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Independent Craft Breweries Struggle Under Distribution Laws that Create a Power Imbalance in Favor of Wholesalers

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INDEPENDENT CRAFT BREWERIES STRUGGLE UNDER DISTRIBUTION LAWS THAT CREATE A POWER IMBALANCE IN FAVOR OF WHOLESALERS

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ABSTRACT

Independent craft breweries are facing historic challenges under the COVID-19 pandemic. To make matters worse, many states prohibit a brewery from terminating a distribution contract with a wholesaler absent statutorily defined "good cause," which typically means fraud, bankruptcy, or other illegal conduct. In this context, lagging sales or poor distribution performance are not grounds for a brewery to terminate a distribution contract. This means that it is nearly impossible, legally or financially, for an independent craft brewery to terminate a distribution contract with an unsatisfactory wholesaler. In essence, states have statutorily tipped the balance of power in favor of distributors over independent craft breweries based on the allegations that large beer manufacturers have too much bargaining power over distributors. One size does not fit all. Indeed, California is currently entertaining a bill to move from a more permissive relationship between breweries and distributors (allowing for termination generally) to a much more strict good cause model that other states have adopted. States must re-evaluate their distribution laws and reject good cause standards that tie a small brewery to a distributor in perpetuity. Stated plainly, good cause distribution statutes harm independent craft breweries, competition, and ultimately consumers.

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INTRODUCTION

Something is rotten when it comes to beer distribution—especially for independent craft brewers.[1] Numerous states artificially tip the balance of power between manufacturers and distributors, in favor of distributors, through the laws governing their distribution contracts.[2] These laws essentially provide a distributor a property right in their distribution contracts to protect their investment; however, they also leave the manufacturer at the mercy of the distributor, even if such a contract is no longer a good fit or the distributor performs in a subpar manner.[3] This is particularly challenging for the thousands of independent craft breweries throughout the nation. Current statutes make it all but impossible for an independent craft brewery to terminate—legally or financially—a distribution contract after execution.[4] There is no justification for protectionist laws that benefit one tier of the industry, distributors, at the expense of another, independent manufacturers. In fact, such laws often harm consumers, who ultimately end up with less variety and higher prices.[5]

As set forth below, distributors enjoy varying levels of protection from their given states to the detriment of independent craft breweries. Breweries can most often only terminate distribution

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[1] The Brewers Association is the national trade group for craft breweries. It defines an independent craft brewery as requiring, among other things, that "[l]ess than 25 percent of the craft brewery is owned or controlled (or equivalent economic interest) by a beverage alcohol industry member that is not itself a craft brewer." *Craft Brewer Definition*, BREWERS ASS'N, https://www.brewersassociation.org/statistics-and-data/craft-brewer-definition/ [https://perma.cc/8XR5-GHQ2].

[2] *E.g.*, DEL. CODE ANN. tit. 6, § 2553(a), (c) (West 2019); N.C. GEN. STAT. ANN. § 18B-1305(d)(4) (West 2019).

[3] *See* Letter from Bilal K. Sayyed, Director, FTC Off. of Pol'y Plan., et al., to Jim Wood, Assembly Member, California State (Mar. 20, 2020) [hereinafter Sayyed FTC Letter], https://www.ftc.gov/system/files/documents/advocacy_documents/joint-comment-ftc-staff-doj-antitrust-division-staff-california-state-assembly-concerning-california/v200008_california_beer_distribution_advocacy_2020.pdf [https://perma.cc/E693-SJJ9] (explaining that good cause requirements have a disparate impact on small brewers and that implementing such requirements will be detrimental to the state's brewing industry).

[4] *See id.*

[5] *See id.*

contracts for statutorily defined "good cause."[6] People are commonly surprised to find out that good cause in the beer manufacturer-distributor context does not include highly relevant and practical considerations such as sales quotas, performance standards, or satisfaction of general contractual duties.[7] Instead, good cause in most states typically means bankruptcy, fraud, or other illegal conduct.[8] Under these laws, breweries are stuck with their distributors in perpetuity, unless they can legally terminate the contract which usually involves paying the distributor the fair market value of the contract.[9] Of course, very few, if any, independent breweries can handle such an expense.[10] This can leave small breweries in the untenable position of either sticking with an underperforming distributor or taking on further debt to terminate the contract and move on to a more fitting distributor.[11]

The growing diversity of manufacturers and products in the beer industry has severely diminished the policy rationale that originally, arguably, justified the protectionism afforded to distributors—especially with respect to independent craft brewers.[12] As set forth more fully below, the traditional justification for distributors receiving legislatively created contractual protections is simply that large beer manufacturers wield too much power over distributors.[13] Big Beer truly is big: "Anheuser-Busch [now AB InBev] is believed to control, directly or indirectly, over 50 percent of all beer sold in this country."[14] While that might be true, there are only a few "Big" breweries, but there are literally thousands of very small breweries in the United States. The Alcohol and

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[6] *E.g.*, DEL. CODE ANN. tit. 6, § 2553(a), (c); N.C. GEN. STAT. ANN. § 18B-1305(a), (d)(4).

[7] *E.g.*, DEL. CODE ANN. tit. 6, § 2553; N.C. GEN. STAT. ANN. § 18B-1305.

[8] *See* N.C. GEN. STAT. ANN. § 18B-1305(c).

[9] Mike Drumm, *Beer Distribution Agreements*, BEER ATT'Y (May 14, 2019), https://beerattorney.com/blog/beer-distribution-agreements/ [https://perma.cc/4ZJG-M89V] (explaining that the ambiguous term "fair market value," with regard to terminating a beer distribution agreement, typically ranges from three to five times the previous year's gross margin).

[10] *See id.*; Sayyed FTC Letter, *supra* note 3, at 9.

[11] *See* Sayyed FTC Letter, *supra* note 3, at 2.

[12] *Id.*

[13] Barry Kurtz & Bryan H. Clements, *Beer Distribution Law as Compared to Traditional Franchise Law*, 33 FRANCHISE L.J. 397, 399 (2014).

[14] *Id.*

Tobacco Tax and Trade Bureau, the federal agency charged with overseeing breweries and other alcohol manufacturers, found that roughly 75% of the 6,400 breweries operating last year produced 1,000 barrels or less.[15] For context, only fifteen breweries in the United States brewed more than 6,000,000 barrels of beer, only twelve breweries brewed between 500,001 and 1,000,000 barrels, and 4,577 brewed between one and 1,000 barrels.[16] As with most things in life, one size does not fit all, nor does it make sense, like legislatively protecting distributors from Big Beer manufacturers' market power at the steep expense of small, independent breweries.

Since Congress passed the Twenty-First Amendment to the United States Constitution, individual states regulate the beer industry through individualized statutory schemes.[17] When states took the reins over alcohol, three types of alcoholic beverage regulatory schemes emerged: prohibition, licensing, and monopoly.[18] Kansas, Mississippi, and Oklahoma were the only states that continued to prohibit alcohol in the post-Prohibition era.[19] Licensing states adopted a three-tiered system that separated the manufacture (brewers), distribution (wholesalers), and retail tiers to protect the market from unfair trade practices that stifle competition.[20] Monopoly states also utilized a three-tier system, but those states exercised a public monopoly over the sale of beer for off-premises consumption.[21] Regardless of whether a state uses a licensing or monopoly system today, nearly every state regulates the brewer-distributor relationship.[22] Whether styled as licensing

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[15] ALCOHOL AND TOBACCO TAX AND TRADE BUREAU, NUMBER OF BREWERS BY PRODUCTION SIZE—CY 2019 (Mar. 11, 2020), https://www.ttb.gov/images/pdfs/statistics/production_size/2019_brew_prod_size_ttb_gov.pdf [https://perma.cc/M2TX-NB2P]. For reference, a barrel of beer contains two kegs' worth of beer.

[16] *Id.*

[17] U.S. CONST. amend. XXI, § 2; Thomas A. Gerhart, *Undermining the Law: How Uninformed Legislating Helps Big Beer Erode California's Tied-House Laws*, 51 U. PAC. L. REV. 25, 30 (2019).

[18] A.H. MARTIN, JR. & E.E. MCCLEISH, THE MKTG. LAWS SURVEY, STATE LIQUOR LEGISLATION 21 (1941).

[19] *Id.* at 21, n.10.

[20] *See* Gerhart, *supra* note 17, at 30.

[21] *See* MARTIN & MCCLEISH, *supra* note 18, at 25.

[22] *See* Marc E. Sorini, *Beer Franchise Law Summary*, BREWERS ASS'N (2014), https://www.brewersassociation.org/wp-content/uploads/2015/06/Beer-Franchise-Law-Summary.pdf [https://perma.cc/6K6S-MJW5].

or monopoly systems, the hurdles contemporary laws present to independent craft brewers in terms of getting out of a harmful distribution contract are, in a word, insurmountable.[23]

As set forth below, California and many other states use a licensing system that gives independent breweries more leeway to negotiate a contract cancellation.[24] The majority of states use a more restrictive distribution scheme known colloquially in the beer community as "beer franchise laws."[25] Beer franchise laws essentially dictate the key terms of any distribution contract, such as what constitutes good cause to terminate a contract, and make it virtually impossible for a manufacturer to get out of a contract.[26] California serves as an important case study. Recent legislation in California, backed by the distributors' lobby, seeks to convert California's current, more permissive regulatory framework to a strict franchise law model with respect to distribution, as has been adopted by other states.[27] As set forth below, there is simply no justifiable basis for making such a change.[28]

Following Prohibition, states slowly began regulating the brewer-distributor relationship.[29] State laws regulating the relationship between a brewer and a distributor have diverged into three distinct categories.[30] The majority of states prohibit a brewer from terminating a distribution agreement unless it satisfies statutory "good cause" requirements.[31] While a bit of a misnomer, this Article refers to them as "pure franchise laws" with respect to the beer industry. Traditional franchise laws and the colloquially named beer franchise laws are not the same thing, and

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[23] *See generally* Sayyed FTC Letter, *supra* note 3.

[24] *See id.*; Kurtz & Clements, *supra* note 13, at 400–01.

[25] *See* Kurtz & Clements, *supra* note 13, at 397–99 (noting similarities and differences between true franchise laws and beer distribution laws); *see also* Sayyed FTC Letter, *supra* note 3; Sorini, *supra* note 22.

[26] *See* Kurtz & Clements, *supra* note 13, at 402–07.

[27] *See* Sayyed FTC Letter, *supra* note 3, at 1, 6–8; Sorini, *supra* note 22.

[28] *See generally* Sayyed FTC Letter, *supra* note 3.

[29] *See, e.g.*, CAL. BUS. & PROF. CODE § 25000.7 (West 2020) (beginning in 2000, instituting the first and only limitation on terminating beer distribution agreements in California).

[30] *See* Jeffrey M. Glazer, *Starting a Brewery: A Web of Regulations*, 89 WIS. LAW. 20, 21, 24 (2016); Sorini, *supra* note 22.

[31] *See* Sorini, *supra* note 22; *e.g.*, ME. REV. STAT. ANN. tit. 28-A, §§ 1454–55 (West 2019) (requiring ninety-day notice, time to cure, and good cause—or loss of license, insolvency, or noncompliance).

most states regulate franchises, fast-food restaurants for example, differently than beer distributors.[32] A growing minority of states require some form of good cause, and they utilize a variety of other means to regulate beer distribution laws.[33] Only two states and the District of Columbia have not enacted any beer franchise laws.[34]

In its 1941 study, the Works Progress Administration noted how alcohol legislation—if applied to other industries—would be unconstitutional.[35] States originally embraced freedom of contract and largely left beer distribution agreements unregulated.[36] Over time, however, distributors lobbied states to limit a brewer's ability to terminate a distribution agreement on the basis that Big Beer has too much power over distributors.[37] The distributors' ultimate goal is for states to implement a good cause requirement before a brewer can terminate a beer distribution agreement—and the majority of states have done so.[38] Such statutory contractual terms are harmful to independent breweries and the consuming public alike.[39]

As briefly mentioned above, beer franchise laws implemented the good cause standard to correct a seeming imbalance in bargaining power between brewers and distributors.[40] Unfortunately,

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[32] *See* Kurtz & Clements, *supra* note 13, at 397; Sorini, *supra* note 22.

[33] *See, e.g.*, Glazer, *supra* note 30, at 24 (observing that a brewer in Wisconsin can usually terminate a distribution agreement "for any, or no, reason"); *see also* OKLA. STAT. ANN. tit. 37A, § 3-111(F)(1) (West 2018) (exempting small brewers from good cause requirements).

[34] *See* Sorini, *supra* note 22 (identifying Alaska and Hawaii as the only states that do not regulate beer franchise law).

[35] *See* MARTIN & MCCLEISH, *supra* note 18, at 19 (reasoning that selling alcohol is "not an inherent right, but [it] is subject to the ... legitimate exercise of [state] police power").

[36] *Compare* 1933 Cal. Stat. 1707 (enacting California's first alcohol laws in 1933), *with* CAL. BUS. & PROF. CODE § 25000.7 (West 2020) (becoming California's restriction on terminating a beer distribution agreement in 2000).

[37] *See, e.g.*, S. RULES COMM., BILL ANALYSIS, SB 1957, at 1–3 (Cal. Aug. 29, 2000) (noting that the California Beer and Beverage Distributors—an industry trade group—sponsored SB 1957 to counterbalance disparate bargaining power between brewers and distributors).

[38] *See* Sorini, *supra* note 22.

[39] *See generally* Sayyed FTC Letter, *supra* note 3.

[40] *See* Sorini, *supra* note 22.

that standard goes too far because it indefinitely binds a brewery, regardless of size or actual bargaining power, to a distributor.[41] The good cause standard has a disparate impact on the craft brewing industry because, unlike large manufacturers, small manufacturers lack the financial resources to buy their way out of a distribution contract.[42] Further, the purpose of beer franchise statutes is to protect a distributor from catastrophic failure because of the loss of a single, large manufacturer;[43] frankly, this is not a realistic concern in contracts between independent craft breweries and distributors.[44] Put simply, states must reevaluate their beer franchise laws and move away from the good cause requirement to properly balance distribution agreements between independent craft brewers and distributors.[45]

I. Relevant Brewing Industry and Distribution Background

The brewing industry experienced two significant changes between 1970 and today that impacted the brewer-distributor relationship.[46] Section I.A explains how large manufacturers developed a global beer industry but surrendered domestic market share along the way.[47] Section I.B describes the increase in large manufacturer-friendly legislation that paralleled large manufacturers' loss in domestic market share.[48] Section I.C describes some basics of beer distribution and the brewery-distributor relationship.[49]

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[41] *See generally* Sayyed FTC Letter, *supra* note 3.

[42] *Id.*

[43] Evan Pitchford, *Relationships Between Producers, Wholesalers, and Retailers: Beer Distribution and Franchise Laws in California (Part 2)*, CONKLE, KREMER & ENGEL PROF. L. CORP., https://www.conklelaw.com/relationships-between-producers-wholesalers-and-retailers-beer-distribution-and-franchise-laws-in-california-part-2 [https://perma.cc/G7BK-9WCU].

[44] *See* Gerhart, *supra* note 17, at 28 (showing seventy-one large manufacturers earned 58% of total retail sales in 2017 compared to 6,266 craft brewers splitting 23% of retail sales); Drumm, *supra* note 9 (explaining that the ambiguous term "fair market value," with regard to terminating a beer distribution agreement, typically ranges from three to five times the previous year's gross margin).

[45] *See generally* Sayyed FTC Letter, *supra* note 3.

[46] *Infra* Sections I.A, I.B.

[47] *Infra* Section I.A.

[48] *Infra* Section I.B.

[49] *Infra* Section I.C.

A. Domestic Dominance to Globalization

In preparation for the Twenty-First Amendment, states enacted alcoholic beverage control acts, and many pre-Prohibition brewers resumed production.[50] More than 900 breweries opened after Congress passed the Twenty-First Amendment.[51] By 1983, there were less than 100 breweries operating in the United States, and six companies produced 92% of all domestic beer.[52] Between 1983–1998, the number of breweries in the United States jumped from 80 to 1500.[53] While the number of brewers increased, large manufacturers' market share of production decreased by 20% between 1983–2018.[54] Additionally, the price of beer fell nearly $1.00 per pint between 1975–1990.[55]

After 2000, a wave of mergers and acquisitions globalized the brewing industry.[56] The globalization began with InBev's 2008 purchase of Anheuser-Busch, creating AB InBev—a brewery that was twice the size of its nearest competitor.[57] As of 2014, the world's ten largest brewers controlled nearly 70% of the global brewing industry and four brewers made up 47% of that figure.[58] AB InBev purchased SAB Miller in 2018 and controlled about

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[50] *Compare, e.g.*, U.S. CONST. amend. XXI (ratified on December 5, 1933), *with* 1933 Cal. Stat. 1707 (approved on June 3, 1933 and becoming effective "[i]f and when it shall become lawful under the Constitution and laws of the United States to manufacture, sell, ... intoxicating liquors"); *see also Mapping the American Brewing Renaissance*, VINEPAIR, https://vinepair.com/map-american-craft-brewing-history/ [https://perma.cc/JV94-5KBP].

[51] *Mapping the American Brewing Renaissance*, *supra* note 50.

[52] *History of American Beer*, BEERADVOCATE, https://www.beeradvocate.com/beer/101/history_american_beer/ [https://perma.cc/9JJW-SEUA].

[53] *Id.*; *Mapping the American Brewing Renaissance*, *supra* note 50.

[54] *History of American Beer*, *supra* note 52; ALCOHOL & TOBACCO TAX & TRADE BUREAU, NUMBER OF BREWERS BY PRODUCTION SIZE—CY 2018 (Apr. 4, 2019), https://www.ttb.gov/images/pdfs/statistics/production_size/2018_brew_prod_size_ttb_gov.pdf [https://perma.cc/JH9Z-JPDV].

[55] Jay Brooks, *The Price of a Beer: 1952–2016*, BROOKSTON BEER BULL. (Mar. 9, 2017), https://brookstonbeerbulletin.com/the-price-of-a-beer-1952-2016 [https://perma.cc/QND8-RZEC].

[56] Erik Strøjer Madsen & Yanqing Wu, *Globalization of Brewing and Economies of Scale* 2 (Aarhus Univ. Sch. of Bus. and Soc. Scis., Econ. Working Paper No. 2014-23, 2014), http://pure.au.dk/portal/files/81993423/wp14_23.pdf [https://perma.cc/Q3SE-MV5D].

[57] *Id.* at 5–6.

[58] *Id.* at 6.

27% of the global beer market in 2019.[59] Finally, AB InBev produces approximately 50% of all beer in the United States today.[60]

Further, the distribution tier is experiencing increased consolidation.[61] More specifically, "wholesalers now include both large vertically integrated firms, such as distributors owned by Anheuser Busch, and large horizontally integrated firms, such as the six California wholesale firms that are part of the Reyes Beer Division of Reyes Holdings, Inc."[62] Reyes Holdings, Inc. is the largest beer distributor in the United States.[63] To illustrate, "[w]ith recent California acquisitions, Reyes is estimated to distribute nearly 100 million cases of beer per year in California—approximately one-third of all the beer sold in California."[64] Distribution consolidation is not a California phenomenon and is occurring nationwide.[65] Given the difficulty of an independent craft brewery getting its product to market, this consolidation only makes it harder for the little guy.[66] And distributor consolidation weakens the argument that distributors need statutory contract protections for fear of closing up shop in the event a single brewery terminates a distribution contract.[67]

B. Increased Legislative Activity

During the period when large manufacturers' domestic market share declined, a wave of legislative changes began to shape states' beer laws in ways that favored one subset of the brewing

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[59] *Analyzing the Global Beer Industry 2019—ResearchAndMarkets.com*, BUS. WIRE (Sept. 9, 2019, 11:41 AM), https://www.businesswire.com/news/home/20190909005737/en/Analyzing-Global-Beer-Industry-2019---ResearchAndMarkets.com [https://perma.cc/EF6J-UTG4].

[60] Adam Davidson, *Are We in Danger of a Beer Monopoly?*, N.Y. TIMES (Feb. 26, 2013), https://www.nytimes.com/2013/03/03/magazine/beer-mergers.html [https://perma.cc/S49V-JBJQ].

[61] *Analyzing the Global Beer Industry 2019—ResearchAndMarkets.com, supra* note 59.

[62] Sayyed FTC Letter, *supra* note 3, at 5 (internal citations omitted).

[63] *See id.*

[64] *Id.*

[65] Anton Popov, Distribution Consolidation and Pricing in the Beer Industry, 2 (Aug. 25, 2019) (unpublished manuscript), available at http://economics.mit.edu/files/17765 [https://perma.cc/2YWG-WWV9].

[66] *Id.* at 5.

[67] *Id.*

industry—large manufacturers.[68] Many states' first changes to their beer laws coincided with large manufacturers' decline in domestic market share.[69] Even today, large manufacturers are seeking legislative exceptions that would give them a market advantage by legalizing pay-to-play activities.[70]

While large manufacturers were working on regaining market dominance, distributors began to voice concern that their manufacturing counterparts overpowered the brewer-distributor relationship.[71] For example, in 2000, the California Beer and Beverage Distributors (CBBD) lobbied for, proposed, and succeeded in passing legislation that regulated California's beer distribution agreements for the first time.[72] The CBBD proposed this law because "beer manufacturers have enjoyed ever increasing market power over their distributors."[73] That justification holds no water.

Although this law prohibits a brewer from terminating a distribution agreement for its distributor's failure to meet an unreasonable sales quota, the law failed to accomplish its objective.[74] More specifically, California Business and Professions Code section 25000.7 states,

> [n]otwithstanding the provisions of any agreement for the sale or distribution of beer between a beer manufacturer and beer wholesaler, no sale or distribution agreement shall be terminated solely for a beer wholesaler's failure to meet a sales goal or

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[68] *E.g.*, Gerhart, *supra* note 17, at 33–34 (discussing four legislative exceptions that favor large manufacturers enacted by California between 1971 and 1990).

[69] *E.g.*, CAL. BUS. & PROF. CODE §§ 25500–25512 (West 2020) (noting California had not added or amended any statutes until 1973, but it has added at least 19 new statutes and amended existing statutes at least 126 times since 1973).

[70] *Compare id.* § 25600.05 (enacted by Chapter 623) (creating an exception to California's beer laws that permits manufacturers to give glassware to retail locations—despite former Governor Brown vetoing a similar bill the previous year), *with* Letter from Jerry Brown, Governor, Cal. State, to Cal. State Assembly (Sept. 6, 2018) ("I also worry that this law creates an economic disadvantage for small beer manufactures [sic]").

[71] S. RULES COMM., BILL ANALYSIS, SB 1957, at 1–3 (Cal. Aug. 29, 2000).

[72] *See* CAL. BUS. & PROF. CODE § 25000.7 (enacted by SB 1957 in 2000); S. RULES COMM., BILL ANALYSIS, SB 1957, at 4–5 (Cal. Aug. 29, 2000).

[73] S. RULES COMM., BILL ANALYSIS, SB 1957, at 4.

[74] *See* CAL. BUS. & PROF. CODE § 25000.7.

> quota that is not commercially reasonable under the prevailing market conditions.[75]

Section 25000.7 thus presents large manufacturers with a relatively small obstacle by discouraging them from terminating a beer distribution agreement.[76] However, large manufacturers can still operate with impunity and behave as if the law did not exist.[77] Today, large manufacturers use their resources to terminate—or effectively terminate—beer distribution agreements simply by paying the distributor to go away (a luxury few, if any, independent craft breweries can afford), which prompted distributors to lobby the Legislature for changes that impact all brewers.[78] While large manufacturers' conduct was the catalyst for those changes, the impact of distributors' proposed changes are strangling to many craft brewers.[79]

C. Beer Distribution Basics

Manufacturers make beer; wholesalers distribute it to the various retail outlets the consuming public enjoy such as bars, restaurants, and other venues.[80] Distributors take the beer from

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[75] *Id.* § 2500.7(a).

[76] *See id.*

[77] Jessica Infante, *Reyes Makes 3rd California Wholesaler Acquisition of 2019 with W.A. Thompson Deal*, BREWBOUND (Oct. 8, 2019, 5:25 PM), https://www.brewbound.com/news/reyes-makes-3rd-california-wholesaler-acquisition-of-2019-with-w-a-thompson-deal (last visited Feb. 12, 2021); Justin Kendall, *Reyes Beverage Acquires Another 4 Million Cases of Constellation Business in Southern California*, BREWBOUND (Oct. 22, 2018, 4:47 PM) [hereinafter *Reyes Beverage*], https://www.brewbound.com/news/reyes-beverage-acquires-another-4-million-cases-of-constellation-business-in-southern-california (last visited Feb. 12, 2021).

[78] *E.g.*, Justin Kendall, *Constellation Brands Forces Distributor Change in Northern San Diego County*, BREWBOUND (June 7, 2018, 5:20 PM) [hereinafter *Constellation Brands*], https://www.brewbound.com/news/constellation-brands-forces-distributor-change-northern-san-diego-county (last visited Feb. 12, 2021) (explaining that Constellation Brands asked its distributor to terminate the distribution agreement—against the distributor's best interest—and the distributor complied only to avoid a lengthy legal battle).

[79] *Reyes Beverage*, *supra* note 77.

[80] Marc Sorini, *Understanding the Three-Tier System: Its Impacts on U.S. Craft Beer and You*, CRAFTBEER.COM (Mar. 6, 2017), https://www.craftbeer.com/craft-beer-muses/three-tier-system-impacts-craft-beer [https://perma.cc/7XH5-RKUH].

the manufacturer and mark the price up to make their profits.[81] Distributors must be licensed by their respective state agencies to engage in distribution.[82] In practical terms, a manufacturer loses roughly 30% in profit per packaged item to the distributor that the manufacturer would otherwise realize in a direct to consumer transaction.[83]

In exchange, the distributor is responsible for caring for the brewer's product in terms of quality control, storage, handling, and delivery.[84] In addition, distributors have to move the beer—they have to "establish retail networks to sell the brands of beer that they carry."[85] Large manufacturers handle their own advertising at national and regional levels, but distributors "often provide point-of-sale promotion like enhanced product placement, setting up displays, conducting in-store events, and supplying retailers with information on the brands they represent."[86] Thus, distributors provide a much needed service to breweries seeking to expand retail presence.[87] At its core, independent craft breweries only enter into a distribution contract to move more beer and expand sales.[88] Yet, in most states, lack of sales or movement of product is not good cause for a manufacturer to terminate a contract.[89]

Under modern statutes, distributors typically receive certain contractual protections.[90] While the exact protections vary among the states, they typically boil down to three main categories.[91] First, nearly every state provides that the brewery-distributor

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[81] Kary Shumway, *How Do You Determine the Price of a Craft Beer? (Price to Distributor, Price to Retailer and Price to Consumer)*, CRAFT BREWING BUS. (Feb. 27, 2018), https://www.craftbrewingbusiness.com/business-marketing/determine-price-craft-beer-price-distributor-price-retailer-price-consumer/ [https://perma.cc/S7LG-ZN67].

[82] *See* CAL. BUS. & PROF. CODE § 25000.7 (West 2020).

[83] Shumway, *supra* note 81.

[84] *See* Sayyed FTC Letter, *supra* note 3, at 5.

[85] *Id.*

[86] *Id.*

[87] *Id.* at 10.

[88] *Id.* at 11.

[89] *Id.* at 7.

[90] *See* CAL. BUS. & PROF. CODE §§ 25000.7, 25000.9 (West 2020).

[91] *See, e.g.*, *id.* §§ 25000.5, 25000.7, 25000.9.

relationship is exclusive to the parties to the contract.[92] That means that once the contract is executed, the brewery cannot allow another distributor to move its product within the bounds of the agreed upon geography—these are known as territorial protections.[93] Second, distributors are often given transfer protections.[94] Transfer protections limit the brewer's ability to prevent distributors from transferring their rights to another distributor (think consolidation).[95] Typically, brewers can be civilly liable for damages if they unreasonably withhold consent to the transfer.[96] Lastly, and most importantly to this Article, distributors typically receive termination protections in which a brewery cannot terminate the contract without statutorily defined good cause.[97] In practice, this means that if a brewery wants to terminate a contract, it is typically required to pay an X-modifier, usually three times annual gross, before the distributor will agree to termination.[98]

II. Defining the Problem

The problem is a legislatively created power imbalance in favor of distributors at the expense of independent craft breweries.[99] After years of unchanged statutory and regulatory schemes, the brewing industry is undergoing a transformation.[100] Large manufacturers are using their resources to drive legislative changes, which gives them advantages over their craft counterparts.[101] Distributors reacted to large manufacturers terminating, or effectively terminating, distribution agreements by pursuing legislation that would bind all brewers.[102] Craft brewers lack the resources

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[92] *See, e.g.*, *id.* § 25000.5.

[93] *See id.*

[94] *See, e.g.*, *id.* § 25000.9.

[95] *See id.*

[96] *See id.*

[97] *See, e.g.*, *id.* § 25000.7.

[98] *See Constellation Brands*, *supra* note 78.

[99] *See* Gerhart, *supra* note 17, at 28.

[100] *Id.*

[101] *See, e.g.*, *id.* at 36 n.105, 37 n.108 (*citing* Letter from Thomas M. Hannigan, Assembly Member, Cal. State, to George Deukmejian, Governor, Cal. State (May 25, 1990) (asking the legislature to enact a law to legitimize an illegal act that MillerCoors and Marine World had unknowingly engaged in sixteen years)).

[102] *See, e.g.*, A.B. 1541, 2019–2020 State Assemb., Reg. Sess., at 98 (Cal. 2019) (as amended on July 11, 2019, but not enacted) (proposing to enact a

to effectively defend themselves against these lobbies and, in both instances, large manufacturers end up harming craft brewers.[103]

States across the nation have been working to find a middle ground between large manufacturers and craft brewers, but distributors are also weighing in on the discussion.[104] In California, the distribution lobby imprecisely identified the problem as stemming from the disparity in bargaining power between brewers and distributors.[105] This generalization failed to account for situations where the distributor has greater bargaining power in distribution contracts, as is the case for the majority of craft brewers.[106]

The CBBD's first attempt to correct the imbalance resulted in a law that places a minor limitation on brewers and avoids the issue of good cause altogether.[107] Nearly twenty years after California enacted its first beer franchise law restriction, the CBBD asked Assembly Member Adam Gray to propose a new restriction with the same justification the CBBD used in 2000.[108] At the CBBD's request, Assembly Member Gray introduced Assembly Bill (AB) 1541 in the California Legislature on February 22, 2019.[109] This bill embodies the debate at hand: what beer laws properly

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good cause standard that would prevent a brewer from terminating a beer distribution agreement unless the brewer satisfies a four-pronged test).

[103] *See Reyes Beverage*, *supra* note 77 (showing how large manufacturers leverage their resources to terminate beer distribution agreements); Telephone Interview with the Office of Assembly Member Adam Gray, Cal. State (Jan. 27, 2020) [hereinafter Gray Telephone Interview] (notes on file with the author) (citing Constellation's termination of that agreement as a cause to propose a good cause requirement for terminating beer distribution agreements in California); *see also* Letter from Maureen K. Ohlhausen, Director, FTC, et al., to Wesley Chesbro, Senator, Cal. State (Aug. 24, 2005) [hereinafter Ohlhausen FTC Letter] (cautioning the California Legislature against enacting a good cause requirement because such requirements harm smaller breweries and can reduce competition and increase the price of beer).

[104] Baylen Linnekin, *Bad State Laws and Big Money Beer Wholesalers Are Still Hurting Craft Brewers*, REASON (Mar. 16, 2019, 8:30 AM), https://reason.com/2019/03/16/bad-state-laws-and-big-money-beer-wholes/ [https://perma.cc/WGF2-2SZ9].

[105] S. RULES COMM., BILL ANALYSIS, SB 1957, at 3–4 (Cal. Aug. 29, 2000).

[106] *Id.*

[107] CAL. BUS. & PROF. CODE § 25000.7(a)–(b) (West 2020).

[108] Gray Telephone Interview, *supra* note 103.

[109] CAL. LEGIS. INFO., BILL HISTORY AB-1541, https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=201920200AB1541 [https://perma.cc/ZZ6A-J8NW].

balance the brewer-distributor relationship in a way that does not disparately impact craft brewers?[110]

AB 1541 is emblematic of the fight that has occurred or is occurring in all states, distributors seeking to change the law in their favor at the expense of independent brewers.[111] AB 1541 attempts to bolster California's already strict termination protections in favor of distributors.[112] California's current termination protection merely provides that missing sales goals or quotas do not constitute "good cause" for a brewery to terminate a contract.[113]

However, AB 1541 provides that a beer manufacturer cannot terminate, or decline to renew, a distribution contract unless the beer manufacturer acts in "good faith" and with "good cause" and the brewer has allowed for notice and cure opportunities.[114] What is worse is that the burden falls on the manufacturer to show that it has acted in good faith and with good cause.[115] Finally, in an overlay draconian twist, AB 1541 provides that the brewer must establish that:

> (1) There is a failure by the beer wholesaler, without reasonable excuse or justification, to comply substantially with essential and commercially reasonable requirements of the agreement....
> (2) The beer wholesaler was given written notice by the beer manufacturer of failure to comply with the agreement, including reasonable supporting documentation.
> (3) The beer manufacturer first acquired knowledge of the failure described in paragraph (1) not more than __ months before the date notification was given to the beer wholesaler.
> (4) The beer wholesaler has been afforded __ days in which to submit a plan of corrective action ....[116]

According to the Federal Trade Commission and the Department of Justice Antitrust Division, "[a] manufacturer, including a craft brewer, could not even decline to renew a contract with a

[110] S. RULES COMM., BILL ANALYSIS, SB 1957, at 4.
[111] *Id.* at 4–5.
[112] A.B. 1541, 2019–2020 State Assemb., Reg. Sess., at 98 (Cal. 2019) (as amended on July 11, 2019, but not enacted).
[113] CAL. BUS. & PROF. CODE § 25000.7(a) (West 2020).
[114] A.B. 1541, at 98.
[115] *Id.*
[116] *Id.*

distributor whose performance it found unsatisfactory, without satisfying all of the Bill's 'good cause' requirements."[117] Stated simply, under the proposed law and under the laws of many states, the brewer-distributor relationship exists in perpetuity because they are next to impossible to terminate.[118]

While the big lobbying efforts of Big Beer and Big Distribution—such as AB 1541—might play loudly to state legislators, the independent brewer's interest in new legislation has far less money behind it, and the lack of representation results in the adoption of harmful legislation.[119] Independent craft brewers often rely on trade associations like the California Craft Brewers Association (CCBA) to defend their interests in the state legislatures.[120] Obviously, distributors and large manufacturers often donate money to the legislators who introduce these bills and chair committees the bills must pass.[121]

Current laws force craft brewers to choose between profits or market exposure by limiting their distribution options to either self-distribution or entering an ironclad pact with a distributor for potentially eternity.[122] While the CBBD's initial assessment came close to identifying the problem, it missed a critical qualifier. The power balance exists between large manufacturers and distributors; legislative remedies that impact all brewers harm small brewers and will have a dire impact on the brewing industry.[123]

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[117] Sayyed FTC Letter, *supra* note 3, at 7.

[118] *Id.*

[119] *See* Gerhart, *supra* note 17, at 28 (explaining that—in 2017—7 large manufacturers earned $64.8 billion in retail sales compared to 6,266 craft brewers splitting $26 billion); Linnekin, *supra* note 104.

[120] *About the CCBA*, CAL. CRAFT BREWERS ASS'N, https://www.californiacraftbeer.com/about-the-ccba/about-ccba-2/ [https://perma.cc/ZL4H-TC64].

[121] *E.g.*, *Campaign Finance and Lobbying Activities*, CAL. SEC'Y STATE, https://www.sos.ca.gov/campaign-lobbying/ [https://perma.cc/Q26G-DM6B] (documenting that the CBBD has donated the maximum allowable campaign donations to Assembly Member Gray and Senator Bill Dodd—the chairs for their houses' respective governmental organization committees).

[122] Linnekin, *supra* note 104.

[123] *See* Ohlhausen FTC Letter, *supra* note 103, at 8 (explaining that good cause requirements have a disparate impact on small brewers and that implementing such requirements will be detrimental to the state's brewing industry).

III. BEER FRANCHISE LAWS

Licensing states keep brewers, distributors, and retailers separate and issue a multitude of licenses to the members of each tier.[124] States like California use a modified three-tier licensing system that permits brewers to self-distribute but still keeps the three tiers separate from one another.[125] Monopoly states control retail sales, thereby keeping brewers and distributors separate from the retail tier.[126] Despite these differences, licensing and monopoly systems create circumstances where brewers may sell their own products, either onsite or by self-distribution, or contract with a distributor to move their product.[127] The system in place does not impact beer franchise laws because both systems carve out a specific place for the brewer-distributor relationship.[128]

Beyond adopting a licensing or monopoly model, states have also developed their own bodies of law dealing with the relationship between brewers and distributors.[129] As noted above, the majority of states require a brewer to have good cause before he or she can terminate a distribution agreement.[130] For a while, some states opted to not regulate this relationship.[131] Today, multiple minority approaches have developed, and these approaches diverge from the good cause requirement.[132] Section III.A examines the good

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[124] MARTIN & MCCLEISH, *supra* note 18, at 21–25.

[125] CAL. BUS. & PROF. CODE § 23357(a)–(d) (West 2020); CAL. BUS. & PROF. CODE § 25500(f)(2)(A) (West 2020).

[126] *Compare, e.g.*, 47 PA. STAT. AND CONST. STAT. ANN. § 4-491(7) (West 2020) ("It shall be unlawful .... [f]or any manufacturer or licensed importer of liquor in this Commonwealth ... to sell or offer to sell any liquor in this Commonwealth ...."), *with* VA. CODE ANN. § 4.1-500(2) (West 2019) (defining a "[b]eer wholesaler" and "beer distributor" as any wholesale license holder "offering beer for sale or resale to retailers").

[127] *See* Sorini, *supra* note 22.

[128] *E.g.*, VA. CODE ANN. § 4.1-500(2).

[129] *Compare*, *e.g.*, MICH. COMP. LAWS ANN. §§ 436.1501–1547(1)–(6) (West 2020) (showing that Michigan is a licensing state), *and* N.C. GEN. STAT. ANN. § 18B-1104(a1) (West 2019) (observing that, like Michigan, North Carolina is a licensing state), *with* Sorini, *supra* note 22 (documenting that Michigan is a good cause state and North Carolina has a small brewer exception).

[130] *See generally* Sorini, *supra* note 22 (noting there are thirty-four states that use a good cause model without any exceptions common among minority states).

[131] *E.g.*, *id.* (observing that Hawaii has not adopted a beer franchise law).

[132] *See generally id.*

cause model and the problem it creates.[133] Section III.B explains the various approaches the growing minority of states have taken with respect to beer franchise laws.[134]

A. The Good Cause Model

Thirty-four states impose a regulatory structure that requires good cause to terminate a beer distribution agreement.[135] In recent years, states like New York, Washington, and California have evaluated implementing good cause requirements but decided against them.[136] Good cause is a high bar to meet because it traditionally requires a brewer to show the distributor failed to substantially comply with the contract's lawful requirements and imposes a sixty-day window to cure the noncompliance.[137]

Common characteristics in the majority approach include: written notice of termination, opportunity to cure, no termination from a change in ownership, and a few other limitations on litigation and attorney's fees.[138] The burden to prove all of these requirements falls squarely on the brewer's shoulders.[139] Additionally, the good cause requirement permits a distributor the right to receive post-termination compensation from the terminating brewer.[140]

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[133] *Infra* Section III.A.

[134] *Infra* Section III.B.

[135] *See supra* note 130 and accompanying text.

[136] *See* N.Y. ALCO. BEV. CONT. LAW § 55-c(4)(c)(i) (McKinney 2013) (enacting a small brewer exception to good cause requirements in 2013); WASH. REV. CODE ANN. § 19.126.020(10) (West 2009) (expanding its small brewer exception from 50,000 barrels to 200,000 barrels in 2009); *see also* CAL. BUS. & PROF. CODE § 25000.7(a)–(b) (West 2020) (adopting a beer franchise law in 2000 that did not contain a good cause requirement).

[137] CAL. BUS. & PROF. CODE § 20020.

[138] *See* Sorini, *supra* note 22 (listing Alabama, Delaware, Iowa, Kentucky, Michigan, and thirty other states who have a good cause requirement and some combination of the other requirements listed in the text above).

[139] *E.g.*, VT. STAT. ANN. tit. 7, § 703 (West 2020) ("[N]o certificate of approval holder or manufacturer shall cancel, terminate, or refuse to continue a franchise, or cause a wholesale dealer to relinquish a franchise, ... unless good cause is shown to exist.").

[140] *See, e.g.*, DEL. CODE ANN. tit. 6, § 2553(a), (c)(1)–(5) (West 2019) ("[T]he franchised distributor whose franchise is threatened shall be entitled to recover damages from the franchisor .... includ[ing], but shall not be limited to, ... [a]

Good cause requirements have produced a perverse result: a distributor need only exhibit minimum effort in its contracts because statutory hurdles impair the brewer's ability to terminate the agreement.[141] This allows distributors to turn the marketing spigot on or off for a given brand on a whim.[142] Laws that require good cause often permit a distributor to sell its distribution rights, subject to the brewer's approval; but brewers do not have the same right.[143] A beer distribution agreement regularly persists through the sale of a brewery.[144] These same beer franchise law provisions even permit a beer distribution agreement to survive the death of the brewer.[145] Ultimately, good cause requirements impact smaller brewers much more than their larger counterparts because small brewers cannot typically buy their way out of such contracts.[146]

The good cause model not only harms independent craft breweries, but it is bad for the consuming public as well.[147] Indeed, the Federal Trade Commission and the Department of Justice Antitrust Division have explained that good cause requirements in the beer context are "likely to diminish competition between ... beer wholesalers and increase manufacturers' costs of obtaining distribution services from wholesalers; these effects, in turn, are likely to raise the costs of beer distribution."[148] Accordingly, consumers are

fractional portion of the franchised distributor's tangible assets[;] ... [l]oss of good will; ... [l]oss of profits[;] ... [a]ll other damages allowed under the law of this State; and ... [t]he reasonable counsel fees and expenses incurred in the action ....").

141 *See* Sorini, *supra* note 22 (listing sixteen highly restrictive characteristics that are common to a "full-fledged beer franchise law[ ]" that make it incredibly difficult for a brewer to terminate a distribution agreement).

142 *Reyes Beverage*, *supra* note 77.

143 *E.g.*, N.C. GEN. STAT. ANN. § 18B-1305(d)(3)–(7) (West 2019) ("Good cause ... does not include ... [a] change in the ownership of [the brewery,] ... brand[,] ... [or] right to distribute a product[;] ... [s]ale or transfer of the rights to manufacture, distribute, or use the trade name of the brand to a [new] supplier[; f]ailure of the wholesaler to meet standards of operation or performance that have been imposed ... unilaterally by the supplier[;] ... [t]he establishment of a franchise agreement between a wholesaler and another supplier[; or t]he desire of a supplier to consolidate its franchises.").

144 *Id.* § 18B-1305(d)(4).

145 *Id.*

146 *Reyes Beverage*, *supra* note 77.

147 *See* Sayyed FTC Letter, *supra* note 3, at 1.

148 *Id.*

likely to see increased costs for beer under a good cause model.[149] The FTC and the DOJ further explained that the proposed California good cause requirement would lessen competition among wholesalers and brewers alike.[150] Wholesaler competition would be lessened because once a brewery signs the distribution agreement, it would be nearly impossible to terminate, and the distributors would have little incentive to compete to sell a given brewery's brands.[151] In other words, distributors would be free to focus their attention on some brands while ignoring others, but the ignored brewery would not be able to terminate the contract.[152] Recognizing that a statutory good cause requirement would likely "affect small brewers to a greater extent than larger brewers," the FTC noted that consumers "may find the variety available to them diminished."[153]

Ultimately, the FTC and the DOJ concluded in a March 20, 2020 letter to Assembly Member Jim Wood that California's current good cause bill, AB 1541, "is likely to impede competition in California beer distribution, to the detriment of California consumers. We see no countervailing consumer protection ...."[154] Accordingly, states that already have good cause statutes or those states considering them should review and reject such protectionism. Good cause requirements are bad for independent craft breweries, competition, and the consuming public.[155]

B. Minority Approaches

There are three distinct minority approaches to beer distribution agreements, and they all have one commonality—they do not have a blanket good cause requirement.[156] This growing minority permits brewers to terminate distribution agreements without good cause much like any run-of-the-mill contract.[157]

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[149] *Id.*
[150] *Id.* at 8–9.
[151] *See id.*
[152] *See id.* at 11–12.
[153] *Id.* at 9.
[154] *Id.* at 13.
[155] *Id.* at 12–13.
[156] *See* discussion *infra* Sections III.B.1, III.B.2, III.B.3.
[157] *See, e.g.*, N.Y. ALCO. BEV. CONT. LAW § 55-c(4)(c)(i) (McKinney 2019) (exempting small brewers from good cause termination requirements in 2013).

Section III.B.1 describes how some states exempt small brewers from their good cause requirement.[158] Section III.B.2 explains how other states require something less than good cause—just cause.[159] Section III.B.3 discusses Wisconsin's no-cause approach to beer franchise laws.[160]

1. The Small-Business Exception

Colorado, Indiana, North Carolina, Oklahoma, Washington, and—more recently—New York adopted an approach to terminating a beer distribution agreement that exempts small brewers.[161] At their cores, states that employ a small business exception are still rooted in the good cause model; they simply exempt small brewers from those requirements.[162]

Oklahoma expressly exempts small brewers from the good cause termination requirements if they produce fewer than 25,000 barrels of beer a year.[163] That is a large amount of beer. According to the Alcohol and Tobacco Tax and Trade Bureau (TTB), in 2019, 4577 of the 6400 breweries in the U.S. produced less than 1000 barrels of beer, and only 102 brewed between 15,000 and 30,000 barrels.[164] Similarly, New York also exempts small brewers from good cause requirements; however, it defines a small brewer as one that produces fewer than 300,000 barrels of beer annually.[165] Lastly, both of these states require a small brewer to pay the distributor fair market value for the lost distribution rights.[166]

While large manufacturers possess the financial resources to terminate distribution agreements, smaller brewers do not.[167]

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[158] *Infra* Section III.B.1.

[159] *Infra* Section III.B.2.

[160] *Infra* Section III.B.3.

[161] *See, e.g.*, OKLA. STAT. ANN. tit. 37A, § 3-111(F)(1) (West 2019); N.Y. ALCO. BEV. CONT. LAW § 55-c(4)(c)(i).

[162] *See, e.g.*, OKLA. STAT. ANN. tit. 37A, § 3-111(B)(1)(a)–(d), (F)(1) (containing the requirements good cause, distributor notification, failure to cure, and certified notification of noncompliance); N.Y. ALCO. BEV. CONT. LAW § 55-c(4), (4)(c)(1) (requiring good cause, prior notification, and failure to cure).

[163] OKLA. STAT. ANN. tit. 37A, § 3-111(F)(1).

[164] ALCOHOL AND TOBACCO TAX AND TRADE BUREAU, *supra* note 15.

[165] N.Y. ALCO. BEV. CONT. LAW § 55-c(4)(c)(i).

[166] *Id.*; OKLA. STAT. ANN. tit. 37A, § 3-111(F)(1).

[167] *See* Gerhart, *supra* note 17, at 28.

The FTC points out that large manufacturers are "in a better position to incur the legal and regulatory costs of termination, and may thus have a greater ability to exercise control over wholesalers."[168] This approach avoids the disparate impact on smaller brewers by not binding them to the same good cause requirements as large manufacturers.[169] Beer distribution laws with a small brewer exception address the problem of powerful, large manufacturers while avoiding the opposite problem of empowering distributors over craft brewers.[170]

2. The Just Cause Model

This model requires something less than good cause before a brewer may terminate a distribution agreement.[171] It can be less restrictive than the majority approach because it might not contain various good cause staples like notice or cure requirements.[172] However, it is more strict than other minority approaches because it implements statutory requirements before any brewer may terminate a beer distribution agreement.[173]

One example of this model is Missouri—a state that defines good cause as substantial noncompliance, bad faith, or that a governmental entity suspended the distributor's license for a minimum of thirty-one days.[174] Missouri uses a watered-down good cause requirement because a brewer may terminate a distribution agreement if the circumstances satisfy any one of the elements as opposed to the standard requirement that all elements are met.[175] Under Missouri law, there are far fewer termination requirements than traditional good cause states, but all brewers—regardless of size—are subject to the statute.[176]

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[168] Sayyed FTC Letter, *supra* note 3, at 9.

[169] *See, e.g.*, OKLA. STAT. ANN. tit. 37A, § 3-111(F)(1); N.Y. ALCO. BEV. CONT. LAW § 55-c(4)(c)(i).

[170] *See, e.g.*, OKLA. STAT. ANN. tit. 37A, § 3-111(B)(1)(a)–(d), (F)(1); N.Y. ALCO. BEV. CONT. LAW § 55-c(4), (4)(c)(i).

[171] *See* MO. ANN. STAT. § 407.413(5)(1)–(3) (West 2019).

[172] *See id.* § 407.413(2), (5)(1)–(3) (containing no notice requirements).

[173] *See id.* § 407.413(5)(1)–(3).

[174] *See id.*

[175] *See id.*

[176] *Compare id., with* N.Y. ALCO. BEV. CONT. LAW § 55-c(4)(c)(i) (McKinney 2019).

This approach appears to be a middle ground between empowered brewers and empowered distributors. However, this approach does not fully address the power that large manufacturers have over distributors.[177] While the good cause model does address that problem, it is too broad in its application.[178] Here, a less-than-good cause approach is just as broad, but it does not do enough to address the problem of onerous burdens on independent breweries looking to terminate contracts with poorly performing distributors.[179]

3. The Wisconsin Model

Wisconsin turns both the majority and other minority approaches on their heads. More closely aligned with California's current approach, a Wisconsin brewer may terminate its distribution agreement without good cause.[180] That is where the similarities end.[181]

In Wisconsin, a brewer does not pay a terminated distributor the fair market value of the contract.[182] Rather, the successor distributor—or the brewer's new distributor—pays the fair market value penalty to the terminated distributor.[183] If there are multiple successor distributors, the new distributors divide the fair market value payment equally.[184] Lastly, if the brewer paid any termination fees to the terminated distributor, the successor distributor deducts that amount from its payment to the terminated distributor.[185]

The Wisconsin model addresses the good cause approach's ancillary problem in a novel way—it shifts the cost of terminating a beer distribution agreement from brewers to distributors.[186] Although this approach ensures terminated distributors receive

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[177] *See generally* MO. ANN. STAT. § 407.413.

[178] *See generally* N.Y. ALCO. BEV. CONT. LAW § 55-c.

[179] *See generally* MO. ANN. STAT. § 407.413.

[180] *See* WIS. STAT. ANN. § 125.33(10)(4)(b), (c)(1)–(4) (West 2019).

[181] *See* Glazer, *supra* note 30, at 24 (observing that a brewer in Wisconsin can usually terminate a distribution agreement "for any, or no, reason").

[182] *See id.*

[183] *See id.*

[184] *See* WIS. STAT. ANN. § 125.33(10)(4)(b).

[185] *See id.*

[186] *Id.*

compensation for their loss, it does not address the CBBD's concerns.[187] Wisconsin shifts the burden of compensation away from brewers and places it on distributors' shoulders.[188] If anything, this approach tries to deter the circumstances that lead to the problem without touching the problem itself.[189]

IV. CALIFORNIA: EMBLEMATIC OF THE BREWING INDUSTRY

California currently fits into an amorphous category—comprised of six states—that has some beer distribution agreement laws that fall short of requiring good cause while still providing protections to distributors.[190] More specifically, current California law, only restricts termination "solely for a beer wholesaler's failure to meet a sales goal or quota that is not commercially reasonable under the prevailing market conditions."[191] If the big distribution lobby has its way, AB 1541 will make it far more difficult for independent breweries to terminate a contract.[192]

The CBBD's justification for proposing AB 1541 is the same as when it proposed California's current beer distribution agreement law in 2000.[193] That justification also aligns with the majority of states' justification for requiring good cause.[194] In short, the justification is that brewers have too much power over distributors.[195]

AB 1541 would align California's beer distribution laws with the majority approach by restricting brewers from terminating a distribution agreement for anything less than good cause.[196] Today,

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[187] *See* Gray Telephone Interview, *supra* note 103.

[188] WIS. STAT. ANN. § 125.33(10)(4)(b).

[189] *See id.*

[190] *See* Sorini, *supra* note 22.

[191] CAL. BUS. & PROF. CODE § 25000.7(a) (West 2020).

[192] *See* A.B. 1541, 2019–2020 State Assemb., Reg. Sess. 1–2 (Cal. 2019) .

[193] *Compare* S. RULES COMM., BILL ANALYSIS, SB 1957, at 1–3 (Cal. Aug. 29, 2000) (stating "the purpose of this bill is to help restore balance in the relationship between beer manufacturers and distributors/wholesalers by requiring that contractual requirements regarding sales goals and quotes be commercially reasonable"), *with* Gray Telephone Interview, *supra* note 103 (discussing the CBBD's position arises from large brewers—namely Constellation Brands—having too much power over their distribution counterparts).

[194] *See* Sorini, *supra* note 22.

[195] *See supra* note 13 and accompanying text.

[196] *See* A.B. 1541 at 3–4.

California is at a crossroads between its current beer franchise laws, its history of proposed changes to those laws, and CBBD—who is continually pushing the state toward the majority, good cause approach.[197] Section IV.A discusses California's current beer distribution franchise laws.[198] Section IV.B explains the history of those laws.[199]

A. Current California Law: Senate Bill 1957 and Business and Professions Code Section 25000.7

Prior to 2000, brewers and distributors were free to contract without government intervention.[200] The CBBD sponsored Senate Bill (SB) 1957 during the 1999–2000 legislative session to counterbalance the disparate bargaining power between brewers and distributors.[201] It justified the law by explaining how powerful brewers had forced distributors into unfavorable contract terms and could terminate those agreements with little recourse.[202] California's Governor Gray Davis signed SB 1957 into law despite the Small Brewer's Association contending the bill contravened the principle of freedom of contract.[203]

SB 1957 added two provisions to the Business and Professions Code.[204] First, Business and Professions Code section 25000.7(a) (SB 1957 codified) states:

> Notwithstanding the provisions of any agreement for the sale or distribution of beer between a beer manufacturer and beer wholesaler, no sale or distribution agreement *shall be terminated solely for a beer wholesaler's failure to meet a sales goal or quota* that is not commercially reasonable under the prevailing market conditions.[205]

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[197] *Compare* CAL. BUS. & PROF. CODE § 25000.7(a) (West 2020), *with* A.B. 1541 at 1–2.

[198] *Supra* Section IV.A.

[199] *Supra* Section IV.B.

[200] *See* CAL. BUS. & PROF. CODE § 25000.7(a) (beginning in 2000, instituting the first and only limitation on terminating beer distribution agreements in California).

[201] *See* A.B. 1541 at 1.

[202] *See* S. RULES COMM., BILL ANALYSIS, SB 1957, at 1–3 (Cal. Aug. 29, 2000).

[203] *Id.* at 4.

[204] CAL. BUS. & PROF. CODE § 25000.7 (West 2020).

[205] *Id.* § 25000.7(a) (emphasis added).

Second, it defined a "beer manufacturer" as any holder of a brewer's license—whether it be in-state or out-of-state—or any licensed importer.[206] Ultimately, SB 1957 limited the circumstances under which a brewer could terminate a distribution agreement.[207]

This statutory change handed distributors a distinct market advantage over manufacturers in 2000.[208] Despite the fact that sales are the sole reason for a manufacturer to enter a distribution agreement, disallowing termination for poorer than expected sales crucially hamstrings small manufacturers. That is, if the distributor underperforms on its end of the bargain, that is not grounds for the brewer to terminate the contract.[209] In reality, other reasons to terminate a distribution agreement pale in importance compared to sales from the manufacturer's perspective.[210] In addition, this change made it exceedingly more expensive for brewers to terminate unsavory distribution contracts, rendering termination impossible for most small manufacturers.[211] Litigation over the term "commercially reasonable" would be difficult and expensive to prove and would almost certainly be a question for the jury.[212] Accordingly, this change removed the main reason a brewer would want to terminate a distribution agreement—poor performance—and it effectively took away the means to do so by making it too difficult and expensive for a brewer to even attempt termination.[213]

Today, the CBBD believes SB 1957 (now Business & Professions Code section 25000.7) did not go far enough in addressing

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[206] *Id.* § 25000.7(b).

[207] *Id.* § 25000.7(a).

[208] *See generally id.*

[209] *See id.*

[210] *See* Ohlhausen FTC Letter, *supra* note 103, at 4–5 (speaking to the different interests and incentives of distributors and manufactures).

[211] *See* James A. Brickley et al., *The Economic Effects of Franchise Termination Laws*, 34 J.L. & ECON. 101, 113 (1991) ("[A]nalysis of the case law supports [the premise] that termination laws increase the costs of termination and nonrenewal."); Tracey A. Nicastro, *How the Cookie Crumbles: The Good Cause Requirement for Terminating a Franchise Agreement*, 28 VAL. U. L. REV. 785, 796–98 (1994) (cataloguing several courts' interpretations of "good cause" that limit a franchisor's ability to terminate franchisees).

[212] CAL. BUS. & PROF. CODE § 25000.7(a).

[213] *See id.*

the alleged power imbalance between brewers and distributors.[214] The CBBD raised the issue of beer distribution agreements once more when it proposed a good cause requirement to Assembly Member Gray early in the 2019 legislative session.[215] Assembly Member Gray eventually amended an existing bill to include the CBBD's requested changes.[216] According to Assembly Member Gray's Office, the CBBD sought to change California's distribution laws after Constellation Brands, a truly gigantic manufacturer, forced four distributors to sell their distribution rights to Constellation products in 2018 and 2019.[217]

B. Pushing California Toward a Good Cause Requirement

California did not have any laws specific to beer franchise agreements from 1933 until 2000.[218] The first law it enacted opened the door for future attempts to further regulate these agreements.[219] Section IV.B.1 discusses good cause legislation that a California senator nearly amended in 2005.[220] Section IV.B.2 explains how the circumstances surrounding that 2005 legislation resulted in similar, current legislation in 2019.[221]

1. AB 417: The Proposed Franchise Act That Never Was

In 2005, California Assembly Member Greg Aghazarian proposed AB 417 to include flavored malt beverages in the statutory definition of "beer."[222] After the bill reached the Senate,

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[214] *Compare* S. RULES COMM., BILL ANALYSIS, SB 1957, at 3 (Cal. Aug. 29, 2000) ("[T]he purpose of this bill is to help restore balance in the relationship between beer manufacturers and distributors/wholesalers by requiring that contractual requirements regarding sales goals and quotes be commercially reasonable ...."), *with* Gray Telephone Interview, *supra* note 103 (proposing at the CBBD's behest for the same reasons that the CBBD cited in 2000).

[215] Gray Telephone Interview, *supra* note 103.

[216] *Id.*

[217] *Id.*

[218] *See generally* CAL. BUS. & PROF. CODE § 25000.7 (West 2020).

[219] *See id.* (California Legislature's first enacted statute pertaining to franchise laws in the alcohol industry).

[220] *Infra* Section IV.B.1.

[221] *Infra* Section IV.B.2.

[222] A.B. 417, 2005–2006 State Assemb., Reg. Sess. (Cal. 2005) (as amended on Aug. 22, 2005, but not enacted).

Senator Wesley Chesbro drafted an amendment to the bill that would tighten beer distribution laws in a manner similar to the recently proposed AB 1541.[223] Ultimately, that amendment never became part of AB 417's legislative record because Senator Chesbro never proposed it.[224]

Before Senator Chesbro could amend AB 417, the Federal Trade Commission explained how his proposed changes would likely have catastrophic effects on California's brewing industry.[225] In that letter, the directors of policy planning, economics, and competition advised Senator Chesbro to avoid adding a good cause requirement to California's beer distribution laws.[226] The directors identified a slew of problems that good cause requirements would create.[227] Senator Chesbro never amended AB 417, the Legislature passed Assembly Member Aghazarian's version of the bill, and Governor Schwarzenegger vetoed it.[228]

2. AB 1541: California Distributors' Most Recent Attempt for a Good Cause Standard

Fifteen years removed from AB 417, California has forgotten the lessons learned by its Legislature in 2005. The topic of good cause beer franchise laws in California remains in dispute because no official legislative record documented Senator Chesbro's efforts and lessons learned.[229] The lack of a legislative record set

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[223] *Compare* Ohlhausen FTC Letter, *supra* note 103, at 2, *with* A.B. 1541, 2019–2020 State Assemb., Reg. Sess. 1–2, at 98 (Cal. 2019) (as amended on July 11, 2019, but not enacted).

[224] *See generally* Ohlhausen FTC Letter, *supra* note 103.

[225] *See id.* at 3 ("One of [your] purported goals is to 'foster vigorous and healthy inter-brand competition in the beer industry.' As explained below, however, [your] Proposal is likely to have the opposite effect." (internal citation omitted)).

[226] *Id.* at 8.

[227] *Id.* (citing a diminished ability to ensure distributors promote product, increased beer costs, and decreased beer selection).

[228] *Compare* A.B. 417, 2005–2006 State Assemb., Reg. Sess. (Cal. 2005) (as amended on Aug. 22, 2005, but not enacted) (passing the Legislature and presented to Governor Schwarzenegger on Sept. 19, 2005), *with* Letter from Arnold Schwarzenegger, Governor, Cal. State, to Members of the Cal. Assembly (Oct. 07, 2005) ("I am returning AB 417 without my signature. This bill would codify current law and practice to treat flavored malt beverages ... consistent with federal standards ....").

[229] *See supra* IV.B.1.

the stage for AB 1541, which would align California's beer distribution laws with the majority approach. This legislation would restrict brewers from terminating a distribution agreement for anything less than good cause.[230]

Under AB 1541, California's beer distribution laws would impose a four-step good cause process.[231] First, the law would adopt the substantial compliance model.[232] Second, brewers would need substantiating evidence and must give the distributor notice of termination.[233] Third, the brewer must notify the distributor of termination within a specified time period—operating much like a statute of limitations.[234] Finally, the distributor could provide a corrective action plan and cure the deficiency within a specified period of time.[235] A brewer may terminate a distribution agreement only after it satisfies all four criteria, barring the distributor does not cure the deficiency.[236]

V. PROPOSAL

Keeping the alleged problem—that large brewers have too much power over distributors—in mind, the majority of states have overcorrected to the good cause model.[237] This model shifts the balance of power strongly in favor of distributors, which is likely to harm a state's brewing industry, competition, and therefore consumers.[238] While this approach appears to address the problem, it creates the opposite problem: distributors have too much power over *small* brewers.[239]

States have realized the harm that the current good cause requirement may bring, and the winds are shifting away from that model.[240] While the just cause and Wisconsin models impose a

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[230] A.B. 1541, 2019–2020 State Assemb., Reg. Sess., at 1 (Cal. 2019) (as amended on July 11, 2019, but not enacted).

[231] *Id.* at 3.

[232] *Id.*

[233] *Id.*

[234] *Id.* at 4.

[235] *Id.* at 3.

[236] *Id.*

[237] *See generally* Sorini, *supra* note 22.

[238] Ohlhausen FTC Letter, *supra* note 103, at 8; *see* Sayyed FTC Letter, *supra* note 3, at 12.

[239] *See id.* at 11–12.

[240] *See supra* Section III.A.

lighter requirement than the rigorous good cause model, neither of these models address the problem.[241] Under both of those models, large manufacturers are still able to leverage their strength over distributors.[242]

The small business exception adequately resolves the problem without creating the ancillary problem that a pure good cause model does.[243] By exempting small brewers, a state can still implement the rigorous good cause requirements without impacting small, independent craft breweries.[244] Further, the small business exception is a dynamic alternative because it allows a state to specify the size requirements for a small brewer and modify that threshold as it sees fit.[245]

If states implement the small business exception properly, they would address distributors' concerns—that brewers have too much power over distributors—while not harming small brewers or the independent brewing industry.[246] This approach focuses on the problem—how large manufacturers' resources permit them free reign in beer distribution agreements—but avoids trapping small breweries in unbreakable pacts.[247] Essentially, creating a small business exception insulates distributors from the impact of large, globalized manufacturers that terminate distribution agreements.[248] Distributors could rest easy knowing large manufacturers cannot take advantage of them,

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241 *See supra* Sections III.B.1–2.

242 *See id.*

243 *See generally Benefits of Beer Franchise Laws*, NAT'L BEER WHOLESALERS ASS'N, https://www.nbwa.org/government/benefits-of-beer-franchise-laws [https://perma.cc/KEM4-EFNP].

244 *See supra* Section III.B.1.

245 Memorandum from Beth Hatef of McDermott Will & Emery LLP on Accommodation of Small Small Brewers in State Beer Franchise Laws, (July 2015) available at https://www.brewersassociation.org/wp-content/uploads/2015/07/State-Law-Small-Brewer-Accommodations-Updated-7-27-2015.pdf (last visited Feb. 12, 2021).

246 *See* Ohlhausen FTC Letter, *supra* note 103, at 8 (noting that a good cause requirement "may affect smaller brewers to a greater extent than larger brewers, because larger brewers may be in a better position to incur the legal costs of termination").

247 *Id.*

248 *See* Sayyed FTC Letter, *supra* note 3, at 9.

and small breweries would benefit from increased competition and market growth.[249]

CONCLUSION

The main problem with the good cause model, as it pertains to independent craft breweries, is that the model seeks to solve a power imbalance that simply does not exist between independent craft breweries and distributors.[250] And while the market power of large manufacturers might be harmful to distributors, one size does not fit all in this context.[251] As the FTC noted, the burdens that the good cause model imposes "upon brewers do not seem calibrated to address any particular bargaining asymmetries between brewers and wholesalers, and we are pessimistic that they could."[252]

States should, in fact, engage in calibration. Legislatures should re-examine their distribution laws to satisfy Big Distribution's concerns of asymmetrical bargaining power with large breweries, but states need not sweep independent craft breweries into that bin. It is time to stop taking the lobbyists' words for it. States must reject the good cause model to allow their independent craft breweries to thrive.

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[249] *See The Great Debate: The Three-Tier System Is Fundamentally Broken,* THE GROWLER (Jan. 27, 2020), https://www.growlermag.com/the-great-debate-the-three-tier-system-is-fundamentally-broken/ [https://perma.cc/CL5Y-9B33].

[250] S. RULES COMM., BILL ANALYSIS, SB 1957, at 4–5 (Cal. Aug. 29, 2000).

[251] *See id.*

[252] Sayyed FTC Letter, *supra* note 3, at 12.