CONCEPT OF TYING AND BUNDLING AND ITS EFFECT ON
COMPETITION: A CRITICAL STUDY OF IT IN VARIOUS
JURISDICTIONS.

INTERNATIONAL PROJECT REPORT

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JULY 2012
ACKNOWLEDGEMENT

On the completion of this paper, I would like to place on record my sincere gratitude towards all those people who have been instrumental in its making.

Firstly, I would like to thank Mr. Sukesh Mishra, Joint Director (Law), for providing me with such an interesting topic to research and for helping me with the research and for always attending on all my queries and doubts regarding the same. Also, I would like to thank all the officers at CCI for their kind co-operation towards the fulfilment of my research paper.

I also owe sincere gratitude to the staff at library for always helping in the process of finding material and other sources for research. And last but not the least I thank my family and friends for supporting me throughout in my endeavours.

ANISHA GUPTA

31.07.2012
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Chapter 1

INTRODUCTION

A large number of antitrust investigations in the US and in Europe concern various kinds of tying and bundling behaviour by firms with market power. The impact of tying and bundling on competition in the market ranges from “Impact on the rivals ability to compete” to “total exclusion of competitors”. In the European Union, (EU), the two decided cases of Tetra Pack II 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 Northern Pacific Railway v. United States and Jefferson Parish. This entire debate essentially involved the deep rooted economic and legal doctrines of Predatory Pricing, Exclusive dealing 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 concept of Tying and Bundling.

A simplistic objection to tying and bundling is that it involves the dominant firm ‘leveraging’ its position in relation to the tied and bundled product to achieve increased sales in the market for the tied and bundled product, thereby extending its market power. The consideration of tying and bundling as anti-competitive and hence, illegal, varies across jurisdictions. To understand the legal provisions regarding tying and bundling in different jurisdictions, it is important to first understand the basic underlying concept, which remains the same, irrespective of any particular legal system.

1.1 TYING

Tying exists when the seller of a product requires his purchasers to take another product as well. The most robust statement one can make about tying is that it is ubiquitous. Consider the following examples: shoes are sold in pairs; hotels sometimes offer breakfast, lunch or dinner tied with the room; there is no such a thing as an unbundled car; and no self-respecting French restaurant would allow its patrons to drink a bottle of wine not coming from its cellar.

In a certain sense, as Robert H. Bork noted in his famous book,

Every person who sells anything imposes a tying arrangement. This is true because every product or service could be broken down into smaller components capable of

1 Virgin Atlantic Airways v. British Airways plc, 257 F. 3d 256 (2d Cir. 2001).
being sold separately, and every seller refuses at some point to break the product down any further\(^2\).

Tying may result in lower production costs. It may also reduce transaction and information costs for consumers and provide them with increased convenience and variety. The pervasiveness of tying in the economy shows that it is generally beneficial.

Tying may also cause harm. 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” (Whinston 1990)\(^3\).

1.2 **Tying may take various forms:**

- **Contractual tying**: The tie may be the consequence of a specific contractual stipulation; for example in the HILTI CASE\(^4\), hilti required users of its nail guns and nail cartridges to purchase nails exclusively from it.

  In *Eurofix-Bauco v Hilti*: The commission held that the requirement of the Hilti that users of its patented nail cartridges should also acquire nails from it exploited customers and harmed competition and was an abuse of a dominant position; a fine of 6 million was imposed for this and other infringements. Hilti appealed *inter alia*, on the grounds that the commission had been wrong to find that the nail guns, the cartridge strips and the nails exploited customers and harmed competition and was an abuse of a dominant position; a fine of 6 million was imposed for this and other infringements. Hilti appealed *inter alia*, on the grounds that the commission had been wrong to find that the nail guns, the cartridge strips and the nails were three distinct product markets rather than forming one indivisible whole, a ‘powder actuated fastening system’ comprising the nail guns and their consumables. The CFI held that there were three markets, and that independent producers should be free to manufacture consumables intended for use in equipment manufactured by others unless in doing so they would infringe intellectual property rights.

- **Refusal to supply**: The effect of a tie may be achieved where a dominant undertaking refuses to supply the tying product unless the customer purchases the tied product.

- **Withdrawal or withholding of a guarantee**: A dominant supplier may achieve the effect of a tie by withdrawing or withholding the benefits of a

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\(^3\) Product bundling and tying in competition, Eugen Kovac, Bonn University, June 2006.

guarantee unless a customer uses a supplier's components as opposed to those of a third party

- **Technical tying**: This occurs where the tied product is physically integrated into the tying product, so that it is impossible to take one product without the other: this is what happened in the *Microsoft case* (discussed later).

No discussion of tying would be complete without mentioning the case of *Eastman Kodak Company v. Image Technical Services, Inc*[^6]. Although this case dealt with numerous aspects of tying law, the case focused on the requirement of market power in the tying market.

**FACTS**: Kodak manufactures and sells photocopiers and micrographic equipment and also sells replacement parts and service for its equipment. Independent service organizations (ISOs) also provide service for Kodak equipment, typically at a lower price than that offered by Kodak. Customers of Kodak equipment could buy the replacement parts themselves and hire the ISOs to service the machines or they could hire the ISOs to provide both the replacement parts and the service. Or, customers could use Kodak to obtain the replacement parts and service.

Kodak eventually instituted a policy of selling the replacement parts only to those buyers of Kodak equipment who purchased Kodak services to repair their machines. Kodak tried to limit the access the ISOs had to replacement parts for Kodak machines. This effectively limited the ability of the ISOs to repair Kodak machines for their customers. A number of ISOs finally filed suit, claiming that Kodak unlawfully tied the sale of service for Kodak machines to the sale of parts. Thus, the tying arrangement was allegedly between Kodak's repair service and its parts.

The *Supreme Court held* that that Kodak has tied the sale of the two products in light of evidence indicating that it would sell parts to third parties only if they agreed not to buy service from ISOs.

Competition law intends to regulate tying as it may result in vertical foreclosure of competition in the market. Tying is harmful because it creates a new monopoly wholly outside the patent. US law took a strict standard against the practice, holding it to be *PER SE infringement*. The recent *Report of the attorney general's committee to study the antitrust laws* declares that the purpose of a tying contract is *monopolistic exploitation*[^7]. This exploitation is achieved by “artificially extending the market for the ‘tied’ product beyond the consumer acceptance it would rate if competing independently on its merit and on equal terms.” The view that tying contracts allow the wielding of monopolistic leverage is widely accepted.

[^5]: The commission required an end to this practice in Novo Nordisk: XXVith Report on Competition Policy (1996), pp 142-143.
[^7]: Report of the attorney general’s national committee to study the antitrust laws 145 (1955).
However, this approach was subjected to sustained criticism, in particular by ‘The Chicago school’ (discussed later): the central thrust of this criticism was that a monopolist can earn its monopoly profit only once, and that if it has monopoly over product A, it cannot increase its profit by leveraging its position into product B.

Tying could be classified into two types i.e. **Static Tying** and **Dynamic Tying** (which is also the dynamic form of pure bundling, as elaborated later).

**Static tying**: The static tie can be thought of as half of a mixed bundle or an exclusivity arrangement. In the static tied-sale, the customer who wants to buy ‘A’ must also buy ‘B’. It is possible to buy ‘A’ without ‘B’ which explains why this is a tie and not a bundle. Thus, the items for sale are ‘B’ alone or an ‘A-B’ package\(^8\).

For example: The video game Halo is exclusive to the Xbox format. A customer that wants to buy Halo must also buy the Xbox hardware. The tie could arise from the manufacturer's power in the market of product B (Xbox hardware).

**Dynamic tying**: In order to purchase good A, the customer is also required to purchase good B\(^9\). What makes this different from the standard pure bundle 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.

For example: A seller of a photocopy machine (product A) may require the purchaser of the machine to use a specific brand of paper i.e. (product B). The paper sales occur over time and vary across users, based on their demand for the copies. A customer would not need to determine how much paper to buy at the time the machine was bought. But under the tying contract, whatever paper was required would have to be bought from the machine seller.

The dynamic tied sale is different from the static tie in another way. The goods involved in a dynamic tie are required to use the product. For example, one cannot use a photocopy machine without a paper but one can enjoy Xbox without the Halo game. Therefore, all the customers that buy the product A must also buy product B in a dynamic tie.

### 1.3 BUNDLING

A firm may sell two or more products together as a bundle and charge more attractive prices for the bundle than for the constituent parts of it. Bundling may have the same effect as a tie-in-agreement.

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

9 The quantity may be zero. But the customer is not allowed to purchase the tied product from a rival supplier
Pure bundling: In a pure bundle, two goods, A and B, are only sold together. They are not available for individual purchase. Furthermore, 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 part of a car.

Most often, when consumers are interested in purchasing two goods A and B separately the market makes this available, even if the price is not always attractive. Thus Microsoft Word and Excel can be purchased separately rather than through the Microsoft Office bundle, even if this is typically not at an attractive price. Many goods are sold only as a bundle and this has become so common that we do not even notice it. An airplane ticket often includes a meal and the customer cannot buy the trip and the meal separately. A university offers a bundle of courses, etc.10

Mixed bundling: In mixed bundling, goods A and B are sold as an A-B package in addition to being sold individually. The package is sold at a discount to the individual prices. (If the price of the A-B package simply equals the individual prices of A and B then this is not classified as bundling).

The key part of the definition of bundling is that the A-B package is sold at a discount to the components. If one thought of this as ordering in a restaurant, the prix fixé menu is a bundle that will typically offer a discount compared to ordering à la carte. In some cases, we will see that the A-B package is not sold at any discount at all. In these cases, there is no strategic impact of the package offering and thus we do not consider this to be bundling.

1.4 Distinction between tying and bundling

Bundling is not tying because “forcing is absent”. In "bundling" there are two or more products and there are inducements to take the whole bundle, or more than one product. The inducement is usually a discount that only applies when multiple products are purchased. The two products are available separately so there is no compulsion to buy product B along with product A.11

The 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. The difference between (mixed) bundling and tying is that under (mixed) bundling both goods are also available on a standalone basis while under tying only the tied good is available separately but not the tied good. This distinction is however inconsequential if, the tied product is valueless without the tying product.12

Tying is a legal concept whereas bundling is primarily an economic concept and the distinction between two is a technical one. Though ‘tying’ and ‘bundling’ are two distinct concepts, the two terms are often used interchangeably by courts and commentators, but in practice bundling and tying operate differently.

In USA, Tying and Bundling (both) are dealt under *Section 3 of the Clayton Act, Section 1 of the Sherman Act and Section 5 of the Federal Trade Commission Act*. In EU, both tying and bundling are dealt under *Article 82(d) of the treaty of European community*. Merely because both the concepts are dealt under with the same law 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. The distinction between the two is still maintained.

1.5 **The commercial rationale for tying and bundling:**

Tying and bundling may make good commercial and economic sense for reasons which are not necessarily anti-competitive. They can be used as a method for obtaining royalties or fees for the use of a process or product i.e. as a metering device. They can enable a supplier to ‘spread the risk’ when trying to penetrate a new market. Tying and bundling can also allow the supplier to achieve economies of scale which are then reflected in the price reduction offered to customers, or to offer a ‘bundle’ which is more attractive (and of greater value) to consumers than the sum of its separate parts. They can therefore have beneficial effects on consumer welfare. Suppliers may also tie products or services together in order to ensure their optimal performance.\(^{13}\)

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\(^{13}\) EU Competition law, 4\(^{\text{th}}\) Edition, pg. 455.
Chapter 2: The Law

2.1 USA law on Tying and Bundling: From Per-Se Illegality approach to Rule of Reason

Section 1 of the Sherman Act, 1890\(^{14}\) and Section 3 of the Clayton Act, 1914\(^{15}\) 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.”

Tying under U.S. law has been defined as “an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier.”\(^{16}\)

The assessment of tying arrangements under U.S. antitrust law has undergone significant changes over time. We can distinguish at least three different approaches.

First, the early period of The per se approach: early cases reflect a strong hostility towards tying arrangements that were regarded as having hardly any purpose beyond the suppression of competition.\(^{17}\) Second, The modified per se illegality approach: Jefferson Parish moved to an approach in which the criteria for tying are used as proxies for competitive harm and, arguably, efficiencies.\(^{18}\) Third, The rule-of-reason approach: Microsoft III introduced a rule-of-reason approach towards

\(^{14}\) 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.”

\(^{15}\) 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 therefore, 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.”

\(^{16}\) Northern Pacific Railway Co. et al. v. United States, 356 U.S. 1, 5-6 (1958)

\(^{17}\) Standard Oil Co. et al. v. United States, [337 U.S. 293, 305-06 (1949)]

tying; recognizing that, at least in certain circumstances,\textsuperscript{19} even the modified \textit{per se} approach would lead to an overly restrictive policy towards tying arrangements.

\section*{2.2 The \textit{Per Se} Illegality Approach}

Early cases viewed tying arrangements largely as a means of restricting competition, with few, if any, redeeming features.

In \textit{United States Steel v. Fortner}, the court held that tying arrangements “generally serve no legitimate business purpose that cannot be achieved in some less restrictive way.”\textsuperscript{20}

\textbf{Northern Pacific Railway v. United States}\textsuperscript{21} is a good example of the early approach. The railroad was the owner of millions of acres of land in several North-western States and territories. In its sales and lease agreements regarding this land, Northern Pacific had inserted “\textit{preferential routing}” clauses. These clauses obliged purchasers or lessees to use Northern Pacific for the transportation of goods produced or manufactured on the land, provided that Northern Pacific rates were equal to those of competing carriers.

The Supreme Court took the view that Northern Pacific had significant market power. The court declared that the \textit{Per-Se rule 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.” In this case, the facts “established beyond any genuine question that the defendant possessed substantial economic power by virtue of its extensive land holdings”

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. It concluded that the \textit{preferential routing clauses} amounted to illegal tying.

In the \textbf{International Salt Co., Inc. v. United States},\textsuperscript{22} case it was held by the court that “sufficient economic power” could be established in a number of ways, not all of which were related to the concept of “market power”.

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\textsuperscript{19} Microsoft III, supra note 4.
\textsuperscript{20} United States Steel Corp. et al. v. Fortner Enterprises, [394 U.S. 495, 503 (1969)]
\textsuperscript{21} Northern Pacific Railway Co. v. United States, [ 356 U.S. 1 (1958)]
\textsuperscript{22} International Salt Co., Inc. v. United States, [332 U.S. 392, 395-96 (1947)]
\end{flushleft}
Sellers forcing customers to accept unpatented products in order to be able to use a patent monopoly, and the patent rights were deemed to give the seller “sufficient economic market power”.\textsuperscript{23}

In later cases, “sufficient economic power” was “inferred from the tying product’s desirability to consumers or from uniqueness in its attributes”\textsuperscript{24} or from the fact that “the seller has some advantage not shared by his competitors;”\textsuperscript{25}

**Exceptional justification and defences**

U.S. courts have, in certain circumstances, accepted justifications for tying arrangements that would otherwise be caught by the prohibition

During the development period of a new industry, a tying arrangement was held to be justified for a limited period on the basis that selling an integrated system would help in assuring the effective functioning of the complex equipment.\textsuperscript{26}

The hostility against tying was largely directed against “contractual tying” while “technological integration” frequently escaped the per se prohibition.

In ILC Peripherals Leasing v. IBM,\textsuperscript{27} for example, IBM’s integration of magnetic discs and a head/disc assembly was not held to amount to an unlawful tying arrangement.

### 2.3 The Modified Per Se Approach

The hostile approach towards tying was revised in *Jefferson Parish*, where the Supreme Court accepted that tying could have some merit and struggled to devise a test that distinguished “good tying” from “bad tying”.

The *Jefferson Parish* case concerned the tying of hospital services and anesthesiological services. An anaesthesiologist applied for admission to the medical staff of East Jefferson Hospital. The hospital denied the application as it had entered into an agreement with *Roux & Associates* to provide all of the hospital’s anesthesiological services. Applicant then sued the hospital, under *Section 1 of the Sherman Act*, seeking an injunction to compel his admission to the medical staff.

\begin{itemize}
  \item \textsuperscript{23} ibid
  \item \textsuperscript{24} United States v. Loew’s Inc. et al., [371 U.S. 38, 45 (1962)]
  \item \textsuperscript{25} United States Steel Corp. et al. v. Fortner Enterprises, Inc.,[ 429 U.S. 610, 620-21 (1977)]
  \item \textsuperscript{26} Jefferson Parish Hospital Dist. No. 2 et al. v. Hyde,[ 466 U.S. 2, 12 (1984)]
  \item \textsuperscript{27} LC Peripherals Leasing Corp. v. International Business Machines Corp., 448 F. Supp. [ 228, 233 (N.D. Cal. 1978)]
\end{itemize}
The Supreme Court took this case as an opportunity to reconsider the Per-Se Approach. The court recognised that tying may, at least in certain circumstances, be welfare enhancing:

“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.”

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:

- The seller conditions its sale of the tying product on the buyer’s purchase of the tied product;
- The tying and tied products are separate and distinct products;
- 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
- A “not insubstantial” amount of interstate commerce in the tied product is foreclosed by the tying arrangement.

The Court moved away from a strict per se test in two respects.

1) 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.

2) The Court emphasized that the economic power required over the tying product was market power and not some 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.

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.\textsuperscript{31}

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.\textsuperscript{32} 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 \textit{Jefferson Parish} has been reaffirmed by the Court in \textit{Eastman Kodak}\textsuperscript{33}, except that on facts and as per the final judgment, Eastman Kodak has been criticized of being slightly more restrictive than Jefferson Parish.

\subsection*{2.4 The Rule-Of-Reason Approach}

U.S. antitrust policy towards tying had a long journey from the hostile approach of the early \textit{per se} rule to a modified \textit{per se} rule willing to consider the possibility of tying efficiencies (with four judges in favour of a rule of reason) under \textit{Jefferson Parish}, to a neutral position under the \textit{Microsoft III} rule of reason approach.

Tying arrangements that do not meet all of the elements of a \textit{per se} tying claim may still be held unlawful as unreasonable restraints of trade under a rule of reason analysis. Unlike a \textit{per se} analysis, where the focus of the inquiry is on the “tying product”, a \textit{rule of reason} inquiry looks at the “competitive effect of the arrangement in the relevant market for the tied product”.\textsuperscript{34} However, it is unlikely that a tying arrangement that passes muster under the strict \textit{per se} standard will be found to violate the less rigorous rule of reason test.\textsuperscript{35}

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\textsuperscript{32} Jefferson Parish Hospital Dist. No. 2 et al. v. Hyde[, 466 U.S. 2 (1984)]
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\textsuperscript{33} Eastman Kodak Co. v. Image Technical Services, Inc.,[ 504 U.S. 451 (1992)]
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\textsuperscript{35} Digital Equipment Corp. v. Unique 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")
\end{flushright}
U.S. v. MICROSOFT

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. 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.

Facts

The U.S. Department of Justice and 21 states raised a number of antitrust charges against Microsoft claiming that it had violated U.S. antitrust law by contractually and technologically bundling the Internet Explorer (“I.E.”) with its Windows operating system. The alleged charges against Microsoft ranged from monopoly leveraging to monopoly maintenance and exclusive distribution.

The District Court, applying the test under Jefferson Parish, held that the combination of IE and Windows met the Jefferson Parish conditions and was therefore illegal.

The Court of Appeals rejected the Jefferson Parish test and concluded that software platforms, such as Windows, should be subjected to a rule of reason balancing anticompetitive effects and efficiencies.

In particular the Court of Appeals held “that integration of new functionality into platform software is a common practice and that wooden application of per se rules in this litigation may cast a cloud over platform innovation for PCs, network computers and information appliances.”

The court of Appeal challenged the District court’s application of the modified per se rule under Jefferson Parish on two grounds:

- At the general level, that a per se rule was inappropriate in cases like Microsoft III which raised a number of novel issues.
- The separate-product test of the modified per se rule was developed under Jefferson Parish could not be relied on in the Microsoft III case.

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36 United States v. Microsoft Corp., (253 F.3d 34 (D.C. Cir. 2001))
39 Microsoft III, supra note 4
40 Ibid At 159. Microsoft had proposed a test that a three-judge panel of the Court of Appeals had used to analyze software integration under a consent decree that Microsoft had entered into with the Justice Department to settle a previous case. That test stated that technological tying is presumed legal if the defendant can show a “plausible claim” of benefits from the tie. See id. The Court, sitting en banc, rejected this as well.
a) **Per Se Rule Inappropriate in Microsoft III case**

The court of Appeals referred to the Supreme Court’s decision in *Broadcast Music, Inc. et al. v. Columbia Broadcasting System, Inc. et al*, 441 U.S. 1 (1979), which had warned, “It is only after considerable experience with certain business relationships that courts classify them as Per Se violations.”

**The Court of Appeal 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:

- “The tying and tied goods are two separate products;
- The defendant has market power in the tying product market;
- The defendant affords consumers no choice but to purchase the tied product from it; and
- The tying arrangement forecloses a substantial volume of commerce.”

The Microsoft III case, however, was fundamentally different from the tying cases so far addressed by the Supreme Court in at least two respects:

1. “In none of the cases was the tied good physically and technologically integrated with the tying good;” and
2. The argument was raised that the “tie improved the value of the tying product to users and to makers of the complementary goods.”

Microsoft argues that IE and Windows are an integrated physical product and that bundling of IE APIs with Windows makes the latter a better applications platform for third-party software. It is unclear how the benefits from IE APIs could be achieved by quality standards for different browser manufacturers.

While the Court of Appeals did not take any view on the validity of the efficiency claims, it came to the conclusion 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.” 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 its 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.

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43 U.S. v Microsoft at [pg. 70]
44 Ibid
b) **Failure of the product test as a proxy for Efficiencies**

The separate-product test of *Jefferson Parish* operates under very narrow assumptions; in particular that all competitors are in similar situation and that under the markets are static.

These assumptions seemed to be particularly inappropriate in the case of *Microsoft III*. According to Microsoft, the reason why none of its competitors’ products required non removal of the internet browser was that “none of them had invested the resources to integrate web browsing as deeply into its operating system as Microsoft. Microsoft also contended that the integration of IE into Windows was innovative and beneficial.”

The Court of Appeal 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.”

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 E.C. Tying and Bundling Law

Contrary to U.S. law, the issue of tying under E.C. law has been addressed largely in the context of the control of unilateral behaviour of dominant firms, although tying may also fall within the scope of the control of restrictive agreements.47

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.

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Analysis of Tying and Bundling under E.C. law

The European Commission and European Courts have adopted a “unified” approach to the different forms of tying and bundling, in other words, contractual tying (including the tying of primary products and consumables) and integration of products have been assessed in the same way without taking into account the different underlying effects of them on competition.

The formal framework of the tying analysis is almost a carbon copy of the U.S. per se approach, following a four-stage assessment:
1) To establish market power (dominance) of the seller in relation to the tying product;
2) To identify tying which means to demonstrate that (a) customers are forced (b) to purchase two separate products (the tying and the tied product);
3) To assess the effects of tying on competition;
4) To consider whether any exceptional justification for tying exists.

Market Power

Article 82 of the E.C. Treaty is applicable only to the extent that the commission is able to establish dominance in a particular market. Dominance in the market for the tying product has been a prerequisite for finding of abusive tying. Thus, the first requirement in the case of an alleged tying abuse is to establish that the firm has a dominant position in the market for the tying product. An analysis of dominance is dependent upon prior findings in the relevant markets in which both the tying and the tied product are sold.48

To have a dominant position is not an offence under Art. 82 EC, but to abuse it is. A dominant undertaking has a special responsibility not to allow its conduct to impair undistorted competition on the common market.49

Napier Brown v. British Sugar 50 The case arose from a complaint by Napier Brown, a sugar merchant in the United Kingdom, which alleged that British Sugar, the largest producer and seller of sugar in the UK, was abusing its dominant position in an attempt to drive Napier Brown out of the UK sugar retail market.

In the subsequent proceedings, the Commission objected, among other things, to British Sugar’s practice of offering sugar only at delivered prices so that the supply of sugar was, in effect, tied to the services of delivering the sugar.

48 DG Competition discussion paper: page 55-56
49 Whish, Richard: page 183-184
Having concluded that British Sugar was dominant in the market for “white granulated sugar for both retail and industrial sale in Great Britain,” the Commission took the view that “reserving for itself the separate activity of delivering the sugar which could, under normal circumstances be undertaken by an individual contractor acting alone” amounted to an abuse. According to the Commission, the tying deprived customers of the choice between purchasing sugar on an ex factory and delivered price basis “eliminating all competition in relation to the delivery of the products.”

**Tetra Pak II**\(^\text{51}\): This case also concerned the tying of consumables to the sale of the primary product. Tetra Pak, the major supplier of carton packaging machines and materials required purchasers of its machines to agree also to purchase their carton requirements from Tetra Pak. The Commission, upheld by the Court, condemned the tying as abuse of a dominant position.

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.

**Tying**

Tying has been defined by the Commission as (a) bundling two (or more) distinct products, and (b) forcing the customers to buy the product as a bundle without giving them the choice to buy the products individually.\(^\text{52}\)

**Separate products**: The second requirement is establishing whether products A and B are separate products. The main criterion to analyse in establishing whether two products are separate or integrated is the potential user or consumer demand for the tied product individually, from a different source than for the tying product.

If B is a separate product, the relevant question is whether there is demand for A as a stand-alone product. Are there consumers prepared to pay a price to acquire product A without product B attached? If so, then A and B are separate products, otherwise, there are two products AB and B, and A is just a component of the first of the two products. When there is no demand for acquiring the components separately from different sellers, then no competition-related issues under Art. 82 EC arises. Tying can only occur when the products are genuinely distinct.\(^\text{53}\)

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\(^{51}\) Tetra Pak II, Commission Decision 92/163/EEC, 1992 O.J. (L 072) 1

\(^{52}\) JONATHAN FAULL & ALI NIHAY, THE EC LAW OF COMPETITION, 166-67[Oxford University Press 1999]

\(^{53}\) Anderman, Steven D. page 73. Dolmans, Maurits & Graf, Thomas: page 227.
The example of abusive behaviour in Article 82 refers to “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” and the question of whether two products are separate is therefore generally assessed on the basis of “commercial usage.” The Commission and the Court discussed the concept of “commercial usage” in detail in the Tetra Pack II case.

Two important points flow from the Court’s assessment in Tetra Pak II.

1) The Court seems to define commercial usage rather narrowly: to establish commercial usage it is not sufficient to show that tied sales are the predominant business practice in the markets in question (or comparable markets); as long as some untied sales occur in the relevant markets (in the Tetra Pak II case, 12 percent), the criterion of commercial usage is not satisfied.

2) Contrary to the express wording in Article 82(d), the Court does not regard absence of commercial usage as a prerequisite for tying; rather, commercial usage seems to be treated similarly to “objective justifications” (see below) which may or may not take tying outside the scope of Article 82.

Coercion Under E.C. law, as under U.S. law, coercion to purchase two products together is a key element to establish abusive tying. Coercion may take many forms. Coercion is clearly given where the dominant firm makes the sale of one good as an absolute condition for the sale of another good. A contractual coercion occurs when the requirement to buy product B is a condition for the sale of product A, i.e. a refusal to supply the tying product separately. Technical coercion is preventing the user from using the dominant product without the tied product. Financial coercion, on the other hand, is a package discount making it meaningless to buy the tied product separately. This may be explicit in an agreement (for e.g. Tetra Pack II case) or de facto (for e.g. Hilti case). However, lesser forms of coercion, such as price incentives or the withdrawal of benefits may also be sufficient.

Anticompetitive effects

Factual evidence of foreclosure is not necessary as a constituent element of tying under Art. 82 EC, but it is enough to show that tying may have a possible foreclosure effect on the market.57

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55 Tetra Pack II sura note 75.
56 Dolmans, Maurits & Graf, Thomas: page 230.
57 Dolmans, Maurits & Graf, Thomas: page 233-234
According to the **British Sugar** case, tying does not need to have any significant effect on the tied market. British Sugar tied the supply of sugar to the service of delivering the sugar. The Commission did not regard it as necessary to assess whether the delivery of sugar was part of a wider transport market and whether the tying foreclosed any significant part of such market. The fact that British Sugar had "reserved for itself the separate activity of delivering sugar" was sufficient as an anticompetitive effect.

In **Hilti**, the Commission went one step further. It took the view that depriving the consumer of the choice of buying the tied products from separate suppliers was *in itself* abusive exploitation: "These policies leave the consumer with no choice over the source of his nails and *as such* abusively exploit him."(Emphasis added.) In other words, as any tying by definition restricts consumer choice in the way described above, the Commission’s position in **Hilti** strongly suggests that foreclosure does not have to be established and that, hence, tying is subject to a *per se* prohibition (with the possible exception of an objective justification).

**Objective and Proportionate Justification**

The practice of tying and bundling can be justified on a legitimate and proportionate basis. If the European Commission manages to prove the existence of the first four requirements, the burden of proof for objective justification for the practice of tying and bundling shifts to the defendant.\(^5^9\) Legitimate objectives put forward for practising tying and bundling must be genuine. A legitimate objective is when tying and bundling enhances efficiency because it is more costly to produce, or distribute the tied products separately, or there might be a need to ensure the quality or safety of the products.

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.\(^6^0\) 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),”\(^6^1\) and that such “combinations are more likely to be found to fulfil the conditions for an efficiency defence than is contractual tying or bundling.”\(^6^2\) 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.

\(^5^8\) DG Competition discussion paper, page 60

\(^5^9\) Anderman, Steven D.: page 76.

\(^6^0\) Guidance on Abusive Exclusionary Conduct,[ at ¶ 61]

\(^6^1\) Article 82 Staff Discussion Paper, Point 205

\(^6^2\) ibid
In Hilti\textsuperscript{63}, 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.

**Microsoft E.U. Case Discussion\textsuperscript{64}**

**Summary of the facts:**
The investigation of Microsoft Corporation by the European Commission started after Sun Microsystems, a US company had filled complaint against Microsoft for refusal to provide interface information necessary for Sun in order to develop product compatible with Windows PC's. The commission decided to investigate Microsoft for its tying of the Windows Media Player with the Windows 2000 PC Operating System.

The European Commission accused Microsoft of infringing Article 82(d) of the EC treaty\textsuperscript{65} by making the purchase of the Windows Client PC OS (tying good) conditional on the acquisition of the WMP(tied good). The commission held that Microsoft used its dominance in the PC OS market to strengthen the position of its WMP in the media player market, a market in which Microsoft faces competition. This behaviour foreclosed competition and was not justified by efficiency reasons.

The following structure was adopted by EU in determining the abuse of dominance by Microsoft:

- **Relevant market:** The relevant product market for operating systems was defined as the PC OS market by the European Commission. The relevant product market of the WMP was defined as the market for streaming media players, functionality of which was to “decode, decompress and play digital audio and video files downloaded or streamed over the internet.”

- **Dominant Position:** As stated above, the relevant market in which dominance has to be established is the one for the tying good (that is the one for PC OSs in this case). Microsoft has had high market shares in the market for PC OSs since at least 1996 and market shares above 90% in the more recent years prior to the decision. Furthermore, the market is characterized by high barriers to entry and by the presence of indirect network effects. Thus, the more users an OS reaches, the more applications will be developed for this OS and the more applications are written for a certain OS, the more users will adopt the OS. Microsoft has acknowledged its dominant position in the PC OS market.

\textsuperscript{63} Hilti v. Commission (II) (CFI)[(1991) ECR II-1439, at ¶ 118]

\textsuperscript{64} Microsoft v. Commission, Case T-201/04, [(2007) ECR II-3601]

\textsuperscript{65} Which is now Article 102 (d) of the Treaty of the Functioning of the European Union (TFEU).
**Abuse of Dominance:** The European Commission found that Microsoft abused its dominant position by tying the WMP to its PC OS. The decision was based on a five step procedure:

1) Microsoft held a dominant position in the PC OS market.
2) The tying good (Windows PC OS) and the tied good (WMP) were two separate products.
3) Microsoft did not give the choice to consumers to obtain the Windows OS without the WMP.
4) Microsoft’s tying foreclosed competition in the streaming media player market.
5) Microsoft’s arguments to justify tying were rejected.

According to the European Commission all these conditions were satisfied in the Microsoft tying case and thus an abuse of dominance by Microsoft was established. Furthermore, the Commission stated that the abuse by Microsoft hindered innovation in the streaming media player market and harmed the competitive process and consumers who ultimately would face less choice. The Commission dismissed all arguments given by Microsoft during the proceedings of the case potentially justifying the tie.

### 2.6 Comparison of E.C. Competition law and U.S. Antitrust Law on Tying and Bundling

E.C. competition law uses almost the same analytical framework for tying as U.S. antitrust policy. This however does not mean that the E.C. approach towards tying is substantially the same as the U.S. approach.

U.S. policy moved from a position of hostility under the *per se* illegal rule, which did not recognize any legitimate purpose for tying and bundling, to a modified *per se* illegal approach, which at least implicitly accepted that tying and bundling even by firms with market power may be efficiency-enhancing. A closer look is required to see whether the underlying rationale of E.C. law with respect to tying and bundling is more in tune with *Jefferson Parish* or the early *per se* rule (or indeed reflects an approach which is different from both). The differences are enlisted below.66

The framework of analysis in the U.S. has been re-interpreted to accommodate a shift in policies moving from *per se* illegality towards a modified *per se* rule and, in

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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 Microsoft 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.

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 revaluation of the separate product test in Jefferson Parish as a proxy for foreclosure, or more recently an even more detailed discussion of the policy rationale of this test in the Microsoft judgment of the DC Circuit Court of Appeals, cited by the Commission in its decision.

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 and have tended to confirm Commission decisions even where these decisions were highly controversial.

After the DC’s decision in Microsoft, 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 Microsoft 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.

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 Microsoft 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.
2.7 The Indian position

One of the objects of the Competition Act in India was to prevent practices having adverse effect on competition. They seek to achieve these by various means. Agreement for price fixing, limited supply of goods or services, dividing the market etc. is some of the usual modes of interfering with the process of competition and ultimately, reducing or eliminating competition. The law prohibiting agreements, practices and decisions that are anti-competitive is contained in Section 3(1) of the Act. Section 3(1) of the Competition Act, 2002 states:

“Anti-competitive agreements.—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) says that “Any agreement entered into in contravention of section 3(1) shall be void.”

Section 3(4) says 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.”

There are two important issues to be noted at this stage:

1) That tying is not an infringement of section 4, i.e. it is not an abuse of dominant position in the Indian law.
2) That the definition excludes services since the word “goods” is explicitly defined in section 2(i).

The law extends sub-section 4 of section 3 of the competition act 2002 to vertical agreements by the usage of the expression “agreements amongst.....at different stages or levels of production chain in different markets......”

Vertical restraints are subject to the Rule of Reason test. So, the benefits and the harm have to be weighted before an act of tying can be declared anti-competitive or to have an appreciable adverse effect on competition, in terms of the language of the law.
Under section 19(3) of the competition act, 2002 six factors are provided for consideration of competition by the authority before coming to any conclusions.

Section 19(3) states that... “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 the consumer
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.”

Three of these factors are indicative of the harm to competition while the remaining three are pro-competitive and enhance welfare.

The scheme of law is clearly for the application of the Rule of Reason Test.

**Case law**

In *Consumer online foundation v Tata sky Ltd & Ors*\(^{67}\) it was said by the DG that “DTH service providers are forcing the consumers to get into a tie-in arrangement with them. They require the purchaser of their DTH Services to also buy/take on rent the STBs procured by them. They are not giving DTH services to those who are not willing to buy/ take on rent their STBs. This is a clear violation of section 3(4) of the Act under which a tie-in arrangement would prime facie be considered violative of section 3 if it has an appreciable adverse effect on competition in India”. Further, as these four DTH service providers control more than 80% of the market, any anti-competitive practice would definitely have an appreciable adverse effect on the market. Hence, this is a clear case of a tie-in arrangement which is having not only an appreciable but a ‘significant’ adverse effect on competition in the market.

The supplementary report was considered by the Commission, in its meeting held on 05.01.2010. After having gone through the supplementary report, the Commission, *vide* its order dated 08.01.2010, sought additional supplementary report with regard to the issue of DTH service providers forcing the consumers to enter into a **tie-in arrangement**.

This issue of tie-in sales of the consumer premises equipment (Set Top Box, Smart Card and Dish Antenna) was examined by the DG in detail including the reasons for the continuance of this practice.

\(^{67}\) Case no. 2 of 2009, Competition Commission of India, March 2011.
The said report focused on two major interfaces related to ‘tie-in’ arrangement. These are:

- Interface between the DTH service provider and STB manufacturer
- Interface between the customer and DTH service provider

On examination of the agreement between the DTH service provider and the customer, it was noted by the DG that no such clause which directly restricts or forces the customer to enter into tie-in arrangement is there. However, on account of the lack of customer awareness and lack of availability of Set Top Boxes and other equipments in open market, the customer does end up buying all the related equipments from the DTH service providers only. The sale of Set Top Box, Smart Card and Dish Antenna is tied-in as all the three equipments are provided in one package and are not readily available for sale in open market-independent of each other. These three components are technically essential as each performs a specific function for availing the DTH service transmission. Owing to the lack of practical interoperability and lack of consumer awareness, the customer has no alternative but to purchase these three equipments from the DTH service provider whose service he is availing. This ultimately results in tie-in arrangements of the Consumer Premises Equipment from the DTH service provider. Except Dish TV, no other DTH service provider, under investigation, has specifically and clearly mentioned in its agreement with the customer that a customer can avail or procure compatible Set Top Box from any other source. This offer of Dish TV is also of no benefit to customer as neither the compatible Set Top Box is commercially and readily available in the open market, nor the consumer is really aware of this possibility.

Summing up the findings, the DG concluded as under:

“The entire forgoing discussion and the recent developments indicate that the ‘tie-in’ sale of the Customer Premises Equipment is happening on account of non-availability of Conditional Access Module (CAM), Set Top Box etc. in the open market, lack of consumer awareness as well as lack of enforcement of licensing conditions by any regulatory authority. The recent development of the news of the likelihood of availability of Conditional Access Module (CAM) in open market will be a positive step towards achieving interoperability. This can be further enhanced and fully interoperability, which is technically possible, can be achieved by the availability of non propriety Set Top Boxes in the open market and enforcement of the clause 7.1 of the DTH licensing agreement relating to achieving interoperability among the DTH Service providers”.

Chapter 3

The economic arguments over 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 Bundling can be studied in three phases, i.e. (1) The Leverage theory, (2) The Chicago School theory, and (3) The Post-Chicago thought.

3.1 The classic leverage theory

Advocates of leverage theory maintain that a tying-good monopolist may profitably require its customers to purchase another(tied) good in order to extend its monopoly power to the tied-good market, thereby violating sections 1 & 2 of the Sherman Act and section 3 of the Clayton Act.

A multi-product firm with monopoly power in one market can monopolize another market that otherwise would have been competitive by using the leverage provided by the market power in the first market. By foreclosing sales in the second market, tying provides the mechanism to accomplish this.

However, the logic of the theory has been criticized and subsequently dismissed by a number of authors from the University of Chicago School such as Bowman, Posner, and Bork who have argued that the use of leverage to affect the market structure of the tied good (second) market is impossible and advanced the “single monopoly profit theorem” which was a powerful riposte to the per se illegality position. It was not until Whinston (1990) that the leverage theory was resuscitated with its first formal treatment. Since then, the theory has been refined and extended in several directions.

The important cases formulating the ‘classic tying doctrine’ includes:
- International salt v. united states [332 U.S. 392 (1947)]
- Northern pacific rwy. Co. V. United states [356 U.S. 1 (1958)]
- Jefferson parish hospital district No. 2. V. Hyde [466 U.S. 2 (1984)]
- Siegel v. Chicken delights, Inc. [448 F. 2d (9th Cir. 1971)]

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Antitrust analysis of tying agreements, prof. choi jay pil, November 2004, pg. 3
In the *international salt case* it was held that agreements which “tend to create monopoly” are forbidden under the law. 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 the *Northern pacific rwy. case* it was said that, “In the 1950’s and 1960’s, the law was interpreted stringently against arrangements to force distributors or customers to take unwanted products, largely on grounds that it prevented competitors of the seller from competing on the merits for business in the tied market. At that time, most illegal tie-ins were invalidated under the *modified per-se rule* (discussed above).

In this case 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[^69].

In *Jefferson parish hospital case* it was said that “The law has eased for the application of the *modified per-se rule*. The tying firm must have *substantial market power* in the market for the tying product. The plaintiff’s burden of demonstrating that there are in fact two products and that the defendant used its power over the first to force the second on the buyers has become substantial.

Still, a tie might be defensible or at least *not subject to the modified per-se rule* if a defendant can show that the conduct is necessary to respond to the market.

The US Supreme Court in *Eastman Kodak* case reaffirmed its commitment to prohibit tie-in sales where the necessary conditions are met.

In *Siegel v. Chicken delights case* MERRILL, Circuit Judge, held: “This antitrust suit is a class action in which certain franchises of Chicken Delight seek treble damages for injuries allegedly resulting from illegal restraints imposed by Chicken Delight’s standard from franchise agreements. The restraints in question are Chicken Delight’s contractual requirements that franchisees purchase certain essential cooking equipment, dry-mix food items and trademark bearing packaging exclusively from Chicken Delight as a condition of obtaining a Chicken Delight trademark licence. These requirements are asserted to constitute a tying arrangement, unlawful per se under section 1 of the Sherman Act.”

The Existence of an unlawful tying arrangement under the “classic leverage theory” included that the plaintiffs must demonstrate that:

- The scheme in question involves two distinct items and provides that one (the tying product) may not be obtained unless the other (the tied product) is also purchased[^70].

[^69]: US and EU competition law: A comparison by Eleanor M. Fox.

• The tying product possesses sufficient economic power appreciably to restrain competition in the tied product market\textsuperscript{71}.
• A "not insubstantial" amount of commerce is affected by the arrangement\textsuperscript{72}.

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.

3.2 **The Chicago school of thought**

A few decades ago, economists associated with the Chicago School\textsuperscript{73} explained how tying could provide increased convenience and lower transaction costs\textsuperscript{74}. They also showed that, as a matter of theory, there are many circumstances in which businesses cannot use tying to leverage a monopoly position in one market in order to secure extra profits elsewhere—a result known as “the single monopoly profit theorem.” In short, the Chicago School claimed that tying conduct produces many benefits from a social viewpoint, at no competition cost, and that it should therefore be treated as *per se* legal.

**a) The welfare increasing effect of ‘tying’ and ‘bundling’**

• Reduction in Production and Distribution Costs

Tying and bundling may give rise to both “economies of scale” and “economies of scope” in ‘production’ and ‘distribution’. For example, machines may be utilized to manufacture two or more products allowing the producer to reduce the size or complexity of its factories. Also, the specialization of labour allows manufacturers to combine the various products that are part of the tie or bundle more efficiently than end users would do. Marketing and distribution

\textsuperscript{71} Northern Pacific R. Co. v. United States, [356 U.S. 1 (1958)]
\textsuperscript{72} International Salt Co. v. United States, [332 U.S. 392 (1947)]

\textsuperscript{74} Chicago economists also noted that tie-ins can be used to accomplish price discrimination. Economic theory has shown that price discrimination can, in principle, be pro- or anticOMPETITIVE, depending upon a series of structural factors, but that it is most often welfare increasing. See DENNIS W. CARLTON AND JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 289-291 (3rd ed., Addison-Wesley 2000). Hence, tying practices aimed at facilitating price discrimination should be typically considered welfare increasing and thus precompetitive. This is more or less the case under U.S. law; however, E.C. competition law treats price discrimination as nearly *per se* illegal. See RICHARD WHISH, *COMPETITION LAW* 657-62 (4th ed., Butterworth’s 2001)(1985).
costs may also be reduced when various products or services are combined."

- **Reduction in Transaction Costs**

  Tying and bundling reduces the costs of searching for the most appropriate combinations of products that satisfy a complex need. And it greatly simplifies use. At one time, 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 bundled software is itself a function of better technology — faster speed and expanded memory. But, perhaps most importantly, it is a response to consumers who value the ease of use of bundled software.

- **Product improvement**

  When products are tied or bundled, the whole may be worth more than the sum of its parts; the resulting combined product offers benefits to consumers above and beyond the individual components added together.

- **Quality assurance**

  Allowing consumers to assemble the individual components themselves may affect the quality of the final product to the detriment of both producers and consumers. Firms bring skill, knowledge and experience on other resources to ‘tying’ or ‘product integration’. With the increasing sophistication, digitalisation and other complexities of the products, it’s more difficult to ensure that whether the final product would meet consumer satisfaction.

  When the consumer assembles the product, it may not be clear if any malfunctions are the fault of the consumer or the component suppliers. Equipment manufacturers may suffer from an undeserved reputation for poor quality, and it may be more difficult for consumers to identify substandard manufacturers.

  ‘Tying’ and ‘Bundling’ components together gives both the consumers and the producers more certainty regarding product quality.

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75 Steven J. Davis, Kevin M. Murphy & Jack McCracken, *Economic Perspectives on Software Design: PC Operating Systems and Platforms*, in MICROSOFT, ANTITRUST AND THE NEW ECONOMY 361 (David S. Evans ed., 2002), for an explanation of the forces and factors that determine whether and when new features and functions are included in commercial operating systems products.

• **Pricing efficiency**

Augustine Cournot showed, in work published in 1838, that a firm monopolising the markets for two complementary products would charge lower prices than would two separate monopolists selling each a different product\(^77\). Complementary products may be priced lower if offered by the same firm in a bundle.

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.

‘Cournot’s model’ is similar to the well-known “double marginalization” 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 the individual profit-maximizing price\(^78\).

• **Practical example**

A simple empirical example\(^79\) can help us to illustrate the benefits of offering an integrated product to consumers. When suffering from cold or influenza, consumers face a number of choices with regard to over-the-counter or non-prescription medications. Many products are available for each individual symptom of nasal congestion, coughing, pain, or fever. In addition to products intended to relieve each symptom individually, there are also multi-symptom products that aim to relieve all cold and flu symptoms. Consumers of the “bundled” medicine benefit from the low prices resulting from savings in marketing and packaging.

Those are not the only savings associated to bundling. Bundling also provides increased convenience as consumers need not bother about which combination of medicines they need - they just purchase the package labelled “Cold and Flu Medicine” and waste no time.

\(^77\) Augustine Cournot, Recherché sur les principes mathematiques de la theories’ des richesses (1838)


\(^79\) David S. Evans & Michael Salinger, Quantifying the benefits of Bundling and Tying, Working Paper (2002)
b) The “Single Monopoly Profit Theorem”

The Single Monopoly Profit Theory holds that a firm with a monopoly in one product cannot increase its monopoly profits by using tying to leverage itself into a second monopoly in another product. This idea is commonly referred as the “single monopoly profit theorem”, and in principle applies to cases where the demands for the two goods are both independent and complementary.

This theorem does not say that monopolists will not engage in tying and bundling. Nor does it say that monopolists cannot make greater profit by tying and bundling. Rather, what it says is that monopolists cannot secure greater profit merely by leveraging their monopoly from one market to another and that they must be engaging in tying and bundling to improve quality or lower cost (i.e. improve efficiency).

An analysis of the single profit monopoly theory can be done on the basis of the nature of the goods, i.e.

- Complementary goods
- Unrelated goods (that are not complementary)

a) Complementary goods

Where the demands for the two goods are complementary and the two products are consumed with fixed ratios, a monopolist could only benefit from the tied good being competitively supplied, since all of the monopoly rents available in the two markets could be captured by a monopoly in one of them.

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...

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81 The single-monopoly profit theorem fails to hold when the two goods are consumed in variable proportions. Trying to extract the rents generated in the tied market through the pricing of the monopoly product is not a valid strategy in that case, since consumers would substitute away from the monopoly product. However, that does not imply that tying is necessarily anticompetitive when goods are consumed in variable proportions. On the contrary, it is precisely under such kind of consumer preferences that the monopolist has an interest in tying to price discriminate efficiently. Supra pg. 118.
to buy cards in the open market for 10 cents 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?\(^82\)

b) **Unrelated goods**

Where the demand for the two goods are independent, i.e., demand for one of them does not depend on the demand on the other one, tying is still unprofitable. In that case tying a competitively supplied good to a monopolistically supplied good is like establishing a tax on the latter. This tax would reduce consumption of the monopoly good unless consumers like the competitively supplied (tied) good and the monopoly prices the tied good competitively, i.e., unless the monopoly makes no rents from the tied market.

### 3.3 Post – Chicago Theories

The contribution of the Chicago School to the “tying and bundling doctrine” was to give the *efficiency motivations* (described above) and their proper place in antitrust analysis, and to reorient the thinking of competition authorities towards understanding that tying and bundling behaviour was likely to be *pro-competitive* as a result of *reducing cost or improving quality*. In the 1990s, however, the so-called *post-Chicago economic literature* showed that the “single profit monopoly theorem” is not as robust as the Chicagoans suggests. The theorem depends, at least in its most extreme form, on the assumptions that the tied market is “perfectly” competitive. When that is not true, the theorem may *fail*.

Economists developed a series of highly stylized models to try and 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 anticompetitive 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.\(^83\)

The basic mechanism that leads to the exclusion of actual and potential competitors from the tied good is *foreclosure,* by tying, the monopolist deprives its competitors in the tied good market of adequate scale, thereby lowering their profits below the

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\(^82\) Posner, supra note 117, at 173.

level that would justify remaining active (or, alternatively, entering) in that market. This section proceeds with a detailed summary of the main papers of the post-Chicago School.

a) **Exclusion and Entry Deterrence in the Tied Good Market**

Whinston’s 1990 *American Economic Review* article is the seminal paper of those that formally analysed the conditions under which the “single profit monopoly theorem” may fail to hold.84

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.

Suppose, for example, that a firm selling two goods, A and B, enjoys a monopoly position in the market for product A but faces competition (actual or potential) in the market for product B. Suppose also that the demands for products A and B are independent, so that the quantity sold of each of them is independent of the price of the other. If the monopolist in market A were to tie its two products, it effectively would be linking its sales of product A to the sale of product B. As a result its incentive to price B aggressively would be greatly increased. Tying, therefore, would lead to lower prices for product B. It would also lead to lower profits in the market for this product. Both the monopolist’s and its competitors’ profits from the sale of product B would fall, but the impact on the latter would be far greater. This is because tying would allow the monopolist to capture sales from its competitors, which in the presence of economies of scale in production would make them less effective competitors. The reduction in profits may induce the monopolist’s competitors to exit the market for product B, or not to enter into it if they were potential competitors. In those cases, tying could both increase the monopolist’s profits and harm consumers.

Whinston’s model, like any other theoretic analysis is fragile; minor changes in assumptions can lead to dramatic differences in results. Whinston’s leveraging result requires that:

- The monopolist of product A be able to commit to tying and
- Tying leads to market foreclosure.

Otherwise, the monopolist’s strategy would be self-defeating. Tying would just serve to increase the intensity of price competition in the market.

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84 Michael D. Whinston, tying, Foreclosure and Exclusion, 80 AM. Econ. Rev. 837 (1990)
b) Protecting Monopoly Rents in the Tying Good Market

Carton and Waldman argue that the logic behind leveraging a monopoly position onto another market through tying may not be to increase profit in that (competitive) market, but to deter future entry into the monopoly (tying) market.

Carlton and Waldman 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. Without that possibility, the monopolist would benefit from entry by a superior complementary product. 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.

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 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.

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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.”\(^9\)

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.\(^9\) 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.\(^9\)

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Chapter 4: Conclusion

The research paper has attempted to explain the basic concept of tying and bundling, along with a critical study of it across various jurisdictions. The economic theories behind the said concepts have been studied. The law of tying and bundling across various jurisdictions have been explained.

The U.S. and E.U. positions have been considered along with the difference in their approaches, to bring out the advantages and disadvantages of these approaches. Case laws have been analysed to understand the working and enforcement of the Competition/Antitrust Laws.

After critically analysing the concept of tying and bundling, the researcher is of the view that the initial Per-Se Illegality Approach in respect of tying and bundling is not a correct stand. Every case of tying and bundling should be judged on its own merits and demerits and not in regard with straight-line jacket formulae. There are established theories both in support of the notion of tying and bundling as resulting predominantly in pro-competitive effects, as well as supporting the counter-nobel that more anti-competitive effects result in the end from such practices. Both schools of thought are, however, not waterproof and a number of problems are always encountered whenever applying one or the other.

A Per Se Approach prohibits certain acts without regard to the particular effects of the acts, i.e. no investigation into the question of possible pro-competitive effects. According to researcher’s view Per-Se prohibition is justified for types of conduct that have manifestly anti-competitive implications and a very limited potential for pro-competitive benefits.

A Rule of Reason Approach on the other hand is about investigating the effects of the challenged conduct, taking into account the particular facts of the case. The Courts decide whether the questioned practice imposes an unreasonable restraint on competition taking into account a variety of factors.

The Rule of Reason Approach which considers the pros and cons of each case is more favourable to the Indian legal system.
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