Intellectual Property Rights, And Competition Law

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Lecture - 18

Tying Arrangements and Intellectual Property under Sherman Act

Dear students, in this class we are going to discuss mainly the US jurisprudence on various interface between intellectual property rights and competition law. And in today's class specifically we are going to discuss the Tying Arrangements and Intellectual Property under the Sherman Act.

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And, in this class we will see the interface in the case of tying of technology with one or more than one product; then licensing provisions and then block booking then copyright and softwares and how the intellectual property softwares are mingling with Competition Law, then trademark and tying, and the interface of tying.

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Tying agreement is nothing, but two products: one is a tying product and the second one is the tied product. Companies try to sell these two products at a time compulsorily to the consumers. Tying agreements include get-back provisions and restrictions on resale of patented products and this tying can be in the nature of restrictions on licensee's ability to sell un-patented product. So, patented product is tied with an un-patented product.

Then again licensees entering into future license with other patentees; then mandatory packaging licensing along with the patents; then royalty provision to collect royalty on the sale of un-patented products; resale price restrictions. All these we can see under the purview of tying.

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And, we will see today the case laws from the US on tying. Intellectual property rights interact with the competition law through the famous cases that has come before different courts in the US. As we already said that the tying arrangements, tying, tie-in arrangements or sale on condition of taking another product all violate antitrust laws. In tying agreements the seller agrees to sell a highly usable product along with not so important product or on the condition that he will give a product or give a service only when the buyer will purchase a less important product or less marketable product.

And, you can see that this is a burden on the consumers, they want to purchase only one product, but the seller says he will only give that particular product if you purchase the tied product which is an unwanted product. The antitrust laws always consider these tying agreements as a violation of antitrust laws. In the case of *Northern Pac Railway Company versus United States* it is said that tying is unlawful according to the provision of Sherman Act and Clayton Act. And, we can see that the patent holders compel the customers to agree to a purchase of un-patented product along with their patented product.

In *Henry versus AB Dick*, the court said that if one product is useful along with another product then this is allowed, but the Clayton amendment came to overrule this Henry case. The Clayton Act amended and overruled this particular decision and said that tying is illegal, tying is violation of the antitrust laws. Again in the *Tele-direct case*, which is one of the most discussed tie-in cases in Canada, it was alleged that selective refusals by the respondent to license its trademark constituted an abuse of dominant position.

But here the court said that the refusal to license is sometimes within the legal bounds and you have to look into the circumstances under which you are selling one product along with another product. So, there was a lot of confusion in the earlier times that whether tying one product with another product is good or bad for the consumers.

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So, we will see the different cases. First of all if you look into the concept of tying: a patented product, a very useful product with a not much important product or non-usable product, when the consumers only want the first product, but do not want the second product. It occurs when the tying product is patented and the tied product is un-patented, but the tying product and the sale of patented product is conditioned. So, the sale of the patented product is conditioned on the purchase of an un-patented product. Here the circumstances are something different.

If two products are useful then the scenario is absolutely different, but if one product is forced on the consumers then the circumstances are different. So, we have to look into the circumstances through different cases.

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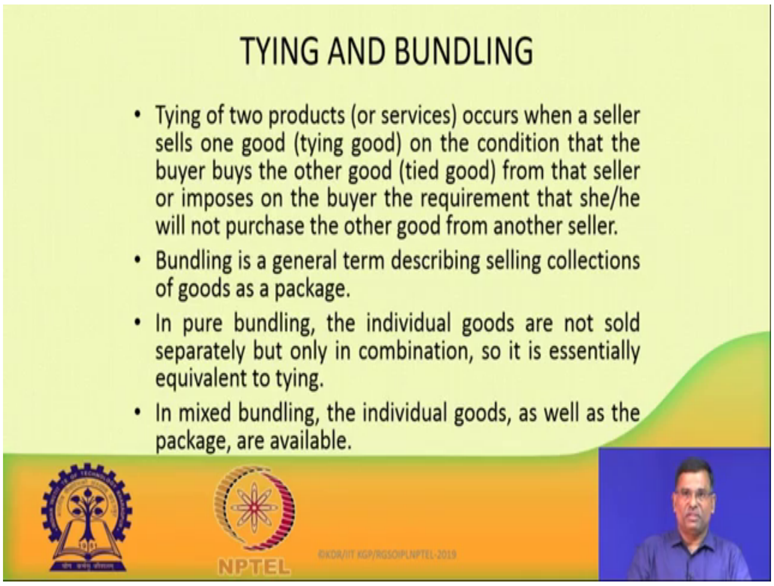

It can be products, it can be services. One of the famous cases we will start with *Microsoft case*. Microsoft in the earlier times tied their Microsoft Media Player along with their Windows. In the US jurisdiction as well as in the European jurisdiction the competition authorities held that tying of Windows products with Windows Media Player is a violation of competition provisions.

Here you can see that sometimes the seller bundle one product with other or service, the product plus service or product plus product. All this will come under the purview of bundling and here the consumers are not allowed to purchase one product alone or purchase the product or avail the services. It is problematic. So, here we can see that the goods are sold separately. If it is in combination: goods plus services it will come under the preview, it will come under the definition of tying.

In a mixed bundling, you can see that the goods are tied with goods, goods are tied with packages, goods are tied with services. So, this can also come under the definition of tying.

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One of the famous cases is the *Eastman Kodak company versus Image Technical Services*. This is 1992 case, one of the famous cases on tying. Here Eastman Kodak, a well known company at that point of time, is in all photographic goods. Eastman Kodak always conditioned all their licenses on one or more items of intellectual property and the licensees purchase another item of intellectual property or goods or service.

So, in this particular case it was held illegal per se. So, these are illegal terms. Eastman Kodak's defence was of increasing efficiency and pro-competitive benefits. So, if tying of one product with another increases efficiency in the market then the scenario is different, but it is the duty of the seller to prove how it increases the efficiency and how it has pro-competitive effects or pro-competitive benefits in the market, it is the duty of the seller to prove that these are beneficial or pro-competitive in the market, then the scenario will be different.

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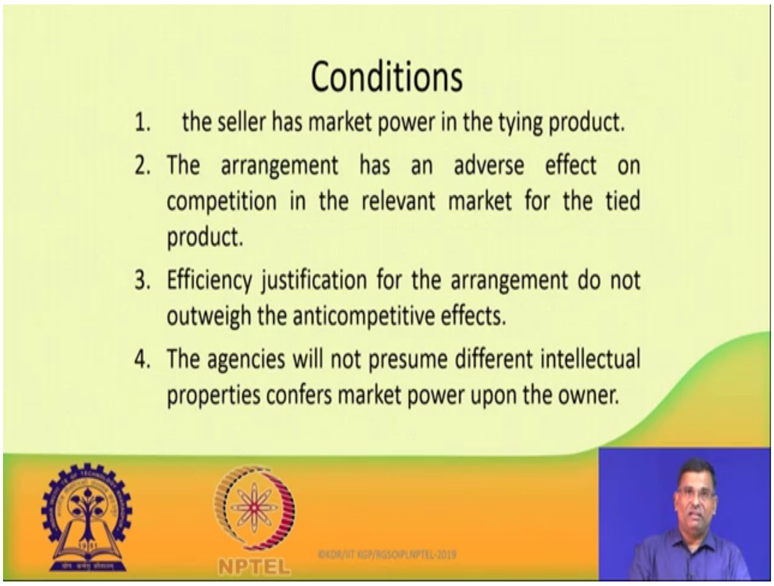

So, when you tie one product with another product you have to fulfil certain conditions. Here the seller has market power in the tying product; if there is no market power then it would not come under the purview of tying. The second condition is that the arrangement has an adverse effect on competition in the market with the tied product. So, if there are no adverse effect on the market, then the competition provisions would not be attracted.

Thirdly, the market efficiency justification. The efficiency means the market efficiency; if the tied product and tying product are going to increase the efficiency in the market, increase the competition then it would not come under the particular of tying or it outweighs the anti-competitive effects. It means that if the efficiency justification outweighs the anti-competitive effects, then it is allowed in the market.

But the competition authorities and the agencies always presume different intellectual properties confer market power upon the owner. So, that is the first condition: market power of the tying product. If the market power is not proved, then tying cannot be proved that is one of the conditions of tying.

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The case of package licensing: the licensing of multiple items of intellectual property in a single license or a group of related licenses together. This must be tested under the purview of tying arrangements and licensing of products; conditioned on the acceptance of license of another separate product. So, you can only accept these licenses at a time or together. In such situations this must pass the test of time.

Usually package licensing is supposed to promote efficiencies in the market, must have a pro-competitive effect, but if it does not have a pro-competitive effect on the market it will come under the tying arrangement and consequently violate the Sherman Act and the Clayton Act.

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The famous case of *International Salt Company versus United States,* the 1947 case. This is one of the first cases where tying was discussed elaborately by the US courts. Here you can see that salt was mostly distributed by this International Salt Company and they tied most of the machineries used for the utilisation of salt products. So, they own machines as well as the utilisation of salt products. One such machine was lixator which dissolves rock and salt into brine using various industrial processes. And the second one is saltomat; saltomat injects the salt in the form of tablets mainly used in the canning processes, in the canned food.

So, it means one is patented and another one is non patented item. But this can only be purchased together. So, the International Salt Company sold these products together and it was held in 1947 that this is a violation of Section 1 of the Sherman Act and Section 3 of the Clayton Act by the court. So, the International Salt Companies case, still holds a valid decision in the United States with regard to tying agreements. It is one of the famous judgment.

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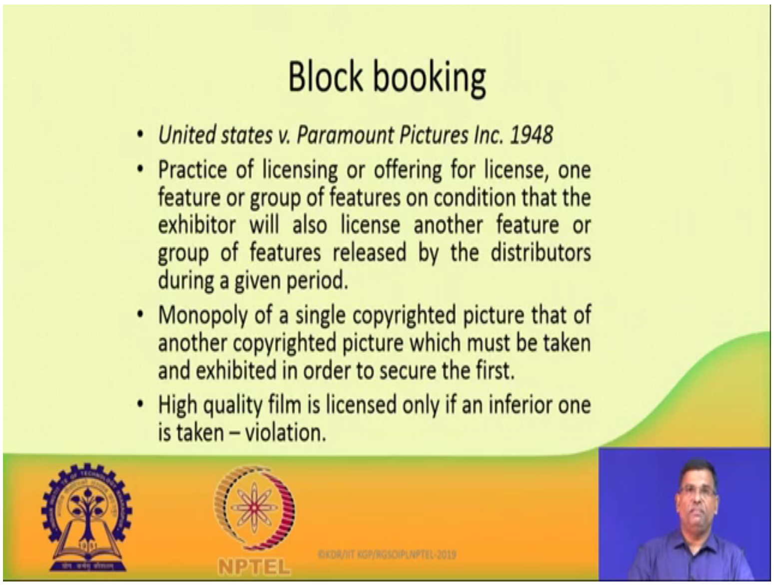

We will come to another concept of block booking. Block booking happens in the cinema in India, there are multiplexes which show cinemas and these multiplexes are owned by different groups. In Paramount Pictures case, in 1948 same thing happened. Paramount Picture is one of the biggest producers of films.

The licensing practices and the licenses offered by them was in such a way that you have to purchase all the films, all the movies of Paramount Pictures. It means that some movies may be very good, but also are forced to purchase the movies which are not so good, may be running or may not be running. So, here the execution of the license had group features. So, that means, you have no other way, you have to take all the movies produced by paramount pictures for a period of time during the contractual period.

So, here it is mostly copyrighted pictures. The copyrighted pictures must be taken and exhibited in order to secure the first. So, here high quality films are also licensed, but you are forced to take an inferior one.

It is nothing, but block booking. Block booking is nothing, but when you are forced to take an inferior quality film. You are forced to show an inferior quality film in your multiplexes along with a good quality movie even though you do not want to show it but otherwise you are not going to get a license for the particular movie. So, the court also said that this kind of block booking is a violation of the Sherman Act.

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It is something different from what we discussed earlier i.e. one product is tied to the other. There is a component of coercion here. Coercion is always an ingredient, a non-separable ingredient of tying claim and you are forced to take what you do not want to take.

Block booking compels the theatre owners to accept movies that they do not want to show. Here the actual coercion is an indispensable element of block booking which is ultimately the violation of the Sherman Act and the Clayton Act. So, the block booking is considered to be an anti-competitive conduct.

There is a price reflection of tying and a price discrimination because one movie may be priced very high, but you are ready to pay a higher price for a good movie, but you are not ready to pay another movie, yet you are forced to take it along with the highly valued high quality movie. So there is a reflection of tying between a good quality movie and a bad quality movie. This will be considered as tying.

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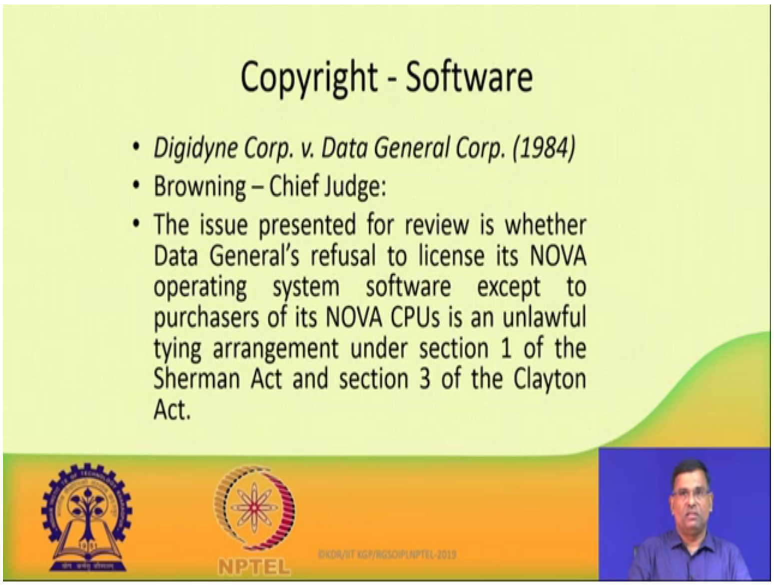

When we come to the softwares, I already mentioned about the Microsoft case. Everybody knows that software in India is non-patentable, but in the United States it is patentable. So, most of the companies like the huge companies, IT companies like Microsoft, Intel, all other companies own thousands of patents on softwares in other jurisdiction. In India softwares are protected under Copyright Law.

We will discuss here, the intellectual property component i.e. the copyright vis-a-vis the softwares in the particular case of *Digidyne Corporation versus Data General Corporation* in 1984. Its a clear case of tying i.e. a product is tied with service. Here the issue was data general corporation's refusal to license operating system. If you purchase the NOVA CPU then only you will get the software otherwise you are not going to get the softwares.

So, the court said that this is nothing but tying arrangement between the machine as well as the software which is a violation of section 1 of the Sherman Act as well as section 3 of the Clayton Act. So, here if you want to purchase one particular machine then you are forced to take the software or other way around if you want to take for example, Microsoft operating system, you want to purchase and put it in your machine, you have to purchase the software as well as the machine from Microsoft, then only you are going to get the license. So, the court clearly said that this is the violation of competition provisions.

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Here the operating system is clearly tying product with the CPU which is a tied product. There are two separate products purchased as one i.e. the tying product and the tied product. Secondly, the market power of the tying product is also very important. So, if you want the software to be there in your CPU you have to purchase the CPU from me, that is the condition.

So, here economic power with respect to the tied product is also important. So, substantial amount of commerce is in the tied product; i.e., the software tied with the CPU. There is definitely a substantial amount of commerce. So, whatever number of softwares you want to sell the same number of CPU also will be sold.

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And, you know very famous case of *Siegel versus Chicken Delight.* As I have said, pictures have copyright, the original owners have the copyright of these pictures.

Chicken delight is a famous brand and has shops in many parts of the United States. So, they have chicken delight franchise in lots of shop with a standard form of franchising agreement. So, the condition chicken delight put is that all franchisees should purchase the cooking equipment, certain dry-mix food specifically bearing trademark packaging exclusively from chicken delights as a condition of obtaining the trademark license.

Here the condition is something different when we compare it to a software or when one product is tied with another product. Here is a service, there is a product, here is a trademark because trademark contains the reputation of the company. Here the company chicken delight says that, if you want to get franchise of my brand, if you want to use my trademark then you have to purchase certain cooking equipment from me and certain mix or packaging from me then only I am going to license it to you. This is the condition.

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Here the situation is something different. Here the contractual requirement constituted certain requirement of purchasing certain equipments. So, the argument is that these equipments are necessary for keeping not only the value but the reputation of the product or the quality of the product.

Chicken delight's name, symbol, operation has the economic power but it was alleged that the franchise is tying arrangements. Why should I purchase all the cooking equipments from chicken Delight? So, the question is these arrangements whether are justified or not? In this particular case all the franchisees filed a class action against the chicken delight. So, the possible defence of chicken delight was *essential component theory.*

These equipments are essential to keep the quality of the product in order to use the trademark of chicken delight. If they can prove the essential component theory, that these are essential to keep the quality of the product then the argument of tying is not going to serve. Tying arrangement is not going to be justified in the case of essential component theory.

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But, the question is again whether they can compel the companies. Like whether Kentucky Fried Chicken KFC can compel the franchisees to purchase equipments from them?

I would say that whether it is chicken delight or KFC they have certain equipments trade secrets, these equipments or fryers are necessary to keep the taste of the food. The equipments are a necessary component of the reputation of the product, necessary component of the quality. So, it is justified. So, the tying is not going to serve.

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You cannot claim that the sale of car along with the tires is tying. Tires are essential part of a car. Without tires you cannot run a car. So, if you can prove that these equipments are necessary part of the other product then the argument of tying is not going to convince, not justifiable. So, the other question is shoe, there is no left leg shoe or right leg shoe. There is only shoe; two shoes are necessary because they are single component.

So, the question is if these are single component or different components. So, whether these are separable items or not separable items, whether the functions can happen in aggregation or it is separable, whether the amalgamation of products can happen or segregation of products can happen.

But whenever amalgamation happens or segregation happens the question of tying comes. If there is a very strong justification for tying i.e. the essential component theory if you can prove it then the argument of tying is not going to there, tying is going to be justified.

So, I strongly believe that if the chicken delight or KFC or company can prove the essential component with the help of essential component theory, they can compel their franchisees to purchase that particular equipment from them because the reputation of the product especially the food products are very important. So, but if you can prove that these are separable items then the argument will sustain.

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The *Tele-Direct* 1997 case, the selective refusals. Selective refusals by the respondents to license the trademark constituted an abuse of dominant position. But, whether it is within the legal bounds, whether I have any right to refuse to deal with anybody, this was the question. We will see the refusal to deal in the next classes.

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In the Eastman Kodak case in 1992 very strong tying comes up and the seller conditioned the sale of one product or service on the purchase of the second one. We can see that the two products or the services are in fact separate and not part of a single product because selling the product along with the post sale services are separate product, not a single product but separate product and service.

The seller has sufficient power in the market for tying product, to enforce the tying because the tying affects substantial amount of commerce. Tying affects the commerce as well. If it is beneficial for the market then the argument of tying is not going to sustain.

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In the famous ice cream case which is known as *Krehl versus Baskin Robbins Ice Cream Company* the question of franchising came. These companies always insist that they should only use our products. If you closely look into this particular case they operate in three levels. Baskin Robbins is a world famous brand of ice creams.

One: they franchise; second they operate themselves, a huge number of manufactures, 8 independent manufacturers, all of them are licensees. Then, third is the franchise stores owners. So, there is a condition that these franchise store owners will only purchase ice creams from their area franchisees; that means, geographically they divided the market.

So, per se geographically dividing the market is a violation of the competition provisions, but here the company as a policy of the company divided their business into three parts. Their own show rooms would make these ice creams and there are 8 independent manufactures which are the licensees of the company and then franchise store owners will purchase ice creams only from these particular manufactures and that also area-wise.

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The question is whether this violates the Sherman Act. They said that their product ice cream is closely tied with trademark; here we have to very closely look into the principles of tying and tied product. Here the allegation is that the ice cream, the product is tied with the trademark. Whether these are inseparable, I do not believe that a particular product is separable from its trademark because the trademark is very closely related with the reputation of that particular product.

So, Baskin Robbins ice cream trademark cannot be separated from that particular products. Here the franchisees failed to establish that Baskin Robbins ice cream products are unlawfully tied with their trademark. The trademark is non-separable from the particular product because the trademark contains the quality of the product and many other things. It contains the reputation and quality of the particular product and trademark.

So, we talked about product, product and services, we talked about one product with softwares, we talked about hardware with software, we talked about products with trademarks. In all these cases there is inseparable tying.

The court said that whenever you try to tie one product with the other one it definitely affects the market. The only question is whether it is justifiable to the extent of tying and the tied product with certain specific recommendations. But, the agencies, the competition authorities always consider tying and tied product is going to affect the market in violation of section 1 of the Sherman Act and section 3 of the Clayton Act. In some of the cases in the next classes we will see how the market is responding to these kind of activities.

In conclusion, I would say that whenever there is tying of two products for selling together when one product is connected with another product or purchase of one product is forced along with another product then the competition provisions will definitely come into play. The courts have amply held that these are violation of the competition provisions.

Thank you.

In the next class, we will look into some other components of Intellectual Property versus Competition Law.