



Court Watch

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Antitrust law can be one of the most complex and confusing areas of law relating to franchise and distribution agreements. Two recent decisions shed light on claims that might be available to franchisees and dealers; the first relates to price discrimination under the Robinson-Patman Act (15 U.S.C. § 13), and the second relates to tying arrangements under the Sherman Antitrust Act (15 U.S.C. § 1).

Limits of the Robinson-Patman Act Confirmed

A recent case interpreting the Robinson-Patman Act illustrates the complexity of its application, while at the same time simply setting forth and interpreting the elements necessary in order to proceed with a claim under the statute, thus clearing up some of the confusion surrounding its application. In *Feesers, Inc. v. Michael Foods, Inc.*, Bus. Franchise Guide (CCH) ¶ 14,301 (3rd Cir. Jan 7, 2010), the U.S. Court of Appeals for the Third Circuit vacated the decision of the district court issued after a bench trial.

Feesers, Inc. ("Feesers"), a regional food distributor, brought a claim for unlawful price discrimination under the Robinson-Patman Act against Michael Foods, Inc. ("Michael Foods") and Sodexo, Inc. ("Sodexo"). Michael Foods is a food manufacturer of egg and potato products, and Sodexo is a food service management company that serves institutions in the planning of their menus, ordering food, and preparing meals. Feesers presented evidence at trial that it paid 59% more than did Sodexo for Michael Food's top-selling products in the time period from 2000 to 2004, a deviation described as "stunning" by an expert witness at the trial.

The Robinson-Patman Act prohibits manufacturers from discriminating in price "between different purchasers of commodities of like grade and quality ... where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce ... " Controversy has surrounded the Robinson-Patman Act since its enactment because of its confusing application and also because of arguments that it has anticompetitive effects that promote monopolistic tendencies, rather than prevent them.

The Supreme Court has tended to construe the application of the Robinson-Patman Act narrowly, thus limiting its reach. The district court decision in this case, however, found that Michael Foods engaged in unlawful price discrimination and issued an injunction enjoining it from refusing to sell its products to Feesers at the same prices as it sold them to Sodexo. The Third Circuit then overturned that decision by finding that Feesers and Sodexo were not actually in competition with one another.

A claim under the Robinson-Patman Act is established by a showing of four elements: 1) that sales were made to two different purchasers in interstate commerce; 2) the products were the same grade and quality; 3) the manufacturer discriminated in price between the two purchases; and 4) the discrimination had a prohibitive effect on competition, known as the "competitive injury" element. The competitive injury element was at issue in this case.

A competitive injury occurs when a substantial price discrimination between competing purchasers exists over time, meaning that the claimant competed with another purchaser and that price discrimination occurred between them. The court in this case looked at the timing of the competition and determined that Feesers and Sodexo did not compete against each other for purposes of the Robinson-Patman Act.

In analyzing the facts, the court found that Feesers, as a food distributor, purchased food from Michael Foods in order to resell it to institutions that self-operate their food service. Sodexo, on the other hand, purchased food from Michael Foods as a food service management company, meaning that it performed the food services on behalf of its customers. Therefore, the court found that the true competition for customers between Feesers and Sodexo occurred in the competitive bid process, when a potential customer was deciding whether to self-operate and purchase from a distributor, or whether to hire a food service management company to handle its food service operations. Thus, any competition between the companies took place before the actual purchase of products from Michael Foods on their customers' behalf. Once the customer chose which company it would do business with, the competition ended. The chosen company would then consummate the purchase of the product from Michael Foods. Therefore, when the two companies were in competition, only "offers to sell" existed from Michael Foods, not actual sales, and no price discrimination could occur based on such an offer.

In making its holding, the Third Circuit recognized the U.S. Supreme Court's directive to narrowly construe the Robinson-Patman Act and to limit it to its basic purpose. It stated that "the price limitation identified by Feesers bears little resemblance to the large independent department stores and chain operations the statute was originally intended to target."

The practical implications of this holding are that it will be extremely difficult for an unlawful price discrimination claim to go forward under the Robinson-Patman Act when a competitive bid market exists in the sales process. Once a customer chooses to engage a company, the purchase price from the manufacturer becomes irrelevant in the price discrimination context because no competition thereafter exists.

In so holding, the Third Circuit rejected the findings of the district court that informal competition could affect the ability to bring a claim, and that an informal bidding process (as opposed to a formal RFP process) amounted to competition between dealers. The Third Circuit also found that it was irrelevant whether the goods were standard products or custom-made, as it rejected Feesers' argument that competition exists in a bid market for standard products because a customer could choose easily between two dealers.

Franchisee Purchasing Requirements May Be Illegal Tying Arrangements

Another often-confused and gray area of antitrust law in franchise and distributor agreements relates to illegal tying arrangements, which arise when an agreement exists in which a party agrees to sell one product (the tying product) "on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase the product from any other supplier." *Burda v. Wendy's Int'l, Inc.*, Bus. Franchise Guide (CCH) ¶ 14,240 (S.D. Ohio Sept. 21, 2009) *quoted from Eastman Kodak Company v. Image Technical Services, Inc.*, 504 U.S. 451, 451 (1992). This becomes illegal under the Sherman Act when the seller of the products maintains what is known as "market power" or appreciable economic power in the tying product market, which affects a substantial volume of commerce in the tied market.

The facts of a recent case relating to interpretation of "market power" are as follows: A Wendy's franchisee (Robert Burda) signed his original franchise agreement in 1996. His franchise agreement provided that he was required to purchase all food supplies from suppliers that met Wendy's quality controls. At the time he became a franchisee, multiple suppliers were available for the food supplies that he purchased. Wendy's later required Burda to purchase his buns and other food supplies from one specific supplier, which was a subsidiary of Wendy's. Burda then brought suit, alleging that the requirement reduced his profits due to the charges for purchases of such supplies, and that it constituted an illegal tying arrangement.

In order to prove that he was the victim of an illegal tying arrangement, Burda attempted to show that Wendy's had market power based on a "lock-in" theory originally established in *Kodak*. Under this theory, market power can be shown if, once an agreement exists to the tying product, the purchaser is locked-in to purchase the tied product, meaning a change in policy occurred unknown to the purchaser at the time of the purchase of the tying product. In this case, the purchase of the franchise was alleged to be the tying product, and the buns and food supplies were alleged to be the tied product.

The court found that the claim could go forward if Wendy's had changed its policy after the initial sale of the franchise or concealed the requirements from Burda at that time. Therefore, if his franchise agreement put him on notice of the exclusive purchase requirement at the time of the execution of the agreement, Burda would be unable to establish a claim under the "lock-in" theory. Importantly, the court found that his franchise agreement did not put him on notice, even though it stated that Burda was required to purchase food supplies from suppliers

who met Wendy's specifications, who had quality controls, and who were approved in writing by Wendy's. Thus, Wendy's motion to dismiss was denied, and Burda was allowed to proceed under his claim.

Even more importantly for franchisors, the court gave examples of language that would have put Burda on notice at the time of the purchase of his franchise. For example, language providing that the franchisor may, in its sole discretion, require supplies "to be purchased exclusively from us or from approved suppliers and distributors" would be sufficient to accomplish this purpose. If his franchise agreement had contained this language, Burda would have been unable to proceed with his claim.

This decision should prompt all franchisors to review their franchise agreements to ensure that the language of any purchasing requirements is sufficient to meet the notice requirements established in this case.

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