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Service (Now) Sold Separately: The Supreme Court Expands the Per Se Prohibition of Tying Arrangements in *Eastman Kodak Co. v. Image Technical Services*

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NOTES AND COMMENTS

SERVICE (NOW) SOLD SEPARATELY: THE SUPREME COURT EXPANDS THE PER SE PROHIBITION OF TYING ARRANGEMENTS IN *EASTMAN KODAK CO. v. IMAGE TECHNICAL SERVICES*

I. INTRODUCTION

The history of American antitrust regulation has long been characterized by frequent, fundamental changes in policy and extensive, heated debate.¹ The law governing the proper treatment of tying arrangements² has always been a shining example of this debate.³ Underlying the tying arrangement dispute are two opposing views of why tying arrangements should be prohibited. The first view asserts that the only valid purpose for prohibiting tying is the promotion of economic efficiency. The second view insists that an additional reason for the prohibition is the promotion of economic health by preventing the centralization of economic power, so that competitor protection is also a valid antitrust policy goal in some situations.

In *Eastman Kodak Co. v. Image Technical Services, Inc.*,⁴ the Supreme Court reentered the antitrust fray by considering the issue of whether a seller's total lack of market power in an equipment market

1. For a thorough discussion of this history as it pertains to tying arrangements see Victor H. Kramer, *The Supreme Court and Tying Arrangements: Antitrust as History*, 69 MINN. L. REV. 1013, 1013 (1985) (asserting that the dispute over the proper application of the antitrust laws "rivals some of the debates about the world's great religions"). Cf. DONALD E. WALDMAN, *THE ECONOMICS OF ANTITRUST* 17 (1986) (analyzing the conflicting interests that are involved in the antitrust arena).

2. A tying arrangement is a "condition imposed by a seller or lessor so that a buyer or lessee may obtain a desired product (the 'tying' product) only if it also agrees to take an additional product (the 'tied' product), which may or may not be desired." BLACK'S LAW DICTIONARY 1519 (6th ed. 1990).

3. Kramer, *supra* note 1, at 1018 n.24 (noting that "[t]oday, a unanimous decision could well evoke more surprised comment than would a seriously divided opinion").

4. *Eastman Kodak Co. v. Image Technical Servs.*, 112 S. Ct. 2072 (1992).

necessarily precludes the possibility of unlawful and economically harmful behavior in the parts and service aftermarkets for that equipment.⁵ A group of independent service organizations (ISOs) challenged Eastman Kodak's sales practices that linked the sale of Kodak replacement parts to the sale of Kodak services.⁶ The ISOs claimed that Kodak's practices constituted an illegal tying arrangement and a monopolization of a relevant market in violation of both sections of the Sherman Act.⁷ Kodak responded with an argument premised on strict economic theory and on the view that the only valid purpose of the antitrust laws is consumer protection. It argued that since it lacked power in the equipment market, as a matter of law, it could not force an anticompetitive tie in the equipment's aftermarkets. In other words, it asserted that interbrand competition for its equipment would spill over to the equipment's aftermarkets, thus preventing any harm to consumers. On this basis, the District Court for the Northern District of California granted summary judgment for Kodak after truncated discovery.⁸

However, a majority of the Supreme Court reversed the District Court by accepting the plausibility of alternative theories that were also founded on an economic analysis and that, at least nominally, focused on consumer protection. Specifically, the Court speculated that previously unrecognized market imperfections—information and switching costs—could prevent the primary and derivative markets from interacting as Kodak asserted. Thus, the *Kodak* majority concluded that it was possible that unlawful tying and monopolization had occurred. In so doing, the Court laid the groundwork for prohibiting many tying arrangements which were previously considered harmless, particularly in the markets for high-technology equipment.

This note will explain the Court's analysis, point out potential conflicts that the opinion could create, and examine underlying policy-based judgments that were at play in the Court's resolution of the case. The

5. A derivative aftermarket is simply a market that is created by the need for support and maintenance of a good sold in a primary market. For example, the primary market for automobiles leads to the creation of the derivative aftermarkets for automobile maintenance and parts.

6. See *infra* part III.A.

7. Sherman Act, 15 U.S.C. § 1 (1988) ("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 illegal.").

Sherman Act, 15 U.S.C. § 2 (1988) ("Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . .").

8. *Image Technical Servs., Inc. v. Eastman Kodak Co.*, No. C-87-1684-WWS (N.D. Cal. Apr. 18, 1988).

conclusions that are reached are two-fold. First, the economic theories upon which the Court bases its decision are not completely sound. Second, despite the Court's focus on consumer protection and economic theory throughout its analysis, the resolution of the case is also based on an unexpressed policy judgment of promoting marketplace diversity by protecting competitors.

II. BACKGROUND

To understand the Court's resolution of *Kodak*, the case must be seen in the context of the pre-existing law. This requires a brief discussion of two topics: (1) the debate over why tying should be prohibited and the law that accompanies that debate; and (2) the *Jefferson Parish* decision, which attempted to settle the law of tying prior to *Kodak*.

A. *The Debate Over Tying Arrangements—Theory and Practice*

Despite the existence of legislation that prohibits tying arrangements, they are only illegal in narrow circumstances, and it is generally agreed that tying is not per se harmful. In fact, the Supreme Court has consistently adopted the view that tying arrangements should only be illegal per se where the seller has the power to force a tie onto unwilling consumers.⁹ The Court adopted this view in recognition of the fact that absent some forcing power a consumer can avoid unwanted ties by buying the tying good elsewhere.¹⁰

In recent years, however, there has been a great deal of controversy regarding exactly what conditions give a seller the ability to force a tie in an economically harmful manner. The primary source of this controversy is a basic disagreement as to the purpose for prohibiting tying. According to one view, the law of tying should seek to promote a diverse marketplace by preventing the use of ties to agglomerate economic power. Under this view, consumers should obviously be protected from being forced to accept an unwanted tie. Furthermore, at times the Court has asserted that direct protection of competitors is a valid policy goal. In fact, the Court expressly adopted this view in both *Northern Pacific*

9. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984).

10. This view can be demonstrated with the simple example of a grocer who sells sugar (the tying good) and vinegar (the tied good) in a competitive market. If the grocer requires that all sugar customers buy a bottle of vinegar, no consumer will be injured; those who do not want vinegar will buy sugar elsewhere. On the other hand, where the seller has monopoly power in the market for the tying good, what some might consider adverse effects may be produced. For example, if the grocer had a monopoly in the sugar market, he could force the sugar customers to also buy the vinegar.

*Railway v. United States*¹¹ and *United States v. Loew's*.¹² Along with this protectionist view, the Court has adopted a broad definition of what market conditions allow forcing: the seller may possess a patented or unique tying product,¹³ or a high market share of the tying product market.

According to another view, however, the only valid reason for prohibiting a tying arrangement is to protect consumers. The most adamant proponents of this view, often referred to as the "Chicago School," assert that attaining economic efficiency should be the primary goal of the antitrust laws.¹⁴ As a result, they conclude that tying arrangements rarely, if ever, adversely impact consumers, and to prohibit their use would merely cause economic harm by interfering with the potential benefits that the parties receive from the tie.¹⁵ These theorists propose that the only time that a tying arrangement should be prohibited is in the exceedingly rare event that it could create monopoly power in the market for the tied product. Although the Chicago School view is popular among scholars and economists, it has never been adopted by a majority of the Supreme Court. However, at times the Court has followed the

11. *Northern Pac. Ry. v. United States*, 356 U.S. 1, 6 (1958) (asserting that one reason ties are prohibited is that "[t]hey deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market").

12. *United States v. Loew's, Inc.*, 371 U.S. 38, 44-45 (1962) "[Tying arrangements] are an object of antitrust concern for two reasons—they may force buyers into giving up the purchase of substitutes for the tied product and they may destroy the free access of competing suppliers of the tied product to the consuming market." (citations omitted).

13. This requirement rests on the view that a seller may use the uniqueness of the product to force the customer to buy the tied product. For example, in *International Salt Co. v. United States*, 332 U.S. 392 (1947), the case that established the framework for the modern *per se* analysis, the Court held that International Salts patent's on salt-dispensing machines allowed it to force its salt products on consumers. In reaching this conclusion the Court did not consider the company's market share or even if competition on the merits was actually harmed. The Court has held that an unlawful tie may be derived from the uniqueness of a good in other contexts. *See, e.g.*, *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958) (unique land); *United States v. Loew's Inc.*, 371 U.S. 38 (1962) (copyrighted motion pictures); and *Fortner Enter., Inc. v. United States Steel Corp.*, 394 U.S. 495 (1969) (hereinafter *Fortner I*) (unique credit terms). *But see* William Montgomery, Note, *The Presumption of Economic Power For Patented and Copyrighted Products in Tying Arrangements*, 85 COLUM. L. REV. 1140 (1985).

14. The "Chicago School," derives its name from its perceived association with scholars at the University of Chicago, most recently Robert Bork and Richard Posner. For the roots of the Chicago School see Ward S. Bowman, Jr., *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957). For more recent summaries of the Chicago School's propositions see ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 90-106 (1978); H. HOVENKAMP, *ECONOMICS AND FEDERAL ANTITRUST LAW* 40-49 (1985) (summarizing the Chicago School analysis); RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 171-84 (1976).

15. The Chicago School proposes that even if a monopolist forced a tie, the consumer is no worse off than if the seller directly raised prices. As a result, the use of a tying arrangement by a monopolist indicates that there is some added economic benefit to the parties that is received by structuring the transaction with a tie.

spirit of the Chicago School and has limited antitrust protection by focusing on consumer protection. It has done this both by narrowing the range of market conditions that allow harmful tying arrangements and by requiring a showing that consumers are harmed by a tie before it will be prohibited.¹⁶

Still, a more recent view of tying arrangements, first proposed by Richard Craswell, seeks to explain why some tying arrangements might exist where traditional concepts of forcing are not at play.¹⁷ One obvious way that this could occur is where the tie is beneficial to both parties.¹⁸ However, Craswell also proposes that *harmful* ties could occur in the absence of forcing because deficiencies in information may allow a seller to implement a harmful tie.¹⁹ The most obvious way that this could occur is when the consumer does not know that a tie is involved at all.²⁰ For example, the buyer might not be aware of what he is getting into due to his own plain ignorance.²¹ Additionally, the seller may trick the buyer into entering the agreement through fraud,²² or where the consumer makes a large investment in the initial purchase of the tying good, a seller may opportunistically impose the tie after the buyer has already become "locked in."²³ Further, it may be possible for "information imperfections to lead to undesirable outcomes even when buyers know beforehand exactly what they are getting."²⁴ This might occur where the consumer

16. See, e.g., *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 611-12 (1953) (holding that a newspaper's tie of advertising space in a morning paper to advertising space in an evening paper did not violate the Sherman Act because the publisher did not possess a dominant market share in the relevant advertising market); *United States Steel Corp. v. Fortner Enter., Inc.*, 429 U.S. 610, 620 (1977) (hereinafter *Fortner II*) (The same unique credit terms involved in *Fortner I* were insufficient to establish the power to force a harmful tie. Instead, a plaintiff must also show that "the seller had the power to raise prices or to require purchasers to accept burdensome terms that could not be exacted in a completely competitive market.").

17. Richard Craswell, *Tying Requirements in Competitive Markets: The Consumer Protection Issues*, 62 B.U. L. REV. 661 (1982).

18. Craswell proposes that there are four basic types of benefits that can be associated with tying. First, a tie could lead to efficiencies in production, as where it is more efficient to produce or distribute two products as a unit. *Id.* at 681-82. Second, a tie could lead to efficiencies in selection, as where a large buyer can take advantage of economies of scale and greater bargaining power. *Id.* at 682-84. This principle underlies many franchise contracts. Third, tying could create efficiencies in product evaluation. *Id.* at 684-86. Finally, tying could create efficiencies in allocating risks. *Id.* at 686-87.

19. Economists have long recognized that imperfect information is one basic type of market failure. Other types of market failures include the existence of monopolies, externalities, or public goods. The antitrust laws have historically focused on preventing market failures that result from monopoly. For a thorough discussion of market failures see ROBERT D. COOTER & THOMAS S. ULEN, *LAW AND ECONOMICS* 45-49 (1988).

20. Craswell, *supra* note 17, at 672-75.

21. *Id.* at 672-74.

22. *Id.*

23. *Id.* at 674-75.

24. *Id.* at 675-79.

cannot estimate the cost of the various choices in the market. For example, a consumer could suffer from the inability to estimate the long-term price of the tie as compared to other market choices, the long-term quality of the alternative choices, or a combination of the two.²⁵ The end result is that the seller who imposes burdensome tying arrangements "will not lose as much business as ideally he should."²⁶

B. *The Jefferson Parish Decision*

Elements from all of these views of tying arrangements played a role in *Jefferson Parish Hospital District No. 2 v. Hyde*,²⁷ the case that established the framework in which *Kodak* was decided. *Jefferson Parish* involved a claim by an anesthesiologist that the Jefferson Parish Hospital District tied anesthesiological services to surgical services in violation of section 1 of the Sherman Act.²⁸ Despite the existence of a very critical, Chicago School based concurrence by three Justices,²⁹ a plurality of the Court created a three part test for determining if a particular tie is per se unlawful.

The first requirement is that a "substantial volume of commerce" must be foreclosed by the tie.³⁰ This requirement is a restatement of a long-held rule that seeks to avoid implementing a per se rule in situations where a small amount of commerce is involved. Without providing a precise definition of "substantial volume," the Court held that the amount of trade involved in the alleged tie of hospital services was sufficient to warrant per se condemnation.

The second requirement is that two separate products must be involved.³¹ The Court held that two separate products are only involved

25. For example, if a consumer wants to buy a car he or she can probably estimate and compare the price and quality of the various cars on the market. However, the prospective buyer may have difficulty in estimating the number of repairs that will be needed over the life of the car, how much this maintenance will cost in the future, or the quality of the repairs that each car dealer will be able to deliver. Since the consumer cannot compare the real costs of *any* choices in the market, he or she might agree to a tie between the car and future parts and service.

26. Craswell, *supra* note 17, at 678.

27. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984).

28. *See supra* note 7.

29. Justice O'Connor's concurring opinion adopted a restrictive, Chicago School analysis. She indicated that just because a seller can force a tie does not mean harmful economic effects will result. Instead, courts should only prohibit tying in the "rare cases where power in the market for the tying product is used to create *additional* market power in the market for the *tied* product." *Jefferson Parish Hosp. Dist. No. 2*, 466 U.S. at 36-37 (footnote omitted). In short, O'Connor adopted the Chicago School view that ties should only be prohibited where they might create monopoly power in the tied product market.

30. *Id.* at 16.

31. *Id.* at 20.

where separate economic demands exist for each product.³² For example, separate demands existed for anesthesiological services and surgical services because patients or surgeons often requested specific anesthesiologists for particular tasks.³³

As one might expect, the third requirement is that the tying arrangement must "involve the use of market power to force [consumers] to buy services they would not otherwise purchase."³⁴ The Court recognized that anticompetitive forcing may occur in three situations: (1) where a seller has a patent or similar monopoly over the product; (2) where the seller's share of the market is high; and (3) where the seller offers a unique product that competitors are not able to offer.³⁵ In short, the Court recognized every source of market power that it had ever accepted at any time. In applying the test to the facts of the case, however, the court was not so liberal and stressed that the tie must be forced before any harm could take place. Jefferson Parish Hospital had 30% of the market share,³⁶ and obviously had unique features—such as close proximity to home—for at least some of its customers.³⁷ However, the court held that since 70% of the local residents used other hospitals, anticompetitive forcing of anesthesiological services was not taking place.³⁸ Thus, the Court was willing to define the sources for market power broadly, but by stressing the need for the seller to force the tie gave a narrow application.³⁹

32. *Id.* This element of the test actually filled a void in the law of tying, because prior to *Jefferson Parish* "there was no generally accepted standard to determine whether what a seller required a purchaser to take was one or several products." Lynn H. Pasahow, *Recent Developments in Tying Law*, 57 ANTITRUST L.J. 379, 382 n.5 (1988). It should also be noted that this test "depends upon economic evidence rather than the nature of the linked products. The court believed such an economically based standard would render the rule more coherent than one based upon abstract inquiry into whether one or two products are involved." *Id.* at 383.

33. *Jefferson Parish Hosp. Dist. No. 2*, 466 U.S. at 22-23.

34. *Id.* at 26.

35. *Id.* at 16-18.

36. *Id.* at 7-8.

37. *Id.* at 26.

38. *Id.* at 26-27.

39. This apparent paradoxical outcome led to divergent opinions of what the decision meant. See, e.g., Roger C. Bern, *Jefferson Parish Hospital District No. 2 v. Hyde: Return to Reality in Economic Power Analysis in Tying Cases*, 53 U. MO. K.C. L. REV. 145 (1985) (indicating a return to a broad definition of market power similar to that which existed prior to *Fortner I*); W. David Slawson, *A New Concept of Competition: Reanalyzing Tie-In Doctrine After Hyde*, ANTITRUST BULL. 257, 258 (1985) (promoting the theory that the "tie-in doctrine was hardly changed."); Note, *Tying Arrangement Analysis: A Continued Integration of the Rule of Reason and the Per Se Rule*, WASH. U. L.Q. (1985) (expressing the belief that the decision "narrowed the distinction between per se and rule of reason analysis of tying arrangements"). However, in practice, *Jefferson Parish* has generally "been interpreted by the lower courts as retreating to a more rigorous market power standard" because it places the focus of the analysis on the "presence or, more often, the absence of any forcing." Pasahow, *supra* note 32, at 388.

The effect of the Court's decision was two-fold. First, it made clear that the Chicago School economic efficiency analysis was rejected and the per se rule remained intact. Second, through the application of its test, the Court limited the scope of antitrust protection to those situations where a consumer might be harmed by a tying arrangement. The Court refused to recognize the effect of the tying arrangement on injured competitors, namely Dr. Hyde, unless consumers were also harmed. Under the facts of the case it appeared that harm and forcing were unlikely since most residents used other hospitals.

Despite this focus on consumer protection, however, the *Jefferson Parish* plurality specifically denied the possibility that other market imperfections—specifically third party payment for health costs and deficiencies in consumer knowledge and information—could provide the power needed to create an anticompetitive tie.⁴⁰ The plurality recognized that these factors might have played a role and noted that “market imperfections” could decrease a consumer’s sensitivity to “the price or quality implications of a tying arrangement.”⁴¹ Further, the Court recognized that competition on the merits might suffer as a result.⁴² Without providing a reasoned analysis to explain its position, however, the Court concluded that these market failures simply “do not generate the kind of market power that justifies condemnation of tying.”⁴³ In short, the Court expressly rejected the view that unlawful tying arrangements may result from a consumer’s inadequate information. It was in this legal landscape that the facts of *Kodak* developed.

III. THE *KODAK* DECISION

A. *The Alleged Anticompetitive Behavior*

Eastman Kodak Company manufactures and sells photocopiers and micrographic equipment⁴⁴ and has always faced stiff competition.⁴⁵ However, due to specific equipment design, a Kodak customer cannot replace Kodak parts with a competitor’s parts, so Kodak equipment owners have always relied on Kodak to produce replacement parts.⁴⁶

40. *Jefferson Parish Hosp. Dist. No. 2*, 466 U.S. at 26-27.

41. *Id.* at 15 n.24.

42. *Id.*

43. *Id.* at 28.

44. *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 112 S. Ct. 2072, 2077 n.1 (1992) (listing the specific equipment involved in the lawsuit such as microfilmers, electronic scanners, microfilm viewers, Computer Output Microform recorders, and Computer Assisted Retrieval systems).

45. *Image Technical Servs. v. Eastman Kodak Co.*, 903 F.2d 612, 621 (9th Cir. 1990), *aff'd*, 112 S. Ct. 2072 (1992) (recognizing that Kodak lacked market power in its equipment markets).

46. *Eastman Kodak Co.*, 112 S. Ct. at 2077.

Kodak manufactures some parts itself and contracts out production of other parts to independent manufacturers.⁴⁷ These are and have always been the only sources for new parts.

In addition to selling parts, Kodak has always serviced its own equipment.⁴⁸ In fact, before 1982 Kodak serviced most of its micro-graphic and copier equipment.⁴⁹ Kodak does not sell a complete package of equipment along with lifetime service and parts.⁵⁰ Instead, it provides two options: (1) contracts that include parts costs; or (2) payment on a per-call basis.⁵¹

Kodak has not always been the only supplier of parts and service to Kodak equipment owners. In the early 1980's, ISOs began offering service, new parts, and used parts to Kodak equipment owners.⁵² The ISOs maintained independent parts inventories, buying some parts from Kodak but most parts from the independent parts manufacturers that produced new parts for Kodak.⁵³ The ISOs apparently filled a market niche, because they cut into the Kodak service market.⁵⁴ Further, some of the ISOs offered service for lower prices than Kodak,⁵⁵ and some customers felt the ISO service was of higher quality.⁵⁶

As might be expected, Kodak reacted to this situation. Initially, it cut some of its prices for service.⁵⁷ However, as a second response, it adopted a policy of eliminating the ISOs entirely by cutting off the supply of parts to them.⁵⁸ This general policy included four specific actions.⁵⁹

47. *Id.*

48. *Id.*

49. *Image Technical Servs., Inc.*, 903 F.2d at 614.

50. *Eastman Kodak Co.*, 112 S. Ct. at 2077.

51. *Id.*

52. *Id.*

53. *Id.*

54. The ISOs served a wide variety of customers, including "government agencies, banks, insurance companies, industrial enterprises, and providers of specialized copy and microfilming services." *Id.*

55. *Id.*; accord *Image Technical Servs.*, 903 F.2d at 614 (some ISOs "offered service for as little as half of Kodak's price.").

56. *Eastman Kodak Co.*, 112 S. Ct. at 2077.

57. *Image Technical Servs.*, 903 F.2d at 614.

58. *Eastman Kodak Co.*, 112 S. Ct. at 2078. Kodak apparently made no effort to hide the intent of its policy. An allegation from one of the ISO's customers that was received in discovery is illustrative:

In 1987, I went to Eastman Kodak . . . for an introduction of new products. At a break in one of the meetings . . . I was asked why [my company] went to third-party services. I told him that it was a matter of lower price, and better service . . . than I was able to get from Kodak. I was told [by a Kodak employee] words to the effect that it doesn't make any difference because we're going to have third-party service by the balls because of the replacement parts."

App. at 538.

59. *Eastman Kodak Co.*, 112 S. Ct. at 2077-78.

First, it refused to sell the new parts that it manufactured to anyone but buyers of Kodak equipment who used Kodak service or who serviced their own machines. Second, it made attempts to persuade the independent manufacturers to quit selling new parts to anyone but Kodak. Third, it pressured Kodak equipment owners and independent parts distributors not to sell new parts to ISOs. Finally, it restricted the availability of used machines, thus limiting the sources of used salvage parts.

The policy worked well. ISOs could not find reliable sources of new parts, and many went out of business, while others lost profits.⁶⁰ This situation forced at least some customers to buy Kodak parts.⁶¹

B. *Treatment in the Lower Courts*

The ISOs brought suit in the Northern District of California,⁶² claiming that, even though Kodak lacked market power in the equipment market, its actions constituted an illegal tying arrangement in violation of section 1 of the Sherman Act and an illegal monopolization of a relevant market in violation of section 2 of the Sherman Act.⁶³ However, the ISOs were unsuccessful; the district court granted limited discovery,⁶⁴ and then granted summary judgement for Kodak.⁶⁵

The ISOs appealed to the United States Court of Appeals for the Ninth Circuit, where the decision was reversed.⁶⁶ The court of appeals, viewing the tie as between *replacement parts* and *service*,⁶⁷ concluded that

60. *Id.* at 2078.

61. *Id.*

62. *Image Technical Servs., Inc. v. Eastman Kodak Co.*, No. C-87-1686-WWS (N.D. Cal. Apr. 18, 1988), *rev'd*, 903 F.2d 612 (9th Cir. 1990), *aff'd*, 112 S. Ct. 2072 (1992).

63. *Id.*; *see supra* note 7.

64. *Image Technical Servs., Inc. v. Eastman Kodak Co.*, No. C-87-1686-WWS, slip op. at 36B (N.D. Cal. Apr. 18, 1988), *rev'd*, 903 F.2d 612 (9th Cir. 1990), *aff'd*, 112 S. Ct. 2072 (1992). This discovery included one set of interrogatories, one set of requests for production of documents, and a total of six depositions.

65. *Image Technical Servs., Inc. v. Eastman Kodak Co.*, No. C-87-1686-WWS (N.D. Cal. Apr. 18, 1988), *rev'd*, 903 F.2d 612 (9th Cir. 1990), *aff'd*, 112 S. Ct. 2072 (1992). The district court based its opinion on three grounds. First, it asserted that the ISOs failed to show that any "contract, combination, or agreement" had taken place at all—only that a unilateral refusal to deal occurred. Second, the district court, viewing the tie as between equipment and parts, asserted that the ISOs did not show a tie had been implemented. Finally, the district court rejected the view that monopolization had occurred because there was no evidence that Kodak attempted to use its power over its own parts to gain monopoly power in any other relevant market.

66. *Image Technical Servs., Inc. v. Eastman Kodak Co.*, 903 F.2d 612 (9th Cir. 1990) *aff'd*, 112 S. Ct. 2072 (1992).

67. *Id.* at 615 (using the *Northern Pacific Railway* definition of tying arrangements. "A tying arrangement is 'an agreement by a party to sell one product but only on the condition that the buyer also purchase a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier.'" (quoting *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958))).

Kodak had two possible bases to force an anticompetitive tie on customers.⁶⁸ First, Kodak had a monopoly over its own parts. Second, its customers were “locked in” due to their large equipment investments. On these bases it reversed the district court on both the tying and monopolization claims.

C. Issues Presented to the Supreme Court

Kodak appealed to the Supreme Court. The Court granted certiorari,⁶⁹ apparently viewing the meager evidentiary record as an opportunity for a theoretical examination of the legality of tying arrangements in derivative aftermarkets. What started as a dispute between two parties evolved into a battle over policy. On one side were the ISOs; on the other were Kodak and various amici who sought to protect the interests of manufacturers of technical equipment, including trade associations and the United States.⁷⁰

To settle the dispute, the Court needed to resolve two issues. First, was it possible that Kodak, which lacked market power in its equipment market, could impose an anticompetitive tie in the aftermarkets for that equipment in violation of section 1 of the Sherman Act? Second, could these ties possibly result in a monopolization of a relevant market in violation of section 2 of the Sherman Act? Despite the efforts of Kodak, the trade associations, and the United States, the Supreme Court answered both questions in the affirmative.

D. The Supreme Court's Decision

1. The Majority's Analysis of the Tying Claim

Justice Blackmun, writing for the majority, addressed the tying claim by applying the *Jefferson Parish* analysis,⁷¹ and he quickly disposed of two parts of the test. First, all parties agreed that a substantial amount of trade was involved, so that issue was immediately dismissed.⁷²

68. *Image Technical Servs.*, 903 F.2d at 616-18.

69. *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 111 S. Ct. 2823 (1991).

70. This outside input was not simply motivated by an abstract interest in antitrust law—the resolution of the issues presented in *Kodak* could impact other pending litigation. In fact, a total of twelve separate lawsuits dealing with the specific issues raised in *Kodak* were pending in eight of the courts of appeals. See, e.g., *Abcor Corp. v. AM Int'l, Inc.*, 916 F.2d 924 (4th Cir. 1990); *Service & Training, Inc. v. Data Gen. Corp.*, 737 F. Supp. 334 (D. Md. 1990); *Allen-Myland, Inc. v. International Business Machs. Corp.*, 693 F. Supp. 262, (E.D. Pa. 1990); *Datagate, Inc. v. Hewlett-Packard Co.*, No. C 96-20018 RPA, 1988 WL 168240 (N.D. Cal. 1988), *appeal filed*, No. 88-15293 (9th Cir. 1988).

71. *Eastman Kodak Co.*, 112 S. Ct. at 2079-89.

72. *Id.* at 2079.

Next, he concluded that Kodak's policies could have created a tie between two distinct products—*parts* and *service*.⁷³ Applying the *Jefferson Parish* separate demand test, the majority reasoned that since parts and service are sold separately, separate demands probably exist for each.⁷⁴

The majority then moved to the remaining *Jefferson Parish* requirement—possession of market power sufficient to force the tie.⁷⁵ Justice Blackmun began this analysis by focusing on the apparent anticompetitive behavior in the markets for Kodak parts and equipment.⁷⁶ Kodak could clearly control the parts it manufactured, and could probably control the distribution of parts produced by the independent manufacturers. This control over the parts market might have allowed it to exclude competitors, raise service prices, and force consumers to accept Kodak service. Thus it appeared plausible that Kodak could force service on its customers as a result of its control over the needed supply of new replacement parts.

Before finally reaching a conclusion, however, the majority addressed the economic argument offered by Kodak, the Amici, and the dissent:⁷⁷ a complete lack of market power in the equipment market absolutely prevents a seller from imposing anticompetitive ties in the equipment's derivative aftermarkets.⁷⁸ This proposal rests on the belief that competition in the primary equipment market will necessarily spill over into the derivative aftermarkets. Consumers will recognize and avoid anticompetitive aftermarket ties by not buying equipment from Kodak in the first place. As a result, if Kodak demanded that its customers accept harmful aftermarket ties, they would buy equipment from other manufacturers, resulting in devastating losses that would make the practice unprofitable. Obviously, if all markets behave as this theory suggests, no seller lacking market power in an equipment market could maintain any anticompetitive aftermarket ties over the long-term.

73. *Id.* at 2079-80. Like the court of appeals, the majority adopted the *Northern Pacific* definition of tying. *See supra* note 67.

74. *Id.* at 2078. In fact, the majority pointed out that the existence of the ISOs as a separate provider of service depended on the existence of separate demands.

75. *Id.* at 2081-89.

76. *Id.* at 2081.

77. *Id.* at 2081-82.

78. *Id.* at 2082 ("A legal presumption against a finding of market power is warranted in this situation, according to Kodak, because the existence of market power in the service and parts markets absent power in the equipment market 'simply makes no economic sense,' and the absence of a legal presumption would deter procompetitive behavior.") (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986)).

The majority, however, disagreed on the ground that Kodak's theory "did not explain the actual market behavior revealed in the record."⁷⁹ Its policies had apparently driven up the total cost of owning Kodak equipment by increasing costs for service and parts. Under these circumstances, according to basic principles of supply and demand, the increased costs should have caused a decrease in Kodak equipment sales. However, there was "no evidence" or even an "assertion that Kodak equipment sales . . . dropped."⁸⁰ As a result, the primary and derivative markets simply were not interacting as Kodak's proffered economic theory suggested they should.⁸¹

Further, the Court accepted the plausibility of specific alternative theories that could explain this market failure: "significant information and switching costs" might have interfered with the interaction between the primary and derivative markets.⁸² The majority echoed Craswell's view that a consumer might accept an anticompetitive tie due to an inability to adequately estimate the prices and qualities of all available choices.⁸³ This is true because estimating the total lifecycle cost of durable equipment may be very difficult and costly.⁸⁴ Much of the information needed to make such an analysis is expensive and even non-existent at the time of the purchase.⁸⁵ Furthermore, even if consumers could acquire and process the information needed to compare the total life-cycle costs of each alternative, they might not for purely legitimate reasons.⁸⁶

There was also no absolute proof that the market would supply the needed information.⁸⁷ Whether Kodak's competitors would provide the necessary information was a question of fact.⁸⁸ It was also uncertain

79. *Eastman Kodak Co.*, 112 S. Ct. at 2084-85.

80. *Id.* at 2085.

81. *Id.* ("Kodak's theory does not explain the actual market behavior revealed in the record.")

82. *Id.* It should be noted that this assertion is in direct conflict with the *Jefferson Parish* view that these types of market failures could not invoke the protection of the antitrust laws. *See supra* text accompanying note 40.

83. *Eastman Kodak Co.*, 112 S. Ct. at 2085.

84. *Id.*

85. Justice Blackmun noted:

During the life of a product, companies may change the service and parts prices, and develop products with more advanced features, a decreased need for repair, or new warranties. In addition, the information is likely to be customer-specific; lifecycle costs will vary from customer to customer with the type of equipment, degrees of equipment use, and costs of down-time.

Id. at 2086.

86. For example, a purchaser "may not find it cost-efficient to compile the information." Also, "some consumers, such as the Federal Government, have purchasing systems that make it difficult to consider the complete cost of the 'package' at the time of purchase." *Id.*

87. *Id.* at 2086-87.

88. *Id.* at 2086.

whether the more "sophisticated" of Kodak's customers would remedy the information deficiencies, especially for all Kodak equipment purchasers.⁸⁹ For example, "sophisticated" purchasers might not make the investment needed to compare the lifecycle cost of Kodak's equipment to the lifecycle cost of competing brands.⁹⁰ Even if they did, Kodak still might be able to maintain anticompetitive practices in the parts and service aftermarkets for two reasons.⁹¹ First, if the number of these purchasers was small, Kodak might find it profitable to let them buy elsewhere so that they could continue to exploit the less sophisticated buyers.⁹² Also, Kodak could make special deals and keep these knowledgeable customers "by varying the equipment/parts/service package, developing different warranties, or offering price discounts on different components."⁹³

The majority did not provide such an extended analysis of its view that the lock-in of equipment owners might provide leverage to force anticompetitive ties.⁹⁴ The Court noted that the heavy initial outlay for Kodak equipment and associated materials might make it uneconomical to change to another equipment brand.⁹⁵ Further, it rejected the view proposed by the dissent that competition in the equipment market would prevent such forcing based on a lock-in.⁹⁶ Once again, Kodak could simply discriminate and give new customers an overall competitive deal.⁹⁷ Thus, the Court concluded that summary judgment should not be granted in Kodak's favor on the section 1 tying claim.⁹⁸

2. The Majority's Analysis of the Monopolization Claim

The majority then focused its attention on the ISOs' claim that Kodak had monopolized the service and parts markets in violation of section 2 of the Sherman Act.⁹⁹ An unlawful monopoly exists where two key elements are in place: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that

89. *Id.* at 2086-87.

90. *Id.* at 2087 ("Given the potentially high cost of information . . . it makes little sense to assume, in the absence of evidentiary support, that equipment-purchasing decisions are based on an accurate assessment of the total cost . . .").

91. *Id.* at 2086-87.

92. *Id.* at 2086.

93. *Id.* at 2087.

94. *Id.* at 2087-88.

95. *Id.* at 2087.

96. *Id.*

97. *Id.*

98. *Id.* at 2088-89.

99. *Id.* at 2089-92.

power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."¹⁰⁰ By extending the theories it presented in its analysis of the ISO's section 1 tying claim, the majority held that a material issue of fact existed as to whether Kodak's tying policies also created an unlawful monopoly.¹⁰¹

This holding was possible because the Court adopted a very narrow definition of the relevant market. Despite Kodak's claim that a single brand of a product or service cannot be a relevant market,¹⁰² Justice Blackmun asserted that the proper market definition could only be determined after a factual inquiry into the "commercial realities" faced by current Kodak equipment owners.¹⁰³ This meant the market analysis only considered the competition in the parts and service markets for Kodak machines. The spillover effect of competition in the primary equipment markets was irrelevant.

In this narrowly defined market, the Court concluded that there was a triable issue as to Kodak's possession of unlawful monopoly power.¹⁰⁴ In analyzing the tying claim, the Court had already established that parts and service for Kodak machines could create separate markets.¹⁰⁵ Further, it was apparent that Kodak, at least after it adopted policies of restricting parts sales, controlled a very high share of the parts and service markets for its equipment.¹⁰⁶

The Court also found that there was a material issue as to whether Kodak's use of monopoly power unjustly foreclosed competition.¹⁰⁷ Since Kodak conceded that it intended to push the ISOs out of the market, liability would turn on whether "valid business reasons" could explain its actions.¹⁰⁸ Kodak asserted that it had three business justifications: (1) insuring that equipment owners received high quality service, (2) reducing inventory costs, and (3) preventing free riding on Kodak's capital investment.¹⁰⁹

However, the majority concluded that material issues of fact existed as to each asserted justification.¹¹⁰ First, there was no clear evidence that

100. *Id.* at 2089 (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966)).

101. *Id.* at 2090-92.

102. *Id.* at 2090.

103. *Id.* (quoting *Grinnell Corp.*, 384 U.S. at 572).

104. *Id.* at 2091.

105. *Id.* at 2090.

106. *Id.* at 2089-90.

107. *Id.* at 2090-92.

108. *Id.* at 2091 (quoting *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 (1985) and *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 432 (2d Cir. 1945)).

109. *Id.*

110. *Id.* at 2091-92.

Kodak needed to remove all of the ISOs from the marketplace to protect its reputation—after all, some Kodak equipment owners *preferred* the ISO service.¹¹¹ Further, Kodak had not proven that its equipment customers were incapable of distinguishing poor quality service from equipment flaws.¹¹² Second, Kodak's assertion that it was actually attempting to control inventory costs was doubtful because the ISOs would not necessarily affect inventory costs.¹¹³ The majority noted that inventories are related only to the amount of parts needed, not to who makes the repairs. In fact, the inventory costs rationale simply could not explain why Kodak prevented the *independent* parts manufacturers from selling parts to the ISOs because in those situations Kodak had no inventory involved. Finally, the majority found that Kodak's alleged effort to stop free-riding, at least under the antitrust laws, was no justification at all; this type of free-riding is simply not prohibited.¹¹⁴ Thus, the Court found that there was no business justification, and that Kodak was not entitled to summary judgment on the section 2 claim, setting the stage for a great deal of debate among scholars and litigation in the federal courts.

IV. ANALYSIS OF THE DECISION

The key to understanding the *Kodak* decision is recognizing that, despite the majority's efforts to base its analysis on rational economic principles, follow the *Jefferson Parish* analysis, and keep its focus on consumer protection, more than strict economic analysis is at play in the decision. In reality, the Court takes great pains to adopt speculative economic theories and narrow market definitions. This effort indicates that what really drives the Court's decision is a desire to protect the ISOs in an effort to maintain marketplace diversity. This can be more fully demonstrated by considering two issues: (1) the extent that the Court's

111. *Id.* at 2091.

112. The majority asserted:

[Kodak's] quality justification appears inconsistent with its thesis that consumers are knowledgeable enough to lifecycle price Kodak simultaneously claims that its customers are sophisticated enough to make complex and subtle lifecycle pricing decisions, and yet too obtuse to distinguish which breakdowns are due to bad equipment and which are due to bad service.

Id.

113. *Id.* at 2091-92.

114. Instead, the Court asserted that free-riding on another business' capital investment is only disallowed where a prohibition is needed to "induce competent and aggressive retailers to make the kind of investment of capital and labor necessary to distribute the product." *Id.* at 2092 n.33. Thus, for this prohibition to apply the ISOs would have to be relying on Kodak's investment in the service market. However, the facts do not suggest that the ISOs were, and Kodak did not suggest it, either.

application of its economic theories makes sense; and (2) the extent that policy considerations might be at play in the decision.

A. *An Economic Analysis*

The key to the Court's economic analysis in *Kodak* is its proposition that information and switching costs could have kept the primary and derivative markets from operating as Kodak's theory predicted. As the *Kodak* dissent¹¹⁵ and lower court decisions have recognized,¹¹⁶ competition in a primary market impacts associated derivative aftermarkets. Rational consumers will, where it is feasible, consider the total cost of a good when making a buying decision. Accordingly, where consumers can accurately estimate the total lifecycle cost of a product, the seller will be forced to charge competitive prices for any tied derivative products, regardless of whether there is *direct* competition in the derivative aftermarkets. Thus, the *Kodak* decision's reasoning either rests solely on the view that market failures were interfering with this predicted interrelationship between the primary and derivative markets, or it is based on some policy rationale other than consumer protection. As a result, the reasonableness of the *Kodak* decision depends upon the validity of these theories and their application in the tying and monopolization claims.

1. The Tying Claim

a. *Information Costs Theories and the Jefferson Parish Framework*

In one sense, *Kodak* brings the law of tying arrangements a step closer to reality because much of its economic analysis rests on a recognition that information costs can affect market behavior in ways that should be considered in analyzing tying arrangements. It is simply untenable to presume that a consumer will make a rational buying decision, thus avoiding all anticompetitive ties, when the information needed to make comparisons between the market choices is unavailable. As Justice Blackmun noted, this problem may be pervasive when the information

115. *Id.* at 2099-2100.

116. *See, e.g.,* *Parts and Elec. Motors, Inc. v. Sterling Elec., Inc.*, 866 F.2d 228 (7th Cir. 1988) (Posner, J., dissenting) (asserting that a seller who lacks power in an equipment market could not successfully maintain a harmful tie for the equipment's parts); *Grappone Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 798 (1st Cir. 1988) (asserting that a car manufacturer could not tie car parts to car sales where car dealers could easily sell other car brands). *Cf. A. I. Root v. Computer Dynamics, Inc.*, 806 F.2d 673 (6th Cir. 1986) (defining the relevant market as small business computers—not a single brand of computer—for purposes of analyzing the effect of a tie between the single brand of computer and a DOS system).

needed for accurate lifecycle pricing is impossible or costly to obtain and may not be supplied by the marketplace.¹¹⁷ Further, despite the dissent's implications to the contrary,¹¹⁸ a rational consumer might view the cost of obtaining the needed information as outweighing the potential benefits. The end result is that, where information is scarce and expensive, long-term and even permanent market distortions could occur when direct competition in an aftermarket is destroyed by a tying arrangement.

It is equally clear, however, that information costs and deficiencies could not result in a seller *forcing* a tie onto consumers, at least not in the *Jefferson Parish* sense of the word. In fact, even Richard Craswell was not concerned that forcing was the problem.¹¹⁹ Instead, the potential source of market failure is the consumer's inability to accurately compare the choices that are freely available in the marketplace.¹²⁰ Another scholar describes this potential cost-hiding effect of tying arrangements as "eliminating, blurring, or confusing competition on the merits."¹²¹ This muddling effect could operate in two specific ways, neither of which involves forcing. Initially, the lack of information causes the consumer to accept a harmful tie. Then, since the consumer only receives the tied good from one source, there is no basis upon which to evaluate its relative price and quality once it is received. The result could be that competition on the merits decreases, and the seller can charge more, provide less, or some combination thereof.

However, because the *Kodak* Court analyzes the case within the *Jefferson Parish* framework, it does not directly recognize that this muddling effect of informational deficiencies is the primary source of market failure. Instead, it asserts that the potential basis for invoking antitrust protection is Kodak's ability to force service due to its control over the supply of its own parts. Under the majority's forcing analysis, however, the consumer's informational deficiencies are still the real reason that the anticompetitive ties are possible. Even if Kodak could force ties due to its control over parts, rational consumers would avoid any aftermarket ties by not buying Kodak equipment if they possessed complete, accurate, and reliable information. Thus, the source of any potential harm

117. See *supra* text accompanying notes 84-90.

118. *Eastman Kodak Co.*, 112 S. Ct. at 2097 (Scalia, J., dissenting) (asserting that "we have never before premised the application of antitrust doctrine on the lowest common denominator of consumer").

119. Craswell, *supra* note 17, at 663 (stating clearly that the purpose of his analysis was to depart "from the traditional tie-in literature by analyzing the conditions under which tie-ins are likely to be imposed by sellers *without any monopoly power*") (emphasis added).

120. *Id.* at 675-76.

121. See Slawson, *supra* note 39, at 268.

must be a breakdown in the interaction between the primary and derivative markets, and the Court's focus on the ability to *force* anticompetitive ties is misplaced.

This quirk in the majority's analysis is not simply a matter of semantics; it leads to ambiguities and analytical sidestepping. First, the Court's use of a forcing test creates a legal precedent that could lead to inconsistent outcomes in very similar cases. Strictly following the *Jefferson Parish* requirements, the majority proposes that the per se rule may be invoked only where there is a *forced* tie between two aftermarket products and information costs prevent the consumer from recognizing and avoiding the anticompetitive tie. Furthermore, it is not clear that the Court intends to provide *any* protection where a seller has directly implemented a tie based on the same information deficiencies.¹²² Thus, if Kodak had directly tied its equipment sales to all maintenance costs (including parts and service) and then charged supracompetitive prices for the maintenance costs, the practices would be allowed. This would be true even though the problems of inadequate information—and the potential ability to charge supracompetitive prices—are identical in both situations; all that is different is the formulation of the problem.¹²³ Even more importantly, in both situations the real source of market failure is not based on forcing, but on the breakdown between the primary and derivative markets caused by muddling of competition on the merits.¹²⁴

122. In a footnote the majority seems to indicate that a consumer's lack of information, standing alone, would not be enough to invoke antitrust protection. Justice Blackmun asserts that:

Whether a tie between parts and service should be treated identically to a tie between equipment and service, as the dissent and Kodak argue, depends on whether the equipment market prevents the exertion of market power in the parts market. Far from being "anomalous," requiring Kodak to provide evidence on this factual question is completely consistent with our prior precedent.

Eastman Kodak Co., 112 S. Ct. at 2087 n.24. This statement indicates that the majority would not prohibit a direct tie in two ways. First, Justice Blackmun does not directly contradict the dissent's assertion that a direct tie would be allowed. Second, the statement focuses on the "exertion of power," which implies that forcing is absolutely required.

123. The *Kodak* dissent correctly recognized that the economic effect of the alleged tie, between parts and service, was the same as if the tie was between equipment and parts. After all, the real effect of the restrictive parts policies is to create a "bundling of equipment on the one hand, with parts and service on the other." *Id.* at 2095. Thus, the dissent reasoned that the economic analysis of the tie should be no different than if the tie was directly between equipment and parts, and concluded that the absence of forcing of equipment meant that the tie was harmless. *Id.* at 2095-96. In particular, the dissent pointed out that:

It is quite simply anomalous that a manufacturer functioning in a competitive equipment market should be exempt from the *per se* rule when it bundles equipment with parts and service, but not when it bundles parts with service. This vast difference in treatment of what will ordinarily be economically similar phenomena is alone enough to call today's decision into question.

Id. at 2096.

124. The Court could have asserted that the real tie was between equipment and service that

The obvious answer is that if information costs are to be recognized as a basis for invoking section 1, their form is irrelevant. Instead, courts should directly recognize the real economic effect of tying in the presence of significant information costs and allow claims even in the absence of forcing. It is likely that judicial attempts to resolve this problem will be the legacy of the *Kodak* decision.

Additionally, slipping into the *Jefferson Parish* analysis creates a precedent that potentially allows the imposition of a per se prohibition based on the existence of information costs; however, the Court completely fails to discuss whether such a per se rule is appropriate. Even if the per se rule is proper where a seller forces the tie—which in and of itself has been vigorously questioned¹²⁵—there is no reason to assume that a similar rule is appropriate where the real source of the ability to implement the tie is inadequate information. The existence of information deficiencies coupled with a tying arrangement is not necessarily harmful. For example, such a tie could actually help consumers cope with inadequate information by aiding in product selection.¹²⁶ Craswell proposed several alternative, non-antitrust remedies that might correct the effects of ties resulting from inadequate information.¹²⁷ However, should the Court decide to remedy these market failures by applying the antitrust laws, the analysis might best proceed under a rule of reason.¹²⁸ At the very least, in this context courts should give the per se test a very

required new parts. Under this view, the limitation of new parts availability would really be a *mechanism* by which the tie was implemented. Admittedly, this view of the tie does not fit the description of a typical tying arrangement. Instead, it would amount to a uniform refusal to deal creating a market environment where consumers would be forced to buy parts and service from the same source that supplied the equipment. However, the Court has recognized that the legality of a particular type of behavior "depends on its competitive consequences, not on whether it can be labelled 'tying'." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 21 n.34 (1984).

125. See *supra* text accompanying note 14.

126. A prime example of this healthy use of tying arrangements is a franchise agreement where the franchisee agrees to purchase supplies from the franchisor, or at least as selected by the franchisor.

127. On this point Richard Craswell noted that "[l]imiting the choice to complete laissez-faire or total prohibition, however, ignores a large set of alternative remedies. This ignorance may be understandable, for under antitrust law these are the only choices available. Tie-ins must be exonerated completely or subjected to treble damage sanctions which effectively prohibit their further use." Craswell, *supra* note 17, at 688.

128. Such a rule could take several factors into consideration. First, courts should focus on whether the existence of information deficiencies actually created anticompetitive conditions—imperfect information is commonplace and does not always lead to harmful conditions. Second, courts should consider whether the seller made efforts to inform the consumer of the existence and costs of the tie. Finally, courts should consider whether the tie is really beneficial—a tie should not be prohibited where the parties agreed to it based on a perceived mutual benefit. For more information on considerations concerning possible remedies see Craswell, *supra* note 17, at 687-700.

narrow application, limiting it to situations where a factual inquiry shows that a tie is creating harm.

b. Consumers' Switching Costs as a Basis For an Aftermarket Tie

The majority's claim that a lock-in of equipment owners could lead to an anticompetitive aftermarket tie is even more problematic. Specifically, the Court's conception of the effect of a lock-in on equipment owners fails to explain why a breakdown between the primary and derivative markets would occur, which is what the theory is designed to accomplish.¹²⁹ The presence of switching costs is simply not related to a new purchaser's ability to recognize and avoid harmful ties. If a potential equipment purchaser could detect anticompetitive aftermarket ties, the switching costs of current Kodak equipment owners would in no way encourage acceptance of this new tying arrangement. All that the lock-in theory does explain is why Kodak could implement a harmful tying arrangement on existing equipment owners. If it would be more costly to buy new equipment than to accept an unfavorable deal on parts and service, a rational consumer would continue to accept the tie. However, even this abuse of market power would correct itself as the equipment owners phased out their Kodak equipment.

Further, under the specific facts of Kodak, it is unlikely that, as the majority claimed,¹³⁰ Kodak could impose anticompetitive ties on all equipment owners and simultaneously avoid a decrease in new equipment sales by giving new equipment buyers special treatment. First, as the majority forcefully noted, the presence of information deficiencies would make it difficult or impossible to measure cost of accepting the tie.¹³¹ Thus, it would be very difficult to properly compensate a new purchaser for accepting future service and parts on unknown anticompetitive terms. Additionally, even if information costs played no role, Kodak's sales practices do not support the majority's proposition that Kodak might have catered to wary equipment customers by altering the package price of "equipment/parts/service."¹³² Kodak only offers one-

129. *Eastman Kodak Co. v. Image Technical Servs.*, 112 S. Ct. 2072, 2085 (1992).

130. See *supra* text accompanying note 93.

131. The mere assertion that Kodak would even need to take action to prevent new customers from fleeing is fundamentally inconsistent with the proposal that information costs would make it difficult, if not impossible, to perceive the existence of a harmful tie. Thus, the Court's information costs theory and lock-in theory are virtually mutually exclusive.

132. See *supra* text accompanying note 93. Kodak's policy of treating equipment purchasers differently is representative of virtually any seller of any high-tech equipment. To limit competitors

year service contracts or charges on a per-call basis.¹³³ Within a year's time *all* Kodak equipment owners could be subjected to a change in prices or service. Some might just be allowed to wait longer—until their one-year service contracts run—before harsher policies could be implemented.

However, even though switching costs, standing alone, could not have allowed Kodak to impose anticompetitive ties on a long-term basis, they could facilitate Kodak's exploitation of consumers' information costs. First, Kodak's ability to rely on income from locked-in equipment owners would decrease the business risk in initially adopting the restrictive parts policies. Second, to the extent that locked-in customers actually could determine the complete lifecycle costs of owning Kodak equipment, they would have less incentive to do so. After all, once locked-in, even consumers that suspect they are being harmed by a tie might not make a thorough investigation if they knew that the cost of switching brands would be prohibitive. Thus, the Court's focus on switching costs as an *independent* basis for long-term anticompetitive behavior appears flawed.

2. The Monopolization Claim

If long-term consumer protection is the Court's goal, the resolution of the monopolization claim is also troublesome. Particularly, the majority's assertion that the relevant market definition could be limited to the choices available to *current* equipment owners is flawed. In order for this definition to be proper, competition in the primary market could not spill over into the derivative aftermarkets. As a result, Kodak's ability to act as a monopolist in the aftermarkets for its own equipment depends on whether the alleged market imperfections—information deficiencies and switching costs—could isolate the aftermarkets from the inter-brand equipment competition to the extent that monopolization would occur. However, these market imperfections could not lead to a long-term monopolization of the aftermarkets.¹³⁴

First, information deficiencies could never lead to the creation of a monopoly in a derivative aftermarket. A monopolist possesses the ability

from engaging in this discrimination would prohibit sellers from adapting to the specific needs of their customers, an activity that is essential to free trade.

133. See *supra* note 51.

134. *Accord* *Virtual Maintenance, Inc. v. Prime Computer, Inc.* 957 F.2d 1318, 1328 (6th Cir. 1992) ("Defining the market by customer demand *after* the customer has chosen a single supplier fails to take into account that the supplier . . . must compete with other similar suppliers to be designated the sole source of in the first place.").

to charge supra-competitive prices because he controls the choices that are available to the consumer. In fact, the "relevant market" is merely the area of commerce in which a monopolist, due to his high market share, controls the choices available to consumers to fill a given need.¹³⁵ However, as already explained,¹³⁶ information deficiencies do not lead to the forcing of choices. Instead, they muddle the relative costs and benefits of the choices that clearly are available.

The importance of this distinction becomes clear when the differing economic effects of each scenario are considered. If Kodak were a monopolist it would seek to decrease supply and charge supracompetitive rates.¹³⁷ Similarly, if information costs were truly the source of the problem, Kodak might still maintain supracompetitive rates as a long-term policy. However, any potential anticompetitive behavior would be limited by the need to attract *new* equipment customers. Kodak would seek to set the price-quality mix at a level just harmful enough so as to evade detection by potential and existing equipment owners. Thus, Kodak's so-called monopoly profits would only be as good as the muddling of competition would allow. In short, although Kodak's actions could be improper, no monopoly would be present.

Additionally, switching costs could not lead to the creation of profitable, long-term monopolistic behavior in the aftermarkets. First, absent either information costs or some principled basis for discriminating between current equipment owners and new equipment purchasers—which was almost surely not present under the facts of Kodak—acting as a monopolist would lead to drastic decreases in new equipment sales. The lost sales of new equipment would certainly prove unprofitable over the long-term and would probably be unprofitable even in the short-term. Second, even if the monopolistic behavior could be focused at the locked-in owners, the practice would be temporary—as equipment would wear out and is replaced, the monopoly would crumble.¹³⁸ Thus, applying section 2 of the Sherman Act would be both unnecessary and inconsistent with the

135. See *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377, 391 (1956) ("where there are market alternatives that buyers may readily use for their purposes, illegal monopoly does not exist"). See also WILLIAM C. HOLMES, 1992 ANTITRUST LAW HANDBOOK 277 (1992).

136. See *supra* text accompanying note 119.

137. Cf. WALDMAN, *supra* note 1, at 38 ("To an economist, monopoly power is the ability to control price. In a technical sense this control should be complete, meaning that the monopolist should control 100 percent of the market. In a realistic, or legal, sense this condition is rarely met, unless a market is defined very narrowly.").

138. It is also very likely that this behavior would prove unprofitable over the long-term. First, the consumers who were mistreated by Kodak would likely never buy from them again. Additionally, subjecting consumers to monopolistic conditions does little to promote good will with the public.

historical purposes of the Act.¹³⁹

C. *A Shift In Policy?*

These so-called “flaws” in the majority’s analysis are better viewed as symptoms of a policy-driven decision by the Court. Certainly, the majority is not using theories that it feels are completely invalid just to reach a policy goal. However, the *Kodak* Court was very willing to accept speculative theories and narrow market definitions, and it is likely that this was done to implement a policy of maintaining marketplace diversity by protecting competitors. Specifically, the Court seeks to shield small providers of service in the aftermarkets for high-technology equipment. Justice Blackmun expressly indicates that this is one consideration and notes that Kodak’s proposed legal rules are unacceptable, not because they are unsound from an economic efficiency standpoint, but because they would “exempt a vast and growing sector of the economy from antitrust laws.”¹⁴⁰ Clearly, the majority *intends* to make it more difficult for manufacturers to tie parts and service and drive competing service firms out of business. It is likely they will be successful. At the very least, the Court’s recognition of the effect of information and switching costs, along with the holding that a single-brand aftermarket can be a relevant market, will allow more plaintiffs to avoid summary judgement and force defendants into trial. In this way the Court affords antitrust protection to the “vast and growing sector of the economy” that is not a party to the *Kodak* suit.

This leads to the question of how far the Court intends to extend antitrust protection to competitors. In particular, does the Court seek a return to the *Northern Pacific*¹⁴¹ and *Loew’s*¹⁴² views that competitor protection, standing alone, is a valid basis for invoking the protection of the antitrust laws? If the *Kodak* decision is any indication, the focus on

139. Justice Scalia, in his dissent, vehemently attacked this application of section 2 and claimed that:

By permitting antitrust plaintiffs to invoke § 2 simply upon the unexceptional demonstration that a manufacturer controls the supplies of its single-branded merchandise, the Court transforms § 2 from a specialized mechanism for responding to extraordinary agglomerations (or threatened agglomerations) of economic power to an all-purpose remedy against run-of-the-mill business torts.

In my view, if the interbrand market is vibrant, it is simply not necessary to enlist § 2’s machinery to police a seller’s intrabrand restraints.

Eastman Kodak Co., 112 S. Ct. at 2101 (Scalia, J., dissenting).

140. *Id.* at 2089 n.29.

141. *See supra* note 11.

142. *See supra* note 12.

forcing and consumer protection remains intact. After all, Justice Blackmun mechanically applied *Jefferson Parish's* three-part test. This application amounted to a stamp of approval on *Jefferson Parish* by a majority of the Court. Further, even if the Court was concerned with protecting competitors, it based its decision upon economic theories that provided a consumer protection rationale for what it was doing. Thus, the Court apparently intends to adhere to *Jefferson Parish*, but it is willing to become creative where it appears that a large number of competitors are being harmed by a particular type of tying arrangement.

Since it is clear that the Court does not seek to establish an express policy of competitor protection, the truly difficult problem posed by *Kodak* is determining when the unspoken policy of competitor protection applies. In other words, now that the Supreme Court has become creative, when should the lower courts follow suit?

The answer lies in a careful consideration of *Jefferson Parish* and *Kodak*. In a very fundamental way, the Court's adherence to *Jefferson Parish* in *Kodak* indicates that the opinions share the same goal—both are ultimately aimed at consumer protection. The *Jefferson Parish* Court was unwilling to adopt speculative theories and narrow market definitions, but the number of competitors and consumers affected was small. The *Kodak* Court, however, did not want to impose legal rules allowing complete removal of competition from aftermarkets based on manufacturer's inherent control over needed materials. Economic theory clearly explains why competition in a primary market would maintain a theoretical efficiency in an aftermarket. However, the elimination of such a great volume of diversity in the marketplace causes economic harms that are not accounted for by strictly applied, economic efficiency-oriented theories.¹⁴³

Thus, *Kodak's* stricter tests should only be applied where two conditions are met: (1) it is clear that the parties to the tie did not attain real benefits from the tie; and (2) allowing the particular tie would decrease the diversity in the marketplace to a degree that consumers would be harmed. If *Kodak* is applied in this narrow manner the fact that its economic theories are flawed becomes significantly less troubling. Furthermore, if applied in this manner, *Kodak* would not only be consistent with the policy underlying *Jefferson Parish* but also with the policy underlying the whole history of the law of tying arrangements.¹⁴⁴

143. *Accord* Slawson, *supra* note 39, at 264-66.

144. *Cf.* Kramer *supra* note 1, at 1066-67. At least one scholar would probably agree and asserts:

V. CONCLUSION

The *Kodak* decision will certainly create a great deal of controversy and spark new debate among legal and economic thinkers. Many will fundamentally disagree, as did the dissent, that information and switching costs should ever provide a basis for invoking the protection of the antitrust laws. Further, even those who agree with the Court's underlying theories, at least upon careful consideration, should note that *Kodak* may become very problematic precedent. Application of the case is likely to be inconsistent and, if applied broadly, could ultimately injure competition by penalizing procompetitive ties. Further, the opinion's acceptance of speculative theories to reach a policy goal—which in and of itself is not clearly defined—is also troubling.

However, the potential harm that the opinion could cause is not inevitable. Due to the fact-specific nature of the case, lower courts could easily limit the opinion's application to the situations where it appears that actual market failures are promoting activities that are clearly anticompetitive. Further, lower courts should keep in mind that the apparent policy decision made by the Court is aimed at promoting marketplace diversity. *Kodak* does not assert that harm to competitors is equivalent to an antitrust violation. In these ways, the opinion's flaws may be limited with relative ease, and it might ultimately cause much more dispute in academic circles than actual harm in the industries of our country.

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The history of the law of tying arrangements has been one of changing tests reflecting changing theories of legitimate application of the antitrust laws. The law has evolved through shifting judicial attitudes, attitudes that sometimes emphasize the contribution of tying arrangements to efficiency and other times insist that other values, such as preservation of competition, control. It cannot be denied that the Supreme Court opinions developing antitrust law have been principled; the difficulty is that two sets of principles, each at war with the other, exist at any given moment. The law pronounced by the Court depends on which principle reaches the result that, to the majority, seems most just, fair, reasonable, or workable.

Kramer, *supra* note 1, at 1066-67.