Monopsony and Predatory Buying: The Canadian Landscape is Wide Open

by
John F. Clifford
and
Sorcha O'Carroll[1]

Competition laws establish a framework for the measurement and constraint of market power that is, or could be, exercised in a manner which has detrimental effects on the efficient operation of markets. Ignoring issues concerning collective conduct, the focus of most antitrust inquiries is on the unilateral exercise of market power in downstream markets – i.e. the ability of a firm to exercise market power through, for example, an increase in prices (or a reduction of services) above (or below, in the case of services) competitive levels for a significant period of time.[2]

Competition laws also are concerned with constraining the inappropriate unilateral exercise of, or increase in, market power in upstream markets, referred to inter-changeably as monopsony or buyer power (and sometimes referred to as predatory buying). The focus of inquiry in upstream markets is whether the firm is exercising or increasing its market power in purchasing markets such that it can profitably lower the price it pays for products below the competitive price for a significant period of time. [3] A group of firms capable of exercising market power as purchasers is an oligopsony.

Our 20+ years of experience applying Canada's modern competition law to mergers and other matters demonstrates that monopsony issues have not often been identified as warranting enforcement action: merger investigations in particular typically focus on the exercise of monopoly power in downstream markets, and in no case challenged by the Commissioner of

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[1] John Clifford is a partner and Sorcha O'Carroll is an associate in the Competition Law Group at McMillan LLP (see www.mcmillan.ca). This paper was prepared for presentation at the Canadian Bar Association, Competition Law Section Annual Conference, October 11 - 12, 2007 (Gatineau, Québec).

[2] See, for example, Competition Bureau, *Merger Enforcement Guidelines*, September 2004, available online at <http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1245&lg=e> at para 2.3 (the "Merger Enforcement Guidelines").

Competition ("Commissioner") have monopsony issues alone been identified as the basis for the complaint. This may explain why more than 24 pages of the *Merger Enforcement Guidelines* are devoted to discussion about monopoly issues, while monopsony issues are mentioned in just a single paragraph and a couple of footnotes!

However, there have been a number of recent investigations and enforcement actions in the merger area where monopsony issues were a prominent feature of the Competition Bureau's investigation. Given this activity we thought it would be useful to summarize statements made and known positions taken by the Commissioner and the Competition Tribunal on monopsony issues, which we do below. As you will see there are not many meaningful pronouncements. We conclude that with the dearth of useful guidance in jurisprudence or from the Competition Bureau, monopsony issues are best analyzed using first principals of economics with resort in appropriate cases to the more developed jurisprudence in other jurisdictions such as the United States.[4]

Why do we care about monopsony?

The exercise of monopsony power may appear in some circumstances to have benign effects or even to be beneficial to consumers. Lower input costs may be invisible to consumers – just a transfer of wealth from one supplier to another in the supply chain without any reduction in inputs – and to the extent that these cost-savings are passed on to consumers, they may even be beneficial. So, unlike most monopoly power cases where antitrust enforcement agencies are concerned about wealth transfers from consumers to producers, the exercise of market power by a monopsonist may not result in any obvious harm to consumers.

In the long-run, however, the inefficiencies created by monopsonies could harm consumers. For instance, if suppliers in the upstream market reduce investments in their businesses in response to monopsony pricing, their production levels may decrease over time,

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[3] *Ibid* at para 2.4. See also: Michael Trebilcock, et al., *The Law and Economics of Canadian Competition Policy*. Toronto: University of Toronto Press, 2002 at 69 [Trebilcock].

[4] See, in particular, M. Sanderson "Economic Theories of Monopsony in Competition Cases" and K. Arquit, "The United States Experience with Predatory Buying: *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*", each presented at the Canadian Bar Association, Competition Law Section Annual Conference, October 12, 2007 (Gatineau, Québec).

decreasing the inputs available to the monoposonist, which would eventually lead to decreased output from the monopsonist, which could restrict supply and raise prices in the consumer market. Even if the exercise of monopsony power does not affect consumer prices directly or immediately, the ultimate object of competition policy is efficiency, not lower prices, and inefficiencies in the upstream market remain a concern.[5]

A monopsonist also may use its power in an upstream market to limit competition in a downstream market. A relatively powerful purchaser could induce sellers to limit their sales to that purchaser's competitors, or could compel a seller to provide it with a product on more favourable terms than those offered to its competitors. Either outcome could enhance the position of the monopsonist in the downstream market and limit the ability of other firms to compete with it.[6]

Factors Influencing the Exercise of Monopsony Power

Generally, a monopsony is more likely to occur in a market for inputs than for end-products because few purchasers of end products will purchase a sufficient volume of products to enable them to exercise market power in that specific end-user market. For example, Canadian mergers cases in which monoposony issues have been considered include the purchase of cattle by processors, the licensing of motion pictures by cinemas and the sourcing of books by bookstores.[7]

Factors such as the perishability of products and sunk costs also may facilitate the exercise of monopsony power in the short-run because they create an imbalance of power in

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[5] Trebilcock, *supra* note 3 at 70.

[6] In *Canada (Commissioner of Competition) v. Superior Propane* (2000), 7 C.P.R. (4th) 385 (Comp. Trib.), one of the factors considered by the Competition Tribunal was the redistribution of income in related markets. While this decision considered possible effects in multiple downstream markets, a similar analysis could be applied in interrelated upstream and downstream markets.

[7] See Competition Bureau assessments of: the Acquisition of Famous Players by Cineplex Galaxy**,** Technical Backgrounder available on the Competition Bureau website at <http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1921&lg=e>, the Acquisition of Weldwood by West Fraser, see: "Competition Bureau reaches agreement to preserve competition in two BC forestry markets", 7 December 2004, available on the Competition Bureau website at <http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=238&lg=e>, and the Acquisition of Better Beef by Cargill Limited, Technical Backgrounder available on the Competition Bureau website at http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1941&lg=e>.

favour of the monopsonist (or potential monopsonist).[8] The value of products such as grain, cattle and some timbers will decline over time, creating pressure for sellers to complete a sale, and, therefore, weakening their bargaining power vis-à-vis buyers. Similarly, sunk costs may reduce the incentive for a seller facing monopsonistic pressure to leave a market, thereby enhancing the opportunities for the monopsonist to exercise its buying power.[9] A book publisher, for instance, that has invested in developing a large catalogue of books could face losses if it withdraws from the market for many of these titles.[10]

However, in the long-run the exercise of monopsony power may lead to lower levels of investment by suppliers, and a resultant decline in the quantity or quality of the products that are available in the market.

Monopsony and Mergers

Merger Enforcement Guidelines

Under section 92(1) of the *Competition Act*,[11] the Competition Tribunal may make an order prohibiting completion of a merger (or requiring parties to take other actions in respect of a completed merger) where it finds that the merger lessens or prevents competition substantially, or that it is likely to have that effect. A merger that increases a firm's buying power will raise concerns about a possible lessening or prevention of competition. However, the Act contains no provision specifically dealing with monopsony issues in merger cases.

The *Merger Enforcement Guidelines* acknowledge that market power can exist in an upstream market:

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[8] For a discussion of the role of perishability in monopsony cases, see: Warren S. Grimes, "Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller", (2005) 72 Antitrust L.J. 563, and Roger D. Blair and Jeffrey L. Harrison, *Monopsony: Antitrust Law and Economics*. (Princeton: Princeton University Press, 1993) at 71.

[9] For a discussion of the role of sunk costs in monopsony cases, see: Warren S. Grimes, "Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller" (2005), 72 Antitrust L.J. 563. The situation of book publishers was elaborated in the assessment of the Chapters/Indigo merger, which is discussed in greater detail below.

[10] The importance of large retail stores as distributor of a wide range of titles from publishers' catalogues was an important issue in the Commissioner's assessment of the Chapters/Indigo merger, see discussion below.

[11] R.S.C. 1985, c. C-34

> Market power of buyers means the ability of a single firm or group of firms to profitably depress prices paid to sellers to a level that is below the competitive price for a significant period of time.[12]

The *Merger Enforcement Guidelines* also state that the analytical framework set out in the Guidelines for assessing the downstream market power of a seller of a product is equally applicable to the assessment of the market power of a purchaser of a product, but do not include any detail discussion about buyer power issues.[13] While this parallel approach is sensible, and the analytical framework useful to define relevant markets, the lack of detailed discussion in the Guidelines on the identification and appropriate analysis of harmful competitive effects resulting from an exercise of monopsony power is notable, particularly given that the effects rarely harm consumers.

Jurisprudence

The first, and only, merger case in which the Competition Tribunal considered monopsony issues was *Hillsdown*.[14] That case involved a merger between two entities active in the meat rendering business. The rendering business involves processing left-over parts of livestock, obtained from the renderer's own business operations or from slaughterhouses, meat packing plants, poultry processing plants, abattoirs, grocery stores, and butcher shops. Renderers either pay for the livestock parts that they collect or charge for collection. The Tribunal determined that the supply of renderable material was inelastic because the cost of this material was negligible relative to the cost of the animal, and because certain suppliers, namely slaughterhouses, were compelled to get rid of their renderable material.[15]

In its decision, the Tribunal indicated that the analysis of competitive effects in the case could be based either on the renderer's possible monopsony power as a purchaser of renderable materials or monopoly power as a seller of rendering services, and stated that there

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[12] *Supra*, note 2 at para 2.4.

[13] *Ibid.*

[14] *Canada (Director of Investigation and Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289 (Comp. Trib.) at 299.

[15] Slaughterhouses are required to have all renderable materials removed before commencing operations the next day.

was no significant difference between the assessment of a merger involving a monopsony and the assessment of a merger involving a monopoly.[16] The Tribunal elected to assess the competition effects of the merger focusing on monopoly power issues because it was a more convenient description.[17]

The Tribunal has not made any other meaningful statements about monopsony power and mergers.

Bureau Investigations

The Competition Bureau has considered the possible enhancement of monopsony power in a number of other merger cases although publicly available information about the Bureau's investigation and assessment of those mergers does not contain any detailed information about how the Bureau analyzed monopsony issued in its investigation.[18] Two cases from 2001 went to the Competition Tribunal on consent and illustrate the Bureau's approach to monopsony issues: the Chapters/Indigo merger and the acquisition of Agricore by United Grain Growers.

Chapters/Indigo

The Commissioner sought a consent order relating to the acquisition of Chapters Inc. by Trilogy Retail Enterprises L.P., and the proposed merger of Chapters with Indigo Books, because of concerns about anticompetitive effects in both upstream and downstream markets.

The Commissioner defined the relevant upstream market as the "full range of English-language trade books purchased from publishers."[19] While there are numerous consumers of books from publishers, the Commissioner identified that large format stores and

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[16] *Supra*, note 13 at 299.

[17] *Supra*, note 8 at page 18.

[18] See for example: "Food Processors Can Merge Following Competition Review", 30 March 30 2004, available on the Competition Bureau website at < http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=325&lg=e>, and the Acquisition of Better Beef by Cargill Limited, Technical Backgrounder available on the Competition Bureau website at http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1941&lg=e>.

[19] *(Canada) Commissioner of Competition v. Trilogy Retail Enterprises L.P., Chapters Inc. and Indigo Books & Music*, CT-2001/003, Statement of Grounds and Material Facts, at para 80.

superstores, such as those operated by Chapters and Indigo, played an important role in the market because of their capacity to carry a much greater range of books than smaller stores, and, therefore, to create a market for a much greater number of the titles offered by publishers. The Competition Bureau's investigation found that Indigo had been Chapters' largest competitor in the purchasing market and that close competition between the firms limited Chapters' ability to demand discounts and other favourable terms of trade from book publishers.[20]

The Commissioner sought and obtained a consent order that required the merged entity to divest certain assets and to enter into an agreed Code of Conduct. The Code of Conduct imposed minimum standards of trade between the merged company and publishers for a period of five years.[21]

Acquisition of Agricore by United Grain Growers

The Commissioner also sought a consent order relating to the acquisition of Agricore by United Grain Growers ("UGG"). In this case, the Commissioner identified concerns about a substantial lessening or prevention of competition in two markets: the purchasing and handling of grain in certain local markets in Western Canada, and canola oil-seed purchasing and processing in Canada.[22]

Both parties to the merger owned primary grain elevators in Western Canada to which farmers would sell their grain. Choice of elevators is limited by geography: there are significant costs associated with the transport of grain, so that selling grain to an elevator a greater distance from the farm may not be a viable alternative. In addition, Agricore had an

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[20] (*Canada) Commissioner of Competition v. Trilogy Retail Enterprises L.P., Chapters Inc. and Indigo Books & Music*, CT-2001/003, Statement of Grounds and Material Facts, at para 85.

[21] See Schedule C to the Consent Order in *(Canada) Commissioner of Competition v. Trilogy Retail Enterprises L.P., Chapters Inc., Indigo Books & Music Inc.*, CT-2001/003 (2001) (Comp. Trib.). Ultimately, the merged entity was unable to sell the stores that it was required to divest, but the other terms of the Consent Agreement remained in effect. See: "The Canadian Competition Bureau's Approach to Merger Remedies", Presented at the Trade Practices Workshop, Queensland, Australia, August, 2004, available online at < http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=2393&lg=e> at footnote 2.

[22] Statement of Grounds and Material Facts, *(Canada) Commissioner of Competition v. United Grain Growers Limited*, CT-2001-007 (2002). In a separate application, the Commissioner addressed the effects of this merger on competition in the market for grain handling services in the Port of Vancouver, but the issues in that application related only to downstream effects.

interest in CanAmera, a leading Canadian manufacturer and marketer of canola oil and one of the largest Canadian producers of canola oil. Archer Daniels Midland Company ("ADM"), which had a substantial interest in UGG pre-merger and would have a significant interest in the merged entity, also was a canola processor and a direct competitor of CanAmera. The Commissioner was concerned that after the merger ADM could receive competitive information about CanAmera, which could lead to a substantial lessening of competition in the market for canola seed purchasing and processing.[23]

The parties entered into a Consent Agreement that required the merged entity to divest six primary grain elevators and to keep all non-public information about CanAmera that it obtained as a result of its interest in CanAmera confidential and separate from ADM.[24] Ultimately, Agricore completed the divestiture of 5 of the 6 required terminals, and a trustee was appointed who completed the divestiture of the sixth terminal.[25]

Forestry Mergers

More recently, buyer power issues were raised by the Competition Bureau in its assessment of a number of forestry industry mergers, such as the acquisition of Slocan Forest Products Ltd. by Canfor Corporation, and the merger of West Fraser Timber Co. Ltd. and Weldwood of Canada Ltd.

In the Canfor/Slocan merger, Canfor was required to divest a sawmill under a consent agreement. The Deputy Commissioner of Competition stated in the Competition Bureau's new release that "[t]his resolution preserves competition in Prince George for log buying, lumber supply to re-manufacturers and the sale and supply of woodchips,"[26] without

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[23] Statement of Grounds and Material Facts, *(Canada) Commissioner of Competition v. United Grain Growers Limited*, CT-2001-007 (2002) at para 62.

[24] Consent Order, *(Canada) Commissioner of Competition v. United Grain Growers Limited*, CT-2001-007 (2002).

[25] See: Gaston Jorré, "Remarks to the Standing Committee on Agriculture and Agri-Food: Current Competition Issues Relating to Port Terminal Grain Handling Services", Ottawa, Ontario, 23 November 2005, available online at < http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=2004&lg=e>.

[26] See: "Competition Bureau reaches agreement to preserve competition in two B.C. forestry markets", Competition Bureau News Release, 7 December 2004, available online at < http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=238&lg=e>.

providing any detailed discussion about the upstream markets or how the Bureau analyzed potential buyer power issues. In the Weldwood/West Fraser case, the parties were required to divest certain sawmill interests and timber harvesting rights under a consent agreement. In its press release, the Competition Bureau indicated that this agreement would allow the merger "while preserving choice for independent timber harvesters, wood re-manufacturers and log sellers in the northern and southern parts of British Columbia,"[27] again without any detail discussion about the Bureau's analytical framework.

Monopsony and Abuse of Dominance

While monopsony issues have merited mention in a few merger cases, and most often are discussed in the merger context, it would be possible to develop an abuse of dominance case based on anti-competitive behaviour by a monopsonist.

To grant an order in an abuse of dominance case, the Competition Tribunal must be satisfied that:

(a) one or more persons substantially or completely control a class of business throughout Canada, or any area thereof;

(b) that person has engaged in, or is engaging in, a practice of anti-competitive acts; and

(c) the practice has had, is having, or is likely to have the effect of substantially preventing or lessening competition in a market.[28]

Section 78(2) of the *Act* provides a list of so-called "anti-competitive acts", several of which stand-out as particularly applicable to a monopsony:

(a) acquisition by a supplier of a customer who would otherwise be available to a competitor of the supplier, or acquisition by a customer of a supplier who would otherwise be available to a competitor of the customer, for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from, a market;

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[27] See: "Bureau resolves competition issues in forestry merger", Competition Bureau News Release, 1 April 2004, available online at < http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=270&lg=e>.

[28] *Supra*, note 11, s. 79(1).

(b) pre-emption of scarce facilities or resources required by a competitor for the operation of a business, with the object of withholding the facilities or resources from a market;

(c) requiring or inducing a supplier to sell only or primarily to certain customers, or to refrain from selling to a competitor with the object of preventing a competitor's entry into, or expansion in, a market.[29]

The list of course is not exhaustive, and both the Commissioner and the Competition Tribunal have made it clear that an anti-competitive act involves any action that is predatory, exclusionary or disciplinary.[30]

In its 1995 decision in *Director of Investigation and Research v. D&B Companies of Canada Ltd.*, the Competition Tribunal considered the exercise of market power by Nielson simultaneously in upstream and downstream markets, albeit in support of an ultimate finding of abuse of dominance in the downstream market.[31] Nielsen provided scanner-based market tracking services: that is, it collected data from scanners in grocery stores, used this data to analyse the share of sales of various products, and sold its analyses to both retailers and manufacturers of grocery products. Nielsen obtained the data by purchasing it from stores, and Nielsen was the only producer of scanner-based market tracking services in Canada.

The Director's application to the Tribunal and the decision of the Competition Tribunal focused on Nielsen's monopoly power in the downstream market. Nielsen's power in upstream markets was addressed only briefly when the Tribunal indicated that the question of whether suppliers of retail data had been able to capture some of Nielsen's monopoly profits was irrelevant to the outcome of the case.[32] One of the expert witnesses in the case, Dr. Ralph Winter, noted that Nielsen staggered the expiry dates of its contracts with retailers in order to reduce their bargaining power. In his view, to successfully enter the market, a competitor would have required access to the scanner data of virtually all retailers. Since Nielsen offered retailers

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[29] *Ibid*, s. 78(2)(h).

[30] See: Competition Bureau, *Enforcement Guidelines on the Abuse of Dominance Provisions (Sections 78 and 79 of the Competition Act)*, July 2001, available on the Competition Bureau website at < http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1251&lg=e>, and *Canada (Commissioner of Competition) v. Canada Pipe Co.*, 2005 Comp. Trib. 3, 40 C.P.R. (4th) 453 at para 191.

[31] *(Canada) Director of Investigation and Research v. The D &B Companies of Canada Ltd.* (1995), CT-94/1.

[32] *Ibid* at pp. 57.

financial incentives to enter into exclusive contracts, an individual retailer had little incentive to challenge the exclusivity provisions when renegotiating its contract with Nielsen.[33] Dr. Winter, however, ultimately concluded that Nielsen's power, or possible lack thereof, in the upstream market was irrelevant to the outcome of the case.[34]

Conclusion

The few substantive statements by the Commissioner and the Competition Tribunal about monopsony issues, and the lack of detailed reports or backgrounders by the Commissioner about the analytical framework applied by the Competition Bureau when it investigated (and required divestiture) in the recent forestry merger cases is unfortunate. The lack of meaningful guidance from the agencies 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.

For example, as highlighted by Margaret Sanderson, there is some doubt about whether buyer power issues ever warrant remedial action if a wealth transfer between producers is not accompanied by an input reduction.[35] In this context, 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.

Monopsony issues have arisen more frequently in the United States than in Canada, and statements have begun to emerge from American authorities about issues such as the importance of an inelasticity of supply to monopsonies, and the need to find a reduction in input in order to find a harm to competition from buyer power.[36] As the Canadian law develops, we may see a more nuanced analysis of the harms from buyer power and an emergence of cases

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[33] Expert Affidavit of R.A. Winter dated 1994.09.20, *(Canada) Director of Investigation and Research v. The D & B Companies of Canada Ltd.* (1995), CT-94/1at pp 55-56.

[34] *Ibid* at pp 70.

[35] *Supra*, note 4.

[36] See, respectively, *Caremax R, Inc. Advance PCS*, FTC File No. 031 0239 (Feb. 11, 2004) available online at www.ftc.gov, and *Todd v. Exxon Corporation*, 275 F.3d 191 (2d Cir. 2001).

examined solely on the basis of monopsony concerns. In the meantime, it may be necessary to resort either to economic first principles or to jurisprudence from other jurisdictions when conducting a comprehensive analysis of monopsony issues in Canadian merger or dominance cases.