



eSAPIENCE CENTER FOR COMPETITION POLICY

CASE NOTE:

ILLINOIS TOOL WORKS V. INDEPENDENT INK

Joshua D. Wright

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*Illinois Tool Works Inc. v. Independent Ink, Inc.***Joshua D. Wright**[♦]**I. *Illinois Tool Works Inc. v. Independent Ink, Inc.***¹

The contractual arrangement in *Independent Ink* is a classic example of a metering tie.² A subsidiary of Illinois Tool Works, the Trident division, licensed its patented printheads to original equipment manufacturers on the condition that they purchase non-patented ink from Illinois Tool. Independent Ink, Inc., a rival distributor and supplier of ink and ink products, brought suit alleging that Illinois Tool Works engaged in an unlawful tying arrangement in violation of section 1 of the Sherman Act and monopolization contrary to section 2 of the Sherman Act.³ The district court granted Illinois Tool's motion for summary judgment on all claims,⁴ only to be reversed by the Federal Circuit, which held that "where the tying product is patented or copyrighted, market power may be presumed rather than proven."⁵ The Supreme Court granted certiorari in order to address "whether the presumption of market power in a patented product should survive as a matter of antitrust law despite its demise in patent law."⁶

Justice Stevens' opinion is largely devoted to identifying the origins of the presumption of market power in patent misuse doctrine,⁷ and the migration of that presumption into antitrust law in *International Salt Co. v. United States* upon the urging

[♦] Assistant Professor, George Mason University School of Law. This case note relies on my prior analysis of the decision. See JOSHUA D. WRIGHT, MISSED OPPORTUNITIES IN INDEPENDENT INK, 2005-2006 *Cato Supreme Court Review* 333 (2006).

¹ *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 126 S.Ct. 1281 (2006), rev'g 396 F.3d 1342 (Fed. Cir. 2005).

² Metering arrangements in this context involve a tying good a tied good. Economists generally refer to tying arrangements that require the purchase of a complementary good as "metering ties," because they allow the seller to charge lower package prices to those who use the product less intensely and, conversely, higher package prices relative to costs for high intensity users. Examples of "metering" are common in the modern economy: computers and punch cards, razors and razor blades, video game consoles and video games, and, of course, printers and ink.

³ 126 S. Ct. at 1284-85.

⁴ *Independent Ink, Inc. v. Trident, Inc.*, 210 F. Supp. 2d 1155, 1173 (C.D. Cal. 2002).

⁵ 396 F.3d at 1348. The Federal Circuit argued that the presumption was required under prior Supreme Court precedent. *Id.* at 1348-49 ("*International Salt* and *Loew's* make clear that the necessary market power to establish a section 1 violation is presumed.>").

⁶ 126 S.Ct. at 1284.

⁷ See *Motion Picture Patents Co. v. Universal Film Manufacturing. Co.*, 243 U.S. 502 (1917).

of the United States.⁸ Having identified the source of the doctrine and its migration into antitrust jurisprudence, the Court noted that Congress had since eliminated the presumption in the same patent misuse context in 1988⁹ and the Court concluded that “it would be anomalous to preserve the presumption in antitrust after Congress has eliminated its foundation.”¹⁰

The Court’s rejection of the patent presumption is worthy of praise. Scholarly commentary has nearly universally adopted the view that the patent presumption is both theoretically¹¹ and empirically misguided.¹² The presumption improperly shifted a substantial burden to antitrust defendants without the power to impact market conditions, thus chilling welfare-enhancing competition.¹³ But the manner in which the Court

⁸ 332 U.S. 392 (1947).

⁹ 35 U.S.C. § 271(d)(5).

¹⁰ 126 S. Ct. at 1291.

¹¹ An exchange between Kathleen Sullivan, on behalf of the respondent, and the Court is telling:

Ms. Sullivan: The patent presumption, not a rule, is a sensible rule of thumb for capturing the wisdom that patents used to enforce requirements ties are more likely than not to show market power. That’s what they’re intended to do through barriers to entry, and that’s what they have done. In fact, the petitioners and Government have been able –unable to show a single procompetitive tie.

Chief Justice Roberts: Are you conceding that the presumption makes no sense outside of the requirements metering context?

Ms. Sullivan: Mr. Chief Justice there could be a sensible argument that you should always presume requirements ties to indicate market power. That’s not the law, and we don’t urge it here

Justice Stevens: I’m kind of curious what your answer is to the Chief Justice’s question.

(Laughter).

Transcript of Oral Argument at 43-44, *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 126 S. Ct. 1281 (2006)(No. 04-1329).

¹² See, e.g., F.M. Scherer, *The Value of Patents and Other Legally Protected Commercial Rights Panel Discussion* (1984), in 53 *Antitrust L.J.* 535, 547 (1985) (“studies suggest that the vast majority of all patents confer very little monopoly power”); John R. Allison et al., *Valuable Patents*, 92 *Geo. L.J.* 435, 437 (2004).

¹³ Chief Justice Roberts and Justice Kennedy recognized this effect of the presumption at oral argument despite attempts to frame the impact of the presumption as de minimis because it was simply a rebuttable presumption with respect to a single element of a tying claim. Transcript of Oral Argument, *supra* note 11, at 34-36.

reaches this result is worthy of some critical analysis.¹⁴ I have written elsewhere that the Court's decision to reject the presumption on the grounds that *International Salt* did not rely on the use of a requirements tie in presuming market power, rather than unequivocally stating that price discrimination cannot imply antitrust market power as an economic matter, was a missed opportunity to clarify antitrust policy in an area of growing importance: competitive price discrimination.¹⁵

The decision, however, also illuminates a number of interesting issues with respect to antitrust doctrine. Perhaps the most fundamental of these is what *Independent Ink* teaches us about the Court's understanding of antitrust market power. I argue here that the Court's analysis correctly recognizes that competitive price discrimination is unlikely to raise antitrust issues, but implicitly endorses a troublesome own-elasticity of demand formulation of antitrust market power.

II. *Independent Ink* and Antitrust Market Power

The Court's discussion of market power, and more specifically the conditions under which price discrimination implies market power, responds to the argument raised by Professors Barry Nalebuff, Ian Ayres, and Lawrence Sullivan that the patent presumption was appropriate for metering ties because they involve price discrimination which demonstrates market power:¹⁶

As we have already noted, the vast majority of academic literature recognizes that a patent does not necessarily confer market power. *Similarly, while price discrimination may provide evidence of market power, particularly if buttressed by evidence that the patentee has charged an above-market price for the tied package, it is generally recognized that it also occurs in fully competitive markets. We are not persuaded that the combination of these two factors should give rise to a presumption of market power when neither is sufficient to do so standing alone.* Rather, the lesson to be learned from *International Salt* and the academic commentary is the same: Many tying arrangements, even those involving patents and requirements ties, are fully consistent with a free, competitive market. For

¹⁴ See also Kevin D. McDonald, *Moving Forward While Facing Backward: Illinois Tool Rejects the Presumption of Market Power in Tying Cases*, 20(3) *Antitrust* 33 (Summer 2006) (criticizing Justice Stevens' analysis for failure to provide guidance on tying doctrine).

¹⁵ Joshua D. Wright, *Missed Opportunities in Independent Ink*, 2005-2006 *Cato Supreme Court Review* 333 (2006).

¹⁶ Brief of Professors Barry Nalebuff, Ian Ayres, and Lawrence Sullivan as Amici Curiae in Support of Respondent, *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 126 S.Ct. 1281 (2006) (No. 04-1329).

this reason, we reject both respondent’s proposed rebuttable presumption and their narrower alternative.¹⁷

Richard Taranto has argued that this formulation “implicitly, but necessarily, adopted a robust understanding of the market power that must be proved for an antitrust challenge to a tying arrangement.”¹⁸ Taranto defines “robust” market power as requiring more than “a departure from the classical model of perfect competition under which sellers face horizontal demand curves,” and finds support for this interpretation in the Court’s citation to academic commentary which collectively embraces the idea that deviations from the perfectly competitive model are ubiquitous in the modern economy, occur in competitive markets, and are not signs of market failure.¹⁹ This analysis is surely correct. But while it is true that the Court recognizes that slight deviations from the perfectly competitive model do not always imply the presence of market power, the Court’s analysis and the academic commentary cited in its support, suggests a problematic own-elasticity of demand formulation of antitrust market power. Indeed, the Court concedes that price discrimination alone may provide evidence of market power under some conditions, and especially when accompanied by above-cost package pricing.²⁰

The Court’s appeal to academic commentary is also consistent with an own-elasticity of demand formulation of market power. While the citation to Baumol and Swanson is consistent with the argument that price discrimination does not imply antitrust market power in a world where nearly all firms face downward sloping demand curves,²¹ the subsequent two citations explicitly adopt the elasticity of demand formulation. Both commentators accept the proposition that price discrimination implies some market power, but not enough to deserve antitrust scrutiny.²² Combined with the

¹⁷ 126 S. Ct. 1281, 1291-92 (2006) (citations omitted)(emphasis added).

¹⁸ Richard G. Taranto, *Illinois Tool Works v. Independent Ink: A Lawyer’s Take on Ending Special Suspicion of Patent Tying*, 2 Competition Policy International 169, 175 (Autumn 2006).

¹⁹ *Id.* at 176.

²⁰ 126 S.Ct. at 1291-92.

²¹ William J. Baumol & Daniel G. Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power*, 70 Antitrust L.J. 661, 666 (2003) (“we assert that evidence of these practices by itself is not enough to demonstrate market power, and in some cases may even establish a presumption of its absence”).

²² PHILLIP E. AREEDA & HERBERT HOVENKAMP, 9 ANTITRUST LAW ¶ 1711 at 100-15 (2d ed. 2004); WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* 374-75 (2003).

Court's earlier statement that price discrimination might sometimes imply antitrust market power, reliance on these scholarly commentaries accepting that price discrimination implies at least some level of antitrust market power is at least suggestive of the own-price elasticity formulation.

The economic error in the own-price elasticity formulation is straightforward. Nearly all firms in the modern economy have the power to price discriminate because they do not face perfect substitutes, but far fewer have the ability to influence market conditions. Antitrust enforcement has generally focused not on the power to price discriminate possessed by virtually all firms, but rather on the ability to control market conditions. Benjamin Klein and John Wiley have persuasively argued that the definitional confusion in antitrust over market power originates from the fact that the term refers to two distinct phenomena in economics and in the law.²³ While economists have long used the term "market power" to refer to the ability to deviate from the marginal cost pricing observed only in textbooks conferred by the absence of perfect substitutes,²⁴ the monopoly power necessary to trigger a violation of the antitrust law generally refers to the power to control *market* conditions.²⁵

The view expressed by Areeda and Hovenkamp, and Landes and Posner that price discrimination implies a degree of antitrust market power which may be insufficient to trigger a violation of the law is the most common attempt to reconcile the economic and antitrust definitions of market power. Judge Richard Posner has adopted a similar view elsewhere, noting that it would be "a profound mistake" to conclude that every firm facing a downward sloping demand curve has monopoly power in the sense meant by antitrust laws because these firms face "almost horizontal" demand curves.²⁶

²³ Benjamin Klein and John Shepherd Wiley, *Competitive Price Discrimination as an Antitrust Justification for Intellectual Property Refusals to Deal*, 70 *Antitrust L.J.* 599, 624-33 (2003).

²⁴ See, e.g., DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 610 (3d ed. 2000) ("A firm . . . has market power if it is profitably able to charge a price above that which would prevail under competition, which is usually taken to be marginal cost").

²⁵ Klein and Wiley, *supra* note 23, at 629-630 & n. 73 (collecting cases), demonstrate that antitrust law generally does define market power in terms of the ability of the firm to influence market conditions rather than focusing in the firm's own elasticity of demand. See, e.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 27 n. 46 (1984) ("market power exists whenever prices can be raised above levels that would be charged in a competitive market").

²⁶ RICHARD A. POSNER, *ANTITRUST LAW* 83 (2d ed. 2001); see also *In re Brand Name Prescription Drugs Antitrust Litigation*, 186 F.3d 781, 786-87 (7th Cir. 1999).

This economic logic, however, is incorrect, and capable of producing perverse results for antitrust analysis. A downward sloping demand curve, which enables a firm to price discriminate, does not imply a level of antitrust market power “too small” to be concerned with for antitrust purposes.²⁷ A firm with trivial market share and the ability to price discriminate may well face significantly inelastic demand if its unique characteristics appeal strongly to a small set of buyers. For instance, “Michael Jordan Cologne for Men” likely faces a highly inelastic demand because some consumers have a strong brand preference from a small but loyal set of followers, but a trivial share of the total market and no ability to influence market conditions. Conversely, one might imagine a scenario under which a rival brand name-cologne has a 95 percent market share but faces more elastic demand than the Michael Jordan brand. It is simply not the case that one can rank the degree of antitrust market power according to a firm’s elasticity of demand. In the first example, Michael Jordan brand cologne is of no antitrust concern because it lacks the ability to influence market conditions, not because it faces an “almost horizontal” demand curve.

III. Conclusion

Independent Ink fails to unequivocally reject the notion that price discrimination implies at least some antitrust market power. While the Court importantly recognizes that price discrimination often is associated with competitive markets and frequently poses little threat to consumer welfare, the implicit adoption of the own-price elasticity formulation remains a troublesome dimension of the Court’s analysis. Under the own-price elasticity formulation, courts are left with the task of understanding how to distinguish “degrees” of price discrimination in a sense relevant to antitrust enforcement. However, greater inelasticity of demand does not imply greater power to control market conditions.

While *Independent Ink* should be applauded for both ridding antitrust law of the presumption that patent rights confer monopoly power and recognizing the central role of competitive price discrimination in markets, the failure to unequivocally reject the own-

²⁷ See Klein and Wiley, *supra* note 23, at 627-28.

price elasticity of demand formulation of antitrust market power leaves open the possibility that antitrust will deter pro-competitive conduct by finding monopoly power in the most mundane instances of competitive contracting.

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