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Tech-Tying Vs. Section 2 Of The Sherman Antitrust Act

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We live in a technology-driven world where businesses are often forced to innovate or die. Occasionally, however, some competitors innovate in a way that unlawfully forecloses competition. One such innovation is a "technological tie" i.e., when a monopolist redesigns a product so that it "locks out" rivals and may only be used in conjunction with its own complementary product.

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At first blush, a technological tie may appear to be pro-competitive. To be sure, technological ties can benefit consumers and create market efficiencies.[1] And importantly, a company generally does not have any duty to make its products compatible with those of its rivals. So when does a technological tie violate the antitrust laws? Unfortunately, there is no simple answer because there is no unanimity among the courts of appeal that have addressed the issue.

As discussed herein, despite this lack of uniformity, when evaluating whether an ostensible innovation is actually an anti-competitive technological tie, courts generally consider the degree of improvement, the purpose of the product redesign, and whether there is genuine consumer demand for the new product.

The Degree of Improvement

The D.C. Circuit advocates the use of a balancing test when evaluating a potentially anti-competitive technological tie. In United States v. Microsoft Corp., the D.C. Circuit considered whether Microsoft violated the antitrust laws by integrating its Internet browser, Internet Explorer, into its Windows 98 operating system.[2] Microsoft achieved this integration by removing its browser from the "Add/Remove Programs" utility and commingling browser and operating system codes. Consequently, the lower court concluded that the redesign blocked rivals from the browser market by discouraging original equipment manufacturers from distributing their browsers.

In analyzing the issue before it, the D.C. Circuit articulated a three-part balancing test: (1) plaintiffs first had to show that the product redesign resulted in anti-competitive effects; (2) if so, defendant had to show that the product redesign produced pro-competitive effects; and (3) if so, then plaintiffs bore the ultimate burden of demonstrating that the anti-competitive effects outweighed the pro-competitive

ones.[3]

Interestingly, the court never employed the balancing test because Microsoft did not argue that excluding Internet Explorer from the Add/Remove Programs utility or commingling the browser and operating system codes achieved any integrative benefit. And by contrast, plaintiff demonstrated that the integration discouraged consumers from using other browsers, thereby reducing the ability of rival browsers to draw developer attention. Thus, having found that the new technology offered no consumer benefit, the D.C. Circuit affirmed the lower court's holding that Microsoft's technology violated the Sherman Act.

The Ninth Circuit rejected the balancing test in favor of a test in which a tie is presumptively legal if the new product offers any improvement from the prior version.[4] In Allied Orthopedic Appliances Inc., v. Tyco Health Care Group LP, the Ninth Circuit affirmed a district court's rejection of a Section 2 monopolization claim by hospitals and health care providers against a medical device manufacturer.[5] The device manufacturer introduced a new insulin pump that was incompatible with competitor replacement parts. At the same time, the device manufacturer discontinued its prior product, which had been compatible with rival pumps. Plaintiffs argued that the district court failed to appropriately balance the benefits of the product improvement against its anti-competitive effects.

The Ninth Circuit disagreed:

There are no criteria that courts can use to calculate the "right" amount of innovation, which would maximize social gains and minimize competitive injury. A seemingly minor technological improvement today can lead to much greater advances in the future.[6]

Hence, the court broadly held that, if a design change improves the product in any way, the product redesign does not violate the antitrust laws unless a monopolist abuses or leverages its power in some other way when introducing the new product. Having found no such abuse, the court rejected plaintiffs' claim.

While sweeping on its face, the Ninth Circuit's decision in Allied Orthopedic may ultimately be limited to the facts before it. Importantly, the improvement offered by the product design change was a conceded fact in the case.[7] Thus, it is not clear whether the reasoning would apply in future cases where the litigants contest the existence of a legitimate improvement.

The Purpose of the Improvement

The Federal Circuit also considers a manufacturer's intent in redesigning its product.[8] In C.R. Bard Inc. v. M3 Systems Inc., a medical device manufacturer redesigned its biopsy guns to make competitor needles incompatible.[9] After a rival designed its replacement needles to fit the new gun design, the device manufacturer sued for patent infringement. In response, the replacement needle manufacturer asserted an antitrust counterclaim, arguing that the device manufacturer altered its gun design to stop consumers from using competitor needles in an attempt to monopolize the needle market.

The Federal Circuit concluded that, for the replacement needle manufacturer to prevail on its attempted monopolization claim, it had to show the device manufacturer changed the design for predatory reasons.[10] In other words, the needle manufacturer had to show the device manufacturer changed its gun design "for the purpose of injuring competitors in the replacement needle market, rather than improving the operation of the gun."[11]

The court referenced two internal documents from the device manufacturer that indicated the manufacturer's predatory intent. One document revealed that the modifications did not affect performance of the gun or the needle. The other document showed that the use of competitor needles would not cause injury to the patient or the physician. Thus, the court held that there was sufficient evidence for the jury to conclude the device manufacturer changed the design for predatory reasons, i.e., "to exclude competing replacement needles."[12]

Consumer Demand

Finally, the Second Circuit analyzes the legality of a product redesign by evaluating whether there is consumer demand, free of coercion, for the new product. In the seminal case Berkey Photo Inc. v. Eastman Kodak Co., Kodak introduced a smaller pocket version of an already successful camera along with a new, specially designed film. But that film fit only with the new pocket camera. According to Berkey, it lost camera sales because the consumers that wished to use the new film were forced to buy the new Kodak camera.

In rejecting Berkey's monopolization claim, the court stated that "[t]he only question that can be answered is whether there is sufficient demand for a particular product to make its production worthwhile, and the response, so long as the free choice of consumers is preserved, can only be inferred from the reaction of the market."[13] Thus, "it is not the product introduction itself, but some associated conduct, that supplies the violation."[14] And that associated conduct is coercion: "If a monopolist's products gain acceptance in the market, therefore, it is of no importance that a judge or jury may later regard them as inferior, so long as that success was not based on any form of coercion."[15]

Unfortunately, the court failed to provide much guidance as to what is coercive conduct. The court cautioned that if Kodak's decision to restrict the new film format to that particular size "was not justified by the nature of the film but was motivated by a desire to impede competition in the manufacture of cameras capable of using the new film," Kodak would have violated Section 2.[16] The court reasoned that "[t]his might well supply the element of coercion."[17] But rather than fully analyze whether Kodak's conduct was coercive, the court rejected Berkey's monopolization claim on other grounds because Berkey failed to establish antitrust injury.

Conclusion

As technology continues to evolve, manufacturers will likely become increasingly incentivized to redesign their products to lock out competition. Until the U.S. Supreme Court weighs in on the issue, however, any manufacturer considering the use of lock-out technology should be cautioned that the benefits of a redesigned product may be outweighed by the inherent antitrust risks.

—By Kellie Lerner and David Kurlander, Robins Kaplan Miller & Ciresi LLP

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[1] U.S. Dep't of Justice, Competition and Monopoly: Single Firm Conduct Under Section 2 of the Sherman Act 87 ("Unduly broad application of a per se prohibition on tying could freeze product innovation and prevent transition to more efficient, integrated products.").

[2] United States v. Microsoft Corp., 253 F.3d 34, 66-67 (D.C. Cir. 2001).

[3] Id. at 58-59.

[4] Allied Orthopedic Appliances Inc. v. Tyco Health Care Grp. LP, 592 F.3d 991, 1000 (9th Cir. 2010).

[5] Id. at 998.

[6] Id. at 1000.

[7] Id. at 994.

[8] Other courts, however, have cautioned that intent should not be the sole consideration for Section 2 liability based on a technological tie. For example, in In re IBM Peripheral EDP Devices Antitrust Litigation, defendant IBM changed the design of a computer Central Processing Unit ("CPU") to block rival CPU peripherals. Peripheral manufacturers argued that IBM's CPU design change was simply an attempt to unlawfully monopolize the peripheral market. While recognizing the importance of analyzing intent, the court cautioned that it should not be the sole consideration in evaluating a potentially anticompetitive technological tie. The court explained that "usually many results are intended, and if only one, even the predominating, intent is illegal, and thus punished, legitimate incentives will be imperiled. Discerning corporate intent is seldom easy, and, in any event, the law against monopolization is much more concerned with the effect of conduct rather than with its purpose." In re IBM Peripheral EDP Devices Antitrust Litig., 481 F. Supp. 965, 1003 (N.D. Cal. 1979) aff'd sub nom. Transamerica Computer Co. v. Int'l Bus. Machs. Corp., 698 F.2d 1377 (9th Cir. 1983). After concluding that plaintiff had not demonstrated that IBM had a predatory intent, the court next considered the extent to which IBM improved the CPU and the effect that the improvement had on the peripheral market. Thus, while the court considered IBM's intent in its analysis, it did not decide the issue solely based on the purpose of the redesign.

[9] C.R. Bard, Inc. v. M3 Sys., Inc., 157 F.3d 1340 (Fed. Cir. 1998).

[10] Id. at 1382.

[11] Id.

[12] Id.

[13] Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 287 (2d Cir. 1979).

[14] Id. at 286 n.30.

[15] Id. at 287.

[16] Id. at 288.

[17] Id.
