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FUNDAMENTALS 201:
ANTITRUST ESSENTIALS FOR FRANCHISE LAWYERS

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Table of Contents

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I. INTRODUCTION

Franchising is one of the nation's leading methods for the sale of goods and services at retail,[1] and it is extremely sensitive to the principles, nuances, and major changes in federal and state antitrust law. This paper presents the antitrust principles every franchise lawyer needs to know, from a practical standpoint, concluding with a "top ten" list.

From 1977-2007, the United States Supreme Court reduced substantially but not entirely the risks faced by franchisors from imposing "vertical" restraints, *i.e.,* those involving firms at different levels of the distribution chain, such as manufacturers and distributors or franchisors and franchisees, but the basic rules condemning "horizontal" restraints, *i.e.*, those involving competitors operating at the same level in the distribution chain, remain automatically ("*per se*") illegal, as companies and businesspersons fined up to $100 million and persons jailed for such violations can attest. In addition, the Supreme Court's 2007 decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,[2] perhaps the leading antitrust opinion in 21st Century distribution law, striking down the rule of *per se* illegality for minimum resale price maintenance (minimum "RPM"), is not as comprehensive as it might appear. And while most state antitrust laws follow federal precedent, some states still ban minimum RPM as *per se* illegal, and at least one has amended its state law to so declare.

II. THE BASIC STATUTES

A. <u>Sherman Act Section 1</u>

Section 1 of the Sherman Act prohibits agreements ("contracts, combinations and conspiracies") in restraint of trade in interstate and United States foreign commerce.[3] The Supreme Court added the word "unreasonable" as a modifier to restraint, because to some degree all agreements restrain trade.[4]

An agreement in violation of Section 1 may be formal or informal, written or inferred from conduct, but must be a "conscious commitment to a common scheme" to achieve an unlawful objective, and the evidence must "tend to exclude the possibility" of unilateral (independent) action.[5] On the other hand, truly unilateral conduct is not a violation of Section 1, even in the case of purely "conscious parallelism," *i.e.*, where a company adopts the same pricing, for example, in response to the *publicly-announced* pricing of a competitor.[6]

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[1] INT'L FRANCHISE ASS'N, THE ECONOMIC IMPACT OF FRANCHISED BUSINESSES, Vol. III View United States (1) (2007).

[2] 551 U.S. 877 (2007).

[3] 15 U.S.C. §1.

[4] *Standard Oil Co. v. United States*, 221 U.S. 1, 63-64 (1911).

[5] *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763-64 (1984); *Am. Tobacco Co. v. United States*, 328 U.S. 781, 809 (1946).

[6] *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 1966 (2007).

Section 1 prohibits as unlawful agreements among competitors to (a) fix or maintain prices or price levels, (b) rig bids, or (c) divide marketing territories or allocate customers. Section 1 is relevant to, but rarely condemns, resale restraints by franchisors imposed upon franchisees requiring franchisees to sell at, above or below certain prices, or only in certain territories, or only to certain customers, or to purchase a product or service as a condition of obtaining the franchise or as a condition of obtaining another product or service ("tying"), or to award an "exclusive" franchise. Today, as a result of the Supreme Court's decisions in 1977, 1984, 1997, and 2007, these resale restraints are normally lawful unless a franchisor has "market power," usually defined as a significant "market share" of the "relevant market," usually at least 30%. Virtually no franchisors enjoy this, because, absent monopoly or very unusual situations, the relevant market is not limited to a single brand.[7]

B. Sherman Act Section 2

Section 2 of the Sherman Act, of limited relevance here, condemns monopolization, attempts to monopolize and conspiracies to monopolize.[8] The first two are unilateral acts. Monopolization occurs when a firm either improperly acquires or maintains by exclusionary conduct dominance in a relevant market.[9] An unlawful attempt is accomplished when a firm seeks by improper acts to achieve a monopoly and has a "dangerous probability of success" in doing so. A market share in excess of 70% generally establishes a prima facie case of monopoly power.[10] In contrast, courts rarely find monopoly power when market share is under 50%.[11] Market shares between 50% and 70% are the areas of greatest uncertainty.[12]

C. The Clayton Act

The Clayton Act principally condemns mergers and acquisitions that threaten to "substantially reduce competition" in a relevant market.[13] It also adds what is today an unnecessary redundancy to Sherman Act Section 1 concerning exclusive dealing and tying arrangements.[14]

D. The Robinson-Patman Act

Under the Clayton Act's 1936 Robinson-Patman Act amendments, the law condemns, among other things, certain forms of price discrimination by a supplier selling to resellers including franchisees, and discrimination in furnishing them promotions and services.[15] The

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[7] *Eastman Kodak Co. v. Image Tech. Servs., Inc.,* 504 U.S. 451, 481-82 (1992).

[8] 15 U.S.C. §2.

[9] *United States v. Grinnell Corp.,* 384 U.S. 563, 570-71 (1966).

[10] ABA SECTION OF ANTITRUST LAW, *ANTITRUST LAW DEVELOPMENTS* at 231 (7th ed. 2012).

[11] *Id.* at 231-32.

[12] *Id.* at 232 & n.38.

[13] 15 U.S.C. § 8.

[14] *Id.* § 14.

[15] *Id.* § 13(a)-(e).

Robinson-Patman Act has been weakened substantially over the years, most significantly by a Supreme Court decision in 2006.[16]

E. The FTC Act

The Federal Trade Commission Act condemns unfair and deceptive methods of competition, and it complements the Sherman and Clayton Acts.[17]

F. Private Enforcement

The Clayton Act allows private parties to sue for treble damages and attorneys' fees for violations of either the Sherman or Clayton Acts (including the Robinson-Patman Act), for damage to a plaintiff's "business or property," and for injunctions to prevent or halt such harm.[18] But there is no private right of action under the FTC Act.

G. Federal Enforcement

The United States, through the Antitrust Division of the Department of Justice and the Federal Trade Commission, enforces the antitrust laws and can obtain civil and criminal remedies, including injunctions, fines, and imprisonment.

H. State Law

Nearly every state has its own antitrust law, dealing with restraints of trade in "intrastate" commerce. Almost every state statute mimics the Sherman and Clayton Acts, and most states are either required to follow or as a matter of course do follow federal antitrust decisions. But this is *not* universally true, and the distinction can be especially significant in the area of RPM since *Leegin* in 2007.

III. THE TWO TESTS OF LEGALITY: THE *PER SE* RULE AND THE RULE OF REASON

A. *Per Se* Rule

There are some agreements which, because of their pernicious effect on competition and lack of any redeeming virtue, are conclusively presumed to be unreasonable and, therefore, illegal. Elaborate inquiry as to the precise harm they have caused or the business justification for their use is not appropriate or permitted. If an agreement is *per se* illegal, that ends the case, except for determination of the remedy.[19]

Except for horizontal agreements to restrain competition, essentially today no practices are *per se* illegal, at least at the federal level. Instead, they are judged under the "rule of reason."

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[16] *Volvo Trucks N.A., Inc. v. Reeder-Simco GMC, Inc.,* 546 U.S. 164 (2006).

[17] 15 U.S.C. § 45.

[18] *Id.* § 15, 16.

[19] *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

B. The Rule of Reason and the Relevant Market

The rule of reason is the most common analytical test for evaluating alleged antitrust violations. In a rule of reason case, the plaintiff's objective is to prove that a challenged practice has or is likely to have a substantial adverse effect on competition in a relevant market. Thus, the relevant market essentially sets the boundaries in which the challenged practice's effect is assessed.[20] To determine whether a particular practice violated the rule of reason, the fact-finder weighs all circumstances relating to the restraint – its origin, justification(s), history, context, purpose, less restrictive alternatives, and – by far the most important – its effect on competition in the relevant market. Today, it is safe to say that, regardless of all other factors, if a restraint does not substantially impair competition in the relevant geographic and product market in which it operates, it will not be held unlawful under the rule of reason. That market is the "interbrand" market, in which all brands compete, not simply the "intrabrand" market, that composed of one supplier's products or services.[21]

The relevant market has two dimensions: a geographic market and a product market. The relevant geographic market is the "area of effective competition . . . in which the seller operates, and to which the purchaser can practicably turn for supplies."[22] The question is whether prices in one area provide a check against price increases in another. Where they do, the two areas are in the same market.[23] While many geographic markets are small, the relevant geographic market for a restraint that operates nationally will be the entire nation. The internet increases that likelihood today. The issue of relevant geographic market has not been critical in most franchise antitrust cases; the primary market definition disputes have arisen in tying cases over the issues of relevant product market and market power.[24]

The definition of a relevant product market is usually where plaintiffs' non-*per se* restraint cases falter, because it is the market in which *all* competitive products and services "reasonably interchangeable" with each other compete, and in which an appreciable number of customers might choose product or service A or B. Products or services in the same product or service market normally are price sensitive, in that if the price of one changes materially, an appreciable number of consumers will shift allegiance. Thus, product or service "cross-elasticity of demand" is the keystone. There are many factors that enter into the definition of relevant product or service markets, including customer views, price relationships, the presence or absence of specialized vendors, industry and public perception of separate markets, the views of competitors, and varying channels of distribution.[25]

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[20] "Without a definition of th[e] market, there is no way to measure" the impact of the challenged conduct on competition. *Walker Process Equip. Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 177 (1965); *Accord Spectrum Sports v. McQuillan*, 506 U.S. 447, 456 (1993).

[21] *See Cal. Dental Ass'n v. FTC*, 526 U.S. 756 (1999); *FTC v. Ind. Fed'n. of Dentists*, 476 U.S. 447 (1986), *Continental TV v. G.T.E. Sylvania, Inc.*, 433 U.S. 36, 49-51 (1977).

[22] *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961).

[23] *United States v. Eastman Kodak Co.*, 63 F.3d 95, 104-05 (2d Cir. 1995).

[24] *E.g., Queen City Pizza, Inc. v. Domino's Pizza*, 124 F.3d 430, 441-42 (3d Cir. 1997).

[25] ABA SECTION OF ANTITRUST LAW, *ANTITRUST LAW DEVELOPMENTS* at 574-77 (7th ed. 2012); *Image Tech. Servs., Inc.,* 504 U.S. at 541; *Brown Shoe v. United States*, 370 U.S. 294, 325 (1962); *AD/SAT v. A/P*, 181 F.3d 216 (2d Cir. 1999); *Queen City Pizza*, 124 F.3d at 438.

As noted, today, it is difficult indeed to establish a violation of the rule of reason under Section 1 by a franchisor possessed of less than a 30% market share.[26] And such a share is hard to come by except in areas in which there are few companies competing. Thus, Subway and McDonald's may have thousands of franchised locations, but they compete in a vastly fragmented market in which the "reasonably interchangeable" products are myriad varieties of modestly priced foods ("fast" and otherwise). Similarly, ExxonMobil may have the leading position in gasoline sales in the United States, but its national share is nothing like the share required for it to have "market power." By contrast, in a non-franchise context, Microsoft, operating in an environment in which there were almost no competitors, was found to have enormous market power. Although it may have acquired such power lawfully, the court found that its perpetuation of that power by unreasonably restrictive means such as tying arrangements violated the rule of reason.[27]

IV. THE BASIC VIOLATIONS

Horizontal restraints arise from agreements between actual or potential competitors, that is, firms operating at the same level of the distribution chain. For example, if two competing franchised businesses (in the same or in different systems) agree with each other to sell an item at the same price, they have entered into a "horizontal" price-fixing arrangement.[28] If the franchisor of a sandwich shop business limits a franchisee to serving the city of Topeka, that agreement would be a "vertical" territorial restraint because it arises between firms operating at different levels of the distribution chain.

There is no principle of antitrust law that all "horizontal" restraints are unlawful and all "vertical" restraints lawful. Competitors may enter into lawful "horizontal" joint ventures or mergers, while franchisors may enter into unlawful "vertical" tying arrangements. Nevertheless, "[c]haracterization of an agreement as horizontal or vertical is important because certain horizontal agreements have been declared *per se* illegal while vertical agreements covering the same subject matter have not."[29]

A. Horizontal Restraints

1. Horizontal Price-Fixing and Bid-Rigging

Any combination between competitors which raises, depresses, fixes, pegs or stabilizes prices, bids, or price or bid levels, is a *per se* violation.[30] "An agreement may be illegal even if it does not set a specific price. It is enough if two or more competitors agree on a range, a price floor or ceiling within which prices will fall or rise, or on list prices, advertised prices, discounts, credit terms, business hours, uniform inputs, refraining from competitive bidding, and supply

[26] *Assam Drug Co. v. Miller Brewing Co.*, 298 F.3d 311 (8th Cir. 1986).

[27] *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001).

[28] An exception to this principle applies in the case of dual distribution. *See infra* text accompanying note 43.

[29] *Garot Anderson Agencies, Inc. v. Blue Cross & Blue Shield United*, 1993-1 Trade Cas. (CCH) ¶ 70,235 at 70,161 (N.D. Ill. Feb. 26, 1993).

[30] *Catalano, Inc. v. Target Sales, Inc.,* 446 U.S. 643 (1980); *United States v. Socony-Vacuum Oil Co., Inc.*, 340 U.S. 150, 223-26 & n.59 (1940).

reductions."[31] *Per se* illegal bid rigging may take various forms such as comparing bids before submission, agreeing to refrain from bidding, knowingly submitting noncompetitive bids and agreeing to rig bids by creating sham competition.[32]

As mentioned above, the unlawful agreement need not be formal or in writing. A tacit, illegal understanding can arise without verbal communication.[33] The proverbial wink and nod may be enough to establish an unlawful agreement in the context of adequate circumstantial evidence.[34] It is, therefore, critical to exercise caution when interacting with competitors to avoid even the appearance that improper subjects may have been discussed or unlawful agreements made.

2. <u>Horizontal Market and Customer Allocation or Division</u>

Market or customer allocation among competitors is, after price-fixing among competitors, the antitrust offense most often prosecuted civilly by the Antitrust Division of the Department of Justice ("DOJ") and Federal Trade Commission ("FTC"), and criminally by the DOJ. It has long been *per se* illegal[35], and remains so.[36] Only if such a restraint is ancillary to a lawful "joint venture" might it be legal.[37] Joint ventures among competitors – whether research, production, or marketing – are beyond the scope of this article.[38]

Of particular interest is the danger of collusion among competitors at meetings of associations, for trade associations provide a setting and an opportunity for agreements to reduce competition. But cooperative advertising programs that require common price promotions were not illegal, even before *Leegin*.[39] Instead, most of the activity in which franchisees within a franchise system might engage that may implicate the antitrust laws occurs when they agree to take certain actions to pressure the franchisor, actions that go beyond rights of free speech and free association. These are discussed in the "group boycott" section below.

3. <u>The Intersection of Employment Law and Antitrust Law: A New Species of *Per Se* Unlawful Conduct?</u>

Although employee non-solicitation agreements between competitors may be permissible if ancillary to an otherwise lawful agreement, such as an agreement to sell a

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[31] ABA SECTION OF ANTITRUST LAW, *ANTITRUST HANDBOOK FOR FRANCHISE AND DISTRIBUTION PRACTITIONERS* at 11 (2008).

[32] ABA SECTION OF ANTITRUST LAW, *ANTITRUST LAW DEVELOPMENTS* at 93 (7th ed. 2012).

[33] *Id.* at 4.

[34] *Id.*

[35] *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

[36] *Palmer v. BRG of Georgia*, 498 U.S. 46 (1990).

[37] *Texaco, Inc. v. Dagher,* 547 U.S. 1 (2006).

[38] *See* DOJ/FTC "Antitrust Guidelines for Collaborations Among Competitors" (2000) http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf.

[39] *In re Nissan Antitrust Litig.*, 577 F.2d 910 (5th Cir. 1978).

business,[40] a naked non-solicitation agreement between competitors risks *per se* illegal treatment under the antitrust laws. In 2010, the DOJ sued 5 high-tech companies, including Apple, Google and Intel, and claimed that their agreements with one another not to solicit each others' employees constituted a naked restraint on competition that was *per se* unlawful under Section 1 of the Sherman Act.[41] The defendants ultimately settled with the DOJ and agreed to alter their hiring practices,[42] but they now face civil antitrust lawsuits arising out of their employment practices. The risks of *per se* treatment of no-poaching and no-solicitation agreements extend beyond high-tech companies to all types of businesses, including franchise systems and franchisee businesses, and they should be avoided.

4. <u>A Note On Dual Distribution</u>

Where a franchisor is both a supplier to franchisees and a competitor through company operations, that is, when it is involved in "dual" distribution, the restraints it enacts are almost always viewed as vertical and thus are judged under the rule of reason.[43] Some early cases treated these as horizontal, but that issue has been settled now.

5. <u>Group Boycotts ("Concerted Refusals to Deal")</u>

The Supreme Court has stated that there "is more confusion about the scope and operation of the *per se* rule against group boycotts than in reference to any other aspect of the *per se* doctrine."[44] In *Northwest,* in which the *per se* rule was held not to apply, the Court explained:

> Cases to which this Court has applied the *per se* approach have generally involved joint efforts by a firm or firms to disadvantage competitors by "either directly denying or persuading or coercing suppliers or customers to deny relationships the competitors need in the competitive struggle." In these cases, the boycott often cuts off access to a supply, facility, or market necessary to enable the boycotted firm to compete, and frequently the boycotting firm possessed a dominant position in the relevant market. In addition, the practices were generally not justified by plausible arguments that they were intended to enhance overall efficiency and make markets more competitive.[45]

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[40] ABA Section of Antitrust Law, *Antitrust Law Developments* at 134-35 (7th ed. 2012).

[41] *U.S. v. Adobe Systems, Inc.*, Case No. 1:10-cv-01629, http://www.justice.gov/atr/cases/f262600/262654.htm.

[42] *Id.*, Final Judgment, http://www.justice.gov/atr/cases/f272300/272393.htm.

[43] *Ryko Mfg. v. Eden Servs.*, 823 F.2d 1215, 1237 (8th Cir. 1987); *Copy Data, Inc. v. Toshiba, Inc.*, 663 F.2d 405 (2d Cir. 1981).

[44] *Northwest Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 294 (1985).

[45] *Id*. at 294-95.

Absent an agreement between direct competitors not to deal with a third party, there is almost no chance that the *per se* rule will apply.[46]

Joint action by franchisees is an area of sensitivity. Franchisees might seek to jointly exert pressure on their franchisor on various issues including marketing, operating costs, and territorial protection, or to induce the franchisor to take action against a franchisee whom they believe is violating a restraint imposed by the franchisor.

Franchisees sometimes engage in joint refusals to pay royalties (a "royalty boycott")[47] or to jointly exit the system,[48] but while courts are likely to rule that these are breaches of contract, they are rarely antitrust violations because "antitrust injury" in non-*per se* cases means injury to competition in general, not to a given competitor.[49] On the other hand, a claim *against* franchisees jointly boycotting the appointment of a new dealer has survived summary judgment.[50]

B. Vertical Restraints of Trade

1. Maximum Resale Price Maintenance

Since 1997, when the Supreme Court overruled three decades of precedent, the rule of reason has governed a franchisor's policy imposing maximum resale prices on its reseller-franchisees.[51] Thus, a franchisor without market power may require its franchisees to charge no more than a specified resale price for goods or services. As caveats to this statement, it should be noted that thirty-four states and territories opposed the shift to rule of reason treatment for maximum resale price maintenance,[52] some states have statutes that on their face prohibit both maximum and minimum resale price maintenance,[53] some older state court decisions apply the *per se* rule to maximum resale price maintenance[54] and some state attorneys general in public

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[46] *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128 (1998); *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 936-37 (7th Cir. 2000) (*per se* violation where toy retailer organized boycott of discounting competitors by major suppliers). *See Integrated Systems & Power, Inc. v. Honeywell Int'l, Inc.,* 713 F. Supp. 2d 286 (S.D.N.Y. 2010).

[47] *Oil Express Nat'l, Inc v. D'Allessandro,* 1998-1 Trade Cases (CCH) ¶ 72,157 (N.D. Ill. 1998).

[48] *McAlpine v AAMCO Auto Transmissions,* 1977-1 Trade Cases (CCH) ¶ 61,359 (E.D. Mich. 1977).

[49] *Brunswick Co. v. Pueblo Bowl-O-Mat, Inc.*, 431 U.S. 477, 489 (1977).

[50] *Arnold Pontiac-GMC, Inc. v. Budd Baer, Inc.*, 826 F.2d 1335, 1339 (3d Cir. 1987); *see also Rossi v. Standard Roofing, Inc.*, 156 F.3d 452, 462 (3d Cir. 1998) ("[A] conspiracy is horizontal in nature when a number of competitor firms agree with each other and at least one of their common suppliers or manufacturers to eliminate their price-cutting competition by cutting his access to supplies").

[51] *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

[52] Brief of Thirty-Three States and the Territory of Guam in Support of Respondents, *State Oil Co. v. Khan*, 522 U.S. 3 (1997), 1997 WL 221797.

[53] *See infra* text accompanying note 79.

[54] *See, e.g., Kolling v. Dow Jones & Co., Inc.*, 137 Cal. App. 3d 709 (1982); *R. E. Spriggs Co., Inc. v. Adolph Coors Co.*, 94 Cal. App. 3d 419 (1979), *cert. denied*, 444 U.S. 1076 (1980).

statements try to hedge their bets about their enforcement priorities.[55] Notwithstanding these caveats, maximum resale price maintenance is generally not regarded as inflicting the same sort of consumer harm as minimum resale price maintenance, and, thus, it would likely take the truly exceptional case, such as a maximum price used to disguise minimum price fixing,[56] to trigger an antitrust challenge to a maximum resale price regime.

2. Minimum Resale Price Maintenance

a. Introduction

Until 2007, a franchisor could suggest resale prices and use persuasion and exposition with its franchisees to convince them to charge them, but it was a *per se* violation for it to require (coerce) its franchisees to resell goods at a certain minimum price or price level, *i.e.*, to refrain from discounting, assuming that was part of the supplier's overall program of price maintenance.[57] But in 2007 in *Leegin*, the Court held that even a program to stamp out discount resale price competition was no longer *per se* illegal – it, too, is governed by the rule of reason.

Leegin, however, was not a blanket endorsement of minimum RPM. The Court pointed out that evidence of illegality under the rule of reason might include (i) a market characterized by suppliers all or nearly all of whom imposed such a minimum price restraint on franchisees, (ii) where the franchisor had market power (the classic rule of reason test), or (iii) where the restraint was agreed upon by franchisees themselves (horizontally), and in effect was foisted upon the franchisor by a franchisee cartel.[58]

Thirty-seven states filed an unsuccessful *amicus* brief in *Leegin*, arguing for continuing the *per se* rule. And, as described below, states do not uniformly follow *Leegin*. Hence, even though Congressional efforts to override *Leegin* have gotten nowhere, at present a franchisor which imposes nationwide minimum resale prices still has major concerns.

b. Understanding *Leegin*[59]

PSKS, the plaintiff in *Leegin*, operated a women's apparel store in Texas. Its signature brand of leather goods and accessories was the "Brighton" line, produced by the defendant. The defendant began a policy of refusing to sell to retailers which discounted Brighton products below its suggested prices, presenting the policy as encouraging the more than 5,000 boutiques

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[55] *See, e.g.*, Roundtable—Antitrust, Cal. Law. (May 2010), available at http://www.callawyer.com/Clstory.cfm?eid=909465 (Remarks of Kathleen Foote, California Department of Justice: "Our view as enforcers is that there's tremendous economic evidence of the anti-competitive and anti-consumer nature of many RPM schemes, and our inclination is to treat those things as per se unlawful.... Given our limited resources, [though,] the cases that we are most likely to take on would be the minimum RPM ones first.")

[56] *See Khan*, 522 U.S. at 11.

[57] *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 720-24 (1988).

[58] *Leegin,* 551 U.S. at 892-94.

[59] Portions of this Section derive from A. Cantor & K.L. Brumbaugh, *Controlling Franchise Pricing After Leegin,* 31st Annual ABA Forum on Franchising (2008). Another thoughtful and later-published article on *Leegin* is W.S. Grimes, *The Path Forward After Leegin*, 75 ANTITRUST L.J. at 467-504 (Fall 2008).

that were the main Brighton outlets to offer their customers a higher-quality sales and service experience than the "mega stores" offered.

When PSKS refused the defendant's request that it stop discounting the Brighton line, the defendant stopped supplying PSKS, whose revenue declined. PSKS sued, alleging that the defendant had entered into unlawful price-fixing agreements with its retailers. At trial, Leegin asserted that its program was unilateral and lawful. The court did not allow Leegin to introduce expert testimony on the procompetitive benefits of its pricing policy, ruling that the testimony was irrelevant under the *per se* rule. The jury found for PSKS, and the court entered judgment of nearly $4 million for treble damages, attorneys' fees and costs.

On appeal, Leegin did not contest the finding that it had entered into vertical RPM agreements with its dealers. Instead, it asserted that the law should be changed and the rule of reason rather than the *per se* rule should have been applied. The Fifth Circuit, believing that it remained bound by prior precedent, however, affirmed."[60]

The Supreme Court concluded, 5-4, that the *per se* rule should be jettisoned and these restraints, like all other vertical restraints, should be judged under the rule of reason. It overruled 96 years of precedent, starting with *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[61]

The majority opinion rested on three main propositions. First, it found that "[t]he reasoning of the Court's more recent jurisprudence has rejected the rationales on which *Dr. Miles* was based."[62] One of those rationales — the common-law rule against restraints on alienation — now seemed an anachronistic formalism rather than a justification resting on "demonstrable economic effect."[63] The other rationale of *Dr. Miles* — that the vertical arrangements were analogous to a horizontal agreement among competing dealers— was also out-dated: "Our recent cases formulate antitrust principles in accordance with the appreciated differences in economic effect between vertical and horizontal agreements, differences the *Dr. Miles* court failed to consider."[64]

Second, reconsidering the matter, the majority found that a *per se* rule was not justified because, although "the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated,"[65] "vertical agreements setting minimum resale prices can have procompetitive justifications."[66] Finally, the court determined that, given the serious flaws of *Dr. Miles* in light of modern antitrust jurisprudence, considerations of *stare decisis* did not mandate retaining it. The court noted that "[o]nly eight years after *Dr. Miles* . . . the Court reined

[60] 171 Fed. Appx. 464 (2006) (per curiam).

[61] 220 U.S. 73 (1911).

[62] *Leegin*, 551 U.S. at 887.

[63] *Id*. at 887-888 (quoting *Sylvania*).

[64] *Id.* at 888.

[65] *Id.* at 894.

[66] *Id.* at 892.

in the decision by holding [in *Colgate*] that a manufacturer can announce suggested resale prices and refuse to deal with distributors who do not follow them."[67]

The dissenters, in an opinion by Justice Breyer joined by Justices Stevens, Souter and Ginsburg, framed the issue as "whether to change a clear and simple price-related antitrust rule that the courts have applied for nearly a century."[68] They could point to no new circumstances that would justify "abandoning a well-established antitrust rule."[69]

While the dissenters found *Dr. Miles' per se* rule "clear and simple," they lamented that the *Leegin* majority's rule of reason for RPM was not. Noting that "it is now unknown . . . how courts will decide future cases under a 'rule of reason,'"[70] the dissent predicted that the majority's change of the legal standard "will unsettle the law"[71] and "will create considerable legal turbulence as lower courts seek to develop workable principles."[72]

c. ***Leegin*'s Effect**

Importantly, *Leegin*, while highly beneficial to franchisors and other suppliers that wish to stamp out discounting by their reseller customers, has not resulted in uniform franchisor victories in lower courts. Thus, in *Toledo Mack Truck Sales & Service v. Mack Trucks, Inc.*,[73] the minimum RPM claims were upheld, despite a complete rule of reason evaluation. The Third Circuit reversed the trial court and ruled the plaintiff had presented sufficient evidence that Mack Truck dealers first had colluded *horizontally* to enter into "gentlemen's agreements" not to compete with each other, and Mack Trucks agreed *vertically* as a result to deny or delay sales assistance to any dealer selling outside its area of responsibility, thus preventing dealer competition. Mack's Achilles' heel was that its restraints resulted from a dealer cartel's pressure, not its own independent decision, one of the evidentiary factors identified in *Leegin* as a sign of illegality. Also, the "dominant retailer" factor in *Leegin* led to the Court's upholding plaintiff's rule of reason analysis in a suit by retailers and consumers against Toys "R" Us, alleging the defendant used its very strong market position to coerce manufacturers to force minimum RPM on their retailers who competed with Toys "R" Us.[74]

On the other hand, the court in *Jacobs v. Tempur-Pedic Intl., Inc.*[75] dismissed a consumer class action alleging Tempur-Pedic's minimum RPM agreements with distributors were protected under *Leegin* where the plaintiffs did not plead sufficient facts to show an

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[67] *Id.* at 901.

[68] *Id.* at 918.

[69] *Id*. at 923.

[70] *Id*. at 926.

[71] *Id*. at 924.

[72] *Id.* at 929.

[73] 530 F.3d 204 (3d Cir. 2008)

[74] *Babyage.com, Inc. v. Toys "R" Us, Inc.,* 58 F. Supp. 2d 575 (E.D. Pa. 2008).

[75] 626 F.3d 1327 (11th Cir. 2011).

anticompetitive effect in the relevant market. And Leegin itself successfully defended the suits against it under the rule of reason after the Supreme Court ruled.[76]

d. State Antitrust and *Leegin*

RPM prohibition in state statutes is not preempted by the Sherman Act.[77] And a post-*Leegin* 2009 Maryland statute not only prohibits minimum RPM but criminalizes it.[78] Fourteen other states at least arguably do or may prohibit minimum RPM: California, Connecticut, Hawaii, Kansas, Mississippi, Missouri, Nevada, New Hampshire, New Jersey, New York, Ohio, South Carolina, Texas and West Virginia.[79]

New York and California have alleged *per se* treatment and entered into consent decrees on that basis.[80] New York's long litigation with Tempur-Pedic led to a determination that the oddly worded New York antitrust statute[81] rendered minimum RPM agreements "unenforceable" but *not* illegal.[82] The Appellate Division subsequently affirmed this determination and said that, even if the statute were properly read to prohibit minimum RPM, the only agreement in effect between Tempur-Pedic and its retailers was an agreement restricting advertising, not pricing, and that Tempur-Pedic's unilaterally adopted minimum pricing policy had been independently acquiesced in by retailers.[83]

e. Suggested Retail Prices

Prior to *Leegin*, a franchisor-supplier was allowed to suggest resale prices ("SRP").[84] It could use "persuasion, conversations, arguments, and exposition" but could not "coerce" a

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[76] *PSKS, Inc. v. Leegin,* 615 F. 3d 412 (5th Cir. 2010) (which also rejected the claim that where the supplier engages in dual distribution, having both franchises and retail operations, that makes the restraints it imposes "horizontal"; as stated above, dual distribution is analyzed as a vertical practice under the rule of reason).

[77] *See California v. ARC America Corp.*, 490 U.S. 93 (1989).

[78] *See* 2009 Md. Stat. § 169-71, amendment to MD Commercial Law § 11-204.

[79] *See, e.g.*, Cal. Cartwright Act, § 16720(d), 16722. For a state-by-state analysis of RPM laws, refer to Michael A. Lindsay's Overview of State RPM chart, a supplement to the Antitrust Source, http://www.americanbar.org/content/dam/aba/publications/antitrust_law/source_lindsay_chart.authcheckdam.pdf .

[80] *New York v. Herman Miller, Inc.*, 2008-2 Trade Cas. (CCH) ¶ 76,454 (S.D.N.Y. Mar. 25, 2008) (consent decree) (*per se* theory under Illinois, Michigan and New York antitrust statutes); *California v. Derma Quest, Inc.*, 2010-1 Trade Cas. (CCH) ¶ 76,922 (Sup. Ct. Ala. Cty. Feb 23, 2010); *California v. Bioelements, Inc.,* 2011-1 Trade Cases (CCH) ¶ 77,306 (Sup. Ct. Riverside Cty. Jan. 11, 2011).

[81] N.Y. Gen. Bus. Law § 369-a, which states in pertinent part that "[a]ny contract provision that purports to restrain a vendee of a commodity from reselling such commodity at less than the price stipulated by the vendor or producer shall not be enforceable or actionable at law."

[82] *New York v. Tempur-Pedic Int'l, Inc.,* 116 N.Y.S.2d 900 (N.Y. Sup. Ct. 2011).

[83] *New York v. Tempur-Pedic Int'l, Inc.,* 2012 NY Slip Op 03557 (N.Y.A.D. May 8, 2012). *See also infra* discussion in sections IV.B.2e and f.

[84] Outside the franchise context, the acronym "MSRP" is often used to denote the "manufacturer's suggested resale price."

franchisee to charge the desired price.[85] Now, of course, it *can* require a franchisee to charge the desired price, unless the policy runs afoul of the rule of reason test under *Leegin* or applicable state law.

Where a state statute or case law rejects *Leegin*, the rule above concerning the limits of SRP continues to apply. Coercion may consist of termination, delays in or refusals to fill orders, or causing other detriments to a non-complying franchisee.[86]

f. **The *Colgate* Doctrine**

Since Justice Holmes' decision in *United States v. Colgate*,[87] in theory a supplier can, absent a monopoly, unilaterally announce in advance the price at which its product must be resold and then refuse to sell to any customer which refuses to comply. And the fact that customers "independently" choose to adhere to the policy to avoid termination does not in and of itself constitute an "agreement" or conspiracy under Section 1. On the other hand, if the customer communicates "agreement," it is one for Section 1 purposes.[88]

This almost existential distinction demonstrates why *Colgate* has been of extremely limited value to suppliers; in a normal situation the resellers do communicate agreement and indeed other resellers appeal to the supplier to enforce the pricing policy. The supplier's only real choice is to immediately terminate dealings with any franchisee which violates the policy, with no warnings and no second chances, which is self-evidently an almost impossible way to do business. As one court observed in 1960, *Colgate* is the law, but for it to be viable, it would take a case of almost "Doric simplicity."[89]

g. **Minimum Advertised Pricing and Cooperative Advertising**

Minimum Advertised Price ("MAP") policies often condition receipt of a supplier's cooperative advertising funds or other promotional benefits upon the franchisee-reseller's agreement to charge the advertised price in the medium chosen (newspaper, radio, television, the Internet) and were governed by the rule of reason even before *Leegin*.[90]

h. **National Account Programs**

International, national, or large regional customers with many outlets often seek centralized purchasing to reduce costs, and seek uniform terms for their purchases. If a

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[85] *Acquaire v. Canada Dry Bottling Co.*, 24 F.3d 401, 410 (2d Cir. 1994).

[86] *Monsanto Co. v. Spray Rite Service Co.,* 465 U.S. 757, 764-66 (1984) (threatening termination of supply); *Acquaire*, 24 F.3d at 411-12 (same); *Isaksen v. Vermont. Castings, Inc.*, 825 F.2d 1158, 1162-63 (7th Cir. 1987) (threatening to confuse orders); *Bender v. Southland Corp.*, 749 F.2d 1205, 1213 (6th Cir. 1984) (retaliation in general for failure to adhere to SRP).

[87] 250 U.S. 300 (1919).

[88] *Monsanto*, 465 U.S. at 761.

[89] *George W. Warner, Inc. v. Black & Decker Mfg. Co.,* 277 F.2d 787, 790 (2d Cir. 1960).

[90] *In re Nissan Antitrust Litig.*, 577 F.2d at 915-17; FTC, Statement of Policy Regarding Price Restrictions in Cooperative Advertising Programs, 6 Trade Reg. Rep. (CCH) ¶ 39,057 at 41,638 (May 21, 1987).

supplier sells to these customers through its franchisees, it can require them to charge the price it has negotiated with the large purchaser, subject of course to the rule of reason. But for states not following *Leegin*, the majority view is that a price cap in a national account program cannot be enforced; the reseller has a right to participate in the national account program at that price, or not to participate, and cannot be sanctioned for failure to do so.[91]

C. Territorial and Customer Resale Restraints

Vertical territorial and customer restraints, *i.e.*, requiring a franchisee to sell from specified locations(s), only in a certain territory, or only to certain customers, are governed by the rule of reason.[92] The change from *per se* treatment to rule of reason has been of real significance. Whereas, under *Schwinn* for ten years, there were dozens of plaintiff's *per se* victories, in over thirty years under *Sylvania*, there have been only two significant reported rule of reason victories by plaintiffs challenging such restraints.[93]

D. Exclusive Appointments

The rule of reason likewise governs a franchisor's vertical decision to grant an "exclusive" to a franchisee, *i.e.*, to agree that the franchisee will be the only franchisee appointed in or to which the franchisor will sell in a certain territory. Such appointments are virtually never held unlawful; normally, that requires a monopoly share of the market on the part of the franchisor, such that there are almost no comparable goods available through another supply source. "There is a virtual avalanche of precedent to the effect that, absent evidence of monopoly, a [supplier] may legally grant . . . an exclusive franchise."[94]

E. Tying Arrangements

A tying arrangement is an "agreement by a party to sell one product, but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that [it] will not purchase that product from any other supplier."[95] Tying can involve services as well as products, and leases as well as sales.[96] A tying agreement will be illegal only if (1) the tying and the tied products are "separate," (2) the seller has "appreciable market power" in the tying product to restrain trade in the tied product, (3) the defendant affords buyers no real choice but to purchase the tied product from it or its designated source, and (4) the tie affects a volume of commerce in the tied product market.[97] After *Jefferson Parish*, tying arrangements are rarely

[91] *Mularkey v. Holsum Baking*, 146 F.3d 1064, 1065 (9th Cir. 1998).

[92] *See Continental TV*, 433 U.S. at 58-59, overruling in part *U.S. v. Arnold, Schwinn & Co.*, 365 U.S. 388 (1967).

[93] *See Graphic Prods. Dist., Inc., v. Itek Corp.*, 717 F.2d 1560 (11th Cir. 1983) (supplier had over 70% market share) and *Eiberger v. Sony Corp.*, 622 F.2d 1068 (2d Cir. 1980) (defendant had a 12% share in an oligopolistic market, but the facts were particularly strong, given defendant's disingenuous explanations for the restraint). *Eiberger* is the only case since *Sylvania* in which a franchisor or supplier without a large market share has lost a vertical post-*Sylvania*-type case.

[94] *G.T.E. Sylvania Inc. v. Continental TV, Inc.,* 537 F.2d 980, 997 (9th Cir. 1976) (en banc), *aff'd*, 433 U.S. 36 (1977).

[95] *N. Pac. Ry. Co.,* 356 U.S. at 5-6.

[96] *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984); *Principe v McDonalds, Corp.,* 631 F.2d 303 (4th Cir. 1980).

[97] *Image Tech. Servs., Inc.,* 504 U.S. at 462; *Microsoft*, 253 F.3d at 85.

condemned as *per se* illegal, because the Court's reformulation of the *per se* rule (into a hybrid, partial rule of reason) forecloses *per se* treatment unless the franchisor sells either a unique tying product, or enjoys in excess of a 30% market share in the tying product, so as to demonstrate the necessary quantum of "market power."[98] Recently, and almost uniquely, a franchisee survived a motion to dismiss a *per se* claim based on these classic requirements.[99]

In 1992 in *Kodak* (a non-franchise case), the Court articulated one *new* means – which has been employed with almost no success by franchisee plaintiffs – to secure a tying victory: *one firm market power*. Thus, if (1) the franchisee can establish that it bought a franchise without a pre-sale disclosure by the franchisor of the extent of both the franchisor's actual and anticipated tying program, *i.e.,* the franchisee lacks sufficient knowledge of the products or services that the franchisee will have to buy from the franchisor or from sources designated by the franchisor, (2) those purchases may be materially more expensive to the franchisee than purchases of the same products or services in an open market, (3) the franchisee invests substantially in its franchise (has large "sunk costs"), and (4) the cost of "switching" to another franchise would be very expensive or not feasible, an unlawful tie can be established, even if the franchisor had no interbrand "market power" in the product or service involved.

The Third Circuit has held the *Kodak* case flatly inapplicable to franchising.[100] And in almost all cases, the franchisors had provided in their Franchise Disclosure Document sufficient information for the franchisee to anticipate the required purchases and costs. No franchisee has won a *Kodak*-type tying claim after trial on the merits, and few survive to reach summary judgment.[101]

The most recent case of note avoiding dismissal on a *Kodak* theory is *Burda v. Wendy's, Int'l*.[102]

F. <u>Refusals to Deal</u>

Refusals to deal (too often commingled with boycotts) refer to the decision of a franchisor to terminate or fail to renew or not to commence dealings with a franchisee. Absent monopoly, a refusal to deal which is unilateral does not violate the antitrust laws.[103] Nor is it even illegal for a franchisor to agree with company A that it will cease doing business with B and appoint A or expand A's territory, unless the franchisor's agreement to do so is made to enforce

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[98] *Digital Equip. Corp. v. Uniq Digital Tech, Inc.*, 73 F.3d 356 (7th Cir. 1996); *Grappone v. Subaru of N. England*, 858 F.2d 792, 796 (1st Cir. 1988) (Breyer, J.).

[99] *Shamrock Mfg., Inc. v. Bridgestone Bandag, LLC.,* 775 F. Supp. 2d 972 (W.D. Ky. 2011) (supplier had very large share of the tying product market).

[100] *Queen City*, 124 F.3d at 441-42.

[101] *See* Allan P. Hillman, *Tying Untied: Revolution or Just a 'Kodak Moment'?*, 21 FRANCHISE L.J. 1 (Summer 2001).

[102] Bus. Franchise Guide (CCH) 14,240 (S.D. Ohio 2009). The later *Shamrock Manufacturing* case, see *supra* note 97 and accompanying text, expressly rejected application of the *Kodak* theory, but as noted above, it denied a motion to dismiss the plaintiff's antitrust claim based on classic tying requirements.

[103] *See Monsanto v. Spray Rite Serv. Corp.*, 465 U.S. 952 (1984) (again, the plaintiff must *also* present evidence that tends to "exclude the possibility of independent action" by the supplier) (citing *United States v. Colgate & Co.*, 250 U.S. 300 (1919)).

or further a policy which is otherwise independently illegal under the antitrust laws.[104] Since such refusals to deal are vertical, they are governed by the rule of reason in all contexts now; thus, the underlying policy the franchisor seeks to advance by refusing to deal with a franchisee must itself be a rule of reason violation. Therefore, terminations may breach the franchise agreement or state relationship laws, but are rarely antitrust violations.

V. PRICE DISCRIMINATION AND DISCRIMINATION IN SERVICES AND FACILITIES

To prove price discrimination under Section 2(a) of the Robinson-Patman Act,[105] a plaintiff must prove: (1) two sales of a "commodity" (not a service) were made in interstate commerce, and were made reasonably contemporaneously; (2) the commodities were of the "like grade and quality"; (3) the seller discriminated in "price" (charged a different price, a term which also includes a number of price-related elements) between the plaintiff and other purchasers; and (4) the discrimination had a significant adverse effect on competition.[106]

The quintessential "secondary line" violation, occurs where a franchisor sells the same product to two franchisees who are in competition with each other, but sells at a higher price to one than to the other. Nevertheless, the plaintiff has a number of hurdles to surmount. Proving a difference in price is the start, not the end, of the journey.

The plaintiff normally must show *specific and substantial* lost sales flowing from the discrimination or discrimination over a long period of time.[107] Significant interbrand competition must have been adversely affected.[108]

Plaintiff must also defeat statutory defenses, if asserted. Two defenses are most prominent: one is "cost justification," for the discrimination.[109] "Cost" under the statute includes distribution costs, such as selling and delivery costs, differences in manufacturing costs, costs of billing and credit losses, advertising, promotion, selling, freight and delivery, catalogs, and warranties.[110] This rarely succeeds because of the need for the supplier to have a genuine accounting justification showing why the price to one purchaser is less than to another, as in justifying a "quantity discount."[111] Quantity discounts are frequently used but in reality most probably would not survive if challenged. Challenges, however, are rare.

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[104] *Business Elecs.*, 485 U.S. at 735-36.

[105] 15 U.S.C. § 13(a).

[106] *Texaco, Inc. v. Hasbrouck*, 496 U.S. 543, 556 (1990).

[107] *Volvo Trucks*, 546 U.S. at 17.

[108] *Id.*

[109] 15 U.S.C. § 13(a).

[110] ABA SECTION OF ANTITRUST LAW, *ANTITRUST LAW DEVELOPMENTS* at 530-32 (7th ed. 2012).

[111] *Hasbrouck*, 496 U.S. at 556.

The other commonly-invoked defense is "meeting competition."[112] Thus, if the franchisor can document that it offered a lower price to A but not to B because it was meeting a low price offered to A (but not B) by a competitor of the franchisor, there is no violation.[113]

The most recent Robinson-Patman case of note is *Feesers, Inc. v Michael Foods*.[114] The plaintiff food distributor Feesers, Inc., claimed that Sodexho, a food service management company, was able to purchase egg and potato products from Michaels at a discounted price that was unavailable to Feesers.[115] The district court entered judgment in favor of the plaintiff after a bench trial.[116] The Third Circuit reversed and instructed the district court to enter judgment for the defendants because Feesers and Sodexho were not competing purchasers, and Feesers thus did not meet the competitive injury requirement of a prima facie case of price discrimination under Section 2(a) of the Robinson-Patman Act.[117] The court held that in a secondary-line price discrimination case, parties competing to win a bid are not "competing purchasers" where the competition for the sales to potential customers occurs before the sale of the product for which the price discrimination violation is alleged.[118] Robinson-Patman plaintiff's victories are now almost as frequent as the appearance of Halley's Comet.[119]

Discrimination in "allowances and services" is also banned by the Robinson-Patman Act.[120] Therefore, a franchisor which, for example, pays its franchisees to furnish it with certain services (such as warehousing, inventorying, marketing etc.) must make such opportunities and payments available to all franchisees on "proportionally equal terms."[121] Similarly, a franchisor which provides such allowances as cooperative advertising funds to franchisees, must extend them on "proportionally equal terms," so that, for example, a franchisee that buys ten units can receive twice (but not ten times) the coop advertising funds received by one that buys five units.[122]

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[112] 15 U.S.C. § 13(b).

[113] *United States v. U.S. Gypsum Co.*, 438 U.S. 422 (1978); *Falls City Indus. v. Vanco Beverages*, 460 U.S. 428 (1983).

[114] 591 F.3d 191 (3d Cir.), *cert. denied*, 131 S. Ct. 160 (2010).

[115] *Id.* at 193.

[116] *Id.*

[117] *Id.*

[118] *Id.* at 194.

[119] *See* Robert J. Toth, *Powerful Law Loses its Punch*, WALL ST. J., May 21, 2012 at http://professional.wsj.com/article/SB10001424052702304746604577380172754953842.html.

[120] 15 U.S.C. § 13(d)-(e).

[121] *See generally*, *Texaco, Inc. v. Hasbrouck*, 496 U.S. 543 (1990).

[122] *Fred Meyer, Inc. v. FTC*, 390 U.S. 341 (1963); *Am. Booksellers Ass'n. v. Barnes & Noble*, 135 F. Supp. 2d 1031, 1068 (N.D. Cal. 2001). *See generally* Guides for Advertising Allowances and Other Merchandising Payments and Services, 16 C.F.R. §§ 240.1-240.15 (1990) (the "Fred Meyer Guides").

VI. MERGERS AND ACQUISITIONS

Section 7 of the Clayton Act prohibits merger and acquisition transactions that may have the effect of substantially lessening competition or creating a monopoly.[123] The FTC's and DOJ's merger enforcement efforts are aided by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"),[124] which requires transactions of a certain size to be reported to and receive advance antitrust clearance from the FTC and DOJ. Currently, transactions valued in excess of $68.2 million may be required to be reported under the HSR Act.[125]

Many foreign jurisdictions in which franchisors conduct business have merger notification regimes as well. Thus, a merger or acquisition transaction involving two substantial franchisors with both U.S. and international operations may be required to be reported to and receive clearance from multiple antitrust authorities in the U.S. and abroad.

VII. PRIVATE SUITS

A. Standing for Private Plaintiffs

"Congress did not intend the antitrust laws to provide a remedy in damages for all injuries that might conceivably be traced to an antitrust violation."[126] Even where an antitrust violation is established by the plaintiff or conceded by a defendant, it does not necessarily follow that any person harmed as a result of such conduct is a person injured by reason of the antitrust laws within the meaning of Section 4 of the Clayton Act.[127] Determining whether a person has standing under Section 4 requires an evaluation of the following factors:

(1) the nature of the alleged injury;

(2) whether the plaintiff is a consumer or competitor in the market where trade was allegedly restrained;

(3) whether the relationship between the plaintiff's harm and the alleged restraint is tenuous or speculative;

(4) the potential for duplicative recovery or complex apportionment of damages; and

(5) the existence of more direct victims of the alleged conspiracy.[128]

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[123] 15 U.S.C. § 18.

[124] Pub. L. No. 94-435, 90 Stat. 1390.

[125] The thresholds are adjusted annually based on changes in the U.S. gross national product. Current thresholds may be found on the website of the Federal Trade Commission, Bureau of Competition, http://www.ftc.gov/os/2012/01/120124claytonact7a.pdf.

[126] *Hawaii v. Standard Oil Co.,* 405 U.S. 251, 263 n.14 (1972).

[127] *See Associated Gen. Contractors v. Cal. State Council of Carpenters*, 459 U.S. 519, 528 (1983).

[128] *Id* at 545*.*

B. <u>The Fact and Amount of Damages</u>

Under the so-called *Illinois Brick* doctrine, a person "indirectly" injured by an antitrust violation, such as a purchaser from a franchisee who was directly injured by a price-fixing conspiracy, is not permitted to recover antitrust damages under the federal antitrust laws for illegal overcharges.[129] There are exceptions to the *Illinois Brick* rule, such as the existence of a "cost-plus" contract between the direct purchaser and the indirect plaintiff.[130] Such an "indirect" plaintiff may obtain an injunction, however, under 15 U.S.C. § 16. And some state antitrust laws, *e.g.*, California's, reject *Illinois Brick*, and allow indirect purchasers to sue under state antitrust law.[131]

A plaintiff seeking damages must establish the "<u>fact</u> of damage," *i.e.*, that the illegal acts were a material cause of damage and that the plaintiff suffered "<u>some</u>" damage from them.[132]

The *amount* of damage must be proven without speculation or guesswork, but it is sufficient that it be a "just and reasonable" estimate. The wrongdoer's violations, which make this proof more difficult, may not act as a shield from a damage award.[133]

Under federal antitrust law, damages for antitrust violations are automatically trebled by the court, and prevailing plaintiffs may recover attorney's fees and pre-judgment and post-judgment interest, thereby increasing potential exposure to defendants.[134]

VIII. EXEMPTIONS

There are many statutory exemptions to the antitrust laws that are not relevant to franchising. But the two judicially-created immunities most frequently invoked that can be relevant are "state action" and so-called "*Noerr-Pennington*" immunity.

The state action doctrine was first recognized in *Parker v. Brown*,[135] in which the Supreme Court upheld a program in California that regulated marketing in the raisin industry. A state may impose restraints on commercial activity which conflict with the antitrust laws, and those acts may immunize the otherwise anticompetitive activities of private parties if the state policy is clearly articulated and affirmatively expressed as state policy and actively supervised

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[129] *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

[130] *Id.*

[131] CAL. BUS. & PROF. CODE. § 16750(a).

[132] *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100,114, n.9 (1969); *Phillips v. Crown Central Petroleum Corp.*, 395 F. Supp. 735, 769 (D. Md. 1975), *aff'd*, 602 F.2d 616 (4th Cir. 1979).

[133] *Bigelow v. RKO Radio Pictures, Inc.,* 372 U.S. 251, 264-65 (1946).

[134] 15 U.S.C. § 15.

[135] 317 U.S. 341 (1943).

by the state itself.[136] Antitrust damage actions against local government entities are expressly barred by the Local Government Antitrust Act of 1984.[137]

In addition, the Supreme Court's "*Noerr-Pennington* doctrine" elevates free speech over charges of antitrust misconduct, as long as the free speech (such as a lawsuit or lobbying effort) is not a total "sham." Thus, for example, competitors may band together to seek to influence legislators. In *Baltimore Scrap Corp. v. David J. Joseph Co.*,[138] the Court described this principle as follows:

> The Noerr-Pennington doctrine guarantees citizens their First Amendment right to petition the government for redress without fear of antitrust liability…. "[T]he Sherman Act does not prohibit two or more persons from associating together in an attempt to persuade the legislature or the executive to take particular action with respect to a law that would produce a restraint or a monopoly…The right of petition is one of the freedoms protected by the Bill of Rights."
>
> An "anticompetitive purpose [does] not illegalize" concerted attempts to influence public officials "even though the resulting official action damaged other competitors at whom the conduct was aimed…." *Noerr-Pennington* immunity from antitrust laws extends to petitioning the courts as well.
>
> *Noerr-Pennington* immunity from lawsuits has two main exceptions, however – "sham litigation" and, arguably, fraudulent litigation. See *Professional Real Estate Investors, Inc. v. Columbia Pictures Indus.*, 508 US. 49, 60, 61-62 n.6 (1993).
>
> Sham litigation must be a two-part test. (citation omitted) First, the lawsuit must be objectively baseless. A lawsuit is objectively baseless only if "no reasonable litigant could realistically expect success on the merits." (citation omitted) If an objective party can "conclude that the suit is reasonably calculated to elicit a favorable outcome, the suit is immunized under *Noerr*, and an antitrust claim premised on the same exception must fail." (citation omitted) By definition, a winning lawsuit is a "reasonable effort at petitioning for redress and therefore not a sham."….Second, in the event the challenged litigation is found to be objectively baseless, the lawsuit must further conceal an attempt to interfere directly with the business relationships of a competitor.[139]

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[136] *Cal. Liquor Dealers v. Midcal Aluminum,* 445 U.S. 97 (1980); *Parker*, 317 U.S. at 350-353.

[137] 15 U.S.C. §§ 34-36.

[138] 237 F.3d 394, 398-99 (4th Cir. 2001).

[139] *Id.* at 398-99 (citations omitted).

IX. ANTITRUST COMPLIANCE PROGRAMS

Given the severe penalties for criminal antitrust violations, including jail time and massive fines, and the considerable expense and risk associated with civil antitrust lawsuits, an antitrust compliance training program should be a component of every franchise business's legal compliance program. As with virtually all compliance programs, an effective antitrust compliance program will include the buy-in and participation of executives, regular training and education, and confidential reporting mechanisms for suspected violations, among other elements.[140]

X. A NOTE ABOUT TRADE & INDUSTRY ASSOCIATION PARTICIPATION

Although trade and industry association activities are perfectly lawful, these activities may create antitrust risks because they involve meetings among competitors. Participation in trade association activities has been the basis for finding antitrust liability on the part of trade association members, both individuals and companies, when those activities have been found to violate the antitrust laws.[141]

Therefore, a few cautions associated with trade and industry association activities bear mention. Trade associations should be joined only when justified by a legitimate business purpose. Particular consideration should be given to the type of association, its objectives, membership eligibility rules, history, activities and methods of operation. Individual participants should be advised to consult their manager before submitting any of their company's statistics or other business information to any trade association. Also, consider advising clients to avoid trade associations which do not have counsel in regular attendance at association meetings. Should a discussion during a trade or industry association stray into a risky area – for example, conversations regarding future prices – the participant should exit the conversation and the meeting immediately.

XI. TOP TEN LIST: PRACTICAL RULES OF THE ROAD

The reach of antitrust in franchising may be far less today than in 1976, when it was pervasive, but the dangers of ignoring antitrust principles far outweigh the benefits. The top ten things to remember:

1. Clients should not discuss pricing with competitors.

2. Be particularly cautious at trade association or industry meetings where competitors are present and avoid conversations related to pricing, future business plans or other sensitive business information.

3. Agreements between or among competitors that reduce competition are *per se* illegal. There is no defense to them. And people can go to jail.

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[140] *See* ABA ANTITRUST SECTION, *ANTITRUST COMPLIANCE: PERSPECTIVES AND RESOURCES FOR CORPORATE COUNSELORS* (2d ed. 2010), for sample antitrust compliance training programs.

[141] *See* ABA ANTITRUST SECTION, *ANTITRUST LAW DEVELOPMENTS* at 40-42 (7th ed. 2012).

4. By contrast, cooperative advertising programs among franchisees, even involving price promotions, are normally lawful, but they cannot be used as subterfuge for a horizontal agreement to suppress other price competition among franchisees.

5. Restraints imposed by a franchisor on franchisees are "vertical" and are judged under the rule of reason. Restraints imposed by franchisors who are "dual distributors" are viewed as vertical also. Unless the franchisor has a strong market share (very rare), they will normally be lawful.

6. *Leegin* is no panacea for aspiring minimum price-fixers. Consider possible problems with state antitrust laws and state antitrust enforcement authorities. Minimum resale price-maintenance programs will not survive in some states.

7. Robinson-Patman concerns are very unlikely to be a problem, but try to avoid being the one franchisor that gets nailed for price discrimination.

8. Terminations and non-renewals may cause few antitrust headaches but watch for state relationship statutes and breaches of contract.

9. Preventive Dentistry: Make sure the client calls you (or you call an expert in the field) before policies are set in stone. For the client, better a $500 fee now than $50,000 later. Urge the client to establish an antitrust compliance program to provide education about and prevent violations of the antitrust laws.

10. Clients should not discuss pricing with competitors (we really mean it).

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Kay Lynn Brumbaugh is a partner in the Dallas and Washington D.C. offices of Andrews Kurth LLP. She represents clients in the areas of antitrust litigation and counseling, class actions, and other complex commercial and business litigation matters. She also represents clients in connection with investigations by the FTC, the DOJ Antitrust Division and various states' attorneys general. Her antitrust representation encompasses assisting clients in obtaining antitrust clearance from federal and state authorities in connection with merger and acquisition transactions. She has provided representation for clients in many industries including energy, food and beverage, franchising and distribution, direct sales, consumer products, manufacturing, health care, technology, transportation and telecommunications.

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