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DISTRIBUTION CONTRACTS

for

Craft Breweries

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Legal Issues and Developments

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Selecting a Distributor: Non-Legal Considerations

Distributor Commitment to Craft

- Is management committed to craft?
- Is the portfolio growing at a rate commensurate with the craft category?
- Are they selective in the craft brands they choose to distribute, or are they brand collectors?
- Is there a dedicated craft manager?

Sales Planning/Execution

- Is there a market plan with specific and measurable goals?
- Are they committed to spending to achieve results? Will they commit to a budget?
- Is there monthly programming – Management by Objective (MOB) or Pay For Performance (PFP)? Do they track results? Will they provide monthly reports?
- Do they use POS? Do they have in-house design and printing capabilities?



Selecting a Distributor: Non-Legal Considerations

Building Craft Awareness

- Does the distributor promote craft brands in the local market? Do they get involved in events that promote craft beer and educate consumers?
- Is there a craft focus on their website? Do they have a Beer Finder?
- Do they regularly e-mail craft news with key retailers?
- Has the distributor been a public advocate for franchise law reform? Does the distributor favor franchise law reform that allows brewers to move to another distributor for cause?

Quality

- Commitment to draft line cleaning and quality.
- Do they have refrigerated storage? – Cases: 50° F – Kegs: 40° F

Beer Franchise Laws Historical Background

- **21st Amendment**

- Repealed 19th Amendment
- Allowed states to regulate

- **Three Tier System**

- *Toward Liquor Control*
- Tied house laws

- **Beer “Franchise” Law**

- State laws governing the relationship between distributors and breweries
- Enacted in 1970s and 1980s when there were many small distributors, and relatively few breweries
- Massachusetts 1971



Beer Franchise Laws General Features

- **Most states have some form of beer franchise law**
 - Not Alaska, D.C., Hawaii

- **Common Features**

- “Agreement” formed **automatically**, and **terms imposed by law**
- **Exclusivity** by territory and brands
- Notice of breach and opportunity to cure; **notice-and-cure**
- Termination for “**Good Cause**” only
- Otherwise, pay a **Termination Fee** (fair market value)
- Applies to beer; not wine or spirits



Beer Distribution Contracts Territory and Exclusivity



- **Territory**

- Be clear about the Territory;
Limit it (can add more later)
- Many states require that territory be stated expressly in a written agreement



- **Exclusive or Non-Exclusive**

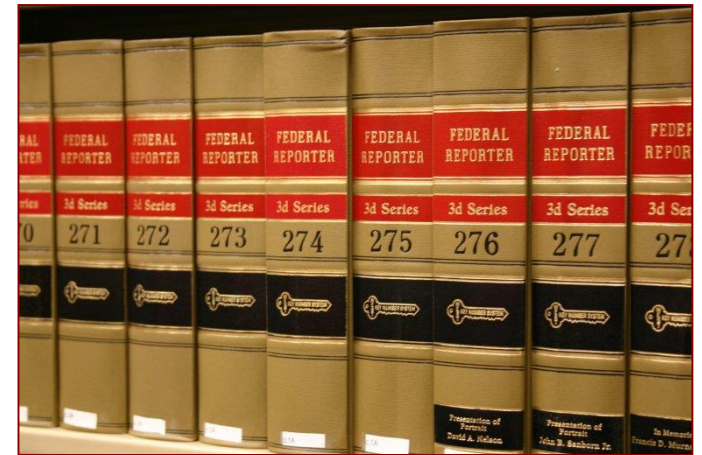
- Clearly define exclusivity to particular brands
- Grant of territory is to sell to “licensed retailers” in that territory
- Possible carve-outs for: i) selected retail accounts, ii) limited self-distribution, iii) promotional shipments, iv) on premise sales and online sales.



Beer Distribution Contracts Termination for “Good Cause”

- **Good Cause**

- **Most franchise laws prohibit termination by brewery without compensation to distributor, unless “for cause”/“good cause”**
- **California law does not require compensation except if brewery is acquired by another brewery**





Beer Distribution Contracts Termination for “Good Cause”

- **If not defined by statute, you can negotiate “good cause” reasons to terminate:**
 - e.g., failure to meet reasonable sales goals or target account penetration
 - e.g., repeated failure to make timely payments
 - e.g., sales by distributor are less than “X” percent of total sales
 - e.g., loss of X percentage of accounts
 - e.g., distributor pulling out of beer or part of territory





Beer Distribution Contracts Termination without Cause

- Also called “Termination for Convenience”
- Some states’ beer franchise laws may not allow termination without cause at all (even with termination fee)
- California beer franchise law does *not* prohibit this





Beer Distribution Contracts Termination without Cause: “Fair Market Value”

- **What is “fair market value”**
- **Often defined as a multiple of distributor’s gross margin on the sale of the brewery’s beers in the past 12 months (1x – 5x or more)**
- **Some states laws define it, but in CA and others states, you can negotiate and define this in contract**



Beer Distribution Contracts Termination without Cause: “Fair Market Value”

- **Examples and Tips**
 - **No termination fee in first year; gradually increases and caps**
 - **Distributor to pay upfront “brand value payment”**
 - **Brewery gets credit as to termination fee for accounts that brewery brought in**
 - **Change of ownership/control in distributor**
 - **Be clear that it is a liquidated damages clause; full and complete satisfaction for termination**



Beer Distribution Contracts Franchise Law Reform

- **Brewer's Association**

- “...any brewer contributing a small percentage of a wholesaler's volume should be exempted from those [beer franchise] laws and free to establish a mutually beneficial contract with the wholesaler”



- **New York:** <300,000 barrels and less than 3% of distributor's sales, pay termination fee
- **Washington:** <200,000 barrels
- **Florida:** [proposed] <250,000 barrels, less than 10% (other bill however has much lower amount)
- **Massachusetts:** [proposed 2017] <6,000,000 barrels and less than 20%, pay “fair market value”
- **California:** distributors lobbying for franchise law and limits



Beer Distribution Contracts “Temporary” Distribution Agreements

- **“Temporary” Distribution Agreements**
 - No such thing in most states
 - Once you send product to a distributor you are potentially in a beer distribution “contract”
 - Limited Exception for Festivals
 - Have an agreement that is limited to just the brands sent to the festival and the territory is only the festival grounds.
 - Get a pre-signed brand release from the distributor.



Beer Distribution Contracts Other Terms

- **Annual Business Plan; regular meetings**
- **Payment Terms**
- **Marketing fund and support**
- **Storage and Handling**
- **Brewery discretion to not sell**
- **FOB shipping**
- **Trademark license (limited)**
- **Dispute resolution and attorneys' fees**
- **Non assignable (if allowed by law)**
- **Audit rights**



Beer Franchise Laws Terminating A Distributor

- **Step 1) Document....Document....Document**
 - You need a paper trail showing failures and notice.
- **Step 2) Find a replacement.**
 - Better to have a replacement buy your brand.
- **Step 3) Negotiate a release or buyout.**
 - For smaller brands, a wholesaler may let you go for nothing or a nominal sum.
- **Step 4) Send breach notice.**
 - Be specific with failures and have targets that need to be met in line with Dist. Agreement and annual plan.
- **Step 5) Respond to the cure notice**
 - You will likely get a superficial response. Hold the wholesaler to targets in termination letter.
- **Step 6) Time for a business decision.**



Questions? Contact Information

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