1977 S.C. Op. Atty. Gen. 161 (S.C.A.G.), 1977 S.C. Op. Atty. Gen. No. 77-209, 1977 WL 24551

Office of the Attorney General

State of South Carolina
Opinion No. 77-209
July 6, 1977

***1** TO: Honorable Allen R. Carter
State Senator
Charleston County

QUESTION

Is the practice of assessing a penalty against a construction loan borrower, if the lender does not handle the permanent loan, legal?

STATUTES INVOLVED

South Carolina Unfair Trade Practices Act, §§ 39–5–10, et seq., Code of Laws of South Carolina (1976).

Sherman Act § 1 (15 U.S.C. § 1).

DISCUSSION

This question arises from the following statement of facts, which is typical of construction financing arrangements in South Carolina. 'Bank' loans 'Contractor' $35,000.00 for eight months in the form of a construction loan on a residence. Under the terms of the loan, in addition to a 1% commitment fee and 9% interest per annum, Contractor agrees to pay a penalty of $300.00, if Bank is not the lender in the permanent financing arrangement on the completed residence.

Is the penalty provision just cited illegal? Inasmuch as it may be construed to be a tying arrangement, it is illegal.

Section 1 of the Sherman Act, 15 U.S.C. § 1, makes a tying arrangement illegal per se whenever (1) the seller ('Bank') has sufficient power with respect to the tying product (construction loan) to restrain free competition in the tied product (permanent financing), and (2) a 'not insubstantial' amount of interstate commerce is affected. Forner Ent., Inc. v. United States Steel Corp., 394 U. S. 495, 499 (1969). The second test may easily be met if the practice is wide spread, due to the flow of 'permanent' money in the interstate commerce associated with agencies of the United States, such as the Federal Home Loan Mortgage Corporation or the Government National Mortgage Association. In any case, the interstate commerce test is not material to the South Carolina Unfair Trade Practices Act., S. C. Code §§ 39–5–10 et seq. (1976).

S. C. Code § 39–5–20 provides:
'(a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.

(b) It is the intent of the legislature that in construing paragraph (a) of this section the Courts will be guided by the interpretations given by the Federal Courts to § 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1), as from time to time amended.'

The Federal Courts have held that Section 5(a)(1) of the FTC Act proscribes practices which run counter to the policies of the Sherman and Clayton Acts. See Atlantic Refining Co. v. FTC, 381 U.S. 357, 369 (1965). Hence, tie-ins have been held violative of Section 5 of the FTC Act. FTC v. Texaco Inc., 392 U.S. 223 (1968). Therefore, a tie-in violates the South Carolina Unfair Trade Practices Act.

A tying arrangement arises when a seller refuses to sell one product or service, the tying item, unless the buyer also purchases another product or service sold by the supplier or his designee or agrees not to deal in the product of a competitor. Northern Pacific Railroad v. U. S., 356 U. S. 1 (1958). In the instant case, 'Bank' has conditioned a construction loan on 'Contractor' taking such steps necessary as to insure that his purchaser secures permanent financing with 'Bank', or pay a penalty. The penalty in this context is substantial as it could easily reflect over 10% of Contractor's profit from the sale. Whether this arrangement is technically a tying arrangement is immaterial, as it operates in the same manner to restrain trade, and it is the restraint of trade which is prohibited.

***2** There are two other material factors necessary to establish an illegal tie. These are (1) sufficient economic power on 'Bank's' part to coerce 'Contractor' in agreeing to the penalty provision, and (2) the coercion. Generally, in cases brought under § 5 of the FTC Act, these elements have been satisfied by showing the great disparity in size between a seller (lender) and buyer (borrower). Atlantic Refining Co. v. FTC 381 U.S. 375 (1965).

CONCLUSION

The penalty provision described in the loan agreement between 'Bank' and 'Contractor' may well be proved to violate the South Carolina Unfair Trade Practices Act, and/or the Sherman Act, subjecting 'Bank' to civil and criminal liability.

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