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'SUI GENERIS'?: AN ANTITRUST ANALYSIS OF BUYER POWER IN THE UNITED STATES AND EUROPEAN UNION

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I. INTRODUCTION

A. Motivation

"Buyer power" is simply market power on the buyer side of a market. In economic terms, buyer power allows buyers to force sellers to reduce the price below the price that would result in a competitive equilibrium. Recent policy concerns regarding buyer power have been with respect to input markets in vertical retail supply industries. In particular, the rise of Wal-Mart and other large, low-cost box chains[1] has raised concerns among competition policy specialists about possible abuse of the market power which, it is alleged, such chains exercise over input suppliers. Similarly, it is sometimes alleged that supermarkets can act as "gatekeepers" through their possession of market power. Other examples of buyer power include the timber industry and the meat-packing industry.[2] The obvious policy question is whether buyer power exhibits special properties that justify different treatment from traditional seller monopoly power for the purposes of antitrust analysis. It is also

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1. Albert Foer, *Introduction to Symposium on Buyer Power and Antitrust*, 72 ANTITRUST L.J. 505 (2005). The importance of the 'buyer power' problem is evidenced by the recent symposium on that topic in the *Antitrust Law Journal*. *See* Symposium, *Buyer Power and Antitrust*, 72 ANTITRUST L.J. 505 (2005).

2. Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 ANTITRUST L.J. 669 (2005), discusses these examples, which involved traditional competition concerns such as predation.

said that increased bargaining power on the part of downstream buyers might create the preconditions for, or be evidence of, abuse of market power.[3]

Antitrust authorities around the world have invested substantial resources in addressing the competitive problems associated with buyer power in the supermarket industry. In the United States the Federal Trade Commission recently held a workshop devoted to supermarket business practices, such as slotting allowances and category management, as well as the question of supermarket monopoly power.[4] Similar inquiries have resulted in Competition Guidelines issued by agencies in Canada and Israel,[5] as well as an OECD investigation.[6] Many EU Member States have taken notice of the increasing levels of retail concentration in their countries.[7] This process of change across the Eurozone has been described as follows:

> The European retail industry is currently undergoing a transition. Its evolution is characterised by an increasing number of mergers, both

3. Foer, *supra* note 1.

4. *See* FEDERAL TRADE COMMISSION, REPORT ON THE FEDERAL TRADE COMMISSION WORKSHOP ON SLOTTING ALLOWANCES AND OTHER MARKETING PRACTICES IN THE GROCERY INDUSTRY (Feb. 2001) [hereinafter FTC REPORT]. U.S. authorities have long been interested in competition issues in supermarkets and the food industry more generally. *See Competitive Issues in Agriculture and the Food Industry*: *Hearing Before the H. Comm. on the Judiciary*, 106th Cong. (1999); *Slotting: Fair for Small Business and Consumers?: Hearings Before the S. Comm. on Small Business*, 106th Cong. (1999); *Slotting Fees: Are Family Farmers Battling to Stay on the Farm and in the Grocery Store?: Hearings Before the S. Comm. on Small Business*, 106th Cong. (2000).

5. *See* Competition Bureau, *Interpretation Bulletin: The Abuse of Dominance Provisions (Section 78 and 79 of the Competition Act) as Applied to the Canadian Grocery Sector* (November 2002) (Can.) [hereinafter *Interpretation Bulletin*]; The Israel Antitrust Authority, *The General Director's Position on Commercial Practices Among Dominant Suppliers and Major Retail Chains* (2003) (Isr.) [hereinafter *General Director's Position*].

6. OECD, DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS COMM. ON COMPETITION LAW AND POLICY, BUYING POWER OF MULTIPRODUCT RETAILERS (1999), *available at* http://www.oecd.org/dataoecd/1/18/2379299.pdf.

7. An indication of the range of these changes, consider the case of Germany. Twenty-five years ago, there were around 700 retail companies purchasing directly from the food industry; by the mid-1980's this number was 260. By the end of 1999, it had fallen to 115. In 1998, the 5 largest retail companies had an accumulated market share (based on turnover) of 64%. This share is forecast to increase to around 75% by 2005. *See* Ulf Böge, *Retailer Power in EC Competition Law*, 2001 FORDHAM CORP. L. INST. 467 (2000) ("Taking into account that the big retail groups also supply formally independent retailers, it can be said that the entire [German] retail trade is more or less in the hands of nine retail groups."). In the U.K., a Report of the Competition Commission found that 56% of U.K. sales were made to three customers and 68% were made to the largest five customers. *See* Competition Commission, *Supermarkets: A Report on the Supply of Groceries from Multiple Stores in the United Kingdom*, ¶11.14 (October, 2000) (U.K.) [hereinafter The Competition Commission Report]. In 1999, the OECD stated that, in at least seven European countries, the top five grocers accounted for more than 60% of retail sales. OECD, *supra* note 6, at 16.

> within Member States and across borders, leading to a corresponding increase in the level of concentration, at the national level and in the EU as a whole. . . .The number of small, independent retailers has, on the other hand, been steadily reduced in most Member States. An historically relatively unconcentrated industry operating along national lines is thus being transformed into an industry dominated by a small number of players, each operating in a number of countries.[8]

Several economic factors are the cause of this increased consolidation: economies of scale, an ability to buy in bulk, a reduction in distribution costs, savings in internal organization and logistics, and the implementation of efficiency-enhancing technological innovations (e.g., bar-code technology). These factors are reinforced by changes in consumer purchasing behavior; consumers now prefer to do most of their shopping in single locations for convenience.[9]

B. Definition of Buyer Power

The term "buyer power" is often used to describe two distinct phenomena. It can refer to what economists have traditionally called "monopsony" power. It can also refer to the concept of bargaining in markets with a small number of retailers. These two scenarios involve a fundamental difference in bargaining and market scale and thus require contextually different economic understandings.

The OECD has defined buyer power as "*the ability of a buyer to influence the terms and conditions on which it purchases goods*," thus implicitly adopting the latter definition rather than monopsony power.[10]

8. Joachim Lücking, *Retailer Power in EC Competition Law*, 2001 FORDHAM CORP. L. INST. 467 at 473. *See also Commission Green Paper on Vertical Restraints in EC Competition Law*, at 6, COM (96) 721 final (January, 1997) [hereinafter *Commission's Green Paper*].

9. *See* Louis Vogel, *Competition Law and Buying Power*, 19(1) EUR. COMPETITION L. REV. 4, 5-6 (1998). This process has been noticed by the European Commission in a recent retail-level merger case:

> In the retail trade there is a close interdependence between the distribution market and the procurement market. Retailers' share of the distribution market determines their procurement volume: the bigger the retailer's share of the distribution market, the larger the procurement volume. And the larger the procurement volume, the more favourable as a rule are the buying conditions which the trader obtains from his suppliers. Favourable buying conditions can in turn be used in various ways to improve one's position in the distribution market (sometimes through internal or external growth, but also through low-price strategies targeted at competitors). The improved position in the distribution market is itself reflected in a further improvement in buying conditions, and so on. The spiral described above leads to ever-higher concentration both in distribution markets and in procurement markets.

Commission Decision 1999/674, *Rewe/Meinl*, 1999 O.J. (L 274) 1, 12 (EC).

10. OECD, *supra* note 6 at 18. For a similar definition, see Margaret Bloom, *Retailer Buyer*

In other words, the policy concern is created by the existence of few-agent bargaining in retail markets. The root concern expressed by the OECD is the extent to which few-agent bargaining will result in different terms in conditions for input suppliers. Note, however, that price discrimination is an unavoidable outcome of few-agent bargaining situations, where outcomes depend on relative bargaining abilities. This has implications for that part of antitrust law (on both sides of the Atlantic) which seeks to forbid price discrimination, a practice which, existing statutory preclusions notwithstanding, economic theory tells us has virtually no negative welfare effects.[11] It is perhaps no coincidence that the rise of large wholesalers and retailers such as the Great Atlantic & Pacific Tea Company led in the United States to the passing of the conceptually discredited and largely unenforced Robinson-Patman Act.[12]

C. Summary of the Argument

The argument of this paper is simple: from an economic policy point of view, there is nothing special about market power on the buyer side of markets. In particular, we reject the contention that retail sector buying power requires different treatment from antitrust authorities compared to other sectors in the economy. Likewise, we find arguments contending that 'buyer power' requires that new or different laws be enacted or judicially developed ultimately unpersuasive.

This paper is divided into three parts. Part I summarizes the relevant economics of buyer power, and more generally, monopsony. Part II compares the relevant antitrust treatment, in the U.S. and Europe, with respect to buyer power and competition policy. Part III applies our legal and economic insights to supermarket competition.

Power, 2001 FORDHAM CORP. L. INST. 399 (2000).

11. *See* 15 U.S.C. § 13 (2005); Treaty Establishing the European Community, Dec. 24, 2002, 2002 O.J. (C325) 65 [hereinafter *Treaty*].

12. The criticism against the Act has been consistent. *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. Prominent antitrust scholar 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).

II. THE ECONOMICS OF BUYER POWER

In this Part we explain the economics applicable to a proper understanding of the issues commonly falling under the rubric "buyer power." Since policy concerns in this area invariably involve market power in upstream buyer markets, we first explain the economics of vertical industries. We then examine the possibility of the unilateral exercise of buyer power in the form of "raising rivals' costs," a competitive threat which is often raised as a policy concern in this context, concluding that it offers no special problem for antitrust policy. We then turn to the relevant economics of the second form of "buyer power:" bargaining and competition within few-agent market environments.

A. Preliminary Point

In theory, there is no reason to exclude the issue of buyer power at the final retail level, that is to say retail shoppers, from our analysis. However, in practice this issue does not arise frequently. The issue of "buyer power" is raised most often within the context of vertical restraints and allegedly exclusionary conduct, and within that context forms a rubric under which many distinct practices might be subsumed. Many of the practices mentioned in the "buyer power" literature are well-known to economists and antitrust lawyers, and it is economically questionable whether anything is added by subsuming them under such a broad rubric:

> I recognize that when scholars or practitioners call for assessing buyer power differently from seller power, they may be using these labels as shorthand for particular industries or for certain industry characteristics. However, it is important to understand what those fundamental economic characteristics might be and incorporate them explicitly into the analysis. Doing so allows for sharper thinking. Sound antitrust policy demands this, and would be undermined by framing distinctions based on the 'buyer' or 'seller' labels.[13]

Alternatively, the live issue from a competition policy perspective is whether there exists a separate category of "concern" to which the label "buyer power" applies distinct from those already known within

13. Marius Schwartz, *Should Antitrust Assess Buyer Market Power Differently than Seller Market Power?*, Statement at the DOJ/ FTC Workshop on Merger Enforcement, February 17, 2004, *available at* www.ftc.gov/bc/mergerenforce/presentations/040217schwartz.pdf.

the economics of vertical restraints and exclusionary conduct.[14] The only available candidate for such possible concern is changes in relative bargaining power. We do not find this answer persuasive.

B. Vertical Restraints

In this subsection we briefly summarize the state of economic learning in the area of vertical restraints, which, over the last 50 years, has significantly influenced the attitude of antitrust authorities.

Vertical contractual relationships exist between upstream (input) suppliers and downstream (retail) firms in most markets. Markets are generally characterized by at least two layers of supply, and in some sophisticated-good industries, more than two levels. Vertical relations in the supply of goods is one characteristic that distinguishes modern capitalism from the artisanal or guild production that characterized the market in Western Europe before the Industrial Revolution.[15] The economics of vertical contractual relationships between manufacturers as input suppliers, and retailers as buyers must inform sensible antitrust policy.

1. Basic Welfare Lesson

A basic lesson of the economics of vertical restraints, and exclusionary conduct in general, is that antitrust analysis *need only be concerned with the welfare of the final consumer.*[16] The end-customer only cares about the quality, quantity, and price of the final product. What transpires upstream in the process of producing the final product is irrelevant to the consumer of the final good. While the history of

14. Peter Carstensen is a leading proponent of this view. *See* Peter Carstensen, *Buyer Power and Merger Analysis – The Need for Different Metrics*, Statement at the DOJ/ FTC Merger Workshop (Feb. 17, 2004), *available at* www.ftc.gov/bc/mergerenforce/presentations/040217carstensen.pdf. *See also* Peter Carstensen, *Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy*, 2000 WISC. L. REV. 531 (2000).

15. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1786). *See* especially *ibid.* Book 1, ¶ 1.3. for Smith's famous description of the concept of the division of labor through the example of a pin factory.

16. *Compare* Salop, *supra* note 2 *and* 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 (2005) *with* Richard O. Zerbe, Jr., *Monopsony and the Ross-Simmons Case: A Comment on Salop and Kirkwood*, 72 ANTITRUST L.J. 717 (2005) (arguing for an efficiency standard in lieu of a consumer welfare standard). The obvious difference between the two standards is that harm to competitors would "count" for the purposes of the efficiency standard, but not the consumer welfare standard.

antitrust enforcement in the United States and Europe has evinced much suspicion of specific contractual relationships or organizational forms between upstream firms and downstream retailers, such as vertical integration, input price-discrimination, "foreclosure," "retail price maintenance," "margin squeeze," "raising rivals' costs," and so on, it is now recognized in modern economics (and increasingly - though not yet entirely - in competition law) that most such practices, considered in themselves, are generally benign from the point of view of end-customer welfare, and only potentially anticompetitive (from the point of view of actual or possible exclusion) under a narrow set of conditions.

2. Monopsony

While the most familiar examples of exclusionary conduct involve cases of upstream input suppliers foreclosing rivals from access to a critical input, monopsony analysis turns this exactly backwards. As monopoly is to the seller context, so "monopsony" is to the buyer context. It is the pure case of only one firm existing as a buyer for some upstream input. In the real world such a pure case is rare, but an example might be (in the short-run) a small town with few other employment opportunities whose inhabitants sell their labor to a local coal mine. The economics of monopsony are analytically identical to the economics of monopoly.[17] Where the monopolist directly withholds supply for the purpose of raising price (which of course reduces welfare), a monopsonist achieves the same ultimate effect indirectly simply by refusing to buy more inputs. If a firm is *simultaneously* a monopsonist (towards input suppliers) *and* a monopolist (towards final customers), then, in this mostly textbook-only example, there would result a double retraction in final supply.

3. The Dual Monopoly Problem

The situation of the simultaneous monopolist/monopsonist is analytically identical to the familiar problem of double marginalization. This problem occurs in industries characterized by an upstream monopolist supplier and a downstream monopolist retailer. This "double marginalization problem" also leads to a double contraction of final output and therefore results in a greater efficiency reduction than one would observe if monopoly conditions persisted over only one level. It is

17. *See, e.g.,* R. G. Noll, Buyer Power and Economic Policy, 72 ANTITRUST L.J. 589, 591 (2005) ("Asymmetric treatment of monopoly and monopsony has no basis in economic analysis.").

a basic insight of economics in the context of vertical contractual relations that an upstream monopolist firm can never do better than just the one monopoly market power and will generally seek to increase output to the joint profit maximizing level such that a surplus would be created which could be shared by both firms. This is not to say that the upstream firm might not seek to maintain a pre-existing monopoly in order to extend the duration of monopoly.[18] Generally, however, the upstream firm increases profits by internalizing the retailer's ability to place a second mark-up on the product. An obvious way to capture this surplus is through vertical merger of the supplier and downstream retailer, which increases consumer welfare.[19] The practice of vertical integration, once looked upon suspiciously by competition authorities in merger analysis, is now, for this and other reasons, regarded as generally benign.[20]

As a substitute to vertical integration, manufacturers and retailers will frequently seek to align incentives by contract. These contracts will frequently involve the supplier delegating distribution and promotion tasks to a retailer. The agent's incentives to promote and distribute the principal's product are not the same as the principal's incentives: the parties require some means of ensuring that the agent performs the delegated tasks as though they were his own. In the business world, countless new and ingenious methods can be found by which contractual parties in principal/agent commercial contexts seek to align incentives through self-enforcing mechanisms.[21] The wedge in incentives that generally exists in the principal/agent context is especially important in vertically structured industries, and pervasive in the retail sector, as will be seen below in the discussion of slotting allowances and category management.[22]

C. Raising Rivals' Costs

The issue of "raising rivals' costs" inevitably arises in the literature

18. *See infra* Section II.C (discussing this possibility).

19. *Horizontal* mergers of firms producing complements will also have the effect of internalizing this double margin to the benefit of consumers.

20. The issue of vertical integration is ineradicably linked to the broader issues of the firm-boundary problem and efficient contracting, much of which is outside the scope of this paper.

21. *See generally*, Benjamin Klein & Kevin Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. AND ECON. 265 (1985).

22. For the theoretical *locus classicus* of moral hazard see Grossman & Hart, *An Analysis of the Principal-Agent Problem*, 51 *ECONOMETRICA 7 (1983).* An excellent and less technical description of the theory, with business examples and extensions, can be found in MILGROM & ROBERTS, ECONOMICS, ORGANIZATION, AND MANAGEMENT (1992).

on "buyer power" perhaps because it is a concept based on the exploitation of market power with respect to input markets. In the monopsony context, raising rivals' costs refers to the possibility that a "power-buyer" might exploit that power in input markets.[23] Salop considers "raising rivals' costs" through overbuying of inputs as a strategy that is potentially consumer-welfare decreasing because it may result in the ability to exercise market power in the final goods market.[24]

The concept of "raising rivals' costs" (RRC) is simple: large, incumbent firms sometimes may have an incentive to raise the costs of competitors within the industry in which they operate. This might be true even if the action that raises their rivals' costs also raises their own: the crux of the issue is the asymmetry in cost structure between the incumbent and its competitors. The RRC concept, that a firm with market power might be able to affect prices in the industry's input markets with exclusionary effect, encompasses many possible types of behaviour. The list of practices that might potentially raise rivals' costs is large, and includes a wide spectrum of conduct ranging from lowering prices to blowing up a rivals' factory. Whether it makes sense to subsume them under a "catch-all" RRC rubric is arguable.[25] One possible classification of this large set of possible behaviour involves vertical versus horizontal relations. With respect to horizontal relations, a further classification might be that rivals' costs can be raised both directly and indirectly. For our purposes, we focus on unilateral vertical "overbuying," and exclude collusive endeavours which can be separately challenged under Sherman Act Section 1 or analogous price-fixing prohibitions.

The RRC concept is frequently invoked in claims that an upstream monopolist's input purchases exclude rivals.[26] RRC overbuying, as

23. Salop, *supra* note 2, at 671.

24. Salop also analyzes the possibility of predatory overbuying, that is, overbuying aimed at gaining monopsony power in the input market rather than attempting to achieve market power in the output market. *Id.* at 675. Salop concludes that successful predatory overbuying "does not necessarily harm consumers," and the likelihood of consumer harm from predatory overbuying is smaller than its output market counter-part, namely predatory pricing. *Id.* at 671, 676. Further, a successful predatory overbuying strategy would be quite difficult to identify and distinguish from the normal competitive process. *See* Benjamin Klein, *Exclusive Dealing as Competition for Distribution on the Merits*, 12 GEO. MASON L. REV. 119 (2003) [hereinafter KLEIN]. Our analysis focuses on the RRC variety of overbuying.

25. *See* MASSIMO MOTTA, COMPETITION POLICY: THEORY AND PRACTICE 491 (2004) ("To sum up, raising rivals' costs theories provide a concept that encompasses many very different practices. Due to the specificities of such practices, I have preferred to deal with them separately.").

26. Steven C. Salop & David T. Scheffman, *Cost-Raising Strategies*, 36 J. INDUS. ECON. 19, 31-32 (1987).

Salop defines it, requires a firm with monopsony power to increase input purchases and, in turn, the input prices faced by its rivals, in order ultimately to increase its ability to raise prices in the output market.[27] RRC overbuying may involve "foreclosure" of rivals from these inputs or else enabling these rivals to suffer a "price squeeze,"[28] a term usually applied to the reverse case of an upstream monopolistic wholesaler simultaneously integrated with some (not all) downstream retailers, and which sells its input (which must be an "essential" input) to the other, competing downstream retailers at a price higher than what it charges its own downstream component.[29] Another proposed model in the RRC literature considers an upstream wholesaler writes exclusive-dealing contracts with established downstream retailers, which forces an entering wholesaler to use or establish an independent, possibly less efficient, retail supply in order to compete.[30] However, in this latter example, the original model was shown to be improperly specified.[31] Once corrected, the practices shadowed by possible impugnation in fact were shown to be welfare-improving. The finding of the welfare-benignancy of this example is an instantiation of what is now known to be a general truth for vertical practices, namely, that they are invariably efficiency-enhancing. This is an economic fact which was during the 1980s gradually accepted by US competition authorities, and, in Europe, accepted eventually also (albeit much later) by the Commission, as is verified by the Commission's introduction in 1999 of block exemptions for vertical relations.[32]

With respect to its application to vertically-related industries, the RRC concept, while it increases our knowledge of the possibility of anticompetitive overbuying, requires restrictive conditions not likely to apply in many retail settings. For instance, a classic example is that of slotting allowances (payments for premium supermarket shelf space).[33]

27. *Id.*

28. This practice is sometimes also called a 'margin squeeze'.

29. Foreclosure-type arguments always require a vertically integrated upstream *monopolist* for threshold validity. For a complete examination of the very restrictive conditions necessary for vertical practices to be able to be said to be (social) welfare reducing, see Patrick Rey & Jean Tirole, *A Primer on Foreclosure, in* HANDBOOK OF INDUSTRIAL ORGANIZATION, VOL. III (Armstrong and Porter eds. 2003).

30. William S. Comanor & H.E. Frech, *The Competitive Effects of Vertical Agreements?* 75 AMERICAN ECONOMIC REVIEW 541 (1985); Frank G. Mathewson & Ralph Winter, *The Competitive Effects of Vertical Agreements*: *Comment*, 77 AM. ECON. REV. 1057 (1987).

31. *See* Marius Schwartz, *The Competitive Effects of Vertical Agreements: Comment,* 77 AM. ECON. REV. 1063 (1987); Mathewson & Winter, *supra* note 30.

32. RICHARD WHISH, COMPETITION LAW 614 (2003) [hereinafter WHISH].

33. *Infra* Section III.B.1.

Some argue that product manufacturers, purchasing a large share of supermarket shelf space, might raise the cost of retail distribution for rivals, thereby increasing the dominant firm's ability to raise prices or restrict output. The fundamental economic response to that concern is that slotting allowances raise the cost of distribution for everybody – and firms compete for retail distribution on a level playing field.[34] In addition, one condition common to RRC models is that large economies of scale must be present in the production of the upstream good, a feature that is not present in many markets where slotting allowances and similar input purchases are observed.

It is certainly *theoretically* plausible for an incumbent firm to bid up the price of an input (say, wages) within an industry which affects all other firms in that industry. If the other firms are more labour intensive, then their input costs will have been disproportionately affected vis-à-vis the incumbent firm. While such a strategy lowers aggregate profits in the industry, the disproportionate effect on costs between incumbent and fringe may lead to the incumbent's market share increasing sufficiently such that *its* profit increases. Whether such a scenario could occur in practice would depend on the relative elasticities of aggregate demand, residual firm demands, and individual firm costs.[35]

However, in terms of antitrust enforcement, it remains unclear whether the rare cases in which this model might become relevant justify, from a cost/benefit point of view, antitrust intervention at all.[36] The risk of false positives is significant, since it is very difficult to distinguish RRC overbuying from legitimate competition for distribution. This risk is exacerbated by the lack of economic knowledge regarding the potentially pro-competitive dimensions of many of these practices.

From an economic perspective, there exists a substantive difference

34. *See* Benjamin Klein & Joshua Wright, *The Economics of Slotting Arrangements* (forthcoming)*, available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=773464. Klein and Wright argue that slotting allowances result in high manufacturer margin products because retailers do not have the incentive to supply the jointly profit-maximizing level of promotional inputs such as shelf space. *See also* Klein, *supra* note 24, 122-28, for a summary of the economic conditions under which exclusive distribution contracts, a more restrictive form of slotting, may cause anticompetitive effects.

35. *See* Steven C. Salop & David T. Scheffman, *Raising Rivals' Costs*, 73 (2) AM. ECON. REV. 269 (Papers and Proceedings, 1983).

36. *See* David T. Scheffman & Richard S. Higgins, *20 Years of Raising Rivals' Costs*, 12 GEO. MASON L. REV. 371 (2003). Conditions for empirically testing the theory are given in Janusz A. Ordover & Garth Saloner, *Predation, Monopolization and Antitrust*, *in* THE HANDBOOK OF INDUSTRIAL ORGANIZATION, VOL. I (R. Schmalensee & R.D. Willig, eds., Elsevier Science Publishers B.V. 1989).

between direct effects on the one hand, and (market-based) indirect effects on the other. The former involve *real* externalities, and the remedy for such cases has always been properly defined and enforced proprietary rights or liability rules.[37] The latter involve *pecuniary* externalities, and it has long been the tradition within welfare economics[38] that such within-market externalities, while equally derogative of first-best efficiency from the point of view of perfect competition,[39] ought not to be a concern of real-world government and judicial policy.[40] In antitrust parlance, this is the classic distinction between protecting competition versus protecting competitors.[41]

Finally, the canonical RRC overbuying model depends on the asymmetry of costs between incumbent and fringe. It is a static, snapshot model which begs the question of how such cost advantages were acquired and why the firm which acquired them ought not be permitted to extract the surplus (or rents) of its innovation (or first mover advantage) through – modulo the existence of antitrust law - legal market activity.[42]

D. The Economics of Bargaining Markets

Standard models of monopoly/monopsony assume a single large agent on one side of the market and many, anonymous, output-negligible (technically: atomless[43]), agents on the other. However, this paradigm is

37. *See* Michael I. Krauss, *Property Rules v Liability Rules*, *in* ENCYCLOPEDIA OF LAW AND ECONOMICS (B. Boukaert & G. De Geest eds., Cheltenham, Edward Elgar 1999), *available at* http://classweb.gmu.edu/mkrauss/prop-liab.htm.

38. *See* Scitovsky, *Two Concepts of External Economies*, 62 J. POL. ECON. 143 (1954).

39. *See* Makowski and Ostroy, *Appropriation and Efficiency: A Revision of the First Theorem of Welfare Economics*, 85 (4) AM. ECON. REV. 808 (1995).

40. *See* ANDREU MAS-COLELL ET AL., MICROECONOMIC THEORY 352 (1995). Traditionally, the common law has seemed implicitly to agree with this welfare assessment. To give one example, the common law constrains the scope of tort doctrine in the context of pure financial loss. *See* the House of Lords' "direct reliance" test (stronger than the "reasonably foreseeable" test), Williams v. Natural Life [1998] 1 W.L.R. 830 (U.K.). *See generally*, LIABILITY FOR PURE ECONOMIC LOSS IN EUROPE: FRONTIERS OF TORT LAW (Bussani & Palmer eds. 2004) (showing that an awareness of the importance of this distinction appears to be common across the legal families of Europe).

41. Scholars have often remarked on the different approaches to the importance of this distinction in the United States and Europe. *See, e.g.,* Eleanor Fox, *We Protect Competition, You Protect Competitors,* 26 WORLD COMPETITION 149 (2003).

42. *See, e.g.*, Louis Makowski, *Perfect Competition, the Profit Criterion, and the Organization of Economic Activity*, 22 (2) J. ECON. THEORY 222 (1980), for modern economics' take on the relationship between 'free' entry, the 'zero profit condition,' proprietary rights, innovation, and the relation (or not) of all these to the concept of perfect competition.

43. Robert J. Aumann, *Markets with a Continuum of Traders*, 32 ECONOMETRICA 39 , 50 (1964).

irrelevant to the current concern in policy circles, which focuses on the context of a few, large, non-anonymous agents on both sides of the market.[44] Accordingly, the concern is with relative changes in bargaining power on one or the other side of the market.

1. Small Versus Large Markets[45]

All markets are comprised of bilateral contracts. In large markets, economists focus on aggregate market variables (market price, quantity, etc.) rather than on the individual-agent level, both because such individual-agent level contracting is anonymous as well as because the absence or presence of any one contracting pair does not (observably) impact upon aggregate market variables.

In a market with only a small number of possible contracting pairs, avoidance of the individual-agent level is no longer an option, since the aggregate market price is directly determined by the bargaining at this level. While a number of theories of bargaining exist,[46] economic theory does not enable price-predictions with respect to the specific institutional case of bilateral-monopoly bargaining. All possible prices within the lens of trade are candidate outcomes. Theory does tell us that in monopolistic bilateral-bargaining situations, firms might invest in bargaining pre-commitments or otherwise seek to enhance their bargaining position, especially when there is the possibility of ex post hold-up, or when relationship-specific investment is involved.[47]

2. The Assignment Model

If a buyer values a widget at 5 euros, while it cost the seller 2 euros to make, then the "lens of trade" is the difference between these two amounts, namely, 3 euros.[48] The ultimate price will divide this surplus

44. *See*, *e.g*., Foer, *supra* note 1 (introducing symposium discussion on buyer power).

45. Professor Inderst mentions two cases: the "market interface paradigm" and the "negotiation interface paradigm." *See* Roman Inderst, *Buyer Power A theorist's perspective*, (Presentation given at U.K. Competition Commission (Jan. 2005)) *available at* http://faculty.insead.edu/inderst/personalwebpage/bp_inderst.pdf (last visited 2/12/2006).

46. The details of these solutions are not germane to the paper. A general discussion can be found at Michael Maschler, *The Bargaining Set, Kernel and Nucleolus*, *in* Aumann and Hart (eds.) HANDBOOK OF GAME THEORY WITH ECONOMIC APPLICATIONS (R.J. Aumann & S. Hart eds., Elsevier Schince Publishers B.V. 1992).

47. *See*, *e.g*., Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 (4) AM. ECON. REV. 519 (1983); Thomas Schelling, *An Essay on Bargaining*, 46 AM. ECON. REV. 281 (1956).

48. We assume (which is definitional for the "assignment model"), that the buyer only wants one widget, and the seller only has one to sell.

between the two participants. Obviously, the buyer maximizes his surplus from the transaction by buying the widget for 2 euros, while the seller maximizes her surplus by selling it at 5 euros. Anything in between is also possible, and where the final price will reside depends on the relative bargaining power of the two agents to the transaction. If there exist other buyers who also value the widget then we no longer have a situation of bilateral-monopoly bargaining but instead have a one-to-many bargaining situation, more commonly known as an auction. The widget will be sold to the buyer with the highest valuation, thus enabling the seller to extract nearly the entire surplus from the transaction. If all the buyers have the *same* valuation, then the seller is a perfectly competitive monopolist who extracts all the surplus. Of course, the example could be reversed so that we have many-to-one bargaining, such that it is the buyer who is a monopolist facing many sellers. Again an auction would be used, and again the buyer would extract all (if a perfect competitor) or nearly all the surplus from the transaction. Continuing in this manner of adding more buyers and sellers to the basic bargaining model,[49] with many agents on both sides of the market, we would have the many-to-many bargaining situation of the double-sided auction, such as in stock markets and many other real-world examples.[50]

a. Primary Lesson

The primary lesson from this assignment model is that there is an inherent link in markets, regardless of their size, between bargaining power and competition. In particular, bargaining power depends on the competition (in the sense of relative substitutability[51]) that exists on your side of the market. In other words, the existence of rival buyers with valuations close to your own will render your bargaining power largely irrelevant.

The preceding example was one of full information, such that both buyer and seller know each other's walk-away value. This was sufficient to reveal the fundamental relationship between bargaining and

49. Replicating the market in this way eventually leads to modern models of perfect competition. For a quick introduction see the preface by Andreu Mas-Colell, *Non-Cooperative Approaches to the Theory of Perfect Competition: Presentation*, 22 J. ECON. THEORY 121 (1980).

50. Of course a stock market involves divisible goods, rather than the discrete case required by the assignment model (indeed, one of the many purposes of a stock market is to *create* divisibility). However, this detail does not upset the basic logic of the model.

51. Theoretical models of competition depend crucially on assumptions made about relative substitutability on either side of the market. Those details are beyond the scope of this article. Of course, agents are complementary across the sides of the market since buyers need sellers and vice versa.

competition. Of course, in the real world, this is not likely to be the case: such values (valuable to both agents) are "private information." If there exist other buyers with private valuations of the widget (either higher, lower or the same as the valuation of the first buyer), then, as before, the seller will hold an auction. From the seller's point of view, the beauty of an auction is that she need not know the private valuations of the buyers. The auction will make them reveal it for her and the widget will be sold to the buyer with the highest valuation, thus enabling her to extract nearly all the surplus.[52] If all of the buyers have the same valuation, then the seller is a perfectly competitive monopolist who extracts the entire surplus.[53]

b. Ancillary Lessons

Two further lessons from this example are that competition forces agents to reveal valuable private information involuntarily (known as informational efficiency), and that there exists a fundamental link between perfect competition and full surplus extraction (known as full appropriation). Since auctions are a means of price discrimination, the first lesson has efficiency implications for the legal proscription of this practice (still found in competition texts). The second lesson has implications for the oft-described "tension" between competition law and intellectual property, since it is well-known in the economics of intellectual property that full appropriation is a necessary condition for optimal R&D investment.

3. Substitutes versus Complements

While substitutability is a necessary condition for competition (and bad for bargaining power), complementarity is a necessary condition for efficient organizational form (such as the existence of firms,[54] or the

52. Some rents are left to the buyer due to her monopoly in her private information.

53. Theoretically speaking, perfect competition is a concept that depends on relative substitutability, not numbers *per se* (this is actually a slightly complicated issue, the details of which are not germane to this article). In this last case of a monopolist seller and multiple, identical buyers, the indispensability of the seller to the transaction (there is only one of her) means that she "deserves" the whole surplus (under the Shapley value criterion where what you get is what you contribute). An agent who has an identical *doppelgaenger* in the economy contributes nothing to the transaction and thus "deserves" zero surplus. *See* Lloyd S.Shapley, *A Value for N-Person Games*, *in* CONTRIBUTIONS TO THE THEORY OF GAMES (Kuhn & Tucker eds.,1953).

54. Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119 (1990).

desirability of mergers and joint ventures).[55] The presence of complements, such as network effects, on either side of the market, impacts standard efficiency results. Recently, these complementarities are properly the focus of investigation by economists, especially with respect to the theory of the firm.[56] The basic lesson is that complementarity should exist under the one institutional form.

A further lesson is that the relationship between buyers and sellers is one of complementarity, not substitutability. Put simply, buyers and sellers aren't competing with each other. Buyers need sellers and sellers need buyers.

E. Applying the Lessons

The basic bargaining paradigm described in the previous subsection has implications for our analysis of some of the issues raised in the literature on buyer power. We briefly consider some of those implications here.

1. Assessing Mergers and "Countervailing" Buyer-Power

When two buyer-firms merge there is an obvious reduction in the upstream sellers' relative bargaining power. Increases of "buyer power" and "bargaining power" often refer to the standard notion within merger law of a reduction in competition. While reductions in bargaining power correlate with a reduction in competition, it is only the latter that matters for competition law purposes. We are careful to note here that our analysis applies generally to unilateral abuses of market power, rather than buyer-side collusion.[57]

Similarly, the "countervailing power"[58] argument makes sense only if its purpose is simply to serve as a proxy concept for the recognition that the market under investigation involves few participants on either

55. *See* ADAM M. BRANDENBURGER & BARRY J. NALEBUFF, CO-OPETITION (1996).

56. *See* Ilya Segal, *Collusion, Exclusion, and Inclusion in Random-Order Bargaining*, 70 REV. ECON. STUD. 439 (2003), for the most recent and general analysis.

57. The argument that buyer-side mergers should be more highly scrutinized than seller-side mergers, particularly in agricultural markets, is presented by Carstensen, *supra* note 14. Carstensen argues that antitrust treatment of buyer power should be designed in a manner that is sensitive to the differences in the economic incentives to collude or unilaterally exercise monopsony power between buyers and sellers. *Id.* We certainly agree that antitrust agencies should be aware of any such differences. We claim only that antitrust need not develop special rules for assessing the consumer-welfare dangers associated with the exercise of buyer power.

58. DOBSON CONSULTING, BUYER POWER AND ITS IMPACT ON COMPETITION IN THE FOOD RETAIL DISTRIBUTION SECTOR OF THE EUROPEAN UNION 19 (1999) [hereinafter DOBSON REPORT].

side. In that light, the label brings competition law in accord with the commercial law presumption that the law will not intervene in negotiations amongst experienced market participants.[59] Any other use of the concept suffers, because, from the point of view of economic efficiency, market power on one side of the market is not ameliorated by the presence of market power on the other side.

2. Monopolization

Neither Treaty Article 82 nor Section 2 of the Sherman Act explicitly create a special category of antitrust analysis for "abuse" or "monopolization" involving firms that seek or invest in increased bargaining power vis-à-vis firms across from them in the market. Nor is it the role of competition law to regulate relative bargaining power between consenting adults in market environments. Common law contract jurisprudence is strongly averse to legal paternalism toward the arms-length (and lawyer assisted) negotiations between sophisticated, experienced market participants. It is questionable what policy would be served by allowing competition law to play a role in regulating any asymmetries of bargaining power between sophisticated parties. It is worth noting that many cases involving buyer exercise of monopoly power are attempts to facilitate an upstream cartel or involve allegations of conspiracy rather than unilateral anti-competitive overbuying.[60]

3. Innovation

One reason given for why "buyer power" should be regarded as different from "seller power" is that, in the long run, buyer power may have adverse effects on sellers' incentives to innovate.[61] It has been

59. *See* Dan O'Brien & Greg Shaffer, *Bargaining*, *Bundling and Clout: The Portfolio effects of Horizontal Mergers* (Fed, Trade Commission, Working Paper No. 266, 2003) (showing that changes in bargaining power upstream, while often leading to transfers in welfare, are rarely a welfare concern from a social point of view).

60. *See*, *e.g,* Toys "R" Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000); Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959); and Interstate Circuit, Inc. v. United States, 306 U.S. 208 (1939).

61. DOBSON REPORT, *supra* note 59.

> [Its effect is to] prevent manufacturers from exploiting their position as fully as thy could do if they were faced with a less concentrated retail sector. . .[and] force manufacturers *to reduce investment in new products or product improvements*, advertising and brand building, eliminate secondary brands and weaken primary brands while strengthening he position of private label brands, and in the process cause wholesale prices to small retailers to rise, further weakening them as competitors. . .

Id. (emphasis added)

shown that this relationship is in fact unclear,[62] which is unsurprising, given that innovation is a means of competition via increasing complementarity (and indispensability), and so determinations of net efficiency depend on the relative balance of efficiencies from exploited complementaries versus inefficiencies from reduced substitutabilities (or competition). Here at least is a sense in which it could be said that "seller power," when it is in the context of a seller facing atomless end-consumers, differs from "buyer power," when it is in the context of a buyer facing a small number of other (upstream) firms: that firms in the latter case have available to them an additional means of competition which end-consumers do not. Namely, competition exists not just among substitute possibilities, but among complement possibilities. And competition with respect to complements is achieved via investment and innovation. And of course, this is not a difference which increases the intellectual case for antitrust intervention against upstream-located firms.

III. ANTITRUST LAW AND BUYER POWER

In this Part we detail the law relating to "buyer power," dealing in turn with both the US and the European legal regimes. It should be noted initially that in terms of antitrust enforcement, the issue of "buyer power" can arise both at the assessment of "dominance" (or monopoly) stage and at the "abuse" or "monopolization" stage. We limit the scope of our analysis to the exercise of monopsony power which has the effect of achieving or maintaining monopsony power. We exclude considerations of retail-level collusion since such conduct is uniformly prohibited by both regimes, and unequivocally decreases consumer welfare.[63]

The Commission has said the same thing, namely that a "dominant buyer determines the success or otherwise of product innovations." Rewe/Meinl, *supra* note 9.

62. Roman Inderst & Christian Wey, *Buyer Power and Supplier Incentives*, CEPR Discussion Paper No. 3547 (2002) found that a seller's incentive to innovate may actually increase in the 'size' of the buyer.

63. This exclusion means that cases like *Toys "R" US,* 221 F.3d 928, where it was alleged that Toys "R" Us facilitated a conspiracy among toy manufacturers, are outside the scope of our analysis. Collusive attempts at the exercise of monopsony power should be familiar to students of American antitrust laws. *See, e.g.*, United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); Eastern States Retail Lumber Dealers' Assn. v. United States, 234 U.S. 600 (1914); American Tobacco Co. v. United States, 328 U.S. 781 (1946); JTC Petroleum Co. v. Piasa Motor Fuels, Inc., 190 F.3d 775 (7th Cir. 1999).

A. United States

The exercise of monopsony power, like its monopoly counterpart, must be distinguished from its mere presence as the result of accident or superior skill for the purposes of antitrust analysis.[64] The fundamental economic objection to the exercise of monopsony power is that it harms consumers in the final output market. Consistent with this concern, Salop points out that American courts and federal agencies have adopted the consumer welfare standard, focusing on the price effects of mergers and exclusionary conduct, yet the exercise of monopsony power need not always reduce consumer welfare.[65] For example, a buyer-side cartel of final consumers may reduce aggregate welfare as a result of the competitive distortion but increase consumer welfare as a result of lower prices. Courts in the United States have consistently rejected arguments that conduct which harms competitors while benefiting consumers, even when the former outweighs the latter in some quantitative sense, violates the antitrust laws.[66]

1. Exclusion

Allegedly exclusionary buyer conduct must satisfy the standards set forth in Sherman Antitrust Act Section 2, which generally requires the plaintiff to present evidence that the defendant's conduct injured consumers.[67] In conventional, seller-side, exclusion cases, American courts generally require the plaintiff to establish seller market power, the degree of foreclosure, the costs imposed on foreclosed rivals wishing to realign supply contracts with other buyers or new entrants, and the length of the exclusionary agreements.[68]

Salop's recent analysis of anticompetitive overbuying by power buyers extends this analysis to buyer-power-driven exclusion by proposing a four-step rule of reason standard that is generally consistent

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64. *See, e.g.*, United States v. Griffith, 334 U.S. 100, 108 (1948) ("large-scale buying is not, of course, unlawful per se . . . . It may not, however, be used to monopolize or attempt to monopolize interstate trade or commerce.").

65. Salop, *supra* note 2, at 689.

66. *See, e.g.,* Kartell v. Blue Shield of Mass, Inc., 749 F.2d 922 (1st Cir. 1984). *See also supra* note 2, at 685-689 (discussing the *Kartell* case).

67. Sherman Anti-Trust Act §2, 15 U.S.C. § 1 (1975).

68. *See*, *e.g.,* PepsiCo., Inc. v. Coca-Cola Co., 114 F. Supp. 2d 243 (S.D.N.Y 2000), *aff'd per curiam*, 315 F.3d 101, 111 (2002); R.J. Reynolds Tobacco Co. v. Philip Morris Inc., 199 F. Supp. 2d 362 (M.D.N.C. 2002) ("RJR II"); *aff'd per curiam*, 67 Fed. Appx. 810 (4th Cir. 2003); Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039 (8th Cir. 2000); Virgin Atlantic Airways Ltd. v. British Airways PLC, 257 F.3d 256 (2d Cir. 2001); Omega Envtl, Inc. v. Gilbarco Co., 127 F.3d 1157, 1163-64 (9th Cir. 1997).

with the approach taken by American courts and antitrust agencies in monopolization cases.[69] Salop proposes that the rule of reason analysis require the plaintiff alleging anticompetitive power-buying behavior to show: (1) artificially inflated input purchasing by a defendant with buyer power; (2) injury to competitors; (3) achievement of market power by the defendant; and (4) consumer harm.[70]

The first step requires the plaintiff to set forth facts establishing that the defendant has artificially increased its purchasing activities in the input market such that input prices have actually increased.[71] Under Salop's rubric, evidence that the increased input prices serve some pro-competitive purpose would suffice to grant the defendant summary judgment in the absence of clear evidence of consumer harm.[72] This is not unlike the "conduct" element in a typical Section 2 monopolization case.

The second step requires the plaintiff to show that a rival was actually injured by the increase in input prices.[73] A plaintiff would be required to present evidence that the defendant's overbuying raised the plaintiff's costs. Essentially, this question turns on whether the rival is disadvantaged by the defendant's input purchases or whether the rival is able to find competitively priced substitute inputs. Injury to the rival, as discussed above, should also include evidence that significant economies of scale prevail in the market for the final good.

The third step would require the plaintiff to present evidence that the defendant had buyer-side monopoly power, although Salop asserts that monopsony power is not a necessary condition for anticompetitive overbuying.[74] U.S. antitrust law is clear that buyer power is to be treated similarly to monopoly power, and courts have uniformly required monopsony power in buyer-side monopolization cases.[75] As with monopoly power, plaintiffs would likely be able to prove monopsony power by calculating market shares in a properly-defined relevant market. In an appropriate case, direct evidence of monopsony power

69. *See* sources cited *supra* note 68.
70. Salop, *supra* note 2, at 690-691.
71. *Id.*
72. *Id.*
73. *Id.*
74. *Id.*
75. *See*, *e.g.,* In re Beef Indus. Antitrust Litig., 907 F.2d 510, 514-16 (5th Cir. 1990) (rejecting claim that defendants had monopsony power in federal cattle procurement market); United States v. Syufy Enters., 903 F.2d 659, 663-71 (9th Cir. 1990) (first run movie screens in Las Vegas did not have monopsony power); DeLoach v. Philip Morris Companies, No. 00CV01235, 2001 U.S. Dist. LEXIS 16909, at *54 (M.D.N.C. 2001) (rejecting motion to dismiss because of allegations that defendant controlled 65% of the tobacco purchasing market).

might be available.

Finally, a plaintiff would be required to show that the defendant's alleged exercise of buyer power resulted in a reduction in consumer welfare.[76] Like step one, the analysis of consumer harm would take into account any plausible pro-competitive justifications offered for the overbuying practice. Insistence upon a showing of actual consumer harm is central to a sensible antitrust policy with respect to buyer power. This requirement is a minimal safeguard necessary to ensure that pro-competitive practices are not prohibited because their consumer-welfare-increasing properties are not well understood by courts and agencies. The burden of proof must be allocated to the plaintiff to show that the defendant's exercise of buyer power caused harm to consumers in a measurable way, i.e. raising output prices or decreasing output quality.

2. Mergers

There is a long history of antitrust enforcement in retail markets, and particularly supermarkets, in the United States. One now infamous decision in a line of expansive interpretations of Clayton Act § 7 includes *United States v. Von's Grocery Co.*,[77] a decision argued by none other than Richard Posner and Warren Christopher. The decision prohibited a merger between two grocery chains controlling only 7.5% of Los Angeles grocery sales post-merger and prompted Justice Stewart's famous observation that "the sole consistency that I can find is that under § 7, the Government always wins."[78] A more recent example of modern merger analysis between two powerful retailers is *FTC v. Staples, Inc.*, where the government was able to use direct econometric evidence to simultaneously show that: (1) office supply superstores were a relevant antitrust market; and (2) a merger of the two leading office supply superstores would significantly increase prices in that market.[79]

The Horizontal Merger Guidelines set out enforcement policy for the FTC and DOJ with respect to horizontal mergers, and also present a

76. *Id.* U.S. antitrust law is clear on the point that consumer welfare guides antitrust policy, not general efficiency considerations. *See* Reiter v. Sonotone, 442 U.S. 330 (1979).

77. 384 U.S. 270 (1966). Interestingly, Von's Grocery has been heavily criticized, but like other outdated merger decisions, never overruled despite empirical evidence that increased concentration over time in the Los Angeles grocery retail market between 1966-2000 is correlated with lower, not higher, prices. *See* Joshua Wright, *Von's Grocery and the Concentration-Price Relationship in Grocery Retail*, 48 UCLA L. REV. 743 (2001).

78. *Von's Grocery Co.*, 384 U.S. at 301.

79. FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1966). *See* RICHARD POSNER, ANTITRUST LAW 157-58 (2nd ed. 2001) (describing the Commission's analysis in *Staples* as evidence that the "[e]conomic analysis of mergers had come of age").

framework for analyzing the competitive effects of those mergers.[80] In addition to the Merger Guidelines, the FTC and DOJ have also promulgated "joint venture" guidelines which carry out the identical function with respect to less complete horizontal integrations.[81]

The Merger Guidelines adopt a five-step procedure for determining whether an agency will challenge a particular merger: (1) defining the relevant market and calculating initial and post-merger concentration levels; (2) analyzing the competitive effects; (3) assessing entry considerations; (4) determining whether any merger-specific efficiencies are present; and (5) determining whether either firm would likely fail without the merger.[82]

The Merger Guidelines' unifying theme is that "mergers should not be permitted to create or enhance market power or to facilitate its exercise."[83] The Merger Guidelines explicitly contemplate mergers that increase or create market power on the buyer side of the market:

> Market power also encompasses the ability of a single buyer (a 'monopsonist'), a coordinating group of buyers, or a single buyer, not a monopsonist, to depress the price paid for a product to a level that is below the competitive price and thereby depress output. The exercise of market power by buyers ("monopsony power") has adverse effects comparable to those associated with the exercise of market power by sellers. In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines.[84]

The FTC and DOJ Antitrust Guidelines for Collaborations Among Competitors ("Joint Venture Guidelines") also explicitly consider buyer power issues. For example, they state that: "competitor collaborations may involve agreements jointly to purchase necessary inputs," and that "many such agreements do not raise antitrust concerns and indeed may be procompetitive."[85] Like the Merger Guidelines, the Joint Venture Guidelines are concerned that buying collaborations "can create or increase market power or facilitate its exercise by increasing the ability or incentive to drive the price of the purchased product, and thereby

80. DEPARTMENT OF JUSTICE AND THE FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES (1997) [hereinafter MERGER GUIDELINES].

81. FEDERAL TRADE COMMISSION AND THE U.S. DEPARTMENT OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS § 3 (2000) [hereinafter JOINT VENTURE GUIDELINES].

82. MERGER GUIDELINES, *supra* note 80.

83. *Id.* at § 0.1.

84. *Id.*

85. JOINT VENTURE GUIDELINES, *see supra* note 81.

depress output, below what likely would prevail in the absence of the relevant agreement."[86] The key economic question is whether the exercise of monopsony power will attract new and profitable purchasing entries that will offset the price reduction.[87]

Buyer power can be an issue for analysis in both upstream and downstream mergers.[88] With respect to the former, buyer power is often raised as a defense to claims that an upstream merger will enhance market power. Of course, mergers between buyers can result in monopsony power that is itself the subject of antitrust inquiry.

a. Countervailing Power

It is often argued that any potential anticompetitive effects caused by a merger of suppliers are mitigated by the presence of countervailing buyer power. Of course, this argument also implies that any merger between power buyers creating monopsony power requires consideration of the presence of upstream monopoly power. As discussed, economic theory does not support the notion that market power at one level of the distribution chain mitigates the potential exercise of market power at another.[89] The Merger Guidelines do not specifically address countervailing power, but the issue might arise at either of two stages in the analysis.

First, "countervailing power" might be considered in the competitive effects analysis.[90] The Merger Guidelines contemplate the merger of firms that might face a small number of agents on the other side of the market, i.e. the merger of sellers facing a small number of buyers or vice versa:

> [I]n some markets sellers are primarily distinguished by their relative advantages in serving different buyers or groups of buyers, and buyers negotiate individually with sellers. Here, for example, sellers may formally bid against one another for the business of a buyer, or each buyer may elicit individual price quotes from multiple sellers. A seller may find it relatively inexpensive to meet the demands of particular buyers or types of buyers, and relatively expensive to meet others'

86. *Id.*

87. *Id.* at § 3.35 n.50.

88. In this Section, we will refer to mergers as encompassing the less complete integrations covered by the *Joint Venture Guidelines* unless otherwise noted.

89. *See* Schwartz, *supra* note 13, at 3 ("countervailing power, however, is unlikely to duplicate the competitive outcome and raises its own risks.").

90. MERGER GUIDELINES, *supra* note 80, at § 2.

demands.[91]

In other words, the Merger Guidelines allow for a relevant market definition that would be limited to particular types of buyers if market realities so demanded. This logic would also apply to a merger of buyers who sell to the same particular type of seller. Such a merger may raise anticompetitive issues.[92]

There is also some debate as to whether countervailing power should serve as an acceptable defense to a merger that would otherwise raise anticompetitive concerns. The efficiencies analysis in the Merger Guidelines suggests that such a defense would not be appropriate. For example, the Merger Guidelines require that proposed efficiencies be "cognizable," meaning that they must be specific to the merger and not arise from anticompetitive reductions in output or service.[93] The Merger Guidelines specifically mention that those efficiencies related to "procurement, management, or capital cost are less likely to be merger-specific or substantial, or may not be cognizable for other reasons."[94] Increased bargaining power vis-à-vis an upstream supplier with market power which improves procurement practices appears uncognizable under this definition. Likewise, a buyer merger resulting in the ability to reduce input prices as a result of monopsony power may not be cognizable, because these efficiencies would stem from an anticompetitive reduction in output or service.

b. Downstream Mergers

Proponents of more stringent treatment of buyer mergers have raised a number of reasons why these mergers might be more likely to raise competitive concerns than their supply-side relatives.[95] For instance, Carstensen argues that buyers' incentives to cheating on collusive agreements might be weak relative to the incentive to defect in

91. *Id.* at § 2.21 n.21.

92. *Staples*, 970 F. Supp. at 1066. This was the case in *FTC v. Staples, Inc*. where the district court issued a preliminary injunction against the merger of two office supply superstores on the grounds that the set of services offered by these superstores was sufficiently unique to define a relevant market.

93. MERGER GUIDELINES, *supra* note 80, at § 4.

94. *Id.*

95. We hold aside practical matters such as identifying the buyer and the seller in vertical distribution chains. *See*, *e.g.*, Schwartz, *supra* note 13, at 4. Marius Schwartz compares the cases of a manufacturer selling goods to a retailer versus a manufacturer who retains ownership of the goods but purchases distribution services from the retailer for a percentage of the final price. *Id.* A merger of the retailers results in an increase in buyer power in the first case and seller power in the second. *Id.*

supplier markets, that monopsony power is prevalent in agricultural markets such as the poultry industry, and that a retailer only need control a small percentage of the total number of outlets to obtain better terms from suppliers.[96] Carstensen concludes that these concerns justify the use of separate metrics for competitive effects analysis of buyer mergers.[97]

Certainly, antitrust authorities should not turn a blind eye to retail markets. In particular, agencies should be concerned with increased concentration at the retail level, other changes that dampen the costs of colluding, and the ability to engage in unilateral overbuying. However, our view is that the Merger Guidelines are broad enough to incorporate these concerns. For instance, the Merger Guidelines expressly allow considerable room for the agencies to consider factors facilitating collusive agreements.[98] There is little serious economic evidence that lower market shares are necessary for buyers to obtain market power. In sum, the Merger Guidelines are sufficiently flexible to be applied to mergers involving buyer power without modification. Nonetheless, buyer-side mergers deserve symmetric treatment such that agencies remain acutely aware of buyer market conditions that may give rise to competitive concerns.

B. European Union

This section details the approach taken by the Community Courts and the Commission when dealing with the exercise of "buyer power." The issue has arisen predominantly in merger cases, either as 'countervailing' power when assessing upstream mergers among suppliers, or else as anticipatory concern when considering downstream mergers among buyers. There is nothing in principle precluding its use as a concept under Treaty Articles 81 and 82 (analogous to Sherman Act Sections 1 and 2), and, indeed, buyer cooperatives and upstream collusive activity are examined under Article 81.[99] However, because both the law and policy on collusion is clear, we ignore such cases in what follows.

96. *See* Carstensen, *Buyer Power and Merger Analysis – The Need for Different Metrics*, *supra* note 14.

97. *Id.*

98. MERGER GUIDELINES, *supra* note 80, at § 2.12. For instance, the Merger Guidelines state that the following factors may be relevant to an investigation: "the availability of key information concerning market conditions, transactions and individual competitors; the extent of firm and product heterogeneity; pricing or marketing practices typically employed by firms in the market; the characteristics of buyers and sellers; and the characteristics of typical transactions." *Id*. at § 2.1.

99. Commission Decision 89/408/EEC, *National Sulphuric Acid Association*, 1989 O.J. (L 190) (a purchasing cooperative granted exemption); *see generally* Whish, *supra* note 32, at 569.

1. Dominance

"Dominance" is the name given in European competition law to that level of market power which is regarded as sufficiently serious as to warrant oversight of the behavior of the "dominant" firm. It is the second stage in the tripartite analysis conducted under Treaty Article 82 dealing with "abuse of dominance."[100] The first stage is the determination of market definition and the last stage the determination of whether the dominant firm has "abused" its dominance. The first two stages are also required to be undertaken by the Commission in all merger decisions (the third stage regarding abuse being anticipatory rather than inquisitive, since merger analysis is an ex ante, forward-looking activity).

The Court of Justice's definition of "dominance" expressly takes into account the influence that customers might have with respect to suppliers: a dominant firm must be able "to behave to an appreciable extent independently of its competitors *and customers* and ultimately of consumers."[101] If a supplier's competitive behavior is significantly constrained by its customers, it cannot be dominant. A buyer can itself be, or become, dominant (say, through a supermarket merger leading to a high share of retail grocery sales).[102] In that case the word "customers" would need to (and does) encompass input suppliers.

2. Mergers

Most of the jurisprudence dealing with "buyer power" has occurred in the context of a buyer's ability to constrain suppliers' exercise of market power, thus limiting the potential dominance of suppliers.[103]

a. Supply-Side Mergers

If buyers are able to influence the terms and conditions on which they acquire goods, then suppliers in that same market, by the definition of dominance given above, are not able to act independently of their customers.

Especially in the context of mergers, but also under Treaty Article

100. Treaty, *supra* note [11].

101. Case 27/76, United Brands v. Comm'n, 1978 E.C.R. 207, at ¶ 65; Case 322/81, NV Nederlandsche Banden Industrie Michelin v. Comm'n, 1983 E.C.R. II-3461, at ¶ 30.

102. *See, e.g.*, Commission Decision 97/277/EEC, *Kesko/Tuko*, 1997 (L 110) 53; and *Carrefour/Promodes,* Case No COMP/M.1684 Comm. Dec. of 25 Jan. 2000.

103. *See*, *e.g., Philip Morris/Nabisco*, Case No COMP/M.2072, Comm. Dec of 10 Oct. 2000; *Friesland Coberco/Nutricia*, Case No COMP/M.2399, Comm. Dec. of 8 Aug. 2001.

82, the Commission has increasingly recognized the role of buyer power as a countervailing force, limiting the market power of suppliers and shifting the balance of negotiating leverage in many markets from suppliers and towards customers. Buyer power has been held to result in a "neutralization"[104] of the effects of supplier dominance or concentration: i.e., "removing the possibility of suppliers exercising market power."[105] Strong buyer power constrains suppliers' ability to raise prices, and in many cases obliges suppliers to lower prices.[106]

In *Granaria/Ültje/Intersnack/May Holding*, the top five customers for nut snacks held shares of 70-95% in various national markets, leading the Commission to conclude that the joint venture on the supply side would not create or strengthen a dominant position.[107] In *Friesland Coverco/Nutricia* (where the four largest customers of dairy drinks accounted for 70-90% of the market), buyer power was one of the main factors leading to the approval of a merger.[108] In *Philip Morris/Nabisco*, an acquisition in the market for chocolate confectionery was found not to create or strengthen a dominant position, in part because large retailers accounted for nearly 50-60% of total chocolate confectionery purchases.[109] In *Enso/Stora*, the Commission found that, as countervailing buyer power existed in the market for newsprint where the two largest buyers each accounted for 25-35% of the market, a merger of two suppliers (despite these suppliers having up to 70% share of the relevant market) would not create or strengthen a dominant position.[110]

b. Buyer-Side Mergers

With respect to mergers between buyers and thus anticipatory concern about future "buyer power," the commission has decided fewer cases. Two important decisions by DG Comp. have set out the basic principles upon which mergers in the retail sector are now assessed.

104. *UPM-Kymmene/Haindl*, Case No COMP/M.2498, Comm. Dec. of 21 Nov. 2001.

105. Commission Decision 1999/641, *Enso Stora*, 1999 O.J. (L 254) 9, 20.

106. Bloom, *supra* note 10, at 409.

107. The top five customers had market shares of 70% in France, 71% in Germany, 95% in Sweden and 95% in the Netherlands *Granaria/Ültje/Intersnack/May Holding*, Case No COMP/JV.32, Comm. Dec. of 28 Feb. 2000, at ¶ 57.

108. *Friesland Coberco/Nutricia*, Case No COMP/M.2399, at ¶ 25.

109. *Philip Morris/Nabisco*, Case No COMP/M.2072, at ¶ 25.

110. Commission Decision 1999/641, *Enso Stora*, 1999 O.J. (L 254) 9 at ¶ 63. *See also* Commission Decision 97/277/EEC, *Kesko/Tuko*, 1997 (L 110) 53 at ¶ 133 (largest customer accounted for 55% of the relevant market).

These are the *Kesko/Tuko*[111] and the *Rewe/Meinl*[112] decisions, which relate to the merger of two leading food retail chains in Finland and Austria respectively. In the former case the merger was prohibited and in the latter it was allowed subject to undertakings.[113] These decisions have informed subsequent antitrust proceedings, such as the recent *Carrefour/Promodes* merger case[114] in France in which the merger, despite there being no concern about ex post dominance (unilateral or collective), required the firms to give undertakings. The Commission's concern about "dependence" led it to propose a "threat point" theory of buyer-mergers in the retail sector.[115] This threat point is defined as the maximum share of revenues that a supplier can afford to lose without a very serious risk of being driven to bankruptcy. Survey evidence of upstream suppliers indicated an *average* threshold of 22%.[116] The Commission stated that a supplier is in a position of "economic dependence" on a buyer when this threshold is exceeded, as loss of this amount of business could lead to bankruptcy.

c. Mechanics of Merger Assessment

The assessment of market power in merger analysis generally involves three stages.[117]

The first stage involves the defining of the relevant market, which in the case of buyer power is the market for the procurement of the relevant product. The procurement market comprises those demand sources to which suppliers may realistically sell their product.[118]

The second stage measures concentration in the properly defined procurement market: a finding of high demand-side concentration suggests buyer-side market power, which either does or (post-merger) will rise to the level of "dominance" (if a buyer-side merger is under consideration), or else can potentially act as a "countervailing power" constraining suppliers (if a supplier-side merger is under consideration).

111. Commission Decision 97/277/EEC, *Kesko/Tuko*, 1997 (L 110) 53.

112. Commission Decision 1999/674, *Rewe/Meinl*, 1999 O.J. (L 274) 1, 12 (EC).

113. *See* Commission Decision 97/277/EEC, *Kesko/Tuko*, 1997 (L 110) 53; Commission Decision 1999/674, *Rewe/Meinl*, 1999 O.J. (L 274) 1, 12 (EC).

114. *Carrefour/Promodes,* Case No COMP/M.1684 Comm. Dec. of 25 Jan. 2000.

115. For more on "dependence" theory, see Vogel, *supra* note 9.

116. The Commission's constant practice of surveying complainants seems to be in ignorance of the "cheap talk" nature of such activity. On the bad news of using subjective survey data, see Marianne Bertrand & Sendhil Mullainathan, *Do People Mean What They Say?: Implications for Subjective Survey Data*, 91 AM. ECON. REV. 67 (2001).

117. DOBSON REPORT, *supra* note 58, at p. 32.

118. Lücking, *supra* note 8.

Customer concentration is significant both in absolute terms (the percentage of demand accounted for by the largest buyer or buyers) and relative to concentration on the supply side.

In assessing demand-side concentration in procurement markets, the Commission has typically looked at the percentage of purchases of the relevant products accounted for by the largest customers in the market. It has tended to examine the issue of buyer power carefully in markets where the largest customers individually account for at least 25% of the relevant market or where they account for at least 50-60% of the market as a group.

The third stage involves an examination of the market behavior by both suppliers and customers in the relevant market. The Commission has, in a number of cases, made a comparison between the two sides of the market to determine whether demand-side concentration exceeds supply-side concentration. The Commission has found that buyer power made the possibility of supplier dominance unlikely in cases where demand-side concentration was equal to or greater than supply-side concentration.[119]

C. European National Regimes

Some European nations (such as France and Germany) in the 1990s enacted regimes specifically focused on "buyer power."[120] These regimes, utilizing a theory of "dependence," attempt to fill the alleged lacuna in the supra-national European law, but antitrust authorities appear to have been reluctant to enforce statutes based on a concept as vague as "dependence."

> In any event, it will always be difficult for the competition authorities to apply any provisions of law that do not fully square with classical price theory and its market effect requirement. There is currently no widely accepted theoretical foundation for a theory of economic dependence. Therefore, in the absence of an established rational doctrine, the scope for application of the rules on abuse of dependence is problematical. Who is to say where economic dependence begins and ends? The scope is virtually unlimited. Given their deep-seated doubts as to the legitimacy of any measures in this area, it is understandable that the competition authorities have steered clear of

119. *Philip Morris/Nabisco, supra* note 103, at ¶ 25 (demand-side concentration ratio 50-60%; supply-side 40-50); Commission Decision 1999/641, *Enso Stora*, 1999 O.J. (L 254) 9, 20, ¶ 84 (demand-side and supply-side concentration equal on the liquid packaging board market, with the top three accounting for nearly 100% of the market).

120. For a description of these laws, see Vogel, *supra* note 9, at 4-5.

this area.[121]

It is unfortunate that in its most recent merger decisional practice the Commission appears to be incorporating this vague and jurisprudentially limited concept into its conditions for approval.[122]

IV. SUPERMARKET COMPETITION

Recently, much focus has been placed on the alleged growth of market power of supermarkets and other big-box retailers. In the U.K., the Competition Commission conducted an inquiry into the U.K. supermarket industry.[123] In continental Europe the Commission allowed a merger between two supermarket chains in France (the Carrefour/Promodes merger), but only after undertakings dealing with concerns of increased post-merger bargaining power were made by the merging firms.[124] Further, antitrust authorities have long scrutinized the supermarket industry in the United States, and are increasingly doing so in the European Union and its member states. This focus has been applied to the competitive process by which suppliers bid for access to retail shelf space, the contractual relationships between manufacturers and supermarkets, and supermarket mergers.[125]

As a representative example of the "concern" regarding the supermarket sector, in the Commission's Green Paper (on Vertical Restraints) states:

> Manufacturers are more and more dependent on distributors and grocery retail for getting their products to the consumers. Since the shelf space for new products is limited, conflicts arise between the increasing number of new product launches and the retailers' objective [of] profit optimization. This conflict has resulted in retailers asking for listing fees (key money) or for discount schemes which sometimes go beyond possible cost savings of the manufacturers. Given the pressure on shelf space, products which are not in a number one or two position increasingly run the risk of being delisted and replaced by

121. Vogel, *supra* note 9, at 9.

122. *See*, *e.g., Carrefour/Promodes,* Case No COMP/M.1684 Comm. Dec. of 25 Jan. 2000.

123. The Competition Commission Report, *supra* note 7, discussed in Dobson, *Exploiting Buyer Power: Lessons from the British Grocery Store Trade*, 72 ANTITRUST L. J. (2005) 529. It should be noted that the Commission eventually reported a finding of no significant market power.

124. *Carrefour/Promodes,* Case No COMP/M.1684 Comm. Dec. of 25 Jan. 2000.

125. *See, e.g.,* Commission Decision 97/277/EEC, *Kesko/Tuko*, 1997 (L 110) 53 at ¶ 133, where the Commission observed that an agreement with the merged entity would be the only way for a supplier to guarantee shelf space in retail outlets representing over 55% of the Finnish market, creating unique purchasing power.

large retailers' own brands.[126]

In this section, we examine how buyer power affects the competitive analysis of various practices in the supermarket industry.

A. The Economics of Supermarkets

Supermarkets offer a number of advantages to suppliers and consumers. First, their economies of scale and scope enable them to obtain inputs more cheaply and thus sell final goods more cheaply to end-customers. A second advantage is that supermarkets and large retailers generally are able to reduce consumer search costs. The third advantage is that supermarkets resolve the coordination problem for shoppers and distributors (a classic complementarity) by placing substitutable goods next to each other. That is, supermarkets are sites of simultaneous substitutability and complementarity. For example, breakfast cereals on a shelf compete with each other while simultaneously offering complementarities with other products in the store. These are important benefits offered to consumers.

It should be noted that economic analysis of multi-product retailers, like supermarkets, has often failed to recognize some fundamental economic realities of the relationships between suppliers and supermarkets. This is the result of assuming that supermarkets simply translate consumer demand for each product at the retail level into a derived demand faced by the manufacturer at the wholesale level. Such an analysis assumes explicitly or implicitly that consumers know the exact product and brand that they will purchase before they come to the store. This is unlikely to be true in general. Retailers have the ability to influence consumer demand, and have discretion regarding what products to stock and how those products will be allocated on their shelves. As will be seen in the next subsection, this economic reality significantly impacts the relationships between suppliers and supermarkets because suppliers compete for access to shelf space.

B. Specific Issues

Some supermarket practices are sometimes suspected of being the result of buyer power or excessive bargaining power. Indeed, if "buyer power" is defined at its broadest as the ability of a customer to influence the terms on which it purchases goods, then because the terms of supply

126. *Commission's Green Paper*, *supra* note 8, at 66.

contracts vary widely, retailer practices that could be cited as evidence of buyer power are potentially endless. For example, the U.K. Competition Commission identified no less than 52 different practices which could evidence buyer power.[127] However, some of these practices have received more attention than others. For instance, the FTC recently conducted an inquiry into the ubiquitous supermarket practice of using slotting fees, or, more generally, supplier payments for shelf space of all kinds.[128] Other behavioural practices common in the supermarket industry which have come under suspicion in some quarters include category management, and the introduction of private label brands. We briefly discuss each in turn.

1. Slotting Allowances

Supermarkets supply premium shelf space which creates promotional sales.[129] Premium shelf space, an end-cap, or an increase in facings will result in additional sales. In large part, this is because consumers do not always know what products or what particular brands they will purchase before they enter the supermarket. Klein and Wright show that shelf space is essentially a form of promotion, and that supermarkets generally have an insufficient incentive to promote a particular brand from the supplier's point of view.[130] Because retail shelf space produces incremental sales by increasing the reservation values of some consumers, promotional shelf space can be thought of as providing a targeted discount to "marginal" consumers who would not

127. In its analysis, the Competition Commission grouped these 52 practices into eight categories: those requiring suppliers to make payments or concessions to gain access to supermarket shelf space; those imposing conditions relating to suppliers' trade with other retailers; those applying different standards to different suppliers' offers; those imposing an unfair imbalance of risk; those imposing retrospective changes to contractual terms with suppliers; those restricting suppliers' access to the market; those imposing charges and transferring costs to suppliers; and those requiring suppliers of groceries to use third-party suppliers nominated by the retailer. The Competition Commission Report, *supra* note 7, at ¶ 2.461, ¶ 2.462.

128. FEDERAL TRADE COMMISSION, SLOTTING ALLOWANCES IN THE RETAIL GROCERY INDUSTRY: SELECTED CASE STUDIES IN FIVE PRODUCT CATEGORIES (2003) [hereinafter SLOTTING ALLOWANCES] *available at* http://www.ftc.gov/os/2003/11/slottingallowancerpt031114.pdf.

129. *See* ADAM RENNHOFF, PAYING FOR SHELF SPACE: AN INVESTIGATION OF MERCHANDISING ALLOWANCES IN THE GROCERY INDUSTRY (2004); Dreze et al., *Shelf Management and Space Elasticity,* 70 J. OF RETAILING 301 (1994); Charles S. Areni et al., *Point-of-Purchase Displays, Product Organization, and Brand Purchase Likelihoods*, 27 J. OF THE ACADEMY OF MARKETING SCIENCE 428 (1999).

130. Klein, Benjamin and Wright, Joshua D., "The Economics of Slotting Arrangements" (2005) (American Law and Economics Association Annual Meetings Working Paper) *available at* http://ssrn.com/abstract=773464.

otherwise purchase the product.[131] Therefore, Klein and Wright show that slotting allowances are an efficient element of the normal competitive process.

Antitrust enforcement on the other hand has sometimes viewed slotting fees as a mechanism by which suppliers with market power can "overbuy" shelf space in order to exclude rivals.[132] However, the possibility of anticompetitive overbuying of shelf space is remote; theories of anticompetitive exclusion require significant economies of scale in manufacturing.[133] While accepting that any particular case would need to be considered on its merits, such economies of scale are unlikely to be present in many grocery products and therefore "overbuying" is unlikely to explain the use of slotting generally. Further, slotting allowances generally only bind supermarkets to provide premium shelf space for a short period of time. Under these conditions, it is highly unlikely that a competitor will be disadvantaged and unable to compete on a level playing field for promotional shelf space.[134]

2. Category Management

Along with slotting allowances, antitrust authorities have concerned themselves with the category management relationships between suppliers and retailers.[135] Category management is a business technique by which retailers divide decisions concerning shelf space allocation, promotion, and inventory by product category.[136] Category management generally involves a retailer designating a particular manufacturer as "category captain" or "category manager." A category manager

131. *Id*.

132. *See*, *e.g*., SLOTTING ALLOWANCES, *supra* note 128. This focus has also resulted in litigation. *See* Complaint, In the Matter of McCormick, 2000 FTC LEXIS 43 (FTC 2000) (No. C-3939); FTC v. H.J. Heinz Co., 116 F. Supp. 2d 190 (D.C.C. 2000), *rev'd*, 246 F.3d 708 (D.C. Cir. 2001); R.J. Reynolds Tobacco Co. v. Philip Morris, Inc., 199 F. Supp. 2d 363 (M.D.N.C. 2002); Coca-Cola Co. v. Harmar Bottling Co., 111 S.W. 3d 287 (2003); Conwood Co. v. United States Tobacco Co., 290 F. 3d 768 (6th Cir. 2002). Slotting fees and other forms of shelf space payments were also central to Coca-Cola's recent settlement with the European Commission that limits the amount of shelf space that Coca-Cola can purchase from retailers, as well as Coca-Cola's ability to offer rebates conditioned on exclusivity or specified levels of sales. *See* Undertaking, Case Comp/39.116/B-2-Coca-Cola. *See also Interpretation Bulletin, supra* note 5; *General Director's Position supra* note 5.

133. *See, e.g.*, Whinston, *Tying, Foreclosure and Exclusion*, 80 AM. ECON. REV. 837 (1990).

134. *See Empirical Industrial Organization Roundtable: Hearing Before the Federal Trade Commission* (2001) (comments of Dr. Klein at page 83), *available at* http://www.ftc.gov/be/empiricalioroundtabletranscript.pdf; Klein and Wright, *supra* note 34.

135. Vogel, *supra* note 9, at 10.

136. FTC REPORT, *supra* note 4, at 47. Category management has been employed in several retail trades for years, but is relatively new to the grocery retail industry. *Id.*

collaborates with the retailer and provides advice concerning which products to carry and how they should be allocated on the shelf space using a schematic known as a "plan-o-gram."

While very little work has been done to empirically test the marketing benefits of category management,[137] it recently played a significant role in a $1 billion verdict in *Conwood Co. v. United States Tobacco*.[138] Klein, Murphy, and Wright analyze the economics of category management, showing that category management can reduce retailer free-riding on supplier payments for promotional shelf space performance in a less restrictive manner than exclusive dealing.[139] Klein, Murphy, and Wright show that because manufacturer payments for promotional shelf space create the opportunity for dealer free-riding on the payments by taking the payments but failing to perform, it makes economic sense that the parties will desire a mechanism to enforce the agreement.[140] Category management, by shifting control of the retailer shelf space to the manufacturer, reduces the retailer incentive to free-ride in a manner that is far less restrictive than exclusive dealing.[141]

While appreciating that category management might have pro-consumer effects, antitrust authorities and commentators have expressed concern that the practice might facilitate exclusion from supermarket shelf space.[142] While not directly related to Salop's RRC overbuying theory, the exclusion mechanism is quite similar. The FTC Report states that: "a captain that is able to control decisions about product placement and promotions could hinder the entry or expansion of other manufacturers, leading to less variety and possibly higher prices."[143] This was one theory advocated by Conwood in its successful antitrust

137. One study reports that the introduction of category management in the laundry detergent segment at a single retailer was correlated with higher average prices, lower sales, but higher retailer profits as inter-brand competition to become the category manager forced lower wholesale prices. *See* Suman Basuroy, et al., *Impact of Category Management on Retail Prices and Performance: Theory and Evidence*, 65 J. MARKETING 16 (2001).

138. *Conwood Co.*, 290 F.3d at 795 (concluding that the manufacturer provided sufficient evidence that the competitor's removing its racks was exclusionary without a legitimate business justification).

139. Benjamin Klein and Joshua D. Wright, *The Antitrust Law and Economics of Category Management*, in mimeo (on file with author) (anticipated publication 2006).

140. *Id.*

141. *Id.*

142. *See*, *e.g.*, Debra Desrocher, et al., *Analysis of Antitrust Challenges to Category Captain Arrangements*, 22 J. PUB. POL'Y & MARKETING 201 (2003); Robert Steiner, *Category Management—A Pervasive New Horizontal/ Vertical Format*, 15 ANTITRUST 77 (2001); Thomas Leary, *A Second Look at Category Management* 2-3 (May 17, 2004), *available at* http://www.ftc.gov/speeches/leary/040519categorymgmt.pdf.

143. FTC REPORT, *supra* note 4, at 51.

suit against United States Tobacco, which also included allegations of product destruction and other business torts.[144]

As with the claim that there exists a possibility that slotting allowances might result in the anticompetitive exclusion of rivals, we are skeptical that category management offers any serious competitive threat short of a naked collusive agreement wherein the manufacturer would serve as the hub of a conspiracy amongst supermarkets. Price-fixing laws are more than sufficient to handle that type of behavior, and there is no debate that it does and should violate antitrust laws. However, the unilateral anticompetitive potential for the abuse of a category management position is mitigated by the fact that the agreements with retailers are terminable at will, that they require significant economies of scale in the supply of the product, and because such abuses would run against the interest of the retailer.[145] It is likely that category management will come to be seen in that class of agreements initially treated suspiciously by antitrust authorities, only to be shown later, and upon closer inspection, to be part of the normal competitive process. It is important to note that both slowing allowances and category management are part of the competitive process for product distribution that brings substantial benefits to consumers. Klein and Wright show that, during the time period where slotting allowances and category management were gaining in popularity amongst supermarket chains, retailer profits did not increase; payments were being passed on to consumers as a result of retail competition.[146]

3. Private-Label Products

Retailers that offer own-label products are both customers and competitors of branded product suppliers. The most important benefit to retailers of successful private-label programs is that it strengthens their position vis-a-vis their suppliers. By increasing the retailer's negotiating leverage against suppliers: they reduce the retailers' dependence on any individual branded product;[147] give the retailer greater flexibility to

144. *See Conwood Co.*, 290 F.3d at 779.

145. *Klein and Wright*, *supra* note 34, at 23.

146. *Id. See also* Joshua D. Wright, *Antitrust Law and Competition for Distribution*, 23 YALE J. ON REG. (forthcoming 2006).

147. The U.K. Competition Commission reported that in the United Kingdom, the largest supplier to the largest grocery retailer accounts for less than 3% of the retailer's total purchases, and only eight suppliers account for 1% or more of its purchases. The Competition Commission Report, *supra* note 7, at ¶ 2.457. It concluded that any grocery retailer with a greater than 8% share in the grocery procurement market (namely, all the five main U.K. retail chains) had buyer power. *Id.* at ¶ 2.458 .

reduce branded products' shelf space or to stock a more limited range; and increases the credibility of the retailer's threats to delist branded products. In other words, private-label products are a form of investment in bargaining position, common enough in bilateral bargaining scenarios.[148] A further possible benefit to retailers of own-label products is that they enables them customarily to be in possession of sensitive commercial information from their branded product suppliers about, for example, the marketing and promotional plans of the branded product. The information is valuable both for the advantage it gives in bargaining with the manufacturer who owns the brand, and also for the positive spillover it creates for the retailer in the marketing of its own, related, private brands.[149]

It is worth pointing out again that, in common law commercial jurisprudence at least, courts are exceedingly reluctant to interpose themselves into the dynamics of bargaining involving experienced large firms. In our view, none of these specific practices warrant special concern over supermarket buyer power.

V. CONCLUSION

In both Europe and the United States there has been much antitrust authority activity recently regarding retail "buyer power." Courts and scholars on both sides of the Atlantic have become alive to the possibility of the potential special problem of buyer power. In Europe in particular, with its comparatively greater concern for the protection of competitors rather than of the competitive process, such concerns have invariably led to a more hands-on approach to the implementation of competition law. In this paper we provide structure to the often bewildering and conceptually difficult number of categories and practices deemed worthy of greater scrutiny because of possible anti-competitiveness. We build on the modern economics of bargaining markets and vertical restraints to provide a clear framework for the general analysis of retail upstream market power. It is our view that

148. Schelling, *supra* note 47.

149. Collins states that

> [t]he retailer will usually obtain from all the major suppliers who supply him advanced details of their marketing and promotional plans, new product introductions and pricing intention . . . that information may well be used by the retailer, qua brand owner, in taking pricing, marketing and promotional decisions about his own private label products that compete with suppliers' brands.

Philip G.H. Collins, *Retailer Buyer Power: Abusive Behaviour and Mergers/Acquisitions*, 2001 FORDHAM CORP. L. INST. 423, 431 (B. Hawk ed., 2000).

arguments for special laws or special antitrust enforcement relating to retail market power are unwarranted on the basis of basic economic theory, and are likely to prove jurisprudentially problematic as has been the case in some European states.