

CHAPTER 4

TYING ARRANGEMENTS

Tying arrangements and full-line forcing offend the object of antitrust for two reasons; they force buyers to give up the purchase of substitutes for the tied or forced products and they deny access by competing suppliers of the tied products to the consuming market.¹

Tying sometimes constitutes monopolization, or attempts to monopolize under Section 2 of the Sherman Act. Tying can also be seen as an "unreasonable restraint of trade" under Section 1 of the Sherman Act. And of course, tying offends Section 3 of the Clayton Act which proscribes sales or leases conditioned on an agreement or understanding that the buyer or lessee will not to deal in the goods of competitors, providing that the agreement or understanding has the potential for substantially lessening competition. The difference between tying and exclusive dealing is that one conditions the sale or lease on the simultaneous purchase of subsidiary items while the other conditions the sale or lease on an agreement not to purchase competing items which may or may not be required in the future. In effect tying, like exclusive dealing, amounts to an agreement or understanding not to deal in the goods of competitors. Tying can also be seen as an unfair method of competition under Section 5 of the Federal Trade Commission Act.

¹Phillip Areeda, Antitrust Analysis: Problems, Text, Analysis, 3rd ed. (Boston: Little Brown and Co., 1981), p.568.

Clearly, tying agreements oppose the basic philosophy of Sherman Act policy which holds that competition should govern the marts of trade. Moreover, if the seller enjoys either a position of power in the market for the tying product, lawful or otherwise, or if a substantial volume of commerce in the "tied" product is restrained, the tying arrangement also violates the more specific standards expressed in Section 3 of the Clayton Act since either factor can represent the requisite "potential lessening of competition." Even in the case of a lawfully held patent, trademark, or copyright monopoly, it is regarded as "unreasonable" to foreclose competitors from any substantial market by means of a tying arrangement. ²

A tying arrangement may be defined as an arrangement by a party to sell one product but only on the condition that the buyer also purchase a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier.³ Where such conditions are successfully extracted, competition on the merits with respect to the tied product is inevitably curbed.⁴ 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 power or leverage in another market. At the same time buyers are forced to forego their free choice between competing products. As a consequence tying arrangements are

²Times Picayune Publishing Co. v. United States, 345 U.S. 594 (1953).#615

³Northern Pacific Railway Co. v. United States, 356 U.S. 1, Areeda3 757. If a buyer agrees to take a product exclusively from one seller without regard for a second or tying product, it is usually referred to as exclusive dealing. Although a tying agreement is a particular kind of exclusive dealing agreement, this latter term usually refers only to non tying exclusive dealing arrangements. In all events, both invoke Clayton 3 and its concern with coercing buyers and foreclosing of rival's opportunity.

⁴This view has its roots in Justice Frankfurter's Standard Stations opinion where he states: Tying agreements serve hardly any purpose beyond the suppression of competition. Standard Oil Co. of California and Standard Stations, Inc. v. United States, 337 U.S. 293, ?? (1949).

held to be unreasonable in and of themselves, that is, unreasonable per se, whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a "not insubstantial" amount of interstate commerce is affected. International Salt,⁵ Paramount Pictures,⁶ U.S. v. Griffith.⁷

In the earlier White case, the court said that per se violations are those antitrust violations, agreements, or practices which because of their pernicious effect on competition and lack of redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused, or the business excuse for their use.⁸ Note that any judicially, as opposed to legislatively, declared per se rule is not conclusively binding on the court as to any set of facts not basically the same. While the per se rule is followed in almost all cases, the court is always conscious of the fact that a specific case might arise in which the facts indicate that an injustice would be done by blindly accepting the per se rule.⁹

Among the other practices which the courts had heretofore deemed to be unlawful in and of themselves were price fixing (Socony-Vacuum),¹⁰ division of markets (Addyston Pipe),¹¹ group boycotts (Fashion Originators Guild).¹² After 1947, tying was

⁵ 352 U.S. 392 (1947).

⁶United States v. Paramount Pictures, 334 U.S. 131 (19??)

⁷United States v. Griffith, 334 U.S. 100 (1948).

⁸White Motor Co. v. United States, 372 U.S. 253 (1963).Areeda2-533

⁹ Areeda3, p. 782.

¹⁰Socony Vacuum Oil Co. v. United States,

¹¹Addyston Pipe & Steel Co. v. United States, 85 Fed 271 (6th Cir. 1898), aff'd 175 U.S. 211

added the list (International Salt).¹³

The judicial concern with tying first appeared as early as 1912 in Justice White's dissent in the A.B. Dick decision.¹⁴ Justice White's prescient dissent in that patent case became the basis for the law five years later in the Motion Picture Patents case.¹⁵ Although these cases were decided under the law of patent misuse, they later were to become precedent for holding tie-in sales illegal in cases brought under Sherman-1 and Clayton-3.¹⁶

Beginning with those early patent misuse cases, it has always been seen as an abuse to license a patented combination only to those who also buy its unpatented components from the patentee. The stream of patent misuse cases condemns every use of a patent as leverage to obtain a monopoly of unpatented material or product. Thus the refusal to license a patent except as part of a "package" is ordinarily unlawful. One invention alone is what the patent grant protects, not that invention plus some embellishment.¹⁷

(1899).

¹²Fashion Originators Guild v. United States

¹³International Salt Co. v. United States, 332 U.S. 392 (1947).

¹⁴Henry v. A.B. Dick, 224 U.S. 1, 49 (1912).

¹⁵Hazeltine Research v. Zenith Radio, 239 F.Supp. 51, 77(N.D. Ill. 1965).

¹⁶Robert Bork, The Antitrust Paradox: A Policy at War With Itself, (New York, N.Y.: Basic Books, Inc., 1978) p. 366. The patent misuse doctrine, first stated in the Motion Picture Patents case, denies protection against direct or contributory infringement where the patentee employs a tying arrangement as a means for restraining competition in the unpatented product or supplies. See also Morton Salt Co. v. Suppiger, 314 U.S. 488 (1942).

¹⁷Hazeltine Research v. Zenith Radio, 239 F.Supp. 51, 77(N.D. Ill. 1965).

The main antitrust as opposed to patent law concern with tie-in sales begins with the 1947 International Salt¹⁸ decision. Drawing on an earlier boycott case,¹⁹ Justice Jackson held that "it was unreasonable, per se, to foreclose competitors from any substantial market."²⁰ This theory was reaffirmed in Justice Frankfurter's dicta in Standard Stations.²¹ In that oft quoted decision dealing with exclusive dealing as opposed to tying, Justice Frankfurter noted the basic similarity of exclusive supply contracts and tying arrangements. While finding some possible redeeming value in exclusive supply contracts, he asserted that "tying agreements serve hardly any purpose beyond the suppression of competition."²² This non-empirical assertion i.e., that tying agreements serve hardly any purpose beyond the suppression of competition, is still the primary justification for the per se treatment of tying under the antitrust laws.

But while tying is treated as a per se violation of Sherman-1, unlike other per se violations, in the case of tying the courts require that the tie-in claim needs to be dressed up with a modicum of economic data before they will recognize it as such.²³ Thus it appears that tying arrangements are illegal per se, but not quite.

¹⁸International Salt Co. v. United States, 332 U.S. 392 (1947).

¹⁹Cite the boycott case mentioned in Int Salt

²⁰Cite the boycott case Jackson uses at this point. Bork p. 366

²¹Standard Oil Co. of California and Standard Stations, Inc v. United States, 337 U.S. 293, 305 (1949). #Bork36

²²Standard Oil Company of California v. United States, 337 U.S. 293, 305-306.

²³Hammond#186

This quasi per se treatment of tying is clearly revealed in the Northern Pacific²⁴ case, where a tie-in was seen as unreasonable per se only when a party had sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a not insubstantial amount of interstate commerce was involved.

Without meeting these two preliminary tests, there would be no illegal tie. Thus the formula for a per se tying violation now reads like this:²⁵

1. Economic power in the market for the tying good plus
2. Substantial commerce in the tied good equals
3. A per se violation of the antitrust laws.

Since one of the requirements for finding a tying arrangement to be illegal under the antitrust laws is that the seller must have "sufficient economic power with respect to the tying product to appreciably restrain free market competition in the tied product," the question of how much economic power is "sufficient" to trigger an antitrust violation automatically arises. The traditional indicia of market dominance in antitrust--the power to control price and exclude competition--is not the only test or even the principal test of whether the tie-in seller has the requisite economic power to restrain trade or lessen competition. Absent a showing of market dominance, the requisite economic power may still be inferred from the tying product's desirability to consumers or from the uniqueness in its attributes.²⁶ And of course, since customers will hardly ever purchase a product which appears undesirable to them, the equating of economic power with the desirability

²⁴Northern Pacific Railway Co. v. United States, 356 U.S. 1 (1958).

²⁵Singer#138

²⁶Areeda, op. cit., p.766.

of the product is a circular way of invariably finding the crucial power in the tying product.²⁷

In the landmark Northern Pacific decision,²⁸ the court clearly stated that "market power in the tying product is not the critical element of the offense." The court goes on to state that in a case where the buyer suffers economic detriment from the tying arrangement because he is precluded from purchasing the tied product at better terms or a better quality elsewhere, economic coercion can be inferred even without any direct showing of market dominance.²⁹ It is sufficient, the court said, if the tying product merely have adequate power to command the arrangement.³⁰ Incidentally, it makes no difference to the legality of the tie that the tied product need not be purchased from the seller unless its price is equal to or less than that of competing sources. Even under these terms, the company that ties the two products has at all times a priority on the business at equal prices. Nor does the fact that the tying clauses in a contract are not always enforced is an insufficient defense. The significant element in enforcement is not the degree of actual insistence upon compliance with the terms of the tying arrangement, but the dire consequences flowing from cancellation of the contract.³¹

The fact is that the requisite economic power can even be inferred from the very

²⁷Singer, Antitrust Economics, p.199.

²⁸356 U.S. 1 at ? (Bork p. 358 #653)

²⁹ 356 U.S. 1 at p. 16.

³⁰See AAMCO Automatic Transmissions v. Tayloe, 407 F.Supp. 430, 437 (E.D. Pa. 1976) "very fact that AAMCO imposed a tie on its many franchisees evidences the power to have done so."

³¹Eugene M. Singer, Antitrust Economics, p. 203.

existence of the tying clauses where no other explanation for their use is offered.³² Moreover the court appears to feel that an alternative explanation sufficient to justify the tie must include a showing of some benefit conferred upon the purchasers in return for their foregoing a free choice of alternatives, as well as the legitimacy of the seller's motive. These requirements are outlined in both Fortner II,³³ and Northern Pacific.³⁴

In the case of a tying product which is patented or copyrighted, the requisite economic power to trigger an antitrust violation in a tying situation is automatically presumed.³⁵ Also, another important index of market power in the tying product is shown by its ability to command a premium price.

In the Siegel case, even a registered trademark was presumed to give the franchisor of that trademark sufficient economic leverage with respect to the tied products to violate the Sherman Act since, like a patent or copyright, the registered trademark presents a legal barrier against competition, especially if a nationally recognized trademark accepted by a large number of franchisees is involved.³⁶ However, unlike a patent or copyright, a trademark is not a "commodity" as the term is used in the Clayton Act and hence franchised trademark tie-ins are not covered by

³² 356 U.S. 1 at ? (Bork p. 358)

³³Unites States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610 (1977).Hammond # 187

³⁴356 U.S. 1 (1958)

³⁵See United States v. Loew's,Inc., 371 U.S. 38 (1962).

³⁶Siegel v. Chicken Delight, 448 F.2d 43,50 (9th Cir. 1971), cert. denied, 405 U.S. 955 (1972). "Where the owner of a well-known and uniquely desirable trademark imposes a tie on its franchisees, the element of economic power required by Fortner is met." AAMCO Automatic Transmissions, Inc. v. Tayloe, 407 F. Supp. 430, 437 (E.D. Pa. 1976).

Clayton 3. Only the Sherman Act rules apply. This extension of the public policy concern for tying arrangements to franchising has been a major source of litigation over the years since the Siegel decision.³⁷

Given that the requisite economic power may be found on the basis of either product uniqueness or consumer appeal, and since "market power" does not necessitate a demonstration of market dominance in the sense usually required by monopolization cases under Section 2 of the Sherman Act, it is typically unnecessary in a tie-in sale case to embark upon a full-scale factual inquiry into the scope of the relevant market for the tying product or into the corollary problem of the seller's percentage share in the defined market. In this sense it is different from other Clayton Act violations, including exclusive dealing.

Comment [1]: Make sure that tying is the only per se area of the Clayton Act. Does exclusive dealing require a market power test?

In spite of the simplicity with which the requisite market power to trigger a tying charge can be demonstrated, several problems still remain. For example, what if the source of the uniqueness arises because the seller is willing to accept a lesser profit, or is willing to incur greater risks than his competitors? Should this kind of uniqueness give rise to an inference of economic power.³⁸ What if the uniqueness derives from the seller's superior reputation or marketing skills or from scale economies resulting in higher productivity and lower costs? Are these kinds of uniqueness that represent undesirable market power? There is no question that they give rise to market power.

³⁷In the Georgetown Antitrust Project 27.3% of the 2,357 case sample of private antitrust cases involved complaints by dealers and 21.1 % of all primary and secondary allegations of illegal practices in the complaints involved charges of tying or exclusive dealing. Steven C. Salop and Lawrence J. White, "Private Antitrust Litigation: An Introduction and Framework," A paper presented at the Georgetown Conference on Private Antitrust Litigation, Airlie House, Virginia, November 8-9, 1985.

³⁸Fortner, Areeda3, p. 802

Similarly, what if competitors are free to offer the same combination of products, or to offer the product on the same terms? Again, does such a basis for uniqueness give rise to the inference of illegal market power? The fact is that the courts have held that unless the seller has the power within the market for the tying product to raise prices or to require purchasers to accept burdensome terms that could not be exacted in completely competitive markets, a product does not have the kind of uniqueness necessary to trigger a violation of the law.

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In addition to market power, the formula for holding a tie-in sale to be illegal requires that a not insubstantial amount of commerce be involved. This turns out to be an even easier hurdle to clear since under most of the post-Fortner decisions almost any amount of commerce restrained by an illegal tie-in agreement constitutes a not insubstantial amount of interstate commerce.³⁹

It goes without saying that for a tie-in sale to exist, there must be at least two separate products. This raises another difficult question: when is a "package" sale to be treated as a case of tying and when is it merely the sale of a "single product" consisting of a series of interrelated components?⁴⁰ Is a season football ticket, for example, a "single product," or does it tie-in the sale of individual games?⁴¹ What about a requirement that pre-season tickets be purchased with the

³⁹Hammond, op. cit., p. 207. In Aqua Flame v. Imperial Fountains, 463 F.Supp. 736 (N.D. Tex. 1979) \$75,000 of commerce in the tied product was sufficient to make a tie unlawful. In Yentsch v. Texaco, 630 F.2d 46 (2d Cir. 1980), the court doubted that \$15,000 was substantial.

⁴⁰ See: Note, Product Separability: A Workable Standard to Identify Tie-in Arrangements Under the Antitrust Laws, 46 S. Cal. L. Rev 160 (1972).

⁴¹See Coniglio v. Highland Servs., 495 F.2d 1286(2d Cir.)cert denied, 419 U.S. 1022

season ticket?⁴² Is this a tie-in sale? Is an installed radio a separate product from the car?⁴³ Does a dry-cleaning franchise granted only on the condition that the franchisee buy his dry-cleaning equipment from the franchisor represent a tie, or are the equipment and the trademark but parts of a "single product?"⁴⁴ What about "turn-key" sales of franchised donut shops?⁴⁵ These are all troublesome questions for the law.

Early on after the Siegel case the issue of whether the trademark was separate from the products sold under that trademark came to the fore. In Redd v. Shell,⁴⁶ the Shell trademark was not seen as a separate product from the gasoline sold under the Shell trademark. This was also held to be the case in Baskin-Robbins⁴⁷ where the ice cream was held not to be separate from the Baskin-Robbins trademark. Likewise, in Barnosky v. Union Oil Co., the court again held that a gasoline trademark merely identifies the source of the gasoline resold by a dealer and is not a separate product.⁴⁸ These cases sought to distinguish themselves from Siegel and Chock Full O'Nuts⁴⁹ on the grounds that they dealt with particular goods rather than with a marketing format.

(1974).

⁴² Driskill v. Dallas Cowboys Football Club, 498 F.2d 321 (5th Cir. 1974).

⁴³ Automatic Radio Mfg. C. v. Ford Motor Co., 390 F.2d (1st Cir.), cert denied, 391 U.S. 914 (1968).

⁴⁴ Northern v. McGraw-Edison Co., 542 F.2d 1336 (8th Cir. 1976).

⁴⁵ Ungar v. Dunkin' Donuts, 531 F.2d 1121 (3rd Cir.), cert denied, 429 U.S. 823 (1976).

⁴⁶ Redd v. Shell Oil Co., 524 F.2d 1054 (10th Cir. 1975), cert. denied, 425 U.S. 912 (1976).

⁴⁷ Krehl v. Baskin-Robbins Ice Cream Co. 1979 Trade Cases Pgh 62806 (C.D. Cal.).

⁴⁸ 1979 Trade Cases, Pgh 62668 (E.D. Mich. 1968).

⁴⁹ 1979 Trade Cases, Pgh 62668 (E.D. Mich. 1968).

But this is a specious distinction, since Shell and Union and Baskin-Robbins are not just "brands," but are also carefully orchestrated operating formats. Moreover, in the case of gasoline, the trademark licensor may not even identify the "source" of the product.

In dealing with such issues, the courts have sought to ascertain whether there are legitimate reasons for selling normally separate items in a combined form. They also ask whether there are other "practical or less restrictive ways" for the franchisor or the seller to achieve the same result.

Robert Bork properly notes that anyone who sells anything in a sense imposes a tie-in sale. This is true because every product or service theoretically can be broken down into smaller components capable of being sold separately (car, motor, sparkplugs,tires,etc) and every seller either refuses at some point to break the product down further, or what amounts to the same thing, charges a proportionally higher price for the smaller unit.⁵⁰ Bork further argues that judges attempts to avoid this ridiculous result by distinguishing between "packages" that are inherently one product and those that are inherently more than one makes no sense since there is no objective way to state the "inherent" scope of a product.

This is exactly the problem raised in the landmark Jerrold case.⁵¹ In the early days of cable TV, Jerrold Electronics Corporation required CATV operators to buy the complete system entirely installed by Jerrold people even when they only wanted to buy a subset of preferred Jerrold components. Jerrold argued this requirement was justified

⁵⁰Robert Bork, Antitrust Paradox, p.378.

⁵¹United States v. Jerrold Electronics Corp., 187 F.Supp. 545 (E.D. Pa. 1960), aff'd per curiam, 365 U.S. 567 (1961).

as necessary to assure subscriber satisfaction and thus to protect Jerrold's "good will." There was no question that each component, including installation, could have been sold separately. Thus the court of course faced the problem of deciding whether this should this be treated as a case of tying the sale of one product and or service to another or merely as the sale of a single product. Jerrold of course contended that the "system" was the product, and that requiring that it be installed by their people was the best and easiest way to insure that it would work well. How is one to decide?

It is apparent that, as a general rule, a manufacturer cannot be forced to deal in the minimum product that could be sold or is usually sold (shades of Colgate).⁵² On the other hand, it is equally clear that one should not be allowed to circumvent the antitrust laws simply by claiming that one is selling a single product. The court's solution seems to have been to examine the facts in order to ascertain whether or not there are legitimate reasons for selling normally separate items in a combined form.⁵³

Bork feels that so long as the notion persists that there is some point in distinguishing one-product sales from two-product sales, so long will the law find itself face to face with the problem of how a tie-in sale can be distinguished from any other sale.⁵⁴ How then should the courts decide if there is a tie-in? Sometimes, they seem to decide whether a tie exists on the basis of whether it is in some sense "justified" or reasonable.⁵⁵ In other instances the distinction seems to be based on "economic

⁵²United States v. Colgate and Co., 250 U.S. 300 (1919).

⁵³Robert Bork, Antitrust Paradox, p.371.

⁵⁴Robert Bork, Antitrust Paradox, p.370.

⁵⁵Areeda, Antitrust Analysis: Problems, Text, Cases, p.734.

intuition."⁵⁶ If the court senses a positive economic value inherent in the tie, it then resorts to a legal fiction by defining the "package" to be a "single product." This seems to be what happened in the curious Principe case.⁵⁷ There, the Fourth Circuit found that a trademark license, building lease, and security deposit were all part of a "single product" as a "matter of law." This really stretches the facts of the case.

There seem to be a number of acceptable business reasons for engaging in tie-in sales that are now coming to be accepted by the courts under the rubric of the "single product definition."

Quality control and the protection of "goodwill" have frequently been accepted as legitimate grounds for allowing a tie-in sale when other less restrictive means are not available for protecting these values.⁵⁸ However, in Data General, the quality control justifications were rejected because of the availability of less restrictive alternatives even though they might even compromise trade secrets. Nor was the tie-in of separate products justified on the ground that the tie-in was necessary to recover development cost.⁵⁹

Technological interdependence has occasionally been viewed as an acceptable justification.⁶⁰ When an essential component's failure to conform to exact specifications

⁵⁶Robert Bork, Antitrust Paradox, p. 371.

⁵⁷Principe v. McDonald's Corp., 631 F. 2d 303 (4th Cir. 1980).

⁵⁸ Dehydrating Process Co. v. A.O. Smith Corp., 292 F.2d 653 (1st Cir.), cert denied, 368 U.S. 931 (1961).

⁵⁹Data General Antitrust Litigation, 490 F. Supp. 1089 (N.D. Cal. 1980).

⁶⁰W. Bowman, "Tying Arrangements and the Leverage Problem," 67 Yale L. J. 19, 27-28 (1957).

might impair the operation of the principal product, the courts will often excuse an otherwise obvious tie-in sale under the guise of the "single product" fiction.

Economies of production achieved through tying arrangements which include almost all assembled parts are routinely permitted by means of the single product fiction. A radio, for example is theoretically a tying arrangement of transistors, integrated circuits and parts. However the "functional necessity" of all the parts in terms of a permanent construction serves to justify the single product fiction.⁶¹

Economies of scale also have served to justify tie-ins. In such cases, tie-ins may actually cut selling costs or internal administrative costs. Tying may also be equivalent to a requirements contract and so lower both selling and manufacturing costs.⁶² This is one of the important gains which explains the growth of vertical marketing systems noted in Chapter 2.

Often tying is used as a device for practicing price discrimination based on the nondiscriminatory measurement of use. This justification has received a mixed reception by the courts. In some instances, the ability to practice price discrimination is seen as an index of illegal market power. In other instances, however, it is seen as completely independent of the objective of achieving monopoly in the tied product. As Professor Ward Bowman notes, the existence of illegal leverage in a tying situation depends upon the effect of the tying arrangement on the output of the tied product, and this is not always easy to evaluate.⁶³

⁶¹Donald Turner, "The Validity of Tying Arrangements Under the Antitrust Laws," Harv L. Rev., Vol LXXXII (November, 1958), 50-75.

⁶²Robert Bork, Antitrust Paradox, p. 379.

⁶³Singer, op.cit p. 194.

In the case of complementary products involving fixed proportions--say nuts and bolts or right shoes and left shoes--it makes no difference to the purchaser to know the separate prices of these items. Charging more or less for the left shoe than for the right does not enhance the profit of the monopolist. Or in the case of the nuts and bolts business, if one of the products is competitive even though the other is monopolistic, tying will not increase the combined monopoly profits. There is only one monopoly profit for the taking. Because they are complementary products used in fixed proportions, the tie-in merely determines the identity of the seller, not the amount sold. The amount sold is determined by the price of the monopolistic product. Such a tie could, however, impose a barrier to entry if new entrants must enter as a producer of both nuts and bolts and that is a problem.⁶⁴

In the case of complements used in variable proportions, the output of the tied good will be less than it would be if the price or output of the tying good were changed and the tied good were sold competitively. In this case, the restriction in the supply of the tied good is properly deemed an exercise of undesirable economic leverage.⁶⁵ Because of this complication, the courts are still reluctant to base their decisions on this price-discrimination justification.

Other reasons frequently cited by economists as justifications for tie-ins are cost savings from full-line representation, disguising price to avoid oligopoly pricing, and

⁶⁴Philip Areeda, Antitrust Analysis, p.735. This seems to have been true of the software industry before IBM terminated the tie between its mainframes and its "free" software in 1969. After that date the entrepreneurial software industry virtually took off. Gary Slutsker, "Charles Wang and His Thundering Nerds," Forbes, July 11, 1988, p.118, 120.

⁶⁵Eugene M. Singer, Antitrust Economics: Selected Legal Cases and Economic Models, p.194.

more efficient pricing of the tied product.⁶⁶ While several of these justifications can be shown to be valuable to the consumer as well as to the firm, the courts have also been reluctant to venture far in this direction, even when it is fairly clear that the business purpose was not to suppress competition. This is not altogether unwise. As Kaysen and Turner note, a tie-in always operates to raise the barriers to entry in the market of the tied good to the level of the market for the tying good: the seller who would supply the one can do so only if he can supply the other, since he must be able to displace the whole package which the tying seller offers. And while it is not always the case, developing a substitute for the tying product may be very difficult, if not impossible. Thus tying often tends to spread market power into markets where it would not otherwise exist: for example, few firms are prepared to supply machines like those of IBM, whereas many may be prepared to supply punched cards.⁶⁷

In rebuttal of this point, Robert Bork argues that if there is in fact a higher payment for the punched cards, it is actually only part of the payment for the machine. He holds there is no effect on any card market broader than that of cards used in IBM machines.⁶⁸

In the Siegel case, the court rejected an argument similar to that of Bork's. Defendant Chicken Delight had argued that franchisees would not have paid a greater increment for the tied items than the franchise was worth to them since how else could the value of the franchise be determined except by reference to what franchisees have

⁶⁶Areeda, op.cit., p.735.

⁶⁷Robert Bork, Antitrust Paradox, p.374.

⁶⁸Robert Bork, Antitrust Paradox: A Policy at War With Itself, p. 375.

demonstrated a willingness to pay.⁶⁹ The court said no.

Once the court has resolved the question of whether two separate products exist, next comes the question of whether the sale of one product has in fact been tied to the purchase of another. There is no problem when the tying agreement is explicit, but often that is not the case. This is especially true in the case of trademark franchised systems, where franchisors rarely use explicit tying clauses in the franchise agreement itself. Often, these ties have to be inferred from the behavior of the parties.⁷⁰ For example, the Volkswagen dealer franchise says only that the dealers are to use their "best efforts" to promote VW parts and accessories including air conditioners. But in Heattransfer Corp. v. Volkswagenwerk, A.G., the jury found that this best efforts clause was enforced in such a way as to require VW dealers and distributors to buy the VW air conditioners.⁷¹

In the United Shoe Machinery⁷² case, the court held that the Clayton Act does not require a formalized undertaking by the buyer or lessee to refrain from using the goods of the seller's competitors. Section 3 applies to arrangements that have the practical effect of precluding the buyer from using other suppliers.⁷³

A related problem arises when the franchisee is pressured to take the tied

⁶⁹Areeda, op.cit., p.794.

⁷⁰A. Hammond, p. 168. See Advance Business Systems & Supply Co. v. SCM Corp., 415 F.2d 55, 64 (4th Cir. 1969), cert. denied, 397 U.S. 920, 90 S. Ct. 928, 25 L. Ed. 2d 101 (1970).

⁷¹ 533 F.2d 964 (5th Cir. 1977).

⁷²United Shoe Machinery Corp. v. United States, 258 U.S. 451 (1922).

⁷³United Shoe Machinery Corp. v. United States, 258 U.S. 451, 456-457 (1922).

product even though he technically has a choice as to whether to buy the tied product or not.⁷⁴ Voluntary ties are legal, but coerced ties are not. That much is clear. Coercion provides the evidentiary basis for finding a tying agreement or condition illegal. But what represents coercion? Normal salesmanship? Merely offering both products? What about a package transaction when the package price is less than the sum of the component prices? What if the seller gives "A" to a customer who agrees to buy "B"?⁷⁵ These are not easy questions.

The so called "sales commission" cases⁷⁶ are instructive in this respect since they deal with powerful firms who "forced" those dependent on them to deal in certain goods. Although these were not technically tying arrangements, the central competitive characteristic was the same. They involve the use of a position of power in one market to curtail competition in another. In these cases, the court held that: the Commission was warranted in finding the effect of the plan was as though Atlantic had agreed with Goodyear to require its dealers to buy Goodyear products and had done so.

The disparity in size and financial strength, the short terms of the prevailing leases, the dire financial consequences attendant upon lease cancellation and the established market preference for certain brands of gasoline--all contribute to give Atlantic a leverage over its dealers and corresponding power to effect some exclusion of competition.⁷⁷

A tie-in still exists even if the dealer is free to sell other competing brands as well as the forced brand. As long as the forced brand must also be sold in order to keep the

⁷⁴ P. Areeda, Antitrust Analysis: Problems, Text, Cases, p.734.

⁷⁵ P. Areeda, Antitrust Analysis, p. 762.

⁷⁶ Atlantic Refining Co. v. F.T.C., 381 U.U. 357 (1965) and F.T.C. v. Texaco, Inc., 393 U.S. 223 (1968).

⁷⁷ P. Areeda, Antitrust Analysis, p. 804, 805.

franchise the tie excludes competitors. This is so because a exclusion occurs whenever a franchisee is forced to take any amount of one product in order to obtain another. This follows from the fact that a franchisee's ability to handle a given type of product is not unlimited.⁷⁸

A frequent problem in franchise tying involves the requirement that the franchisee purchase required materials or products from specified alternative sources. There is of course no illegal tying arrangement where the tying company has absolutely no interest in the sales of the third company whose products are favored by the requirement.⁷⁹ That is obvious. The problem comes when the franchisor benefits from the requirement.

If there is a kickback or commission or royalty paid to the franchisor for requiring his franchisees to purchase their requirements from a specific source, this is seen as an illegal tie.⁸⁰ This poses the interesting problem of whether the franchisor must license others to produce the required product royalty free in order to avoid a tying charge?

On the other hand, there is no unlawful tie when the franchisor requires the franchisees to only purchase from approved sources, including himself, and the franchisor has not unreasonably withheld approval of alternative sources. This is competition on the merits of the offer. It is only illegal if the approval of alternative sources is unreasonably withheld.⁸¹ Neither is it unlawful to require that one's

⁷⁸Hammond, p. 181.

⁷⁹Kenner v. Sizzler Family Steak Houses, 597 F.2d 435 (5th Cir. 1979).

⁸⁰See Ohio-Sealy Mattress Mfg. Co. v. Sealey, 585 F.2d 821 (7th Cir. 1978).

⁸¹Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368 (5th Cir. 1977).

franchisees only use Underwriter's Lab approved attachments or to impose other reasonable specifications.⁸² But what if the specifications are purely aesthetic or arbitrary or seem to be only a means of preventing off-the-shelf versions of the product which are widely available from being used? Are such specifications "reasonable?" If the requirements are merely a subterfuge, then a tie-in can be found.

A related problem arises when the franchisee uses equipment and premises owned by the franchisor. This is common in the gasoline and fast-food industries. For example, in the gasoline business, refiner-landlords typically lease the service station to a dealer, but only "loan" him the tanks, pumps and signs. This has been a much disputed arrangement. In the 1923 Sinclair case, the court vacated an order by the Federal Trade Commission against thirty or more refiners requiring them to abandon the practice of leasing underground tanks and pumps to retail dealers at nominal prices and upon condition that the equipment should be used only with the gasoline supplied by the lessor.⁸³ The court found that the written contract did not undertake to limit the lessee's right to use or deal in the goods of a competitor, but leaves him free to follow his own judgement even though the effect of the restrictive covenant is to confine most dealers to the product of their lessors.

The lessee is free to buy wherever he chooses; he may freely accept and use as many pumps as he wishes and may discontinue any or all of them.⁸⁴

In a more recent case, the court again held that the supplier is privileged to prevent the sale of rival gasoline through tanks and premises

⁸²Polytechnic Data Corp v. Xerox Corp., 362 F. Supp. 1 (N.D. Ill. 1973).

⁸³Federal Trade Commission v. Sinclair Refining Co. 261 U.S. 463 (1923).

⁸⁴Areeda3 p. 776

he owns.⁸⁵ Still the issue is not completely settled. In the landmark Bogosian case, the issue was raised anew.⁸⁶ In that case major refiners were charged with leasing their stations including tanks, pumps and signs to lessee-dealers only if the dealers would agree to purchase all gasoline sold under the refiner's brand exclusively from the landlord-supplier. This case raises all of the most difficult questions of applying the developed law of tying to vertical marketing systems and is thus worthy of detailed examination even if it is not the last word on tying legally.

The essence of the complaint in the Bogosian case was that fifteen of the major oil companies had jointly imposed a system of lease arrangements on their lessee-dealers which were designed to eliminate wholesale price competition between themselves on sales to these independent lessee-dealer, and that the dealers had been damaged by the absence of price competition at the wholesale level.⁸⁷

The lessee-dealers contended that it was illegal for these major oil companies to require as a condition to the leasing of a gas station site that the lessee-dealer only purchase from the landlord (lease claim), and that they only sell gasoline supplied by the landlord from all pumps bearing the landlord's trademark (trademark claim).⁸⁸

More specifically, the dealers alleged that:

⁸⁵Davison v. Crown Cent Petroleum Co., 1977 Trade Cases, Pgh.61277 (D. Md. 1976).

⁸⁶Bogosian v. Gulf Oil Corp., 561 F.2d 434 (1977).

⁸⁷Bogosian v. Gulf Oil Corp., 561 F.2d 434,447 (1977).

⁸⁸Bogosian v. Gulf Oil Corp., 561 F.2d 434,451 (1977).

Defendants, through a course of interdependent consciously parallel action, have required all dealers who lease, sublease, or renew such leases or subleases for one or more defendant's service stations to:

- (a) license the use of the lessor's trademark;
- (b) sell only lessor's gasoline; and
- (c) not sell gasoline purchased from any other source under the licensed trademark.⁸⁹

The dealers further alleged that these restrictions forced them to buy gasoline at whatever price their lessor offered and prevented them from selling other brands of gasoline.⁹⁰

Interestingly enough, there was no single lease provision which required that the lessee-dealer purchase all gasoline from his lessor. Rather, the dealers contended that it was a "constellation" of lease provisions in each agreement which accomplished the same result. This constellation includes provisions that the lease shall expire in either 6 or 12 months, that lessee can make no alteration to the leasehold without the lessor's approval, that lessee must license the use of lessor's trademark, that as a condition of the trademark, lessee not sell gas other than that provided by lessor from pumps bearing lessor's trademark, that lessee pay rent as a percentage of gas volume sales subject to a minimum rent, and that the lease shall terminate whenever the lessee fails to purchase a stated quantity of gasoline.⁹¹ All of these provisions operate together to achieve the tie-in.

Moreover, while there were over 400 different types of leases in effect, the oil

⁸⁹Bogosian v. Gulf Oil Corp., 561 F.2d 434,439 (1977).

⁹⁰Bogosian v. Gulf Oil Corp., 561 F.2d 434,439 (1977).

⁹¹Bogosian v. Gulf Oil Corp., 561 F.2d 434,452 (1977).

companies conceded that a trademark protection clause in one form or another was contained in every lease agreement or arrangement between defendant oil companies and their respective lessees.

These trademark protection clauses were the primary basis for the dealers' claim of illegal tying agreements.⁹² Fairly read, it was the dealers' contention that the trademark protection clauses, both singly and in conjunction with these other clauses evidenced an antitrust violation.⁹³

In general, these trademark protection clauses, however worded, prohibit a lessee-dealer from selling any gasoline under the lessor's trademark or brand name from any of the tanks or pumps bearing lessor's trademark or brand name or insignia, unless such gasoline is sold and supplied to lessee by lessor.⁹⁴

Moreover, the dealers contended that all gasoline of the same octane rating was fungible as evidenced by the fact that the oil companies freely exchanged gasoline between themselves at the wholesale level when it suited their purpose. Thus the dealers argued that defendants' trademarks should be regarded as warranting only the quality rather than the source of the gasoline. If so, the requirement that only gasoline actually purchased from the landlord be sold at the leased station is a misuse of the trademark to achieve an illegal tie.⁹⁵

⁹²Bogosian v. Gulf Oil Corp., 561 F.2d 434,453 (1977).

⁹³Bogosian v. Gulf Oil Corp., 561 F.2d 434,453 (1977).

⁹⁴Bogosian v. Gulf Oil Corp., 561 F.2d 434,453 (1977).

⁹⁵Bogosian v. Gulf Oil Corp., 561 F.2d 434,453 (1977).

The oil companies countered that this constellation of lease provisions did not prevent a lessee from installing his own pumps and tanks from which to sell other brands of gas. It was the oil company position that the trademark protection clause only prevents lessee-dealers from selling gasoline purchased from other sources through pumps and from tanks bearing the trademark of the landlord, a provision approved by the court in the Sinclair case.⁹⁶ The dealers countered that this was an illusory right since it was clearly uneconomical for a dealer to invest thousands of dollars to install different tanks and pumps under a 6-12 month lease, especially when such alternations can be grounds for termination, and when the minimum purchase quota provisions would insure termination if competing brands were in fact sold.⁹⁷

The oil companies also argued that their products were superior to others on the market and that even without the constellation of lease provisions the dealers would have purchased their gasoline from them.

In response to this argument, the court said:

It has never been an element of plaintiff's case to disprove, nor even a permitted defense, that the tied product is superior to others available on the market, or that even without the tie requirement plaintiff would have purchased the tied product.⁹⁸

Moreover, the court felt the record indicated that the reason dealers did not seek to purchase gasoline from other companies was not their lack of desire to do so, but that they feared termination of their leaseholds if such an attempt were made, or that

⁹⁶Sinclair Refining Co. v. Federal Trade Commission, 261 U.S. 463 (1923).

⁹⁷Bogosian v. Gulf Oil Corp., 561 F.2d 434,452 (1977).

⁹⁸Bogosian v. Gulf Oil Corp., 561 F.2d 434,449 (1977).

such an attempt would be futile.⁹⁹

In certifying the class and remanding for trial, the court said the question to be resolved was:

...whether the leasing practices of defendants, individually and collectively, through interdependent consciously parallel actions, as aforesaid, including the use of short-term leases, leases based on contracts for the sale of lessor's brand of gasoline, and other contractual arrangements, have enabled the defendants to compel the lessee-dealers to purchase the lessor's brand of gasoline and not to purchase any other brand of gasoline for resale.¹⁰⁰

The court felt that if the plaintiffs were able to show that the lease agreements in use by all defendants had similar clauses which had the practical economic effect of precluding sale of other than the lessor's gasoline, they will have shown that the purchase of gasoline was in fact tied in to the lease of the service station. Under these circumstances, the lease agreement itself conditions the sale of one product (here a lease) upon purchase of another.¹⁰¹

Obviously, the oil companies disagreed. Relying upon Ungar v. Dunkin' Donuts of America, Inc.,¹⁰² they had argued that in addition to the constellation of lease provisions, coercion must also be shown in such cases, a position accepted by the trial

⁹⁹Bogosian v. Gulf Oil Corp., 561 F.2d 434,448 (1977).

¹⁰⁰Bogosian v. Gulf Oil Corp., 561 F.2d 434,445 (1977).

¹⁰¹Bogosian v. Gulf Oil Corp., 561 F.2d 434,452 (1977).

¹⁰²Ungar v. Dunkin' Donuts of America, Inc., 531 F.2d 1211 (3rd Cir. 1976).

court. However, on appeal, the 3rd Circuit found that neither Ungar nor any other case has so held.¹⁰³

In Ungar, all of the franchise agreements carefully avoided conditioning the sale of allegedly tied products on the purchase of the franchise, and some even affirmatively secured the right to purchase those products from other suppliers.

In situations like Ungar, the existence of a tie-in, if there is one, has to be inferred on the basis of business conduct. Typically in such cases, a dominant party, such as the franchisor, suggests, persuades or requests that the economically dependent party, such as the franchisee, purchase certain products in conjunction with other products which the franchisee seeks to buy. The theory is that there is more in this seemingly innocent conduct than meets the eye. In such situations, the franchisee senses that the franchisor has created an economic arrangement in which the perceived threat of termination buttresses the franchisor's salesmanship.¹⁰⁴ This was true in Ungar. Was it also true in the Bogosian situation?

The 3rd Circuit, which had also decided Ungar, thought not and was careful to distinguish Bogosian from the Ungar situation:

Although in Ungar we spoke of coercion as being implicit in the leverage concept upon which the tying rule is premised, we were not articulating coercion as a separate legal element of proof. As we indicates ..., leverage or coercion is implicit when plaintiff proves the conditioning or sale of one product upon purchase of another. We read Ungar to have

¹⁰³Bogosian v. Gulf Oil Corp., 561 F.2d 434,449 (1977).

¹⁰⁴Bogosian v. Gulf Oil Corp., 561 F.2d 434,450 (1977).

required coercion to be proved only because the conditioning of the sale of one product upon purchase of another was not reflected in the agreement or in the operation of its terms [as it is in Bogosian]. We refused to "construct" such a condition from proof of salesmanship coupled with dominance of the seller over the buyer.¹⁰⁵

The principle of Ungar, then, is that when a class action tie-in claim is made without basis in an express agreement, proof of salesmanship coupled with inequality of bargaining power does not automatically prove the existence of the tie, but rather proof of actual coercion on an individual basis is also necessary to prove the existence of a tie.¹⁰⁶

But of course Bogosian was different from Ungar in that it was based on a "constellation" of provisions in the lease agreement even though there was no single clause tying gasoline to the station lease. Consequently, the court concluded that once a defendant has conditioned the sale of one product upon the purchase of another there is no requirement that he prove that the purchase was coerced by the seller's requirement.¹⁰⁷

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Looking back over the tying cases, it is clear that the central core of the adjudicated unlawful tying arrangements is the forced purchase of a second distinct commodity with the desired purchase of a dominant "tying" product, resulting in economic harm to competition in the "tied" product market. The concern is with leverage in one market being used to exclude sellers in a second.¹⁰⁸ In this sense, tying is not an isolated issue since this leverage issue permeates the whole of antitrust.

¹⁰⁵Bogosian v. Gulf Oil Corp., 561 F.2d 434,450 (1977).

¹⁰⁶Bogosian v. Gulf Oil Corp., 561 F.2d 434,451 (1977).

¹⁰⁷Bogosian v. Gulf Oil Corp., 561 F.2d 434,450 (1977).

¹⁰⁸Areeda, op. cit. p. 753 #616

Although as a matter of policy, one might be concerned with the coercive narrowing the buyer's freedom of choice, the central policy concern with tie-ins has been their effect on competition in the market for the tied product. A tie-in forecloses other sellers of the tied product from an opportunity to compete for patronage on the independent merits of the tied product standing alone and without the intrusion of the tying product as an "alien factor."¹⁰⁹ This is the key offense against competition.

Not all commentators are happy with the court's conclusion on this matter. Robert Bork for one argues that most of the tie-in cases have been decided incorrectly because there is no viable theory which explains how tying arrangements injure competition.¹¹⁰ He would argue that outside of the world of judicial economics, that if there is one purpose that a tie-in does not serve, it is the suppression of competition.¹¹¹ He thus concludes that the law in this field is unjustified and is itself inflicting harm upon consumers.¹¹² Let us look at this argument.

Primarily, it is Bork's position that the pro-competitive or benign business justifications for tying have not been given enough weight in the development of the law and that the notion that tie in sales are per se illegal has lead to results which have harmed consumers as well as

¹⁰⁹Cite the case from which this quote is drawn.

¹¹⁰Bork, 372.

¹¹¹Bork, p. 367.

¹¹²Bork, Antitrust Paradox, p. 381.

sellers.

It seems plain enough that tying arrangements used to achieve economies of scale, nondiscriminatory measurement of use, and efficient technological interdependence are valuable not merely to the firm, but to consumers. Price discrimination should also be classified as an efficiency valuable to consumers.¹¹³

Bork feels that the law's opposition to tying arrangements is largely based on what he sees as a discredited transfer-of-power theory.¹¹⁴ He feels that it is discredited since, if the seller has already charged the full monopoly value of the tying product, he cannot then charge still more in the form of coercion to take what amounts to a requirements contract for the tied product. That would be double counting of monopoly power. Thus he concludes that the tying arrangement, whatever else it may accomplish, is obviously not a means of gaining two monopoly profits from a single monopoly.

This view that tying arrangements do not necessarily extend the tying product monopoly into a second monopoly over the tied-good market is also consistent with the conclusions reached by both Professors Bowman and Burstein in their widely cited studies.¹¹⁵ It is instrumental in causing all three of them to make substantially the same recommendation, namely, that the law should not oppose tying arrangements in cases where only incidental effects exist in the market for the tied product.

There is also widespread agreement among almost all commentators that there is no economic significance to a tie-in when each product is sold in a perfectly competitive market, and that such tie-ins should not be attacked.¹¹⁶ It is clear that there is no economic effect when a seller of corn ties it to the purchase of wheat. But of course most markets are not like corn and wheat, and that is where the consensus begins to break down.

¹¹³Bork, Antitrust Paradox, p. 381

¹¹⁴Bork, Antitrust Paradox, p. 372.

¹¹⁵Eugene M. Singer, Antitrust Economics, p.191.

¹¹⁶Areeda 3, p. 750.

Likewise, most commentators agree that there are no grounds for condemning tying arrangements involving trivial market shares in the tied product and thus having little or no effect in the market for the tied market. Using this criteria, the International Salt and other decisions are seen to be unfaithful to the intent of the law. These commentators would argue that in pursuing arrangements involving trivial market shares in the tied product, the courts have lost sight of why the law should be concerned with tying arrangements at all, and whether the economy or even the plaintiffs have been harmed by a given tie.¹¹⁷

Comment [2]: Need to get Areeda's ideas about how to eliminate trivial cases or cases where plaintiff suffers no damage separate from others without harming enforcement of law which is important for society.

While many would agree with the above conclusions, that doesn't mean that there still aren't strong reasons for opposing tying as a commercial practice.

Earlier, you remember that Professor Bowman showed that while tying arrangements involving tied products which are used in fixed proportions have no effect on the output of the tied product (but only determined the identity of the seller), this was not the case with tied products which are not used in fixed proportions.¹¹⁸ In the latter cases, output is reduced and prices are often higher than would otherwise be the case if the markets were kept separate. He acknowledged that this is a classic example of the exercise of leverage, i.e., using power in one market to affect prices and output in another.¹¹⁹ In such cases, the issue is not whether leverage is exercised, but whether its exercise should always be viewed as illegal per se. Are there legitimate social ends which might justify the exercise of leverage that should be taken into account by the court under a "rule of reason" approach to tying? That is the issue!

On the other side of the issue, you will remember that, Professors Kaysen and Turner have convincingly argued that tying can, and typically does, serve as a barrier to entry.¹²⁰ For example, they argued that it is hard for a paper company to enter the tabulating card business if it also has to manufacture and sell the tabulating equipment. Tying also reduces competition if successful entry into gasoline refining requires the development of extensive retail facilities or if entry into gasoline retailing requires entry into gasoline refining. In such cases, the gains to society from allowing tying are more than offset by the loss in competitive vigor in the market for the tied product.

¹¹⁷Areeda, Antitrust Cases, p. 734.

¹¹⁸Cite the pages where Bowman's ideas are discussed.

¹¹⁹Cite Bowman here

¹²⁰Cite page where the Kaysen and Turner quote appears.

To complicate matters even further, if the focus is changed from the tied good in isolation to a combination of the tying good and the tied good, the conclusion that the purchaser must necessarily be harmed is no longer clear. Before accepting the tie-in, the purchaser must weigh the positive utility from the potential purchase of the tying good as well as the tied good, and deduct the negative utility from the required purchase of the tied good. The net utility derived from the potential purchase must exceed the utility foregone by the expenditure for the combined purchase price of the two items.¹²¹ Presumably, if the purchaser does not like the combination, he is free to reallocate his income to the purchase of other items.

The court has repeatedly rejected this last idea, even when the tying product was patented or when the tie involved a franchised trademark.¹²²

It is argued as a merit of this system of sale under a license notice that the public is benefited by the sale of the machine at what is practically its cost, and by the fact that the owner of the patent makes its entire profit from the sale of the supplies with which it is operated. The fact, if it be a fact, instead of commending, is the clearest possible condemnation of the practice adopted, for it proves that under the color of its patent, the owner intends to and does derive its profit, not from the invention on which the law gives it a monopoly, but from the unpatented supplies with which it is used, and which are wholly without the scope of the patent monopoly.¹²³

For many commentators, the court's rule is too extreme. In the case of a patented product they ask why the court should even be concerned with a patentee's limitations on the use of his patented product at all. If the patentee's objective is not unlawful when effected by other means, they ask what is so objectional about the means he chooses.¹²⁴

This was the position taken by Justice Holmes in his dissent from the majority

¹²¹Eugene M.Singer, Antitrust Economics, p.199.

¹²²See Motion Picture Patents Co. v. Universal Film Manufacturing Co., 243 U.S. 502 (1917) and Siegel v. Chicken Delight, 448 F.2d 43 (9th Cir. 1971).

¹²³Motion Picture Patents Co., pp. 516-517.

¹²⁴Areeda 3, p. 745.

decision in the Motion Picture Patents case where he contended that since the patent law gives the patentee the right to withhold his invention unconditionally from the public, he should be allowed the less severe alternative of conditionally withholding his patent. And of course a typical condition would be that the patented machine can only be used in conjunction with unpatented supplies purchased from the patentee. Justice Holmes maintained that the tying arrangement merely allowed the patentee to obtain what he was rightfully entitled to under the patent law, and that the means are secondary:

But there is no predominant public interest to prevent a patented teapot or film feeder from being kept from the public, because, as I have said, the patentee may keep them tied up at will while his patent lasts. Neither is there any such interest to prevent the purchase of the tea or films that is made the condition of the use of the machine. The supposed contravention of the public interest sometimes is stated as an attempt to extend the patent law to unpatented articles, which of course it is not, and more accurately as a possible domination to be established by such means. But the domination is one only to the extent of the desire for the teapot or film feeder, and if the owner prefers to keep the pot or the feeder unless you will buy his tea or films, I cannot see in allowing him the right to do so anything more than an ordinary incident of ownership.¹²⁵

In the Siegel case, Chicken Delight charged no fee for the use of its trademark and operating methods, but required its franchisees to buy certain cooking utensils, cooking mixes and related paper products from them at inflated prices. In defense of this arrangement, Chicken Delight argued that the franchisees suffered no injury because they would not have paid a greater increment for the tied items than the franchise was worth to them. The court disagreed for several reasons, but in part on the grounds that what a franchisee would have paid for the franchise was a question of fact to be determined upon trial.¹²⁶

¹²⁵Motion Picture Patents Co., p. 520.

¹²⁶Siegel v. Chicken Delight, 448 F.2d 43 (9th Cir. 1971).

In commenting on this particular point, Professor Areeda asks a compelling question which would seem to undermine the court's summary dismissal of this defense. He asks "how can the value of the franchise be rationally determined except by reference to what franchisees have demonstrated a willingness to pay?"¹²⁷ This is a good question. Yet one must still ask whether this completely settles the issue. It is one thing to say that the premium paid for the tied products is but part of the total return the franchisee was entitled to get based on the market value of the tying product, that the arrangement is merely a matter of taking less than one could have gotten for the tying product and making it up in the price for the tied product. There are numerous reasons for adopting this method of pricing that are not antisocial or anticompetitive. Consider the following example used by Professor Stigler in his discussion of the Loew's case.

...assume that a film distributor sees that Channels 2 and 4 have different demands for the two films that he has to offer for the moment. The prices they are willing to pay are as follows:

	Channel 2	Channel 4
Gone with the Wind	\$1,000	\$600
Getting Gertie's Garter	400	500

The distributor will see that if he offers the same price to each station, he will do best by charging \$600 for GWTW and \$400 for GGG. By selling each film to each station, he receives a total revenue of \$2,000. Had he charged the higher price either station would

pay for each film, he would have sold one film to each and received a total of only \$1,500. But he can achieve a solution better than either of these. If

¹²⁷Areeda 3, p. 794.

he charges each station the maximum it is willing to pay for each film, practicing perfect price discrimination, the distributor will get \$2,500. But that may not always be possible or wise. Blatant price discrimination might cause resentment, might arouse interest of the Antitrust Division or the Federal Trade Commission (whose inattention is worth money), or might be difficult to accomplish when the distributor is not sure of the precise maximums of many stations. He may, therefore, choose to block book the films, refusing to sell except in one package at a single price. By setting the package price of \$1,100 for GWTW and GGG together, he can sell both channels and receive a total revenue of \$2,200, a \$200 improvement over selling the films separately.¹²⁸

Extending the above example to a continuing franchise or distributor situation, presumably the total charge cannot exceed the combined value of the two products to the marginal buyer assuming that the arrangement was clear to the franchisee "up front" before the initial investment in the franchise is made. But it is quite another matter if the ties were imposed without adequate understanding by the franchisee, or if they were imposed only after the franchisee had made a substantial investment in the continuing relationship. The coercion exerted on an existing dealer, lessee, or franchise holder can be substantially greater than on a potential franchisee or dealer. It thus becomes important to look at the comparative bargaining power of the parties to determine whether or not the arrangement is benign. In the case of a distributor or franchisee who invests a substantial amount of his resources in the ongoing operation, it would be unwise for him to risk his whole business by not complying with the tying arrangement imposed by his supplier/franchisor. The coercive pressure that can be exerted on these

¹²⁸Bork, Antitrust Paradox, p. 378-79.

dependent buyers is much greater than on buyers not so committed. It is much greater than the traditional indices of market power would suggest. Because of this very real threat of termination or non-renewal the cost of losing the investment in the franchise operation needs to be factored in. If so, this means that the price the dependent buyer is willing to pay for the combined "package" greatly exceeds the amount that an uncommitted customer would be willing to pay. This combined price can substantially exceed the "up front" competitive market price of the franchise and is properly regulated by public policy. Society gains nothing from allowing a supplier to extort its distributors.

In a sense then the analysis of leverage needs to shift from an analysis of market power in the traditional sense to an analysis of the economic power that is exerted over particular customers. If the customers are end users and/or original equipment manufacturers or even households, then few problems arise since in most cases alternative sources are extensive, even in markets characterized by substantial market power measured in conventional terms. But in the case of existing distributors or franchisees, the problem is altogether different and the threat of termination and consequent loss of investment including good will in the operation can be devastating. The premium that can be charged such dependent customers is much in excess of the market value of the franchise before a continuing relationship has been established.

Two points come out of this discussion so far. First, tying is not an undifferentiated practice which always has a negative economic effect. Contrary to Justice Frankfurter's dicta in Standard Stations that "tying agreements serve hardly any purpose beyond the suppression of competition," there appear to be many desirable social benefits which can and should be realized from tying arrangements.

Second, the basis on which leverage is exerted can either derive from the

desirability of the tying product, or it can derive from the fear of the termination of a valuable ongoing relationship which is an entirely different matter.

Both of these points suggest that the per se treatment of tying is an inappropriate way of dealing with this important commercial practice. The gain to business and government from the predictability of the per se treatment of tying arrangements does not even begin to compensate for the loss of the social benefits which often flow from these arrangements. On the other hand, many anticompetitive and antisocial consequences of tying still remain and need to be regulated. Thus the position that all tie-in arrangements should be legalized is also undesirable since it would allow certain anticompetitive and extortionate effects to flourish. A middle "rule of reason" approach seems to be the answer.

The presence of interrelated demands is almost universal in the modern multiple product firm. And of course, this interrelated demand requires a multiple product analysis for finding the optimum price structure for the product line. Product line pricing is not and should not be illegal. Moreover, tying arrangements are one of the most elementary forms of product line pricing whereby a firm operates simultaneously in more than one market for the purpose of maximizing overall profit.¹²⁹ The law should not needlessly interfere with this practice. Maximizing profit is not antisocial in and of itself. Remember the objection to monopoly is not that it makes some people too rich, but that it leaves consumers poorer than they need be and that it misallocates scarce resources.¹³⁰

¹²⁹Singer, Antitrust Economics, p. 187.

¹³⁰Bork, Antitrust Paradox, p. 375.

Monopoly misallocates resources because the monopolist must restrict output to maximize net revenues--but that proposition holds only if the monopolist is confined to charging a single price. If he could charge the monopoly price to all who would pay it, and a series of lower prices to others, he would produce the same amount as a competitive industry. Under these circumstances, there would be no misallocation of resources. ...tying arrangements are often methods of approximating this result. When they are, they are both pro-monopolist and pro-consumer, and it makes no particular sense to object to the pro-monopolist effect and overlook the pro-consumer effect. Striking the tie-in in such cases merely makes everybody worse off.¹³¹

Professor Bowman is right when he suggests that we need to distinguish between leverage as a revenue maximizing device and leverage as a monopoly creating device.¹³² The first involves the use of existing power and should not be regarded as per se illegal. The second requires the addition of new power and often should be regarded as illegal. If the tying seller is maximizing his return on the tying product, and the same output of the tied product can still be produced as would be produced under circumstances consistent with competitive production of the tied product, no additional or new monopoly effect should be assumed.¹³³ But if prices are higher and output of the tied product is reduced from the competitive level, new power has been created and should be addressed.

Comment [3]: Be sure to distinguish between arrangements that direct the gains from more efficient resource use to the consumer as opposed to the producer. Note that the social gain is the same either way.

Thus, in order to make a fair appraisal of leverage, the courts must look at economic evidence for the empirical content of words such as "dominance," "exploitation," "leverage," or "market," which appear in the Supreme Court rule that

¹³¹ Bork, Antitrust Paradox, p. 375

¹³² Ward Bowman, "Tying Arrangements and the Leverage Problem," pp. 19-20, cited in Singer, p. 191.

¹³³ Bowman, op.cit., p. 20. cited in Singer, p. 194.

"...the essence of illegality in tying arrangements is the wielding of monopolistic leverage; a seller exploits his dominant position in one market to expand his empire into the next."¹³⁴

Tying arrangements contain the potential for good as well as for bad. The courts must become more sophisticated in distinguishing between different types of tying arrangements and in identifying those conditions that lead to good and bad results and rule accordingly. Tying is not a per se matter.

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NOTES

¹³⁴Eugene M.Singer, Antitrust Economics, p.198. The quotation is from Times-Picayune Pbl. Co.v. United States, 345 U.S. 594, 611 (1953).