So You Want to Get Married? How Is Your Relationship with Wholesalers?

By Sara Schorske

WHILE MAKING wine may be your passion, selling the wine is certainly the key to your winery's success and longevity. And selling your wine beyond the borders of your home state makes wholesalers indispensable. This inevitable requirement gives new meaning to the old saying, "Can't live with 'em, can't live without 'em!"

Although relationships with wholesalers are rarely passionate, they are a lot like marriages, and should be viewed as seriously. In some states you can get hitched unwittingly, without rings or ceremony, simply by shipping a small initial order to a prospective distributor. In some states it's easier to divorce your spouse than it is to change your distributor.

Everyone has their opinions on how to pick the perfect Mr. or Ms. Right, so we will leave it to others to give advice about choosing the right wholesaler. Our goal is to explain the regulatory framework in which the marriage to your wholesaler will exist, so you can understand the vows you are (presumed by law to be) taking.

When you decide that you want to expand into a new market, the very first and most fundamental step is to establish a relationship with a distributor in that market. This is an important step that you must undertake to open up almost any new state—even before you can register your brands or become licensed as a supplier. Therefore, many winery-distributor relationships are marriages of convenience, and wineries frequently enter into this relationship not understanding the fundamentals, only later to regret their ignorance. We hope this article will provide you with the basic principles that govern winery-wholesaler relationships, so you will know when you are tying the knot and how strong the cord is that binds you.

How Did I Get Married Anyway?

In some states, that first shipment or sale to the distributor, or the initial filing of the letter of appointment with your out-of-state supplier registration, is all it takes to tie the knot with a wholesale house for the foreseeable future. It is like the classic scene in the movies, in which the man wakes up in the morning only to discover that, according to local custom, his innocent conduct the night before has betrothed him to the local girl. The simple acts of appointing a distributor by letter, submitting the state form notifying the state of your distributor and perhaps also its designated territory, or even selling just one bottle may be enough to create a binding and long-term relationship, the terms of which are strictly dictated by the laws of the wholesaler's state.

It should not be surprising that these laws favor the home-state wholesaler over the faraway supplier. Wholesalers have sponsored the legislation and found their local legislature happy to both protect the interests of a local business over those of an out-of-state supplier, and to maintain control over the distribution of alcoholic beverages within their state, using their in-state middle tier members as willing deputies of the law. Remember that wholesalers collect state excise taxes (in most states), maintain records, and help insure that the state's laws concerning the sale and distribution of alcoholic beverages are followed.

Many wineries have been doing business with wholesalers on a handshake for years, and most will tell you they prefer it that way—not aware that the laws of the wholesaler's state often define the terms and duration of that relationship. It's only when there is a serious dispute that they discover they got married in a country where divorce is not an option.

The statutes and regulations which create this situation are known as "franchise laws." Over thirty states have franchise laws that in some respect or other regulate the relationship between suppliers and wholesalers. These laws range greatly in the regulatory obstacles they represent, and there is a bewildering lack of uniformity in requirements and regulations. Some simply require notifying the authorities of your chosen distributor (and sometimes, its assigned territo-

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ries). Others specify the procedures for changing distributors or modifying the terms of your agreement. Many states have provisions that limit a supplier's right to terminate a wholesaler to specific—and often very limited—reasons, and in a handful of states these laws are designed to keep you virtually married for life. Sometimes, this lifetime commitment binds you for the life of your brand, whether you still own your winery or not, and whether your winery still owns the brand or not. In states like that, even death parts you not!

The most basic requirement of the franchise laws is the registration of your distributor. Over 20 states require that a supplier register its distributor. Sometimes this is done by filing a copy of the letter of appointment; sometimes the state has a form for designation of the distributor(s) and the brands that will be carried by each distributor. This step is normally part of your initial licensing as a out-of-state supplier or the registration of your brands. Some states require a written contract or agreement with the distributor, and some of those states insist that the contract be filed with state regulators. Changes in distributors, the brands they carry for you, and their territories often must reported to the state, sometimes in advance of the changes.

In many cases the state restrictions effectively limit the supplier's powers to change or renegotiate its agreements with the distributor. If you can't fire the distributor, your bargaining power is certainly constrained. Some states require a supplier who wants a change to submit a detailed explanation of "good cause" for the change to the state agency, with a copy to the distributor, who may file an objection and/or request a hearing. Then it's up to the state to decide if you get your divorce—or not. (Here's a chilling thought: how would you like to stay married to someone after an unsuccessful divorce attempt?)

Designation of Territories

Some states require the supplier to designate the territories that the wholesaler will service as part of the registration process. More than ten states require these territories to be exclusive. Even in states where assigning exclusive territories is not a legal obligation, many wholesalers want an exclusive appointment for a particular territory.

Then again, exclusive territories are illegal in some states, where the legislature has deemed them to restrain competition. Recently the Indiana ABC voted to repeal its rule banning exclusive territories for beer wholesalers on the finding that the rule was actually reducing competition, limiting availability of competing or specialty brands, and decreasing the number of wholesalers. Since wholesalers could sell anywhere in the state, they promoted large shipments based on discounted prices. The large retailers, recognizing a good thing when they saw it, began to play the wholesalers against each other to drive down the wholesale price. As more and more wholesalers entered the price wars, the profit margins eroded, service began to suffer, and distributors stopped investing in carrying new product lines. Several distributors were actually forced out of business.

Termination of Wholesalers

Some states allow the firing of the wholesaler for no reason at all, often called the "at will" termination, but franchise laws usually limit a supplier's rights to terminate a wholesaler. Most franchise laws do allow a winery to terminate for good cause, but often the allowable grounds are restricted to a few specific causes. Some states permit the termination of the local wholesaler for general commercial reasons (such as non-performance). Other states interpret good cause in amazingly restrictive ways.

On top of requiring a bona fide good cause, many states impose requirements such as advance notice to both the wholesaler and the state, giving the wholesaler an opportunity to "cure" (correct) any deficiencies. After termination, the winery may be required to repurchase the wholesaler's inventory at its laid-in cost.

In Georgia, a classic example of a strict franchise state, the regulations recognize a wholesaler's failure to maintain sales volume consistent with the sales volumes of other wholesalers to constitute good cause for termination. However, a supplier who wants to terminate the distributor must submit a detailed explanation of the specific reasons to the State Revenue Commissioner, with a copy to the wholesaler, who can file an objection to the reasons. The State Revenue Commissioner then conducts a hearing and makes a decision. Historically the State

Revenue Commissioner has invariably decided these disputes in favor of the local wholesaler.

If state law requires reason or good cause to terminate, a winery should always document its reasons and put its complaints or warnings in writing. (The standard recommendation is, "Praise verbally, complain in writing.") If the distributor is not meeting agreed-upon sales or service standards, or its performance is substandard in any other way, make sure to say so in a letter.

Written Contracts

Clearly, a written contract with a distributor is a good idea and some states even require it. Many of the obvious points of friction can be addressed in the agreement, and performance standards should certainly be included as well. Some of the highlights the agreement should cover are:

- territorial restrictions (either geographic or by customer segment, for example, "on-premise retailers only");
- terms of sales and payment, including credit terms;
- performance standards;
- the duration or term of the agreement; and
- termination of the agreement.

From the winery's perspective, provisions governing the wholesaler's post-divorce handling of remaining inventory are crucial to prevent "bombing" (the liquidation of inventory at a low price) and to allow the winery, or its new wholesaler, to acquire the existing inventory.

In modern marriages, pre-nuptial agreements have become popular primarily to pre-solve the problems of a possible future dissolution. Similarly, the primary reason for a written distributor agreement is to handle termination of the distributor. As one of the leading attorneys in this field has said: "From the winery's point of view, [written agreements] serve one principal purpose: to make it as easy as possible for a winery to fire its wholesalers." While no one wants to start a business relationship thinking about its end, the use of a written agreement can sometimes help ameliorate the effects of the local laws favoring the wholesaler.

Due to the various franchise requirements and laws, it is not possible to have one contract fit all states, but in all cases a written agreement can help establish the wholesaler's obligations. Even though there is so much competition for shelf space that new wineries feel fortunate to locate a wholesaler, it is still possible to negotiate a short contract which can help level the playing field.

Is There Friendship After Marriage?

The foundation of a good winery-distributor relationship is not unlike the foundation of a good marriage. Make sure the courtship is long enough to establish compatibility. Understand that you're not just writing your own wedding vows: the commitments you are undertaking may be imposed by law. Keep the communication clear and the expectations well understood. Share the responsibilities of the relationship fairly.

Just as marriages often crack and break under financial strains, commercial pressures can also make winery-wholesaler relationships difficult to maintain. Still, they're an essential part of winery expansion, so you just have to find a way to live with it, and hopefully, love it!