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NINTH CIRCUIT RULES THAT PRODUCT IMPROVEMENT IS EXEMPT FROM SCRUTINY UNDER THE FEDERAL ANTITRUST LAWS

On January 6, 2010, the Ninth Circuit held, among other things, that US antitrust laws do *not* prevent a monopolist from improving its products, even when the improvement adversely affects competition. The decision—*Allied Orthopedic Appliances Inc.* v. *Tyco Health Care Group LP* (No. 08-56315)—reaffirms important protections from antitrust liability for innovation in any type of market, and it therefore could have significant impacts in many cases involving a variety of different products.[1]

BACKGROUND

In *Allied*, the plaintiffs were users of a medical device composed of a sensor and a monitor to receive, interpret, and display information from the sensor. As one of its patents over the device was expiring, the device's manufacturer redesigned the sensor and monitor by moving critical functions from the monitor to the sensor. The redesign rendered its monitors incompatible with competitors' generic sensors. The plaintiffs alleged, among other things, that the manufacturer thereby unlawfully maintained a monopoly over the sensor market in violation of Section 2 of the Sherman Act. The manufacturer defended with undisputed evidence that the redesign also provided new features and reduced the overall cost.

The Ninth Circuit held that, because of the manufacturer's undisputed evidence of these product improvements, no further antitrust scrutiny would be permitted—a jury would not be permitted to rule for the plaintiffs even if the benefit of the improvements was outweighed by their anticompetitive effect. (In its decision, the Ninth Circuit also rejected claims that marketing agreements used to promote the redesigned device violated Section 1 of the Sherman Act and that withdrawal of the old device violated Section 2 of the Sherman Act.)

THE INNOVATION ISSUE

The issue in *Allied* is not new. Parties have long disputed what standards should be applied in cases involving product design, introduction or redesign by a firm with significant market power. It has long been settled that Section 2 does not prohibit the mere possession of a monopoly through competition on the merits—"as a consequence of a superior product, business acumen,

1 *Available at:* http://www.ca9.uscourts.gov/opinions/view_subpage.php?pk_id=0000010189.

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or historical accident."[2] Rather, a violation arises only when a party willfully attempts to possess a monopoly by excluding rivals in a manner that unnecessarily restricts competition. In *Allied* and many other cases, the dispute is how to make the distinction between product designs that are competitive and those that are exclusionary.

Plaintiffs have argued that this distinction must be made under a broad balancing test that is generally applied to most Section 2 cases, such as the test recently applied by the DC Circuit in *United States* v. *Microsoft Corp.*, 253 F.3d 34 (2001).[3] They then invite courts to permit juries to weigh the innovations' adverse effects on competition against the value of their improvements.

In contrast, manufacturers have argued that product improvement is aggressively competitive conduct that most often benefits consumers. Accordingly, innovation should not be chilled by broad balancing tests that introduce the risk of false positives and significant litigation costs. They draw on cases in which the US Supreme Court has sanctioned a categorical approach to Section 2 liability and articulated special rules of *per se* lawfulness in situations where aggressive competition can be mistaken easily for exclusionary conduct.[4] In those cases, the Court has cited concerns that the antitrust laws do not chill aggressive competition, the very goal they attempt to foster, and do provide rules that courts can practically and efficiently administer.

NINTH CIRCUIT REJECTS THE BALANCING TEST

In *Allied*, the Ninth Circuit accepted the manufacturers' view that product design and introduction cases implicate special concerns and thus warrant special rules. In assessing whether product design and introduction are exclusionary, the Ninth Circuit states absolutely: "product improvement alone does not violate Section 2."[5] This *per se* rule of lawfulness applies because "[t]here is no room in this analysis for balancing the benefits or worth of a product improvement against its anticompetitive effects."[6]

The court eschews a general balancing test for two reasons. First, a balancing test would be at "cross-purposes with the antitrust laws."[7] The antitrust laws aim to foster competition on the merits through innovation among other things, yet subjecting a manufacturer to antitrust damages whenever a jury determines *post hoc* that an innovation's adverse effects on competition outweigh its benefits would chill aggressive competition on the merits through product innovation.[8] Second, courts could not administer a balancing test in product improvement cases. Judges and juries would have to come to subjective determinations about the "'right' amount of innovation," and they would have to consider what advances even the most minor innovations may bring in the future. Yet they lack the objective criteria and foresight to do so.[9]

IMPLICATIONS

Allegations that product designs, introductions, or redesigns violate the federal antitrust laws are not uncommon. They frequently arise when the redesign of one product eliminates or simply diminishes competition in markets for complementary products or services, such as when a manufacturer integrates some or all the functionality of one product into another product, redesigns an interface between two products, or changes a product in a manner that affects aftermarkets for parts or services. Under more unique circumstances, they can also arise when the introduction of a new product affects competition in the same market, such as under generic product substitution laws in the pharmaceutical industry. Plaintiffs commonly allege that such conduct violates Sherman Act Section 2's prohibition against monopolization and attempted monopolization.

2 *United States* v. *Grinnell Corp.*, 384 U.S. 563 (1966).
3 *See*, e.g., *Abbott Labs.* v. *Teva Pharmaceuticals USA, Inc.*, 432 F. Supp. 2d 438 (D. Del. 2006).
4 *See*, e.g., *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (predatory pricing); *Weyerhaeuser Co.* v. *Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007) (predatory bidding); *see also Verizon Commc'ns, Inc.* v. *Law Offices of Curtis V. Trinko LLP*, 540 U.S. 398 (2004) (refusal to deal).
5 Slip Op. at 408.
6 *Id.* at 411.
7 *Id.* at 412.
8 *Id.*
9 *Id.*

While *Allied* should provide innovative manufacturers sufficient protection from antitrust liability in the Ninth Circuit, a manufacturer can face product design antitrust claims in any jurisdiction in which its products are distributed. State, other federal, and foreign jurisdictions may have laws that are less clear than, or even contrary to, *Allied*. The European Commission, in particular, has considered the effects on competition when determining whether product improvements are unlawful. A manufacturer, therefore, must consider carefully the laws of each jurisdiction in which its products are distributed.

If you would like more information about any of the matters discussed in this advisory, please contact your Arnold & Porter attorney or:

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