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Just How Far Can a Franchisor Go? Ensuring System-Wide Compliance with Price Promotions.

Michael L. Sturm
Principal
Gray Plant Mooty
Washington, D.C.

Elizabeth A.N. Haas
Partner
Foley & Lardner LLP
Milwaukee, Wisconsin

Joseph Lewis
President & CEO
Painting with a Twist, LLC
Mandeville, Louisiana

Franchisor-sponsored price promotions can easily fall into the rubric of resale price maintenance, and resale price maintenance can be an antitrust landmine for the unknowing franchisor. But, as the Supreme Court recognized in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), not all resale price maintenance is harmful to consumers and, indeed, certain vertical price restraints that eliminate *intra*brand competition can actually promote *inter*brand competition by encouraging retailers to invest time and capital in tangible or intangible services and promotional efforts that differentiate franchisors' brands from competing brands.

Of course, the *Leegin* decision did not hold that all resale price maintenance is lawful, and franchisors should think carefully before implementing price promotions that amount to resale price maintenance. To that end, this paper outlines the legal issues for franchisors to consider before implementing any type of resale price maintenance. It includes a discussion of the legal nuances surrounding the *Leegin* decision and sets forth best practices in the wake of *Leegin*.

1. **Legitimate Business Reasons for “Fixing” Franchisees’ Resale Prices**

“Price-fixing” sounds bad—in part because, under certain circumstances, it is a felony. In addition to criminal penalties, price-fixing can provide the basis for the recovery of treble damages, attorneys’ fees, and other remedies in private actions for violation of Section 1 of the Sherman Act. See 15 U.S.C. § 15(a). But in franchising, there are legitimate reasons that a franchisor might want to “fix” the prices charged by its franchisees. If the franchisor were vertically integrated, operating all of its franchised outlets as “company stores,” the traditional prohibitions against resale price maintenance would not even come into play. To compete effectively in the marketplace, a franchise system needs to be able to offer its customers a uniform experience.

For decades, the federal courts have recognized that the franchisee is licensed to use the franchisor’s trademark to identify “a network of stores whose very uniformity and predictability attracts customers.” *Principe v. McDonald’s Corp.*, 631 F.2d 303, 309 (4th Cir. 1980). These cases recognize that, when a customer patronizes an establishment identified by the franchisor’s trademark, the customer expects to have the same experience¹—regardless of where the business is located, and regardless of whether it is operated by the franchisor or by an independent franchisee. As the Seventh Circuit summarized, “no one expects a McDonald’s outlet to compete with other members of the

¹ See, e.g., *Susser v. Carvel Corp.*, 206 F. Supp. 636, 640 (S.D.N.Y. 1962) (“The cornerstone of a franchise system must be the trade name or trademark of a product. It is this uniformity of product and control of its quality and distribution which causes the public to turn to franchise stores for product.”), *aff’d*, 332 F.2d 505 (2d Cir.), *cert. granted*, 379 U.S. 885 (1964), *cert. dismissed*, 381 U.S. 125 (1965).

system by offering pizza.” *Chicago Prof'l Sports Ltd. P'Ship v. Nat'l Basketball Ass'n*, 95 F.3d 593, 598 (7th Cir. 1996).

Historically, there has been one glaring exception to the uniformity that otherwise characterizes franchise systems. When customers patronize a national chain that is completely company-owned and company-operated, they can expect that nationally advertised prices will in fact be available nationally. Yet that may not be true when they patronize a national chain that includes franchised outlets. To the contrary, many “sales” and other promotions advertised by franchisors feature a disclaimer that the advertised prices are “available only at participating locations.”

Changes in federal antitrust jurisprudence have opened the door for franchisors to exercise far more control over franchisee pricing than they have traditionally done. But if challenged, the franchisor needs to be able to articulate a legitimate reason for seeking to control the resale prices of its franchisees.

The case is easier to make if the franchisor seeks to control **maximum** resale prices. Lower prices generally benefit consumers. In certain circumstances, franchisees can have the incentive and opportunity to charge more than the franchisor would like—upsetting nationally advertising promotional programs and sometimes resulting in claims of price gouging. Even with maximum resale price maintenance, however, franchisees sometimes complain that honoring the required discount (as with a “value menu”) causes them to lose money. Such an argument is easier to rebut if the franchisor itself has successfully tested the discount program in its own “company stores.”

Why the franchisor might want to prevent discounting—so-called **minimum** resale price maintenance—can be more difficult to explain. Bargain basement pricing may be inconsistent with the brand image that the franchisor seeks to have associated with the franchise system. And in the long run, it may not benefit consumers if it adversely affects the ability of franchisees to provide the level of service that the franchisor seeks to have associated with its licensed trademark.

Having such an explanation is one of many things that a franchisor will need to do to control the resale prices of its franchisees without creating an unacceptable risk of antitrust liability. The ways in which it **may** be possible for a franchisor to do so in light of current antitrust jurisprudence are explored herein.

2. **The Law of Resale Price Maintenance Before and After *Leegin***

The Supreme Court’s landmark decision in *Leegin Creative Leather Products Inc. v. PSKS Inc.*, 551 U.S. 877 (2007) held that vertical minimum resale price maintenance is no longer *per se* unlawful. But does that mean that a franchisor can now dictate its franchisees’ resale prices and procure agreements from franchisees not to charge less than the franchisor’s suggested resale price? Unfortunately, that is a question that cannot be answered with a simple “yes” or “no.” Understanding why requires:

- review of more than a century of Sherman Act Section 1 jurisprudence;

- examination of what the Supreme Court actually held in *Leegin* and why it so held;
 - review of what the Supreme Court did **not** hold in *Leegin*; and
 - consideration of the reaction to *Leegin* that, especially in certain jurisdictions, makes reliance on it more risky than virtually any other Supreme Court decision.
- a. **Review of Sherman Act Section 1 jurisprudence**

For nearly a century before the Supreme Court’s 2007 decision in *Leegin*, efforts to prevent discounting by way of minimum resale price maintenance agreements were held to be *per se* unlawful in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. In other words, agreements fixing the minimum resale prices of franchisees were presumed to be unreasonable restraints of trade “without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.” *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 5 (1958). The Supreme Court’s 2007 decision in *Leegin* overturned the *per se* condemnation of minimum resale price maintenance, opining that minimum vertical price-fixing should instead be scrutinized under the “Rule of Reason.” The Rule of Reason is the “traditional framework of analysis” under Section 1 of the Sherman Act. *Cont’l T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 49 (1977). It requires the court to determine— on a case-by-case basis—whether the restraint in question “is one that promotes competition or one that suppresses competition.” *Nat’l Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 691 (1978).

Since 1911, it had been *per se* unlawful under Section 1 of the Sherman Act for franchisors to control the resale prices of their franchisees. *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). “That *per se* rule,” according to the dissent in *Leegin*, “is one upon which the legal profession, business, and the public have relied for close to a century.” 551 U.S. at 908. A review of antitrust jurisprudence suggests, however, that *Dr. Miles*—including not only its holding but also its rationale—had been steadily eroded by other Supreme Court decisions long before *Leegin*. The *per se* rule articulated in *Dr. Miles* did not distinguish between “horizontal” and “vertical” restraints—a distinction that took on greater significance in antitrust jurisprudence in the decades that followed.²

² “Vertical” restraints are imposed by a firm at one level of the market on firms at a different level. For example, restrictions imposed by a franchisor on its franchisees and restrictions imposed by a manufacturer on its dealers or distributors are more likely than not to be considered vertical. See generally *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 378-79 (1967); *United States v. Sealy, Inc.*, 388 U.S. 350, 352-54 (1967).

“Horizontal” restraints involve firms at the same level of the market—such as franchisors or other businesses that compete with one another. Horizontal restraints are more likely to be *per se* unlawful under Section 1 of the Sherman Act because they

Meanwhile, the ink was barely dry on *Dr. Miles* when the Supreme Court announced the so-called “*Colgate* doctrine.” In its 1919 decision in *United States v. Colgate & Co.*, 250 U.S. 300 (1919), the Supreme Court held that Sherman Act Section 1 does **not** prohibit a manufacturer from announcing a resale pricing policy and then refusing to do business with distributors that fail to adhere to the policy. *Id.* at 307. This distinction between unilateral conduct and concerted activity is certainly faithful to the text of Section 1 of the Sherman Act, which prohibits only “contracts, combinations, and conspiracies in restraint of trade.” 15 U.S.C. § 1.

For several decades after *Colgate*, and continuing to some extent to this day, the courts have wrestled with whether various efforts to control resale prices are “unilateral” rather than resulting from an unlawful contract, combination, or conspiracy in restraint of trade. From the case law, the distinction between permissible unilateral conduct and impermissible concerted action has not always been clear. For example, franchisors have been exonerated of claims for unlawful resale price maintenance if they merely engage in “exposition, persuasion, argument, or pressure” to encourage franchisees to decide independently to observe suggested resale prices.³ But a franchisor could be deemed to have crossed the line between permissible “exposition, persuasion, argument, or pressure” and impermissible “coercion” by making “threats of termination, as long as they secure adherence to the fixed price.”⁴ In other cases decided under the *Colgate* doctrine, courts have found **no** unlawful coercion where a franchisor merely **suggests** resale prices, or even where a franchisor advertises suggested resale prices.⁵ Courts have found unlawful coercion, however, where a franchisor threatens sanctions for noncompliance with suggested prices,⁶ actually imposes sanctions for non-compliance,⁷

frequently are “naked restraints of trade with no purpose except stifling of competition.” *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963).

³ See, e.g., *Gray v. Shell Oil Co.*, 469 F.2d 742, 747 (9th Cir. 1972) (jury was properly instructed that “the ‘decisive’ issue before them was whether Shell dealers were free to make their own pricing decisions or whether Shell deprived its dealers of their free choice by use of affirmative conduct.”), *cert. denied*, 412 U.S. 943 (1973); *Knutson v. Daily Review, Inc.*, 548 F.2d 795, 806 (9th Cir. 1976) (“[t]aken in its entirety, the letter does not amount to coercion, but relies on ‘individual self-interest to bring about general voluntary acquiescence.’”) (quoting *United States v. Parke, Davis & Co.*, 362 U.S. 29, 46-47 (1960)), *cert. denied*, 433 U.S. 910 (1977).

⁴ See, e.g., *Yentsch v. Texaco, Inc.*, 630 F.2d 46, 53 (2d Cir. 1980).

⁵ See, e.g., *Martindell v. News Group Pub’ns, Inc.*, 621 F. Supp. 672 (E.D.N.Y. 1985); *Engbrecht v. Dairy Queen Co. of Mexico, Missouri*, 203 F. Supp. 714, 719 (D. Kan. 1962).

⁶ See, e.g., *Yentsch v. Texaco, Inc.*, 630 F.2d at 53; *Bowen v. New York News, Inc.*, 522 F.2d 1242, 1254 (2d Cir. 1975), *cert. denied*, 425 U.S. 936 (1976); *Girardi v. Gates Rubber Co. Sales Div., Inc.*, 325 F.2d 196, 198 (9th Cir. 1963)

⁷ See, e.g., *Lehrman v. Gulf Oil Corp.*, 464 F.2d 26, 38 (5th Cir.), *cert. denied*, 409 U.S. 1077 (1972).

polices compliance with suggested resale prices,⁸ or uses short-term leases and contracts that make it easier to terminate discounters.⁹

Notwithstanding such precedents, is it **really** inconsistent with *Colgate* for a franchisor to threaten to terminate—or even to actually terminate—a discounter that deviates from suggested resale prices? Here is what the Supreme Court said on this issue, long before *Leegin*, in its 1984 decision in *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984):

Under *Colgate*, the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply. And a distributor is free to acquiesce in the manufacturer's demand in order to avoid termination.

If any prior Supreme Court decision eventually proved to foreshadow the impending death of the *per se* prohibition of resale price maintenance, it was most likely the 1977 decision in *Cont'l T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). In *GTE Sylvania*, the Supreme Court held that vertical **non-price** restraints would henceforth be judged under the Rule of Reason rather than being deemed *per se* illegal. *Id.* at 59. More important than the holding of *GTE Sylvania* was its rationale. First and foremost, the Supreme Court in *GTE Sylvania* announced that interbrand competition—competition among sellers of different brands—is the primary concern of antitrust law. *Id.* at 52 n.19. At the same time, the Supreme Court recognized in *GTE Sylvania* that vertical non-price restraints may “promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products.” *Id.* at 52 n.19.

After deciding *GTE Sylvania*, but before deciding *Leegin*, the Supreme Court decided a number of cases that eroded the *per se* prohibition against resale price maintenance. These decisions include:

- the 1984 decision in *Spray-Rite* holding that—under the *Colgate* doctrine—the fact that a franchisee is terminated following complaints from other franchisees about its discounting is insufficient proof of concerted action;¹⁰

⁸ See, e.g., *Interphoto Corp. v. Minolta Corp.*, 295 F. Supp. 711, 716 (S.D.N.Y.), *aff'd per curiam*, 417 F.2d 621 92d Cir. 1969).

⁹ See, e.g., *Sahm v. V-1 Oil Co.*, 402 F.2d 69, 71-72 (10th Cir. 1968).

¹⁰ See 465 U.S. at 768:

The correct standard is that there must be evidence that tends to exclude the possibility of independent action by the manufacturer and distributor. That is, there must be direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others had a conscious commitment to

- the 1988 decision in *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988) holding that a vertical restraint of trade is not *per se* unlawful unless it includes some agreement on price or price levels;
- the 1990 decision in *Arco* limiting the standing of private plaintiffs to assert claims for **maximum** resale price maintenance;¹¹ and
- the 1997 decision in *State Oil Co. v. Khan*, 522 U.S. 3 (1997) holding that **maximum** resale price maintenance is no longer *per se* unlawful.

b. **Rationale for the Supreme Court’s 2007 decision in *Leegin***

Notwithstanding its more recent decisions in *Spray-Rite*, *Sharp Electronics*, *Arco*, and *Khan*, the Supreme Court’s 1919 decision in *Colgate* played a prominent role in its June 28, 2007 decision in *Leegin*. In fact, the Supreme Court arguably could have decided *Leegin* on the basis of *Colgate* alone. At trial, the defendant in *Leegin* contended that it had established a “unilateral pricing policy” that was permitted under *Colgate*. 551 U.S. at 884. Elsewhere in its opinion, however, the Supreme Court in *Leegin* stated that “[o]n appeal *Leegin* did not dispute that it had entered into vertical price-fixing agreements with its retailers. Rather, it contended that the rule of reason should have applied to those agreements.” *Id.* at 884-85. Ultimately, the *Leegin* majority did not base its decision on whether the defendant had a “unilateral pricing policy” that was permissible under *Colgate* or whether it had “vertical price-fixing agreements with its retailers” that were *per se* unlawful under *Dr. Miles*. In *Leegin*, the Supreme Court found this distinction established by its prior precedents unpersuasive because “[t]he economic effects of unilateral and concerted price setting are in general the same.” *Id.* at 902-03. These economic effects were, in the view of the *Leegin* majority, decisive because the *per se* rule is supposed to be reserved for restraints that “always or almost always tend to restrict competition and decrease output.” *Id.* at 886, quoting *Sharp*, 485 U.S. at 723.

a common scheme designed to achieve an unlawful objective.

¹¹ In *Atlantic Richfield Co. v. U.S.A. Petroleum Co.*, 495 U.S. 328, 345 (1990), the Supreme Court held that (1) competitors of a franchisor and its franchisees generally lack standing to pursue claims that a franchisor and its franchisees engaged in maximum resale price maintenance, as long as the franchisor and its franchisees were not selling below cost; and (2) a franchisor’s own franchisees lack standing to assert vertical maximum price-fixing claims except under certain circumstances, including the inability of franchisees to provide necessary services in conjunction with the sale of products at the low prices allegedly fixed by the franchisor. See also *Jack Walters & Sons Corp. v. Morton Bldg., Inc.*, 737 F.2d 698, 708-09 (7th Cir. 1984), *cert. denied*, 469 U.S. 1018 (1984); *Slowiak v. Hudson Foods, Inc.*, 1992 Trade Cas. (CCH) ¶ 69,821 (W.D. Wis. 1992), *aff’d on other grounds*, 987 F.2d 1293 (7th Cir. 1993).

In deciding *Leegin*, the Supreme Court found that each of the potentially pro-competitive justifications for vertical **non-price** restraints that it had articulated in *GTE Sylvania* could apply with equal force to vertical **price** restraints as well. Like vertical non-price restraints on intrabrand competition, the *Leegin* Court found, the elimination of intrabrand price competition “encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer’s position as against rival manufacturers.” 551 U.S. at 890. In addition, “[r]esale price maintenance also has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between.” *Id.* at 890. One of the principal pro-competitive justifications for vertical **non-price** restraints—the elimination of “free riding” by other franchisees—applies with equal force to resale price maintenance, the *Leegin* Court found.¹² Resale price maintenance can also increase interbrand competition, according to the *Leegin* majority, “by facilitating market entry for new firms and brands” and by “by encouraging retailer services that would not be provided even absent free riding.” *Id.* at 891-92. The Supreme Court’s observations about “retailer services” are particularly germane to the “system standards” that franchisors typically seek to impose on franchisees:

It may be difficult and inefficient for a manufacturer to make and enforce a contract with a retailer specifying the different services the retailer must perform. Offering the retailer a guaranteed margin and threatening termination if it does not live up to expectations may be the most efficient way to expand the manufacturer’s market share by inducing the retailer’s performance and allowing it to use its own initiative and experience in providing valuable services.

Id. at 892 (internal citations omitted).

¹² See 551 U.S. at 890-91:

Consumers might learn, for example, about the benefits of a manufacturer’s product from a retailer that invests in the showrooms, offers product demonstrations, or hires and trains knowledgeable employees. ... Or consumers might decide to buy the product because they see it in a retail establishment that has a reputation for selling high-quality merchandise. ... If the consumer can then buy the product from a retailer that discounts because it has not spent capital providing services or developing a quality reputation, the high-service retailer will lose sales to the discounter, forcing it to cut back its services to a level lower than consumers would otherwise prefer. Minimum resale price maintenance alleviates the problem because it prevents the discounter from undercutting the service provider. With price competition decreased, the manufacturer’s retailers compete among themselves over services.

(internal citations omitted).

c. **What the Supreme Court did not hold in *Leegin***

By holding that vertical minimum price-fixing is no longer *per se* illegal, the Supreme Court did **not** hold that vertical minimum price-fixing is always legal. To be sure, proving that a restraint of trade is unreasonable under the Rule of Reason is much more difficult for a plaintiff than establishing a *per se* violation. The *Leegin* majority specifically identified several circumstances in which vertical minimum price-fixing may be anti-competitive. These include resale price maintenance that facilitates a horizontal cartel among franchisors¹³ or franchisees¹⁴ or makes it easier for a dominant seller—either a franchisor or a “downstream” franchisee—to abuse its market power.¹⁵ The year after *Leegin* was decided, a motion to dismiss a resale price maintenance claim was denied on two out of the three grounds that the Supreme Court in *Leegin* expressly recognized as actionable: based on allegations that the resale price maintenance at issue had been imposed by a dominant seller and that it was horizontal rather than vertical because it

¹³ See *Leegin*, 551 U.S. at 892:

An unlawful cartel will seek to discover if some manufacturers are undercutting the cartel’s fixed prices. Resale price maintenance could assist the cartel in identifying price-cutting manufacturers who benefit from the lower prices they offer. Resale price maintenance, furthermore, could discourage a manufacturer from cutting prices to retailers with the concomitant benefit of cheaper prices to consumers.

(internal citations omitted).

¹⁴ See *id.* at 893:

A group of retailers might collude to fix prices to consumers and then compel a manufacturer to aid the unlawful arrangement with resale price maintenance. In that instance the manufacturer does not establish the practice to stimulate services or to promote its brand but to give inefficient retailers higher profits. Retailers with better distribution systems and lower cost structures would be prevented from charging lower prices by the agreement.

(internal citations omitted).

¹⁵ See *id.* at 893-94:

A dominant retailer, for example, might request resale price maintenance to forestall innovation in distribution that decreases costs. A manufacturer might consider it has little choice but to accommodate the retailer’s demands for vertical price restraints if the manufacturer believes it needs access to the retailer’s distribution network. ... A manufacturer with market power, by comparison, might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants.

(internal citations omitted).

had been adopted at the behest of competing dealers. *Toledo Mack Sales & Serv. v. Mack Trucks Inc.*, 530 F.3d 204, 225 (3d Cir. 2008).

Under any of these three scenarios, an aggrieved consumer, an injured franchisee, or a competitor of a franchisee or franchisor that has suffered competitive injury has potential remedies under the federal antitrust laws. These remedies are **not** necessarily limited to attempting to establish a Sherman Act Section 1 violation under the Rule of Reason. If resale price maintenance in fact facilitates a horizontal cartel, **horizontal** price-fixing remains as *per se* unlawful today as it was back in 1911 when *Dr. Miles* was decided. A dominant seller with **monopoly power** faces liability for monopolization, attempted monopolization, or conspiracy to monopolize in violation of Sherman Act Section 2, 15 U.S.C. § 2. And the abuse of **market power** can, under certain circumstances, establish liability for *per se* unlawful tying in violation of Section 1 of the Sherman Act and exclusive dealing in violation of Section 3 of the Clayton Act, 15 U.S.C. § 14.

By holding that vertical minimum price-fixing is no longer *per se* unlawful under Section 1 of the Sherman Act, the Supreme Court did not necessarily change state antitrust law. Certainly many states look to decisions under Section 1 of the Sherman Act in interpreting state law prohibitions on restraints of trade and state “little FTC Acts.” In fact, some state laws expressly reference their federal counterparts and state that they are to be construed similarly. See, e.g., Fla. Stat. Ann. § 542.32 (“due consideration and great weight” to be given to federal construction of antitrust laws). Few if any state antitrust and unfair competition laws, however, **must** be construed consistent with their federal counterparts.

After *Leegin*, state enforcement authorities still retain the discretion to prosecute vertical minimum price-fixing. Some indication of their sentiments may be evident from the fact that various state attorneys general, represented by the National Association of Attorneys General, filed an *amicus* brief seeking a contrary result in *Leegin*. Of course, NAAG also favored retaining the *per se* prohibition against **maximum** resale price maintenance, yet its members did not seem particularly active in prosecuting vertical maximum price-fixing after the Supreme Court decided *Khan*. In terms of jury appeal and political popularity, however, there may be a significant downside for a prosecutor who goes after a franchisor that has tried to force its franchisees to charge lower prices. That downside risk may not be present where a prosecutor goes after a franchisor that wants to end discounting. Regardless of what the economic literature cited by the *Leegin* majority may claim, the potential benefits of minimum resale price maintenance may not be intuitively obvious to the jurors, judges, and/or arbitrators called upon to decide its legality. Indeed, these potential benefits were ultimately not persuasive for the four Supreme Court Justices that dissented in *Leegin*.

Last but not least, the Supreme Court’s decision in *Leegin* did not amend the numerous franchise agreements proclaiming that the franchisor has no right to control resale prices. Some of these contracts are long term or even “evergreen,” or effectively have become perpetual in duration as the result of state “relationship” laws prohibiting their termination or nonrenewal. Contractual recitals that franchisees are free to make

resale pricing decisions independently and unilaterally were obviously written in light of the longstanding *per se* prohibition against resale price maintenance. The fact that resale price maintenance is no longer *per se* unlawful, however, does not mean that parties cannot agree *not* to engage in resale price maintenance. When the Supreme Court held that resale price maintenance is no longer *per se* unlawful, it did not purport to re-write contracts that allow the franchisee to control pricing. There is no reason that private parties cannot agree to refrain from engaging in an activity—resale price maintenance—that may be permitted by federal antitrust law (or may not be, depending upon whether it passes muster under the Rule of Reason). In short, the Supreme Court’s decision in *Leegin* does not provide a right to engage in resale price maintenance that is otherwise prohibited by contract, and a franchisor’s attempt to engage in resale price maintenance in the face of a contrary provision may result in a claim for breach. See, e.g., *Stuller, Inc. v. Steak N Shake Enters., Inc.*, 877 F. Supp. 2d 674, 693-94 (C.D. Ill. 2012) (relying in part upon Memorandum of Understanding stating that “Franchisee is free to establish menu prices that may differ from the menu pricing used by the Franchisor”).

d. **Reaction to *Leegin* at the federal and state levels**

State attorneys general actively enforce state laws under which resale price maintenance agreements remain *per se* unlawful. More than a dozen states—including California and New York—have antitrust and consumer protection statutes that make resale price maintenance *per se* unlawful regardless of how federal antitrust law is applied. Since *Leegin*, California has entered into consent decrees with both “bricks and mortar” and Internet sellers treating resale price maintenance as *per se* unlawful.¹⁶ *California v. Bioelements, Inc.*, Case No. 10011659, 2011 WL 486328 (Cal. Super. Ct. Jan. 11, 2011). Courts interpreting California law have treated RPM as *per se* unlawful.¹⁷ *Darush MD APC v. Revision LP*, No. 12-cv-10296, 2013 WL 1749539, at *6 (C.D. Apr. 10, 2013). Similarly, the post-*Leegin* consent decree in the *Herman Miller* litigation whereby resale price maintenance claims brought by the States of Illinois, New York, and Michigan were settled reflects a *per se* approach.¹⁸ *New York v. Herman Miller Inc.*, No. 08 CV-02977 (S.D.N.Y. March 25, 2008) (Stipulated Final Judgment and Consent

¹⁶ See *California v. Derma Quest, Inc.*, 2010-1 Trade Cas. (CCH) ¶ 76,922 (Sup. Ct. Ala. Cty. Feb. 23, 2010) (agreements with resellers of beauty products); *People v. Bioelements, Inc.*, 2011-1 Trade Cas. (CCH) ¶ 77,306 (Sup. Ct. Riverside Cty. Jan. 11, 2011).

¹⁷ *Darush v. Revision*, 2013 U.S. Dist. LEXIS 60084 (C.D. Cal. 20130 (“[u]nder current California Supreme Court precedent, . . . vertical price restraints are unlawful under the Cartwright Act [California’s antitrust law] [and] there is no indication that precedent is changing”).

¹⁸ *New York v. Herman Miller, Inc.*, No. 08-CV-02977, 2008-2 Trade Cas. (CCH) ¶ 76,454 (S.D.N.Y. Mar. 25, 2008) (Stipulated Final Judgment and Consent Decree).

Decree. And in 2009, the State of Maryland passed a “*Leegin* repealer” state antitrust law.¹⁹

At the federal level, antitrust enforcers have been unwilling to give resale price maintenance a green light when there is a potential for anti-competitive effects. The Department of Justice Antitrust Division offered the following unofficial guidance for applying the Rule of Reason to resale price maintenance:

First, a plaintiff would be required “to make a preliminary showing of the existence of the agreement and scope of its operation as well as the presence of structural conditions under which RPM is likely to be anticompetitive.” Christine A. Varney, Assistant Attorney Gen., U.S. Dep’t of Justice, *Antitrust Federalism: Enhancing Federal/State Cooperation, Remarks before the Nat’l Ass’n of Attorneys General*, p. 8 (October 7, 2009) (internal quotations and citations omitted).

Next, “the burden would shift to the defendant to demonstrate either that its RPM policy is actually—not merely theoretically—procompetitive or that the plaintiff’s characterizations of the marketplace were erroneous.” *Id.* at 8-9. “At a minimum, the defendant would have to establish that it adopted RPM to enhance its success in competing with rivals and that RPM was a reasonable method for accomplishing its procompetitive purposes.” *Id.* at 9.

The Federal Trade Commission has also advocated for a truncated Rule of Reason analysis where an RPM is “inherently suspect,” explaining that a court may “engage in a truncated review when, for example, the practice at issue [is] plainly anticompetitive and d[oes] not appear to have any countervailing competitive virtue.” *Id.*

3. “Best Practices” After *Leegin*: “Dos” and “Don’ts”

Although *Leegin* may permit more aggressive policing of discounters, a safer approach is to adopt policies and practices for which there was a viable antitrust defense even before *Leegin* was decided. As a practical matter, that means doing the following:

1. Verify that the effort to police discounting does not run afoul of any contractual provisions.
2. Verify that the impetus for minimum resale price maintenance came from the top down (in other words, from the franchisor) rather than from franchisees.
3. Verify that there is no other potential basis for antitrust liability.

¹⁹ See Md. Code Ann. § 11-204(b).

4. Use vertical non-price restraints instead of, or in addition to, vertical price restraints.
5. Provide incentives for adherence to suggested resale prices instead of, or in addition to, sanctions for non-compliance.

A discussion of each of these recommendations follows.

1. Verify that the effort to police discounting does not run afoul of any contractual provisions. As previously discussed, the Supreme Court's decision in *Leegin* does not "trump" any contractual provisions that may prohibit resale price maintenance. Besides reviewing the franchise agreement, counsel should also review any documents incorporated by reference therein, such as operations and policy manuals that may or may not address resale price maintenance. It is also wise to review the FDD with respect to any presale disclosures, particularly if the FDD predates *Leegin*. Ideally, the franchise agreement will contain a merger and integration clause that hopefully will bar the introduction of parol evidence to vary its terms. It might, nevertheless, be prudent to interview key personnel simply to verify that there have been no such oral promises, as franchisee counsel often attempt to use them to avoid the plain language of the contracts that their clients have signed. In addition, as discussed in the *Steak N Shake* case discussed above, there may be subsequent documents that could be used by a court to construe arguably ambiguous contractual provisions, such as provisions giving the franchisor control over a "system" but not indicating whether the "system" includes pricing decisions.²⁰

2. Verify that the impetus for minimum resale price maintenance came from the top down (in other words, from the franchisor) rather than from franchisees. The reason for this recommendation should be obvious in light of the foregoing discussion of the antitrust jurisprudence that preceded *Leegin* and *Leegin* itself: otherwise the restraint may be considered horizontal. It is a mistake to **assume** that restrictions imposed by franchisors on their franchisees are vertical for a number of reasons. One is that most franchisors engage in "dual distribution." In other words, franchisors often have "company stores" in addition to franchisees or engage in various forms of direct sales, both on the Internet and through more traditional means. As a result, franchisors may have **both** a vertical relationship (as a supplier) and a horizontal relationship (as a competitor) with their franchisees. In most cases involving dual distribution, courts have at least presumed — if not explicitly held—that the relationship

²⁰ The Court ruled based upon extrinsic evidence and expert testimony that the franchisor's control over the "system" as originally defined did not include the power to control pricing. *Stuller v. Steak N Shake*, 877 F. Supp. 2d at 694. Interestingly, the parties' experts agreed that franchisor control of pricing was a fairly recent development.

is vertical notwithstanding the presence of dual distribution.²¹ The Second,²² Seventh,²³ Ninth,²⁴ and Tenth²⁵ Circuits analyze **all** dual distributorships as vertical restraints subject to the Rule of Reason. (Before 1980, however, dual distributorships were treated as horizontal in the Second, Third, and Fifth Circuits. Of these courts, all but the Third Circuit has issued a later ruling that such arrangements could be vertical.²⁶) In some Circuits, a

²¹ The Supreme Court has indirectly ruled that dual distributorships involve only vertical restraints. In *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) and *White Motor Co. v. United States*, 372 U.S. 253 (1963), the Supreme Court did not address the dual distribution aspect of the cases. Instead, its holdings were based on the premise that the distribution systems in question were vertical. “Both times it has faced the issue, the Supreme Court has, *sub silentio*, treated dual distribution systems as imposing only vertical restraints.” *Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1355 (9th Cir. 1982). In its 1982 *Krehl* opinion, the Ninth Circuit stated that “the Court’s silence is an unsteady foundation upon which to base a decision.” However, in 1999, the Ninth Circuit directly cited *White Motor* to support its statement that dual distributorships were vertical: “[I]n *White Motor Co. v. United States*, the Supreme Court indicated that a similar system, where a truck manufacturer sold both to dealers and directly to certain customers while forbidding the dealer to sell to these customers, was a vertical system.” Compare *id.* at 1355 with *Ajir v. Exxon Corp.*, 1999 U.S. App. LEXIS 11046, * 11 (9th Cir. May 26, 1999).

²² See, e.g., *Elecs. Commc’ns Corp. v. Toshiba America Consumer Prods.*, 129 F.3d 240, 243 (2d Cir. 1997) (“[V]ertical restraints are generally subject to “rule of reason” analysis ... This is so even if the distributor and manufacturer also compete at the distribution level.”); *Copy-Data Sys. v. Toshiba America*, 663 F.2d 405, 409 (2d Cir. 1981) (citing “the Supreme Court’s dictate that ‘departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than ... upon formalistic line drawing.”).

²³ See, e.g., *Illinois Corporate Travel, Inc. v. American Airlines, Inc.*, 889 F.2d 751, 753 (7th Cir. 1989) (“Dual distribution ... does not subject to the per se ban a practice that would be lawful if the manufacturer were not selling direct to customers; antitrust laws encourage rather than forbid this extra competition”).

²⁴ See, e.g., *Ajir v. Exxon Corp.*, 1999 U.S. App. LEXIS 11046, * 11 (9th Cir. May 26, 1999) (“Such hybrid [dual distribution] relationships are treated under the law as vertical relationships.”).

²⁵ See, e.g., *Dart Indus., Inc. v. Plunkett Co. of Oklahoma, Inc.*, 704 F.2d 496, 499 (10th Cir. 1983); *Smalley & Co. v. Emerson & Cuming, Inc.*, 13 F.3d 366, 368 (10th Cir. 1993).

²⁶ See *Pitchford v. Pepi, Inc.*, 531 F.2d 92 (3d Cir. 1975). Compare *Hobart Bros. Co. v. Gilliland, Inc.*, 471 F.2d 894 (5th Cir. 1973) with *Red Diamond Supply v. Liquid Carbonic Corp.*, 637 F.2d 1001 (5th Cir. 1981) and *Midwestern Waffles, Inc. v. Waffle House, Inc.*, 734 F.2d 705 (11th Cir. 1984). Compare *Interphoto Corp. v. Minolta Corp.*, 295 F. Supp. 711 (S.D.N.Y. 1969), *aff’d on other grounds*, 417 F.2d 621 (2d Cir. 1969) with *Copy-Data Sys. v. Toshiba America*, 663 F.2d 405 (2d Cir. 1981).

factual analysis is required to determine whether a dual distributorship is horizontal or vertical. In determining whether dual distributorships are vertical, the Fourth,²⁷ Fifth,²⁸ Sixth,²⁹ Eighth,³⁰ and Eleventh³¹ Circuits have examined the source, purpose, and effect of supplier-imposed restraints. In the dual distribution cases analyzed by these courts, the source of the restraint was the supplier. In each case, the court found that the restraint's financial benefits to the supplier arose from **increased interbrand** competition, and **not** reduced **intra-brand** competition. As a result of these factual findings, these courts found the dual distribution networks under review to be vertical. These courts have also recognized, however, that such agreements could be considered horizontal if the benefits accrued primarily to the franchisees rather than to the franchisor.³²

A second and related reason for verifying that the franchisor or the manufacturer was the source of the restraint is that—even where there is no “dual distribution”—an apparently vertical agreement could be viewed as a proxy for a *per se* unlawful horizontal

²⁷ See *Hampton Audio Elecs., Inc. v. Contel Cellular, Inc.*, 1992 U.S. App. LEXIS 13620, *8 (4th Cir. Jun. 10, 1992) (“[dual distributorship] restrictions are subject to the ‘rule of reason’ analysis if the restrictions ‘redound[] primarily to the benefit of the manufacturer as a result of increased interbrand competition.’”); *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 638 F.2d 15, 16-17 (4th Cir. 1981) (“We accept the district court’s rule of reason discussion, which clearly indicates that the restraints were for the purpose of promoting interbrand competition.”).

²⁸ See *Abadir & Co. v. First Mississippi Corp.*, 651 F.2d 422, 426 (5th Cir. 1991) (“The rationale for each *per se* rule is an economic analysis of ... the potential economic advantages which might motivate the parties Because the potential economic advantages ... are those characteristic of a vertical ... agreement, the *per se* horizontal rule does not apply.”); See *Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001, 1004 (5th Cir. 1981) (“When the manufacturer is the source, the conspiracy is vertical.”).

²⁹ See *Int’l Logistics Group, Ltd. v. Chrysler Corp.*, 884 F.2d 904, 906 (6th Cir. 1989) (“the implemented marketing policies were ‘vertical’ ... although some minimal horizontal competitive effects may have resulted, the marketing policies ... were not directed toward ... parties at the same competitive level even though Chrysler, the manufacturer, was also a distributor.”).

³⁰ See *Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1231 (8th Cir. 1987) (“If evidence is consistent with the hypothesis that the firm at the top of the vertical chain designed the restrictions for its own purposes, an inference of [horizontal] conspiracy is inappropriate.”).

³¹ See *Midwestern Waffles, Inc. v. Waffle House, Inc.*, 734 F.2d 705, 721 (11th Cir. 1984) (“Because there is no evidence [the restraint] ... has the tendency to reduce interbrand competition, reduce the availability of services ..., or artificially maintain prices, a rule of reason analysis is appropriate.”).

³² See, e.g., *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 638 F.2d 15, 16-17 (4th Cir. 1981).

agreement. For example, the Supreme Court found a *per se* illegal horizontal price-fixing agreement where—having conspired to boycott discounting dealers—a group of General Motors dealers and their trade association procured an agreement from General Motors to boycott the discounters.³³ Horizontal agreements among competitors remain just as unlawful after *Leegin* as they were before. A plaintiff might attempt to argue that a franchisor and franchisee had joined in a so-called “hub-and-spokes” conspiracy.³⁴ According to this theory, the franchisor would be the “hub” and the franchisees would be “spokes” connected to the franchisor via their franchise agreements. Under the law in almost all of the circuits, however, to be successful such a claim would also require proof of the “rim” agreements between the individual franchisees, not just the “spokes” between the franchisor and the franchisees.³⁵

3. Verify that there is no other basis for potential antitrust liability.

Although resale price maintenance is no longer *per se* unlawful, the *per se* rule is alive and well when it comes to other types of restraints—including horizontal market allocation, horizontal price fixing, group boycotts, and tying. If the franchisor has an unusually high market share, if virtually everyone else in the industry is also engaged in minimum resale price maintenance, or if the impetus for the restraint arguably came “downstream” from franchisees, the franchisor could face *per se* liability after all. Also, as previously discussed, Sherman Act Section 2’s prohibitions against monopolization, attempted monopolization, and conspiracies to monopolize are unaffected by *Leegin*.

4. Use vertical non-price restraints instead of, or in addition to, vertical price restraints. As previously discussed, the four decades of antitrust jurisprudence since *GTE Sylvania* have confirmed that vertical non-price restraints generally survive Rule of Reason scrutiny. Many of these non-price restraints—such as exclusive territories and location clauses—may be nearly as effective as resale price maintenance in prohibiting “free riding” and the other perceived evils of discounting. In some cases, such vertical non-price restraints might be used in lieu of price restraints. At the very least, they provide a second line of defense for accomplishing the objectives of the franchisor.

5. Provide incentives for adherence to suggested resale prices instead of, or in addition to, sanctions for non-compliance. Although the cases decided under the *Colgate* doctrine are not always consistent with one another, they do make clear that it is not unlawful to refuse unilaterally to deal with discounters or to provide incentives for franchisees to comply with suggested resale prices. Adopting pricing policies that can be defended as “unilateral” and/or as incentive programs thus may help reduce potential

³³ *United States v. Gen. Motors Corp.*, 384 U.S. 127, 146 (1966).

³⁴ *See, e.g., United States v. Apple, Inc.*, 791 F.3d 290 (2d Cir. 2015).

³⁵ *See, e.g., Total Benefits Planning Agency v. Anthem Blue Cross & Blue Shield*, 552 F.3d 430, 436 (6th Cir. 2008) (affirming dismissal of complaint and rejecting hub-and-spokes theory because “the critical issue for establishing a *per se* violation with the hub and spoke system is how the spokes are connected to each other. The amended complaint falls short of presenting such a connection, offering only [an insufficient] rimless theory”).

antitrust liability. In addition, such “carrots” may be more effective than the “stick” of contractual provisions in securing compliance.

4. **Playing It Safer—But Not Necessarily Safe: Colgate and MAP Policies**

Rather than “push the envelope” of resale price maintenance law in the wake of *Leegin*, many franchisors have adopted a more conservative approach of seeking to control franchisee resale prices—especially minimum prices—in ways that may have survived antitrust scrutiny even before *Leegin*. Two common ways of doing so include minimum advertised price (“MAP”) policies and *Colgate* policies.

A MAP policy is a franchisor’s policy that franchisees not **advertise** prices below a price specified by the franchisor. The objective of a MAP policy is to keep the franchise system’s pricing at a level consistent with the franchisor’s desired brand image and to protect franchisees that invest resources in promoting the product or providing customer service at the level desired by the franchisor. A MAP policy does **not** restrict the prices at which franchisees can sell goods and services.

In contrast, a *Colgate* policy allows a franchisor to refuse to sell to franchisees that do not adhere to the franchisor’s suggested resale prices. Ensuring compliance without crossing the line between “unilateral” and “concerted” action is difficult. Compared to MAP policies, *Colgate* policies are subject to heightened antitrust scrutiny.

Even MAP policies are subject to antitrust scrutiny and potential liability. A successful antitrust challenge to a MAP policy can result in both treble damage liability and injunctive relief. For example, a consent decree in a challenge by the FTC to a MAP policy adopted by CD manufacturers included a bar on the adoption of any MAP policy for seven years. *In re Universal Music & Video Distribution Corp.*, File No. 971 0070 (2000) (FTC action against compact disc distributors for MAP policy). A group of CD manufacturers, however, is difficult to analogize to a franchisor, particularly in view of the Supreme Court’s repeated admonition that “it is ‘[t]he promotion of interbrand competition,’ after all, that ‘is the primary purpose of the antitrust laws.’” *Ohio v. American Express Co.*, 138 S. Ct. 2274, 2290 (2018) (quoting *Leegin*, 551 U.S. at 890).

Many MAP policies grew out of cooperative advertising programs whereby the franchisor provided funding for franchisee advertising but restricted the ability of franchisees to use the funds to advertise below the franchisor’s suggested resale prices. Several such programs were challenged under Section 1 of the Sherman Act as *per se* unlawful minimum resale price maintenance. Even before the Supreme Court’s decision in *Leegin*, however, such programs were generally upheld under the Rule of Reason as long as (1) franchisee participation in the program was not mandatory, (2) the program applied only to advertising paid for by co-op funds, (3) the program permitted the franchisee either to advertise the suggested retail price or no price at all, and (4) franchisees were not required to actually charge the advertised prices.

These pre-*Leegin* challenges to MAP policies resulted in relatively few reported decisions—not all of which were favorable to the franchisor or supplier. In

Worldhomecenter.com, Inc. v. Thermasol, LTD, No. 05Civ3298 (DRH)(ETB), 2006 U.S. Dist. LEXIS 46323 (E.D.N.Y. July 10, 2006), the court denied a motion to dismiss where complaint alleged that the MAP policy had been implemented at the behest of complaining distributors. In contrast, in *Holabird Sports Discounters v. Tennis Tutor, Inc.*, 993 F.2d 228 (4th Cir. 1993) (unpublished) (slip opinion at 1993 U.S. App. LEXIS 10918), the appeals court upheld summary judgment in favor of the manufacturer because the distributor failed to identify sufficient evidence tending to exclude the possibility that TTI and its dealers acted independently with regard to the MAP policy). See also *In re Nissan Antitrust Lit.*, 577 F.2d 910 (5th Cir. 1978) (upholding MAP Policy for co-op advertising program under Rule of Reason).

The FTC has also provided the following guidance for cooperative advertising programs and MAP policies:

The law allows a manufacturer considerable leeway in setting the terms for advertising that it helps to pay for. The manufacturer offers these promotional programs to better compete against the products of the other manufacturers. There are limited situations when these programs can have an unreasonable effect on price levels. For instance, the FTC challenged the Minimum Advertised Price (MAP) policies of five large distributors of pre-recorded music because the policies were unreasonable in their reach: they prohibited ads with discounted prices, even if the retailer paid for the ads with its own money; they applied to in-store advertising; and a single violation required the retailer to forfeit funds for all of its stores for up to 90 days. The FTC found that these policies, in effect for more than 85 percent of market sales, were unreasonable and prevented retailers from telling consumers about discounts on records and CDs. Issues involving advertising allowances may become of less practical concern as manufacturers adjust to new standards that allow more direct influence on retail prices.³⁶

Notwithstanding *Leegin*, MAP policies—even as a substitute for explicit minimum resale price maintenance—are not a cure-all for potential antitrust liability. Under the Rule of Reason, the franchisor still needs to show that the pro-competitive benefits outweigh anti-competitive effects. A MAP policy is preferable in states that continue to view minimum resale price as per se unlawful. Still, the franchisor needs to be able to articulate the effects on competition, both interbrand and intrabrand, and the rationale for the policy. To survive antitrust scrutiny:

³⁶ See <https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/dealings-supply-chain/manufacturer-imposed>, citing *In re Universal Music & Video Distribution Corp.*, *supra*.

- The MAP policy must be a true minimum advertised price policy that does not control resale pricing.
- The MAP policy should be initiated vertically as unilateral action of the franchisor.
- Franchisor personnel must understand the distinctions between MAP and resale price maintenance and neither explain nor enforce the policy as if it established minimum resale prices.

One other option to adopt a hybrid *Colgate* MAP policy. This affords another potential line of defense to antitrust liability. The *Colgate* doctrine allows a franchisor to unilaterally and independently announce in advance the minimum price at which its products should be resold and refuse to sell to any franchisee that does not comply. The fact that franchisees independently chose to adhere to the policy to avoid termination is, without more, insufficient to establish a “contract, combination, or conspiracy” for Sherman Act Section 1 purposes. In practice, a *Colgate* policy is difficult to implement and—as proved to be the case in *Leegin*—may not be a complete solution. For a *Colgate* policy to be effective, the franchisor must be willing to cut off the offending franchisee. The franchisor has no choice but to terminate sales immediately with no warnings, no second chances, and no continued shipments in response to assurances of future compliance—regardless of size of the violator or volume of its purchases. Of course, immediate termination may conflict with state franchise “relationship” laws. And resumption of sales following the franchisee’s promise to adhere to suggested prices in the future could give rise to allegations of a vertical resale price maintenance agreement.

The following factors should be considered in drafting and implementing a MAP policy:

1. **Limitations on scope of the policy:** The greater the restrictions on where the franchisee is forbidden to advertise low prices, the more likely the MAP policy is to be viewed as a restriction on resale pricing. Is it akin to restricting the franchisee’s ability to resell at prices of its own choosing? Channel advertising restrictions (e.g., Internet) are potentially easier to defend, at least where other methods of communicating price are available.
2. **Concentrated markets or large market share:** These facts could make the MAP policy less likely to survive scrutiny under the Rule of Reason.
3. **Proof of benefits to interbrand competition:** Consider what efficiencies and pro-competitive benefits are actually being achieved. Gather information on how low prices affect franchisees’ ability to provide services that promote the franchise against other brands.
4. **Advertising subject to MAP policy:** Does it apply to all advertising or just advertising paid for by the franchisee?

5. **Unilateral enforcement:** The franchisor should not jointly with other franchisees to stop discounting.
6. **Penalties for violation:** The penalties should be tied to the harm caused by the violation and should not exceed the magnitude necessary to ensure compliance with the MAP policy. Clearly, the penalties should include the withdrawal of advertising allowances applicable to the violation. It may also be appropriate to disqualify the franchisee from participating in certain programs. Other penalties—while perhaps appropriate under the antitrust laws—may raise issues under state franchise “relationship” laws because they may amount to actual or constructive termination. Such penalties could include rescission of any previously granted license to use the franchisor’s trademarks and other intellectual property, refusal to accept future orders for all or certain lines of products, and/or termination of the franchisee’s ability to purchase the franchisor’s products.
7. **Definition of price “advertising” subject to MAP policy:** Some MAP policies do not allow consumers to see prices until the product is placed in a shopping cart. Although defensible in theory, that practice is analogous to the MAP policy at issue in *In re Universal Music & Video Distribution Corp.* That policy resulted in a significant adverse ruling against the CD manufacturers and a prohibition on the CD manufacturers having any MAP policy at all. In contrast, requiring that an initial webpage that shows a variety of products list only the MSRP should raise an acceptable antitrust risk if (1) the page states something to the effect of “click on individual product for any pricing specials” and (2) upon clicking on that product, the consumer sees the actual price that would be charged. The consumer would then have the option whether to put that product into the shopping cart.
8. **Close-outs and promotions:** The franchisor can elect to reduce the MAP to reflect periodic promotional sales or product close-outs. Advise of changes at least thirty days in advance.
9. **Promotions not inconsistent with MAP:** Examples may include consumer financing, free shipping, free wrapping or gift card, awarding free store product with purchase of MAP product, store branded credit/charge card offers, no sales tax, military sales through an authorized government agency, storewide or category price promotions (e.g., 10% off everything in the store, provided there is no special attention drawn to products subject to the MAP policy), discounts on discontinued products as long as accurately described as discontinued, and statements in advertising that consumers can “call for current pricing.”
10. **Q&A/talking points approved by counsel:** These should be designed to help ensure that the MAP policy does not result in an “agreement” as to minimum resale prices. For example, the franchisor should make clear that it

will not discuss its relationship with any particular franchisee with other franchisees.

5. **Best Practices: Implementing a System-Wide Price Promotion**

No matter how much the franchisor tries to “play it safe,” there is no guarantee that a system-wide pricing promotion will survive an antitrust challenge. Still, there are some “best practices” to try to avoid a challenge—or at least to minimize the possibility that it would be successful. Some factors to consider, and some suggested ways of addressing each of them, include the following:

- Did the impetus for the pricing program come from the franchisor or franchisees?
- Did the franchisor implement a program initiated by franchisees?
- Was the pricing program preceded by complaints from one or more franchisees about the pricing of one or more other franchisees?
- Did the franchisor test the pricing program itself in “company stores” before rolling it out to the franchisees?
- Are there differences in state antitrust laws or enforcement policies that need to be taken into account?
- Does the program actually mandate certain resale prices or is it limited in scope to advertising?
- Is the pricing program consistent with the provisions of the franchise agreement regarding pricing by franchisees?

A discussion of each of these factors follows.

a. **Franchisee-initiated pricing programs.**

The fact that the program was instituted by franchisees does not necessarily make the program “horizontal” resale price maintenance that is *per se* unlawful under Section 1 of the Sherman Act. Under *Leegin*, however, that fact might increase the likelihood that the pricing program would be condemned on that basis. See *Toledo Mack Sales & Servs., Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (3d Cir. 2008). 551 U.S. at 893 (noting potential for retailer collusion and stating that “[a] horizontal cartel among . . . competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful”). To defend the pricing program as a vertical restraint under the Rule of Reason, the franchisor should be able to articulate some legitimate reasons for the pricing program from the standpoint of the franchisor, as discussed below. The case for successfully characterizing the pricing program as a “reasonable” vertical restraint will be strengthened if the franchisor tests it first in company stores.

b. **Franchisee complaints about pricing.**

Under the *Spray-Rite* doctrine, the fact that the pricing program was preceded by franchisee complaints does not automatically establish the existence of a “contract, combination, or conspiracy”—much less an “unreasonable” horizontal conspiracy that is *per se* unlawful under Section 1 of the Sherman Act. Still, it is evidence on which both such elements of an antitrust violation could be based. That is all the more reason for the franchisor to have its own legitimate business reason for the pricing program and to have tested it first in “company stores,” as discussed below.

c. **Franchisor testing in “company stores.”**

As previously discussed, franchisor “resale price maintenance” in vertically integrated “company stores” is not a “contract, combination, or conspiracy” under Section 1 of the Sherman Act. Testing the pricing program first in company stores makes it easier for the franchisor to articulate a legitimate business justification that the program is a “top down,” vertical restraint rather than being the product of a “horizontal” conspiracy among franchisees.

d. **Differences in state antitrust laws.**

Even if the states in which the franchisor has franchisees are not among those with express “*Leegin* repealer” statutes, there may be differences in the antitrust enforcement policy in certain states that are worth considering. If so, the franchisor may decide not to insist upon strict franchisee compliance in such jurisdictions.

e. **RPM versus “unilateral” conduct.**

As previously discussed, the program may not be price-fixing at all if it is truly unilateral—for example, if it is limited in scope to minimum advanced prices or conditional reimbursement from a cooperative advertising fund.

f. **Franchise agreement provisions.**

Many franchise agreements have provisions regulating franchisee pricing that were drafted in an era in which all types of resale price maintenance—even vertical ***maximum*** price-fixing—was condemned as *per se* unilateral. Consistent with the state of the law at the time, such provisions typically state that the franchisee maintains complete independence with respect to pricing decisions. Absent an amendment to the franchise agreement, such provisions may be an even greater impediment to the implementation of pricing programs than federal or state antitrust laws.

6. **Concerns Relating to Maximum or Value Pricing**

Much of the foregoing discussion has concerned **minimum** price maintenance, which potentially is more problematic from an antitrust perspective as evidenced by, among other things, the close 5-4 vote in the Supreme Court to reverse application of the *per se* for minimum pricing as opposed to the unanimous vote to do the same ten years

earlier with respect to maximum prices.³⁷ Some franchisors, however, may be more concerned with the extent to which they can compel franchisees to adhere to **maximum** prices, for example in connection with value menus or other promotions.

Like *Leegin*, *State Oil v. Khan* does not hold that vertical agreements specifying a maximum price are necessarily lawful; rather, they are subject to scrutiny under the Rule of Reason.³⁸ Claims under the Rule of Reason are notoriously difficult to prove, however, and there have been few (if any) reports of successful claims based on maximum price restraints since *State Oil v. Khan* was decided over two decades ago. In addition, while state antitrust laws may or may not follow the Supreme Court's doctrinal lead, maximum price restraints appear on their face to be more favorable to consumers, and therefore are less likely to be challenged by state enforcers who face competing demands for limited resources and may prioritize more politically appealing targets.

In contrast to minimum price restraints, where the greatest threat to a franchisor's program will likely arise from the antitrust laws, the greatest threat to a franchisor's effort to impose maximum prices or value pricing may come from disgruntled franchisees who assert that the franchisor's pricing model abridges the franchisee's contractual rights or interferes with or prohibits profitable operations.

As noted above, many pre-*Leegin* agreements (and some post-*Leegin* agreements) are silent as to or directly disavow the franchisor's ability to control franchisee pricing. Where the agreement does not speak directly to pricing, courts have reached different conclusions as to whether the franchisor can control franchisee pricing based on the franchisor's more general right to control and modify the brand's system of operation. Thus, in *Stuller, Inc. v. Steak N Shake Enter., Inc.*, 877 F. Supp. 2d 674, 694 (C.D. Ill. 2012), the Court found that the franchise agreement language was ambiguous as to whether control over the "System" included pricing, and then concluded that "[t]he undisputed extrinsic evidence demonstrates that price and promotions were not part of the System. As such, [the franchisor] could not modify the System to require [the franchisee] to follow[] [the franchisor's] pricing and promotions." The Court therefore granted summary judgment to the franchisee.

Reflecting the importance of contractual language, however, a different court subsequently considered a later version of Steak N Shake's franchise agreement and reached the opposite conclusion. The franchise agreements at issue in *Steak N Shake Enterprises v. Globex Co.*, 110 F. Supp. 3d 1057, (D. Colo. 2015) provided that the

³⁷ *Compare Leegin*, 551 U.S. at 907 (overruling *Dr. Miles* and holding that minimum price restraints should be judged under the Rule of Reason) *with State Oil Co. v. Khan*, 522 U.S. 3, 7 (1997) (overruling *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) and holding that maximum price restraints should be judged under the Rule of Reason).

³⁸ 522 U.S. at 22 ("In overruling *Albrecht*, we of course do not hold that all vertical maximum price fixing is *per se* lawful. Instead, vertical maximum price fixing, like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason").

franchisee was required to comply with “the System ‘including a designated menu (including the maximum, minimum, or other prices the Franchisor specifies for menu items and mandatory promotions)’” Unsurprisingly, the Court found this language to be unambiguous; the franchisee’s failure to comply with the pricing specified by the franchisor (including an “under \$4.00” menu) constituted a breach that entitled the franchisor to summary judgment.

Even with language that is less emphatic, some franchisors have been able to prevail on claims that their authority over a system included at least some authority to set maximum prices. In *Burger King Corp. v. E-Z Eating Corp.*, 572 F.3d 1306, 1314 (11th Cir. 2009), the Eleventh Circuit found that “[t]here is simply no question that [Burger King] had the power and authority under the Franchise Agreements to impose the Value Menu on its franchisees” based upon language requiring compliance with Burger King’s “comprehensive restaurant format and operating system.” A district court within the same circuit reached the same conclusion in a case brought by the Burger King franchisee association. In *National Franchisee Ass’n v. Burger King Corp.*, 715 F. Supp. 2d 1232, 1242-45 (S.D. Fla. 2010), the Court reasoned that Burger King’s “inclusion of Value Menu items with specified prices in its manual was consistent with its “authority to establish and make changes in its comprehensive restaurant format and operating system, including product specifications.”

As is often the case in franchise cases, resolution of the contract interpretation issues in favor of the franchisor did not dissuade the franchisees from asserting other claims. The court in the *Burger King* case initially denied the franchisor’s motion to dismiss the franchisee association’s claim alleging breach of express and implied duties of good faith because the franchisees had alleged that selling double cheeseburgers at the mandated \$1.00 price was below cost and potentially could lead to franchisee bankruptcies. *Id.* at 1245. In a subsequent decision, however, the court focused on the franchisor’s discretion to control the system and framed the good faith issue as “whether the impact has been so injurious that the measure could not reasonably have been considered within the contemplation of the parties.” *National Franchisee Ass’n v. Burger King Corp.*, No. 09-CV-23435, 2010 WL 4811912*5 (Nov. 19, 2010). Under this standard, the court granted Burger King’s motion to dismiss.

In support of their claim under the implied covenant, the franchisees argued that Burger King was mandating pricing of certain items, including a double cheeseburger, at levels below the franchisee’s cost or below a level at which the franchisee could make a profit. Even accepting the truth of the allegations for purposes of a motion to dismiss, the Court rejected these claims as a matter of law because “Section 5 [of the Franchise Agreement gives BKC the right to set prices for products sold by franchisees. This includes the discretion to set prices for a single product below cost provided that the pricing decision is one ‘which BKC in the good faith exercise of its judgment believes to be desirable and necessary.’ A decision to price a single product below cost is not automatically a bad faith exercise.” *Id.* The Court found that the plaintiffs’ focus on losses attributable to a single product or a small number of products in a multi-product business could not support a claim of bad faith. While the ruling was fact-driven, it suggests that

franchisors generally will have significant latitude to set prices, assuming that the right is established expressly or at least implicitly in the franchise agreement.

7. **Conclusion**

Changes in the federal antitrust laws have created opportunities for franchisors to exert additional control over their systems. Direct franchisor control of franchisee pricing is no longer the subject of *per se* prohibition, even with respect to minimum prices. Taking advantage of such opportunities, however, still is not without risk. Knowing the contours of the law surrounding resale price maintenance will help minimize the risks associated with price promotions and permissible “resale price maintenance” in whatever form it takes to avoid running afoul of the antitrust laws.