COMMENT

AFTER *GILLETTE*: AN ANALYSIS OF PREMIUM PRODUCT MARKETS UNDER THE *1992 MERGER GUIDELINES*

DAVID J. DADOUN*
DIANA L. DIETRICH**

I. INTRODUCTION

> The willingness to spend more for a brand has to do with how much risk there is in giving it up. The more risk, the higher the price differential you will support.[1]

Philip Morris's widely-reported decision to slash prices of its Marlboro brand cigarettes has led the way for recent media scrutiny of brand reputation as a marketplace phenomenon.[2] In particular, news reports have noted the time and expense sometimes needed to build and maintain a product's brand reputation and consumer loyalty, as well as consumer willingness to switch to lower-priced private labels for some goods, but not for others.[3] These observations resemble factors that the two federal antitrust agencies may consider relevant in analyzing certain mergers and acquisitions under the *1992 Horizontal Merger Guidelines*.[4] Merger

* David J. Dadoun is a staff attorney with the Mergers I Division, Bureau of Competition, Federal Trade Commission.

** Diana L. Dietrich is an associate with the law firm of Howrey & Simon, and formerly a staff attorney with the Mergers I Division. The views expressed in this article do not necessarily represent the views of the Federal Trade Commission or any Commissioner, or the law firm of Howrey & Simon. The authors wish to thank Ann Malester and Casey Triggs for their comments and assistance in the preparation of this article.

1. Eben Shapiro, *Price Lure of Private Label Products Fails To Hook Many Buyers of Baby Food, Beer*, WALL ST. J., May 13, 1993, at B1, B8 (quoting George Rosenbaum, Chief Executive Officer of Leo J. Shapiro & Associates).

2. *See, e.g., id.* at B1 (noting that private label manufacturers lose sales as branded manufacturers cut prices); Gabriella Stern, *Brand Names Are Getting Steamed Up To Peel Off Their Private-Label Rivals*, WALL ST. J., April 21, 1993, at B1 (reporting the announcement of price cuts by manufacturers of branded products).

3. *See, e.g.*, Laura Bird, *Advertisers Seek to Save Brands From Price Cuts*, WALL ST. J., April 21, 1993, at B1 (noting that advertisers plan to maintain consumer loyalty through advertising); Shapiro, *supra* note 1, at B1 (suggesting that some brand-name products have remained insulated from private-label competition).

4. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, 4 TRADE REG. REP. (CCH) ¶ 13,104 (May 5, 1992) [hereinafter *Merger Guidelines*]. The Department of Justice and Federal Trade Commission share jurisdictional review to challenge mergers and acquisitions under § 7 of the Clayton Act. Clayton Act § 7, 15 U.S.C. § 18 (1988). Although not law, courts recognize the *Merger Guidelines* as an "advi-

investigations separately pursued by the Federal Trade Commission and the Department of Justice within the last year suggest that brand reputation and consumer loyalty to brand-name products may lead the agencies to recognize either premium product markets or significant entry barriers, or both, under the *Merger Guidelines.*[5]

This article examines the circumstances under which brand reputation may emerge as a significant factor in a *Merger Guidelines* analysis of a proposed transaction. Part II offers a brief review of two recent enforcement actions by the Justice Department and the Federal Trade Commission in which premium product markets based on brand reputation and consumer loyalty were recognized. Part III outlines factors that the agencies are likely to consider in weighing the relevance of brand reputation in their product market and entry analysis. Finally, this article highlights certain industry characteristics that may signal potential anti-competitive concerns within a premium product market under the *Merger Guidelines.*

II. Recent Premium Product Market Cases

Both the Department of Justice and the Federal Trade Commission recently have alleged the existence of premium product markets in challenging acquisitions under Section 7 of the Clayton Act.[6] In *United States v. Gillette Co.*,[7] the Justice Department sought to enjoin Gillette's proposed tender offer to Parker Pen Holdings, Ltd., on the grounds that the acquisition might substantially lessen competition "in the premium fountain pen market."[8] In *Dentsply International, Inc.*,[9] the Federal Trade Commission issued an administrative complaint and obtained a consent agreement requiring Dentsply to divest its line of branded silver alloy products. The Commission's complaint alleged that the effect of Dentsply's acquisition of certain assets of Johnson & Johnson's Professional Dental Care Division "may be

sory aid" when evaluating mergers and acquisitions under § 7 of the Clayton Act. *See* Ansell Inc. v. Schmid Laboratories, 757 F. Supp. 467, 475 (D.N.J. 1991) (viewing the 1984 Merger Guidelines as "an advisory aid in determining the relevant product market"). *See also* S. Newborn & V. Snider, *The Growing Judicial Acceptance of the Merger Guidelines*, 60 Antitrust L.J. 849 (1992) (courts give weight to the *Merger Guidelines*).

5. *See generally Merger Guidelines* §§ 1.1 and 3.0 (product market and entry analysis).
6. 15 U.S.C. § 18 (1988).
7. 828 F. Supp. 78 (D.D.C. 1993).
8. *Gillette*, 828 F. Supp. at 80.
9. 57 Fed. Reg. 48,228 (Federal Trade Comm'n 1992).

to substantially lessen competition" in the "premium silver alloy" market.[10] In each case, evidence of brand reputation and consumer loyalty weighed strongly in the agencies' analysis under the *Merger Guidelines.*

A. *United States v. Gillette Co.*

In *Gillette,* the Department of Justice alleged that the relevant market consisted of "premium fountain pens" with suggested retail prices between fifty and four hundred dollars.[11] The Justice Department defined the market as "high quality refillable fountain pens that have an established premium image among consumers."[12] Gillette and Parker together controlled forty percent of this alleged relevant market.[13]

The defendants urged the court to reject the Justice Department's premium market definition as too narrow.[14] They argued that the court could not segregate the market based on price,[15] and that the government's market definition failed to include other writing instruments that competed against premium fountain pens.[16] According to the defendants, all writing instruments,

---

10. *See id.*

11. *Gillette,* 828 F. Supp. at 80 n.1. The Department offered evidence showing that industry participants would not switch to other writing modes if the prices of premium fountain pens increased, but the court ultimately rejected this contention. *See* Supplemental Memorandum In Support Of United States' Motion For Preliminary Injunction and Reply Of The United States To Defendants' Memorandum In Opposition, United States v. Gillette Co., 828 F. Supp. 78 (D.D.C. 1993) (No. 93-0573) (public version).

12. *Id.* at 81.

13. *Id.* at 80. Gillette controlled 21% of the premium fountain pen market, and Parker controlled 19% of the premium fountain pen market. *Id.*

14. *Id.* at 81. Defendants argued that the relevant product market included "all writing instruments" costing more than ten dollars. *Id.* at 81 n.5. Defendants made the contention that several cases which rejected premium market distinctions precluded the court from finding a narrowly drawn premium product market. *Id.* at 81 n.6 (citing Brown Shoe Co. v. United States, 370 U.S. 294, 326 (1962); Liggett & Myers, Inc. v. Federal Trade Comm'n, 567 F.2d 1273, 1274-75 (4th Cir. 1977); In re Super Premium Ice Cream Distrib. Antitrust Litig., 691 F. Supp. 1262, 1268 (N.D. Cal. 1988), *aff'd,* 895 F.2d 1417 (9th Cir. 1990); United States v. Jos. Schlitz Brewing Co., 253 F. Supp. 129, 134 (N.D. Cal. 1966), *aff'd,* 385 U.S. 37 (1966); Coca-Cola Bottling Co. of N.Y., 93 F.T.C. 109, 190-91 (1979)).

Interestingly, premium market definitions have been argued in the past as a defensive measure by defendants to carve separate markets so that there would be no competitive overlap. *See* United States v. Gillette Co., 828 F. Supp. 78, 83 n.8 (D.D.C. 1993).

15. Relying on Brown Shoe Co. v. United States, 370 U.S. 294, 326 (1962), defendants argued that writing instruments competed on a continuum of prices. *Gillette,* 828 F. Supp. at 81-82.

16. Defendants claimed that other writing modes, including ballpoint pens, rollerball pens and pencils competed against refillable fountain pens. *Gillette,* 828 F. Supp. at 83. The court agreed that customers find these writing modes as competitive substitutes with fountain pens, but rejected defendants' contention that all writing instruments priced more than ten dollars were in the relevant product market. *Id.* at 83-84.

including those with retail prices below fifty dollars, competed against pens priced as high as four hundred dollars.[17]

The court rejected both parties' arguments and opted instead for a middle ground in ruling that the relevant market consisted of "all premium writing instruments" with retail prices from forty to four hundred dollars.[18] The court ultimately found little likelihood that Gillette could exercise market power in this market and declined to enjoin the transaction.[19] The decision is noteworthy because of the court's willingness to accept a premium product market—albeit a broader one than the government alleged—that excluded lower-priced functional substitutes.

B. *Dentsply International, Inc.*

In *Dentsply*, the Federal Trade Commission issued an administrative complaint against Dentsply International, Inc., alleging that the relevant market consisted of "premium silver alloy."[20] Dentsply had proposed to acquire certain assets of Johnson & Johnson's Professional Dental Care Division, including its "premium silver alloy business."[21] The Commission defined the relevant market as "premium silver alloy . . . perceived to be of high quality and consistency" used by dentists to treat dental caries.[22]

In its complaint, the Commission alleged that the relevant market was highly concentrated with high entry barriers, and that the acquisition increased the likelihood of collusion.[23] The relevant market defined in the complaint excluded silver alloy products not perceived by dentists as possessing the quality and consistency associated with premium silver alloy products.

On the strength of the evidence showing a low cross-elasticity of demand between writing instruments in the $10.00 to $40.00 range and those in the $40.00 to $400.00 range, the court found a premium market consisting of writing instruments priced in this latter range. *Id.* at 82. The court also found that pens costing more than $400.00 constituted "jewelry items" and did not compete with fountain pens below this threshold. *Id.*

17. *See id.* at 81-82.

18. *Id.* at 83. The court in effect accepted defendants' argument that other writing modes competed against fountain pens, and plaintiff's argument that a distinct premium market existed for such writing instruments. The court reasoned that "manufacturers, retailers, and purchasers of the pens recognize that there is a distinction between these pens" based on "image, prestige, and status." *Id.* at 82. The court found that premium writing instruments such as ball point pens offered the "same prestige, image, and quality" as premium fountain pens. *Id.* at 83 n.9.

19. *Id.* at 82-83, 85-86.

20. 57 Fed. Reg. 48,228 (Federal Trade Comm'n 1992).

21. *Id.*

22. *Id.*

23. *Id.*

Dentsply entered into a consent agreement requiring it to divest its premium silver alloy line to remedy § 7 Clayton Act[24] and § 5 Federal Trade Commission Act[25] violations alleged in the Complaint.[26]

III. Premium Product Market and Entry Analysis Under the Merger Guidelines

In testing whether a premium product market exists, the enforcement agencies must take several factors into account. From the product market standpoint, those factors include evaluating whether different price structures exist between functionally interchangeable product groups, determining whether switching costs between branded and unbranded product groups result in a low cross-elasticity of demand, examining other intangible factors that support delineating premium markets, and measuring the relative strength and concentration of competitors in the proposed market. From the entry standpoint, those factors include determining whether new entrants can gain brand acceptance in the marketplace in a timely manner, whether new entrants are likely to invest in the sunk costs that are required to build brand loyalty over time, and whether market characteristics limit sales opportunities to new entrants. All of these factors are discussed in greater detail below.

A. *The Relevant Market*

Defining the relevant product market marks the starting point for merger analysis.[27] The case law in which federal courts have rejected premium product markets, especially for consumer goods, dictates that the enforcement agencies proceed with caution when considering whether to define a relevant premium product market based on the existence of premium products.[28]

---

24. 15 U.S.C. § 18 (1988).

25. 15 U.S.C. § 45 (1988).

26. 57 Fed. Reg. 48,228 (Federal Trade Comm'n 1992).

27. *See Merger Guidelines* § 1.1. *See also* Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962) (holding that definition of the relevant market is a "necessary predicate" to examining the effects of a merger).

28. *See, e.g., Brown Shoe*, 370 U.S. at 326 (rejecting market division between high-priced and low-priced shoes); Murrow Furniture Galleries, Inc. v. Thomasville Furniture Indus., Inc., 889 F.2d 524, 528 (4th Cir. 1989) (rejecting definition of name brand high quality furniture market); Nifty Foods Corp. v. Great Atlantic & Pac. Tea Co., 614 F.2d 832, 840 (2d Cir. 1980) (rejecting distinct private label frozen waffle market from brand name waffles); Pennsylvania v. Russell Stover Candies, Inc., 1993-1 Trade Cas. (CCH) ¶ 70,244 (E.D. Pa. 1993) (rejecting branded gift boxed chocolate market); In re Super Premium

Nevertheless, a thorough analysis under the *Merger Guidelines* may mandate delineating such a discrete market in appropriate circumstances.[29]

Ice Cream Distrib. Antitrust Litig., 691 F. Supp. 1262, 1268 (N.D. Cal. 1988) (rejecting premium ice cream market); Tasty Baking Co. v. Ralston Purina, Inc., 653 F. Supp. 1250, 1258 (E.D. Pa. 1987) (rejecting premium snack cake and pie market in favor of overall snack cake and pie market); Saltz & Sons, Inc. v. Hart Schaffner & Marx, 1985-2 Trade Cas. (CCH) ¶ 66,768 (S.D.N.Y. 1985) (rejecting better quality suit market); Mesirow v. Pepperidge Farm, Inc., 1981-2 Trade Cas. (CCH) ¶ 64,292 (N.D. Cal. 1981) (rejecting premium cookie market); United States v. G. Heilman Brewing Co., 345 F. Supp. 117, 121 n.3 (E.D. Mich. 1972) (rejecting premium beer market); United States v. Jos. Schlitz Brewing Co., 253 F. Supp. 129, 145-46 (N.D. Cal. 1966) (same); In re Heublin, Inc., 96 F.T.C 385, 576 (1980) (finding an all wine market); In re Coca-Cola Bottling Co. of N.Y., 93 F.T.C 110, 204-05 (1979) (same); In re Liggett & Myers Inc., 87 F.T.C. 1074, 1147-48 (1976) (rejecting premium dog food market); In re Warner-Lambert Co., 87 F.T.C. 812, 876-77 (1976) (rejecting separate markets for branded and unbranded thyroid drugs).

29. Courts will recognize premium markets where such a definition reflects competitive realities. United States v. Continental Can Co., 378 U.S. 441, 457 (1964). *See, e.g.*, International Boxing Club of N.Y. v. United States, 358 U.S. 242, 252 (1959) (holding that championship boxing is a separate market from professional boxing); Photovest Corp. v. Fotomat Corp., 606 F.2d 704, 713-14 (7th Cir. 1979) (finding that drive-thru photo processing constitutes a separate market from other retail photo processing where distinct premium pricing and low cross-elasticity is shown); Avnet, Inc. v. Federal Trade Comm'n, 511 F.2d 70, 77 (7th Cir. 1975) (holding that rebuilt and reconditioned auto parts constitute a separate market from new items where low cross-elasticity and distinct pricing are shown); A.G. Spalding & Bros., Inc. v. F.T.C., 301 F.2d 585, 601, 603 (3d Cir. 1962) (finding that high-priced athletic goods constitute a distinct market from low-priced athletic goods); Ansell Inc. v. Schmid Laboratories, Inc., 757 F. Supp. 467, 471 (D.N.J. 1991) (holding that branded latex condoms constitute an "economically significant submarket"); Shaw v. Rolex Watch, U.S.A., Inc., 673 F. Supp. 674, 679 (S.D.N.Y. 1987) (finding that Rolex watches compete with other "high quality timepieces"); United States v. Black and Decker Mfg. Co., 430 F. Supp. 729, 738-40 (D. Md. 1976) (holding that lightweight chainsaws for the occasional user comprise a separate market from professional model chainsaws where distinct prices are shown); United States v. Federal Co., 403 F. Supp. 161, 166 (W.D. Tenn. 1975) (finding that competition between advertised premium flour brands and unadvertised non-premium and private label brands is attenuated); Philadelphia World Hockey Club, Inc. v. Philadelphia Hockey Club, Inc., 351 F. Supp. 462, 501 (E.D. Pa. 1972) (holding that the National Hockey League constitutes a separate market from minor and amateur leagues); United States v. Penzoil Co., 252 F. Supp. 962, 972-73 (W.D. Pa. 1965) (finding that Penn Grade crude oil constitutes a separate line of commerce from other crude oils where it commands premium prices above other crudes).

The Supreme Court recently affirmed the idea that "one brand of a product" might constitute "a separate market" for antitrust purposes. *See* Eastman Kodak Co. v. Image Technical Services, Inc., 112 S. Ct. 2072, 2090 (1992). The proposition that one product can by itself constitute a relevant market, however, has been rejected by courts in the past. *See, e.g.*, International Logistics Group v. Chrysler Corp., 884 F.2d 904, 908 (6th Cir. 1989) (cannot limit market to Chrysler parts); Carlock v. Pillsbury Co., 719 F. Supp. 791, 843 (D. Minn. 1989) (Haagen-Dazs ice cream not relevant market). *But see* Heatransfer Corp. v. Volkswagenwerk, AG, 553 F.2d 964, 979-81 (5th Cir. 1977) (air conditioners for single brand of automobiles constitutes the relevant market). *See generally* ABA ANTITRUST SECTION, LAW DEVELOPMENTS 206-07 (3d ed. 1992).

1. Pricing

Product market definition under the *Merger Guidelines* revolves around an assessment of how consumers would be expected to respond to a hypothetical "small but significant and nontransitory" price increase—say, five percent—for a postulated product group.[30] If demand for the product is sufficiently elastic such that consumers would defeat the hypothesized five percent price increase by switching to substitutes rather than paying the higher price, then the postulated product is not a relevant antitrust product market.[31] If, however, product demand is inelastic to the point that consumer switching would be insufficient to defeat the price increase, the postulated product group is considered a relevant product market.[32]

The existence of different price tiers or price structures among functionally interchangeable products—brand-name widgets versus private-label widgets, for example—may signal to the enforcement agencies that a certain degree of demand inelasticity already exists for the product in the upper price tier.[33] The agencies would then be expected to assess whether this demand in-

30. *Merger Guidelines* § 1.11.

31. *Id.*

32. *Id.*

33. Courts occasionally have found distinct product markets based on existing price level differentials with no further showing of low elasticity required. *See, e.g.*, Donald B. Rice Tire Co., Inc. v. Michelin Tire Corp., 483 F. Supp. 750, 755 (D. Md. 1980) (holding that a $30 price differential between radial and non-radial tires supported separate product market finding in Sherman Act § 1 case); United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 739 (D. Md. 1976) (finding that lightweight chain saws priced below $170 were a distinct submarket under Brown Shoe Co. v. United States, 370 U.S. 294 (1962), notwithstanding absence of low demand elasticity evidence). More prevalent, however, appear to be decisions requiring further evidence of low cross-elasticity beyond that of existing price level differentials. *See, e.g.*, Nifty Foods Corp. v. Great Atlantic and Pacific Tea Co., 614 F. 2d 832, 840 (2d Cir. 1980) (holding that separate markets for private-label and branded waffles were not supportable where evidence of low cross-elasticity was not shown); Beatrice Foods Co. v. Federal Trade Comm'n, 540 F.2d 303, 310 (7th Cir. 1976) (finding separate product markets for do-it-yourself and professional paint brush items was not supportable where evidence of distinct price groupings or low cross-elasticity between differently-priced items was not shown); In re Warner-Lambert Co., 87 F.T.C. 812, 877 (1976) (holding that lack of price elasticity between branded and unbranded thyroid products at existing levels does not foreclose the possibility that customers will shift to the unbranded product if the price differential increased); *accord* Avnet, Inc. v. Federal Trade Comm'n, 511 F. 2d 70, 77 (7th Cir. 1975) (holding that a 25-50% price differential between new and rebuilt part lines, combined with the absence of substantial price interaction between the two lines supported finding of two distinct product markets); United States v. Federal Co., 403 F. Supp. 161, 167 (W.D. Tenn. 1975) (finding private-label and premium branded flour markets where premium brands sold for a higher price and where a premium brand competitor made no effort to track private-label prices as it did with premium brand prices).

elasticity is of a degree sufficient to support a "premium" product market definition for the higher-price product tier.

In determining whether a premium product market is appropriate, the general *Merger Guidelines* product market methodology applies.[34] Once it is determined that the merging companies are competitors in a particular brand-name or higher-priced segment, the next step involves an inquiry into how customers would respond to a "'small but significant and nontransitory'" price increase.[35] In most contexts, the agencies utilize a five percent price increase lasting for the foreseeable future to make this determination.[36]

Thus, if a five percent increase in the price of brand-name widgets would cause customers to switch to private label widgets in sufficient numbers to make the price increase unprofitable, then a premium market definition would not appear appropriate.[37] If, on the other hand, demand was sufficiently inelastic so that customers pay the five percent price increase rather than switch to private label widgets, then the agencies would have a basis to define a premium product market.[38]

The historical pricing relationship between a postulated premium product market and its non-premium counterpart may provide important evidence either to buttress or undermine a premium product market definition.[39] For example, facts showing that previous attempts to raise premium product prices were unsuccessful because sales were lost to non-premium products weigh against finding a premium product market.[40] Consequently, price histories for all premium and non-premium com-

34. *See generally Merger Guidelines* § 1.11.
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. The *Merger Guidelines* include among a listing of relevant evidence to be taken into account in considering likely buyer reaction to a price increase, "evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price." *Id.*
40. *See, e.g.*, State of New York v. Anheuser-Busch, Inc., 811 F. Supp. 848 (E.D.N.Y. 1993) (holding that stipulated product market which included premium, superpremium, domestic, and imported beer was correct where evidence of demand elasticity in response to price changes was presented). Alternatively, the absence of price interaction may support finding separate markets. *See, e.g.*, Photovest Corp. v. Fotomat Corp., 606 F.2d 704, 713-14 (7th Cir. 1979) (drive-thru photo processing constitutes a separate market from other retail photo processing where distinct premium pricing and low cross-elasticity shown); Avnet, Inc. v. Federal Trade Comm'n, 511 F.2d 70, 77 (7th Cir. 1975) (rebuilt and reconditioned auto parts constitute a separate market from new items where evidence of low cross-elasticity shown).

petitors—coupled with sales and market share data for the corresponding time period—could prove highly probative in premium product market inquiries. Similarly, relevant product market evidence may come from marketing or strategic documents showing the degree, if any, to which premium market competitors make pricing decisions based upon the likelihood of customers switching to non-premium products.[41]

2. Switching Costs

The "timing and costs of switching products" comprise another category of relevant product market evidence enunciated in the *Merger Guidelines*.[42] Switching costs may be a prominent factor in understanding and defining a premium product market. In fact, switching costs largely may explain consumer reluctance to substitute to a lower priced alternative.[43] The higher the customer's cost of switching to a non-premium product, the less likely the customer is to switch, even in the face of a five percent price increase for the premium product.

In some cases, switching costs may derive from actual, easily determined qualitative differences between premium and non-premium products. In other words, the premium product is actually of higher quality, and consumers objectively know it. Faced with a readily ascertainable difference in the quality or performance of a particular product, consumers may simply decide that the cost of foregoing a desired level of quality or performance is unwarranted by the non-premium product's lower price. Simply put, the consumer is willing to pay more to get more.[44]

---

41. The agencies will also evaluate "evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price." *Merger Guidelines* § 1.11. *See also* United States v. The Federal Co., 403 F. Supp. 161, 167 (W.D. Tenn. 1975) (premium branded flour market supportable where seller of branded premium flour made no effort to keep track of seller of private-label flour).

42. *Merger Guidelines* § 1.11.

43. *See* Dennis A. Yao, *Beyond The Reach Of The Invisible Hand: Impediments To Economic Activity, Market Failures, And Profitability*, 9 STRATEGIC MANAGEMENT J. 59, 64 (1988) [hereinafter Yao, *Beyond the Reach*] (establishing that a brand name lowers a consumer's switching costs and thus explains a consumer's preference for higher priced branded items). *See also* PHILIP FITZELL, PRIVATE LABEL MARKETING IN THE 1990S, at 148 (1992) (30% of U.S. consumers almost never switch between brands, 51% occasionally switch brands, and only 19% often try new or different brands).

44. *See, e.g.*, Photovest Corp. v. Fotomat Corp., 606 F.2d. 704, 714 (7th Cir. 1979) (holding that drive-thru photo finishing kiosks were a distinct product market in a monopolization case where consumers were "willing to pay a premium for the convenience of drive-thru service" and more specialized sales services); United States v. Lever Brothers Co., 216 F. Supp. 887, 891 (S.D.N.Y. 1963) (holding that low sudsing detergents that sold for a

Trickier perhaps, but not necessarily less significant, are those cases in which consumers cannot readily ascertain quality differences before use, but where consumers deem the risks associated with using a non-premium product to be high. Where consumers are unable (or find it economically inefficient) to conduct low-risk product quality tests themselves, they may be likely to adhere to premium product brands with established quality records even if the prices of these products increase and no actual quality difference exists between the premium and non-premium products groups.[45] Consumer perceptions of quality differences between premium and non-premium products may control, especially where they may incur some risk in switching from one product group to the other. For example, consumers may be unwilling to switch from a recognized brand-name condom with established quality acceptance to an unestablished, but lower-priced condom for fear of the consequences if the product fails.[46] One commentator has suggested that a similar risk-aversion phenomenon may be at work in shaping consumer purchasing habits for baby food and certain personal hygiene products.[47]

Marketing and advertising, of course, may play an important role in creating and reinforcing the concept of a quality differential between premium and non-premium products in consumers' minds, even if no actual quality difference exists between premium and non-premium products. Marketing efforts create and reinforce loyalty to premium products among imperfectly informed consumers who may consider the risk or costs associated with trying an unestablished product too high. Where the evidence indicates that late-coming new entrants face formidable challenges in establishing competitive premium quality brand

higher price and exhibited different performance characteristics when used in automatic washing machines are a distinct relevant submarket of heavy duty detergents).

45. *See, e.g.*, Dennis A. Yao, *Challenges in Merger Analysis: the 1992 Merger Guidelines and Beyond*, Illinois State Bar Association Antitrust & Unfair Competition Law, at 3 (January 1993) (asserting consumers often seek quality assurances by relying on established brand name recognition).

46. In Ansell Inc. v. Schmid Laboratories, Inc., 757 F. Supp. 467 (D.N.J. 1991) a federal district court held brand-name latex condoms to be a distinct product market from a broader product market of all latex condoms sold wholesale in the United States. The court did not explicitly discuss switching costs in its decision. It did, however, acknowledge that "the key to successful sales of latex condoms in the retail market is a well-known and recognized brand name." *Ansell Inc.*, 757 F. Supp. at 473.

47. *See* Shapiro, *supra* note 1, at B8, (identifying private label deodorants, face creams, soaps, and shaving creams as products that have failed to achieve more than 2% market penetration).

reputations,[48] the possibility of a premium market definition derived from perceived quality differences may be heightened.

3. Intangible Factors

The recent *Gillette* decision illustrates another facet of consumer behavior that may contribute to the operation of a premium product market: customers may be willing to pay more for an intangible value such as prestige or cachet. The district court in *Gillette* accepted the position that fountain pens in the fifty to four hundred dollar range constituted an economically relevant submarket.[49] The foundation for this finding was evidence showing that fountain pens in this price range "afford their users (as well as those who merely put them in their breast pockets) image, prestige, and status"[50] that consumers were willing to pay five percent more for if prices increased post-merger. Thus, in appropriate (albeit, perhaps infrequent) cases, intangibles such as prestige may, in significant part, drive low demand elasticity and warrant a premium market definition.

B. *Market Structure*

Under the *Merger Guidelines*, the agencies identify not only those firms that currently produce or sell in the relevant market, but also the firms that can enter and exit the relevant market within one year without incurring significant sunk costs.[51] The *Merger Guidelines* label firms that can enter and exit in this manner as "uncommitted entrants."[52] Where brand reputation and consumer loyalty are at issue, however, the agencies will most likely treat potentially entering firms as committed entrants under the entry analysis, because penetrating premium or

48. *See infra* notes 57-115 and accompanying text for a discussion of associated entry issues.

49. United States v. Gillette Co., 828 F. Supp. at 82-83. The government's case ultimately failed upon the court's finding that low demand elasticity did exist between premium fountain pens priced from $50-$400 and premium writing instruments of other modalities such as ballpoint pens, rollerball pens, and mechanical pencils priced from $40-$400. *Id.* at 83. In adopting this expanded premium product market definition, the court concluded that the "same prestige, image, and quality obtainable from a $50 fountain pen are obtainable for approximately $40 in other modes of writing instruments." *Id.* at 83 n.9.

50. *Gillette*, 828 F. Supp. at 82.

51. *Merger Guidelines*, § 1.32. The *Merger Guidelines* define "a significant sunk cost" as an expense that cannot be "recouped within one year of the commencement of the supply response." *Id.* Sunk costs include the investment to market and build product acceptance in the relevant market. *Id.*

52. *See id.*

branded markets usually requires the expenditure of significant sunk costs.[53]

For those firms in the market, the agencies will likely measure market shares based on past years' dollar sales, and not on past years' unit sales or current production capacity.[54] Dollar sales are more likely to reflect a firm's current and future competitive significance, because prices received per unit directly reflect on the firm's brand strength, and thus its competitive significance.[55] Otherwise, measuring a firm's market share by unit sales or production capacity is likely to overstate the competitive significance of a firm with relatively low brand reputation, and understate the competitive significance of a firm with relatively high brand reputation.[56]

C. *Brand Reputation As An Entry Barrier*

Several cases support the proposition that the marketing expenses required to build brand recognition may alone constitute a barrier to entry sufficient to allow anticompetitive effects.[57]

---

53. The *Merger Guidelines* state explicitly that a firm which possesses the capability to enter in response to a "small but significant and nontransitory" price increase but likely would not due to "difficulties in achieving product acceptance," among other factors, will not be considered a market participant. *Id.*

54. *See id.* at § 1.41.

55. *See* Yao, *Beyond the Reach, supra* note 43, at 64, 68 n.24 (sellers that establish brand reputations and consumer loyalty before market maturity can achieve supra-normal profits where imperfect market information exists); Ronald S. Bond & David F. Lean, *Consumer Preference, Advertising And Sales: On The Advantage From Early Entry*, FTC BUREAU OF ECONOMICS WORKING PAPER NO. 14, October 1979, at 4 (consumer preferences for established brands may explain the market shares and profitability of existing brands).

56. The agencies calculate market concentration by using the Herfindahl-Hirschman Index. *See Merger Guidelines* at § 1.5.

57. *See, e.g.*, United States v. Pabst Brewing Co., 384 U.S. 546, 559-60 (1966) (Harlan, Stewart, J.J., concurring) (brand recognition and consumer preference developed by extensive marketing constitute "a substantial barrier" to entry); Southern Pac. Communications Co. v. Am. Tel. and Tel. Co., 740 F.2d 980, 1002 (D.C. Cir. 1984) (overcoming brand preference constitutes a barrier to entry); General Foods Corp. v. F.T.C, 386 F.2d 936, 945 (3d Cir. 1967) (consumer brand preference established by extensive marketing constitute an entry barrier); A.G. Spalding & Bros., Inc. v. F.T.C., 301 F.2d 585, 618, 620 (3d Cir. 1962) (established reputation for quality and consumer preference through advertising constitute a formidable barrier to entry); Ansell Inc. v. Schmid Laboratories, Inc., 757 F. Supp. 467, 471, 474-75 (D.N.J. 1991) (overcoming consumer loyalty and developing brand name recognition constitute a barrier to entry); Tasty Baking Co. v. Ralston Purina, Inc., 653 F. Supp. 1250, 1263 (E.D. Pa. 1987) (the high costs to develop brand recognition constitute an entry barrier); F.T.C. v. Coca-Cola Co., 641 F. Supp. 1128, 1137 (D.D.C. 1986) (the time and expense required to overcome consumer preferences and develop brand name recognition constitute a substantial barrier to entry), *vacated*, 829 F.2d 191 (D.C. Cir. 1987); United States v. Mrs. Smith's Pie Co., 440 F. Supp. 220, 229 (E.D. Pa. 1976) (the time and cost to develop brand and consumer recognition constitute an entry barrier); United States v. Black and Decker Mfg. Co., 430 F. Supp. 729, 752 (D. Md. 1976) (lack of brand recognition and the advertising expenditures required to develop it

Under the *Merger Guidelines*, the agencies employ a three-part test to determine whether entry is "so easy" that market participants cannot exercise market power post-merger.[58] Unless entry passes the timeliness, likelihood, and sufficiency tests, it is unlikely to constrain the exercise of market power.[59] The sufficiency test is generally satisfied by answering the first two questions; namely, whether sufficient entry can occur in a timely manner, and whether entry is likely to occur under current market conditions.[60]

1. Timeliness

New entrants must achieve a significant market impact within two years from entering the relevant market for entry to be considered timely.[61] In markets where brand reputation and consumer loyalty are present, penetrating the market and achieving a significant market impact may take substantially longer than two years.[62] Factors that limit a new entrant's ability to achieve a significant market impact in a timely manner include: establishing premium brand name recognition at higher costs than entrenched premium brands that already possess premium reputations; being able to develop unique or improved products in mature markets where buyer inertia prevents successful entry on development of brand reputation alone; and gaining access to distribution channels where an entrant's proven track record must first be shown. No single factor is dispositive in assessing

constitute an entry barrier); United States v. Crowell, Collier and MacMillan, Inc., 361 F. Supp. 983, 1001 (S.D.N.Y. 1973) (brand recognition and reputation for quality constitute an entry barrier); In re Procter & Gamble Co., 63 F.T.C. 1465, 1553 (1963) (brand preference established by mass advertising can constitute a barrier to entry), *aff'd*, 386 U.S. 568 (1967).

58. *See Merger Guidelines* § 3.0.

59. *See id.*

60. Where committed entry is likely to occur, the *Merger Guidelines* generally view such entry as sufficient to counteract the possible exercise of market power post-merger. *Id.* at § 3.4. Where unilateral price elevation in a differentiated (that is, premium) product market is of concern, however, the new entrant's product must be sufficiently close to the products of the merged firm to render the price increase unprofitable. *Id.* The timeliness and likelihood tests generally help resolve these concerns.

61. *Id.* at § 3.2. Unless a new entrant deters or counteracts the exercise of market power within a two year period from entry, the entrant's impact on the market will not be deemed "significant." *Id.* The time period for measuring entry encompasses initial planning to actual impact on the market. *Id.* Where technical and regulatory barriers exist, such as in medical markets, the time period for successful entry and the development of brand reputation may take even longer than in markets where initial market entry is of shorter duration.

62. *See* FITZELL, *supra* note 43, at 25 (1992) ("perceived [brand] value derives from the equity built into a brand name over the years").

whether entry can occur in a timely manner, but each is probative from the antitrust perspective as to whether entry is likely to occur in a timely fashion.

a. First Mover's Advantage

Sellers that establish their reputations before market maturity possess a distinct advantage over new entrants with no brand loyalty.[63] Also known as "first-mover's advantage,"[64] early entrants incur lower costs for entry than later entrants, and develop brand loyalty with their products before substantial loyalty to any one product exists.[65] In markets where consumers lack perfect information, reliance on brands with established reputations takes on even greater importance.[66] Once firms develop intense consumer preference for their products, the entrant's task of overcoming this loyalty in the absence of perfect information is a difficult process. Medical products, such as those at issue in *Dentsply*, may illustrate this phenomenon.

Brand reputation signals to consumers which products are effective and safe, and reduces the risk and cost from switching from one product to the next.[67] Where some level of risk exists in switching to a new product, and the switching costs for testing a new product are high, brand loyal consumers are even less likely to try an unestablished brand, even at a lower price.[68] Indeed, one study showed that prescribing physicians responded more favorably to established brands than to the promotion of late entrant brands, precisely because of first-mover's advantage.[69] Therefore, a new firm may not expect to gain a significant mar-

63. *See* Yao, *Beyond the Reach*, Yao, *supra* note 43, at 64 (sellers that establish their brand names before market maturity can achieve supra-competitive profits); *see also* Bond & Lean, *supra* note 56, at 17 (early entrants with brand name recognition possess a substantial sales advantage).

64. *See* Yao, *Beyond the Reach*, *supra* note 43, at 68.

65. *See id.* at 68.

66. *See id.* (presumably early entrants do not possess any advantage in branded markets where perfect information exists, because buyers would know the features of all products, even of new entrants), *see also id* at 64 (the absence of switching costs do not give incumbent firms leverage in the use of their established brand names).

67. Brand characteristics can include consumer recognition, trademark or copyright protection, research and development, package design and innovation, marketing, and quality control procedures. *See* FITZELL, *supra* note 43, at 25.

68. Perceived, but not actual, differences may place functionally interchangeable products in different product markets (that is, premium and non-premium). A new entrant must then develop the perception through marketing that its product is equivalent or superior to competing products in the relevant market. *See* Yao, *supra* note 45, at 3.

69. *See* Bond & Lean, *supra* note 55, at 17.

ket impact in a market where switching costs are high and useful market information is low, until development of the brand name signals to consumers that the product is of comparable quality to the incumbent brands.[70]

b. Market Maturity Saddled With Innovation

Buyer inertia in mature markets also may limit an entrant's ability to achieve a significant market impact in a timely manner.[71] When buyers place primary importance on product innovation, development of a comparable but not significantly unique or improved product line may be insufficient to overcome consumer loyalty to incumbent brands. For example, a study of a branded therapeutic drug market showed that branded drugs that first offered effective treatment achieved greater sales than later brands that merely duplicated, but did not improve, existing therapy.[72] Therefore, timely entry in the absence of such product improvements may be difficult, if not unlikely, in mature markets.[73]

c. Distributional Barriers

Failure to gain access to distribution channels because of lack of brand recognition may also prolong a new entrant's ability to achieve a significant market impact in a timely manner.[74] Wholesale or retail distributors of a new entrant's products must cover the cost to inventory the new product.[75] Retailers and wholesal-

70. Overcoming first-movers' advantage may also limit a new entrant's sales opportunities. Where first mover's advantage significantly diminishes a new entrant's sales opportunities, entry may be less likely to occur. *See infra* notes 79-81 and accompanying text for a discussion of the likelihood test under the *Merger Guidelines*.

71. Such inertia also may limit a new entrant's sales opportunities, and thus affect the likelihood of entering in the relevant market. *See infra* notes 79-81 and accompanying text for a discussion of the likelihood test under the *Merger Guidelines*.

72. Bond & Lean, *supra* note 55, at 20.

73. Obviously such a problem does not exist in markets characterized by rapid changes in technology.

74. *See, e.g.*, United States v. Black and Decker Mfg. Co., 430 F. Supp. 729, 752 (D. Md. 1976) (lack of brand awareness can hinder a new entrant's access to distribution); *In re Heublein*, 96 F.T.C. 385, 546 (1980) (access to distributional channels and shelf space difficult where new entrant lacks brand recognition). Failure to access appropriate distribution channels may also limit a new entrant's sales opportunities. *See infra* notes 79-81 and accompanying text for a discussion of factors that limit sales opportunities to new entrants under the likelihood test of the *Merger Guidelines*.

75. A new entrant can theoretically underwrite the cost of inventory, but this increases the sunk costs for new entry, and the amount of market share a new entrant must gain in order to reach minimum viable scale. Underwriting the cost of inventory may therefore adversely affect the likelihood that new entry will, in fact, occur. *See infra* notes 84-93 and

ers are unlikely to undergo the risk and expense of taking new inventory of an unproven product, until the entrant establishes itself in the market.[76] Faced with a "chicken-or-egg" dilemma, new entrants may therefore be forced to seek alternative, and less attractive channels of distribution until they gain acceptance in the marketplace.[77] A new entrant's inability readily to access the most effective distributional channels may deter new entry altogether, or at the very least allow incumbents to enjoy their market positions without retaliating against a new entrant until such market acceptance occurs.[78]

2. Likelihood

Even if new entry could occur in a timely manner, entry still must be likely to occur to deter possible competitive effects from a given transaction.[79] Under the *Merger Guidelines*, entry is viewed as likely if a new entrant can enter profitably at prevailing premerger prices.[80] Factors that determine whether new entry is likely to occur include: the sunk costs that are required to enter the market; the minimum viable scale that new entrants must achieve to enter profitably; and the sales opportunities available to new entrants. In premium markets where incumbents possess first-mover's advantage, brand loyalty may diminish a new entrants' sales opportunities further, making entry less likely to occur.[81] Again, the enforcement agencies assess these factors in

---

accompanying text for a discussion of how an entrant's minimum viable scale affects the likelihood of entry in the relevant market.

76. This is especially the case for *de novo* entrants with no brand recognition in adjacent markets. Even new entrants with established reputations in collateral markets may face some, albeit less difficulty, in gaining access to the appropriate distribution channels. *See, e.g.*, United States v. Crowell, Collier and MacMillan, Inc., 361 F. Supp. 983, 999, 1001 (S.D.N.Y. 1973) (brand reputation of one product line not transferable to another). *See also* Ansell Inc. v. Schmid Laboratories, Inc., 757 F. Supp. 467, 473 (D.N.J. 1991) (in branded latex condom market, retailer's decision to carry a product depends upon the product's proven or reasonably anticipated turnover).

77. Such channels may include selling direct, or through smaller, regional suppliers. Firms with no experience in selling direct may thus take significantly longer to achieve a significant market impact than if they sold through experienced distributional outlets.

78. *See also Merger Guidelines* § 3.4 (under the sufficiency analysis new entry must be responsive to localized sales opportunities where the competitive effect is not uniform across the relevant market).

79. *See Merger Guidelines* § 3.3.

80. *See id.* If premerger circumstances strongly indicate coordinated interaction, the agencies will pick a price more reflective of a competitive price. *See also id.* at §§ 1.11, 2.1.

81. *See supra* notes 64-70 and accompanying text for a discussion of first-mover's advantage.

their entirety and are unlikely to build an antitrust case on one factor alone.

a. Sunk Costs

Firms attempting to enter markets where brand reputation and consumer loyalty are present may have to incur significant sunk costs before they achieve market acceptance and impact the market significantly.[82] In medical product markets such as in *Dentsply*, or luxury good markets as in *Gillette*, extensive marketing may be crucial to gaining product market acceptance and penetrating the relevant market.[83] In some branded product markets, however, entry may be unlikely to occur where the sunk entry costs are so huge that they exceed the potential return on any investment opportunity. An entrant's minimum viable scale is one measure of whether entry is in fact likely to occur.

b. Minimum Viable Scale

The *Merger Guidelines* define an entrant's minimum viable scale ("MVS") as "the smallest average annual level of sales that the committed entrant must persistently achieve for profitability at premerger prices."[84] Entry is viewed as likely only if the sales opportunities available to a new entrant exceed an entrant's MVS.[85] Understanding MVS, therefore, is crucial to determining the likelihood of entry as set out in the *Merger Guidelines*, and how the Department of Justice and the Federal Trade Commission use MVS to help ascertain the likelihood that entry will occur.

Fundamentally, MVS is a minimum market share target that the new entrant must achieve to operate profitably in the mar-

82. *See Merger Guidelines* § 3.0 and n.25. *See also* United States v. Pabst Brewing Co., 384 U.S. 546, 559-60 (1966) (Harlan, Stewart, J.J., concurring) (new entrant must undergo intensive advertising and incur considerable expenses to establish brand recognition); F.T.C. v. Coca-Cola Co., 641 F. Supp. 1128, 1137 (D.D.C. 1986) (building brand recognition requires enormous sums of money and years of effort); In re Procter & Gamble Co., 63 F.T.C. 1465, 1553 (1963) (heavy advertising expenditures vital for successful entry to occur), *aff'd*, 386 U.S. 568 (1967).

Advertising costs for a particular brand are sunk, because they generally are not transferable to another brand, or recoverable once spent. *See Merger Guidelines* § 1.32 (sunk costs include marketing expenses).

83. *See* United States v. Gillette Co., 828 F. Supp. 78, 85 (D.D.C. 1993) (significant investment required to build market share in the premium writing instrument market); Yao, supra note 45, at 3 (developing brand reputation and consumer acceptance may involve substantial sunk costs).

84. *Merger Guidelines* § 3.3.

85. *Id.*

ket.[86] The market share target is determined by the sunk costs that a new entrant must incur to penetrate the relevant market[87] and the risk of the investment in a given market.[88] In markets where significant brand reputation and consumer loyalty exist, latecomers must often spend more than incumbents to achieve equivalent market shares.[89] Such an effect, by requiring a new entrant to spend proportionately larger shares of its revenue on advertising, increases the entrant's MVS.

Under the *Merger Guidelines*, entry is only likely to occur where a potential entrant can reasonably expect to achieve its MVS goal.[90] In premium markets where new entrants must incur significant sunk costs to gain product acceptance, an entrant's MVS may exceed the available sales opportunities.[91] Indeed, in his concurring opinion in *United States v. Pabst Brewing Co.*, Justice Harlan recognized that the expense to develop consumer recognition and brand acceptance may pose a "substantial barrier" to new entry.[92] Under such circumstances, entry is unlikely to occur.[93]

---

86. *See id.*

87. *Id.*

88. The greater the risk, the greater dollar value and thus return on an investment a potential entrant will require in determining whether entry is worthwhile.

89. *See* Bond & Lean, *supra* note 55, at 4-6 (an intense preference for early brands might require later entrants to devote a higher percentage of their sales dollars to promotion, and thus increase an entrant's sunk costs).

90. *See id.* Absent a belief that the available sales opportunities are sufficient for an entrant to achieve its MVS target, entry is unlikely to occur.

91. For example, a potential entrant may calculate its MVS to be fifteen percent of the relevant market. Under such circumstances, the potential entrant will not attempt entry unless it feels reasonably certain that it can capture this share of the market. If the potential entrant calculates that it can only capture ten percent of the market based on available sales opportunities, it is unlikely to attempt entry under current market conditions.

92. 384 U.S. 546, 559-60 (1966) (Stewart, J., concurring). Numerous courts have found that the sunk costs to build brand recognition through advertising constitute a significant barrier to entry. *See, e.g.*, Southern Pac. Comm. Co. v. Am. Tel. & Tel. Co., 740 F.2d 980, 1002 (D.C. Cir. 1984) (large capital outlays to overcome brand preference constitute a barrier to entry); Tasty Baking Co. v. Ralston Purina, Inc., 653 F. Supp. 1250, 1263 (E.D. Pa. 1987) (the high costs to develop brand recognition constitute a substantial barrier to entry); United States v. Mrs. Smith's Pie Co., 440 F. Supp. 220, 229 (E.D. Pa. 1976) (advertising costs to develop brand and consumer recognition constitute an entry barrier); United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 752 (D. Md. 1976) (advertising costs to develop brand awareness represents a barrier to entry).

Although none of these cases addresses the problem directly, each supports the proposition that the sunk costs required to develop a premium brand reputation under the likelihood test of the *Merger Guidelines* may hinder new entry from occurring.

93. *See Merger Guidelines* at § 3.3. Even if an entrant can enter profitably at premerger prices, it must have "a significant market impact" in the relevant market to resolve competitive effect concerns under the *Merger Guidelines*. *See id.* at § 3.2. Therefore, a firm that fails to expend the resources which are necessary to build brand recognition and constrain the potential competitive effects has not technically entered the relevant market.

c. Available Sales Opportunities

The *Merger Guidelines* depict several types of sales opportunities that new entrants might expect to capture when entering a market suffering from post-merger anticompetitive effects. Sales opportunities may flow from the output reduction associated with a price increase that results from the merger and an entrant's ability to capture a share of expected market growth.[94] These sales opportunities may be limited, however, if the market is mature (and if no market growth is expected in the foreseeable future), and if new entrants can expect incumbent retaliation in response to new entry.[95] Sales opportunities may be inhibited further where consumer loyalty diminishes an entrant's ability to divert sales from brand-entrenched incumbents or where first-mover's advantage requires an entrant to spend proportionately more on marketing. These factors may additionally decrease a prospective entrant's incentives to invest in markets where sales opportunities are already low.

(1) Expected Sales Opportunities

A new entrant can expect to capture the full output reduction associated with a hypothetical five percent price increase post-merger. In practice, however, the enforcement agencies face a difficult time estimating a firm's MVS and available sales opportunities with any certainty. Nevertheless, the *Merger Guidelines* theorize that a hypothetical monopolist's profitable five percent price increase would translate into a corresponding sales opportunity of five percent of the relevant market.[96] In addition, an entrant should expect to capture an equal share of market growth, if the relevant market expects to experience such growth for at least two years following the anticompetitive effects of the merger.[97] Where such growth exists, an entrant's total sales op-

---

See id. at § 1.11 (a product that fails to defeat a price increase is excluded from the relevant market). *See also* F.T.C. v. Coca-Cola, 641 F. Supp. 1128, 1137 (D.D.C. 1986) (profitable entry in carbonated soft-drink market considered remote where entry on a sufficient scale requires years of effort and enormous sums of money).

94. *See Merger Guidelines* § 3.3.

95. *Id.*

96. *See id.* § 3.3 n.32.

97. *Id.* The *Merger Guidelines* state that such market growth or decline is only relevant where "total market demand is projected to experience long-lasting change during at least the two year period following the competitive effect of concern." *Id.*

Unless the relevant market expects to experience substantial growth for at least two years, such growth will probably have an insubstantial impact on the likelihood of entry. Because new entrants should generally expect to capture an equal share of market expan-

portunity can be reasonably estimated to determine whether entry is likely to occur.[98] If the total sales opportunity exceeds or equals an entrant's MVS, entry is likely to occur.

Calculating an entrant's sales opportunities with these beginning figures provides the best estimation of sales opportunities available to new entrants under the *Merger Guidelines.* However, this initial estimate fails to take into account difficulties that new entrants face in diverting sales away from established incumbents. In differentiated or premium product markets where such difficulties might exist, an entrant's sales opportunity may not even reach the five percent threshold normally expected from the output reduction resulting from the merger. Depending on an entrant's MVS, entry under such circumstances may be unlikely to occur.

(2) Reduced Sales Opportunities

Numerous factors may militate against a new entrant capturing even a five percent share in a premium market where significant consumer loyalty is present. Unless a market expects future growth, a five percent target generally represents the best scenario for available sales opportunities to a new entrant.[99] In a mature or declining market, however, the available sales opportunities may be significantly less than the five percent target when based on past annual sales data.[100] Such a reduction in

---

sion, an entrant with an expected sales opportunity of 5% should capture this percentage of total market growth.

Such variables as consumer acceptance, marketing expenditures, incumbent retaliation, product quality, and service will naturally affect an entrant's total sales opportunity.

98. For example, an entrant's expected sales opportunity in a market with $10 million in annual sales would be approximately $500,000 ($10.0 million x .05). If the market is expected to experience an annual growth rate of 10%, total market growth amounts to $1.0 million per year. A new entrant's hypothetical share of this growth amounts to only $50,000 ($500,000 x .10). Therefore, a new entrant's total sales opportunity amounts to only $550,000. If an entrant must secure more than this amount of the market to achieve a profit, entry is unlikely to occur.

99. Where multiple firms enter the market simultaneously, those firms will generally fight among themselves for the 5% sales opportunity available from the hypothetical output reduction. Therefore, if five firms of equal significance attempt to enter, each should theoretically expect a sales opportunity of 1%. If the MVS exceeds this amount, entry is theoretically unlikely. For the sake of argument, however, the agencies may "award" a 5% sales opportunity to the surviving entrant, reaching the same result as if only one firm had entered the market.

100. *Merger Guidelines* § 3.3. An entrant should hypothetically still capture 5% of the relevant market, but where an expected decline in demand is shown, the total sales opportunity will be less than in previous years. For example, if in FY01 revenues in the total market amounted to $1.0 million, the available sales opportunity to a new entrant would be $50,000 ($1.0 million x .05). If in FY02 projected revenues decline to $900,000, the

market demand may therefore impact negatively on the likelihood that entry will occur.[101]

Sales opportunities may be limited in mature markets where innovation is important.[102] In premium branded product markets, a saturation in product innovation takes on even greater importance. To overcome consumer loyalty for existing brands, product improvement or new innovation may be required if new entrants are to penetrate the relevant market successfully.[103] Absent such innovation, a firm contemplating entry may be forced to engage in a costly marketing program to build the perception of brand or product differentiation among customers, thus increasing its MVS.[104]

Offering substantial product improvements to enhance sales opportunities may present significant problems in mature markets with little room for product innovation. Where significant brand reputation and consumer loyalty exists, as in *Dentsply* and *Gillette*, evaluating whether substantial product improvements can occur within a given industry will be crucial to determining whether sufficient sales opportunities are available for new entrants to achieve MVS.[105] The difficulty of developing significant product improvements may signal that limited sales opportunities exist for new entrants, diminishing the chances that new entry will occur.[106]

---

available sales opportunity would be reduced to $45,000 ($900,000 x .05). The decline in market demand thus reduces the entrant's total sales opportunity in FY02 by $5,000.

101. Obviously where market projections show substantial negative growth for several years and the sunk costs for entry are high, the greater the negative impact these factors will have on the likelihood of new entry.

102. In the consumer products area, for example, modest product improvements in design, ease of use, color, or scent may be insufficient to overcome strong consumer preferences for existing brands with relatively comparable attributes. In medical markets, product designs which offer significant clinical improvements in treatment or use may only be sufficient to overcome physician preference for products that are otherwise therapeutic.

103. *See Merger Guidelines* § 3.3 n.33 (sales opportunities depend upon the "relative appeal, acceptability and reputation of incumbents' and entrants' products to the new demand").

104. *See supra* notes 57-60 for a discussion of marketing costs to build brand reputation and meeting the MVS requirement.

105. No exact mathematical formula can be used to determine a potential entrant's sales opportunities. Although the *Merger Guidelines* offer a model in calculating an entrant's sales opportunities, in reality such quantification is imprecise and difficult to formulate.

106. This discussion assumes that new entrants must incur significant sunk costs to achieve brand acceptance, increasing an entrant's MVS beyond the reach of the limited sales opportunities.

First-mover's advantage and intense consumer preference for established brands also may limit available sales opportunities for new entrants. In markets where imperfect information exists, consumers often seek assurances of quality and attempt to reduce switching costs by relying on a product's brand name.[107] Such brand loyalty has been found to allow entrenched firms to achieve supracompetitive profits, even when new entrants offer equally comparable goods.[108] Therefore, where consumers place a premium on such brand recognition, as in premium markets, limited sales opportunities may exist until a new entrant gains sufficient brand recognition in the marketplace.[109]

Incumbent retaliation may limit available sales opportunities as well.[110] Because first-mover's advantage allows established firms to spend proportionately less on advertising than new firms do, entrants may have reason to fear a retaliatory promotional campaign by incumbent firms.[111] Although new firms might expect to capture some sales by a massive promotional campaign, those opportunities diminish once incumbent firms launch equally aggressive campaigns.[112] Furthermore, new entrants earn less on the dollar when promoting a product, and those returns expectedly diminish further in the face of retaliatory advertising by incumbents.[113] Therefore, the mere threat of retaliation in premium product markets may deter new entry from occurring.

Finally, firms contemplating entry in premium markets may face limited sales opportunities where access to key distribution channels is blocked or hampered.[114] Lack of brand name recognition may stifle an entrant's sales opportunities because vendors may be unwilling to underwrite the expense of adding unproven products to their inventory. Where the inventory requirements are especially cumbersome or costly, difficulty in gaining access to the appropriate channels may prove especially difficult.[115] Un-

107. *See* Yao, *supra* note 45, at 3; *see also* Yao, *Beyond the Reach*, *supra* note 43, at 64.

108. Yao, *Beyond the Reach*, *supra* note 43, at 68.

109. *See also Merger Guidelines* § 3.3 n.33 (entrants' anticipated share depends on the "relative appeal, acceptability and reputation of incumbents' and entrants' products").

110. *Merger Guidelines* § 3.3.

111. Bond & Lean, *supra* note 55, at 5-6.

112. *See id.*

113. *Id.* at 4-6.

114. *See supra* notes 74-78 and accompanying text for a discussion of cases which recognize that brand recognition may operate as a barrier to entry in gaining access to distribution channels.

115. This might be the case where volume requirements are large, increasing the cost to stock new items. Furthermore, adding new inventory takes shelfspace from existing

til entrants gain such recognition, new entrants might be forced to seek less attractive distribution channels that offer only limited sales opportunities, impacting negatively on an entrant's ability to achieve MVS, and thus its likelihood of entering the market.

IV. Conclusion

In spite of many previous decisions that rejected premium markets, *Gillette* and *Dentsply* present strong indications that premium product markets can and will be found under the *Merger Guidelines*' approach to merger analysis. Moreover, in appropriate cases, the enforcement agencies may define premium product markets, conclude that sufficient entry is either unlikely or untimely, and challenge the proposed transaction. It is impossible to identify without close scrutiny which industries may harbor premium product markets. However, such scrutiny may include considering the following: whether the relevant product is a well-established branded product with entrenched consumer recognition; whether significant price differentials between branded and private-label products exist in the market; whether customers face significant switching costs, possibly attributable either to actual quality differences or perceived risk in switching to a lesser-known brand; whether distributors are reluctant to stock non-established brands; and whether substantial sunk costs in marketing and advertising are necessary to build a competitive brand reputation. The presence of these factors in a particular case, of course, must be examined on an individual basis. The *Merger Guidelines* present a workable framework for identifying and examining them.

stock. Therefore, opportunity costs arise in replacing proven items in inventory with unproven products into inventory. Distributors may be unwilling to replace existing stock with new entrants' products unless and until it is clear that the new products can outpace the incumbents' products in sales and gross margins.