DISTRIBUTION & FRANCHISE

Legal News Alert™

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Please contact the following attorneys if you would like further information about the progress of the legislation or want additional information regarding distribution and franchise matters:

Michael J. Lockerby
Washington, D.C.
202.945.6079
mlockerby@foley.com

Kimberly J. Shur
Washington, D.C.
202.945.6011
kshur@foley.com

Please contact the following attorneys if you would like further information about the progress of the legislation or want additional information regarding public affairs matters:

Theodore H. Bornstein
Washington, D.C.
202.945.6188
tbornstein@foley.com

Cleta Mitchell
Washington, D.C.
202.295.4081
cmitchell@foley.com

"Mixed Signals" From Washington? Senators Propose Restoring Automatic Treble Damages for Manufacturers and Franchisors That Prohibit Discounting

For manufacturers and franchisors that want to prevent discounting by dealers, distributors, franchisees, and other retailers, the federal antitrust "rules of the road" changed recently. These rules would change back, however, if three U.S. Senators have their way.

Recently, Senators Herb Kohl (D-WI), Joseph R. Biden (D-DE), and Hillary Rodham Clinton (D-NY) introduced the Discount Pricing Consumer Protection Act, S.B. 2261. If enacted, S.B. 2261 would reverse the June 28, 2007 decision of the U.S. Supreme Court in *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007). (The *Leegin* decision was the subject of a June 28, 2007 Foley Legal News Alert™.) Even if *Leegin* remains the law of the land, that decision did not give an automatic "green light" to manufacturers and franchisors that want to prohibit discounting. At best, the Supreme Court's decision in *Leegin* gave the antitrust equivalent of a "flashing yellow" light to resale price maintenance (RPM), or "vertical" minimum price-fixing.

Before *Leegin,* resale price maintenance had been, for nearly a century, per se unlawful in violation of Section 1 of the Sherman Act, 25 U.S.C. § 1. In other words, manufacturers and franchisors that entered into agreements with dealers, distributors, franchisees, and other retailers fixing their minimum resale prices would automatically face treble damages liability for violating Sherman Act Section 1's prohibition against unreasonable restraints of trade. This per se rule meant that RPM agreements were automatically deemed to be unreasonable restraints of trade "without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."[1]

By instead holding that RPM is subject to the so-called "Rule of Reason," the Supreme Court in *Leegin* at least gave manufacturers and franchisors that seek to

[1] *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 5 (1958); *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

prohibit discounting a chance to tell their side of the story. Defenders of RPM have long argued that low margins and "free riding" by discounters can make it difficult for non-discounting retailers to meet their suppliers' standards for promoting the brand and providing aftermarket support. Because manufacturers and franchisors must compete vis-à-vis other brands, many have argued, resale price maintenance does not harm ***interbrand*** competition — the principal concern of antitrust law.[2] A manufacturer that owns its retail outlets can always "fix" its resale prices (as can a franchisor at its company stores). Why should a hotel or restaurant chain that chooses to franchise be subject to different rules than competitors whose outlets are company-owned?

These and other arguments ultimately prevailed in the Supreme Court when it decided *Leegin.* It remains to be seen, however, whether Congress will agree. Meanwhile, suppliers that believe discounting to be detrimental to their brands need not stand frozen in the proverbial headlights of federal antitrust law. Even before the introduction of S.B. 2261, the *Leegin* decision was surrounded by a great deal of uncertainty. This uncertainty and some suggested "best practices" for risk avoidance are the subject of an article that Foley published in the Fall 2007 edition of the *ABA Franchise Law Journal* entitled "Franchising After *Leegin:* A License to Fix Prices?"

Regardless of whether Congress reverses *Leegin,* and regardless of whether state antitrust enforcers continue to condemn RPM, suppliers that wish to prevent discounting need to obtain the advice of counsel on a number of issues. These include the following:

1. Many dealer, distributorship, and franchise agreements signed before the recent *Leegin* decision contained provisions intended to avoid per se liability for RPM. These contracts expressly state that dealers, distributors, and franchisees make independent pricing decisions. As a result, suppliers that want to police discounting need to have their counsel verify that such efforts do not run afoul of any contractual provisions.

2. *Leegin* did ***not*** change the rule that ***horizontal*** price-fixing — price-fixing among entities at the same level of distribution — remains per se unlawful under Section 1 of the Sherman Act.[3] Suppliers that wish to prevent discounting should ***not*** simply assume that restrictions imposed on dealers, distributors, and franchisees are "vertical." Rather, they need to obtain the advice of counsel as to whether the restraint is truly vertical. This can be particularly complicated when suppliers engage in "dual distribution." Dual distribution includes situations in which manufacturers sell products through independent dealers, distributors, or retailers but also own some retail outlets or otherwise "sell direct." It also includes situations in which franchisors operate "company stores" in addition to licensing franchisees to offer goods and services under the franchisor's trademark. Depending upon which U.S. Circuit Court of Appeals has jurisdiction over the parties, counsel may need to verify that the impetus for RPM came from the top down (in other words, from the franchisor or manufacturer) rather than from franchisees, dealers, and distributors — and that it benefits primarily the supplier through increased ***interbrand*** competition.[4]

3. *Leegin* did not change the rules governing other bases for federal antitrust liability — including monopolization, attempted monopolization, and conspiracies to monopolize in violation of Sherman Act Section 2 and price discrimination in violation of the Robinson-Patman Act. As a result, suppliers that wish to prevent discounting need to have counsel verify that their conduct provides no other potential basis for antitrust liability.

[2] *Cont'l T.V., Inc. v. GTE Sylvania, Inc.,* 433 U.S. 36 (1977).

[3] *White Motor Co. v. United States,* 372 U.S. 253, 263 (1963).

[4] *See, e.g., Int'l Logistics Group, Ltd. v. Chrysler Corp.,* 884 F.2d 904, 906 (6th Cir. 1989); *Ryko Mfg. Co. v. Eden Servs.,* 823 F.2d 1215, 1231 (8th Cir. 1987); *Midwestern Waffles, Inc. v. Waffle House, Inc.,* 734 F.2d 705, 721 (11th Cir. 1984); *Donald B. Rice Tire Co. v. Michelin Tire Corp.,* 638 F.2d 15, 16-17 (4th Cir. 1981).

4. For the 30 years since the Supreme Court's 1977 decision in *GTE Sylvania*,[5] vertical non-price restraints have been judged under the Rule of Reason. Vertical non-price restraints — such as exclusive territories — may be nearly as effective as RPM in preventing "free riding" and other perceived problems caused by discounting. Suppliers therefore should consult with legal counsel about the potential for using vertical non-price restraints instead of, or in addition to, vertical price restraints.

5. Ever since the Supreme Court's 1919 decision in *United States v. Colgate & Co.*, 250 U.S. 300 (1919), Section 1 of the Sherman Act has been interpreted as ***not*** prohibiting a manufacturer from unilaterally announcing a resale pricing policy and then refusing to do business with resellers that fail to adhere to the policy. Suppliers that wish to prevent discounting therefore should have their counsel analyze whether it is possible to do so under the *Colgate* doctrine.

In short, both *Leegin* and the introduction of S.B. 2261 underscore the importance of not simply assuming that certain conduct automatically will or will not pass muster under federal antitrust law. Many manufacturers and franchisors have concluded that discounting by independent retailers harms their brands and their distribution systems. These manufacturers and franchisors need to obtain specific legal advice as to whether it is possible to realize their business objectives in a way that minimizes potential antitrust exposure — regardless of whether *Leegin* continues to govern interpretation of Section 1 of the Sherman Act.

[5] *See* n.2, *supra.*

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