Comments on the Proposed Horizontal Merger Guidelines' Analysis of Mergers Affecting Buyer Power

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The agencies deserve praise for explicitly acknowledging the relevance of buyer power by according the issue a separate section in the new Merger Guidelines. Moreover, and contrary to views sometimes attributed to the agencies, the Guidelines are clear that a merger that is likely to have only substantial adverse effects on upstream sellers and no direct adverse effect on consumers would still be illegal. Although this declaration has a strong basis in the history of antitrust enforcement, in light of the preoccupation with consumer effects that has permeated the various editions of the Guidelines, it is an important reaffirmation of the fundamental policy of the Clayton and Sherman Acts.

Unfortunately, the section does not articulate any specific buyer related issues that might be examined differently than would be the case on the seller side. My review of the various relevant sections of the Guidelines, i.e., market definition, competitive effects, the definition of efficiencies and criteria for preliminary presumptions of the likely substantiality of effects (HHI index numbers) revealed no separate discussion or qualification related to buyer power.

It seems to me that either in *"12. Mergers of Competing Buyers"* or throughout the relevant parts, there ought to have been some clearer recognition of the differences in analysis. My suggestion (attachment A) is that Part 12 should be expanded with several bullet points that frame the distinctive buyer side issues. The major ones are buyer side product and geographic market definitions including appropriate criteria for defining a hypothetical monopolist; relevant competitive effects criteria; and a recognition based on the case law that buyer power issues can emerge with lower market shares/concentration than are usually employed on the seller side.

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The market definition discussion either in Part 12 or in the relevant sections should acknowledge that buyer market definition in both geographic and product terms must focus on where sellers can look for sales in the quantity that they require (e.g., sugar from cane and beets is identical, but the inputs, including the methods of processing, are quite distinct; live chickens can travel only limited distances meaning processors buy locally, but processed chicken is sold in at least a national and perhaps global market). In addition, the 5% and 10% price increase measures when applied to price cuts would often be truly draconian. No rational monopolist is likely to impose such a large discount on inputs. Such price cuts would imply that the pre-merger market was deeply flawed and that buyers had not achieved very effective competition in such markets.[1] Finally, rational buyers may well use "all or nothing" contracts even in relatively less concentrated markets, and a monopolist anticipating declining output would be even more likely to use this strategy. The concept, explained in Blair and Harrison's book[2] as well as in a working paper by Robert Taylor of Auburn,[3] is that the buyer sets a price for a quantity of output that approximates the quantity that would have been produced in a competitive market, but sets a price equal to average cost, i.e., below marginal cost. Given buyer power, the buyer compels the seller to produce at the competitive level and appropriates the "infra-marginal" rents. While some might view this as a "mere wealth transfer," its longer term impact is to deter investment, innovation and growth in the upstream market. Moreover, where such buying is possible, the definition of relevant markets may result in a gross overestimate because of the apparent lack of change in output predicted for a post-merger market.

With respect to competitive effects, most buying markets involve "one to one" transactions. As the Guidelines recognize in Part 6.2, somewhat different analysis should apply when there is bargaining or auctions. A significant reduction in the number of substantial buyers in a relevant market will greatly increase the potential risk of unilateral coercive conduct aimed at sellers. The *Klors*[4] and *Toys R Us*[5] cases illustrate these risks in circumstances that

[1] There is no indication in the Guidelines of the basis for the assumption that a rational monopolist would impose such a price increase on customers or decrease on suppliers. There is no recognition that price increases need to be related to the ratio of sales to investment in order to ascertain what kind of return on investment would result from a proposed price change. This is a fundamental flaw in the Guidelines running back over several versions.

[2] Roger D. Blair, Jeffrey Harrison, MONOPSONY: ANTITRUST LAW AND ECONOMICS (1993).

[3] C. Robert Taylor, *Monopsony and the All-or-Nothing Supply Curve: Putting the Squeeze on Suppliers*, available at: http://www.auburn.edu/~taylocr/topics/market/supplycurve.html.

[4] Klors v. Broadway-Hale, 359 U.S. 207 (1959).

involved relatively low levels of market concentration based on conventional supply side analysis.

The central analytic point is that buyers have the discretion to buy, and so in a market of competing sellers, the volume buyer has great leverage to demand lower prices or other anticompetitive favors from the supplier anxious to make a sale.

[5] Toys R Us v. FTC, 221 F3d 928 (7th Cir. 2000).

A related point coming from auction analysis is that buyer cartels are more likely to be stable and durable even when they incorporate a significant number of participants (see, e.g., *Todd v. Exxon*[6]). The implication of this observation is that risks of collusive conduct among buyers will exist at lower levels of concentration and can include buyers with more diverse interests in output markets.

A third point is that the competitive effects of increased buyer power are often manifest at levels one or two stages removed from the immediate market in which power exists. The basic insight is that the consolidated buyer in turn deals with fewer direct suppliers on whom it confers buying power that did not exist before. This power is used on the most vulnerable input suppliers to those newly powerful buyers. The net result is that increased concentration of buying at one level can be and often is reflected back upstream until its effects are felt by powerless sellers. Hence, the fact that immediate suppliers do not see problems and might even welcome a consolidation of buyers does not mean that the merger creating such power will not have adverse economic effects. The experience of dairy farmers selling to cheese companies whose prices for milk declined as a direct result of Kraft's manipulation of the cheese market is a powerful example of this kind of upstream effect.[7]

The competitive effects analysis in turn tells us that the HHI concentration levels and change in concentration need to be adjusted to reflect the likely risks to competition posed by mergers creating buyer power. Because elasticity of demand and supply as well as the potential to shift lines of production by sellers will affect significantly the level of risk, I would favor using HHI index numbers as the basis for saying when further investigation should occur and would not create a clear presumption of illegality for levels below the 2500 threshold used in the revised guidelines. But when an HHI exceeds 1200 and certainly when it exceeds 1400 post merger, and the merger results in a change of 100 or more points, there ought to be a focused inquiry into the potential for adverse competitive effects. This is because at such levels of concentration both tacit buyer collusion is feasible in many buying markets and unilateral selective exploitation of sellers is also possible (see Part 4.1.4).

Finally, the section on efficiencies is troublesome. It fails to distinguish the exploitation of buyer power (e.g., transfer of producer surplus from seller to buyer via an all or nothing contract) from real cost savings in the overall production process. Wealth transfers, even if passed on to consumers by virtue of downstream competition, are mere pecuniary gains. In the context of buyer power, they reflect the distortions of the competitive process that result from such power.

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[6] Todd v. Exxon, 275 F.3d 191 (2nd Cir. 2001).

[7] Knevelbaard Dairies v. Kraft Foods, 232 F.3d 979 (9th Cir. 2000).

Attachment A
Proposed Revisions of Part 12 of the Horizontal Merger Guidelines

I have the following concrete suggestions for Part 12:

1) Example 23 should be revised. First, A and B should be identified as "the two largest buyers" whose combination would result in a significant increase in concentration in a buying market that is highly concentrated. Second, the hypothetical should explicitly state that there is no expected significant change in the prices for downstream products using the commodity. Third, the hypothetical should make clear that given these assumed facts, the merger would be illegal.

2) Prior to Example 23, the Guidelines should include the following bullet points:

* Product and geographic markets, when buyer power is an issue, should identify the alternatives that sellers reasonably face as outlets for their production.

* Because of the potential that buyers may be able to impose "all or nothing" contracts on their suppliers (or suppliers of their suppliers), evidence that the total output of a market subject to buyer power will not be reduced does not preclude a finding that a merger will unlawfully increase buyer power.

* The fact that after a merger, the combined buyer can reduce the prices paid for inputs does not demonstrate that the merger has an efficiency enhancing effect. It is essential to determine from which suppliers and on what basis (e.g., lower transaction costs, increased efficiency in production, exploitation of the upstream suppliers via "all or nothing contracts" or other exploitative or exclusionary conduct) the resulting lower input costs will arise. As Part 6.2 recognizes, in markets with either auction or direct purchase via contract, there needs to be careful assessment of any claims of post-merger efficiency.

* With respect to unilateral effects, because many input markets do not conform to the conventional public market model as a result of the direct negotiation and purchase of most such inputs, mergers creating substantial buyer power can create significant risks of unilateral exploitation of sellers and the imposition on them of exclusionary requirements, but at the same time, buyers needing substantial quantities of any input have incentives to seek out price competitive suppliers. In assessing the risks of unilateral effects on the buyer side of the market, it is important to identify the likely causes of the price reductions the merging parties anticipate and the likely impact of such lowered prices on more remote upstream input suppliers. The analysis in 6.2 reinforces the importance of this concern on the buying side as the buyer is the party with the power of deciding among potential sellers.

*With respect to coordinated effects, buyers, despite being competitive in downstream markets or operating in relatively distinct market contexts, have less incentive to defect from an effective tacit or express collusion over input prices. Hence, mergers resulting in moderately concentrated buying markets will be subject to careful review to determine whether they will increase the risk of buyer collusion or coordination.