

Beer Distribution 101
“Must Know Tips”
Regarding Wholesaler Contracts

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Beer Distribution 101

What We'll Cover

- Brief History of Three-Tier System
- Other Background Issues
- “Must Know Tips” for a Distribution Agreement

What We Won't Cover

- Successor Manufacturer & Valuation Issues
- Price Posting/Marketing Regulations



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Brief History of the Three-Tier System

- Prior to 1919, brewers sold directly to retailers
=> Led to anti-competitive business practices (“tied-houses”) & unscrupulous marketing tactics aimed at inducing excessive consumption.
- The 18th Amendment outlawed manufacture, distribution and sale of alcoholic beverages (ushered in Prohibition).



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Brief History of the Three-Tier System

- The 21st Amendment (1933) repealed the 18th Amendment => Gave states primary authority to regulate distribution within their borders, and the three-tier system was born. Under the system, manufacturers (e.g., brewers) produce and sell to distributors (aka wholesalers), who then sell to retailers (markets, bars/restaurants, etc.), who, in turn, sell to consumers.
- The three-tier system is designed to (1) prevent pre-prohibition evils, (2) generate revenues for the states, (3) facilitate state and local control over alcoholic beverages, and (4) encourage temperance.



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Brief History of the Three-Tier System

License vs. Control States:

- States generally fall into one of two categories -- “license states” and “control states”. License states regulate distribution by issuing licenses to businesses in each tier. (CA is a license state.)
- Although control states also have licensing requirements, the main difference is that control states obtain a direct interest in distribution revenues by taking an ownership stake as distributors or retailers of the product.



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Other Background Issues:

- All 50 states regulate the sale and distribution of beer within their borders.
- Many states address beer separately from wine and distilled spirits, making beer distribution one of the most highly regulated industries in the U.S.
- To complicate matters, differences among the states in terms of laws, licensing schemes, taxes, and control processes result in a legal “minefield” that can be difficult to navigate for brewers, distributors, retailers, and the attorneys who advise them.



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Other Background Issues (con't.):

- In CA, small brewers can self-distribute, and can engage in on-site sales at a tap/tasting room. Off-site sales also allowed at brewery and certain farmer's markets.
- Self-distribution typically confined to the local area near the brewery, but all successful breweries will need to decide whether to use a 3rd party distributor for the next phase of their growth.
- An inherent imbalance of power used to exist in distribution relationships in favor of breweries. To address this problem, many states passed so-called “franchise laws” aimed at balancing power in favor of distributors.



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Other Background Issues (con't.)

These balancing protections can be generally categorized as:

- Territorial Protections;
- Transfer Protections;
- Termination Protections; and
- Dispute Resolution Protections.



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Other Background Issues (con't.)

Territorial Protections :

- Nearly all states protect beer distributors by allowing for exclusive sales territories.
- In CA brewers must grant distributors an exclusive sales territory for their brands in writing and file a copy with the ABC.



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Other Background Issues (con't.)

Transfer Protections:

- Most states also limit brewers' ability to prevent distributors from transferring their rights to another distributor (or upon a change of ownership or control). Typically, brewers cannot withhold consent or unreasonably delay a distributor's transfer if the transferee meets standards and qualifications that are "reasonable", nondiscriminatory and are applied uniformly.
- In CA, a brewer that unreasonably withholds or denies consent is liable in damages to distributor (and distributor "goodwill" may be part of those damages).



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Other Background Issues (con't.)

Termination Protections:

- Arguably most significant protection provided to distributors. Restrictions interpreted broadly, and “good cause” interpreted narrowly. Thus, agreements can have a perpetual term in many jurisdictions.
- In CA, these protections are less comprehensive than in many other states. While most require a brewer to have “good cause” to terminate the agreement, CA only provides that the agreement can’t be terminated solely for the distributor’s failure to meet a sales goal or quota that is not commercially reasonable under prevailing market conditions. Still, this is a very complex & tricky area.



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Other Background Issues (con't.)

Dispute Resolution Protections:

- States generally impose mandatory venue requirements, and void provisions that specify any law other than that state's to govern the distribution agreement.
- Additionally, all states (including CA) have provisions that require their own laws to govern the distribution of beer within their own borders, and prohibit the parties from “waiving” those provisions.



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Other Background Issues (con't.):

- So, laws have traditionally been skewed in favor of distributors...but *does this actually reflect reality?*
- Vast majority of CA breweries are small, and face large, powerful distributors (as well as very influential retailers (e.g., BevMo!, Costco, etc.)).
- Distributors are gatekeepers to the market, and have tremendous say and influence on how your products will be sold.
- Given globalization and consolidation of distribution tier, how do CA craft brewers protect themselves?



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“Must Know Tips”:

- Get Effective Counsel!
- Explore All Options (look at distributors who have a reputation for working well with smaller breweries and have means of connecting with new customers).
- Understand the Basics of a Contract; Don't Blindly Sign What's Put in Front of You!!



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Contract Basics (con't.):

- Scope of Relationship
 - Territory (clearly defined);
 - List of all products covered by agreement;
 - Exclusivity; and
 - Term of agreement.
- Pricing and Payment Terms
 - Timing, location of payments;
 - Credit terms/terms of sale; and
 - Late payment penalties.



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- Rights and Obligations of the Parties
 - Scope of marketing/sales efforts (e.g., jointly developed sales & marketing plan);
 - Reporting requirements & audit rights;
 - Delivery, order & inventory requirements (e.g., joint stock rotation plan);
 - Minimum purchase requirements;
 - Quality control requirements/standards;
 - Confidentiality obligations;
 - Indemnification provisions; and
 - Representations and warranties (parties duly licensed, in good standing, etc.).



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- Intellectual Property Issues
 - Distributor's right to use supplier brand names/trademarks to perform;
 - Registration comes highly recommended;
 - This is a right to use, NOT a transfer of ownership;
 - Limitations on use should be specified; and
 - Keep in mind that these provisions protect both the distributor and supplier.



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- Termination Provisions
 - When permitted & what constitutes “cause” (remember restrictions under CA law);
 - Distributor’s ability to cure breach before termination vs. automatic termination (bankruptcy, etc.);
 - “Liquidated damages” to distributor when terminate without cause?;
 - Post-termination obligations (buy backs, promotional items, etc.); and
 - Survival of certain provisions upon expiration or earlier termination.



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- Miscellaneous Provisions (“Boilerplate”)
 - Governing law and venue (must stick to state where doing business);
 - Attorneys’ Fees clause;
 - Notices (how given when deemed received);
 - Dispute Resolution;
 - Signatures by Fax or E-mail;
 - Severability clause; and
 - Counterparts clause.



Questions?

Thanks for Listening, and Good Luck!

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