



RAISING THE BAR

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

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Agenda

- Introductions
- Legal Framework
- Case Studies
- Best Practices
- Q&A

Legal Framework

- Sherman Act § 1 (1890)
 - “[e]very contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal”

Legal Framework

- “Unreasonable” restraints
- Per se versus Rule of Reason
- Quick-Look

Legal Framework

- Rule of reason claims
 - Defined product market
 - Defined geographic market
 - Anticompetitive effects

Legal Framework

- Horizontal versus Vertical Restraints
- Horizontal
 - Competitors at same level
- Vertical
 - Different level of distribution chain

Legal Framework

- Vertical restraints -- expansion of per se liability
 - Dr. Miles (1911)
 - US v. Arnold Schwinn (1967)
 - Albrecht v. Herald (1968)

Legal Framework

- Vertical restraints -- elimination of per se liability
 - GTE Sylvania (1977)
 - State Oil v. Khan (1997)
 - Leegin (2007)

Legal Framework

- Rationale
 - Primary concern of antitrust laws is interbrand competition
 - Vertical restraints can strengthen interbrand competition by limiting/eliminating intrabrand competition

Legal Framework

- Circumvention of the rule of reason
 - Dual distribution
 - Hub and Spoke

Legal Framework

- Other impediments
 - State antitrust laws
 - Independent authority
 - Leegin repealers
 - Franchise Agreements/FDDs
 - Practical considerations

Legal Framework

- A minimum advertised price (“MAP”) policy is a supplier’s policy that resellers not advertise prices below a price specified by the supplier
- Objective: promotes value associated with the product’s brand image and to protect resellers who invest resources in promoting the product or provide customer service

Legal Framework

- MAP policy does not restrict the price at which resellers can sell the product
- Started in conjunction with cooperative advertising programs whereby a manufacturer provides advertising money but restricts the ability to advertise low prices in those ads

Legal Framework

- Applying the rule of reason, such programs were held generally not to violate the law as long as:
 - Dealer participation is not mandatory
 - They apply only to ads paid for by co-op funds
 - They permit the distributor either to advertise the suggested retail price or no price at all
 - The distributors are not required to actually charge the advertised prices

Legal Framework

- Especially outside of the co-operative advertising context, MAP programs at the federal level subject to rule of reason analysis need to prove procompetitive benefits outweigh anticompetitive effects.
- May avoid “per se” illegality in connection with state enforcement in states that continue to view minimum resale price policies as per se unlawful, but should keep in mind:
 - Effect on competition, both inter- and intra-brand
 - Reason for the policy

Legal Framework

- Key concerns with MAP programs
 - Must truly be a MAP program that does not control resale price
 - Should be initiated vertically as unilateral action of supplier
 - Sales personnel must understand the distinctions between MAP and resale price maintenance and neither explain nor enforce the policy as if it established a resale price
 - Penalties should be tied to harm caused by the violation

Legal Framework

- Limit the scope
 - Greater the restriction on where reseller is forbidden to advertise low prices, more likely to be viewed as restriction on sale price
 - Channel advertising restrictions (e.g. internet) potentially easier to defend, at least where other communications of price available

Legal Framework

- Colgate Policy
 - Allows a manufacturer to unilaterally and independently announce in advance the minimum price at which its product should be resold and refuse to sell to any customers that do not comply
 - The fact that customers independently chose to adhere to the policy to avoid termination is, without more, insufficient to establish an agreement for Section 1 purposes
 - Very difficult to implement

Legal Framework

- Must cut off the offending distributor – no choice but to terminate immediately of product purchasing privileges 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
 - AND resumption of sales following the reseller’s promise to adhere to suggested prices in the future could give rise to allegations of a vertical price agreement
 - BUT dealer laws in some states may prevent the company from terminating the distributor/dealer for violating the policy thus rendering the policy toothless
- Heightened antitrust risk

Legal Framework

- Courts wrestle with whether various efforts to control resale prices are “unilateral” rather than resulting from an unlawful agreement
 - “Exposition, persuasion, argument or pressure” to encourage franchisees to decide independently to observe suggested resale prices can be permissible
 - Can cross the line by making threats of termination if secure adherence to a fixed price
 - In other cases, no unlawful coercion where a franchisor merely suggests resale prices or advertises suggested resale prices
 - Courts have found unlawful coercion where a franchisor actually imposes sanctions for non-compliance

TIGER CAPITAL BRANDS STRATEGIC PLANNING MEETING

Tiger Capital Brands is the owner of multiple franchise brands located in New Orleans. We own Painting with a Twist and just purchased Ben's Broiler, a flame broiled hamburger concept. Each of Tiger's brands are national brands that are located in registration and non-registration states and have a different strategic advertising plan. The General Counsel of Tiger is seeking your advice on how to handle some of the system-wide pricing and promotions that the CMO, COO and CEO are adamant about implementing.

CASE STUDY #1 – Ben's Broiler

- Ben's Broiler is a drive-thru only QSR. We believe that the key to our success is to position ourselves slightly above the low price burger QSR's with a better quality product, but below the higher priced premium burger chains.
- To ensure we stay in our niche, we plan on establishing a minimum and maximum menu price for our burgers and combos that the franchisees must stay within. In addition, we will implement two pricing programs: (i) a value meal with a fixed of \$1.00 any location can charge on several designated items; and (ii) a fixed combo meal price of \$5.00, with the meal changing each day of the week.
- Our franchisees want the ability to charge higher or lower prices and are complaining that they cannot make money on the value meals or fixed combo meal promotions.

CASE STUDY #2 – Painting with a Twist®

- Painting with a Twist is a franchisor in the “Paint & Sip” industry. We have over 300 locations and two of these are company owned units. We have invested heavily in the design of our retail facilities, development of our art, artists, technology and our advertising to build our brand and deliver a quality experience to our guests.
- Our brand strategy and economic model depend upon maintaining a certain brand image and pricing structure to generate an adequate return on investment for the franchisee at the studio level. Several of our competitors are “discount” competitors that offer lower pricing or Groupon offers but do not invest in the design of the retail facilities or hire the level of artist that we do.

CASE STUDY #2 – Painting with a Twist®

- Franchisees of Painting with a Twist offer social events to the public in which guests may sign up for a group class to paint a particular painting while enjoying wine or their favorite beverage. The paintings are advertised to the general public on the franchisees' website studio calendars for a certain night of the week at a retail price. We provide a suggested retail price ("SRP") to franchisees to charge guests for the class, typically \$35 or \$45 per person.
- Some of the franchisees in larger markets are starting to intentionally discount the retail price or offer discount promotions (BOGO) to compete with competitors and other franchisees that are advertising the same paintings. This is starting a price war lowering profitability and creating bitterness among local Painting with a Twist franchise owners.

[Reserve a seat »](#)

TUESDAY, MAY 7

\$30.00



THE ESSENCE OF WINE! *PUBLIC EVENT*****
4:00 PM - 6:00 PM

[Reserve a seat »](#)

TUESDAY, MAY 7

\$30.00



READY FOR THIS JELLY *PUBLIC EVENT*****
7:00 PM - 9:00 PM

[Reserve a seat »](#)

TUESDAY, MAY 7

\$30.00



#1PENCIL, #1 TEACHER!! *PUBLIC EVENT*****
7:00 PM - 9:00 PM

[Reserve a seat »](#)

WEDNESDAY, MAY 8

\$35.00



BED OF BLOOMS *PUBLIC EVENT*****
4:00 PM - 6:00 PM

[Reserve a seat »](#)

CASE STUDY #2 – Painting with a Twist®

“I have already gone on record complaining about the [XYZ] studio's use of extreme discounting practices. As you can see, in recent weeks, they have been doing numerous BUY ONE GET ONE (BOGO) promotions, including doing these on Friday and Saturday nights. As a Franchise, you made a conscious effort to explain how Groupon devalues the brand and trains customers to wait for deals and that it is a business practice that is to be avoided at all costs. This is exactly what is happening. They are single-handedly retraining customers in the area. I had recently received an email asking about this and now I am fielding calls asking if we participate in BOGO's. My proud response has been that I DO NOT NOR WILL I EVER do BOGO's. In my opinion, I have lost customers due to this selfish and unwise business practice.”

CASE STUDY #2 – Painting with a Twist®

“As a Franchisee, I rely upon the Franchise's good name, reputation and brand awareness in the market to help bring customers in. As you expect me to help protect the "brand", I have the same expectation of the Franchise. I understand that there are rules/regulations regarding pricing however, there are also rules that Franchisees must abide by per the Franchise Agreement. Section 4.10 of the Franchise Agreement, Personal Conduct and Best Efforts, states that "Franchisee agrees to refrain from committing any act or pursuing any course of conduct that tends to bring Franchisor's Mark into disrepute. Furthermore, Franchisee must use its best efforts to promote and increase the demand for Painting With A Twist services.....Franchisee agrees to refrain from ANY business or advertising practice which may be injurious to the PWAT Unit or the goodwill associated with Franchisor's Marks and the System."

CASE STUDY #2 – Painting with a Twist®

Our franchise agreement specifically states in several sections that the franchisee is allowed to set its own prices.

THIS IS A MESS. WHAT DO WE DO?

Best Practices After *Leegin*

- Verify that the effort to police discounting does not run afoul of any contractual provisions
- Verify that the impetus for the RPM came from the top down
- Verify no other basis for antitrust liability
- Use vertical non-price restraints where possible
- Provide incentives for adherence to suggested resale prices instead of sanctions for non-compliance

Best Practices for Implementing a MAP Policy

- Consider limitations on the scope
- Be mindful of concentrated markets or large market share
- Consider efficiencies and pro-competitive benefits
- Determine which advertising is subject to the MAP policy and define it in policy
- Unilateral enforcement, with training for sales personnel
- Appropriate penalties for violation
- Exceptions to policy

Best Practices for System Wide Promotions

- Franchisee-initiated pricing programs
- Franchisee complaints about pricing
- Franchisor testing in “company stores”
- Differences in state antitrust laws
- RPM versus “unilateral” conduct
- Franchise agreement provisions

Q&A

QUESTIONS OR COMMENTS?