup>48</sup>. This means, to maximize profits the monopsonist's output price P must equal  $MFC_{\log} / MP_{\log}$ , where  $MFC_{\log}$  signifies the marginal factor cost of logs (the increase in total expenditures on logs that results from buying an additional log), and  $MP_{\log}$  denotes the marginal product of logs (the incremental increase of total output that results from buying one more log).

The effect of monopsony becomes clear if one compares this equation with the corresponding equation of another sawmill that - like Appellee Ross-Simmons Hardwood Lumber Co. Inc. in Weyerhaeuser - must compete in both the lumber output market and in the log input market. In this case, the firm faces a constant log price regardless of the amount of logs it buys and processes. In effect,  $MFC_{\log}$  is constant and equal to the prevailing price of the log-supply ( $P_{\text{Supply}}$ ). Again, the mill will purchase an additional log as long as the market value of the incremental lumber produced exceeds the market price of the log. That is, the optimal purchasing decisions will be at the point where the output price P is equal to  $P_{\text{Supply}} / MP_{\log}$ , which is the marginal cost for this firm.

As illustrated in Figure 1 the MFC for a monopsonist exceeds the competitive level, i.e.,  $MFC_{\log}$  is greater than  $P_{\text{Supply}}$ . Consequently, the marginal cost for the firm lacking buying power ( $P_{\text{Supply}} / MP_{\log}$ ) is lower than for the monopsonist ( $MFC_{\log} / MP_{\log}$ ). Since marginal cost drives the firm's output decision, a profit maximizing strategy would prompt the monopsonist to reduce its output relative to the level of a set of sellers without monopsony power.

This output reduction will have no impact on the market price because the monopsonist is selling its lumber in a competitive market and the lost sales of the monopsonist will be

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<sup>47</sup> Assuming a fixed number of machines, employees, etc. makes the discussion less cumbersome. But the results will principally hold in the long run, too. See Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 36-37.

<sup>48</sup> A rigorous derivation is provided by Roger D. Blair & David L. Kaserman, *ANTITRUST ECONOMICS* 178, 7-9 (1985).

made up by other sellers<sup>49</sup>. In effect, the monopsonist will sell its reduced output at the competitive market price. That means the reduced price paid for the input is not passed on to consumers. Instead, the decrease in the monopsonist's average costs simply increases its profit<sup>50</sup>.

### **b) Monopsonists possessing market power in the output markets**

The situation is turning worse if the monopsonist also possesses some power in the output market. An example would be if Weyerhaeuser produced a unique product. When a monopsonist has market power in downstream markets it faces a negatively sloped demand curve and can determine the output price by unilaterally adjusting the output quantity. The expected welfare consequences under these circumstances are highlighted by Blair and Harrison<sup>51</sup>:

“Since the profit-maximizing output is determined by the intersection of the marginal cost and marginal revenue curves and marginal revenue declines as output expands, an increase in marginal cost will result in a decrease in the firm's profit-maximizing output. Since the demand curve has a negative slope, a decrease in quantity leads to an increase in price. Thus, when a firm with some market power in the sale of its product acquires

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<sup>49</sup> Contemplating all markets this result would appear to be illusory: The reduced output of the monopsonist means that resources must be reallocated in other markets. This reallocation will lead to distortions and inefficiencies because lower-productivity suppliers will displace higher-productivity suppliers. Thus, a loss of social and consumer welfare due to monopsony is almost certain even if the monopsonist faces significant competition in downstream markets. See Roger G. Noll, “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 594, 600 FN 25 (2005): “To offset the lost production (of the monopsonist), additional resources,  $X + x$ , must be shifted to ... production elsewhere. Even if all local factor markets are perfectly competitive so that the marginal value product (MVP) is the same in all industries everywhere, the social loss will be  $MVP(X + x) - MVP(X)$ . The existence of monopsony exploitation requires that  $x$  be positive, even if the monopsonist's share of the competitive final goods market is infinitesimal. Moreover, competitive pricing in the final-goods market does not require a large number of firms with tiny market shares, so that competitive outcomes are consistent with circumstances in which  $x$  is a very large number.”

<sup>50</sup> Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 41 FN 13.

<sup>51</sup> Blair & Jeffrey L. Harrison, *ANTITRUST POLICY AND MONOPSONY*, 76 *Cornell L. Rev.* 297, 305-06 (1991) (Original Notes, that provide a rigorous derivation, omitted).

monopsony power in the purchase of its inputs, the prices paid for those inputs decrease, but the marginal cost of production rises, the monopsonist's output falls, and the price to its customers actually increases.”

After all, under the classical textbook assumptions of a profit maximizing monopsonist facing an upward sloping input supply curve and pursuing a single price policy, monopsony power on the demand side is the mirror image of monopoly power on the supply side. “Monopoly power is marked by the ability of sellers to raise price above competitive levels, which requires the ability to limit output. Monopsony power involves the ability of buyers to lower input prices below competitive levels, which requires the ability to restrict the quantity demanded of the input. In either case, the quantity that would be exchanged is less than the quantity exchanged under competitive conditions, and the result is allocatively inefficient.”<sup>52</sup> Remarkably, the monopsonist will not pass on the reduced input prices to its customers. To the contrary, if the monopsonist also enjoys market power in its output market, the reduced quantity of input bought at lower prices causes output prices to rise.

## **2. Specific market conditions: inelastic supply and all-or nothing offers**

Under some circumstances buying power may yield quite distinct economic results. These cases involve the employment of buying power without reducing the quantity purchased and without causing (short term) efficiency losses. Indeed, most examples of “monopsony” that have given rise to antitrust litigation or have been debated controversially do not accord with the simplistic assumptions of the classical model of monopsony. Rather, powerful buyers have been able to depress the price of their input without reducing the quantity purchased. An illustrative case arises if supply is (perfectly) inelastic. Another example involves negotiated long-term contracts that specify both price and quantity. Such contracts may offer powerful buyers the chance to push sellers onto their

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<sup>52</sup> Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 42. While the preceding discussion deals with buying power in input market the results also hold for other types of single-price monopsony, see Roger G. Noll, “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 594 (2005) (discussing final consumer cartels).

all-or-nothing supply curve. The subsequent sections will in turn address these specific instances<sup>53</sup>.

### **a) Inelastic supply**

The classical example of perfectly inelastic supply is a perishable commodity. Perishability makes short-run supply perfectly inelastic since sellers are not able to save costs by reducing output<sup>54</sup>. This is obvious in labor markets. Since lost hours of work today can never be recovered, labor is a thoroughly perishable commodity<sup>55</sup>. Perishability is also present in many primary product markets. In the *In re Beef Industry Antitrust Litigation*, for instance, the plaintiff-beef producers alleged that the supply of beef was fixed in the short run since a fattened steer must be sold within a relatively short time after it becomes “choice grade.” This left the plaintiffs unable to withhold output after they were offered depressed prices. Other factors also account for the inelasticity of supply in many primary

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<sup>53</sup> Another complicated issue involves bilateral monopolies. For a detailed discussion see Richard D. Friedman, *ANTITRUST ANALYSIS AND BILATERAL MONOPOLY*, 1986 *Wis. L. Rev.* 873 (1986); Roger G. Noll, “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 594, 607-611 (2005).

<sup>54</sup> See James Murphy Dowd, *OLIGOPSONY POWER: ANTITRUST INJURY AND COLLUSIVE BUYER PRACTICES IN INPUT MARKETS*, 76 *B.U. L. Rev.* 1075, 1078 FN 10 (1996): “To understand perishability, imagine a continuum of goods along which the rate of deterioration of the valuable life of a good increases as one moves from right to left. For example, a bar of gold may represent one extreme on the spectrum. The total value of the bar remains relatively constant over any given span of time. In contrast, an hour of labor lies at the polar opposite on the continuum. The total value of that one hour of labor declines to zero as the hour is used up. Despite the fact that the laborer can command value for future hours of work, the laborer can never recapture the value of the hour just past. ... A product like grapes will fall toward the perishable end of the continuum. I emphasize this point to indicate the kind of power that a purchaser offering relatively constant value assets (e.g., cash) may have over a seller of perishable goods, simply by virtue of the former's ability to out-wait the latter.”

<sup>55</sup> *Roberta TODD v. EXXON CORPORATION, et al.*, 275 F.3d 191, 211 (2<sup>nd</sup> Cir. 2001) (stating that “labor is a classic example of inelastic supply flow”); Nicholas Kaldor, *Essays on Value and Distribution* 155-56 (1960) (arguing that “[j]ust as one cannot ‘bottle up’ sunshine ... to-day's labour hours cannot be deferred until to-morrow: they must be used immediately or lost”). See also Roger G. Noll, “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 594 (2005), at 603 – 05 (discussing attempts to depress wage rates of professional athletes who have almost no chance to take other jobs that are similarly lucrative).

product markets. In *Weyerhaeuser*, for example, the annual supply of alder logs was relatively inelastic. Theoretically, sellers had the option of withholding some logs from the market for some time<sup>56</sup>. This opportunity was limited, however, since most of the alder harvest was only a byproduct of the softwood harvest<sup>57</sup>.

If supply is fixed, i.e. if the supply curve tends to be vertical, buyer power simply moves the demand curve to a lower level. That is, powerful buyers are able to depress input prices without lowering input purchases. As demonstrated, the lower input prices typically do not translate into lower prices for consumers. If supply is perfectly inelastic, therefore, monopsony does neither influence the quantity of inputs purchased, nor the quantity produced by the monopsonist, nor the price demanded for the output. Suppliers, however, will receive less for their products and the powerful buyers will earn higher returns.

These purely redistributive short-run effects do not appear to interfere with the central objectives of antitrust law. Nevertheless, important long term consequences deserve closer attention: The transfer of wealth from the supply-side of the market to the buying side creates expectations about future profit opportunities. As their profit expectations shrink, the producers' incentives to invest and produce diminish<sup>58</sup>. The resulting underinvestment, in turn, either impairs the quality or diminishes the quantity of supply. All these effects are hard to measure, but real. And they engender adverse consequences for

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<sup>56</sup> The importance of an opportunity to withhold output for some time has been stressed by the 2<sup>nd</sup> Circuit in *Roberta TODD v. EXXON CORPORATION, et al.*, 275 F.3d 191, 211 (2001) (arguing that “sellers' supply could be elastic if, for example, they have the option of withholding some output from the market in hopes of higher prices in future years.”)

<sup>57</sup> See Richard O. Zerbe Jr., *MONOPSONY AND THE ROSS-SIMMONS CASE: A COMMENT ON SALOP AND KIRKWOOD*, 72 *Antitrust L.J.* 717, 722 (2005) (stating that softwood decisions “generally determine alder harvest because it is economical to harvest them together, and softwoods are more important”).

<sup>58</sup> Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 72, Richard O. Zerbe Jr., *MONOPSONY AND THE ROSS-SIMMONS CASE: A COMMENT ON SALOP AND KIRKWOOD*, 72 *Antitrust L.J.* 717, 723 (2005) (contending “reduced plantings of alder seedlings by industrial and small woodland owners” due to the prospect of future monopsony prices).

consumer welfare in the long run. Therefore, a wise antitrust policy should extend the view beyond the static analysis of short-term effects<sup>59</sup>.

### **b) All-or-nothing offers**

A monopsonist may also be able to pay lower prices without lowering the quantity purchased by engaging in all-or-nothing offers. In this case, the monopsonist offers sellers a contract to provide a quantity of output that equals the quantity in competitive markets, but at lower price. In an ideal scenario, the monopsonist offers exactly the price that corresponds to the average variable cost of production instead of the long-run average cost of supply. If suppliers accept the offer the surplus is entirely shifted to the monopsonist. This will happen if the monopsonist manages to push the sellers onto their all-or-nothing supply curves.

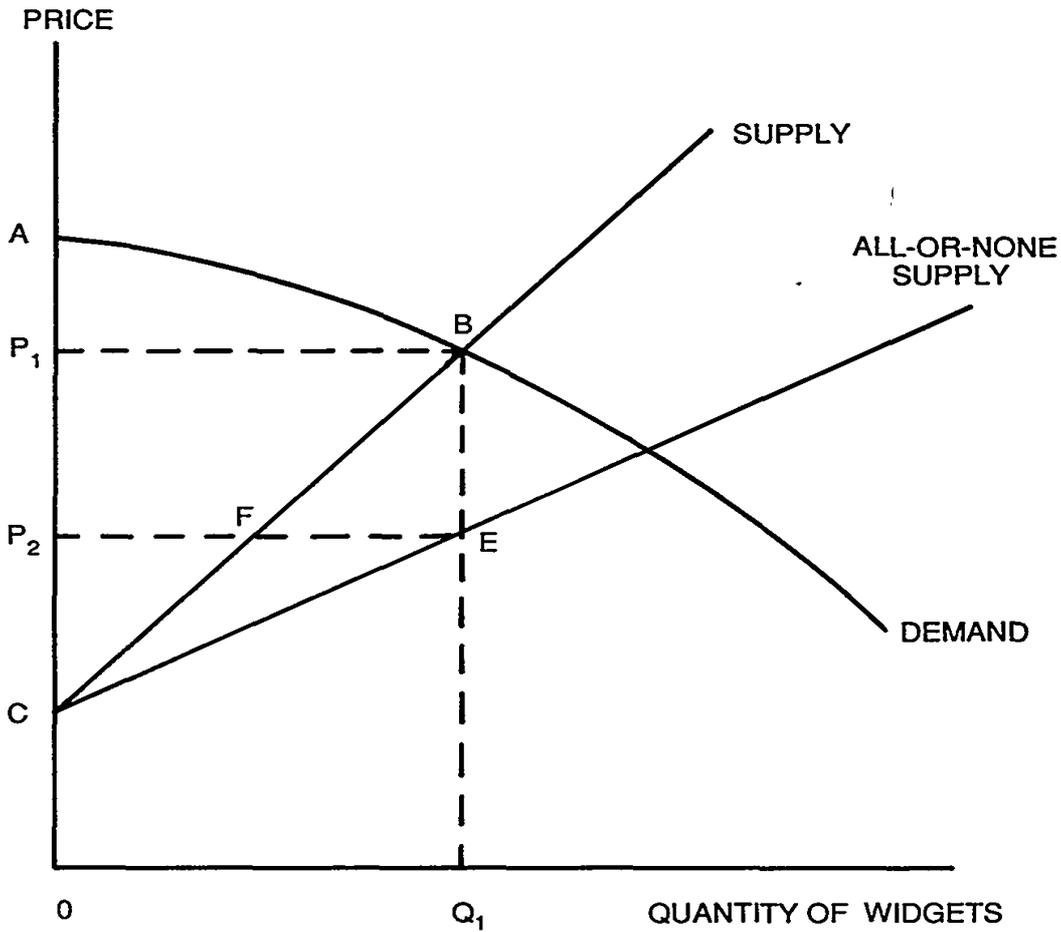
While the standard supply curve assumes distinct prices and then asks how much output will be produced at each price level, all-or-nothing offers confront producers with a different question: How much quantity will they make available at each price if the alternative is to sell nothing at all?<sup>60</sup> Facing this alternative, suppliers can be expected to sell when their short-run costs of production are covered. Hence, the all-or-none supply-curve lies below the supply-curve.<sup>61</sup>

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<sup>59</sup> Roger D. Blair & Jeffrey L. Harrison, id., at 72.

<sup>60</sup> Richard Layard & A.A. Walters, MICROECONOMIC THEORY (1978), at 244: “Lying below the supply curve is the seller’s all-or-nothing price, showing the minimum price per unit at which he is willing to sell each quantity.”

<sup>61</sup> Roger D. Blair & Jeffrey L. Harrison, MONOPSONY: ANTITRUST LAW AND ECONOMICS (1993), at 73.



**Figure 2**, Source: Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 *Cornell L. Rev.* 297, 318 (1991)

Figure 2 depicts these effects: Producer surplus is equal to the triangular area  $CBP_1$ . After being pushed onto the all-or-nothing supply curve the surplus of suppliers decreases by the rectangle  $P_1BEP_2$ . At the same time, the surplus of the monopsonist ( $ABP_1$ ) rises by the same area. Since the area above the supply curve and below  $P_2$  ( $DFP_2$ ) is equal to area  $EFB$ , all surplus is shifted from producers to the monopsonist.

The quantity of output in all-or-nothing scenarios, however, is exactly the same as in competitive markets. Therefore, all-or-nothing offers involve no short term inefficiencies. On the other hands, consumers will not profit from the lower prices of the monopsonist, either. A monopsonist ordinarily cannot be expected to pass on its lower input prices. Instead, it will increase its profit margins. Thus, like monopsony in the case of inelastic

supply, all-or-nothing offers have purely distributional consequences in the short run<sup>62</sup>: The surplus is transferred from the selling side of the market to the monopsonist.

(1) Single price all-or-nothing offers

Frequently, all or-or-nothing offers are equated with perfect price-discrimination<sup>63</sup>. Indeed, pushing all suppliers exactly onto their respective all-or-nothing supply curves necessarily involves the ability to price-discriminate. Yet, all-or-nothing offers may be a profitable strategy for powerful buyers even without price discrimination when all suppliers have similar cost structures. Specifically, suppliers are prone to accept single price all-or nothing offers if they all have constant long-run average costs some of which are sunk. Sunk costs ensue if long-term investments cannot be switched to other productive uses at reasonable costs. For example, machines can be sufficiently specialized to be committed to a specific market. In such instances, the investments in the machines need not yield competitive returns to keep them producing for the market for a while<sup>64</sup>. Therefore, all suppliers will stay in business for some time even if the powerful buyer offers a single price that is below the long term costs of supply, as long as the price matches the average variable cost of production of the least efficient supplier<sup>65</sup>.

An illustrative case arises in the context of investments in human capital, such as the education required to become a physician. The long and expensive professional training may render physicians who have completed their education vulnerable to all-or-nothing offers by health insurance companies and HMOs. Indeed, physician-plaintiffs have frequently challenged the maximum prices offered by monopsonistic health care insurers on a take-

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<sup>62</sup> The long-term consequences for consumer welfare, however, are likely to be clearly negative, see *infra*, at aa.

<sup>63</sup> Roger G. Noll, "BUYER POWER" AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 603 (2005) (stating that monopsonists (like monopolists) can avoid efficiency losses by engaging in perfect price discrimination, or 'all or nothing' offers").

<sup>64</sup> Roger G. Noll, "BUYER POWER" AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 602 (2005).

<sup>65</sup> In the long-run, of course, sufficient revenues to cover both short-term cost and sunk cost are indispensable to maintain and enable sufficient investments in new machines and technology. Although the exploitation of seller is a transitory phenomenon, the "short run" in which it can occur can be very long.

it-or-leave it basis<sup>66</sup>. Similarly, the famous First Circuit Court of Appeals decision in *Kartell v. Blue Shield of Massachusetts*<sup>67</sup> dealt with Blue Shield's prohibition against balance billing, i.e. the practice of physicians to charge fees to certain classes of higher-income patients in addition to the fixed fee schedule of Blue Shield. The principal interest of the insureds in these cases was to lower physician fees without facing negative side-effects in form of reduced quantity or quality of medical services available to the insured<sup>68</sup>.

Physician-plaintiffs usually alleged that the fee schedules of the big insurers were set below the competitive level. In *Kartell*, plaintiffs specifically contended that the prohibition of balance billing as a prerequisite for Blue Shield's payments led to prices below the long term cost of their services. To underpin their allegation they pointed to a significant decline in reimbursement: After "reforming" the fee schedule and implementing the prohibition against balance billing Blue Shield's payments to physicians dropped by 30 %<sup>69</sup>. As an empirical matter it is unclear whether this decrease in payments actually caused

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<sup>66</sup> Jill Boylston Herndon, HEALTH INSURER MONOPSONY POWER: THE ALL-OR-NONE MODEL, 21 J. Health Econ. 197 (2002); Peter J. Hammer & William M. Sage, MONOPSONY AS AN AGENCY AND REGULATORY PROBLEM, 71 Antitrust L.J. 949, 971 (2004).

<sup>67</sup> *Kartell II*, 749 F.2d 922 (1st Cir. 1984). In a celebrated opinion then Judge Stephen Breyer brought seven years of litigation to an end reversing the findings of the district court. The district court had held that Blue Shield's ban on balance billing violated Section 1 of the Sherman Act, *Kartell v. Blue Shield*, 582 F. Supp. 734 (D. Mass. 1984) (in the following: *Kartell I*). For a thorough discussion see Peter J. Hammer & William M. Sage, MONOPSONY AS AN AGENCY AND REGULATORY PROBLEM, 71 Antitrust L.J. 949 (2004).

<sup>68</sup> Economically, Blue Shield and other insurers combine physician services and insurance into a product that they sell to consumers in exchange for a premium. See Mark V. Pauly, MARKET POWER, MONOPSONY, AND HEALTH INSURANCE MARKETS, 7 J. Health Econ. 111, 113 (1988). The First Circuit, in principle, acknowledges this structure, see *Kartell II*, 749 F.2d at 923 ("Blue Shield provides health insurance for physician services. ... The consumers of Blue Shield's insurance ... can see any 'participating doctor,' i.e., a doctor who has entered into a standard Participating Physician's Agreement with Blue Shield."). Yet, in the final analysis then Judge Breyer sees Blue Shield simply as a purchasing agent of the insured. For a critique of this central allegation see Mark V. Pauly, MARKET POWER, MONOPSONY, AND HEALTH INSURANCE MARKETS, 7 J. Health Econ. 111, 113 (1988), Peter J. Hammer & William M. Sage, MONOPSONY AS AN AGENCY AND REGULATORY PROBLEM, 71 Antitrust L.J. 949 (2004).

<sup>69</sup> *Kartell II*, 582 F. Supp. at 741.

fees to decrease below the long term costs of supply<sup>70</sup>. At least, the claim does not run afoul of economic theory: It appears plausible that a monopsonistic insurer is able to partially extract the competitive return on medical training from physicians who have already completed their education. That is, even when prices are suppressed below the long-run total costs, essentially all doctors will continue to practice. Furthermore, the existence of contractual, legal, and professional norms may prevent physicians from reducing the quality of their services or from discriminating among patients according to source of payment.

The long run consequences of such a policy, however, are much more difficult to predict. Two developments, at least, may yield misallocative effects that finally harm consumers. First, monopsony will diminish the incentive of physicians to invest in human capital in order to keep abreast with the latest knowledge and skills. Consequently, quality-adjusted supply will decline over time. Second, monopsony fees will discourage some future physicians from entering into medical school or, after entry, from pursuing additional training for a specialty. This will also reduce the future supply of qualified doctors in the long run.

These developments may eventually erode the capacity of the monopsonist to exploit market power because more and more doctors will leave the market and no surplus on the supply side is left to extract<sup>71</sup>. At first glance, this would appear to be counterintuitive since the long-run exit of suppliers or underinvestment in new technologies and human capital is clearly at odds with the interest of Blue Shield or any other monopsonist. There-

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<sup>70</sup> No empirical economic studies have been pursued on this point. The drop in payments to physicians is not all too meaningful since physician fees may have been inflated due to market power on part of the physicians before the new fee schedule was implemented. See Roger D. Blair & Jill Boylston Herndon, (2004) (arguing that countervailing buyer-side market power could act as a second-best solution to upstream provider power in health care markets).

<sup>71</sup> See for a similar discussion concerning specialized buildings and machines Roger G. Noll , “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 593 (2005) (arguing that a firm “must earn sufficient quasi-rents to yield a competitive return or its investors will not be willing to replace capital investments as they wear out or become obsolete. In this case, a monopsonist can extract quasi-rents for a while, but only for as long as the remaining useful life of the assets that are committed to supply the market.”)

fore, one might imagine the monopsonist squeezing a price that permits just the right number of suppliers to stay in business and invest in new technologies.

Indeed, that is exactly the argument put forward by S. R. Walton, Chairman of Wal-Mart, in a recent article about regulating buying power of large retailers<sup>72</sup>: “Wal-Mart depends on maintaining a sustainable business relationship with each of our suppliers. It is important that Wal-Mart's suppliers remain profitable on their sales to Wal-Mart so they can continue to keep our shelves fully stocked with the assortment of products our customers demand”<sup>73</sup>. To the extent Wal-Mart actually carries out this policy, suppliers may have better chances to earn a competitive return on investment and to invest in future development. In the context of real world business, however, the notion of a monopsonist paying the socially optimal price to its suppliers seems illusory. It rests on unrealistic assumptions about the availability of information and the rationality of business conduct.

It is clearly difficult for Wal-Mart to ascertain the suppliers' long-run costs and to determine which profits they should reasonably make. The same is true for Blue Shield and other insurers with regard to physician fees: For example, suppliers may understate their own costs in order to land the enormous business of the monopsonist. Or, more likely, they may overestimate their ability to reduce costs in the future. In any event, the danger of permanently losing significant revenues is likely to spark a cutthroat competition among suppliers.

At the same time, Wal-Mart, Blue Shield and other large buyers are facing similar problems vis- à-vis their own competitors: On the one hand they have an interest in sustaining a viable competition on the supply side of the market. On the other hand they also have a strong incentive to out-compete their rivals by securing better deals from suppliers. This creates a prisoner's dilemma for the monopsonist and its (bigger) rivals: In the long run, paying a competitive price to the suppliers is the most profitable strategy. In the short run, however, each can increase its profits by paying suppliers less than the rivals do. This strategy is particularly attractive if there is a significant difference between suppli-

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<sup>72</sup> S. Robson Walton, WAL-MART, SUPPLIER-PARTNERS, AND THE BUYER POWER ISSUE, 72 *Antitrust L.J.* 509 (2005).

<sup>73</sup> S. Robson Walton, *id.* at 512.

ers' long run total costs and their short-term average costs so as to enable the monopsonist to extract large rents by making all-or-nothing offers. As a result, when a monopsonist and its competitors cannot resolve this prisoner's dilemma, they are likely to negotiate a price that is inadequate to cover the total costs of all suppliers.

For all these reasons the monopsonist will more readily set prices too low – even though this may cause some suppliers to exit the market and weaken the bargaining position of the monopsonist in the long run. Thus, in reality, closer attention to long-run consequences of monopsony is clearly warranted<sup>74</sup>.

## (2) Price discrimination

Theoretically, a monopsonist can avoid forcing less efficient suppliers out of business by engaging in price-discrimination, i.e. by offering prices that account for the individual cost structure of each supplier<sup>75</sup>. If the price exactly matches the individual average cost of supply in the short-run – not the long-run total cost - the monopsonist can extract the entire surplus of suppliers. And since the monopsonist will buy exactly the quantity of output that would be provided if the market were competitive, the exercise of monopsony will neither distort the input market nor inflict any harm on consumers.

In reality, similar problems as in the case of single price all-or-nothing offers are likely to ensue: Perfect price discrimination presupposes that the monopsonist be able to ascertain the short-run cost function of each supplier. Only then is the monopsonist in a position to offer each a distinct price for the same product. Since the monopsonist lacks the requisite information, however, its attempts to discriminate between suppliers through contract negotiation are unlikely to be perfect. As a result, efficiency loss will occur. Indeed, in the final analysis imperfect price discrimination can be as deleterious as making all-or nothing offers at a single, predetermined price. It may distort input market and create the expectation among suppliers that increasing productivity is not worth while. Such an expecta-

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<sup>74</sup> Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 75.

<sup>75</sup> See also Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 90 (arguing that a monopsonist may also engage in price discrimination in order to exploit differences in supply elasticities).

tation would further aggravate the problem of long-run underinvestment in monopsonized markets.

These effects of discriminatory monopsonization are discernable in professional sports. Usually players and teams negotiate individual contracts with huge income differences<sup>76</sup>. If the teams manage to monopsonize the salary of the players<sup>77</sup> they need two types of information to avoid efficiency losses: (i) the minimum wage necessary to keep the player in the sport (i.e. his reservation wage) and (ii) the magnitude of incentives required to induce high performance<sup>78</sup>. Practically, the teams neither know the reservation wage nor do they have sufficient information about the response of a player to the opportunity to earn more money. As a result, teams are not likely to put in place the combination of base wage and performance incentive that keeps the best players in sports and causes every player to put forth the optimal effort in playing games and improving skills. Moreover, monopsony in player markets will prevent promising talents from entering into the player market because the uncertain gains of a successful career as a professional athlete may be too low to bear the significant (opportunity) costs of training for a professional sports career<sup>79</sup>. Thus, the exercise of monopsony power in the market for athletes reduces the quality of play. This, in turn, will eventually translate into harm to consumers because the satisfaction derived from sport diminishes.

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<sup>76</sup> Roger G. Noll , “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 603 (2005) (arguing that the salaries of professional athletes “vary enormously, with the most-skilled veterans earning salaries roughly 100 times the collectively bargained minimum wage”).

<sup>77</sup> Roger G. Noll , *id.* at 604: “A common practice of leagues is to adopt some form of “player reservation system,” which gives each team exclusive rights to a proportionate share of players, such as through a rookie draft or exclusive geographical territories, and to adopt a rule that gives teams exclusive rights to employ these players for at least part of each player's career. For at least the first few years of a career, a player is faced with accepting the offer of one designated team or not playing professionally in the sport.”

<sup>78</sup> Roger G. Noll , *id.*, at 604.

<sup>79</sup> Roger G. Noll , *id.* at 605-606: “In picking a career, a rational worker will compare the costs of preparing for an occupation with the expected gains. In the case of an athlete, the costs are the time, effort, and expense that are devoted to improving athletic skills, and the benefit is the probability of becoming good enough to be a professional athlete multiplied by the wage that a professional athlete earns plus any additional psychic gratitude that comes from being a major-league athlete. If a player's earnings are suppressed by a monopsony employer, the optimal amount of preparation declines as does the number of people who attempt to enter the occupation”.

### 3. Conclusion

In sum, economic analysis underpins the symmetry of markets: for every seller there is a buyer. And successful deployment of buying power may cause as great inefficiencies as monopoly<sup>80</sup>. Under the classical model, a monopsonist will buy and process too few inputs at a depressed price. This profit maximizing strategy of the monopsonist diminishes the surplus of producers and causes inefficiencies in the input market. Consumers are definitely harmed if the monopsonist also possesses downstream market power because the reduced output of the monopsonist will lead to higher prices for consumers. If the monopsonist sells in competitive markets consumers ordinarily do not benefit from the lower input prices of the monopsonist because a profit maximizing monopsonist will not pass on its lower costs to its customers.

In the case of inelastic supply and all-or-nothing offers no allocative inefficiencies occur in the short run. However, misallocative effects of monopsony pricing are to be expected in the long run. Specifically, too few investments in new technologies and human capital will be made. These long-run effects can inflict significant welfare losses on consumers. Therefore, monopsony is not only likely to impair aggregate welfare. It also reduces consumer welfare in most instances.

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<sup>80</sup> See John B. Kirkwood, BUYER POWER AND EXCLUSIONARY CONDUCT: SHOULD BROOKE GROUP SET THE STANDARDS FOR BUYER-INDUCED PRICE DISCRIMINATION AND PREDATORY BIDDING?, 72 Antitrust L.J. 625, 653 (2005) (describing monopsony as the “mirror image” of monopoly). Similarly, the Supreme Court in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S.Ct. 1069, 1075 (2007) argued that “monopsony power is market power on the buy side of the market. ...As such, a monopsony is to the buy side of the market what a monopoly is to the sell side and is sometimes colloquially called a “buyer’s monopoly.” (citing Blair & Harrison, ANTITRUST POLICY AND MONOPSONY, 76 Cornell L.Rev. 297 (1991)). See also *Khan v. State Oil Co.*, 93 F.3d 1358, 1361 (C.A.7 1996) (“[M]onopsony pricing ... is analytically the same as monopoly or cartel pricing and [is] so treated by the law”), vacated and remanded on other grounds, 522 U.S. 3, 118 S.Ct. 275, 139 L.Ed.2d 199 (1997); *Vogel v. American Soc. of Appraisers*, 744 F.2d 598, 601 (C.A.7 1984) (“[M]onopoly and monopsony are symmetrical distortions of competition from an economic standpoint”).

#### **IV. Unilateral pricing policies and Section 2 of the Sherman Act**

The economic similarity between monopoly and monopsony suggests that buying power should be subject to the same antitrust rules and concepts that govern the exercise of market power of sellers. In terms of section 2 of the Sherman Act this is possible in principle although the statutory language would appear to address the selling side only<sup>81</sup>. The declaration that a firm shall not “monopolize” or “attempt to monopolize” has always been interpreted so as to encompass conduct of firms possessing market power on either side of the market. Indeed, monopsony has sometimes been colloquially called a “buyer's monopoly.”<sup>82</sup> Consequently, section 2 of the Sherman Act can be applied to conduct by both sellers and buyers.

Probably most influential in adding substance to the sweeping language of section 2 of the Sherman Act was Judge Learned Hand's opinion in *Unites States v. Aluminum Co. of America (Alcoa)*<sup>83</sup>. Alcoa established that a claim of “monopolization” requires a structural component, that is a high degree of market power of the monopolizing firm, and a conduct component, that is an abuse of this power in the form of “anticompetitive behavior”. Assuming sufficient market power of a buyer to satisfy the “structural component”<sup>84</sup>, the following discussion focuses on the conduct component of potential section 2 claims.

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<sup>81</sup> § 2 Sherman Act, 15 U.S.C. § 2 reads as follows: “Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.”

<sup>82</sup> Blair & Harrison, *ANTITRUST POLICY AND MONOPSONY*, 76 *Cornell L.Rev.* 297 (1991), at 301 and 320; Thomas A. Piraino, *A PROPOSED ANTITRUST APPROACH TO BUYERS' COMPETITIVE CONDUCT*, 56 *Hastings L.J.* 1121, 1125 (2005).

<sup>83</sup> *Unites States v. Aluminum Co. of America et al.* 148 F.2d 416 (2nd Cir. 1945). Alcoa was decided by the U.S. Court of Appeals for the Second Circuit since four members of the U.S. Supreme Court disqualified themselves.

<sup>84</sup> Originally, courts almost solely relied on the market share to ascertain whether a firm possessed sufficient market power. In recent years however, estimates of demand und supply side substitutability have increasingly informed the assessment of market power. A sophisticated

Specifically, the next sections address three types of unilateral conduct (i) monopsony pricing, i.e. buyers forcing one or more suppliers to reduce their prices below the competitive level<sup>85</sup>, (ii) predatory bidding or overbuying, i.e. driving up prices by bidding up the market or purchasing higher quantities of inputs in order to exclude competitors or to prevent new competitors from entering the market<sup>86</sup>, and (iii) price discrimination, i.e. paying distinct prices to different suppliers or inducing suppliers to sell at different prices in order to exclude or harm competing buyers.

### **1. Monopsony pricing**

As stated above, monopsony pricing ordinarily reduces aggregate social welfare and more often than not also impairs consumer welfare<sup>87</sup>. Yet, tracking the outcomes in monopoly cases suggests caution to assume a violation of § 2 of the Sherman Act when a monopsonist solely exercises its market power to lower input prices. For very good reasons courts have refrained from holding a monopolist liable if it simply availed itself of the opportunity to control prices by unilaterally restricting output. First, courts and commentators have pointed to the danger of chilling competition<sup>88</sup>. Second, as a practical

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method to measure buying power has been suggested by Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 47-61.

<sup>85</sup> Thomas A. Piraino, *A PROPOSED ANTITRUST APPROACH TO BUYERS' COMPETITIVE CONDUCT*, 56 *Hastings L.J.* 1121, 1137 (2005).

<sup>86</sup> *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S.Ct. 1069, 1075-76; John B. Kirkwood, *BUYER POWER AND EXCLUSIONARY CONDUCT: SHOULD BROOKE GROUP SET THE STANDARDS FOR BUYER-INDUCED PRICE DISCRIMINATION AND PREDATORY BIDDING?*, 72 *Antitrust L.J.* 625, 652 (2005) (establishing that in a predatory-bidding scheme, a purchaser of inputs “bids up the market price of a critical input to such high levels that rival buyers cannot survive (or compete as vigorously) and, as a result, the predating buyer acquires (or maintains or increases its) monopsony power.”)

<sup>87</sup> *Supra*, at III.

<sup>88</sup> See Justice Scalia’s opinion in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (arguing that 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”). See also Roger G. Noll, “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 613-614 (2005) (arguing “that society is better off if entrepreneurs have a

matter, there is no sensible remedy to monopoly pricing: A structural relief in the form of a dismantling order is likely to cause inefficiency by thwarting economies of scale<sup>89</sup>. The alternative of price regulation is hardly more appealing since courts and juries are ill equipped to ascertain a reasonable price<sup>90</sup>.

The same arguments also hold for buyers using their power to influence prices down: It is the lure of supracompetitive profits associated with monopsony that induces firms to innovate and gain competitive advantages. Furthermore, supracompetitive profits are a source of dilution of monopsony power as new firms are pulled in the markets.

Against this backdrop it comes to no surprise, that courts have been very reluctant to deem monopsony pricing sufficient to satisfy the conduct element of a monopolization claim. A decision of the Fifth Circuit Court of Appeals in *In Re Beef Industry Antitrust Litigation* is a rare exception<sup>91</sup>. In this case cattle ranchers alleged that a large buyer of cattle had misused its monopsony power in violation of Section 2 of the Sherman Act by pushing the price of cattle below the normal competitive level. The Fifth Circuit rejected the claim due to insufficient evidence. But the Court opined that plaintiffs could have

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financial incentive to invent ways to produce better products at lower costs, even if doing so creates a monopoly”)

<sup>89</sup> Roger G. Noll, *id.* at 615 (pointing to primary products, where “local monopsony arises when economies of scale produce only one or a very few local firms that acquire the product as an input”, for example by building a pipeline); Roger Blair & Jeffrey L. Harrison, *ANTITRUST POLICY AND MONOPSONY*, 76 *Cornell L. Rev.* 297, 307 FN 55 (1991) (arguing that restructuring a single buyer is likely to impose social welfare losses of uncertain magnitude “since there is an efficiency rationale for the existence of a single, large buyer”).

<sup>90</sup> From the outset of the Sherman Act the Supreme Court has rejected efforts to judge competitive conduct under the rubric of “fairness” or “reasonableness” of prices. See Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself* 22 (2d ed. 1993) (pointing to *United States v. Trans-Missouri Freight Ass’n*, 166 U.S. 290 (1897), Justice “Peckham saw that a reasonable-price standard was no standard”). One year later, then-Judge Taft’s argued that such an approach “set[s] sail on a sea of doubt” since the fairness or reasonableness of a price is an illusory question in the antitrust context. *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 284 (6th Cir. 1898), *aff’d* as modified, 175 U.S. 211 (1899); see also *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 427 (2d Cir. 1945) (rejecting a monopolization claim that would ask whether defendant had earned more than a “fair profit”).

<sup>91</sup> 907 F.2d 510 (5<sup>th</sup> Cir. 1990).

prevailed if they had been able to prove that the purchaser used its market power to reduce “its purchases of and its prices for fed cattle.”<sup>92</sup>

While this finding accounts for the economic inefficiencies caused by monopsony pricing, most courts reached a different conclusion. For example, Judge Breyer in *Kartell* cautioned that antitrust liability ought not to hinge upon the reasonableness of the price in question because “normally the choice of what to seek to buy and what to offer to pay is the buyer’s.”<sup>93</sup> Breyer added that “courts only rarely try to supervise the price bargain directly,”<sup>94</sup> and he placed special significance on the fact that “the prices at issue here are low prices, not high prices.”<sup>95</sup> This opinion has influenced several other courts. In *Westchester Radiological Associates v. Empire Blue Cross & Blue Shield*<sup>96</sup>, for instance, a group of radiologists alleged that an insurance company had unlawfully exercised its buying power to depress the prices its subscribers paid for radiology services. The District Court of the Southern District, N.Y., concluded: “The law does not prevent (a reseller) with market power from negotiating a good price ... Even if the (reseller) has monopoly power, an antitrust court will not interfere with a (reseller’s) determination of price ... A legitimate (reseller) is entitled to use its market power to keep prices down.”<sup>97</sup> In a recent decision, the District Court of the Middle District of North Carolina found “that antitrust law does not provide a remedy for ‘nonabusive monopsony conduct.’ There is no provision that can force a single buyer to pay higher prices for its inputs, ‘[j]ust as section 2 of the Sherman Act does not forbid the structural condition of monopoly.’”<sup>98</sup>

All these decisions suggest that monopsonists can set monopsony prices without violating Section 2 of the Sherman Act in quite the same fashion as monopolists can set monopoly

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<sup>92</sup> *Id.* at 515.

<sup>93</sup> *Kartell II*, 749 F.2d, at 927.

<sup>94</sup> *Id.*, at 928.

<sup>95</sup> *Id.*, at 930.

<sup>96</sup> *Westchester Radiological Associates v. Empire Blue Cross and Blue Shield, Inc.*, 707 F. Supp. 708, (S.D.N.Y.), affirmed, 884 F.2d 707, 708 (2d Cir. 1989), cert. denied, 493 U.S. 1095, 110 S. Ct. 1169, 107 L. Ed. 2d 1071 (1990).

<sup>97</sup> *Id.*, at 715.

<sup>98</sup> *D. Lamar DELOACH et al. v. PHILIP MORRIS COMPANIES, INC., et al.*, F.Supp.2d, 2001 WL 1301221 M.D.N.C. (2001), at 14 (citing Roger Blair & Jeffrey L. Harrison, *ANTITRUST POLICY AND MONOPSONY*, 76 *Cornell L. Rev.* 297, 307 (references and emphases omitted)).

prices. However, there has been an important exception to the rule with regard to monopolies: Monopolists have for a long time not been permitted to decline to sell to competitors in downstream markets for which their product is an essential facility or input<sup>99</sup>. Taking his cue from these decisions, Thomas Piraino proposes a similar rule for large buyers. According to his proposal, buyers - like defendants in the essential facilities cases - “should be deemed to have a corresponding duty to deal with all eligible suppliers on reasonable terms. This duty would include agreeing to purchase from suppliers at prices no more than ten percent below the prevailing competitive price.”<sup>100</sup>

This proposition does not seem to be very appealing. First, the essential facility doctrine itself has come under attack recently. In *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko* the Supreme Court seems to have all but abandoned it<sup>101</sup>. It is quite unclear whether and in which circumstances a firm with market power is still required to insure that all eligible parties can use its facilities upon reasonable and equal terms<sup>102</sup>. As a result, the essential facility doctrine is a weak basis to develop a broad exception to the legality of monopsonists influencing prices down. In any event, the approach puts judges and juries in the position of finding the reasonable price<sup>103</sup>, a task for which judges have

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<sup>99</sup> See *United States v. Otter Tail Power Co.*, 410 U.S. 366 (1973).

<sup>100</sup> Thomas A. Piraino, *A PROPOSED ANTITRUST APPROACH TO BUYERS' COMPETITIVE CONDUCT*, 56 *Hastings L.J.* 1121, 1177-1178 (2005).

<sup>101</sup> *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398. In quite clear words Justice Scalia notes: “This conclusion would be unchanged even if we considered to be established law the ‘essential facilities’ doctrine crafted by some lower courts, under which the Court of Appeals concluded respondent's allegations might state a claim. We have never recognized such a doctrine, and we find no need either to recognize it or to repudiate it here. It suffices for present purposes to note that the indispensable requirement for invoking the doctrine is the unavailability of access to the ‘essential facilities’; where access exists, the doctrine serves no purpose”.

<sup>102</sup> In a narrow interpretation, the significance of *Trinko* may be limited to industries that are subject to detailed regulation. (See Scalia, *id.*: “One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small”).

<sup>103</sup> In particular this aspect seems to have informed the reserved attitude of the majority of the *Trinko* Court towards the essential facilities doctrine. See Scalia, *id.* stating that “enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill-suited”.

no expertise and a matter wholly outside the ken of most jurors<sup>104</sup>. Specifically, in most cases it is not easy to identify the competitive price and the 10 % margin below the competitive level - proposed by Piraino to avoid false positives<sup>105</sup> - appears arbitrary.

All in all, despite the deleterious economic effects of monopsony pricing, no antitrust response exists to this type of conduct. Monopsony pricing cannot be deemed an abuse of market power under section 2 of the Sherman act. If at all, specific regulation tailored to the concrete circumstances of an industry might be a solution to overcome monopsonistic inefficiencies in cases of durable monopsony<sup>106</sup>. These are rare since the prospect of supracompetitive profits is likely to quickly erode monopsony power as new firm enter an industry.

## **2. Overbuying and Predatory bidding**

If monopsony pricing does not violate section 2 of the Sherman Act the question arises what constitutes improper, i.e. inherently anticompetitive, pricing conduct of buyers. Again, looking at the other side of the market is telling: In monopoly cases predatory pricing is the type of conduct that has traditionally been seen to most clearly satisfy the conduct element of the monopolization claim. For example, in Alaska Airlines the Ninth Circuit Court of Appeals opined that “the Sherman Act punishes any individual or entity that uses ‘predatory’ means to attain a monopoly, or to perpetuate a monopoly after the competitive superiority that originally gave rise to the monopoly has faded.”<sup>107</sup>

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<sup>104</sup> See the illustrative report of Arthur Austin, THE JURY SYSTEM AT RISK FROM COMPLEXITY, THE NEW MEDIA, AND DEVIANCY, 73 *Deriv. U. L. Rev.* 51, 54 (1995) (stating that “at no time did any juror grasp - even at the margins - the law, the economics or any other testimony relating to the allegations or defense. ... [A]t no time have I ever encountered a juror who had the foggiest notion of what oligopoly, market power, or average variable costs meant, much less how they applied to the case.”).

<sup>105</sup> Thomas A. Piraino, A PROPOSED ANTITRUST APPROACH TO BUYERS’ COMPETITIVE CONDUCT, 56 *Hastings L.J.* 1121, 1176-1177 (2005).

<sup>106</sup> Roger G. Noll, “BUYER POWER” AND ECONOMIC POLICY, 72 *Antitrust L.J.* 589, 619 (2005) (arguing that “the best solution to the problem of a durable monopoly or monopsony will be a form of regulation”).

<sup>107</sup> *Alaska Airlines, Inc. v. United Airlines, Inc.* 932 F.2d 1571 (9<sup>th</sup> cir. 1991).

The corresponding conduct to predatory pricing on the buying side of the market is overbuying or overbidding. Both involve predatory means in order to excluder competitors. In a predatory-bidding scheme, the purchaser causes prices to rise by offering to pay more for inputs. In a predatory-overbuying scheme, the purchaser causes prices to rise by demanding more of the input. Either way, the economic effects are the same: input prices rise. Therefore both claims are analytically identical and should be treated in the same fashion<sup>108</sup>.

While it is settled law, that attaining and perpetuating monopoly and monopsony by predatory means may, in principle, satisfy the conduct element of section 2 of the Sherman Act, there has for long been a controversy about the exact boundaries of liability. In terms of predatory pricing, Courts have increasingly limited the scope of section 2 claims. In its famous decisions in *Brooke Group*<sup>109</sup> and *Matsushita*<sup>110</sup> the Supreme Court finally developed a two prong test that must be satisfied to sustain a predatory pricing claim: First the plaintiff must demonstrate that "the prices complained of are below an appropriate measure of its rival's costs."<sup>111</sup> Second the plaintiff must prove that the defendant had a "reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered."<sup>112</sup>

A vivid dispute has evolved among courts and commentators, whether equivalent standards should be applied to the corresponding conduct of buyers. According to the Ninth Circuit Court of Appeals a plaintiff need not show that the predatory buyer operated at a loss during the phase of predation and that a dangerous probability of recouping ex-

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<sup>108</sup> The supreme Court also stressed this point in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S.Ct. 1069, 1076 FN3 (2007) (arguing that "(o)ur use of the term 'predatory bidding' is not meant to suggest that different legal treatment is appropriate for the economically identical practice of 'predatory overbuying.'")

<sup>109</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993).

<sup>110</sup> *Matsushita Elec. Industrial Co. v. Zenith Radio*, 475 U.S. 574 (1986).

<sup>111</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp*, 509 U.S. 209, 222 (1993) (citing *Matsushita Elec. Industrial Co. v. Zenith Radio*, 475 U.S. 574, 585 FN 8).

<sup>112</sup> *Brooke Group, id.*, at 224 (citing *Matsushita Elec. Industrial Co. v. Zenith Radio*, 475 U.S. 574, 588-89).

isted<sup>113</sup>. Rather, the Ninth Circuit adopted a rule of reason approach and upheld the District Court’s jury instruction. Pursuant to this instruction a jury can find a predator liable if it purchases more input “than necessary” in order to prevent the competitors from obtaining the inputs needed “at a fair price”.<sup>114</sup> Many commentators disagreed, pointing to the difficulties in regulating prices, the danger of chilling competition and the ambiguous effect on consumer welfare<sup>115</sup>.

The Supreme Court has resolved the controversy this year in *Weyerhaeuser*<sup>116</sup>. The Court found that claims of predatory pricing of sellers and overbidding of buyers are analytically similar. “Both claims involve the deliberate use of unilateral pricing measures for anticompetitive purposes. And both claims logically require firms to incur short-term losses on the chance that they might reap supracompetitive profits in the future.”<sup>117</sup> Justice Thomas, writing for a unanimous court, adds that predatory bidding mirrors predatory pricing in exactly those respects that it deemed significant in *Brooke Group*: First, a “predatory-bidding scheme requires a buyer of inputs to suffer losses today on the chance that it will reap supracompetitive profits in the future. For this reason, ‘[s]uccessful monopsony predation is probably as unlikely as successful monopoly predation.’”<sup>118</sup> Second, he expresses concerns that imposing too lax a standard of liability might be destructive of competition on the merits: “Like the predatory conduct alleged in *Brooke Group*, actions taken in a predatory-bidding scheme are often ‘the very essence of competition.’”<sup>119</sup> Third, Justice Thomas notes that a “failed predatory-bidding scheme can be a

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<sup>113</sup> *Confederated Tribes of Siletz Indians of Or. v. Weyerhaeuser Co.*, 411 F.3d 1030, 1037 - 1040 (9th Cir. 2005).

<sup>114</sup> *Id.*, at 1039 – 1040.

<sup>115</sup> See, for instance, brief amici curiae of Law Professors Daniel A. Crane, Richard A. Epstein, Thomas A. Lambert, Fred S. McChesney, Thomas D. Morgan, Christopher Sprigman, and Joshua D. Wright in support of petitioner *Weyerhaeuser*, 2006 WL 2459516 (U.S.). See also Steven C. Salop, *ANTICOMPETITIVE OVERBUYING BY POWER BUYERS*, 72 *Antitrust L.J.* 669, 703-706 (2005).

<sup>116</sup> *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S.Ct. 1069 (2007).

<sup>117</sup> *Id.*, at 1076.

<sup>118</sup> *Id.*, at 1077, citing Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 66.

<sup>119</sup> *Id.*, at 1077 (quoting *Matsushita Elec. Industrial Co. v. Zenith Radio*, 475 U.S. 574, at 594). The court then establishes a number of arguably legitimate objectives why a buyer might bid up

'boon to consumers' in the same way that we considered a predatory-pricing scheme to be"<sup>120</sup>. Finally, he points to distinct differences between predatory pricing and predatory bidding schemes and draws the inference that the latter, if at all, are less likely to be deleterious to consumer welfare 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. ... 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."<sup>121</sup>

Consequently, the Supreme Court imposed a slightly adjusted version of the Brooke Group standard to claims of predatory bidding. According to this standard, a plaintiff must prove that the defendant's alleged predatory bidding led to "below-cost pricing of the predator's outputs"<sup>122</sup>. That is, the predator's bidding on inputs must have caused the firm to suffer losses from selling its products or services. Furthermore, a predatory-bidding plaintiff must prove that the predator has a "dangerous probability of recouping the losses incurred in bidding up prices through the exercise of monopsony power"<sup>123</sup>. Because Ross-Simmons conceded that it had not satisfied the Brooke Group standard at trial, the Supreme Court vacated the judgment of the Ninth Circuit Court of Appeals.

Ultimately, the Supreme Court established a new short cut rule for predatory bidding and overbuying which is very difficult to satisfy. Obviously, the court was anxious to intrude upon the operation of market forces and to preserve wide room for pricing discretion and competition. That is, in terms of deterrence, the court considered the expected cost of over-deterrence as greater than the expected cost of under-deterrence in predatory bid-

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input prices (bidding up inputs because of "miscalculation of its input needs", or as a "part of a procompetitive strategy to gain market share in the output market", or as a "hedge against the risk of future rises in input costs or future input shortages").

<sup>120</sup> *Id.*, at 1077-1078 (citing *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993)).

<sup>121</sup> *Id.*, at 1078 (citing Steven C. Salop, *ANTICOMPETITIVE OVERBUYING BY POWER BUYERS*, 72 *Antitrust L.J.* 669, 676 (2005)).

<sup>122</sup> *Id.*, at 1078.

<sup>123</sup> *Id.*, at 1078.

ding cases<sup>124</sup>. Furthermore, it would appear that the decision is also based on other rationales for truncated rules, namely reducing the analytic and decision making burden for courts<sup>125</sup> and reducing uncertainty for and facilitating planning by firms: The new two prong test is easy to handle and comprehensible for courts, juries, and firms alike, whereas the “reasonableness”-standard of the Ninth Court of Appeals is not.

The last point clearly supports the new rigorous antitrust standard for predatory bidding which mirrors the Group Brook test for predatory pricing. Given the virtual impossibility to ascertain the competitive price in an industry, any effort to enforce “fair” or “reasonable prices” is prone to further distort markets instead of providing a sensible remedy to unfair pricing measures. And “the difficulty of distinguishing an anticompetitive overbuying strategy from a competitive purchase expansion can be similar to the difficulties in predatory pricing matters.”<sup>126</sup>

As to the soundness of the Justice Thomson’s economic discussion of monopsony and predatory bidding, however, some doubts would appear to be in order. Evidently sticking with the classical model of a single price monopsonist, Justice Thomas expects consumers to benefit in the first phase of the predatory bidding scheme, when the buyer is bidding prices up: “In the first stage the predator’s high bidding will likely lead to its acquisition of more inputs. Usually, the acquisition of more inputs leads to the manufacture of more outputs. And increases in output generally result in lower prices to consumers.”<sup>127</sup> Turning to the recoupment-period, then, he finds only ambiguous indicia of consumer harm since output prices may remain constant when a predatory bidder simply exercises

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<sup>124</sup> See Steven C. Salop, ANTICOMPETITIVE OVERBUYING BY POWER BUYERS, 72 *Antitrust L.J.* 669, 698 (2005) (arguing that a “rationale for short-cut rules is to consciously place a thumb on one side of the scales of justice.”).

<sup>125</sup> See *FTC v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411 (1990) (arguing that – even if short-cut rules lead to erroneous determinations in a fraction of the cases – a judicial economy rationale may still justify the truncated scrutiny if those errors are unlikely enough. That is, the errors “may be a small price to pay for the streamlined process”, Steven C. Salop, *id.*, at 698.)

<sup>126</sup> See Steven C. Salop *p. id.*, at 703 (stressing that “predatory pricing might instead be called predatory ‘overselling.’”).

<sup>127</sup> *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S.Ct. 1069, 1077 (2007).

its power “to force down input prices and capture monopsony profits”<sup>128</sup>. This reasoning is one-sided and somewhat skewed.

As demonstrated above, monopsony pricing will not engender constant output prices but will drive output prices up in most instances<sup>129</sup>: According to the classical economic model, a monopsonist will maximize its profit by reducing input purchases. This, in turn, probably yields lower quantities of output sold at higher prices. To create a circumstance in which monopsony power does not increase output prices requires assuming a perfectly competitive output market. In this case the reduced output of the monopsonist will be fully offset by increased output from other producers<sup>130</sup>. Indeed, in Weyerhaeuser downstream lumber markets were alleged to be competitive. If supply in downstream markets is perfectly elastic, however, the increased purchases of the monopsonist during the predatory phase of the bidding scheme will not lead to more output and lower prices to consumers, as assumed by Justice Thomas.

Moreover, Justice Thomas’ opinion does not reflect the specific conditions of the geographic log market at issue. While the Ninth Circuit placed special significance on the fact that supply of logs was inelastic, Thomas did not even mention this feature of the market when assessing the consumer welfare implications of the alleged predatory-bidding scheme. Supply inelasticity, however, heavily influences the economic effects of monopsony<sup>131</sup>: If the supply of inputs is inelastic, neither market purchases of the monopsonist nor its output quantity will rise during the predatory period. As a result, consumers cannot benefit from lower output prices<sup>132</sup>. Admittedly, consumer harm during the subsequent recoupment phase is also unlikely in the short run, even if the predator causes its rivals to exit, because the monopsonist will still buy all the supply. In the long run, though, negative (dynamic) effects of monopsony pricing are likely to occur in the

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<sup>128</sup> *Id.*, at 1078.

<sup>129</sup> *Supra*, at III 1.

<sup>130</sup> *Supra*, at III 1 a (as demonstrated, such an assumption is fairly unrealistic).

<sup>131</sup> *Supra*, at III 2 a.

<sup>132</sup> Steven C. Salop, *ANTICOMPETITIVE OVERBUYING BY POWER BUYERS*, 72 *Antitrust L.J.* 669, 678 (2005).

form of underinvestment<sup>133</sup>. Specifically, the missing prospect of competitive returns on hardwood seedlings will probably cause woodland owners to plant less alder seedlings<sup>134</sup>.

Finally, the special features of the market cast doubt on Justice Thomas' discussion of the profitability of the alleged predatory bidding scheme. First, the inelasticity of log supply renders it less dangerous to bid prices up since the monopsonist needs to buy only a constant quantity of logs at inflated prices, whereas its losses would increase significantly if more input is supplied at the higher price. Second, Weyerhaeuser used modern technology, including sawing equipment "that increased the amount of lumber recovered from every log"<sup>135</sup>. Under such circumstances the common notion that a dominant firm engaged in predatory pricing incurs higher losses than an equally efficient victim with a smaller market share does not necessarily apply: rivals may simply be "more vulnerable to the input price increase because they use relatively more of the input in their production process than does the firm engaged in the overbuying strategy"<sup>136</sup>.

After all, the facts in Weyerhaeuser seem to constitute a weak case to apply the principally persuasive standard set forth by the Supreme Court. Since supply was relatively inelastic in the short run but became more elastic in the long run, while demand for the downstream product of the monopsonist was relatively (but not perfectly) elastic, the alleged predatory bidding scheme of Weyerhaeuser was likely to harm consumers as well as competitors. At the same time, the probability of Weyerhaeuser's predatory bidding scheme to succeed was clearly elevated. Thus, the arguments in favor of a truncated analysis under these circumstances are not fully persuasive.

Greater shortcomings are to be expected if one undertakes to generalize the Weyerhaeuser test to other forms of exclusionary pricing decisions of powerful buyers without considering the concrete economics at issue. For example, a strategy of rising rivals costs by overbuying which aims at increasing *output prices* is likely to work out without pay-

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<sup>133</sup> See *supra*, at III 2 a, b.

<sup>134</sup> Richard O. Zerbe Jr., *MONOPSONY AND THE ROSS-SIMMONS CASE: A COMMENT ON SALOP AND KIRKWOOD*, 72 *Antitrust L.J.* 717, 722 (2005).

<sup>135</sup> *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S.Ct. 1069, 1072 (2007).

<sup>136</sup> Steven C. Salop, *ANTICOMPETITIVE OVERBUYING BY POWER BUYERS*, 72 *Antitrust L.J.* 669, 680 (2005).

ing so high an input price that the firm will incur a loss on the sale of the output<sup>137</sup>. Thus, it seems fair to suggest that the Weyerhaeuser decision does not go beyond aligning the law of predatory selling and predatory bidding. In particular, one should be very cautious to apply the Weyerhaeuser test if plaintiff's theory of abusive conduct is based on raising rivals' costs or on non-price predatory conduct.

### 3. Price discrimination

US antitrust law specifically addresses price-discrimination in Section 2 of the Clayton Act as amended by the Robinson-Patman Act<sup>138</sup>. This act defines price discrimination plainly as a difference in price<sup>139</sup>. Such an approach does not easily square with economic analysis<sup>140</sup> and the general objective of the Sherman Act to protect competition, not competitors<sup>141</sup>. As a result, the sweeping prohibitions of the Robinson-Patman Act have been met with at times harsh criticism<sup>142</sup>.

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<sup>137</sup> Steven C. Salop, ANTICOMPETITIVE OVERBUYING BY POWER BUYERS, 72 Antitrust L.J. 669, 679-682 (2005) (arguing that Raising Rivals Cost (RRC) "overbuying raises more significant consumer harm concerns" and "that a below-cost pricing test for RRC overbuying is more likely to lead to false negatives. Thus, a court should not require the below-cost pricing test as a formal requirement for RRC overbuying."). The Supreme Court in Weyerhaeuser also distinguishes this case from the plain predatory bidding scheme at issue: "If the predatory firm's competitors in the input market and the output market are the same, then predatory bidding can also lead to the bidder's acquisition of monopoly power in the output market. In that case, which does not appear to be present here, the monopsonist could, under certain market conditions, also recoup its losses by raising output prices to monopolistic levels."

<sup>138</sup> § 15 U.S.C. § 13.

<sup>139</sup> *FTC v. Anheuser-Busch, Inc.*, 363 U.S. 536, 549 (1960).

<sup>140</sup> The economic definition of price discrimination is a price differential that does not correspond to the difference in the marginal costs of serving two buyers. See, e.g., Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 19.

<sup>141</sup> John B. Kirkwood, BUYER POWER AND EXCLUSIONARY CONDUCT: SHOULD BROOKE GROUP SET THE STANDARDS FOR BUYER-INDUCED PRICE DISCRIMINATION AND PREDATORY BIDDING?, 72 Antitrust L.J. 625, 631 - 634 (2005).

<sup>142</sup> For collections of this criticism, see ABA Antitrust Section, Monograph No. 4, *THE ROBINSON-PATMAN ACT: POLICY AND LAW* (vol. 1, 1980 & vol. 2, 1983). See also John B. Kirkwood, *id.*, at 72 Antitrust L.J. 625, 648 (2005) (arguing that the criticism may simply reflect "the Act's notorious tendency to discourage sellers from granting cost-justified concessions to large buyers. Such concessions are, of course, more likely to benefit consumers than unjustified

This paper does not aim at reiterating the controversy on the reasonableness of a general prohibition on price discrimination. Rather, it specifically addresses price-discrimination that may violate Section 2 of the Sherman Act. In the context of buying power, price discrimination can satisfy the conduct element of “monopolization” or “attempted monopolization” when it is used by powerful buyers as a means of excluding rival buyers.

Again, the controversy about the equivalent conduct of sellers, i.e. exclusionary price discrimination of sellers possessing market power, highlights the problem. As explained by John Kirkwood<sup>143</sup>, “a powerful seller uses price discrimination as an exclusionary device when it charges supracompetitive prices in some geographic markets and eliminates [new] competitors in other markets through predatory pricing. ... If this geographic discrimination is likely to destroy or suppress the new competition, it will have caused what is called ‘primary line’ injury - injury inflicted by a powerful seller on other sellers.”

Price discrimination employed by sellers as an exclusionary device and predatory pricing are closely intertwined and analytically similar: In both cases a competitor claims that a rival has unduly priced its products in an attempt at eliminating or retarding competition and thereby gaining or maintaining market power in the relevant market<sup>144</sup>. This caused the Supreme Court in *Brooke Group* to find that primary line discrimination and predatory pricing should be subject to identical legal standards<sup>145</sup>. That is, to establish actionable primary line discrimination a plaintiff must prove that the defendant engaged in predatory pricing<sup>146</sup>. And to supply this proof the plaintiff must demonstrate the two demanding

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discrimination. Doubtlessly, though, much criticism of the Act is rooted in the belief that even unjustified concessions induced by large buyers frequently benefit consumers as a whole”).

<sup>143</sup> John B. Kirkwood, *id.*, at 626. See also *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) (“That below cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured.” Citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)).

<sup>144</sup> See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 221 (1993) (establishing that “it has become evident that primary line competitive injury under the Robinson Patman Act is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act.”).

<sup>145</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, *id.*, at 220 - 221.

<sup>146</sup> Because of the economic similarity the Supreme Court in *Brooke Group*, *id.*, at 221-222, even construed the Robinson Patman Act prohibition against primary line discrimination in light of the liability standards under Section 2 Sherman Act. To this end, the Court discounted the sweeping

requirements set forth in *Brooke Group*: (i) below cost pricing and (ii) a dangerous probability<sup>147</sup> or at least a reasonable prospect<sup>148</sup> of recoupment<sup>149</sup>.

In *Weyerhaeuser* the Supreme Court established a two prong test for predatory bidding that directly mirrors the *Brook Group* test for predatory selling. Thus, the question arises whether this new standard for predatory bidding should also be applied to discriminatory conduct of buyers that harms competing buyers, i.e. “secondary line discrimination”<sup>150</sup>. Since the Supreme Court directly derived the *Weyerhaeuser* test as a mirror image from the *Brook Group* standard there seems to be a strong case to answer the question in the affirmative<sup>151</sup>.

Simply extending the *Weyerhaeuser* standard to exclusionary price discrimination of powerful buyers, however, would appear to be flawed. Buyers may harness very different forms of price discrimination to exclude rivals. On a broad level, one has to distinguish between buyers paying different prices for identical input to their suppliers and buyers inducing suppliers to receive a more favorable price vis-à-vis their rivals. Although both

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ban on price discrimination in the *Robinson-Patman Act* by stressing the purpose of the statutory qualifications, namely that the effect of such discrimination “be substantially to lessen competition” (§ 13 (a)). Furthermore, the statutory defenses in § 13(a), (“changing conditions affecting the market for or the marketability of the goods concerned,”) and § 13 (b) (conduct undertaken “in good faith to meet an equally low price of a competitor,”) convinced the court “that Congress did not intend to outlaw price differences that result from or further the forces of competition. Thus, the *Robinson Patman Act* should be construed consistently with broader policies of the antitrust laws.”).

<sup>147</sup> Under § 2 of the *Sherman Act*. See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp*, *id.*, at 222, 224.

<sup>148</sup> Under § 2 (a) of the *Clayton Act* as amended by the *Robinson-Patman Act*. See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp*, *id.*, at 222, 224.

<sup>149</sup> See John B. Kirkwood, BUYER POWER AND EXCLUSIONARY CONDUCT: SHOULD BROOKE GROUP SET THE STANDARDS FOR BUYER-INDUCED PRICE DISCRIMINATION AND PREDATORY BIDDING?, 72 *Antitrust L.J.* 625, 626 (2005) (arguing that “*Brooke Group* brought the *Robinson-Patman Act* closer to the other antitrust laws by holding that price discrimination that injures rival sellers cannot violate the *Robinson-Patman Act* unless it meets the tests for predatory pricing under the *Sherman Act*.”).

<sup>150</sup> John B. Kirkwood, *id.*, at 626 (2005).

<sup>151</sup> This question has been debated even before *Weyerhaeuser* in light of the *Brook Group* standard. See John B. Kirkwood, *id.*, at 627 (establishing that defendants “often argue that buyer-induced secondary line discrimination requires the mirror image of monopoly power-single-firm monopsony power”).

forms of price discrimination may be used as an exclusionary device they involve quite distinct economic effects. These differences suggest applying different legal standards.

**a) Direct price discrimination of buyers**

When powerful buyers engage in direct price discrimination, that is, if they pay different prices for inputs of identical quality, a strong case can be made to apply the Weyerhaeuser standard. In particular, one can conceive of conduct of a discriminatory buyer that exactly mirrors the primary line discrimination of powerful sellers: A powerful buyer can bid up prices or engage in overbuying in some geographic market to exclude a (new) rival buyer, while the powerful buyer pays competitive or even monopsony prices to its suppliers in other geographic markets at the same time, thereby financing its predatory campaign<sup>152</sup>.

Such a price discrimination scheme would appear to be actionable under section 2 of the Sherman Act only<sup>153</sup>. Given the similarity to a predatory bidding scheme<sup>154</sup> and in light of the Brook Group findings, then, there is no reason to deviate from the Weyerhaeuser standard. This means a predatory-bidding plaintiff would have to prove that the predator's bidding caused the cost of producing its relevant output to rise above the revenues generated in the sale of those outputs. Furthermore, a plaintiff would have to prove that the defendant had a dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power<sup>155</sup>.

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<sup>152</sup> Discriminatory pricing, though, may also be a profitable strategy to exploit differences in supply elasticities. See Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 90 -92.

<sup>153</sup> The prohibitions of the Robinson-Patman Act do not seem to extend to a discriminatory monopsonist. See Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 92.

<sup>154</sup> The competitive injury of this type of price discrimination is of the same character as the injury inflicted by predatory pricing.

<sup>155</sup> *Supra*, at IV 2.

### **b) Buyer induced price discrimination**

The ordinary Robinson-Patman scenario of secondary line price discrimination, however, is different<sup>156</sup>. Here the buyer does not engage in direct discrimination. Rather, it induces a supplier to price discriminate by prompting the supplier to grant a price concession that it does not offer to the rivals of the buyers. The buyer, then, can utilize the resulting cost advantage to drive some rival buyers out of business or, at least, to weaken their competitiveness. Although the ultimate target is the same, buyer induced price discrimination raises economic concerns and problems quite distinct from direct discrimination. These differences suggest that the Weyerhaeuser test – or an adjusted variation thereof - should not govern buyer-induced price discrimination.

Most notably, a buyer that elicits favorable contractual terms from sellers does not incur any loss from its conduct. Thus, there is no reason to believe that induced discrimination cases are rarely tried and even more rarely successful. That is, a crucial rationale for both the Weyerhaeuser and the Brook Group test is missing. Moreover, any test referring to the price/cost ratio of the powerful buyer or its suppliers does not reach the core of the complaint, namely potential market distortions through discriminatory conduct that is not cost justified<sup>157</sup>.

This does not mean, though, that buyer induced price discrimination of sellers should be subject to a laxer standard of liability under section 2 of the Sherman Act. The consumer and social welfare consequences of induced price discrimination are ambiguous and complicated<sup>158</sup>. While consumer welfare is likely to be enhanced in many cases, there is also a broad array of circumstances under which price discrimination may harm consumer

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<sup>156</sup> Section 2 (f) of the Clayton Act as amended by the Robinson Patman Act makes it “unlawful for any person ... knowingly to induce or receive a discrimination in price which is prohibited by this section.”

<sup>157</sup> See John B. Kirkwood, BUYER POWER AND EXCLUSIONARY CONDUCT: SHOULD BROOKE GROUP SET THE STANDARDS FOR BUYER-INDUCED PRICE DISCRIMINATION AND PREDATORY BIDDING?, 72 Antitrust L.J. 625, 631 (2005) (stating that, from a legal perspective, “non-cost-justified discrimination is the core of the secondary line offense”).

<sup>158</sup> See for example Roger G. Noll , “BUYER POWER” AND ECONOMIC POLICY, 72 Antitrust L.J. 589, 622 (2005) (arguing that “standard price discrimination benefits some consumers and increases efficiency, but it harms other consumers, transfers more wealth to the monopolist, and can be used against downstream competitors to leverage monopoly into other markets”).

welfare<sup>159</sup>. By the same token, the effect on competition in input markets depends on the specific facts at issue: Buyer induced price discrimination is likely to stimulate competition if suppliers earn supracompetitive rents, particularly in oligopolistic markets with excess capacity<sup>160</sup>. On the other hand, price discrimination renders suppliers more vulnerable to all-or-nothing offers of strategic buyers<sup>161</sup>, thereby increasing the danger of underinvestment and underdevelopment in the long term<sup>162</sup>. Sweeping short-cut rules are hardly able to capture these differences. Thus, a rule of reason standard under Section 2 of the Sherman Act would appear to be preferable<sup>163</sup>.

Practically, induced price discrimination cases are usually not tried under Section 2 of the Sherman Act but under section 2 (f) of the Clayton Act since this provision is still inter-

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<sup>159</sup> John B. Kirkwood, BUYER POWER AND EXCLUSIONARY CONDUCT: SHOULD BROOKE GROUP SET THE STANDARDS FOR BUYER-INDUCED PRICE DISCRIMINATION AND PREDATORY BIDDING?, 72 *Antitrust L.J.* 625, 645 (2005) (arguing that buyer-induced non-cost-justified discrimination, in most instances, is likely to benefit consumers. But he hastens to add that “there are five situations in which such discrimination would reduce consumer welfare. Consumers may therefore benefit from a limited prohibition of buyer-induced discrimination.”)

<sup>160</sup> F.M. Scherer & David Ross, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* (3d ed. 1990), at 528 -532 provide an extensive analysis of a buyer's ability to exercise countervailing power against sellers. They argue that suppliers pricing above marginal cost have an “incentive to make discriminatory price cuts” if they would otherwise lose business. This incentive is seen to be particularly large when the sellers are oligopolists with excess capacity, and when the amount of business at stake is substantial: “[O]ligopolists are prone to cut prices in order to land an unusually large order, especially when they have excess capacity. Large buyers can exploit this weakness by concentrating their orders into big lumps, dangling the temptation before each seller, and encouraging a break from the established price structure.”

<sup>161</sup> Roger D. Blair & Jeffrey L. Harrison, *MONOPSONY: ANTITRUST LAW AND ECONOMICS* (1993), at 89-90.

<sup>162</sup> See *supra* at III 2 b.

<sup>163</sup> Even if a full rule of reason test is applied, the burden of persuasion can be adjusted to reflect differential expected error costs, see Steven C. Salop, ANTICOMPETITIVE OVERBUYING BY POWER BUYERS, 72 *Antitrust L.J.* 669, 698-699 (2005). This accords with the suggestions of Thomas A. Piraino, A PROPOSED ANTITRUST APPROACH TO BUYERS' COMPETITIVE CONDUCT, 56 *Hastings L.J.* 1121, 1143-1145 (2005) with regard to Section 1 of the Sherman Act: “Cases of alleged induced discrimination should be classified at the middle of the Sherman Act continuum and analyzed under an intermediate approach that is more detailed than the per se rule but less detailed than the rule of reason.”

puted so as to directly protect competing buyers<sup>164</sup>. As a result it would seem much easier for plaintiffs to prevail if they suffer secondary line injury. Powerful buyers, though, may still escape punishment because liability under section 2 (f) is contingent upon the fact that the induced discrimination was prohibited from the perspective of the seller<sup>165</sup>. This means, a powerful buyer can solicit bids from various sellers. Each seller may then have a valid “meeting competition” defense for a discriminatory offer<sup>166</sup>. If this is the case, i.e. without unlawful price discrimination of the seller, the buyer, likewise, will not be answerable under section 2 (f)<sup>167</sup>. Thus, in terms of induced price discriminations, the meeting competition defense of sellers essentially insulates powerful buyers from liability in most instances<sup>168</sup>.

## V. Conclusion

Irrespective of some differences between market power of sellers and buyers, monopoly pricing and monopsony pricing ordinarily have similar economic effects. Both engender inefficiencies and both are likely to be inimical to consumer welfare. Since courts are increasingly committed to considering economic analysis in cases tried under Section 2 of the Sherman Act, these similarities have caused courts to apply essentially the same legal rules to both monopolists and powerful buyers. This trend has engendered quite harsh

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<sup>164</sup> John B. Kirkwood, BUYER POWER AND EXCLUSIONARY CONDUCT: SHOULD BROOKE GROUP SET THE STANDARDS FOR BUYER-INDUCED PRICE DISCRIMINATION AND PREDATORY BIDDING?, 72 Antitrust L.J. 625, 632 (2005) (arguing that the “legislative history of the Robinson-Patman Act and numerous court decisions-before and after Brooke Group-indicate that the primary purpose of prohibiting non-cost-justified secondary line discrimination is not to promote consumer welfare, but to protect small business”).

<sup>165</sup> Great Atlantic & Pacific Tea Co. v. FTC, 440 U.S. 69, 81 (1979).

<sup>166</sup> See Section 2 (b) of the Clayton Act. It provides that “nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor”.

<sup>167</sup> Great Atlantic & Pacific Tea Co. v. FTC, 440 U.S. 69, 81 (1979).

<sup>168</sup> Notably, the Supreme Court characterized the meeting competition defense as perhaps “the primary means of reconciling the Robinson-Patman Act with the more general purposes of the antitrust laws of encouraging competition between sellers.” Great Atlantic & Pacific Tea Co. v. FTC, 440 U.S. 69, 83 FN 16 (1979).

liability standards concerning monopsony pricing, overbidding and price discrimination since courts have increasingly construed the conduct component of claims of “monopolization” and “attempted monopolization” narrowly.

The rigorous liability standard for unilateral pricing decisions of powerful buyers is clearly justified in the classical case of single-price monopsony. Although monopsony pricing is likely to reduce consumer and aggregate social welfare, no sensible remedy exists to prevent powerful buyers from reducing input purchases and depressing input prices. Furthermore, it is the lure of supracompetitive monopsony profits that spurs vigorous competition.

In the context of overbidding, similar concerns have caused the Supreme Court in *Weyerhaeuser* to establish a two prong test that may be characterized as the mirror image of the *Brook Group* test for predatory pricing and price discrimination on the selling side. As far as the court was concerned about the virtual impossibility for courts and juries to identify a reasonable price (whether qualified as the competitive price or defined by the cost structure of the powerful buy) the decision is persuasive. The rigorous standard of proof in *Weyerhaeuser*, however, discounts the potentially negative effects of predatory bidding on consumer welfare in specific cases. In particular, the Court completely neglects the hard to measure, but real long run effects of buying power. Thus, the *Weyerhaeuser* standard should not be generalized and applied to other types of predatory conduct of powerful buyers, namely raising rivals’ costs, without carefully contemplating the specific facts at issue.

Similarly, with regard to price discrimination that is used as an exclusionary device, the *Weyerhaeuser* test should govern only those cases that directly mirror primary line discrimination on the selling side. Thus, the test should be applied to direct price discrimination of buyers bidding up prices in some (geographic) markets, while paying monopsony prices in others. The usual *Robinson-Patman Act* scenario of buyers inducing sellers to offer favorable prices, however, is outside the realm of the *Weyerhaeuser* test. Anyhow, due to the ambiguous effects on consumer and aggregate social welfare and due to the availability of the “meeting competition defense” in the *Robinson-Patman Act*, powerful

buyers are effectively insulated from antitrust liability when they solicit bids from multiple sellers and induce them to sell at favorable prices.