

## Brown Bag Program

# A New Wave of Robinson-Patman Act Section 2(c) Litigation: Anti-Brokerage Claims in the Franchise Supply Context

An ABA Section of Antitrust Law “Brown Bag” Conference Call, held November 12, 2002, co-sponsored by the Section’s Robinson-Patman Act and Corporate Counsel Committees.

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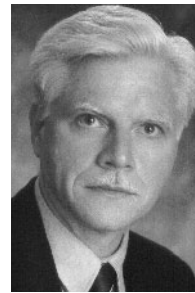


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**Editor’s Note:** This program traces recent, innovative applications of Section 2(c) of the Robinson-Patman Act<sup>1</sup> in lawsuits that challenge supply practices in the hotel industry and in franchise relationships. Section 2(c) prohibits

*any person engaged in commerce . . . to pay or grant, or to receive or accept, anything of value as a commission, brokerage or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares or merchandise, either to the other party to such transaction or to an agent, representative, or other intermediary. . . .*

*The first wave of these cases involves hotels. Many hotel owners contract out the operation of their properties to well-known managers, such as ITT Sheraton and Marriott. The management agreements typically provide that the operator will charge all operating costs to the owner and receive a management fee. The recent cases brought by the hotel owners assert that the operators received undisclosed rebates, or “sponsorship funds,” from vendors in connection with purchases of supplies the operators charged to the owners. The hotel owners assert that operators’ retention of these payments violates their fiduciary duties to the owners and, in addition, that the payments violate Section 2(c) of the Robinson-Patman Act as a “kickback” paid to the operators.*

*In the first of the hotel cases to go to trial, 2660 Woodley Road Joint Venture v. ITT Sheraton Corp.,<sup>2</sup> a jury agreed with the owner. The jury’s verdict awarded the owner about \$10 million in compensatory damages and \$39 million in punitive damages on the breach*

<sup>1</sup> 15 U.S.C. § 13(c).

<sup>2</sup> 2002 U.S. Dist. LEXIS 439, 2002-1 Trade Cas. (CCH) ¶ 73,601 (D. Del. Jan. 10, 2002).

of fiduciary duty claims, and an additional \$750,000 in compensatory damages for the Section 2(c) violation, which was subject to trebling under the Clayton Act. The trial court issued a ruling on January 10, 2002, that denied the defendant's motion for judgment *n.o.v* or a new trial on any of the claims but reduced the punitive damages award to approximately \$17 million. Shortly after that ruling, many more cases were filed challenging hotel operators' practices.<sup>3</sup>

Building on the hotel cases, a second wave of cases has been initiated by franchisees in the fast-food industry against their franchisors. Typically, a fast-food franchisor will either designate approved suppliers of foodstuffs or paper goods, from whom franchisees must make purchases, or will purchase and supply these items itself. When the franchisors make these designations or make the purchases, they sometimes receive fees from the suppliers.

An association of Blimpies' franchisees initiated an arbitration proceeding against their franchisor, contending that the franchisor's receipt of such payments, among other things, violates Section 2(c) and raised their costs of supplies.<sup>4</sup> A group of franchisees of the "Huddle House" restaurant chain brought suit against their franchisor on the same theory.<sup>5</sup>

In the recent past, franchisees challenging such arrangements as unlawful tie-in sales had, for the most part, had their challenges rebuffed.<sup>6</sup> Have franchisees found a better mousetrap in Section 2(c)?

Donald S. Clark, Secretary of the Federal Trade Commission, started the program with an overview and history of Section 2(c). W. Michael Garner, who represents the Blimpies franchisees in their 2(c) arbitration, addressed the types of arrangements that franchisees would seek to challenge. Alicia L. Downey, who frequently defends franchisors, analyzed defenses likely to be available to franchisors in these actions.

—MATTHEW MOLOSHOK

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**MARGARET ZWISLER:** Welcome to our Brown Bag on Section 2(c) of the Robinson-Patman Act. Section 2(c) of the Robinson-Patman Act has been used very little over the years. Recently, however, both practitioners and the courts have been grappling with new applications of this provision to some common business practices in the franchise and distribution context. Even the *New York Times* in late September 2002 ran an article about a case between Marriott and some of its hotel owners in which Section 2(c) is one of the fundamental claims.<sup>7</sup> Once you have been in the *New York Times* it's certainly time to address this subject. The recent interest in this kind of problem is the genesis for our program.

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<sup>3</sup> Some hotel "rebate" cases decided or pending at the time of the Brown Bag discussion included:

*2600 Woodley Road Joint Venture v. ITT Sheraton Corp.*, 2002 U.S. Dist. LEXIS 439, 2001-1 Trade Cas. (CCH) ¶ 73,601 (D. Del. Jan. 10, 2002)

*In Town Limited Partnership v. Marriott International, Inc.*, No. 2:02-0481 (S.D.W.V. filed May 23, 2002)

*CTF Holdings, Inc. v. Marriott International, Inc.*, No. 02-271-SLR (D. Del. filed Apr. 12, 2002)

*Flatley v. Marriott International, Inc.*, No. 02-11577-RCL (D. Mass. filed Aug. 5, 2002)

*SHC Laguna Niguel I LLC v. Marriott International, Inc.*, No. BC280028 (Cal. Super. Ct. filed Aug. 20, 2002)

Copies of the complaints in these cases can be found at the ABA Section of Antitrust Law Robinson-Patman Act Committee Web page using this link: <http://www.abanet.org/antitrust/committees/rp/programs.html>.

The *Flatley* suit settled, and was dismissed voluntarily on December 24, 2002.

<sup>4</sup> *The Association of Blimpie Franchisees, Inc. v. Blimpie Int'l*, AAA File No. 50 T 114 00431 02 (filed Nov. 18, 2002) The Blimpies' complaint in arbitration may be found at the Robinson-Patman Committee Web page, *see supra* note 3.

<sup>5</sup> *Ash-Bash, Inc. v. Huddle House, Inc.*, Civil Action No. 02-2276 (WBH) (N.D. Ga. filed Aug. 15, 2002) The Huddlehouse complaint may be found at the Robinson-Patman Act Committee Web page, *see note 3* above.

<sup>6</sup> *See, e.g.*, *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430 (3d Cir.1997); *Little Caesar Enters., Inc. v. Smith*, 34 F. Supp. 2d 459 (E.D. Mich.,1998). *But see* *Collins v. Int'l Dairy Queen, Inc.*, 939 F. Supp. 875 (M.D. Ga.1996).

<sup>7</sup> L. Browning, *May I Speak to the Manager? A Storm at Marriott*, N.Y. TIMES, Sept. 29, 2002, at Sec. 3, p. 1, col. 2.

**BRIAN HENRY:** Several of our committee members saw the articles on Marriott in the *New York Times* and in the *Wall Street Journal*<sup>8</sup> and identified this as a potential area for a Brown Bag program. The Brown Bag format provides the opportunity to learn about a new area and raise awareness regarding a developing area. I think you will find that there are really no clear answers. Our goal today is to increase the audience's awareness of this wave of Section 2(c) cases and better inform everyone as to possible approaches to handling 2(c) issues that may arise in their daily practice.

I would like to kick the program off by introducing our panelists. Don Clark is the Secretary of the Federal Trade Commission. He has been in that post since 1988, and was involved in the FTC's *Boise Cascade* case and the *Bookseller* cases. He is going to start the program by providing some background on the origins of the Robinson-Patman Act and particularly the elements of a 2(c) claim. Then Michael Garner, a partner at Dady & Garner in Minneapolis, Minnesota, will provide some background on the franchisee perspective of a Section 2(c) case. Michael's practice fundamentally involves franchisees and distributors filing suits against franchisors and he will bring that perspective and experience to his presentation today. Alicia Downey will follow. She is a partner in the Boston office of Bingham McCutchen, in its antitrust and trade regulation group. She is going to provide the defendant's response to a 2(c) claim. So our goal here is to provide the background on what 2(c) is all about; to provide a potential plaintiff's perspective in bringing a 2(c) case; and then a defendant's potential response to a 2(c) case.

**DONALD CLARK:** As you mentioned, I am with the Federal Trade Commission. I very much appreciate the opportunity to participate in this discussion today. I should first note, as we always have to, that the views I express are my own and do not necessarily represent the views of the Federal Trade Commission or of any members of the Commission or any members of the Commission staff. The Federal Trade Commission Act prohibits unfair methods of competition—our antitrust mission—and unfair or deceptive acts and practices—our consumer protection mission. Two laws we enforce are particularly relevant to franchise practices. The Commission is empowered to enforce the Clayton Act, including Section 2 of that statute and of course Section 2(c). Also, the Commission has adopted and enforces a trade regulation rule entitled *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, more commonly known as the Franchise Rule.<sup>9</sup>

My job is to describe the historical context in which Congress created the Robinson-Patman amendments to the Clayton Act, including, in particular, Section 2(c). I think we will all recall that in 1936 Congress believed large firms could dominate markets through predation and other forms of economic warfare directed against smaller firms. And Congress felt that "power buyers" like large retailers could use their market power to extract price concessions from manufacturers and other sellers that were not available to their smaller competitors.

The major legislative purpose of the Robinson-Patman Act was to provide some measure of protection to small independent retailers and their independent suppliers from what was thought to be unfair competition from vertically integrated, multi-location chain stores. Consistent with the context in which the statute was created in 1936, the Supreme Court and the Commission have concluded that the Act's fundamental principle is to assure, to the extent reasonably practicable

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<sup>8</sup> See WALL ST. J., Aug. 21, 2002.

<sup>9</sup> 16 C.F.R. Part 436, available at <http://www.ftc.gov/bcp/franchise/16cfr436.htm>.

and consistent with economic efficiency considerations, that firms at the same functional level would stand on equal competitive footing so far as price is concerned.

Of course, interpreting and elaborating on this basic principle is crucially important, because maximizing consumer welfare and economic efficiency in a free market economy necessarily anticipates that different firms perform differently and will fare differently. In my view, therefore, our objective should be to interpret the Robinson-Patman Act in as economically sound a fashion as possible. The Supreme Court has on several occasions stated that the Act must in fact be interpreted consistently with the broader policies of the antitrust laws, so my perspective would be that we want to ensure that Section 2(c) is enforced in a way that is as consistent as possible with the other provisions of the antitrust laws. The Supreme Court, of course, has taken a similar position with respect to Section 2(c) in the *Broch* case<sup>10</sup> and in other cases as well.

Let me now focus more particularly on the provisions of Section 2(c). In relevant part Section 2(c) prohibits a party to a sales transaction from granting to or receiving from the other party a “commission, brokerage or other compensation or any allowance or discount in lieu thereof except for services rendered in connection with the sale or purchase of goods, wares, or merchandise.” And it goes on at some length, but that is the gist of the provision.

The circumstances that led to the inclusion of this provision in the 1936 amendments to the Clayton Act are instructive. In the 1920s and 1930s many small manufacturers and processors marketed their output through independent sales brokers. Those brokers solicited orders from potential customers, forwarded the orders to the producers/sellers, and received commissions from the sellers for their efforts. However, as competition in a variety of retail sectors developed, many large buyers began to maintain their own elaborate purchasing departments. These buyers did not need the services of a seller’s broker because they bought their merchandise directly from the producers/sellers. As a consequence, in many cases, these large buyers required the sellers either (1) to pay them the commission that would otherwise have gone to a broker or (2) to give them allowances in lieu of brokerage reflecting the savings in the cost of distribution attributable to their performing the brokerage function. That was the genesis of Section 2(c); it was designed to protect smaller sellers, in particular manufacturers and brokers, from what were thought to be unfair practices by large buyers.

With this background in mind, I think that the best enunciation of the purpose of Section 2(c) remains the Supreme Court decision in *FTC v. Henry Broch & Co.*, where the Supreme Court defined the objectives of Section 2(c) in the following way:

The Robinson-Patman Act was enacted in 1936 to curb and prohibit all devices by which large buyers gain discriminatory preferences over smaller ones by virtue of their greater purchasing power. A lengthy investigation revealed that large chain buyers were obtaining competitive advantages in several ways other than direct price concessions and were thus avoiding the impact of the Clayton Act.<sup>11</sup>

The Court noted:

One of the favorite means of obtaining an indirect price concession for large buyers was by setting up “dummy” brokers who were employed by the buyer and who, in many cases, rendered no services. The large buyers demanded that the seller pay “brokerage” to these fictitious brokers who then turned it over to their employer. This practice is one of the chief targets of Section 2(c) of the Act.<sup>12</sup>

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<sup>10</sup> *FTC v. Henry Broch & Co.*, 363 U.S. 166 (1960).

<sup>11</sup> *Id.* at 168–69.

<sup>12</sup> *Id.* at 169.

Dummy brokers were not the only means by which the Congress perceived the brokerage function to be abused, but preventing their use was, I think, the primary goal of the statute.

In short, the primary goals of Section 2(c) were to eliminate the practice of dummy brokerage and, at the same time, to eliminate hidden preferences that might be masked by the brokerage function by forcing them into the open; that is, to ensure that firms—instead of trying to hide price reductions they were offering through brokerage and other kinds of arrangements—would bring their pricing behavior out into the open so it could be evaluated under the more forgiving price discrimination provisions embodied in Sections 2(a) and 2(f) of the Robinson-Patman Act.<sup>13</sup>

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That is the genesis of Section 2(c). The Supreme Court also, however, importantly has recognized a number of exceptions to what would otherwise be rather severe restrictions in Section 2(c). In particular, the Court placed the following limitations on the basic prohibition. First, the Court noted in the *Broch* case that if the broker had simply agreed to accept the lower commission at issue on all sales to all buyers, there plainly would be no room for finding that the price reductions were violations of Section 2(c). In other words, in *FTC v. Broch*, the problem from the Court's perspective was that Broch had used the reductions at issue to secure the business of a single buyer. On the other hand, if the same commissions had applied to all sales made by Broch, that would not have presented a problem. So, discrimination is one of the requirements that you have to find to show a 2(c) violation.

Second, the Court indicated that a "reduction in price coupled with a reduction in brokerage" did not automatically compel the conclusion that an allowance in lieu of brokerage has been granted.<sup>14</sup> As I mentioned, one of the chief concerns was to avoid masking direct discounts through indirect brokerage reductions. The Court wanted to emphasize that the mere presence of such a reduction in price at the same time one found a reduction in commissions did not mean that a violation had occurred; it would depend on the circumstances of each case.

Third, the Court noted that the record in *Broch* contained no evidence that the buyer rendered any services to the seller or to the respondent broker, and that left the Court comfortable with finding a Section 2(c) violation. By implication, however, the Court suggested that if the buyer had rendered services to the seller or the broker then the payments might have been permissible. In fact, the Court said that if the buyer that secured the discounts at issue had actually rendered services to the seller or to the respondent broker, "[w]e would have quite a different case."<sup>15</sup>

The *Broch* decision thus adds those three important caveats to the Section 2(c) provisions, and courts in later cases have applied them or extended them to other situations.

For example, the Fifth Circuit has added something of a cost justification defense to Section 2(c). In *Thomasville Chair Company v. FTC*, it held that allowances in lieu of brokerage are prima facie discriminatory only if they are "without justification based on actual bona fide differences in the cost of sales and resulting from the differing methods or quantities in which commodities are sold or delivered."<sup>16</sup> The Commission has extended these exceptions by ruling that if the buyer purchases products for its own account and then resells them to wholesalers, that may be permissible. In the *Edward Joseph Hruby* case,<sup>17</sup> the Commission determined that while the discounts

<sup>13</sup> See Herbert R. Gibson, Sr., 95 F.T.C. 553, 740, *modified*, 96 F.T.C. 126 (1980), *aff'd*, 682 F.2d 554 (5th Cir. 1982).

<sup>14</sup> 363 U.S. at 175.

<sup>15</sup> *Id.* at 173.

<sup>16</sup> *Thomasville Chair Co. v. FTC*, 306 F.2d 541, 545 (5th Cir. 1952).

<sup>17</sup> *Edward Joseph Hruby*, 61 F.T.C. 1437 (1962).

that the buyer received were equal to the usual brokerage amounts, the discounts did not violate Section 2(c) because they simply reflected a functional discount, which the buyer received because the buyer was performing significant services.

In addition, Section 2(c) expressly creates an exception for payments for services rendered. Although early cases limited the scope of this exception to payments by a seller to its broker, the Supreme Court in *FTC v. Broch* once again expressly stated that if a buyer renders any services to a seller or to the respondent broker, so that the price reduction at issue is justified by the elimination of services normally performed by the seller or its broker, that would have presented a different case. Thus, for example, a number of much more recent cases considered the situation in which a school district schedules photography sittings for its students and provides space for such sittings in exchange for a commission from the photographer on sales of photographs to the school's students. Courts confronting these situations have concluded that the commissions do not violate Section 2(c) because they fall within the services rendered exception; that is, the school district is performing services and therefore it is entitled to compensation without running afoul of Section 2(c).

Finally, of course, Section 2(c) has also been held to prohibit commercial bribery, and I think this is consistent with the more general principle that if a broker or some other entity is acting as an agent for another party but is in fact violating its fiduciary duty by taking kickbacks—commercial bribery representing probably the quintessential example of that kind of situation—then that is going to violate Section 2(c).

The final thing I wanted to mention is that Section 2(c) technically does not require a showing of injury to competition in order to establish a violation. However, Section 4 of the Clayton Act requires a private plaintiff to establish the existence of actual injury from the practice at issue in order to recover damages. Thus, as a practical matter, the plaintiff in a given case must show that it suffered injury from the allowances in lieu of brokerage or commercial bribery at issue. Typically the plaintiff would have to show it is competing with a favored participant or participants in the transaction involved. That is one last gloss on Section 2(c) which I think we want to keep in mind as we consider how the statute best should be enforced.

**MICHAEL GARNER:** Franchisees' interest in this type of claim arises largely as a result of a spate of recent cases that are not strictly franchise cases, and I'll describe the general fact pattern in those cases. There are number of them, and there is at least one decision in favor of the plaintiff. Those cases arise in the lodging industry. Typically, what we are seeing is that owners of a hotel property have contracted with an operator, such as a Marriott or a Sheraton, to operate the property pursuant to an operating agreement or an agency agreement. The operator in turn contracts with third parties to supply goods and perhaps services to the property—e.g., soaps, amenities, that type of thing. The plaintiffs in these cases assert that the operator has taken payments from the suppliers. Typically, what happens is that the owner is going to be paying the suppliers for the actual cost of goods or services and a payment is then going from the supplier to the operator. That was attacked under Section 2(c) in a number of cases, and there was a jury verdict that was upheld notwithstanding a motion for judgment as a matter of law, in *2660 Woodley Road Joint Venture v. Sheraton*.<sup>18</sup>

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<sup>18</sup> See *supra* note 3.

Now, that fact pattern is not terribly different from the setting that you often encounter with franchisors and franchisees. In a typical business format franchise, a franchisor licenses the trade-name, the trademark, and the system for doing business to the franchisee, and usually third parties will supply the goods that the franchisee actually sells, so that the burger franchisor will have meat suppliers that supply hamburgers, or bakers that supply the buns, or paper suppliers that supply the plates and napkins. Also, a franchisor will often operate locations of its own, what we call company-owned stores. If not side-by-side, I think it is fair to say the company-owned stores are in competition with franchisee-owned outlets.

There are a number of legal constraints on the franchisor/franchisee relationship that I think have to be taken into consideration in evaluating a 2(c) claim or any of the other claims that may arise in connection with this type of a fact pattern. One is the Lanham Act. The franchisor is licensing its name to the franchisee and it has a right to control the trademarks and the use of the trademarks and the quality of the goods and services that are used under its mark. So it has to have some type of arrangement with the supplier of the goods and services. The second consideration that you have here is something that Don mentioned, the FTC Franchise Rule, and also the law in approximately 16 states that requires a franchisor to make disclosures to prospective franchisees prior to purchase, and those include disclosures of any compensation that the franchisor receives from third party suppliers.<sup>19</sup> And then, third, the franchisor has to be mindful of antitrust considerations other than the Robinson-Patman Act, particularly tying claims. There have been a number of cases over the years where franchisees have claimed that the franchisor has unlawfully tied the use of the trademark to particular goods or services that have to be purchased either from the franchisor or from its designated suppliers.

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In traditional business format franchising, the franchisor will usually derive its revenue stream from royalty payments that franchisees pay, typically a percentage of their gross sales. The franchisors in recent years, however, have begun to look to suppliers as a source of revenue. Today, when franchisors are finding that their ability to expand the number of units or their ability to increase same store sales is constrained by saturation of the market and economics and competition, the franchisors are looking elsewhere for revenues, and that leads them to look to suppliers as a source of revenue. So we're finding, as franchisee lawyers, that franchisors are increasingly turning to their suppliers and cutting deals to obtain payments from the suppliers on account of sales that are made to franchisees. These deals can come up in a number of different contexts and a number of different ways. I've got a number of hypothetical examples here.

The first fact pattern we see is where the franchisor requires the franchisee to purchase from a designated supplier, prohibits the franchisee from making purchases from any other supplier, and meanwhile the franchisor receives consideration from the supplier based on the franchisee purchases. That's one fact pattern that we see.

A second fact pattern that we see is the same as the first except that the franchisee is free to purchase from any supplier that meets the franchisor's reasonable requirements, and the franchisor has, in fact, approved such alternative supplier. So, if the franchisor is getting a payment from Pepsi but Coke is also approved and it doesn't get a payment from Coke, and the franchisee can go to Coke, that's a different situation.

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<sup>19</sup> For state laws requiring pre-sale disclosures to franchisees, see 1 W.M. GARNER, FRANCHISE AND DISTRIBUTION LAW AND PRACTICE § 5.26 (2002).

A third situation is where the franchisor requires the franchisee to purchase from designated suppliers. There is no direct payment from the supplier to the franchisor, but the supplier sells to franchisees at one price and sells the same products at a discount to the franchisor for company-owned stores.

I think that all of these fact situations have the potential to run afoul of a 2(c) claim. Whether the claim will successfully run the course is a matter we can discuss.

*One thing that I noticed in reviewing the cases is that you can pretty much tell what the outcome is going to be by how the facts are described.*

Certainly in the first situation, where the franchisee is locked in, you've got a pretty good claim on behalf of the franchisee. In the second situation, where the franchisee is free to purchase from any other supplier, I think somebody's going to mention the words "no antitrust injury." And in the third situation, you don't actually have a payment but you do have a discount that may be in lieu of a payment.

In real life, all of these fact patterns get complicated by a number of other factors. The franchisor may make representations to the franchisee that it will get the franchisee the best prices or reduced prices from the suppliers. There may be nondisclosures of various types under the FTC disclosure statement or the Uniform Franchise Offering Circular or "UFOC." There may be claims of fiduciary relations involved as well. We see claims arising not only under 2(c) of the Robinson-Patman Act, but also disclosure issues if the franchisor has not fully disclosed. There may be little FTC Act claims, particularly if the franchisor has not fully disclosed. There may be breach of contract claims, fraud claims, RICO claims. There could be price discrimination claims under 2(a) of the Robinson-Patman Act, and conceivably there could be tying claims that get involved in this type of fact pattern.

What are some of the issues and defenses that defendants are going to raise? First, as I mentioned earlier, they will say "no antitrust injury." One that we anticipate will be raised is a claim that services have in fact been rendered by the franchisor. That particular claim raises an interesting question on the interplay between the franchisor's duty to monitor and police the use of its trademark and whether it's actually performing services for the supplier. And sometimes we have heard franchisors say, well, we're entitled to make a profit on this and that's how we do business.

As I mentioned earlier, we do have a jury verdict in this one case, in the *Sheraton* case.<sup>20</sup> There was a jury verdict not only on the 2(c) claim but also on breach of contract claims, breach of fiduciary duty claims and certain others. There are a number of other cases that are pending as we speak. So with that introduction to the franchisee's viewpoint, I'll turn it over to Alicia.

**ALICIA DOWNEY:** What I'm going to try to do is address the flip side of what Michael was just talking about, specifically with reference to these recent hotel cases, some of which have only just been filed in the last six months. Others have been pending now for awhile, although there really haven't been any substantive decisions on some of the 12(b)(6) motions that have been filed in response to the 2(c) claim, at least as yet. We should be seeing them coming out within the next few months, so the legal landscape on this issue may be clearer in the very near future.

One thing that I noticed in reviewing the cases is that you can pretty much tell what the outcome is going to be by how the facts are described. The plaintiffs (and the courts in some of the cases that found their way into news reports) have defined the transactions giving rise to the 2(c) claim as being either "kickbacks," or "bribes," or "secret rebates." But the franchisor or the person being

<sup>20</sup> See *supra* note 3 and accompanying text.

accused of violating 2(c) might have called these payments “signing bonuses,” or “sponsorship funds” or “incentive programs.” How these different payments are labeled has implications not only for the litigation but also the counseling side of things. If you can connect these payments to legitimate agreements the payments are being made under—and as Michael mentioned too, if they are connected to the core franchisor function of protecting goodwill, the brand, and the trademark—and if they’re not actually called kickbacks or bribes within the company—you will have a better case going forward.

With respect to the technical elements of whether a private 2(c) claim can prevail, a couple of points have already been mentioned. In the hotel cases, the 12(b)(6) defenses have asserted, flat-out, that the plaintiffs’ claims essentially assert conduct constituting commercial bribery, rather than “dummy brokerage” conduct governed by Section 2(c). I think at this point some circuits have embraced the commercial bribery cause of action. Others have questioned it.<sup>21</sup> I know here in the First Circuit, they held it up to the light but have not made a final decision yet.<sup>22</sup> Yet that’s the threshold issue—whether Section 2(c), or some other provision of the antitrust laws, allows somebody in the hotel owner’s position to actually sue for commercial bribery.

Let’s say it does. What are they really complaining about? I think in the hotel cases you’ll see they’re really complaining that the owner didn’t get the payment. They’re the ones buying the stuff. They’re asserting that, if there are going to be payments made by vendors, the owners, not the operators, should have received the payment. So it’s really a claim more like conversion, perhaps, or breach of contract by third-party beneficiaries, to the extent that the operators were contractually bound to order supplies and then somehow kept the rebate payments for themselves. But at bottom the plaintiffs are claiming that they are the rightful recipient of the rebate. Again, there’s a basis there to question whether you’re really stating a Section 2(c) claim in that instance.

I think there have also been allusions to the fact that in the bribery context, perhaps a prerequisite is an agency or fiduciary relationship between the agent being bribed and the person on whose behalf they are supposed to be buying. A franchisor/franchisee relationship is not one that ordinarily gives rise to a fiduciary relationship and, in fact, many franchise agreements specifically disavow the existence of any such relationship. So to the extent that a fiduciary relationship is a prerequisite for a bribery claim, showing the requisite agency relationship or fiduciary duty could be a problem.

The more serious issue, and a major focus of the defenses asserted in these cases, is the “antitrust injury” requirement. It may be true that a plaintiff may not have to prove injury to competition at large to satisfy Section 2(c), but the plaintiffs are asserting their claims under the Clayton Act, and in order to get private plaintiff standing, a plaintiff needs to show the type of injury that the antitrust laws were intended to prevent. And that requires showing more than just simply not getting money to which you were allegedly entitled. The hotel cases have put this antitrust injury issue squarely before the courts. This is a threshold defense. It will be interesting to see which way the wind blows on this. It’s true that in the *2660 Woodley Road* case against ITT Sheraton, that did not seem to be an issue, but there were some interesting facts in that case that

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<sup>21</sup> See generally, Keller W. Allen & Meriweather D. Williams, *Commercial Bribery, Antitrust Injury and Section 2(c) of the Robinson-Patman Anti-Discrimination Act*, 26 GONZ. L. REV. 167 (1990/1991).

<sup>22</sup> See *Augusta News Co. v. Hudson News Co.*, 269 F.3d 41 (1st Cir. 2001); *Bridges v. MacLean-Stevens Studios, Inc.*, 201 F.3d 6 (1st Cir. 2000).

may have allowed the plaintiffs to go further with the claim than perhaps some of the plaintiffs will be able to go.<sup>23</sup>

The other issue, too, is who has standing to bring a commercial bribery claim. The common-sense thought about it is that the people who are really harmed when a buyer is bribed are the competitors of the seller, that is, the people who lost profits and lost business because they were unwilling to pay the bribe. The sellers—the competing sellers who did not pay the bribe—should be the ones who have standing to claim that they suffered antitrust injury as a result of the bribery. But in the hotel cases the plaintiffs are not those sellers. The plaintiffs are the folks who claim that they were somehow deprived of the benefit of the bribes—that is they say, in effect, that they were entitled to the bribe—or that the payments shouldn't have been made at all and that such payments unfairly increased their costs.

Another defense we see asserted in these cases is that the hotel owners agreed to allow the hotel operators to do the buying under their operating contracts. The contracts play a large role in really deciding whether a payment was wrongful or not. They're all different, and they play a major role in the case. It's not just the fact of payment that gives rise to the 2(c) violation. It has to do with all the details of parties' relationship and the procurement services that are being provided. If the contract specifically states that the hotel owner has agreed that it will make exclusive use of the operator to perform the buying function, then perhaps they've contractually agreed that there isn't going to be any competition. They can't complain of a competitive injury because they agreed at the outset that they would have only one source of goods.

The other potential defenses turn on the extent to which the payments were disclosed at the outset of the relationship as part of the system that the franchisor, or the hotel operators were operating. Where there is such disclosure then perhaps the payment is less "smelly." There is a lot of discussion in the cases about who knew what. These recent cases are based as much on allegations of hidden accounting practices and the buyer's failure to disclose, as they are on anything else.

What about cases in which the payments were in fact passed through to the plaintiffs? What damages have they suffered? I think that's a legitimate question to ask, and I think we're seeing in a couple of systems that the payments are in fact being distributed, in one form or another, to the franchisees or owners. Perhaps not as quickly or as systematically or as transparently as plaintiffs have suggested is their right, but again you'd have to question where the damage is in that case.

With respect to counseling on these issues, I think whether you are going to be working with an unhappy franchisee or the franchisor, there are likely to be a number of issues between the parties, not just the vendor payments. The 2(c) claims generally are not prosecuted alone. They come with a host of common law claims and sometimes with other federal antitrust claims. I don't see anybody thinking that the 2(c) claim is so strong that the plaintiff will present a single count complaint under Section 2(c) in this context. And there are, as I mentioned, some real threshold 12(b)(6) defenses that could well turn out to be successful in the end. But until those cases get decided and taken up on appeal, as a couple of them are right now, you have to realize that the exposure is probably pretty significant at the moment. Once it gets to a jury, if the case is pre-

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<sup>23</sup> *Ed. Note:* In a subsequently issued decision in one of the hotel cases under consideration, *In Town Hotels Limited Partnership v. Marriott Int'l, Inc.*, 2003 WL 536755 (S.D. W. Va. Feb. 25, 2003), the court denied the motion to dismiss, finding that antitrust injury standing requirements are met in the context of a 2(c) claim, where plaintiff alleges an injury to itself flowing from corruption of an agency relationship.

sented in the vocabulary of “kickbacks” and “bribes” and so forth, it’s going to be pretty difficult to get the claims knocked out altogether. A defense, for example, that “everybody else is doing it” or that “we’re entitled to make a profit too,” I see as being of diminished strength, at least right now.

Disclosure, though, could well be the key here, and I am talking not just about disclosure in the UFOC to potential franchisees, but also disclosure to existing franchisees. Of course that’s going to raise the other issue of whether you’ll generate complaints that you wouldn’t have otherwise had if you suddenly disclose something that perhaps was not common knowledge before with respect to receipt of vendor payments. Going forward, and with respect to existing business models, you really do have to consider whether there are services being rendered, what arguments can be made. By the same token, you also have to try to ensure that internal communications, the contract documents, the UFOC, and other disclosure documents do not undermine the argument that services of value to the franchisees or owners are being provided for these payments. Businesspeople should be counseled to avoid, for example, gleeful remarks about “getting something for nothing” or using loaded terms like “kickback.” ●