

# NEGOTIATING DISTRIBUTION AGREEMENTS:

## A Presentation to the Florida Beer Wholesalers Association

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# Consumers are Driving the Diversification of Product Portfolios

## Consumer Factors Driving the 'Better for You' Trend

Drinking habits are changing; consumers are reducing their alcohol intake. The quality of ingredients, flavor, alcohol content, and origin are increasingly important in the mind of the consumer.

## Brands Blurring Category Lines

Beverage brands are blurring category lines to meet consumer demand. The rise of hard seltzer, a blend of sparkling water and alcohol, existed well before COVID, but hard seltzers further exemplify the better-for-you alcoholic drink trend. They have captured the attention of adults across all generations by being marketed as low-calorie, low sugar alternatives to beer and other beverages. Now, hemp-derived THC beverages are added to the mix.

To survive and thrive, you need to keep up with these evolving consumer trends.



C H A N G E

# Challenges to Beer Regulatory Structures, Beer Distribution Models & Current Modes of Operation

- Diversification of Portfolios – Spirits, Wine, Non-Alcoholic Beverages
- New Beer Market Entrants – Distillers, Wineries, Big Soda
- Complex and Often Incompatible Regulatory Schemes
- eCommerce
- Increasing Consolidation at the Supplier, Wholesaler and Retailer Tiers
- Cannabis/Hemp
- Increasing and, at times, inconsistent regulatory enforcement



CHANGE

# Entrance of Big NA Players

NA Company	Brand	"Brewer"	Distributor
Coca- Cola	Topo Chico Hard Seltzer	Molson Coors	Molson Coors Distribution Network
Pepsi	Hard Mtn Dew FMB	Boston Beer	Boston Beer Network
Monster Beverage	Beast	CANarchy	Generally existing CANarchy dist.
Coca- Cola	Fresca	Constellation	Constellation beer distribution network
Coca- Cola	Simply Spiked Seltzer	Molson Coors	Molson Coors Distribution Network

# Evolution of Diversified Distribution Portfolios

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- Malt Beverages: Largely three-tier, no slotting fees, exclusive territories, franchise protection.
- Distilled Spirits and Wine: Fewer distribution outlets, high spotting distribution practices, little franchise protection.
- Non-alcoholic beverages: Channel exclusion, account exclusion, slotting fees are the norm, little franchise protection.



# Can the Beer Distribution Model Survive?

- Where relationships with distillers, wineries, and NA suppliers are not subject to franchise laws?
- Where distribution agreements with NA suppliers exclude certain channels and large accounts and traditionally allow for no-cause termination?
- Where slotting fees are the industry standard with NA products but not the spirits, wine or beer that distributors are delivering to retailers?
- Where ECommerce is still growing at an unprecedented pace?



# Current Liquor Regulations are Incompatible with the Soda Distribution Model

Three-tier laws prohibit vertical integration.

Tied-house laws prevent licensure of cross-tier ownership and slotting fees

Central warehouse and retail-to-retail bans prohibit retail fulfillment

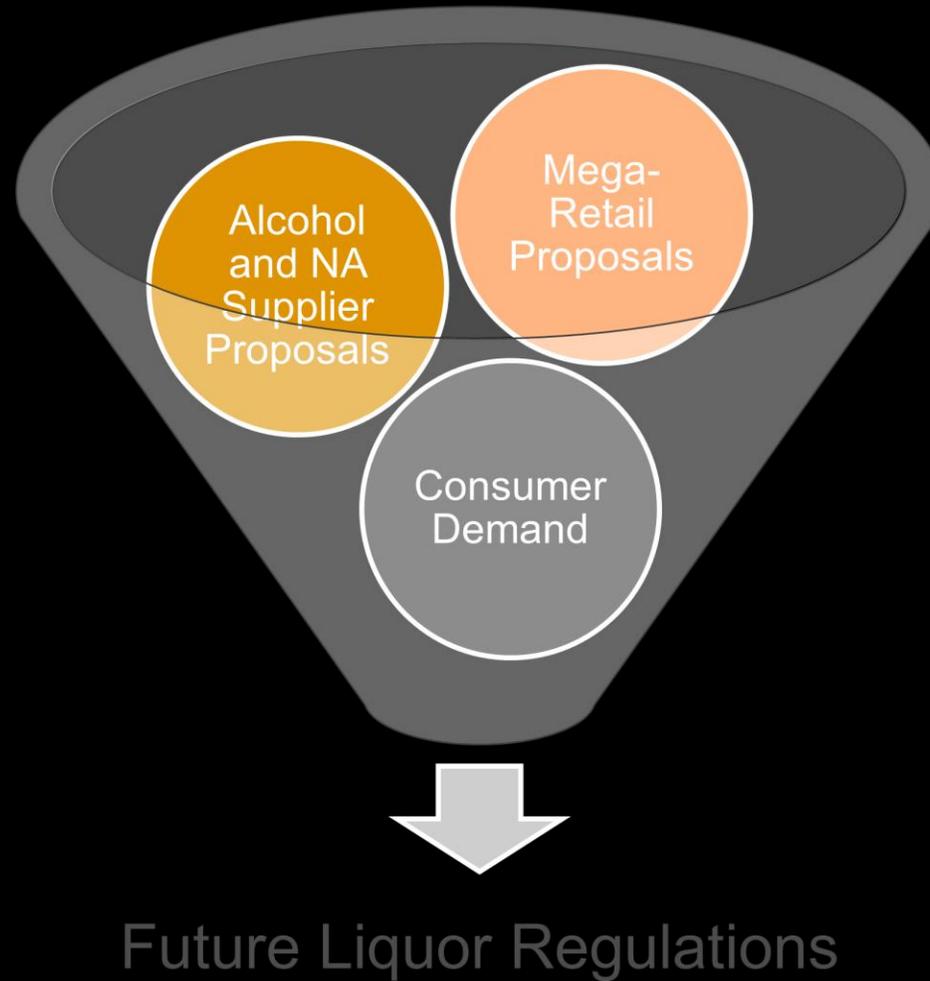
Exclusive territory laws prevent channel and account exclusion

Anti-discrimination provisions inhibit preferential pricing

Franchise laws inhibit supplier control

Some suppliers and mega-retailers are seeking to amend liquor laws to accommodate their business model.

# Impact on Liquor Regulation?



# Managing Relationships

- Policymakers & the Regulatory Environment
- Suppliers & Distribution Agreements
- Chain Retailers



# Policymakers & the Regulatory Environment: Need for Aggressive Advocacy

Extoll the benefits of the current beer regulatory system:

- Unparalleled consumer choice and variety
- A level competitive playing field (absence of slotting fees and pay-to-play, barriers to vertical integration, and independence guaranteed by franchise laws)
- Maintenance of an orderly, transparent and accountable distribution system (exclusive territories)
- For suppliers, this translates into brand builders
- For retailers, this translates into efficient distribution logistics
- For consumers, this translates into many beverage choices and regulations that effectively balance competition with control.

# Distribution Agreements

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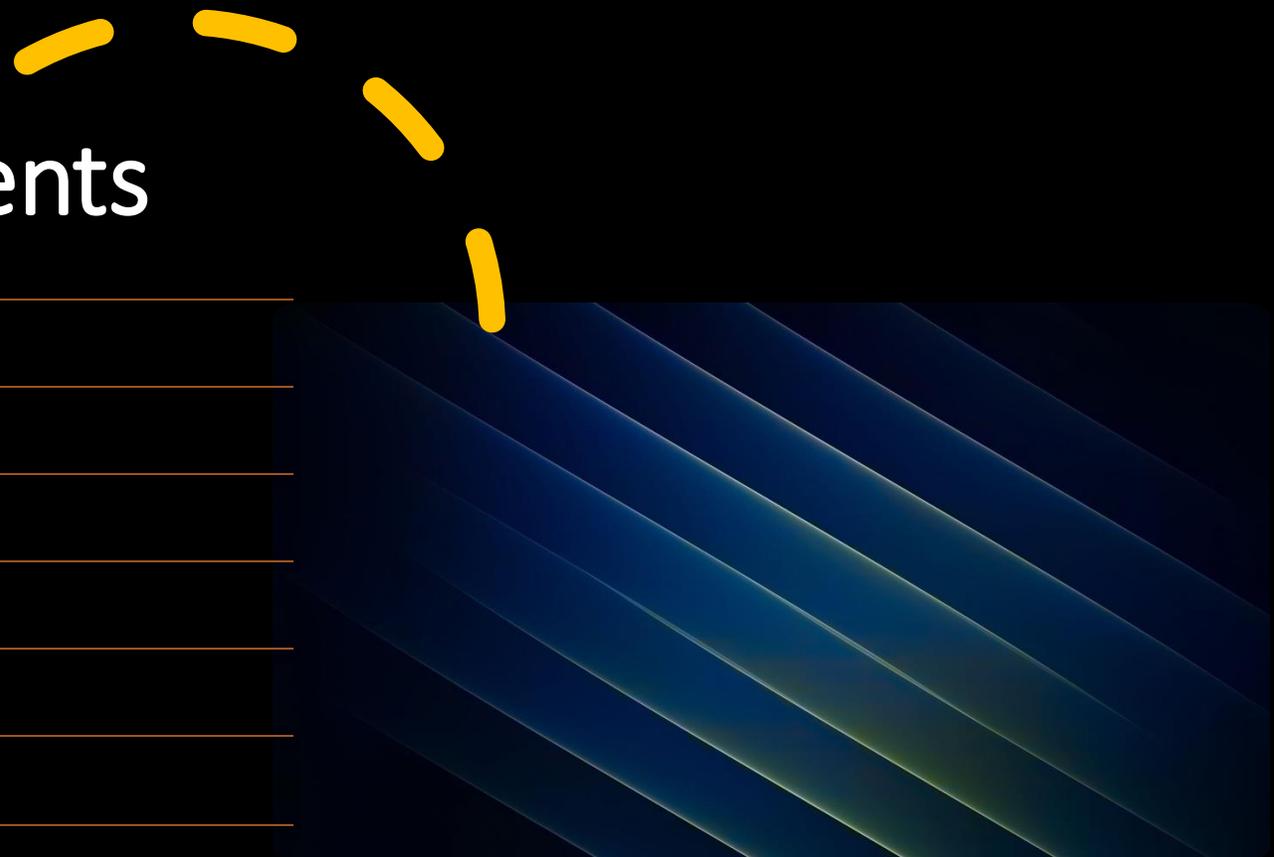
- Have all proposed distribution agreements reviewed by counsel
- Determine whether a franchise law applies
- While it is preferable to review all agreements by the same standard, a greater level of scrutiny is required if a franchise law does not apply.
- To the extent possible, you want to conform spirits, wine, beer and NA distribution agreements.



# Florida Franchise Laws

- Florida has a strong beer franchise law.
- Fla. Stat. § 563.022 et seq applies to a beer distributor, but not to other alcoholic beverages.
- There is no general franchise or fair dealer law in Florida per se.
- **Accordingly, a greater level of scrutiny is required for Wine, Spirits, and NA Agreements.**

# Key Provisions in Distribution Agreements



Term of the Agreement

Exclusive Distributor Rights

Products and Territory

Management Changes

Change in Control/Sale of Distributorship

Termination

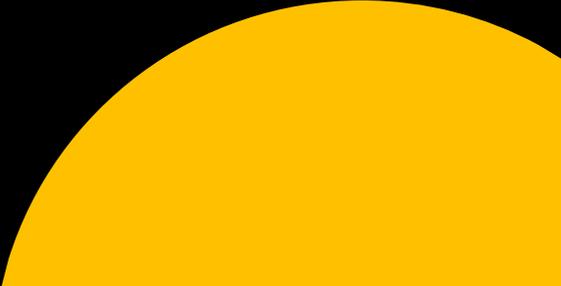
Successor Provision

Liquidated Damages

Venue & Jury Trial

Arbitration

Choice of Law



# Term of the Agreement

- Typically, a distribution agreement will identify the time period governed by the agreement.
- If there is a set term, in the absence of a contrary provision, the agreement is likely only terminable for cause.
- If no term is identified (i.e. an indefinite term), no franchise law applies, and the agreement does not require good cause to renew or terminate, the agreement and the relationship between supplier and distributor is terminable at will without cause.

# Term of Agreement: Recommendations

- If your beer franchise laws do not apply, insist upon a set term and/or a provision which requires notice, an opportunity to cure and good cause to either not renew at the end of the term or to terminate the agreement prior to the end of the term. Alternatively, negotiate a termination payment that is commensurate with the value of the distribution rights.

# Exclusive Distribution Rights

- Some distribution agreements will award exclusive distribution rights to specified products in a specified territory. Others will covertly identify that the you are “a” distributor, rather than the exclusive distributor.
- Some distribution agreements will reserve the supplier’s right to distribute to certain channels or chain accounts.

# Exclusive Distribution Rights: Recommendations

- If a supplier purports to reserve the right to self distribute to specified channels or accounts, look at any such attempted carveouts and attempt to limit those channels or accounts or eliminate them completely. If carveouts are included, they should not be expanded without your consent.
- An alternative is to negotiate an invasion fee with regard to sales to excluded accounts. But, note that invasion fees for a reservation of rights may be used as a backdoor way to avoid your exclusivity. If an invasion fee is included, ensure you have clarity on the amount and the manner in which it applies.

# Products and Territory

- Some distribution agreements will only apply to products that are identified on an exhibit to the agreement.
- Other distribution agreements will grant the distributor the right to distribute “brand extensions”.
- Other distribution agreements will grant the distributor the right to distribute any current or future product of the supplier.

# Products and Territory: Recommendations

- Attempt to negotiate the right to distribute at least future brand extensions on the theory that you have invested in and grown the “brand” in the territory and that fractured distribution will cannibalize the brand.
- Attempt to reserve for yourselves the rights to all brands and the option to elect to sell such brands after being provided notice of the new brands/product lines going into the market.

## Change in Control/Sale of Distributorship/Management Changes

- Typically, distribution agreements will prohibit a distributor from changing control, selling distribution rights or the assets of the business or changing management without the consent of the supplier.
- Often, the supplier will reserve the right to approve or refuse to approve any such changes in its sole discretion.
- The supplier will typically provide that it has the right to terminate the agreement if such approval is not obtained prior to effectuating the change. A supplier may attempt to reserve absolute discretion to approve or not approve.

## Change in Control/Sale of Distributorship/Management Changes: Recommendations

- Ascertain if the Florida franchise laws apply. If so, the manufacturer may not unreasonably withhold its consent/approval to an assignment, sale, or transfer of assets, stock, or ownership.
- If the Florida franchise laws do not apply, negotiate a provision which requires that the supplier may not unreasonably withhold consent and, as an additional option, that the requirement for any consent is waived for a family member or existing owner.

# Termination

- Often, a supplier will reserve the right to not renew an agreement or terminate an agreement prior to its term without cause in its sole discretion.
- Even where “good cause” is ostensibly required, the agreement may define good cause in such a broad manner that it is tantamount to termination without cause.
- Furthermore, distribution agreements will often attempt to limit a supplier’s damages obligations in the event that the agreement was wrongfully terminated.

# Termination: Recommendations

- Ascertain if the Florida franchise laws apply. If so, they embody nonwaiver provision which render unenforceable any conflicting provision in a distribution agreement.
- The Florida franchise laws require a manufacturer to act in good faith, 90 days' notice of a failure to comply with the agreement prior to the termination, good cause, and an opportunity to cure, which requires 30 days to submit a corrective action plan and an additional 90 days to cure the noncompliance or sell the distributorship.
- It is not clear if liquidated damages (i.e. the provision that purports to limit a supplier's damages in the event of wrongful termination) are enforceable under those laws, although the argument could be made that they are unenforceable when the law prohibits a termination unless good cause is shown.
- If the Florida franchise laws do not apply, negotiate a provision that requires notice, an opportunity to cure, and good cause. If not possible, negotiate a liquidated damage provision that fairly represents the value of the terminated distribution rights. But, it is important to keep in mind that the preemptive value will likely only increase with your sales, so ensure the preemptive value is reasonable under the circumstances.
- Also important to ensure that you have the right under the contract to terminate without cause, and without penalty, upon a specified period of time's notice.

# Termination: Post Termination

- You want to require the Supplier repurchase all the product and inventory that you hold at your laid-in cost
- Structure that obligation in the obligatory, rather than permissive
- Obligate the Supplier to pick up product from your warehouse
- If Florida's beer franchise law applies, Fla. Stat. 563.022 (20) will require the manufacturer to repurchase such inventory.

# Successor Provision

- Unless the franchise law includes a successor provision or the distribution agreement provides that a manufacturer cannot sell its business or assign the distribution agreement to a third party without a distributor's consent, the distribution agreement will be terminated by those acts and the successor to a manufacturer is not obligated to distribute through the existing distributor.
- Similarly, if a distributor entered into a distribution agreement with an importer and the supplier terminates the importation agreement, the new importer is not obligated to distribute through the existing distributor.

# Successor Provision: Recommendations

- Ascertain if a franchise law applies and if it embodies a “true successor” provision which obligates the successor to a brewer or an importer to the existing distribution agreement and prohibits the successor from terminating that agreement. Florida’s beer franchise law does include such a provision in Fla. Stat. 563.022 (16).
- If such a law does not apply, attempt to negotiate similar provisions in the distribution agreement itself.

# Venue & Jury Trial & Arbitration

- Often, suppliers will provide that any dispute has to be litigated in their state and that the distributor is required to waive its right to a jury trial.
- Alternatively, suppliers will provide that any dispute has to be arbitrated before a specified arbitration provider with the arbitration to occur in the supplier's state.
- Arbitration is final (i.e. no right to appeal) and an arbitrator does not have to follow the law.

# Venue & Jury Trial & Arbitration: Recommendations

- Ascertain if a franchise law applies and if it protects the distributor's right to litigate in its home state before a jury of its peers. If Florida's beer franchise law applies, it does embody the right to bring an action in the circuit courts of Florida and authorizes the action before a judge or jury.
- If the franchise law does not apply, either achieve that result by contract or do not specify a venue.
- If arbitration, attempt to include a provision that the arbitration occurs before the American Arbitration Association (a nonprofit provider), that the arbitration occurs in the distributor's state, that the arbitrator is required to follow the law of the distributor's state (if a franchise law is applicable), and that errors of law are appealable to a district court in the state.

# Additional Suggested Contract Terms: Intellectual Property/Indemnification

- Most agreements have specific provisions related to intellectual property rights.
- Ensure that Supplier confirms they either own the IP or have exclusive right to utilize it.
- Include a provision in the indemnification clause that Supplier agrees to indemnify you for any damages in any matter brought by a 3rd party against you alleging that your distribution/use of the IP violates that 3rd party's rights.
- Additional indemnification requirements where Supplier will indemnify you if products are unlawful in any way, including state laws, and for any product liability issues, as well as any other conduct that is Supplier's over which you have no control

# Additional Suggested Contract Terms: Supplier Reps and Warranties

- Want to ensure Supplier is representing and warranting things such as:
  - Compliance with all applicable law, including manufacturing, packaging, labeling;
  - Supplier's holding of the requisite licenses/permits to perform its obligations under agreement;
  - The entering into the agreement will not give rise to a third-party claim of a competing wholesaler in the territory.

# Hemp-Derived THC Products: Risk & Mitigation

- Hemp-derived THC edible products are subject to competing federal standards.
- The Federal Farm Bill legalized “hemp” defined as the plant *cannabis sativa* L. and any part of that plant including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than .3 percent on a dry weight basis. 7 USC 1639o(1).
- By definition, “marijuana” does not include hemp, as defined in section 1639o of Title 7. 21 USC 802(16)(B)(i).
- But, the FDA retains jurisdiction over food.

# The FDA

- FDA retains jurisdiction over FDCA/Public Health Service Act
- FDA prohibits interstate commerce of food with THC/CBD
- “FDA has therefore concluded that it is a prohibited act to introduce or deliver for introduction into interstate commerce any food (including any animal food or feed) to which THC or CBD has been added. FDA is not aware of any evidence that would call into question these conclusions.”
- “When this statutory prohibition applies to a substance, it prohibits the introduction into interstate commerce of any food to which the substance has been added unless FDA, in the agency’s discretion, has issued a regulation approving the use of the substance in the food (section 301(l)(2) of the FD&C Act [21 U.S.C. § 331(l)(2)]). To date, no such regulation has been issued for any substance.”
- FDA’s enforcement actions limited to delta-8 (synthetic), excessive amounts of THC, and marketing to children.



# What about TTB?

- Unlawful to incorporate THC/CBD into alcohol
- Hence all of the beverages are non-alcoholic products
- TTB defers to FDA guidance on “ingredient safety issues.”
- No applications for formulas containing “hemp” ingredients
- Federal Basic Permit issues?
- TTB jurisdiction only over alcoholic beverages
- TTB may pursue action against basic permits of industry members
- Condition on federal basic permit is compliance with FAAA, with the 21st Amendment, and with all other Federal laws relating to distilled spirits, wine, and malt beverages, including taxes with respect thereto.”

# Risk Summary

- Approximately 1 in 5 distributors is selling some type of THC/CBD product. To my knowledge, TTB has not initiated any enforcement actions concerning the distribution of these products. As a result, the implication is that the prosecution risk for distributing products lawful under the Farm Bill and, and products lawful under state law, still exists but is fairly small.
- The risk is further mitigated if hemp-derived beverages are legal on a state level. While TTB likely has no jurisdiction over non-alcoholic THC-infused products, it does have jurisdiction over regulatory compliance related to Federal Basic Permits. With FDA's position that THC or CBD-infused edible products delivered into interstate commerce violates the Food, Drug, and Cosmetic Act, the sale of such products could be a violation of Federal law.
- The risk of carrying medical marijuana or recreational cannabis is substantially greater, given its continued status as a Schedule 1 under the Controlled Substances Act (a felony). Similarly, it is clear that alcoholic beverages with CBD or THC would be considered unlawful.

# Mitigation Strategies

While selling THC or CBD infused products is a business decision, there are some mitigation measures that can be put into place:

- (1) Do not sell any alcoholic beverages containing THC or CBD.
- (2) Create a separate corporate legal entity to distribute the products in an effort to further shield or insulate the primary wholesale business and its assets.
- (3) Require certain representations and warranties in any distribution agreement, including (a) Supplier is licensed to sell the products; (b) the sale of the products complies with federal and state law; (c) that Supplier will indemnify the distributor for any misrepresentation or breach of warranty or for any product liability claims brought by a 3<sup>rd</sup> party.
- (4) Ensure that the distribution agreement related to these products gives you the opportunity to terminate the agreement, without penalty, upon notice in the event the sale of the products becomes prohibited by federal or state law.
- (5) Ensure that Supplier holds product liability insurance and names you as an additional loss payee.

# Federal Updates

- Recent Continuing Resolution opening the Federal Government included an Ag. Budget bill that changes laws related to hemp.
- There is a one-year delay in implementation on that hemp language. However, after one year, on or about November 12, 2026, the definition of “hemp” will be modified from .3% delta-9 THC or less on a dry weight basis, to the new definition of .3% total THC, including “any other cannabinoids that have similar effects (or are marketed to have similar effects) on humans or animals as a tetrahydrocannabinol (as determined by the Secretary of Health and Human Services).” This change obviously greatly reduces the variety of plants that currently qualify as federally legal “hemp.”
- This bill further bans any products containing cannabinoids that are synthesized or manufactured outside of the cannabis plant or not capable of being naturally produced by it. Within 90 days of enactment, the FDA is obligated to publish a list of all cannabinoids capable of being naturally produced by the Cannabis sativa L. plant, all THC class cannabinoids naturally occurring in the plant, and all other cannabinoids with similar effects. Many states that have a regulatory system, such as Minnesota, already expressly prohibit synthetic cannabinoids, thereby addressing this concern.
- Perhaps more critically, this bill imposes, for the first time, a cap on the amount of THC that may be in a legal hemp product, which would include edible products. That new cap will be .4 mg of THC per container. That is less than one half of one mg of THC. As those distributors currently selling these products know, the traditional THC content in a beverage container is either 5 or 10 mg. This new .4 mg cap would dramatically change the types of legal products and eliminate the vast majority of products currently in the market.
- Congress already taking steps to act.

# Questions & Comments

