IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

PEPSICO, INC.,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	**CIVIL NO. 00-229-GPM**
	)	
MARION PEPSI-COLA BOTTLING COMPANY,	)	
	)	
	)	
Defendant.	)	

MEMORANDUM AND ORDER

MURPHY, Chief District Judge:

This matter is before the Court on Defendant's motion for partial summary judgment on Counts II through IV of Pepsico's amended complaint (Doc. 327) and on Plaintiff's motion for summary judgment on Counts II through IV of the first amended complaint and on Counts III through IV of the counterclaim (Doc. 333).[1] The Court held a hearing on the motions on May 20, 2003 (*see* Doc. 362), and took the motions under advisement. For the reasons set forth below, Plaintiff's motion for summary judgment is granted, and Defendant's motion for summary judgment is denied.

BACKGROUND

The only remaining claims concern the constitutionality of the "Soft Drink Industry Fair Dealing Act," 815 ILCS 730/1-99 ("Soft Drink Act"). This Act – the conception of Marion Pepsi's President, Harry L. Crisp, II, who hired a Chicago law firm to draft the legislation and lobby for its passage (*see* Doc. 337, para. 9) – became effective on May 21, 1999 (*see* 815 ILCS 730/99). The

[1] The Court notes that the amended counterclaim was dismissed with prejudice by Order dated October 24, 2002, pursuant to a partial settlement between the parties. (*See* Doc. 357.)

parties seek a declaratory judgment concerning the Act's constitutionality. Jurisdiction is premised upon federal question jurisdiction and diversity of citizenship. *See* 28 U.S.C. §§ 1331, 1332.[2] Declaratory relief is sought pursuant to 28 U.S.C. § 2201.

District Judge David R. Herndon dismissed all claims except those dealing with the constitutionality of the Act pursuant to a stipulation and settlement agreement on October 24, 2002.[3] (*See* Doc. 357.) Pepsico contends in Count II of the amended complaint that the Illinois Soft Drink Act violates the Contracts Clause of the United States Constitution. Count III alleges that the Act violates the Contracts Clause of the State of Illinois Constitution, and Count IV alleges that the Illinois Soft Drink Act violates the Commerce Clause of the United States Constitution.

The parties have a long-standing business relationship. Pepsico develops and promotes carbonated and noncarbonated soft drinks and other products, and also manufactures and sells concentrate to bottlers to be used in the processing of bottled and canned soft drink products and fountain beverage syrup. (*See* Joint Statement of Uncontested Material Facts ("Joint Statement") at ¶ 1.) Marion Pepsi processes, bottles, cans, sells, and distributes various soft drink products. Marion

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[2] Plaintiff Pepsico, Inc., is a North Carolina corporation with its principal place of business in New York, and Marion Pepsi-Cola Bottling Company ("Marion Pepsi") is a Missouri corporation with its principal place of business in Marion, Illinois. (*See* Doc. 157, paras. 4-5.) The amount in controversy exceeds $75,000, exclusive of interest and costs. (*See* Doc. 157, para. 6.)

[3] At the May 20, 2003, hearing, the Court expressed concern whether the case continued to present an actual controversy following settlement of the other claims. The parties addressed the issue to the satisfaction of the Court, and Pepsico submitted a supplemental brief regarding the existing case or controversy (*see* Doc. 366). Upon consideration of Pepsico's argument, the Court is satisfied that there is a "substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment." *Peick v. Pension Ben. Guar. Corp.*, 724 F.2d 1247, 1258 (7th Cir. 1983), *quoting Maryland Casualty Co. v. Pacific Coal and Oil Co.*, 312 U.S. 270, 273 (1941). Marion Pepsi has invoked the Soft Drink Act as a source of rights within the ongoing and existing contractual relationship between the parties, and the Court finds it proper to decide the issue.

Pepsi also processes, sells, and distributes beverage syrups used in the preparation of various fountain soft drink products. (*See* Joint Statement at ¶ 2.)

Between 1960 and 1998, Pepsico and Marion Pepsi entered into various agreements called "exclusive bottling appointments." These appointments authorized Marion Pepsi to process concentrate into a finished Pepsico soft drink product and to bottle, can, sell, and distribute the product in a defined geographic territory, including counties in Illinois, Missouri, Kentucky, Arkansas, and Tennessee. (*See* Joint Statement at ¶ 3.) Pepsico and Marion Pepsi also entered into agreements called "syrup appointments" during the same time frame. These appointments authorized Marion Pepsi to process concentrate into a Pepsico beverage syrup used to produce fountain soft drinks and to sell and distribute that syrup in the territory. Collectively, the exclusive bottling appointments and syrup appointments are referred to in this litigation as "appointments." Each appointment is a formal written contract which is governed by New York law. (*See* Joint Statement, Exhibit A, ¶ 21.)

In relevant part, the Soft Drink Act regulates the power of suppliers of soft drink products to change their business relations with their distributors. Under the Act, "supplier" is defined as "a person engaged in the manufacture or marketing of soft drink beverage concentrate, syrup, or other soft drink beverage base for use in the preparation of soft drink products sold under trademarks owned or licensed by such person." 815 ILCS 730/5. "Distributor" is defined as "a person in this State who (i) directly or through a cooperative or association of which the person is a member, bottles or cans one or more soft drink beverage or processes soft drink beverage concentrate into beverage syrup and (ii) sells, distributes, or delivers such soft drink beverages or soft drink beverage syrup under trademarks owned or licensed by a supplier." *Id.* Under the Act, a supplier is prohibited from canceling, failing to renew, or otherwise terminating a distribution agreement "without good cause to do so." 815 ILCS 730/15(a)(1). Similarly, a supplier may not "unilaterally" amend or modify any such agreement, *see* 815 ILCS 730/15(a)(2), and it is required to exercise "good faith" in negotiating any amendment to the distribution agreement and may not retaliate against a distributor or discriminate in pricing or terms against a distributor that fails to agree to an amendment to the agreement. *See* 815 ILCS 730/15(a)(3-4). Unless with "good cause," the supplier must also offer to a distributor the right to "bottle or can any new soft drink beverages introduced by the supplier," and it may not

> sell, distribute, and deliver such soft drink beverages or soft drink beverage syrup under trademarks owned or licensed by the supplier or offer a distributor such right on terms and conditions less favorable than such right is offered to any other distributor of the supplier, including any distributor owned in whole or in part by the supplier.

815 ILCS 730/15(a)(6).

The Act also governs relations between the supplier and a distributor who has the right to distribute within a geographic area. It prohibits the supplier from selling product to a different distributor within that geographic area. Specifically, the Act provides

> [n]o supplier who, pursuant to a distribution agreement, has granted a person exclusive right in a generally defined geographic area to (i) directly or through a cooperative or association of which the person is a member, bottle or can one or more soft drink beverages, or process soft drink beverage concentrate into beverage syrup, and (ii) sell, distribute, or deliver such soft drink beverages or soft drink beverage syrup under trademarks owned or licensed by the supplier, shall, directly or through any officer, agent, employee, or representative, enter into an agreement authorizing, permitting, contemplating, or exercising such rights in the same geographic area.

815 ILCS 730/15(b).

If a supplier wishes to cancel its contract with a distributor, it must follow the procedure detailed in the Act. *See* 815 ILCS 730/20. This procedure requires the supplier to explain in writing and with backup documentation the reasons why it wants to cancel 90 days in advance of the effective date of cancellation. *See* 815 ILCS 730/20(b). The distributor's cure of the stated reasons for cancellation within 60 days voids the cancellation notice. The Act also prohibits a supplier from unreasonably withholding or delaying its consent to a distributor's decision to sell or otherwise transfer the business. *See* 815 ILCS 730/25. The Act even requires a supplier to "buy out" a distributor it no longer wishes to work with. *See* 815 ILCS 730/30(a). Civil suits to determine fair market value are authorized in the event the parties cannot agree. *See* 815 ILCS 730/30(b).

The Act authorizes various judicial remedies as well. A supplier's violation of the notice, transfer, or reasonable compensation provisions entitles a distributor to sue for damages, including costs, expenses, attorney's fees, and injunctive relief. *See* 815 ILCS 730/35(b). Punitive damages are available upon a finding that a party to a distribution agreement has failed to act in good faith. *See* 815 ILCS 730/35(e).

Particularly relevant to the constitutional issue before the Court, the Act also purports to have prospective application only:

> [T]his act shall, to the fullest extent permitted by law, apply (i) to conduct occurring after the effective date of this Act, whether or not such conduct relates to a distribution agreement entered into before the effective date of this Act, and (ii) to distribution agreements entered into or amended after the effective date of this Act, including any renewal of a distribution agreement in existence on or before the effective date of this Act.

815 ILCS 730/40. Thus, renewal is broadly defined. If the distribution agreement has a definite term, it is "renewed" if the supplier ships soft drink concentrate or syrup to the distributor after the designated term expires. If the distribution agreement is on successive periodic terms, it is renewed if the supplier ships "soft drink concentrate or syrup to a distributor after the expiration of the month, year, or other period of the distribution agreement." *Id.* Most significant to this case, if the

agreement does not have a designated term of duration "or is terminable at will upon notice," renewal occurs upon "shipment of soft drink concentrate or syrup to a distributor after the effective date of this Act." *Id.*

Finally, the Act applies even if the parties to a soft drink distributorship agree in advance that it should not apply. "Any contract or agreement purporting to waive or vary the provisions of this Act, or purporting to preclude the application of this Act to any distributorship subject to this Act is void and unenforceable to that extent." 815 ILCS 730/10(c).

ANALYSIS

Summary judgment is proper where the pleadings and affidavits, if any, "show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." FED. R. CIV. P. 56(c); *Wyatt v. UNUM Life Ins. Co. of America*, 223 F.3d 543, 545 (7th Cir. 2000); *Oates v. Discovery Zone*, 116 F.3d 1161, 1165 (7th Cir. 1997); *see also Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). The movant bears the burden of establishing the absence of fact issues and entitlement to judgment as a matter of law. *Wollin v. Gondert*, 192 F.3d 616, 621-22 (7th Cir. 1999). The Court must consider the entire record, drawing reasonable inferences and resolving factual disputes in favor of the non-movant. *Schneiker v. Fortis Ins. Co.*, 200 F.3d 1055, 1057 (7th Cir. 2000); *Baron v. City of Highland Park*, 195 F.3d 333, 337-38 (7th Cir. 1999).

Although the non-movant may not simply rest on his pleadings, *Chemsource, Inc. v. Hub Group, Inc.*, 106 F.3d 1358, 1361 (7th Cir. 1997), and although defeating summary judgment takes more than just a "swearing match," *In Re Wade*, 969 F.2d 241, 245 (7th Cir. 1992), it is the movant who bears the burden of establishing "that he is entitled to judgment under established principles." *Yorger v. Pittsburgh Corning Corp.*, 733 F.2d 1215, 1222 (7th Cir. 1987). If he does not discharge that burden, then he is not entitled to judgment. *Id.* When presented with cross motions for summary judgment, the Court must consider each motion separately and evaluate admissible evidence in the light most favorable to the non-moving party. *Bennett v. Roberts*, 295 F.3d 687, 694 (7^{th} Cir. 2002). In this case, the facts necessary for resolution of the pending motions are not disputed.

Three constitutional provisions are at issue: the Contracts Clause of the United States and State of Illinois constitutions, and the Commerce Clause of the United States Constitution. The Contracts Clause in the United States and Illinois Constitutions are similar. Specifically, the Contracts Clause of the United States Constitution provides:

> No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.

UNITED STATES CONST., Art. I, § 10(1). The Illinois Constitution has a similar provision: "No … law impairing the obligation of contracts … shall be passed." ILL. CONST., Art. I, § 16. The Illinois Supreme Court applies federal case law to interpret the Illinois Contracts Clause, so the two provisions are interpreted similarly. *See Dowd & Dowd Limited v. Gleason*, 693 N.E.2d 358 (Ill. 1998).

The proper standard for determining a Contracts Clause violation was set forth by District Judge Herndon in his March 28, 2001, Order on motions to dismiss. (*See* Doc. 156.) That standard will not be repeated in its entirety here. The Court simply notes that in deciding whether a change in the law operates as a substantial impairment of a contractual relationship, the Court looks at (1) whether there is a contractual relationship; (2) whether a change in law impairs that contractual relationship; and (3) whether the impairment is substantial. *General Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992).

The Commerce Clause to the United States Constitution states: "The Congress shall have Power … To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." UNITED STATES CONST., Art. I, § 8. Judge Herndon set forth the proper legal standard in his Order addressing the motions to dismiss, and it will not be repeated in its entirety here. In short, the Commerce Clause "precludes the application of a state statute to commerce that takes place wholly outside the State's borders, whether or not the commerce has effects within the State." *Healy v. Bier Institute*, 491 U.S. 324, 336 (7th Cir. 1989), *quoting Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982).

Contracts Clause

The test for evaluating a Contracts Clause challenge to a state statute requires a court to analyze (1) whether there is a contractual relationship; (2) whether a change in law impairs that contractual relationship; and (3) whether the impairment is substantial. *General Motors Corp.*, 503 U.S. at 186. It is undisputed that the parties' relationship is contractual. Thus, in this case, the analysis turns on the second and third factors.

The Act does not withstand Contracts Clause scrutiny. This change in the law certainly impaired the pre-existing contractual relationship between Pepsico and Marion Pepsi. Although the legislation purports to avoid the Contracts Clause problem by redefining the term of the appointments, Pepsico was required to ship Marion Pepsi its requirements of concentrate under the appointments between Pepsico and Marion Pepsi (executed before May 21, 1999) which were valid and enforceable when the Act took effect. Thus, the only way Pepsico could avoid a renewal of the appointment would be to breach its pre-existing contract. Treating shipments made after the effective date of the Act as a renewal of the appointment impairs Pepsico's contractual rights because it transforms the conduct mandated by the pre-existing contract into a mechanism for renewing the contract with new terms to which Pepsico did not consent.

The Act also impairs Pepsico's right to terminate its contracts by imposing new requirements on termination. Before its enactment, Pepsico could have terminated an appointment if Marion Pepsi failed to comply with any of the appointment's terms and conditions. (*See* Joint Statement, Exhibit A, ¶ 10). Under the Act, however, Pepsico must provide Marion Pepsi with 90 days advance notice and repeated opportunities to cure its defaults. *See* 815 ILCS 730/20. And it may even be required to pay Marion Pepsi the "fair market value" of the business that has been terminated. 815 ILCS 730/30.

These impairments of the pre-existing contractual relationship are substantial. The Supreme Court has stated that a law works a substantial impairment if it abridges legitimate expectations upon which the parties reasonably relied in contracting. *Allied Structural Steel Company v. Spannaus*, 438 U.S. 234, 246 (1978). The Act certainly abridges the expectations which existed between the parties when the appointments were formed. This is evident in the Act's impairment of Pepsico's right to terminate the appointments discussed above. These requirements do not exist in the appointments as written or under New York law.

The Act also creates rights for Marion Pepsi which are found no where in the appointments. As such, it is a substantial impairment of Pepsico's ongoing contractual rights. Specifically, the Act substantially changed the contractual relationship between the parties by changing the covenant of good faith and fair dealing applicable to distribution agreements. The Act defines good faith as "honesty in fact in the observation of reasonable commercial standards for fair dealing in trade." 815 ILCS 730/5. This imposes a reasonableness requirement on Pepsico's exercise of contractual discretion and significantly changes the standard. The law of contracts does not impose a duty to be reasonable.

Moreover, the Act imposes good faith restrictions where the covenant of good faith and fair dealing has no application. Specifically, the Act requires that a supplier exercise good faith in the negotiation of amendments, modifications, or changes in the distribution agreement and prohibits discrimination in pricing, fees, charges, or other terms when distributors withhold assent to such amendments, modifications, or changes. *See* 815 ILCS 730/15(a)(3-4). These good faith requirements change the pre-existing contractual relationship and, interestingly, only apply to suppliers and not distributors. New York law does not apply the implied covenant of good faith and fair dealing to the negotiation of contracts or amendments. The covenant "is limited to performance under a contract and does not encompass future dealings or negotiations between parties." *Village on Canon v. Banker's Trust Co.*, 920 F. Supp. 520, 535 (S.D.N.Y. 1996), *quoting Bank of New York v. Sasson*, 786 F. Supp. 349, 354 (S.D.N.Y. 1992).

The Act also imposes a reasonableness standard on Pepsico's ability to control transfers of bottling businesses whereas the appointments give Pepsico the unconditional right to consent to transfer without any consideration of reasonableness. Finally, and perhaps most substantially, the Act requires Pepsico to offer Marion Pepsi appointments for new Pepsico products by prohibiting a supplier from failing to offer a distributor (absent good cause) the right to bottle or can and sell, distribute, and deliver new products introduced by the supplier. *See* 815 ILCS 730/15(a)(6). The appointments do not contain a promise that future beverage products will be offered by Marion Pepsi. Such a requirement does not exist in the parties' contracts and is not found under New York law. It is a substantial impairment of the pre-existing contractual relationship.

Before the Act, the soft drink industry had been virtually unregulated. The Seventh Circuit has noted that whether a contractual impairment is substantial depends upon consideration of "the foreseeability of the law when the original contract was made." *Chrysler Corp. v. Kolosso Auto*

Sales, Inc., 148 F.3d 892, 894 (7th Cir. 1998). Marion Pepsi argues that the Illinois Franchise Disclosure Act, 815 ILCS 705/1-705/44 (2002), should have given Pepsico the heads up that regulation was likely. But many of the appointments were entered into even before the enactment of the Illinois Franchise Disclosure Act (January 1, 1988), and the Soft Drink Act goes much farther than the Illinois Franchise Disclosure Act ever attempted to go.

These substantial impairments are not justified. In spite of the general proclamations in the Act that it is for the public good, careful analysis of the Act's provisions leads to only one conclusion: it serves the private interest to one party in a contractual relationship by attempting to level the playing field, and it does nothing to promote the greater good of society. *See Equipment Mfrs. Inst. v. Janklow*, 300 F.3d 842, 861 (8th Cir. 2002) ("leveling the playing field between contracting parties is expressly prohibited as a significant and legitimate public interest"). The Court agrees with Pepsico that the substantial impairment of contracts is not "incidental [to the Act's] main effect" – it is the main effect. *Exxon Corp. v. Eagerton*, 462 U.S. 176, 191 (1983). None of the advanced public policy rationales justifies applying the Act to agreements that were negotiated decades ago. The Act violates the Contracts Clause of both the Illinois and United States Constitutions.

The Commerce Clause

A significant portion of Marion Pepsi's territory is located in the States of Missouri, Kentucky, Arkansas, and Tennessee. The critical inquiry under the Commerce Clause is whether the practical effect of the Act is to control conduct beyond the boundaries of the State. *Healy*, 491 U.S. at 336.

The answer to the inquiry is yes: many provisions of the Act have the practical effect of controlling conduct which occurs outside of this State. For instance, Pepsico must pay Marion Pepsi the fair value of its non-Illinois operations upon termination. The Act could compel Pepsico to offer Illinois distributors such as Marion Pepsi the same benefits as out-of-state distributors by imposing requirements to offer new products to Marion Pepsi which are offered to out-of-state bottlers; it requires Pepsico to tailor its commercial activity outside of Illinois to the Illinois regulatory scheme; it imports by statute competitive advantages enjoyed in other states; and it controls the conduct of Pepsico beyond the borders of this State. Taken together, these provisions of the Act violate the Commerce Clause.

Severability

Finally, Marion Pepsi urges the Court to sever any possible invalid provision from the rest of the Act. *See* 815 ILCS 730/10(e). "The settled and governing test of severability is whether the valid and invalid provisions of the Act are so mutually connected with and dependent on each other as conditions, considerations or compensations for each other as to warrant the belief that the legislature intended them as a whole, and if all could not be carried into effect, the legislature would not pass the residue independently." *Kendall-Jackson Winery Limited v. Branson*, 82 F. Supp. 2d 844, 867 (N.D. Ill. 2000), *citing People, ex rel. Chicago Bar Ass'n v. State Bd. of Elections*, 558 N.E.2d 8998 (1990). Although the Court has an obligation to uphold legislative enactments whenever reasonably possible, "[w]hen it appears … that the General Assembly would not have passed the statute with the invalid portion eliminated, severing the unconstitutional portions is inappropriate and the entire act should be declared unconstitutional." *Kendall-Jackson*, 82 F. Supp. 2d at 867. The Court must consider "whether the legislative purpose or object in passing the Act is significantly undercut or altered by the elimination of the invalid provisions." *Id.*, *citing Best v. Taylor Mach. Works*, 689 N.E.2d 1057, 1101-1102 (1997). Thus, "[e]ven in cases where the valid sections of an act are complete and capable of being executed, the entire act will be declared void if, after striking the invalid provisions, the act that remains does not reflect the legislative purpose in enacting the legislation." *Kendall-Jackson*, 82 F. Supp. 2d at 867-868, *citing Taylor*, 689 N.E.2d at 1102.

In light of the foregoing, the provisions which violate the Contracts and Commerce Clause cannot be severed from the Soft Drink Act. The impairments are found throughout the Act, and severing them would render the Act meaningless.

CONCLUSION

For the foregoing reasons, Defendant's motion for partial summary judgment (Doc. 327) is **DENIED**. Plaintiff's motion for summary judgment on Counts II through IV of the first amended complaint (Doc. 333) is **GRANTED**. The Court declares the Soft Drink Industry Fair Dealing Act, 815 ILCS 730/1-99, unconstitutional. The Clerk is directed to enter judgment accordingly, and Pepsico is awarded its costs.

IT IS SO ORDERED.

DATED this 18th day of July, 2003.

s/ G. Patrick Murphy
G. PATRICK MURPHY
Chief United States District Judge