TERMINATIONS AND REFUSALS TO DEAL
A State Law Perspective
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INTRODUCTION

"The substitution of one distributor for another in a competitive market of the kind herein does not eliminate or materially diminish the existing competition of distributors of other beers, is not an unusual business procedure, and, in our judgment, is not an unreasonable restraint of trade." Ace Beer Distributors, Inc. v. Kohn, 318 F. 2nd 283 at 287 (6 Cir), cert. denied 391 U.S. 1062 (1968)

"Who says that competition is supposed to be fair, that we judge the behavior of the market place by the ethics of the courtroom? Real competition is bruising rivalry, in which people go out of business under intense pressure... [C] ompetition is 'a gale of creative destruction.'" Fishman v. Estate of Wirtz, 1986-2 Trade Cas. (CCH), ¶ 67,356 (7 Cir. 1986) (Easterbrook, J. dissenting)

“It is almost always possible to write a contract provision with greater precision, although often the possibility is not apparent until a dispute has arisen.” Century 21 Real Estate Corp. v. Meraj Investment Corp. No. 01-1330 Slip op. (10 Cir. Jan. 13, 2003)

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I. Overview--
Topical Context
Distribution Rights,
A Property Right, Its Ownership and "Value":

A. Lawsuits by terminated wholesale distributors, retail dealers and product and format franchisees against a former supplier or franchisor are a common occurrence. Typically, these lawsuits involve terminations or forced-sale episodes triggered by a supplier joint venture or corporate takeover or a supplier's efforts to consolidate, downsize and otherwise alter its distribution system or add or switch distribution channels. Not infrequently, claims are made also against the replacement distributor. And today, as suppliers remarket and retool their systems and expand into new distribution channels or onto the Internet, an increasing number of distributors sue suppliers for "poaching", encroachment and interference with prospective advantage.

The following materials address claims frequently asserted to protect distributors' ongoing economic interests and expectations. Distributor lawsuits are not confined to traditional contract and
quasi-contract claims. Frequently they are rooted in the Uniform Commercial Code, special-purpose state laws, dealing with franchise and traditional manufacturer-distributor or dealer relationships, trademark statutes, and common law business relationship and tort principles.

In the latter category falls South Carolina’s recognition of an actionable business tort claim arising not from issues of existence of a right to terminate but rather from the unconscionable way in which a termination is executed. \textit{deTreville v. Outboard Marine Corp.}, 439 F.2nd 1099 (4 Cir. 1971).

The special-purpose state statutes commonly and variously are called “dealer protection”, “franchise fair dealing”, and “distributor and dealer relationships” laws. They are of two types: those of general application (19 states and Puerto Rico, Virgin Islands and District of Columbia,) and those of a “special industry” variety, e.g., typically, motor fuel retailers, automobile dealers, farm implements dealers and beer, wine and spirits distributorships.

These materials are not intended to be exhaustive. They intend to be instructive of the wide array of contract, common law, equity and statutory claims available to remedy commonplace termination scenarios. They won't answer questions about industry-specific situations. Blocking-and-tackling fundamentals are to be re-taught and updated.

We will focus on when a distribution contract exists and when it doesn't and on garden-variety contract construction questions. Then, we'll examine circumstances when law and equity or a remedial statutory scheme can impose additional --and, frequently, not-so-obvious-- affirmative duties on parties to various distribution and marketing arrangements.

Commentary is offered about often-paradoxical directions the law sometimes takes. Other times, this commentary offers a recommended "practice guide", suggesting useful analytical and discovery tools or a insight or two to aid corporate and private practitioners craft more creative offensive or defensive game plans.

In these remarks, particularly those in the immediately following introduction, we note it is difficult to consistently put forward purely neutral, ideologically free statements of the law and simultaneously offer useful context in terms of a thorough, pragmatic understanding of the sharply divergent business and human factors giving rise to the underlying controversies. Accordingly, we ask readers' indulgence.

Also the following \textit{A Property Right, Its Ownership and "Value”} section, these materials seek to advance the understanding of counsel for lenders and investors in distributorship properties.

Attention is also directed to a later section in these course materials titled "Third Party Solutions to Consolidation-Termination Disputes". It aims to augment this rights and remedies discussion by exploring successful litigation avoidance and collaborative techniques and offering insight into ostensibly conflicting motivations of mature industry supplier-brand owners and their distributors in disputes about consolidation-termination compensation, contract amendment and conduct that alters the fundamental economic and competitive circumstances of a supply chain
B. Throughout, these materials place emphasis on the respective rights of the parties to clashes prompted by supplier expansions into new channels and into patronage that encroaches a protected franchisee territory or product line.

Similar problems are examined in the context of supplier moves to recalibrate, reshape and “remarket” a system. These moves include direct or joint ownership that bypasses existing independent outlets, conceiving and executing brand exclusivity programs to rein in interbrand competition in multibrand distributorships and between the overlapping networks of acquisitive multibrand producers and importers, material alteration of the manner in which a supplier interacts with large regional, national and global retailers, particularly regarding delivery logistics and delivered pricing, and direct supplier intervention in independent owner-operator operations to undbundle warehouse and delivery from promotion and merchandising functions.

For the most part, these remodeling projects aim to drive down supply chain intermediaries’ profit margins and by doing so to make the supplier’s brands more attractive to high velocity national discounters and mass merchandisers seeking lower delivered costs. Not infrequently these power buyers limit their retail margins to nearly half the margins earned by wholesaler and rival dealers.

The vital importance to suppliers of gaining or preserving such unfettered “flexibility” to reorganize time-honored distribution networks in order to perk up performance and profits and gain greater brand identity is evident in the words of Judge Easterbrook, speaking for a unanimous 7th Circuit panel in Kendall-Jackson Winery Ltd. v. Branson, 212 F. 3rd 995 (7 Cir. 2000). The court rejected an appeal by wholesalers of spirits and wine of an injunction in an action by their suppliers, who claimed an expansive revamp of state laws regulating the relationships between companies marketing and distributing alcoholic drinks, know as the Illinois Wine and Spirits Industry Fair Dealing Act of 1999, was constitutionally impaired. The measure’s flaw was a ban against distillers, vintners and their importer counterparts from terminating or significantly altering new and existing distribution arrangements without “good cause”, which the act defined in terms of the objective criteria of some distributor deficiency, fault or act of bad faith. [Not in issue was a comparable law passed decades earlier governing brewery/importer and beer distributor relationships.]

In opening his opinion and without any reference to the record on appeal, Judge Easterbrook gratuitously observed: “[S]uppliers, which often encourage competition the relationships between companies marketing and distributing alcoholic drinks, among distributors for the privilege of acting as wholesalers (a process that holds down the cost of distribution services) were dismayed by the new statute.”

Judge Easterbrook doesn’t identify the “cost” or say whether or not the only “cost of distribution” the plaintiff marketers wished to or feasibly could hold down was their wholesalers’ profit margins. Nor does the opinion explain whether the putative competition Judge Easterbrook alludes to squeezed this cost component entirely out of the system or merely shifted, reallocated and delivered middleman profits to other presumably needy market players.
Global business guru McKinsey & Company is much more forthcoming on these questions. Frank, plainspoken answers point to increased producer profitability as the overriding driver. The answers to the queries Judge Easterbrook didn’t make are found in a recent McKinsey study.

Released in late-January, 2003, the study examines how, despite the lack of a “free hand” and the modicum of control they have over dealerships under state franchise laws --which the consultancy says “protect dealers from such intrusive moves”-- and the EU’s “revised block exemption” slated to take effect by October 2003 --which the consultancy portrays as “designed to erode the manufacturer’s control over car retailing”-- U.S. and European automobile marketers still can alter their traditional supplier role and restructure their dealer networks to reduce inefficiencies and achieve overall system performance improvements.

According to the published study, auto manufacturers’ mission is to relocate and purge poor performers and “sleepy family businesses”, who McKinsey charges “lack market intelligence”, so as to better “coordinate” the sales and pricing efforts of thousands of geographically-dispersed dealerships, and attain “an optimally configured network, [where] the manufacturer must put the best dealers in control”.

McKinsey consultants’ candidly state:

“Auto manufacturers…have a distribution headache: their retailing systems built up in an incremental and uncoordinated way over several decades, are relics of the past. Given the wafer-thin profits that manufacturers in both markets currently realize on car sales, these companies are in sore need of the extra margins that a more efficient distribution system could deliver. Indeed, there is plenty of room for consolidation as well as other efficiency-enhancing improvements, but both markets have been highly regulated in ways that stifled change….” Knupfer, Richmond, Vander Ark, “Making the most of US auto distribution”, The McKinsey Quarterly, 2003 No. 1 p. 36 (Emphasis supplied.)

The topics that Judge Easterbrook and McKinsey address center on distribution system downsizing and consolidation and other reshapings of distribution logistics, profit models and strategy. They are of great and immediate consequence today and supply the backdrop of this part of the course. So, it appears worthwhile to digress momentarily in this introduction to examine these paradigms of 21st Century commerce in an overview of the increasingly typical franchise-distribution contract conflicts to which they give rise.

No longer are commonplace contracts cribbing other companies’ and textbook templates, which for the most part laundry-list the parties’ respective duties in relatively inoffensive terms that overtly the agreement can be used as a selling tool for franchises and dealerships. Today, minimally acceptable practice is documentation –a base contract and reams of incorporated accordion-like performance and operating standards customized to the particular industry-- concerned about assuring it’s the supplier’s individualized business judgment and competitive plans that set the benchmark of unsatisfactory performance, limiting the supplier’s potential exposure to claims of contract default, and insisting merchant customers abdicate their right to jury trial in favor of binding