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—Gary Ettelman and  
Keith B. Hochheiser

*Gary Ettelman and Keith Hochheiser are partners in the law firm Ettelman & Hochheiser, of Garden City, NY. Inquiries can be directed via e-mail to Gary at gettelman@e-hlaw.com*

# NEW SUPPLIER TRICKS:

## WHEN ARE EXCLUSIVE TERRITORIES NOT EXCLUSIVE?

**T**his year promises to an important one in the beer industry, particularly with respect to legal issues. The Supreme Court will deliver its long awaited decision in the direct shipping cases. Although the overwhelming consensus is that the decision will not be the death knell for the three tier system, the decision could have a dramatic long-term impact on the industry. Similarly, Costco is pushing forward its attack on the middle tier; can Wal-Mart be far behind? There are sure to be many significant legal developments this year which may start to change the face of the landscape in the years to come. Only time will tell. What is certain, however, is that now more than ever, wholesalers are going to have to pay close attention to legal developments in order to know what their rights are, how they may be changing and how they can protect themselves against those that would attempt to take the food off of their collective and individual tables.

While it is self-evident that major developments such as a Supreme Court decision can have dramatic impact over time, it is less evident, but nonetheless true, that seemingly innocuous events may erode a wholesaler's rights over time with equally devastating effect. This article is about one of those less obvious events: the new trend of suppliers to refuse to grant the distribution rights to brand extensions or new products to their existing distributors according to their existing footprints, and instead offering such products to the wholesaler they want their brand consolidated into, even though this results in the consolidating wholesaler selling outside of its footprint. Suppliers and consolidating wholesalers have developed a mechanism designed to erode wholesaler's rights in an attempt to coerce the transfer of brands.

### **Selling Outside Of Your Footprint.**

Historically, beer distributor territories have been defined by the major domestic brand they carried. For example, if a Bud or Miller wholesaler had the brand exclusively in a specific geographic territory other smaller domestic brands or imported brands would typically follow suit and grant their brands to the wholesaler on an exclusive basis in its “footprint”. Suppliers were aggressive in maintaining the sanctity of their wholesalers' respective footprints and strongly discouraged their wholesalers from selling any brand beyond their footprint. Accordingly, when brewers rolled out new products or brand extensions, there was never an issue as to what wholesaler would get the product; new products and brand extensions were offered to each of their existing wholesalers within each wholesaler's footprint.

Fast forward to the age of consolidation and you find a whole new practice developing. First, while staying within one's footprint used to be an almost inviolate supplier demand, now it seems only to be a requirement for those of its suppliers that the particular brewer would like to terminate – excuse me - consolidate. It is no secret that suppliers have been preaching scale, scale and more scale. Well, to achieve more scale you have to either take in more brands within your footprint or expand your footprint; or both. Accordingly, where brewers would historically discourage (translation: stop) a supplier venturing out of its footprint and into the footprint of another one of its exclusive distributors, now for those fortunate suppliers who are the suppliers' consolidators of choice, those unwritten rules no longer apply. In fact, such expansion is encouraged.

Expansion out of one's footprint may be perfectly legitimate. This occurs, for example where a distributor who is not under any duress or compulsion to sell, sells a brand to a whole-

saler out of the wholesaler's historical footprint. On its face, this is a good thing because, theoretically, it expands the market by increasing the number of wholesalers to whom a particular distributor may sell a brand. The more potential purchasers there are the greater the potential price. In practice, however, this rarely occurs because of the supplier approval process which often determines to whom you may sell in any event. The real problem, and one that is becoming more widespread, is that acquisition of brands outside of one's traditional footprint is not the result of open market transactions but, rather, are brewer and consolidating wholesaler motivated.

### **When Attempts To Consolidate Fail.**

It is no secret that over the last ten years there has been tremendous consolidation in the beer industry both at the brewer level and at the wholesaler level. While wholesaler consolidation has certainly slowed, it is not for the lack of trying by brewers and consolidating wholesalers. A large reason for the slow down is that wholesalers who are not willing sellers are asserting their rights under various laws, including state beer franchise laws; thereby frustrating the attempts of brewers and consolidating wholesalers to consolidate. As a result, brewers, and consolidating wholesalers are taking different tactics in an attempt to force their will upon recalcitrant wholesalers to compel them to sell. Perhaps you have been on the receiving end of some of these tactics: lack of supplier support, failure by reps to timely advise you of programs, complaints over phantom problems, allegations of poor performance have historically been the supplier's traditional tools of choice. Now, however, some suppliers are "kicking it up a notch" with respect to brand extensions.

### **Whose Territory Is It Anyway?**

Consider this scenario. You have distributed a particular brand on an exclusive basis in a given territory for decades. You have been a good soldier, dutifully building the good-will of the brand in the face of steep competition. You have marketed the brand, contributed your fair share of advertising costs, purchased an untold amount of P.O.S. materials, cajoled retail customers into giving you prominent displays, made sure that the beer on your customers' shelves has been fresh, redeemed empties – even when your customers don't sort them and done just about every other thing that good wholesalers do on a daily basis for the brand. Despite your efforts to push the brand, sales

have been somewhat off, not just in your territory, but in the entire region, including "Mega-Wholesaler's" territory. Supplier has been hounding you to sell to Mega-Wholesaler for some time, but you have refused. Supplier announces the release of a new product, a low carb beer. "Great" you say to yourself, this is just the thing we need to pump some life into the brand. The next day, however, you get a call from your sales rep who advises you that you will not be getting the new product in your territory - Mega Wholesaler will. "Wait a minute", you say, "I am the exclusive wholesaler in this territory!" The rep calmly explains that under your contract, you are the exclusive wholesaler only of the products listed in the agreement and that the supplier is under no obligation to give you anything else that it sells.

Sound far-fetched? Well maybe ten years ago it was but no more. Suppliers and their consolidating wholesalers that have been frustrated in their attempts to consolidate are now frequently resorting to this precise tactic to put additional pressure on wholesalers who have been unwilling to sell to "Mega-Wholesaler". The first question which you may ask is whether it is significant that "Mega-Wholesaler" gets the new product and you don't. The short answer, of course, is that it depends on the product. If a small volume supplier came out with a new product there would probably not be a great impact on your business. On the other hand, if A-B were to replace "Bud-Light" with "Bud Premium Light", and refused to give it to you, you would clearly be greatly impacted. The impact, however, goes beyond the lost opportunity of selling a new product, and these can be far more devastating. First, your previously exclusive territory will no longer be exclusive. This presents competition issues for other brands that you are selling as well. Moreover, historically, brand extensions cannibalize existing brand sales. This is not an issue if you are selling both the new and the old products, however, if "Mega-Distributor" is selling the new products and you only the old, your sales will be cannibalized with no corresponding boost. Further, the failure of a supplier to give you a new product sends an extremely negative message to your other suppliers and your customers. This could interfere with your ability to get new brands, or your ability to get brand extensions from other suppliers. The bottom line is that the failure of a supplier to offer a distributor brand extensions erodes the value of the distributorships, the more significant the new label is, the more significant the erosion.

The real issue, therefore, is whether you can

stop a brewer from giving a brand extension in your territory to a competitor. The answer, not surprisingly, depends on a number of factors, the most important of which, however, is whether the wholesaler is willing to fight. If yes, there are a number of tools available to thwart these "back-door consolidations".

### **Determine What Your Rights Are.**

As is the case with any dispute, the first thing you need to do is determine what rights you have. Your written agreement is the starting point of this analysis, but is not, by any means, the end of the analysis. Accordingly, even assuming that your written agreement does not appear to give you the rights to brand extensions in your territory do not despair. In addition to the written agreement there may be oral agreements that have been in place and have been performed by the parties or implied agreements which are relevant. You should also examine your historic relationship with the supplier to determine if there has been any precedent established in the past whereby new products were introduced by the supplier and offered to you as opposed to Mega-Supplier. Under the Uniform Commercial Code, which governs the relationship between brewers and wholesalers, a course of performance between a brewer and a wholesaler may require that the brewer give you the brand extension in the present situation.

Then, of course, there are beer franchise statutes which may be applicable, even if not obvious on their face. For example, in New York, although the statute does not specifically mention an obligation to provide new products or brand extensions to existing wholesalers, the statute prohibits the amendment or material modification of an agreement without good cause. Material modification is defined as a change in the competitive circumstances under which the agreement was entered. It seems beyond dispute that under most, if not all situations where a new product or brand extension is rolled out and given to a competitor of a wholesaler in the wholesaler's previously exclusive territory, that there has been a change in competitive circumstances. Just the fact that there are now two distributors for the brand in the territory now as opposed to one before should, even in the absence of other factors, be sufficient to demonstrate a change in competitive circumstances. There is far more, however. Cannibalization of existing brand sales by sales of the brand extension; the fact that the existing wholesaler will now effectively be marketing and advertising the brand in its

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