

TYING ARRANGEMENTS AND THE SINGLE PRODUCT ISSUE

The Supreme Court's initial, one sentence definition of a tying arrangement—an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product¹ has been refined to include three necessary elements for a transaction to be labeled a tie-in. First, the seller must have sufficient economic power in the tying product to restrain competition in the tied product,² since the purpose of such an arrangement is to use a seller's dominance in the primary market as leverage to better his position in the secondary market.³ Second, there must be a "not insubstantial" amount of interstate commerce affected.⁴ Thirdly, it is clear that the definition must include the requirement that two separate products be sold. As early as the decision in *Standard Oil Co. of California v. United States*, it was concluded that "tying arrangements serve hardly any purpose beyond the suppression of competition"⁵ and the modern application of the tie-in doctrine has been no less harsh on agreements that fit the tie-in form.⁶ The use of a tie-in analogy to condemn the sales commission plans in the TBA cases⁷ despite their failure to conform to the classical definition, is the most notable extension of the tie-in doctrine. The tying rationale was extended again by the Supreme Court's opinion in *Fortner Enterprises v. U.S. Steel*.⁸ U.S. Steel Homes Credit Corporation, a wholly owned subsidiary of U.S. Steel, loaned money to a Louisville, Kentucky developer, for the development of a large tract of land. The loan was made on the condition that prefabricated houses be purchased from U.S. Steel Corp., Homes Division and that a house be erected on each lot of the subdivision. As a matter of form the transaction was ripe for the allegation that it was an illegal tie-in. Credit—the tying product—was "sold" only on the condition that homes—the tied product—also be purchased.

Despite its procedural shortcomings,⁹ *Fortner* will in all likelihood be heralded as a landmark antitrust case. The decision breaks new ground

¹ *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).

² *Id.* at 6.

³ See Bowman, *Tying Arrangements and the Leverage Problem*, 67 *YALE L.J.* 19 (1957).

⁴ *Northern Pac. Ry. v. United States*, 356 U.S. 1, 6 (1958).

⁵ 337 U.S. 293, 305-306 (1949). But see Markovits, *Tie-ins, Reciprocity, and the Leverage Theory* 76 *YALE L.J.* 1939 (1967).

⁶ "[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. . . ." *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958).

⁷ See e.g., *F.T.C. v. Texaco, Inc.*, 393 U.S. 223 (1968); *Atlantic Ref. Co. v. F.T.C.*, 381 U.S. 357 (1965).

⁸ 394 U.S. 495 (1969).

⁹ The decision was a reversal of a summary judgment in favor of defendant U.S. Steel Corp. See note 42 *infra*.

in the area of market dominance, i.e., did U.S. Steel have sufficient economic power in the credit market to restrain competition in the homes market;¹⁰ and raises the more fundamental question of whether credit is a proper tying product at all.¹¹ It is the purpose of this article however, to explore another current tying issue considered by the Court in *Fortner*: whether an alleged tie-in is actually the sale of one product conditioned on the purchase of another or merely the sale of a single product. The importance of determining whether the sale of a package of two or more physically distinct articles is a single product or not is apparent. A court determination that the items sold were in fact a unit destroys by definition the application of a tying analysis. Conversely, if the sale of two or more items customarily sold as a unit is determined to be a sale of separate products, and if the dollar amount is not insubstantial, a court may be forced to conclude that the transaction is illegal per se.¹²

In order to consider the contribution of *Fortner*, a brief sketch of a few of the major Supreme Court decisions that developed the tying doctrine and how they relate to the single or separate products issue is necessary. The tie-in transactions initially scrutinized by the Court involved the attempt by a holder of a patent to tie nonpatented products to the sale of the patented product.¹³ The cases were decided not under the antitrust laws but under the patent laws, with the remedy being denial to the patentee who imposed tying agreements of his rights against an infringer of his patent.¹⁴ Not until *International Salt Co. v. United States*,¹⁵ where defendant conditioned the lease of patented salt dispensing machines on the purchase of salt required for use in the machines, did the Court conclude that tie-ins were illegal per se under the antitrust laws.¹⁶ In the patent cases the question of single or separate products was never a problem because the patent itself defined the tying product. Note also that the decision in *International Salt* was based on violations of both section 3 of the Clayton Act and section 1 of the Sherman Act. *Fortner* was of necessity solely a Sherman Act case due to the fact that credit had

¹⁰ See 83 HARV. L. REV. 234 (1969).

¹¹ 69 COLUM. L. REV. 1435 (1969).

¹² Hoerner, *Some Issues in Tying and Exclusive Dealing*, 38 CIN. L.R. 233, 242 (1969). "If shoes and shoe strings are considered separate products, the court is forced into a tying analysis and may find it very difficult to uphold the arrangement, despite the fact that custom and common sense seem to suggest that the manufacture and sale of shoes with shoe strings in them should no more be held illegal than "tying" the sale of a left shoe to a right shoe."

¹³ Cf. *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917); *Henery v. A. B. Dick Co.*, 224 U.S. 1 (1912).

¹⁴ See *Morton Salt Co. v. G. S. Suppiger Co.*, 314 U.S. 488 (1942).

¹⁵ 322 U.S. 392 (1947).

¹⁶ Earlier allusions to the antitrust laws are found in *Mercoird Corp. v. Minneapolis Honeywell Regulator Co.*, 320 U.S. 680, 684 (1944). Cf. *United Shoe Mach. Corp. v. United States*, 258 U.S. 451 (1922).

previously been held not to be a "commodity" as is required for the application of section 3 of the Clayton Act.¹⁷

The two major Supreme Court cases following *International Salt* were both nonpatent Sherman Act cases: *Northern Pac. Ry. v. United States*¹⁸ and *Times-Picayune Publishing Co. v. United States*.¹⁹ Like *Fortner*, both cases were decided under the Sherman Act since neither of the tying products, land and services, respectively, were "commodities." *Northern Pac. Ry.* is primarily significant for its evaluation of the amount of control of the tying market necessary to find a violation. The "sufficient economic power" standard that was adopted represents a minimal threshold when compared with the earlier standards, e.g. ninety-five percent control in *United Shoe Mach. Corp. v. United States*.²⁰ *Northern Pac. Ry.* is representative of the uncompromising application of per se illegality and is the benchmark against which business justification defenses measure their success.

It was the *Times-Picayune* decision, that first presented the Court's consideration of the single or separate products issue; the decision being based in part on a finding that only one product was involved. Defendant publishing company controlled two of the three major newspapers in New Orleans. In order to obtain advertising space in the morning paper, the *Times-Picayune*, potential purchasers were required to also buy space in defendant's afternoon paper, the *States*. In rejecting the claim that the afternoon paper had been tied to the sale of the morning paper, the Court held the products to be identical and the market the same.²¹

Although advertising space in the *Times-Picayune*, as the sole morning daily, was doubtless essential to blanket coverage of the local newspaper readership, nothing in the record suggests that advertisers viewed the city's newspaper readers, morning or evening, as other than fungible customer potential. We must assume, therefore, that the readership "bought" by advertisers in the *Times-Picayune* was the selfsame "product" sold by the *States* and, for that matter, the *Item*.²²

Similarly, in *Crawford Transport Co. v. Chrysler Corp.*,²³ the exercise by Chrysler of its contractual rights with its dealers to choose carriers for shipping its automobiles was challenged under the Sherman Act as an illegal tie of transportation services to the sale of automobiles. The district court concluded that the transaction involved the sale of a single product with ancillary provisions for delivery.

¹⁷ *United States v. Investors Diversified Servs., Inc.*, 102 F. Supp. 645 (D. Minn. 1951).

¹⁸ 356 U.S. 1 (1958).

¹⁹ 345 U.S. 594 (1953).

²⁰ 258 U.S. 451 (1922).

²¹ *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 614 (1952).

²² *Id.* at 613.

²³ 235 F. Supp. 751 (E.D. Ky. 1962), *aff'd*, 338 F.2d 934 (6 Cir. 1964), *cert. denied*, 380 U.S. 954 (1965).

[I]t is just as vital to Chrysler to have that car delivered in the proper way as it is to see that it is . . . properly made, and to say . . . it has engaged in an unlawful enterprise, seems to be contrary to the reasonable conception of almost, if not altogether, universal business practices.²⁴

The approach taken by the *Times-Picayune* and *Crawford* cases would seem to include only those cases where the two allegedly separate products were so closely related as to be considered a unit.²⁵

Although the same result is reached, the *Times-Picayune* and *Crawford* line of reasoning must be segregated from the combination patent situation where the unity of the package of products is defined by law. Most patented products are unique combinations of unpatented products or materials. Thus where a patentee is the holder of a patent for a complete system there is no tie-in of the component parts of that system, even though the same parts may be or are sold individually. This is because the patentee is only exercising the power conferred on him by statute.²⁶ Reasoning of this kind becomes crucial in a typical franchise arrangement. There is the danger that a tying analysis may be invoked if the trademark or copyright that is licensed is treated as a separate product from the related articles or goods used by the franchisee. To avoid this problem courts have been willing to hold the conglomeration of legal rights and physical goods to be a single product:²⁷ "[I]t is conceptually impossible . . . to view a license to use a trademark as separate and distinct from the sale of the trademarked product or its ingredient."²⁸

A second approach to solving the single product issue concerns products that clearly are physically distinct. They may be sold separately and there is no combination patent to protect the sale of the package as a unit. A defendant may nevertheless argue that market circumstances require sale as a unit. This line of reasoning is best represented by *United States v. Jerrold Electronics Corp.*²⁹ At the inception of commercial television Jerrold Electronics Corp. had developed an unpatented television antenna system capable of reaching remote geographical areas that conventional apparatus could not. Because the system was innovative and untested numerous failures resulted from improper installation and maintenance. To avoid the problem Jerrold Electronics adopted a policy of conditioning the sale of new systems on (1) an acceptance by the buyer of a service

²⁴ *Id.* at 755.

²⁵ For general discussion of the "single product defense," see, Austin, *The Tying Arrangement: A Critique and Some New Thoughts*, 1967 WIS. L. REV. 88, at 116.

²⁶ See Turner, *The Validity of Tying Arrangements under the Antitrust Laws* 72 Harv. L. Rev. 50, 69. "If the patent statute means anything it means that the patent defines the "product" and that the sale of that "product" is not a tie-in in the legal sense."

²⁷ Hoerner, *supra* note 12 at 243.

²⁸ Carvel Corp., 1965-1967 Transfer Binder TRADE REG. REP. ¶17,298 (FTC 1965). For copyright, see *Cardinal Films, Inc. v. Republic Pictures Corp.*, 148 F. Supp. 156 (S.D.N.Y. 1957).

²⁹ 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961). (noted in 49 CALIF. L. REV. 746 (1961) and 70 YALE L.J. 804 (1961)).

contract and (2) a mandatory purchase of the entire system in order to insure proper servicing. The government attacked the tie-in of the service contracts under section 1 of the Sherman Act and the requirement that the full system be purchased under section 3 of the Clayton Act. Although the court questioned³⁰ whether a single product was involved, a general criterion for resolving the issue was formulated: "The facts must be examined to ascertain whether or not there are legitimate reasons for selling normally separate items in a combined form to dispel any inferences that it is really a disguised tie-in."³¹

The "legitimate reasons" philosophy of *Jerrold* was given vitality in *Dehydrating Process Co. v. A. O. Smith Corp.*³² "We think the principle recognized by the district court in *Jerrold*, that a proper business reason may justify what might otherwise be an unlawful tie-in, is sound."³³ Unlike *Jerrold Electronics*, which was a fledgling company, the defendant in *Dehydrating Process* was an established manufacturer of silos and unloading equipment. After many years of receiving customer complaints arising from the use of competitors unloaders with defendant's silos, *Dehydrating Process Co.* adopted a policy whereby unloaders were only installed if the purchaser already owned or was presently buying a *Dehydrating* silo. The Court cited the continued malfunctioning of the products despite attempts to educate customers and the resultant damage to reputation as sufficient business justifications for defendant's policies.³⁴ The significance of the *Jerrold* and *Dehydrating Process* cases stems from the fact that market exigencies may be considered at the product definition level. If a single product characterization results, the harsh per se illegality treatment required by *Northern Pac. Ry.*³⁵ may be circumvented without having to carve out an exception to the uncompromising language of that opinion.

Such was the state of the single product issue prior to the Supreme Court's opinion in *Fortner Enterprises, Inc. v. U.S. Steel Corp.*³⁶ Plaintiff, *Fortner Enterprises Inc.* (hereinafter *Fortner*) wished to purchase and develop a large tract of land on which it planned to construct homes. In order to do so it secured a loan from U.S. Steel Homes Credit Corpora-

³⁰ "[T]he defendants' position would seem to be highly questionable." *Id.* at 560. Four factors gave rise to the courts doubt: "Others who entered the community antenna field offered all of the equipment necessary for a complete system, but none of them sold their gear exclusively as a single package. . . . [H]ardly any two versions of the alleged product were the same. [T]he customer was charged for each item of equipment and not a lump sum for the total system. Finally, while *Jerrold* had cable and antennas to sell which were manufactured by other concerns, it only required that the electronic equipment in the system be brought from it." *Id.* at 559.

³¹ *Id.* at 559.

³² 292 F.2d 653, (1st Cir. 1961), cert. denied, 368 U.S. 931 (1961).

³³ *Id.* at 655.

³⁴ 292 F.2d at 656.

³⁵ 356 U.S. 1 (1958).

³⁶ 394 U.S. 495 (1969).

tion (hereinafter Credit Corporation), a wholly owned subsidiary of U.S. Steel Corp. The amount of the loan was approximately \$2,000,000 of which \$300,000 was used to purchase and develop the land. The remainder was used to purchase prefabricated houses from U.S. Steel, Homes Division (hereinafter Homes Division). The loan agreement provided that the financing would be available only on the condition that Homes Division's prefabricated houses be erected on each lot of the subdivision. The agreement further provided that the obligation to buy houses would cease whenever the loan was repaid. When some of the houses erected proved to be defective, Fortner sued, seeking an injunction preventing enforcement of the obligation to purchase and lost profits because of the defects and unreasonably high prices of the houses. Plaintiff's complaint alleged an illegal tie-in under section 1 of the Sherman Act.³⁷ Defendant, U.S. Steel Corp., was granted summary judgment in the district court,³⁸ and the Sixth Circuit affirmed without opinion.³⁹ In a five to four decision the Supreme Court reversed, holding that summary judgment was improper because the pleadings and affidavits raised an issue of fact.

Under the "legitimate reasons" test of *Jerrold* the *Fortner* facts lend themselves to a single product construction. The nature of the legitimacy test clearly requires a factual determination in each case, yet the factual basis of majority opinion in *Fortner* for finding the existence of separate products is questionable. Justice Black, writing for the majority, first concedes that it may be impossible to separate credit from the product sold where there is a typical sale with credit terms by a single seller.⁴⁰ He distinguishes the present transaction from the typical credit sale by the existence of two facts: (1) Credit Corporation and Homes Division were separate corporations, and (2) the amount loaned exceeded the amount needed to purchase the houses.⁴¹ Although these facts are not discussed directly in terms of legitimacy, an earlier part of the opinion indicates that on remand "[i]t may turn out that the arrangement involved here serves legitimate business purposes. . . ."⁴² If the language is an instruction to

³⁷ Fortner also alleged a conspiracy to monopolize under section 2 of the Sherman Act.

³⁸ 293 F. Supp. 762 (W.D. Ky. 1966).

³⁹ 404 F.2d 936 (6th Cir. 1968).

⁴⁰ 394 U.S. 495, 507. Justice Black also indicates that the legality of credit sales is not determined here. "It will be time enough to pass on the issue of credit sales when a case involving it actually arises." *Id.*

⁴¹ *Id.* at 507.

⁴² *Id.* at 506. The ambiguity over this point is brought out in the dissent by Mr. Justice Fortas.

"At another point the majority even suggests that if U.S. Steel can show 'legitimate business purposes' and the absence of 'competitive advantage' (*ante*, at 506) in the credit market, it will have made out a defense. But in an earlier part of the opinion, the majority says explicitly that 'it is clear that petitioner raised questions of fact which, if proved at trial, would bring this tying arrangement within the scope of the *per se* doctrine' (*ante*, at 500-501)." *Id.* at n. 524.

If the latter directive is controlling no examination of business justifications would be appropriate.

the trial court to consider valid business purposes in connection with the single product issue, U.S. Steel has substantial arguments in favor of the proposition that one product, not two, were sold.⁴³

It is not an uncommon practice for manufacturers and suppliers to finance their dealers or retailers, and in almost every case the financing is conditioned on the purchase of their goods.⁴⁴ Such an arrangement provides for the simplification of transaction by eliminating a financial institution as intermediary. Also, because the purchaser-dealer is a source of future income to the seller-lender, there is an added inducement to extend credit to new venturers when the risks are too high for conventional lenders. Fortner Enterprises was a new business and there was testimony to show that most of Credit Corporation's borrowers were not prime financial risks.⁴⁵ Furthermore, the fact that the loan here was for more than the price of the houses is not fatal to the argument. It is also not an uncommon practice for the seller-lender to finance such fixtures, displays or other assets that are necessary for the retailer to dispense seller's goods and that cannot be financed through conventional lenders.

A holding on the single product issue contrary to that of the majority in *Fortner* may also be defended under the *Times-Picayune* and *Crawford* line of reasoning. Credit Corporation made its financing available solely to franchised dealer-builders of the Homes Division and solely for the purpose of constructing Homes Division houses.⁴⁶ Where such is the case, as opposed to a general purpose financial institution the primary function of which is lending, there is considerable merit to the proposition that the items are so functionally related as to constitute the sale of a single product, *i.e.*, the sale of homes with an ancillary financing provision⁴⁷ similar to the incidental delivery services in *Crawford*.

The kind of transaction condemned in *Fortner* may well be the very kind of price competition that the Sherman Act was enacted to encourage. Such a conclusion admittedly requires an expansive reading of a reversal of a summary judgment as well as nonrecognition of the potential threat that tying of products to credit may have to legitimate antitrust interests (all four of the dissenting judges conceded that the tie of products to credit might run afoul of the antitrust laws). Yet it brings into focus what may be the most fundamental weakness of the *Fortner* approach: the willingness to apply the "extraordinary onerous incidents of per se illegality"

⁴³ It is doubtful whether such an option is open to the trial court in light of the following language: "we cannot see how an arrangement such as that present in this case could ever be said to involve only a single product." *Id.* at 507.

⁴⁴ See generally Brief for Respondent at 49-53.

⁴⁵ Brief for Respondent at 6.

⁴⁶ *Id.* at 5.

⁴⁷ It was the conclusion of Mr. Justice Fortas' dissent that there was a sale of a single product with incidental financing provisions. 394 U.S. 495, 523 (1968).

to this type of arrangement.⁴⁸ Application of the per se rule clearly has the advantage of ease of administration due to the fact that the blanket prohibition of *Northern Pac. Ry.* requires no consideration of market structure or practical business justifications. It is equally clear, however, that the same doctrine works injustice when applied to situations not precisely the same as those that gave rise to the doctrine. The loan arguments made by Credit Corporation are a far cry from the attempts of the earlier patentees to extend their statutory monopolies into other markets. The *Fortner* decision applies a cure that is disproportionate to the evil it seeks to correct. Determination that a single product has been sold is a useful tool for exempting certain transactions that are supported by legitimate business considerations from the harsh application of *Northern Pac. Ry.* The finding is especially appropriate where alternative methods of protecting antitrust interests, such as section 5 of the Federal Trade Commission Act or section 2 of the Clayton Act, are available. *Fortner Enterprises, Inc. v. U.S. Steel Corp.* is such a case.

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⁴⁸ *Id.*