

Conwood Companies, LP v. United States Tobacco Company -

Has the US Sixth Circuit Merged With DGComp?

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For the reader who does not want to have his or her mind confused by facts and details, just consider the following questions:

1. When is business activity designed to increase sales at the expense of a competitor in a way that the EC would call an “abuse of dominance” also considered sufficient to support cause of action for a treble damages meeting the rigorous standards of § 2 of the Sherman Act?
2. When can a Court sustain a finding of monopoly power in a national product market despite undisputed evidence that the number of competitors increased the number of competing brands increased, sales volumes of competitors increased, and no competitor was forced to exit?
3. Where can you find a Court willing to accept the proposition that evidence that the plaintiff’s sales and market share has *increased* in certain states within the allegedly national market is nonetheless fully consistent with the proposition that there has been monopolization of the national market, and then agree that this evidence of sales increases in areas where the plaintiff competed and succeeded can be used by an expert to calculate damages allegedly caused by monopolization in areas where the plaintiff did

not compete by employing the competitive strategies and alternatives that were successful elsewhere.

5. Where can you find a Court that will allow an expert to testify that a competitor should reasonably expect that its growth in the first ten years following entry (from a 0% market share to an 11% market share) will be replicated during the next 10 years, so that an increase in market share of 2.5% (to 13.5%) amounts to proof of antitrust injury? And what Court allows the expert to assert that he tested “all plausible explanations” after admitting that he only tested those explanations “for which I had data,” and admitting that his data set was limited?

6. Where can you find a trial court and a Court Appeals which will describe the requirements for a Sherman Act monopolization case as ones that can be satisfied by “repeated unethical activity which is exclusionary without a legitimate business justification,” describe “exclusionary” conduct as “predatory,” and --by quoting some words from the Supreme Court’s decision in *Aspen Skiing Co. v. Aspen Highlands Skiing Co.*, 472 U.S. 585 (1985) -- define “exclusionary” as any effort to exclude rivals which is based on something other than efficiency?

The simple answer is *Conwood Company, L.P. v. United States Tobacco Co.*, 290 F.3d 768 (6th Cir. 2002). A more complete answer is: You can find this kind of result anywhere, if --

- ◆ The defendant concedes at the start of the case that it has monopoly power.
- ◆ Your CEO admits that he is “embarrassed” by the conduct and trial testimony of his officers.

- ◆ All you can say in response to the plaintiff's case is that they did not show enough to make a claim, and you have no affirmative case to explain your conduct.

The recent experience of the United States Tobacco Company ("USTC") in defending against the claims of its competitor in the sale of "wet snuff," Conwood Company, L.P., satisfies all foregoing prerequisites. It is antitrust opinion which is analytically questionable, if not also a prime example of "bad facts make bad law." But the outcome, in retrospect, is not surprising. Doctrinal issues get honed at the intersection created by the clash of two positive arguments that are in tension. They get submerged when, as, in Conwood, the evidence of bad acts is overwhelming. "Bad facts" can transform a traditional, rule-bound § 2 Sherman Act monopolization case into a lawsuit that focuses on (and is decided on) "abuse of dominant position" standards -- no different than if the proceeding had taken place in Brussels instead of before a jury in Kentucky.

Having posed the questions, and provided the answers, some readers may wish to know more about the facts!

Between 1911 and 1970, USTC was the only seller of "wet snuff." It thus had a 100% market share. But since 1970, its national market share was on the downslide, falling to 87% in 1990 and then to 78%. During that period, Conwood grew to 11% and then 13.5%. At the same time, output increased. The three new competitors introduced 24 new brands. The total volume of wet snuff being sold by all sellers taken together increased, by 16 million pounds. In addition none of the new competitors exited the business. And the other two firms in the market, who were competitors of USTC and Conwood, and which had only 2% of the market in 1990, moved up to an 8.5% market share in later years.

USTC's decline from 100% would usually be seen as an indication that this high market share number, standing alone, would not support a finding that USTC had exercised market power. Most antitrust analysts looking at the economic details would have taken the fact that Conwood was able to grow from a zero position to an 11% market share between 1978 and 1990, and then to 13.5% by 1999, as proof that competition was functional, if not vigorous. Moreover the other two small competitors grew from a collective 2% share to a collective 8.5% share by 1999. In other words, they grew in absolute numbers and at a rate of growth far greater than did Conwood. There was also evidence that Conwood was not equally successful in all markets . Not only is that a wholly unremarkable fact, but not surprisingly, Conwood's sales penetration grew at a faster rate in areas where it had a strong early foothold than it did in areas where it did not. One would expect as much. If Conwood had \$1.00 to spend on enhancing its sales, it would be logical to spend it in areas where it had achieved success, and illogical to spend it in areas where its competitors had greater strength. Such details would usually be cited as proof that the market was dynamic in a positive way, even with a player with a dominant 78% share.

But this is not a "usual" case.

Conwood filed an action against USTC in the United States District Court for the Eastern District of Kentucky in 1999. Discovery, motions, a jury trial, a verdict and an appeal followed . A few weeks ago, on May 15, 2002, the United States Court of Appeals affirmed the jury verdict and judgment requiring USTC to pay Conwood **over \$1 Billion** (\$1,050,000 to be exact) plus attorneys' fees to Conwood

At trial, the jury -- properly instructed as to the nuances of monopolization under Section 2 of the Sherman Act -- found that USTC exercised monopoly power to injure Conwood and -- accepting the "analysis" put forward by Conwood's damage expert, that its conduct had that

injurious affect. The jury, the trial judge and the Court of Appeals all found USTC's explanation that any acts of improper behavior were "no more than isolated sporadic torts" was an excuse contrary to the evidence.

The claims that Conwood's expert failed to meet the standards of *Daubert v. Merrell Dow Pharm. Inc.*, 509 U.S. 579 (1993), were rejected. Instead, the Court of Appeals invoked the typical mantra that "these are matters which are traditionally addressed by vigorous cross-examination and presentation of contrary evidence" rather than exclusion of expert testimony.

The evidence which allowed the jury to find a pervasive, orchestrated scheme involving exercise of monopoly power, provides most of the explanation for the result:

- USTC personnel provided false sales information to major customers (who had tasked them, as a "category manager," with tracking such data for all brands) inflating USTC's actual sales, and thus leading those retailers to reduce shelf space for Conwood.
- USTC personnel knew that retail managers did not pay attention to the marketing of this minor product line and took advantage of that fact.
- When local data indicated that non-USTC brands were winning consumer acceptance, USTC referred to national data instead, covering up actual market trends.
- USTC personnel wrote memos stating that they were taking steps to "reject competition on the merits" and to limit "value-priced" competition.

- USTC used point-of-sale displays designed to provide space for competitors along with USTC products in order to impair the competitors' positioning, while making it more difficult for competitors to put in their own independent displays.
- When USTC sales representatives restocked or arranged displays, they would routinely remove and junk Conwood displays (often with no authority to do so).
- As the positioning of competitive products was reduced, USTC raised prices to retailers and consumers -- often a normal reflection of strong brand preference and inelasticity of demand, but in this case "proof" that the goal of a price increase without competitive loss was the driving force..

In the face of this evidence, USTC's Chairman was forced to tell the jury that he was "embarrassed by the evidence."

Antitrust lawyers can argue about whether USTC should have admitted that it had "monopoly power." In U.S. antitrust practice it might have been useful to draw the line at a more precise point; namely, that a 78% market share often indicates monopoly, but successful efforts by such firms do not necessarily prove monopoly power and do not necessarily involve the exercise of monopoly power. But USTC apparently had no positive "story" to deliver.

Moreover, the evidence concerning USTC's role as a "category manager" was, at best equivocal, since USTC had apparently deliberately misused this role with its principal _____,

"Category manager" is not a pejorative (or monopolistic) term. In modern distribution practice, major customers recognize that they are able to shift the cost of certain functions, such as tracking sales and margins in an overall product category, to their major suppliers. The

suppliers who act as “category managers” are supposed to provide data and margin-enhancing recommendations to the retailer. The retailers remain in charge with full decisional authority. But USTC recognized that many “category management” situations are de facto, “category management abdication. USTC thus acted to abandon their category management obligations and, instead, used the “category management” position to advance their own business interests.

What can we learn from *Conwood*? One should not treat the decision as an aberration, or as an instance in which the United States Court of Appeals for the 6th Circuit thought there were the European Commission. There are some lessons:

- At trial, lawyer’s arguments are “too little, too late”. Carefully crafted analysis of legal technicality only matters when the legal arguments correspond to the business reality. Business reality is seen in what businesspersons actually do and, most importantly, what they say and write about what they do.
- Always look for one “affirmative case” that explains your conduct. If there is no affirmative case to explain the activity under scrutiny and the only explanation is “we did wrong but we only did it sporadically”, chances are you have been going down the wrong path from the start. An “affirmative case” is based on the answer to the following question: “If you were faced with the following challenge (such as declining sales, or a challenge from a franchisee violating a competitive restriction in the franchise contract) is your conduct the kind of response that (a) is lawful; (b) is of a character that the average person would expect you to make and makes good sense.” USTC could not assert that it was simply playing the competitive “game” as it was meant to be played and its employees’ memos reflected a sense of arrogance that seems to have been encouraged by top management.

- The we were there “Keystone Kops” defense is a loser. Jurors, and, increasingly, judges, will reject a company’s claim that “Wed didn’t know what was going on.” Jury research shows that people expect franchisors to know what they are doing. It goes with the position.
- If your Chairman or CEO really is “embarrassed”, it means that the firm did not have *any* compliance program. An effective compliance program is essential in all business operations . The motto should be “Que sera, C-E-R-A” or “Whatever will be, C-E-R-A: The “C-E-R-A” acronym gives the elements: C--conditioning employees toward compliance by leadership; E--education; R--reinforcement; and A-audit.

In the end, *Conwood* is a strong reminder to lawyers and clients that becoming enmeshed and entranced by the “jots and tittles of the law” cannot be a substitute for understanding the broad principles on which antitrust doctrine rests, and making sure that business conduct, at all levels, is measured against that standard.