Clarifying Competition Law:

Aftermarket risk and challenge under US and EU antitrust/competition law

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Robert Bell is head of the EU & UK competition team at Bryan Cave with over 20 years of experience advising on complex competition and regulatory matters involving some of the leading cases before The Office of Fair Trading (OFT), the European Commission and UK and European Courts.

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Jacob Kramer’s trial and appellate litigation practice focuses on antitrust matters and complex commercial disputes.

Mr. Kramer’s antitrust litigation experience includes the defense of price-fixing, monopolization, tying, and conspiracy claims. He has worked on all phases of antitrust litigation and has substantial experience presenting antitrust issues to both judges and jurors. In particular, Mr. Kramer has worked extensively with aftermarket issues, which often arise in disputes between manufacturers and distributors or independent service organizations.

In the area of commercial litigation, Mr. Kramer has successfully litigated a broad array of complex commercial disputes in jury trials and other proceedings, including cases involving contract, employment, civil rights, and intellectual property claims. Mr. Kramer also has extensive experience with alternative dispute resolution, including through mediation and arbitration.
Agenda

1. Why are aftermarkets important?
2. US and EU legal prohibitions
3. What we mean by ‘defining the market’
4. US Kodak case and antitrust considerations in aftermarkets
5. EU case law including the effect of the US Kodak case on EU thinking
6. US and UK conclusions
Why are aftermarkets important?

- Profitable (high margins)
- A way to recoup investment in R&D
- Recurring revenue
- An area of conflict between manufacturers, independent service organisations ("ISOs") and the consumers themselves
- The law has struggled to find the right balance between protecting each party’s interests:
  - IP and investment issues for the manufacturers
  - Barriers to entry for ISOs
  - The impact on cost for consumers and consumer choice
US Antitrust Prohibitions

Sherman Antitrust Act (1890)
- Section 1: Agreements that impose unreasonable restraints on trade are illegal
- Section 2: Monopolization, attempted monopolization, and conspiracies to monopolize are unlawful

Clayton Antitrust Act (1914)
- Allows private parties to enforce the Sherman Act in civil suits for treble damages, injunctions, and attorneys’ fees
EU Antitrust Prohibitions

• Article 101 of the Treaty on the Functioning of the European Union (TFEU) – Prohibition against anti-competitive agreements

• Article 102 of the TFEU – Prohibition against an abuse of dominance

• Conduct must appreciably affect trade between EU Member States. Law enforced by the European Commission

• Parallel national competition system in EU Member States that follows EU competition rules. Enforced by Member State’s regulators when conduct has no cross border effect
Defining the market

• The importance of defining the market

• “Primary market” and “Aftermarket”. Is there one market or two?

• Central question: When does the primary market fail to discipline a manufacturer’s conduct in the aftermarket?
US developments

• Kodak stops selling copier parts to ISOs

• ISOs alleged that Kodak unlawfully tied copier parts to Kodak-brand service

• Kodak’s theory: the primary market always disciplines the aftermarket

• Supreme Court disagrees and finds that, in some cases, primary market will not discipline the aftermarket

• ISOs prevail at trial
Kodak Factors

- US Supreme Court identified factors that show a lack of discipline between the primary market and the aftermarket:
  - Customers are “locked in” by “switching costs”
  - Customers face “information costs” or policy changes
  - Manufacturer charges “supracompetitive prices” in the aftermarket
  - Central question: does primary market competition restrain a manufacturer from exploiting locked-in customers?
Alcatel USA, Inc. v. DGI Technologies, Inc., 166 F.3d 772 (5th Cir. 1999)

- **Primary market product:** Telephone switches for long-distance calls
- **Aftermarket:** Expansion cards

**Challenge:** Seller of reverse-engineered expansion cards claimed it was unlawful for manufacturer to (1) use software patch to disable its expansion cards and (2) threaten to void warranties

**Outcome:** No separate aftermarket for expansion cards (after trial)

**Rationale:** Customers engaged in lifecycle pricing (no information costs) and could not have reasonably expected to buy expansion cards from a third party (no policy change or exploitation)
US – DSM Desotech

- *DSM Desotech Inc. v. 3D Sys. Corp.*, 749 F.3d 1332 (Fed. Cir. 2014)
  - **Primary market product:** 3D printers (“stereolithography machines”)
  - **Aftermarket:** Resin used in 3D printers
  - **Challenge:** Resin-maker claimed it was unlawful for manufacturer to use technological lock (RFID) to prevent use of unapproved resins
  - **Outcome:** No separate aftermarket for resins (summary judgment)
  - **Rationale:** Only a few customers purchased the equipment before learning about the RFID lock (no information costs, policy change, or exploitation)
Queen City Pizza, Inc. v. Domino’s Pizza, Inc., 124 F.3d 430 (3d Cir. 1997)

- **Primary market product:** Domino’s Pizza franchise
- **Aftermarket:** Pizza supplies approved (and resold) by Domino’s
- **Challenge:** Franchisees claimed that Domino’s unlawfully required them to purchase only approved pizza supplies in franchise agreement
- **Outcome:** No aftermarket for approved pizza supplies (motion to dismiss)
- **Rationale:** Restriction was disclosed in the franchise agreement (no information costs, policy change, or exploitation)
EU developments
EU - Background

• **Pre Kodak** – Many EU cases on spare parts for machines – see Hugin Cash Registers v Commission [1979] ECR 1869 and Case 238/87 Volvo v Veng ((1988)) ECR 62/1

• On Hugins analysis, was easy to show manufacturer dominance of the secondary market

• **Post Kodak** – Adoption of the Kodak principles by EU and national regulators

• Must show dominance in primary market

• Market power in a secondary market only if lock-in and informational imperfections could be established
EU – Digital undertaking

• The Digital Undertaking (1998) 10 European Competition Law Review 176

• Concerned complaints by two leading ISOs regarding the maintenance and support of Digital Equipment Corporation mid-range systems

• Alleged that Digital unlawfully tied the provision of hardware to software maintenance services by ensuring the price of software services were considerably more attractive when included in a hardware and software package than when sold on a stand-alone basis

• Case concluded by undertakings agreed by Digital as to supply and pricing

• Commission held Digital did not have dominance in the primary market

• A secondary market existed in the support of the systems alone and this is where Digital had dominance and were excluding the ISOs and exploiting customers

• The Commission appeared to be persuaded that the special circumstances present in Kodak were present in this case due to high switching costs (lock in) and the inability to whole life cost at time of purchase
EU/UK – Synstar/ICL

- Synstar Computer Services (UK) Ltd v ICL (Sorbus) Limited and International Computers Limited [2001] UKCLR 585/Fujitsu

- Synstar, a leading ISO, had alleged that ICL was exploiting its monopoly power under Chapter II of Competition Act 1998

- Alleged abuse regarded not providing ISOs with certain diagnostic software without which they could not maintain mainframes

- OFT held no dominance by ICL in the secondary market for maintenance of computer equipment with mainframe functionality in the UK

- Held no secondary market in ICL specific equipment as customers were able to whole life cost hardware and other support services at the time of purchase

- Held no infringement
EU – Pelikan/Kyocera


- In Pelikan/Kyocera, the EU Commission declared that the printer market and the consumables market were a single market as competition in the first led to it disciplining the second

- As in Systar/ICL, held there was no secondary market as consumers were able to whole life cycle and could switch printers at low cost so no lock in

- In Info-Lab/Ricoh, ISOs had complained that Ricoh was refusing to supply empty toner cartridges for its photocopiers in contravention of Article 102 TFEU. ISOs would then fill them with ink at a lower cost to the Ricoh branded variety

- Following Kyocera, held consumers were able to life cycle cost and thus could change the primary market easily, meaning there was no distinct secondary market

- The Commission found that Ricoh did not have a dominant position and thus could not be required to supply empty toner cartridges
• In the EFIM complaint of 2009, (also concerning print cartridges) the Commission followed its analysis in the Pelikan and Kyocera cases

• Case concerned the ISOs lack of access to crucial technology in order to supply replacement cartridges by four printer manufacturers: Hewlett-Packard, Epson, Canon and Lexmark.

• Case dismissed by the Commission on the grounds that there was no community interest as the manufacturers were not likely to have a dominant position on the secondary market, having no dominant position in the primary market for printers.
• On 20 September 2011, the EU Commission accepted legally binding commitments from IBM regarding the maintenance market for its mainframe computers.

• The Commission appears to have considered the relevant market to be the secondary market for the maintenance of IBM mainframe systems.

• The Commission considered this the relevant market due to high switching costs for the primary product and the inability of ISOs to switch to non-IBM spare parts. IBM were therefore held dominant on this secondary market.

• Indicates that the Commission takes the view that the secondary market is separate and distinct from the primary market.

• This case was a settlement rather than a formal competition decision, so the description of the Commission’s case is somewhat limited.
US – Conclusion

• It is difficult to prevail on a Kodak-type claim, but it is not impossible

• Aftermarket risk factors:
  
  • Necessary but not sufficient: Lock-in (costly, durable equipment)
  
  • Key: Post-sale “exploitation” of locked-in customers (cost increases)

• Aftermarket restrictions disclosed at the point of sale are generally safe

  • Contracts are important
  
  • Customers that know what they are getting into are not exploited
• Kodak principles alive and well in the EU

• ISOs unlikely to establish dominance in a secondary market unless they can prove:
  • High switching costs
  • Inability to whole life cost
  • Equipment for which the manufacturer is ceasing to produce a new version and will be exiting the primary market, likely removing the manufacturer’s incentive to price competitively in secondary markets
  • The strongest case would be one where the manufacturer has dominance in the primary market.
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