Warranty Tie-in Sales Provisions Are Generally Illegal, But Could They Also Violate Antitrust Laws?

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Say you're an original equipment manufacturer, or OEM, of industry-leading copiers or printers, but aftermarket parts and toner suppliers are eating into your revenue and profits. What can you do? Make your toner more competitive in the marketplace? Or, pursue an aggressive marketing strategy of bundling your products? What about using your warranty as a marketing tool? Is it fair or legal to compete by conditioning the copier's warranty on your buyers' use of your OEM-brand toner? Could you be sued by a competitor?

While it has been no secret that warranty tie-in sales provisions usually violate the Magnuson-Moss Warranty Act (see below), a recent federal court decision now on review by the U.S. Supreme Court suggests that you might need to worry about an antitrust lawsuit, too. "Tying" the purchase of a popular product to the purchase of another, less desirable product could violate the antitrust laws when the manufacturer has market power. Market power measures a company's ability to charge a premium price for its products. As a rule of thumb, a seller probably does not have market power unless it controls at least 60 percent or more of the relevant market.

In January 2005, a federal court of appeals issued a controversial ruling that makes it easier for purchasers and competitors to show market power and sue for an antitrust tying violation. The court in Independent Ink v. Illinois Tool Works determined that binding Supreme Court precedent requires a presumption of market power for patented "tying products." This decision, if upheld by the Supreme Court, could upset other federal decisions upholding warranty tie-in sales provisions against antitrust challenges for lack of market power.

Warranty Tie-In Sales Provisions Usually Violate the Magnuson-Moss Warranty Act

Antitrust issues aside, the Magnuson-Moss Warranty Act severely restricts an OEM's ability to employ warranty tie-in sales provisions. The Act, with limited exceptions, prohibits manufacturers from linking a warranty to the use of other branded products sold by the same manufacturer. The Federal Trade Commission's Businessperson's Guide to Federal Warranty Law provides a good example of an illegal warranty tie-in provision: "In order to keep your new Plenum Brand Vacuum Cleaner warranty in effect, you must use genuine Plenum Brand Filter Bags." Likewise, the FTC has said that automobile manufacturers may not condition their warranties on the use of specific brand name parts or motor oil, at least not without proof that they are necessary to proper functioning or performance. A manufacturer can still require in its warranties the use of certain types or grades of parts or accessories, e.g., upright vacuum cleaner bags or 50-grade motor oil, just not a specific brand.

To get an exemption to these rules, the manufacturer must persuade the FTC that non-OEM products do not perform adequately or safely. But in today's competitive market, some aftermarket products not only meet but even exceed the quality of the branded products. With the high quality and competitive prices of many aftermarket products, Magnuson-Moss exemptions can be anti-competitive and harmful to consumers and should be relatively rare.

The U.S. Supreme Court's Ultimate Decision Could Increase The Risk of Antitrust Liability For OEMs

Illegal tying is a violation of the Sherman Act and can result in liability of treble damages. Essentially, tying consists of forcing the sale of the tied product on a customer who is really only interested in buying the tying product. The U.S. Supreme Court in the Jefferson Parish decision described tying as follows:

[T]he essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms.

Aftermarket competitors of OEMs, therefore, should be able to provide the buyer with the opportunity to purchase an alternative product on different terms.

But considerations differ somewhat in the warranty context. In practical terms, a warranty is part of the purchase of a major product like a copier. The relevant product market could be defined as the market for copiers with warranties. Absent market power or collusion among the OEMs, a purchaser could ordinarily shop around for a better warranty in a competitive market. And antitrust lawsuits based on warranty tie-in sales provisions have historically failed because the competitor could not prove the OEMs' market power. Even in these circumstances, however, the OEMs still need to comply with the provisions of Magnuson-Moss.

The Independent Ink decision threatens to change that paradigm because, in the appellate court's view, under old, but still binding Supreme Court precedent, a manufacturer of a patented product would be presumed to have market power in the market for the patented product and would have the burden of proving otherwise. In Independent Ink, the manufacturer of patented print heads for bar codes (Trident) also required customers to purchase bar code ink exclusively from Trident. At issue is whether Trident had sufficient market power to coerce its customers into buying Trident ink. Ordinarily, in a competitive market, a single entity would probably lack the ability to force its customers to purchase a complementary, branded product. An economist might define market power as the ability to raise prices without losing profits to competitors. In a tying situation, market power is the ability to coerce a customer into buying a supplementary product that the customer would not have bought in a competitive market. Absent market power, which is usually said to be 60 percent or more of the relevant market, a seller cannot unilaterally raise prices without losing corresponding market share.

But the legal definition of market power for patented products may have expanded beyond its economic rationale. The U.S. Supreme Court ruled in 1962 in United States v. Loew's that the existence of a patent on a product creates a presumption of market power sufficient to support liability for illegal tying. Following Loew's, the Independent Ink court concluded that "a rebuttable presumption of market power arises from the possession of a patent over a tying product." According to that court, "a patent presumptively defines the relevant market as the nationwide market for the patented product itself, and creates a presumption of power within that market." In the court's view, the "mere presence of competing substitutes for the tying product" does not rebut the presumption of the manufacturer's market power in the market for the patented product.

Most legal commentators, economists, and even the United States government would probably agree that, economically speaking, intellectual property rights by themselves cannot create market power. Market power instead depends on the lack of availability of reasonable substitute products, whether or not the products are patented. The Supreme Court's seemingly contrary decision in Loew's has been widely criticized for its economically obsolete approach to market power. Independent Ink's revival of that authority is likely to face the same wave of criticism. To be sure, the Supreme Court will have no shortage of "friend of the Court" briefs from industry and intellectual property organizations alike urging reversal. But if the Independent Ink decision is upheld, any OEM with a patented copier presumptively has market power in the nationwide relevant market for that copier and would risk antitrust liability, not to mention liability under the Magnuson-Moss Warranty Act, by conditioning its product warranty on the purchase of unpatented toner products.

Both OEMs and their aftermarket competitors will be watching with great interest indeed when the U.S. Supreme Court finally decides this issue. A decision is expected by the end of June 2006.