Can A Franchisor Require Franchisees to Buy Supplies, Ingredients, or Products From It?

by Howard Ullman on February 28, 2012

Tied in Knots?

The antitrust laws sometimes forbid product "tying." A tying arrangement is an agreement by a party to sell one product on the condition that the buyer also purchases a different (or tied) product. In the franchise context, franchisors sometimes require franchisees to buy products from them or affiliated companies. Are these arrangements lawful?

Franchisors and franchisees see these arrangements differently. The franchisees – perhaps upset with the pricing of the franchisor-supplied products – may allege an antitrust violation, claiming that the franchise is the "tying" product and the required supplies or ingredients are the "tied" products. (Such ties can hurt competition in the tied product market – for example, if fast food franchises are at issue, ties could deny an important customer base to a competing supplier of food ingredients. That is what makes ties potentially anti-competitive.) The franchisor, of course, will argue that it is entitled on quality, reputation, uniformity, and consistency grounds to require that only certain supplies, ingredients, or products be used in its franchised operations.

The courts' treatment of these claims has been somewhat complicated and not entirely uniform. It's probably safe to say that these claims will fail if the franchisor lacks "market power" in the tying product market, or if the plaintiff does not adequately allege product market definitions. In the past, these market power and market definition requirements have stymied plaintiffs. But, as I note below, these claims have not been entirely foreclosed.

In Queen City Pizza, Inc. v. Domino's Pizza, Inc., 124 F.3d 430, *reh'g denied*, 129 F.3d 724 (3d Cir. 1997), the Third Circuit took a strict view of how to determine the relevant product markets. The plaintiff franchisees argued that Domino's had tied the franchise to the purchase of ingredients and supplies, and that the ingredients and supplies used in the operation of a Domino's pizza shop constituted a relevant market. (The plaintiffs also alleged, among other things, that Domino's had power in the market for "Domino's approved" pizza dough and used that power to force plaintiffs to buy unwanted ingredients and supplies in the "aftermarket" for sales of supplies to Domino's franchisees, and that Domino's had monopolized the market for ingredients and supplies used in Domino's stores.)

The court disagreed, holding that the relevant product market could not be limited to Domino's franchisees. The ingredients and supplies used in a Domino's franchise were interchangeable with products from other suppliers used in the broader market. The question was not whether a Domino's franchisee could use both approved and non-approved products, but whether pizza makers generally could use such products interchangeably. They could. The franchise agreement's contractually-imposed exclusivity restraints could not amount to or create market power; the question was whether the franchisor had pre-contract market power, not whether it had post-contractual "power" under the franchise agreement.

However, two relatively recent cases illustrate that the law in this area may not be entirely settled, or at least that tying claims in the franchise context are not completely dead. For example, in *Burda v. Wendy's International, Inc*., 659 F. Supp. 2d 928 (S.D. Ohio 2009), the court refused to dismiss a franchise tying claim. Wendy's had allegedly insisted that franchisees purchase foods or ingredients from it (or its affiliates) after franchisees entered into a franchise agreement that, at least according to the pleadings, did not contemplate such exclusivity. The lack-of-disclosure-at-time-of-franchising allegation was significant. Because the Wendy's franchisees allegedly did not know that the "market power" was contractually established by the franchise agreements, the court concluded that *Queen City Pizza* was not controlling. (In *Queen City Pizza*, the standard form franchise agreement expressly provided that Domino's reserved the right to require ingredients and supplies to be purchased exclusively from it.)

Compare *Burda* with *Martrano v. The Quizno's Franchise Co., L.L.C*. (W.D. Pa. 2009). There, the court rather quickly dismissed a tying claim, reasoning that the alleged market for "Quick Service Toasted Sandwich Restaurant Franchises" was improper as a matter of law. Before plaintiffs signed their franchise agreements, they could have chosen among other fast food franchises, or, more narrowly, among other fast-food sandwich franchises. In such markets, Quizno's did not have market power. Therefore, plaintiffs had no tying claim.

So what's the upshot? First, franchisors still have broad abilities to impose supply and ingredient restrictions. But they are much safer if they do so as part of the franchise disclosures and the franchise agreement, rather than imposing them later. Such surprise restrictions may stimulate arguments that franchisees are suddenly "locked in" to exclusive sources of supply in connection with a market where the franchisor has market power, and ultimately prompt the filing of antitrust claims.

Second, in rejecting an aftermarket claim, the *Queen City Pizza* court stressed that the ingredients and supplies at issue were interchangeable with other ingredients and supplies on the broader market. The only factor that differentiated them was that they were approved by Domino's. There may be cases, however, where products are not interchangeable. If the franchisor supplies truly unique products, and requires franchisees to purchase the products exclusively from it, some caution and further analysis is warranted.

Tagged as: Franchising, Market Definition, Tying