Articles

At Participating Locations Only: Legal Implications of Encouraging Franchisees to Participate in Discounting or Promotional Programs

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Consumers are tempted with a continuous stream of advertisements about restaurants' cheap hoagies,[1] deeply discounted menus,[2] and even frugal full-course meals.[3] Franchised fast-food eateries and full-service restaurants alike craft promotional programs to attract customers seeking a tasty meal and a good deal.[4] These dining deals remain popular among consumers as the United States digs itself out of the Great Recession.[5]

1. CommercialsinUSA, *Subway Five Dollar Footlong Commercial*, YouTube (Mar. 9, 2009), http://www.youtube.com/watch?v=MJF3mknSTlo.

2. CommercialsinUSA, *McDonalds Dollar Menu Commercial ("What Can I Get for a Dollar?")*, YouTube (Apr. 28, 2009), http://www.youtube.com/watch?v=FyzYI3TV8IQ.

3. Selena West, *Olive Garden 3-Course Italian Dinner for Two TV Commercial*, YouTube (Mar. 5, 2013), https://www.youtube.com/watch?v=3ti03nN0ti4.

4. *See* Richard Gibson, *Burger King Franchisees Can't Have It Their Way*, Wall St. J. (Jan. 21, 2010, 12:01 AM), http://online.wsj.com/news/articles/SB10001424052748704320104575014941842011972 (noting that franchisors favor such programs because it allows them to be competitive in the "current consumer environment").

5. Diana Ransom, *Can They Really Make Money Off the Dollar Menu?*, AllBusiness.com, http://www.allbusiness.com/food-beverage/restaurants-food-service-restaurants-fast/12344164-1.html (last visited May 28, 2014).

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But at what cost? Many franchisees see the promotions as a bite out of their bottom line. On the other hand, franchisors tout the successes of the pricing promotions and encourage franchisees' participation in such promotions. How far can franchisors go to encourage participation in these promotional opportunities? This article will attempt to answer that question by addressing the legal implications of the franchisor's actions in encouraging its franchisees' participation in these promotional programs.

I. Background

Vertical resale price maintenance agreements (RPM agreements) are those agreements between a manufacturer, producer, or franchisor and its resellers whereby the manufacturer, producer, or franchisor sets either a maximum or minimum price at which its product will be sold farther down the distribution chain.[6]

Historically, courts have disfavored RPM agreements and have condemned them as per se violative of the Sherman Act.[7] That is, courts have concluded that these agreements are violative of the Sherman Act without proof of how the agreements harmed competition. The reduced burden of proof coupled with the potential for treble damages and attorney fees served to deter the maintenance of vertical price restraints.[8]

However, in recent times, RPM agreements have not received such harsh treatment. The Supreme Court in two seminal cases, *State Oil Co. v. Khan*[9] and *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[10] held that the maintenance of vertical RPM agreements, whether they establish maximum or minimum resale prices, is not a per se violation of the Sherman Act's prohibition on restraints on trade.[11] Now, vertical price restraints are to be evaluated under the rule of reason test and will not be disturbed unless they unreasonably restrain trade. These cases essentially opened the door for franchisors to experiment with the use of vertical RPM agreements.

6. Alicia L. Downey, *Antitrust Constraints on Vertical Price Agreements and Unilateral Pricing Conduct*, *in* ANTITRUST COUNSELING & COMPLIANCE (2012).

7. *See* Dr. Miles Med. Co. v. John D. Park & Sons, Co., 220 U.S. 373 (1911) (declaring vertical RPM agreements that establish minimum prices per se unlawful), *overruled by* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007); *see also* Albrecht v. Herald Co., 390 U.S. 145 (1968) (instructing that vertical RPM agreements that establish maximum prices are per se illegal), *overruled by* State Oil Co. v. Khan, 522 U.S. 3 (1997).

8. Robert T. Joseph, *Antitrust Law, Franchising, and Vertical Restraints*, 31 FRANCHISE L.J. 3 (2011).

9. 522 U.S. 3 (1997).

10. 551 U.S. 877 (2007).

11. *See Khan*, 522 U.S. at 22 (concluding that vertical RPM agreements that establish maximum prices are no longer per se unlawful); *see also Leegin*, 551 U.S. 877 (teaching that vertical RPM agreements that establish minimum prices are no longer per se unlawful).

A. *Franchisor Encouragement of Franchisee Participation in Promotional Programs*

System-wide promotional programs are attractive to franchisors for several reasons. First and foremost, franchisors (and franchisees) favor these promotional initiatives because they work.[12] These programs are effective at increasing traffic to the franchised restaurants, and they have the potential to expand an enterprise's market share.[13] To illustrate, in April 2009, KFC unveiled its grilled chicken dish on the Oprah Winfrey Show and announced a promotional coupon entitling the holder to free chicken. Within twenty-four hours of the announcement, 10.5 million coupons for the free chicken were downloaded from the franchisor's website, and at least four million were actually redeemed during the two-day promotion.[14] Likewise, Subway franchisors (and franchisees) were delighted by the increased customer traffic when the franchisor unveiled its $2 dollar sandwich during its Customer Appreciation Month.[15] Second, franchisors appreciate the brand recognition that accompanies such programs. When customers patronize a franchised restaurant identified by the franchisor's marks, they predict and anticipate having an experience that is familiar to them without regard to whether the establishment is a franchise or is wholly owned and operated by the franchisor. Maintaining uniform promotional practices assures customers that they will enjoy the consistency that they have come to expect. Franchisors also find appealing the level of uniformity and control associated with network-wide promotional programs. Finally, these promotional initiatives are attractive to franchisors, whose revenue is based on a percentage of franchisees' gross sales, because these promotions allow the franchisor to better predict revenue.

B. *Franchise Community's Use of Vertical RPM Agreements*

In the wake of *Khan* and *Leegin*, the franchise community initially adopted a "wait-and-see approach," awaiting judicial and legislative guidance before exercising any right to establish RPM agreements.[16] That reluctance may be explained in a number of ways.

12. Nick Lieber, *Are Discounts and Freebies Doing Franchise Owners More Harm than Good?*, BLOOMBERGBUSINESWEEK (Aug. 3, 2009), http://www.businessweek.com/stories/2009-08-03/are-discounts-and-freebies-doing-franchise-owners-more-harm-than-good.

13. *Id.*

14. Diana Ransom, *Can They Really Make Money Off the Dollar Menu? A Look at What the Deals Really Cost and Why They Have Become a Battleground for Franchisees*, WALL ST. J. (May 21, 2009, 12:01 AM), http://online.wsj.com/news/articles/SB124292373005243859.

15. *See* Sandra Pedicini, *Subway Restaurants Aim for Healthy Growth in Central Florida*, ORLANDO SENTINEL (May 27, 2012), http://articles.orlandosentinel.com/2012-05-27/business/os-cfb-talking-with-dipasqua-20120527_1_subway-restaurants-subway-sales-new-location (franchisor representative discussing the benefits of the $2 hoagie promotion to the franchise system).

16. Joseph, *supra* note 8.

First, the primary reason that franchisors, in particular, are reluctant to enter into RPM agreements is because many franchisors are contractually bound by existing franchise agreements. These agreements, entered into under preexisting law that proscribed the use of RPM agreements, expressly limit the franchisor's ability to set vertical price restraints.[17] As old franchise agreements are renegotiated and new ones are executed, this argument loses its force.[18]

Second, the rule of reason standard is marked with uncertainty. Both the *Leegin* and *Khan* decisions instruct that vertical RPM agreements, whether they set minimum or maximum price restraints, are not per se unlawful. The validity of such agreements will be evaluated through the lens of the rule of reason test. Under the rule of reason test, courts must consider both the anticompetitive and pro-competitive effects of vertical price restraints and can only strike down such price restraints where the anticompetitive effects outweigh the competitive advantages. Unlike the per se rule, the rule of reason test is fact-intensive. In evaluating the anticompetitive and pro-competitive effects of vertical price restraints, courts must consider a variety of factors, including information about the business; the condition of the business before and after the imposition of the price restraint; and the history, nature, and effect of the price restraint.[19] What may be considered reasonable in one context may not be so considered in another context.

Third, although vertical price restraints will be analyzed under the rule of reason standard under federal law, the same treatment is not guaranteed under state antitrust laws. Most states have antitrust statutes, nicknamed "baby Sherman Acts," that share many of the same features as their federal counterpart.[20] Despite the similarities, some states' antitrust statutes may proscribe RPM agreements. For instance, California has left undisturbed a pre-*Leegin* statute that may prohibit the maintenance of vertical RPM agreements.[21] Likewise, other states, such as Maryland, have expressly denounced the rule of reason approach to evaluating vertical RPM agreements by statute.[22] The threat of state law challenges may prevent franchisors from setting system-wide prices.

17. *See*, *e.g.*, Stuller, Inc. v. Steak N Shake Enters., Inc., 695 F.3d 676, 677 (7th Cir. 2012) (noting that a franchisee had been permitted, under a preexisting franchise agreement, to establish prices for goods over the course of seventy years).

18. Victor D. Vital & Elizabeth Wirmani, Leegin: *All Bark, No Bite?*, 13 FRANCHISE LAW. (Summer 2010), *available at* http://apps.americanbar.org/abapubs/design/franlwy/sum10/7_Leegin.html.

19. State Oil Co. v. Khan, 522 U.S. 3, 10 (1997).

20. Michael H. Seid, *Franchisor Setting Prices-Tinkering Again with the Rules of Business*, MSA WORLDWIDE 2 (2011), http://www.msaworldwide.com/Franchisor%20Setting%20Prices%202010.pdf.

21. Vital & Wirmani, *supra* note 18.

22. *Id.*

Still another reason that franchisors may be reluctant to act on this newfound freedom relates to a franchisor's relationship with its franchisees. In mature franchise networks, franchisees have appreciated and expect to exercise their independent discretion in establishing prices. By exercising a right to establish vertical price restraints, a franchisor may disrupt the relationship that it has long fostered with its franchisees.

In more recent years, the franchise community has started to abandon the wait-and-see approach to resale price maintenance agreements. During the Great Recession, many restaurant franchisors began experimenting with discount menu promotions in their franchise systems.[23] Proving itself successful, the discount menu promotions phenomenon has lingered afterward, and the franchise community has started to revamp and refine its use. For instance, some of the largest quick-service restaurant franchises have rolled out tiered-value menus, which feature a variety of items at various value prices.[24] In early 2013, Wendy's announced that it would revamp its value menu. It gave the value menu a new name, the "Right Price Right Size Menu"; changed the pricing structure; and modified some of its value menu items.[25] The Right Price Right Size Menu, unlike its traditional value menu, is not limited to $.99 offerings.[26] Instead, Wendy's has value tiers whereby customers shopping the new value menu may choose from $.99 offerings, $1.29 offerings, and even $1.79 offerings.[27] Likewise, McDonald's recently adopted the tiered approach to its value menu.[28] Its traditional "Dollar Menu" has been replaced with the "Dollar Menu & More" menu. The quick-service giant's new value menu offers consumers individual offerings priced between $1.00 and $2.00 or shareable options priced at $5.00.[29]

The shift from pure dollar menus to tiered-value menus has taken shape as companies consider the long-term implications of the promotions. Maintaining the pure dollar menu does not make sound long-term economic sense. Deeply discounted menus are great loss leaders. These menus and promotions like them lure customers into a restaurant in hopes that they will spend money on discounted items as well as other high-margin offerings. However, running deeply discounted promotions may come with unintended

23. Daniel P. Smith, *The Case for Cheap Eats: Why Restaurants Play in the Affordable Menu Game*, QSR MAG. (July 2011), http://www.qsrmagazine.com/menu-innovations/case-cheap-eats.

24. Brad Tuttle, *Fast-Food Chains Are Desperate to Kill the Dollar Menu*, TIME MAG. (Jan. 14, 2014), http://business.time.com/2014/01/14/fast-food-chains-are-desperate-to-kill-the-dollar-menu/.

25. Martha C. White, *Wendy's Doubles Down on Dollar Menu*, TIME MAG. (Jan. 3, 2013), http://business.time.com/2013/01/03/wendys-doubles-down-on-dollar-menu/.

26. *Id.*

27. *Id.*

28. Press Release, McDonalds, McDonald's USA Launches New Dollar Menu & More to Offer Customers More Choices (Nov. 7, 2013), http://news.mcdonalds.com/US/news-stories/McDonald-s-USA-Launches-New-Dollar-Menu-More-to-Of.

29. *Id.*

consequences. For instance, McDonald's maintained its pure dollar menu for a decade, but in recent years the discount menu has not translated into significantly increased market share or sales.[30] Instead of luring customers in to purchase the dollar and costlier options, quick-service customers are spending their dining dollars on the deeply discounted menu items and foregoing the other regular-priced options that restaurants offer.[31] A company's brand may also take an unintended hit from deep discounting. Low prices, although initially attractive, may create the perception of diminished quality and value and brand a restaurant as a discount or cheap eats location, even though that was not the intent of the discounting initiative.

II. Analysis

A. *Recent Cases*

1. Steak N Shake Litigation

In the summer of 2010, quick-service franchise Steak N Shake modified its seventy-year-old pricing policy to require that all of its franchisees follow the franchisor's new pricing and promotional initiatives.[32] Specifically, the franchisor's policy provided that "[a]ll restaurants are required to follow set company menu and pricing as published with the exception of breakfast items. Additionally, all restaurants are required to offer all company promotions as published."[33] Prior to the adoption of the new policy, franchisees retained the ability to control menu prices.[34]

Most Steak N Shake franchisees adopted the new policy without much debate; however, one franchisee refused to implement the policy, believing that it still had the authority to set menu prices under its existing franchise agreement.[35] When the franchisee refused to implement the new pricing and promotion policy, Steak N Shake notified the franchisee that failure to implement the new policy would result in the termination of its franchises.[36] The franchisee filed suit in a federal district court in Illinois, alleging breach of contract and breach of the implied covenant of good faith and fair dealing or, alternatively, violation of a state franchise disclosure statute. In filing the suit, the franchisee sought to enjoin the franchisor from enforcing the policy against it and from taking any adverse action against it for noncompliance during the pendency of the lawsuit.[37] The franchisee also sought declaratory

30. *See* Candice Choi, *McDonald's Dollar Menu Fails to Boost Sales*, HUFFINGTON POST (Apr. 9, 2013), http://www.huffingtonpost.com/2013/04/19/mcdonalds-dollar-menu-sales-profit_n_3117498.html.

31. *See* Tuttle, *supra* note 24.

32. Stuller, Inc. v. Steak N Shake Enters., Inc., 695 F.3d 676, 677 (7th Cir. 2012).

33. Stuller, Inc. v. Steak N Shake Enters., Inc., 877 F. Supp. 2d 674, 686 (C.D. Ill. 2012).

34. *Stuller*, 695 F.3d at 677.

35. *Id.*

36. *Id.*

37. Stuller, Inc. v. Steak N Shake Enters., Inc., 10-CV-3303, 2011 WL 2473330, at *2 (C.D. Ill. June 22, 2011) *aff'd*, 695 F.3d 676 (7th Cir. 2012).

relief that it was not required to comply with Steak N Shake's new pricing and promotional policy.[38]

Ultimately, the U.S. District Court for the Central District of Illinois sided with the franchisee and granted its motion for preliminary injunction.[39] Soon thereafter, Steak N Shake filed an interlocutory appeal challenging the court's grant of the preliminary injunction.[40] At the appellate level, Steak N Shake argued that the preliminary injunction should not have been granted because the threshold requirements—specifically, the irreparable harm requirement—for a preliminary injunction had not been established.

The Seventh Circuit did not buy Steak N Shake's argument, holding that the franchisee would suffer irreparable harm because there was sufficient evidence to demonstrate that implementing the pricing policy would be "a significant change to [the franchisee's] business model. . . . "[41] The court noted that if the franchisee were to win on the merits of the case it would suffer irreparable harm because it would be difficult to reestablish the enterprise goodwill and reputation it had worked to build since 1939.[42]

While the case was on appeal, the district court granted the franchisee's motions for summary judgment and held that the franchise agreements covering four of the franchisee's five restaurants were ambiguous because they were unclear whether the franchisor could compel franchisees to follow prices that the franchisor had established.[43]

The court then turned to extrinsic evidence to ascertain the parties' intent with regard to which party could control pricing.[44] The district court was convinced that the parties intended to reserve in the franchisee the right to establish prices for several reasons. First, the negotiations leading up to the execution of the franchise agreement supported such a reading of the franchise agreement. During negotiations, a representative from Steak N Shake sent the franchisee a memorandum indicating that it was free to set prices and that by law all franchisees may establish their own prices.[45] Second, a state-required franchise disclosure form that the franchisor provided to the franchisee before the execution of the existing franchise agreement aided the court in reaching its conclusion. The disclosure, although never incorporated into the franchise agreement, specifically provided the franchisees with the right to set their own prices, and many did so.[46] Third, the parties' course of performance bolstered the court's reading of the franchise agreement. The franchisee was free to set its own prices for seventy years. Moreover, when the franchisee requested custom menus that reflected a

38. *Id.*
39. *Id.* at *13.
40. *Stuller*, 695 F.3d at 677.
41. *Id.* at 680.
42. *Id.*
43. *Id.* at 690.
44. Stuller, Inc. v. Steak N Shake Enters., Inc., 877 F. Supp. 2d 674, 690 (C.D. Ill. 2002).
45. *Id.* at 692.
46. *Id.* at 692–93.

10 percent price increase that it established, Steak N Shake merely recommended against the increase.[47] It did not take any further action to prevent the franchisee from implementing the increase. Fourth, the court was certain that its reading of the franchise agreement represented the intent of the parties because of the way in which the new pricing and promotional policy was presented to franchisees. Steak N Shake sent a letter to its franchisees unveiling the new policy. In the letter, the franchisor asked franchisees to agree to the policy in exchange for additional marketing funds.[48] The court noted that such a request was contrary to Steak N Shake's claim that the franchisee was already obligated to follow its pricing and promotional practices under the franchise agreement.[49]

Steak N Shake also initiated litigation against its franchisees related to RPM agreements.[50] In *Steak N Shake Enterprises, Inc. v. Globex Co., LLC*, the franchisor sought to enjoin its franchisees' alleged post-termination trademark infringement and unfair competition following termination of their franchise agreements for failure to comply with Steak N Shake's RPM agreements.[51] In *Globex*, the franchise agreements at issue expressly granted Steak N Shake the right to control prices.[52] The *Globex* franchisees refused to comply with Steak N Shake's pricing policy and noted that such refusal was not a breach of the franchise agreement because no menu item was offered at a price inconsistent with Steak N Shake's à la carte menu pricing. Following Steak N Shake's termination of the *Globex* franchisees' franchise agreements, the *Globex* franchisees continued operating their restaurants, prompting Steak N Shake to file suit.[53] Ultimately, the court concluded that the franchisees were in default and enforced their post-termination obligations.[54]

Even after the resolution of the *Stuller* and *Globex* cases, Steak N Shake's promotion and pricing policy continues to be challenged. In April 2013, three other franchisees sued the franchisor to settle disputes related to its promotion and pricing policy.[55] It is not yet clear how those cases will be resolved because the U.S. District Court for the Southern District of Indiana compelled the parties to arbitrate their disputes.[56]

47. *Id.* at 693.
48. *Id.*
49. *Id.*
50. Steak N Shake Enters., Inc. v. Globex Co., LLC, No. 13-CV-01751-RM-CBS, 2013 WL 4718757 (D. Colo. Sept. 3, 2013).
51. *Id.* at *7.
52. *Id.* at *2–3.
53. *Id.* at *14.
54. *Id.* at *16–17.
55. Druco Rest., Inc. v. Steak N Shake Enters., Inc., 1:13-CV-00560-LJM, 2013 WL 5779646 (S.D. Ind. Oct. 9, 2013).
56. Druco Rest., Inc. v. Steak N Shake Enters., Inc., 1:13-CV-00560-LJM-DML, 2014 WL 268113 (S.D. Ind. Jan. 23, 2014).

2. Burger King Litigation

Global quick-service chain Burger King faced a similar challenge to its pricing policy. Since the late 1960s, Burger King had allowed its franchisees to set prices on the menu items they sold.[57] The franchisor began modifying its pricing policy as early as 2005.[58] However, the modification was implemented only after the franchisor submitted to its franchisees a proposal that would allow the franchisor to set maximum prices that its franchisee could charge for certain items included on a new "value menu."[59] At least 67.7 percent of voting franchisees supported the value menu proposal.[60] In 2006, Burger King rolled out its new value menu.[61] Burger King sent a memorandum to its franchisees outlining the value menu and its exceptions.[62] The memorandum also explained that failure to comply with the required value menu would be grounds for termination of the franchise agreement.[63]

Soon after receiving the value menu memorandum, a franchisee in Manhattan refused to implement the discount pricing policy because it believed that it fell within an exception to the policy.[64] Burger King reminded the franchisee that failure to comply with the value menu policy would constitute a default of the franchise agreement.[65] Burger King notified the franchisee of the procedure to request approval of an exemption from the policy.[66] The franchisee did not follow the exemption procedures, and its franchise agreements were terminated.[67]

In *Burger King Corp. v. E-Z Eating, 41 Corp.*, Burger King sued the franchisee for a variety of claims, including breach of contract; the franchisee countersued, alleging that Burger King breached the implied covenant of good faith and fair dealing.[68] Both parties moved for summary judgment. The U.S. District Court for the Southern District of Florida granted summary judgment in favor of Burger King, and the franchisee appealed.[69] The Eleventh Circuit upheld the district court's decision, holding that there was "simply no question" that Burger King could impose the value menu on its franchisees.[70]

57. Nat'l Franchisee Ass'n v. Burger King Corp., 715 F. Supp. 2d 1232, 1236 (S.D. Fla. 2010).
58. *Id.*
59. *Id.*
60. *Id.*
61. Burger King Corp. v. E-Z Eating, 41 Corp., 572 F.3d 1306, 1309 (11th Cir. 2009).
62. *Id.*
63. *Id.*
64. *Id.* at 1310.
65. *Id.*
66. *Id.*
67. *Id.* at 1311.
68. *Id.* at 1307.
69. *Id.* at 1306.
70. *Id.* at 1314.

Notwithstanding the unsuccessful challenge to Burger King's pricing policy in *E-Z Eating, 41 Corp.*, more franchisees sued the franchisor, alleging that it lacked authority to impose prices on products that they sell.[71] In 2008, the franchisor announced its intention to add the double cheeseburger to the value menu and proposed the idea to franchisees.[72] On two occasions, franchisees voted against adding the double cheeseburger to the value menu, claiming that it costs franchisees more than $1.00 to make it.[73] Despite the objections, Burger King unilaterally added the double cheeseburger to the value menu and required all of its U.S. franchisees to offer the item at the value menu price.[74] Burger King's unilateral modification to the value menu prompted franchisees, represented by a trade association, to file suit challenging Burger King's alleged authority to impose maximum prices.[75]

The district court found that Burger King's right to set prices had already been decided by the appellate court in *E-Z Eating, 41 Corp.* and, as further support, cited the specific provision of the franchise agreement that conferred such right:

> [The franchisee] agrees that changes in the standards, specifications and procedures may become necessary and desirable from time to time and agrees to accept and comply with such modifications, revisions, and additions to the MOD Manual which BKC in the good faith exercise of its judgment believes to be desirable and reasonably necessary.[76]

Thus, the court was compelled to adhere to precedent and dismiss the franchisees' claim that Burger King lacked the authority to establish prices.[77] The court warned that the case is not yet over. It held that although the franchise agreement gave Burger King the right to establish prices, the finding does not necessarily mean that the franchisor did so in good faith.[78]

Following these cases, Burger King abandoned its plans to make the double cheeseburger part of the value menu. It instead increased the price of the double cheeseburger to $1.29 and introduced the "Buck Double," a burger with two meat patties and one slice of cheese.[79] The franchisor placed the Buck Double on the value menu and required franchisees to sell it at $1.00.[80] This addition to the value menu prompted the trade association

71. Nat'l Franchisee Ass'n v. Burger King Corp., 715 F. Supp. 2d 1232 (S.D. Fla. 2010).
72. *Id.* at 1236.
73. *Id.*
74. *Id.* at 1236–37.
75. *Id.* at 1237.
76. *Id.* at 1242.
77. Interestingly, both the district court and the Eleventh Circuit concluded that Burger King had the right to establish prices even though that right was not expressly granted in the contract. Such a result is contrary to the one reached by the *Stuller* court, where the court concluded that the franchise contract provision regarding Steak N Shake's right to modify its operating system did not allow it to dictate downstream prices.
78. *Nat'l Franchise Ass'n*, 715 F. Supp. 2d at 1245.
79. Nat'l Franchisee Ass'n v. Burger King Corp., 2010 U.S. Dist. LEXIS 123065, at *4 (S.D. Fla. Nov. 19, 2010).
80. *Id.*

to amend its complaint to allege that the franchisor breached its express and implied duties of good faith by requiring franchisees to sell the double cheeseburger and the Buck Double at $1.00.[81]

Arguing that the amended complaint failed to allege facts sufficient to demonstrate that the value menu prices would have a substantial adverse effect on the franchisees' overall business operations, Burger King again moved to dismiss the claim.[82] In granting the franchisor's motion to dismiss the claim, the court rejected the franchisees' argument that requiring them to sell items below cost constitutes per se bad faith.[83]

III. Antitrust Considerations

All of the above cases analyzed the legality of the franchisor's ability, from the contract perspective, to establish prices. Although neither the Steak N Shake nor the Burger King cases considered whether the pricing policies at issue violated federal antitrust law, antitrust claims may nonetheless remain viable challenges, in addition to contract claims, to vertical RPM agreements.[84]

As previously noted, both *Khan* and *Leegin* opened the door for the establishment of vertical resale price restraints. However, neither of those cases should be read to have created in franchisors a per se right to dictate prices. They merely teach that when a franchisor seeks to implement such a policy, it may do so as long as the agreements are reasonable restraints on trade. Any unreasonable vertical RPM agreement will still violate the Sherman Act. How these issues will play out is unclear—no U.S. court has had the opportunity to determine whether a franchisor's attempt to vertically restrain prices is prohibited on antitrust grounds.

IV. Best Practices for Franchisors Seeking to Impose RPM Agreements

There are valuable lessons to be learned from the Steak N Shake and Burger King cases.

A. *Know Specifics of Agreement Before Implementing New Policies*

First, franchisors should take a hard look at the specifics of their franchise agreement and any disclosure documents before implementing a vertical pricing policy to ascertain whether they have the right to require franchisee participation. In *Stuller*, the parties were operating under a franchise agreement

81. *Id.*
82. *Id.* at *6.
83. *Id.* at *16–17.
84. *See* Nat'l Franchise Ass'n v. Burger King Corp., 715 F. Supp. 2d 1232, 1245 n.7 (S.D. Fla. 2010) (inviting franchisee trade association to file antitrust suit challenging the franchisor's "maximum price fixing").

that did not explicitly reserve in the franchisor any right to establish downstream prices, and the court found that the franchisor did not have the right to impose RPM agreements on the franchisees. Conversely, in *Globex*, the franchise agreements at issue reserved the franchisor's right to specify prices for promotional menu items, and the court upheld the franchisor's enforcement of its pricing policy against its franchisees.

Thus, counsel for franchisors interested in implementing RPM agreements in their franchise systems would be wise to include a provision in the franchise agreement or modifications to the existing franchise agreement that expressly and unambiguously reserve in the franchisor the right to establish maximum and minimum prices.[85] In fact, following the *Stuller* decision, Steak N Shake modified its franchise agreements to expressly include the right to establish prices as part of its ability to manage the franchise system.[86] Absent a clear right in the franchise agreement to set pricing, a franchisor may be exposing itself to a variety of risks, including alienating franchisees, disrupting the franchise system, and even incurring litigation involving the interpretation of an ambiguous franchise agreement.

B. *Maintain Consistency with Agreement*

Second, the parties' action should be consistent with the express terms of the agreement, particularly if the franchisor operates under a franchise agreement that lacks an explicit right to set prices. In *Stuller*, the franchisor never manifested an intent to retain control over pricing matters and had long allowed the franchisee to establish its own prices. Even after the franchisor in *Stuller* claimed that it had the right to set prices, it failed to exercise the right. In response to a franchisee's request that the franchisor print

85. *See* Julie Bennett, *Dollar Wars*, FRANCHISE TIMES (Apr. 2012), http://www.onlinedigitalpubs.com/display_article.php?id=1015670 (suggesting that a such a provision may look like the following: "We may exercise rights with respect to the pricing of products and services to the fullest extent permitted by then-applicable law. These rights may include (without limitation) prescribing the maximum and/or minimum retail prices which you may charge customers for the products and/or services offered and sold at your franchised unit.").

86. *See* Steak N Shake Enters., Inc. v. Globex Co., LLC, No. 13-CV-01751-RM-CBS, 2013 WL 4718757 (D. Colo. Sept. 3, 2013) (indicating that the franchise agreement at issue here was executed on or about September 26, 2012, a date after another federal district court concluded that its previous franchise agreement was ambiguous). SNS's modified franchisee agreement now provides that each franchisee:

(1) acknowledges that maintaining uniformity in every component of the operation of the "System" is essential to the success of Steak N Shake restaurants, "including a designated menu (including maximum, minimum, or other prices the Franchisor specifies for menu items and mandatory promotions)." "System" is defined to include advertising and promotional programs and menu, which SNS Enterprises may change in its sole discretion;
(2) agrees to serve, sell or offer for sale all of the (and only the) food and beverage products and merchandise listed in the then-current standard menu or menus specified by SNS Enterprises; and
(3) agrees not to deviate from SNS Enterprises' standards and specifications for serving or selling food and beverage products and merchandise, including prices and mandatory promotions, without SNS Enterprises' prior written consent.

Id. at *3.

menus with pricing 10 percent above the franchisor's specified prices, the franchisor merely advised against the price increase instead of compelling the franchisee to comply with the franchisor's pricing policy.

Although at first glance it appears that mature franchise systems operating under a policy that allows franchisees to set prices will not be able to overcome the "course of performance" analysis in *Stuller*, *Burger King* instructs that even some of these mature franchises may have a history that demonstrates that franchisees lack absolute control over prices. For instance, in *Burger King*, the franchisor had allowed franchisees to control prices since the late 1960s, but that right to control was not without limits. System-wide pricing initiatives were developed cooperatively among the franchisor and its franchisees, with the franchisor presenting proposed pricing initiatives to its franchisees for approval by majority vote.

Under similar circumstances, it may be prudent to highlight the franchisor's involvement in pricing decisions. For instance, counsel for a franchisor may want to emphasize that the franchisee never had absolute control over prices if the franchise agreement required that the franchisee get franchisor preapproval of menus, prices, or other price-related promotions.

C. *Conduct Market Research and Testing*

Third, before implementing any promotional pricing initiatives, franchisors should do their research. The Steak N Shake line of cases highlights the consequences of not conducting market research before introducing system-wide promotional initiatives. The better practice would be for franchisors to conduct market research and investigate the potential returns that flow from these kinds of system-wide pricing programs. Market research could prove valuable to help gauge the price point, duration, and customer and franchisee reaction to the promotion.

Likewise, research may involve testing the promotion on a segment of the franchise system. It is not uncommon for franchisors to test novel concepts, whether it is a new menu item or new hours, in select markets before they roll out the new concept to the entire franchise system.[87] New promotional campaigns should be tested much the same way. Franchisors could obtain participants in the test phase of the promotion from at least three sources: (1) corporate-operated restaurants, (2) franchisees that would like to voluntarily participate, and (3) franchisees whose franchise agreements expressly reserve in the franchisor the right to set prices. Successfully testing the prospective promotion among this segment of the franchise system can be particularly useful when encouraging the remainder of the franchise system to embrace the promotion.

87. *See*, *e.g.*, Maureen Morrison, *McDonald's Tests Higher Priced Offerings to Appease Franchisees*, Ad Age (Sept. 4, 2013), http://adage.com/article/news/mcdonald-s-tests-higher-priced-items-appease-franchisees/243981/ (highlighting McDonald's testing of its new value menu in select markets).

D. *Invite Participation*

Fourth, the Burger King line of cases teaches that franchisors may successfully implement compulsory value menus when they get franchisees involved. The global burger giant had in place a democratic system for introducing new concepts to its franchisees.

Although not every franchise system will have a similar institution, many franchise systems have franchise advisory councils (FACs) comprised of franchisor and franchisee representatives who work together to improve the franchise system and resolve challenges that impact the system as a whole. Before implementing promotional initiatives like discount menus, it may be prudent to get feedback from the system's FAC. The FAC feedback will serve as a barometer of advantages of the promotional initiative and any potential obstacles to implementation. After receiving feedback, franchisors may want to tweak the promotional program to meet the franchise system's needs. By involving the FAC in the promotion's preliminary phase, franchisees feel like active participants in the process, franchisee backlash or resistance is likely minimized, and franchisees anticipate the promotion when it is implemented system-wide. Moreover, inviting participation from franchisees will foster greater support for future promotional initiatives.

Conclusion

Since 1997, the Supreme Court has backtracked on its judicial condemnation of vertical price restraints and opened the door for franchisors to experiment with mandatory system-wide pricing initiatives.[88] Many franchisors have accepted the invitation to experiment with these kinds of price restraints.[89]

To date, cases involving those franchisors that experimented with system-wide pricing policies have generated mixed results.[90] Certainly, those cases teach that a franchisor's attempts to establish prices that its franchisees may charge for products may be challenged in more than one way.[91] Franchisees may challenge the franchisor's authority to dictate prices on breach of contract grounds. Alternatively, franchisees may take the antitrust route

88. *See* State Oil Co. v. Khan, 522 U.S. 3 (1997); Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

89. *See, e.g.*, Nat'l Franchise Ass'n v. Burger King Corp., 715 F. Supp. 2d 1232 (S.D. Fla. 2010); Stuller, Inc. v. Steak N Shake Enters., Inc., 695 F.3d 676, 677 (7th Cir. 2012).

90. *See* Stuller, Inc. v. Steak N Shake Enters., Inc., 877 F. Supp. 2d 674, 692 (C.D. Ill. 2012) (holding that franchise agreement provision that granted franchisor the right to modify the franchise system did not encompass the right of the franchisor to set prices); *But see*, Burger King Corp. v. E-Z Eating, 41 Corp., 572 F.3d 1306, 1314 (11th Cir. 2009) (concluding that the franchisor's right to establish prices was found in provision of franchise agreement that gave the franchisor the right to changes and additions to its operating system).

91. *See* Nat'l Franchise Ass'n, 715 F. Supp. 2d. at 1245 n.7 (suggesting antitrust suit may be an additional way to challenge the franchisor's authority to set prices); *see also Stuller*, 877 F. Supp. 2d 674 (franchisee contested franchisor's authority to set maximum prices on contract interpretation grounds).

and demonstrate that the franchisor's pricing policies are unreasonable restraints on trade.

With more franchise systems adopting these maximum pricing policies, it will be interesting to see how courts will resolve these disputes.[92] However, before involving the courts, franchisors may choose to engage in a few best practices to prevent these kinds of disputes and get back to the business of making quality food.

92. Jonathan Maze, *Value of Menus: Cutting Prices Not Always a Panacea*, FRANCHISE TIMES (May 2008), http://www.franchisetimes.com/May-2008/Value-of-menus/.