THREE-CORNERED SOLUTIONS TO CONSOLIDATION TERMINATION DISPUTES

Forms and Materials

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Distributorship and franchise wrongful termination and breach of contract disputes cases follow common patterns. By and large, these disputes fit neatly into 10 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 the distributor and the market.

3. Where the supplier is also an intermediary, for instance, supplier is an importer, the supplier loses its source for the goods it sells to the distributor.

4. 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.

5. Time expires.

6. A third-party suitor offers supplier or distributor a better deal or a more attractive basis on which to earn a greater return on investment.

7. Distributor or supplier engages in anticompetitive conduct, fraud and dishonesty, economic abuse, overreaching or comparable wrongdoing, criminal or not.

8. Supplier or distributor undertake actions perceived as producing a "hostile workplace" for the other's employees or repeatedly engage in improper or outright unlawful business, racial, sexual or other discriminatory, deceptive, arbitrary, or "egregious" opportunistic practices –superficially permissible under an agreement. Arguably, such conduct includes violations of recognized ethical codes and custom and practice ubiquitously observed by industry members.

Envisioned in this model are patterns of business activity that are fundamentally inconsistent with and materially impair the essential sense of mutual trust, community of interest and allegiance among supplier-independent distributor system members and so endanger the entire distribution network’s stability and potential for reliable growth and profits for both parties going forward. Often such acts are wrongful independent of the contract or consist of conduct the controlling agreement fails to address. For illustration, this classification might include retaliation by a supplier that distributes in competing channels against members its independent distributor channel who refuse to give their
customers discount coupons redeemable only by a competing channel member’s place of business.

Arguably also placed in this classification are policies, practices and programs that so tightly control one party’s freedom of action as to contradict the most essential distinguishing feature of a supplier-distributor relationship, the independence of both parties to manage on a day-to-day basis their respective businesses. Practical application of this test is “daunting”, as a jurist said, for intellectual rigor is required locate a “balance of the protection of the interests of the one party in future enjoyment of contract performance and society’s interest in respect for the integrity of contractual relationships, on the one hand, and, on the other, the right of freedom of action on the part of the party interfering and society’s concern that competition not be unduly hampered”. Guard-Life Corp. v. S. Parker Hardware Mfg. Corp., 50 NY 2nd 183, 190 (1980)

(9) Supplier perceives --correctly or not-- that individual or clusters of distributors (usually small ones) lack the financial wherewithal, creditworthiness, present capacity to generate earnings in sufficient amounts to reinvest or borrow at the levels the supplier desires or its profit model calls for each party to make in capital upgrades or marketing and promotional activities.

In this model, a supplier concludes a distributor or a class of distributors cannot or will not undertake costly capital improvements, added service functions or other performance-related activities required to "remain competitive" in a rapidly changing technological and competitive environment or to advance the supplier’s “long-term brand building strategy.” [Indeed, it’s constantly amazing to discover how many otherwise solid distributors find themselves caught in the backwash of “the jet stream of economic and social change”, as a columnist depicted the evolutionary process that business inexorably undergoes.]

Assuming not in issue is the good faith in which such a decision is made and applied, disputes fitting this pattern often center on the professed reasonableness of a supplier judgment to exercise a reserved right to unilaterally amend its agreements systemwide or to significantly upgrade its operating and sales standards for distributors. In many of these cases, disputes break out over the totality of the standards’ changes and their mandate that, regardless of affordability or projected returns, each distributor make far richer investments than before on a timetable of the supplier’s making.

Not unusual are supplier fiats calling for sizable incremental reinvestment of profits or new investment in working or locked-in equity capital. Other examples include commands that, again without factoring in plausible returns on invested capital, rigidly require distributors to make significant upgrades in in warehouse and delivery facilities or their maintenance and appearance, in personnel matters, or in high speed computers, cutting-edge software, wireless, broadband communications and related systems engineering, which the supplier’s management or maybe an ultimate reseller desire for CMR purposes or to track in-transit and retail inventories and sales patterns.
Distributors search for compelling reasons and finding none to their satisfaction, they identify the supplier initiative as “a squeeze out.” Distributors then assess their bargaining power. Suppliers justify their action as simple, self-evident “good business” or “Best Practice”. They dig in their heels.

Disputes fitting this analytical compartment are accompanied, more often than not, by a unilateral supplier judgment in the name of “flexibility” to change the rules in midstream. Most frequently, this takes the form of a contract amendment or one or more supplements to operating, sales and administration standards and criteria. At the furthest end, a supplier flat out modifies its business or “profit-sharing” model. Airlines decisions to chuck or distance themselves from independent travel agents fit this bill. In these cases, the customary rationalization is the change is necessary or an appropriate in response to changing customer tastes, buying patterns, cost-price squeezes, a desire or need for risk shifting, a loss of pricing power, a shift in the balance of power among suppliers, intermediary distributors and retail outlets, or an industry-wide restructuring occasioned, for example, by technological innovation in production, packaging or product handling or by a changing legal and regulatory atmosphere.

A business model modification with the capacity to ignite a heated, protracted dispute can be unrepresentatively simple and facially innocuous. For instance, sure to ignite conflict would be a supplier call on distributors to eschew their usual functions pertaining to local marketing, promotion and merchandising and, instead, service select accounts or a customer class as a pure logistics provider, on a fee basis, in return for the favor of a targeted buyer’s increased patronage or prospects of most favored display and promotional treatment or both. Even in the dubious case the supplier intends to eliminate local marketing, promotion and merchandising of its products, the practical effect of this sort of initiative will not only alter the established allocation of functions among supply chain members but also deconstruct both supplier’s and distributor’s profit models under which their relationship was formed and has been performed.

(10) Supplier --or, at times distributors— for tactical or strategic ends, reorganizes, realigns, restructuring or consolidates or abandons established distribution methods, markets or companies in order to stimulate greater efficiencies, productivity, revenues and profits and to bolster competitiveness and market share.

Sometimes, these realignments involve a supplier’s election to withdraw certain but not all of its products or services from a marketplace or similarly to “rationalize” its product or brand mix. Other times, a supplier’s move is one of retrenchment out of a particular unprofitable geographic market, tacitly or openly conceding by that withdrawal that earlier it overextended itself or it had lost market power in a once lucrative market.

Two fact sets are the most common depictions of strategic realignment, restructuring or consolidation at work to bring about a supplier-distributor dispute. Both
illustrate just how swiftly fortunes change in the modern, globalized U.S. economy, as well as how fast entrenched “partners” with a strong community of interest can part company and instantly morph into plaintiff and a defendant.

One is the byproduct of supplier-level consolidation, as companies acquire others with well-matched product or service lines or simply buy a rival’s products and brands. For a myriad of reasons, the acquirer chooses to replace the acquired company’s distributors with its own or visa versa. An ostensible goal is to bring into line product and territorial footprints. The outcome is fewer distributors, each with greater size, scale and scope of brands or geography. Presumably, each surviving distributor and the supplier benefit from lower operating and administrative costs, and improved profit potential.

The second subset of scenarios doesn’t center on a supplier merger or combination or a brand or product line acquisition. Nevertheless, difficulties integrating prior brand and product line acquisitions and a supplier’s earlier inability to eliminate the consequent redundancy do offer a supplier a convenient spin for a policy rationale.

Both arrays of consolidation scenarios share a characteristic. It is: the presence of a premeditated supplier program that intends to systematically deconstruct a time-honored distribution network in a prescribed process controlled by a supplier and over which distributors are for all intents by-standers without determinative input or influence.

The mechanics of deconstruction vary —whether the objective is called “a downsizing”, “a streamlining” “moving to the next plateau, or “a flattening of the system to make it appear seamless and get closer to the consumer”. The approach and techniques run a broad gambit.

A supplier may elect to announce plans to resolutely pursue within a fixed time frame an intensely aggressive program to consolidate the entirety or what it and it alone regards as important parts of its distribution network for products or brands and then exercise its contractual rights to jettison existing distributors in favor of fewer distributors who meet proscribed criteria. [In these situations expect somewhere in the supplier’s files there is a sort of “wish-for distributor list”.] Belligerent, in-your-face, quarrelsome tactics aren’t uncommon.

Neither is it unusual for a supplier to pay some, but rarely all, exited distributors to reacquire the rights. The odds-on reason for this varied treatment is either, by design or conveniently with astounding prescience, the controlling agreement contains a buy-out option or supplier management is litigation risk-adverse or or agreement terms are ambiguous. Roughly contemporaneous with the “buy back”, the supplier reassigns the distribution rights in ways intended to make the switch cost-neutral to the supplier. Not unheard of is for a supplier to earn a profit point or two in these transactions.

A softer but no less resolute approach is revealed in other cases; even where the