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Tying Arrangements: Avoiding Antitrust Liability

Leveraging Market Power Arguments and Seller Defenses

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I. Tying Arrangement Rules and Jurisprudence

A. What is tying?

B. Tying statutes: Clayton Act, Sherman Act and Federal Trade Commission Act

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"[A] tying arrangement may be defined as an agreement by a party to sell one product [the tying product] but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."

Northern Pacific Railway Co. v. United States, 356 U.S. 1, 5-6 (1958).

"[Tying arrangements] deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market."

Northern Pacific Railway, 356 U.S. at 6.

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Challenging Tying Arrangements

Section 1 of the Sherman Act:

> **"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."**

15 U.S.C. § 1

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Challenging Tying Arrangements

Section 3 of the Clayton Act (but only for products – not services):

> **“It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of *goods, wares, merchandise, machinery, supplies, or other commodities*, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, *on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors* of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.”**

15 U.S.C. § 14

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Challenging Tying Arrangements

Section 5 of the FTC Act:

> **"Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."**

15 U.S.C. § 45(a)(1)

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"Tying agreements serve hardly any purpose beyond the suppression of competition."

Standard Oil Co. v. United States, 337 U.S. 293, 205 (1949).

"Our cases have concluded that the essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms."

Jefferson Parish Hosp. Dist. No. 2. v. Hyde, 466 U.S. 2, 12 (1984).

Elements of a *Per Se* Challenge to a Tying Arrangement

- **Two separate products or services are involved**
- **The sale or agreement to sell one product or service is conditioned on the purchase of another**
- **The seller has sufficient economic power in the market for the tying product to enable it to restrain trade in the market for the tied product**
- **A not insubstantial amount of interstate commerce is affected**

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First Element: Two Separate Products or Services

"[A] tying arrangement cannot exist unless two separate product markets exist."

"[T]he answer to the question whether one or two products are involved turns not on the functional relation between them, but rather on the character of the demand for the two items."

***Jefferson Parish*, 466 U.S. at 19, 21.**

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Second Element: Proof of Conditioning

"Of course, where the buyer is free to take either product for itself there is no tying problem even though the seller may also offer the two items as a unit at a single price."

***Northern Pacific*, 356 U.S. at 6 n.4.**

Second Element: Proof of Conditioning

***Universal Grading Service v. eBay, Inc*.**, **No. C-09-2755, 2012 WL 70644 (N.D. Cal. Jan. 9, 2012): No allegations that showed conditioning under eBay's Counterfeit Currency and Stamps Policy.**

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Third Element: Market Power in the Tying Product

“[I]n all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product.”

Illinois Tool Works v. Independent Ink, **547 U.S. 28, 46 (2006).**

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Third Element: Market Power in the Tying Product

A patent in the tying product does not create a presumption of market power.

***Illinois Tool Works v. Independent Ink*, 547 U.S. 28 (2006)**

Fourth Element: A Substantial Amount of Commerce in the Tied Product Is Affected

"[W]e have refused to condemn tying arrangements unless a substantial volume of commerce is foreclosed thereby."

***Jefferson Parish*, 466 U.S. at 16.**

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Fourth Element: A Substantial Amount of Commerce in the Tied Product Is Affected

***Brantley v. NBC Universal, Inc.*, __ F.3d __, No. 09-56785, 2012 WL 1071257 (9th Cir. March 30, 2012):**

Tying is about suppressing competition in the market for the tied product, not protecting customers from buying unwanted products.

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Tying Law Is Still Evolving

Rule of reason – not *per se* – applies "where the tying product is software whose major purpose is to serve as a platform for third-party applications and the tied product is complementary software functionality."

***United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001).**

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Tying Arrangements: Avoiding Antitrust Liability

Leveraging Market Power Arguments and Seller Defenses

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DEVELOPMENT AND HISTORY OF TYING LAW

May 1, 2012

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Starting Point: *Jefferson Parish*

Under certain circumstances, a tying arrangement may be *per se* illegal

- *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12-13 (1984)

Basic elements of a *per se* claim (covered in first part of webinar)

- Conditioned purchase (or lease)
- Separate and distinct products
- **Market power over the tying product sufficient to “force” buyer to purchase tied product**
- “Not insubstantial” effect on (interstate) commerce

Rule of Reason applies to ties that are not *per se* illegal

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Overview

How did we get here?

- Early approaches
- The Supreme Court's *Fortner* decisions

Jefferson Parish

Post-*Jefferson Parish* cases

***Kodak* and derivative aftermarkets – am I safe just because I have a small market share?**

Post-*Kodak* issues, including some brief thoughts on intellectual property (IP) issues

Defenses / best practices

Early Approaches

“Economic power” in the tying product requirement

Patent cases: requisite showing found where seller used a patent monopoly over the tying product to force purchasers to accept an unpatented product (so-called patent tying)

- *International Salt Co. v. United States*, 332 U.S. 392 (1947)
- *IBM Corp. v. United States*, 298 U.S. 131 (1936)

Necessary to establish monopoly power over the tying product to find a *per se* violation of Sherman Act § 1

- *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953)

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1950s–1960s Era

Monopoly power or "dominance" <u>not</u> a precondition to *per se* unlawful tying under the Sherman Act

- *Northern Pacific Ry. v. United States*, 356 U.S. 1 (1958). Question is not whether defendant has or approaches actual monopoly, but whether "a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product." *Id*. at 6
- *United States v. Loew's, Inc.*, 371 U.S. 38 (1962). Block-booking of package of motion pictures for TV distribution. "Even absent a showing of market dominance, the crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes." *Id*. at 45. In the case of copyrighted films (or patented products), "[t]he requisite economic power is presumed." *Id*. at 45

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The *Fortner* Cases (Late 1960s-1970s)

***Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495 (1969) (*Fortner I*)**

***United States Steel Corp. v. Fortner Enterprises, Inc.*, 429 U.S. 610 (1977) (*Fortner II*)**

- U.S. Steel Homes Credit Corp. (a subsidiary) allegedly conditioned the granting of loans with very favorable terms on Fortner's agreement to purchase U.S. Steel's prefabricated homes
- Tying product: loans. Tied product: prefabricated homes

Fortner I

Unique and advantageous product could support a tie

Supreme Court reversed summary judgment in favor of defendants

- Fortner had alleged enough re tying product market power to require a trial on the issue of *per se* illegality. *Fortner I*, 394 U.S. at 506
- Economic power adequately alleged because the "unique" and advantageous financing terms could reflect competitive advantage in the credit market. *Id*. at 505. "[T]he proper focus of concern is whether the seller has the power to raise prices, or impose other burdensome terms such as a tie-in, with respect to any appreciable number of buyers within the market." *Id*. at 504

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Fortner II

Uniqueness not enough; cost advantage or significantly differentiated product

Two trials later, the court of appeals affirmed verdict for plaintiff. Case returned to the Supreme Court

- The Court reversed again, finding insufficient evidence that defendant had "appreciable economic power" in the tying product market. *Fortner II*, 429 U.S. at 611-12
- Uniqueness or desirability of tying product may sometimes justify *per se* treatment, but not always:
  - "[T]he question is whether the seller has some advantage not shared by his competitors in the market for the tying product. Without any such advantage differentiating his product from that of his competitors, the seller's product does not have the kind of uniqueness considered relevant in prior tying-clause cases." *Id*. at 620-21

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Fortner II

Insufficient evidence of economic power in the credit market

- 100% financing was “unique” in the sense that no one else offered it, but this sort of uniqueness did not demonstrate economic power:
  - “Quite clearly, if the evidence merely shows that credit terms are unique because the seller is willing to accept a lesser profit – or to incur greater risks – than its competitors, that kind of uniqueness will not give rise to any inference of economic power in the credit market . . . .” *Id*. at 621-22
- Without evidence that defendant had some cost advantage over its competitors, or could offer a form of financing that was significantly differentiated from that which other lenders could offer, the unique character of financing did not support conclusion of economic power. *Id*. at 622

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Pre-*Jefferson Parish* Summary

Monopoly power required for *per se* treatment?

- Yes: *Times-Picayune Publishing Co.*
- No: *Northern Pacific Ry.*

Patent establishes monopoly power? Yes

Unique attributes sufficient?

- Yes: *Loew's*
- No: *Fortner II*

Cost advantage or a significantly differentiated product

- ???

In short, the law was in flux and not entirely clear

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Jefferson Parish

Hospital contract with a group of anesthesiologists required all anesthesiology services to be performed by the group

Tying product: hospital services. Tied product: anesthesiology

Focus on sufficient market power

- Five-Justice majority opinion: certain ties are *per se* illegal, others are evaluated under the Rule of Reason. Forcing is required – the seller uses its market power "to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms." *Id*. at 12
- *Per se* condemnation is appropriate only if the existence of forcing is probable or likely. Forcing is likely only if the seller possesses "market power," as demonstrated by (i) a patent monopoly or similar monopoly, (ii) a high market share, or (iii) a unique product that others cannot offer. *Id*. at 15-17

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Jefferson Parish

Sufficient market power

- Consumer preference for the hospital was not necessarily probative of significant market power. *Id*. at 26
- Hospital's 30% market share was by itself insufficient to infer market power
  - Post-*Jefferson Parish*, few if any courts have found requisite market power from a market share below 30%
  - 30% to 50%: a *per se* tying claim is theoretically possible, although probably not very strong
  - Above 50%: *per se* tying claims begin to have some substantial weight

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Post-*Jefferson Parish* Cases

A number of courts have rejected plaintiffs' claims, finding no market power in the tying product market. *E.g.*, trademarked products / franchise cases after *Jefferson Parish*

- *Webb v. Primo's, Inc.*, 706 F. Supp. 863, 869 (N.D. Ga. 1988) (franchisor lacked market power because there were many other pizza, sub and Italian restaurants in market)
- *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1346-47 (9th Cir. 1987) (uniqueness of Mercedes cars to consumers did not establish uniqueness in the market for dealership franchises, which was the relevant market) (*dictum*)

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Post-*Jefferson Parish* Cases

Generally, courts have focused on market power as measured through market share, rather than examining "uniqueness"

- *Klo-Zik Co. v. General Motors Corp*., 677 F. Supp. 499 (E.D. Tex. 1987) (engines were not significantly different from other engines to be unique; although engines were patented, no showing of effects patents had on product's interchangeability with other products)

But there have been exceptions

- *Microbyte Corp. v. New Jersey State Golf Ass'n*, 1986-2 Trade Cas. (CCH) ¶ 67,228 at p. 61,163 (D.N.J. 1986) (sponsored golf tournaments were unique because of association prestige and tradition)
- *Tic-X-Press, Inc. v. Omni Promotions Co. of Ga*., 815 F.2d 1407, 1420 (11th Cir. 1987) (defendant controlled only enclosed concert facility that could seat more than 4,000 people)

Post-*Jefferson Parish* Cases

Truly unique products may support a tying claim

- Seventh Circuit: to support a finding of uniqueness, a plaintiff must show a barrier to entry that prevents competition and that uniqueness means the inability of a seller's rivals to offer a similar package, not simply the fact that no rival has chosen not to do so. *Will v. Comprehensive Accounting Corp*., 776 F.2d 665, 672 (7th Cir. 1985), *cert. denied*, 475 U.S. 1129 (1986)
- Other courts look to cost or competitive advantage that cannot be duplicated
- Query whether a defendant with a truly unique product can ever have less than a very high market share, *i.e.*, are the two tests really the same?

Patents continued to presumptively confer market power (but not after *Illinois Tool*, *infra*)

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Post-*Jefferson Parish* Cases

Sometimes even market power doesn't require *per se* treatment. *See United States v. Microsoft Corp*., 253 F.3d 34, 89 (D.C. Cir.) (*en banc*), *cert. denied*, 534 U.S. 952 (2001). There, the court declined to apply the *per se* rule to arrangements involving the bundling (technological integration) of computer (platform/application) software

- Such arrangements may have pro-competitive efficiencies
- *Jefferson Parish*'s two product test does not authorize an inquiry into the efficiencies of the bundle
- Software bundling is commonly employed even by firms without market power
- The judiciary has insufficient experience with computer software tying arrangements to permit a confident conclusion that they are predominantly anticompetitive

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Post-*Jefferson Parish* Cases

The offense of *per se* tying remains a somewhat strange or hybrid sort of *per se* offense. The *per se* rule is only triggered after some significant inquiry into the status of the tying product market

- "The 'per se' doctrine in tying cases has thus always required an elaborate inquiry into the economic effects of the tying arrangement." *Jefferson Parish*, 466 U.S. at 34 (O'Connor, J., concurring)
- "[T]here is often no bright line separating per se from Rule of Reason analysis. Per se rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct. For example, while the Court has spoken of a 'per se' rule against tying arrangements, it has also recognized that tying may have procompetitive justifications that make it inappropriate to condemn without considerable market analysis." *NCAA v. Board of Regents*, 468 U.S. 85, 104 n. 26 (1984)

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Kodak and Aftermarkets

Or: "You're not necessarily safe even if you have a low primary market share"

***Eastman Kodak Co. v. Image Technical Services, Inc*., 504 U.S. 451 (1992)**

- Kodak implemented policies to prevent independent service organizations (ISOs) from obtaining replacement parts for Kodak copiers, making it difficult or impossible for ISOs to compete with Kodak in providing copier service to end-users
- ISOs claimed that Kodak had unlawfully tied service to parts
- The Supreme Court held that Kodak was not entitled to summary judgment on a Section 1 claim or on a Section 2 (monopolization) claim

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Kodak

Sufficient evidence that Kodak had power over parts to force customers to purchase unwanted service from Kodak

- Kodak controlled 100% of the tying product market (Kodak-compatible replacement parts)
- Customers had been forced to buy Kodak's service, which was allegedly inferior and more expensive. *Id*. at 464-65

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Kodak

Derivative aftermarkets and market power

- Kodak argued that it lacked market power in the primary equipment market for copiers and therefore, as a matter of law, could not have market power in derivative aftermarkets for parts of service. The Court, assuming that the primary market was competitive, rejected this argument
  - No evidence that Kodak had actually lost equipment sales after it raised service prices. *Id*. at 472
  - High aftermarket prices could depress primary market sales only if consumers were knowledgeable of the total cost of the package – equipment, service, and parts – at the time of purchase, *i.e*., consumers must engage in accurate lifecycle pricing. *Id*. at 473
  - If “lock-in” or brand switching costs are high, consumers will tolerate some level of service price increases before changing brands. *Id*. at 476-77

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Kodak

Thus, post-*Kodak*, a small market share in a primary market will not necessarily preclude application of the *per se* rule to tying involving a derivative or aftermarket

Kodak asserted business justifications

- Need to ensure quality service
- Need to control inventory costs
- Desire to prevent ISOs from free-riding on Kodak's efforts

Insufficient to prove that Kodak was entitled to judgment as a matter of law. *Id*. at 483-86

Post-*Kodak* Era

Patents themselves no longer establish market power

- *Illinois Tool Works, Inc. v. Independent Ink, Inc*., 547 U.S. 28 (2006)
  - “After considering the congressional judgment reflected in the 1988 amendment [to the Patent Act], we conclude that tying arrangements involving patented products should be evaluated under the standards applied in cases like *Fortner II* and *Jefferson Parish* rather than under the *per se* rule applied in … *Loew’s*. While some such arrangements are still unlawful, such as those that are the product of a true monopoly or a marketwide conspiracy, *see*, *e.g.*, *United States v. Paramount Pictures, Inc*., 334 U. S. 131, 145-146 (1948), that conclusion must be supported by proof of power in the relevant market rather than by a mere presumption thereof.” *Id*. at 42-43

Market power is the key inquiry

Defenses and Best Practices

Always consider your market share and market position before imposing a tie

If you are considering a tie involving aftermarkets, consider whether lifecycle pricing is transparent to consumers, and consider not imposing a tie on consumers who have already purchased product in the primary market

Goal is always to obtain Rule of Reason, rather than *per se* treatment

- Rule of Reason victories for plaintiffs are rare; must show actual adverse effect on competition

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Insufficient Justifications

Justifications generally – in *per se* cases versus Rule of Reason cases

- Strange nature of "*per se*" tying offense
- *Kodak* and *Jefferson Parish* don't suggest justifications, but some courts have considered and sometimes accepted defenses

Insufficient

- Buyer could purchase tied product from someone else
- Sporadic enforcement of ties, or convenience of seller
- Protection of goodwill, or quality control if there is a less restrictive way to protect these interests (*e.g.*, by specifying product standards, designating approved outside suppliers, etc.)
  - *International Salt*, 332 U.S. at 397-98; *Jefferson Parish*, 466 U.S. at 25 n. 42

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Potentially Plausible Justifications

Necessity of tie to assure effective functioning of new products or equipment in an emerging industry

Necessity of tie to assure product utility / compatibility where separate sales lead to widespread customer dissatisfaction

Products must be used together and specifications of possible substitutes for tied product cannot practicably be provided (too complex, disclosure of trade secrets, etc.)

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DEVELOPMENT AND HISTORY OF TYING LAW

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Intellectual Property and Tying After Illinois Tool Works: Is There a Per Se Rule Against Tying?

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For Strafford Publications

May 1, 2012

What Is Tying?

- When a seller conditions the sale of a product on the purchase of a second product, or on an agreement that the second product will not be bought from someone else.

See, *No. Pacific Rwy.*, 356 U.S. at 5-6.

Why Do Sellers Use Ties?

- **Consumers demand them**
- **Quality control**
- **Risk sharing for new products**
- **Price discrimination / Metering**
  - Hovenkamp, Janis, & Lemley, IP AND ANTITRUST § 21.2 at 21-12 (metering is **"nearly always procompetitive"**)
  - F. H. Easterbrook, *Intellectual Property Is Still Property*, 13 HARV. J.L. & PUB. POL'Y at 112 (price discrimination through tying achieves **"the best of both worlds"**).

The Attitude Toward Tying Has "Evolved" Over The Last Century

- **1947**: "[T]he tendency of the arrangement to the accomplishment of monopoly seems obvious." *International Salt*, 332 U.S. at 396.

- **1988**: "[B]oth the majority and minority opinion in [*Hyde*] recognized that tying's anticompetitive mechanism is not obvious." *Grappone*, 858 F. 2d at 794 (Breyer, J.)

Tying is Now Viewed As Generally Procompetitive

- **1949:** "Tying agreements serve hardly any purpose beyond the suppression of competition." *Standard Oil*, 337 U.S. at 305.

- **2004:** "Today it seems quite clear that most tie-ins benefit competition, even when the defendant has tying product power." IX Areeda & Hovenkamp, ¶ 1720a at 220.

The 'per se' rule arose in patent cases, based on the leveraging fallacy.

- **1912:** Tying allows the patentee "to bring within the claims of his patent things which are not embraced therein, thus … to multiply monopolies at the will of an interested party." *Henry v. A.B. Dick*, 224 U.S. 1, 53 (White, C.J., dissenting).

- **1984:** "[A] tied product normally does not increase the profit that the seller with market power can extract from sales of the tying product." *Hyde*, 466 U.S. at 36.

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The Per Se Rule Against "Tying"

I. Two Products

II. Sale Of Tying Product Conditioned On Purchase Of Tied Product

III. Market Power In Tying Product (Even If Patented)

IV. Volume Of Business In Tied Product Not "Insignificant Or Insubstantial"

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Why Is Power in the Tying Product Important?

- Without market power in the tying product, "no tying arrangement can harm competition." 10 Areeda & Hovenkamp, ¶ 1734b3 at 39.

- "[H]ow can a firm with only 30 percent of a market exclude competitors by tying two products together? A firm that wants to produce only one will have no trouble finding customers." R. A. Posner, *Antitrust Law* at 265 (2d ed.).

The Court Never Thought That Patents Conveyed Actual Market Power

- **1958**: "Of course *it is common knowledge* that a patent does not always confer a monopoly over a particular commodity. Often the patent is limited to a unique form or improvement of the product and the economic power resulting from the patent privileges is slight."

- No. Pacific Ry., 356 U.S. at 10 n.8 (emphasis added).

The Court Eventually Required *Real* Market Power In The Tying Product

- *Fortner II* (1977) and *Hyde* (1984) rejected uniqueness as insufficient to show real market power.

- After *Hyde*, the lower courts split, with the majority rejecting a presumption of market power in patent cases.

The Unfortunate Dictum in *Hyde*

1984: "For example, if the Government has granted the seller a patent . . . it is fair to assume that the inability to buy the product elsewhere gives the seller market power. *Loew's*, 371 U.S., at 45-47."

Hyde, 466 U.S. at 16.

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The Consensus That Patents Do Not Convey Market Power

- **1988:** Congress amended the patent laws to ensure that a claim of tying raised as a "misuse" defense to a patent enforcement action could not succeed without proof of market power in the tying product. 35 U.S.C. § 271(d)(4), (5)).
- **1995:** Both enforcement agencies adopted guidelines eschewing any presumption that "a patent, copyright, or trade secret necessarily confers market power upon its owner."

Illinois Tool Works: A Classical Tie

- To buy Illinois Tool Works' patented printhead for applying barcodes to packages, you must buy the unpatented ink it uses from Illinois Tool works as well.
- The Federal Circuit affirmed dismissal of the §2 claims, but reversed on tying, saying it was bound by *Loew's* to presume market power in the patented tying product.

***Illinois Tool Works*' Simple Holding:**

"Today, we … hold that, in **all** cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product."

Illinois Tool Works v. Independent Ink, 126 S. Ct. 1281, 1293 (2006).

Illinois Tool Works' "Guidance"

"While some such arrangements are still unlawful, such as those that are **the product of a true monopoly** or a **market wide conspiracy**, *see, e.g., United States v. Paramount Pictures, Inc.*, 334 U.S. 131, **145-146** (1948), that conclusion must be supported by proof of power in the relevant market …."

Id. at 1291.

AFTER *ILLINOIS TOOL WORKS*

- **IS THE PER SE RULE DEAD?**
  - ***It is at least "mostly" dead …***
- **WHAT LANGUAGE IN *ILLINOIS TOOL WORKS* SAYS SO?**
  - ***Well … nothing, actually.***

Ask Judge Diane Wood:

- "*Illinois Tool Works* thus stands only for the proposition that a plaintiff must prove that a holder of intellectual property has … market power…. If a plaintiff can do so, then the [per se] framework of [*Hyde*] continues to apply."

- *Reifert v. South Central Wisc. MLS Corp.*, No. 05-3601 at 17 (7th Cir. 6/12/06)

The DOJ/FTC IP Report Concurs:

- "Although in *Illinois Tool Works Inc*. *v*. *Independent Ink*, *Inc*. the Supreme Court recognized that many tying arrangements, 'even those involving patents and requirements ties,' can be procompetitive, that case did not present a vehicle for the Court to revisit its conclusion that some tying arrangements constitute *per se* violations." [DOJ/FTC IP Report at 109.]

The DOJ and FTC Have Already Rejected The Per Se Rule

- "Pursuant to the Antitrust-IP Guidelines, the Agencies, as a matter of prosecutorial discretion, consider both the anticompetitive effects and the efficiencies attributable to a tie." DOJ/FTC IP Report at 110 (2007).

Compare *Hyde* Opinion:

"It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements … are unreasonable 'per se.'" [***Hyde***, 466 U.S. at 9]

With *Illinois Tool*:

"Many tying arrangements, even those involving patents and requirements ties, are fully consistent with a free, competitive market." [***ITW***, 126 S. Ct. at 1292]

Abraham v. Intermountain Health Care, **461 F.3d 1249, 1264 (10th Cir. 2006).**

- Whether products can be considered distinct turns … on the character of the demand for the two items." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 19 (1984), **abrogated on other grounds** by *Illinois Tool Works v. Indep. Ink*, 126 S. Ct. 1281 (2006).

Evading The Per Se Rule
Illinois Tool

- *U.S. Philips Corp. v. ITC*, 424 F.3d 1179 (Fed. Cir. 2005)
- Bundling of “essential” with “non-essential” patents alleged to be *per se* misuse
- The Court *affirmed* the finding of market power in the tying product.

So, Why Not Per Se Misuse?

- “In the case of patent-to-product tying, the patent owner uses the market power conferred by the patent to compel customers to purchase a product in a separate market.”
- “By contrast, a package licensing agreement that includes both essential and nonessential patents does not impose any requirement on the licensee.”

U.S. Philips, 424 F.3d at 1189-90.

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Thus Did *U.S. Philips* Reject The *Per Se* Rule …

- "The package license is thus not anticompetitive in the way that a compelled purchase of a tied product would be." [Id. At 1190.]

- "[Accordingly,] the analysis that led the Commission to apply the rule of per se illegality … was legally flawed." [Id. At 1193.]

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What Happens After *Illinois Tool*?

- *Monsanto Co. v. Mitchell Scruggs*, *et al.*, No. 04-1532 (Fed. Cir., August 16, 2006).

- Monsanto's licenses "stated that if a grower chose to use glyphosate herbicide in connection with [Monsanto's patented] seeds, then the grower must use [Monsanto's unpatented] herbicide." [Slip Op. at 15.]

Now, A Patent-To-Product Tie Can Also Ignore The *Per Se* Rule

- "The [district] court stated that if the seed partner agreements did amount to a tie, per se treatment was not appropriate." [p. 16]

- "In this **unusual** setting, the rule of reason applies to the defense of patent misuse based on the alleged tying arrangement." [p. 19.]

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The Even Less Subtle Approach of the Seventh Circuit

- "In 1985, our Circuit began to incorporate the rule of reason in our tying analysis [in the *Carl Sandburg Village* case]." *Reifert v. So. Central Wisc. MLS Corp.*, 450 F.3d 312, 317 n.2 (7^{th} Cir. 2006).

- "[T]he Supreme Court recently adopted Justice O'Connor's reasoning in [*Hyde* in] … *Ill. Tool Works* …." *Id.*

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So … *What* Per Se Rule?

- "Although the per se analysis of the [*Hyde*] majority was not expressly overruled, in the intervening twenty-one years since *Carl Sandburg*, the Supreme Court has not found occasion to disagree with this Circuit's approach." [*Reifert*, 450 F.3d at 317 n.2.]

There has long been some support for viewing tying's per se "rule" only as a guideline

- Supreme Court: *U.S. v. Jerrold Elec. Corp.*, 365 U.S. 567 (**1961**) (per curiam).

- First Circuit (Breyer, J.): *Grappone, Inc. v. Subaru of New England*, 858 F.2d 792, 799 (1st Cir. **1988**) ("it is conceivable that the 'tie' was 'efficient' enough a way to do business that the agreement could have escaped *per se* condemnation …").

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Einer Elhauge,
"TYING, BUNDLED DISCOUNTS, AND THE DEATH OF THE SINGLE MONOPOLY PROFIT THEORY"

- "But the Court has always considered procompetitive justifications before rejecting them, and *Illinois Tool Works* affirmatively states that the Court now accepts the view that ties can have procompetitive justifications. …

  Accordingly, today it is more accurate to read Supreme Court precedent on tying as embracing a rule of reason, where anticompetitive effects must be shown or inferred and procompetitive justifications are admissible."

- 123 Harv. L.Rev. 397, 425-6 (2010)

Bundling as Coercion?

- "[P]laintiff may] stake its tying claim not on a theory that PeaceHealth explicitly (e.g., by contract) or implicitly coerced insurers to purchase [the tied product] … as a condition of obtaining [the tying product], but on a theory that PeaceHealth's bundled discounts effectively left insurers with no rational economic choice other than purchasing [the tied product] from PeaceHealth."

  Cascade Health Solutions v. PeaceHealth, 502 F.3d 895, 929 n.30 (9th Cir. 2007)

Are Patents Different?

- *Schor v. Abbott Labs* (7th Cir. 2006)

- Abbott holds a patent on protease inhibitor called ritonavir (Norvir), used to treat AIDS.

- Norvir is dangerous alone, but is very effective as a booster for other protease inhibitors.

Schor v. Abbott Labs

- Abbott thus sells Kaletra, which combines the Norvir booster with another inhibitor.

- Plaintiffs want Abbott to sell Norvir alone, so that it can be combined with competitive inhibitors, but Abbott allegedly charges **much** more for Norvir alone than for Kaletra.

Is Abbott "Tying" Kaletra to Norvir?

- NO: "Abbott sells ritonavir as part of Kaletra, but this is not a tie-in because ritonavir is available separately as Norvir. Abbott will sell to anyone willing to pay its price: there is no refusal to deal. The price of Norvir cannot violate the Sherman Act: *a patent holder is entitled to charge whatever the traffic will bear. This is true of both Norvir's price, and of a claim that the patent holder has engaged in price discrimination ….*"

Schor v. Abbott Labs., 457 F.3d 608, 610 (7th Cir. 2006)

Technological Ties

I ABA Antitrust Law Developments (Seventh):

- "Physical tie-ins that result from redesigning the tying product so as to make the products of rival sellers incompatible generally have been upheld as lawful." (p. 185)
  - citing, e.g., *Foremost Pro Color, Inc. v. Eastman Kodak Co.*, 703 F.2d 534, 543 (9^{th} Cir. 1983)

Is Your iPod A Techno Tie?

- "The Ninth Circuit in [*Foremost Pro*] identified the technological tie as a species of tying arrangement, but expressly declined to find that allegations of technological ties, without more, could provide the basis for *per se* Section 1 liability. …Ultimately, this Court is not aware of any case where *per se* tying liability was found on the basis of a technological tie."

The Apple iPod iTunes Antitrust Litigation at 8, No. C 05-00037 JW (5/15/2009)

"Rule of Reason" Tying Cases

- *Brantley v. NBC Universal*, 2012 WL 1071257 (3/30/12)
- Tying 'good' cable shows to 'bad' cable shows
- Requires competitive effect in tied market
- Reduced choice and higher prices for consumers not enough, given procompetitive tendencies of tying.

Two Products???

- *Rick-Mik Enterprises, Inc. v. Equilon Enterprises LLC*, 532 F.3d 963, 975 (9th Cir. 2008):

- "Applying the 'character of demand' test, Rick-Mik's complaint fails to plead facts necessary to assess whether credit-card services are distinct from the franchise agreements.

- ….With franchises, the franchisee knows the contractual limitations and duties before entering into the contract. A complaint about such contractual obligations is not an antitrust matter."

Checklist of 'Other' Defenses

- No financial interest in the tied product
- There is no reduced competition in the tied market, because
  - customer would not have bought it at all, or
  - the tied market is already monopolized
- No antitrust injury (without an impact on competition)
- Tie fits an exception to per se rule
  - necessary for new product
  - *Microsoft* (software?)
  - *Grappone* catch-all (any other 'efficient' reason)