KIRKLAND & ELLIS Alert

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SIXTH CIRCUIT DECISION RE-AFFIRMS NEED FOR HEIGHTENED CARE WHEN MARKETING PRACTICES AFFECT SMALLER COMPETITORS

The number of monopolization cases has been increasing, spurred by the Department of Justice's "win" over Microsoft and the increased concentration caused by the incredible merger wave of the 1990's. But we can expect the recent affirmation of a $1.05 billion award by the Sixth Circuit in *Conwood Co. v. United States Tobacco Co.*, 290 F.3d 768 (6th Cir. 2002), *cert. denied*, – U.S. – (Jan. 13, 2003), to have an even greater impact.

The *Conwood* decision stands as a sobering wake-up call for large consumer product manufacturers, especially those serving as "Category Captains" for large retailers.

While the FTC has previously threatened enforcement action against anticompetitive category management practices that (i) facilitate collusion among retailers or manufacturers or (ii) exclude smaller competitors (or raise their costs), *Conwood's* $1 billion treble damages verdict certainly drives home the liability risk. *Conwood* provides excluded competitors with a glimmer of litigation hope and suggests that they may begin documenting exclusionary acts that affect their business with litigation in mind. *Conwood* also highlights the need to take a close look at marketing conduct beyond the practical control of high-level executives. In particular, it reminds us of the need for effective, top-down antitrust training and compliance procedures.

In *Conwood*, the defendant, United States Tobacco Co. ("UST"), had 75 percent of a niche market – U.S. moist snuff. This is a very narrow market definition, but one UST was unable to rebut. This high share in a niche market was sufficient to establish UST's "monopoly power" and give rise to a higher standard of care and greater antitrust scrutiny.

Conwood, the plaintiff, was one of only four competitors in the U.S. moist snuff market. Its market share growth, after an initial spurt, had begun to plateau by the time UST's alleged anticompetitive conduct began. At the time of trial, Conwood's market share stood at only 13 percent. UST's liability and the huge damages award were based entirely on the amorphous claim that Conwood would have grown faster had UST behaved appropriately.

Conwood claimed UST "misused its position as category manager" and otherwise engaged in exclusionary conduct to limit Conwood's success. Specifically, UST allegedly "exclude [d] competition by ***suggesting*** that retailers carry fewer [competing] products," attempted to "control the number of price value brands," and suggested that stores stock UST's "slower moving products" instead of the better selling products of competitors.

Conwood also identified certain, more egregious market behavior by UST. For example, UST allegedly removed Conwood's critical "point of sale" displays without sufficient authorization. (POS displays were critical in the moist snuff market because of the limits on tobacco advertising). UST also took advantage of "inattentive store clerks with various 'ruses'" (such as obtaining permission to "reorganize or neaten the section"), provided "misleading information to retailers," and entered "into exclusive agreements in an effort to exclude rival's products."

UST's defense – that the conduct was "sporadic", amounted to no more than "insignificant tortious behavior, and constituted ordinary marketing services" that did not "injure competition" – held no sway with the court. Nor did the court credit the fact that retailers make the ultimate stocking decisions.

Conwood involves extreme circumstances, to be sure. But it also focuses attention on how a lack of appropriate controls over field sales personnel can create significant antitrust risk, and how seemingly independent or isolated acts can be weaved together to present a persuasive anticompetitive story.

In the end, as in most antitrust cases, UST was undone by its own documents and the self-serving testimony of competitors. UST's documents revealed a "plan" to stem the introduction of competing lower-priced brands. Sales representatives bragged about how they excluded competitors. Managers and executives exhorted their people to be aggressive in getting rid of competitors. Competitors similarly testified about the difficulties they faced in counteracting UST's influence over shelf space.

Conwood succeeded by casting aspersions on what seemed – when viewed in isolation – to be legitimate business activity; for example, reacting competitively to new entrants. Conwood also faulted UST for providing misleading or "skewed" – ***but truthful*** – data to retailers, claiming, for example, that UST should have used local, rather than national, sales data. Likewise, Conwood recovered "damages" for lost sales even where the retailer ***consented*** to the removal of competitors' displays or product.

For major consumer products companies, *Conwood* provides an opportunity to re-emphasize core principles:

- ***First***, firms with high shares (even in narrowly defined markets) must exercise heightened care when taking actions affecting smaller rivals, including actions affecting shelf space.

- ***Second***, when placed in a position of "trust" by a retailer, as when acting as "category captain," information provided to the retailer must be truthful and unbiased, and designed to grow the category overall.

- ***Third***, the sales force must be trained, regularly reminded, and incentivized to refrain from coercive or misleading sales tactics.

- ***Fourth***, there should be thorough antitrust review of retailer arrangements affecting rivals' access to shelf space.

- ***Fifth***, executives must become sensitized to the consequences of written comments and the need to emphasize ***procompetitive*** rationales for all business conduct.

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For More Information

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