TYING LAW: THE CLASH BETWEEN THE SUPREME COURT AND LOWER COURTS

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I. Introduction

In 1994, Phillip Areeda stated: "Tying law is now in a confused state."[1] Thirteen years later, his assessment of tying law had not improved: "Tying law still remains in a confused state."[2] The reason for this indictment is not hard to see. Almost unique in antitrust jurisprudence, lower courts have either ignored or rejected Supreme Court precedents, and there is a general sense among lower courts and commentators that tying law, in its present state, is in need of major overhauling, if not abandonment.

A tying arrangement is "an agreement by a party to sell one 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."[3] The Court in *Jefferson Parish Hospital Dist. No. 2 v. Hyde,*[4] stated 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."

The United States Supreme Court historically has taken a very aggressive stance against tying arrangements. Older decisions were particularly harsh on tying arrangements. In *Times-Picayune Pub. Co. v. United States*, the Court stated "[t]ying arrangements, we may readily agree, flout the Sherman Act's policy that competition rule the marts of trade."[5] The Court further noted that: "'(t)ying agreements serve hardly any purpose beyond suppression of competition.'"[6] In the more recent decision of *Jefferson Parish*, the Court stated unequivocally that: "It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable 'per se'."[7]

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1 9 Areeda & Hovenkamp, Antitrust Law ¶1701d, at 27 (2d ed. 1991).

2 Areeda & Hovenkamp, Antitrust Law 1701d, at 24 (2d ed. 2004).

3 *Northern Pac. Ry. Co. v. United States* 356 U.S. 1, 5-6 (1958).

4 66 U.S. 2, 12 (1984)

5 345 U.S. 594, 605 (1953).

6 *Id.*, 345 U.S. at 605, citing *Standard Oil Co. of California v. United States*, 337 U.S. 293, 305 (1949). The Supreme Court's condemnation of tying agreements goes back at least as far as *United Shoe Machinery Corp. v. United States*, 258 U.S. 451 (1922). There, the Court held that Section 3 of the Clayton Act makes it unlawful to condition the lease of defendant's patented shoe machinery on the use of supplies provided by the defendant. The Court described these conditions as "tying restrictions". *Id.* at 458. In *International Salt Co. v. United States*, 332 U.S. 392, 396 (1947), the Supreme Court for the first time held that certain kinds of tying arrangements were per se illegal. *See Jefferson Parish*, 466 U.S. at 9. In *International Salt*, the Court held as per se illegal defendant's practice requiring persons that leased its patented salt dispensing machines to purchase its salt products.

7 466 U.S. at 9.

In its most recent pronouncement, the Supreme Court somewhat backed away from its earlier attitude towards tying arrangements. In *Illinois Tool Works, Inc. v. Independent Ink, Inc.*, the Court announced a more complex attitude towards tying arrangements: "Over the years, however, this Court's strong disapproval of tying arrangements has substantially diminished."[8] In that decision, the Court noted that *United States Steel Corp. v. Fortner Enterprises, Inc.*, rejected "[t]he assumption that 'tying arrangements serve hardly any purpose beyond the suppression of competition.'"[9]

This change in attitude toward tying arrangements came principally from lower courts which rejected Supreme Court precedents. This article focuses on the conflicts between United States Supreme Court and lower federal courts. Specifically, this article will examine the following issues: (1) What are the elements of a tying claim?; (2) In what sense is a tying arrangement ever per se illegal?; (3) What test should be applied to determine whether the purported tying and tied items are separate products or services?; (4) Is a showing of market power in the tying product always required, or is it presumed in certain areas such as copyright? This article will address also California decisions under the Cartwright Act which tend to reflect older United States Supreme Court policies and attitudes that lower federal courts have rejected.

II. The Elements of a Tying Claim

According to the Supreme Court, establishing that a tying arrangement is illegal requires proof of four elements: (1) the purportedly tying and tied items are separate products or services; (2) the availability of the tying product or service has been conditioned on the purchase, rental or license of the tied item or on not dealing with the defendant's competitors in the market for the tied product or service; (3) the defendant has appreciable market power in the tying product market; and (4) the arrangement affects a substantial volume of commerce in the tied product market.[10] A majority of appellate courts have gone beyond these Supreme Court cases to impose an additional element that the party imposing the tie must have an economic interest in the tied product,[11] but not all courts agree.[12] In fact, the requirement of an economic interest in the tied product would seem to be inconsistent with *Jefferson Parish*, wherein the entity providing the tied product, anesthesia, was a professional medical corporation, not the hospital that required the use of the

8 547 U.S. 28, 35 (2006).

9 429 U.S. 610, 622 (1977) (*Fortner II*) 547 U.S. 28; 126 S. Ct. at 1287.

10 *See Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 461-62 (1992); *Jefferson Parish*, 466 U.S. at 12-18.

11 *See, e.g.*, *County of Tuolumne v. Sonora Cmty. Hosp.*, 236 F. 3d 1148, 1158 (9th Cir. 2001) ("[I]f the tying entity receives no economic benefit from the tie, then we can safely presume that it is not attempting to spread its power into the tied-product market, and we need not strike the arrangements down as an illegal tie under the antitrust laws."). *See also Venzie Corp. v. United States Mineral Products Co., Inc.*, 521 F. 2d 1309, 1317 (3d Cir. 1975); *Keener v. Sizzler Family Steak Houses*, 597 F. 2d 453, 456 (5th Cir. 1979); *Crawford Transport Co. v. Chrysler Corp.*, 338 F. 2d 934, 939 (6th Cir. 1964), *cert. denied*, 380 U.S. 954 (1965); *Carl Sandburg Village Condominium Assoc. No. 1 v. First Condominium Development Co.*, 758 F. 2d 203, 208 (7th Cir. 1985); *Midwestern Waffles, Inc. v. Waffle House, Inc.*, 734 F. 2d 705, 712 (11th Cir. 1984); *Sports Racing Serv., Inc. v. Sports Car Club of America, Inc.*, 131 F. 3d 874, 888 (10th Cir. 1997).

12 *Gonzales v. St. Margaret's Housing Development Fund Corp.*, 880 F. 2d 1514,1517 (2d Cir. 1989) ("The majority in *Jefferson Parish* does not require any 'economic interest' by the tying seller in the tied-product market.")

preferred provider.[13]

Making out a tying claim under the Cartwright Act is complicated because there are two provisions prohibiting tying arrangements: Sections 16720 and 16727. Section 16720 is patterned after the Sherman Act, and section 16727 is the state equivalent of the Clayton Act Section 3.[14] Decisions under the federal act are instructive when interpreting these sections.[15] Section 16727 is limited to the sale of goods, merchandise, machinery, supplies or commodities.[16] If the tie involves land, services or credit, Section 16720, not Section 16727, applies.[17]

The elements needed to establish a tying claim under these two sections are not identical. Proof of a Section 16720 violation requires a showing that: (1) a tying agreement, arrangement or condition existed whereby the sale of the tying product was linked to the sale of the tied product; (2) the party had sufficient economic power in the tying market to coerce the purchase of the tied product; and (3) a substantial amount of sale was effected in the tied product . . . ; (4) the complaining party must prove that he suffered pecuniary loss as a consequence of the unlawful act."[18] In contrast, "[u]nder section 16727, a per se violation is established if either element (2) or (3) is established along with elements (1) and (4)."[19]

Although the elements for a tying claim enumerated by California courts do not explicitly include a requirement that separate products be involved, it is absolutely clear that, just as in federal cases, separate products are required.[20] Accordingly, the requirements for proving a Section 16720 violation are effectively the same as required under *Jefferson Parish*. The requirements for establishing a Section 16727 violation, however, are more relaxed than is required by *Jefferson Parish*, because a Section 16727 plaintiff is required to prove either that the seller had sufficient economic power in the tying market to coerce the purchase of the tied product or that a substantial amount of sale was affected in the tied product, but not both.

As noted above, most federal circuit courts require that the seller have an economic interest in the tied product market. At least one California decision has followed that trend.[21]

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13 *Jefferson Parish* , 466 U.S. at 5.

14 *People v. National Ass'n of Realtors*, 120 Cal. App. 3d 459, 471-72 (1981).

15 *Corwin v. Los Angeles Newspaper Serv. Bureau, Inc.*, 4 Cal. 3d 842, 852-53 (1971).

16 *Morrison v. Viacom, Inc.*, 66 Cal. App. 4th 534, 546-47 (199).

17 *Id.*, 66 Cal. App. 4th at 546-47; *Suburban Mobile Homes, Inc. v. AMFAC Communities, Inc.*, 101 Cal. App. 3d 532, 549-50 (1980).

18 *Suburban Mobile Homes*, 101 Cal. App. 3d at 542; *Classen v. Weller*, 145 Cal. App. 3d 27, 37-38 (1983).

19 *Morrison*, 66 Cal. App. 4th at 542; *see also People v. National Ass'n of Realtors*, 120 Cal. App. 3d at 472.

20 *See, e.g.*, *Corwin*, 4 Cal. 3d at 858-59 (enumerating factors to be taken into account to determine whether one or two products are involved); *People v. National Ass'n of Realtors*, 120 Cal. App. 3d at 470-71 (rejecting the defendant's contention that membership in the board of realtors and access to its investment listing services were separable portions of a single product).

21 *RLH Industries, Inc. v. SBC Communications, Inc.*, 133 Cal. App. 4th 1277, 1284 (2006).

III. The Per Se Illegality of Tying Arrangements.

In *Northern Pacific Ry. Co.*, the Supreme Court stated that "there are certain agreements or practices which because of their pernicious effect on competition and lack of any 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."[22] The "principle of per se unreasonableness" applies to such agreements and practices and the Court listed tying arrangements, along with price fixing, division of markets and group boycotts, as "[a]mong the practices which the courts have heretofore deemed to be unlawful in and of themselves . . . ."[23] In *Jefferson Parish*, the Court affirmed the rule that tying arrangements are unreasonable per se.

Tying is not, however, per se unlawful in the same sense as are other per se antitrust violations, such as horizontal price fixing. The per se nature of tying has been described as "quasi," "odd", "peculiar" and "highly idiosyncratic."[24] There are two features of tying law that distinguish it from other per se antitrust violations. First, a plaintiff bringing a tying claim must establish that the defendant has market power "to force a purchaser to do something he would not do in a competitive market".[25] Second, "there must be substantial potential for impact on competition in order to justify per se condemnation . . . . It is for this reason that we have refused to condemn tying arrangements unless a substantial volume of commerce is foreclosed thereby."[26] In addition, a number of courts have even permitted the defendant to justify the tying restriction by proving its overall competitive reasonableness, even after the plaintiff has proven all of the elements of a per se tying violation.[27]

In sharp contrast, a plaintiff attempting to prove horizontal price fixing agreement need prove only that the price fixing activity occurred and need not prove its competitive unreasonableness.[28] No elaborate study of the market is required to prove a horizontal price

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22 *Northern Pacific Ry. Co.,* 356 U.S. at 5.

23 *Id*.

24 *U.S. Health Care, Inc. v. Healthsource, Inc.*, 986 F. 2d 589, 593 n.2 (1st Cir. 1993) ("Tying is sometimes also described as a per se offense but, since some element of power must be shown and defenses are effectively available, 'quasi' per se might be a better label."); *Roy B. Taylor Sales, Inc. v. Hollymatic Corp.*, 28 F. 3d 1379, 1382 (5th Cir. 1994), *cert. denied*, 513 U.S. 1103 (1995); 9 Antitrust Law, ¶ 1720a at 220 (2d ed. 2004) ("Highly idiosyncratic per se rule"); 10 Antitrust Law, ¶ 17E at 337, n. 6 (2d ed. 2004) ("The so-called per se rule against tying is also peculiar in requiring proof of substantial power in the market for the tying product. (citation omitted) It also requires proof of some minimal effects in the tied market.").

25 *Jefferson Parish*, 356 U.S. at 13-14. *See also PSI Repair Services v. Honeywell, Inc.*, 104 F. 3d 811 (6th Cir.), *cert. denied*, 520 U.S. 1265 (1997) ("[U]nder tying's per se rule, the seller must possess substantial market power in the tying product market. In addition, tying's per se rule provides for an inquiry into whether the defendant's conduct has procompetitive effects. *See Kodak*, 504 U.S. at 478-79. Such an extensive factual inquiry is hardly the stuff of per se analysis.)"

26 *Id.*, at 16.

27 *See, e.g.*, *Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F. 2d 1342, 1348 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988); *PSI Repair Serv.,* 104 F. 3d at 815 n. 2; 9 Antitrust Law ¶ 1720a at 220 (2d ed.).

28 *Northern Pacific Ry.*, 356 U.S. at 5; *United States v. Socony-Vacuum Oil Co. Inc.*, 310 U.S. 150, 219-21, 225-26 n. 23 (1940); *Mailand v. Burckle*, 20 Cal. 3d 367, 380 (1978).

fixing illegality and so there is no need to define the market or demonstrate that the defendant has market power.[29]

What, then, distinguishes the per se tag for tying law from rule of reason analysis? According to Areeda, "[T]he only thing this per se rule excludes is real proof that the tie impairs the vitality of competition in the tied market."[30]

Of course, determining that a particular tying arrangement is not per se illegal does not end the analysis. The arrangement may still be examined under the rule of reason. In *Jefferson Parish*, for example, the court held that the tie was not per se illegal, but then examined the tie under the rule of reason.[31]

IV. The Requirement of Separate Products

One of the necessary elements of an unlawful tying arrangement is that the tying and tied items be separate products. "[A] tying arrangement cannot exist unless two separate product markets have been linked." *Jefferson Parish*.[32] *Jefferson Parish* is the first Supreme Court case to set forth a test for separate products for purposes of tying law; although it was not the first time the Court faced a dispute over whether separate products were involved.[33]

A. Tests for Separate Products Pre-*Jefferson Parish*.

Although the Supreme Court consistently condemned tying restrictions since *United Shoe Machinery Corp. v. United States* was decided in 1922, it provided no test for separate products for over sixty years, until *Jefferson Parish* was decided in 1984. Lower courts were left with the task of deciding whether one or more products were involved in an alleged tie without any guidelines from the Supreme Court for that 60-year period.

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29 *FTC v. Superior Court Trial Lawyers Assoc.*, 493 U.S. 411, 435-36 and n. 19 (1990). The characterization in *Jefferson Parish* of "per se condemnation" as "condemnation without inquiry into actual market conditions," 466 U.S. at 15, is highly misleading, as can be seen in the court's own analysis of both the requirements of a tying case and the actual market conditions in the dispute before the Court. Lower courts have unanimously not followed this pronouncement as a direction to ignore actual market conditions in analyzing per se tying arrangements.

30 9 Antitrust Law, ¶ 1720a at 220 (2d ed.). *See also Standard Oil Co. of California v. United State*s, 337 U.S. at 304 ("[*International Salt*], at least as to contracts tying the sale of a nonpatented to a patented product, rejected the necessity of demonstrating economic consequences once it has been established that 'the volume of business affected' is not 'insignificant or insubstantial' and that the effect of the contracts is to 'foreclose competitors from (a) substantial market.'") At least one court has rejected the per se label for all tying arrangements. *See Reifert v. South Central Wisconsin MLS Corp.*, 450 F. 3d 312, 317 n. 2, (7th Cir. 2006) (citing *Carl Sandburg Vill. Condo Ass'n.*, 758 F. 2d at 210).

31 *Jefferson Parish*, 466 U. S. at 29-31.

32 *Id.* at 21.

33 In *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495 (1969) (*Fortner I*), the Supreme Court dealt explicitly with a dispute over whether there was more than one product, but resolved the dispute without establishing a test. In *Fortner I*, U. S. Steel's Credit Corporation required borrowers seeking to obtain loans for the purchase and development of certain land to agree to erect a prefabricated house manufactured by U.S. Steel on each lot purchased. U.S. Steel contended that the sale of manufactured homes on credit constituted only one product, not two. The Court rejected that contention because one corporation offered credit on condition that borrowers buy housing from a separate corporation; and the amount of the loans far exceeded the cost of the prefabricated homes, the loans were not offered solely to buy homes. *Id.* at 1260-61. The court did not attempt to establish guidelines or a test for separate products.

One prominent approach in the lower courts was the "function of the aggregation" test articulated in *Siegel v. Chicken Delight, Inc.*[34] The court ruled that in determining whether the aggregation of separable items should be regarded as one or more items, the court should apply a "function of the aggregation" test. That test required consideration of "whether the amalgamation of products resulted in cost savings apart from those reductions in sales expenses and like normally attendant upon any tie-in, and whether the items are normally sold or used as a unit with fixed proportions."[35] None of the authorities cited by the court provided any legal or economic support for its claim that these considerations were dispositive or even relevant. The court's decision was not, however, based on these considerations, but on its determination that the purported function of the aggregation of packaging, mixes and equipment was to protect the good will and quality standards of the trademark, and that the good will and quality standards did not depend on the source of the components.[36] Thus the court held that the packaging, mixes and equipment were separate products from the franchise.

B. The *Jefferson Parish* Test for Separate Products

In *Jefferson Parish*, the Court had to decide whether a hospital unlawfully tied anesthesia services to the use of its operating rooms. The plaintiff alleged that the hospital had engaged in illegal tying by requiring its surgery patients to purchase anesthesia services from a single firm of anesthesiologists. The hospital argued that the arrangement did not involve two products, but rather "a functionally integrated package of services."[37] The 5 to 4 majority decision set forth the present doctrine of tying grounded in per se analysis. The dissent stated a strong alternative view of tying based on a rule of reason analysis.

1. The Majority Decision in *Jefferson Parish*

The majority first distinguished between lawful and unlawful tying agreements. It emphasized that some tying arrangements are lawful and, indeed, procompetitive. The Court was careful to point out that "every refusal to sell two products separately cannot be said to restrain competition."[38] Buyers often find packaged sales attractive, and packaged sales can be a way of competing effectively. Such conduct is not unlawful if the two products can be purchased separately in a competitive market.[39] The Court distinguished unlawful from lawful tying arrangements as follows: "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

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34 448 F.2d 43, 48 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).

35 *Id.* at 48.

36 *Id.* at 49.

37 *Jefferson Parish*, 466 U.S. at 18-19.

38 *Id.* at 11.

39 *Id.* at 11, 14.

all, or might have preferred to purchase elsewhere on different terms. When such 'forcing' is present, competition on the merits in the market for the tied item is restrained and the Sherman Act is violated."[40]

Based on these principles, the Court addressed the hospital's claim that only one product was involved, because the anesthesia services and the operating room services were a "functionally integrated package of services."[41] The Court held that 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."[42] The correct test for separate products is whether the products "were distinguishable in the eyes of buyers."[43] But the consumer demand element is qualified by the requirement that it must be efficient to offer the two products separately: "Thus, in this case no tying arrangement can exist unless there is a sufficient demand for the purchase of anesthesiologyical services to identify a distinct product market in which it is efficient to offer anesthesiological services separately from hospital services."[44] The consumer demand test for separate products follows from the purpose of tying law, which is to prevent tying arrangements from foreclosing competition on the merits in a product market distinct from the market for the tying item. Whether a separate market for the tied item exists depends on whether there is consumer demand for the tied item separate from consumer demand for the tying item and whether it is efficient to provide them separately. This does not mean that there must be demand for one item without the other, but rather demand for the two products from different sellers.[45]

The Court rejected the hospital's functionally related test pointing out that it had often found "functionally linked products at least one of which is useless without the other to be prohibited tying devices."[46] In fact, the Court noted, "in some situations the functional link between the two items may enable the seller to maximize its monopoly return on the tying item as a means of charging a higher rent or purchase price to a larger user of the tying item."[47]

Applying the consumer demand test to the case at hand, the Court held that anesthesia services and operating room services were different products because "consumers differentiate between anesthesiological services and the other hospital services . . . ."[48] It

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40 *Id.* at 12. This passage must be understood with another passage in which the court stated that "when a purchaser is 'forced' to buy a product he would not have otherwise bought even from another seller in the tied product market, there can be no adverse impact on competition because no portion of he market which would otherwise have been available to other sellers has been foreclosed." *Id.* at 16. As the court in *Wells Real Estate, Inc. v. Greater Lowell Bd. of Realtors*, 850 F. 2d 803, 814-15 (1st Cir.), *cert. denied*, 488 U. S. 955 (1988), explained "we read the [latter] passage not as relevant to the issue of plaintiffs' injury and standing to sue, but as regarding the plaintiffs' showing as to the 'not insubstantial' volume of commerce that is foreclosed by the tie." *Accord Barber & Ross Co. v. Lifetime Doors, Inc.*, 810 F. 2d 1276, 1279 n. 1 (4th Cir.), cert. denied, 484 U. S. 823 (1987).

41 *Jefferson Parish*, 466 U.S. at 18-19.

42 *Id.* at 19.

43 *Id.* at 19, citing *Times-Picayune Publishing Co.*, 345 U.S. 594.

44 *Id.* at 21-22. *Accord Eastman Kodak*, 504 U.S. at 462.

45 *See United States v. Microsoft*, 147 F.3d 935, 946-47 (D.C. Cir. 1998).

46 *Id.* at 19 n. 30. *Accord Eastman Kodak*, 504 U.S. at 463.

47 *Jefferson Parish*, 466 U.S. at 19 n. 30.

48 *Id.* at 23.

referenced evidence that has come to be described as direct and indirect evidence of consumer demand. Direct evidence refers to evidence of what buyers want; whereas indirect evidence is that which defendant's competitors offer in the tied market. Thus, the Court pointed to evidence that buyers wanted hospital services and anesthesiology services separately, other hospitals treated them as separate products (only 27% of hospitals tied the two products together), and the defendant billed separately for both.[49]

2. The Dissent in *Jefferson Parish*

Instead of per se treatment, the dissent would apply a rule of reason analysis to tying arrangements: "The ultimate decision whether a tie-in is illegal under the antitrust laws should depend upon the demonstrated economic effects of the challenged agreement."[50] Moreover, the dissent would severely cut back the types of tying arrangements that would be unlawful. Rule of reason analysis would condemn tying arrangements "primarily in the rare cases where power in the market for the tying product is used to create additional market power in the market for the tied product."[51] There is even some suggestion in the dissent that Section 1 tying law should be abandoned altogether in favor of Sherman Act Section 2 analysis: "exploitation of consumers in the market for the tying product is a possibility that exists and that may be regulated under section 2 of the Sherman Act without any reference to any tying arrangement that the seller may have developed."[52]

According to the dissent, the extension of market power from one market to another is unlikely unless three conditions are met. "First, the seller must have power in the tying product market."[53] "Second, there must be a substantial threat that the tying seller will acquire market power in the tied product market."[54] "Third, there must be a coherent economic basis for treating the tying and tied products as distinct."[55] The dissent parted company with the majority's consumer demand test for separate products with respect to this third condition. The dissent noted that all but the simplest products could be broken into two or more components that are tied together. The dissent's test for separate products is, "[f]or products to be treated as distinct, the tied product must, at a minimum, be one that some consumers might wish to purchase separately without also purchasing the tying product."[56] The dissent explicitly rejected the majority's consumer demand test.[57]

Even if two products have different uses, tying them together would not necessarily be an unlawful arrangement. The economic justification for the sale of the two products as a unit would have to be considered. "When the economic advantages of joint packaging are substantial the package is not appropriately viewed as two products . . . ."[58]

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49 *Id.* at 36 n. 36.

50 *Id.* at 41.

51 *Id.* at 36 n.4.

52 *Id.* at 35-36.

53 *Id.* at 37.

54 *Id.* at 38.

55 *Id.* at 39.

56 *Id.* at 39.

57 *Id.* at 39 n. 8.

58 *Id.* at 40.

Applying the rule of reason and the dissent's test for separate products to the facts of the case, the dissent would not rule that anesthesia and surgical services were separate services, because anesthesiology services have no use other than in conjunction with surgery. Even if they were separate, there is no Section 1 violation, because tying surgical services and anesthesiology services cannot increase the hospital's interest in the tied product.[59]

The differences between the majority and the dissent can be summarized as follows. First, the majority applied a modified per se analysis to tying arrangements; whereas the dissent would apply a rule of reason analysis. According to the dissent, even if the tying arrangement involves the forced sale of two different products, the arrangement is lawful if the economic advantages of joint packaging are substantial. Second, the majority would require that the tying arrangement have a not insubstantial effect in the tied market; whereas the dissent would require that the tying arrangement create a substantial threat that the tying seller will acquire market power in the tied-product market. Third, the majority applied a consumer demand test for separate products; whereas the dissent would reject that test in favor of one that looks to whether the economic effects of the sale of the package as a unit are substantial.

The Court reaffirmed the consumer demand test in *Eastman Kodak*.[60] In *Eastman Kodak*, the plaintiffs alleged a tying arrangement between Kodak parts and service. Kodak responded that parts and service constituted a single product "because there is no demand for parts separate from service."[61] The Court rejected Kodak's contention. "For service and parts to be considered two distinct products, there must be sufficient consumer demand so that it is efficient for a firm to provide service separately from parts," citing *Jefferson Parish*.[62] Under that test, service and parts for Kodak copiers were separate products because they have been and continue to be sold separately. As for Kodak's claim that there was no demand for parts separate from service, the Court responded that it had often condemned tying arrangements even when one of the bundled items was useless without the other.[63]

C. Critique of the *Jefferson Parish* Test for Separate Products

The *Jefferson Parish* test for separate products has been criticized with respect to (1) products that integrate physically separate products and (2) products that reflect technological advances. First, determining whether two items are the same or different products for purposes of applying tying law is a difficult one. As Judge Posner stated in *Jack Walters & Sons Corp. v. Morton Building, Inc.*, "The problem is that there is no obvious way of deciding whether a single product is a single product or an assemblage of components.[64] In some sense, it is all too easy to find that any manufactured article constitutes a tie-in of

59 *Id.* at 43.

60 504 U.S. 451.

61 504 U.S. at 463.

62 *Id.* at 462.

63 *Id.* at 463, citing *Jefferson Parish*, 466 U.S. at 19 n. 30.

64 737 F. 2d 698, 703 (7th Cir.), *cert. denied,* 469 U.S. 1018 (1984).

separate products.[65]

Judge Posner was critical of the separate demand test of *Jefferson Parish*:

> There are separate markets for sugar and sugarless breakfast cereals, but it would be surprising to find that a sugary cereal was a tie-in (sugar tied to cereal), assuming the seller refused to sell a sugar-free version. The belt example also becomes problematic under the separate-market approach. Belts are rarely sold without buckles; but surgical operations are even more rarely sold without anesthesia (held in *Jefferson Parish* to have been tied to the hospital's operating rooms). . . . We doubt that, even after *Jefferson Parish*, belts are tie-ins of buckles to straps; yet we cannot be sure where the separate-markets text will lead.[66]

A second criticism of the *Jefferson Parish* demand test for separate products lies in the area of technological development. The critique is that the test is a static one and does not account for dynamic industries where new assemblages of previously separate products create efficiencies over and above those provided by the separated products. Computer software presents an especially difficult problem for determining whether separate products are involved. While there can be dispute over whether the anesthesia services and the surgical services are separate, there can be no doubt as to which part of the total arrangement constitutes the anesthesia services and which the operating room services. But with respect to software, it is not so clear. For example, is Windows 98 really a different product from Internet Explorer when the software for one is integrated with that of the other?

There can be no doubt that technological advances have come about when previously separate products have been integrated into one product. Consumers have benefited from product integration. The danger is that product innovation may be stifled if a too-stringent test of separate products is used to condemn integration as per se unlawful tying. On the other hand, not all innovation is beneficial to consumers or even benign: "Innovation need not always take the form of building a better mousetrap. Instead, the 'innovation' may be

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65 Judge Posner pointed out that "[a]lmost every product can be viewed as a package of component products: a pair of shoes, for example, as a package consisting of a left shoe and a right shoe; a man's three-piece suit as a package consisting of a jacket, vest, and pants; a belt as a package consisting of a buckle and a strap. As shown by the last of these examples, it is possible to describe a product as a package of components even if the components are physically integrated at the point of sale to the consumer. Indeed, much of what is called 'manufacturing' is the assembly, i.e., physical integration, of components, often components manufactured by other companies. . . . Very few products today are produced like a statue that is made by pouring molten bronze into a cast—the ultimate single product." *Jack Walters & Sons*, 737 F.2d at 703.

66 *Id*. at 704. The problem of applying—if not judicial resistance to--the separate demand test of *Jefferson Parish* is exemplified in *Lloyd Design Corp. v. Mercedes-Benz of North America*, 66 Cal. App. 4th 716 (1998). In rejecting a tying claim based on a Mercedes-Benz decision to use floor mats manufactured by plaintiff's competitor, the court characterized plaintiff's tying claim disdainfully, "If we accept Lloyd's argument that the floor mats and the car are two separate products, the only 'standard' equipment on cars would be the chassis, engine and body: car seat, vanity mirror and steering wheel manufacturers (among others) would be claiming that their products come in all different shapes, sizes and colors and should therefore be separate product options left up to the consumer." *Lloyd Design Corp.*, 66 Cal. App. 4th at 722. Although the plaintiff contended that there was a demand for car mats separate from a demand for Mercedes-Benz cars, the court did not consider the separate demand test in rejecting the plaintiff's tie-in claim.

an anticompetitive tie that no one has tried before."[67] A clear test for separate products is needed to distinguish legitimate tying from illegitimate tying in the technological context. The test should reflect the purposes of the antitrust laws.

The tying issue presented in *United States v. Microsoft Corp.*,[68] was whether Microsoft's contractual and technological bundling of the Internet Explorer web browser ("IE") (the "tied" product) with its Windows operating system ("OS") (the "tying" product) resulted in a tying arrangement that was per se unlawful.[69] The district court decided that Microsoft unlawfully tied Windows 98 and Internet Explorer.[70] The appellate court reversed, on the ground that "the rule of reason, rather than per se analysis, should govern the legality of tying arrangements involving platform software products."[71]

Microsoft contended that Windows and its IE browser are not separate products. The *Microsoft* court acknowledged the *Jefferson Parish* consumer demand test for separate products.[72] The court noted that *Jefferson Parish* recognized the benefits of tying under certain situations. Accordingly, the court read the consumer demand test as "a rough proxy for whether a tying arrangement may, on balance, be welfare-enhancing, and unsuited to per se condemnation."[73] It noted that "the separate-products test is not a one-sided inquiry into the cost savings from a bundle.[74] The court went on to observe that *Jefferson Parish* "chose proxies that balance costs savings against reduction in consumer choice."[75] "Reduction in consumer choice" is just another way of saying "injury to competition".

The court was critical of the consumer demand test for several interrelated reasons. First, "because of the pervasively innovative character of platform software markets, tying in such markets may produce efficiencies that courts have not previously encountered and thus the Supreme Court had not factored into the per se rule . . . ."[76] The *Jefferson Parish* test was not formulated with computer software in mind.

The *Microsoft* court's major criticism was that the *Jefferson Parish* test tends to "chill innovation . . . by preventing firms from integrating into their products new functionality previously provided by standalone products—and hence, by definition, subject to separate

67 10 Antitrust Law ¶ 1746 at 206 (2d ed.).

68 253 F. 3d 34 (2001) ("2001 Microsoft Decision")

69 *Id.* at 84.

70 The district court held that Microsoft unlawfully tied Windows 98 and IE based on the following findings: (1) Microsoft required licensees of Windows 95 and 98 also to license IE as a bundle at a single price; (2) Microsoft refused to allow OEMs to uninstall or remove IE from the Windows desktop; (3) Microsoft designed Windows 98 in a way that withheld from consumers the ability to remove IE by use of the Add/Remove Programs utility, (stating that IE was subject to Add/Remove Programs utility in Windows 95); and (4) Microsoft designed Windows 98 to override the user's choice of default web browser in certain circumstances. The court found that these acts constituted a per se tying violation. *Id.* at 84-85.

71 *Id.* at 84.

72 *Id.* at 85-87.

73 *Id.* at 87.

74 *Id.* at 88.

75 *Id.*

76 *Id.* at 93.

consumer demand."[77] It noted that many innovations involved bundling previously separate products. The consumer demand test is static and not dynamic. "The per se rule's direct consumer demand and indirect industry custom inquiries are, as a general matter, backward-looking . . . ."[78] The *Jefferson Parish* test for separate products may ignore efficiency benefits from integration of previously separate products.[79] The problem identified by the court occurs in a time period when some competitors are beginning to bundle products previously sold separately that other competitors have not yet bundled. Unless all competitors begin to bundle at the same time, some can be said to have tied products in two markets.[80] "If integration has efficiency benefits, these may be ignored by the *Jefferson Parish*" test.[81]

The *Microsoft* court's criticism of the consumer demand test transcends the limited area of software bundling. The argument can be applied to any innovation, consisting of previously unbundled items, that has efficiency benefits; "The separate products test is a poor proxy for net efficiency from newly integrated products.[82] The court cited to 10 Areeda, *Antitrust Law*, 1746 ("The New Product Rationale") in its argument.[83] Areeda's critique of the *Jefferson Parish* test is not confined to the tech area.

The court held that the rule of reason instead of the per se rule should be used to test Microsoft's bundling of Windows 98 and IE. The rule of reason would consider "the benefits of bundling in software markets, particularly those for OSs, and balancing these benefits against the cost to consumers whose ability to make price/quality tradeoffs in the tied market may have been impaired."[84]

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77 *Id.* at 89.

78 *Id.* at 89.

79 *Id.* at 89, 92.

80 This is precisely what the court held in *Automatic Radio Mfg. Co. v. Ford Motor Co.*, 272 F. Supp. 744 D. Mass. 1967), *aff'd*, 390 F. 2d 113 (1st Cir.), *cert. denied*, 391 U.S. 914 (1968). The case is interesting because of the different way it treated radios from other car accessories: "The court does reject the suggestion of the defendant that the plaintiff's situation is indistinguishable from that of sellers of bumpers, hang-on fender lights, outside auto trunks and luggage racks which were in vogue decades ago. Their goods became parts of automobiles and lost their identities as accessories. Radios have retained their identity as separate products." *Id.* at 748. The different treatment of radios from other accessories reflected the fact that at the point in time the decision was rendered, some accessories had become standard in the industry while radios had not. Today all or almost all cars come equipped with radios and so there would be a different result if the claim were brought today.

Consider this item from the *Wall Street Journal*: "[T]he Treo is a true breakthrough. Unlike other combo devices, which were either phones with Palms jammed into them or Palms with phone features added, the Treo is a true hybrid. It was designed from the ground up to be a new kind of device, which the company calls a 'communicator'." *Wall Street Journal*, November 29, 2001, at B1. It is not at all inconsistent with *Jefferson Parish* that certain items would be considered separate products at one point, but one, integrated product at another. The *Microsoft* court's analysis focuses on the time period when an industry is moving from a situation when no one bundles an item to a situation when everyone bundles the item.

81 *2001 Microsoft Decision*, 253 F. 3d at 89.

82 *Id.* at 92.

83 *Id.* at 89.

84 *Id.* at 94.

The fundamental problem with the court's analysis is that the court left confused the test for separate products. The court explicitly rejected the consumer demand test for separate products, yet it provided no alternative to determine whether Windows 98 and IE are separate products. The court made it impossible for plaintiffs to prove a tying claim on remand because it rejected the only available test for separate products. How, then, was the district court on remand to determine the first step in a tying claim; i.e., whether OS and IE are separate products?

In sum, the separate product test articulated in *Jefferson Parish* has been rejected by lower courts and there is not yet a viable alternative.

California reported decisions have yet to address the separate product test of *Jefferson Parish*. A California Supreme Court decision that predates *Jefferson Parish* set out four factors that courts should take into account when determining whether separate products are involved.[85] As noted above, the court in *Lloyd Design Corp.*, a post-*Jefferson Parish* decision, summarily rejected the claim that automobiles and floor mats were separate products, but did not address the *Jefferson Parish* test for separate products. It is unclear whether California courts, when faced with a dispute over whether separate products are involved will use the factors enumerated in *Corwin* or use the *Jefferson Parish* test or perhaps use some other.

V. The Requirement of Market Power in the Tying Product Market

A tying arrangement is per se unreasonable whenever a party has sufficient economic power in the in the tying product market to appreciably restrain competition in the tied product market and if the arrangement affects more than an insubstantial volume of interstate commerce in the tied product.[86] The Supreme Court in *Eastman Kodak* equated "economic power" with "market power" and defined "market power" as the power "to force a purchaser to do something that he would not do in a competitive market." (Citation omitted). It has been defined as 'the ability of a single seller to raise price and restrict output.' (Citation omitted). The existence of such power ordinarily is inferred from the seller's possession of a predominant share of the market."[87] The Court in *Jefferson Parish* rejected the tying claim, because the defendant possessed less than 30% of the tying market. A number of courts require proof that the seller have at least 30% share of the tying product market.[88]

The Supreme Court had, until recently, held that patents and copyrights were sufficiently unique to create a rebutable presumption that their holders possessed sufficient

85 *Corwin,* 4 Cal. 3d at 858-59. "[T]he following factors should be taken into account: (1) Whether competitors offer to sell the products or services separately or only as a unit. (2) Whether the combined product or service is composed of varying assortment of component parts. (3) Whether buyers are or can be charged separately for the allegedly separate products or services. (4) Whether the defendant ever sells or offers to sell the products or services separately." (Citations omitted.) The court noted that "we have not found, nor has our attention been directed to, any definitive test for the determination of this question (separate products)…." *Id.* This comment is not surprising in that the United States Supreme Court never provided a test for separate products before *Jefferson Parish*.

86 *Fortner I*, 394 U.S. at 495.

87 *Id*. at 464.

88 *See Hardy v. City Optical, Inc.*, 39 F. 3d 765, 767 (7th Cir. 1994); *Breaux Bros. Farms, Inc. v. Teche Planting Co.*, 21 F. 3d 83, 87 (5th Cir.), *cert. denied*, 513 U.S. 963 (1994).

market power in the tying product market.[89] But in *Illinois Tool Works*, the Court overruled *International Salt*, holding that there is no presumption, rebutable or otherwise that patent holders enjoy market power in the market for the tying product.

The Court in *Illinois Tool Works* cited *United States v. Loew's, Inc.,*[90] which dealt with copyright, twice with disapproval but did not expressly overrule it. The previous Court pronouncement was that copyrights conferred a rebuttable presumption of market power in the holder of the copyright owner. But even before *Illinois Tool Works*, lower courts had already rejected the presumption of market power in the tying product market for copyright holders.[91] After *Illinois Tool Works*, at least one court has applied the rationale of that decision and held that copyrights do not confer on their holders a presumption of market power.[92] It would seem that the presumption of market power in a copyright has seen its days numbered.

California courts recognize that a seller can be liable "even though the power falls short of dominance and even though the power exists only with respect to some buyers in the market."[93] Rather than requiring that the seller have a specific percentage of the market of the tying product, "crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes."[94] One example of a unique product from which crucial economic power may be inferred is land: "Land because of its uniqueness and scarcity easily confers the power to restrain competition."[95] A mobile home park was held to be sufficiently unique to support a tying claim because of the fact that "it was a first-class park with large sites and full recreational facilities, including swimming pools."[96] It is unclear whether California courts will continue to hold that the uniqueness of the tying product is sufficient to establish the requisite economic power. The decisions that have so held are over twenty years old and rely on United States Supreme Court decisions such as *Northern Pacific Ry. Co.*[97] and *Loew's*,[98] whose condemnation of tying arrangements have been undermined by later Supreme Court decisions.

VI. Conclusion

In *Kahn v. State Oil Co.*,[99] Judge Posner criticized the then current law that maximum

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89 *International Salt Co. v. United States,* 332 U.S. 392 (patents); *United States v. Loew's, Inc.*, 371 U.S. 38 (copyrights).

90 __ U.S. __; 126 S. Ct. at 1288-89, 1292.

91 *A. I. Root Co. v. Computer/Dynamics, Inc.*, 806 F. 2d 673, 676 (6th Cir. 1986).

92 *Paramount Pictures Corp. v. Johnson Broadcasting, Inc.*, 432 F. Supp. 2d 707, 708 (S.D. Tex. 2006).

93 *Suburban Mobile Homes*, 101 Cal. 3d at 544.

94 *Corwin*, 4 Cal. 3d at 858, citing *Fortner I*, 294 U.S. 495, 502-03; *Suburban Mobile Homes*, 101 Cal. 3d at 544; *Classen v. Weller*, 145 Cal. App. 3d 27, 37 (1983).

95 *Classen*, 145 Cal. App. 3d at 37.

96 *Suburban Mobile Homes*, 101 Cal. App. 3d at 544.

97 *Classen,* 145 Cal. App. 3d at 37.

98 *Suburban Mobile Homes*, 101 Cal. App. 3d at 544.

99 93 F. 3d 1358 (7th Cir. 1996).

vertical price restraints were per se illegal, argued that *Albrecht v. Herald Co* [100] was "unsound when decided",[101] but nonetheless held that the vertical price restraint in that case was per se illegal. The United States Supreme Court took up Judge Posner's challenge to the per se characterization of maximum vertical price restraints and, reversing prior rulings, held in *State Oil Co. v. Khan* that maximum vertical price restraints were subject to the rule of reason.[102] In sharp contrast to Judge Posner's approach, lower appellate courts systematically ignored or even rejected Supreme Court precedents with respect to tying arrangements.[103]

The disconnect between the Supreme Court's and lower courts' decisions necessitate the Supreme Court to clarify this area of law. Specifically, the Court should make clear: (1) what are the elements of a tying claim; (2) whether tying arrangements are to be ever examined as per se violations, and, if so, what the per se tag means with respect to tying arrangements; (3) what the test for separate products should be, especially with respect to (a) products that consist of parts that have been separate products, and (b) products that reflect technological advancements; and (4) whether there remains any rebutable presumption that copyrights confer market power on the copyright holder. It is not likely that the Court will address all of these issues in the near future. In the meantime, lower courts must do the best they can.

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100 390 U.S. 145 (1968).

101 *Id*. at 1363.

102 522 U.S. 3 (1997).

103 See Judge Wood's concurring opinion in *Reifert v. South Central Wisconsin MLS Corp.*, 450 F. 3d at 323, in which she criticized the majority's' decision that all tying arrangements should be analyzed under a rule of reason stating: "But it is not for this court to anticipate the Supreme Court's overruling of its earlier decisions, even if the passage of time and the impact of later cases that create doctrinal tensions are evident to all."