

Technology antitrust: Avoiding the emerging threats

Hanno Kaiser
Latham & Watkins LLP
U.C. Berkeley School of Law (Lecturer)

27th Annual All Hands Meeting, Santa Clara, CA
October 28, 2015

Agenda

- A quick look across the pond: European Union update (“platform regulation”)
- New rules for sponsors promoting their platform?
- New rules for product design changes?
- New rules for “must have” products?

European Union Update

Intense EU focus on “online platforms” in connection with the DSM

Digital Single Market (DSM)
Vice President Andrus Ansip

DG COMP
Commissioner Margrethe Vestager

- e-Commerce sector inquiry (5/2015)
- Google search investigations
- Google Android investigation

DG CNECT (“Connect”)
Commissioner Günther Oettinger

- Public consultation on the regulatory environment for platforms, online intermediaries, data and cloud computing and the collaborative economy (9/2015)

Do you agree with the definition of “Online platform” as provided below?

<https://ec.europa.eu/eusurvey/runner/Platforms/>

- “Online platform” refers to an undertaking operating in two (or multi)-sided markets, which uses the Internet to enable interactions between two or more distinct but interdependent groups of users so as to generate value for at least one of the groups. Certain platforms also qualify as Intermediary service providers.
- Typical examples include general internet search engines (e.g. Google, Bing), specialised search tools (e.g. Google Shopping, Kelkoo, Twenga, Google Local, TripAdvisor, Yelp,), location-based business directories or some maps (e.g. Google or Bing Maps), news aggregators (e.g. Google News), online market places (e.g. Amazon, eBay, Allegro, Booking.com), audio-visual and music platforms (e.g. Deezer, Spotify, Netflix, Canal play, Apple TV), video sharing platforms (e.g. YouTube, Dailymotion), payment systems (e.g. PayPal, Apple Pay), social networks (e.g. Facebook, LinkedIn, Twitter, Tuenti), app stores (e.g. Apple App Store, Google Play) or collaborative economy platforms (e.g. AirBnB, Uber, Taskrabbit, Bla-bla car). Internet access providers fall outside the scope of this definition.

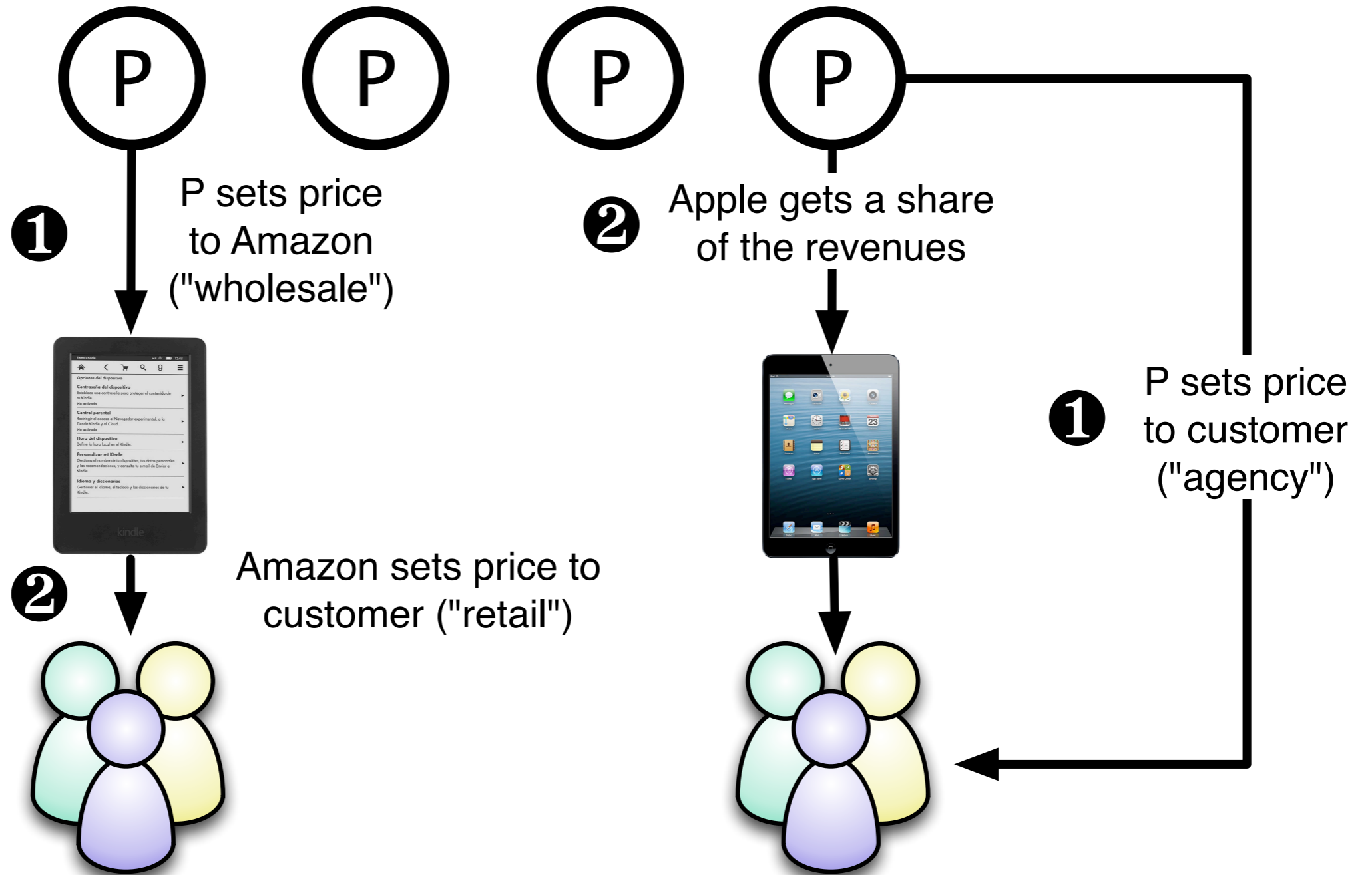
Pitfalls for platform sponsors

Antitrust risks for platform sponsors after *U.S. v. Apple* (“eBooks”)

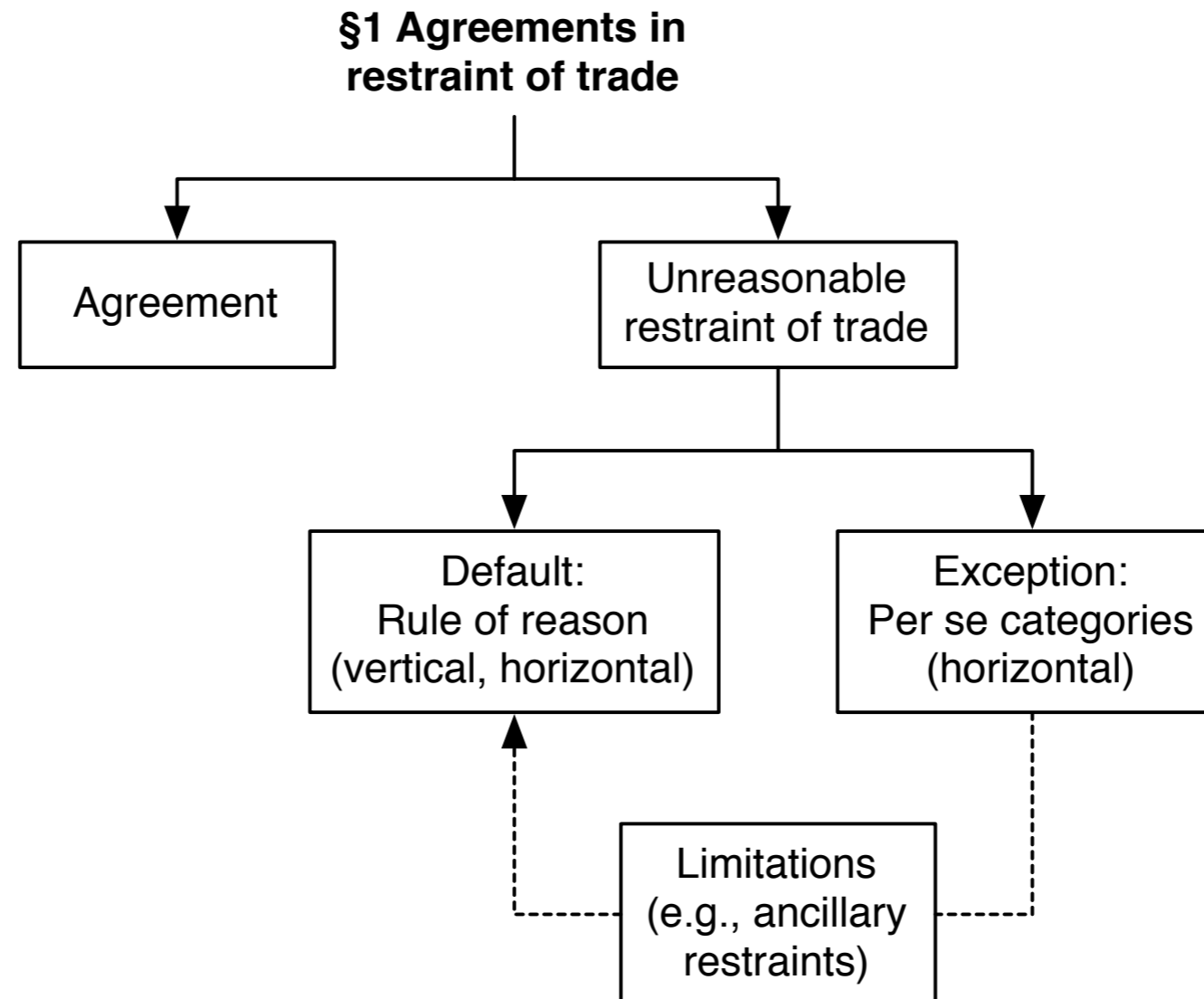
U.S. v. Apple Inc., 787 F.3d 131 (2d. Cir. 2015)

- Launching a new platform commonly requires signing up a critical mass of participants on one side first (developers, content owners, carriers, publishers, restaurants, etc.)
- To launch the iPad/iBookstore platform, Apple signed up key publishers
- Drawing on the successful App Store experience, Apple proposed an agency model. The publishers set the prices for their books and Apple receives a fee
- To ensure that ebooks in the iBookstore would be priced competitively, Apple required price caps (e.g., no more than \$14.99) and a “most favored nation” clause (no higher prices in the iBookstore than elsewhere)
- The launch of the iPad/iBookstore platform provided the first meaningful competitive challenge to Amazon's Kindle platform
- DOJ brought a civil price fixing lawsuit against the publishers and Apple. The publishers settled. Apple went to trial. The S.D.N.Y. agreed with DOJ. The 2d Cir. affirmed in a split decision.

Wholesale and agency model



§1 of the Sherman Act: Basic structure (Recap)



Key findings in the eBooks case

1. **Agreement:** “[T]he relevant “agreement in restraint of trade” in this case is not Apple's vertical Contracts with the Publisher Defendants (which might well, if challenged, have to be evaluated under the rule of reason); it is the horizontal agreement that Apple organized among the Publisher Defendants to raise ebook prices.” Id., at 26.
 2. **Per se standard:** “The conspiracy among Apple and the Publisher Defendants comfortably qualifies as a horizontal price-fixing conspiracy.” Id., at 30.
 3. **Rule of reason:** Also unlawful under a truncated rule of reason, “shifting the inquiry directly to a consideration of the defendant's procompetitive justifications.” Id., at 33.
- Divided ruling
 - One judge: Per se only.
 - One judge: Per se and truncated rule of reason.
 - One judge (dissent): Neither per se nor rule of reason.

Concern: Blurring the line between horizontal and vertical agreements

- Apple is vertically related to the publishers. Apple is not a horizontal competitor.
- The vertical/horizontal distinction is vital, because only horizontal agreements can be per se illegal. (Tying is not *really* per se illegal.)
- This is not a “hub and spoke” conspiracy situation, in which the competitors (“spokes”) agree with each other using a middleman (“hub”).
- The dissent observes correctly: “[T]he Supreme Court teaches [in Leegin] that a vertical agreement designed to facilitate a horizontal cartel “would need to be held unlawful under the rule of reason.”
- This puts platform sponsors in a very awkward position: How do you assure platform participants whom you are trying to sign up that they will “not be alone”?

Concern: Immediate focus on business justifications

- One judge applied a truncated version of the rule of reason—in which the focus is immediately on the business justifications
- This “cutting to the chase” approach has become increasingly popular with the agencies
- But the whole point of the rule of reason (ROR) is that a showing of anticompetitive effects (AE) is a threshold issue for the plaintiff. No AE, no ROR case.
- Without a clear AE threshold requirement, companies can be called to justify their business strategies at any time—an invitation for unmoored agency inquiries
- In this case, Apple had 0% market share when it launched the iPad and the iBookstore. It had no market power at all.

Concern: Limiting the ROR inquiry to a single aspect of the platform

- The iPad/iBookstore is a multi-sided platform, organizing the interactions of multiple constituencies, including:
 - Users (who buy the iPad and the books in the iBookstore)
 - Publishers (who place their books in the iBookstore and pay Apple)
 - Developers (of other applications for the iPad who care about the user's perception of the platform)
- When Apple launched the iPad/iBookstore, the success of the platform was highly uncertain—the tablet category had a long history of failures
- Apple's entry into the eReader platform market provided the first real alternative to Amazon's Kindle/Kindle Store platform
- By focusing on the eBook content only, the decision misses important context for the rule of reason inquiry

How to reduce risk in negotiating with platform participants?

- Some participants will be reluctant to invest in a new platform. They will seek assurances that if they commit to the platform they will “not be alone” and that the new platform will have a critical mass. This is an unavoidable and legitimate request.
- As a platform sponsor, ensure—and document—that all communications with participants are strictly one-on-one.
- As a platform sponsor, do not “relay messages” from one participant to the other (“hub and spoke” risk)
- If feasible—e.g., if there are only a handful of participants—consider forming different teams that negotiate with the participants separately
- Be alert to signs of pre-existing collusion among the participants—hard-to-control risk of later claims that the platform “facilitated” an existing conspiracy

Antitrust liability for product design changes

Innovation as exclusionary conduct: The law of “product hopping”

New York ex rel. Schneiderman v. Actavis PLC, 787 F.3d 638 (2d. Cir. 2015)

- In 2004, Forest releases Namenda IR (2x/day)
 - Patent protected until 7/2015
 - After 7/2015, > 5 generics poised to enter the market
- In 2010, Forest gets FDA approval for Namenda XR (1x/day)
 - Patent protected until 2029
- Forest attempts to switch patients from IR to XR
 - First: Discounts for XR, no marketing for IR (“soft switch”)
 - Then: Discontinuation of IR (“hard switch”)
- N.Y. State AG brings suit under §2 and §1 of the Sherman Act

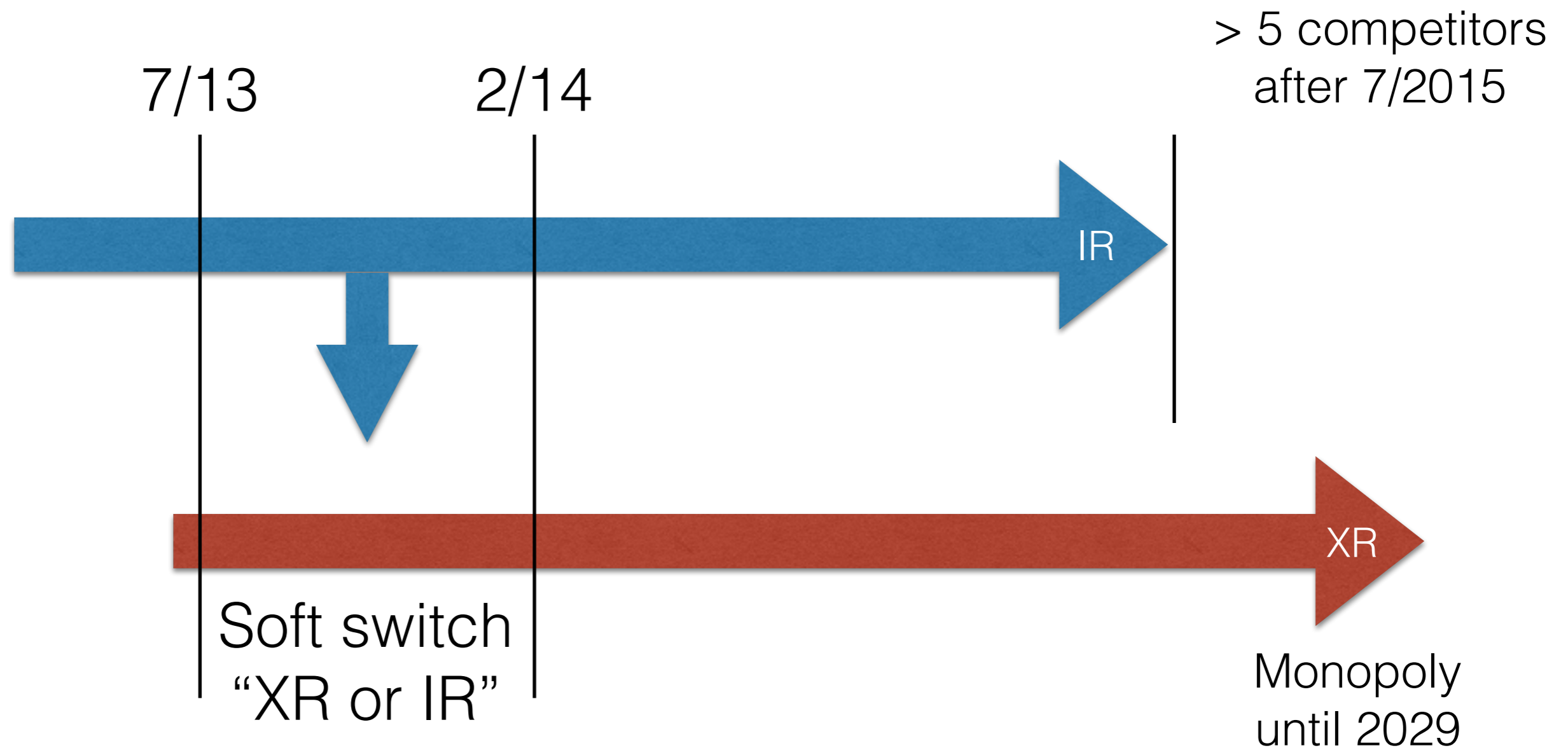
The S.D.N.Y orders Forest to keep making the old product

1. During the Injunction Term ... the Defendants shall continue to make **Namenda** IR (immediate-release) tablets available on the same terms and conditions applicable since July 21, 2013 ...
2. Defendants shall inform healthcare providers, pharmacists, patients, caregivers, and health plans of this injunction ... and the continued availability of **Namenda** IR ...

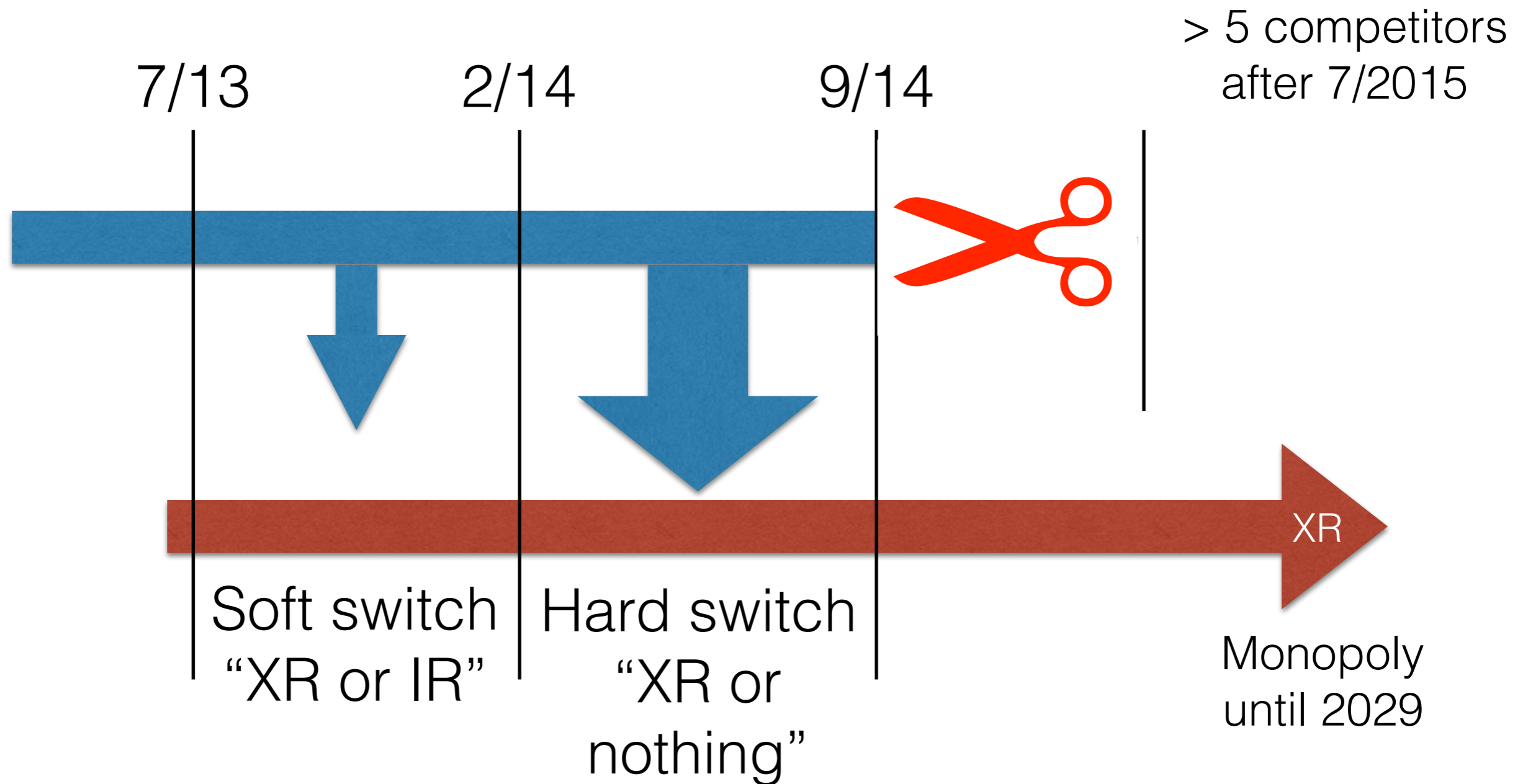
The Second Circuit affirms the injunction

- ① This case raises a novel question of antitrust law: under what circumstances does conduct by a monopolist to perpetuate patent exclusivity through successive products, commonly known as “product hopping,”² violate the Sherman Act, 15 U.S.C. §§ 1 and 2. This question is an issue of first impression in the circuit courts.
- ② Defendants' hard switch crosses the line from persuasion to coercion and is anticompetitive.
- ③ For the reasons stated above, we **AFFIRM** the District Court's order granting New York's motion for a preliminary injunction.

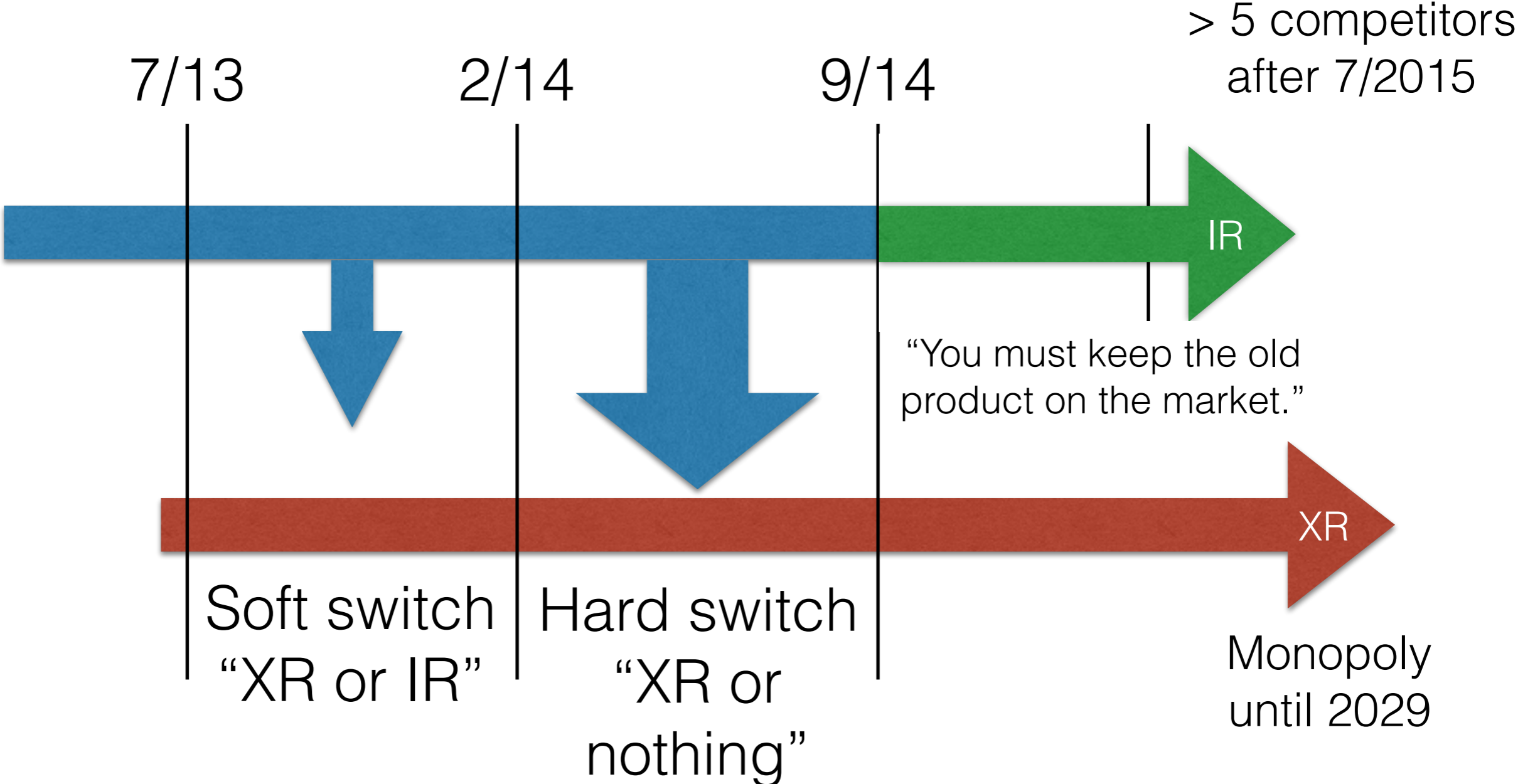
Migrating customers v.1



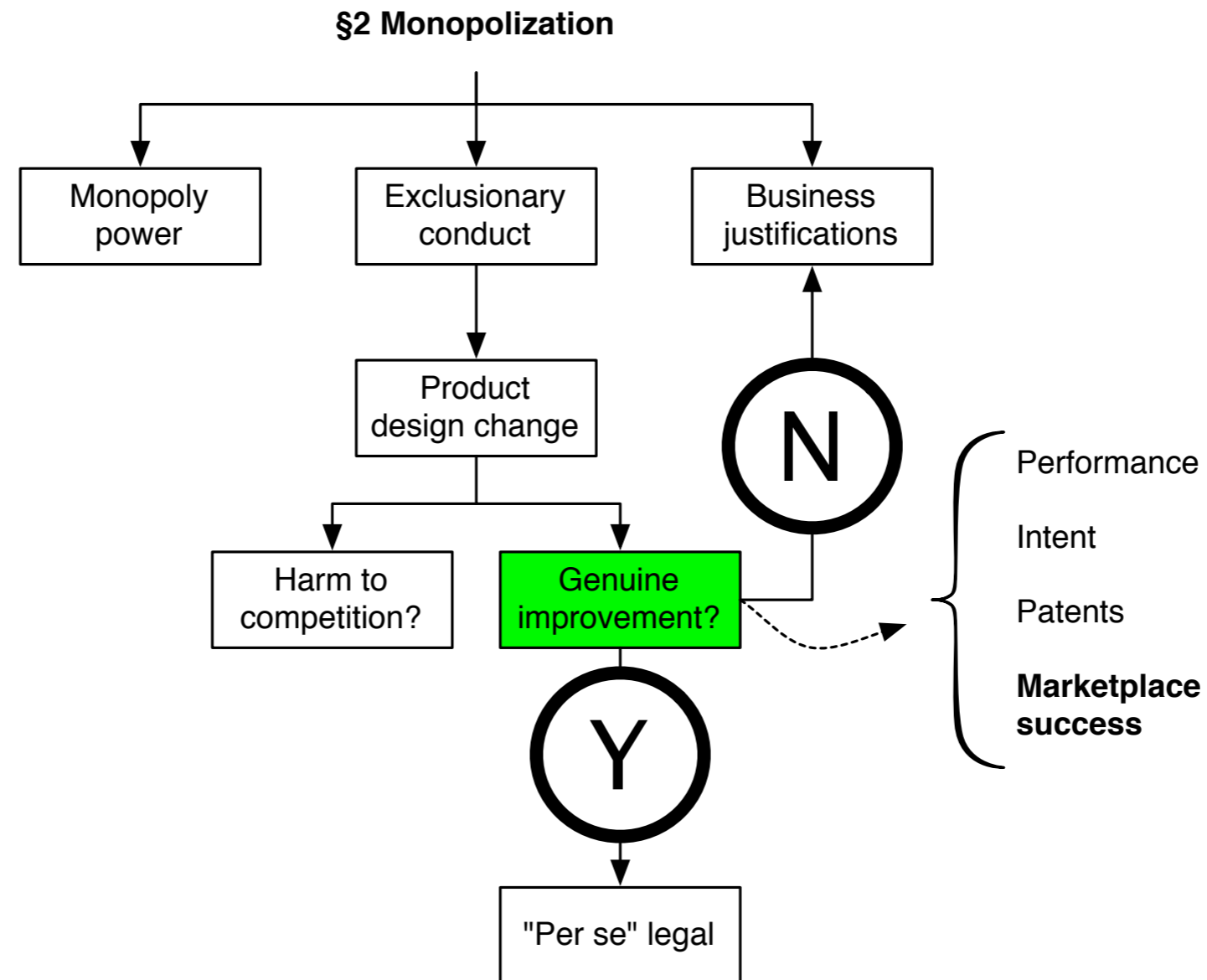
Migrating customers v.2



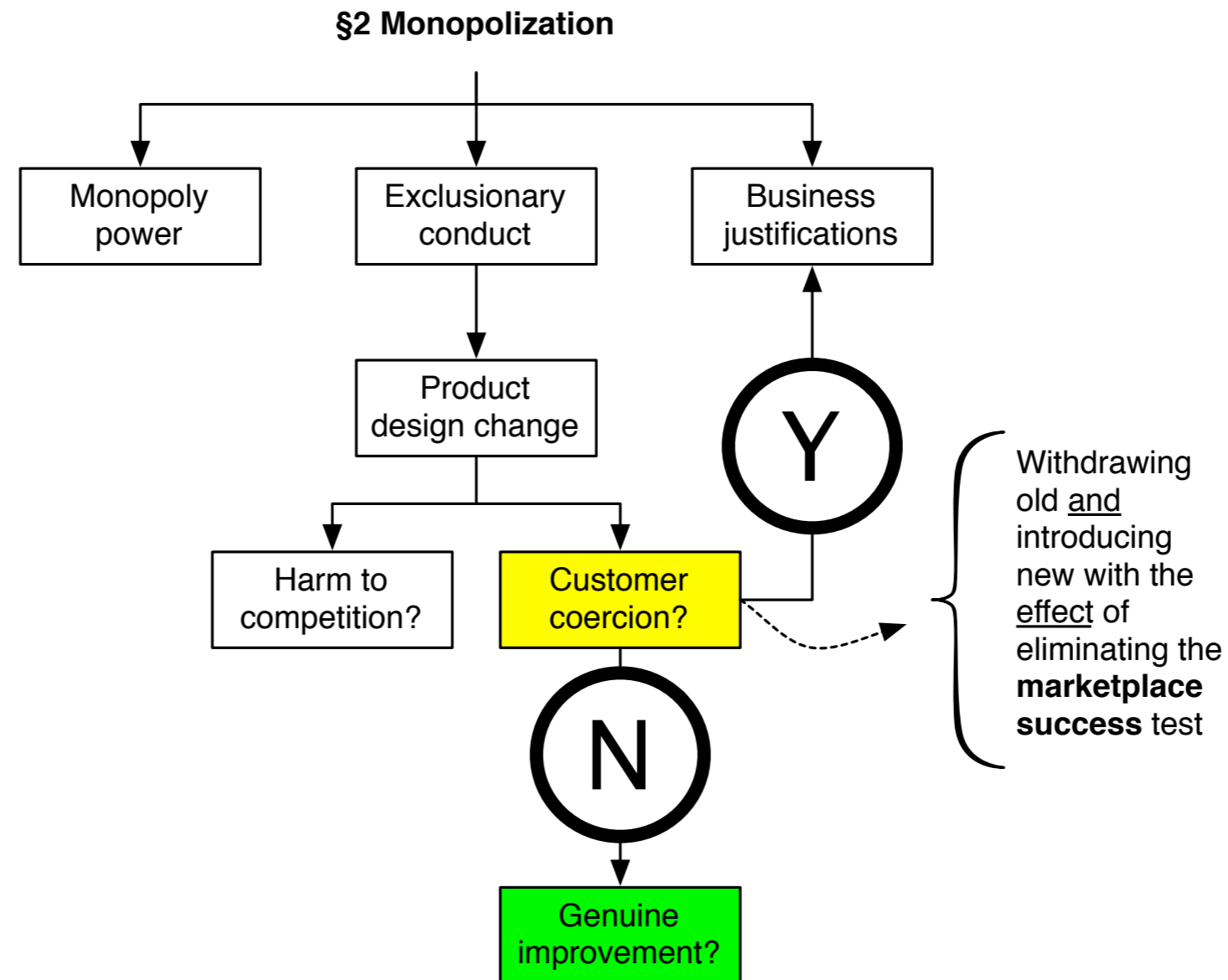
Court order: Keep old product on the market



Legal standard: Genuine improvements are not exclusionary



Coercion element = exclusion despite improvement



How to mitigate antitrust risks from the “coercion” test?

- The coercion test creates uncertainty in situations where a company discontinues an old product to migrate customers to a new product
- One can take the position that *NY v. Actavis* only applies to pharmaceuticals, because without IR on the market, the generics could not avail themselves of the state substitution laws to boost conversion to generic drugs. The “sponsored conversion” regime is unique to the pharmaceutical context.
- A reasonably safe course of action is to sunset the old product only after the new product has been on the market for a while

Market power for “must have”
products

Anti-steering rules as unlawful restraints of trade

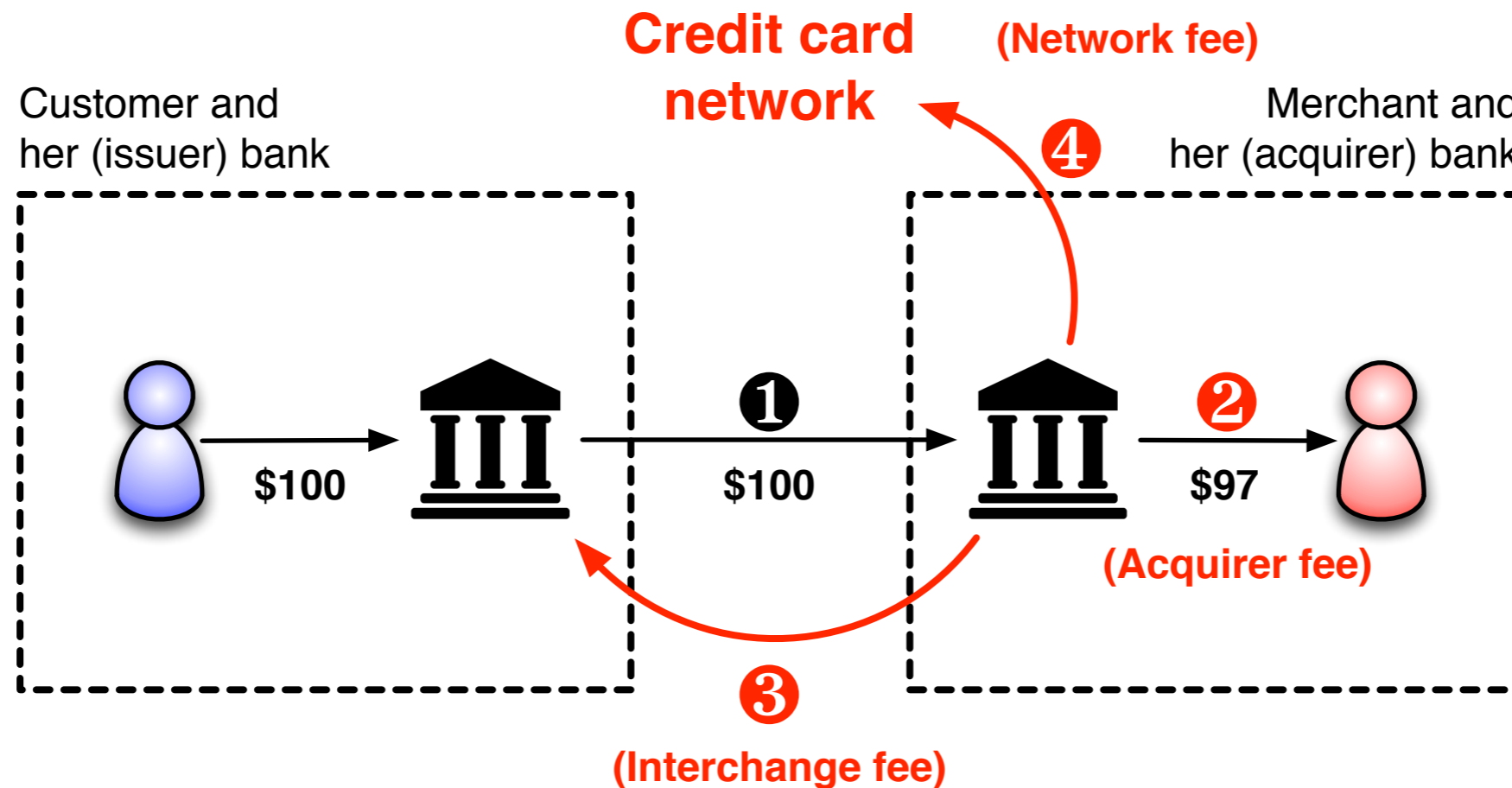
United States v. American Express, 2015 WL 728563 (S.D.N.Y. 2015)

- Amex (like Visa and MasterCard) imposes anti-steering rules—or non-discrimination provisions (NDP)—on its >3 million merchants
- According to the NDPs, Amex-accepting merchants must not, for example:
 - Express a preference vis-a-vis a customer for a competing card (“We prefer Visa”)
 - Provide incentives to customers for using competing cards (“Free shipping if you pay with Discover”)
 - Disclose how much Amex charges the merchant (“Amex charges us x%.”)
- DOJ challenged the NDPs as unreasonable restraints of trade under §1 of the Sherman Act. Visa and MasterCard settled. Amex went to trial. The court held that the anti-steering rules violated §1 under a ROR standard.

Key findings in the Amex case

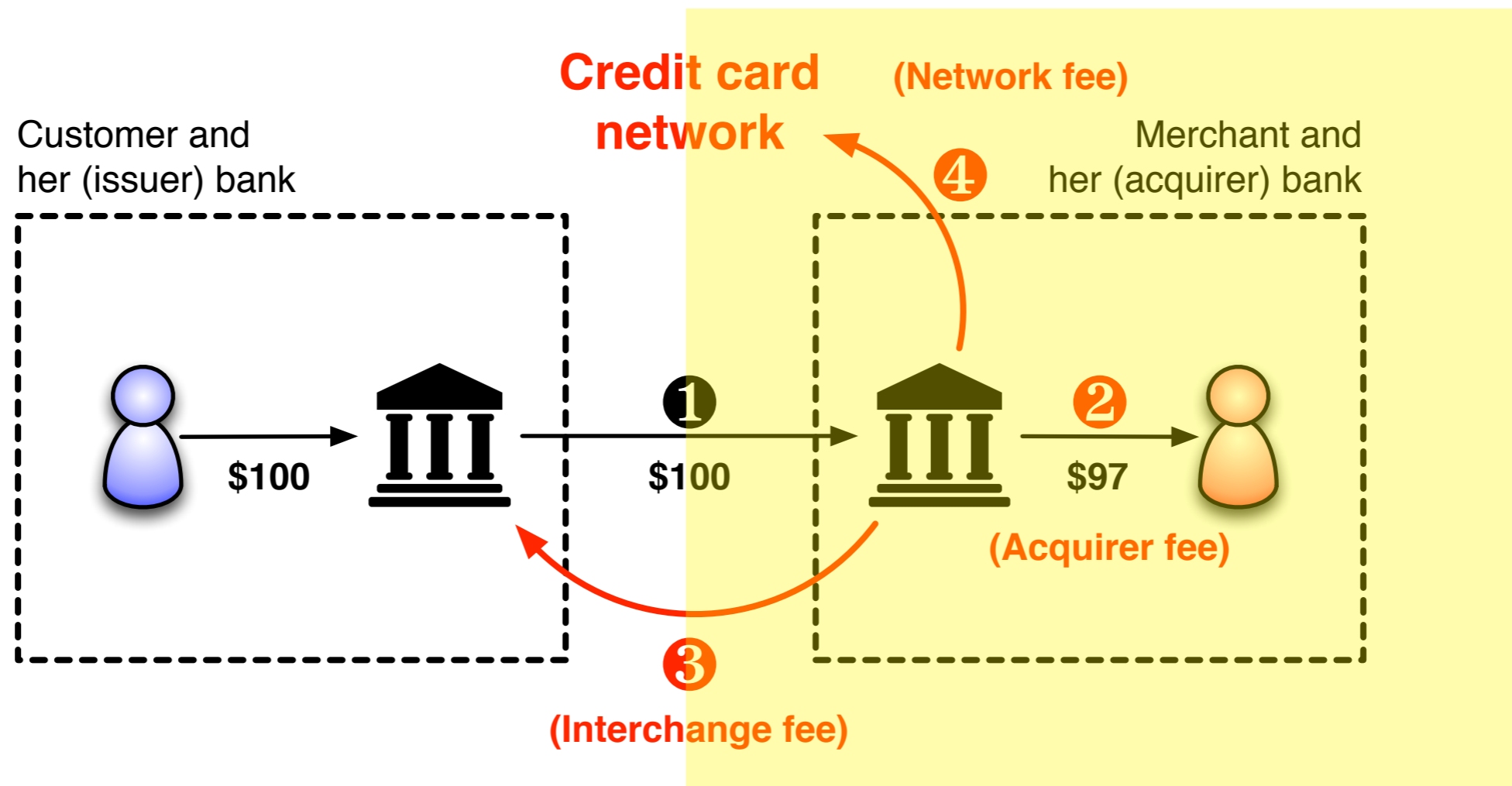
- **Agreement:** Amex' standard agreement with its merchants, containing the NDPs
 - Classified as a vertical non-price restraint and thus subject to ROR
- **Relevant market:** "General purpose credit and charge card network services"
- **Market power:** Amex' "**26.4%** share of a highly concentrated market with significant barriers to entry suggests that the firm possesses market power. ... [Amex'] highly **insistent** or loyal cardholder base is critical to the court's finding of market power." Id., at 37.
- **Anticompetitive effects** include: Reduction of competition with Visa, MasterCard, Discover; blocking of new, low-cost business models; higher prices to merchants

Credit card networks are two-sided transaction platforms



The relevant market is limited to the merchant side (network services)

Credit card network services market



Low market share + high entry barriers + insistence = market power

- A market share below 30%, without more, does not normally support an inference of market power
- But “cardholder insistence effectively prevents merchants from dropping [Amex]. ... The forgone profits associated with losing Amex-insistent customers rendered dropping Amex commercially impractical.” *Id.*, at 38.
- “Though [Amex] may be fairly characterized as a discretionary card for consumers when compared to the ubiquity enjoyed by Visa and MasterCard, the degree to which its cardholders insist on using their Amex cards affords the network significant power over merchants.” *Id.*
- “Defendants’ efforts to minimize the significance of cardholder insistence by recasting it as mere ‘brand loyalty’ are unavailing.” *Id.*

The concept of insistence-based market power

- In defining the relevant market, the court focuses on the merchant-facing network services market to the exclusion of the customer-facing card issuer market
- But customer loyalty obtained in the card issuer market amplifies market power in the network services market
- Customer loyalty (but no market power) on one side of the platform could thus be transformed into market power on the other side of the platform.
- That can be a slippery slope, where firms with excellent customer satisfaction (but no market power) are held to a higher standard than firms with greater market share and more limited customer satisfaction

Thank you!

hanno.kaiser@lw.com

Please note that the views expressed in this presentation are mine and not necessarily those of Latham & Watkins LLP or its clients.