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[Justin J. Hakala](#)**MESSAGE FROM THE CHAIR**

We are at the halfway point of the Antitrust, Franchising and Trade Regulation Section's year and are doing our best to fulfill promises to further develop the Section's presence within the community of attorneys that practice in these areas. The Section has delivered a number of events to the membership thus far and we hope to carry our momentum into the second half of the year.

On the heels of a successful Franchising Seminar at the Hotel Baronette and a first snow gathering at Michael Symon's Roast in Detroit, the council is currently planning to continue bring value back to the Section membership. In addition to upcoming events, we will be focusing the second half of this year on strengthening ties between the Section's membership and the Antitrust bar's of surrounding states and Ontario. Please watch your email for announcements of future events, as well as our spring social activity, which is currently being planned.

Best regards,

Blair Renfro

Chair SBM Antitrust, Franchising and Trade Regulation Section

**SECTION NEWS****To All Franchise Law Practitioners:**

Are we serving your franchise law and practice needs? Please take a few minutes to communicate your comments and suggestions as to how we are doing. Feel free to call, email, or write our section secretary and franchise committee co-chairperson, Howard Lederman at (248) 642-3600 (B), (248) 561-0559 (Cell), [lederman@normanyatooma.com](mailto:lederman@normanyatooma.com), 219 Elm Street, Birmingham, Michigan 48009.

**Now Accepting Submissions**

If you have an antitrust, franchising, or trade regulation article that you would like to submit to be considered for publication in an upcoming newsletter, please submit your work to the Section's Publications Editor, [Justin Hakala](#).

**Missed the Last E-Newsletter?**

If you missed the last eNewsletter, be sure to check out the archives at the State Bar of Michigan Website, accessible [here](#).

**MICHIGAN NEWS*****Rogers v. Comcast Corp.*, 2:2010-CV-10547 (E.D. Mich)**

February 9th, 2010

Plaintiffs, certain Comcast customers, have recently filed a class action suit against Comcast, alleging that people who purchase premium cable have no choice but to pay a rental fee for a "cable box" or "set-top box" in order to view premium cable, and that they must pay a separate fee for this service. According to the complaint, the defendant's actions constitute an unlawful tying arrangement between the cable service and the cable boxes,

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**DEAL LOG:**

Pfizer Inc.  
&

Wyeth Pharmaceuticals

The Federal Trade Commission has approved a final consent order regarding Pfizer Inc.'s recent acquisition of Wyeth. The final order settles charges that the transaction as proposed would have been anticompetitive in a number of markets for animal vaccines and pharmaceutical products, and is designed to resolve those competitive issues by requiring divestiture of assets in those areas.

[FTC Docket](#)

Danaher Corp.  
&

MDS Analytical Technologies Inc.

The FTC will require the divestiture of MDS Inc.'s assets related to its laser microdissection business as a condition of allowing Danaher Corporation and MDS Analytical Technologies (US) Inc. to proceed with their proposed merger. The proposed settlement is designed to preserve competition in the North American market for laser microdissection devices – a key tool for scientific research.

[FTC Docket](#)

resulting in an impermissible restraint of trade, in violation of both state and federal law.

### **Auto Component Suppliers: Antitrust Raids** February 25th, 2010

On February 25th the FBI raided the U.S. offices of numerous auto suppliers of components as part of a global antitrust investigation. The FBI raided the offices of Denso Corp. (Southfield), Yazaki North America (Canton) and Tokai Rika. All raids took place Tuesday evening during the snowstorm. U.S. Department of Justice Antitrust Division spokeswoman Gina Talamona was quoted as saying the investigation relates to the possibility of anti-competitive cartel conduct between these suppliers. The Wall Street Journal reported that similar raids took place in Europe and Japan. Leoni and SY Systems Technologies GmbH confirmed that their offices were investigated. The Daily Yomiuri and Kyodo News reported that Yazaki Corp., Furukawa Electronic Co. and Sumitomo Electronic Industries Ltd., all manufacturers of automotive wire harnesses were all raided by Japan's Fair Trade Commission over the possibility of collusion and customer allocation agreements.

### ***Valassis Communications Inc. v. News America Inc.*, 2:2006-CV-10240 (E.D. Mich.)** February 1st, 2010

News Corp. agreed to settle Valassis' antitrust actions relating to the marketing of newspaper coupon inserts and in-store product advertising notices for \$500 million. The settlement includes a jury award of \$300 million that Valassis earned in Wayne County Circuit Court. Valassis was represented by Miller Canfield, Paddock & Stone PLC, the Law Offices of David Mendelson PC, Plunkett Cooney PC, and the Baskin Law Firms. News America is represented by Hogan & Hartson LLP, Constantine Cannon LLP and Honigman Miller Schwartz & Cohn LLP.

### **Packed Ice Antitrust Litigation, MDL No. 1952 (E.D. Mich.)**

Plaintiffs and Home City Ice continue to seek preliminary approval of the settlement between them in the Eastern District of Michigan. Co-defendants Arctic Glacier and Reddy Ice Holdings, Inc. continue to object to the settlement. Additionally, the briefing on Co-defendants Arctic Glacier and Reddy ice's motion to dismiss appears to be fully briefed and prepared for oral arguments.

### **Refrigerant Compressors Antitrust Litigation, MDL No. 2042 (E.D. Mich.)**

On November 2, 2009, the Eastern District of Michigan appointed local attorney David H. Fink and The Miller Law Firm, P.C. as Interim Lead Counsel for the Direct Purchaser Plaintiffs. The Court further ordered that David H. Fink and The Miller Law Firm, P.C. and S. Thomas Weinner of Weinner & Gould, P.C. are hereby appointed to the Interim Executive Committee for Direct Purchaser Plaintiffs. With respect to the Indirect Purchaser Plaintiffs, the Court ordered that David E. Plunkett and Williams, Williams, Rattner & Plunkett, P.C. as Interim Lead Counsel for the Indirect Purchaser Plaintiffs.

**NATIONAL NEWS**

### **Commission Announces Revised Filing Thresholds for Clayton Act Antitrust Reviews** January 19th, 2010

The Federal Trade Commission approved a Federal Register notice announcing the revised

Dow Chemical Co.  
&  
Rohm & Haas

The Federal Trade Commission has approved the petition of The Dow Chemical Company seeking approval to divest its acrylic acid monomers and latex polymers businesses to Arkema Inc., a wholly owned subsidiary of Arkema Group. Dow was required to divest these businesses to a Commission-approved acquirer under the terms of a Decision and Order issued in March 2009. The Decision resolved competitive concerns raised by Dow's merger with Rohm & Haas.

[FTC Docket](#)

Panasonic Corp  
&  
of Sanyo Electric Co., Ltd.

The Federal Trade Commission has approved a final consent order on Panasonic Corporation's acquisition of Sanyo Electric Co., Ltd. The final order settles charges that Panasonic's purchase of Sanyo would have undermined competition in the worldwide market for nickel metal hydride (NiMH) batteries, which power two-way radios and other products, and are used by police and fire departments nationwide. The portable NiMH battery assets will be sold to FDK Corporation, a subsidiary of Fujitsu Ltd.

[FTC Docket](#)

Ticketmaster Entertainment Inc.  
&  
Live Nation, Inc.

The DOJ is seeking to enjoin the proposed merger of Ticketmaster Entertainment, Inc. and Live Nation, Inc., because if not enjoined, says the DOJ, the merger will eliminate competition and increase barriers to entry between the companies in the

thresholds for the Hart-Scott-Rodino (HSR) Antitrust Improvements Act, which requires premerger notification for certain large transactions. The FTC is required to revise the filing thresholds annually, based on the change in gross national product. Certain related thresholds and limitations in the HSR rules also are adjusted by this notice. This year, the threshold for reporting proposed mergers and acquisitions decreased from \$65.2 million to \$63.4 million. The additional revised thresholds, can be found as a link on the [FTC's Web site](#).

## ENFORCEMENT ACTIONS

### *Authors Guild v. Google*

February 4th, 2010

The DOJ, concerned about eliminating the joint-pricing mechanisms among publishers and authors and about providing a mechanism by which Google's competitors can gain comparable access, said that despite the substantial progress reflected in the proposed amended settlement, antitrust issues remain. In part the DOJ stated, "[T]he amended settlement agreement suffers from the same core problem as the original agreement: it is an attempt to use the class action mechanism to implement forward-looking business arrangements that go far beyond the dispute before the court in this litigation."

[DOJ Docket](#)

### *In re Roaring Fork Valley Physicians I.P.A., Inc.*

February 3rd, 2010

The Colorado physicians' group, Roaring Fork Valley Physicians I.P.A., Inc. has come to an agreement with the FTC. According to the FTC, approximately 85 competing independent physicians and physician practice groups acting through Roaring Fork engaged in concerted refusals to deal and to fix prices with payers offering coverage for health care services in the Garfield County, Colorado area. The FTC alleged that Roaring Fork orchestrated and carried out these illegal agreements, and Roaring Fork's physician members participated in these illegal agreements, which have increased prices for consumers of physician services in the Garfield County area and have no legitimate justification. Roaring Fork agreed to halt its use of allegedly anticompetitive negotiating tactics against health insurers.

[FTC Docket](#)

### *DOJ Reaches Settlement with Daily Gazette Company and MediaNews Group Inc.*

January 20th, 2010

The DOJ has reached a proposed settlement with the Daily Gazette Company and MediaNews Group Inc. (now known as Affiliated Media Inc.), that requires the companies to restructure their newspaper joint operating arrangement and take other steps to remedy the anticompetitive effects of the transaction. The DOJ had filed suit alleging that the transaction violated the Clayton and Sherman Acts by consolidating ownership and control of the only two local daily newspapers in Charleston, W.Va., under the Daily Gazette Company and eliminating competition between them.

[DOJ Press Release](#)

### *In re Service Corp. Int'l*

January 8th, 2010

provision of primary ticketing services to major concert venues in the United States.

[DOJ Docket](#)

**Dean Foods  
&  
Foremost Farms**

The DOJ has filed a complaint challenging Dean's acquisition of the Consumer Products Division of Foremost Farms USA, a merger between the first and fourth largest sellers of school milk and fluid milk in Wisconsin, the UP, and northeastern Illinois. The merger would eliminate competition between the two, according to the DOJ, and could substantially lessen competition Wisconsin and the UP.

[DOJ Docket](#)

**Have We Missed Something?**

Do you know of a recent case that you don't see in the newsletter? Please [email](#) the editor with recently resolved or newly pending cases that we have missed.

Federal Trade Commission has approved a final consent order on Service Corporation International's acquisition of Palm Mortuary of Nevada. The final order settles charges that SCI's purchase of Palm Mortuary would have substantially reduced competition in the highly concentrated market for cemetery services in the Las Vegas metropolitan area, by combining the first and third largest providers of cemetery services and associated merchandise and property in Las Vegas, Nevada, thus violating Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Service Corporation International must sell a cemetery and funeral home in Las Vegas to complete its proposed acquisition of local rival Palm Mortuary, Inc., alleviating the anti-competitive concerns.

[FTC Docket](#)

***In re Intel Corp.***

**December 16th, 2009**

The FTC is alleging that Intel Corporation has violated of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. They allege that Intel holds monopoly power in the markets for personal computer and server CPUs, has maintained a 75 to 85 percent unit share of these markets since 1999, and that they were and are now engaged in conduct designed to maintain Intel's monopoly in the markets for Central Processing Units ("CPUs") and graphics processing units ("GPUs").

[FTC Docket](#)

## LEEGIN'S IMPACT ON FRANCHISOR-FRANCHISEE RELATIONS

By Howard Yale Lederman<sup>†</sup>

The GTE Sylvania Decision And The Khan Decision

In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,<sup>1</sup> the U.S. Supreme Court overruled about 100 years of decisions and held that the rule of reason would govern whether vertical price restraints or vertical resale price maintenance ("RPM"), popularly known as vertical price fixing, violated the federal antitrust laws. Over two years after *Leegin*, its impact on franchise agreements and relations remains unclear. But *Leegin* has the potential for a considerable long-term impact on franchisor-franchisee relations.

RPM is one form of vertical restraint. A vertical restraint arises, where a manufacturer restrains a distributor of its products, or a higher level distributor, like a wholesaler, restrains a lower level distributor, like a retailer. Vertical restraints include:

1. Resale price maintenance
2. Exclusive sales territories
3. Outlet restrictions (restricting distributors from selling to non-approved dealers or distributors or to another specific dealer or distributor altogether)
4. Location restrictions (restricting distributors from selling the manufacturer's product from any location other than their distributorship agreement-defined location)
5. Exclusive distributorship agreements<sup>2</sup>

An RPM or "vertical price-fixing agreement" involves a manufacturer's efforts to determine at what price its distributors can sell its products or a higher level distributor's efforts to determine at what price its lower level distributors can do so. Under RPM, the manufacturer or higher level distributor often enforces its set prices "through a [manufacturer's or] supplier's refusal to deal with a particular distributor."<sup>3</sup>

Understanding *Leegin* requires understanding the 1977 U.S. Supreme Court decision extending the rule of reason to vertical nonprice restraints, *Continental T.V. v. GTE Sylvania, Inc.*<sup>4</sup> Indeed, *GTE Sylvania* arose from a franchisee-franchisor dispute. There, GTE Sylvania, a television set manufacturer and franchisor, aimed to increase its market share, by attracting more aggressive and capable retailers. It began selling nonexclusive franchises, but restricted its franchisees severely, compelling them to sell GTE Sylvania television sets only within their approved territories and only from their approved franchise locations within their territories. The Court held that these vertical nonprice restraints were not per se illegal, and that the rule of reason governed the factfinder's evaluation of these vertical nonprice restraints.

The *GTE Sylvania* Court defined how interbrand competition differs from intrabrand competition: "Interbrand competition is the competition among the manufacturers of the same generic product-television sets

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<sup>†</sup> Secretary, State Bar of Michigan, Antitrust, Franchising & Trade Regulation Section and Attorney, Norman Ya-tooama & Associates, PC, Birmingham, Michigan. Mr. Lederman recognizes the contributions of Justin J. Hakala, Publications Editor, Antitrust, Franchising & Trade Regulation Section, and Attorney, Morgan & Meyers, PLC, to this article.

<sup>1</sup> 551 U.S. 877, 127 S. Ct. 2705, 168 L. Ed. 2d 623 (2007).

<sup>2</sup> Richard Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6 (Winter 1981)

<sup>3</sup> *Kunert v. Mission Financial Services Corp.*, 110 Cal. App. 4<sup>th</sup> 242, 263, 1 Cal. Rptr. 3d 589 (2003), *review den.* 2003 Cal. Lexis 8286 (2003). *Accord*, Theodore L. Banks (Assistant General Counsel, Kraft General Foods, Inc.), 1 *Distribution Law* (Little Brown & Co. 1993), sec. 2.1, p. 194.

<sup>4</sup> *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 97 S. Ct. 2549, 53 L. Ed. 2d 568 (1977).

in this case . . . . In contrast, intrabrand competition is the competition between the distributors—wholesale or retail—of the product of a particular manufacturer.”<sup>5</sup> Interbrand competition can also occur among non-manufacturing suppliers, like wholesalers and franchisors, selling products or services retailers, including franchisees. Vertical RPM usually restricts “the territories within which distributors may sell or the types of customers to whom they may sell.”<sup>6</sup>

While vertical RPM could have anticompetitive effects, it could also have procompetitive effects. By reducing intrabrand competition, these restraints could promote interbrand competition. The Court cited *GTE Sylvania*’s aim of attracting more aggressive and capable franchisees as exemplifying how vertical nonprice restraints could increase interbrand competition and this have a strong procompetitive impact. The Court also found that vertical RPM could encourage dealers to offer better service and repair facilities and mentioned motor vehicles and household appliances as exemplifying industries, where encouraging retailers to do so would be procompetitive and otherwise beneficial. Vertical RPM would insulate dealers from competition from free riding discounters selling the same products, but not offering the same service or repair facilities.

The Court also reasoned that a per se regime governing vertical nonprice restraints could hurt or even eliminate small franchisees: “We also note the per se rules in this area may work to the ultimate disadvantage of the small businessmen[,] who operate as franchisees. To the extent that a per se rule prevents a firm from using the franchise system to achieve efficiencies that it perceives as important to its successful operation, the rule creates an incentive for vertical integration into the distribution system, thereby eliminating to that extent the role of the independent businessmen.”<sup>7</sup> Thus, the Court saw a per se regime as encouraging franchisors to abandon franchising in favor of company stores, where franchisors could mandate nonprice efficiencies, including territorial and location provisions. Accordingly, the *GTE Sylvania* Court concluded that vertical nonprice restraints were no longer per se illegal, and that factfinders must evaluate them under the rule of reason.

*GTE Sylvania* foreshadowed the modern Court’s severe restriction of per se rules and increasing adoption of the rule of reason, first in vertical nonprice restraints and then in price restraints. Seven years after *GTE Sylvania*, the Court found that the economic effects of vertical retail price maintenance were the same as those of vertical nonprice restraints.<sup>8</sup> Several commentators advocated extension of *GTE Sylvania* to vertical price restraints.<sup>9</sup> One commentator explained: “Other types of vertical restraints indirectly control price, such as by limiting the customers to whom a dealer may sell. Since all vertical restraints tend to . . . impact on price, if the non-price vertical restraints are allowed, there is . . . no reason not to also evaluate direct RPM on a reasonableness basis.”<sup>10</sup> Another commentator noted that *GTE Sylvania*’s free-rider prevention rationale arose from an earlier commentators’ promotion of RPM.<sup>11</sup> The later commentator advocated RPM as essential “to effectuate the Supreme Court’s own policy toward nonprice restrictions.”<sup>12</sup>

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<sup>5</sup> *GTE Sylvania*, 433 U.S. 26, 52 n.19. Accord, Robert L. Steiner, *How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 Antitrust L. J. 407, 409 (1997).

<sup>6</sup> William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 984 (1985).

<sup>7</sup> *GTE Sylvania*, 433 U.S. 26, 57 n.26 (Robert C. Keck, *The Schwinn Case*, 23 Bus. Law 669 (1968); Earl E. Pollack, *Alternative Distribution Methods After Schwinn*, 63 Nw. L. Rev. 595, 608-610 (1968)).

<sup>8</sup> Banks, *supra*, sec. 2.3.1 (citing *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 761 (1984)).

<sup>9</sup> Banks, *supra*, sec. 2.1, p. 195, Posner, *supra*, pp. 9-11, Robert H. Bork, *The Antitrust Paradox* (The Free Press 1993), p. 288.

<sup>10</sup> Banks, *supra*, sec. 2.1, p.195. Accord, Posner, *supra*, pp. 9-11.

<sup>11</sup> Posner, *supra*, p. 11, citing L. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960).

<sup>12</sup> Posner, *supra*, p. 11.

Twenty years after *GTE Sylvania*, the Court concluded that vertical maximum price restraints were no longer per se illegal, and that factfinders must evaluate them under the rule of reason.<sup>13</sup> Again, while acknowledging these restraints' possible anticompetitive effects, the Court found enough significant procompetitive effects to substitute the rule of reason analysis for per se illegality. Therefore, the Court extended some of *GTE Sylvania's* reasoning from nonprice vertical restraints to maximum price vertical restraints.

### The *Leegin* Decision

Leegin "design[ed], manufactur[ed], and distribut[ed] leather goods and accessories," including a line of women's belts called Brighton belts.<sup>14</sup> In 1995, a retailer, PSKS, which operated Kay's Kloset, a women's clothes store, began buying these belts from Leegin. Two years later, Leegin adopted RPM under the guise of "suggested retail prices." In 1997, Leegin began enforcing mandatory RPM and "refused to sell to retailers that discounted Brighton goods below suggested prices."<sup>15</sup> Leegin rationalized its RPM policy as encouraging its retailers to provide a high level of customer service and protecting its brand's image and reputation.

In 2002, Leegin discovered that Kay's Kloset had been discounting "Brighton's entire line by 20 percent," thus violating Leegin's RPM policy.<sup>16</sup> Kay's Kloset rationalized its discounting, by stressing its need to compete with other "nearby retailers . . . undercutting Leegin's suggested retail prices."<sup>17</sup> Unmoved, Leegin demanded that Kay's Kloset cease discounting. When Kay's Kloset refused, Leegin stopped Brighton belt shipments. Leegin's move reduced Kay's Kloset's sales and profits severely.

PSKS sued Leegin for vertical price fixing. When "Leegin planned to introduce expert testimony describing the procompetitive effects of its pricing policy," *Id.*, the district court barred the testimony based on the per se rule of *Dr. Miles Medical Co. v. John D. Park & Sons Co.*<sup>18</sup> The per se rule barred manufacturers from agreements with distributors setting minimum prices that distributors could charge for the manufacturer's goods. The district court entered judgment on a jury verdict for PSKS. Affirming based on the *Dr. Miles* per se rule, the Fifth Circuit held that in barring the expert testimony, the district court had not abused its discretion.

Reversing, the U.S. Supreme Court overruled *Dr. Miles* and held that the rule of reason, not the per se rule, governs whether vertical RPM violated the Sherman Antitrust Act. Until *Leegin*, the Court had held four restraints on trade, horizontal and vertical price fixing, division of market agreements, group boycotts, and tying arrangements, subject to a conclusive presumption of anticompetitive impact and thus per se illegal.<sup>19</sup> The Court reiterated that "Section 1 of the Sherman Act prohibits '[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States.'"<sup>20</sup> The Court repeated its longstanding position that Section 1 "'outlaws[s] only unreasonable restraints.'"<sup>21</sup>

Long ago, the Court developed the rule of reason to evaluate whether a practice restrained commerce in violation of Section 1. The Court characterized the rule as "the accepted standard for testing whether a practice restrains trade in violation of [Sec.] 1."<sup>22</sup> Under this rule, the factfinder evaluates all relevant circum-

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<sup>13</sup> *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

<sup>14</sup> *Leegin Creative Leather Products*, 551 U.S. 877, 882.

<sup>15</sup> *Id.* at 883.

<sup>16</sup> *Id.* at 884.

<sup>17</sup> *Id.* at 884.

<sup>18</sup> 220 U.S. 373 (1911).

<sup>19</sup> *Northern Pacific Railway Co. v. U. S.*, 356 U.S. 1 (1958) (all four), *GTE Sylvania*, 433 U.S. 36, 52 n. 18 (vertical price fixing), *Monsanto*, 465 U.S. 752, 761 (vertical price fixing).

<sup>20</sup> *Leegin Creative Leather Products*, 551 U.S. 877, 885 (quoting 15 U.S.C. Sec. 1).

<sup>21</sup> *Id.* at 885, quoting *Khan*, 522 U.S. 3, 10.

<sup>22</sup> *Id.* at 885.

tances, including “specific information about the relevant business’ and ‘the restraint’s history, nature, and effect.”<sup>23</sup> “Whether the businesses involved have market power is a further, significant consideration.”<sup>24</sup> Restraints stimulating competition are reasonable and do not violate Section 1. Restraints damaging competition and thereby harming consumers are unreasonable and violate Section 1.

The Court adopted the reasoning of several earlier decisions, like *GTE Sylvania*, concluding that the rule of reason governed whether vertical RPM violated the federal antitrust laws. “The justifications for vertical price restraints are similar to those for other vertical restraints.”<sup>25</sup> Like those restraints, vertical RPM “can stimulate interbrand competition . . . by reducing intrabrand competition . . . .”<sup>26</sup> Promoting interbrand competition is essential, because the antitrust laws’ main purpose is to protect interbrand competition. “A single manufacturer’s use of vertical price restraints tends to eliminate intrabrand price competition; this in turn encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer’s position as against rival manufacturers.”<sup>27</sup> As a new reason, the Court cited vertical RPM’s “potential to give consumers more options so that they choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between.”<sup>28</sup>

Like the *GTE Sylvania* Court, the Court explained that without vertical RPM, retailers might not provide services increasing interbrand competition. These services include better showrooms, product demonstrations, and knowledgeable employees. Vertical RPM prevents retailers providing these services from losing out to discounters “free riding” on retailers providing these services and thus increasing demand for the products and services involved. Therefore, the retailers compete less on price and more on quality and service, thereby increasing interbrand competition.

Further, the Court recognized that in several cases since 1977, it had held that the rule of reason, not the per se rule, governed whether vertical RPM violated the antitrust laws.<sup>29</sup> For example, the Court had upheld a manufacturer’s right to “impose territorial restrictions on distributors and allow only one distributor to sell its goods in a given region.”<sup>30</sup> Finally, the Court found that the impacts of these vertical nonprice restraints were similar to the impacts of the vertical price restraints: “[B]oth reduce intrabrand competition and can stimulate retailer services.”<sup>31</sup> Like vertical nonprice restraints, vertical price restraints increased interbrand competition. Accordingly, the Court concluded that the factfinder must evaluate vertical price restraints, like vertical nonprice restraints, under the rule of reason.

The four dissenting justices asserted that RPM agreements could operate like horizontal price restraints and “may have serious anticompetitive consequences. *In respect to dealers*: Resale price maintenance agreements, rather like horizontal price agreements, can diminish or eliminate price competition among dealers of a single brand or (if practiced generally by manufacturers) among multibrand dealers. In doing so, they can prevent dealers from offering customers the lower prices that many customers prefer; they can prevent

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<sup>23</sup> *Id.* at 885 (quoting *Khan*, 522 U.S. 3, 10).

<sup>24</sup> *Id.* at 886 (citing *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984)).

<sup>25</sup> *Id.* at 890 (citing *GTE Sylvania*, 433 U.S. 36, 54-57).

<sup>26</sup> *Id.* at 890 (citing *GTE Sylvania*, 433 U.S. 36, 51-52).

<sup>27</sup> *Id.* at 890.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 901 (citing *GTE Sylvania*, 433 U.S. 36; *Sharp Electronics Corp.*, 485 U.S. 717; *Khan*, 522 U.S. 3; *Monsanto*, 465 U.S. 752).

<sup>30</sup> *Leegin Creative Leather Products*, 551 U.S. 877, 903 (citing *GTE Sylvania*, 433 U.S. 36).

<sup>31</sup> *Leegin Creative Leather Products*, 551 U.S. 877, 903-904 (citing *Sharp Electronics Corp.*, 485 U.S. 717, 728; *Monsanto*, 465 U.S. 752, 762-763; Brief for Economists as *Amici Curiae*, pp. 17-18; Steiner, *supra*, pp. 446-447 (1997) (further citation omitted)).

dealers from responding to changes in demand, say, falling demand, by cutting prices . . . .”<sup>32</sup> Moreover, the dissenters rejected the majority’s conclusion that vertical nonprice restraints and vertical price restraints deserved the same rule of reason evaluation: The dissenters called price “the economy’s ‘central nervous system.’”<sup>33</sup>

### THE FRANCHISING LANDSCAPE

Franchising involves a franchisor and a franchisee. In the Michigan Franchise Investment Law (“MFIL”), the Michigan Legislature defined three contractual requirements for a distributor to be a franchisee and thus for the law to apply:

- (a) A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor.
- (b) A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services substantially associated with the franchisor’s trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate.
- (c) The franchisee is required to pay, directly or indirectly, a franchise fee.<sup>34</sup>

These requirements are the starting point for painting the franchise landscape as it relates to *Leegin*. In exchange for the franchisee’s payment of a franchise fee and royalties, the franchisor permits him to sell the franchisor’s goods and services under the franchisor’s brands and trademarks and in accordance with the franchisor’s standards.<sup>35</sup> “In theory, the franchise systems is the ideal partnership between big business and the small independent business [person]: ‘[T]he franchisor obtains new sources of expansion capital, new distribution markets, and self-motivated vendors of its products, while the franchisee acquires the products, expertise, stability, and marketing savvy usually reserved for larger enterprises.’”<sup>36</sup> The present severe recession changes this model: To attract franchisees, many franchisors must help prospective franchisees obtain credit. This help ranges from obtaining favorable bank credit reports on the franchise system as a whole to lending money directly to prospective franchisees.<sup>37</sup>

But franchising features uniformity, standardization, and stringent franchisor contractual control.<sup>38</sup> Most franchise agreements involve small, unit franchisees. “[T]here is a huge disparity of power between the

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<sup>32</sup> *Leegin Creative Leather Products*, 551 U.S. 877, 910 (Breyer, Stevens, Souter & Ginsberg, JJ., dissenting) (citing P. Areeda & H. Hovenkamp, 8 *Antitrust Law* (2d ed. Aspen Law and Business 2004), sec. 1632c, pp. 319-321, Robert L. Steiner, *The Evolution and Applications of Dual-Stage Thinking*, 49 *The Antitrust Bulletin* 877, 899-900 (Winter 2004); Comanor, *supra*, pp. 990-1000.

<sup>33</sup> *Leegin Creative Leather Products*, 551 U.S. 877, 926 (Breyer, Stevens, Souter & Ginsberg, JJ., dissenting) (quoting *National Society of Professional Engineers v. U. S.*, 435 U.S. 679, 692 (1978), quoting *U. S. v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 226 n.59 (1940)).

<sup>34</sup> Mich. Comp. Laws 445.1502(3).

<sup>35</sup> Melissa Ann Gauthier, *Note, The SJC & Dunkin Donuts: Squeezing The Filling Out Of The Small Franchisee*, 41 *New England L. Rev.* 757, 761 (Summer 2007); David J. Kaufmann, *An Introduction to Franchising in Understanding Franchising: Business & Legal Issues* (David J. Kaufmann ed. 2001), pp. 9, 14.

<sup>36</sup> Gauthier, *supra*, p. 761. *Accord*, Kaufmann, *supra*, pp. 9, 14.

<sup>37</sup> Carol Tice, *Where to Go When You Can’t Find the Dough*, *Entrepreneur* (January 2010), available at [www.entrepreneur.com/magazine/entrepreneur/2010/january/204368.html](http://www.entrepreneur.com/magazine/entrepreneur/2010/january/204368.html).

<sup>38</sup> Gauthier, *supra*, p. 761. *Accord*, April V. Pennington, *An American Icon*, *Entrepreneur* (Jan. 2005), p. 80-82, Dhawal Shah (Certified Franchise Executive from International Franchise Association), *Why should entrepreneurs choose*

unit franchisee and the franchisor, such that the unit franchisee has no bargaining leverage. In addition, the franchise agreement is most often an adhesion contract, which prevents the unit franchisee from even attempting to negotiate for more favorable terms.”<sup>39</sup> In the franchise agreement, the franchisor often dictates “certain business practices, operating procedures, employee relations, warranties, hours of operation, capital improvements, and so on that impact one’s business . . . . For better or worse, the trademark limits a franchisee’s independence, and also binds all franchisees together.”<sup>40</sup> “[F]ranchisors have a nearly ironclad contract that can be used to control franchisees.”<sup>41</sup>

One court has characterized the franchisor-franchisee relationship as a “symbiotic one. The success of the franchisor and franchisee are interrelated.”<sup>42</sup> Based on recognition of this interrelatedness and mutual dependence on each other for success, some franchisors have adopted a more cooperative approach offering their franchisees more autonomy. They see this approach as giving them a competitive advantage, by permitting franchisees to serve the differing needs of customers in different areas, regions, and localities. More autonomous franchisees can respond to changing customer needs and feedback more efficiently and effectively, thus generating more sales and profits for franchisor and franchisee alike.<sup>43</sup>

Additionally, the franchise landscape features wide franchisee experience, motivation, and personality differences impacting on which business models are best for franchisees. Some serious franchising problems arise from recessions attracting involuntary entrepreneurs and nonentrepreneurs into franchising, because regular employment is hard to find.<sup>44</sup> A headline illustrates the problem.<sup>45</sup> Furthermore, “[m]any prospective franchisees know nothing about the business and often have no prior business experience . . . .”<sup>46</sup>

Lastly, the franchise landscape operates not in monopolistic or semi-monopolistic industries, but in competitive ones. Fast food, other restaurants, hotels and motels, retail services, real estate sales, and other franchise-covered industries are competitive. Franchisors generally do not have overwhelming market power in their product or geographic markets.

#### LEEGIN’S PROBABLE IMPACT ON FRANCHISOR-FRANCHISEE RELATIONS-PART I

For several legal and practical reasons, *Leegin’s* franchising impact will be relatively little. First, *GTE Sylvania* has legalized vertical nonprice restraints increasing franchisor power and decreasing franchisee independence in areas impacting on price. As long as the franchisor can show the proposed vertical RPM’s pro-

*Franchising, Your Story Team* (June 22, 2009), available at <http://www.yourstory.in/expert-talk/1094-business/2228-why-should-entrepreneurs-choose>.

<sup>39</sup> Gauthier, *supra*, p. 795 (footnotes omitted); accord, Harold Brown, et al, *Franchising: Realities & Remedies* (rev. ed. Law Journal Press 2000), sec. 3.02[1][a][v], Harold Brown, *Franchising: Realities & Remedies* (2d ed. Law Journal Press 1978), pp. 4-5, 8, 11, 34-35., Shah, *supra*.

<sup>40</sup> An Interview with Peter M. Birkeland (2002) available at <http://www.press.uchicago.edu/Misc/Chicago/051900in.html>, pp. 2-3; accord, Shah, *supra*.

<sup>41</sup> *Id.* at p.3.

<sup>42</sup> *Schotziky’s, Ltd. v. Sterling Purchasing National Distributing Co.*, 520 F.3d 393, 407 (5th Cir. 2008).

<sup>43</sup> Betsy Ludlow, *Building Autonomy into a growing franchise system*, *Franchising World* (October 1, 2005), available at <http://www.allbusiness.com>, pp. 1-3.

<sup>44</sup> An Interview with Peter M. Birkeland (2002) available at <http://www.press.uchicago.edu/Misc/Chicago/051900in.html>, p. 1.

<sup>45</sup> Staff Writer, *Can’t find a job? Work for yourself!*, *The Career News* (February 8, 2010), p. 1.

<sup>46</sup> Gauthier, *supra*, p. 79 (footnotes omitted); accord, Staff of House Committee on Small Business, 101st Cong., *Report on Franchising in the U.S. Economy: Prospects & Problems* [hereinafter “Prospects & Problems”] (Committee Print 1990), pp. 49-50, David Hess, *Covenant, The Iowa Franchising Act: Towards Protecting Reasonable Expectations of Franchisees and Franchisors*, 80 Iowa L. Rev. 333, 340 (Jan. 1995).

competitive impact, the courts will probably uphold the proposed vertical RPM. Since franchisors have other means available to accomplish the same end as vertical RPM, they will seldom need to use them. Franchisors can use exclusive territories and other vertical nonprice restraints to accomplish the same end.

Second, the *Colgate* Doctrine remains alive and well: The franchisor can suggest or set a price and then stop dealing with a franchisee refusing to adhere to that price.<sup>47</sup> Franchisors can also use combinations of pressures, incentives, and suggested retail prices. This combination is legal: The antitrust laws do not bar franchisors' suggested retail prices, franchisor price communications with franchisees, franchisor persuasion of franchisees, or even franchisor pressure on franchisees.<sup>48</sup> As a result, the franchisor can use its much greater economic and market clout to promote and even enforce adherence to suggested retail prices. Accordingly, in most cases, resort to formal vertical price restraints will be unnecessary.

But franchisor use of the *Colgate* Doctrine along with unilateral pressures and threats to enforce vertical RPM can backfire and devastate franchisees, just like the *Leegin* dissenters predicted. Media Arts Group's ("MAG") experience illustrates such devastation. In the mid-1990s, MAG established a network of dealers called Signature Dealers to sell Thomas Kinkadee's artwork. These dealers met the first two MFIL franchise requirements, but not the third. Relying on the *Colgate* Doctrine, MAG established and enforced its Retail Sales Policy imposing vertical RPM on all Signature Dealers. As Marshal Stockburn simplified dancing in *Pale Rider*, MAG simplified its Retail Sales Policy: "The retail sales policy is simple: You must sell limited edition product at or above suggested retail price. Should you be found to be offering products at lower discounted price than suggested retail price, your dealership will be terminated."<sup>49</sup>

MAG representatives described the policy's purpose as preserving the integrity of the Thomas Kinkadee product....it would devalue the artwork if you put it on sale."<sup>50</sup> MAG explained further: It "believes that selling product below [suggested] retail price harms the integrity of the work[,] and collectors typically do not expect discounted works to increase in value."<sup>51</sup> MAG added that underselling harms Kinkadee's reputation and thus the artwork's.<sup>52</sup> Lastly, MAG emphasized that underselling and discounting gives the impression "that the art is tottering," a negative impression for collectors and dealers.<sup>53</sup> The Signature Dealers understood and accepted these purposes.<sup>54</sup> Just as *Leegin* Leather Products justified its RPM policy as preventing discounting from harming Brighton products' brand image and reputation, so MAG justified its Retail Sales Policy as preventing discounting from harming the Kinkadee artwork's reputation. Under *GTE Sylvania's* and *Leegin's* rationales, both policies could promote interbrand competition.

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<sup>47</sup> See *Monsanto*, 465 U.S. 752, 761, *U.S. v. Colgate*, 250 U.S. 300, 307, 39 S. Ct. 465, 63 L. Ed. 992 (1919), *Bender v. Southland Corp.*, 749 F.2d 1205, 1212 (6th Cir. 1984).

<sup>48</sup> See *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d 698, 707-708 (7th Cir. 1984) (Posner, J.), *Dunn v. Phoenix Newspapers, Inc.*, 735 F.2d 1184, 1187 (9th Cir. 1984), *Carlson Machine Tools, Inc. v. American Tool, Inc.*, 678 F.2d 1253, 1261 (5th Cir. 1982), *Martindell v. News Group Publications, Inc.*, 621 F. Supp. 672, 679 (E.D. N.Y. 1985).

<sup>49</sup> *Karen Hazlewood, et al v. Media Arts Group, Inc.*, American Arbitration Association [hereinafter "AAA"] Arbitration Proceeding No. 74-114-01360-03-SAT, 4/18/05 Arbitration Hearing Transcript [hereinafter "AHT"], p. 452 (quoting Hearing Exhibit 2, 1/30/98 MAG Retail Sales Policy (Mr. Spinello and Ms. Hazlewood owned two MAG Signature Dealerships)).

<sup>50</sup> *Hazlewood, supra*, 12/16/04 AHT, p. 2901; *accord, Hazlewood, supra*, 12/16/04, p. 448 (Jeff Spinello Testimony).

<sup>51</sup> *Hazlewood*, 12/16/04 AHT, p. 471 (quoting Hearing Exhibit 9, MAG Question and Answer Sheet on the Retail Sales Policy).

<sup>52</sup> *Id.* (quoting Hearing Exhibit 9, MAG Question and Answer Sheet on the Retail Sales Policy).

<sup>53</sup> *Id.* at 472 (quoting Hearing Exhibit 9, MAG Question and Answer Sheet on the Retail Sales Policy).

<sup>54</sup> *E.g., Hazlewood, supra*, 12/16/04 AHT, p. 460, Jeff Spinello Testimony; *Hazlewood, supra*, 4/18/05 AHT, Karen Hazlewood Testimony.

How MAG carried out and enforced its Retail Sales Policy illustrated the *Colgate* Doctrine's stringent limits—real and perceived. MAG's counsel, Robert Murray declared the policy to be “unilateral, meaning that it is not a contract. It is just a policy that we have adopted as our own internal policy,” because MAG agreements with its “distributors” to set prices were illegal.<sup>55</sup> The Dealer Agreements did not include the policy.<sup>56</sup> MAG gave its Signature Dealers copies of the policy and told them to read and understand it, “but don't discuss it with us.”<sup>57</sup> When Mr. Spinello asked MAG representatives about the policy, they responded: “It is not open to discussion.”<sup>58</sup> The reason: any MAG-dealer discussion of the policy would expose MAG and the dealers to undefined “potential legal claims.”<sup>59</sup> MAG even refused to communicate with Signature Dealers reporting other Signature Dealers' or other MAG dealers' real or suspected policy violations.<sup>60</sup>

MAG repeatedly warned Signature Dealers that if they violated the policy, MAG would terminate their dealer agreements for default.<sup>61</sup> To enforce the policy, MAG relied on its regional and district manager network and secret shopper services.<sup>62</sup> On discovering a discounting or underselling Signature Dealer, MAG terminated it without warning immediately.<sup>63</sup>

Why did MAG act as it did? Fear of landing in contracts, combinations, of conspiracies with its Signature Dealers to enforce then-per se illegal vertical RPM leading to successful or even unsuccessful antitrust suits, each result costing MAG millions of dollars. Before *GTE Sylvania*, the U.S Supreme Court had restricted the *Colgate* Doctrine so severely and had expanded the concept of contracts, combinations, and conspiracies so broadly that in MAG's eyes, even the slightest hint of joint action with dealers to set or maintain vertical prices, MAG-dealer discussion of the policy, dealer expression of assent to the policy or prices, or even expression of dealer acquiescence to the prices risked becoming a combination.<sup>64</sup> Unlawful combinations could arise from higher level distributors or manufacturers obtaining adherence to their prices by any means other than simple refusal to deal.<sup>65</sup> These means went beyond express or implied agreements into the actual course of

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<sup>55</sup> *Hazlewood, supra*, 6/20/05 AHT, p. 4214, Robert Murray Testimony.

<sup>56</sup> *Hazlewood, supra*, 6/20/05 AHT, pp. 4285-4286, Robert Murray Testimony; *Hazlewood, supra*, MAG Exhibit 445, 3/26/99 Dealer Agreement.

<sup>57</sup> *Hazlewood, supra*, 6/20/05 AHT, pp. 4216-4217, Robert Murray Testimony. *Accord, Hazlewood, supra*, 12/16/04 AHT, p. 451, quoting 11/98 Thomas Kinkade University Manual

<sup>58</sup> *Hazlewood, supra*, 12/16/04 AHT, p. 454, Jeff Spinello Testimony; *accord, Hazlewood, supra*, 12/16/04 AHT, pp.454-455.

<sup>59</sup> *Hazlewood, supra*, 12/16/04 AHT, p. 458 (quoting 11/98 Thomas Kinkade University Manual).

<sup>60</sup> *Hazlewood, supra*, 6/20/05 AHT, pp. 4217, 4284, Robert Murray Testimony.

<sup>61</sup> *Hazlewood, supra*, 12/16/04 AHT, p. 743, Jeff Spinello Testimony (MAG district and regional managers Tarik Williams, Chris Hunt, Steve Campbell, and Karen Foss warned Mr. Spinello and Ms. Hazlewood at different times)

<sup>62</sup> *Hazlewood, supra*, 6/20/05 AHT, pp. 4217-4218, Robert Murray Testimony.

<sup>63</sup> *Hazlewood, supra*, 6/20/05 AHT, pp. 4284, 4293, 4294, Robert Murray Testimony. *See also, Hazlewood, supra*, 12/16/04 AHT, pp. 742-743, Jeff Spinello Testimony (MAG terminated a discounting dealer near one of his dealerships).

<sup>64</sup> *E.g., Albrecht v. The Herald Co.*, 390 U.S. 145(1968); *id.* at 163 (Harlan, J., dissenting), *overruled on other grounds Khan*, 522 U.S. 3; *U.S. Parke, Davis & Co.*, 362 U.S. 29 (1960), *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441, 453-455, (1922), *Frey & Son, Inc. v. Cudahy Packing Co.*, 256 U.S. 208, 210 (1921), *U.S. v. Schrader & Son, Inc.*, 252 U.S. 85, 99 (1920), *Bork, supra*, pp. 280-281, *Posner, supra*, p. 12.

<sup>65</sup> *E.g., Yentsch v. Texaco, Inc.*, 630 F.2d 46, 52 (2d Cir. 1980), *Parke, Davis & Co.*, 362 U.S. 29, 39-41, *Beech-Nut Packing Co.*, 257 U.S. 441, 453-455.

dealing.<sup>66</sup> Moreover, the Court had warned that any manufacturer or distributor “may not use coercion on its retail outlets to achieve resale price maintenance.”<sup>67</sup>

Even in good times, the Signature Dealers understood the Retail Sales Policy as preventing them from moving slow selling inventory.<sup>68</sup> When the 2001 recession hit, most Signature Dealers wanted to reduce prices across the board or discount certain items and communicated their positions to MAG: “We begged. We pleaded. When times got tough, we really needed to do something. And there was the retail pricing policy.”<sup>69</sup> However, MAG continued to enforce the policy.<sup>70</sup> The dealers could not lower prices or discount to meet falling demand.<sup>71</sup> As a result, dealer sales, revenues, and profits tumbled and multitudes of Signature Dealers collapsed.<sup>72</sup> While not the only reason for their demise, MAG’s use of the *Colgate* Doctrine with pressures and threats to begin and enforce vertical RPM was a powerful contributor.

#### LEEGIN’S PROBABLE IMPACT ON FRANCHISOR-FRANCHISEE RELATIONS-PART II

Even before *Leegin*, the U.S. Supreme Court had signaled a possible modification of the *Parke Davis* regime: Manufacturer and higher level distributor combined action with lower level distributors is illegal only if the agreed-on restriction restricts competition unreasonably.<sup>73</sup> This position implies that the manufacturer or higher level distributor must have enough market power to do so. Most franchisors do not. “[I]f a firm lacks market power, it cannot affect the price of its products; that price is by defined by the market.”<sup>74</sup>

*Leegin* carries this process several steps further: If the communication’s or combination’s objective, RPM, is no longer per se illegal, the communication or combination used to accomplish, implement, and enforce it is likelier to be legal. Finally, more enlightened franchisors recognize that “a franchise relation is a symbiotic one. The success of the franchisor and franchisee are interrelated.”<sup>75</sup> Mutual franchisor-franchisee recognition of the need for mutual cooperation to succeed leads to more, not less communication and combination in pricing, as in other areas, to assure mutual success. “A manufacturer and its distributors have legitimate reasons for exchanging information about the prices and the reception of their prices in the market.”<sup>76</sup> For franchisor and franchisee success, effective pricing is crucial and effective pricing cooperation often indispensable. Thus, to promote a more cooperative franchise system, more franchisor-franchisee communication and combination are essential. Therefore, as opposed to *Parke Davis*, *Leegin* and *Monsanto* permit a more cooperative franchise pricing system to emerge.

<sup>66</sup> *E.g.*, *Yentsch.*, 630 F.2d 46, 52, *Parke, Davis & Co.*, 362 U.S. 29, 39-41, *Beech-Nut Packing Co.*, 257 U.S. 441, 453-455.

<sup>67</sup> *Yentsch v. Texaco, Inc.*, 630 F.2d 46, 52 (2d Cir. 1980) (quoting *Simpson v. Union Oil Co.*, 377 U.S. 13, 17(1964)).

<sup>68</sup> *Hazlewood, supra*, 12/16/04 AHT, pp. 448, 452 (Jeff Spinello Testimony), 4/18/05 AHT, Karen Hazlewood Testimony, p. 2903.

<sup>69</sup> *Hazlewood, supra*, 12/16/04 AHT, p. 449.

<sup>70</sup> *Hazlewood, supra*, 12/16/04 AHT, p. 449.

<sup>71</sup> *Hazlewood, supra*, 12/16/04 AHT, p. 449.

<sup>72</sup> *Hazlewood, supra*, 6/21/05 AHT, p. 4738 (Herbert Montgomery Testimony) (number of Signature Dealers fell 40%); 6/22/05 AHT, p. 4749 (Herbert Montgomery Testimony-Signature) (Dealers accounted for at least 50% of MAG’s business during the relevant time period); 6/22/05 AHT, p. 4830 (Herbert Montgomery Testimony-9/11’s impact); 7/13/05 AHT, p. 5906 (Richard Barnett Testimony-recession’s impact); 7/19/05 AHT, pp. 6886-6902 (Richard Barnett Testimony) (many particular Signature Dealers had gone out of business or closed dealerships and their names); 7/20/05 AHT, pp. 7219-7223 (Richard Barnett Testimony) (many particular Signature Dealers had gone out of business or closed dealerships and their names).

<sup>73</sup> *Monsanto*, 465 U.S. 752, 761.

<sup>74</sup> Posner, *supra*, p. 16.

<sup>75</sup> Schotziky’s, Ltd., 520 F.3d 393, 407.

<sup>76</sup> *Monsanto*, 465 U.S. 752, 762.

Of course, the changes also permit franchisors able to show pro-competitive impacts to combine with franchisees to implement and enforce RPM, by using all the means that MAG feared to use. Again, if RPM is no longer per se illegal, the communication or combination used to accomplish, implement, and enforce it is likelier to be legal. Therefore, franchisors are likelier to combine and implicitly agree with some franchisees to enforce RPM on non-adhering franchisees for purposes like protecting brand image and reputation, preventing free-riding, enabling the franchisor to compete more effectively against other franchisors in the relevant market, and the other *Leegin* reasons. If non-adhering franchisees do sue for vertical price fixing, under the rule of reason, they will probably have to prove the following elements:

1. A contract, combination, or conspiracy between the franchisor and the adhering franchisees;
2. A contract, combination, or conspiracy producing anti-competitive impacts within the relevant geographic and product markets;
3. The contract's, combination's and conspiracy's illegal objectives and conduct;
4. Proximate cause and damages.<sup>77</sup>
5. Sufficient franchisor product market and geographic market power to control prices, as opposed to having the product or geographic market, or both, control prices.<sup>78</sup>

Using these factors, franchisors able to show legal, procompetitive objectives and impacts will be well on their way to victory. Arbitrators and courts, if not juries, will probably approve combinations and implicit agreements for these purposes and with these impacts.

#### LEEGIN'S PROBABLE IMPACT ON FRANCHISOR-FRANCHISEE RELATIONS-PART III

Several other events have stopped a franchisor stampede to adopt vertical RPM. Because of congressional efforts to overturn *Leegin*, many franchisors' counsel have not urged their clients to rush into vertical RPM. They have pointed to existing, often long-term, franchise agreements containing provisions declaring that franchisees are independent contractors and thus expressly or impliedly determine price independently of franchisors.

In addition, many franchisors sell goods not only through franchisees, but also through company stores or even directly to the general public. In these situations, the lines between horizontal and vertical RPM become blurred. The risk of horizontal price fixing findings and resulting treble damages and other heavy financial penalties and litigation costs against these franchisors remains significant. Furthermore, the rule of reason does not mean slam-dunk franchisor victories. Vertical price restraints leading to higher prices are likely to convince juries to reject any procompetitive impacts based on better quality or service, especially in today's severe recession.<sup>79</sup>

Moreover, Christine Varney, the new Assistant Attorney General for the U.S. Department of Justice's Antitrust Division, has expressed her view that vertical price fixing criminal prosecutions, even under the rule of reason, remain possible. Also, under most state statutory or common laws, vertical RPM remains illegal. One state, Maryland, has amended its antitrust law to bar vertical RPM as per se illegal. Several state attorneys general, for example, in New York, have warned that they will enforce these state laws. Forty-one state

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<sup>77</sup> *Toledo Mack Sales & Service, Inc.*, 530 F.3d 204, 225 (3d Cir. 2008).

<sup>78</sup> *See Leegin*, 551 U.S. 877, 898.

<sup>79</sup> *Foley & Lardner, Return To The Past? Congress Seeks To Overturn Leegin*, Legal News Alert: Distribution and Franchise available at [http://www.foley.com/publications/pub\\_detail.aspx?pubid=6211](http://www.foley.com/publications/pub_detail.aspx?pubid=6211), pp. 1-2.

attorneys general have written Congress to express support for the pending Discount Pricing and Consumer Protection Act designed to restore the *Dr. Miles* Rule and make vertical RPM per se illegal.<sup>80</sup>

If franchisors do resort to formal vertical price restraints, they can cite several reasons from *GTE Sylvania* and *Leegin* in support. First, they can assert that vertical price restraints are essential to protect their brand's reputation for quality and value. Second, they can assert that vertical price restraints are essential to encourage franchisees to invest the money in selling and servicing the goods or in selling the services properly through a combination of good service, effective product demonstrations, better trained and knowledgeable employees, and the like. Third, franchisors can cite the need or desirability to stop "free rider" franchisees from muscling out other dealers offering what the franchisors consider proper sales and service. Fourth, franchisors can use the threat of abandoning franchising in favor of company stores. Fifth, new franchisors can cite the need to attract good franchisees to compete with dominant or established franchisees.

Franchisors can also cite several non case law reasons in support. First, at least a significant minority of franchisees are not true entrepreneurs and are not ready to accept the risk of independent pricing. Second, at least a significant minority of franchisees do not have enough business experience or particular product or service experience to price the product properly. Third, permitting multitudes of franchisees to price products as they please will destroy the franchise systems' uniformity and thereby drive customers away.

For the franchisor, vertical RPM has serious risks. In the United States and Canada, for example, certain metropolitan areas and certain regions have higher or lower prices than others. Vertical RPM requires the franchisor to know the pricing situations in many different metropolitan areas and regions. "Many prices are set not only by economic factors, but also by 'price psychology,' which depends on a number of subjective factors that may nor be known (or 'felt') by a manufacturer remote from a market."<sup>81</sup> If the franchisor overprices, its sales, revenues, and profits can nosedive. If the franchisor underprices, its brand integrity and value can nosedive, and sales, revenues, and profits can later nosedive. Finally, as vertical RPM reduces franchisee autonomy even more, the resulting franchise system will not attract aggressive, capable, and independent-minded retailers, but only bureaucrats, involuntary entrepreneurs and nonentrepreneurs. So, vertical RPM gives the franchisor more control, but only at the cost of more responsibility.

For the franchisee, vertical RPM can destroy his independence and turn him into a de facto employee. "[P]rice is an emotional and personal issue. No other marketing and selling factor is so obvious and powerful."<sup>82</sup> Vertical RPM removes the franchisee's "ability to manage his bottom line," undermines his "economic

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<sup>80</sup> Foley & Lardner, *Return To The Past? Congress Seeks To Overturn Leegin*, Legal News Alert: Distribution and Franchise available at [http://www.foley.com/publications/pub\\_detail.aspx?pubid=6211](http://www.foley.com/publications/pub_detail.aspx?pubid=6211), p 2, Sheppard Mullin Richter & Hampton LLP, Antitrust Law Blog, "Per Se" or Not "Per Se" – An Historical "Quick Look" at Minimum RPM Under California Law (November 10, 2009), available at <http://www.antitrustlawblog.com/2009/11/articles/article/per-se-or-not-per-se-an-historical>, S. 148, 111<sup>th</sup> Cong., 1st Sess., 155 Cong. Rec. s133-135 (2009), Richard A. Duncan and Alison K. Guernsey, *Waiting for the Other Shoe to Drop: Will State Courts Follow Leegin?*, 27 Franchise L. J. 173, 174 (2008); *Exit A Plus Realty v. Zuniga*, 395 N.J. Super. 655, 664, 930 A.2d 491, 497 (2007), *Maitland v. Burckle*, 572 P.2d 1142, 1147 (1979) (holding vertical RPM agreement between a franchisor and a franchisee per se illegal under California Cartwright Act); *Kunert.*, 110 Cal. App. 4th 242, 263, New York General Business Law sec. 369-a, Md. Com. Law Code Ann. Secs. 11-201-213 (2005); S. B. 239 (Md. 2009) and H.B. 657 (Md. 2009); see also, *California v. ARC America Corp.*, 490 U.S. 93, 101-102 (1989) (federal law does not preempt the area of prevention of monopolies or regulation of business for that purpose, and thus, states are free to regulate in these areas, even to the extent of contradicting or rejecting federal courts' interpretations of federal antitrust laws).

<sup>81</sup> Banks, *supra*, sec. 2.1, pp. 195-196.

<sup>82</sup> Banks, *supra*, sec. 2.1, pp. 195-196.

viability,” and contradicts “any policy designed to promote the existence of independent small businesses.”<sup>83</sup> Indeed, “competitive pricing is often the most important ‘marketing’ tool a distributor possesses. In many cases, advertising may consist of...announcements that certain products are available at a specified price. N.6”<sup>84</sup> Along with nonprice restraints, vertical RPM can turn the franchise into a de facto company store.

Lastly, the obvious: Since a rule of reason antitrust case demands that the franchisee spend far more time, money, and effort to win an acceptable settlement, let alone an acceptable trial court judgment or arbitration decision, and since proving a rule of reason case is far more difficult, fewer franchisees than ever will sue franchisors for antitrust violations.<sup>85</sup>

### CONCLUSION

*Leegin* will probably not have a big short-term impact on franchisor-franchisee relations. For thirty years before *Leegin*, franchisors and franchisees had operated under the *Colgate* and *GTE Sylvania* regime featuring immense franchisor contractual and practical power over franchisees. This power included franchisor power to impose vertical nonprice restraints, like exclusive territories, defined locations, and the like impacting on price. Further, the franchisor could unilaterally announce prices and force franchisees to accept them. Like *MAG*, the franchisor could use a suggested retail price system featuring a combination of unilateral secrecy, pressure, and threats for franchisees to adhere to the suggested retail prices. *Leegin* has enabled franchisors to impose formal vertical RPM. But formal RPM use has some risks, and most franchisors do not need to run these risks to accomplish their purposes. For these reasons, *Leegin*'s short-term impact will be less than anticipated.

But *Leegin*'s long-term impact may be huge. In a rule of reason regime, franchisors' counsel will probably feel in a stronger position to advise their clients to implement and enforce formal RPM in implicit agreement or combination with adhering franchisees determined to retain competitive parity, especially with nearby competing franchisees. In a rule of reason regime, franchisors' counsel will probably feel that the risks of non-adhering franchisees prevailing in a vertical price fixing action are little, while the benefits of promoting a formal RPM system may appear considerable. Thus, *Leegin* may well blur the differences between franchises and company stores and encourage the same contracts, combinations, and conspiracies that the Sherman Act's original supporters intended to prevent.

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<sup>83</sup> Banks, *supra*, sec. 2.1, pp. 195-196.

<sup>84</sup> Banks, *supra*, sec. 2.1, pp. 195-196.

<sup>85</sup> See Posner, *supra*, p. 15.