

1 EASTMAN KODAK CO. V. IMAGE TECHNICAL SERVICES, INC. 504 U.S. 451 (1992)

2

3 Justice Blackmun delivered the opinion of the Court. {454}

4

5 This is yet another case that concerns the standard for summary judgment in an
6 antitrust controversy. The principal issue here is whether a defendant's lack of
7 market power in the primary equipment market precludes—as a matter of law—the
8 possibility of market power in derivative aftermarkets. {454-55}

9

10 Petitioner Eastman Kodak Company manufactures and sells photocopiers and
11 micrographic equipment. Kodak also sells service and replacement parts for its
12 equipment. Respondents are 18 independent service organizations (ISO's) that in
13 the early 1980's began servicing Kodak copying and micrographic equipment. Kodak
14 subsequently adopted policies to limit the availability of parts to ISO's and to
15 make it more difficult for ISO's to compete with Kodak in servicing Kodak
16 equipment. {455}

17

18 I. A.

19

20 Kodak does not sell a complete system of original equipment, lifetime service,
21 and lifetime parts for a single price. Instead, Kodak provides service after the
22 initial warranty period either through annual service contracts, which include
23 all necessary parts, or on a per-call basis. {457}

24

25 Kodak provides 80% to 95% of the service for Kodak machines. {457}

26

27 Beginning in the early 1980's, ISO's began repairing and servicing Kodak
28 equipment. They also sold parts ... ISO's provide service at a price
29 substantially lower than Kodak does. ... Some customers found that the ISO
30 service was of higher quality. {457}

31

32 In 1985 and 1986, Kodak implemented a policy of selling replacement parts for
33 micrographic and copying machines only to buyers of Kodak equipment who use
34 Kodak service or repair their own machines. {458}

35

36 Kodak and the OEM's agreed that the OEM's would not sell parts that fit Kodak
37 equipment to anyone other than Kodak. {458}

38

39 Kodak intended, through these policies, to make it more difficult for ISO's to
40 sell service for Kodak machines. It succeeded. ISO's were unable to obtain parts
41 from reliable sources ... and many were forced out of business, while others
42 lost substantial revenue. ... Customers were forced to switch to Kodak service
43 even though they preferred ISO service. {458}

44

45 B.

46

47 In 1987, the ISO's filed the present action in the District Court, alleging,
48 inter alia, that Kodak had unlawfully tied the sale of service for Kodak
49 machines to the sale of parts, in violation of § 1 of the Sherman Act, and had
50 unlawfully monopolized and attempted to monopolize the sale of service for Kodak
51 machines, in violation of § 2 of that Act. {459}

52

53 II.

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55 | TYING |
56 +-----+

57
58 A tying arrangement is "an agreement by a party to sell one product but only on
59 the condition that the buyer also purchases a different (or tied) product, or at
60 least agrees that he will not purchase that product from any other supplier."
61 Such an arrangement violates § 1 of the Sherman Act if the seller has
62 "appreciable economic power" in the tying product market and if the arrangement
63 affects a substantial volume of commerce in the tied market. {461-62}

64
65 A.

66 +-----+
67 | TWO PRODUCTS |
68 +-----+

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70 [A] reasonable trier of fact must be able to find, first, that service and parts
71 are two distinct products, and, second, that Kodak has tied the sale of the two
72 products. {462}

73
74 For service and parts to be considered two distinct products, there must be
75 sufficient consumer demand so that it is efficient for a firm to provide service
76 separately from parts. {462}

77
78 Kodak insists that because there is no demand for parts separate from service,
79 there cannot be separate markets for service and parts. By that logic, we would
80 be forced to conclude that there can never be separate markets, for example, for
81 cameras and film, computers and software, or automobiles and tires. That is an
82 assumption we are unwilling to make. "We have often found arrangements involving
83 functionally linked products at least one of which is useless without the other
84 to be prohibited tying devices." {463}

85
86 +-----+
87 | TIE |
88 +-----+

89
90 [R]espondents have presented sufficient evidence of a tie between service and
91 parts. The record indicates that Kodak would sell parts to third parties only if
92 they agreed not to buy service from ISO's. {463}

93
94 B.

95 +-----+
96 | MARKET POWER IN THE TYING PRODUCT MARKET = PARTS |
97 +-----+

98
99 [W]e consider the other necessary feature of an illegal tying arrangement:
100 appreciable economic power in the tying market. Market power is the power "to
101 force a purchaser to do something that he would not do in a competitive market.
102 It has been defined as "the ability of a single seller to raise price and
103 restrict output. The existence of such power ordinarily is inferred from the
104 seller's possession of a predominant share of the market." {464}

105
106 1.

107
108 [The ISOs] contend that Kodak has more than sufficient power in the parts market

109 to force unwanted purchases of the tied market, service. {464}

110
111 [The ISOs] provide evidence that certain parts are available exclusively
112 through Kodak. [The ISOs] also assert that Kodak has control over the
113 availability of parts it does not manufacture. {465}

114
115 +-----+
116 | EXCLUSIONARY EFFECT IN THE TIED MARKET = SERVICE |
117 +-----+

118
119 [The ISOs] also allege that Kodak's control over the parts market has excluded
120 service competition, boosted service prices, and forced unwilling consumption of
121 Kodak service. [The ISOs] offer evidence that consumers have switched to Kodak
122 service even though they preferred ISO service, that Kodak service was of higher
123 price and lower quality than the preferred ISO service, and that ISO's were
124 driven out of business by Kodak's policies. {465}

125
126 2.

127
128 [Kodak] urges the adoption of a substantive legal rule that "equipment
129 competition precludes any finding of monopoly power in derivative aftermarkets."
130 {466}

131
132 Legal presumptions that rest on formalistic distinctions rather than actual
133 market realities are 467 generally disfavored *467 in antitrust law. {467}

134
135 Kodak's proposed rule rests on a factual assumption about the cross-elasticity
136 of demand in the equipment and aftermarkets: "If Kodak raised its parts or
137 service prices above competitive levels, potential customers would simply stop
138 buying Kodak equipment. Perhaps Kodak would be able to increase short term
139 profits through such a strategy, but at a devastating cost to its long term
140 interests." {469-70}

141
142 The fact that the equipment market imposes a restraint on prices in the
143 aftermarkets by no means disproves the existence of power in those markets. ...
144 [T]here is no immutable physical law—no "basic economic reality"—insisting that
145 competition in the equipment market cannot coexist with market power in the
146 aftermarkets. {471}

147
148 To review Kodak's theory, it contends that higher service prices will lead to a
149 disastrous drop in equipment sales. ... Service prices have risen for Kodak
150 customers, but there is no evidence or assertion that Kodak equipment sales have
151 dropped. {472}

152
153 Respondents offer a forceful reason why Kodak's theory, although perhaps
154 intuitively appealing, may not accurately explain the behavior of the primary
155 and derivative markets for complex durable goods: the existence of significant
156 information and switching costs. These costs could create a less responsive
157 connection between service and parts prices and equipment sales. {473}

158
159 For the service-market price to affect equipment demand, consumers must inform
160 themselves of the total cost of the "package"—equipment, service, and parts—at
161 the time of purchase. {473}

162

163 Given the potentially high cost of information and the possibility that a seller
164 may be able to price discriminate between knowledgeable and unsophisticated
165 consumers, it makes little sense to assume, in the absence of any evidentiary
166 support, that equipment-purchasing decisions are based on an accurate assessment
167 of the total cost of equipment, service, and parts over the lifetime of the
168 machine. {475-76}

169
170 A second factor undermining Kodak's claim that supracompetitive prices in the
171 service market lead to ruinous losses in equipment sales is the cost to current
172 owners of switching to a different product. If the cost of switching is high,
173 consumers who already have purchased the equipment, and are thus "locked in,"
174 will tolerate some level of service-price increases before changing equipment
175 brands. Under this scenario, a seller profitably could maintain supracompetitive
176 prices in the aftermarket if the switching costs were high relative to the
177 increase in service prices, and the number of locked-in customers were high
178 relative to the number of new purchasers. {476}

179
180 Moreover, if the seller can price discriminate between its locked-in customers
181 and potential new customers, this strategy is even more likely to prove
182 profitable. {476}

183
184 [The ISOs] have offered evidence that the heavy initial outlay for Kodak
185 equipment, combined with the required support material that works only with
186 Kodak equipment, makes switching costs very high for existing Kodak customers.
187 {477}

188
189 It is clearly reasonable to infer that Kodak has market power to raise prices
190 and drive out competition in the aftermarkets, since respondents offer direct
191 evidence that Kodak did so. {477}

192
193 III.

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195 | MONOPOLIZATION |
196 +-----+

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198 [The ISOs] also claim that they have presented genuine issues for trial as to
199 whether Kodak has monopolized, or attempted to monopolize, the service and parts
200 markets in violation of § 2 of the Sherman Act. "The offense of monopoly under §
201 2 of the Sherman Act has two elements: (1) the possession of monopoly power in
202 the relevant market and (2) the willful acquisition or maintenance of that power
203 as distinguished from growth or development as a consequence of a superior
204 product, business acumen, or historic accident." {480-81}

205
206 A.

207 +-----+
208 | MONOPOLY POWER |
209 +-----+

210
211 [The ISO's] evidence that Kodak controls nearly 100% of the parts market and 80%
212 to 95% of the service market, with no readily available substitutes, is,
213 however, sufficient to survive summary judgment under the more stringent
214 monopoly standard of § 2. {481}

215
216 Kodak also contends that, as a matter of law, a single brand of a product or

217 service can never be a relevant market under the Sherman Act. We disagree. The
218 relevant market for antitrust purposes is determined by the choices available to
219 Kodak equipment owners. {481-82}

220
221 B.

222 +-----+
223 | EXCLUSIONARY CONDUCT |
224 +-----+

225
226 As recounted at length above, respondents have presented evidence that Kodak
227 took exclusionary action to maintain its parts monopoly and used its control
228 over parts to strengthen its monopoly share of the Kodak service market. {483}

229
230 Liability turns, then, on whether "valid business reasons" can explain Kodak's
231 actions. {483}

232
233 +-----+
234 | BUSINESS JUSTIFICATIONS |
235 +-----+

236
237 Kodak contends that it has three valid business justifications for its actions:
238 "(1) to promote interbrand equipment competition by allowing Kodak to stress the
239 quality of its service; (2) to improve asset management by reducing Kodak's
240 inventory costs; and (3) to prevent ISOs from free-riding on Kodak's capital
241 investment in equipment, parts and service." Brief for Petitioner 6. Factual
242 questions exist, however, about the validity and sufficiency of each claimed
243 justification, making summary judgment inappropriate. {483}

244
245 +-----+
246 | #1 QUALITY CONTROL |
247 +-----+

248
249 [The ISOs] have offered evidence that ISO's provide quality service and are
250 preferred by some Kodak equipment owners. {483}

251
252 Kodak simultaneously claims that its customers are sophisticated enough to make
253 complex and subtle lifecycle- pricing decisions, and yet too obtuse to
254 distinguish which breakdowns are due to bad equipment and which are due to bad
255 service. Kodak has failed to offer any reason why informational sophistication
256 should be present in one circumstance and absent in the other. {484}

257
258 +-----+
259 | #2 INVENTORY CONTROL |
260 +-----+

261
262 Presumably, the inventory of parts needed to repair Kodak machines turns only on
263 breakdown rates, and those rates should be the same whether Kodak or ISO's
264 perform the repair. {484-85}

265
266 +-----+
267 | #3 FREE RIDING |
268 +-----+

269
270 [A]ccording to Kodak, the ISO's are freeriding because they have failed to enter

271 the equipment and parts markets. This understanding of free-riding has no
272 support in our case law. {485}

273
274 DISSENT
275
276 Justice Scalia, with whom Justice O'Connor and Justice Thomas join, dissenting.

277
278 I.
279
280 Where a defendant maintains substantial market power, his activities are
281 examined through a special lens: Behavior that might otherwise not be of concern
282 to the antitrust laws—or that might even be viewed as procompetitive—can take on
283 exclusionary connotations when practiced by a monopolist. {488}

284
285 The Court today finds in the typical manufacturer's inherent power over its own
286 brand of equipment—over the sale of distinctive repair parts for that equipment,
287 for example— the sort of "monopoly power" sufficient to bring the sledgehammer
288 of § 2 into play. ... Moreover, because the sort of power condemned by the Court
289 today is possessed by every manufacturer of durable goods with distinctive
290 parts, the Court's opinion threatens to release a torrent of litigation and a
291 flood of commercial intimidation that will do much more harm than good to
292 enforcement of the antitrust laws and to genuine competition. {489}

293
294 II. A.
295
296 Had Kodak—from the date of its entry into the micrographic and photocopying
297 equipment markets—included a lifetime parts and service warranty with all
298 original equipment, or required consumers to purchase a lifetime parts and
299 service contract with each machine, that bundling of equipment, parts, and
300 service would no doubt constitute a tie under the tests enunciated in Jefferson
301 Parish, supra. Nevertheless, it would be immune from per se scrutiny under the
302 antitrust laws because the tying product would be equipment, a market in which
303 (we assume) Kodak has no power to influence price or quantity. See id., at
304 13-14; United States Steel Corp. v. Fortner Enterprises, Inc., 429 U. S. 610,
305 620 (1977) (Fortner II); Northern Pacific R. Co. v. United States, 356 U. S. 1,
306 6-7 (1958). The same result would obtain, I think, had Kodak—from the date of
307 its market entry— consistently pursued an announced policy of limiting parts
308 sales in the manner alleged in this case, so that customers bought with the
309 knowledge that aftermarket support could be obtained only from Kodak. {490-91}

310
311 The only thing lacking to bring all of these purchasers (accounting for the vast
312 bulk of the commerce at issue here) squarely within the hypotheticals we have
313 described is concrete evidence that the restrictive parts policy was announced
314 or generally known. {492}

315
316 B.
317
318 "[S]uch reasoning makes every maker of unique parts for its own product a holder
319 of market power no matter how unimportant its product might be in the market."
320 {493-94}

321
322 Under the Court's analysis, the per se rule may now be applied to single-brand
323 ties effected by the most insignificant players in fully competitive interbrand
324 markets, as long as the arrangement forecloses aftermarket competitors from more

325 than a de minimis amount of business. {494}

326
327 The leverage held by the manufacturer of a malfunctioning refrigerator (which is
328 measured by the consumer's reluctance to walk away from his initial investment
329 in that device) is no different in kind or degree from the leverage held by the
330 swimming pool contractor when he discovers a 5-ton boulder in his customer's
331 backyard and demands an additional sum of money to remove it; or the leverage
332 held by an airplane manufacturer over an airline that has "standardized" its
333 fleet around the manufacturer's models; or the leverage held by a drill press
334 manufacturer whose customers have built their 498 production lines around the
335 manufacturer's particular style of drill press; or the leverage held by an
336 insurance company over its independent sales force that has invested in company-
337 specific paraphernalia; or the leverage held by a mobile home park owner over
338 his tenants, who are unable to transfer their homes to a different park except
339 at great expense, see generally *Yee v. Escondido*, 503 U. S. 519 (1992).
340 Leverage, in the form of circumstantial power, plays a role in each of these
341 relationships; but in none of them is the leverage attributable to the dominant
342 party's market power in any relevant sense. Though that power can plainly work
343 to the injury of certain consumers, it produces only "a brief perturbation in
344 competitive conditions –not the sort of thing the antitrust laws do or should
345 worry about." *Parts & Elec. Motors, Inc. v. Sterling Elec., Inc.*, 866 F. 2d 228,
346 236 (CA7 1988) (Posner, J., dissenting). [497-98]

347
348 III.

349
350 But this showing [of high market shares] could easily be made, as I have
351 explained, with respect to virtually any manufacturer of differentiated products
352 requiring aftermarket support. By permitting antitrust plaintiffs to invoke § 2
353 simply upon the unexceptional demonstration that a manufacturer controls the
354 supplies of its single-branded merchandise, the Court transforms § 2 from a
355 specialized mechanism for responding to extraordinary agglomerations (or
356 threatened agglomerations) of economic power to an all-purpose remedy against
357 run-of-the mill business torts. {503}