



Independent Retailers & Distributors Square off Against the Majors

The major tobacco product manufacturers' relationships with retailers and distributors are becoming increasingly contentious. Three tobacco litigators describe the battleground regarding the majors' retail promotion programs. >BY **ASHLEY L. TAYLOR, JR., ANTHONY F. TROY, AND BRYAN M. HAYNES**

Nearly everyone within the tobacco industry is familiar with the major tobacco manufacturers' retail promotion programs, which promote certain cigarette brands by rebating a portion of the product's price. The rebate payments are made to participating retailers according to the

terms of contracts signed between the majors and the retailers.

According to the manufacturers, those contracts prevent the retailers from selling the promotional cigarettes to anyone but consumers and require the contracted retailers to pass on the full rebated amount to the consumer through a

reduced retail price. If a retailer buys a carton of cigarettes for the full list price of \$40, for example, and the manufacturer pays the retailer an \$8 rebate payment, the retailer is contractually obligated to resell the carton of cigarettes for \$8 less than its normal sale price.

It is the manufacturer's intent that contracts limit the sale of rebated cigarettes strictly to consumers in the retailer's store, and that only limited quantities of cigarettes (usually three to five cartons) may be sold to any one customer at a time. The promotional contracts may also contain provisions governing the percentage of the manufacturer's cigarettes that must be sold as a percentage of total sales, the layout of fixtures and counter displays in stores, and the maintenance of inventory levels.

The task of explaining the manufacturer's policies to retailers and ensuring their compliance falls upon the manufacturer's sales representatives. But disputes arise when reps allegedly tell the retailers that the written agreement's carton limits and provisions mandating sales only to consumers, do not apply.

Arguably, sales representatives have an incentive to waive the manufacturer's sales restrictions, since they are compensated based on product sales in their territories. A waiver of the restrictions can lead to higher sales in those territories. Relying on the verbal statements of the manufacturer's sales reps, retailers then sell cigarettes in excess of the limits established by the parties' written agreements, to consumers or distributors. In many cases, there may also be an allegation that the manufacturer itself is aware of the retailer's excess sales, by virtue of the manufacturer's access to the retailer's sales data, and waived those limits by failing to enforce them.

WHEN DISPUTES HEAD TO COURT

The manufacturer inevitably denies that the sales representative waived the written agreement's sales restrictions or argues that its representative lacked authority to waive those restrictions in the first place. The issue for the court in such disputes is whether the written agreement's provisions are trumped by the

representative's verbal waiver of those provisions. Established principles of contract interpretation often support the retailer's contention that the representatives' statements take precedence over the written agreements' sales restrictions.

In another line of cases, the contracted retailer arguably violates its agreement with the manufacturer by selling promotional cigarettes to distributors or to consumers in excess of the written agreements' carton limits. However, the manufacturer does not sue its contracted retailer, with which the manufacturer may often have an established business relationship that the manufacturer does not want to jeopardize. Instead, the manufacturer sues the entities that purchased the promotional cigarettes from the contracted retailer — often fourth-tier distributors. Because the fourth-tier distributor does not have an agreement with the manufacturer prohibiting it from purchasing or selling the manufacturer's products, the manufacturer must rely on somewhat novel legal theories in order to assert a claim against the distributor.

In one recent case, the manufacturer asserted a claim under the Racketeer Influenced and Corrupt Organizations ("RICO"), a statute enacted by Congress to combat organized crime. The manufacturer alleged that certain of its contracted retailers conspired with fourth-tier distributors and others to misrepresent to the manufacturer that promotional cigarettes had been sold directly to consumers.

After the manufacturer discovered the alleged breaches by its contracted retailers, the manufacturer terminated some —but not all — of their contracts, and initiated litigation against the fourth-tier distributors that purchased promotional cigarettes from the contracted retailers. In addition to relying on the federal RICO statute, the manufacturer has also asserted claims against the fourth-tier distributors for tortious interference with contract and the state unfair trade practices statute.

Regardless of whether the manufacturer's suit involves a garden-variety claim for breach of the written

sales restrictions or more novel theories that must be implicated when no contractual obligation exists, disputes between the major manufacturers and their contracted retailers and non-contracted distributors are becoming increasingly prevalent. Prudent retailers and distributors are well-advised to seek legal counsel with respect to their purchases and sales of the majors' promotional products. **S**

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