Antitrust Law Blog

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Where There Is An "At-Will," There Is A Way

A market share discount engaged in by an alleged monopolist, coupled with a new product innovation that was not compatible with competitor's products, passes Sherman Act scrutiny. *Allied Orthopedic v. Tyco Health Care*, 08-56314 (9th Cir. January 6, 2010).

Plaintiffs were a group of hospitals and health care providers that purchased pulse oximetry sensors from defendant Tyco Health Care Group, L.P. ("Tyco"). The complaint alleged violations of Section 1 and Section 2 of the Sherman Act for alleged exclusionary marketing practices, which plaintiffs claimed unlawfully foreclosed competition from generic sensor manufacturers. Plaintiffs also alleged that Tyco introduced a new patented pulse oximetry system, "OxiMax" in order to unlawfully maintain its monopoly in the market for oximetry sensors, in violation of Section 2. The complaint alleged that Tyco willfully designed its new product to be incompatible with generic sensors used by the plaintiffs, thus creating a "lock-in" situation as to existing Tyco "installed-base" customers, thus denying competitive opportunities to plaintiffs.

The district court denied plaintiff's motion for class certification and granted defendant Tyco's motion for summary judgment on both the Section 1 and 2 claims. On January 6, 2010, the Ninth Circuit affirmed.

It was admitted that Tyco was an early entrant into the pulse oximetry market, and had a substantial base of installed monitors, which exceeded that of its competitors. Its technology was protected by a patent which was on the verge of expiration. Accordingly, Tyco allegedly adopted a strategy of developing a new patented sensor design that was incompatible with the products used by the plaintiffs.

In launching its new "OxiMax" product, it notified other equipment manufacturers that all of its products subject to the prior patent would be discontinued. It then offered two types of marketing agreements. The first was a "market-share discount". The second was a "sole source agreement", namely an exclusive dealing contract. As it's name implies, the market share discount plan granted purchasers discounts off list prices if they committed to purchase the same percentage of their products as in the past. Thus, the greater percentage of a customer's requirements that it purchased from Tyco, the greater the discount it would receive under the new OxiMax plan. However, the OxiMax market share discount plan did not obligate any purchases, and was subject to "at-will" cancellation. Similarly, the sole-source agreement was also at-will.

The district court granted defendant Tyco's motion for summary judgment on the ground that as the allegedly restrictive agreements were "at-will", they could not have any foreclosive effect in the market, and were nothing more than an opportunity for customers to purchase at lower prices, thus benefiting purchasers and consumers alike.

The Ninth Circuit affirmed. Citing its previous cases in *Omega Environmental, Inc. v. Gilbarco, Inc.,* 127 F. 3d 1157 (9th Cir. 1997), and *Twin City Sportservice, Inc. v. Charles O. Finley & Co., Inc.,* 676 F. 2d 1291, 1303-04 (9th Cir. 1982), the court held that an exclusive dealing provision that was at-will, could not foreclose competition in a substantial way of any line of commerce. As to both the market-share discount and the sole-source agreements, the court held that because they were at-will, they could not contractually obligate customers to purchase anything from Tyco, and thus could have no foreclosive effect.

The district court also granted summary judgment as to the Section 2 claim. It found that, as a matter of law, the OxiMax design was a "superior and more sophisticated offering", and thus was not subject to anti-competitive effects analysis. The design and introduction of product improvements is legitimate competition on the merits.

Turning the clock back to the "compatible peripheral" IBM cases of the 1970's and 80's, the court noted that the introduction of a superior product, even for exclusionary purposes, was not condemned under the antitrust laws. Rather, the issue was whether the product innovation was a contribution to the art. *See California Computer Prods. v. IBM Corp.,* 613 F. 2d 727, 735 (9th Cir. 1979) and *Transamerica Computer Co. v. IBM Corp.,* 698 F. 2d 1377 (9th Cir. 1983).

Of note, defendant Tyco did not contest, for the purposes of the Ninth Circuit appeal, that it was a monopolist in the pulse oximetry sensor market. Rather, the focus of the dispute was whether Tyco had unlawfully *maintained* its monopoly power by aftermarket exclusionary conduct. In its analysis, the Ninth Circuit engaged in a form of structured or "quick look" rule of reason inquiry. First, it asked the question whether the innovation was a contribution to knowledge. It noted, but did not decide, that the fact that a patent had issued on the new product was at least "evidence". The more important question asked was whether there was a business justification. The court noted that "as a general rule, courts are properly very skeptical about claims that competition has been harmed by a dominant firm's product design changes." Slip Opinion, p. 409. For this proposition, it cited *Berkey Photo, Inc. v. Eastman Kodak Co.,* 603 F. 2d 263, 281 (2nd Cir. 1979), and the more recent case of *United States v. Microsoft Corp.,* 253 F. 3d 34, 65 (D.C. Cir. 2001). The court held that a design change that improves a product by providing a new benefit to consumers does not violate Section 2, absent some associated and unprivileged anti-competitive conduct. The reduction of manufacturing costs and prices to consumers, coupled with improved performance of the product in the market is a sufficient justification to forego any further effects analysis. The court held that Tyco was under no duty to help its competitors survive or expand. It was immaterial that it designed its product as not to be compatible with rivals. This was not dissimilar to the analysis taken by the *United States Supreme Court in Verizon Communications v. Law Offices of Curtis v. Trinko, LLP,* 540 U.S. 398 (2004) (limitations on duty of monopolist to deal with rivals). Thus, where there is a consumer benefit from a product improvement, there is no 'technological predation'. See *California Computer Prods,* 613 F. 2d at 744.

Finally, the court noted a policy reason for the deference given under the antitrust laws for beneficial product improvement designs. The court noted that balancing the consumer benefits of the product innovation with the exclusionary impact on rivals was beyond the expertise or resources of federal courts. Thus, it does not present a factual issue, and is a policy determination. In this regard, it is reminiscent of the early Sherman Act decision in *United States v. Trenton Potteries Co.,* 273 U.S. 392 (1927). There, the Supreme Court recognized that it was beyond its expertise, on a policy basis, to make a determination whether a concerted pricing agreement was "reasonable". *Trenton Potteries* gave great efficacy to the expansion, during that era, of "per se" rules. Here, however, the district court noted that the issue of Section 2 liability founded on product innovation was not per se lawful, but was subject to a more structured rule of reason analysis. However, it also noted that statements of an innovator's intent to harm a competitor through genuine product improvement are insufficient in themselves to create an issue of fact that warrants a denial of summary judgment, citing *Oahu Gas Serv., Inc. v. Pacific Res., Inc.,* 838 F. 2d 360 (9th Cir. 1988).

It was interesting to note that while defendant Tyco did not contest its monopoly status, the record, as noted by the Ninth Circuit, supported the proposition, again resurrecting the IBM compatible peripheral cases, that a declining market share was contra indicative of current market power. See *Transamerica Computer Co. v. IBM Corp.,* 698 F. 2d 1377 (9th Cir. 1983); *Syufy Entertainment v. American Multicinema,* 793 F. 2d 990 (9th Cir. 1986).

At-will rules.

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