1. Introduction

1. BACKGROUND

The antitrust law of tying arrangements was born amid policy disputes about the proper scope of patent coverage. Initially, the complaints were that the defendant was attempting to expand the scope of its patents monopoly by requiring the licensee to purchase unpatented complementary products as a condition of obtaining a license to the patent. The Supreme Court’s conclusion that tying arrangements in the presence of tying product power are unlawful ‘per se’ expressed a policy judgment that severely limited the scope of the intellectual property grant, particularly because the rule was applied to IP owners who in fact lacked significant market power.\(^1\)

The US IP law has since changed its approach to tying and now sees it as legal per se and importantly recognises that tying requires significant market power to be harmful and that this market power does not stem exclusively from the IP right itself. US antitrust law appears to be moving in the same direction. However, it is doubtful whether the same can be said for EC competition law. In a time when globalisation and increased cooperation between states, not least in the sphere of competition law, are becoming more significant for the world economy, harmonisation or at least a similar mindset on how to treat multinational corporations and their actions in the market place plays a crucial role.

In the last couple of years there have been two major developments which have sparked the writing of this book. First, two major and very similar cases involving one multi-national company, Microsoft, have gone through the courts in both the US and the EC, both revolving around the conduct of tying. The cases have provided an excellent opportunity for a comparison of the approaches applied to tying arrangements on both sides of the Atlantic and highlight the flaws and failings of the current approaches to tying, in particular the wooden separate product test. The saga however, does not end here; the EC Commission has filed preliminary charges against Microsoft in yet another tying case, and in the US Microsoft continues to be monitored.\(^2\)


\(^2\) Keizer, Gregg, ‘Update: EU hits Microsoft with new antitrust charges’, Hedvig Schmidt - 9781849802352
The book therefore comes at a time when the understanding of tying and its effect upon the markets is crucial, especially with the increasingly rapid development of technologically advanced and complex products. There is an urgent need to develop competition rules which encourage innovation but retain the delicate balance between the protection of innovation and ensuring a competitive market.

Recent events and challenges presented by unilateral conduct to competition enforcement have prompted both the European Commission (the Commission) and the US Department of Justice (DoJ) to review the approach taken under Article 82 of the EC Treaty and Section 2 of the Sherman Act, which is the second important development influencing the writing of this book. The review of Article 82 is driven by a desire to align the legal analysis of Article 82 with that of the recent modernisation of Article 81 EC and the EC Merger Regulation and develop a more economic approach, which can both accommodate recent economic thinking by being more realistic or true to the reality of the market place, and contain practical and workable rules. The Section 2 Report of the US Department of Justice highlights similar concerns; namely the search for ‘clear, objective, effective, and administrable’ standards, which section 2 case law so far has been unable to achieve of its own accord.


6 Section 2 Report, supra n. 3, p. vii.
Both competition authorities and scholars highlight the need for a modernisation of the approach to unilateral conduct, and this includes in particular a more economic approach – one that moves away from *per se* illegality of certain types of conduct. The book will contribute to this modernisation debate in relation to tying and will offer a solution.

2. TYING

Tying is the selling or licensing of a product or service made conditional on the sale or licensing of another (related) product. It is a common and well-established business strategy applied by large and small companies, in competitive markets as well as in oligopolies, and monopolies. The reasons behind tying are plentiful: cost reduction, quality improvement, and reducing price inefficiencies; but it can also be used to foreclose markets, undercut rivals, mitigate competition, obscure prices and develop new products through technological integration.

Consumers are faced with tying of products or services on a daily basis, in the form of cars with air conditioning and stereos; computers with operating systems and internet browsers; telephone and broadband connections.

Industries and products are developing rapidly, offering increasingly more technologically advanced and complex products. Many are inter-linked, consisting of add-on features, for instance, the mobile phone, which in turn led to the development of the camera phone, music player and internet browser, all contained in one small phone.

Early US antitrust law treated tying as severely as price fixing, market division and other forms of horizontal restraints, and held it to be illegal *per se* despite tying in nature being a vertical restraint and without clear evidence of actual harm. However, in later cases the US courts required there to be market power before deeming the tying arrangement illegal, and a four-step test was developed to assess tying. The four steps were (1) the need for market power, (2) the presence of two separate products, (3) the finding of (potential) anti-competitive effects, and (4) the lack of any objective justifications for the tying arrangement.

Yet the US courts have continued to label tying as illegal *per se*, and it has remained one of the main concerns of the US antitrust authorities. In comparison, tying has only recently entered into the sphere of greater attention from the EC competition authorities, although EC case law demonstrates an

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equally harsh treatment of tying arrangements and a similar four step-test has been deployed. In other words, once a dominant company has been found to tie products or services together, it has been found to infringe competition law without much consideration being given to the effects the tying conduct has on the market and the competitors.

The recent Microsoft cases on both sides of the Atlantic have resulted in renewed attention being given to tying as unilateral conduct and have sparked a debate amongst both lawyers and economists questioning the legal approach taken to tying. In particular, many economists have argued that tying is in fact not the crude business strategy that it has been made out to be in the courts, but can in certain circumstances be an important tool for innovation. The argument follows the idea that technological integrated (tied) products are not necessarily anti-competitive but in fact a form of innovation – a way for companies to innovate and introduce new products into the market. There is therefore a clear gap between the current case law approach and economic thinking in respect of tying which is worth exploring. Consequently, many scholars have argued for a more lenient treatment of tying in case law. This book will lend itself to the same line of arguments.

In the Microsoft cases, Microsoft in the US was accused of tying its Internet browser, Internet Explorer, to its operating system, Windows; similarly, in the EU Microsoft was accused of tying its media player, Windows Media Player, to Windows. Although the four-step approach to tying was applied on both sides of the Atlantic and on the facts the cases were very similar, the outcomes differed significantly. In the US, the Court of Appeals remanded the tying issue to the lower court for a rule of reason assessment, whereas in the EU the Court of First Instance (CFI) found Microsoft guilty of tying and required it to offer a version of Windows without its Windows Media Player.

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Importantly, the Microsoft cases demonstrated a difference in the understanding of products and what constitutes an objective justification. In particular, the cases raised the question of when a product ceases to be a product and instead becomes a component of another product. Yet neither the US nor the EC case provided an answer, despite being of great significance to the understanding of tying. The book will explore this question in greater detail and seek to provide an answer.

The US Microsoft case also marked a (potential) turning point in US case law towards a more lenient approach to tying, and in particular technological integration. Interestingly, this seems to have been mimicked in the Section 2 Report from the US Department of Justice.\(^{10}\) In comparison, the EC Microsoft case left little sign of a similar turnaround for future EC case law.

The Microsoft cases exhibited the concerns of the competition authorities to ensure effective competition in high-technology industries and fast moving markets, but also showed that the current approach to tying is ill-equipped to handle more advanced forms such as technological integration.

3. OUTLINE OF THE BOOK

The book will firstly assess the current approach to tying arrangements as a form of unilateral behaviour in both the EU and the US. Secondly, it will discuss the scope for improvements by assessing the four-step tests for tying which have been developed under both EC and US competition law. The book will outline a proposal for an adapted test for tying based on the current EC competition law approach, but will also address its application to US antitrust law. The book will apply three different perspectives: an economic perspective, a competition law perspective, and an IP law perspective. The development of competition law demonstrates that it is highly reliant upon economic theories and principles, and thus an assessment of tying would be incomplete without a discussion of the underlying economic thinking behind it as a business strategy. The economic perspective will also provide a reference point in the book for why there should be a change in the legal approach to tying.

The IP law perspective is included for two reasons: firstly, the US approach to tying has its origins in the Patent Misuse Doctrine and, secondly, in particular in the EU, most of the tying cases, where the tying was found to be abusive, involved some form of IP right.

Although many scholars have acknowledged the link between US antitrust and IP law in relation to tying, none seems to have taken this further. With the

\(^{10}\) Section 2 Report, supra n. 3, 88–89.
inclusion of the IP law perspective this book seeks to do so by asking the following questions: firstly, whether tying of IP rights or IP right protected products is treated more harshly than other forms of tying arrangements; secondly, whether we can learn something from the IP law approach to tying – does the IP law provide an alternative model to tying?

The starting point, in Chapter 2 is an overview of economic literature and economic arguments applicable to tying arrangements in an attempt to draw lessons from the development of economic thinking on tying. The chapter will look at efficiency and strategic reasons behind tying to identify when, from an economic perspective, tying can be seen as pro-competitive and when the tying arrangement is harmful.

Chapters 3 and 4 will assess the EC competition law and US antitrust law approaches to tying respectively focusing upon Article 82 and the Sherman Act Sections 1 and 2 and the Clayton Act Section 3. The chapters will identify the problems and highlight the benefits of the current approaches by examining current case law on tying.

Chapter 5 will analyse the policy on tying arrangements adopted by US IP law. As mentioned, the US has developed a misuse doctrine mainly based on tying in IP case law. It therefore provides a useful insight into an alternative method of dealing with tying arrangements.

Chapter 6 will draw upon the lessons learned from the previous chapters, that is the economic theories surrounding tying and how they square up with the current approaches taken under EC competition law and US antitrust law, and whether any lessons can be learned or elements applied from the approach taken towards tying under the US patent misuse doctrine, to build up a suggestion for a new approach to tying under competition law. This is done by asking crucial questions, such as should tying continue to be perceived as illegal *per se*? What are the alternative solutions? And what are the consequences? Should we adopt a new test for tying? And if so what should this test look like? Which essential elements should it contain? In particular, it suggests a distinction between the treatment of contractual tying and that of technological integration, providing an all-important safe haven for innovation and product development.

Finally some concluding remarks are set out in Chapter 7, which also takes a brief look at future cases and the prospect for application of the proposed test.