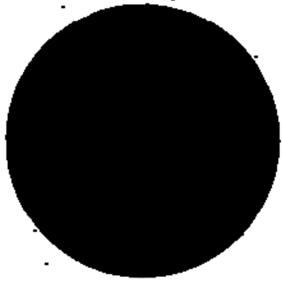

Federal Trade Commission

**Monopsony and The Meaning of "Consumer Welfare"**
**A Closer Look at**

there is continuing debate over what "consumer welfare" means. To some, "consumer welfare" focuses on the effects of the conduct on consumers in the relevant market. In this view, antitrust liability ultimately turns on whether the seller will have market power over consumers purchasing the output of the relevant market.[3] To others, including many from the Chicago School, "consumer welfare" is a much broader concept.[4] They believe the antitrust laws should be applied in a way that maximizes society's wealth as a whole. – or to use their language, that protects "allocative efficiency." Put differently, when they use the term "consumer welfare" they refer not just to the welfare of consumers in the output market but to the welfare of all consumers in society. Finally, there are those that argue that this is largely an academic debate with no real world impact because there is very little difference between the two standards.[5]

This debate over the meaning of consumer welfare has been revived over the last year. Last fall, the Antitrust Modernization Commission solicited testimony on the topic when it

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[3] *See,* Jonathan M. Jacobson & Gary J. Dorman, *Joint Purchasing, Monopsony, and Antitrust*, 36 ANTITRUST BULL. 1 (1991); Jonathan M. Jacobson & Gary J. Dorman, *Monopsony Revisited: A comment on Blair & Harrison,* 37 ANTITRUST BULLETIN 151, 153 (Spring 1992); Steven C. Salop, *Question: What is the Real and Proper Antitrust Welfare Standard? Answer: The True Consumer Welfare Standard,* presented to the Antitrust Modernization Commission (Nov. 4, 2005); Robert H. Lande, *Wealth Transfers Should Guide Antitrust*, 58 ANTITRUST L.J. 631 (1988); Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: the Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65 (1982).

[4] *See,* R.Bork, The Antitrust Paradox 66 (1978); Kenneth Heyer, "Welfare Standards and Merger Analysis: Why not the Best?" Vol. 2. COMPETITION POLICY INTERNATIONAL, No.2 (Autumn 2006) (advocating the use of a total welfare standard in merger analysis); Charles (Rick) Rule, "Consumer Welfare, Efficiencies, and Mergers," Statement for the Hearing of the Antitrust Modernization Commission, (Nov. 17, 2005); Charles (Rick) Rule and David Meyer, "An Antitrust Enforcement Policy to Maximize the Economic Wealth of All Consumers" 33 ANTITRUST BULLETIN 677 (1988).

[5] *See,* Thomas O. Barnett, DAAG, Antitrust Div, 2004 Milton Handler Annual Antitrust Review: Substantial Lessening of Competition – the Section 7 Standard, 2005 COLUM. BUS. L. REV. 293, 297 (2005) ("[T]he consumer welfare and total welfare standards can diverge, although I think it is a rare case in practice.")

discussed the role of efficiencies in merger analysis.[6] The Supreme Court has an opportunity to weigh in on the debate when it decides *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.* later this term.[7]

To date, the Court's position has been opaque. It has been almost thirty years since the Supreme Court described the antitrust laws as a "consumer welfare prescription."[8] The Court borrowed the phrase from Judge Bork, a preeminent Chicago School scholar. But it is unclear whether the Court also adopted the philosophy behind Judge Bork's use of the phrase. Judge Bork, like other Chicago School adherents, be

As I mentioned earlier, in *Weyerhaeuser* the Supreme Court has an opportunity to clarify what it meant in *Reiter*. In *Weyerhaeuser*, Ross-Simmons – a saw mill in the Pacifi

2 of the Sherman Act.[10] However, lurking beneath that question is the much more fundamental – and cosmic – question as to what "consumer welfare" means.

More specifically, the Petitioners and Solicitor General advocated adoption of the *Brooke Group* standard used in evaluating a claim of predatory selling, when the claim is one of predatory buying. The premise of their position was that the antitrust laws protect sellers and buyers equally. Reasoning from that premise they contended that it was appropriate to use the same standard in a predatory buying case as in a predatory selling case.[11]

That premise, in turn, was rooted in the view that a buyer exercising monopsony power – by initially paying supra-competitive input prices to eliminate competitive buyers and then paying sub-competitive input prices – creates allocative inefficiencies just as does a seller exercising monopoly power by initially charging sub-competitive prices to eliminate competitive sellers. That is Judge Bork's view of "consumer welfare" – namely that the antitrust laws should prevent conduct that creates allocative inefficiencies and thereby inhibits the maximization of the wealth of society as a whole.[12]

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[10] Brief on the Merits for the United States as Amicus Curiae, No. 05-381 (August 24, 2006); *see afor tl r5 tlw5 9.5T0 0Tc -0.0 Tw 2port Tw cert.4 8.8 Tm(Brief on the Merits for the United States aT/T*

frequently made by lay juries.[13] To me, "consumer welfare" means just that – the welfare of those who are confronted by actual or threatened exercises of seller market power in the output market. I think that view of "consumer welfare"generally – and of the way the antitrust laws apply to an exercise of monopsony power specifically – are consistent with the Guidelines adopted by both the DOJ and the FTC.[14]

To be sure, Section 0.1. of the 1992 Horizontal Merger Guidelines provides that the likelihood a merger will result in buy side market power – in other words, monopsony power – may be pernicious in certain circumstances.[15] But the Merger Guidelines do not suggest that those circumstances exist anytime that monopsony power may distort allocative efficiency. To the contrary, the only provisions of the Guidelines bearing on the meaning of "consumer welfare" are the provisions dealing with efficiency claims. Those provisions require that

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[13] Assuming that an exercise of monopsony power may lead to inefficient allocation of scarce resources, antitrust rules that turn on whether or not those inefficiencies have occurred or are likely to occur, would be very difficult to administer. Indeed, it is arguable that even if the enforcement agencies with their large staffs of economists, could do so in exercising their prosecutorial discretion, it would be impossible to make such determinations in the rough and tumble of courtroom litigation. See Joseph Farrell and Michael L. Katz, "The Economics of Welfare Standards in Antitrust," Vol. 2. COMPETITION POLICY INTERNATIONAL, No.2 (Autumn 2006).

[14] The agencies, and more importantly the courts, focus on the price and quantity effects in the output market of the allegedly anticompetitive conduct. A move away from this consumer welfare standard to a total welfare standard could make a big difference in some cases. For example, under a total welfare standard, one might approve a merger that resulted in higher prices and reductions in input if the merger also results in costs savings to the monopolist (or the cartel) that outweighed those harms. *See,* Oliver E. Williamson, *Economies as an Antitrust Defense: the Welfare Trade-offs*, 58 AM. ECON. REV. 18 (1968); *see also,* supra note 3 Salop, *Question: What is the Real and Proper Antitrust Welfare Standard?* As Professor Salop has observed, that result is hardly consistent with the Supreme Court's oft-repeated declaration that "the antitrust laws are designed to protect competition." *Brunswick Corp v. Pueblo Bowl-O-Mat, Inc.,* 429 U.S. 477, 488 (1977).

[15] *See,* U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines § 0.1 (1992) *reprinted in* 4 Trade Reg Rep. (CCH) ¶ 13,104.

protect sellers and buyers equally.

Several arguments have been advanced to support the position that the Sherman Act

Additionally, *Mandeville Farms* was a Section 1 case in which *concerted* conduct was alleged.

case.

Second, a number of economists believe that monopsony is merely the mirror image of monopoly and therefore there is little reason to treat the two differently under the law. They support that position on the basis of Judge Bork's view of "consumer welfare,"arguing that market inefficiencies created by anticompetitive restraints on input markets can "distort" those markets and produce a dead weight loss to total welfare.[22] More specifically, these economists contend that some producers of the input product will either produce less or cease production altogether, resulting in less-than-optimal output of the product or service.[23] But other economists disagree, pointing out that in any event, the antitrust laws protect the welfare of consumers in output markets, not total welfare, and the welfare of those consumers is rarely harmed by an exercise of monopsony power in input markets.[24] Indeed in *Brooke Group*, the Supreme Court's concern was explicitly for the welfare of consumers in the output market, not total welfare or the risk of some theoretical "dead weight" loss.[25]

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Third, another argument advanced in support of the position staked out by Petitioners and the Solicitor General is that the Sherman Act's drafters were concerned that sellers could be harmed by firms exercising monopsony power. Yet others take issue with this interpretation of the legislative history.[26] Indeed, Judge Frank Easterbrook has noted that "the choice [Congress] saw was between leaving consumers at the mercy of trusts and authorizing the judges to protect consumers. However you slice the legislative history, the dominant theme is the protection of consumers from overcharges."[27]

This is not to say that I believe that monopsony power does not ever distort competition – or that it should never be condemned. However, I disagree with the premise that the antitrust laws protect sellers in input markets equally with consumers in output markets, with the citation of *Mandeville Farms* in support of that proposition, and with the definition of "consumer welfare" which underlies that proposition.

*B. What is the appropriate test for evaluating Predatory Purchasing/Over-bidding*

As previously discussed, Petitioners – along with a number of their amici including the Solicitor General – argue that *Brooke Group* should apply foursquare to a buyer case alleging predatory buying in an input market as well as to a seller case alleging predatory pricing in an output market.[28] I also disagreed with that conclusion for several reasons.

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[26] Robert H. Lande, *Chicago's False Foundation: Wealth Transfers (Not Just Efficiency) Should Gui28B4.52Tm(As previo92m(Robert H. n2alse02.97eBT21uTm(Robert H. Lande, )TjETBT5gc[c96*

First, the risk of false positives is not the same in buy side cases involving input markets as it is in sell side cases involving output markets. In both cases, to be sure, there is a predation period and a harvest period. However, the resemblance ends there. In the sell side case involving an output market, there is a real risk of false positives; during the predation period, the defendant sells at low prices, and if a challenge is unwarranted so that the low pricing is chilled, consumers will be injured by being deprived of the low prices. That is the heart of the Supreme Court's *Brooke Group* opinion and analysis.[29] However, the same thing cannot be said of buy side cases involving an input market at least where the defendant buyer lacks market power in selling in the output market. During the predation period, the defendant (or defendants) buy input at high prices, but they cannot pass those high prices along to consumers because the vigorous competition in the output market will constrain them from doing so; conversely, during the harvest period, the defendant (or defendants) buy at low prices, and the vigorous competition in the output market gives them every incentive to pass those low prices on to consumers. Thus, as the Ninth Circuit said, the issue of over-deterrence in a buy-side predatory pricing case is not nearly as great as it is in a sell-side predatory pricing case.[30]

Second, absent market power in the output market, applying the *Brooke Group* test in a predatory buying case may actually deter conduct that benefits consumers. As the Health Care Guidelines state, efforts by a defendant (or defendants – i.e., a buying group) to reduce buy side

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Reigns: Using Section 2 to Ensure a 'Competitive Kingdom'" Opening Session, Joint DOJ/FTC Hearings on Section 2 of the Sherman Act (June, 20 2006).

[29] *Brooke Group,* 509 U.S. at 224 ("Even if the ultimate effect of the cut is to induce or reestablish supracompetitive pricing, discouraging a price cut and forcing firms to maintain supracompetitive prices, thus depriving consumers of the benefits of lower prices in the interim, does not constitute sound antitrust policy.").

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input prices is potentially beneficial to consumers in those circumstances because the buy side savings are apt to be competed away. As stated above, there is a school of thought (e.g., Blair & Harrison) that theorizes that a unilateral or collective exercise of monopsony power "distorts" the operation of the input market to the detriment of sellers in that market and/or others associated with those sellers. But whether and when input prices are "artificially" high or low is speculative at best, and there is a very real risk that a false finding of artificiality will deprive consumers of low prices in the output market. Indeed, if the analysis focuses on whether buy-side prices will distort allocative efficiencies and thereby impair the welfare of all consum

Circuit in *Weyerhaeuser* essentially focused on that issue. As the Solicitor General asserts, that instruction is too amorphous and difficult to apply.[32] If the jury gets that wrong, the error costs can be high.

Fourth, and finally, a much easier liability test is available. It is one that would screen out all predatory buying claims where the defendant lacks market power in the output market.[33] This analysis could be conveyed to a lay jury by instructions which are simple (and familiar because juries in Section 1 Rule of Reason and Section 2 cases are currently instructed that market power is an essential element of the claim and then instructed how to determine whether the defendant has market power.). Beyond that, this kind of analysis, based on whether the defendant has used exclusionary conduct to create or maintain market power in the output

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them, simply to deny access to rival sawmills. However, even here courts must be careful. For example, stockpiling of inventories in times of anticipated shortages is perfectly pro-competitive behavior. A firm that has a reasonable expectation at the time of purchase that it actually will use an input in its own production should never be condemned for behaving predatorily. In any event, the fact findings here were that Weyerhaeuser was reselling the finished lumber in a competitive market. In that case, it could have sold all it wanted at the competitive price. For the same reason, such a firm would have no incentive to overbuy and destroy the excess – in a competitive resale market there would be no excess." Herbert Hovenkamp, *The Law of Exclusionary Pricing*, 2 COMPETITION P