Antitrust Law - Tying Agreements, the Per Se Rule, and Credit

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Fortner Enterprises entered into a credit agreement whereby U.S. Steel Homes Credit Corp. was to provide 100 per cent financing for Fortner’s purchase and development of land for the construction of private homes. For each of the lots purchased with the loan proceeds, Fortner was to purchase a prefabricated steel home from U.S. Steel Corp., the credit corporation’s parent. Fortner claimed that the prefabricated materials were priced unreasonably high and were defective and unusable. Following an unsuccessful attempt to be released from the agreement, Fortner brought suit against U.S. Steel and U.S. Steel Homes Credit Corp. under sections 1 and 2 of the Sherman Act. In the suit Fortner sought treble damages for lost profits and an injunction against enforcement of the requirement that it purchase the prefabricated homes from U.S. Steel. Fortner alleged that the defendants were conspiring to restrain and monopolize trade in the sale of prefabricated homes through its tying agreement requiring the purchase of homes (the tied product) in order to obtain credit (the tying product). The district court granted defendants’ motion for summary judgment, holding that no showing was made that defendants enjoyed sufficient market power over the tying product (credit), and that a substantial volume of commerce in the tied product (the homes) was foreclosed. The court of appeals affirmed without opinion. Held, reversed and remanded: (1) The standards relied on by the district court are necessary only to bring the doctrine of per se illegality into operation; a plaintiff can still prevail on the merits whenever he can prove, on the basis of a more thorough examination of the purposes and effects of the practices involved, that the general standards of the Sherman Act have been violated. (2) "Sufficient economic power" does not require that the defendant have a monopoly or even a dominant position throughout the market for the tying product. Fortner Enterprises, Inc. v. U.S. Steel Corp., 394 U.S. 495 (1969).

I. Governemntally Imposed Restrictions on Business Practices

With the general purpose of maintaining market competition, Congress has imposed restrictions on business through antitrust legislation. The Sherman Act of 1890 was the first, and remains the most important, legislative restriction on business activities. As authorized by this Act and

1 15 U.S.C. §§ 1, 2 (1964). Section 1 states in relevant part: "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 to be illegal... ."
5 V. Mund, supra note 4, at 98.
subsequent legislation, various types of business activities have come under attack through actions taken by the federal government and through private litigation in suits for treble damages or for injunctions.

The Clayton Act, which supplements the Sherman Act, specifies certain types of activities that are illegal, one of which is the tying agreement when that agreement causes a substantial injury to competition. Significantly, under section 3 of the Clayton Act the proscription of tying agreements is limited to the lease or sale of "goods, wares, merchandise, machinery, supplies, or other commodities" as the tying product when tied to another product of similar nature. A tying agreement has been subsequently defined as "an agreement by a party to sell one product [the tying 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."

Prior to the Clayton Act, tying agreements had been upheld as valid and not in violation of the antitrust laws in Henry v. A.B. Dick Co. This case was decided on the basis of the "rule of reason" test first stated by the United States Supreme Court in Standard Oil Co. v. United States. The rule of reason was explained as a test that would allow the Court independent determination, on a case-by-case examination, of the harmful or beneficial economic effect of the particular business activity under scrutiny. This was required, reasoned the Court, because the Sherman Act did not specifically define what acts were in restraint of trade. After passage of the Clayton Act and its specific proscription of some tying agreements, the Court in Motion Picture Co. v. Universal Film Co., following the statutory language of that Act, held a tying agreement illegal and thus overturned A.B. Dick.

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9 Id.
10 Hence, a tying agreement involving a tying product that is not one of the specifically listed items is not necessarily illegal under the Clayton Act. In addition to the Clayton Act, the Federal Trade Commission Act, passed the same year (1914) was intended to supplement the Sherman Act in stopping in their incipiency unfair trade practices that hindered competition. For a Sherman Act violation the illegal activities had to be fullblown. V. Mund, supra note 4, at 209. Specifically of importance is section 5(a) of this Act: "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful." 15 U.S.C. § 41(3)(1) (1964).
12 224 U.S. 1 (1912). See also Heaton-Peninsular Button-Fastener Co. v. Eureka Specialty Co., 77 F. 288 (6th Cir. 1896).
13 211 U.S. 1 (1911).
14 Id. at 60. It was argued that the rule of reason had to be read into the Act because every contract in business restrains the parties to that contract in some way. See note 1 supra. Without the rule of reason commerce would have become impossible.
16 Id. at 517-18. See text accompanying notes 11, 22, 25, and 26 infra for a discussion of tying agreements that were subsequently held illegal in various situations under both the Sherman and Clayton Acts. But, even in actions under the Clayton Act not all tying agreements have been held illegal. In Federal Trade Comm’n v. Sinclair Ref. Co., 261 U.S. 463 (1923), at issue was a contract between a refiner of petroleum products and a retail dealer. The refiner undertook to furnish a tank and pump free, or at less than cost, for handling the product sold by the retail dealer on condition that the equipment be used for any other purpose than storing and handling the product of the refiner the right to the equipment should terminate. The contract was held by the Court not being in violation of section 3 of the Clayton Act.
II. TYING AGREEMENTS AND THE "PER SE" RULE

In 1947 the Supreme Court in *International Salt Co. v. United States*\(^{15}\) dealt tying agreements another serious blow. In an action brought by the United States under section 1 of the Sherman Act and section 3 of the Clayton Act, the Court affirmed summary judgment against the defendant enjoining it from placing certain restrictions on lease agreements of its patented salt processing machines. The agreements required the lessee to purchase from the defendant all unpatented salt and salt tablets used by one type of machine, and on a different machine allowed the lessee to purchase salt of equal grade from any competitor provided the defendant was not able to meet the competitor's price. In holding that "it is unreasonable, *per se*, to foreclose competitors from any substantial market,"\(^{16}\) the Court avoided the necessity of first determining whether or not the agreed-to restraint was unreasonable within the Sherman Act. The Court added that "[t]he volume of business affected by these contracts cannot be said to be insignificant or insubstantial and the tendency of the arrangement to accomplishment of monopoly seems obvious."\(^{17}\) Concerning the agreement giving the lessee the option to purchase from a competitor if the defendant could not meet the price, the Court held that this did "not avoid the stifling effect of the agreement on competition."\(^{18}\) Hence, both tying agreements were held to be in and of themselves illegal.\(^{19}\)

The present test of the illegality of tying agreements was established in *Northern Pacific Railway v. United States.*\(^{20}\) Northern Pacific had leased and sold land along its right of way on condition that the lessee or grantee ship over Northern Pacific's lines all commodities produced or manufactured on the land, provided that its rates were "equal to those of competing carriers."\(^{21}\) The Government filed suit seeking a declaration that Northern Pacific's "preferential routing" agreements were "unreasonable restraints of trade under section 1 of [the Sherman] Act."\(^{22}\) In affirming summary judgment against the defendant, Mr. Justice Black, speaking for the majority, set out the test for determining whether or not a tying agreement was a *per se* violation: It must be shown that (1) the defendant has "sufficient economic power [over the tying product] to impose an appreciable restraint on free competition in the tied product," and (2) "that a 'not insubstantial' amount of interstate commerce is affected."\(^{23}\)

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\(^{15}\) 332 U.S. 392 (1947).
\(^{16}\) Id. at 396.
\(^{17}\) Id. *International Salt Co.* was the country's largest industrial salt producer. *Id.* at 394.
\(^{18}\) *Id.* at 397.
\(^{19}\) *Standard Oil Co. v. United States,* 337 U.S. 293 (1949), in distinguishing between a requirements contract (whereby the buyer is bound to purchase all of his requirements of a particular product from one seller) and a tying agreement, the Court was constrained to limit the rule laid down by *International Salt* to tying agreements. The Court noted that there were important economic differences between the two and that tying agreements were of greater economic harm. *Id.* at 305-07. The Court said that "[t]ying agreements serve hardly any purpose beyond the suppression of competition." *Id.* at 305-06. Hence, the Court was endorsing the notion that tying agreements were *per se* illegal restraints on competition.

\(^{21}\) *Id.* at 3.
\(^{22}\) *Id.* at 4.
\(^{23}\) *Id.* at 11.
In addition to the above test, other aspects of Northern Pacific are important. First, in discussing the application of the per se rule to proscription of certain business practices, Justice Black stated the reason for using it: "[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." Secondly, the Clayton Act specifies certain commodities that are illegal subjects of tying agreements. In Northern Pacific the tying product was land, an item not mentioned in the Clayton Act. However, the Court held the tying of preferential routing agreements (the tied product) to the sale or lease of land (the tying product) to be per se illegal under the Sherman Act. Hence, whenever the test for per se illegality is met, illegal tying agreements can be found even though the product is not specified in the Clayton Act.

The Northern Pacific test was broadened in United States v. Loew's, Inc. Distributors of motion picture films conditioned the sale of one or more copyrighted feature films to television stations upon the purchase of one or more other films. The Court unanimously held that the tying agreements were in violation of section 1 of the Sherman Act because "by their 'inherent nature' and by their 'effect' [they] injuriously restrained trade.

The Court refused to accept the argument that the distributors did not have dominance in the market for television exhibition of feature films—the "monopolistic position" terminology used in an earlier case. The Court held that this was a misconstruction of the applicable legal standard because "'sufficient economic power' as contemplated by the Northern Pacific case is a term more inclusive in scope than 'market dominance.' Furthermore, sufficient economic power "may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes. Following the reasoning in Loew's it might be possible to find the economic power over the tying product from its desirability or uniqueness alone. The use of this as a leverage to bring the tied product into the market place would be detrimental to competition in the tied product, and would satisfy the first of the two-part test of Northern Pacific, thus placing the

24 Id. at 5 (emphasis added).
25 See notes 7, 8 supra, and accompanying text.
27 Id. at 49.
30 Id. at 45. In a footnote to the above quote, Mr. Justice Goldberg, speaking for the Court, went on to discuss the aspect of uniqueness and desirability in the tying product as an indication of economic power:

Since the requisite economic power may be found on the basis of either uniqueness or consumer appeal, and since market dominance in the present context does not necessitate a demonstration of market power in the sense of § 2 of the Sherman Act, it should seldom be necessary in a tie-in sale case to embark upon a full-scale factual inquiry into the scope of the relevant market for the tying product and into the correlation problem of the seller's percentage share of the market. This is even more obviously true when the tying product is patented or copyrighted, in which case sufficiency of economic power is presumed.

Id. at 45 n.4.
tying agreement within the per se rule of illegality under the Sherman Act.

Careful examination of tying agreement cases indicates that there is in reality another test in addition to the "rule of reason" approach that takes into consideration all of the economic factors and the "per se" test that supposedly forecloses examination of possible economic harm. This third test is an "almost" per se test. It is one that is often called a per se test and applies the per se standards of illegality. However, instead of foreclosing examination of the particular harm caused by the agreement and only requiring proof of the agreement\textsuperscript{31} and its having fulfilled the per se standards of illegality, under this third test an examination is nonetheless made.\textsuperscript{32}

III. \textsc{Fortner Enterprises, Inc. v. U.S. Steel Corp.}

In \textit{Fortner Enterprises, Inc. v. U.S. Steel Corp.}\textsuperscript{33} the United States Supreme Court held that an agreement tying the purchase of prefabricated homes to credit may violate the general standards of the Sherman Act. Mr. Justice Black's reasoning indicates that a plaintiff should have the opportunity to prove that the defendant exercised sufficient economic power over the credit market and that the agreement imposed an unreasonable restraint on competition in the prefabricated home market.

The reasoning follows several steps. First, in distinguishing \textit{Fortner} from \textit{International Steel} and \textit{Northern Pacific} with respect to the requirements of whether the agreement need be per se illegal, the Court reasoned that a plaintiff must meet the standards of \textit{Northern Pacific} only to bring into play the per se rule. The district court had held that \textit{Fortner} had failed to meet both requirements. However, Justice Black reasoned that this is not necessary because a Sherman Act violation can be established "on the basis of a more thorough examination of the purposes and effects of the practices involved."\textsuperscript{34} At first glance this would appear to be a reversal of the cases establishing that tying agreements are per se illegal and a return to the rule of reason approach of examining the economic aspects of the particular business activity under question. Yet, the remaining steps of Justice Black's reasoning are based on the test established in \textit{Northern Pacific} in which the Court found a per se violation. In fact, Justice Black also wrote the opinion in \textit{Northern Pacific} and argued at length why the per se classification should be established so as to eliminate examination of the economic aspects.\textsuperscript{35} This gives some indication that the Court is backing

\textsuperscript{31} See note 24 supra, and accompanying text.

\textsuperscript{32} For an extensive discussion of, and arguments against, application of the per se rule, see Austin, The Tying Arrangement: A Critique and Some New Thoughts, 1967 Wis. L. Rev. 88; Baldwin & McFarland, Tying Arrangements in Law and Economics, 8 Antitrust Bull. 743 (1963); Baldwin & McFarland, Some Observations on "Per Se" and Tying Arrangements, 6 Antitrust Bull. 433 (1961); Johnston, Some Twilight Zone Antitrust Problems, 1 Antitrust Bull. 615 (1956); Singer, Market Power and Tying Arrangements, 8 Antitrust Bull. 653 (1965).

\textsuperscript{33} It should be noted that in United States v. Loew's, Inc., 371 U.S. 38 (1962) (see note 26 supra, and accompanying text, and note 30 supra), Mr. Justice Goldberg never uses the term "per se."

\textsuperscript{34} See note 24 supra, and accompanying text.
away from a strict application of the per se rule and that *Fortner* is an example of the “almost” per se test.

Second, Justice Black reasoned that to satisfy the standard of “sufficient economic power,” the defendant need not “have a monopoly or even a dominant position throughout the market for the tying product.” Economic power can be established over something less than all the buyers in a relevant market. This again appears to be a lessening of the indicia of control necessary to indicate the forcing of a less desirable product upon a buyer by tying it to a more desirable product. The Court’s holding apparently means that only “some of the buyers” need be affected to establish the requisite economic power.

Third, Justice Black cited *Loew’s* in support of the argument that the defendants’ unique terms were a possible indication of economic power. This, without other indications of economic power, is the most difficult step of the reasoning to justify. If one really had economic control over a particular product, he would usually raise prices rather than lower them. However, the uniqueness and desirability of a product, when coupled with a lower price and offered solely on the condition that the buyer accept a less desirable product, can be an indication that the seller is willing to take a loss on the desirable product in order to increase sales on the less desirable product. This ability to take a loss in another area has often been indicative of great economic power. Hence, the Court is not holding that the tying agreement is per se illegal, but is rather looking at the economic effects of the particular business practice involved.

The dissent in *Fortner* raises the specter that the majority opinion would invalidate all credit purchases, reasoning that in fact when any purchase is made on credit the purchase is tied to the credit terms. Therefore, upon showing unique credit terms, economic power can be inferred, and thereby “the mere fact that the credit is offered on uniquely advantageous terms makes the transaction a per se violation of section 1 of the Sherman Act.”

The majority disagreed, reasoning that the selling of items on credit is “a far cry from the arrangement involved here, where the credit is provided by one corporation on condition that a product be purchased from a separate corporation, and where the borrower contracts to obtain a large sum of money over and above that needed to pay the seller for the physical products purchased.” Nonetheless, this will probably be one of the biggest questions to evolve from this decision. For the first time in an antitrust suit alleging an illegal tying agreement, the use of money or credit as the tying product has been attacked. Previous cases have held that for a tying product to evidence a per se violation of the antitrust laws, it must be shown that the seller of the tying product had sufficient economic power.

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36 194 U.S. at 502 (emphasis added).
37 Id.
38 Justice Black gives two other, but subsidiary, indicia of economic power: (1) the nationwide operations of the credit corporation, and (2) that other lending institutions—banks and mortgage companies—might have been prohibited by statute from offering the same terms. Id. at 505-06.
39 Id. at 514, 519. (*Fortner* was decided by a 5-4 majority.)
40 Id. at 516.
41 Id. at 507.
over that product. Therefore, considering the relative ease with which the majority indicates that economic power can be shown, the potentiality of a lender to exercise economic power over the supply of money is of no small significance.

Significantly, in *Fortner* the Court reversed a summary judgment and remanded the case for trial. Thus, despite the Court's interpretation of the legal questions decided by the lower court, material questions of fact remain to be determined. This is important because the Court held that *Fortner* was entitled to present evidence concerning the economic effects of the agreement within the general standards of the Sherman Act. That credit might be capable of being a tying product would seem to depend on the economic proof that could be mustered in court. That the case was remanded is also important because there seems to be a question, depending on which party one listens to, of whether plaintiff was approached by defendants to enter into a credit agreement that tied with it the purchase of homes, or whether plaintiff was offered the homes with defendant including a credit arrangement to finance the purchase. The determination of this fact issue would bear on the question of whether *Fortner* affects general credit purchases. Were it to be proven in court that the latter of the above conflicting stories was what actually happened, the importance of *Fortner* would be greatly dissipated. This would be a reversal of which of the two products was the tying product and would materially explode the basis upon which the majority reached its conclusion.

IV. CONCLUSION

*Fortner* appears to be based on the *International Salt-Northern Pacific-Loew's* line of reasoning and at the same time appears to be backing away from it. The determination of whether or not the defendants exercised economic power over the tying product was based on the rationale developed by this line of cases. However, the Court also held that the plaintiff need not necessarily be required to meet the standards of the per se rule of illegality, but may be allowed to present evidence of the total economic effect of the tying agreement to prove it illegal under the Sherman Act. Hence, tying agreements are not necessarily illegal per se. Rather, they might be illegal based on their total economic effect if the requirements of *Northern Pacific* are met: (1) that the defendant exerts economic power over the tying product so that its exertion of this power through the tied product would be an illegal restraint on competition in the market for the tied product; and (2) that a not insubstantial amount of interstate commerce is affected. In what is probably an understatement this appears to be a contradiction. Apparently, *Fortner* stands as an example of the third, though never stated, test of "almost" per se illegality. In an

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42 See note 34 infra, and accompanying text.

43 Interestingly, the majority opinion is based on plaintiff's version of the facts, while one of the two dissenting opinions seems to have adopted the defendants' version that the agreement was one to purchase the homes with a credit arrangement to finance that purchase. 394 U.S. at 519-20. This confusion gives additional support for the case being remanded.