UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,	)	
	)	
Plaintiff,	)	
v.	)	Civ. Action No. 1:00CV01501 TFH
	)	
SWEDISH MATCH NORTH AMERICA INC., *et al.*,	)	PUBLIC VERSION
	)	
Defendants.	)	

MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION

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Introduction and Summary

Swedish Match North America Inc. ("Swedish Match"), the largest seller of loose leaf chewing tobacco in the United States, seeks to acquire the chewing tobacco business of National Tobacco Company, L.P. ("National"), the third largest seller. Swedish Match markets loose leaf

[1] PX 144 at 3. The second largest loose leaf brand is "Levi Garrett," sold by Conwood Co. The fourth largest is "Red Man Golden Blend," also sold by Swedish Match. PX . Both firms also sell loose leaf chewing tobacco under additional brand names: Swedish Match's other brands include Red Man Select, Southern Pride, J.D.'s Blend, Granger Select, Work Horse, Union Standard, Pay Car, and Red Horse. PX at 4-5. National's other brands include Beech-Nut Wintergreen, Durango, Trophy, and Havana Blossom. PX at 3.

Swedish Match and National already lead price increases in the chewing tobacco business: One or the other company has led prices up in each industry-wide pricing increase since July 22, 1997, and the two other significant competitors (Conwood and Swisher) have followed. PX at 44-45, 70-71 ( ); PX at 1078. The acquisition would only add to Swedish Match's ability to increase prices for loose leaf tobacco. Mergers that create or enhance that market power – "the ability profitably to maintain prices above a competitive level for a significant period of time"[2] – constitute the harm to competition and consumers against which merger enforcement is directed. *Merger Guidelines* § 0.1; *U.S. v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir. 1988), *cert. denied*, 493 U.S. 809 (1989).

National is one of Swedish Match's two principal competitors in the sale of loose leaf chewing tobacco. Red Man and Beech-Nut compete for many of the same customers, according to

PX at 3731. Red Man and Beech-Nut today compete on price, as declining demand puts pressure on these firms to increase sales by taking market share from each other.

observes:

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[2] U.S. Dep't of Justice and Federal Trade Comm'n, *Horizontal Merger Guidelines* § 0.1 (1997) (hereinafter "*Merger Guidelines*") (Appendix I hereto). While the *Merger Guidelines* are not binding on the courts, courts have considered them in determining a proposed acquisition's impact on competition. *See, e.g., FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986); *Olin Corp. v. FTC*, 986 F.2d 1295, 1299 (9th Cir. 1993), *cert. denied*, 510 U.S. 1110 (1994); *FTC v. University Health, Inc.*, 938 F.2d 1206, 1211 n.12 (11th Cir. 1991); *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 49, 53-58 (D.D.C. 1998); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1076, 1082 (D.D.C. 1997).

PX at 1609. Absent judicial intervention, this direct and substantial competition between Swedish Match and National will be lost forever.

Accordingly, the Federal Trade Commission ("Commission") asks this Court to enjoin Swedish Match's proposed acquisition of National's chewing tobacco brands, pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), pending a full administrative trial on the merits before the Federal Trade Commission.[3]

This merger would substantially strengthen what is already the largest firm in this market – Swedish Match – and create a competitor roughly twice the size of the only other significant competitor (Conwood, maker of "Levi Garrett"). This already highly concentrated market would become significantly more concentrated. When a merger increases market concentration as much as this one, "it will be presumed" that the merger "is likely to create or enhance market power or facilitate its exercise."[4] Indeed, Swedish Match's 60% post-merger market share will be *double*

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[3] Section 13(b) of the FTC Act authorizes the Commission to seek, and empowers this Court to grant, preliminary relief pending the completion of administrative proceedings challenging the proposed acquisition. Section 13(b) further provides that the Commission must commence its administrative proceeding within 20 days after the issuance by a federal court of any preliminary injunction. The Commission is empowered to bring an administrative complaint challenging the transaction under Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21, and under Section 5 of the FTC Act, 15 U.S.C. § 45. Defendants have committed not to close the acquisition until after the Court rules on the Commission's motion for a preliminary injunction.

[4] *Merger Guidelines* § 1.51; *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 364 (1962); *United States v. Phillipsburg Nat'l Bank*, 399 U.S. 350, 365-67 (1970); *PPG*, 798 F.2d at 1502-03; F. Scherer & D. Ross, *Industrial Market Structure & Economic Performance* 82 (3d ed. 1990) (hereafter "Scherer & Ross") ("when the leading *four* firms control 40 percent or more

of the total market, oligopolistic behavior becomes likely," emphasis added).

[5] Swedish Match's senior vice president for sales and marketing testified by declaration in

[6] *See, e.g., FTC v. Elders Grain Co.*, 868 F.2d 901, 904 (7th Cir. 1989); *PPG*, 798 F.2d at 1508; *FTC v. Lancaster Colony Corp.*, 434 F. Supp. 1088, 1096 (S.D.N.Y. 1977) ("at best, divestiture is a slow, cumbersome, disruptive and complex remedy").

[7] In particular, the FTC is not required to show irreparable harm. *FTC v. Warner Communications, Inc.*, 742 F.2d 1156, 1159 (9th Cir. 1984). Nonetheless, without an injunction, the public interest in effective antitrust enforcement will be irreparably harmed, because competition will be eliminated in the interim and because of the inadequacy of eventual relief through post-consummation divestiture. *See* pp. 42-43 below.

(2) balance the equities." *PPG*, 798 F.2d at 1501-02; *University Health*, 938 F.2d at 1217; *Warner Communications*, 742 F.2d at 1160; *Cardinal Health*, 12 F. Supp. 2d at 44; *Staples*, 970 F. Supp. at 1071. The Court's "task is not to make a final determination on whether the proposed

[8] *University Health*, 938 F.2d at 1218; *Warner Communications*, 742 F.2d at 1162; *see Cardinal Health*, 12 F. Supp. 2d at 45; *Staples*, 970 F. Supp. at 1070-71. This Court need not resolve all conflicts of evidence or analyze extensively all antitrust issues. Such final resolution is the province of the administrative proceeding. *Warner Communications*, 742 F.2d at 1164.

F. Supp. at 1097. Although the Court may properly consider private equities as well as public, the public equities are to be given far greater weight in the balance. *PPG*, 798 F.2d at 1506; *Warner Communications*, 742 F.2d at 1165; *Elders Grain*, 868 F.2d at 903.

II. THE PROPOSED ACQUISITION VIOLATES THE ANTITRUST LAWS.

Section 7 of the Clayton Act prohibits any merger or asset acquisition "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." Section 7 is intended to arrest anticompetitive acquisitions "in their incipiency" and, accordingly, requires a prediction as to the merger's likely impact on future competition. *Philadelphia Nat'l Bank*, 374 U.S. at 362.[9] In this case, acknowledge that the merger will eliminate one of their two most significant competitors. As a result, the merger will increase the ability of Swedish Match to increase prices of Beech-Nut, for example, both because a significant portion of the customers Beech-Nut would lose if it were to raise price would have switched to Red Man (and therefore Swedish Match will keep their business) and because Swedish Match will have only one other significant competitor – Conwood – to worry about.

[9] Because Section 7 addresses the probable future effects of an acquisition, it necessarily requires predictions and inherently "deals in probabilities, not certainties." *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962). The government need only show a reasonable probability, not a certainty, that the proscribed anticompetitive activity may occur. "All that is necessary is that the merger create an appreciable danger of [anticompetitive] consequences in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for." *Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986), *cert. denied*, 481 U.S. 1038 (1987); *Staples*, 970 F. Supp. at 1072.

Merger analysis, under Section 7 of the Clayton Act, requires determinations of: (1) the "line of commerce

[10]

. PX ; PX .

[11] Even remote and insignificant competitors might provide some remotely "competitive" alternative, e.*g.*, some consumers might consider buses to be an alternative to airplanes if the price of airline travel tripled. Market definition is an exercise to distinguish close and distant competitive constraints, so that the analysis can then proceed to examine whether the merger significantly reduces competition among *close* constraints. *See, e.g.*, 4 P. Areeda, H. Hovenkamp & J. Solow, *Antitrust Law* ¶ 929c (rev. ed. 1998) (hereafter "Areeda"); F. Fisher, *Industrial Organization, Economics and the Law* 37-38 (1991) ("if market definition is to be at all useful in antitrust cases, the 'market' must include those firms and services that *act to constrain* the activities of the firm or firms that are the object of attention," emphasis added); *cf. Philadelphia Nat'l Bank*, 374 U.S. at 356-57 (commercial bankin2 ô Tj 6336ark

Therefore, the relevant product market "must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn . . . ." *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 612 n.31 (1953). The antitrust agencies and the courts have implemented this test by seeking to identify the smallest group of products over which prices could be profitably increased by a "small but significant" amount (normally 5 percent) for a substantial period of time (normally one year). *Staples*, 970 F. Supp. at 1076 n.8; *Merger Guidelines* § 1.11, at 5-6.

"The *outer boundaries* of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325 (emphasis added). "Reasonable interchangeability" and "cross-elasticity of demand" are distinct concepts. *Staples*, 970 F. Supp. at 1074. "Reasonable interchangeability" asks whether products or services perform the same function. "Cross-elasticity of demand" asks whether demand for one product is affected by the price of the other product, and seeks to determine whether customers would in fact substitute one for the other in the event of small changes in price. *Id.*[13] "Accordingly, the Court must determine

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the post-merger firm." 4 Areeda ¶ 913a, at 59; *accord, e.g.*, Shapiro, "Mergers with Differentiated Products," 10 *Antitrust* 23 (1996); Baker, "Product Differentiation Through Space and Time: Some Antitrust Policy Issues," 42 *Antitrust Bull.* 177 (1997); *see* pp. 31-33 below.

[13] "'Interchangeability' implies that one product is roughly equivalent to another for the use to which it is put; while there may be some degree of preference for the one over the other, either would work effectively. A person needing transportation to work could accordingly buy a Ford or a Chevrolet automobile, or could elect to ride a horse or a bicycle, assuming those options were feasible. The key test for determining whether one product is a substitute for another is whether there is cross-elasticity of demand between them: in other words, whether the demand for the second good would respond to changes in the price of the first." *Allen-Myland, Inc. v. International Business Machines Corp.*, 33 F.3d 194, 206 (3d Cir.), *cert. denied*, 513 U.S. 1066 (1994).

whether . . . there is reason to find that if the defendants were to raise prices after the proposed merger[], their customers would switch to alternative sources of supply to defeat the price increase." *Cardinal Health*, 12 F. Supp. 2d at 46; *accord, Archer-Daniels-Midland*, 866 F.2d at 246 ("these concepts help evaluate the extent competition constrains market power and are, therefore, indirect measurements of a firm's market power").

For that reason, superficial similarities between products that seem to perform the same functions may be misleading. Instead, courts most often look to customers' perceptions of the marketplace, the defendants' documents reflecting the "

[14] *United States v. Grinnell Corp.*, 384 U.S. 563, 572 (1966); *Brown Shoe*, 370 U.S. at 325; *Olin*, 986 F.2d at 1299, 1302-03; *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 218 n.4 (D.C. Cir. 1986) ("industry or public recognition of the [market] as a separate economic unit matters because we assume that economic actors usually have accurate perceptions of economic realities"); *Merger Guidelines* § 1.11.

[15] As late as 1998, National did not identify U.S. Tobacco, the leading seller of moist snuff, as a competitor for its loose leaf business. PX 144 at 9 (North Atlantic Trading Co. 1998 Form 10-K, filed March 31, 1999); *accord*

Swedish Match's annual reports likewise recognize that loose leaf constitutes a distinct market. PX 50 at 17 (Swedish Match's 1999 Annual Report) ("four major producers dominate the market for chewing tobacco, which includes brands in several price segments"); PX 49 at 13 (Swedish Match's 1998 Annual Report) ("four manufacturers dominate the chewing tobacco industry in the US"); *accord all similar* PX 47 at 23; PX 48 at 14; PX at 3; PX at 3. Other documents show that the parties recognize loose leaf as a separate market and attribute market shares to individual loose leaf competitors, separate and apart from moist snuff. PX at 2553; PX at 4, 5; PX at 0633; PX at 1787.

Swedish Match's former chief operating officer, and its current senior vice president for sales and marketing, both have given sworn testimony to the effect that loose leaf and moist snuff are separate markets. Harold Price, Swedish Match's senior vice president of sales and marketing with 18 years experience in the industry, stated in an affidavit executed last October: "In my experience, consumers of moist snuff do not switch to other forms of smokeless tobacco (for example, loose leaf) in response to price increases of moist snuff." PX 200 ¶ 3.[16]

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[16] *Conwood Co. v. United States Tobacco Sales and Marketing Co.*, Case No. 5:98-CV-00108 (U.S. District Court, Western Division of Kentucky, Paducah Division) (jury verdict March 28, 2000) In that case, Conwood sought and obtained a jury verdict that moist snuff constituted a distinct product market from loose leaf tobacco, and that U.S. Tobacco had monopolized that product market by engaging in exclusionary or restrictive conduct. Post-trial motions are pending, with rulings expected no earlier than July 1, 2000.

testified before Commission staff

William G. McClure III, President of Pinkerton Tobacco Company from 1992 to 1997 and chief operating officer of Swedish Match from 1997 to 1999, testified during the *Conwood* trial on March 13, 2000 (after he had left Swedish Match) that moist snuff and loose leaf are in different markets:

> Q. Mr. McClure, during your time at [Swedish Match], did you view the moist snuff market as a separate product market?
>
> A. Absolutely.
>
> Q. Can you tell us why?
>
> A. Well, the products are very different. They're used in a different way from chewing tobacco. The consumer taste preferences are different. The demographics of the consumer base are different. You'll find them in a smokeless tobacco section, but they're very distinct product markets. There was some overlap. We had some consumers who would use both products, but for the most part they were separate consumer bases.
>
> . . .
>
> Q. Mr. McClure, during your time at Pinkerton, did you see any evidence that consumers switched away from moist snuff in response to these price increases, switched to other products?
>
> A. Anecdotally, maybe isolated consumers; but on the whole, the market for chewing tobacco continued to decline at pretty much the same rate, while the market for moist snuff continued to expand. So for a while it seemed that price had little effect on the consumer.
>
> So we were in the chewing tobacco business, and that would be the natural competition for snuff, but we couldn't see any evidence that they were switching to chewing tobacco in any measurable degree.

PX 177 at 7-9.

. An economic study may be "useful as a guide to interpreting market facts, but it is not a substitute for them." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 242 (1993).

3. *The Evidence Shows that Loose Leaf Tobacco Is a Distinct Market from Moist Snuff.*

In *Brown Shoe*, the Supreme Court identified "practical indicia" of product market boundaries, including

> industry or public recognition of the submarket as a separate economic entity, the product's particular characteristics and uses, unique production facilities, distinct customers, sensitivity to price changes, and specialized vendors.[17]

Other evidence relied on by courts, and present here, includes differences in price movements between the purportedly competing products, and evidence that sellers do not look at the

[17] 370 U.S. at 325. This Court has recently endorsed these criteria. *Cardinal Health*, 12 F. Supp. 2d at 46; *Staples*, 970 F. Supp. at 1075; *see also Bon-Ton Stores v. May Dep't Stores Co.*, 881 F. Supp. 860, 868-70 (W.D.N.Y. 1994).

PX ¶¶ 4, 14 ( ).

for ,

the loose leaf tobacco firm (with about of the market), states:

PX ¶¶ 4, 14 (, emphasis added).

Convenience store distributors, who buy loose leaf chewing tobacco from the manufacturers and distribute it to convenience stores and who are the loose leaf companies' largest distribution channel, also attest that loose leaf chewing tobacco is a separate product market. PX ¶ 4 ( ); PX ¶ 4 ( ); PX ¶ 4 ( );

PX ¶¶ 6-9 ( ). the relationship between loose leaf chewing tobacco and moist snuff to the relationship between cigars and cigarettes, noting that while both cigars and cigarettes are tobacco products and some people use both, the products are very different and few people switch between them on the basis of small changes in price. PX ¶ 4 ( ). compares the relationship between loose leaf chewing tobacco and moist snuff to the relationship between beer and soda pop, citing similar factors. PX ¶ 5 ( ).[18]

b. *Loose Leaf's Particular Characteristics and Uses*

Loose leaf tobacco differs in many respects from moist snuff. Loose leaf and moist snuff have different prices, packaging, and textures. They are manufactured using different process and raw materials and consequently have different tastes. Loose leaf and moist snuff are consumed differently, which has important implications in how and where each product is used. Finally, loose leaf and moist snuff largely have different customer bases.

Moist snuff is a more expensive product than loose leaf. Premium moist snuff sells for around $3.20 per can at retail; premium loose leaf sells for around $1.80 per pouch at retail. PX at 2541. Moist snuff is sold in small, round 1.2-ounce plastic containers, while loose leaf is sold in larger three-ounce pouches. PX at 49 ( ); PX at 4. Moist snuff is a more finely ground product than loose leaf and has a higher moisture content. *Compare* PX

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[18] Defendants submitted nine declarations to the Commission. Six of those declarants have executed supplemental declarations clarifying their testimony,
PX ¶ 5 ( );
PX ¶ 6, 9 ( ); PX ¶ 11 ( ); PX ¶ 9 ( ); PX ¶ 8, 9 ( ); PX ¶ 4 ( ).

158 *with* PX 159; *see* PX at 47 ( ); PX ¶ 8 ( ); PX ¶ 6 ( ).

Moist snuff looks like ground coffee, whereas individual tobacco leaves are clearly visible in loose leaf. *Compare* PX 158 *with* PX 159; *see* PX ¶ 5 ( ); PX ¶¶ 5, 6, 8 ( ).

Moist snuff is made from Kentucky and Tennessee tobacco, which is cured with smoke, much as meats are cured in a smoke-house. PX ¶ 9 ( ); PX ¶ 8 ( ); PX at 47 ( ). Tit 6ib

loose leaf. PX ¶ 8 ( ); PX ¶ 7 ( ).

Some users of loose leaf also use moist snuff. This "dual usage" reflects occasional preferences, much like another consumer might sometimes drink beer and sometimes drink wine.

PX at 0076, 0083 (emphasis added); *accord* PX at 77, 78 ( ); PX at 6348, 6351. There is no significant evidence that consumers substitute snuff for loose leaf on the basis of price -- the key question in determining whether moist snuff is a price constraint on loose leaf.

. In a survey designed

. PX at 9470.

The major reason for using a secondary brand

. In fact,

consumers

are so brand loyal that only will buy another loose leaf brand when is out-of-stock; will go to another store to find or simply forego buying any loose leaf at

that time. PX at 9474; PX at 2316 (“

”). Because of brand loyalty,

loose

leaf purchasers are said to have “ ”:

PX at 0440. However, “

,”

. The behavior described in Swedish Match’s own market research is that consumers would substitute less expensive loose leaf, but not more expensive moist snuff, if loose leaf prices increased slightly.

Courts have repeatedly rejected “share of stomach” arguments – all beverages, all snacks,

or the like.[19] In affirming that reconstituted lemon juice is a distinct product market from fresh lemons, the Sixth Circuit explained the standard:

[19] *E.g.*, *Borden, Inc. v. FTC*, 674 F.2d 498, 507-10 (6th Cir. 1982) (fresh lemons not in the same market as reconstituted lemon juice, i.e., ReaLemon), *vacated and remanded for entry of consent order*, 461 U.S. 940 (1983); *Tasty Baking Co. v. Ralston Purina, Inc.*, 653 F. Supp. 1250, 1257-60 (E.D. Pa. 1987) (snack cakes and pies constitute an "'economically significant submarket,'" which does not include donuts, danish, cookies, brownies, etc.); *Coca-Cola*, 641 F. Supp. at 1133 (rejecting argument that carbonated soft drinks are "reasonably interchangeable" with all other beverages including tap water).

c. *Distinct Customers*

Loose leaf and moist snuff have largely different customer bases. A study commissioned by

PX at 1078. Loose leaf tobacco users are typically an average age of ; moist snuff is used by . PX ¶¶ 7,10 ( );

PX ¶ 7 ( ). A marketing study finds that the average age of Beech-Nut users is , the average age of Red Man users is years, and states that:

PX at 9422, 9425, 9429; *see also* PX at 2553; PX at 1938. Loose leaf users typically live in in the ; many . PX at 30 ( ). Moist snuff users . PX at 2553; PX ¶¶ 7, 10 ( ); PX ¶¶ 5, 7 ( ). While most snuff users . PX ¶ 10 ( ); PX ¶ 7 ( ); PX at 3394-3395.

d. *Sensitivity to Price Changes*

that demand for loose leaf is relatively inelastic, or insensitive to price increases. Inelastic demand provides conclusive evidence that a commodity constitutes an antitrust product market. R. Posner, *Antitrust Law* 125 (1976). A 1998 National Tobacco presentation notes as an industry characteristic "

." PX at 0631. A National Tobacco states:

PX at 0625 (emphasis supplied).

e. *Differences in Price Movements Between Loose Leaf and Moist Snuff*

Loose leaf competitors tend to raise prices following Swedish Match or National. PX at 44-45, 70-71 ( ); PX at 1186; PX at 2642. However, there is little correlation between loose leaf price changes and moist snuff price changes.

loose leaf chewing prices move emaff 4 00 0(2) Tj 0tic8.Ingnsi

PX at 1321. Swedish Match increased the price of loose leaf in July 1997 while simultaneously decreasing the price of Timber Wolf moist snuff by .[20] The dramatic price cut of Timber Wolf was a direct result of U.S. Tobacco introducing a price value moist snuff, Red Seal, in direct competition with Timber Wolf.

, PX at 67 ( ), plainly showing that, in making business decisions,

.

f. *Loose Leaf Pricing Is Determined by Competition with Other Loose Leaf Brands*

other loose leaf brands, and not moist snuff, to be the competition for its loose leaf brands. In pricing and making other business decisions relating to loose leaf, Swedish Match looks to other loose leaf brands. For example, the :

PX at 0860. The document makes

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[20]

. PX at 1726.

.[21]

A 1998 business plan for Red Man in North Carolina states "

." PX at 0609; *accord*, PX at ( ) (" "). When Swedish Match introduced Southern Pride, a new price value brand of loose leaf chewing tobacco, it specifically targeted

. PX at 1602. Swedish Match introduced Southern Pride in that "

." PX at 1603. A follow-up memo tracks whether Southern Pride

. PX at 0520. There is no concern or mention in either

of these documents as to whether Southern Pride is

.

A 1998 study

. PX at 0987, 0997, 0998. Similarly, National

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[21] . at 1579.05-06; PX at 0746; PX at 1938, 1953; PX at 0862; PX at 0794; PX at 0615.

PX at 1189.

In calculating the effects on sales and profitability of increased discounting of Red Man,

, even though

. PX at 112-13 ( ); PX at 4327. Nor has

(

). PX at 175 ( ).

Swedish Match documents

; they do not track .

PX at 0867, 0868; PX at 0514; PX at 0671; PX at 44 ( ) (“

). The the company is very concerned about the competition within the loose leaf category, but unconcerned about competition from moist snuff. *See* pp. 29-37 below. Defendants’ documents rarely have looked at moist snuff prices when setting loose leaf prices.

As described above, the evidence shows that moist snuff is not a significant price competitor with loose leaf chewing tobacco. Instead, the principal competition affecting the price of both Swedish Match’s and National’s loose leaf tobacco comes from each other’s products and from other loose leaf products. Focusing on a loose leaf tobacco market, and on the competition between loose leaf firms, identifies the area of effective competition. *Brown Shoe*, 370 U.S. 324. Loose leaf is perceived as a market “by those who strive to profit in it.” *Coca-Cola*, 641 F. Supp. at 1132; *accord Rothery*, 792 F.2d at 218 n.4 (“we assume that economic actors usually have accurate perceptions of economic realities”). Defining a loose leaf market allows the Court to

answer the right question – whether the combination of two of the three principal makers of loose leaf would substantially reduce competition. Once the question is properly framed, the answer is apparent: Allowing Swedish Match to acquire National's brands would eliminate substantial *current* competition.

B. This Merger Will Significantly Increase Concentration in the Market for Loose Leaf Chewing Tobacco in the United States.

It is well established that the "market shares which companies may control by merging is one of the most important factors to be considered" when analyzing the likely effects of an acquisition. *Brown Shoe*, 370 U.S. at 343.[22] Where a merger results in a significant increase in concentration and produces a firm that controls an undue percentage of the market, the combination is so inherently likely to lessen competition substantially that it "must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects." *Philadelphia Nat'l Bank*, 374 U.S. at 363. On this evidence alone the Commission establishes its *prima facie* case that this merger violates the antitrust laws. Having done so, the Commission is entitled to a presumption that the merger is illegal.

No matter how measured, the merged firm will have an overwhelming share of the loose leaf market. Swedish Match and National together had of the loose leaf market in 1999. PX .[23] These market shares far exceed the 30% *or less* that has been held to be presumptively

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[22] Courts recognize that "significant market concentration makes it 'easier for firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.'" *University Health*, 938 F.2d at 1218 n.24. "Where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels." *PPG*, 798 F.2d at 1503.

[23] PX

. *Accord, e.g.,* PX at 2553; PX at 4, 5; PX at

0633; PX at 1787; PX 126 at 62; PX 143 at 9; PX 144 at 8-9 (defendants' documents reflecting similar market shares).

[24] The *Merger Guidelines* measure concentration using the Herfindahl-Hirschman Index ("HHI"), which is calculated by summing the squares of the market share of each participant. A merger that results in an HHI over 1800 indicates a highly concentrated market; an increase in the HHI of 50 points in a highly concentrated market raises significant antitrust concerns. Where the post-merger HHI is over 1800 and the increase in the HHI is over 100 points, it is presumed that the merger will be anticompetitive. *Merger Guidelines* § 1.51, at 16-17.

[25] *See United States v. Rockford Mem. Corp.*, 898 F.2d 1278, 1283-84 (7th Cir.) (Posner, J.), *cert. denied*, 498 U.S. 920 (1990); *Pacific Coast Agric. Export Ass'n v. Sunkist Growers*, 526 F.2d 1196, 1204 (9th Cir. 1975), *cert. denied*, 434 U.S. 959 (1976); H. Hovenkamp,

[26] 798 F.2d at 1502-03. Courts have barred mergers resulting in substantially lower concentration levels. *Elders Grain*, 868 F.2d at 902 (acquisition increased market shares of largest firm from 23% to 32%); *Hospital Corp. of Am.*, 807 F.2d at 1384 (acquisition increased market share of second largest firm from 14% to 26%); *Warner Communications*, 742 F.2d at 1163 (four-firm concentration ratio of 75%); *Cardinal Health*, 12 F. Supp. 2d at 52 (mergers resulting in two firms with 40% and 37% respectively "clearly cross the 30% threshold"); *United States v. United Tote*, 768 F. Supp. 1064, 1069-70 (D. Del. 1991) (merger between two firms with 13 and 27% of sales, increasing the HHI from 3940 to 4640, held presumptively unlawful);

"ultimate burden of persuasion" that the merger will in fact substantially reduce competition. *Baker Hughes*, 908 F.2d at 983; *Cardinal Health*, 12 F. Supp. 2d at 63.

1. *The Merger Will Reduce Price Competition.*

These two defendants are among each other's most direct competitors. Today they compete hard against each other, and – – base their prices primarily on the competition they face from each other and from Conwood.

that analyzes

"

." PX at 2. A document analyzing

decision to sell states:

PX at 0461. A report states:

PX at 0247.

PX at 0693 (emphasis added).

." PX at 0341.03. The

proportion

of Red Man volume sold under discount

. PX at 3668.

While several documents focus on

the source of this and its brands are

also

significant competitive threats. A recent emphasizes the

company's

success with

.[28] PX at 0204.

would ameliorate some competitive pressures and may lead to higher prices for consumers.

This merger is likely to reduce competition in at least two ways:

– The merger will significantly increase Swedish Match's existing, acknowledged market power, allowing it to raise price further without regard to its competitors' activities.

– It will make it that much easier for the two remaining significant firms to coordinate their pricing.

A. *Unilateral Price Increases.*

Post-acquisition, Swedish Match will be in a position to exercise market power unilaterally, through its control of the combined Swedish Match and National Tobacco portfolio of brands. Swedish Match might then find it profitable to increase the price of one brand of the combined portfolio unilaterally, if a large enough number of users of that brand who switch to another brand in response to a price increase would switch to other brands owned by the merged entity. A firm would find it profitable to exercise such a unilateral price increase if the profits from the higher-priced brand, plus the profits from new sales to other Swedish Match brands by users switching from the higher-price brand, outweigh the profits lost by users who switch to non-Swedish Match brands.

For a unilateral price increase to be profitable, the two brands at issue need not be the two

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[28] After this document was written,

. PX at 105 ( ).

"closest" substitutes in some absolute sense or in the minds of *all* consumers. There need only be a substantial number of consumers who would switch between the two brands in response to a price increase in one of them. *See* 4 Areeda ¶ 914; ABA, *Mergers and Acquisitions* at 107-09. A unilateral price increase is particularly plausible in this market, where products are differentiated, PX at 0506, 0509, brand loyalties are strong, PX at 9474, PX at 1764, and the merged firm's brands would have a market share.[29] PX .

Swedish Match's Red Man brand is one of the oldest consumer brands in the U.S., dating back to 1887. PX at 1009. Beech-Nut is also a venerable brand, dating back to 1897. PX at 0638. Red Man is the largest selling loose leaf brand in the nation, with a market share; Beech-Nut is the third largest selling loose leaf brand, with a market share.[30] Red Man and Beech-Nut compete in the traditional, full flavor segment of the market. PX at 0860; PX at 0509; PX at 0635. A Swedish Match document states "

." PX at 3732. The document adds that:

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[29] The likelihood of a unilateral price increase is heightened

. PX at 73-74 ( ).

[30]

. PX ( ).

PX at 3731. National's senior vice president for sales and marketing also testified that . PX at 179 ( ). Clearly, for a significant number of users, Red Man and Beech-Nut are very close substitutes.

One market survey found that of users also purchase [31] and that of users also purchase .[32]

, suggesting that is the best alternative for

[31] PX at 0904. A slightly higher number of , also purchase *Id.* This suggests that only a slightly higher percentage of users regard as a better substitute than for .

[32] PX at 0907. A slightly higher number of users, , also purchase . *Id.* This suggests that only a slightly higher percentage of users regard as a better substitute than .

Match might find it profitable to increase the price of Beech-Nut unilaterally, because a large percentage of affected consumers would switch to Swedish Match brands, and Swedish Match therefore would not lose the sale. Likewise, Swedish Match could increase the price of Red Man, or of other brands it controls.

B. *Price Coordination.*

By reducing the number of major competitors to two, the acquisition would make it easier for Swedish Match and Conwood to coordinate their behavior. The ability of firms to coordinate their actions – to pull their competitive punches, with the expectation that their competitors would do the same – is one of the central concerns of the antitrust laws.[33]

The most important determinant of the practicability of coordination is the number of participants in the market.[34] both wholesale and retail prices in this market, including discounts, can be and indeed are observed by competitors. PX at 70, 103-104, 116 ( ); PX at 0301.4324; PX at 0057, 0058. The two firms can coordinate without actually agreeing on a price, since each firm already knows the prices of the other firm and can act accordingly.

The acquisition will effectively create a duopoly of Swedish Match and Conwood,

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[33] Coordination need not be explicit price fixing, but includes tacit collusion. *Merger Guidelines,* § 2.1, at 18; *Cardinal Health,* 12 F. Supp. 2d at 45 n.8.

[34] "The relative lack of competitors eases coordination of actions, explicitly or implicitly, among the remaining few to approximate the performance of a monopolist." *Cardinal Health*, 12 F. Supp. 2d at 45 n.8; *FTC v. PPG Indus.*, 628 F. Supp. 881, 885 n.9 (D.D.C.), *aff'd in pertinent part, rev'd in part*, 798 F.2d 1500 (D.C. Cir. 1986). By reducing the number of major firms from 4 to 3, coordination obviously will be enhanced. Courts have found violations where the decrease in the number of competitors was less significant. *See Elders Grain,* 868 F.2d at 902 (reduction from 6 to 5 competitors); *Hospital Corp. of America*, 807 F.2d at 1387 (reduction from 11 to 7 competitors); *Bass Bros.*, 1984-1 Trade Cas. ¶ 66,041, at 68,609-10 (reduction from 7 to 5).

increasing the likelihood of coordinated interaction in the U.S. loose leaf market. Two firms, Swedish Match and Conwood, would control of the loose leaf market; three firms, Swedish Match, Conwood, and Swisher, would control of the market. PX .

This market has several characteristics that favor coordination. Pricing is very transparent.

. PX at 0512; PX at 0787.

The price lists include prices for discounted products, which typically come with a 25 or 40 cent coupon printed on the package. PX at 0097; PX at 0787. Competitors' price lists employ exactly the same list price for their directly competing products – the current price for full priced Red Man, Beech-Nut, and Levi Garrett is $ a case, or $ a pouch.[35] Competitors keenly follow each others' pricing, at both the wholesale level and the retail level.[36] PX at 70, 103-104, 116 ( ); PX 4324; PX at 0057-58. Discounting is typically done through "sniped" product, or coupons printed on the pouch, which are clearly visible. Finally, competitors monitor each other's market shares on a monthly basis through Nielsen and IRI reports. PX at 0499; PX at 0018-38.

Transactions are numerous and small, both at wholesale and retail. National's top ten wholesale customers represent of its revenue. PX at 1794. Consequently, the

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[35] . PX at 4324.

[36] . PX at 0512; PX at 0787; PX at 1041, 1044. . PX at 117 ( ); PX at 0057, 0058.

incentive to cheat on a collusive scheme is small, as the gains through cheating would also be small. *Merger Guidelines* § 2.12.

The market already exhibits behavior associated with coordination or oligopolistic behavior. Swedish Match,

. PX at 71 ( ). Minutes from a September 3, 1997 board meeting state:

PX at 1186. An investment report, commenting on a price increase initiated by National Tobacco in January 1998, states:

PX at 2642. While discounting has increased in recent years as loose leaf firms have attempted to replace lost volume (caused by a decline in overall loose leaf sales) by taking share from each other, uninhibited price wars have been rare. Manufacturers have historically cooperated (implicitly) in implementing price increases. A memorandum states:

PX at 1768.

Post-merger, the remaining competitors could easily coordinate in a number of ways, such as simply eliminating couponing and other forms of discounting. Indeed, the acquisition would eliminate excess capacity that has accrued due to declining demand. PX at 0201. This excess capacity may be one of the causes for the aggressive discounting which has come to characterize the industry. Removing this excess capacity would in turn lead to less discounting. *Cardinal Health*, 12 F. Supp. 2d at 63-64.

2. *Entry Is Unlikely to Defeat the Acquisition's Anticompetitive Effects.*

Entry by new firms would not defeat a merger's anticompetitive effects unless that entry would be likely to occur in a timely manner (*e.g.*, two years) and in sufficient magnitude to constrain anticompetitive behavior.

908 F.2d at 989.[37] In order for new entry to be likely, the sales opportunities available to a new entrant must be sufficient to enable the entering firm to operate at a large enough scale to make entry profitable. *Merger Guidelines*, § 3.3.[38]

The defendants recognize that they are safe from the threat of competition from new entrants. National's SEC filings, made subject to liability under § 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), states:

> The company believes that the smokeless tobacco market, including loose leaf chewing tobacco, and RYO cigarette paper industry, are each characterized by non-cyclical demand, brand loyalty, *significant barriers to entry*, minimal capital expenditure requirements, high profit margins, consistent price increases at the wholesale level as well as the ability to generate strong and consistent free cash flows.

PX 126 at 0327. (emphasis added). A memorandum states:

PX at 1751.

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[37] Similarly, in *Cardinal*, this Court found that defendants (despite their efforts) had failed to come forward with sufficient evidence of sufficiency of entry (and of likelihood of entry) to rebut the presumption from concentration. 12 F. Supp. 2d at 58; *accord Staples*, 970 F. Supp. at 1087 (finding entry to be unlikely).

[38] Courts often look to the history of entry in assessing the likelihood of future entry. *See Staples*, 970 F. Supp. at 1087 (recent trend of exit, not entry); *United Tote*, 768 F. Supp. at 1076, 1080-82 (lack of entry supported finding of barriers); *California v. American Stores, Inc.*, 697 F. Supp. 1125, 1131-32 (C.D. Cal. 1988), *rev'd in part on other grounds*, 872 F.2d 837 (9th Cir. 1989), *rev'd*, 495 U.S. 271 (1990), *aff'd in pertinent part*, 930 F.2d 776 (9th Cir. 1991); *FTC v. Illinois Cereal Mills, Inc.*, 691 F. Supp. 1131, 1144-45 (N.D. Ill. 1988), *aff'd sub nom. FTC v. Elders Grain*, 868 F.2d 901 (7th Cir. 1989).

De novo entry into loose leaf chewing tobacco would involve substantial sunk costs in product development and marketing. Swedish Match spent million in 1996, million in 1997, and million in 1998, promoting and advertising Red Man. PX . In 1999, National Tobacco spent about promoting its loose leaf brands. PX . Conwood introduced a new price value brand, Morgan's, about three years ago. Conwood has spent about in promoting this brand, including the expenses for advertising, free sampling, sales force time and effort, and couponing. PX ¶ 16 ( ). Morgan's has gained a market share and the brand is currently . *Id.*

Entry would require the expenditure of substantial sunk costs for a manufacturing plant. Swedish Match spent to construct its plant in 1972. PX at 12. The time from initial planning to full production was approximately . *Id.* Swedish Match estimates that replacing its current facility would cost and take . *Id.*[39]

Entry would also require significant sunk costs to establish a sales force to gain

[39] Although National claims that it could replace *its* plant , PX at 5, Swedish Match claims
PX at 15-16.
PX
at 0646. *See also* PX at 0626; PX at 1793 ("
")

. PX at 0555. Declining consumption limits the sales opportunities available to a new entrant. It also means that a new entrant would have to take sales from incumbent competitors, increasing competition, decreasing market pricing, and making more it more difficult for the new entrant to earn an acceptable return on investment. PX ¶ 15 ( ).

Restrictions on advertising and merchandising make promotion of a new brand difficult. Several states have enacted legislation that requires all tobacco products, including loose leaf, to be placed behind the counter. This effectively restricts the amount of retail space that is available for tobacco products and makes it more difficult for a new entrant and other competitors with small market shares to gain distribution: "

." PX at 0311. After behind-the-counter legislation became effective in Texas in 1998, National's sales in that state

. PX at 0313. *See also* PX at 0931, 0933.

[40]) . Fred Stoker was founded in 1947. Originally, the company sold one and five pound packages of loose leaf through mail order catalogues. PX at 14. Since 1994, the company has expanded its sales through tobacco outlets and gained a market share. PX at 14; PX . The company sells in the price-value segment of the market and its sales are

[40] The existence of a fringe firm does not preclude a finding of anticompetitive effects. To the contrary, courts have been reluctant to find that small players might suddenly expand to constrain a price increase by leading firms. *Philadelphia Nat'l Bank*, 374 U.S. at 367; *United States v. Rockford Mem. Corp.*, 898 F.2d at 1283-84 ("three firms having 90 percent of the market can raise prices with relatively little fear that the fringe of competitors will be able to defeat the attempt by expanding their own output to serve customers of the three large firms").

. PX at 155, 220-221 ( ). If packaging chewing tobacco and selling it cheaply were the only prerequisites for success in this business, Fred Stoker should have a huge market share. The fact that,

(Swedish Match's net margins on loose leaf have been , PX ; *see also* PX at 0631, a National document describing the loose leaf industry as having " "), the only entrant into this market in years has attained market share underscores the difficulty of entry and expansion into this market.

3. *Defendants' Asserted Efficiencies Cannot Save this Transaction.*

Defendants argued before the Commission that the proposed acquisitions would result in significant efficiencies. The Supreme Court has stated that "possible economies cannot be used as a defense to illegality" in Section 7 merger cases. *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 580 (1966); *see also Philadelphia Nat'l Bank*, 374 U.S. at 371; *Phillipsburg Nat'l Bank*

[41] As Judge Gesell wrote: "Any federal judge considering regulatory aims such as those laid down by Congress in Section 7 of the Clayton Act should hesitate before grafting onto the Act an untried economic theory such as the wealth-maximization and efficiency-through-acquisition doctrine expounded by [defendants] . . . . To be sure, efficiencies that benefit consumers were recognized [by Congress] as desirable but they were to be developed by dominant concerns using their brains, not their money by buying out troubling competitors. The Court has no authority to move in a direction neither the Congress nor the Supreme Court has accepted." *Coca-Cola*, 641 F. Supp. at 1141.

just as the antitrust agencies consider pro-competitive efficiencies in evaluating a merger's likely competitive effect. *Merger Guidelines* § 4.0, at 18-20.

All courts, however, agree that the ultimate issue under Section 7 is whether a proposed merger is likely to lessen competition substantially in any line of commerce in any section of the country, and if it is determined that a merger would have such an impact, proven efficiencies, however great, "will not insulate the merger from a Section 7 challenge." *University Health*

potentially illegal acquisitions stems from the historic difficulty of effectively splitting a combined operation into viable entities after the acquisition is consummated. This is particularly true in cases like this one,

. PX at 15; PX at 15.

. The ineffectiveness of divestiture as a remedy, and the need for injunctive relief to maintain the status quo, was demonstrated so frequently that by 1966 it became the subject of judicial notice by the Supreme Court in *FTC v. Dean Foods Co.*, 384 U.S. 597, 606 n.5 (1966).

Section 13(b) manifests congressional recognition of the enforcement problem. *Weyerhaeuser*, 665 F.2d at 1081 n.20. As the court noted in *FTC v. Rhinechem Corp.*, 459 F. Supp. 785, 790 (N.D. Ill. 1978):

> Section 13(b) in part reflects Congress' dissatisfaction with the efficacy of divestiture as a remedy in antitrust cases. To achieve its goal of facilitating successful governmental intervention before the eggs are even cracked, thereby relieving the government from the necessity of trying to unscramble them at some later date, Congress rendered the traditional equity requirements inapplicable in a Section 13(b) suit.

As this Court noted in *Staples*, another compelling reason to halt illegal acquisitions before they occur is to prevent the interim harm to competition that would result even if a suitable divestiture remedy could be devised. 970 F. Supp. at 1091. As the District Court for the

Northern District of Ohio stated in enjoining two acquisitions in 1984, "later remedies cannot remove retroactively the harm that has already occurred. Courts should, therefore, prohibit consummation of a merger pursuant to Section 13(b) where serious questions are raised about its legality." *Bass Bros.*, 1984-1 Trade Cas. ¶ 66,041, at 68,622.

Conclusion

For the foregoing reasons, the Court should grant the Commission's motion for a preliminary injunction against the proposed acquisition.

Respectfully submitted,

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