STATE BAR OF MICHIGAN

ANTITRUST, FRANCHISING, AND TRADE REGULATION NEWSLETTER

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ABA Spring Antitrust Meeting will also host the next meeting of your section, so please join us at 8:30 A.M. Thursday Breakfast with the Regulators at the MICHIGAN table.

Our next regularly scheduled meeting will be held Friday at noon May 4th in Southfield.

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MESSAGE FROM THE CHAIR

Fred K. Herrmann

Dear Members of the Antitrust, Franchising, and Trade Regulation Section:

Whether you are a veteran of the Section or a new member, we hope that you will find this newsletter informative and relevant to your practice. More importantly, we hope that it will encourage you to stay active in the Section and share additional ideas and material with your fellow members. If you are interested in submitting an article (or an idea for an article) to be considered for an upcoming issue, please contact James Adams or Howard Lederman.

This has been a team-building year for the Section. Through the voluntary work of many people, we have assembled a full team of active officers and Council members, and filled a number of vacancies. I would like to personally thank Chair-elect Paul Novak, Secretary James Adams, and Treasurer Howard Lederman. Paul, James, and Howard have provided invaluable leadership in support of the Section. Among other projects, Paul spearheaded the Gasoline Pricing seminar we sponsored in November that you will read more about in this newsletter. James and Howard have worked together with the staff at Howrey, LLP to get this newsletter to print, including authoring articles. Thanks to the support of Howrey, LLP James has been traveling from Washington, D.C. to Michigan to attend our Council meetings, and also spoke at the November seminar. Howard has been instrumental in putting our ListServ on line. I encourage each of you to become actively involved in the ListServ – Howard has provided a "how to" in this newsletter

I would also like to recognize Brock Swartzle and Stuart Bordman. Brock serves as chair of our Legislative Committee. Please see Brock's most recent updates in this newsletter. Stuart volunteered to serve as chair of our Franchising Committee. One of our major goals for this year, and the future, is to increase the Section's involvement in franchising-related activities. Please provide Stuart with any input or suggestions you may have regarding how the Section can increase its service to the franchising community.

Additional contributors to this newsletter include Rick Juckniess, Howard Iwrey, and Suzanne Sonneborn. Rick and Howard are regular participants in Council meetings and other Section activities. We greatly value and appreciate their contributions. Suzanne is our Section liaison from the office of the Attorney General, and we appreciate her insights from the enforcement perspective.

The Section held its 2006 Annual Meeting on September 15, 2006 at the Ypsilanti Marriott at Eagle Crest, in conjunction with the Annual Meeting of the State Bar. We will hold our 2007 Annual Meeting on Friday, September 28, 2007, from 8:00 am to 11:00 a.m. at the DeVos Convention Center / Amway Grand Plaza Hotel in Grand Rapids. We invite you to join us at the Annual Meeting, or any of our periodic Council meetings. Please contact me or one of the Section officers if you are interested in attending any of our meetings.

Thank you for your continued interest and support of the Section. I hope you will become as active as possible and I encourage you to take full advantage of all of the activities the Section offers.

Sincerely,

Fred K. Herrmann
Chairperson 2006-2007

Supreme Court News

Bell Atlantic v. Twombly*

By Thomas J. Dillickrath**
Senior Associate, Howrey LLP

For the second time in the past several years, Verizon Communications ("Verizon") is participating in a petition to the Supreme Court for relief in the context of an antitrust legal action arising from the 1996 Telecommunication Act ([1]. In both cases, the fundamental issues underlying Verizon's petition are of great import to the legal and business communities. The Court's ruling in favor of Verizon in the first matter, *Verizon Inc. v. Law Offices of Curtis V. Trinko*; [2] raised far reaching implications for application of Section 2 of the Sherman Act[3] to a dominant firm's refusal to deal with its rivals, and effectively vitiated several theories of anticompetitive harm often relied upon by antitrust plaintiffs, refusal to deal and monopoly leveraging. Now, in *Bell Atlantic Corp. v. Twombley,*[4] Verizon and other "Baby Bells"[5] ask the Court to reverse the ruling of the Second Circuit and hold that a complaint brought under Section 1 of the Sherman Act[6] (U.S.C. § 1) must allege specific facts that, if true, will demonstrate the existence of an antitrust conspiracy and not mere parallel conduct.

The Supreme Court granted *certiorari* after the Second Circuit overruled the District Court dismissal for Plaintiff's bare bones assertion of conspiracy and failure to cite a single "plus factor" in its complaint. [7] Many legal analysts criticized the decision as lowering the threshold standard for a Section 1 complaint, and, moreover, inviting frivolous lawsuits with only the most bare-bones allegations of conspiracy, aimed at gaining a settlement based on a defendant's assessment comparing the (unquestionably exorbitant) costs of discovery against the likelihood of winning dismissal at the summary judgment stage.

The case law of other circuits was in direct conflict with the standard promulgated by the Second Circuit, thereby setting up the requisite circuit conflict for a grant of *certiorari.* It is black-letter antitrust law that in order to survive a motion for summary judgment, an antitrust plaintiff seeking damages under Section 1 for a claim based on parallel conduct must present evidence in a Section 1 claim "that 'tends to exclude the possibility' that

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* No. 05-1126.

**Mr. Dillickrath's practice focuses on complex antitrust litigation, particularly in high-tech industries. His practice also includes issues related to international competition law. Mr. Dillickrath can be reached at dillickratht@howrey.com

[1] Prior to implementation of the Telecommunications Act of 1996, 47 USC 609, a number of so-called "Baby Bell" companies operated regional telephone companies, essentially monopolies within their geographic region. The 1996 Act required these incumbent local exchange carriers ("ILECs") to provide new entrants ("CLECs") with access to their local telephone networks.

[2] 540 U.S. 398 (2004). Verizon Communications INC V. Law Offices of Curtis V. Trinko, LLP.

[3] (15 U.S.C. § 2)

[4] No. 05-1126

[5] Petitioners here include Bell Atlantic Corp., BellSouth Corp., Qwest Communications, Inc., SBC Communications, Inc. (now known as AT&T Inc.) and Verizon Communications, Inc. (successor to Bell Atlantic Corp.)

[6] 15 U.S.C. § 1.

[7] . Plaintiff/respondents, on behalf of all users of telephone and internet services in the continental United States, filed suit against the ILECs, alleging that they conspired to keep CLECs out of the local markets. They alleged that defendants both (1) agreed not to compete as CLECs in each others' markets and (2) agreed to engage in parallel behavior to keep CLECs from entering their respective markets.

the alleged conspirators acted independently.”[8] These plus factors, therefore, must exclude self-interested conduct as an explanation for the parallel conduct. The district court in *Twombly* applied this standard, and held that a complaint under Section 1 alleging only parallel conduct and attendant market circumstances must meet the *Matsushita* “tends-to-exclude” standard.[9] This standard was also supported by the United States, as *amicus curae* on behalf of Petitioner.

The Petitioners argued that the *Matsushita* standard, as a principle of substantive antitrust law, should be incorporated into the 12(b)(6) dismissal standard. Therefore, Petitioners argued, the Second Circuit standard, premised on a “realm of possibilities” test, was improper, as it did not comport with the fundamental principles of antitrust law. Specifically, Petitioners argued that parallel conduct, in almost all circumstances, does not support an inference of conspiracy. Moreover, the Second Circuit standard failed to require plaintiffs to sufficiently allege facts tending to exclude the possibility of independent conduct, as required under *Matsushita*, and, hence, antitrust law. Thus, Petitioners argued that the claims brought by plaintiffs should be dismissed, since there were good-faith legitimate business reasons for the challenged conduct.

The Brief of the United States made very similar arguments to those tendered by petitioners, noting that the standard should require sufficient factual predicate in a complaint to suggest that there is at least “a reasonably grounded expectation that discovery will reveal evidence of an illegal agreement.” Otherwise, there could be a groundswell of meritless antitrust cases merely alleging parallel conduct with the language of conspiracy. The Solictor General’s brief was more cautious on the particular facts of this case, but came out strongly against the Second Circuit standard. It is interesting to consider the strength of the United States’ position, in contrast to the wait-and-see approach taken with regard to the petition for *certiorari* in *LePage’s*,[10] the infamous Third Circuit Section 2 decision that has been heavily criticized by the antitrust bar.

Respondents, unsurprisingly, argued that Petitioners sought to impose a heightened pleading standard in antitrust cases, and that defendants are only entitled to dismissal under the Federal Rules of Civil Procedure (“FRCP”) where there is no set of facts alleged whereby the plaintiff could prove his case. Respondents noted that FRCP 8.1 requires only a concise pleading of the relevant facts. CITE. Further, respondents argued that the “slippery slope” argument brought forth by both Petitioners and the United States is obviated by the existence of the *Matsushita* standard on summary judgment. In any event, respondents argued that, on the facts, Petitioner was not even entitled to summary judgment or dismissal under a *Matsushita*-inspired 12(b)(6) standard, since they did indeed allege various plus-factors.

On November 27, 2006, the Supreme Court heard what turned out to be an extremely lively oral argument. The Justices were engaged, and actively questioned the attorneys for both sides, as well as the United States as *amicus curae*.

Michael Kellogg of Kellogg, Huber, Hansen, Todd, Evans & Fliegel, LLC, a veteran Supreme Court advocate, appeared for Petitioners. Justice Stevens (who some Court-watchers consider the most antitrust-savvy of the Justices) allowed Mr. Kellogg just a few opening comments before reading him the allegation in the complaint stating “plaintiffs allege upon information and belief that defendants have entered into a contract combination or conspiracy to prevent competitive entry…and agreed not to compete with one another and otherwise allocated customers and markets to one another.” This really represented the crux of the case—was this allegation sufficient to state a

[8] *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 474 U.S. 574, 588 (1986) (internal citations omitted).

[9] *See, e.g., Cayman Exploration Corp. v. United Gas Pipe Line Co.*, 873 F.2d 1357, 1361 (10th Cir. 1989).

[10] *3M v. LePage’s Inc.*, No. 02-1865, Brief of the United States as *Amicus Curae* (noting that “the Court should not prematurely

claim under the antitrust laws? Petitioners clearly anticipated this question, and responded that it was insufficient just to recite a legal conclusion. In Petitioner's view, the allegation of conspiracy was not a fact, but, rather, a mere inference that plaintiffs sought to draw from actual facts they did allege.

Petitioners based this argument on a reading of *Matsushita* as constituting substantive antitrust law; therefore, if parallel conduct is equally consistent with conspiracy or with ordinary business judgment, the existence of an antitrust conspiracy cannot be inferred. Justice Stevens seemed very skeptical of importing the *Matsushita* summary judgment standard into the motion to dismiss standard. He was even more skeptical that plaintiff/Respondents had failed to make a sufficient factual allegation it their complaint, calling the premise that this was not a statement of fact "mind-boggling." Further, Justice Stevens noted that "dozens" of antitrust cases were no more specific than that brought in *Twombly*.[11] Justice Ginsburg, a former Civil Procedure professor, suggested that Petitioners were seeking to re-write the FRCP by adding evidentiary requirements at the pleadings stage.

Assistant Attorney General Thomas O. Barnett personally argued on behalf of the United States, stressing that the Second Circuit decision could be read to immunize a complaint from a motion to dismiss merely by alleging parallel action or inaction, thereby ignoring the reality that parallel conduct is ubiquitous. Mr. Barnett suggested that the proper formulation of the standard, derived from the Court's decision in *Dura Pharms. Inc. v. Broudo*[12], is that there must be some reasonably founded expectation that an agreement is present within the meaning of Section 1.

Mr. Barnett noted that substantive antitrust law make clear that conscious parallelism, without more, is definitely not an illegal agreement within the meaning of Section 1. Justice Stevens questioned whether a starker complaint, only alleging agreement but not conscious parallelism, would succeed, and, therefore, in this case, the plaintiff/Respondents were being in effect punished for stating additional language in the complaint. Under some intense questioning over the scope of the minimum pleading standard, Mr. Barnett agreed that it would be sufficient if, for example, there was an allegation that, over a nine-year period, all defendants raised their price at the same time, thereby meeting the "low threshold" and providing some indication of specifics. In any event, the U.S. position was more strongly focused on applying an appropriate standard than on the specifics of the instant case, or of hypotheticals.

J. Douglas Richards of Milberg Weiss argued on behalf of Respondents. Mr. Richards began by noting that the position taken by the United States was directly opposite positions taken in earlier cases, in terms of converting evidentiary statements into pleading requirements. The Court seemed singularly unimpressed with this argument. Justice Scalia asked if it was sufficient for a plaintiff to simply allege "I was injured by the negligence of the defendant in driving the automobile" under the rules. Mr. Richards replied—perhaps problematically for Respondents--"Perhaps."

Both Chief Justice Roberts and Justice Scalia questioned Mr. Richards intently on whether the complaint alleged any agreement other than the existence of parallel conduct. In response, Mr. Richards stated that the allegation was indeed sufficient, as it was not the plaintiff's burden in the first instance, and in any event, plaintiffs had sufficiently alleged that the conduct of the ILECs[13] in not entering into competition with the CLECs[14] was against their self-interest. CJ Roberts offered an intriguing hypothetical—a grocery store and a

[11] A number of the justices questioned why respondents didn't simply ask for a more definite statement of facts under Rule 12(e). Mr. Kellogg acknowledged that petitioners did not do so, but noted that respondents acknowledged they had no more specificity, and, if they did have more specifics, would have supplemented their complaint

[12] 544 U.S. 336 (2005).

[13] Independent Local Exchange Carrier.

[14] Competitive Local Exchange Carrier.

pet store are located across the street from each other; if the grocery store did not sell pet supplies, would that set out an antitrust violation in a complaint? Mr. Richards replied that it would, since unless there is no "conspirable motive" present, the case cannot be dismissed.

Justice Breyer noted that if the Court accepted that standard, it would be relatively easy for plaintiffs to get a "ticket to discovery." Moreover, Justice Breyer noted that while there might arguably have been plus factors alleged as to the failure to compete as a CLEC, there were no plus factors alleged as to the conspiracy to keep new entrants out of the regional markets. Justice Scalia went further, stating that respondents had an equally strong motive not to compete with the CLECs, and, therefore, the inference suggest by Respondents was inappropriate.

Questioning then turned to the hypothetical of whether even if respondents could prove everything alleged in the complaint, they would still lose at trial (apart from agreement). Mr. Richards agreed they would lose at summary judgment or trial ("after several years" as Justice Scalia dryly noted). Respondents repeatedly asserted that merely alleging that Petitioners acted against self-interest was sufficient to make it a fact for pleading purposes. This argument was met with skepticism by the Court, with Chief Justice Roberts noting that the allegation of agreement was an inference drawn from other allegations, not an independent allegation..

Additional vigorous questioning came from Justice Alito (parenthetically, a *LePage's* dissenter), asking whether if there were only an allegation that, on information and belief, an agreement in restraint of trade existed, that would be sufficient to state a claim under Section 1, absent the extra language that led here to the inference.

After protracted and repeated questioning, Mr. Richards stated that if such an allegation met the pleading requirements of Rule 8(a), but perhaps not the Second Circuit standard. Another interesting line of questioning revolved around Respondents argument that Congressional intent in enacting the 1996 Telecommunications Act was that the ILECs compete as CLECs. Justice Scalia told Mr. Richards that if that is the criterion "your case is very weak."

While the role of Supreme Court prognosticator is thankless, it appears (at least to this writer) that the Petitioners may have gotten the better of the argument. [15] At least one other antitrust commentator has stated that he "did not get a sense that the Court wants to apply the Matsushita standard to the 12(b)(6) context or to apply tests for economic rationality to gauge the adequacy of the pleadings." [16] In any event, should the Court decline to reverse the Second Circuit decision, expect an increase in Section 1 claims, and growing uncertainty for the business and legal communities.

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[15] In the interest of full disclosure, the author has represented Verizon in other matters, and believes that the standard proposed by Petitioners is the correct one.

[16] Prof. Shubha Ghosh, Antitrust Prof Blog, *available at* http://lawprofessors.typepad.com/antitrustprof_blog/.

Appellate Court News

NICSAND VACATED

By Rick Juckniess, Esq.
Miller, Canfield, Paddock and Stone, P.L.C.

The recent Sixth Circuit antitrust opinion in *Nicsand, Inc. v. 3M Co.*, 457 F.3d 534 (6th Cir. 2006), has been vacated and rehearing en banc was granted on November 22, 2006. The opinion was perhaps most notable for its reaffirmance of the "necessary predicate" test for antitrust injury. The test requires that "the illegal antitrust conduct was a necessary predicate to their injury or that defendant's could exclude plaintiffs only by engaging in the antitrust violation." *Id.* at 550. The test has received scrutiny and criticism from other circuits since antitrust defendants have interpreted this doctrine as requiring a plaintiff to allege that the only way the defendant could have caused the plaintiff's injury was through the antitrust violation itself. The Sixth Circuit has edged back these interpretations and may do so again more forcefully in its en banc treatment of *Nicsand.*

Michigan Courts News

Zurich Settlement

By Suzanne D. Sonneborn
Assistant Attorney General
Consumer Protection Division
Michigan Department of Attorney General

On December 4, 2006, Michigan and ten other states (California, Florida, Hawaii, Maryland, Massachusetts, Oregon, Pennsylvania, Texas, Virginia and West Virginia) reached agreement on and entered final judgments in their respective state courts requiring one of the world's largest insurers, Zurich American Insurance Co., to implement a variety of business reforms as part of a multi-state antitrust settlement reached by the ten states in March. Zurich and its U.S. subsidiaries were alleged to have engaged in bid-rigging, price-fixing and customer allocation schemes in the commercial insurance market. These companies and several other large international insurers allegedly conspired together in order to increase premiums for insurers and commissions for brokers.

In a complaint that was filed on December 4, 2006 in Ingham County Circuit Court along with the injunctive relief judgment, Michigan alleged that Zurich and its U.S. subsidiaries, Steadfast Insurance Company, Fidelity & Deposit Company of Maryland, Empire Fire & Marine Insurance Company, American Guarantee & Liability Insurance Company, Empire Indemnity Insurance Company, and Assurance Company of America, conspired together to increase premiums for insurers and commissions for brokers. On one occasion, it was alleged that a commercial insurance broker solicited and obtained a fake insurance quote from Zurich and another insurer as part of a scheme to guarantee that a pre-selected insurer would be the successful bidder for insurance coverage required under a parking and shuttle contract that Detroit Metro Airport held with a maintenance company. Zurich subsequently supplied the fake quote and the maintenance company purchased the insurance on the Airport's behalf with the belief that bidding for the policy had been conducted competitively.

Michigan's injunctive relief judgment, as well as the judgments simultaneously filed in the other participating states' state courts, contain comprehensive

injunctive provisions that are intended to prevent the recurrence of such marketplace abuses. Zurich is prohibited from engaging in any of the practices that resulted in the violations at issue for a period of ten years subject to court supervision and enforcement by the states. Specifically, Zurich will no longer be allowed to pay secret "contingent commissions" to insurance brokers, nor to act with its brokers to overcharge commercial clients for their policies. All compensation paid to commercial brokers and agents must be disclosed to the customer on a secure Web site or via a toll-free telephone number. The compensation disclosure includes both standard insurance commissions paid by policyholders and any form of commission paid by Zurich to its brokers for placing customer business. Policy holders may find such information helpful in making a decision to place or renew the insurance coverage with Zurich.

As part of a companion settlement in a private class action lawsuit pending in federal court in New Jersey, *In Re: Insurance Brokerage Antitrust Litigation, et al*, U.S. District Court for the District of New Jersey, MDL No. 1663, Zurich and other large commercial insurers will be required to distribute at least $121.8 million in refunds to commercial policyholders, with an estimated $3.2 million directed to commercial policyholders in Michigan. The New Jersey court preliminarily approved this monetary payout on November 8, 2006.

Market Theory Gets Buried

by Rick Juckniess (principal, Miller, Canfield, Paddock & Stone)

In the recent opinion, *Michigan Division-Monument Builders of North America v. Michigan Cemetery Ass'n*, __ F.Supp.2d __, 2006 WL 3084843 (E.D.Mich, October 27, 2006), Judge Sean F. Cox dismissed antitrust tying claims brought by cemetery monument dealers against Michigan cemeteries and the Michigan Cemetery Association. The Court rejected the "unique" approach plaintiffs took to allege market power in a relevant geographic market for cemetery lots: claiming that every cemetery in Michigan was its own relevant market. Defendants were represented at the 12(b)(6) stage by Rick Juckniess, a principal at Miller, Canfield, Paddock & Stone.

Plaintiffs claimed that the cemeteries had conspired to tie the sales of cemetery lots (the tying product) to monuments or monument installation (tied products and services). To survive at the 12(b)(6) stage, plaintiffs needed to allege that defendants had market power in a relevant geographic market. They attempted to manufacture the required market power by alleging that "each Defendant cemetery is a separate relevant geographic market and therefore each individual cemetery has complete market power within its own cemetery to tie burial plots to monument sales and installation." *Id.* at *5. Defendants characterized this effort for what it was, as the Court observed:

> Defendants contend that Plaintiffs have manufactured market power by alleging that there are 3,800 separate geographic markets with respect to cemetery plots in Michigan that purportedly do not compete with each other. Defendants assert that Plaintiffs' position that consumers seeking to purchase a burial plot in Michigan have no choices and must select burial in a single cemetery is ludicrous. Defendants note that Washtenaw County alone has almost 200 cemeteries.

Id. at *5.

To make each cemetery its own relevant market, plaintiffs simply alleged that each cemetery is land and thus "unique," such that cemeteries are not reasonably interchangeable and do not compete. "Uniqueness" as a basis for market power in land had derived from an expansive interpretation of Northern Pacific Ry. v. United States, 356 U.S. 1 (1958), where the "uniqueness" of land was referred to, but was based on specific characteristics, including that the land in question, was "strategically located in checkerboard fashion amid private holdings and within economic distance of transportation facilities." Id. at 519.

The Supreme Court corrected this expansion of "uniqueness" as a source of market power 20 years later when they explained:

> The question is whether the seller has some advantage not shared by his competitors in the market for the tying product. Without any such advantage differentiating his product from that of his competitors, the seller's product does not have the kind of uniqueness considered relevant in prior tying-clause cases.

United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610, 620-21, 97 S.Ct. 861, 51 L.Ed.2d 90 (1977). It appeared most courts and litigants thereafter recognized the limitations of uniqueness, some courts referring to the rejected "age old notion of the uniqueness of land to provide the basis for" market power. *Florida Monument Builders v. All Faiths Memorial Gardens*, 605 F.Supp. 1320 (S.D. Fla. 1984). The *Monument Builders* plaintiffs may be the last to have lost the argument that land's "uniqueness" can support market power.

It is true that the idea of uniqueness providing a basis for a presumption of market power *had* partially survived in decisions holding that a patent can provide a basis to infer market power, since it has been certified as a "unique" product by the United States Patent and Trademark office. It was this remaining presumption that the Supreme Court put to rest this year in *Illinois Tool Works, Inc. v. Independent Ink, Inc.*, ___ U.S. ___, 126 S.Ct. 1281, 164 L.Ed.2d 26 (March 1, 2006), where it held: "[I]n all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product." *Illinois Tool Works Inc. v. Independent Ink, Inc.*, No. 04-1329, 2006 WL 468729 at *12 (March 1, 2006).

Thus, Judge Cox held that, if any doubt remained, *Illinois Tool* provided the final nail in the coffin:

> The Court agrees that the reasoning in that case makes it clear that presumptions, whether based on the uniqueness of a patent or the uniqueness of land, cannot support a valid antitrust claim. The Court, therefore, concludes that Plaintiffs' allegation of market power based upon the uniqueness of land is insufficient as a matter of law.

Michigan Division-Monument Builders, 2000 WL 3084843 at *9.

Plaintiffs also separately asserted that market power could derive from the fact that "once a grave is purchased, the owner or his or her family who wish to memorialize the deceased must install the memorial or monument in that cemetery." *Id.* at 9. Defendants argued, and the Court agreed, that this was actually a "lock-in" theory -- a claim based on a consumer's required purchase of additional products or services after it is "locked-in" by a purchase of the tying product or service. Plaintiffs had not met the clear "lock-in" requirements set out by the Sixth Circuit. *PSI Repair Svcs., Inc. v. Honeywell, Inc.*, 104 F.3d 811 (6th Cir. 1997). Evidently recognizing the fatal omissions in their pleading, plaintiffs explicitly disclaimed the "lock-in" theory, but inexplicably continued to argue its principles. The Court rejected this ploy as well, finding both that the "lock-in" theory had not been pled *and* that it had been disclaimed. *Id.* at *9, n.6.

The plaintiffs have filed a notice of appeal with the Sixth Circuit.

Defendants were represented at the 12(b)(6) stage by Rick Juckniess, Larry Saylor and Pete Jensen of Miller, Canfield, Paddock & Stone.

Legislative Update

By Brock A. Swartzle
Law Clerk to the Hon. David W. McKeague
U.S. Court of Appeals for the Sixth Circuit

> "The great problem of legislation is, so to organize the civil government of a community . . . that in the operation of human institutions upon social action, self-love and social may be made the same." John Quincy Adams, Society and Civilization, *American Review* (July 1845).
>
> "The problem of cat versus bird is as old as time. If we attempt to resolve it by legislation who knows but what we may be called upon to take sides as well in the age old problems of dog versus cat, bird versus bird, and even bird versus worm." Gov. Adlai E. Stevenson (Apr. 23, 1949).

Therein lay both the promise and the danger of legislation, especially those acts aimed at market competition and competitors.

Welcome to the Legislative Update of the State Bar's Antitrust, Franchising, and Trade Regulation Section. "Legislative" is a bit of a misnomer, as the Update will also cover significant regulatory actions. Our goal for the Update is to provide you with an overview of recent legislative and regulatory proposals and actions affecting antitrust, franchise, and trade law, as well as some in-depth analysis of particularly significant matters.

Given the newsletter's recent hiatus, this issue's Update consists solely of short summaries of statutes and regulations enacted and proposed over the last couple of years:

- **Increased Criminal Penalties** – The Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, 118 Stat. 665, increased both the statutory maximum term of imprisonment for antitrust offenses from three to ten years, and the maximum corporate fine from $10m to $100m. The United States Sentencing Commission has revised upward the advisory penalties for antitrust offenses.

- **Wire Tapping** – Under the USA PATRIOT Improvement and Reauthorization Act of 2005, Pub. L. No. 109-177, 120 Stat. 192, federal antitrust enforcers can seek judicial authorization to intercept wire and oral communications to gather evidence of suspected criminal violations of Sections 1, 2, or 3 of the Sherman Act. 18 U.S.C. § 2516(1)(r).

- **Competition for a New Century** – Under the Antitrust Modernization Commission Act of 2002, Pub. L. No. 107-273, 116 Stat. 1856, Congress created a bi-partisan commission charged with examining whether the competition laws need to be modernized. The commission will prepare and submit a report to Congress and the President with its findings and recommendations. The commission has recently held hearings on whether to modify or even repeal several major acts, including the Robinson-Patman Act and the McCarran-Ferguson Act.

- **Energy Prices** – Both Congress and the Michigan Legislature have been active on the topic of energy prices. The U.S. House of Representatives passed the Federal Energy Price Protection Act of 2006, H.R. 5253. The bill would make price gouging in fuels an unfair or deceptive act in violation of Section 5 of the Federal Trade Commission Act. In the U.S. Senate, Senator Cantwell (D-WA) has sponsored a bill entitled "Clean Energy Development for a Growing Economy" (the "Clean EDGE Act of 2006"), S.2829. The bill would make energy price gouging a federal crime, as well as give federal authorities new powers "to prevent and prosecute manipulation of fuel supplies and anti-competitive behavior." http://democrats.senate.gov/energy/cleanedge/. With the Democrats now in control of both the U.S. House and Senate, it appears more likely that some sort of energy price-gouging legislation will be passed at the federal level. For its part, the Michigan Legislature has also looked at placing

restraints on energy prices. *See, e.g.*, HB 289 (forbidding price-gouging of gasoline "during an emergency period and in an emergency area").

- **Consumer Protection** – The Michigan Legislature is considering a number of changes to Sections 2, 3, 4 and 11 of the Michigan Consumer Protection Act. As described by the House Committee on Judiciary, HB 4044, 4045, and 4046 would

  > eliminate the current immunity against product liability lawsuits that specifically applies to drugs approved by the federal Food and Drug Administration (FDA); create a three-year window in which claims could be filed for injuries attributable to FDA-approved drugs during the time the immunity was in place; and allow civil suits to be filed under the Consumer Protection Act if a business misrepresented risks associated with a drug, herb, dietary supplement, or botanical supplement.

- Other bills to amend the Michigan Consumer Protection Act include: HB 4217 (proposing to amend Section 4; would explicitly place burden of proof on person who asserts act does not apply to a particular method, act or practice); SB 129 (proposing to amend Sections 3 and 11; would prohibit "unconscionable" sale or rental prices for "any essential commodity . . . dwelling unit or self-storage facility" during "an emergency period"); and SB 274 (proposing to amend Section 3; would prohibit a retailer from issuing a gift certificate or gift card that expires or charging a consumer who uses a gift card an inactivity fee or other service fee).

- **Second Requests Under Hart-Scott-Rodino** – Under the Hart-Scott-Rodino Antitrust Improvements Act, Pub. L. No. 94-435, 90 Stat. 1383 ("HSR"), entities that meet certain size and sales thresholds must notify federal authorities when they merge with or acquire another entity. The Federal Trade Commission ("FTC") recently reformed the "second-request" process by which it seeks additional information from the entities after the initial thirty-day waiting period. *See* Reforms to the Merger Review Process (Feb. 16, 2006). The changes are intended to streamline the process and lessen the burden on the entities. The changes include limiting the number of employees whose files must be searched to thirty five, and limiting the number of years the entities must "look-back" from three to two.

- **Electronic Filing** – Federal authorities have implemented an electronic filing system that allows merging and acquiring entities to submit their HSR notification filings via the Internet. 71 FR 35995-36007.

- **HSR Jurisdictional Thresholds** – As a result of recent HSR amendments, the FTC adjusts the jurisdictional thresholds based on annual changes in the gross national product. Among other adjustments, the FTC increased the minimum transaction size threshold from $53.1m (2005) to $56.7m (2006). It also increased the thresholds for filing fees. 71 FR 2943-2944.

- **Update to Business Activity Classifications** – In their HSR notification filings, merging and acquiring entities describe their business activities using the North American Industry Classification System ("NAICS"). The FTC has changed its rule to require that entities use 2002 as the base year for reporting activities, rather than 1997. 70 FR 77312-77319. In practical terms, this means that entities must use the 2002 version of the NAICS manual.

- **Premerger Notification for LLCs and Partnerships** – The FTC expanded the HSR notification rules for LLCs and partnerships. The FTC promulgated the rules to reconcile its treatment of corporate and unincorporated entities. Under the old rules, mergers and acquisitions involving partnerships and LLCs were rarely reportable. Under the new rules, transactions that result in a person holding at least 50% of the interests in a partnership or LLC may trigger the filing requirements if the minimum transaction size threshold is met. 70 FR 11502-11525.

For live links to these legislative and regulatory updates, as well as other research links covering antitrust, franchise, and trade regulation, please go to the Section's website at http://www.michbar.org/antitrust/news.cfm.

SECTION LISTSERV

Our section is now offering a free discussion e-mail listserv service to members. The purposes of our listserv are to encourage communication among our section members, provide a forum for discussion of current events affecting our section members of our section, and inform our section members of upcoming events affecting our section members or our section.

We have sent electronic invitations to members for whom we have an e-mail address. If you did not receive an invitation, or you wish to sign up for the listserv on your own, go to http://groups.michbar.org/, click on "AntiTrust," complete the form titled "**Subscribe to the Antitrust list.**"

Section News and Views

By Chair-Elect Paul Novak

Representatives from the Michigan State Legislature, the Michigan Governor's Office, petroleum trade associations, interested industry stakeholders, antitrust attorneys, and students attended the Antitrust Section's November 14, 2006 seminar entitled **Gasoline Pricing and the Antitrust Laws**. The seminar included a variety of speakers from both industry and government including:

- John Felmy, Chief Economist of the American Petroleum Institute;
- David Meyer, Economist at the Federal Trade Commission;
- Robert Hubbard, Chair of the National Association of Attorney General Antitrust Task Force and Assistant Attorney General in New York Attorney General Eliot Spitzer's office;
- James Adams, antitrust attorney at the Washington D.C. office of Howrey and, LLP.
- Paul F. Novak, attorney at Clark Hill PLC and former Division Chief of the Michigan Attorney General's Special Litigation Division; and
- Peter Gunst of the Associated Food and Petroleum Dealers.

A variety of topics were covered in the one day seminar including panel discussions on whether mergers in the Michigan petroleum markets had resulted in too much concentration in the industry, whether price fixing or "price gouging" was responsible for any of the recent high prices in the petroleum industry, and whether Michigan should enact proposed legislation "The Petroleum Marketing Stabilization Act" to prevent below cost or predatory pricing in the industry.

The seminar received positive reviews from the governmental policy makers and industry stakeholders in attendance and was an informative and educational "case study" on application of the antitrust laws in the context of a specific industry. Mr. Gunst and Mr. Meyer spoke respectively in favor of, and in opposition to, the proposed Petroleum Marketing Stabilization Act. The general consensus of the speakers was that no "grand conspiracy" was to blame for recent upward trends in Michigan gasoline prices (though a few speakers held out the prospect that localized markets might be the subject of collusive behavior).

The Antitrust and Trade Regulation Section is planning upcoming seminars on topics such as "health care markets and the antitrust laws" as well as a primer on Michigan Franchise Investment law. If you are interested in these topics, or others, feel free to contact Vice-Chair Paul Novak at 517-318-3034 with suggestions.

Franchising Corner

What Is a Franchise Fee Under MFIL?
The Michigan Court of Appeals' First Attempt to Answer

By Howard Yale Lederman
Treasurer and Publications Committee Chairperson
Norman Yatooma & Associates, P.C.

In the past several decades, franchising has exploded into "a giant engine of the American economy. According to the GAO Report (relying on International Franchise Association estimates), franchising accounts for `50 percent of all retail sales and…$1 trillion in sales annually in the United States.' [12]" [17] In the past two years, companies offering franchises nationwide grew by 900 to 2,500, according to a recent International Franchise Association-commissioned study.[18] "A recent PricewaterhouseCoopers study found that the franchising sector generates 18 million jobs in the United States alone and yields $1.53 trillion in economic output." [19] The number of franchise establishments has mushroomed to "more than 760,000…."[20] The 18 million jobs represent about 14% of U.S. jobs.[21] The $1.53 trillion represents about 10% of the U.S. private sector economy.[22] In Michigan,"[t]he number of companies selling franchises has grown 27% in Michigan since 2003, with 1,350 now operating, according to the Michigan Attorney General's Office." [23] Thus, notwithstanding Michigan's severe recession, franchising is big business.

Federal and state regulation has lagged way behind this franchising explosion. However, due to the huge imbalance of power between franchisor-franchisee and the proliferation of abuses, the Federal Trade Commission and 17 states began to act.[24] In 1974, the Michigan Legislature passed the Michigan Franchise Investment Act [MFIL] incorporating the FTC's franchise definition. [25] The statute's purpose was "to remedy perceived abuses by large franchisors engaged in manipulating, coercing or lying to unsophisticated investor franchisees." [26] The legislature defined three contractual requirements for MFIL 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

[17] US General Accounting Office, *Federal Trade Commission Enforcement of the Franchise Rule,* GAO-01-776 (July 2001), p5, http//www.gao.gov/new.items/d01776.pdf.

[18] Edward Wood Dunham, *Federal Franchise Legislation and Congress's Own Duty of Competence and Due Care,* reprinted from 21 Franchise L J (Fall 2001), http://www.wiggin.com/pubs/articles_template.asp?ID=144850112, p 3, citing and quoting the above GAO Report and International Franchise Association Estimates).

[19] International Franchising Association, *Welcome to the IFA,* http://www.franchise.org/:

[20] International Franchising Association, *Welcome to the IFA,* http://www.franchise.org/:

[21] Joanne Flemming, *Ready-Made Business,* Lake Winnebago B2B (___ 2005), citing 2003 PriceWaterhouse Study.

[22] Flemming, *supra,* citing 2003 PriceWaterhouse Study.

[23] Greta Guest, *Betting it all on a franchise,* Detroit Fee Press (December 10, 2006), pp 1A, 32A, citing Michigan Department of Attorney General information.

[24] *Disclosure Requirements and Prohibitions Concerning Business Opportunity Ventures [FTC Disclosure Requirements],* 16 CFR Ch 1, Parts 436.2(a)(1)(ii) & (2) effective October 21, 1979.

[25] Michigan Franchise Investment Law [MFIL], MCL 445.1501-MCL 445.1538.

[26] *Jerome-Duncan, Inc v Auto-By-Tel,* 989 F Supp 838, 842 (ED Mich 1997), citing Michigan House Legislative Analysis,

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."[27]

This article will focus on the third, franchise fee requirement.

The franchise fee requirement's purposes are to protect franchisees, especially "those entities [making] a firm-specific investment…where there is no investment, there is no fear of inequality of bargaining power."[28] MFIL defines a franchise fee as "a fee or charge that a franchisee or subfranchisor is required to pay or agrees to pay for the right to enter into a business under a franchise agreement, including but not limited to payments for goods and services. The following are not the payment of a franchise fee:

"(a) The purchase or agreement to purchase goods, equipment, or fixtures directly or on consignment at a bona fide wholesale price…."[29]

The Michigan Administrative Code includes regulations clarifying the franchise fee definition:

"(2) The words `fee or charge' as used in…the act include, but are not limited to:

"(a) Present payments, deferred payments, and royalty payments required of the franchisee by the franchisor arising from sales of goods or services offered by the franchisee or its agents or affiliates, or payments as a condition to maintaining the franchise relationship or other payment for payment for goods at a bona fide wholesale price….

"(c) Payments for services. These payments are presumed to be in part for the right granted to the franchisee to engage in the franchise business. Ideas, instruction, training, and other programs are services and not goods, irrespective of whether offered, distributed, or communicated by word of mouth, through instructions or lectures, in written or printed form, by record or tape recording, or any combination thereof…..

"(e) Minimum purchase or minimum inventory requirements other than at a bona fide wholesale price for which there is a well-established market in this state."[30]

The Michigan Administrative Code also includes a "bona fide wholesale price" definition: It "refers to a price that constitutes a fair payment for goods purchased at a comparable level of distribution, and no part of which constitutes a payment for the right to enter into, or continue in, the franchise business…."[31]

Until mid-2006, Michigan appellate courts had not decided any significant cases centering on MFIL's franchise fee requirement. However, on May 25, 2006, the Michigan Court of Appeals decided

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[27] MCL 445.1502(3).

[28] *Wright-Moore Corp v Ricoh Corp,* 794 F Supp 844, 850 (ND Ind 1991) (on remand). *Accord, Wright-Moore v Ricoh Corp,* 908 F2d 128, 136 (CA 7, 1990) (both summarizing legislative purposes behind most state franchise laws and Indiana Deceptive Franchise Practices Act), *Kenosha Liquor Co v Heublein, Inc,* 895 F2d 418, 419 (CA 7, 1990) (Wisconsin Fair Dealership Act), *Forester, Inc v Atlas Metal Co,* 105 Wis 2d 17, 24; 313 NW2d 60 (1981) (same), *Moodie v School Book Fairs, Inc,* 889 F2d 739, 742 (CA 7, 1989) (same), *Moore v Tandy Corp,* 819 F2d 820, 822-823 (CA 7, 1987) (same), *Thueson v U-Haul International, Inc,* 144 Cal App 4th 664,, 675; 50 Cal Rptr 3d 669 (2006), *modif* 2006 Cal App Lexis 1833 (2006) (California Franchise Investment Law), *Gentis v Safeguard Business Systems, Inc,* 60 Cal App 4th 1294, 1298-1299; 71 Cal Rptr 2d 122 (1998), *review den* 1998 Cal Lexis 2531 (1998) (same), *Getty Petroleum Marketing, Inc v Ahmad,* 253 Conn 806, 819; 757 A2d 494 (2000) (Connecticut Franchises Law), *Hartford Electrical Supply Co v Allen Bradley Co,* 250 Conn 334, 345; 730 A2d 824 (1999) (same), *Kubis & Perszyk Associates, Inc v Sun Microsystems, Inc,* 146 N J 176, 182-184; 680 A2d 618 (1996) (New Jersey Franchise Practices Act).

[29] MCL 445.1503(1).

[30] Mich Admin Code R 445.101(2).

[31] Mich Admin Code R 445.101(6).

Hamade v Sunoco, Inc (R & M).[32] There, for the first time, a Michigan appellate court analyzed MFIL's franchise fee requirement.

In *Hamade,* in 1986, Mr. Kheireddin Hamade, with Sunoco's approval, bought a Sunoco gas station and "entered into a dealer supply franchise agreement with Sunoco, which lasted until 1989."[33] Then, the parties entered into another such agreement covering the 1989-1992 period. From 1992 to 1997, the parties annually extended the 1989 agreement. Then, Sunoco conditioned its signature on a new agreement on Mr. Hamade's agreement to a mandatory monthly fuel sales increase from 42,000 gallons to 94,000 gallons, well over a 100% increase. Sunoco also conditioned its signature on Mr. Hamade's agreement to arrange for and pay for larger fuel tanks, relocation of the fuel tank area, installation of a canopy, installation of larger service station islands and fuel dispensers, and remodeling of the service station store. All these mandates arose from Sunoco's pressure on Mr. Hamade to sell more and more fuel.

Although these mandates cost him $400,000-$500,000, Mr. Hamade completed them. After loaning Mr. Hamade $55,000 for part of these mandates, Sunoco conditioned any long-term agreement on his agreement to repay this loan. Mr. Hamade accepted the precondition. In addition, Sunoco loaned him certain equipment valued at $43,500. Sunoco amortized these loan and equipment charges over the subsequent 1997 contract period. The parties agreed on a 1997 contract incorporating these and other provisions described below. In September 2000, Sunoco approved the opening of a new Sunoco station about a mile away from Mr. Hamade's station. This event coupled with Sunoco's December 2000 delivery of bad fuel, drove customers away and caused his station to fail.

In 2001, Mr. Hamade sued Sunoco on several claims, including MFIL claims. In 2003, he amended his complaint to include additional MFIL claims. On July 25, 2005, Defendants moved for summary disposition on the MFIL claims. On August 26, 2005, the lower court granted the motion, holding that MFIL did not apply, because Mr. Hamade had not paid a franchise fee. Mr. Hamade appealed to the Michigan Court of Appeals.

On May 25, 2006, the Court affirmed. Since Defendants had not contested Mr. Hamade's fulfillment of the first two requirements for MFIL application, the Court focused solely on the third requirement, the franchise fee requirement. As Mr. Hamade admitted at his deposition that he had not paid a direct franchise fee, but asserted that he had paid an indirect franchise fee, the Court focused on the indirect franchise fee issue.

Throughout its decision, the Court ignored MFIL's remedial legislative purpose and the huge imbalance of power between Mr. Hamade and Sunoco. The Court interpreted the relevant statutory and regulatory provisions without even alluding to either. This failure opened the Court's decision to legitimate criticism.

First, the Court rejected Mr. Hamade's position that Sunoco's compulsory monthly fuel sales quota increase from 42,000 gallons to 94,000 gallons imposed an indirect franchise fee. The Court adopted the reasoning of two cases interpreting other states' franchise laws: *Digital Equipment Corp v Uniq Digital Technologies, Inc* and *Wright-Moore Corp v Ricoh Corp*.[34]

"`An obligation to carry a large inventory can be the economic equivalent of a franchise fee. An excessively large inventory transfers cash to the seller without producing benefits for the buyer; and the interest the seller earns by making the sales

[32] *Hamade v Sunoco, Inc (R & M),* 271 Mich App 145; 721 NW2d 233 (2006), *lv den* 477 Mich 912; 722 NW2d 808 (2006).
[33] *Id* at 148.

[34] *Digital Equipment Corp v Uniq Digital Technologies, Inc,* 73 F3d 756, 760 (CA 7, 1996), *Wright-Moore,* 908 F2d 128, 136.

earlier is a kind of fee. Like a cash payment, it transfers wealth from buyer to seller.'"[35]

The Court found that the sales price was a bona fide wholesale price, as Sunoco required him "to purchase his monthly quota of fuel at the dealer tank wagon price (DTW) price in effect at the time and place of delivery."[36] While Sunoco presented affidavits of two employees responsible for setting DTW prices explaining how the DTW price was a wholesale price, Mr. Hamade's contrary evidence was inadequate. Moreover, there was evidence that during the year before the signing of the 1997 agreement, Mr. Hamade "was selling a monthly average of fuel closer to the agreed-upon amount of 94,000 gallons a month."[37] Accordingly, the Court found that sales quota "reasonable in light of [his] sales history."[38] The Court also rejected Sunoco's approval of a new dealership a mile away and delivery of tainted fuel as "irrelevant," because the relevant time for determining whether a franchise exists is "at the time of the offer or sale."[39] Thus, the Court concluded that an indirect franchise fee arising from the vastly increased monthly fuel sales quota or fuel prices was absent. The Court's conclusion and reasoning on the inventory requirement and sales price issues were well-supported.

Next, the Court held that the 1997 agreement's "$10,000 collateral deposit" was not an indirect franchise fee. The agreement required Mr. Hamade to deposit that amount with Sunoco to pay any past, present, or future debts to Sunoco. "Sunoco was obligated to pay interest on the collateral deposit and had to return it to Hamade at the end of the agreement."[40] The Court concluded that the compulsory deposit was not an indirect franchise fee, because there was not "a transfer of wealth from the franchisee to the franchisor."[41] The Court relied on *Implement Service, Inc v Tecumseh Products Co,*[42], where a federal district court interpreting the Indiana Deceptive Franchise Practices Act found no indirect franchise fee arising from a dealer's performance of free warranty work for customers. The manufacturer reimbursed the dealer for the warranty work, thereby removing any transfer of wealth. The Court reasoned that as Mr. Hamade had "retained ownership of the deposited funds and was not deprived of the time value of the funds [due to earned interest], there was no transfer of wealth to Sunoco" and no indirect franchise fee."[43]

The Court's analysis had a serious drawback. The Court overlooked Sunoco's compulsion for Mr. Hamade to deposit the $10,000 with Sunoco. This compulsory deposit was a precondition of Sunoco's agreement to contract with Mr. Hamade. This compulsion overrode the requirements for Sunoco to pay interest on the deposited funds and return them. These two requirements did not change the compulsory deposit from a contract precondition. Accordingly, the Court's reasoning on the mandatory deposit was erroneous and incomplete.

Then, the Court held that Sunoco's compulsory service station rehabilitation costing Mr. Hamade $400,000-$500,000 did not constitute an indirect franchise fee for several reasons. First, the Court emphasized that he paid a contractor, not Sunoco, to rehabilitate the station. Second, the Court pointed to the $43,500 equipment loan. Third, the Court characterized the $55,000 loan "to pay for the installation of the loaned equipment" as a gift.[44] Fourth, the Court cited the rehabilitation part involving "the remodeling of the garage bays into a convenience store, whose profits benefited only Hamade."[45] While recognizing that "Sunoco

[35] *Hamade,* 271 Mich App 145, 156, quoting *Digital Equipment Corp,* 73 F3d 756, 760.

[36] *Hamade,* 271 Mich App 145, 157.

[37] *Id* at 158.

[38] *Id.*

[39] *Id* at 159.

[40] *Id* at 160.

[41] *Id.*

[42] *Implement Service Service, Inc v Tecumseh Products Co,* 726 F Supp 1171, 1179 (SD Ind 1989).

[43] *Hamade,* 271 Mich App 145, 160.

[44] *Id* at 161.

[45] *Id.*

indirectly benefited from the improvements to the extent that the improvements might contribute to an increase in the sale of fuel," the Court found that any such increase "also benefited Hamade."[46] Concluding that "the improvements primarily benefited Hamade(,) rather than Sunoco, " the Court determined that they did not establish an indirect franchise fee.[47]

The Court's reasoning on payment to a contractor, though representing predominant case law, is not meritorious. *Implement Service* involved a small engine dealer's performance of free warranty work on small engines. The Court concluded that this performance did not constitute a franchise fee, as the dealer performed the work for customers, not the manufacturer. The dealer also conducted training schools for others and distributed advertising displays. The Court concluded that these services involved no indirect franchise fees, as they were ordinary business endeavors leading to ordinary business expenses, and the dealer performed them for others. Then, *Implement Service* referred to *Premier Wine & Spirits of South Dakota, Inc v E & J Gallo Co.*,[48] where the Court referred to the California Commissioner of Corporations' guidelines reading as follows: "`A payment to or for the account of third parties not affiliated with the franchisor is not a `franchise fee' within the meaning of Section 31011 [of the California Franchise Relations Act], even though the franchisee is required by the agreement to make such payment and even if the franchisor collects it from the franchisee on behalf of a third party if such payment is not made for the right to enter into business.'"[49] Finally, the Court cited three other cases, where the courts "held that payments to third parties do not constitute payment of a `franchise fee.'"[50] These decisions rested on the same ordinary-extraordinary and franchisor-third party distinctions as noted above, and the courts did not explain explain the latter distinction's rationale.

The above guidelines and case conclusions contradicted the franchise acts' remedial legislative purpose and introduced unjustified franchise fee distinctions. If a franchisor compels a franchisee to pay a fee to attend training sessions as a condition of signing a franchise agreement, the compulsion to pay should be a franchise fee. The key is not to whom the prospective franchisee pays the fee, but who requires it to pay the fee. Whether the franchisor conducts training classes or seminars with in-house employees or contracts with a third party to conduct the classes or seminars makes no difference. The requirement is the same. Moreover, such training classes or seminars are not ordinary business expenses, but extraordinary, unusual business expenses. Thus, permitting these expenses to constitute franchise fees does not bring every sales relationship within the franchise laws. These principles apply to Mr. Hamade's payments to a contractor to remodel the station. His remodeling expenses were not ordinary business expenses, but extraordinary business expenses. His payment to an outside contractor, rather than to Sunoco, to remodel the station should make no difference. The key is Sunoco's requirement that Mr. Hamade remodel the station. Sunoco's requirement made Mr. Hamade's payments to the remodeling contractor indirect franchise fees.

The second and third parts of the *Hamade* Court's reasoning regarding the service station rehabilitation likewise contradicted the franchise acts' remedial legislative purpose and were not meritorious. The $43,500 equipment loan charge and the $55,000 were indirect franchise fees, because Sunoco conditioned its approval of the 1997 Agreement on Mr. Hamade's agreement to repay these amounts. The repayment requirement negated the Court's finding that the $43,500 equipment loan charge was a gift. Likewise, the repayment requirement negated the Court's finding

46 *Id* at 162.

47 *Id.*

48 *Premier Wine & Spirits of South Dakota, Inc v E & J Gallo Co,* 644 F Supp 1431 (ED Cal 1986).

49 *Id* at 1438-1439, quoting California Commissioner of Corporations, *Guidelines for Determining Whether an Agreement Constitutes a `Franchise,'"* CCH Business Franchise Guide, para 7558 at 12,353.

50 *Id* at 1438.

that the $55,000 loan to pay for the installation of the above equipment was a gift. Both amounts were loans. The Court's reasoning that Mr. Hamade's purchase of every required gallon of fuel changed the $55,000 amount from a loan into a gift overlooked that repayment of the loan remained mandatory. Mandatory repayment of a gift is self-contradictory. Amortization through fuel purchases was only the repayment means. It did not change the requirement or repayment facts. Neither MFIL nor the regulation mandated any particular form of repayment for repayment to meet the indirect franchise fee requirement. The Court also overlooked MFIL's remedial legislative purpose.

The remaining parts of the Court's reasoning regarding the service station rehabilitation are likewise not meritorious. In deciding a motion for summary disposition, the Court had no business deciding whom the station rehabilitation benefited more. Again, the Court ignored Sunoco's requirement to rehabilitate the station. In its benefits finding, the Court focused on the $43,500, the $55,000, and the convenience store profits. But the Court said little or nothing about Sunoco's compulsory condition and its obvious reason. Sunoco compelled the convenience store, because Sunoco had decided that it was important in attracting customers to the station to buy fuel. Thus, the convenience store benefited Mr. Hamade and Sunoco. The Court's focus on benefits was beside the point. The compulsion was the point. If he wanted to contract with Sunoco, Mr. Hamade had to remodel the garage into a convenience store. He had to pay $400,000-$500,000 to do so. He had to repay $55,000 and $43,500 amounts. Since these payments were mandatory to meet Sunoco's rehabilitation condition, they constituted indirect franchise fees.

Moreover, the Court concluded that Sunoco had conditioned its signature on the 1997 Agreement "on his [Mr. Hamade's] ability to repay the $55,000 loan made with the signing of the agreement."[51] The loan was "amortized over the term of the agreement. If the agreement was terminated for any reason, Hamade was obligated to return the unamortized portion….the amortization…was linked to the total fuel Hamade was required to purchase during the [agreement] period….For every gallon of fuel Hamade purchased, the advance was amortized by `.00975 cents' Thus, if Hamade fulfilled his obligations under the 1997 Agreement, he would not be obligated to return the advanced funds. Consequently,…the $55,000 advance was not a loan. Instead, it was a transfer of wealth from Sunoco to Hamade, [though]…amortized over the life of the agreement."[52] The Court found Mr. Hamade's affidavit stating that the $55,000 amount was a loan was "conclusory" and contradictory to his deposition testimony.[53] In dicta, the Court stated that if the $55,000 amount was a loan, "Plaintiff presented no evidence that [he] was required to accept a loan from Sunoco as a condition of entering into the 1997 Agreement," and "the repayment of loan principal is not a transfer of wealth from the franchisee to a franchisor."[54] While recognizing that compulsory franchisee payment of interest above "the fair market rate" to the franchisor "might arguably constitute the indirect payment of a franchise fee, " Mr. Hamade did not present any evidence of any Sunoco-charged interest.[55] For these reasons, the Court found that the 1997 Agreement provision on the $55,000 transferred amount did not create on indirect franchise fee.

The analysis preceding the above paragraph applies to this paragraph. Furthermore, as stated further above, amortization of the loan meant repayment of the loan. Amortization was the repayment means. It did not change the $55,000's nature. Also, the amortization's existence contradicted the Court's statement that the $55,000 was a transfer of wealth from Sunoco to Mr. Hamade. If Sunoco's $55,000 payment to Mr. Hamade represented a transfer of wealth from Sunoco to Mr. Hamade, why wouldn't his repayment represent a transfer of wealth from

[51] *Hamade,* 271 Mich App 145, 162.

[52] *Id* at 163.

[53] *Id.*

[54] *Id* at 164.

[55] *Id.*

Mr. Hamade to Sunoco? The Court's focus on interest was beside the point. Sunoco's 94,000 gallon a month mandatory fuel purchase quota was so exorbitant that interest was unnecessary. Additionally, the compulsion, not interest's presence or absence, made Mr. Hamade's payments indirect franchise fees. Nor was Mr. Hamade's affidavit conclusory. He stated that if he had not agreed to rehabilitate the station and repay the above amounts, Sunoco would not have contracted with him. He stated that Sunoco had conditioned its signature on the 1997 Agreement on his agreement to buy 94,000 gallons of fuel a month, pay for the loaned equipment, and repay the $55,000 amount. Accordingly, the Court's interest, amortization, and affidavit findings were erroneous.

Therefore, the Court held that Mr. Hamade did not meet the MFIL franchise fee requirement, that he did not have a franchise relation with Sunoco, and that MFIL did not apply. In doing so, the Court created express and implied guidelines on what would constitute an indirect franchise fee. While helpful to practitioners, these guidelines are subject to challenge, and practitioners should feel free to challenge them.

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