

THE DOCTRINES OF TYING AND BUNDLING

-CONCEPT AND THE INDIAN CASE

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TABLE OF CONTENTS

TABLE OF CASES.....	iv
1. Introduction- Defining Tying and Bundling.....	1
1.1 Research Methodology, Scope and Scheme	5
2. Economic Rationale behind Tying and Bundling	6
(i) The Classical Leverage Theory:	6
(ii) The Chicago School of thought:	7
(a) Efficiencies Argument:.....	8
(b) The Single Monopoly Profit Theory:.....	10
(iii) Post-Chicago theories:.....	11
Whinston’s Argument:	12
Defensive Leveraging:.....	14
3. The Law	15
3.1 USA Law on Tying and Bundling	16
3.1.1 The Per Se Rule	17
3.1.2 Modified Per Se Rule	19
3.1.3 The Rule of Reason Approach.....	21
3.2 US v. MICROSOFT	22
3.3 EU Law on Tying and Bundling.....	26
3.3.1 The Per Se Approach	27

3.3.2 MICROSOFT v. COMMISSION	29
3.4 Comparative Analysis of the USA and EU Legal Positions on Tying and Bundling	33
4. The Indian Position	34
4.1 Sections 3 and 19- Tracing the Rule of Reason Approach in the Indian Competition Act, 2002	35
5. Conclusion	38
BIBLIOGRAPHY.....	vi
(1) BOOKS	vi
(2) ARTICLES	vii

TABLE OF CASES

<i>Barber & Ross Co. v. Lifetime Doors, Inc.</i> , 810 F.2d 1276, 1280 (4th Cir.), <i>cert. denied</i> , 484 U.S. 823 (1987);	25
<i>Breaux Brothers Farms, Inc. v. Teche Sugar Co.</i> , 21 F.3d 83, 88-89 (5th Cir. 1994).....	25
<i>Broadcast Music, Inc. et al. v. Columbia Broadcasting System, Inc. et al.</i> , 441 U.S. 1 (1979).	25
<i>Carl Sandburg Village Condominium Association v. First Condominium Development Co.</i> , 758 F.2d 203, 210 (7th Cir. 1985).....	25
<i>Casey v. Diet Center</i> , 590 F. Supp. 1561, 1570 (N.D. Cal. 1984)	25
<i>Digital Equipment Corp. v. Uniq Digital Technologies, Inc.</i> , 73 F.3d 756 (7th Cir. 1996)..	25
<i>Eastman Kodak Co. v. Image Technical Services, Inc.</i> , 504 U.S. 451 (1992).	24
<i>Grappone, Inc. v. Subaru of New England, Inc.</i> , 858 F.2d at 799;	25
<i>Hilti v. Commission (II) (CFI) [1991] ECR II-1439</i>	32
<i>Hodge v. Villages of Homestead Homeowners Ass'n, Inc.</i> , 726 F. Supp. 297 (S.D. Fla. 1989)	20
<i>IBM v. United States</i> , 298 U.S. 131 (1936).....	10
<i>International Salt Co. v. United States</i> , 332 U.S. 392 (1947).....	10
<i>Jefferson Parish Hospital Dist. No. 2 et al. v. Hyde</i> , 466 U.S. 2 (1984).	23
<i>Jefferson Parish Hospital Dist. No. 2 v. Hyde</i> , 466 U.S. 2, 12 (1984)	10
<i>LePage's Inc. v. 3M.</i> , 324 F. 3d 141 (3d Cir. 2003)	4
<i>Martino v. McDonald's System</i> , 625 F. Supp. 356, 362-63 (N.D. Ill. 1985)	25
<i>Microsoft v. Commission</i> , Case T-201/04, [2007] ECR II-3601	32
<i>Motion Pictures Patents Co. v. Universal Films Manufacturing Co.</i> , 243 U.S. 502 (1917)..	4
<i>Mozart Co. v. Mercedes-Benz of North America, Inc.</i> , 833 F.2d 1342 (9th Cir. 1987), <i>cert.</i>	

<i>denied</i> , 488 U.S. 870 (1988).....	20
<i>Northern Pacific Railway Co. v. United States</i> , 356 U.S. 1 (1958).....	21
<i>Parts & Electric Motors, Inc. v. Sterling Electric, Inc.</i> , 826 F.2d 712, 721 (7th Cir. 1987).	25
<i>State of New York et al. v. Microsoft Corp.</i>	29
<i>Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.</i> , 959 F.2d 468, 484-85 (3d Cir.) (en banc), <i>cert. denied</i> , 506 U.S. 868 (1992).....	25
<i>Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.</i> , 959 F.2d 468, 496 n.42 (3d Cir.), <i>cert. denied</i> , 506 U.S. 868 (1992)	20
<i>Twin City Sportservice, Inc. v. Chas. O. Finley & Co.</i> , 512 F.2d 1264 (9th Cir. 1975), <i>reaff'd</i> , 676 F.2d 1291 (9th Cir.), <i>cert. denied</i> , 459 U.S. 1009 (1982).....	20
<i>U.S. Steel Corp. v. Fortner Enterprises</i> , 394 U.S. 495, 503 (1969) (“ <i>Fortner I</i> ”)	21
<i>United States v. Jerrold Electronic Corp.</i> , 187 F. Supp 545 (E.D. Pa. 1960), <i>aff'd per</i> <i>curiam</i> , 365 U.S. 567 (1961).	22
<i>United States v. Microsoft Corp.</i> , 253 F.3d 34 (D.C. Cir. 2001).....	25
<i>United States v. Microsoft Corp.</i> , 253 F.3d 34 (D.C. Cir. 2001).....	25
<i>United States v. Topco Assocs., Inc.</i> , 405 U.S. 596, 607-08 (1972).....	25
<i>Virgin Atlantic Airways v. British Airways plc</i> , 257 F. 3d 256 (2d Cir. 2001).	4
<i>Webb v. Primo's, Inc.</i> , 706 F. Supp. 863 (N.D. Ga. 1988)	20

1. Introduction- Defining Tying and Bundling

The antitrust control of discounts, rebates and selective pricing by dominant firms has been commanding a lot of attention in contemporary times. On both sides of the Atlantic, there has been high-profile enforcement activity in the recent past.¹ In the European Union, (EU) the two decided cases of *Michelin v. Commission* and *British Airways v. Commission* in 2003 stirred up the debate regarding discounts, rebates and selective pricing. The same, in the United States of America, (USA) was the effect of the two cases of *Virgin Atlantic Airways v. British Airways plc*² and *LePage's Inc. v. 3M*.³ This entire debate essentially involved the deep rooted economic and legal doctrines of Predatory Pricing, Exclusive dealings and that of Tying and Bundling. Hence, in the light of this background, the scope of study of this research paper has been restricted to one aspect of the debate, i.e. the concepts of Tying and Bundling.

Even though the jurisprudence regarding these concepts originated only in the early part of the 20th Century, and has gained significance recently, [as a part of Interpretation and Enforcement mechanisms of Antitrust Authorities, which are judicial/quasi judicial in character] their origin actually dates back to the time of evolution of the Principles of doing Business. Doing business has always, in plain terms, been about winning over a market share, by competing with rivals in the same/distinct sectors of the market, and employing techniques to ensure themselves of consumer preferences, over such rivals. In this process and over the years of such business activity, some of these techniques (in this context, tying and bundling) have come to be considered as unfair and anti-competitive in an open market. These have been declared so in Legislative Instruments⁴ and by Enforcement Authorities. These concepts were originally developed in Patent cases,⁵ and were subsequently identified as issues in Antitrust Law.

1 Christian Ahlborn and David Bailey, "Discounts, rebates and selective pricing by dominant firms: a trans-Atlantic comparison," Chapter 7 in "Handbook of Research in Trans-Atlantic Antitrust", Philip Marsden (ed.), at p. 195.

2 *Virgin Atlantic Airways v. British Airways plc*, 257 F. 3d 256 (2d Cir. 2001).

3 *LePage's Inc. v. 3M*, 324 F. 3d 141 (3d Cir. 2003)

4 In the United States, Section 1 of the Sherman Act and Section 3 of the Clayton Act; In the European Union, Article 82 of the Treaty of European Communities.

5 *Motion Pictures Patents Co. v. Universal Films Manufacturing Co.*, 243 U.S. 502 (1917).

The threshold at which these techniques (Tying and Bundling) are considered to be anti-competitive and hence, illegal, varies across jurisdictions. Therefore, while the thought that Tying and Bundling are illegal transcends national jurisdictions, the little extent to which they may be considered to be legal varies from one legal system to another. To understand the legal positions regarding Tying and Bundling in different jurisdictions, it is imperative to first understand the basic underlying concepts, which remain the same, irrespective of any particular legal system.

Tying: It refers to the behaviour of selling one product (tying product) conditional on the sale of another product (tied product).⁶ Competition Law intends to regulate Tying as it may result in foreclosure of competitors from the market. Tying can work because the supplier is dominant in the market for the tying product, so the customer has difficulty going elsewhere for it and therefore does not shop around for the tied product.⁷ Competition Authorities may fear that the dominant supplier can extract two monopoly prices, one from the tying and one from the tied product.⁸

Robert Bork, an eminent Antitrust Law Jurist has gone to the extent of saying that “Every person who sells anything imposes a tying arrangement. This is true because every product or source could be broken down into smaller components capable of being sold separately, and every seller refuses at some point to break the market down any further.”⁹ It is only when such a Tying arrangement becomes anti-competitive that it is considered illegal.

A simple example of tying is when a “Trends and Fashion” supplement is tied to a daily newspaper on Sundays, and one is forced to pay a higher price for that day, even when one may not be interested in the “Trends and Fashion” supplement.¹⁰ There are a lot of other less obvious examples from day to day life; like, shoes with laces, travel agent selling a plane ticket along with hotel accommodation, etc.

6 Jean Tirole, “The Analysis of Tying Cases: A primer”, December 9, 2004, Institut d’Economie Industrielle, University of Toulouse, at p. 6.

7 Jones and Sufrin, *EC Competition Law: Text, Cases and Materials.*, 3rd ed, 2007, at p. 514.

8 The Commission considered the same in the *Eurofix-Bauco* case, [1988] Oj L65/19, [1989] 4 CMLR 677; Herbert Hovenkamp, “Federal Antitrust Policy” § 10.4 (1999).

9 R. H. Bork, “The Antitrust Paradox: A Policy at War with Itself”, New York, the Free Press, 1978, at p. 378.

10 Massimo Motta, “Competition Policy: Theory and Practice”, 1st ed., 2004, 10th rep., 2008, at p. 460.

Some jurists have classified Tying into two types, i.e. Static Tying and Dynamic Tying (which is also the dynamic form of pure bundling, as elaborated later). In a Static tie, the customer who wants to buy product A must also buy product B. “It is possible to buy A without B, which also explains as to why this is a tie and not a bundle (explained later). Thus, the items for sale are B alone or an A-B package.”¹¹ In the second type of tying, in order to purchase good A, the customer is also required to purchase good B. What makes it different from the former type is that the quantity of good B may vary from customer to customer. Thus the items for sale are A-B, A-2B, A-3B, etc.¹²

Bundling: It refers to the practice of selling two products together. One distinguishes “pure bundling” where products are made available as a package only and not separately and “mixed bundling” which occurs when products are offered both as a bundle and also individually.¹³ In a Pure Bundle, two goods, A and B are only sold together. They are not available for individual purchase. Moreover, in a Pure Bundle, the goods A and B are offered only in some fixed proportion, such as one steering wheel and four tyres as a part of a car. One reason to look at pure bundling arises when bundling is done through technology. With a contractual bundle, there is at least the possibility of disposing off the unwanted part of the bundle. If one does not like the meals that one with a vacation package, one can dispose them off and not have them, whereas that is not the case with technological bundles, as disposing off may be too costly, or even impractical.¹⁴

On the other hand, in a mixed bundle, goods A and B are sold together in a package A-B, and also may be sold individually. The package is sold at a discounted rate, than individual prices. This provision of the package at a discounted rate is the most important criteria for it to constitute mixed bundling. For example, at a restaurant, provision of discounts in a pice fixed menu as opposed to an *ala carte'* menu is an example of mixed bundling.¹⁵

11 Prof. Barry Nalebuff (Yale University), “Bundling, Tying and Portfolio Effects”, DTI Economics Paper No. 1, Part 1, February 2003, at p. 15.

12 Ibid.

13 Ch. Ahlborn, D. Bailey and H. Crossley, “An Antitrust Analysis of Tying: Position Paper”, GCLC Research papers on Article 82 EC - July 2005, at p. 167.

14 Prof. Barry Nalebuff (Yale University), “Bundling, Tying and Portfolio Effects”, DTI Economics Paper No. 1, Part 1, February 2003, at p. 14.

15 Ibid.

Differences between tying and Bundling: The first difference between Tying and Bundling is that in Bundling, unlike Tying, there is no element of “Coercion” or “force” upon the customer to buy the bundled product.¹⁶ “Coercion” has generally been held to be present in Tying whereas bundling “prevented goods from competing directly for consumers’ choice on their merits, i.e. being selected as a result of “buyer’s independent judgment”.”¹⁷ Another difference between tying and (pure) bundling is that the tied product is available on a stand-alone basis under tying, but not under (pure) bundling. However, under Mixed Bundling, the products are available both, as a package, as well as on a stand alone basis. Moreover, Tying is a legal concept whereas Bundling is primarily an economic concept.¹⁸

The distinction between Tying and Bundling is technical. In the case of Tying, one of the products, that is the tied product, can be purchased independently. In the case of Bundling, no distinction is made between the purchases of the products involved. Either none of the products can be purchased independently of the other (pure bundling) or both products can be purchased independently but their joint sale gives to customers a discount (Mixed Bundling).¹⁹

There has been a recent argument that in some ways, the distinction between Bundling and Tying has been blurred. The Commission’s decision in the *Microsoft* case has taken the view that “not affording customers a choice as to whether to acquire the tying product without the tied product in itself amounts to coercion”²⁰, independently of whether it affects the “buyer’s independent judgment” in selecting competing products. According to this view, certain forms of bundling and tying are then indeed synonyms. This can also be stated in the backdrop of the fact that the two concepts of Tying and Bundling are not dealt with under separate laws. In the USA, both, Tying and Bundling are dealt with under Section 1 of the Sherman Act and Section 3 of the Clayton Act; and in the EU, both are

16 “Antitrust in Distribution- Tying, Bundling and Loyalty Discounts, Resale Pricing Restraints, Price Discrimination- Part I,” The Metropolitan Corporate Counsel, April 2006, at p. 11.

17 US Court of Appeals for the District Court of Columbia in *Microsoft III*, 253 F3d 34, 346 U.S. App. D.C. 330.

18 Ch. Ahlborn, D. Bailey and H. Crossley, “An Antitrust Analysis of Tying: Position Paper”, GCLC Research papers on Article 82 EC - July 2005, at p. 167.

19 Ekaterina Rousseva, “Rethinking Exclusionary Abuse in EU Competition Law,” 1st ed., 2010, Chapter 6, “Tying and Bundling”, at p. 219.

20 Commission Decision of 24 March 2004, COMP/C-3/37.792, *Microsoft* at para.834.

dealt with under Article 82 (d) of the Treaty of European Communities. However, for the purposes of this research paper, it is maintained throughout that there exists a slight distinction between the two concepts, even though their treatment under Law may be substantially similar.²¹

1.1 Research Methodology, Scope and Scheme

Object: The object of this research paper is to understand the Economic-Legal concepts of Tying and Bundling. The Paper also seeks to analyze the economic rationale behind the said concepts. Ultimately, the paper attempts to find out how the USA and EU positions on Tying and Bundling can be incorporated into the Indian Jurisprudence regarding Competition Law.

Research Scheme: Having discussed the underlying basics of the concepts of Tying and Bundling which prevail uniformly, irrespective of any particular jurisdiction, the research paper seeks to examine the Economic Rationale behind the said concepts. Then, the paper attempts to understand specific Legal provisions concerning Tying and Bundling, in USA and EU, along with drawing out the differences in the two said positions. Whilst discussing the specific provisions, the paper seeks to study the two cases of Microsoft (both EU and USA judgments). Other cases, both from the EU and the USA shall also be discussed briefly. Finally, the paper seeks to examine as to which position (USA or EU) is more suited to the Indian Legal System, in terms of substantive legal provisions and enforcement procedures.

Research Methodology: The research methodology employed is primarily doctrinal whereby various books and articles published in periodic journals available at the CCI Library constitute the primary sources of information; and websites on the worldwide web have also been accessed for additional reference. A uniform method of citation has been followed throughout the research paper.

21 Firstly, it is stated that merely because both the concepts are dealt with under the same laws doesn't mean that they are the same. They are two forms of abuse and their regulation is done in a similar manner, by the same laws. Also, for the purposes of the argument presented in the Microsoft case, the Economics behind the argument is not the subject of research here, hence, it is not being rebutted. Moreover, it is only one such argument and deals with a sub-set of Bundles that may be similar to Tying arrangements. On the totality, however, the distinction between Tying and Bundling is still maintained.

Scope and Limitations of Research: The concepts of Tying and Bundling are both legal and economic concepts with a large extent of detailed economic theory behind them. The research paper has dealt with the basic economic concepts, but is limited by the fact of the researcher being a law student. Hence, this is primarily a legal research paper, and the detailed principles of economics and econometrics have not been dealt with. Moreover, since these concepts have a huge amount of jurisprudence behind them, the researcher is also limited by time, leaving time only for the absolute essential topics to be discussed. Finally, lack of adequate Internet Databases has also constrained the level of research done.

2. Economic Rationale behind Tying and Bundling

To understand the concepts of Tying and bundling, it is necessary to consider the Economic Rationale behind the two concepts, the economic benefits for consumers and the economic disadvantages, if any, for competitors in an open market. The evolution of the economic rationale behind Tying and Bundling²² can be studied in three phases, i.e. (i) The Leverage theory, (ii) The Chicago School theory, and (iii) The Post-Chicago thought.

(i) The Classical Leverage Theory: According to the leverage theory, tying “provides a mechanism whereby a firm with monopoly power in one market can use the leverage provided by this power to foreclose sales in, and thereby monopolize, a second market”²³ If the firm did so, a firm seeking to compete in the market for the tied good would be foreclosed from selling to all those who received the tied good in conjunction with their purchase of the tying good. Little attention was paid initially to whether tying was an efficient way of exploiting existing monopoly power in the tying good, or a method of creating a new monopoly in the tied good.²⁴

The important cases formulating classical tying doctrine include the *International Salt* case²⁵, the *Northern Pacific Case*²⁶ and the *Jefferson Parish case*.²⁷ *International Salt*

22 In this section, the researcher has discussed the economic rationales of both the concepts of Tying and Bundling together, as the said theories are with reference to both. Hence, whilst the researcher maintains the differences between the two concepts, these theories are considered as being applicable to both, irrespective of the above mentioned differences.

23 Michael D. Whinston, “Tying, Foreclosure and Exclusion”, *The American Economic Review*, September 1990, Vol. 80, No. 4, at p. 837.

24 Ward S. Bowman, “Tying Arrangements and the Leverage Problem,” 67 *Yale L.J.* 19, 23–24 (1957)

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

and *Northern Pacific* established liberal approaches to analyzing the existence of market power, extension, and forcing. Market power was more or less presumed in *International Salt* from the fact that the tying products, i.e. salt processing machines were patented. In *Northern Pacific*, the Court concluded that the defendant had market power in the tying product (land) because of its sizeable holdings and because of what it described as the “strategic location” of the parcels. Hence, the classical leverage theory included monopolizing the market of both the tying product and the tied product and using the monopoly in the tying product to do so. So, what is opposed as a part of this theory is the extension of market power by the dominant firm. However, this school of thought was largely criticized by another set of theorists known as the Chicago School of thought.

(ii) The Chicago School of thought: The proponents of the Chicago School²⁸ have mainly argued that Tying involves the integration of components into one product and this can lead to significant economic efficiencies, resulting in lower costs of production and distribution and improvements in quality.²⁹ Apart from this they also argue for the “Single Monopoly Profit theorem”, which means that a dominant firm, through the process of Tying, can only gain advantage of its monopoly once, in the market of the tying product only.

The Chicago school claimed that tying conduct produces many benefits from a social viewpoint, at no competition costs, and that it should therefore be treated as per se legal. Tying can lower costs and promote convenience, both for producers and consumers. Tying can create economies of scale and scope in production and distribution³⁰; give rise to

26 *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1 (1958).

27 *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984). Also, see *IBM v. United States*, 298 U.S. 131 (1936).

28 Aaron Director & Edward H. Levi, “law and the future trade regulation,” 51 *NW. U. L. REV.* 281 (1956); George J. Stigler, “The Organization of Industry” (1968); Richard A. Posner, “Antitrust Law: An Economic Perspective” (1976); R. H. Bork, “The Antitrust Paradox: A Policy at War with Itself”, New York, the Free Press, 1978; Walter J. Adams & Janet L. Yellen, “Commodity Bundling and the Burden of Monopoly,” 90 *Q.J. ECON.* 475 (1976); Richard L. Schmalensee, “Gaussian Demand and Commodity Bundling,” 57 *J. BUS.* S211 (1984); R. Preston McAfee, John McMillan & Michael D. Whinston, “Multiproduct Monopoly, Commodity Bundling, and Correlation of Values,” 104 *Q. J. Econ.* 371 (1989); Michael A. Salinger, “A Graphical Analysis of Bundling,” 68 *J. BUS.* 85 (1995); Yannis Bakos & Eric Brynjolfsson, “Bundling Information Goods: Pricing, Profits, and Efficiency,” 45 *MGMT. SCI.* 1613 (1999).

29 Richard Whish, “Competition Law”, Chapter 17, “Abuse of Dominance (I): Non-Pricing Practices”, 6th ed., 2008, at p. 680.

30 S J Davis, K M Murphy and J MacCrisken, “Economic perspectives on software design: PC operating systems and platforms” in D S Evans, (ed.) “Microsoft, Antitrust and the New Economy”, (2002).

new or improved products and services³¹; help manufacturers ensure quality; lead to lower prices when the tying and tied products are complements;³² and reduce the costs of searching for the most appropriate combination of products that satisfy a complex need.

(a) Efficiencies Argument: At the basic level, the Chicago School argues that Tying increases convenience and lowers transaction costs.³³ Tying can also be used to increase efficiency of distribution systems by allowing them to reduce agency and information costs.³⁴ Tying reduces the costs of searching for the most appropriate combinations of products that satisfy a complex need, and it greatly simplifies use. One of the first and foremost advantages of Tying and Bundling is the reduction of transaction costs. For example, if one has to set up a computer lab in a school or a governmental office, it would be convenient for one to have one supplier set up the personal computers, along with all the software and hardware like monitor, mouse, printer, projector, etc (all facilities required in such a lab) instead of having separate sellers set up the software and hardware individually. At the same time, doing the former would also result in reduction of transaction costs that would be involved if the latter option is chosen. The higher the number of transactions avoided, the lesser the transaction costs incurred. Cost synergies from tying and bundling are most valuable when consumer valuations are positively co-related.³⁵

Similarly, earlier, software technologies such as toolbars, modem support, power management and sound were all formally offered as stand alone products. Today, they are universally offered as an integrated, “bundled” or “tied” part of the operating system. The widespread use of the tied software is itself a function of better technology, faster speed and expanded memory. But it is also a response to consumers who value the ease of use of bundled or tied software.³⁶

31 Amil Petrin, “Quantifying the Benefits of New Products: The Case of the Minivan”, (2002) 110 *Journal of Political Economy* 705, at 728.

32 A Cournot, “Recherches sur les Principes Mathématiques de la Théorie des Richesses”, (1838).

33 D. W. Carlton and J. M. Perloff, *Modern Industrial Organization*, pp. 289-291 (3rd ed., Addison-Wesley 2000).

34 Roy W. Kenney & Benjamin Klein, *The Economics of Block Booking*, 26 J.L. & ECON. 497 (1983).

35 M.S. Salinger, “A Graphical Analysis of Bundling”, 68 J. Bus. 85 (1995).

36 D. Evans, J. Padilla and M. Polo, “Tying in Platform Software: Reasons for a Rule of Reason Standard in European Competition Law”, (2002) 25 *World Competition* 509.

Tying gives rise to both, Economies of Scale³⁷ and Economies of Scope,³⁸ especially for the purposes of production and distribution. For example, “Peugeot and buyers of Peugeot bicycles both benefit from Peugeot’s tie of the ring bell, saddle, brakes and other equipment, even though this tie forecloses rival equipment manufacturers’ access to Peugeot bicycles. Similarly, a three-star restaurant chef and her customers both benefit from the customers’ inability to select among the pastries of all top pastry shops in the region.”³⁹ Also, there are other added benefits, for example, if there is existence of specialized labour, it would result in increased efficiency in production and distribution of combined goods. Marketing and distribution costs may also be reduced when various products or services are combined. The software industry provides an example of these types of savings.⁴⁰

What is also relevant to be considered here is the “Cournot effect.”⁴¹ Cournot considered the case of a monopoly seller of good 1 and a different monopoly seller of good 2 where the two goods are used together by the customer. Cournot used as an example the case of copper and zinc that are combined to make brass. His insight was that two monopolists, acting independently, will set an inefficiently high price. Were they to merge or coordinate their pricing, they would lower their prices and earn more money. The simple intuition is that the lower price of good 1 stimulates sales of good 2 (and vice versa) and this effect is not considered when goods 1 and 2 are sold independently. Hence, it would be possible for the merging firms to make more money.

The reason why, in the researcher’s opinion, this argument was put forth by the Chicago School was to consider that in this case, as mentioned above as an example of the “Cournot effect”, the prices would fall, so that the consumers would also be better off. Hence, the merger is a Pareto improvement. The “Cournot effect” is known as the horizontal equivalent to the “double marginalisation” problem in the analysis of vertical integration, where a monopoly provider of two goods at different levels of supply will maximize its profits across the two goods, while separate providers will price each good at

37 There are economies of scale when unit costs of production fall with the total quantity produced.

38 There are economies of scope when unit costs of production fall because two or more goods are produced jointly.

39 J. Tirole, “The Analysis of Tying Cases: A Primer”, 1 *Competition Policy International*, Spring 2005.

40 S. J. Davis, K. M. Murphy & J. MacCrisken, “Economic Perspectives on Software Design: PC Operating Systems and Platforms”, in David S. Evans (ed.), “Microsoft, Antitrust and the New Economy” (2002) at p. 361.

41 A Cournot, “Recherches sur les Principes Mathématiques de la Théorie des Richesses”, (1838).

the individual profit maximizing price.⁴²

However, there are two assumptions behind the “Cournot effect.” The first is that the basic Cournot model does not consider the impact of the merger on any other firms in the market. The second unstated assumption is that the firms set a single price in the market to all customers.⁴³ Therefore, whether the “Cournot effect” is applicable depends on a case to case basis and there is no argument of its uniform applicability.

(b) The Single Monopoly Profit Theory: The main argument of the Chicago School is that a monopolist does not have an interest in monopolizing a second market since it can reap all the profits from the market in which it is already a monopolist. An analysis of the single monopoly profit theory can be done on the basis of the nature of goods, i.e. (1) Complementary goods, and (2) Unrelated goods, that are not complementary.

(1) Complementary goods: Where a monopolist ties complementary goods that are used in fixed proportion, the demand for the tying and the tied goods are interdependent; i.e. the demand of each good depends on the joint price for the combination of the two goods. The imposition of a tie-in under these circumstances determines the identity of the seller but the amount of the tied product actually sold will not differ from the amount that could be sold if the optimum price for the tying product were set. In such a case, the monopolist has no economic incentive to monopolize the tied market because he can extract all monopoly profit through the price of the tying product. Another monopoly is not created and leverage does not take place. The seller establishes only a new method of exercising its already existing monopoly power.⁴⁴

As a matter of fact, rather than attempting to monopolize the tying market, the monopolist has a greater economic interest in the tied market being competitive and supplied by efficient competitors. The rationale is that the increase in demand for the tied good increases the demand for the tying product. Thus, leveraging or tying or bundling of complementary goods in an unattractive strategy.

42 J. Tirole, “The Theory of Industrial Organization”, (1988), at p. 333.

43 Barry Nalebuff, “Bundling: GE-Honeywell (2001)”, Case 16 in John E. Kwoka, Jr. and Lawrence J. White (eds.), “The Antitrust Revolution: Economics, Competition, and Policy”, 4th ed., 2004, at p. 393.

44 Ward S. Bowman, “Tying Arrangements and the Leverage Problem,” 67 Yale L.J. 19, 23–24 (1957).

Richard Posner illustrated this result with a simple example: “Let a purchaser of data processing be willing to pay up to \$1 per unit of computation, requiring the use of one second of machine time and ten punch cards, each of which costs 1 cent to produce. The computer monopolist can rent the computer for 90 cents a second and allow the user to buy cards in the open market for 1 cent a card or, if tying is permitted, he can require the user to buy cards from him at 10 cents a card; but in that case he must reduce his machine rental charge to nothing, so what has he gained?”⁴⁵

(2) Unrelated goods: the Chicago school theorists argued that even if the tied goods are not complementary and demand for one of them does not depend on the demand of the other one, tying is still unprofitable. If a good on a competitive market were tied to the good on a monopolistic market, customers would pay de facto a tax on the supply of the tying monopoly good. Unless customers are willing to purchase the tied good and provided it is offered at a competitive price, the demand for the monopoly product will shrink and the monopolist would lose.⁴⁶

Therefore, where demands for the two goods are independent (in other words the quantity demanded by consumers of one good is independent of the price of the other good), tying a competitively supplied good to a monopolistically supplied good is like establishing a tax on the latter, which has the possibility of reducing consumption of the monopoly good unless the monopolist prices the tied good competitively.

(iii) Post-Chicago theories: the post-Chicago theorists agree with the major assertions made by the Chicago scholars but find that model insufficiently general for it takes only a static perspective of the market and is concerned only with the short run profit maximization. By considering dynamic models and by focussing on the long term profit maximization, post-Chicago scholars demonstrate that leveraging can be used as a profitable strategy by monopolists. They also subscribe to the viewpoint that the Chicago theory depends, at least in its most extreme form, on the assumptions that the tied product

45 Richard A. Posner, “Antitrust Law: An Economic Perspective” (1976) at p. 173.

46 Ekaterina Rousseva, “Rethinking Exclusionary Abuse in EU Competition Law,” 1st ed., 2010, Chapter 6, “Tying and Bundling”, at p. 239.

and tying products are used in fixed ratios and that the tied product market is “perfectly” competitive. If a particular case does not fall within these assumptions, it may result in being anticompetitive.

Therefore, economists developed a number of models to try to understand the competitive implications of tying and bundling when the structure of the tied market is oligopolistic, rather than perfectly competitive. They showed that a firm enjoying monopoly power in the tying good might have an anti-competitive incentive to tie when the tied good market is imperfectly competitive if, in addition, tying keeps potential rivals out of the market for the tied product or, alternatively, helps the monopolist to preserve its market power in the tying product market.⁴⁷

Whinston’s Argument: Michael Whinston’s “Tying, Foreclosure, and Exclusion” is widely recognized as the seminal post-Chicago article on tying.⁴⁸ Whinston presents a series of models in which he first makes assumptions in which tying does not increase profits and then alters the assumptions slightly so that they do. His argument was that leveraging a monopoly position in the tying market onto an adjacent (tied) market may be privately profitable when the tied market is subject to economies of scale and, therefore, it is imperfectly competitive, and leveraging successfully induces the exit (or deters the entry) of competitors in the tied market.

His article shows that an undertaking that has monopoly power in both the tying and the tied markets may use tying in order to deter entry of potential competitors with a superior product in the tied market. According to his model, a monopolist may be successful in discouraging entry if competing in the market for the tied good requires economies of scale. Through the tying practice, the monopolist may deny the economies of scale necessary for the entrant.

It is imperative to consider the fact that the above mentioned exclusionary effects of this mechanism take place as long as the bundle has commitment value that is if the

47 Ch. Ahlborn, D. Bailey and H. Crossley, “An Antitrust Analysis of Tying: Position Paper”, GCLC Research papers on Article 82 EC - July 2005, at p. 174.

48 Michael D. Whinston, “Tying, Foreclosure, and Exclusion,” 80 AM. ECON. REV. 837 (1990).

incumbent can irreversibly commit to selling the two products together, for example, either by product design or by technological processes. If there is lack of commitment value, exclusion does not occur; as the rival knows that, if it entered or stayed in the market, the incumbent would reverse its bundling decision, as it also earns lower profits when both firms are active.⁴⁹ Also, in this model, tying does not have by assumption, any efficiency role. Therefore, an efficiency defence should be allowed to the incumbent monopolist that allegedly used tying to exclude competitors.

Complementary goods: Where products are perfectly complementary, the outcome is the same, irrespective of whether bundling occurs or not. This is because in a perfectly complementary market, the Chicago theory regarding the Single Monopoly Profit holds.⁵⁰ Although, Whinston finds two specific examples where an incumbent profitable uses tying to exclude competitors in a complementary market; one where product A is not essential, the other where an inferior alternative to product A exists.⁵¹ Overall, however, complementarity makes it less likely (albeit not impossible) that an incumbent will use tying for exclusionary purposes.⁵²

Another complementary products model was put forth by Choi and Stefanadis,⁵³ where they argued that an incumbent firm is monopolizing both components, and faces an entrant in each market. Each potential entrant can enter the market for one component if it has a successful innovation. However, innovation is risky as it involves a fixed initial investment. So, in this context, if the incumbent commits to bundling, entry in one component market is possible only if both innovations are simultaneously successful. Therefore, bundling reduces the incentives to invest and consequently it will be less likely that innovations will appear, and that entrants will oust the incumbent.⁵⁴ Anticipating that incumbent firms will bundle in the future, competitors would not invest in cost reducing innovation for one of the components which they sell because the bundling would prevent

49 As Bundling implies more aggressive competition, and this destroys profits if both firms are in the market.

50 Kuhn et al., "Economic theories of bundling and their policy implications in abuse cases: an assessment in light of the Microsoft case," *European Competition Journal*, (2005), 1(1), at pp. 85-121, at p. 95.

51 In the example where there exists two products, A and B in a complementary product market.

52 Massimo Motta, "Competition Policy: Theory and Practice", 1st ed., 2004, 10th rep., 2008, at p. 465.

53 JP Choi and C Stefanadis, "Tying, Investment and the Dynamic Leverage Theory", (2001) 32 *RAND Journal of Economics* 52.

54 Farrell and Katz, "Innovation, rent extraction, and integration in systems markets," (2000) *Journal of Industrial Economics*. Vol. 48, at pp. 413-432.

them from recovering the cost of innovation. This model does show that the incentives for innovations are reduced if an incumbent can commit to future bundling and competitors reduce their investment in research and development.

Defensive Leveraging: Carlton and Waldman⁵⁵ first considered sellers of systems of two components, a primary good and a complementary good. The primary good can be used by itself, while the complementary good can be used only in conjunction with the primary good. One firm is initially a monopolist in both. A firm with a superior complementary good has the opportunity to enter. It cannot enter the market for the primary good at the same time, but it has the prospect of doing so at some point down the line. This possibility of the entrant also producing the primary good serves the same role in the Carlton-Waldman analysis as the potential entrant in the tying good in Whinston's complementary goods model.⁵⁶ Without that possibility, the monopolist would benefit from entry by a superior complementary product.⁵⁷ The key insight of this dynamic model is that foreclosure today in the tied market for a complementary product may protect the monopoly in the tying market later on.⁵⁸

Carlton and Waldman showed that tying the complementary good to the monopoly product gives the monopolist a head start in the race to become the standard in the market for the complementary good market. This incentive exists because the incumbent sees its monopoly position in the primary good market subject to the threat of entry. Otherwise, it would prefer to have competition in the complementary good market, so as to ensure the adoption of the best standard and to appropriate the rents generated by that standard via a higher price in the primary product market.

Notwithstanding its conceptual simplicity, the validity of the theory developed by Carlton and Waldman relies on a number of strong assumptions that do not always fit well with the facts of each case. First, Carlton and Waldman's theory requires that entry into the

55 D. Carlton and M. Waldman, "The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries", (2002) 33 *Rand J. Econ.* 194.

56 Massimo Motta, "Competition Policy: Theory and Practice", 1st ed., 2004, 10th rep., 2008, at p. 465.

57 K.N. Hylton and M. Salinger, "Tying Law and Policy: A Decision-Theoretic Approach," 69 *Antitrust Law Journal* No. 2 (2001) at p. 494.

58 Ariel Ezrachi, "Article 82 EC: Reflections on its Recent Evolution", Studies of the Oxford Institute of European and Comparative Law, (2009).

tied market is very costly. Otherwise, the strategy of foreclosure could be defeated by simultaneous entry into two complementary markets. Second, their theory does not fare well when the product sold in the monopoly market has a life of its own (i.e. when some consumers have a demand for the monopoly good only). In this case the profitability of entry in the monopoly market is much less affected by the monopolization of its complementary market.⁵⁹

Although the post-Chicago theories challenge the general validity of the single monopoly profit theory of the Chicago School, they do not advocate a return to the classical approach to tying. Proponents of post-Chicago theories recognize the fact that tying is frequently efficiency enhancing in a wide range of circumstances and suggest “a very cautious approach in antitrust cases involving tie-in sales, even in cases where harm is theoretically possible.”⁶⁰

A great deal of post-Chicago literature focuses on the role of customer’s information problem and the seller’s ability to exploit this lack of information through tying.⁶¹ If consumers were perfectly informed about the best combination of goods, leverage of monopoly power from one to another market would be difficult. Lack of information on the part of consumers about the quality of the tied products, the life cycle of the tying good and the consumer’s natural preference for a package from the same brand when it comes to complementary goods, may confer significant power on a single producer. Tying a new product to an old one might be even easier since consumers would not have experience to judge the benefits or the disadvantages of the package sale.⁶²

3. The Law

Apart from considering the economic rationale behind the concepts of Tying and Bundling, it is necessary to understand the legal provisions concerning these concepts, and

59 Ch. Ahlborn, D. Bailey and H. Crossley, “An Antitrust Analysis of Tying: Position Paper”, GCLC Research papers on Article 82 EC - July 2005, at p. 176.

60 D. Carlton and M. Waldman, “How can Economics Improve Antitrust Doctrine towards Tie-in Sales: Comment on Jean Tirole’s “The Analysis of Tying: A Primer””, 1 *Competition Policy International* (2005).

61 Ekaterina Rousseva, “Rethinking Exclusionary Abuse in EU Competition Law,” 1st ed., 2010, Chapter 6, “Tying and Bundling”, at p. 242.

62 Prof. Barry Nalebuff (Yale University), “Bundling, Tying and Portfolio Effects”, DTI Economics Paper No. 1, Part 1, February 2003; R Craswell, “Tying Requirements in Competitive Markets: The Consumer Protection Issue”, 62 *Boston University Law Review* 661.

to understand how Law and Economic theories function together, in order to maintain a competitive environment amongst the various players in the market. This section seeks to discuss the legal provisions and Competition (Antitrust, in USA) regimes in the USA and EU. A distinction is also sought to be made between the two regimes.

3.1 USA Law on Tying and Bundling

Section 1 of the Sherman Act, 1890⁶³ and Section 3 of the Clayton Act, 1914⁶⁴ deal with the concepts of Tying and Bundling. A tying agreement is subject to both these provisions and although the wording in the two sections differs, both of them apply a similar substantive standard. Section 1 of the Sherman Act prohibits “every” agreement in “restraint of trade”, depending upon the “unreasonableness” of such a restraint. Section 3 of the Clayton Act forbids tying agreements when “the effect....may be to substantially lessen competition or tend to create a monopoly.” From a bare perusal of the two sections, it does not appear that the two Acts set a different standard for judging as to whether a particular transaction is anti-competitive or not.

Areeda and Hovenkamp⁶⁵ have also opined on this issue and have related the applicability and enforceability of the two Acts to an issue of Antitrust Policy, which is independent of the verbal formulations in each statute. Therefore, they have stated that the two statutes must judge the anti- or pro-competitiveness of tying in the same way, unless some other aspects of the two statutes dictate otherwise. To prove so, they considered three unpersuasive arguments for treating tie-ins harshly under the Sherman Act, as distinct from

63 Section 1 of the Sherman Act, 1890 reads as: “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.”

64 Section 3 of the Clayton Act, 1914 reads as: “It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.”

65 Phillip E. Areeda and H. Hovenkamp, “Antitrust Law: An Analysis of Antitrust Principles and their Application,” Vol. IX, 2nd ed., 2004, at p. 216, ¶ 1719.

the Clayton Act; (1) that the Sherman Act provides for criminal sanctions, which the Clayton Act does not, (2) The Congress would not have enacted the Clayton Act, unless it prohibited more than the Sherman Act, and (3) Various technical limitations on Clayton Act coverage would be defeated when the Sherman Act, which is not so limited, prohibits as much as the Clayton Act. These three arguments, however, were rejected by Areeda and Hovenkamp as being devoid of any merit whatsoever to affirm that there exists a single standard under both the statutes in American Law, for judging anti- or pro-competitiveness of a tying transaction.

While this was the position appearing from the bare text of the statutes and as per juristic opinion, the Courts have differed, slightly, in their approach in pointing out the differences between the two statutes and the standards applied therein. One point of difference that was pointed out was that while the Clayton Act requires only showing that the challenged conduct “may tend” to substantially lessen competition, the Sherman Act requires proof of an *actual effect* on competition.⁶⁶ Also, the Clayton Act’s coverage is more limited than the Sherman Act, since the Clayton Act applies only when both the tying and the tied products are tangible goods and commodities, rather than real estate or intangibles such as franchises or services.⁶⁷ Apart from these slight differences, it was maintained that the analysis applied under the Clayton Act to tying arrangements is very much like the analysis typically used under Section 1 of the Sherman Act.⁶⁸

3.1.1 The Per Se Rule

Tying arrangements traditionally have been analyzed under the *per se* rule of antitrust analysis because they have been viewed as serving little purpose other than the restriction of competition.⁶⁹ The first case to state the legal standard under Section 3 of the

66 *Twin City Sportservice, Inc. v. Chas. O. Finley & Co.*, 512 F.2d 1264 (9th Cir. 1975), *reaff'd*, 676 F.2d 1291 (9th Cir.), *cert. denied*, 459 U.S. 1009 (1982).

67 *Hodge v. Villages of Homestead Homeowners Ass'n, Inc.*, 726 F. Supp. 297 (S.D. Fla. 1989); *Webb v. Primo's, Inc.*, 706 F. Supp. 863 (N.D. Ga. 1988).

68 *Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 496 n.42 (3d Cir.), *cert. denied*, 506 U.S. 868 (1992); *Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F.2d 1342 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988).

69 *U.S. Steel Corp. v. Fortner Enterprises*, 394 U.S. 495, 503 (1969) (“*Fortner I*”)

Clayton Act was *International Salt Co. v. United States*⁷⁰ International Salt tied the purchase of salt to the lease of two patented machines, the Lixator and the Saltomat. The issue was whether the tying provisions violated the two statutory provisions, i.e. Section 1 of the Clayton Act and Section 3 of the Sherman Act and the Court held that they did.

It was found that International Salt had monopoly power in the markets for the tying products because they were patented. It was also found by the Court that a not insubstantial amount of business was foreclosed in the market as a result of the tying arrangement. The court held that this was all that was required to find liability. The per se rule operated from this point as it was “unreasonable, per se, to foreclose competitors from any substantial market.” Although International Salt was far from obtaining monopoly power in the market for salt, the Court held this irrelevant because the Clayton Act forbids agreements that *tend to create a monopoly* and “it is immaterial that the tendency is a creeping one rather than one that proceeds at full gallop.”⁷¹

The next case that sought to address various unanswered questions after the *International Salt* case and other preceding cases, was *Northern Pacific Railway Co. v. United States*.⁷² In this case, the defendant railroad had inserted clauses into contracts to sell and to lease land located near its rail lines that required purchasers and lessees of land to ship goods produced on land over Northern Pacific’s rails, provided that Northern Pacific’s rates were not above those of competing carriers. Because the tying product was land, which was not a “commodity”, Section 3 of the Clayton Act did not apply. The issue then was as to whether the preferential routing contracts violated section 1 of the Sherman Act, and the Court held that they did.

The Court declared that the rule in *International Salt* is a per se rule that applies 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.*⁷³ In this case, the facts “established beyond any genuine question that the defendant possessed substantial

⁷⁰ *International Salt Co. v. United States*, 332 U.S. 392 (1947).

⁷¹ *Ibid.*, at ¶ 396.

⁷² *Northern Pacific Railway Co. v. United States*, 356 U.S. 1 (1958).

⁷³ *Ibid.*, at ¶ 6.

economic power by virtue of its extensive land holdings.”⁷⁴ Also, a not insubstantial amount of interstate commerce had been affected. The market power component of the test of Northern Pacific is more lenient than that suggest by International Salt. International Salt was found to have monopoly power in the tying product market, while there was no such finding in Northern Pacific. The court said that monopoly power is not a requirement for application of the per se rule, all that is required is “sufficient economic power to impose an appreciable restraint” on competition in the tied market.⁷⁵

The Goodwill Defense: The argument that tying is a means of protecting a manufacturer’s reputation (basically, goodwill) appears in many of the cases, including the IBM case⁷⁶ and International Salt, wherein it was rejected. However, in *United States v. Jerrold Electronic Corp.*,⁷⁷ the court relied on the Northern Pacific standard and carved out an exception for goodwill cases as a defense.

Jerrold sold antenna systems with the requirement that the purchaser let Jerrold and only Jerrold install and service the system. Many of its contracts provided for the exclusive use Jerrold equipment whenever extra capacity was needed, and forbade installation of extra equipment without Jerrold’s approval. Jerrold sold a majority of new antenna systems from 1950 to mid-1954, and was the leader in sales of community television antenna systems. The government claimed that this violated Section 1 of the Sherman Act and parts of this violated Section 3 of the Clayton Act. The Court said that even though the instant case satisfied the Northern Railways criteria, however, in view of the “unique circumstances” and the fact that it could examine the industry in historical detail easily, the Court considered the reasonableness justification of the defendant and ruled in Jerrold’s favour. Hence, this is how a goodwill defense was carved out as an exception to the per se rule.

3.1.2 Modified Per Se Rule

The hostile approach towards tying displayed in *Northern Pacific* and other cases

74 Id., at ¶ 7.

75 Id., at ¶ 10.

76 IBM v. United States, 298 U.S. 131 (1936).

77 *United States v. Jerrold Electronic Corp.*, 187 F. Supp 545 (E.D. Pa. 1960), aff’d per curiam, 365 U.S. 567 (1961).

was revised in *Jefferson Parish*,⁷⁸ in which the Supreme Court accepted that there might be circumstances in which tying might be beneficial to consumers. The case concerned the tying of hospital and anesthesiological services. Specifically, East Jefferson Hospital had entered into an agreement with a professional medical corporation, Roux & Associates, to provide the hospital with all of its anesthesiological services. It therefore rejected an application for admission to the medical staff from another anesthesiological, who proceeded to seek an injunction to compel his admission.

In this case, the court held that “Not every refusal to sell two products separately can be said to restrain competition. If each of the products may be purchased separately in a competitive market, one seller’s decision to sell the two in a single package imposes no unreasonable restraint on either market, particularly if competing suppliers are free to sell either the entire package or its several parts. Buyers often find package sales attractive; a seller’s decision to offer such packages can merely be an attempt to compete effectively, a conduct that is entirely consistent.”⁷⁹

The majority’s reference in *Jefferson Parish* to “certain tying arrangements” being unreasonable *per se* refers to situations in which the following four elements are satisfied: “(1) The seller conditions its sale of the tying product on the buyer’s purchase of the tied product; (2) The tying and tied products are separate and distinct products; (3) The seller possesses sufficient economic power or market power in the market for the tying product to enable it to appreciably restrain competition in the market for the tied product; and (4) A “not insubstantial” amount of interstate commerce in the tied product is foreclosed by the tying arrangement.”⁸⁰

The Court moved away from a strict *per se* test in two respects. First, in determining whether the two-product test was met, it focused on whether there was a separate demand for the tied product rather than on the functional relationship between the two products, which had been the approach in earlier cases. Second, the Court emphasized that the economic power required over the tying product was market power and not some

78 *Jefferson Parish Hospital Dist. No. 2 et al. v. Hyde*, 466 U.S. 2 (1984).

79 *Ibid.*, at ¶ 19.

80 *Id.*, at ¶ 9.

vague notion of economic power. This insistence on proof of market power over the tying product meant that market power could no longer be inferred simply from the existence of a tie.⁸¹

The Supreme Court therefore focused on adapting the definitional criteria of tying (namely the question of whether the products involved were “separate” and the concept of sufficient economic power) in an effort to exclude cases that were not likely to result in anti-competitive effects.⁸² Ultimately the court held that a market share of 30% was not sufficient to constitute the requisite market power. It was not therefore necessary to conduct an assessment of the individual tying arrangements in the actual circumstances of the case.⁸³ Therefore, this was the slight departure from the traditional per se illegality rule and came to be known as the modified per se rule. The Supreme Court’s approach to the test for “tying” two products in *Jefferson Parish* has been reaffirmed by the Court in *Eastman Kodak*,⁸⁴ except that on facts and as per the final judgment, *Eastman Kodak* has been criticized of being slightly more restrictive than *Jefferson Parish*.

3.1.3 The Rule of Reason Approach

The Rule of Reason co-exists with a per se rule in two senses. First, though often unacknowledged, reasonability sometimes enters through the backdoor and dissuades a Court from classifying the restraint before it as a “tie-in” in the first place. Some courts have declined to find two products tied together when the challenged arrangement seems reasonable, either because it served legitimate functions or because threats to competition seemed fanciful. Most frequently, the courts have ended up classifying a practice as exclusive dealing rather than tying, with the result that it is made subject to the rule of reason.⁸⁵ Second, the per se rule do not exhaust the concerns of antitrust law. A refusal to condemn a particular restraint per se does not necessarily mean that antitrust law is indifferent to that restraint or affirmatively approves it, the rule of reason remains

81 David W. Hull, “Tying: A transatlantic perspective”, Chapter 9 in Philip Marsden (ed.), “Handbook of Research in Trans-Atlantic Antitrust”, (2006), at p. 291.

82 Ch. Ahlborn, D. Bailey and H. Crossley, “An Antitrust Analysis of Tying: Position Paper”, GCLC Research papers on Article 82 EC - July 2005, at p. 180.

83 *Jefferson Parish Hospital Dist. No. 2 et al. v. Hyde*, 466 U.S. 2 (1984).

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

85 Phillip E. Areeda and H. Hovenkamp, “Antitrust Law: An Analysis of Antitrust Principles and their Application,” Vol. IX, 2nd ed., 2004, at p. 316, ¶ 1727.

applicable.

Tying arrangements that do not meet all of the elements of a per se tying claim may still be held unlawful as unreasonable restraints of trade under a rule of reason analysis. Unlike a per se analysis, where the focus of the inquiry is on the tying product, a rule of reason inquiry looks at the competitive effect of the arrangement in the relevant market for the tied product.⁸⁶ However, it is unlikely that a tying arrangement that passes muster under the strict per se standard will be found to violate the less rigorous rule of reason test.⁸⁷

Although *Jefferson Parish* still represents the general position in the U.S. with respect to tying, the Court of Appeals' judgment in *Microsoft III*⁸⁸ indicates a preference, in some circumstances at least, for a rule of reason approach, noting the Supreme Court's warning in *Broadcast Music v. CBS*⁸⁹ that "it is only after considerable experience with certain business relationships that courts classify them as *per se* violations."⁹⁰

In *Microsoft III*, the Court of Appeals concluded that a per se rule was inappropriate, due to the fact that the circumstances in *Microsoft III* differed from previous cases, and that the "separate products" approach used in *Jefferson Parish* was not a suitable approach given that it was backward looking. The case was therefore referred back to the District Court with a direction to conduct a rule of reason analysis which balanced the anti-competitive effects and efficiencies.

3.2 US v. MICROSOFT⁹¹

86 *Jefferson Parish*, 466 U.S. at 18, 29; *Fortner I*, 394 U.S. at 499-500; *Breaux Brothers Farms, Inc. v. Teche Sugar Co.*, 21 F.3d 83, 88-89 (5th Cir. 1994); *Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 484-85 (3d Cir.) (en banc), cert. denied, 506 U.S. 868 (1992); *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d at 799; *Parts & Electric Motors, Inc. v. Sterling Electric, Inc.*, 826 F.2d 712, 721 (7th Cir. 1987), appeal dismissed after remand, 866 F.2d 228 (7th Cir. 1988), cert. denied, 493 U.S. 847 (1989); *Barber & Ross Co. v. Lifetime Doors, Inc.*, 810 F.2d 1276, 1280 (4th Cir.), cert. denied, 484 U.S. 823 (1987); *Carl Sandburg Village Condominium Association v. First Condominium Development Co.*, 758 F.2d 203, 210 (7th Cir. 1985); *Martino v. McDonald's System*, 625 F. Supp. 356, 362-63 (N.D. Ill. 1985); *Casey v. Diet Center*, 590 F. Supp. 1561, 1570 (N.D. Cal. 1984).

87 *Digital Equipment Corp. v. Uniq Digital Technologies, Inc.*, 73 F.3d 756 (7th Cir. 1996) ("substantial market power is an indispensable ingredient of every claim under the rule of reason").

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

89 *Broadcast Music, Inc. et al. v. Columbia Broadcasting System, Inc. et al.*, 441 U.S. 1 (1979).

90 *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) at 124 quoting *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 607-08 (1972).

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

This is one of the most celebrated cases in today's Antitrust policy and involves a number of interesting aspects of competition policy. However, only the tying and bundling aspects of the case have been discussed in detail, and a mere mention has been made to the other issues, keeping in mind the scope of study in the instant research work. Also, the judgment of the Court of Appeal has been stressed upon as it reflects a shift from the per se rule (which has already been discussed in detail) to a rule of reason approach, which is also what makes this case so important in today's Antitrust Jurisprudence.

Factual Background: In 1998, the Department of Justice in the USA and a group of states filed separate complaints, later combined, alleging antitrust violations by Microsoft. The allegations related to the effect of a tying arrangement by Microsoft, whereby its Internet browser, Internet Explorer (IE), was tied to its Operating System (OS), which has deleterious effects on competition amongst other players in the browser market, especially Netscape Navigator.

In April 2000, the District Court found Microsoft liable for breach of Antitrust Laws on the following grounds: (1) Maintenance of monopolization in the market of Intel-compatible operating systems for personal computers (PC), windows OS belonging to this category (an infringement of section 2 of the Sherman Act); (2) Attempted monopolization of the Internet Explorer market; and (3) tying its Windows OS with IE, which was a violation of section 1 of the Sherman Act.

The Court of Appeals (CA) passed its judgment in June, 2001 and ruled the following: (1) Microsoft was guilty of maintenance of monopolization for some of the business practices it had adopted (but on other, CA reversed the ruling of the District Court); (2) Microsoft was not guilty of attempted monopolization; and (3) It was stated that tying allegations should be analyzed under a Rule of Reason, rather than a per se rule, and therefore, remanded the case to the District Court for reconsideration in the context of the Rule of Reason approach.

Assessment of Relevant Market: The District Court defined the market as that of all *Intel-compatible PC OS world-wide*. Microsoft, on the other hand, claimed that the product

market definition should be wider, and should also include the following: (i) non-Intel compatible OS (mainly, Mac OS); (ii) OS for non-PC devices (hand-held computers and portal websites); and (iii) “middleware” products which are not OS.

The CA accepted the definition of the District Court and excluded the kind of products mentioned by Microsoft for the following reasons⁹²: (1) If there was a substantial price increase of Windows, consumers would not switch to Mac OS, because of the cost of acquiring new hardware and compatible software applications, and because of the effort needed to learn the new system and transfer all data in that format; (2) Hand-held devices do not perform all the functions of a PC, and are perceived by customers as a supplement rather than a substitute for their PC; and (3) Although potentially, middleware could take over the OS’ platform function, this is a lengthy process. Hence, the definition of relevant market remained the same, as defined by the District Court, i.e. that of all “*Intel-compatible PC OS world-wide.*”

Market Power: The CA also affirmed the District Court’s ruling that there exists market power, as enjoyed by Microsoft because of two reasons, first, that Microsoft enjoys extremely high market shares, which are suggestive of dominance; and second, the fact that there exists, significant barriers to entry. Also, Microsoft was found to have monopoly power in the relevant market.⁹³

Wrongful Conduct: there are two constituents of monopolization, one is the existence of monopoly power and the second is the method of acquisition of that monopoly power, which should also be anti-competitive and not “as a consequence of a superior product, business acumen or historic accident.” The CA put forth a principle which should be used to assess the alleged anti competitive effects of Microsoft’s actions. First, for a conduct to be exclusionary it must have an anti-competitive effect, i.e. it must harm both the competitive process and the consumers. Second, the burden of proof rests on the plaintiff to prove the anti-competitive effects. Also, the plaintiff must show that the anti-competitive harm outweighs the pro-competitive benefits.⁹⁴

92 Massimo Motta, “Competition Policy: Theory and Practice”, 1st ed., 2004, 10th rep., 2008, at p. 514.

93 US v. Microsoft, at ¶¶ 20-23.

94 US v. Microsoft, at ¶¶ 26-28.

CA on the Law of Tying: The CA considered the *Jefferson Parish* and the *Eastman Kodak* cases to state the four elements of a per se tying violation: “(1) the tying and tied goods are two separate products; (2) the defendant has market power in the tying product market; (3) the defendant affords consumers no choice but to purchase the tied product from it; and (4) the tying arrangement forecloses a substantial volume of commerce.”⁹⁵

The CA’s ruling departs from *Jefferson Parish* only insofar as it focuses the “separate product” inquiry on whether there is some “technological value to integration” that improves it in certain ways than leaving the customer to combine the separate products on his own. Ultimately, the Court of Appeals did not take any view on the validity of the efficiency claims. However, it took the view that “judicial ‘experience’ provides little basis for believing that, ‘because of their pernicious effect on competition and lack of any redeeming virtue’ a software firm’s decisions to sell multiple functionalities as a package should be ‘conclusively’ presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm that they have caused or the business excuse for their use.”⁹⁶ In other words, the conclusion of the ruling is that the existing four point test for the application of the per se rule is inadequate in this case, because it fails to consider the innovative component of tying of IE with Windows, and the possible welfare advantages deriving from a close integration of these two products.⁹⁷

The Court of Appeals also recognised that the *per se* rule’s “direct consumer demand and direct industry custom inquiries are, as a general matter, backward looking and therefore systematically poor proxies for overall efficiencies in the presence of new and innovative integration”. It therefore concluded that there was merit to Microsoft’s broader argument that *Jefferson Parish*’s consumer demand test would “chill innovation to the detriment of consumers by preventing firms from integrating into their products new functionality previously provided by standalone products — and hence, by definition, subject to separate consumer demand.”⁹⁸

95 *Ibid.*, at ¶ 70.

96 *Id.*, ¶¶ 70-85. Also, Ch. Ahlborn, D. Bailey and H. Crossley, “An Antitrust Analysis of Tying: Position Paper”, GCLC Research papers on Article 82 EC - July 2005, at p. 184.

97 Massimo Motta, “Competition Policy: Theory and Practice”, 1st ed., 2004, 10th rep., 2008, at p. 521.

98 *US v. Microsoft*, at ¶ 83.

Remanded to District Court and its new Judgment: The District Court, in the remanded case,⁹⁹ adopted a number of remedies that aim at prying open competition in the Intel compatible OS market. The main remedies were¹⁰⁰: (1) provide original equipments managers (OEM's) with the flexibility of deciding their configuration of Windows OS, for instance, by lifting illegal license restrictions related to non-Microsoft middleware or services provided by Internet Access Providers (IAP's); (2) require Microsoft to alter its Windows technology to ensure that OEMs and end users may disable various functions of windows; (3) protect OEMs from possible retaliation, by introducing some uniformity in the licenses for Windows; and (4) include various provisions avoiding that Microsoft could restrict diffusion of middleware through IAP's. The court also adopted some compliance and enforcement provisions to ensure that the remedies will be properly implemented.

It can therefore be concluded that, while there is no universal standard for the treatment of technological integration cases, like the US v. Microsoft case, courts have clearly been willing to approach these types of cases from a *per se* legality standpoint as opposed to applying the *per se* illegality approach taken towards classical ties, as is evident from the judgment of the CA in the instant case, and the attempted remedies by the District Court in the case remanded to it, in its attempt to adopt an “explicitly forward looking approach.”

3.3 EU Law on Tying and Bundling

In the EU, tying is given as an example of an abuse of dominance. Article 82(d) of the EC Treaty lists Tying as an example of abuse of dominance as: “*making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.*” In EU Law also, the Microsoft case has played an essential role in shaping the law of Tying and Bundling in terms of the fact of adding another condition to the requirements of proving existence of anticompetitive effects of a tie or bundle.

99 *State of New York et al. v. Microsoft Corp.*

100 Massimo Motta, “Competition Policy: Theory and Practice”, 1st ed., 2004, 10th rep., 2008, at p. 523.

3.3.1 The Per Se Approach

Prior to the *Microsoft* decision, the Commission and the European Courts have consistently applied a *per se* prohibition approach, without considering whether a particular tying practice is in fact harmful or beneficial to consumers. The European institutions tended to be doctrinaire in their approach, appearing to assess tying arrangements by reference to their form rather than their effects: the tendency is to say a tying has this form; therefore it is exclusionary – even if there is manifest evidence that that is not the case.¹⁰¹ Although in *Microsoft* the Commission acknowledged that the circumstances at hand required it to engage in a more detailed examination of the likely effects of the practice at issue, it is at this stage still unclear whether it is the Commission’s intention to limit this approach to specific circumstances, and what the legal basis for such a test actually is.

Under the *per se* approach, to establish an illegal tie, it sufficed to show the following¹⁰²: (1) dominance in the tying product market, (2) the existence of two separate products, (3) that the customer was coerced into purchasing the products together, and (4) As in any Article 82 case, the possibility of objective justifications for the practice was also examined, though these were typically given short shrift.

(1) Dominant Position: On a bare perusal of Article 82, it can be said that an infringement would only take place if there exists, a dominant position, and that too, in the tying market. However, this is not really a requirement in the tied market. DG COMP’s *Discussion paper* suggests, uncontroversially, that a finding of abuse would be more likely where the dominant undertaking is dominant in both markets.¹⁰³

(2) Two Distinct/Separate Products: The two leading cases, *Hilti*¹⁰⁴ and *Tetra Pak(II)*,¹⁰⁵ both dealt with relatively ‘easy’ tying cases involving consumables. Both of these cases were ‘easy’ in the sense that the tying and tied products were physically

101 E. Rousseva, “Modernizing by Eradicating: How the Commission’s new Approach to Article 81 EC Dispenses with the Need to Apply Article 82 EC to Vertical Restraints”, (2005) 42 *C.M.L.R.* 587.

102 Richard Whish, “Competition Law”, Chapter 17, “Abuse of Dominance (I): Non-Pricing Practices”, 6th ed., 2008, at p. 682.

103 *Discussion Paper*, ¶ 184.

104 Commission decision of 22 December 1987, *Eurofix-Bauco v Hilti*, (1988) OJ L 65/19.

105 Commission decision of 24 July 1991, *Tetra Pak II*, (1992) O.J. L72/1.

separate products that were not only intuitively distinct, but with respect to which it was easy to show a separate demand in the market. Thus, in both cases, the European Commission and the European Courts had no trouble rejecting arguments to the effect that the tying and tied product formed a single product.¹⁰⁶ In *Hilti*, the Commission found that Hilti abused its dominant position by selling the customer cartridge strips for its nail guns only if the customer also bought its nails from it. Also, evidence that cartridge strips and nails were manufactured and sold separately by third parties was used to reject the argument that the nail guns, cartridge strips and nails formed a single powder-actuated fastening system.

In *Tetra Pak (II)*, the Commission found that Tetra Pak had abused its dominant position by conditioning the sale of its packaging machines on the customer's agreement to purchase the cartons used in the machines only from them. Here, the fact that machines and cartons were sold separately in a closely-related market involving non-aseptic packaging machines (as opposed to the aseptic packaging machines at issue in the case) was used to reject the argument that machines and cartons formed an integrated packaging system.¹⁰⁷

(3) Coercion: The European Commission has often criticized a number of companies for failure to give customers a choice to obtain the tying product without the tied product.¹⁰⁸ In *Tetra Pak II*, the CFI stated that “the Court of Justice has in particular ruled that, where an undertaking in a dominant position directly or indirectly ties its customers by an exclusive supply obligation, that constitutes an abuse since it deprives the customer of the ability to choose his sources of supply and denies other producers access to the market.”¹⁰⁹ Hence, coercion is widely regarded as: “a crucial element of the abuse. Any company, even a dominant one, is free to sell two or more products together. The abuse will only occur when the customers of a dominant company are coerced to purchase two

106 Christian Ahlborn and David Bailey, “Discounts, rebates and selective pricing by dominant firms: a trans-Atlantic comparison,” Chapter 7 in “Handbook of Research in Trans-Atlantic Antitrust”, Philip Marsden (ed.), at p. 294.

107 Ibid.

108 *The Community v International Business Machines Corporation*, EC Commission Notice of 1 August 1984, [1984] 3 C.M.L.R. 147; Commission decision of 18 July 1988, *Napier Brown - British Sugar*, (1988) O.J. L284/41.

109 *Tetra Pak II*, ¶ 137.

products together against their will.”¹¹⁰

(4) Objective Justification: A dominant undertaking may be successfully able to argue that tying is objectively justified or enhances efficiency, and the burden of proof to do so would be on the dominant firm. In the guidelines on Abusive Exclusionary Conduct, the Commission noted that tying and bundling may give rise to an objective justification by producing savings in production, distribution and transaction costs.¹¹¹ In addition, the Article 82 Staff Discussion Paper noted that “combining two independent products into a new, single product may be an innovative way to market the product(s),”¹¹² and that such “combinations are more likely to be found to fulfill the conditions for an efficiency defence than is contractual tying or bundling.”¹¹³ The guidance on Abusive Exclusionary conduct, however, simply notes that the Commission may also examine whether combining two independent products into a new, single product might enhance the ability to bring such a product to the market to the benefit of customers.

In *Hilti*¹¹⁴, the dominant undertaking sought to justify its tie on the ground that using only Hilti-brand nails with its nail guns and cartridge strips was consistent with public safety, and provided various statements claiming that third party consumables were unsafe. The Court of First Instance (CFI) rejected this argument, noting that Hilti did not approach the competent authorities in the UK to express its safety concerns.

3.3.2 MICROSOFT v. COMMISSION¹¹⁵: Introduction of a Restrictive Rule of Reason Approach

The most important novelty in the analysis carried out by the Commission and affirmed by the CFI is the establishment of the “Foreclosure Effect” as the fifth condition for testing the existence of a tying arrangement.¹¹⁶ In recital 841 of its decision the Commission recognised that, *“There are indeed circumstances relating to the tying of WMP*

110 J. Faull and A. Nikpay, “The EC Law of Competition,” (1999), at ¶ 3.202.

111 Guidance on Abusive Exclusionary Conduct, at ¶ 61.

112 Article 82 Staff Discussion Paper, Point 205.

113 Ibid.

114 *Hilti v. Commission (II) (CFI)* [1991] ECR II-1439, at ¶ 118.

115 *Microsoft v. Commission*, Case T-201/04, [2007] ECR II-3601.

116 Ekaterina Rousseva, “Rethinking Exclusionary Abuse in EU Competition Law,” 1st ed., 2010, Chapter 6, “Tying and Bundling”, at p. 252.

which warrant a closer examination of the effects that tying has on competition in this case. While in classical tying cases, the Commission and the Courts considered the foreclosure effect for competing vendors to be demonstrated by the bundling of a separate product with the dominant product, in the case at issue, users can and do to a certain extent obtain third party media players through the Internet, sometimes for free. There are therefore indeed good reasons not to assume without further analysis that tying WMP constitutes conduct which by its very nature is liable to foreclose competition.” Thus, the Commission found that, although there was currently competition in the media player market, the alleged tying arrangement had the potential to foreclose competition. In reaching this conclusion, the Commission emphasized the danger that the media player market might eventually tip towards Microsoft.

Factual Background: Two decades after the *IBM* proceedings, the issue of technological tying came to the fore once again in proceedings against Microsoft. Following a complaint by Sun Microsystems to the Commission alleging that Microsoft had infringed Article 82 by failing to disclose and make available for use sufficient interface information, the Commission began a further investigation in 2000 into the effects of the alleged tying of Microsoft’s Windows Media Player (WMP) with the company’s Windows PC operating system (PC OS).

European Commission’s Judgment: the European Commission moved away from the strict per se approach of *Hilti* and *Tetra Pak*, towards a test that takes into consideration the effects of the tying practice in the market for the tied product and allows at least some consideration of efficiencies and pro-competitive justifications. The Commission found that Microsoft’s tying of its Windows Media Player to its Windows operating system constituted an illegal tie under Article 82.

The Commission decided that PC OS and WMP were separate products, focusing on the existence of separate demand for and supply of streaming media players.¹¹⁷ That being so, the Commission considered that Microsoft’s tying of WMP, by refusing to give customers the choice as to whether to acquire WMP¹¹⁸ had the effect of foreclosing the

117 Microsoft v. Commission, ¶¶ 803-813.

118 Ibid., at ¶ 829.

market to competitors by putting competing products at a disadvantage which is unrelated to their price or quality. The Commission effectively considered that independent streaming media players were foreclosed unless they were able to achieve levels of distribution comparable to those achieved by WMP through Windows.¹¹⁹ The Commission concluded that Microsoft had not shown that tying WMP was “indispensable” to the realization of various efficiencies and that, therefore, there was no objective justification for such behaviour.¹²⁰

A huge amount of fine was imposed on Microsoft by the Commission and it was also ordered to present a version of Windows PC OS without WMP. “The untying remedy does not mean that consumers will obtain PCs and operating systems without media players. Most consumers purchase a PC from a PC manufacturer which has already put together on their behalf a bundle of an operating system and a media player. As a result of the Commission’s remedy, the configuration of such bundles will reflect what consumers want, and not what Microsoft imposes.”¹²¹

A Critique of the Commission’s Decision: The fundamental problem with the Commission’s analysis is that it asserted that Windows including media player technologies is not a single product; it never investigated whether there was any (let alone material) demand for client PC operating systems without media player technologies.¹²² Without knowing whether there is material demand for windows without media player technologies, the Commission had no way of assessing whether the failure to offer that alternative (a) foreclosed competition or otherwise distorted the market; or (b) represented normal pro-competitive commercial conduct. Also, this judgment comes at a time when the US Courts have been rejecting the application of mechanical approaches to tying, especially technological tying and have been moving towards a Rule of Reason approach, aimed at ascertaining whether the integrated product is more valuable to end users than the sum of its parts.

119 Id., at ¶ 863.

120 Ch. Ahlborn, D. Bailey and H. Crossley, “An Antitrust Analysis of Tying: Position Paper”, GCLC Research papers on Article 82 EC - July 2005, at p. 191.

121 Commission Press Release IP/04/382, 24 March 2004.

122 Evans and Padilla, “Tying under Article 82 EC and the Microsoft decision: a comment on Dolmans and Graf.” (2004) *World Competition*, 27(4), 503-512.

The Commission has never directly addressed the problem of “Consumer harm” in assessing the competitive impact of Microsoft’s conduct in the streaming media market.¹²³ Authoritative commentators have recently denounced an increasing attitude towards neglecting the issue of consumer harm on antitrust policy, and considered weaker, “edentulous” consumer harm adopted in cases like *Intel, Microsoft* or *Visa* to represent “economically unsound policy.” Also, technological integration should be treated differently from traditional tying allegations.¹²⁴ Moreover, the beneficial impacts of technological tying also have to be considered in light of the Chicago School theories as having merit in them, as distinct from their applicability to traditional tying.¹²⁵

Judgment of the Court of First Instance (CFI): The CFI reviewed the Commission’s decision which condemned Microsoft of infringing Article 82 by pre-installing and thereby technically bundling WMP with PC OS. A peculiarity of the case, which distinguishes it from traditional tying cases, as noted by the Commission and the CFI, was that bundling did not entirely preclude users from acquiring and using competing media players along with WMP. This was the reason why the Commission opted for and the CFI approved a new test for abusive tying practices.

On the first issue of separate products, the CFI affirmed the Commission’s finding and added that the other vendors of OS’s had made the installation of other media players optional, hence, justification on the basis of commercial usage did not exist in this case.¹²⁶ On the second issue regarding Coercion also, the CFI affirmed the Commission’s finding and held that establishing coercion required only that consumers could not obtain Windows OS without WMP. Regarding the third criteria of Foreclosure, the Commission’s analysis of the establishment of foreclosure effect was affirmed by the CFI. The CFI stated that the Commission’s analysis demonstrated the strong impact of the ideas of the post-Chicago school of thought.¹²⁷ Finally, the CFI affirmed the Commission’s rejection of Microsoft’s

123 R. Pardolesi and A. Renda, “The European Commission's case against Microsoft: Kill Bill?” (2004) 27(4) *World Competition* 513, at 560-61 and 562-63.

124 Art and McCurdy, “The European Commission's media player remedy in its Microsoft decision: compulsory code removal despite the absence of tying or foreclosure,” (2004) *European Competition Law Review*, 25(11), 694-707

125 R. Pardolesi and A. Renda, “The European Commission's case against Microsoft: Kill Bill?” (2004) 27(4) *World Competition* 513, at 560-61 and 562-63.

126 CFI's Judgment., ¶ 940.

127 Ekaterina Rousseva, “Rethinking Exclusionary Abuse in EU Competition Law,” 1st ed., 2010, Chapter 6,

argument regarding objective justification on facts. Therefore, it can be seen that CFI has affirmed the Commission’s ruling on all aspects and hence is subject to all those criticisms which the Commission’s judgment was, of an apparent introduction of a new approach, which, clearly does not reflect from its judgment.

3.4 Comparative Analysis of the USA and EU Legal Positions on Tying and Bundling

There are a lot of similarities between application of Section 1 of the Sherman Act and Section 3 of the Clayton Act and Article 82 of the EC Treaty. However, there also exist some differences between the two regimes, which have primarily arisen after the introduction of the Rule of Reason Approach, in both sides of the Atlantic. The differences are enlisted below¹²⁸:

Sr. No.	USA Law on Tying and Bundling	EC Law on tying and Bundling
1	The framework of analysis in the U.S. has been re-interpreted to accommodate a shift in policies moving from <i>per se</i> illegality towards a modified <i>per se</i> rule and, in certain circumstances, a rule of reason approach. This shift in policy frequently reflected new views in economic theory.	EC law by contrast has until recently been largely static and immune to influence from economic thought. Courts have tended to infer an exclusionary effect from a company’s actions by reason of the action’s nature rather than its effect. In its <i>Microsoft</i> decision, the Commission has moved away from excessive formalism but its insistence on a high evidential requirement for efficiencies, in particular the newly established need to show “indispensability” still shows considerable hostility towards tying.
2	U.S. Courts have engaged in a debate about the purpose of certain criteria within the context of a cost-benefit or error-cost analysis. An example is the re-evaluation of the separate product test in <i>Jefferson Parish</i> as a proxy for foreclosure, or more recently an even	In the EU such a debate has been entirely absent and the approach has been, again, overly formalistic. More generally, contrary to other areas of competition law, European Courts have been largely silent on policy issues in abuse of dominance cases

“Tying and Bundling”, at p. 252.

128 The enunciation of these differences has been heavily influenced and drawn from David W. Hull, “Tying: A transatlantic perspective”, Chapter 9 in Philip Marsden (ed.), “Handbook of Research in Trans-Atlantic Antitrust”, (2006), at p. 296; and Ch. Ahlborn, D. Bailey and H. Crossley, “An Antitrust Analysis of Tying: Position Paper”, GCLC Research papers on Article 82 EC - July 2005, at p. 198

	more detailed discussion of the policy rationale of this test in the <i>Microsoft</i> judgment of the DC Circuit Court of Appeals, cited by the Commission in its decision.	and have tended to confirm Commission decisions even where these decisions were highly controversial.
3	After the DC's decision in <i>Microsoft</i> , there is a clear departure from the per se rule to the rule of reason approach, especially in technological tying cases.	The test actually applied by the Commission in <i>Microsoft</i> included a fifth condition, i.e. the consideration of objective justifications and efficiencies, which is more characteristic of a rule of reason analysis. However, the ultimate effect of the judgment is not really characteristic of a rule of reason approach and exists, a lot of ambiguity as to whether it has been introduced into EU Law or not.
4	The Burden of Proof on the plaintiff under the rule of reason approach was not too high, especially when compared to the EU approach on burden of proof on a plaintiff.	The Commission placed a much heavier burden of proof on Microsoft than would have been the case under the US rule of reason approach. The allocation of the burden of proof can have a decisive impact on the effect of a legal standard. In the <i>Microsoft</i> case, the burden of proof placed on the defendant was so high that, arguably, it transformed what purported to be a rule of reason standard into a per se test.

4. The Indian Position

Section 3 of the Indian Competition Act, 2002 deals with “tie-in arrangements” and classifies them as anti-competitive. As per Section 3(1), “no enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.” Section 3(2) classifies such agreements as being void.

Section 3(4) provides that: “Any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of

production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including-- (a) tie-in arrangement.....shall be an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition in India.” The Explanation to Section 3(4) defines “tie-in arrangements” as “any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods.” This provision is all that is present in Competition Law Jurisprudence in India regarding Tying and Bundling.

It is to be noted that there is no separate classification of the two separate concepts of Tying and Bundling. Taking a liberal approach, (which has been discussed later) the phrase “tie-in arrangements” can be said to include both the concepts. However, it is still subject to judicial opinion and one would have to wait to see how Competition Law jurisprudence evolves in that regard. The underlying argument in this section of the research paper is to put forth the point that the Rule of Reason approach is more suited to the Indian Legal System and to trace the said approach in the existing statutory provisions of the Competition Act itself.

4.1 Sections 3 and 19- Tracing the Rule of Reason Approach in the Indian Competition Act, 2002

It is the researcher’s primary argument that the “Rule of Reason” approach can be read into Section 19 of the Indian Competition Act, 2002. Rule of Reason assessments are typically conducted through the so-called method of the “competitive balance,” according to which the potential pro-competitive and anticompetitive effects of tying are balanced in light of the available evidence.¹²⁹ Hence, a Rule of Reason approach is where all of the circumstances of a case are considered in deciding whether the tie should be prohibited as imposing an unreasonable restraint on competition or should be permitted on account of its beneficial effects. A decision maker is effectively asked to undertake a balancing exercise and determine whether the demonstrable, pro-competitive effects of a tie outweigh its likely anti-competitive effects. This is in contrast to a “per se approach,” wherein four conditions have been laid down and if those conditions are satisfied, it is considered anti-competitive

¹²⁹ P Manzoni, “The European rule of reason-crossing the sea of doubt” (2002) 23 *European Competition Law Review* 8, 392-9.

straightaway.

The first indicating factor to the effect that the Rule of Reason approach can be read into the Indian Competition Act, 2002 is the existence of the phrase “*which causes or is likely to cause an appreciable adverse effect*” in Section 3, which puts forth the need for determining an ‘appreciable adverse effect.’ The Act does not define the phrase and has left it to be determined by the Commission as to what would be considered as having an appreciable adverse effect on competition. For the purposes of such determination, various factors have been enlisted in Section 19, which have to be taken into consideration by the Commission.

Section 19(3) reads as: “*The Commission shall, while determining whether an agreement has an appreciable adverse effect on competition under section 3, have due regard to all or any of the following factors, namely:—*

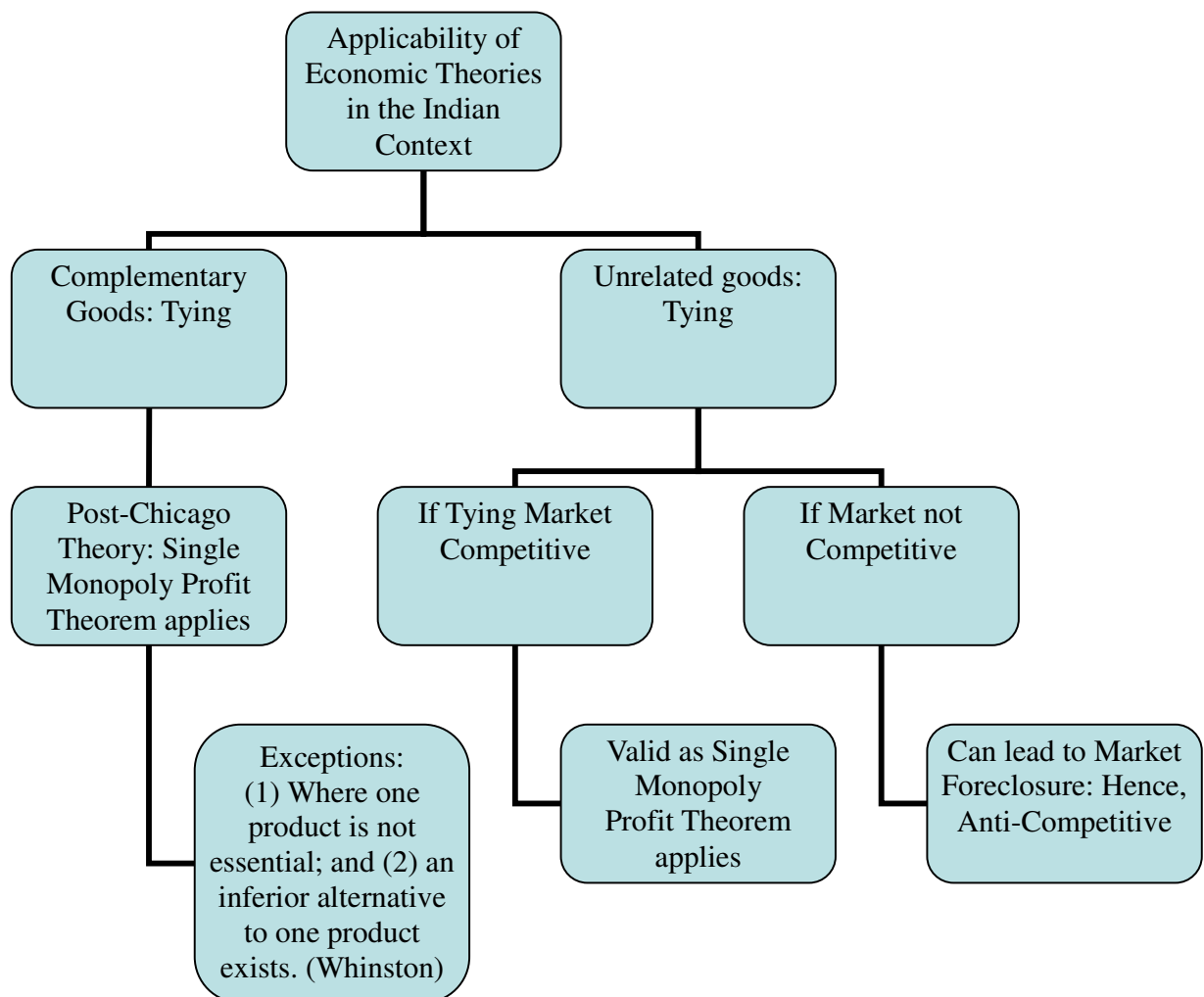
- (a) creation of barriers to new entrants in the market;*
- (b) driving existing competitors out of the market;*
- (c) foreclosure of competition by hindering entry into the market;*
- (d) accrual of benefits to consumers;*
- (e) improvements in production or distribution of goods or provision of services;*
- (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.”*

Hence, as it can be seen from the section, the Commission, while determining what is anti-competitive and what is not under section 3 (which also includes tie-in arrangements), has to look at overall market conditions, which includes entry barriers, foreclosure conditions, accrual of benefits, etc. Thus, even though it has not been stated explicitly,¹³⁰ the Rule of Reason approach can be traced from the Act itself, within Section 19. However, it is only when Section 19(3) would be applied by the Commission in a particular case would one be able to determine as to whether the Rule of Reason approach, as advanced in the judgment of the Court of Appeal in the case of *US v. Microsoft*, is drawn into the Indian Legal System. This would also depend upon the approach of the

130 Which may be due to the lack of convergence of economic-legal theories in the bare statutory provisions, or such an appearance thereof.

Commission towards the enforcement aspect of Sections 3 and 19, which could vary from case to case.

Applicability of Economic Theories in the Indian Context: This section seeks to summarize the economic theories and the economic rationale behind the applicability of the Rule of Reason approach, which have been in existence during the enunciation of the approach in the *US v. Microsoft* case. The reason for doing so is to simply state the Economic rationale which comes along with the Rule of reason approach. The following diagram, which has been put forth on the basis of the “nature of goods” in a market, summarizes the applicability of these theories¹³¹:



¹³¹ Kindly refer to the Economic Rationale behind Tying and Bundling, Section 2 of this research paper, for a detailed analysis of these theories as this section merely aims at summarizing them and their application together.

5. Conclusion

This research paper has sought to make an argument to the effect that the “Rule of Reason” approach (in the context of tying and bundling) can be traced within the Indian Competition Act, 2002 and that the US approach is more favourable to the Indian Legal System, contrary to the EU Approach, which is still ambiguous. Further, the economic theories and their applicability has been examined in the Indian legal system, since these are the theories that come along with the Rule of reason approach, as identified in the Microsoft judgment.

For the purpose of putting forth the said argument, the research paper has attempted to explain the basics of Tying and Bundling. The economic theories behind the said concepts have been studied and their viability within statutory provisions has also been considered. The law, as it exists in different jurisdictions, has been studied to consider the most appropriate legal system from which India can draw its jurisprudence regarding Tying and Bundling, since it is in the nascent stage. For these purposes, the US and EU positions have been considered along with the differences in approach, to bring out the benefits and drawbacks of both the approaches. Also, case laws have been analyzed in the context in which they took place to consider the working of and enforcement procedures of Competition/ Antitrust Law. This method has been followed to develop and further the argument that the US position on Tying and Bundling is more favourable to the existing Indian Legal System.

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