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## Reimagining Power Imbalance in California's Beer Distribution Laws

Daniel J. Croxall

*University of the Pacific, McGeorge School of Law, dcroxall@pacific.edu*

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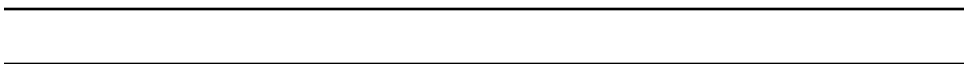
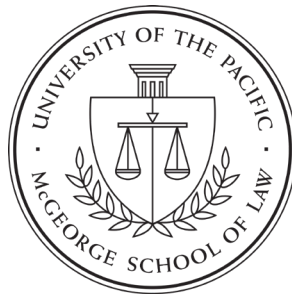
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# UNIVERSITY OF THE PACIFIC LAW REVIEW



# Reimagining Power Imbalance in California’s Beer Distribution Laws

by Daniel J. Croxall\*

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## I. INTRODUCTION

Beer distribution is a tricky business for both the distributor and the beer manufacturer. It is even more tricky for the manufacturer when that brewer is a “craft” brewer who holds little-to-no market power and thus commands little-to-no attention from distributors.<sup>1</sup> Distributors make their money on volume. And when the scales of beer production are put into perspective, most craft breweries are but a blip on a distributor’s radar screen.<sup>2</sup> The result is that the craft brewer is at a major disadvantage in terms of attention from the distributor and therefore shelf space placement and tap handle allocation. The market is getting extremely difficult for small craft brewers for several reasons, not the least of which is a set

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\* Daniel J. Croxall is a Professor of Law, Legal Practice at the University of the Pacific McGeorge School of Law. Professor Croxall created and teaches the world’s first craft beer law class at a law school. He would like to thank the editors of the University of the Pacific Law Review for inviting this article and for extremely helpful and professional editing.

1. The Brewer’s Association defines a craft brewer as follows: (1) Small: “Annual production of 6 million barrels of beer or less (approximately 3% of U.S. annual sales). Beer production is attributed to the rules of alternating proprietorships.” (2) Independent: “Less than 25[%] of the craft brewery is owned or controlled (or equivalent economic interest) by an alcohol industry member that is not itself a craft brewer.” (3) Brewer: “Has a TTB Brewer’s Notice and makes beer.” See *Craft Brewers Definition*, BREWERS ASS’N, <https://www.brewersassociation.org/statistics/craft-brewer-defined/> (last visited Mar. 5, 2022) (on file with the *University of the Pacific Law Review*). For the purposes of this article, “Big Beer” also means beer distributors who distribute primarily or solely distribute macro beer products. To put this into perspective, the vast majority of craft breweries produce less than 5,000 barrels of beer annually. See *Number of Brewers by Production Size – CY 2016*, U.S. DEP’T OF THE TREASURY: ALCOHOL & TOBACCO TAX & TRADE BUREAU (Mar. 31, 2021), [https://www.ttb.gov/images/pdfs/statistics/production\\_size/2020\\_brew\\_prod\\_size\\_ttb\\_gov.pdf](https://www.ttb.gov/images/pdfs/statistics/production_size/2020_brew_prod_size_ttb_gov.pdf) (on file with the *University of the Pacific Law Review*).

2. See *id.*

of laws found in the California Business and Professions Code that are designed to “protect” distributors from an alleged power imbalance that arguably once existed that benefitted brewers to the detriment of distributors.<sup>3</sup> That power imbalance, if it ever existed, does not exist today.

The time has come for the California Legislature to reimagine its beer distribution laws. They needlessly protect the middle tier of the alcohol market, distributors, to the severe economic disadvantage of the first tier, manufacturers. While money obviously speaks in the halls of the Legislature, elected officials should look at the larger picture. They need to realize the economic benefits of the craft brewing industry in terms of taxes and jobs,<sup>4</sup> and thus the Legislature can and should revise California's distribution law before the craft brewing industry becomes yet another economic extinction. That is not an exaggeration.

#### *A. The Three-Tier System and Current Law*

Almost every state and the US federal government adopted versions of what is known as “the three-tier system” to minimize formerly rampant unfair business practices in the alcoholic beverage market that were very common prior to Prohibition and to ostensibly promote temperance among American drinkers.<sup>5</sup> Under the three-tier system, manufacturers (known as tier one), wholesalers (known as tier two), and retailers (known as tier three) cannot perform the privileges of the other tiers, and they are prohibited from exerting any undue influence over members of the other tiers.<sup>6</sup> Stated differently, the main ideas behind the three-tier system were that a manufacturer cannot distribute or sell beverages for retail, a distributor cannot manufacture or sell for retail, and a retailer cannot manufacture or distribute alcoholic beverages.<sup>7</sup>

Maintaining distance between the tiers is intended to prohibit retail outlets from favoring to large manufacturing interests through undue pressure and influence at the expense of smaller market competitors.<sup>8</sup> The three-tier system is supposed to protect consumers from being inundated with only one company's products or having their choices limited because the retailer owes the distributor or manufacturer loyalty, while simultaneously minimizing aggressive marketing

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3. See CAL. BUS. & PROF. CODE §§ 25000.1–25000.9 (West 2022).

4. For example, as of July 2021, California alone had 1100 craft breweries within its borders that provided over sixty-five thousand jobs with a total economic impact in our state of \$9.66 billion. *Craft Beer Statistics*, CAL. CRAFT BREWERS ASS'N, <https://californiacraftbeer.com/ca-craft-beer/craft-beer-statistics/> (last visited Mar. 9, 2022) (on file with the *University of the Pacific Law Review*).

5. See, e.g., *Mo. Broadcasters Ass'n v. Schmitt*, 946 F.3d 453 (8th Cir. 2020); *Retail Digit. Network v. Prieto*, 861 F.3d 839, 843 (9th Cir. 2017); *Actmedia, Inc. v. Stroh*, 830 F.2d 957, 958 (9th Cir. 1986).

6. See *Prieto*, 861 F.3d at 850–51.

7. See *Schmitt*, 946 F.3d at 456.

8. *Prieto*, 861 F.3d at 850–51.

techniques that large manufacturers are known to employ, furthering states' interests in promoting temperance.<sup>9</sup>

With respect to beer specifically, the situation is more acute than with other alcoholic beverages. Independent craft beer has been a major financial challenge for large corporate manufacturers who have in turn placed increased pressure of distributors to focus their sales attention on the larger brands instead of smaller craft breweries.<sup>10</sup> More specifically, independent craft beer has taken a large chunk of the overall U.S. beer market from Big Beer in a short period of time, and Big Beer exerts its significant influence over distributors to help quell the tide.<sup>11</sup> To illustrate, we can look to the relatively recent proliferation of breweries springing up and taking market share from many of the bigger names often associated with beer.<sup>12</sup> Brands such as Budweiser, Coors, and Miller have seen their collective dominance reduced as competition increases and consumer trends shift.<sup>13</sup>

Following Prohibition, a multitude of breweries began to fill the vacuum left by the failed constitutional amendment. However, diversity in the marketplace dwindled. Consolidation of manufacturers is obvious when looking at market shares from 1947—when the top ten producers controlled 19% of the beer market—to 1978—when the same metric ballooned to 92.3%.<sup>14</sup> By 1979, a total of 44 companies produced beer throughout the nation, with ten of those companies controlling over 90% of the market; in short, a handful of breweries dominated essentially the entire market.<sup>15</sup> Indeed that is why distributors lobbied to have the laws changed to give them legislative protections from manufacturers.

Interest in producing beer on a smaller scale began to reemerge following the passage of H.R. 1337, which legalized the home production of a small amount of beer or wine for personal consumption.<sup>16</sup> Starting in 1980, the tides began to change, setting the foundations for the real growth of craft beer. For the next two decades, hundreds of breweries opened across the country; however, in 2000, three

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9. *Stroh*, 830 F.2d at 960.

10. See *Craft Beer vs. Big Beer*, CRAFT BEV. CONSULTANTS, <https://craftbeverageconsultants.com/2015/01/craft-beer-vs-big-beer/> (last visited Mar. 9, 2022) (on file with the *University of the Pacific Law Review*) (defining Big Beer to include large corporate brewers and their “sub-companies”).

11. *National Beer Sales & Production Data*, BREWERS ASS'N, <https://www.brewersassociation.org/statistics-and-data/national-beer-stats/> (last visited Dec. 15, 2020) (on file with the *University of the Pacific Law Review*).

12. *Beer Volume Declines Continue, Despite Gains in Craft and Imported Brews*, PR NEWSWIRE (Oct. 10, 2018, 6:00 AM), <https://www.prnewswire.com/news-releases/beer-volume-declines-continue-despite-gains-in-craft-and-imported-brews-300727917.html> (on file with the *University of the Pacific Law Review*).

13. Saabira Chaudhuri, *Budweiser Brewer Shares Dive as It Loses More U.S. Market Share*, WALL ST. J. (Feb. 27, 2020 at 6:34 AM), <https://www.wsj.com/articles/budweiser-brewer-takes-profit-hit-loses-more-u-s-market-share-11582793027>.

14. Douglas F. Greer, *The Causes of Concentration in the Brewing Industry*, 21 Q. REV. OF ECON. & BUS. 87, 88–89 (1981).

15. Douglas F. Greer, *Beer: Causes of Structural Change*, in *INDUSTRY STUDIES* 28, 32 tbl.2.1 (Larry Duetsch, ed., 1998).

16. H.R. Res. 1337, 95th Cong. § 2(B)(1)(e) (1978) (enacted).

firms still controlled 81% of the market.<sup>17</sup> While the growing number of breweries did not impact the major players for the first twenty years, that would change beginning in 2000. By 2014, craft beer had ballooned to include 3,418 breweries who collectively enjoyed 19.3 domestic market share.<sup>18</sup> This number has continued to grow year over year, and while its growth has slowed, craft beer continues to eat away at Big Beer's dominance. Even while the United States sees an overall decline in the consumption of beer, craft and independent breweries continue to make incremental gains on the market leaders.<sup>19</sup> By 2019, there were over 8,000 craft and independent brewers that account for over 25% of the 116-billion-dollar market.<sup>20</sup>

## II. CURRENT LAW AND JUSTIFICATIONS

### A. *The State of the Law Today*

Current law heavily favors the second tier (distributors) over the first tier (manufacturers) and specifically puts small craft breweries in an economically untenable position.<sup>21</sup> Through powerful lobbies such as the National Beer Wholesalers Association (“NBWA”) and others, distributors have been able to carve out legislative benefits that drastically shift the power balance between them and manufacturers in the distributor's favor.<sup>22</sup>

In California, contracts between manufacturers and distributors do not operate as ordinary business contracts. Instead, they more closely resemble franchise agreements.<sup>23</sup> California has specifically enacted several laws that favor distributors. Perhaps the most important legislative gift that the wholesaler's lobby has given to the wholesalers in California is exclusivity within a given territory.<sup>24</sup> Essentially, this means that only one distributor can sell, transfer, and deliver a manufacturer's beer in a specific territory.<sup>25</sup> To be precise, California Business and

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17. Martin Stack, *A Concise History of America's Brewing Industry*, ECON. HIST. ASS'N (July 3, 2004), <https://eh.net/encyclopedia/a-concise-history-of-americas-brewing-industry/> (observing America's largest brewers produced—in millions of barrels—Anheuser-Busch: 99.2, Miller: 39.8, Coors: 22.7; with Total Domestic Sales of 199.4 million barrels).

18. *2014 Craft Beer Data Infographic*, BREWERS ASS'N, (Mar. 16, 2015), <https://www.brewersassociation.org/association-news/2014-craft-beer-data-infographic/> (on file with the *University of the Pacific Law Review*).

19. *National Beer Sales & Production Data*, *supra* note 11.

20. *Id.*

21. See CAL. BUS. & PROF. CODE §§ 25000.1–25000.9 (West 2022).

22. Daniel Croxall, *It's Time to Reimagine Craft Beer Distribution Contracts*, CRAFT BEER LAW PROF (Sept. 23, 2021), <https://www.craftbeerprofessor.com/2021/09/its-time-to-reimagine-craft-beer-distribution-contracts/> (on file with the *University of the Pacific Law Review*).

23. See generally Daniel Croxall, *Independent Craft Breweries Struggle Under Distribution Laws that Create a Power Imbalance in Favor of Wholesalers*, 402 WM. & MARY L. REV. 418 (2021).

24. See CAL. BUS. & PROF. CODE § 25000.5 (West 2022) (“Beer manufacturers; designation of territorial limits; conditions for sale of any given brand”).

25. *Id.* (declaring that beer manufacturers “shall designate territorial limits in the state within which the

Professions Code states that a distributor cannot distribute beer in any given territory of the state unless “[t]he wholesaler has first entered into a written agreement with the manufacturer of that brand, which sets forth the territorial limits within which the brand shall be distributed *by the wholesaler*.”<sup>26</sup> In practice, this means that a manufacturer cannot simply take her business elsewhere if the wholesaler is doing a poor job. Instead, the manufacturer is essentially stuck with one wholesaler per territory.<sup>27</sup> Exclusivity can thus be extremely detrimental to a manufacturer.

One might just assume that if a wholesaler is doing a sub-par job in a given territory, the manufacturer could just terminate the contract and hire another distributor. That is not the case. The wholesaler’s lobby has ensured that terminating a distribution agreement is next to impossible for a manufacturer.<sup>28</sup> Specifically, California Business and Professions Code section 25000.7 codifies that a manufacturer cannot terminate a contract without liability for the main reason a manufacturer would want to—poor performance.<sup>29</sup> Section 25000.7 states as follows:

Notwithstanding the provisions of any agreement for the sale and distribution of beer between a beer manufacturer and a 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.<sup>30</sup>

Lack of sales is obviously the key reason that a manufacturer would want to terminate a distributor contract. In practice, this means that a manufacturer will almost certainly be liable for terminating a distribution contract.<sup>31</sup> It is quite easy for a distributor to make an argument that the manufacturer’s expectations were not “commercially reasonable.” And keeping in mind that most craft breweries operate on extremely tight budgets and margins because they are very small,<sup>32</sup> craft breweries cannot afford to litigate these matters, especially in the face of potential damages at the end of the tunnel.

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brands of beer manufactured by [the manufacturer] may be sold by wholesalers of beer to customers”).

26. *Id.* at § 25000.5(b)(1) (emphasis added).

27. *See id.* Manufacturers and wholesalers are free to determine a “territory” for themselves. Most often, in the author’s experience, counties are designated as territories for these purposes.

28. *See* CAL. BUS. & PROF. CODE § 25000.7 (West 2022) (“Agreements for sale or distribution of beer; failure to meet sales goal or quota; termination of agreement prohibited”).

29. *Id.*

30. *Id.* (emphasis added).

31. *See, e.g.,* Mission Bev. Co. v. Pabst Brewing Co., 15 Cal. App. 5th 686, 699 (2d Dist. 2017).

32. *See Number of Brewers by Production Size – CY 2020*, U.S. DEP’T OF THE TREASURY: ALCOHOL & TOBACCO TAX & TRADE BUREAU (Mar. 31, 2021), [https://www.ttb.gov/images/pdfs/statistics/production\\_size/2020\\_brew\\_prod\\_size\\_ttb\\_gov.pdf](https://www.ttb.gov/images/pdfs/statistics/production_size/2020_brew_prod_size_ttb_gov.pdf) (on file with the University of the Pacific Law Review) (reporting that most brewers produce less than 1,000 barrels per year).

There are several other legislative gifts that the distributor's lobby has obtained for distributors at the expense of manufacturers.<sup>33</sup> But the two described above are perhaps the most onerous on craft brewers because of the expense and the risk of litigation. For most craft breweries, attempting to terminate a distribution contract would be a "bet-the-company" scenario that is unlikely to resolve in the breweries' favor—a risk that small breweries cannot afford to take.

### *B. Alleged Justifications for Legislative Gifts to Distributors*

The legislative history surrounding the passage of statutes adjusting the power balance in the beer market in favor of distributors reveals several interesting, but not surprising things. As one might expect, industry supporters of these bills include the usual suspects—distributors themselves and big companies who stood to benefit from increased distributor power over manufacturers.<sup>34</sup> That's not surprising. But the justifications provided in the legislative history are surprising when viewed against today's marketplace. In short, the justifications fail and literally no longer make sense.

First, a review of the legislative history behind the relevant statutes,<sup>35</sup> shows that it was a very limited and very special interest that supported the bills designed to tip the scales away from manufacturers.<sup>36</sup> Specifically, the primary supporter of these bills was the California Beer and Beverage Distributors ("CBBD")—a non-profit trade association representing distributors and related groups.<sup>37</sup> The CBBD appears relatively innocuous, but it is an advocacy group with constituents.<sup>38</sup> Perhaps quite predictably, other supporters of the Senate bill included Coors Brewing Company, Miller Brewing Company, and Anheuser Busch.<sup>39</sup> One might wonder why a large manufacturer would support such a bill. The answer is because it helps them garner power in the market. Specifically, large manufacturers like

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33. For example, distributors can sell distribution rights to other distributors, and the manufacturer cannot object unless it is commercially reasonable to do so. *E.g.*, CAL. BUS. & PROF. CODE § 25000.9 (West 2022) ("Any beer manufacturer who unreasonably withholds consent or unreasonably denies approval of a sale, transfer, or assignment of any ownership interest in a beer wholesaler's business with respect to that manufacturer's brand or brands, shall be liable in damages to the beer wholesaler. Recoverable damages under this section shall not exceed the compensatory damages sustained by the wholesaler and the wholesaler's costs of suit. The fair market value of the beer wholesaler's business shall include, but is not limited to, its goodwill, if any.").

34. See ASSEMBLY COMMITTEE ON GOVERNMENTAL ORGANIZATION, COMMITTEE ANALYSIS OF SB 1957, at 4 (Aug. 21, 2000) (listing Anheuser-Busch Companies, Inc. and Coors Brewing Company as supporters).

35. CAL. BUS. & PROF. CODE §§ 25000.3—25000.9 (West 2022).

36. ASSEMBLY COMMITTEE ON GOVERNMENTAL ORGANIZATION, COMMITTEE ANALYSIS OF SB 1957, at 2 (Aug. 21, 2000).

37. See generally *About CBBD*, CAL. BEER & BEV. DISTR., [https://www.cbdd.com/CBBD/Get\\_to\\_Know\\_CBBD/About%20CBBD/CBBD/About\\_CBBD.aspx](https://www.cbdd.com/CBBD/Get_to_Know_CBBD/About%20CBBD/CBBD/About_CBBD.aspx) (last visited Mar. 5, 2022) (on file with the *University of the Pacific Law Review*).

38. *Id.*

39. ASSEMBLY COMMITTEE ON GOVERNMENTAL ORGANIZATION, COMMITTEE ANALYSIS OF SB 1957, at 4 (Aug. 21, 2000).



AB-InBev and Coors have their own distribution arms.<sup>40</sup> Thus, not allowing small manufacturers to terminate contracts for poor performance helps larger manufacturing and distribution entities maintain their market positions. In addition, because wholesalers make their money on volume, high volume manufacturers will naturally garner the favor of distributors over smaller manufacturers who produce less volume.

The August 18, 2000 Bill Analysis from the Assembly Committee on Governmental Organization sets for the alleged justification for changing the law to favor distributors. The Committee's analysis states as follows: "According to the California Beer and Beverage Distributors, the primary supporter of this legislation, the purpose of this bill is to help restore balance in the relationship between beer manufacturers and distributors/wholesalers."<sup>41</sup> Moreover, the same analysis states that "[r]ecent market developments have seen beer manufacturers grow larger through consolidation and globalization, while beer wholesalers have generally retained their same marketing territories and have not enjoyed parallel growth."<sup>42</sup> Perhaps the most telling part of all of this is when the Bill Analysis cuts to the chase and states the real reason behind the legislative gift: "Beer wholesalers are dependent for their livelihood on retaining the distribution rights to the *major brands in their portfolio*."<sup>43</sup> There it is. That's the point. Distributors do not make their primary income from craft brewers. Therefore, naturally, their attention and loyalty will be with the larger manufacturers. Small breweries are left to pick up the scraps. As described below, the foundational justifications for government intervention into the market and handing distributors a power boost simply does not exist in today's market. Indeed, the market conditions are now precisely opposite than those the bill sponsors introduced for Senate Bill 1957 (2000).

### III. CONSOLIDATION: AN UNANTICIPATED SCENARIO

The laws favoring distributors described above have gone too far. Indeed, the perceived power imbalance that once arguably existed remains no more. Instead, the power dynamics of the alcoholic beverage industry—most acutely perhaps in beer—has been flipped on its head. Distributors who once might have claimed that manufacturers (i.e., brewers) have an unfair advantage in the market over distributors simply cannot make that argument any longer.<sup>44</sup> The conditions of the

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40. Anheuser-Busch Wholesaler Locator, ANHEUSER-BUSCH, <https://www.abwholesaler.com/common/wholesaler-locator/> (last visited Mar. 5, 2022) (on file with the *University of the Pacific Law Review*); COORS DISTRIB. CO., <https://www.cdcoors.com> (last visited Mar. 5, 2022) (on file with the *University of the Pacific Law Review*).

41. ASSEMBLY COMMITTEE ON GOVERNMENTAL ORGANIZATION, COMMITTEE ANALYSIS OF SB 1957, at 2 (Aug. 21, 2000).

42. *Id.*

43. *Id.* at 2–3.

44. See Kate Bernot, *Stuck in the Middle with Who?, Pt. 2 – What California's Distribution Consolidation Could Mean for Breweries*, GOOD BEER HUNTING (Mar. 5, 2020),

alcoholic beverage market have changed so dramatically that the very foundation of the laws giving artificially benefiting distributors cannot be sustained.

The primary reason for the changed circumstances in the market can be boiled down to one word: consolidation. As noted above, distributors used to claim that they need legislative contractual protections, much like those of franchisees, because the multitude of manufacturers left distributors at the mercy of manufacturer's whims.<sup>45</sup> Over the last five years, and over the last year in particular, the distribution arm of the three-tier system, has been trending towards a duopoly.<sup>46</sup> In fact, where California used to have many distributors throughout the state willing and able to distribute beer, two companies now essentially dominate the market.<sup>47</sup> Those companies are AB-InBev's distribution arm and Reyes Beverage Group.<sup>48</sup> "The fear is that one or two companies—Reyes and AB InBev—will have an outsized influence on which beers the majority drinkers see in coolers. That's already true; the question is whether it is illegal."<sup>49</sup> Antitrust issues aside, the root of this problem stems from the outdated and unfair laws giving distributors insurmountable power over the breweries in their portfolios.

Kate Bernot, one of the beer industry's recognized industry experts, provides some essential background to this issue. "Distributor consolidation in California accelerated in 2020, capping a two-year stretch in which Reyes Beverage Group acquired 10 wholesalers up and down the state."<sup>50</sup> While a company acquiring *ten* competitors in a year might seem glaring, when put into context, the point is even more stark. "Through four significant acquisitions last year, Reyes added 12.65 million case equivalents in California—nearly as much Coors Banquet as was sold *in the entire U.S. in 2019*."<sup>51</sup> If one stops to think about that statistic, it becomes quite clear where the power lies in the distribution arm of the industry. In 2020 alone, "Reyes wholesalers were selling 1.6 times as much beer in California as AB-InBev-aligned (ABI) distributors, controlling 43% of all beer sold in the state, per Beer Marketer's Insights."<sup>52</sup> In 2021, that number is almost 50% of all the beer sold in the state.<sup>53</sup>

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<https://www.goodbeerhunting.com/sightlines/3/5/what-californias-distribution-consolidation-could-mean-for-breweries> (on file with the *University of the Pacific Law Review*).

45. See ASSEMBLY COMMITTEE ON GOVERNMENTAL ORGANIZATION, COMMITTEE ANALYSIS OF SB 1957, at 4 (Aug. 21, 2000).

46. See Kate Bernot, *Golden Opportunity — California Tensions over Consolidation, Stay-At-Home Orders, Cannabis Provide National Case Studies*, GOOD BEER HUNTING (Jan. 19, 2021), <https://www.goodbeerhunting.com/sightlines/2021/1/19/california-tensions-over-consolidation-covid-cannabis> (on file with the *University of the Pacific Law Review*).

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. Bernot, *supra* note 46.

53. Tom McCormick, *Consolidation in California Leads to Wholesaler Association Split*, PRO BREWERY

AB-InBev, another huge player in the distribution market, is a bit handcuffed in the distribution tier. “Antitrust laws [mean]that AB InBev can wholly own only 5% of its distribution; Reyes doesn’t have such a limitation.”<sup>54</sup>

This consolidation creates market accessibility problems for the state’s roughly 1,100 craft breweries.<sup>55</sup> As a member of the California Family Beer Distributors, a small distributor trade and lobbying group, put it, “Our businesses came together out of rising concerns around monopolistic business practices, such as forced consolidation, decreased access to market for craft brewers and loss of local jobs at large.”<sup>56</sup> Because distributors, especially large distributors, earn their profits on volume not quality,<sup>57</sup> continued consolidation means that small breweries will have an increasingly hard time getting the attention of their distributors. Frankly, big distributors “regard (small brewers) as a pain in the ass.”<sup>58</sup> Moreover, “Critics of distributor consolidation say Reyes’ seemingly inexorable momentum and growth are slowly giving it control of the majority of shelves—and with it, control of drinkers’ access to choice, and outsized influence in setting shelf resets.”<sup>59</sup> It is perhaps commonsense or even human nature that a business is going to favor higher earners over lesser ones.

All this consolidation thus undercuts the alleged justifications for giving distributors statutory power over their manufacturing partners. More specifically, the argument that manufacturers have an unfair power position over distributors is simply false because

consolidation within the distribution industry arguably is having an even greater effect on beer drinking in the United States. The country has far more breweries than ever before—8,800, up from about 1,800 in 2010, a stunning fivefold increase in just over a decade—but most craft beer is limited to the region where it’s brewed.<sup>60</sup>

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(Jan 19, 2021), <https://www.probrewer.com/beverage-industry-news/distribution-and-retail/consolidation-in-calif-leads-to-wholesaler-association-split/> (on file with the *University of the Pacific Law Review*).

54. Bernot, *supra* note 44.

55. See *Craft Beer Statistics*, *supra* note 4 (noting that California has more craft breweries than any other state).

56. *California’s Family-Owned Beer Distributors Launch New Association*, CAL. FAM. BEER DISTRIBS. (Dec. 7, 2020), <https://californiafamilybeerdistributors.com/news/californias-family-owned-beer-distributors-launch-new-association> (on file with the *University of the Pacific Law Review*).

57. Chris McClellan, *Mounting Pressure*, BREW ENTHUSIAST (June 23, 2018), <https://www.thebrewenthusiast.com/blog/2018/6/19/mountingpressure> (on file with the *University of the Pacific Law Review*).

58. Chuck McFadden, *Beer Battle Brewing over Distribution*, CAPITOL WEEKLY (Jan. 25, 2021), <https://capitolweekly.net/beer-battle-brewing-over-distribution/> (on file with the *University of the Pacific Law Review*).

59. Bernot, *supra* note 46.

60. Matt Krupnick, *There Are Nearly 9,000 Craft Breweries in the US – But Big Beer Dominates*, GUARDIAN (Oct 21, 2021, 6:00 AM), <https://www.theguardian.com/environment/2021/oct/21/craft-breweries-face-big-obstacles> (on file with the *University of the Pacific Law Review*).

This is thus the inverse of the justification the distributors provided the legislature when seeking California's current favorable laws. There can be no legitimate complaining that manufacturers wield an unfair bargaining position in this environment.

#### IV. WHAT CALIFORNIA SHOULD DO

The time has come for California to recognize that market conditions have been turned on their head since the passage of these pro-distributor laws. In fact, several states have recognized the economic reality and have changed their law to provide more equal bargaining power between distributors and manufacturers.<sup>61</sup> Perhaps more than any other, Vermont has recently led the way in terms of fixing any overcorrections that no longer make sense.<sup>62</sup> California should follow Vermont's footsteps and undue the harm that its legislative gifts are inflicting upon small craft brewers.

In 2019, Vermont passed a law aimed at re-leveling the power dynamics between distributors and wholesalers.<sup>63</sup> Essentially, Vermont changed its law to eliminate a distributor's unilateral transfer protections described above. That is, Vermont decided it was imprudent to allow distributors to simply sell their distribution rights to another distributor despite a manufacturer's views. Vermont Statutes Annotated, Title 7, section 707 ("Section 707") essentially gives a manufacturer a procedure to object to a distributor's attempt to sell the distribution rights where one did not exist before.<sup>64</sup> Section 707 requires the distributor to provide notice to the manufacturer that, among other things, outlines the "qualifications of the proposed transferee which, in the opinion of the wholesale dealer, make the proposed transferee competent to operate the franchise."<sup>65</sup> In addition, in the event the manufacturer does not wish the proposed new distributor to distribute its beer, Section 707 provides the manufacturer with the ability to "petition the Superior Court for a hearing no later than 60 days prior to the date of the proposed sale or transfer. The petition shall clearly state the . . . manufacturer's reasons for resisting the proposed sale or transfer."<sup>66</sup> This represents a marked return to equilibrium from what wholesalers have been able to achieve in terms of legislative gifts throughout the country.

Vermont did so for the reasons mentioned above—namely, the justification for favoring distributors legislatively no longer makes any sense. Specifically, the legislative history reveals that the Vermont Legislature passed Section 707 to address the power imbalance that it had created in years passed that favored

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61. *See, e.g.*, VT. STAT. ANN. tit. 7 § 707 (West 2022).

62. *See id.*

63. *See id.*

64. *Id.*

65. *Id.*

66. *Id.*

distributors.<sup>67</sup> First, the legislature recognized that Vermont’s pro-distributor laws “were enacted in 1976 when there were 103 breweries nationally, with five dominant national brewers, compared to roughly 5,000 distributors throughout the United States . . . . When Vermont’s franchise laws were enacted, they protected the public welfare by *correcting an imbalance in the economic and bargaining power* between large national brewers and wineries and smaller local wholesale distributors in order to promote fair business relations.”<sup>68</sup>

Vermont, however, wisely also recognized that times have changed and are essentially opposite from the market conditions in 1976.<sup>69</sup> “In the decades since then [1976], the numbers of breweries and wineries compared with wholesalers have nearly reversed.”<sup>70</sup> Further, with respect to consolidation, the Legislature noted that, “Each of the three largest Vermont beer wholesalers serves the entire State and represents hundreds of beer brands.”<sup>71</sup>

As argued above, the power imbalance that once might have existed in favor of manufacturers and thus resulted in the legislative power structure favoring distributors is no more. The Vermont Legislature expressly recognized that,

The significant imbalance in economic and bargaining power that the franchise laws were adopted to address is absent from the dynamics between wholesale distributors and the many small and regional craft brewers and vinous beverage producers that have entered the marketplace. Therefore, the policy reasons that supported adoption of the franchise laws do not apply to a growing segment of smaller brewers and vinous beverage producers that wish to sell their products in Vermont.<sup>72</sup> Accordingly, Vermont passed Section 707 to restore balance in the manufacturer and distributor relationship. If Vermont can see that distributors have been handed free power over craft brewers, California should be able to do the same. As Vermont has recognized and other states should, such legislation has outlived its alleged usefulness and must be fixed if craft breweries are to survive.

## V. CONCLUSION

The market just isn’t what it used to be. The dramatic increase of craft breweries over the last decade juxtaposed with the increased consolidation and reduction in distributors have flipped the power dynamic on its head. Unlike in the

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67. See H. 710, 2018 Leg., 2017–2018 (Vt. 2018) <https://legislature.vermont.gov/Documents/2018/Docs/BILLS/H-0710/H-0710%20As%20Introduced.pdf> (on file with the *University of the Pacific Law Review*).

68. *Id.* (emphasis added).

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

1970s, distributors now wield all the power in the beer market while craft brewers have next to none. Accordingly, the time has come to abandon legislative gifts that distributors typically enjoy, such as transfer protections, termination protections, and exclusivity to promote a healthy market where craft brewers do not have to beg and plead for shelf placement. Unless states change their schema, craft brewers will not survive the great distributor consolidation of the early 2020s.

