Distributorship and franchise wrongful termination and breach of contract disputes cases follow common patterns. By and large, these disputes fit neatly into 9 models. They can be organized in terms of the objectively provable market conditions faced by the parties at the time or the subjective motivation underlying a supplier's actions:

1. The distributor repeatedly falls short and fails to comply with its explicit and implied sales, distribution, promotion, working capital, ownership and management or other material agreement obligations.

2. The supplier repeatedly falls short of its explicit and implied supply, marketing, advertising, or other duties to support.

3. Overall market prospects for the relationship fall short of the parties expectations, for example where the product or brand is negatively impacted by social, cultural and political and regulatory dynamics or public controversy.

4. Time expires.

5. A third-party suitor offers supplier or distributor a better deal or the basis for a greater return on investment.

6. Distributor or supplier engages in anticompetitive conduct, fraud and dishonesty, economic abuse, overreaching or comparable criminal wrongdoing.

7. Supplier or distributor undertake actions perceived to create a "hostile workplace" for the other's employees or repeatedly conduct themselves in ways which constitute lawful or unlawful economic, business, racial, sexual or other discriminatory, arbitrary, unfair, deceptive or opportunistic policies that destroy the core of mutual trust and allegiance among system members and, consequently, endangers the entire distribution network’s stability and its potential for reliable growth and profits going forward.

8. Supplier perceives --correctly or not-- individual or groups of small distributors lack the financial wherewithal, profits for reinvestment or creditworthiness or are insufficiently motivated to generate additional long-term capital. Thus, the supplier concludes its distributors cannot or will not undertake costly capital improvements and added functions required to "remain competitive" in a fast changing technological and competitive environment, for example, capital for investment in computers, leading-edge software and communications equipment to track retail inventories and sales patterns.

9. Supplier --or, infrequently, distributors-- strategically reorganize, realign, restructure or consolidate and displace established distribution methods or markets to stimulate greater
efficiencies, productivity, revenues and profits or market share. 

These last two models are the most problematic. In both, while perhaps triggered by alterations on the regulatory landscape and comparable externalities, the driving dynamic of change is a supplier's internal, subjective economic rationale, not any sense of distributor default, deficiency or performance shortcomings which can be tested by objective measures.

SUBJECTIVE AND OBJECTIVE CAUSE:

It is vital in termination and consolidation planning that suppliers remain wary of the vital distinction between “subjective” and “objective” cause.

The differences are outcome-determinative in states where compatibility with general purpose franchise and industry-specific distribution relationship laws is the litmus test of a supplier’s success in ridding itself of a distributor, opting out of an agreement, substituting one standard form agreement with another, or implementing consolidations and system-rationalizations without the prospect of a preliminary injunction and without compensation.

This seminal issue arises under general application and industry-specific statutes [e.g., format and product franchises, alcoholic beverages, gasoline/petroleum products, farm implements, lawn and garden equipment, and construction and industrial equipment] in Alabama, Arizona, Arkansas, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, Nevada, New Jersey, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Vermont, Virginia, Washington, West Virginia and the District of Columbia. For a comprehensive listing of statutory citations for general application relationship laws and a checklist of industry-specific law jurisdictions, see CCH Product Distribution Guide (Foley & Lardner, 1999) §4.01C.

A standard formulation of such broad state minimum commercial conduct standards for material modification, rescission, cancellation, termination or non-renewal of documented and undocumented supplier-distributor arrangements is--

“the failure by any party to an agreement, without reasonable excuse or justification, to substantially comply with an essential, reasonable and commercially acceptable requirement imposed by the other party under the terms of an agreement”. Pennsylvania Liquor Code, 47 P.S. §4-431(d)(1)(1980).

In a few jurisdictions, the statutory compliance threshold is slightly narrower; focusing not on the “agreement” in a vacuum, but rather on the entire “business relationship” from a relationship’s the onset.

So, for example, under the brand new the New York “Malt Beverage Fair Dealing Law, a wrongful termination occur absent a failure to meet what, presumably after bargaining, the parties confirm in writing to be “all essential and material terms, requirements, standards of performance and
conditions of the business relationship,...provided the [supplier] has acted in good faith”. Subdivs. 2(g) and 3, §55-c of Chap. 3-B of New York Consolidated Laws (effective Sept. 25, 1996)(emphasis supplied). That act also expansively defines “material modification” of an agreement, for which “good cause” is the predicate, beyond the words within the four-corners of a contract to include “a substantial and significant change in the competitive circumstances under which the agreement was entered and is performed which is caused by a brewer without fault on the part of the wholesaler.” Id. §3. .

An large number of these state relationship laws interpret “good cause” to mean the supplier’s termination and non-renewal judgments are tested against standards of objective reasonableness [distributor fault or deficiency], rather than a subjective reasonableness [any sound business justification of the supplier]. E.g., “Malt Beverage Fair Dealing Law”, subdivs. 2(e)(ii), (f), (g), 4, §55-c of Chap. 3-B of New York Consolidated Laws (effective Sept. 25, 1996); See, Wright-Moore Corp. v. Ricoh Corp., 908 F. 2nd 128 (7 Cir. 1990); Chrysler Motors v. Nebraska Mtr. Veh. Ind. Lic. Bd., 274 NW 2d 862 (1979); Dr. Pepper Btlg. Co. v. Frantz, 842 S.W. 37 (AK 1992). See also, Salomon Dist. Inc. v. Brown Foreman Corp., 888 F. 2nd 170, 173 (1 Cir. 1989)(harshly castigating defendant-supplier’s lawyers for even contending in pleadings that Maine law allows for “cause” to be defined in terms other than a distributor’s demonstrable shortcomings or contract breach.); Kealy Pharmacy and Home Care Service v. Walgreen Co., 539 F. Supp. 1357(WD WI 1982) aff’d in part and vacated in part, 761 F. 2nd 345 (7 Cir. 1985)(alteration of system from independent dealers to company-owned stores only). .

But compare, American Mart Corp. v. Jos. E. Seagram & Sons, 824 F. 2nd 733, 734 (9 Cir. 1987) (new nationwide marketing and distribution consolidation plan justified termination of Nevada wholesalers if executed in non-discriminatory manner and in good faith); Ziegler Co., Inc. v. Rexnord, Inc., 433 N.W. 8 (Wis., 1988) (modification of relationship to address serious supplier economic problems might be required to be adhered to by distributor); and the intimations in St. Joseph Equipment Co. v. Massey-Ferguson Inc., 546 F. Supp. 1245 (WD WI 1982) and Westfield Center Service Inc. v. Cities Service Oil, 432 A. 2nd 48 (NJ, 1981) which foreshadow outcomes whereby such as permanent withdrawal from multi-state markets, the a national marketer’s discontinuance of unprofitable brands, and other financially important changes in multi-state distribution methods can not, on constitutional grounds, be subject to a state law veto. .

These authorities suggest such outcomes, at least, absent “a profit-grab”, where enforcement is by an injunction which in effect holds hostage a supplier and its system. . Damages may be another thing. . Satellite Receivers, Ltd. v. Household Bank, 922 F. Supp. 174 (E.D.WI, 1996)(“good cause” found where finance company’s terminated an affinity/private label credit card program with participating dealer-merchants because of low profit contribution to company’s bottom line and recurring dealer practices which it perceived to injure its business reputation.)

The suggestions made in St. Joseph’s Equipment, Westfield Center Service, and Satellite Receivers, in this writer’s view, quite likely will take on greater significane in the late-90s for distribution law practitioners. . More and more they will confront profoundly complex constitutional issues attendant to a single state’s restrictions on termination, nonrenewal and critically-need modification of a supplier-distributor relationship in a national and multi-state enterprise consolidation.
and forward vertical integration context or as part of comparable programs to “rationalize” product lines, marketing and distribution. Comparable constitutional issue almost certainly will arise as suppliers seek to exploit electronic commerce in business-to-business and business-to-consumer transactions, thereby converting their distribution from single to multiple channel operations.

Satellite Receivers (which goes to great lengths to try to reconcile the outcome in Kealy Pharmacy, supra, suggests the financial and business jeopardy faced by the interstate enterprise need not be life threatening, but management’s motivation to stem modest losses to a bottom line fed by many other sources may do to justify supplier initiatives for radical structural changes in a distribution system.

The crux of the anticipated conflict with explicit and “dormant” Commerce Clause principles are illustrated when state relationship laws in practical effect veto or delay key and vital program elements which demonstrably are capable of boosting by measurable amounts a supplier’s company-wide productivity and multi-state competitiveness. See e.g., Instructional Systems Inc. v. Computer Curriculum Corp., 35 F. 3rd 813 (3 Cir. 1994) cert denied 115 S. Ct. 1176 (1995) reversing 826 F. Supp. 831 (D.NJ 1993); see also Satellite Receivers v. Household Bank, supra, and by analogy the discussion below of Florida v. Rochambeau Wines and Liquors, Inc. et al, (N.D.FL. TCA 95-40462-WS).

For an illuminating view of the Commerce Clause rationale employed to test the constitutionality of relationship laws, see Palmer-Lucas, Inc. v. Martin’s Herend Imports, Inc, 827 F. Supp. 345 (WD Pa. 1993), which overturned a Pennsylvania law regulating sales representative relationships by principals who do not have a fixed place of business or comparable presence in the Commonwealth.

“DOWNSIZING” AND STRATEGIC COMPETITIVE ADVANTAGE:

Routinely, the last two scenarios, Nos. 8 and 9, take the form of a supplier-instigated territorial, brand and product realignments or their consolidation in fewer outlets. Blameless distributors are cut from the roster. Some find themselves rooted out of the business entirely. The number of a supplier’s distributors is reduced.

Rival producer-marketers frequently find free and ready access to financially viable and experienced multi-line distributors and dealers --supply chain intermediaries which purchase, warehouse, resell and physically deliver two or more competing products in the same geographic area or to common customer classes-- is foreclosed.

For the consolidator, who realizes quality, uniqueness or price advantage aside, distribution is a bottleneck in industry organization, what academics label “strategic competitive advantage” is at work. For the thinking consolidator, it’s a “win-win” game. By “distribution densification” with each surviving intermediary attaining greater “critical mass” in localized markets, competitors’ prospects for market share gains, improved productivity, incremental industry profit-pool accumulations, and local
and overall betterment of competitive position are impaired, harmed or diluted.

Such strategically motivated distribution system "downsizing" and system-wide reorganizations are increasingly common in specialty or regional segments of mature, saturated industries. Overcapacity is present in production or distribution, often in both. Typically, product category expansion is financially prohibitive or competitively unlikely. Antitrust considerations may come to bear as well. Market share gains are topped-out for industry leaders or a supplier’s growth depends on new product development, dramatic increases in service levels by downstream intermediaries and diversification.

Such a commonplace mature distribution system restructuring --to breathe new life into an entire product line in a regional market where lasting new product innovations are unlikely and the industry isn’t concentrated--, is a case where a realignment intends to pare the number of route distributors for a brand to boost distributor brand exclusivity and service levels.  


But, brand, territorial and customer realignments and consolidation and similar restructurings of entrenched methods of distribution aren’t the exclusive province of mature industries. Increasingly, a farsighted new entries in new markets and fledgling sub-sectors of mature industries anticipate from the start their own brands’ trade and consumer acceptance of their brands. As in the microbrewing business, many write into early-stage distribution agreements a reservation of “flexibility” later to rewrite and customize distributor assignments. As their brands mature, they reserve the option to restructure and re-realign the system by “splitting atoms” in geographic, functional or customer terms. Here there is no obvious antitrust problem.

A seminal study of franchise relationships is worth mention here. The University of Michigan economists point out, for the individual supplier-franchisor enterprise, these system-consolidation strategies often are deftly executed by managing finely-balanced and thoroughly-premeditated, sets of interactions between “share (of profit pool) contract” incentives and outright compulsion on downstream distribution chain members.

The activist firm’s goal is to reduce franchisee independence and correspondingly heighten dependence (by inducing constant liquidity constraints, among other devices), so a franchisor can stimulate higher levels of product and brand exclusivity, reach financially-desirable expansion objectives and induce intense loyalty, cooperation and compliance with operating policies propounded by distant upstream marketing executives. [The study gives new perspective on the notion that, when it comes to franchisees and distributors, “independence” is an amorphous myth subject to arbitrary and ad hoc interpretation depending on whether you are feasting on the ox or being gored by the animal.]

The theoretical study, which serious students of distribution and marketing law and policy need continually keep at hand, is Kaufmann & LaFontaine, “Costs of Control: The Source of Economic Rents for McDonald’s Franchisees” 37 Journal of Law and Economics, 417 (Univ. of Chicago, 1994). The key incentive, the authors suggest, is to induce in franchisees a belief and