Articles

WHAT THE CANADIAN CRIMINAL CONSPIRACY AMENDMENTS MEAN FOR BUYING-SIDE AGREEMENTS (INCLUDING MERGERS WITH BUYING-SIDE EFFECTS)

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Suite à l'amendement de l'article 45 de la *Loi sur la concurrence*, les dispositions criminelles relatives aux complots ne s'appliquent plus aux ententes d'achats groupés. Ceci a eu deux conséquences : (1) les cartels aux effets monopolistiques et les cartels aux effets monopsonistiques sont traités asymétriquement même si l'effet économique de ces cartels est symétrique; et (2) on en connaît davantage sur l'approche du Bureau de la concurrence concernant les ententes entre acheteurs, dont les fusions affectant les marchés d'approvisionnement. La justification pour le traitement asymétrique des ententes d'approvisionnement en matière de complots est empirique : la plupart du temps, les ententes d'approvisionnement ne sont pas économiquement nuisibles, c'est-à-dire qu'elles n'impliquent que des exercices de pouvoir compensateur. Cependant, l'asymétrie sous-jacente de traitement pourrait néanmoins se révéler problématique, soulevant des questions quant à la caractérisation d'une entente comme étant une entente d'achat ou de vente, avec un impact considérable sur l'effet juridique potentiel d'une telle détermination.

1. Introduction

With the implementation of revised section 45 of the Canadian *Competition Act* (the "Act") on March 12, 2010, the criminal conspiracy provision appears to no longer apply to joint purchasing agreements, even those between firms that compete in respect of the purchase of products. The provision only refers to the "supply" or "production" of a product and, if this were not sufficiently clear, the Competition Bureau's (the "Bureau") *Competitor Collaboration Guidelines* resolve any remaining ambiguity (at least as to the Bureau's understanding): "... joint purchasing agreements ... are not prohibited by section 45, but may be subject to a remedy under the civil agreements provision in section 90.1...."[1] As a result of this amendment, cartels with monopoly effects and cartels with monopsonistic effects are treated asymmetrically even though the economic effect of such cartels is symmetric in that both result in a reduction in economic surplus. The only possible justification for this is expediency in the face of empirical outcomes: that is, more often than not buyer side agreements are not economically harmful in that they only entail exercises of countervailing power as opposed to monopsony power.

That buyer agreements often entail an exercise of only countervailing power is widely accepted. If an upstream supplier of an input has market power, an agreement among buyers to reduce the price of the input can effectively counter that market power with the net effect that more of the input is purchased and surplus is increased.[2] [3] In contrast, on the selling side, it would be very rare that an agreement that effectively raises output prices would increase surplus,[4] because this could only occur if the pre-merger price were below the competitive price. Consequently, absent a requirement for agreements to result in an undue lessening of competition as was required under the previous version of section 45, as a matter of expedience, it is not unreasonable that buyer agreements would fall outside the criminal provisions. However, the underlying asymmetry in treatment could still prove problematic. It can raise questions as to the proper characterization of an agreement as a buying or selling one, and so whether justice is served when one characterization can result in a $25 million fine and a prison term of up to 14 years, and the other in only the dissolution of the arrangement.

A surprising consequence of the exclusion of buying agreements from the cartel provision is that, in ex-

plaining within the *Competitor Collaboration Guidelines*[5] ("Collaboration Guidelines") how buying agreements will be treated under new civil provision 90.1, the Competition Bureau (the "Bureau") makes its clearest statement yet as to how it approaches issues of monopsony and buying power. This statement presumably applies equally to mergers that potentially have an impact on input markets; if not, the Bureau risks asymmetric treatment of non-criminal horizontal arrangements among competitors and (equally non-criminal) mergers. The discussion of monopsony in the context of section 90.1 is particularly notable because the Bureau has been historically criticized for a "lack of meaningful guidance" on this issue.[6]

In this paper I examine the economics of the symmetry across monopoly and monopsony effects, the bases for its asymmetric treatment, and the questions this asymmetry raises in regard to the characterization of transactions. I also examine the treatment of buyer agreements as discussed within the Collaboration Guidelines and its implications on buying side mergers.

For purposes of clarity, before proceeding further, it is worthwhile defining some terminology. This is particularly the case since this is an area where there are numerous similar terms, and the same terms can sometimes take on different meanings. The definitions used herein follow that outlined by Chen.[7] In particular, monopsony power is defined as the ability of a firm to profitably reduce the price of an input below competitive levels by reducing its purchases of the input (in the case of a group of firms, this can be referred to as "oligopsony power" as well as monopsony power; herein, monopsony power is used to include oligopsony power). The potential for the exercise of monopsony power arises when a large buyer or group of buyers of an input is supplied by competitive firms whose costs increase with each additional unit of quantity produced.[8] In contrast, a buyer only has countervailing power (also referred to as "bargaining power") when it is able to offset, at least in part, the market power of *sellers*. Countervailing power is exercised only when in its absence a buyer would pay prices in excess of competitive levels. Countervailing power counters the market power of suppliers. Buyer power is an umbrella term that includes monopsony, oligopsony and countervailing power.

Section 2 discusses the asymmetry in approach to buying and selling cartels under the criminal conspiracy provisions. Section 3 examines the discussion within the Collaboration Guidelines on monopsony power-creating horizontal arrangements and its implications for merger review. Section 4 briefly compares the Bureau's approach within the Collaboration Guidelines to that contained in the US Merger Guidelines and the approach generally taken by the European Commission ("EC"). Section 5 concludes.

2. Asymmetric Approach to Buying and Selling Cartels

2.1 The Status of Buying Cartels Under the Act and According to the Bureau

Subsection 45(1) of the Act reads as follows:

> 45. (1) Every person commits an offence who, with a competitor of that person with respect to a product, conspires, agrees or arranges
> (a) to fix, maintain, increase or control the price of the *supply* of the product;
> (b) to allocate sales, territories, customers or markets for the *production or supply* of the product; or
> (c) to fix, maintain, control, prevent, lessen or eliminate the *production or supply* of the product. [emphasis added]

If this is not considered sufficiently clear to indicate that conspiracies to buy a product are not included in the criminal provision, the Bureau's Collaboration Guidelines resolve any remaining ambiguity as to the Bureau's own understanding:

> The prohibition in paragraph 45(1)(*a*) applies to the price for the **supply** of a product, and not to the price of the **purchase** of a product. Accordingly, joint purchasing agreements – even those between firms that compete in respect of the purchase of products – are not prohibited by section 45, but may be subject to a remedy under the civil agreements provision in section 90.1 where they are likely to substantially lessen or prevent competition [emphasis in original].[9] [10]

As such, agreements on the selling side to fix prices are illegal but agreements on the buying side are not. This is the case despite the fact that buying side agreements that result in the exercise of monopsony power will have a negative affect on welfare in the same way as those on the selling side.

2.2 The Economics of Monopoly and Monopsony

The symmetry of monopoly and monopsony was recognized by the Canadian Competition Tribunal[11] in the context of a merger between two meat rendering companies ("*Hillsdown*"). In that decision, the Competition Tribunal noted that it could analyse the competitive effects of the merger from the perspective of a monopsonist or a monopolist, and that no significant difference resulted from the two characterizations.[12] In particular, the Competition Tribunal suggested that any transaction can be characterized as a sale of a service or the purchase of inputs.

This is a reasonable finding if the firm in question is neither the initial producer nor the end-user; in other words, that it is in the middle of two markets buying from one and selling in the other.[13] (As such, while a group of final consumers might collectively have monopsony power, their monopsony power could not be re-characterized as monopoly power since they consume the good in question.)

To illustrate, suppose there are two pipelines that transport oil from northern Alberta to oil refineries further south.[14] The two pipelines collude in selling their oil transportation services, setting a monopoly price for such services. They are caught and are so subject to criminal prosecution under section 45. Alternatively, suppose the two pipelines do not sell transportation services but rather buy crude oil in northern Alberta and then resell it at points further south. The two pipelines form a buying group for the purchase of crude, pushing the price of crude down such that crude producers reduce the amount of crude they make available to the pipeline. There are complaints and the buying arrangement is subject to civil review under section 90.1. While the legal outcome of the two matters are quite different, the economic effects are the same.

Suppose in the case where oil pipeline transportation services are being sold that the price of oil at the end of the pipelines is competitive – there are multiple sources of oil in this particular area – and that the competitive price for oil is $\$100/m^3$. Further suppose that the marginal cost of transporting oil via the pipeline is C_p and absent collusion, price of transportation (P_p) is set equal to marginal cost. When the two pipelines collude, however, they set the price of transportation services at the monopoly price. Since demand for pipeline services are derived from downstream demand for oil, pipeline producers know the quantity of oil transportation services they will be able to sell oil producers will be given by the equality of oil producers' marginal cost (the marginal cost of oil ($C'(Q)$) plus the cost of transportation, i.e., $C'(Q) + P_p$) and their marginal revenue. Marginal revenue in this case will be \$100 given the competitive downstream market for oil. This provides the demand curve faced by the pipeline producers ($P_p = \$100 - C'(Q)$). As such, the pipeline producers' profits (Π_p) can be written as

$$\Pi_p = (\$100 - C'(Q) - C_p)Q$$

Assume the resulting profit maximizing price is $\$75/m^3$. At this price, assuming that oil producers' demand for pipeline transportation services is not perfectly inelastic, the oil producers purchase fewer transportation services than they otherwise would were transportation sold competitively. Given the downstream price of $\$100/m^3$ for oil and a monopoly transportation cost of $\$75/m^3$, the oil producers' profits are $(\$100 - \$75 - AC(Q^M))Q^M$ (where AC(Q) is the average cost of oil production) and pipeline cartelists' profits are $(\$75 - C_p)Q^M$.

Now instead, suppose that the pipeline owners buy crude oil at the northern end of the pipeline and then re-sell it at the southern end. The pipeline owners now come together to jointly purchase crude oil at the northern end of the pipeline. They reduce the purchase price. If the upstream market for oil is competitive, oil suppliers will supply out to their marginal costs so that the profit function faced by pipeline suppliers will be as before; that is, $\Pi_p = (\$100 - C'(Q) - C_p)Q$.

As such, the quantity that maximizes pipeline operators' profits will be the same as before, resulting in a price paid for upstream oil of $\$25/m^3$. The oil producers will have profits of $(\$25 - AC(Q^M))Q^M$ and the pipe-

line owners will make profits of (\$100 – \$25 – C_p)Q^M. Both oil producers and pipeline owners have the same profits in the monopsony case as in the case of monopoly.[15]

The net result in both situations is a loss in surplus in the intermediate pipeline market: with monopoly, too few pipeline transportation services are purchased in the market to be socially optimal such that too little crude is transported, while with monopsony, too little crude is supplied for transportation.

This loss in surplus arises even though in both the monopoly and monopsony examples the market for the sale of crude oil at the end of the pipelines remains competitive. There is no change in the total amount of crude oil produced (only the particular pipelines at issue will have lost market share), and there is no change in the price of crude oil in the downstream market at the end of the pipelines. This is not to say that there might not be an additional source of inefficiency stemming from the competitiveness of the downstream market for crude oil. The reduction in oil transported through the pipelines will be made up by other crude oil producers (who perhaps use trucks, ships or other pipelines for their transportation) increasing their output. If those oil producers increase their output by bringing on-line an oil source that is less productive than the oil source that would have otherwise produced the crude oil but for the monopsony/monopoly, there will be a misallocation of resources from the more efficient oil source to the less. Alternatively, if the crude oil market is not in fact competitive, the reduction in oil transported through the pipelines as result of either the buyer or seller cartel will result in a reduction in output in the crude oil market at the end of the pipelines and so a higher price and reduced surplus in that market as well.

As a theoretical matter, monopsony is no less harmful than monopoly. As in the case of monopoly in selling services, monopsony transfers surplus from the upstream market (the supply of crude oil in northern Alberta) to the intermediate market (the oil pipeline transportation market) and in so doing creates a deadweight loss and an inefficient allocation of society's resources. If the question of economic surplus in the market at issue were the only consideration, there would be no reason to proscribe one type of agreement and not the other. Nonetheless, the Parliament of Canada chose to treat these situations asymmetrically.[16]

2.3 A Matter of Expedience

The decision to treat monopoly and monopsony differently was presumably made based on the likelihood of harm. Not all agreements to fix prices, allocate markets or eliminate the production or supply of a product on the selling side will necessarily be surplus-reducing.[17] Similarly, not all buying side agreements will have such an effect. However, more often than not, such agreements are harmful on the selling side and are not on the buying side. Buying side agreements often have the effect of reducing upstream prices without causing a reduction in output. In other words, such agreements often have the effect of countervailing pre-existing upstream market power, rather than resulting in output-reducing market power. As such, to preclude the capture of such efficiency-enhancing agreements where defendants can no longer rely on the requirement that agreement unduly lessens competition, buying agreements have been excluded from section 45 altogether.

This question of expedience is at least partially suggested by the Collaboration Guidelines but only in the context of small- and medium-sized firms: "The Bureau recognizes that small- and medium-sized firms often enter into joint purchasing agreements to achieve discounts similar to those obtained by larger companies. Given that such arrangements can be pro-competitive, they are not deserving of condemnation without a detailed inquiry into their actual competitive effects; as such, they should only be subject to review under the civil agreements provision in section 90.1."[18] [19]

2.4 Characterization of Transactions

While it may be desirable to exclude certain type of behaviour from a *per se* law, in the case of buying and selling cartels, this exclusion raises the question of the proper characterization of a transaction as either involving a sale or a purchase. It is not completely clear that direction of payment would dictate the outcome given the Tribunal's decision in *Hillsdown* that a transaction can be characterized as a sale of a service or the purchase of an input. In keeping with that decision, the US Merger Guidelines note in an example in regard to "implicit prices" that "[i]f pipelines buy the oil at one end and sell it at the other, the price charged for trans-

porting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as 'pipeline transportation of oil from point A to point B' than as 'oil at point B'."[20] If this type of reasoning were to prevail in the case of buying agreements taking place in Canada, not only could a buying agreement that has monopsony effects be captured, so could one that merely countervails upstream market power. Moreover, given the significant difference in penalties for the two types of cartels – a fine up to $25 million and a prison term up to 14 year in the case up selling cartels versus dissolution of the agreement in the case of buying cartels – defendants have strong incentive to re-characterize an agreement as one involving purchase.

3. The Competitor Collaboration Guidelines, Mergers and Monopsony Power

The asymmetric approach to monopoly and monopsony has the surprising benefit of the Bureau clearly stating that not all input price reducing agreements will result in a lessening of competition. While this statement is made in the context of joint purchase agreements, it would be wholly unreasonable for the Bureau to fail to extend this logic to agreements that are in fact mergers. Historically, the Bureau has failed to make this position clear in the merger context. This has lead to uncertainty as to whether the Bureau would proscribe buyer-side mergers that are unlikely to reduce surplus. However, even with this uncertainty now resolved, questions remain as how to assess cases of monopsony and to successfully distinguish such cases from those involving bargaining power.

3.1 Is a Reduction in Output Necessary for an Agreement Between Buyers to Raise Issues?

The Canadian *Merger Enforcement Guidelines* (the "MEGs") are 46 pages long. Within that, a mere single paragraph and one footnote address the question of monopsony power:

> 2.4 The analytical framework is equally applicable when assessing market power by buyers of a product. Market power of buyers means the ability of a single firm or group of firms to profitably depress prices paid to sellers (for example, by reducing the purchase of inputs) to a level of that is below the competitive price for a significant period of time.[21]

Given this brevity, it is not surprising that a lack of clarity follows. The most important issue is whether "reducing the purchase of inputs" or reducing some other dimension of competition (such as quality) is necessarily part of an exercise of market power by buyers, or whether wealth transfers from sellers to buyers as a result of countervailing power is sufficient. In other words, do the merger provisions apply to cases of merger that improve the ability of the merged entity to countervail upstream market power, or is it limited to cases of monopsony power?

Applicability of Guidance in the Collaboration Guidelines to Buyer Mergers

Prior to the amendment to section 45, when section 45 applied to the purchase of a product and potentially applied regardless of whether the input price reduction was accompanied by an output decrease (depending on how an undue lessening of competition was interpreted and assessed),[22] it was arguable from a policy point of view that the merger provisions too should apply in this way. That is, that the merger provisions should consider cases of buying power that do not also constitute monopsony power. Otherwise, the merger provisions risked rendering *per se* legal behaviour that was might otherwise be subject to the criminal price-fixing provisions. Given the amendments to section 45, however, such an interpretation of buyer market power in the case of merger no longer makes sense. Exercises of buyer market power through joint purchasing agreements are no longer proscribed criminally but are examined under section 90.1 to determine whether they likely constitute monopsony power. Only if they do, will agreements be considered likely to substantially lessen or prevent competition in the relevant upstream market.[23]

It would be wholly unreasonable if the approach to civil buying agreements under 90.1 did not also apply to the merger provisions. Mergers, after all, are simply a particular type of agreement. This reasoning remains despite the fact the Bureau is careful to limit its discussion of joint purchasing agreements and monopsony power "[f]or the purpose of section 90.1."[24]

Collaboration Guidelines on Output Reduction

In regard to output reductions in the context of joint purchasing agreements, the Bureau notes as follows:

> ... the Bureau considers a single buyer to have "monopsony power" where the buyer holds market power in the relevant purchasing market such that it has the ability to decrease the price of a relevant product below competitive levels with a c*orresponding reduction in the overall quantity of the input produced or supplied* in a relevant market, *or a corresponding diminishment in any other dimension of competition* [emphasis added].[25]

This, it would appear, should resolve the question of whether mere transfers in wealth are subject to remedy in regard to buying agreements (or mergers between buyers) but for a footnote accompanying this statement:

> Cases where the supply curve is perfectly inelastic such that a price decrease below competitive levels does not result in a decrease in output but only a wealth transfer may also give rise to concerns. This scenario should be understood to be generally included in the category of upstream market power.[26]

In other words, if the input in question is one where supply cannot be easily altered, the Bureau may still pursue a merger between buyers that lowers the price to such input providers even though there will be no decrease in output. The Collaboration Guidelines do not elaborate any further on this point, but presumably the types of products that this would entail are the types that are often considered in buyer power cases: agricultural products[27] and products that are by-products of other production processes. For agricultural and other similar products, the amount of output can be altered from one growing season to the next but often cannot be easily or profitably altered within a growing season. By-product production meanwhile is typically contingent on demand for the associated main product. Examples might include scrap metal, rendered meat by-product (as in the *Hillsdown* case), and steam from heat-intensive production facilities.

Logs are potentially the type of 'agricultural' product of concern. In 2004, they were the focus of two separate Bureau consent agreements, involving two separate mergers within the forestry industry.[28] In both cases, the settlement involved the divestiture of saw mills. In neither case, however, did the Bureau's publicly available information note whether the merger would result in a decline in log purchases. Rather, in regard to one of the mergers, it noted only that "[t]his transaction would have resulted in less choice for log sellers, wood re-manufacturers and wood-chip sellers."[29]

The exception to the need for output reductions (or a corresponding diminishment in any other dimension of competition) in cases of perfectly inelastic supply is unlikely to much increase the scope of section 90.1 in cases of joint purchasing agreements or the merger provisions in the case of buyer mergers. Perfectly inelastic supply curves are likely to be relatively rare or a question of (mis)measurement.

In cases of agricultural products, growing seasons are typically no more than a year such that a producer can adjust her output the following year should low prices compel her to do so. As such, an observation of perfectly inelastic supply may only be a question of the period over which it is observed. In such situations, output should be measured over a period which is sufficiently long for adjustment and should at least match the duration of the expected price increase.

Even in cases where the growing period is considerably longer, such as in the log example, the log is typically not the only input to production. Other inputs can include cutting, management, transportation and others. A decrease in log prices could compel a producer to rationalize output on the basis of inadequate return on the sum of these inputs, not just the cost of the log itself. This is similarly true for by-products. One need not look further than recyclable materials to know that producers will forgo the cost of selling such materials in favour of storing or destroying them if the price of recyclables is sufficiently low.[30] In such situations, production of a by-product, or the product itself in cases such as logs, should not be confused with the sale of such products.

Wealth Transfers when Considering Efficiencies

Despite the Collaboration Guidelines stating otherwise (with the exception of cases of perfectly inelastic supply), consideration of cases where there is only an upstream wealth transfer as a result of a merger between buyers is arguably not out of keeping with the Canadian Federal Court of Appeal's decision that wealth transfers be considered when assessing whether efficiency gains likely to be brought about by a merger will offset the anti-competitive effects arising from that merger.[31] Given that section 90.1 parrots the merger provisions wording in regard to efficiencies, the same standards of review presumably apply to joint purchasing agreements. In carrying out such trade-off analysis, the balancing weights standard is typically applied. Under that standard, any increase in surplus arising from the efficiency gain from the merger is balanced against the deadweight loss resulting from the likely anti-competitive effects of the merger, and where appropriate, some portion (including possibly all or none) of the associated transfer of surplus from consumers to producers.[32]

It arguably remains unclear, however, whether a finding of a substantial lessening of competition must necessarily also include a deadweight loss such that wealth transfers are only considered in the trade-off analysis given a finding of a deadweight loss. That said, considering the expressed concern with wealth transfers by the Federal Court of Appeal, it is welcome that the Bureau has not suggested that *any* decrease in input prices are subject to anti-trust scrutiny, and it has rather restricted itself to only those situations where the price decrease is accompanied by a deadweight loss (i.e., an unambiguous exercises of monopsony power) and/or those situations where the wealth transfer arises from a perfectly inelastic supply curve, which are likely to be relatively rare. Here, as elsewhere, most price decreases should be welcome.

3.2 The Analytical Framework for Cases of Monopsony

As noted above, the MEGs indicate that the analytical framework for assessing market power on the selling side is equally applicable on the buying side (a similar statement is also made in the US Merger Guidelines[33]). This, however, is not as straightforward as it may first seem. Topics for consideration include: the base price against which a lessening of competition is determined, market definition, barriers to entry, and the role of the downstream market. Again, the Collaboration Guidelines are illuminating, but it is not clear that the order of steps suggested by the Collaboration Guidelines are really the ones anyone, including the Bureau, would or should follow when determining the likelihood of monopsony. Rather, the first step should be determining whether input sellers have market power. It is this that will determine whether any buyer power is likely to be one of monopsony, and so whether output is likely to increase or decrease.

Competitive Price

In the case of mergers between suppliers, whether the merger is likely to result in a substantial lessening of competition is based on an assessment of whether the merged entity is likely "able to sustain higher prices than would exist in the absence of the merger by diminishing existing competition."[34] That is, changes in market power are measured relative to the prevailing price (at least in most instances).[35] In the case of a merger between buyers, however, the use of the prevailing price would be at risk of including prices that are above competitive levels and so at risk of including situations of bargaining power rather than monopsony power.[36] The Collaboration Guidelines, in specifying only a concern with exercises of monopsony power, indicate that a decrease in price below "competitive levels" is of interest. (This echoes the MEGs in the description of buyer market power as prices paid to sellers that are below the competitive price.) This raises the first question as to what a competitive price actually entails.

The usual candidate for the competitive price is marginal cost. Short-run marginal cost, however, ignores contributions to fixed cost, and it is not clear from a simple reference to it, whether marginal cost is limited to those instances where the market is in long-run equilibrium (characterized by zero economic profits) or it is any time price is equal to marginal cost (which may be characterized by profits). Moreover, measuring marginal cost is notoriously difficult, with average variable cost – a wholly different concept better suited for determining shutdown points – often acting as a substitute. Using the average cost curve instead, while

computationally somewhat easier, does not resolve the issue of short-run versus long-run. Also, some would argue that its use is not theoretically sound. Regardless of the cost used, in all cases, cost measurement issues are compounded when the market in question is characterized by multi-product firms. So, even if the measure of competitive price through a cost proxy can be agreed upon, this does not mean that it can be easily and un-controversially estimated.

Here again the Collaboration Guidelines are instructive. While they do not define "competitive price levels," they do note that a price below competitive levels has "a *corresponding* reduction" in the overall quantity produced or supplied or a "*corresponding* diminishment" in any other dimension of competition. This provides an elegant solution to the question of not so much what constitutes a competitive price (which remains unresolved), but whether the observed price is in fact competitive: if input suppliers will reduce their output (or some other dimension of competition) when price is below the prevailing price, the prevailing price is considered competitive.[37]

Market Definition

The MEGs indicate that a key consideration in merger review is market definition. This again poses challenges in the context of monopsony. Markets in buying cases are defined around the *sellers* to the merging parties. In particular, the Collaboration Guidelines indicate that the Bureau "applies a hypothetical monopsonist test under which a relevant market is defined as the smallest group of products and the smallest geographic areas in which a sole, profit-maximizing buyer (the "hypothetical monopsonist") would impose and sustain a significant and non-transitory price decrease below levels that would exist in the absence of the joint purchasing agreement."[38] As consequence, one obtains a list of differing markets in which one or more seller to the merging parties participates, depending on whether a seller is likely to experience a price decrease below prevailing prices. As such, while the test is called the hypothetical monopsonist test, because it uses prevailing prices (which may or may not be competitive), it defines markets on the basis of buying power, not on the basis of monopsony power.

The issue is further complicated by the fact that market definition in monopsony cases – being centered around sellers – can be unintuitive, can involve an assessment of the costs of switching by buyers not just sellers, and the resulting market can be different for each supplier potentially affected by the downstream transaction.

In the case of downstream sellers of products, market definition is determined on the basis of consumers' willingness to switch to other products or geographic areas in face of a price increase. As such, market definition depends on their actions, rather than the actions of sellers. In the case of the hypothetical monopsonist test, market definition depends on *suppliers* having profitable, alternative outlets for their products, which in turn depends on buyers and their willingness to switch. That, in turn, may vary depending on who the seller is.

To illustrate, take the example of corn farmers who sell corn to corn processors.[39] Suppose that the buyers, who are either merging or entering into a joint purchasing agreement, are purchasing corn from farmer A and farmer B. Farmer A is located to the south of the processor and farmer B is located to the north. Suppose that in face of a price decrease by the processors, farmer A has numerous other potential buyers located further south to which it can profitably turn. Farmer B, however, has no other proximate processors. Consequently, it appears that the processors would be able to profitably lower prices paid to farmer B but not to farmer A, and so both would be in different relevant geographic markets.[40] Now suppose, however, that farmer A typically produces corn of a particular variety which the main southern processor cannot process without incurring additional costs. These costs are not insignificant and not ones that farmer A could profitably incur on behalf of the buyer, and so these costs preclude profitable sale to that processor. So, despite the fact that processor A is in a broader geographic market than processor B, it too might face a decrease in the price of its corn. Further suppose, however, that farmer A (unlike farmer B) has the type of land that is also good for producing canola. Farmer A is in a position to profitably increase its canola production in response to a corn price decrease in sufficient quantity to render the corn price decrease unprofitable for the

processors. Consequently, we have two sellers of corn with two different geographic markets and two different products markets, one of them including canola.

Barriers to Entry

The consideration under market definition of costs buyers face in switching sources of supply or the costs to sellers of switching to the production of other products starts to blur the line between market definition and barriers to entry. In downstream seller cases, markets are defined from the perspective of buyers and so potential supply-side substitutes are not considered until barriers are assessed, or, they are considered in market definition only to the extent that firms can profitably divert sales from existing buyers to those in the relevant market and/or profitably bring idle capacity online without incurring significant sunk costs.[41] In the case of buyer mergers, market definition hinges on supply-side substitution.

The Collaboration Guidelines do little to elucidate this blurring, noting only that "where parties to the joint purchasing agreement account for a significant portion of the input purchases, the Bureau will consider whether barriers to entry into buying the relevant input are high."[42] As such, the Collaboration Guidelines do not address such issues as the timeframe over which buyer "entry" is to be assessed. Nor does it address the possible interaction between barriers on the buyer side and those on the input supply side. While in the short-run, a supplier of a product subject to monopsony power may have no or few alternatives for the sale of its product, in the longer-run, in response to depressed monopsony prices, it may seek out and/or develop alternative outlets. A monopsonist, in such a situation, may be less willing to exercise its monopsony power if it believes that such an exercise would jeopardize its long-run source of supply as result of high barriers to entry into supply.

Monopsony Power (and the Order of Steps Taken to Assess its Likelihood)

At this point in the analysis, having defined markets, determined levels of share accounted for either the merged entity or the joint purchasing group, and assessed barriers to entry, one could still be in a situation of a highly concentrated buying market with high barriers to entry into buying, but only bargaining power rather than monopsony power. This is not a situation that is likely to arise in downstream mergers. The above types of conditions – high market share/concentration in a well-defined market with high barriers to entry – are often deemed sufficient to conclude market power in the assessment of a merger among sellers. The reason is that it is highly unlikely that the prevailing price in such a merger would be below the 'competitive' price (which is analogous to a prevailing price which is above the competitive price in a merger of buyers). The insufficiency of these factors to find monopsony power is acknowledged in the Collaboration Guidelines.[43] It notes additional factors the Bureau will consider in distinguishing between bargaining power and a likely exercise of monopsony power:[44]

1. Whether the supply curve is highly elastic;
2. Whether the upstream supply of the input is characterized by a large number of sellers and low barriers to entry such that the normal selling price of a supplier is likely competitive; and
3. Whether it seems likely that certain suppliers will exit the market in response to the anticipated price decrease or will scale back production.

It is these factors that go the heart of the matter. In regard to factor 1, as noted above, an upward-sloping supply is a necessary condition for the exercise of market power. However, simply-stating so by noting that the elasticity of the supply curve is a factor for consideration does little to clarify how elasticity is likely to be assessed. In some ways, this is similarly the case in regard to factor 3; that factor is essentially a restatement of the definition of monopsony power. That said, factors 1 and 3 are welcome in that they again emphasize that bargaining power is insufficient, and clarify what is required for monopsony power.

Factor 2 does provide new information as to how bargaining and monopsony power may be distinguished. In fact, it is so key that in practice it is the likely starting point for all monopsony cases, and if it is not, it should be. Bargaining power arises when a firm (or firms) is able to offset, at least in part, the market power of *sellers* (and so one would expect, that in its absence, a buyer would pay prices in excess of competitive

levels). An observation of seller market power suggests that an exercise of monopsony power is unlikely. In such situations, there is no need to define markets, asses barriers and so forth. As such, an assessment of the market power of sellers is equally important to the analysis as that of buyers, suggesting that, unlike in selling-side mergers where only selling-side market power is thoroughly assessed,[45] both market power by sellers and buyers should be carried out. Moreover, an assessment of the likelihood of market power by sellers to potentially monopsonistic buyers should be the first step. Fortunately, competition agencies have a long history of assessing whether sellers have market power, and those tools tend to be well-known and transparent.

Downstream Market

Nowhere in the analytical framework contained in the Collaboration Guidelines for assessing monopsony power does the downstream market play a role. This is reasonable to the extent that the surplus loss of concern in cases of monopsony power occurs in the upstream market. As such, there need not be any change in output or price in the downstream market. That said, whether buyers are incented to exercise monopsony power, even when they are in a position to do so, is not independent of the downstream market. The downstream market structure can impact the profitability of an exercise of monopsony power. As noted in the above oil pipeline example, in competitive downstream markets, the only downstream effect of decreased input purchases and the corresponding decrease in downstream output will be lost downstream market share. This will reduce, although not necessarily eliminate, the incentive to exercise monopsony power. Reduced input purchases may nonetheless be profitable for the firm if the benefit of the cost savings upstream outweighs the costs associated with decreased market share downstream. If alternatively the buyers in question also have downstream market power so that they have an incentive to reduce downstream output, this will reinforce any incentive to reduce upstream purchases.

4. Comparison of Canadian, US and EC Approaches

The most striking difference in the approach to monopsony in Canada versus that in the EC and, until the recent clarification in the US Merger Guidelines, in the US was that Canada was more hawkish. The EC, given its focus on consumer welfare in competition policy, puts it in the unusual position that it has a more conservative approach than Canada to mergers that result in monopsony power. The EC will not pursue cases of merger resulting in monopsony power unless it is also accompanied by downstream market power.[46] Whether this was also the case in the US – given its similar focus on consumer welfare – was not historically completely clear.[47] The US Merger Guidelines resolve any ambiguity. Therein, the US agencies note, "[n]or do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell."[48]

While the above is a welcome clarification to the US approach to buyer mergers, the US Guidelines remain frustratingly cryptic in regard to the role of output reductions in monopsony power. The US Guidelines use the term monopsony power but do not define it, leaving it unclear whether they simply mean situations where there is one (or a dominant) buyer or they wish to limit monopsony power to those situations where its exercise has an output effect (or a similar effect on another dimension of competition).

The uncertainty in regard to the need for an output effect is further confused by the Agencies noting that they "do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power."[49] While a short-run reduction in output may not be the *only* indicator of enhanced buyer market power, it is not clear whether the US agencies nonetheless view it as a necessary (but not necessarily sufficient) indicator. If it is not a necessary indicator, it should be made clear whether this is because the Agencies are possibly concerned with (a) incidents of bargaining power, (b) wish to only indicate that they are also concerned with non-price elements of competition that may not have an obvious impact on quantity or, rather, because (c) they wish to also capture situations of (perfect) price discrimination where the monopsonist can extract the maximum surplus from suppliers without reducing output. If the latter, this may be noteworthy but likely exceptional.

5. Conclusion

With the implementation of revised section 45 of the Canadian *Competition Act* on March 12, 2010, the criminal conspiracy provisions appear to no longer apply to the purchase of a product. As a result, buyer and seller cartels are treated asymmetrically under the law, even though their effects can be uniform. Such asymmetry is justifiable on the basis of likelihood of harm and the need for expedience. Whether buyer cartels are less likely to be harmful to the economy than seller cartels is an empirical matter but it is generally understood to be so. As recognized by the Competition Tribunal and the US agencies, however, transactions can be characterized as either the purchase of an input or the sale of a service, raising the specter of dispute over transaction characterization particularly given the significant difference in punishment available under sections 45 and 90.1.

That buyer cartels are now exempt from the criminal conspiracy provisions has the surprising benefit of shedding light on the Bureau's approach to mergers between buyers. The Bureau's Collaboration Guidelines makes clear that it will only consider those joint purchasing agreements that constitute a likely exercise of monopsony power as having lessened or prevented competition substantially. It would be wholly unreasonable on the part of the Bureau if this position were not extended to mergers between buyers, given that mergers differ from joint purchasing agreements only in that they constitute a particular type of agreement.

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Endnotes

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[1] *The Competitor Collaboration Guidelines* ("Collaboration Guidelines"), Competition Bureau, Canada, December 2009, at 11.

[2] This is not to suggest that two monopolies are better than one. Even in such countervailing situations, it is preferable that upstream market power not be the result of unnecessary or poorly enforced or managed regulation, a merger that should be subject to competition review, or abuse of dominance. Moreover, as noted by Ungern-Sternberg (2003) and Dobson and Waterson (1997), lower wholesale prices need not translate to lower downstream prices if increased countervailing power is accompanied by increased concentration in the downstream market. This is not considered herein since, in practice, increased downstream market power as result of an agreement would be separately considered and investigated under applicable provisions of the Act (mergers, civil arrangements, or the conspiracy provisions).

[3] Chen (2003) and Eruktu (2005) contemplate situations where increased countervailing power has a net negative welfare effect. In both papers, an increase in countervailing power by an asymmetrically large buyer may make its rivals worse off and so potentially result in a decrease in effective downstream competition. These theories are akin to "waterbed" theories of anticompetitive harm whereby "a discounted price to a buyer with market power results in an increase in the wholesale price to other buyers – a so-called waterbed effect – that results in an increase in prices to downstream consumers" (Roundtable on Monopsony and Buyer Power, Note by the Secretariat, OECD, October 10, 2008, at paragraph 18). The Bureau has indicated that it will investigate waterbed theories of harm under its abuse provisions but "in order for a change in downstream market structure, which may result from secondary line price discrimination implied but the cycle hypotheses, to be considered harmful it must be the case that the intended purpose of the discrimination was the exclusion or disciplining of competitors (as opposed to some pro-competitive rationale), and that such exclusion/disciplining results in enhanced downstream market power. A simple observation of price discrimination in the input market would not normally be sufficient to conclude an anti-competitive effect." The Bureau further noted that it has no experience with waterbed effect cases (Roundtable on Monopsony and Buyer Power, Note by Canada, OECD, October 16, 2008, at paragraphs 28-29 (http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02995.html)). Since the focus of discussion in this paper is agreement and not abuse of dominance, negative welfare effects from countervailing power of the type considered by Chen and Eruktu are not considered herein.

[4] Here, and throughout this paper, it is assumed that all other potential sources of changes in efficiency – productive or dynamic – are constant with any agreement.

[5] *Competitor Collaboration Guidelines,* Competition Bureau, Canada, December 23, 2009.

[6] Clifford and O'Carroll note, "The lack of meaningful guidance from the [Commissioner and the Competition Tribunal] makes it more difficult for advisers to apply analytical frameworks with confidence that the Bureau will adopt similar frameworks for its investigation and assessment of a merger that raises monopsony issues ... the transparency and predictability of the Competition Bureau's analysis of monopsony issues would benefit from the Commissioner supplementing the *Merger Enforcement Guidelines* with a more detailed discussion of these issues." (John Clifford and Sorcha O'Carroll, "Monopsony and Predatory Buying: The Landscape is Wide Open", Canadian Bar Association Conference – Competition Law Section, October 2007, at 11).

[7] Zhiqi Chen, "Buyer Power: Economic Theory and Antitrust Policy", *Research in Law & Economics,* vol. 22, 2007, at 19-20. See also "Re: Roundtable on Monopsony and Buyer Power (22-23 October 2008)", letter to all competition delegates and observers, July 24, 2008, Frederic Jenny, Chair of Competition Committee, OECD.

[8] That is, the marginal cost of a supplier is increasing.

[9] Collaboration Guidelines at 11.

[10] Whether the courts will agree with this interpretation of amended section 45 remains to be seen.

[11] This recognition is noted in the Bureau's *Merger Enforcement Guidelines* (see *Merger Enforcement Guidelines,* September 2004, Competition Bureau, Canada, at footnote 10).

[12] *The Director of Investigation and Research v. Hillsdown (Holdings) Canada Ltd.*, et al., Reasons and Order, Competition Tribunal, March 9, 1992, at 18.

[13] Care must be taken that in re-characterizing a monopsony purchase into a monopoly sale, the same buyers and sellers are at issue. *Hillsdown* is illustrative. The transaction entailed the merger of two renderers of meat by-products. In some cases, the renderers purchased renderable material (mainly from slaughterhouses); in other instances, slaughterhouses and the like purchased rendering services from renderers (*Hillsdown* at 9). When renderers purchased renderable material, they purchased this material from a set of slaughterhouses who were distinct from the slaughterhouses to whom rendering services were sold. These two different sets of slaughterhouses had different substitutes available to them, and so paid different prices (*Hillsdown* at 8). As such, two different markets were at issue, *each* of which could have been characterized as a sale of services or a purchase of inputs.

[14] For purposes of this example, assume that pipelines are not regulated in any way.

[15] Alternatively, if the upstream market for the supply of oil is not competitive, the pipeline operators will not have monopsony power and will not be able to purchase the same quantity of oil as transported in the monopoly pipeline services case, resulting in different equilibrium outcomes under the pipeline monopoly and oil buying agreement scenarios.

[16] The asymmetric approach was not chosen in the case of bid-rigging. Buyers secretly agreeing to fix the purchase price of a product sold through auction continue to be circumscribed on a *per se* basis. The mechanism by which buying agreements in auctions are sanctioned are by way of pre-announcement. If the person requesting bids or tenders is informed of the agreement beforehand, section 47 does not apply. The Collaboration Guidelines indicate, however, that such agreements may be examined under section 90.1 (Collaboration Guidelines, at 2).

[17] For example, firms forming such agreements may not collectively have market power.
[18] Collaboration Guidelines, at 11.
[19] Such agreements can typically be pro-competitive in two ways: one, through countervailing power that increases output as described above; and two, through bulk purchases allowing for more cost-effective sale (e.g., by reducing transaction or transportation costs).
[20] US Merger Guidelines, August 2010, at 10.
[21] MEGs, 2004, at paragraph 2.4. As noted above, the footnote that addresses buyer market power notes the Competition Tribunal finding in *Hillsdown.*
[22] For example, charges were brought under section 45 against six taxi companies and seven individuals in St. John's for conspiring to unduly prevent or lessen competition in the purchase of contracted rights to operate taxi cab services from or on the premises of contracting businesses and public institutions in the City of St. John's and elsewhere in the Province of Newfoundland and Labrador (see "Competition Bureau charges St. John's taxi companies with conspiracy", Media Release, Ottawa, July 9, 2004, and "Newfoundland Court Confirms Dismissal of Conspiracy Charges in St. John's Taxi Case for Failure to Establish a Relevant Market", *Perspective*, Davies Ward Phillips & Vineberg LLP, October 22, 2007.) Publicly available information on the case does not discuss whether the alleged agreement had an impact on output.
[23] Collaboration Guidelines, at 33.
[24] Collaboration Guidelines, at 33.
[25] Collaboration Guidelines, at 33.
[26] Collaboration Guidelines, at footnote 23.
[27] Relatively few mergers have been challenged in the US on the basis of buying side considerations. Of the more recent cases, one was in the grain industry (*United States v. Cargill, Inc. and Continental Grain Co.* (filed July 8, 1999), http://www.usdoj.gov/atr/cases/f2500/2552.htm (complaint), 64 FEDERAL REGISTER 44,046 (1999) (competitive impact statement), 2000-2 Trade Cases (CCH) ¶ 72,967 (final judgment), as noted in "Roundtable on Monopsony and Buyer Power: Note by the United States", Directorate for Financial and Enterprise Affairs, Competition Committee, Organisation for Economic Co-operation and Development, October 13, 2008, at 6).
[28] One involved the merger between Canfor Corporation and Slocan Forest Products Ltd. ("Bureau resolves competition issues in forestry merger", Media Release, Competition Bureau, Canada, April 1, 2004), and the other a merger between West Fraser Timber Co. Ltd and Weldwood of Canada Ltd. (see "Competition Bureau reaches agreement to preserve competition in two B.C. forestry markets", News Release, Competition Bureau, Canada, December 7, 2004).
[29] "Bureau resolves competition issues in forestry merger", Media Release, Competition Bureau, Canada, April 1, 2004.
[30] Matt Richtel and Kate Galbraith, "Back at Junk Value, Recyclables Are Piling Up", *The New York Times,* December 7, 2008 (http://www.nytimes.com/2008/12/08/business/08recycle.html).
[31] In particular, the Federal Court of Appeal found that "In referring to "the effects of any prevention or lessening of competition", subsection 96(1) does not stipulate what effects must or may be considered. When used in non-statutory contexts, the word, "effects", is broad enough to encompass anything caused by an event. Indeed, even though it does not consider the redistribution of wealth itself to be an "effect" for the purpose of section 96, the Tribunal recognizes, as all commentators do, that one of the *de facto* effects of the merger is a redistribution of wealth ... the Tribunal erred in law when it interpreted section 96 as mandating that, in all cases, the only effects of an anti-competitive merger that may be balanced against the efficiencies created by the merger are those identified by the total surplus standard ..." *Commissioner of Competition* v. *Superior Propane Inc.,* Reasons for Judgment, 2001 FCA 104, at paragraphs 77 and 139.
[32] *Bulletin on Efficiencies in Merger Review*, Competition Bureau, Canada, March 2, 2009, at 4.
[33] "To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market." (US Merger Guidelines, 2010, at 32).
[34] MEGS, 2004, paragraph 2.9.
[35] In prevent cases, the price that would have prevailed absent the merger is the base price of concern (MEGs, 2004, at paragraph 2.10).
[36] As noted herein at footnote 4, it is possible that countervailing power may result in negative welfare effects in the downstream market. The Bureau has, however, indicated that it would consider such cases under the abuse provisions and that price discrimination in an upstream market generally does not raise concerns.
[37] This implicitly assumes that the prevailing price is not already subject to a weak exercise of monopsony power (i.e., an exercise of monopsony power that does not fully maximize profits) such that at the prevailing price, suppliers are already supplying less than the competitive output and should the price be further depressed, suppliers would supply even less output. If there is reason to believe that the prevailing price is less than the competitive price prior to the implementation of the buying agreement or the buying side merger, the above noted methodology for ascertaining whether the prevailing price is likely to be the competition price is inappropriate.
[38] Collaboration Guidelines, at 34.
[39] This is an elaboration of an example that is contained in the Collaboration Guidelines at 34.
[40] This is no different from downstream mergers being characterized by multiple geographic markets conditional on the ability to price discriminate across those geographic areas.
[41] MEGs, at paragraph 4.2.
[42] Collaboration Guidelines, at 35.
[43] Collaboration Guidelines, at 35.
[44] Collaboration Guidelines, at 35.
[45] The Bureau will consider countervailing power on the part of buyers in selling-side mergers (MEGs, at paragraphs 7.1-7.3). However, it is unlikely that such power will exist absent the availability of alternatives sellers, which would have been assessed when assessing seller market power and barriers to entry.
[46] "Roundtable on Monopsony and Buyer Power: Note by the European Commission", Directorate for Financial and Enterprise Affairs, Competition Committee, Organization for Economic Co-operation and Development, October 13, 2008, at paragraph 12.
[47] Werden, Gregory, "Monopsony and the Sherman Act: Consumer Welfare in a New Light", *Antitrust Law Journal*, 74, 3 (2007): 707-737, at 707.
[48] US Merger Guidelines, at 33.
[49] US Merger Guidelines, at 33.