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Distributor Termination

Problems and Solutions

Rob Carrol, Partner

Kate Hardy, Senior Associate

NIXON PEABODY

Summary

- Finding a distributor
- Franchise protection statutes
- Contract issues
- Termination issues
- Compensation



Finding a distributor

- Supplier consolidation issues
 - › What are the implications?
 - Greater concentration of brands at fewer wholesalers
 - “Share of mind” for smaller brands
 - Price of entry goes up but can still be done
 - › Examples at US level: Seagram, Schenley, Hiram Walker, National Distillers, Heublein, Fleischmans, Mondavi, Miller, Anheuser-Busch
 - › Examples at international level: Allied Domecq, Vincor, Southcorp, Hardys

Consolidation issues

- Distributor consolidation
 - › Who is left?
 - SWS, Sunbelt Charmer, Glazers
 - › Fewer distribution options
 - › Most major markets have 2 or 3 choices
 - › Harder for small players
- Retailer consolidation
 - › Greater upstream pressures
 - › Big Box stores
 - › Restaurant/hotel/casino chains
 - Concerns about “pay to play” for bars or drink lists



Franchise protection statutes

- A wide number of states protect wine and spirits distributors as favored local businesses
- Almost all states have beer distribution franchise laws
- Distributors are considered franchisees with rights which cannot be easily terminated – even though they do not pay for distribution rights like classic franchisees
- The statutes make it very difficult and/or very time consuming for a supplier to terminate a distributorship
- Usually, the statute creates an evergreen contract which must be renewed absent statutory cause
- If supplier does not renew, must leave the market (e.g. in GA where supplier must leave for four years)

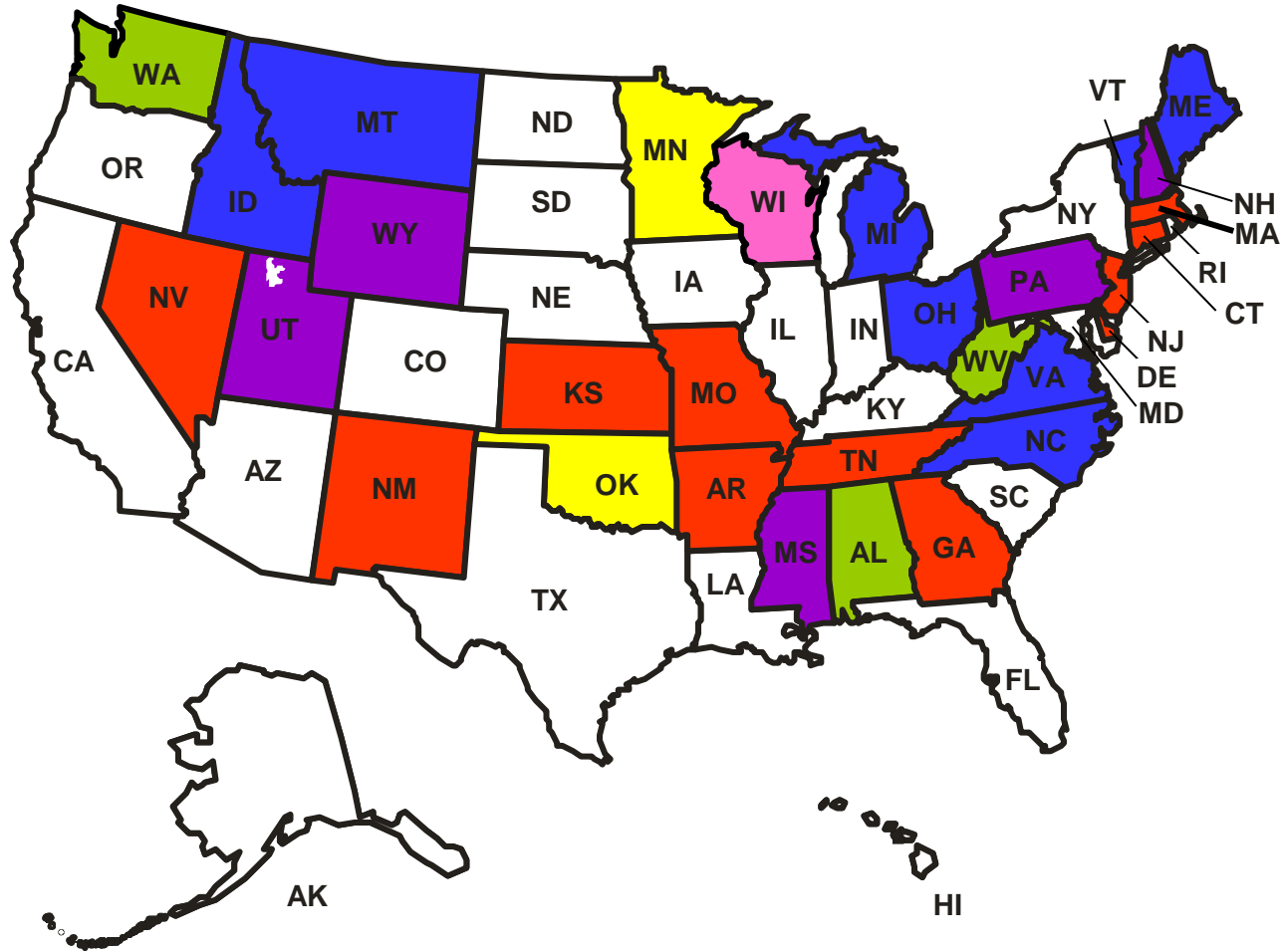
Affected markets

- Not all States have franchise laws – including key markets like NY, CA, IL, FL, TX, CO
- There are only a few key ways to terminate a franchise protected distributor
 - › Bankruptcy/loss of license
 - › Change of brand ownership – limited
 - › Good or just cause
- Issue of indemnity
- The absence of a franchise protection statute does not mean that you can terminate at will



Franchise Protection map

Wines and Distilled Spirits



Franchise Protection Map Key

- Red = State franchise protection for wholesalers for wine and spirits
Pink = State franchise protection for wholesalers of spirits
- Blue = Control state for spirits; state franchise protection for wine
- Purple = Control for both wine and distilled spirits
- Green = Control state for spirits; no state franchise protection for wine (Note: In WA wine is sold both by the state and through the private sector.)
- White = No state franchise protection for wine or spirits (Note: RI has no wine or spirits franchise law or regulation, but has a general franchise law that a clever lawyer might try to apply.) (Note: SC has franchise protection for wine according to an AG opinion.)
- Yellow = Required to sell to all wholesalers; applies to both wine and spirits in OK and only to spirits in MN
- **N.B. Even where no state franchise protection exists, there may be distributor registration and/or notice requirements or local restrictions.**

Basic termination rights

- A supplier is given basic termination rights by contract generally where the distributor is incapacitated from performing its duties
 - › distributor loses key license
 - › distributor change of control
 - › force majeure event of significant duration
 - › distributor becomes bankrupt or fails to answer a petition, lien or charge
- The bankruptcy laws will obviously factor in here as well on whether a supplier can in fact exercise contractual rights to terminate in those circumstances

Change of ownership

- Some States distinguish between purchase of a brand as an asset purchase or as a stock purchase
- Generally, compensation must be paid or the distributors concerned work out a “swap”
- Some States will not allow a successor to terminate an existing distributorship when a brand is purchased – they will be tied to the prior distributor as a “successor in interest”
- States which do allow termination will generally give a very short timeframe in which a supplier can do so

Good/just/sufficient cause

- Classic non-performance issues
 - › Build a file
 - › Praise orally, complain in writing
- Failure to pay is the easiest
- Controversial area of business reasons
 - › Greater acceptance
 - › Consolidation can be a reason
 - › NV Seagram case
 - › OH Schieffelin case
 - › 6th Circuit considering OH TWG case
- Often lengthy notice provisions and opportunity to cure



Contracts generally

- Most contentious are usually supplier/distributor contracts
- You also see grape purchase agreements, vineyard lease agreements, winemaking agreements, alternating proprietorship agreements, winemaking consulting agreements
- Other than in franchise protection jurisdictions, all agreements will be pretty much exclusively governed by their terms other than general contractual and equitable principles

Distributor Contracts

- Long term vs. short term
 - › Don't want to get locked in but you want the distributor to invest in the brand
- Trial basis option
 - › Get resignation letter in advance
 - › Watch the statutory effective dates, e.g. in MA you have six months before a franchise is created
- Renewal options
 - › Generally automatic
 - › Percentage growth
 - › Tied to category growth
- Escape clauses
 - › Material change of ownership
 - › “Trial marriage”
 - › Documented performance failures

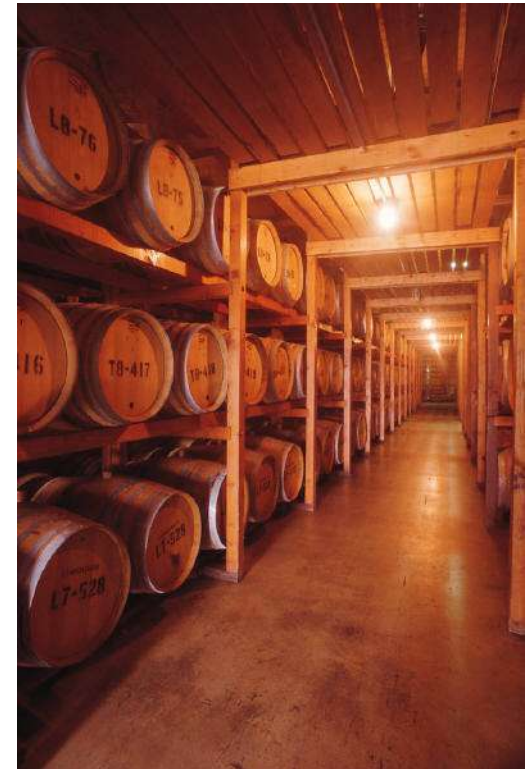


Useful provisions

- Performance based requirements
- Marketing cooperation and funding (e.g. per case investments, participation in training and seminars, joint promotional efforts and advertising)
- Reporting obligations
- Line extensions/new products –automatic inclusion? (may be problematic – competitive brands)
- Necessary cost increases (e.g. fuel)
- Mandatory arbitration – out of State neutral location
- Liquidated damages will help limit termination claims

Termination issues

- Good paper trail is essential where performance is concerned
- Indemnity from new distributor
- Distributor brand swap
- Compensation
 - › liquidated damages
 - › generally a multiple of prior year sales



Questions?

- Thanks for listening!
- To reach us:
 - › Rob Carrol, partner, Nixon Peabody San Francisco
 - rcarrol@nixonpeabody.com
 - +1-415-984-8404
 - › Kate Hardy, senior associate, Nixon Peabody New York
 - khardy@nixonpeabody.com
 - +1-212-940-3186