COMPARING FRANCHISE RELATIONSHIPS AND BEER DISTRIBUTION RELATIONSHIPS

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Beer distribution laws differ from traditional franchise laws in many ways, but they do share some commonalities. As a matter of fact, many states now regulate the relationship between those who brew or import beer into a particular state, known as brewers, and those who receive beer, warehouse beer, and distribute beer to retailers, known as distributors, by way of special relationship statutes that have been patterned after, and closely resemble, the relationship statutes some states have passed to protect franchisees in traditional franchise relationships.

The Franchise Relationship

A franchise is a business relationship in which (1) the franchisee's business will be substantially associated with the franchisor's trademark; (2) the franchisee pays the franchisor a fee to engage in the business and utilize its trademark; and (3) the franchisee will operate the business under a marketing plan or system substantially prescribed by the franchisor.

Franchising is regulated at the federal level by the Federal Trade Commission (FTC), which imposes very specific pre-sale disclosure requirements on franchisors selling franchises in any state by way of its amended Federal Trade Commission Rule on Franchising, known as the "FTC Rule," and at the state level through pre-sale registration and disclosure statutes and franchise relationship laws. For example, thirteen states, referred to as "registration states," require franchisors to register their franchise offering documents before offering or selling franchises within their borders, and seventeen states have franchise relationship acts, in one form or another, aimed at protecting franchisees from unfair treatment after the relationship is formed. Many states have no franchise-specific laws whatsoever and rely on the FTC Rule and on state remedies for fraud and breach of contract to address problems that arise in the franchise context.

The Distribution Relationship

In general, product distribution relationships are not regulated by specific federal or state laws. However, certain distribution relationships involving particular products are highly regulated at both the federal and state levels, including, for example, those relating to the distribution of petroleum products, automobiles, and beer. In a typical product distributorship arrangement, the distributor operates an independent business under its own trade name and purchases and resells the supplier's products according to its own procedures, not according to the supplier's system or prescribed marketing plan. In the eyes of the customer, the distributor's business is not substantially associated with the supplier's trademark, and it is unlikely the distributor will pay a fee to engage in selling the supplier's products.

Petroleum Products

The federal government is the primary regulator of distribution relationships involving petroleum products. Congress enacted the Petroleum Marketing Practices Act (PMPA) (15 USCA §§ 2801-2806) in 1978 to protect petroleum distributors and retailers. The PMPA defines a "franchise" as a contract between (1) a refiner and a distributor; (2) a refiner and a retailer; (3) a distributor and another distributor; or (4) a distributor and a retailer, pursuant to which a refiner or distributor, as petroleum franchisor, allows a retailer or distributor, as petroleum franchisee, to use a trademark owned or controlled by the petroleum franchisor in connection with the sale, distribution, or consignment of gasoline or another motor fuel. The PMPA applies to contracts with terms of three years or longer and prohibits petroleum franchisors from terminating a petroleum franchise, or failing to renew one, except in accordance with its provisions.

Automobiles

The Automobile Dealers' Day in Court Act (DDCA) (15 U.S.C.A. §§ 1221-1225) was enacted by Congress in 1956 to rebalance power in relationships between auto manufacturers and auto dealers. The DDCA enables a franchised automobile dealer to bring suit to recover damages it has sustained from an automobile manufacturer's failure to act in good faith in complying with the terms of the automobile franchise or unreasonable termination or refusal to renew the dealer's franchise. Under the DDCA, the term "automobile manufacturer" means any business enterprise engaged in the manufacture or assembly of passenger cars, trucks, or station wagons, and "franchise" means the written contract between an automobile manufacturer engaged in commerce and an automobile dealer that purports to fix the legal rights and liabilities of the parties. "Automobile dealer" means any business engaged in the sale or distribution of passenger cars, trucks, or station wagons, and operating under the terms of an automobile franchise contract.

Beer

Unlike petroleum products and automobiles, states take the primary role in regulating the distribution of beer, and all fifty states regulate the sale and distribution of beer within their borders. Because of the dramatic brand consolidation that has occurred in the beer industry, many states address the distribution of beer separately from wine and liquor, making the beer distribution industry one of the most highly regulated industries in the United States. To complicate matters, the differences among the states in terms of their statutes, regulations, licensing schemes, taxes, and control processes result in a legal minefield that can be difficult to navigate for brewers, distributors, retailers, and the attorneys who advise them.

Prior to 1919 and the passage of the 18th Amendment, brewers and producers of alcoholic beverages sold their products directly to retailers, which led to anti-competitive business practices and unscrupulous marketing tactics aimed at inducing excessive consumption. To combat that problem, the states ratified the 18th Amendment, ushering in the prohibition era and outlawing the manufacture, distribution, and sale of alcoholic beverages. The 21st Amendment repealed the 18th Amendment in 1933 and gave states the primary authority to regulate the distribution of alcoholic beverages, including beer, within their borders. The three-tier system of alcohol production, distribution, and sale was born.

The three-tier system is designed to prevent pre-prohibition style marketing tactics, to generate revenues for the states, to facilitate state and local control over alcoholic beverages, and to encourage temperance. Its three tiers consist of brewers (top tier), distributors (central tier), and retailers (bottom tier). Brewers produce the product and sell it to distributors, also called wholesalers, who then sell the product to retailers (retail stores, taverns, etc.), who, in turn, sell the product to consumers. In many states, importers are treated as brewers, placing importers in the top tier of distribution. In a decision handed down in May 2005, the U.S. Supreme Court, in *Granholm v. Heald*, 544 U.S. 460, 476 (2005), found the three-tier distribution system to be "unquestionably legitimate."

The remedy that primarily differentiates beer distribution law from franchise law is the legal right beer distributors have to reasonable compensation upon termination of the beer distribution agreement by the brewer, for any reason.

Relationship Laws: Specific Protections for Beer Distributors That Mirror Franchisee Protections

An inherent imbalance of power exists between the contracting parties in beer distribution relationships that resembles the imbalance of power that exists in franchising relationships. To address this problem, many states have passed legislation aimed at balancing power in favor of distributors by requiring good faith dealings between the parties to beer distribution agreements. Not unlike franchising, which requires franchisees to make substantial initial investments to get their franchised businesses up and running, distributing beer requires beer distributors to make substantial investments in infrastructure, which is one of many reasons why states have an array of statutes, rules, and regulations aimed at balancing power in favor of beer distributors. These balancing protections include, among others: (1) territorial protections, (2) transfer protections, and (3) termination protections.

Territorial Protections

To begin with, nearly all states protect beer distributors by allowing brewers to grant beer distributors exclusive sales territories for their brands. In fact, most states require brewers to grant distributors an exclusive sales territory for their brands. This differs substantially from franchising, however. In all states, franchisors *may* grant exclusive territories to their franchisees, but they rarely do. The fact that states generally require brewers to provide distributors with an exclusive territory in which no competitors may distribute the brewer's beer, but franchisors are not required to provide exclusive territories to their franchisees, and typically do not, demonstrates the degree to which beer distributors enjoy even greater territorial protections than do franchisees.

Transfer Protections

Most states also limit brewers' ability to prevent distributors from transferring their distribution rights under distribution agreements. Typically, states allow brewers to require their distributors to provide them with written notice and obtain their prior approval before transferring any substantial portion of the distribution rights licensed under the distribution agreement to another distributor, or in advance of a change of ownership or control of the distributor. However, in most states, brewers may not withhold consent or unreasonably delay a distributor transfer if the transferee meets reasonable standards and qualifications required by the brewer that are nondiscriminatory and are applied uniformly to all similarly situated distributors. For example, the California Alcoholic Beverage Control Act (the "ABC Act") provides that a brewer or supplier that unreasonably withholds consent "or unreasonably denies approval of a sale, transfer, or assignment of any ownership interest in a beer wholesaler's business with respect to that [brewer's] brand or brands, shall be liable in damages to the [distributor]."[1] In addition, most state beer distribution statutes allow distributors and their owners to bequeath or devise their interest in the distribution business, and the distribution agreement, without the need to obtain the brewer's consent, and sometimes without notice.[2]

Although the transfer-related protections provided to beer distributors tend to exceed those afforded to franchisees in most jurisdictions, a few states do extend transfer protections to franchisees by statutory provisions that resemble those commonly provided to beer distributors. Interestingly, though, transfers tend to be less contentious in the franchise context and franchisors are usually willing to consent to franchise agreement transfers to qualified buyers, provided the franchisor receives payment of a transfer fee and the buyer signs the franchisor's then-current form of franchise agreement for the remainder of the term existing under the seller's franchise agreement.

Termination Protections

Protecting distributors against having their distribution agreements terminated or not renewed without good cause is, perhaps, the most significant protection states provide beer distributors. Some states limit the definition of good cause, and thus the right of the brewer to terminate the agreement, to instances in which the distributer has committed fraud, been convicted of a felony, filed for bankruptcy, or knowingly distributed the brewer's products outside of its exclusive territory.[3] Most states' statutes bar brewers from modifying, not renewing, or terminating any beer distribution agreement unless the brewer acts in good faith. Termination and non-renewal restrictions are interpreted broadly and good cause is universally interpreted narrowly in the beer distribution context. As a result, beer distribution agreements take on a perpetual duration, more or less, in many states.

Although the ABC Act contains some protections for beer distributors, California's protections against the unreasonable termination of beer distribution agreements are noticeably less comprehensive than those in most other states. As stated above, most states require that a brewer have "good cause" to terminate the distribution agreement. California, however, is one of five states whose beer statutes do not have such a requirement.[4] The ABC Act merely provides that "No sale or distribution agreement shall be terminated solely for a beer [distributor's] failure to meet a sales goal or quota that is not commercially reasonable under the prevailing market conditions."[5]

While fewer than a majority of states provide specific statutory protections against the early termination of a franchise agreement by the franchisor, most of those that do require the franchisor to have good cause to terminate a franchise agreement before its expiration. Good cause generally includes the failure of the franchisee to comply with any lawful requirement of the franchise agreement after notice and a reasonable opportunity, which generally does not exceed thirty days, to cure the failure. Filing for bankruptcy, failing to comply with the franchisor's "system" in a way that may damage the franchisor's reputation, under reporting sales, or selling unauthorized products are just a few additional examples of acts that may constitute good cause for a franchisor to terminate a franchise agreement.

The remedy that primarily differentiates beer distribution law from franchise law is the legal right beer distributors have to *reasonable compensation* upon termination of the beer distribution agreement by the brewer, for any reason. In general, reasonable compensation payments are equivalent to one-to-three years' worth of the beer distributor's profits, calculated as one hundred percent of the beer distributor's gross margins on each case of the brewer's products sold to customers, multiplied by the number of cases of product actually sold by the beer distributor to customers during the twelve months prior to the termination. If the brewer terminates a beer distribution agreement in bad faith, or for any reason other than good cause, the brewer must also pay the distributor the fair market value of "all assets, including ancillary businesses, relating to the transporting, storing and marketing of [the brewer's] products" and the goodwill of the distributor's business. Clearly, these protections go a long way toward shifting the balance of power back toward distributors in the beer distribution relationship.

Conclusion

While beer distributorship arrangements are distinctly different from traditional franchise arrangements, there are certain commonalities. Although the three-tier system of beer distribution can trace its origins to the prohibition era and the 21st Amendment, modern beer laws governing beer distribution relationships between brewers and distributors have been patterned after franchise relationships laws. Why not, after all, since brewers resemble franchisors in that they tend to hold the lion's share of power in the beer distribution business relationship. Considering the complexity of and differences among the various state statutes in both contexts, it is easy to see why expert legal advice from an attorney specializing in franchising and beer distribution law is essential at every step for those doing business in franchising and the beer distribution industry.

ENDNOTES

(1) Cal. Bus. & Prof. Code § 25000.9 (West 2014).

(2) *See* Iowa Code Ann. § 123A.6(2) ("[U]pon the death of a wholesaler, a brewer shall not deny approval for any transfer of ownership or management to a designated member, including the rights under the agreement with the brewer").

(3) Wis. Stat. Ann. § 125.33(10)(b-c).

(4) *See* Gary Ettelman & Keith B. Hochheiser, "The Legal Buzz" Miller & Coors II: To Sell or Not to Sell (That is the Question), Ettelman & Hochheiser, P.C., http://www.e-hlaw.com/articles_buzz_MillerCoors2.htm (stating five states, including California, Kansas, Missouri, Oklahoma, and Wisconsin, do not require that termination may be effected only if "good cause" exists). Of note, New York passed the Small Brewer's Bill in 2012 allowing small brewers to terminate without "good cause," provided they pay the distributor the fair market value of the lost distribution rights.

(5) Cal. Bus. & Prof. Code § 25000.7 (West 2014).

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