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WHEN SHOULD PRIVATE LABEL GOODS BE INCLUDED IN A PRODUCT MARKET?

An important antitrust issue when considering mergers of producers of major branded consumer goods is whether nonbranded counterparts to these goods (e.g., private labels or generics) should be considered part of the relevant product market. The approach of the Department of Justice and Federal Trade Commission Horizontal Merger Guidelines is to include private labels in the product market on a case-by-case basis. Under the Guidelines' principles, branded products constitute a relevant market if a hypothetical monopolist of major brands could nontrivially increase price without losing enough sales to non-major brand competitors to make the price rise unprofitable. If enough buyers would switch to the private labels, then private labels should be in the market.

This case-by-case approach is consistent with the mixed findings of the economics literature. On the one hand, there is some evidence that concentration among brand name providers increases the spread between branded and private label prices, suggesting that private label goods do not closely discipline branded products and thus should not be included in the market. On the other hand, a large literature suggests that the existence of a price premium for branded products, by itself, does not indicate that branded products are a relevant antitrust market. Price premiums may in fact signal subtle attributes of quality. These results urge a more even-handed treatment of private label goods in market definition.

The antitrust agencies have grappled with the proper treatment of private label goods in a number of merger cases over the last ten years. A merger in the hot cocoa mix industry provided the first instance at the FTC in which private labeling was a key issue. Subsequently, mergers in other industries—spice, flour, pet food, soft drink bottling, tuna fish, and ice cream, among others—involved similar FTC and DOJ inquiries. In the spice industry, for example, the FTC staff appears to have found that generic and private label sellers do not market a "full line" of spices, and therefore should not be included in a product market that encompasses a complete line. By contrast, the staff appears recently to have found that possession of a brand name was not a central factor in competition among cat food producers, and that private label cat food should be included in a product market with branded cat food.

Among the indicia that the antitrust agencies appear to look at when considering whether to include private label goods in the product market are (a) differences between branded and nonbranded products either in physical qualities or more subtle product attributes such as reputation or quality assurance, (b) proprietary secrets, patents, or know-how relating to formulation that branded producers enjoy, (c) rates of repeat purchase of individual brands and of all brands relative to private label goods, (d) seasonality of demand which indicates that consumers may be less brand-loyal for a product purchased infrequently, (e) prices of some private label products above and others below prices of branded products, (f) indirect purchases on behalf of consumers such as children perceived to be less sensitive to quality differences, and (g) econometric estimates of relevant elasticities such as the price elasticity of demand for branded products.

The most recent visible enforcement activity in which the issue of private label products was para-

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mount was an FTC administrative proceeding and subsequent appeal concerning Coca Cola Bottling Company of the Southwest's acquisition of the Dr. Pepper and Canada Dry franchises of San Antonio Dr. Pepper Bottling Company. The ALJ allowed the merger based largely on the conclusion that the proper product market included nonbranded carbonated soft drinks. The ALJ's finding was based on evidence that (a) branded and nonbranded carbonated soft drinks competed against one another in a broad sense, (b) branded and nonbranded carbonated soft drinks had similar functional characteristics such as taste and formula, (c) branded market shares fell relative to nonbranded shares during a period when branded prices rose relative to nonbranded prices, and (d) some parallelism existed between the price movements of branded and nonbranded carbonated soft drinks over time.

The Commissioners, however, overturned the ALJ's findings, arguing that bottler competitors in the Southwest Texas area had testified explicitly that the branded carbonated soft drink bottlers in San Antonio could profitably raise their prices by 10 percent. In addition, the Commissioners found insufficient parallelism between branded and nonbranded price movements to justify a single market. Finally, they determined that evidence of falling branded market share during an episode of rising prices of the branded products represented the loss of "marginal" consumers who were not numerous enough to defeat the price increase which remained in effect. As such, the proper market definition should be branded carbonated soft drinks.

The treatment of private label and generic products in defining product markets presents difficult analytical and empirical issues. Moreover, economic theory provides little firm guidance on the issue. As with other issues in antitrust enforcement, the Merger Guidelines provide a sound policy of case-by-case assessment of the facts.

Senior Economist Robert D. Stoner previously was an economist at the Federal Trade Commission and has worked on a number of mergers in consumer goods industries where treatment of private label sales has been an important market definition issue.

A FUTURE FOR ELECTRICITY FUTURES?

The wholesale market for electricity is becoming increasingly competitive, with transactions based more and more on prices set by market forces rather than regulation. Producers and consumers of electricity will face new financial risks as a result of the changing market environment. A proposed futures contract for electricity may help manage these new risks, and provide market participants with information on prices as well.

Spot prices, and the underlying supply of and demand for electricity, have always been subject to large short-term and long-term variations which pose uncertainty to generators of electricity and their customers. Historically, price risks have been managed through long-term power contracts and rate regulation, but this is changing. Gradual improvements in communications and computer technology related to the transmission of electricity have expanded the geographic scope of markets so that electricity production facilities are generally not regarded as natural local monopolies, but rather as part of a regional network that has at least the potential for competition. Moreover, significant legislative and regulatory changes are affecting the pricing of electricity and the structure of the industry. Competition in the generation of electricity has been enhanced by the Public Utility Regulatory Policy Act and the Energy Policy Act. The Federal Energy Regulatory Commission is broadening access to transmission service by requiring comparable service tariffs as a condition for approval of many kinds of transaction agreements. State public utility commissions are testing methods of incentive regulation or other variations on the traditional rate of return model.

These changes pose new risks for utilities, independent power producers (IPPs), and consumers. Utilities face risks that increased competition will render investments or contracts uneconomic. IPPs and industrial users will be exposed to greater price risks as long-term contracts that guarantee price and quantity are replaced by shorter term transactions. Consumers, who are accustomed to stable electricity rates, could begin to see prices that vary with supply and demand conditions.

Risk management instruments are emerging in response to the changing competitive environment. Electricity forward agreements are being brokered in the United Kingdom, an electricity futures contract

has just begun trading in Norway, and an electricity futures contract may be introduced by the New York Mercantile Exchange by early 1996. Derivative instruments, particularly futures contracts (which allow buyers and sellers to lock in the future price of a commodity) and options contracts (which allow the buyer to set a cap or floor on price fluctuations in the underlying commodity), can help manage the financial risks associated with an increasingly competitive market environment. While traditional long-term power contracts provide both electricity and insurance against adverse price moves, derivatives would allow entities to separate their power transactions from their insurance transactions—conducting each with whoever offers the best price. Power could be bought and sold on the spot market, and insurance against unforeseen price changes could be obtained with derivatives.

Futures markets also function as a price discovery mechanism. Because futures prices represent the collective prediction of large numbers of buyers and sellers, they are a valuable pricing tool for participants. Even those who do not participate directly in the futures market are likely to benefit by its existence. Futures prices are widely reported and readily accessible. Thus the market price for electricity can more easily be observed than through reports of prices negotiated between private parties. As a result, futures can aid in forecasting and planning decisions, such as whether to build new capacity, commit to a contract to purchase power, or invest in demand-side management. Regulators may begin to rely on futures prices in their prudence reviews, which would benefit utilities by removing some of the uncertainty associated with regulators' decisions. If the futures contracts are long enough (and regulators permit it), utilities could even protect against rate base disallowances by hedging with futures and options.

Whether electricity is a commodity that will lend itself to successful futures trading remains to be seen. Some electricity characteristics, such as the homogeneity of a kilowatt-hour, make it an excellent candidate, while others, such as the extreme importance of the time and place of delivery and the variation in regional supply and demand conditions, will require careful design to create a successful contract.

Susan E. Dudley, EI Director of Environmental Analysis, evaluated the potential impact of electricity futures on utilities for the Edison Electric Institute.

FREE TRADE AND ANTITRUST IN PANAMA

The Government of Panama is implementing a new economic program of free market reforms. This program includes reducing tariff and nontariff trade restrictions, privatizing certain state-owned companies, and allowing prices to respond to market forces. A key part of the policy is an antitrust law supported by an effective enforcement agency and judicial body. These play fundamental roles in facilitating the functioning of markets.

Panama is well-situated to serve as a hub for international trade and commerce because a significant portion of the world's trade passes through the Panama Canal. Nevertheless, the Panamanian economy has not reaped the full benefits of trade and competition. Economic growth and efficient performance of its firms have been thwarted by cartels and import restrictions. The Panamanian constitution nominally outlaws anticompetitive behavior, but, because there is no enforcement mechanism, this law has been ignored. Indeed, restrictions on trade and competition have historically been supported by government policies and agencies. High duties and other restraints are imposed on imports. New entrants into many lines of business face restrictive licensing. So-called "health regulations" severely limit the number of firms permitted to operate in some markets. Government-supported cartels are widespread, especially in the agricultural sector for products such as beef, corn, milk, onions, rice, and tomatoes, but also for petroleum and other key products. Domestic prices for many agricultural products are two to three times the prevailing world levels.

In the fall of 1994 USAID sponsored a team of lawyers and economists to assist the Government of Panama in drafting the legislation necessary to promote free markets. Panama's draft antitrust law is modeled after the antitrust laws of Mexico and the United States. The basic structure of the Mexican statute provided the more appropriate model because the Panamanian and Mexican systems are both based on European civil law, as opposed to the U.S. system which is founded in English common law. The main provisions of the draft law concern horizontal restraints of trade, mergers, and abuses of monopoly

SELECTED EI CASES IN 1994

Defense Industry Mergers: Working with O'Melveny & Meyers on behalf of Lockheed, EI Principal Philip B. Nelson analyzed competition in satellites, launch vehicles and other defense products in Lockheed's merger with Martin Marietta. He also worked with Hogan & Hartson on the sale of General Dynamics' launch vehicle business to Martin Marietta.

Hospital Merger: EI Senior Economists John H. Preston and Margaret E. Guerin-Calvert worked with King & Spalding; Munger, Tolles & Olson; Jones, Day, Reavis & Pogue; and Collier, Shannon, Rill & Scott to analyze Charter Medical's multimarket psychiatric hospital acquisition from National Medical Enterprises.

Satellite Acquisition: EI Principal Peter R. Greenhalgh and Senior Economist John H. Preston assisted Hogan & Hartson in gaining clearance for GE Americom's acquisition of GTE's commercial satellite business. Their analysis focused on properly identifying available capacity given existing lease and sales agreements.

Home Health Care Litigation: EI Principal Barry C. Harris and Senior Economist David A. Argue helped Post & Schell, Dechert Price & Rhoads, and others win summary judgment on behalf of home health provider Liberty Health Systems and its hospital owners. Plaintiff alleged restraint of trade and monopolization.

Cleveland TV Agreement: In defense of a proposed local marketing agreement between TV stations WUAB and WOIO, EI Principal Joseph W. McAnneny and Senior Economist Michael G. Baumann worked with Dow, Lohnes & Albertson to persuade DOJ that broadcast TV advertising competes with advertising in other media.

British Telecom/MCI Joint Venture: A proposed global network joint venture between British Telecom and MCI cleared U.S. antitrust authorities after a competitive analysis performed by EI Senior Economists John H. Preston and Robert D. Stoner, who worked with Hogan & Hartson on behalf of British Telecom.

power. Horizontal restraints will be subjected to a *per se* standard, while other matters will be judged by a "rule of reason." The law will also allow private class actions to be filed in response to anticompetitive behavior. The merger law, a first for Panama, is intended to prevent disbanded cartel members from circumventing the new anticollusion measures by merging. Few mergers in a small open economy are likely to be anticompetitive because imports generally provide adequate competition. Any anticompetitive mergers that do occur are most likely to be in small service or other industries in which international trade cannot provide adequate competition. The prenotification standard is intended to be set low enough to detect firms merging in domestic industries not disciplined by imports, yet high enough that the antitrust authorities can limit the use of their scarce resources to reviewing the most important mergers.

The draft law also includes a provision to allow the antitrust authorities to intervene in regulatory hearings and other government proceedings to advocate procompetitive policies. It authorizes the antitrust authorities to develop educational programs to spread information about the new law and enforcement policies. Additionally, the draft law repeals those parts of existing laws and decrees that have restricted competition. All of these measures are intended to facilitate introduction of the concept of free competition to the Panamanian economy. This can be especially difficult in countries such as Panama where government institutions have traditionally played an active role in regulating prices and limiting entry and trade.

Currently, support for opening the economy is broad among Panamanians and has been advanced by the two most recent national governments. The draft law, which must be approved by the legislature before it can be enacted, should be submitted to the legislature in early 1995. Enactment of the new antitrust laws and strengthening enforcement has the promise to greatly improve Panama's economy. Exposing the Panamanian economy to the twin disciplines of unprotected international trade and open competition within its borders will make Panamanian firms more efficient and allow the economy to grow.

EI Senior Economist David D. Smith was the chief economic advisor to the Government of Panama for the drafting of its antitrust law. In 1992 he was on a team, headed by EI President Bruce M. Owen, to draft a new antitrust law for Argentina.