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PAGE ONE

How Driving Prices Lower Can Violate Antitrust Statutes
'Monopsony' Suits Mount As Companies Are Accused Of Squeezing Suppliers

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As more of the world's markets become dominated by a few big companies, a rare form of antitrust abuse is raising new concern: When corporations illegally drive down the prices of their suppliers.

On the coast of Maine, blueberry growers alleged last year that four big processors conspired to push down the price they would pay for fresh wild berries. A state-court jury agreed last year and awarded millions in damages. In South Carolina, International Paper Co. faces a lawsuit that it conspired with its timber buyers to depress softwood prices in several states. In Alabama and Pennsylvania, federal antitrust enforcers last year targeted insurance companies that imposed contracts forcing down fees charged by doctors and hospitals. The insurers abandoned the practice.

The power to drive down prices is an issue as well in a Federal Trade Commission investigation of R.J. Reynolds Tobacco Co.'s pending $2.6 billion acquisition of BAT PLC's Brown & Williamson unit, lawyers close to the case say. The FTC, they say, is looking at whether the combined company could force tobacco-leaf growers to accept lower prices. Other major U.S. cigarette makers recently reached a settlement with tobacco farmers valued at $1.2 billion to resolve a private lawsuit accusing them of secretly agreeing to avoid competitive bidding at tobacco auctions.

"Price fixing and other forms of collusion are just as unlawful when the victims are sellers rather than buyers," R. Hewitt Pate, the Justice Department's antitrust chief, told a Senate Judiciary Committee hearing late last year. The hearing aired farmers' concerns that a few giant agribusinesses now control commodity prices in many markets.

Mirror Image

Usually relegated to the back pages of law books, this mirror image of monopoly is known as monopsony or, when more than one company is involved, oligopsony. It arises when one or more companies gain enough buying power to push their suppliers' prices down.

It isn't a new legal theory, but it is getting more attention now because of the rise of giant companies in a global marketplace. Buyer muscle has become more visible in recent years as markets become more concentrated through mergers and joint ventures. In meatpacking, the business of slaughtering cattle and pigs, four companies control 80% of the market. In four out of 10 U.S. cities, a single health insurer has at least a 50% market share. Concentration is also rising in markets from aluminum refining to baby food.

Most of the time, there is nothing wrong when big companies squeeze suppliers for lower prices. Hard bargaining by profit-minded business buyers can help drive down prices for consumers.

But if dominant buyers use their clout to distort the market and push prices down, the legal theory goes, consumers ultimately can lose. That's based on the assumption that producers will stop innovating, or producing at all, if they can't get a fair price. Monopsony, which has been found to violate federal antitrust statutes, can be alleged in either government or private suits.

Wal-Mart Lesson

Finding the fine line between healthy, price-cutting competition and harmful price-reducing monopsony has historically made government antitrust enforcers cautious about taking action in this area. Wal-Mart Stores Inc. illustrates the problem. The world's largest retailer has enormous power to squeeze suppliers, who have repeatedly asked regulators to rein it in. But many economists see Wal-Mart as an example of how buyer power can benefit consumers. Despite its size, Wal-Mart doesn't control the retail marketplace, and so far there's no clear evidence that its hard bargaining limits supplier output or lessens efficiency.

Because of this need to weigh consumer welfare carefully, the government brings fewer monopsony cases than monopoly cases. "The link between buyer power and consumer harm can be really hard to prove," says David Balto, a former policy director at the FTC who is now at the law firm of White & Case in Washington.

Some of the biggest recent cases have been brought by private companies. Altria Group Inc.'s Philip Morris USA and the other major cigarette makers -- except R.J. Reynolds -- agreed last year to settle a suit filed against them by American tobacco farmers in federal court in Greensboro, N.C. The manufacturers, without admitting wrongdoing, agreed to give the farmers $212 million in cash and to buy billions of dollars in tobacco over 10 years.

The farmers had alleged that cigarette makers and middleman tobacco buyers illegally conspired to push down prices by rigging bids, among other practices. After the suit was filed in late 2000, cigarette makers shifted to purchasing directly from growers at higher prices, and by last fall, the familiar sing-song chant of tobacco auctioneers had died across much of the south.

According to the allegations in the suit, buyers met before auctions to exchange bidding data and traveled on each other's corporate jets to and from tobacco auctions. The result: Philip Morris's buyer, which purchases some 65% of U.S. tobacco, would bid first and set the price, with the rest of the buyers placing "tie bids," the suit said.

Peter DeSantis, a veteran auctioneer who has sold bales of burley tobacco in barns from Florida to Tennessee, said in a sworn statement in 2002 that despite the appearance of active bidding "there's been virtually no price competition" since the mid-1990s. Robert Cage, a past winner of the World Tobacco Auctioneering Championship, said in a separate 2002 sworn statement, "Tobacco auctions have really been a

tobacco allocation system for many years."

Reynolds, the manufacturer planning to fight the suit, has agreed to buy Brown & Williamson, combining the second- and third-largest U.S. cigarette makers. The FTC is looking into two potentially harmful effects of the deal. To prevent the combined company from gaining the power to raise consumer prices in some markets, the FTC could force the sale of two or three cigarette brands as a condition of federal approval.

In addition, the FTC is expected to investigate whether the deal will create a danger of monopsony, based in part on evidence of bidding conspiracies in the tobacco farmers' private lawsuit, lawyers close to the case say.

Reynolds has denied all of the accusations in the farmers' suit and said that it has had no part in any alleged auction conspiracy. The company has also said that it expects the FTC to approve the Brown & Williamson deal without the forced sale of any cigarette brands.

Beef and Pork

In agriculture, beef and pork producers complain bitterly that the Justice Department, which shares antitrust responsibilities with the FTC, has failed to police the meat market. Private antitrust actions are pending against each of the industry's four largest meatpackers. These slaughtering operations buy animals from cattle ranchers, feedlots, and farmers and sell the meat to large food distributors.

The suits all claim that meatpackers illegally manipulate the market to keep prices low. In each case, the companies are fighting the allegations. One suit, a class action brought by cattlemen against industry giant IBP, a unit of Tyson Foods Inc., has just gone to trial in federal court in Montgomery, Ala.

The most recent government monopsony cases have been in insurance and agriculture. In 2000, the Justice Department demanded the sale of grain silos and terminals as a condition of approving Cargill Corp.'s acquisition of Continental Grain Co. This action was meant to protect farmers in the Midwest who otherwise would have had only one buyer for their soybeans and wheat.

In 1999, the Justice Department found that Aetna Inc.'s acquisition of Prudential Insurance Co.'s health-care unit could unfairly drive down doctors' bills in Houston and Dallas. The department forced the companies to sell assets in both cities.

Pulpwood Prices

In two previously unreported health-care cases, the Justice Department last year investigated alleged monopsonistic contract terms imposed on doctors and hospitals by a Blue Cross plan in Alabama and by Highmark, a Pennsylvania insurer. The contracts demanded preferential rates and had the effect of discouraging doctors from offering lower prices to others. Both companies denied wrongdoing but withdrew the provisions that were under federal scrutiny.

In the paper industry, consolidation hit hard in the pinewoods of South Carolina, according to a lawsuit pending in federal court in Columbia. Timber owners there allege that giant International Paper illegally wields monopsony power over them, driving down pulpwood prices statewide by more than 35% over three years. International Paper has become the world's largest paper maker -- and biggest timber buyer -- largely as the result of a string of acquisitions since 1995.

In order to be more competitive in global markets, International Paper imposed a new "Quality Supplier" system on its timber buyers in 2000. But these intermediary firms, which buy the right to harvest timber owned by individual landowners, were all told what to bid by International Paper, the suit alleges. Buyers who strayed from this secret conspiracy by offering higher bids faced retaliation or were dropped by International Paper, the suit says.

The suit quotes an International Paper manager saying to a group of buyers that he saved "tons of money" with the supplier program, which was then extended to other states. Landowners in South Carolina, Georgia, North Carolina and Virginia got less for their harvested timber, and the value of their land declined, the suit says.

Referring to International Paper's recent acquisitions of Federal Paperboard, Union Camp and Champion Paper, Russ Berke, a lawyer for the landowners says in an interview, "The Justice Department let all of those mergers go forward without looking very closely at the effect on suppliers."

In its answer filed in court, International Paper said it created the supplier program "to improve efficiency and reliability and reduce costs." It said that it doesn't have enough market share to influence prices, calling the monopsony claims "economic sophistry." The company has filed a motion to have the suit dismissed.

In state court in Rockland, Maine, a jury found last November that four berry processors colluded over four years to set the price they would pay for wild blueberries raked from wind-swept fields in Washington County. A group of growers sued, winning $18.7 million in damages.

The processors deny any wrongdoing and say they will appeal. If the jury verdict stands, the judgment amount will be tripled under state law, to $56.1 million. The processors say that having to pay that sum would put them out of business.