

May 14, 2014

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Walter McClure
B.C.I. LLC

RE: Terms of a Distribution Agreement

Dear Mr. McClure:

ISSUE: This is in response to your e-mail dated April 8, 2014, in which you stated that your company has brands of beer registered in Pennsylvania that are sold to Pennsylvania-licensed distributors in accordance with franchise agreements. You ask about ways to protect your brands from being permanently franchised by a particular distributor in the event that the distributor in question was not actively selling your products. For example, you inquire if it would be permissible to include wording in your agreements that would require the distributor to release the brand due to inactivity after a certain specified period.

OPINION: As you know, the distribution of malt beverages within Pennsylvania is governed primarily by section 431 of the Liquor Code [47 P.S. § 4-431]. Pursuant to section 431(d) of the Liquor Code, all out-of-state manufacturers whose products are sold and delivered in Pennsylvania are required to give distribution rights for their products to importing distributors (“IDs”), authorizing them to sell malt or brewed beverages (“beer”) in a specific geographic area within Pennsylvania. [47 P.S. § 4-431(b)]. ID licensees may then in turn sell the beer to other IDs within their assigned geographic territory, as long as the primary ID has entered into a written agreement with the secondary ID, setting forth the terms and conditions under which beer may be resold. In addition, ID licensees may sell directly to other licensees of the Pennsylvania Liquor Control Board (“Board”) as well as to the public.

With regard to in-state licensed manufacturers, such manufacturers may choose to function as their own primary distributor, or may name a distributor or importing

distributor as the primary or original supplier of their products. [47 P.S. § 4-431(d)(5)].

As to the distribution agreements themselves, section 492(19) of the Liquor Code makes it unlawful for a manufacturer to modify, cancel, terminate, rescind, or not renew without good cause any distribution agreement. [47 P.S. § 4-492(19)]. Further, prior to the modification, cancellation, termination, rescission, or non-renewal of such agreements written notice of such modification, cancellation, termination, rescission, or non-renewal must be provided to the affected party and the Board by certified mail.

Such written notice must be provided at least ninety (90) days prior to the effective date of the proposed modification, cancellation, termination, rescission, or non-renewal. The notice should state all reasons for the proposed modification, cancellation, termination, rescission, or non-renewal of the distribution agreement. If the D or ID who has been put on notice of the potential end of the distribution agreement rectifies the deficiencies noted in the letter, then the proposed modification, cancellation, termination, rescission, or non-renewal shall be null and void. Further, while this section states that the parties may choose to waive some or all of the requirements in section 492(19), if they do so in writing, it is somewhat unclear whether the waiver provision applies to the notice requirement or whether the parties may agree in writing to waive the “good cause” requirement.

The Liquor Code defines “good cause” as “the failure by any party to the agreement, without reasonable excuse or justification, to comply substantially with an essential, reasonable and commercially acceptable requirement imposed by the other party under the terms of an agreement.” [47 P.S. § 4-431(d)(1)].

Finally, section 431 of the Liquor Code, grants to the Court of Common Pleas of the county wherein the ID is located, the authority to enjoin the modification, rescission, cancellation or termination of a distribution agreement, at the request of the affected ID. Unlike section 492(19) of the Liquor Code, that section does not specifically reference the non-renewal of a distribution agreement.

Therefore, as to your question of whether it is permissible to include terms that anticipate termination of an agreement in the event of a specified period of inactivity, such may be the case if the waiver provision of section 492(19) of the

Liquor Code is read to allow for waiver of both the ninety (90) day notice requirement and the “good cause” requirement. Conversely, if the waiver provision of section 492(19) of the Liquor Code is read to only allow for waiver of the ninety (90) day notice requirement, then a territorial agreement with a specific termination provision end date must continue absent good cause.

Again, this is an area of the law that specifically allows the aggrieved D or ID to seek immediate redress in the Courts of Common Pleas and is outside the jurisdiction of the Board. This office’s interpretation of the Liquor Code, while binding on the Pennsylvania State Police, Bureau of Liquor Control Enforcement, is not binding on the Courts of Common Pleas. Therefore, you may wish to consult private counsel experienced in Pennsylvania liquor law, who have litigated such matters.

THIS OPINION APPLIES ONLY TO THE FACTUAL SITUATION DESCRIBED HEREIN AND DOES NOT INSULATE THE LICENSEE OR OTHERS FROM CONSEQUENCES OF CONDUCT OCCURRING PRIOR TO ITS ISSUANCE. THE PROPRIETY OF THE PROPOSED CONDUCT HAS BEEN ADDRESSED ONLY UNDER THE LIQUOR CODE AND REGULATIONS. THE LAWS AND POLICIES ON WHICH THIS OPINION IS BASED ARE SUBJECT TO CHANGE BY THE LEGISLATURE OR THE PENNSYLVANIA LIQUOR CONTROL BOARD.

Very truly yours,

FAITH S. DIEHL
CHIEF COUNSEL

cc: Pennsylvania State Police,
Bureau of Liquor Control Enforcement
Jerry W. Waters, Director of Office of Regulatory Affairs
Tisha Albert, Director, Bureau of Licensing
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