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THE USE OF BUSINESS THEORY IN ANTITRUST LITIGATION

SPENCER WEBER WALLER*

I have previously written about how and why antitrust has systematically devalued business discourse and theory in favor of a virtually exclusive reliance on economics as its guiding discipline.¹ Thus, I do not intend to discuss at great length the historical reasons why antitrust has ignored the theories that are second nature to the very decision makers whose behavior is regulated by the antitrust laws. In essence, antitrust came of age in the 1930s when business theory was utterly discredited by the Great Depression; and it was economics, primarily the work of Edward Chamberlin,² that provided antitrust with a framework to vigorously enforce the law at the time that Thurman Arnold reinvigorated the Antitrust Division during the later half of the Roosevelt Administration. Since then, the level of antitrust enforcement has waxed and waned and the prevailing economic theories have changed from Structure-Conduct-Performance³ to the Chicago School,⁴ and now to the post-

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1. Spencer Weber Waller, *The Language of Law and the Language of Business*, 52 CASE W. RES. L. REV. 283 (2001).

2. EDWARD CHAMBERLIN, *THE THEORY OF MONOPOLISTIC COMPETITION* (8th ed. 1962).

3. Some of the principal texts embodying this approach include JOE S. BAIN, *INDUSTRIAL ORGANIZATION* (2d ed. 1968); CARL KAYSEN & DONALD TURNER, *ANTITRUST POLICY* (1959); EDWARD S. MASON, *ECONOMIC CONCENTRATION AND THE MONOPOLY PROBLEM* (1957); CARL KAYSEN, *UNITED STATES V. UNITED SHOE MACHINERY CORPORATION: AN ECONOMIC ANALYSIS OF AN ANTI-TRUST CASE* (1956); JOE S. BAIN, *BARRIERS TO NEW COMPETITION: THEIR CHARACTER AND CONSEQUENCES IN MANUFACTURING INDUSTRIES* (1956); UNITED STATES ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS, *REPORT* (1955).

4. See generally ROBERT H. BORK, *THE ANTITRUST PARADOX* (2d ed. 1978); Richard A. Posner, *The Chicago School of Antitrust*, 127 U. PA. L. REV. 925 (1979).

Chicago school.⁵ But the debate over the future of antitrust policy has been monopolized by economics rather than other disciplines.

Antitrust has been impoverished by this choice. It is only recently that antitrust scholars have begun to explore concepts that are second nature to the business person and the business school.

From the first day of business school, an MBA student (and her undergraduate counterpart) is trained to avoid selling mere commodities, avoid price competition, acquire and maintain durable market power (sometimes labeled sustainable competitive advantage), differentiate between products and services, build brand equity, create entry barriers, and train or discipline competitors into becoming good competitors rather than destabilizing forces. The business best sellers and the enormous consulting industry reinforce this training and dialogue long after the student has graduated and entered the work force to actually practice what her professors have preached.

Most antitrust economics, particularly the Chicago school variety, thus assume away the most interesting questions. Business theory emphasizes those strategies which are most likely to create sustainable competitive advantage and are only rarely based on price. The poverty of price theory premised on markets where price and output are the only variables deemed essential to competition is illustrated in the derisive wisdom of most marketing and brand management texts that "any fool can cut price." Instead, the greatest triumph to a marketer is to take a commodity type product and turn it into a successful brand with premium pricing insulated from attacks by rivals based solely on price. The marketing literature is replete with praise for examples of this strategy such as Starbucks coffee, Perrier sparkling water, Perdue chicken, Chiquita bananas, Nutrasweet artificial sweetener, and Gillette shavers.⁶

None of this means that a firm's strategic planning department or outside consultants are a walking Section 2 violation or that the marketing department's decisions are automatically proof of treble damage liability. But in the face of the assault of the Chicago School that market power is at best transitory and antitrust enforce-

5. See generally Waller, *supra* note 1, at 304-10; see also Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213 (1985).

6. See Waller, *supra* note 1, at 323-28.

ment is almost never worth the effort and cost, it raises the classic Groucho Marx question: "Who are you going to believe, me or your own eyes?"⁷

The sophisticated antitrust lawyer has not yet had to fully engage this voluminous body of literature. Nor has she wanted to do so. Bad business literature is notoriously jargon ridden, atheoretical, case specific, and at times faddish and quickly abandoned in favor of the next trend or fad. It is much harder to engage in the analysis of a business school type case analysis with its messy facts instead of applying more prestigious, seemingly more scientific, economic analysis which appears to produce determinate answers (output reducing; therefore illegal; output enhancing, efficiency enhancing; therefore, legal).

Business theory is, however, becoming an increasingly valuable tool for antitrust. Most practitioners are already familiar with such discourse in analyzing the so-called 4C documents in Hart-Scott-Rodino filings which discuss the merging firms competition and business strategy in their own vocabulary and not the language of the government's antitrust guidelines or industrial organization economics. Similarly, the Supreme Court has opened the door for more use of business theory and discourse in its *Aspen Ski* decision which called for an analysis of the business justifications for the allegedly anticompetitive acts of monopolists.⁸ Similarly, such analysis has an equally important role for the analysis of mergers and abuse of dominant position cases under the competition law of the European Union.

When business theory is properly used, the pool of experts is enlarged for both parties and judges and juries can better interpret the purpose and effect of business decisions which rely on the kind of strategic planning and marketing taught in the modern business school. We are no longer limited to industrial organization economists, and business professors and management consultants are elevated to equal footing.

Such testimony can help analyze intent evidence in a more nuanced fashion than any of the current approaches. Too often,

7. Groucho Marx, Comedians and Humorist Quotes, available at <http://www.comedyzone.net/quotes/comedians/marx2.htm> (last visited Oct. 1, 2001).

8. *Aspen Skiing Co. v. Aspen Highlands Skiing Co.*, 472 U.S. 585 (1985).

discovery focuses on the location of the so-called “smoking gun” which is touted as the key to the case by plaintiffs, and dismissed by defendants as either just locker room talk by lower level employees or dismissed outright as legally or economically irrelevant. In the real world, such evidence falls somewhere in between these two extremes, and business theory has more to offer than most of its price theory or industrial organization counterparts in determining what significance, if any, to accord to such real world documents.

Business theory is more accessible than its industrial organization equivalent to most judges, jurors and the public in assessing antitrust policy and specific decisions and cases. On its face, it does not favor either plaintiffs or defendants, but paints a more realistic picture of the motives, successes, and failures of the actual decision makers subject to the antitrust laws.

Just as Enron has brought the significance of accounting to the public’s attention, it is now antitrust’s turn to bring strategic planning and marketing to the forefront. We live in a branded world where the market leaders for most consumer products have shown an amazing durability over the decades, and more recent brand leaders in the high-tech sector or the remains of the dot-com economy often have little more than their brand to parade before the public. The time has come to engage with the important enduring insights of business theory in order to better understand the antitrust enforcement priorities of both the government and private parties, and to better present the argument of clients in making or responding to serious allegations of wrongdoing.

To illustrate the importance of business theory, I will discuss two recent cases: one where a knowledge of modern marketing is necessary to simply understand what the case is about, and the second to illustrate how a controversial and hard to decide predatory pricing case could be better argued by *both* plaintiff and defendant. Finally, I will briefly mention a series of other cases where marketing issues have been raised and where a business theory perspective would have been a valuable addition to the standard antitrust analysis.

I. CONWOOD TOBACCO V. UST OR "I'M LOST IN THE SUPERMARKET. . ."9

The retail marketing of consumer goods has become a highly empirical enterprise made possible by point of purchase computer scanning and retail tracking services.¹⁰ Large and small retailers alike have begun to be bombarded by a tidal wave of new brands and product extensions of existing brands to offer on their shelves. Retailers have reacted through two strategies, both of which have the potential to affect competition. First stores frequently require payments from manufacturers to display one brand over another. The justification is simple: Shelf space is precious and rarely would a supermarket (or particularly a smaller store) offer more than a few brands of any particular product.¹¹ Retailers seeking to increase profits increasingly have turned to so-called slotting allowances in which the manufacturers offer cash payments or valuable services to the retailers to win the best place on the shelf. The complex implications of these practices for antitrust law and competition policy are just beginning to be explored.¹²

The other, and even more significant, new practice involves retailers delegating to one of the manufacturers themselves the stocking and display functions of not only their own product, but all of the various competing brands for a particular type of product. This practice is known as category management, and the firms selected are normally known as category captains. Not surprisingly, it is the leading firm in a particular category that typically is selected to perform this function. While this practice is undoubtedly valuable to the retailers, the potential for harm to competition is obvious. This potential for harm is increased when the category captain is in

9. THE CLASH, *Lost in the Supermarket*, on London Calling (Sony 1979).

10. Competition between the two principal rivals for the provision of retail tracking services has itself been the subject of ongoing antitrust litigation in the United States, Canada, and the European Union with the latest installment in the United States reported in *Information Resources, Inc. v. The Dun & Bradstreet Corp.*, 294 F.3d 447 (2d Cir. 2002). See *infra* note 24 and accompanying text.

11. Some of the implications of the practical limits on shelf space are explored in *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001). See *infra* note 26 and accompanying text.

12. See American Antitrust Institute Website, <http://antitrustinstitute.org> (search term: slotting allowance).

charge of selecting which competing brands to carry in addition to how such competing brands will be displayed.

The most significant antitrust case where these issues were analyzed is *Conwood Tobacco v. United States Tobacco Co.*¹³ *Conwood* involved a long running dispute between the dominant firm in the moist snuff market and an aggressive new entrant. Moist snuff is sold primarily at convenience stores, gas stations, grocery chains, and Wal-Mart type super stores, where in-store display and advertising are the most important marketing vehicles. Most of these retailers have designated United States Tobacco ("UST") as the category captain, and delegated to it the stocking and display function as well as the power to recommend or decide which competing brands will be carried.

The facts of *Conwood* are so egregious that while understanding the modern world of marketing is necessary to understand what occurred, deciding the case proved to be relatively easy. The plaintiff entered the moist snuff market creating a series of lower priced brands to compete with the dominant higher priced brands of UST. The evidence showed that the plaintiff enjoyed a measure of success until UST began to misuse its power as category captain. While the retailers had an incentive to maximize their profits by carrying the most desirable combination of premium and value brands, they had to carry UST as the dominant brand. In order to protect its higher priced premium brands from lower priced competitors and to restrict the growth of value brands, the evidence showed that UST removed, damaged, and ordered the redesign of the point of purchase display racks to disadvantage its competitors. At times, UST's lack of subtlety included simply throwing out the products of its competitors while arranging the stocking and display of the store's moist snuff section. UST also provided false information to certain retailers which caused them to favor UST over its competitors in what brands to order and how to display them. The plaintiffs ultimately prevailed. A jury verdict of over one billion dollars after trebling¹⁴ was affirmed on appeal.¹⁵

13. 290 F.3d 768 (6th Cir. 2002). There are also subsequent pending class actions against United States Tobacco by snuff purchasers and distributors.

14. *Conwood Co., L.P. v. U.S. Tobacco Co.*, 2000 WL 33176054 (W.D. Ky. 2000).

15. *Conwood*, 290 F.3d 768 (6th Cir. 2002).

What is interesting is that both sides extensively used business theory and business experts in presenting their evidence to the jury on both liability and damages issues instead of relying solely on the usual array of economists. Among others, the plaintiffs relied on expert testimony from Gregory Gundlach a marketing professor from the University of Notre Dame, who holds both a law degree and an MBA and has written extensively about the relationship between marketing and antitrust.¹⁶ UST's defense that the misconduct was either isolated incidents or normal business conduct was rejected by the jury and the appeals court. A lucid well-tryed case grounded in business reality and theory appears to be the cause.

II. *LePage v. 3M* or "Tapeheads"¹⁷

The *3M* litigation poses a more interesting and harder version of many of the same issues raised in the *Conwood* case because the inflammatory and indefensible behavior of the field personnel of UST is not present. This case concerns the market for tape and again consists of a dispute between the dominant firm and newer entrants seeking to expand sales of lesser priced or private label tape. Once again, the focus was the interaction between the dominant firm and its largest customers, including Wal-Mart, Kmart, and various office superstores.

When faced with new competition and eroding market share or profit margins, 3M, the dominant firm, responded in a much more facially legitimate way than UST did in its markets. 3M created various rebate and incentive programs across all the various product lines sold by the company. In contrast, its competitors primarily sold only tape. As a practical matter, sellers had to exclusively sell 3M tape in order to achieve the largest rebates and incentives to the disadvantage of 3M's tape competitors.

In the private treble damage litigation that followed, the plaintiff contended that 3M was seeking to unlawfully maintain its monopoly in order to avoid having to lower the price of its premium

16. See, e.g., Gregory T. Gundlach, *Marketing and Antitrust*, in HANDBOOK OF MARKETING AND SOCIETY (Paul N. Bloom & Gregory T. Gundlach eds., 2001); see also Gregory T. Gundlach, *Choice as the Focus of Antitrust: A Marketing Perspective*, 62 U. PITT. L. REV. 527 (2001).

17. TAPEHEADS (Anchor Bay Entertainment 1988) (starring John Cusack and Tim Robbins).

tape and to avoid the migration of its customers to either lower priced brands or private label tape. The defendant argued that the incentive plans and rebates were a healthy form of price competition and that any injury to the plaintiff was the result of self-inflicted wounds from failing to compete vigorously enough for key accounts.

Oddly enough, both sides avoided business theory entirely and fought the case almost exclusively on predatory pricing grounds. The jury held in favor of the plaintiff and the trial court followed with judgment as a matter of law for the defendant. The Third Circuit affirmed in a split decision. The majority affirmed the grant of judgment as a matter of law holding that there could be no predatory pricing without proof of price below some measure of cost which was lacking in the case before it.¹⁸ The dissent argued that price above cost could still be predatory, or at least part of unlawful monopolization or attempted monopolization, in line with earlier Third Circuit precedent.¹⁹ This opinion subsequently has been vacated and the case has been set for rehearing en banc.²⁰

3M is thus a missed opportunity for both sides and the Court to discuss the rich marketing and strategic behavior literature on the creation and reactions to the introduction of private label brands.²¹ While it's hard to second guess a winning strategy, 3M chose to put all its eggs into the price theory basket. 3M, however, had a different marketing-based story that it could also have told which is that of a market leader which competes on innovation for the benefit of consumers and competition.

3M's corporate website gives a hint of the marketing strategy that 3M and similar defendants could use in conjunction, or instead of, the standard way of addressing these issues. The web site states:

Through innovation, we've created markets ranging from Post-it® Notes and Scotch® Tapes to reflective sheeting for road signs and optical films for electronic displays. In

18. See *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

19. See *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir.), *cert. denied*, 439 U.S. 838 (1978).

20. 277 F.3d 365 (3d Cir. 2002).

21. See, e.g., KEVIN LANE Keller, STRATEGIC BRAND MANAGEMENT 205-13 (1998).

addition to creating new markets, we continually reinvent ourselves in existing markets to stay ahead of competition.²²

In arguing for a vigorous form of competition based on innovation, I offer a hypothetical strategy that may or may not fit the needs of 3M in this particular case, but does illustrate that plaintiffs do not have a monopoly on the use of business theory or business theory experts to make their case. It could well be that in this case, the plaintiffs could have better used a marketing theory to make their case in chief, or rebut 3M's defense, rather than rely on decades of old precedent that runs counter to the Supreme Court and the clear majority of predatory pricing cases. It is now simply too late for either party in 3M to introduce the kind of record evidence, expert witnesses, jury instructions, and arguments by counsel on either side to transform this case from a mundane case about predatory pricing into a rich discussion of marketing strategy. In that case, both sides could have better articulated their real world actions and their effects to the jury and court.

III. ALL THE BEST CASES ARE MARKETING CASES OR "WELCOME TO THE JUNGLE"²³

So many of the important recent antitrust cases have focused on the marketing tactics of dominant competitors. For example, *Information Resources Inc. v. The Dun & Bradstreet Corp.*²⁴ concerns competition in the vitally important market for retail scanning services which generate the basic data for most marketing decisions for consumer product manufacturers and the antitrust agencies when examining these markets. The plaintiff's case concerns pricing decisions and exclusive dealing provisions in contracts between A.C. Nielsen, the dominant Dun & Bradstreet subsidiary, and retail chains throughout the world. Understanding and applying marketing theory helps both explain why this case is so significant and how to decide the merits of this dispute, not just in the United States,

22. See 3M homepage, available at http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=MMM&script=2100 (last visited Oct. 25, 2002).

23. GUNS 'N ROSES, *Welcome to the Jungle*, on APPETITE FOR DESTRUCTION (Geffen Records 1987).

24. 294 F.3d 447 (2d Cir. 2002).

but also in Canada and the European Union where aspects of this case have been investigated and litigated.²⁵

The significance of marketing in antitrust has spread far beyond large private antitrust suits where the litigation is itself the continuation of marketing by other means. Virtually all private and government litigation is being forced to come to grips with marketing theory in engaging in the type of market definition which is integral to virtually all antitrust issues. How supermarkets actually market baby food was pivotal in the FTC's successful challenge to the combination of the number 2 and 3 baby food manufacturers²⁶ and its equally successful challenge to Staples's acquisition of one of its two principal office superstore rivals.²⁷ While any of these cases can be tortured into standard price theory oriented questions of market definition and anticipated output restrictions, marketing simply does a better job at conveying the essence of the dispute.

For example, the FTC, the European Union, and the English Office of Fair Trading each recently have examined competing bids by Carnival Cruises and Royal Caribbean to acquire Princess Cruises. The definition of the relevant market, as always, becomes a critical issue. If the market is deemed to be package vacations or all vacation travel then either combination poses no appreciable risk to competition. On the other hand, if the market is deemed to be cruises alone, or more narrowly broken down by destination, point of embarkation, or the degree of luxury, then the agencies must address a host of difficult questions before deciding their course of action. The marketing of the cruise experience versus other vacation experiences (which is somewhat different in the United States and Europe) proved to be far more significant than the familiar but arid 5% price test spelled out in the United States Horizontal Merger Guidelines and their foreign equivalents.²⁸

25. Other cases where marketing holds the key to unraveling the legal significance of who did what to whom include *Pepsico v. The Coca-Cola Co.*, 114 F. Supp. 2d 243 (S.D.N.Y. 2000), which similarly examined exclusive dealing provisions with fast food chains and *RJR Reynolds Tobacco Co. v. Philip Morris Inc.*, 199 F. Supp. 2d 362 (M.D.N.C. 2002) dealing with point of sale promotion and advertising for cigarettes.

26. *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001).

27. *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997).

28. U.S. DEP'T OF JUSTICE & FEDERAL TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 1 (1992)(rev. 1997).

IV. CONCLUSION

While economics is an important tool for antitrust policy, we need to do better. Regardless of one's position of the proper type of economics or how to incorporate non-economic values into antitrust, the business world and its theories have much to offer as well. Actually using business theory to interpret and evaluate the legal consequences of important business decisions makes sense at so many levels. It better corresponds with the training and actual mind set of the business leaders whose decisions are being judged. It more closely reflects and better explains the real world in which those decisions are being implemented. Moreover, strategic planning and marketing are just two of the offerings from the business world for both plaintiffs and defendants to make their decisions more understandable to judges and juries. When billions of dollars and the fate of entire companies are at stake, why would you expect anything less from the clients and the counselors who represent them?