IN THE

# Supreme Court of the United States

UNITED STATES TOBACCO COMPANY, UNITED STATES TOBACCO SALES AND MARKETING COMPANY INC., UNITED STATES TOBACCO MANUFACTURING COMPANY INC., UST INC.,
*Petitioners*,

v.

CONWOOD COMPANY, L.P., CONWOOD SALES COMPANY, L.P.,
*Respondents*.

**Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit**

## PETITION FOR A WRIT OF CERTIORARI

ERNEST GELLHORN
*Counsel of Record*
LAW OFFICE OF ERNEST GELLHORN
2907 Normanstone Lane, N.W.
Suite 100
Washington, D.C. 20008-2725
(202) 319-7104

*Counsel for Petitioners*

NEAL R. STOLL
JAMES A. KEYTE
CHARLES S. LENT
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036-6522
(212) 735-3000

JOHN S. REED
RIDLEY M. SANDIDGE
REED WEITKAMP SCHELL & VICE PLLC
500 W. Jefferson Street,
Suite 2400
Louisville, Kentucky 40202
(502) 589-1000

October 17, 2002

## QUESTIONS PRESENTED

1. Whether liability under section 2 of the Sherman Act, 15 U.S.C. § 2, may be based on a manufacturer's misleading "suggestions" and "recommendations" to retailers where there is no foreclosure of the competitive process or of a substantial portion of the market.

2. Whether the largest damages award in the history of the antitrust laws ($1.05 billion) may be imposed without disaggregating the effects of lawful competition or other marketplace factors and without linking plaintiff's injury to any antitrust misconduct.

## RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Petitioners United States Tobacco Company (now U.S. Smokeless Tobacco Company), United States Tobacco Sales and Marketing Company Inc. (now U.S. Smokeless Tobacco Brands Inc.), United States Tobacco Manufacturing Company Inc. (now U.S. Smokeless Tobacco Manufacturing Limited Partnership), and UST Inc. make the following disclosure:

> Petitioner UST Inc. is a publicly owned corporation, the stock of which is traded on the New York Stock Exchange as "UST." U.S. Smokeless Tobacco Company is a direct wholly owned subsidiary of UST Inc. U.S. Smokeless Tobacco Brands Inc. is a direct wholly owned subsidiary of U.S. Smokeless Tobacco Company. U.S. Smokeless Tobacco Manufacturing Limited Partnership is a partnership, the two partners of which are direct wholly owned subsidiaries of U.S. Smokeless Tobacco Company.

## TABLE OF CONTENTS

TABLE OF CONTENTS—Continued





TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued





TABLE OF AUTHORITIES—Continued

IN THE

# Supreme Court of the United States

No. ___

UNITED STATES TOBACCO COMPANY, UNITED STATES TOBACCO SALES AND MARKETING COMPANY INC., UNITED STATES TOBACCO MANUFACTURING COMPANY INC., UST INC.,

*Petitioners,*

v.

CONWOOD COMPANY, L.P., CONWOOD SALES COMPANY, L.P.,

*Respondents.*

**Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit**

## PETITION FOR A WRIT OF CERTIORARI

## OPINIONS BELOW

The Sixth Circuit decision from which this appeal is taken (App. 1a) is reported at *Conwood Co. v. United States Tobacco Co.*, 290 F.3d 768 (6th Cir. 2002). The district court opinion denying petitioners' post-trial motion for judgment as a matter of law and motion for a new trial, or in the alternative, a reduced damages award (App. 46a), is reported at 2000 U.S. Dist. LEXIS 12797 (W.D. Ky. Aug. 10, 2000).

## JURISDICTION

The judgment of the United States Court of Appeals for the Sixth Circuit was entered on May 15, 2002. A timely petition for rehearing was denied on July 19, 2002. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

Section 2 of the Sherman Antitrust Act, 15 U.S.C. § 2, and section 4(a) of the Clayton Act, 15 U.S.C. § 15(a), are reproduced at App. 78a.

## INTRODUCTION

In a sweeping decision with profound implications for antitrust policy and competition, the Sixth Circuit applied section 2 of the Sherman Act to condemn a dominant firm's legitimate business conduct and to impose Brobdingnagian damages of $1.05 billion without showing that defendant's conduct impaired competition and without limiting the damages award to the unlawful conduct of the defendant. In conflict with the Fifth Circuit's decision in *Stearns Airport Equip. Co. v. FMC Corp.*, 170 F.3d 518 (5th Cir. 1999), the court condemned aggressive nonprice competition that is integral to the everyday competitive process. The Sixth Circuit's ruling that defendant's conduct harmed competition directly conflicts with decisions in several circuits requiring proof of "substantial foreclosure" of the marketplace. *See, e.g., United States v. Microsoft Corp.*, 253 F.3d 34, 87 (D.C. Cir.), *cert. denied*, 122 S. Ct. 350 (2001). Moreover, contrary to the Eighth Circuit's decision in *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir.), *cert. denied*, 531 U.S. 979 (2000), and the Ninth Circuit's decision in *Image Tech. Servs., Inc. v. Eastman Kodak Co.,* 125 F.3d 1195 (9th Cir. 1997), *cert. denied*, 523 U.S. 1094 (1998), the Sixth Circuit upheld a damages judgment that failed to disaggregate the effects of lawful competition or other marketplace factors and that failed to link the claimed injury and damages to any specific illegal monopolization conduct.

Defendant, the leading manufacturer of moist snuff, aggressively marketed its products to retailers in the 1990s through category management services, innovative display racks, and customer incentive programs. Plaintiff, the second



largest manufacturer, asserted that defendant misled retailers through category management recommendations, duped store clerks into using defendant's exclusive display racks (which housed all competitors' products), used incentive payments to gain in-store advertising advantages, and removed plaintiff's display racks and in-store advertising without retailer authorization. Ignoring contrary authority from other circuits, as well as this Court's admonition not to federalize state tort law, the Sixth Circuit found that section 2 liability may be based on a monopolist's "misleading" sales practices and tortious acts when carried out with the intent to increase sales at the expense of rivals. Also in conflict with several circuits, the court found harm to competition without requiring proof that plaintiff was foreclosed from participating in the competitive process or that a substantial portion of the market was foreclosed to the competitive efforts of plaintiff and other firms.

In upholding the jury's unprecedented damages award, the Sixth Circuit ignored basic requirements approved by other circuits that antitrust damages (i) disaggregate the effects of lawful competition and other marketplace factors affecting plaintiff's sales and (ii) link claimed injuries to specified antitrust misconduct. By rejecting these limiting principles, the Sixth Circuit trivializes the antitrust injury requirement of section 4 of the Clayton Act and invites unbounded damages awards that force a defendant to pay for injuries for which it is not responsible.

The decision below warrants review because it abolishes principled limits and strict judicial oversight of private treble damages actions. Left undisturbed, the Sixth Circuit will become a haven for massive antitrust damages claims based on little more than aggressive or unfair nonprice competition by dominant firms. That will chill competition, not promote it.

## STATEMENT OF THE CASE[1]

Conwood, the plaintiff-respondent, filed this private treble damages action against USTC, the defendant-petitioner, for antitrust violations and damages that it asserted occurred between 1990-97 (the alleged violation period). The jury found USTC liable for a violation of section 2 of the Sherman Act and awarded damages of $350 million which the district court trebled to $1.05 billion.

### 1. The Parties And The Changing Demands Of Retail Customers

Moist snuff is a smokeless tobacco product sold in retail stores throughout the country. USTC's primary brands are Copenhagen and Skoal, and Conwood's is Kodiak. In addition, Swedish Match North America, Inc. ("Swedish Match") produces Timberwolf, a discount brand, and Swisher International Group ("Swisher") sells niche brands.

Approximately 300,000 retail stores offer moist snuff. App. 23a. Chain stores, mass merchandisers, drug stores and convenience stores account for approximately 60% of sales. The relationship between moist snuff manufacturers and retailers changed in the early 1990s when retailers requested expanded services to help them use product space more efficiently, control inventories, and increase profitability. *Id.* at 6-7a.

Retailers uniformly testified that they retained the decision-making authority over the products, displays and point-of-sale advertising ("POS") in their stores, and Conwood's Chief Executive Officer, William Rosson, acknowledged that "he could not name one store that gives final decision-making power over its snuff section to his company's competitors."

[1] The parties listed in the caption, *United States Tobacco Company, et al.* and *Conwood Company, L.P., et al.*, are referred to herein as "USTC" and "Conwood."



Retailers were not bound by long-term exclusive contracts; they testified that they controlled the products, display racks and POS in their stores. *Id.* at 26a.

#### a. Category Management

Category management is an industry practice used by retailers to make optimal shelf space and product assortment decisions based on analyses of sales data and other market information. Manufacturers become involved in the process by making suggestions and recommendations and by challenging their rivals' proposals. Retailers test these suggestions against their own independent analyses and make the final decisions. *Id.* at 7a. Conwood did not offer category management services. *Id.* at 6a n.1, 7a.

No retailer testified that USTC abused its category management position. However, interpreting documentary evidence, Robert Blattberg, a Conwood expert, testified that in certain "instances" USTC misled retailers with false data. *Id.* at 10-11a. He asserted that USTC had violated the trust of the category management relationship by seeking to control rival distribution, limit the growth of competitors' price-value brands, and increase USTC's distribution and sales at the expense of its competitors. *Id.* at 10-11a, 27a.

#### b. Competition For Rack Innovation And Placement

Many retailers in the early 1990s (particularly chains) requested that manufacturers design display racks to house the moist snuff products of all companies in a single rack—so-called "exclusive racks"—to reduce shelf space, facilitate inventory control and display all brands uniformly. *Id.* at 6a. USTC and Swisher offered these racks and won exclusive rack competitions at several chains, including K-Mart (Swisher) and Wal-Mart (USTC). In contrast, Conwood did not develop an exclusive rack, and therefore did not participate in these competitions. *Id.* at n.1. A manufacturer providing an exclusive rack often obtained a competitive advantage by placing its POS on the rack's header card. *Id.* at 5-6a.

Chain store witness testified that USTC did not remove any racks without permission and did not mislead their store personnel. Conwood, however, presented testimony from its sales personnel, several former USTC employees, and four small retailers, and documentary evidence that some USTC sales personnel removed Conwood racks without permission and that some of USTC's rack placements were obtained by "misleading" or "dup[ing]" inattentive store clerks. *Id.* at 12-15a, 22a. Conwood sales personnel also testified that they spent substantial time reinstalling racks, products and POS. Mr. Rosson testified that Conwood spent $100,000 per month to replace up to 20,000 racks across 300,000 stores. *Id.* at 12a, 25a.

Conwood challenged the legality of all USTC exclusive rack agreements with retailers, including the *authorized* removal of thousands of Conwood racks that resulted from approved store resets made in response to retailer requests and that followed accepted business practices. JA 1271-74, 2771-77; *see also* App. 6a n.1. Conwood admitted that retailers often switched back and forth between exclusive and multiple rack formats, JA 2801, and its sales representatives testified that they were successful 95% of the time in persuading stores using exclusive racks to return to a multiple rack format. App. 13a. Conwood did not present any evidence showing the number or location of racks removed without retailer authorization. Nevertheless, the Sixth Circuit concluded that a jury could infer that USTC's unauthorized removals of Conwood's racks, products and POS were "pervasive." *Id.* at 30a.



**c. Retailer Incentive Programs**

In the 1990s, moist snuff manufacturers, again except for Conwood, offered incentive programs for retailers. USTC's Customer Alliance Program ("CAP") was typical. For a payment of 3-8¢ per 10-can roll sold (less than 0.3% of the wholesale price), retailers collected sales data for USTC, participated in USTC promotions, and granted preferred rack or POS placement to USTC. *Id.* at 12a. These agreements were without term and retailers could cancel them without penalty. CAP payments were based on sales and not on the number of USTC products stocked by the retailer. JA 2995-97.

**2. The Performance Of Conwood And Its Rivals In The 1980s And 1990s**

By 1983, four years after Conwood first entered the market, its products achieved a 7.7% national market share. Thereafter, its performance leveled off. Conwood gained only 2.9 percentage points between 1983-90 (the comparable non-violation period) and 3.0 points between 1990-97 (the alleged violation period). JA 2787. In the 1980s and 90s, USTC's national market share dropped from 97 to 77%. During the alleged violation period, the collective market share of USTC's competitors nearly doubled. JA 2786; *see* JA 3768-70.

Overall output of moist snuff increased sharply during the 1990s with sales of moist snuff reaching 135% of their 1990 level and the number of brands increasing from 28 to 40. In 1994, Swedish Match introduced Timberwolf, which captured 7% of the market within four years. Moist snuff manufacturers increased their sales, profits and prices in the 1990s. Conwood's profit margins increased substantially during the 1990s, JA 3787-90; its margins in moist snuff were substantially higher than any other segment of its business, JA 3796-98; and its return on equity soared from 33 to 75% between 1991-98. JA 3794.

### 3. Plaintiff's Damages Evidence

#### a. Dr. Leftwich's Analysis

In support of its claim for as much as $488 million in pre-trebled damages, Conwood offered the testimony of Dr. Richard Leftwich, an expert in business valuation. Leftwich was asked to test Conwood's hypothesis that USTC's misconduct across state lines in the 1990s prevented Conwood from increasing its market shares in the states in which it had not performed well in the 1980s—i.e., where it had not established a foothold (so-called "low share" states). The hypothesis assumed that Conwood's ability to compete in states in which it had achieved a foothold as of 1990 (so-called "high share" states) was not significantly affected by USTC's alleged misconduct. Based on conversations with Conwood personnel, Leftwich defined a foothold state as one with a market share of at least 15 or 20% as of 1990, App. 16a, thereby creating a range of 34 to 46 low share states. (Leftwich's data included the District of Columbia and all states except Alaska and Hawaii.)

According to Leftwich, he tested this foothold hypothesis by examining whether Conwood's market share growth by state in the 1990s correlated with the 1990 starting points. *Id.* at 16a, 40a. His basic study was limited to three simple linear regressions. First, he tested whether Conwood's moist snuff market share increases by state in the seven year alleged violation period (1990-97) were correlated with their 1990 starting points. JA 1103. He concluded that they were (i.e., if Conwood's share for a state was low in 1990, it tended to stay that way; if it was high in 1990, it continued to grow more rapidly thereafter). Second, he ran the same test for the six year pre-violation period (1984-90), his version of a before and after test. This second regression did not reveal the same correlation (i.e., Conwood's 1984-90 growth by state was not correlated to the 1984 starting points). JA 1106. And, third, he ran a regression for the looseleaf market, a



smokeless tobacco market in which USTC did not compete, his version of a yardstick test. That test did not reveal any correlation between Conwood's 1990 starting point in looseleaf shares and its performance to 1997. JA 1107.

Based on these regressions, Leftwich found that those states in which Conwood's moist snuff gained a foothold in the 1980s continued to do well in the 1990s, while those states in which it did not have a foothold did not grow as well. He concluded that the data pattern he saw was consistent with Conwood's hypothesis—that it was USTC's alleged misconduct that kept Conwood from growing where it did not have a foothold as of 1990.[2] App. 17a, 40a. Further, because Conwood's hypothesis assumed that, but for USTC's misconduct, its market share in all low share states would grow just as much as in its most successful states during the 1990s, Leftwich's damages calculation added share points to the baseline of each low share state—8.1 points (under the 20% foothold threshold) and 6.5 points (under the 15% foothold threshold). JA 1111-13. As a result, Leftwich estimated damages of $313 or $488 million before trebling. App. 17a, 43a.

#### b. Mr. Rosson's Estimate

In addition, Conwood's Chief Executive Officer, William Rosson, testified that in his opinion Conwood would have achieved a 22-23% national market share by 1997 but for USTC's tactics—a figure almost 10 points higher than the shares Conwood in fact achieved for that period and triple the growth it had achieved prior to the alleged violation period

---

[2] Leftwich tested whether various demographic factors (age, income, etc.) had a disproportionate effect on Conwood's self-defined low share states. However, he did not test whether other marketplace factors (e.g., competition from Timberwolf, marketing restrictions in various states) that affected Conwood's sales in the 1990s disproportionately affected Conwood's low share states. JA 1140-46.

(1983-90).[3] Rosson also testified that each percentage point was worth $10 million annually and that Conwood therefore was entitled to $400 million in damages. *Id.* at 15a.

### 4. The District Court's Rulings

Conwood alleged that USTC had engaged in exclusionary conduct by below-cost pricing, exclusive dealing, coercion of retailers, and rack innovation as a form of predation. Compl. ¶¶ 27-28, 30. These allegations were not pursued by Conwood at trial. Instead, it asserted that USTC had misled retailers to obtain exclusive rack placements, had removed Conwood racks without retailer authorization and had provided misleading data to influence retailers' shelf space and product assortment decisions. The court held, at the summary judgment stage, that it was up to the jury to decide whether such conduct violated section 2. It also found that Conwood did not have to offer any economic proof of the extent of market foreclosure from USTC's alleged misconduct.

The trial court denied USTC's *Daubert* motion challenging the admissibility of Leftwich's study and testimony, finding that he had used "generally accepted" methodologies and that his opinions were for the jury to consider. It also rejected the argument that Dr. Leftwich was required to disaggregate the effects on Conwood sales flowing from lawful conduct or other marketplace factors. Instead, it found that because the jury awarded damages in Leftwich's "mid-range," it must have "adequately considered only those damages that were a direct result or likely consequence of UST's unlawful conduct." App. 55a.

[3] Conwood's national sales manager also testified that Conwood's sales were higher than its national average in retail locations that did not use USTC exclusive racks. App. 16a. That testimony made no distinction between Conwood's low share or high share states as defined by Dr. Leftwich.



### 5. The Sixth Circuit's Decision

The Sixth Circuit affirmed, holding that USTC's misleading category management practices and exclusive racks obtained by ruse or tortious acts violated section 2 when carried out with the intent of maintaining USTC's market share at the expense of its smaller rivals. Notwithstanding the retailers' requests for USTC's category management services and incentive programs, the court found that USTC had not presented a valid efficiency justification for its conduct.[4] In finding that USTC's tortious rack and POS removals were "pervasive," the court asserted that there was "no indication that" the removals "were authorized by the stores at which they occurred." App. 25a.

The court relied on expert testimony that USTC "used its position as category manager to exclude competition by suggesting that retailers carry fewer products, particularly competitor's products"; that it attempted to "control the number of price value [discount] brands introduced in stores"; and that USTC acted unlawfully "by suggesting that stores carry its slower moving products instead of better selling competitor products." The court found this to be "probative of USTC's intent to exclude competition." *Id.* at 26a. It cited evidence that USTC "misused its position as category manager by providing misleading information to retailers in an effort to dupe retailers into believing, among other things, that USTC products were better selling so that retailers would carry USTC products and discontinue carrying Conwood products." *Id.* at 22a. The court acknowledged, however, the uniform testimony of retailers that they tested all data, reviewed all manufacturers' recommendations, and otherwise made all decisions for their stores. *Id.* at 26a.

[4] The Sixth Circuit nevertheless recognized that USTC's exclusive rack placements often resulted from winning rack competitions requested by major retail chains in which Conwood chose not to participate. App. 6a n.1.

The court rejected USTC's argument that Conwood failed to show that competition was "foreclosed." *Id.* at 18-19a. The court did not identify any standard for assessing foreclosure but rather noted that Conwood was disadvantaged by USTC's tactics. It found that but for USTC's conduct, the market "would have grown more" and would have increased consumer choice. *See id.* at 33-34a. The court further found that Conwood's damages presentation satisfied *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993), because Leftwich had used "generally accepted methods for proving damages." Finally, the court ruled that the jury could be presumed to have followed the court's instructions relating to disaggregation. The Sixth Circuit therefore upheld the $1.05 billion damages judgment. App. 22a, 26a, 28-29a & n.4, 39-42a.

## ARGUMENT

Nearly ten years ago, when faced with confusion and conflict about the permissible scope of *price* competition, this Court declared in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223-24 (1993), that price competition by dominant firms essentially was *per se* lawful as long as the defendant's prices were above some appropriate measure of cost or recoupment was improbable. The Court's stated antitrust policy was specific and certain: aggressive price competition by firms with monopoly power was not to be deterred unless it was clear that competition would be significantly impaired for the long term.

This case presents the Court with an opportunity to resolve a conflict in the circuits regarding the legal boundaries of *nonprice* competition under section 2 of the Sherman Act. Nonprice competition by manufacturers, which includes offering innovative services, persuading retailers to increase shelf space at the expense of rivals and promoting products through advertising and incentive programs, is the essence of



competition in concentrated markets, especially for branded products. *See generally* Douglas Ginsburg, *Nonprice Competition*, 38 Antitrust Bull. 83 (1993).

The lower courts are in conflict, however, as to when aggressive nonprice competition may rise to a section 2 violation. The root of the confusion lies in the blurred line between "the process of Creative Destruction"[5] caused by everyday nonprice competition and illegal exclusionary conduct. The Fifth Circuit in *Stearns* held that aggressive, even "misleading" nonprice competition cannot be exclusionary as a matter of law when other rivals are free to participate in the competitive process. 170 F.3d at 527. When the Sixth Circuit's opinion is stripped of various forms of misleading conduct, its holding condemns simple tortious acts (rack removals not shown to be authorized) contrary to this Court's admonition that the antitrust laws "do not create a federal law of unfair competition" and that "[e]ven an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws." *Brooke Group*, 509 U.S. at 225. Lower courts also are in conflict on what evidence of foreclosure is necessary to prove harm to the competitive process. For even the most preclusive form of nonprice behavior, exclusive dealing agreements, the D.C., Eighth and Ninth Circuits require substantial foreclosure of the market—not just some unspecified reduction in product exposure—before section 2 is implicated.

The Sixth Circuit stands in even starker contrast with its sister courts on the subject of antitrust damages. The decision below absolves a plaintiff of any responsibility to disag-

[5] *See* Joseph Schumpeter, *Capitalism, Socialism and Democracy* 84 (2d ed. 1947); *see also Ball Mem'l Hosp., Inc. v. Mut. Hosp. Ins., Inc.*, 784 F.2d 1325, 1338 (7th Cir. 1986) ("Competition is a ruthless process.").

gregate the effects of lawful conduct or other market factors or to link its claimed damages to specified antitrust misconduct. Given the enormity of this damages award—the largest private antitrust judgment in the history of the antitrust laws[6]—these conflicts should have given the Sixth Circuit pause to scrutinize plaintiff's damages theory and evidence with special care.

The Sixth Circuit's holding, however, conflicts with rulings by the Eighth and Ninth Circuits. It did not require that plaintiff offer an evidentiary basis for the jury to disaggregate the effects of lawful conduct from the damage award, *see Concord Boat*, 207 F.3d at 1048, 1054; *Image Tech. Servs.*, 125 F.3d at 1223-24, and it did not require that plaintiff test for the most likely alternative explanations for Conwood's poor performance in numerous states or for the causes of its alleged antitrust injuries. *See Blue Dane Simmental Corp. v. American Simmental Ass'n*, 178 F.3d 1035, 1040-41 (8th Cir. 1999). This massive damages award demonstrates what can result when antitrust plaintiffs and their experts are not restrained by principles requiring proof that the defendant was responsible for plaintiff's antitrust injuries. Here their expert admittedly "rolled up" all alleged misconduct "into one ball of wax" (Dr. Leftwich's words, JA 1133-34) without differentiating exclusionary conduct or identifying injuries not caused by defendant's identifiable antitrust misconduct. Had the Sixth Circuit adopted the rulings of the Eighth and Ninth Circuits, the damages would not have included the effects of competition itself.

These damages conflicts reflect the absence of recent guidance from this Court. Its primary antitrust damages rulings are limited and dated. *See Zenith Radio Corp. v. Hazeltine*

[6] The only larger private antitrust judgment was overturned on appeal. *See MCI Communicaitons Corp. v. AT&T Co.*, 708 F.2d 1081 (7th Cir. 1982).



*Research, Inc.*, 395 U.S. 100 (1969) (antitrust damages based on yardstick test); *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251 (1946) (recognized application of yardstick and before-and-after tests); *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555 (1931) (proof of lost earnings based on price presentations and executive's reasonable estimate of plant's market value). *See also J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557 (1981) (automatic damages not available in private secondary line Robinson-Patman Act actions). However, antitrust treble damage actions have greatly expanded in number and scope in the last 33 years. They now constitute almost 95% of all antitrust cases and the lure of treble damages has induced plaintiffs to convert ordinary tort or contract disputes into antitrust claims. *See* Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice*, ch. 17 (2d ed. 1999) (summarizing literature); Phillip Areeda & Herbert Hovenkamp, 2 *Antitrust Law*, ¶ 340 (2d ed. 2000) ("*Antitrust Law*"); Frank Easterbrook, *Treble What?*, 55 Antitrust L.J. 95 (1986). Moreover, advances in the use of economics and statistics to assess causation and damages have increased the sophistication and complexity of expert testimony which in turn requires closer review by trial and appellate courts.

## I. THIS COURT SHOULD RESOLVE THE CIRCUIT CONFLICT ON THE BOUNDARIES OF LAWFUL NONPRICE COMPETITION UNDER SECTION 2

### A. The Sixth Circuit's Condemnation Of Aggressive Nonprice Competition Conflicts With The Fifth Circuit's Ruling In *Stearns*

This Court has outlined workable and objective standards for determining many types of conduct that may be deemed "unreasonably exclusionary" under section 2.[7] Further, in

[7] *See Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451

*Brooke Group*, this Court carefully spelled out the criteria for defining predatory pricing; it made clear that unless above-cost pricing (no matter how aggressively pursued) is linked directly to an independent antitrust violation, such conduct cannot violate section 2 as a matter of law. 509 U.S. at 222-23; *see also Concord Boat*, 207 F.3d at 1061-62.[8] This Court, however, has never addressed whether and to what extent section 2 may be used to condemn nonprice activities that are part of the selling process itself. The lower courts have responded with contrary rules; one shackles robust competition, the other encourages it.

In holding that section 2 condemns misleading or unfair suggestions to retailers regarding racks or category management, the Sixth Circuit's *Conwood* opinion conflicts with the analysis of the Fifth Circuit in *Stearns*. In *Stearns* the plaintiff challenged defendant's "orchestrated program" to limit plaintiff's ability to compete for airport jetways by training sales personnel to manipulate bid specifications and mislead buyers on the merits of competing products. 170 F.3d at 521. The Fifth Circuit held that while defendant's conduct may have been "wrong, misleading, or debatable," *id.* at 524, it constituted an economically rational attempt to increase sales for its products, and therefore was legitimate business conduct under section 2 as a matter of law. The court reasoned that where customers receive competing presentations and suggestions and make decisions in their own economic interests, antitrust courts should not interfere. *Id.* at 527.

(1992) (tying); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) (refusal to deal); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (tying and exclusive dealing).

[8] Antitrust courts have consistently held that intent is not a sound basis for defining exclusionary conduct under section 2. *See, e.g., Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 231-32 (1st Cir. 1983) (Breyer, J.).



This conflict between the Fifth and Sixth Circuits in *Stearns* and *Conwood* reflects a deep-seated disagreement among the circuit courts over the role of nonprice competition that arguably is misleading or unfair. The Fifth Circuit's rule in *Stearns*, that the antitrust laws do not penalize conduct that is merely unfair, is supported by the Seventh and Eighth Circuits. *See Phil Tolkan Datsun, Inc. v. Greater Milwaukee Datsun Dealers' Adver. Ass'n, Inc.*, 672 F.2d 1280, 1288 (7th Cir. 1982) (§ 1: "*unfair competition is still competition*, and will be actionable under the antitrust laws generally only where a defendant with substantial market power uses the unfair means to increase its share of the market *by eliminating a competitor*") (emphasis added); *Concord Boat*, 207 F.3d at 1046, 1059, 1062 (no § 2 violation even though defendant "fraudulently concealed" deals and used unfair market share incentive programs).[9] Conversely, the Sixth Circuit in *Conwood* has now joined the Second Circuit in holding that misleading conduct alone can be a basis for section 2 liability. *See National Ass'n of Pharm. Mfrs. v. Ayerst Labs.*, 850 F.2d 904, 916 (2d Cir. 1988) (monopolization claim based on false statements to buyer states a § 2 claim). *See generally* 3A *Antitrust Law* ¶ 782b (collecting and analyzing cases).

It is important that this Court resolve this basic conflict concerning everyday forms of nonprice competition in the retail industry. Courts have long recognized the efficacy of

[9] The Ninth Circuit also has followed the suggestion in the Areeda and Hovenkamp treatise that plaintiffs may rely on misleading competition to establish § 2 liability only if they overcome a *de minimis* presumption by showing, among other things, false representations that "induce[d] reasonable reliance" and were not "susceptible of neutralization . . . by rivals." 3A *Antitrust Law* ¶ 782b; *see American Prof'l Test. Serv., Inc. v. Harcourt Brace Jovanovich Legal & Prof'l Publ'ns, Inc.*, 108 F.3d 1147, 1152 (9th Cir. 1997).

aggressive rivalry for shelf space.[10] Moreover, the practice of category management by retailers—which is dependent on manufacturers' suggestions and recommendations (App. 6-7a)—is now an essential aspect of the competitive process. *See* Federal Trade Commission Staff, *Report on the FTC Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry* 47-49 (2001) (finding category management efficiency enhancing and stating that competitive concerns are reduced when retailers check suggestions "against the recommendations of other manufacturers and their own data"), available at *http://www.ftc.gov/os/2001/02/slottingallowancesreportfinal.pdf.* A dominant firm's non-coercive suggestions to retailers regarding which free display racks to use or products to accept should be *per se* legitimate business conduct. Such nonprice competition is economically rational and all rivals are free to compete in the same way without regard to their size. *See Aspen*, 472 U.S. at 605. Under the Sixth Circuit's ruling, however, there is no standard to guide courts or competing firms on the boundary between lawful competition and illegal exclusionary conduct or the criteria that should be applied in evaluating the dominant firm's marketplace conduct.[11] As dominant firms

[10] *See R.J. Reynolds Tobacco Co. v. Philip Morris Inc.*, 199 F. Supp. 2d 362, 387 (M.D.N.C. 2002) (§ 1 claim); *Jays Foods, Inc. v. Frito-Lay, Inc.*, 664 F. Supp. 364, 370 (N.D. Ill. 1987); *Frito-Lay, Inc. v. Bachman Co.*, 659 F. Supp. 1129, 1134-36 (S.D.N.Y. 1986). *See also Bayou Bottling, Inc. v. Dr Pepper Co.*, 725 F.2d 300, 304 (5th Cir. 1984).

[11] Because the Sixth Circuit did not base liability solely on instances of unauthorized rack removals (simple torts), this Court need not address whether such conduct, alone, may form the basis of § 2 liability. Moreover, to the extent the decision appears to aggregate procompetitive conduct (innovative racks requested by retailers, CAP and everyday suggestions and recommendations) with torts to create § 2 liability, that approach is contrary to the Ninth Circuit's decision in *California Computer Prods., Inc. v. IBM Corp.*, 613 F.2d 727, 738 (9th Cir. 1979). In any event, even a ruling that torts alone are sufficient to find § 2 liability should include a requirement that the plaintiff prove market foreclosure.



are forced to lead the "quiet life," market efficiency and consumer welfare will suffer.

### B. The Sixth Circuit's Failure To Require Proof Of Substantial Foreclosure Conflicts With Rulings By Four Other Circuits

The Sixth Circuit's decision also reflects division in the circuits over whether business practices can be condemned without proof of unreasonable and substantial market foreclosure under section 2. The Sixth Circuit ruled that USTC violated section 2 because it "shut Conwood out from effective competition," preventing Conwood from placing racks, products and POS in stores as "true competition" would have allowed. App. 30-34a. However, it is not disputed that plaintiff participated in the competitive process. Nor was Conwood foreclosed from the market (e.g., Conwood's products were in 81% of retail stores selling smokeless tobacco). Instead, the court relied on plaintiff's expert testimony that the market would "have grown more" absent USTC's alleged misconduct. *Id.* at 31a.

The Sixth Circuit's decision to relieve plaintiff of any foreclosure requirement conflicts with the D.C. Circuit's holding in *Microsoft.* There the court examined Microsoft's practices that "severely restricted Netscape's access to those distribution channels leading most efficiently to the acquisition of browser usage share," concluding that "a monopolist's use of exclusive contracts, in certain circumstances, may give rise to a § 2 violation even though the contracts foreclose less than the roughly 40% or 50% share usually required in order to establish a § 1 violation." 253 F.3d at 70 (citation omitted). It ruled that in a section 2 case, plaintiff must prove foreclosure of "a *substantial percentage* of the available opportunities for browser distribution" which was demonstrated by Microsoft's exclusive deals with 14 of the top 15 internet access providers. *Id.* (emphasis added). The First, Eighth and Ninth Circuits apply similar foreclosure requirements under section 2. *See Barry Wright*, 724 F.2d at 237 (emphasizing importance that foreclosure be properly defined by reference to the entire market; three year fixed-quantity contracts did not constitute "significant foreclosure" because they "extended over something less than [the customer's] expected requirements and lasted about two years"); *Concord Boat*, 207 F.3d at 1063 (dismissing § 2 case because rivals not shown to be foreclosed from any portion of market); *Western Parcel Express v. United Parcel Serv. of Am., Inc.*, 190 F.3d 974, 976 (9th Cir. 1999) (dismissing monopolization claim because the "customer . . . [could] terminate the contract for any reason with very little notice" and "for 'virtually any reason at any time'").[12]

## II. THIS COURT SHOULD RESOLVE SERIOUS CONFLICTS IN THE CIRCUITS ON THE PROOF REQUIRED FOR ANTITRUST DAMAGES

The Sixth Circuit's decision upholding this billion dollar judgment creates substantial conflicts with the Eighth and Ninth Circuits on two of the most basic issues in determining antitrust damages: first, whether an antitrust plaintiff must *disaggregate* the effects on plaintiff's sales flowing from lawful competition and other market factors; and second, whether an antitrust plaintiff must *link* its claimed damages to the specified antitrust misconduct.

[12]Similarly, § 1 of the Sherman Act, 15 U.S.C. § 1, and § 3 of the Clayton Act, 15 U.S.C. § 14—provisions that reach *further* than § 2—require a showing of either actual or likely market foreclosure from unlawful practices. *See Jefferson Parish*, 466 U.S. at 7-8 (foreclosure in the range of 30% insufficient); *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 394 (7th Cir. 1984) (Posner, J.) (law of exclusive dealing requires a showing that "at least one significant competitor" was kept "from doing business in a relevant market" otherwise "the agreement cannot possibly harm competition").



### A. The Decision's Failure To Require Plaintiff To Disaggregate Conflicts With Rulings Of The Eighth And Ninth Circuits

Perhaps the most striking conflict created by the Sixth Circuit's decision is its approval of a jury damages verdict without any evidence that would enable the jury to disaggregate the effects of lawful conduct and other market forces affecting plaintiff's sales in the violation period. Leftwich's damages methodology attributed Conwood's failure to achieve 6.5 or 8.1 points of market share growth in its low share states in the 1990s entirely to USTC's unlawful tactics. His damages numbers of $313 or $488 million were derived from assumptions about the threshold level of a foothold state, rather than by directly measuring and parsing the effects of USTC's conduct or other market factors on Conwood's performance in the 1990s. *See* App. 40-41a, 43a. Indeed, Leftwich acknowledged that his study was incapable of disaggregating the effects of lawful conduct or other marketplace factors.[13] JA 1130-34. The Sixth Circuit conceded that USTC's marketing activities involved lawful industry practices and that other market factors affected Conwood's performance in the 1990s. *See* App. 6a n.1, 28a n.4. It nonetheless upheld the damages verdict, reasoning that because the jury was properly instructed, it is presumed to have segregated the effect of lawful competition from other marketplace factors affecting Conwood's sales. *Id.*

The Sixth Circuit's failure to require plaintiff to present evidence on which the jury could make disaggregation determinations squarely conflicts with the Eighth Circuit's decision in *Concord Boat* and the Ninth Circuit's ruling in *Image Tech. Servs.* In *Concord Boat*, plaintiff's expert study

[13] While Leftwich asserted that only USTC's antitrust misconduct affected Conwood's growth in low share states, he did not test this counterfactual assumption. JA 1140-46.

assumed that any market share greater than 50% maintained by the defendant was the result of defendant's anticompetitive conduct, and therefore resulted in alleged monopolistic overcharges. There, too, the district court permitted the expert to testify because his methods were generally accepted and defendant was only "complain[ing] about how . . . [the] model [was applied] to the facts of this case." *Concord Boat*, 207 F.3d at 1055. However, the Eighth Circuit reversed, holding that an expert study that failed to disaggregate lawful conduct could not be submitted to the jury. *See id.* at 1057 ("it did not incorporate all aspects of the economic reality of the stern drive engine market and . . . it did not separate lawful from unlawful conduct").

Similarly, in *Image Tech. Servs.*, the Ninth Circuit held that a proper jury instruction could not replace the plaintiff's failure to offer an evidentiary basis for disaggregation:

> The ISOs [plaintiffs] must segregate damages attributable to lawful competition from damages attributable to Kodak's monopolizing conduct. A failure to do so contravenes the command of the Clayton Act. *Although the district court instructed the jury to award only those damages arising from Kodak's monopolization of the service market, the ISOs point to no basis in the record for quantifying lost sales of used equipment caused by Kodak's service monopoly.*

125 F.3d at 1224 (emphasis added) (citations omitted); *accord Amerinet, Inc. v. Xerox Corp.*, 972 F.2d 1483, 1494 (8th Cir. 1992) ("'When a plaintiff improperly attributes all losses to a defendant's illegal acts, despite the presence of significant other factors, the evidence does not permit a jury to make a reasonable and principled estimate of the amount of damages.'") (quoting *MCI*, 708 F.2d at 1162).

In this case, Conwood abandoned its predatory pricing claim, which was based on USTC's pricing practices (now conceded to be lawful) that allegedly harmed Conwood sales.



Moreover, the Sixth Circuit appeared to acknowledge that the provision of innovative racks requested by retailers was procompetitive, *see* App. 6a n.1; that the industry practice of category management (i.e., non-misleading suggestions and recommendations) was lawful and efficiency enhancing, *id.* at 28a; and that USTC's economies of scale, category management and promotional activities were lawful. *Id.* at 28a n.4. The effects of each on Conwood therefore should have been disaggregated. Moreover, it is not disputed that the rapid rise of Timberwolf harmed all of Swedish Match's competitors, and that the introduction of regulations forcing the reduction of available shelf space for moist snuff products harmed all firms including Conwood. In circuits requiring that the jury be given evidence from which it could segregate the effects of lawful competition and other marketplace factors, the record here would require dismissal before trial, *see City of Vernon v. Southern Cal. Edison Co.*, 955 F.2d 1361, 1372-73 (9th Cir. 1992), or rejection on appeal. *See Taylor Publ'g Co. v. Jostens, Inc.*, 216 F.3d 465, 485 (5th Cir. 2000). In the Sixth Circuit, however, these lawful effects may simply be rolled up into the expert's "ball of wax" damages estimate and left for the jury to sort out with no basis for doing so.

### B. The Sixth Circuit's Decision Upholding Plaintiff's Theory Of Damages Misinterprets *Joiner* And Conflicts With The Eighth Circuit

Finally, the Sixth Circuit's holding that Conwood had adequately linked its billion dollar plus damages claims to antitrust misconduct baldly misinterprets this Court's decision in *General Electric Co. v. Joiner*, 522 U.S. 136 (1997), and is contrary to the Eighth Circuit holdings in *Blue Dane* and *Concord Boat.* Leftwich's study tested the relationship of two variables: Conwood's 1990 starting share and its 1990-97 growth by state. He used no variables for the alleged antitrust misconduct to test Conwood's foothold hypothesis; nor did he test that hypothesis for the variables that most likely affected

Conwood's sales in the 1990s. *See* pp. 9 n. 2, 21 & n. 13 *supra*. Instead, Leftwich's conclusion on causation rested solely on the assumption that if Conwood's 1990 starting shares were in some manner uniquely related to its subsequent share growth, then USTC's conduct was responsible for Conwood's continued lackluster performance in the 1990s in 34 or 46 low share states. *See* pp. 8-9 *supra*.

The analytical gap in Leftwich's methodology is as wide as it is fundamental. Misreading this Court's directive that an expert's *ipse dixits* are never sufficient, *Joiner*, 522 U.S. at 146, the Sixth Circuit failed to determine whether the trial court had "carefully and meticulously" parsed Leftwich's study to assess whether it was relevant for measuring Conwood's antitrust injuries. Here, Leftwich's methodology could not link USTC's antitrust misconduct to Conwood's continued lack of growth in the 1990s in its poor-performing low share states of the 1980s. Indeed, his regressions would support equally plausible hypotheses that Conwood's growth in the low share states in the 1990s was suppressed by: (i) the introduction of numerous other rival brands, including a very successful discount product (Timberwolf); (ii) new regulatory restrictions on shelf space; (iii) thousands of retailer product assortment decisions; or, most obviously, (iv) a continuation in particular states of the very factors that caused Conwood's prior slow growth. Leftwich's study was unable to discriminate among any of these alternative causes of Conwood's differential growth or to distinguish them from USTC's alleged misconduct.[14] Leftwich's assertion that these other factors did not need to be tested because they were "reflected in the real world market," JA 90, is no answer; his study did not assess whether any one or all of them suppressed Conwood's market share growth in its so-called low share states in the 1990s.

[14] Plaintiff did not solve this defect by importing his self-identified USTC "bad acts" data (derived from employee litigation affidavits) into the model used by USTC's expert. App. 41-42a. Leftwich did not use any data from this hearsay information to test the foothold hypothesis; rather, he used it to adjust 1997 market shares so as to increase his damages estimates. JA 1111-13. Moreover, he conceded on cross-examination that he had no idea whether these bad acts represented authorized or unauthorized conduct. JA 1135-40.



Leftwich's methodology to determine causation also would have been rejected by the Eighth Circuit in *Blue Dane*. There the court affirmed the trial court's exclusion of plaintiff's expert because he had relied on a before and after methodology to prove causation without developing variables to test for other plausible explanations on the record. 178 F.3d at 1040-41. As the Eighth Circuit stated, the issue of a methodology's relevance is not determined by its "general acceptance," but rather by its reasonableness for "'draw[ing] a conclusion regarding the particular matter to which the expert testimony was directly relevant.'" *Id.* at 1040 (quoting *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 154 (1999)). The court then explained why plaintiff's reliance on a before and after test as indirect proof of the cause of its injuries was defective:

> Although [the expert] utilized a method of analysis typical within his field, that method is not typically used to make statements regarding causation without considering all independent variables that could affect the conclusion. We find no evidence in the record that other economists use before-and-after modeling to support conclusions of causes of market fluctuations.

*Blue Dane*, 178 F.3d at 1040-41; *see also United States v. City of Yonkers*, 197 F.3d 41, 54-55 (2d Cir. 1999) (rejecting expert's study of racial disparities in test scores because he failed to use a variable that isolated racial discrimination as an explanatory factor). Leftwich's study was similarly defective; he purported to test Conwood's foothold hypothesis without using any variable for other market factors that indisputably affected Conwood's sales in the 1990s, each of which was just as likely to have a differential impact on states in which Conwood already was performing poorly as of 1990.[15] That Leftwich supposedly tested for all variables "for which he had data," App. 41a, is no justification; in fact, he made no attempt to develop the relevant data.

More broadly, the Sixth Circuit's acceptance of a damages model that is not linked to the specified antitrust misconduct conflicts with the holding in *Concord Boat*. There the court excluded an expert's report that modeled damages without reference to the various marketplace factors affecting plaintiff's sales or to the alleged underlying misconduct. *See supra* pp. 21-22. Similarly here, Leftwich's model created an unreal marketplace in which the reasons for Conwood's unsatisfactory performance in the 1983-90 period were ignored; in which the effects of lawful competition and other market factors in the 1990s were assumed away for lack of data; and in which Conwood's wildly optimistic but for performance projection was based solely on formulaic assumptions built into the model (i.e., the assumption that Conwood's performance in *every* low share state would gain 6.5 or 8.1 market share points in 1990-97). *See McGlinchy v. Shell Chemical Co.*, 845 F.2d 802, 807 (9th Cir. 1988) (rejecting testimony of unreasonably optimistic sales projections). And, perhaps most importantly, as in *Concord Boat*, it was not disputed that Dr. Leftwich's rigid damages model

[15] Nor would it have been particularly difficult for Leftwich to gather the relevant data on USTC's alleged misconduct or other market factors. Plaintiff's own marketing expert compiled a list of chains that selected exclusive racks, and Leftwich could have used these data to test the effects of exclusive racks on Conwood's sales across states. JA 1134-35. Leftwich similarly could have tested the effects on Conwood of Timberwolf's share growth across states or the effects of state regulations affecting available shelf space.



and his massive estimates remained the same irrespective of the identity or legality of some or all of the underlying conduct. JA 1132-46.

If the sufficiency or fit requirements of *Joiner* are to have any meaning in antitrust damages analysis, this Court must resolve the conflict in the circuits in favor of the rule in *Blue Dane* and *Concord Boat*. The Eighth Circuit has articulated clear legal standards for ensuring that antitrust damages are based only on the effects of antitrust misconduct. The Sixth Circuit not only offers no standard by which to undertake that analysis, it fully abdicates this responsibility to the jury.

* * *

The importance of these damages issues and the need for specific guidance from this Court cannot be overstated. Left uncorrected, the Sixth Circuit's systematic bias for Type I errors will impede vigorous competition by dominant firms and provide an open invitation for speculative damages claims. It is "a recipe for uncertainty, unpredictability, and endless litigation." *United States v. Mead Corp.*, 533 U.S. 218, 250 (2001) (Scalia, J., dissenting).

## CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

NEAL R. STOLL
JAMES A. KEYTE
CHARLES S. LENT
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036-6522
(212) 735-3000

JOHN S. REED
RIDLEY M. SANDIDGE
REED WEITKAMP SCHELL &
VICE PLLC
500 W. Jefferson Street,
Suite 2400
Louisville, Kentucky 40202
(502) 589-1000

ERNEST GELLHORN
*Counsel of Record*
LAW OFFICE OF ERNEST
GELLHORN
2907 Normanstone Lane, N.W.
Suite 100
Washington, D.C. 20008-2725
(202) 319-7104

*Counsel for Petitioners*

October 17, 2002