

## The Antitrust Roadblock: Preventing Consolidation of the Craft Beer Market

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## I. INTRODUCTION

Wicked Weed Brewing Company opened its doors in 2012 to a thriving North Carolina craft beer scene, and it grew like a weed.<sup>1</sup> In 2014, Wicked Weed introduced the Funkatorium—a popular taproom and barrel-aging facility.<sup>2</sup> The following year, the brewery opened a third production facility, which included a 40,000 square foot, 50-barrel brewhouse.<sup>3</sup> To put that number into perspective, this facility alone is capable of brewing 1,550 gallons of beer in a single batch.<sup>4</sup> Then in 2016, Wicked Weed opened a 57,000 square foot brewery and barrelhouse built on 17 acres; the company’s largest facility.<sup>5</sup> After opening four production facilities in less than five years, the brewery employed over 200 workers<sup>6</sup> and produced over 150 unique beers a year.<sup>7</sup> Wicked Weed’s creations have won numerous awards in notable tasting competitions,<sup>8</sup> and the brewery itself won the title of best craft brewery in North Carolina and in the 17-state South.<sup>9</sup>

In May 2017, Wicked Weed announced what it called a “strategic partnership” with The High End, a division of the Belgian beer giant Anheuser-Busch InBev (“AB InBev”).<sup>10</sup> In other words, “Wicked Weed sold out to a Big Brewery.”<sup>11</sup>

Why would a wildly successful craft brewery decide to sell to a large corporation?<sup>12</sup> Looking at the beer industry as a whole, the trend is not an uncommon one.<sup>13</sup> In fact, by 2018 Wicked Weed was the tenth craft brewery

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1. Press Release, Anheuser-Busch, Wicked Weed Brings Flavor and Funk to the High End (May 3, 2017), <http://www.anheuser-busch.com/newsroom/2017/05/wicked-weed.html> (on file with *The University of the Pacific Law Review*).

2. Jane Lothrop, *Wicked Weed to Build Fourth Production Facility*, BREWBOUND (Mar. 17, 2016, 11:09 AM), <https://www.brewbound.com/news/wicked-weed-to-build-fourth-production-facility> (on file with *The University of the Pacific Law Review*).

3. *Id.*

4. *See Defining a Brewery by Barrels*, KALISPELL BREWING CO., <http://kalispellbrewing.com/wp/definining-a-brewery-by-barrels/> (last visited Apr. 5, 2018) (on file with *The University of the Pacific Law Review*) (explaining one barrel contains 31 gallons of beer).

5. Lothrop, *supra* note 2.

6. Travis M. Andrews, *‘Treachery’: Craft Brewery Wicked Weed Enrages Fans by Partnering with Big Beer*, CHI. TRIB. (May 5, 2017, 11:38 PM), <http://www.chicagotribune.com/business/ct-wicked-weed-inbev-backlash-20170505-story.html> (on file with *The University of the Pacific Law Review*).

7. Chris Furnari, *Anheuser-Busch to Purchase Wicked Weed Brewing*, BREWBOUND (May 3, 2017, 9:35 AM), <https://www.brewbound.com/news/anheuser-busch-purchase-wicked-weed-brewing> (on file with *The University of the Pacific Law Review*).

8. *Id.*

9. Andrews, *supra* note 6.

10. *Id.*

11. *Id.*

12. *See id.* (explaining Wicked Weed’s rapid success and subsequent sale).

13. Matt Allyn, *Is That Really Craft Beer? 33 Surprising Corporate Brewers*, MEN’S JOURNAL, <http://www.mensjournal.com/food-drink/drinks/is-that-really-craft-beer-21-surprising-corporate-brewers->

acquired by AB InBev since 2011.<sup>14</sup> Other notable transactions include Big Beer conglomerate Constellation Brands' 2015 acquisition of Ballast Point Brewing Company for the eye-popping price tag of one-billion dollars,<sup>15</sup> and Lagunitas Brewing Company's 2015 sale of half of its ownership interest to Dutch brewer Heineken.<sup>16</sup> Then in May 2017, coinciding with the Wicked Weed-AB InBev transaction, Heineken bought Lagunitas' remaining interest to take 100% ownership of the company.<sup>17</sup> These horizontal transactions, where one brewery purchases interest in another brewery, are part of the recent consolidation of the beer market.<sup>18</sup>

With the assistance of the alcohol industry's legal framework, Big Beer is smothering its craft brewery competitors.<sup>19</sup> The United States' legal system for alcohol distribution, commonly called the "three-tier system," and beer franchise laws are antiquated and allow Big Beer to influence marketplace access.<sup>20</sup> Unfortunately, the three-tier system often places craft breweries at a disadvantage because small breweries lack the resources of their larger counterparts.<sup>21</sup> As noted by associates of craft breweries whom have chosen to partner with Big Beer, successful craft breweries looking to grow and expand to other geographic markets effectively have only one option—join Big Beer.<sup>22</sup> The obvious route, selling ownership interests to Big Beer, provides craft breweries with the resources they need to grow, such as access to ingredients, equipment, and a wider distribution area.<sup>23</sup> While these partnerships may be beneficial for the handful of

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20150923 (last visited Apr. 13, 2018) (on file with *The University of the Pacific Law Review*) (listing 33 popular craft brewery mergers and acquisitions by Big Beer companies).

14. Furnari, *supra* note 7 (providing the other AB InBev craft beer acquisitions are Goose Island, Blue Point, Brewing, 10 Barrel Brewing, Elysian Brewing, Golden Road, Breckenridge Brewery, Four Peaks Brewing, Devil's Backbone, and Karbach Brewing).

15. Peter Rowe, *Ballast Point to be Sold to N.Y. Corporation for \$1B*, SAN DIEGO UNION TRIB. (Nov. 16, 2015, 8:51 AM), <http://www.sandiegouniontribune.com/entertainment/beer/sdut-ballast-point-sold-corona-constellation-brands-2015nov16-story.html> (on file with *The University of the Pacific Law Review*).

16. *Id.*

17. *Id.*

18. PHILIP H. HOWARD, TOO BIG TO ALE? GLOBALIZATION AND CONSOLIDATION IN THE BEER INDUSTRY 1 (2013), available at <https://ssrn.com/abstract=2268705> (on file with *The University of the Pacific Law Review*) (explaining that Big Beer has grown from less than 50% of total sales in 2005 to over 70% in 2012).

19. Michael Kiser, *Critical Drinking—On Breaking Up “Ma Beer” and The Three Tier*, GOOD BEER HUNTING (Aug. 31, 2017), <http://goodbeerhunting.com/blog/2017/8/30/critical-drinking-breaking-up-ma-beer-and-the-three-tier> (on file with *The University of the Pacific Law Review*).

20. *Id.*

21. Marc Sorini, *Understanding the Three-Tier System: Its Impacts on U.S. Craft Beer and You*, CRAFT BEER.COM (Mar. 6, 2017), <https://www.craftbeer.com/craft-beer-muses/three-tier-system-impacts-craft-beer> (on file with *The University of the Pacific Law Review*).

22. Kate Taylor, *People Are Furious That This Craft Brewer ‘Sold Out’ to Anheuser Busch—Here’s Why the Founders Say They’re Wrong*, BUSINESS INSIDER (May 3, 2017, 5:03 PM), <http://www.businessinsider.com/wicked-weed-founders-take-on-sell-out-criticism-2017-5> (on file with *The University of the Pacific Law Review*) (explaining from the owners' perspective that the transaction was an opportunity for growth of craft beer, not inhibition).

23. *Id.*

Big Beer-owned craft breweries, they come to the market at the cost of fair competition, consumer choice, and product variety.<sup>24</sup>

To improve competition and promote variety in the marketplace, regulators must amend the existing alcohol regulatory system to match the current market.<sup>25</sup> Although three-tier distribution is an imperfect legal system, it is a necessary regulation and safeguards against legitimate competition concerns, namely a complete Big Beer takeover.<sup>26</sup> To solve the issue of large-scale market consolidation, craft brewers should first look to the federal government to help protect the craft beer industry by closely scrutinizing horizontal transactions under an antitrust analysis.<sup>27</sup> After reducing market consolidation, regulations should focus on creating a true independent distribution tier<sup>28</sup> and reconsidering current beer franchise laws.<sup>29</sup>

Part II of this Comment attempts to define “craft” beer and the values of the culture that are threatened by market consolidation.<sup>30</sup> Part III reviews the history behind regulations in the beer market, and the development of the three-tier alcohol distribution system and beer franchise laws.<sup>31</sup> Part IV examines how current regulations affect the craft beer industry and shape the relationships between the tiers.<sup>32</sup> In light of the growing concerns of a monopoly on the craft beer market, Part V discusses antitrust actions in the craft beer industry and how scrutinizing future brewery acquisitions under an antitrust analysis will help protect the market.<sup>33</sup> Part VI then suggests further changes to alcohol regulation that will prevent consolidation and promote variety and consumer choice.<sup>34</sup>

## II. THE CRAFT BEER MARKET

The Brewer’s Association defines craft breweries as “small, independent and traditional.”<sup>35</sup> “Small” means that the brewery produces less than six million barrels of beer annually.<sup>36</sup> “Independent” refers to the restriction that a craft

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24. Dan Croxall, *Let’s Make Sure We Are Talking About the Same Things: Tied-House Laws the Three-Tier System*, CRAFT BEER L. PROF. (Feb. 6, 2017), <https://www.craftbeerprofessor.com/2017/02/lets-make-sure-talking-things-tied-house-laws-three-tier-system/> (on file with *The University of the Pacific Law Review*).

25. See *id.* (explaining that without laws, the market would unfavorably benefit large corporations).

26. Kiser, *supra* note 19.

27. *Infra* Part V.

28. *Infra* Part VI.A.

29. *Infra* Part VI.B.

30. *Infra* Part II.

31. *Infra* Part III.

32. *Infra* Part IV.

33. *Infra* Part V.

34. *Infra* Part VI.

35. CANDACE L. MOON & STACY ALLURA HOSTETTER, *BREW LAW 101: A LEGAL GUIDE TO OPENING A BREWERY—CALIFORNIA EDITION 1* (Paula L. Fleming & Doug McNair eds., 2015).

36. *Id.*

brewery may not have greater than 25% ownership by another industry member.<sup>37</sup> “Traditional” means that breweries produce the majority of their beer from traditional ingredients.<sup>38</sup> While the Brewer’s Association has set forth a technical definition, the hallmark of craft beer is the culture of innovation, collaboration, and community.<sup>39</sup>

The craft beer culture is the foundation of the industry, and the values that craft beer embodies are important to both the industry and its patrons.<sup>40</sup> AB InBev’s acquisition of Wicked Weed garnered widespread notoriety and disdain because the large corporation’s values run counter to the craft culture.<sup>41</sup> Many, both inside and outside of the craft beer industry, wrote articles criticizing the transaction and questioning what it meant for the craft beer market.<sup>42</sup> As a testament to this disapproval, over 50 of the 70 craft breweries scheduled to attend Wicked Weed’s annual Funkatorium Invitational tasting competition withdrew, forcing Wicked Weed to postpone the competition indefinitely.<sup>43</sup>

From 2015 to 2016, the number of craft breweries in the United States increased by over 16% to an all-time high of 5,234.<sup>44</sup> Craft breweries’ total dollar share of the domestic beer market, at just under 22%, was also at an all-time high at the close of 2016—and Big Beer noticed.<sup>45</sup> The five largest brewers in America account for nearly 80% of the market share, and Big Beer companies are actively looking to become more involved in the craft beer sector.<sup>46</sup> Anheuser-Busch alone possesses a domestic market share of over 40 percent.<sup>47</sup> The backlash from the Wicked Weed acquisition demonstrates that people are beginning to notice Big

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37. *Id.*

38. *Id.* at 2 (listing the four traditional ingredients of beer are water, hops, malt, and yeast).

39. *Id.*

40. *Id.*

41. Carol Viau, *AB InBev Scoops Up Asheville’s Wicked Weed: Purchase Leaves Craft Beer Lovers in Dismay*, THE MOUNTAINEER (May 7, 2017), [https://www.themountaineer.com/news/business/ab-inbev-scoops-up-asheville-s-wicked-weed/article\\_a4bb06a8-336b-11e7-9644-5b594557e797.html](https://www.themountaineer.com/news/business/ab-inbev-scoops-up-asheville-s-wicked-weed/article_a4bb06a8-336b-11e7-9644-5b594557e797.html) (on file with *The University of the Pacific Law Review*).

42. Compare *id.*, with Taylor, *supra* note 22 (explaining a selling brewery owner’s response to social backlash).

43. Press Release, Funkatorium Invitational (May 9, 2017), <https://www.wickedweedbrewing.com/funkatorium-invitational-update/> (on file with *The University of the Pacific Law Review*).

44. Press Release, Brewer’s Association, Steady Growth for Small and Independent Brewers (Mar. 28, 2017), <https://www.brewersassociation.org/press-releases/2016-growth-small-independent-brewers/> (on file with *The University of the Pacific Law Review*).

45. *Id.*

46. Alastair Bland, *Craft Beer, Brought to You by Big Beer*, NPR (July 28, 2017, 12:03 PM), <https://www.npr.org/sections/thesalt/2017/07/28/539760477/craft-beer-brought-to-you-by-big-beer> (on file with *The University of the Pacific Law Review*); *Industry Fast Facts*, NAT’L BEER WHOLESALERS ASS’N, <https://www.nbwa.org/resources/industry-fast-facts> (last visited Apr. 8, 2018) (on file with *The University of the Pacific Law Review*).

47. *Industry Fast Facts*, *supra* note 46.

Beer conglomerates' attempts to capitalize on the rising popularity of craft beer.<sup>48</sup>

While no definitive monopoly over the beer market currently exists, many people believe it is a near monopoly, or headed in that direction.<sup>49</sup> One article even goes so far as to dub Big Beer companies "Ma Beer," a nod to the AT&T monopoly over the telecommunications sector popularized as "Ma Bell."<sup>50</sup> "Ma Bell" was later dismantled through antitrust measures, and the article suggests a similar application to Ma Beer.<sup>51</sup> Another news site prefaced its article on the recent consolidation of the beer market with a graphic depicting Monopoly mascot Rich Uncle Pennybags (representing Big Beer) standing on a tap handle holding bags of money with his hat placed on every tap handle.<sup>52</sup> The federal government seems to share the same sentiment; the United States Department of Justice ("DOJ") recently examined Anheuser-Busch's motives in light of their merger with SABMiller, the company that brews Coors.<sup>53</sup> The DOJ required notice of and promised to scrutinize any future Anheuser-Busch craft brewery acquisitions.<sup>54</sup>

Although the craft beer market has continued to grow, the trend towards consolidation and monopolization of the market threatens craft breweries and the craft beer culture.<sup>55</sup>

### III. THE REGULATION OF ALCOHOL

The current landscape for alcohol regulation began forming with the passage of the Twenty-First Amendment to the United States Constitution, which ended Prohibition.<sup>56</sup> The regulations that have formed since Prohibition act together to hinder the growth of the modern craft beer market.<sup>57</sup> Changes in the dominant paradigm over decades of brewing without the equivalent shift in the regulatory framework have resulted in a system where manufacturing rights and relationships

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48. Bland, *supra* note 46 (describing Big Beer's buy-out of craft breweries and squeeze-out of the distribution industry).

49. See generally Kiser, *supra* note 19; Adam Davidson, *Are We in Danger of a Beer Monopoly?*, N.Y. TIMES (Feb. 26, 2013), <http://www.nytimes.com/2013/03/03/magazine/beer-mergers.html> (on file with *The University of the Pacific Law Review*) (discussing the recent trends in the American beer market towards a monopoly).

50. Kiser, *supra* note 19.

51. *Id.*

52. Dave Infante, *The Great Craft Beer Sellout*, THRILLIST (Oct. 13, 2016), <https://www.thrillist.com/drink/nation/craft-breweries-selling-out-big-beer-companies> (on file with *The University of the Pacific Law Review*).

53. Diane Bartz, *Exclusive, U.S. Queries AB InBev On Distribution Incentives and Merger Probe*, REUTERS (May 24, 2016, 10:07 PM), <http://www.reuters.com/article/us-a-b-i-craftbeers-probe-exclusive/exclusive-u-s-queries-ab-inbev-on-distribution-incentives-amid-merger-probe-idUSKCN0YG0EG> (on file with *The University of the Pacific Law Review*).

54. Kiser, *supra* note 19.

55. Brian D. Anhalt, *Crafting a Model State Law for Today's Beer Industry*, 21 ROGER WILLIAMS U. L. REV. 162, 190 (2016).

56. U.S. CONST. amend. XXI.

57. Kiser, *supra* note 19.

are used to stifle and overpower craft breweries.<sup>58</sup> Section A explains the history behind alcohol regulation that led to the dominant three-tier distribution system and how it functions today.<sup>59</sup> Section B details the history of the enactment of beer franchise laws and their effect on the beer industry.<sup>60</sup>

#### *A. The Three-Tiered Distribution System*

Subsection 1 describes the origins and implementation of the three-tier system.<sup>61</sup> Subsection 2 elaborates on the role of each of the tiers in the system.<sup>62</sup>

##### *1. Roots of the Three-Tier System*

The Eighteenth Amendment, which instituted Prohibition, was rooted in the temperance movement.<sup>63</sup> The temperance movement sought to legally limit or proscribe alcohol consumption based on the idea that alcohol “spawned a multitude of social, political, and economic evils.”<sup>64</sup> The movement particularly targeted tied-houses, a common distribution scheme of the pre-Prohibition era.<sup>65</sup>

“Tied-house” is the term for a retailer that is controlled by an alcohol manufacturer, either through direct ownership or exclusive contract agreements.<sup>66</sup> The tied-house system led to a distribution structure where the producer controlled both the production and sale of beer, which resulted in numerous bars, each exclusively serving only the controlling producer’s alcohol.<sup>67</sup> These bars and pubs competed for business by lowering prices and offering other incentives to drink at their bars, which promoted a culture of overconsumption.<sup>68</sup> In 1920, the Prohibition banned the production and sale of alcohol in the United States, and tied-houses faded.<sup>69</sup>

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58. *Id.*

59. *Infra* Part III.A.

60. *Infra* Part III.B.

61. *Infra* Part III.A.1.

62. *Infra* Part III.A.2.

63. GARRETT PECK, *THE PROHIBITION HANGOVER: ALCOHOL IN AMERICA FROM DEMON RUM TO CULT CABERNET 9* (2009).

64. DAVID E. KYVIG, *REPEALING NATIONAL PROHIBITION 8* (2d ed. 2000).

65. Ryan R. Lee, *Prohibition’s Hangover: How Antiquated Illinois Beer-Law is Abused by Big Beer to the Substantial Detriment of Craft Breweries*, 37 N. ILL. U. L. REV. 144, 149–50 (2016).

66. Tim Heffernan, *Last Call: Industry Giants Are Threatening to Swallow up America’s Carefully Regulated Alcohol Industry, and Remake America in the Image of Booze-Soaked Britain*, WASH. MONTHLY (Nov. 2012), <https://washingtonmonthly.com/magazine/novdec-2012/last-call/> (on file with *The University of the Pacific Law Review*).

67. *Id.*

68. *See id.* (explaining that some bars would also offer gambling or prostitution as an incentive to attract customers).

69. U.S. CONST. amend. XVIII, *repealed* by U.S. CONST. amend. XXI; Lee, *supra* note 65, at 150.

After a tumultuous few years where alcohol was prohibited but remained prevalent in society,<sup>70</sup> the ratification of the Twenty-First Amendment in 1933 ended the Prohibition.<sup>71</sup> Although the Prohibition was largely unsuccessful, some semblance of the temperance movement remained, and Congress sought to avoid the under-regulated and profit-driven system that led to the Prohibition.<sup>72</sup>

The first section of the Twenty-First Amendment repealed the Prohibition, while the second banned “[t]he transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof.”<sup>73</sup> The second section allotted states the power to regulate the transportation, importation, and use of alcohol.<sup>74</sup> To avoid returning to the pre-Prohibition system, the federal government and every state has passed some variation of a tied-house law that prohibits common ownership interest between brewers and retailers.<sup>75</sup> The majority of states have opted for the strongest protection against tied-houses by adopting the three-tier distribution system.<sup>76</sup>

## 2. The Three Tiers

In its pure form, three-tier distribution is the ultimate separation of the retailer from the producer.<sup>77</sup> The three-tier system separates the alcohol market into three distinct categories, or “tiers”: producers, wholesalers, and retailers.<sup>78</sup> As producers, brewers may only manufacture and package their beers.<sup>79</sup> Wholesalers are the distributors who contract with producers to sell their products to retailers.<sup>80</sup> Retailers then sell the products to consumers.<sup>81</sup> Instituting the distributors as an independent middleman either limits or eliminates the producers’ involvement and interest in retailers, and severely curtails the ability of brewers to assist or incentivize the lower two-tiers.<sup>82</sup> The strict separation of the three tiers helps avoid

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70. PECK, *supra* note 63, at 13–14 (explaining that Americans continued to drink alcohol after the 18th Amendment, and Prohibition gave rise to organized crime in order to supply that alcohol).

71. U.S. CONST. amend. XXI, § 1.

72. Andrew D’Aversa, *Brewing Better Law: Two Proposals to Encourage Innovation in America’s Craft Beer Industry*, 165 U. PA. L. REV. 1465, 1473 (2017).

73. U.S. CONST. amend. XXI, § 2.

74. *Granholt v. Heald*, 544 U.S. 460, 484 (2005) (“The aim of the Twenty-First Amendment was to allow States to maintain an effective and uniform system for controlling liquor by regulating its transportation, importation, and use.”).

75. Justin M. Welch, *The Inevitability of the Brewpub: Legal Avenues for Expanding Distribution Capabilities*, 16 REV. LITIG. 173, 178 (1997).

76. D’Aversa, *supra* note 72.

77. *Id.* at 1475.

78. Sorini, *supra* note 21.

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*



overconsumption and other tied-house evils of the pre-Prohibition paradigm.<sup>83</sup>

### *B. Beer Franchise Laws*

Beer franchise laws that act in concert with the three-tier distribution system are key developments that have created a lasting impact on the craft beer industry.<sup>84</sup> Franchise laws regulate the contractual relationship between the distribution and production tiers.<sup>85</sup> Like the three-tier distribution system, beer franchise laws require some historical context to understand their role in the craft beer industry.<sup>86</sup>

In the 1970s, state legislatures created beer franchise statutes to compensate for an imbalance in bargaining power when the market was dominated by a handful of large breweries interacting with numerous small distributors.<sup>87</sup> States designed these statutes for a national market with less than 50 brewers and over 5,000 distributors,<sup>88</sup> in stark contrast to the over 8,000 permitted brewers in the beer market today.<sup>89</sup> At the time, many small distributors carried only one brand of beer, and the dynamic resulted in a large power imbalance where the small wholesalers were at the mercy of the producer.<sup>90</sup> Breweries were much larger and had more resources than distributors, which granted producers the power to choose from the many small distributors.<sup>91</sup> This dynamic gave producers much influence over distribution contracts and franchise negotiations.<sup>92</sup> The franchise laws statutorily provided contractual protections for the distribution tier against the brewers.<sup>93</sup>

To state it simply, franchise laws are “regulations about what you can and cannot contract with distributors about.”<sup>94</sup> Franchise laws dictate contractual terms of distribution agreements and may not be drafted around by parties to the contract.<sup>95</sup> The typical franchise law provides several contractual protections to cure the perceived bargaining power imbalance.<sup>96</sup> Common franchise law

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83. *Id.*

84. Anhalt, *supra* note 55, at 163.

85. *Id.* at 163–64.

86. *See id.* at 164 (explaining that beer franchise statutes were enacted to solve the particular issue of imbalance of bargaining power at the time).

87. *Id.* at 174.

88. Steve Hindy, *Free Craft Beer!*, N.Y. TIMES (Mar. 29, 2014), [https://www.nytimes.com/2014/03/30/opinion/sunday/free-craft-beer.html?\\_r=1](https://www.nytimes.com/2014/03/30/opinion/sunday/free-craft-beer.html?_r=1) (on file with *The University of the Pacific Law Review*).

89. *See Industry Fast Facts*, *supra* note 46 (reporting data on the total number of breweries permitted by the U.S. Alcohol and Tobacco Tax and Trade Bureau, not solely craft brewers).

90. Hindy, *supra* note 88.

91. Anhalt, *supra* note 55, at 174.

92. *Id.*

93. *Id.* at 164.

94. MOON & HOSTETTER, *supra* note 35, at 166.

95. MARC E. SORINI, BEER FRANCHISE LAW SUMMARY (2014), available at <https://s3-us-west-2.amazonaws.com/brewersassoc/wp-content/uploads/2017/04/Beer-Franchise-Law-Summary.pdf> (on file with *The University of the Pacific Law Review*).

96. *Id.*

protections include: termination protections, transfer protections, territorial protections, and procedural protections and remedies.<sup>97</sup>

Termination protections may greatly limit a brewer's ability to terminate contracts with a distributor.<sup>98</sup> Some common termination protections include strict definitions of "good cause" termination, notice and cure provisions,<sup>99</sup> and limiting a brewery's ability not to renew a distribution contract.<sup>100</sup> Transfer protections limit a brewer's ability to prevent a distributor from transferring their distribution rights to another distribution company.<sup>101</sup> While most states either allow or require distributors to notify brewers of a change of distribution rights, brewers are often subject to clauses where ownership change cannot be "unreasonably" withheld, giving brewers few rights to halt a transfer.<sup>102</sup> Territorial protections mandate exclusive distribution territories for wholesalers<sup>103</sup> where other wholesalers are not allowed to distribute the same brands.<sup>104</sup> Damages and procedural protections also protect distributors in the event of litigation or other conflicts.<sup>105</sup> Among these protections are fee-shifting statutes to the prevailing party and "reasonable compensation" provisions that provide for a distributor's compensation, even for good cause termination.<sup>106</sup> As further discussed below,<sup>107</sup> these protections for distributors make it very difficult for brewers to terminate or amend distribution contracts, which can lead to disastrous consequences for breweries.<sup>108</sup>

#### IV. EFFECTS OF CURRENT REGULATION

Three-tier distribution and beer franchise laws are the mainstays of beer industry regulation.<sup>109</sup> In light of its historical origins, the current regulatory scheme is a well-intentioned and relatively successful mechanism for achieving post-Prohibition goals, such as preventing tied houses.<sup>110</sup> However, the recent

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97. Anhalt, *supra* note 55, at 170.

98. MOON & HOSTETTER, *supra* note 35, at 167 (explaining that statutory termination protections may set an "impractically high bar" for terminating a distribution agreement).

99. BEER FRANCHISE LAW SUMMARY, *supra* note 95.

100. Anhalt, *supra* note 55, at 175.

101. BEER FRANCHISE LAW SUMMARY, *supra* note 95.

102. *Id.*

103. *Id.*

104. Barry Kurtz & Bryan H. Clements, *Beer Distribution Law as Compared to Traditional Franchise Law*, 33 FRANCHISE L. J. 397, 402 (2014).

105. BEER FRANCHISE LAW SUMMARY, *supra* note 95.

106. Anhalt, *supra* note 55, at 179.

107. *Infra* Part IV.C.

108. D'Aversa, *supra* note 72, at 1473.

109. *See id.* at 1475–76 (listing three-tier laws and franchise laws as two major regulations in the current alcohol industry).

110. Dan Croxall, *Ever Played Jenga? Too Many Exceptions to Tied-House Laws Render the Whole System Vulnerable*, CRAFT BEER L. PROF (Feb. 9, 2017), <https://www.craftbeerprofessor.com/2017/02/ever-played-jenga-many-exceptions-tied-house-laws-render-whole-system-vulnerable/> (on file with *The University of the*

growth of the craft beer sector has changed the dynamic of the market and we are seeing that the regulations formed since Prohibition hinder rather than help the growth of modern craft breweries.<sup>111</sup> A shift in the dominant paradigm from *brewers* in power to *distributors* in power, without the equivalent shift in the regulatory framework, has resulted in a system where distribution rights are being used to stifle and overpower craft breweries.<sup>112</sup>

Section A delineates the benefits of the existing alcohol regulatory system that protects competition.<sup>113</sup> Section B analyzes the negative ways in which the regulations can combine to inhibit growth and competition in the industry.<sup>114</sup> Section C explores the modern power imbalance in the relationships between the three tiers as a result of the current regulatory system.<sup>115</sup>

#### *A. Protecting Competition in the Market*

While this Comment is written to address the obstacles that the current regulatory scheme imposes on craft beer, there are still components of the existing regulations that aid in preventing horizontal and vertical integration and promoting variety and competition.<sup>116</sup> The three-tier distribution system has succeeded in preventing the pre-Prohibition tied-house evils by prohibiting manufacturers from owning distributors or retailers.<sup>117</sup> There are also other practical advantages to separating the three tiers.<sup>118</sup> Separating production and distribution allows for a more economically efficient system where each tier focuses on their own business goals.<sup>119</sup> Many craft brewers are small and lack the financial ability to distribute their own product, and distribution companies offer the resources of warehousing and trucks for shipping.<sup>120</sup> This, in turn, allows the brewers to focus on brewing and the wholesalers to focus on distributing.<sup>121</sup> Dedicating resources to one task also allows small craft brewers to reach a larger consumer pool than would otherwise be available through their own independent distribution companies.<sup>122</sup> The three-tier system has practical advantages on the retail and consumer end as

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*Pacific Law Review*).

111. Kiser, *supra* note 19.

112. *Id.*

113. *Infra* Part IV.A.

114. *Infra* Part IV.B.

115. *Infra* Part IV.C.

116. *Let's Make Sure We Are Talking About the Same Things*, *supra* note 24.

117. PECK, *supra* note 63, at 11.

118. Sorini, *supra* note 21.

119. *Id.*

120. *Id.*

121. *Id.*

122. *See id.* (“In a world without independent distributors, small brewers would mostly be limited to distributing in a very limited geographic area.”).

well.<sup>123</sup> Because of a distributor's capacity to market multiple brands, retailers can meet their demands by dealing with a few distributors that carry a wide variety of products, rather than dealing with each individual manufacturer.<sup>124</sup>

Beer franchise laws also provide benefits to the beer industry.<sup>125</sup> The contractual protections franchise laws provide ensure that distributors are independent and (mostly) free from brewer coercion and undue influence.<sup>126</sup> This is particularly important to small independent craft brewers because distributors often carry multiple brands.<sup>127</sup> Franchises are another restraint on Big Beer that allow distributors to make the necessary investments to allow craft brands to expand in the market.<sup>128</sup> A further upshot is that investment in craft brands is both beneficial for brewers and independent distributors because a new and bigger market for a beer means business for both the brewer and distributor.<sup>129</sup>

To summarize, the three-tier system and franchise laws provide for a middleman—the independent distributor.<sup>130</sup> Independent distributors promote temperance, allow brewers to focus on brewing while reaching a larger consumer market, and offer retailers a larger selection of beer.<sup>131</sup>

### B. Inhibiting Craft Brewery Growth

Though there are proven upsides to the current regulatory system, it is also the source of much frustration for craft breweries.<sup>132</sup> First and foremost, the existing system creates barriers to entry that make it difficult for craft breweries to establish a place in the market.<sup>133</sup> Although distributors provide investment to small craft breweries, it may still be difficult for a new brewer to secure a distribution contract because small and new brands do not have much value to distributors.<sup>134</sup> The lack of brand recognition may make it more difficult for a distributor to sell the product,

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123. *Id.*

124. *Id.*

125. *Benefits of Beer Franchise Laws*, NAT'L BEER WHOLESALERS ASS'N, <https://www.nbwa.org/government/benefits-of-beer-franchise-laws> (last visited Jan. 6, 2018) (on file with *The University of the Pacific Law Review*).

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. Sorini, *supra* note 21.

132. *Id.*

133. See Mike Reis, *Beer Issues: What's Up With the Three-Tier System?*, SERIOUSEATS, <http://drinks.seriousseats.com/2014/01/craft-beer-three-tier-system-pros-cons-distributor-retailer-debate.html> (last visited Jan. 7, 2017) (on file with *The University of the Pacific Law Review*) (explaining that the three-tier system has many negative effects with a disproportionate effect on small craft brewers).

134. David R. Scott, *Brewing Up a New Century of Beer: How North Carolina Laws Stifle Competition in the Beer Industry and How They Should Be Changed*, 3 WAKE FOREST J. L. & POL'Y 417, 427–28 (2013).

and thus distributors may be unwilling to carry new brands.<sup>135</sup> Importantly, distributors also require payment for the products they deliver, and small craft brewers may lack the financial resources to both operate a production facility and pay for distribution.<sup>136</sup> A brewery's inability to find an agreeable distribution contract can have dire consequences because the three-tier system was designed to prevent breweries from distributing their own product, with few exceptions.<sup>137</sup> With the current distribution scheme, it is easy for the existing laws to stifle growth and competition in the craft beer industry.<sup>138</sup>

While the independence of the distribution tier is the cornerstone of this regulatory system, it may also cause problems.<sup>139</sup> Because distributors are separate entities, many business decisions concerning products are left to the discretion of the distributor, if not provided for in the distribution agreement.<sup>140</sup> These include decisions like advertising<sup>141</sup> and shipping schedules.<sup>142</sup> While shipping times are seemingly inconsequential, freshness is an important aspect to many craft beers, and distributors delivering beers after their freshness date is a common issue.<sup>143</sup>

Brewers have also criticized distributors for the lack of transparency in their relationships with other brewery clients.<sup>144</sup> Another pertinent business decision distributors may make without interference or oversight is the other client-breweries that the company decides to associate with.<sup>145</sup> While ownership interests between the tiers are technically illegal, methods exist for brewers to assist or incentivize distributors who prioritize that brewer's product.<sup>146</sup> A problem arises in this scenario because franchise laws make it very difficult for a brewery to leave or break a contract with a distributor who treats it unfairly.<sup>147</sup> To compound the problem, the territorial exclusivity protection that franchise law provides distributors makes it so that the contracted distributor is the only company with the rights to distribute the beer.<sup>148</sup> In the end, a brewery may be stuck with an underperforming distributor because the distributor's rights to the beer effectively

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135. *Id.*

136. *Id.* at 427.

137. Reis, *supra* note 133.

138. *Infra* Part IV.C (explaining how the regulations can have negative effects on the relationships between tiers).

139. See Reis, *supra* note 133 (listing the "Cons" of the three-tier system).

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.*

144. *BA Position Statements: Transparency in Brewer-Distributor Relationships*, BREWERS ASS'N, <https://www.brewersassociation.org/government-affairs/ba-position-statements/> (last visited Jan. 5, 2017) (on file with *The University of the Pacific Law Review*).

145. *Id.*

146. Bartz, *supra* note 53.

147. Reis, *supra* note 133.

148. *Id.*

block a brewery from contracting with another distributor.<sup>149</sup>

The current alcohol regulatory system is a source of consternation for small breweries that can either inhibit them from entering the market and expanding, or otherwise trample their rights in the unfortunate event they contract with an inadequate distributor.<sup>150</sup>

### C. The Struggle of Unequal Bargaining Power

In today's market, Big Beer is trying to cash in by riding the wake of the craft beer explosion.<sup>151</sup> On top of craft brewery acquisitions, Big Beer is using any advantage it can to profit on the thriving craft beer industry.<sup>152</sup> Their tactics include abusing the regulatory system to exploit its weaknesses.<sup>153</sup>

Examples of Big Beer's abuse of the laws are AB InBev's ownership of its own distribution branch and its incentive program for "independent" distributors.<sup>154</sup> AB InBev's distributors are contractually obligated to spend a specified amount on advertising AB InBev products each year.<sup>155</sup> The announced incentive program refunds 75% of the distributor's advertising costs if AB InBev beers make up at least 98% of the distributor's sales.<sup>156</sup> This program is legal under the current system, but creates an enticement to promote AB InBev beers to the exclusion of other craft brands.<sup>157</sup>

Among other things, AB InBev has a history of using its own advertisements to target craft brewers; ranging from its 1997 assault on Boston Beer Company of Sam Adams fame,<sup>158</sup> to Super Bowl ads in both 2015 and 2016 mocking the craft beer culture as a whole.<sup>159</sup> Needless to say, Big Beer companies do not care about the facets of craft beer that craft drinkers do: flavor, diversity, and community.<sup>160</sup> In the words of Tom McCormick, the Executive Director of the California Craft

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149. *Id.*

150. *See id.* (listing the difficulties three tier imposes on small breweries).

151. Randall Benton, *As Craft Beer Flourishes, Big Beer Continues to Buy in and Blur the Lines*, SAC. BEE (Dec. 2, 2016 8:00 AM), [www.sacbee.com/food-drink/beer/article118258943.html](http://www.sacbee.com/food-drink/beer/article118258943.html) (on file with *The University of the Pacific Law Review*).

152. *Id.*

153. *See* Bartz, *supra* note 53 (explaining that AB InBev used a distributor incentive program to bypass the prohibition of breweries owning interests in distributors).

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. Elizabeth Flock, *Hopslam: How Big Beer Is Trying to Stop a Craft Beer Revolution*, U.S. NEWS (Feb. 8, 2013, 2:49 PM), <https://www.usnews.com/news/articles/2013/02/08/hopslam-how-big-beer-is-trying-to-stop-a-craft-beer-revolution> (on file with *The University of the Pacific Law Review*).

159. Brad Tuttle, *Budweiser Doubles Down by Mocking Craft Beer Again in Super Bowl Ad*, TIME (Feb. 6, 2016), [time.com/money/4210344/budweiser-super-bowl-50-ad-mock-craft-beer/](http://time.com/money/4210344/budweiser-super-bowl-50-ad-mock-craft-beer/) (on file with *The University of the Pacific Law Review*).

160. Benton, *supra* note 151.

Brewer's Association, Big Beer is now "utilizing nearly all of the tools in their toolbox to capture the craft beer market."<sup>161</sup>

## V. THE ANTITRUST ROADBLOCK

With the recent up-tic in mergers and acquisitions of craft breweries, federal and state governments must take a more aggressive stance to ensure that Big Beer does not consume the remainder of the beer market.<sup>162</sup> First, the federal government—as it suggested it would—should examine Big Beer's mergers and acquisitions under an antitrust lens with regard to anticompetitive effects.<sup>163</sup> Then, states should overhaul the existing system to accommodate the new craft beer industry by creating a truly independent three-tier distribution system and revamping franchise laws to match the current state of the industry.<sup>164</sup>

Section A looks at the application of antitrust law to the beer industry through the lens of past antitrust scrutiny of Big Beer mergers.<sup>165</sup> Section B discusses how future applications of antitrust law could halt consolidation of the beer market.<sup>166</sup>

### A. Antitrust in the Craft Beer Industry

Popular sentiment, as well as statistics, show that the beer industry is on its way to becoming a monopoly.<sup>167</sup> While craft beer put up a valiant effort in 2016 with a total dollar market share of 21.9%,<sup>168</sup> four Big Beer companies comprise nearly 80% of the market.<sup>169</sup> The largest of those companies, AB InBev, is blurring the lines of the three-tier system and flirting with vertical integration by purchasing distributors, and even beer rating websites.<sup>170</sup>

A major sign that antitrust is a plausible tool for defending competition laws

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161. *Id.*

162. See U.S. DEP'T OF JUSTICE, JUSTICE DEPARTMENT REQUIRES ANHEUSER-BUSCH INBEV TO DIVEST STAKE IN MILLERCOORS AND ALTER BEER DISTRIBUTOR PRACTICES AS PART OF SABMILLER ACQUISITION (July 20, 2016), available at <https://www.justice.gov/opa/pr/justice-department-requires-anheuser-busch-inbev-divest-stake-millercoors-and-alter-beer> (on file with *The University of the Pacific Law Review*) (explaining the Federal Government's decision to block a Big Beer acquisition, requiring a divestiture of assets and change in distribution practices).

163. *Id.*

164. *Infra* Part VI (suggesting changes to three-tier and franchise laws).

165. *Infra* Part V.A.

166. *Infra* Part V.B.

167. *Supra* Part II (stating that five Big Beer companies occupy over 80% of the beer market and listing examples of people arguing the industry is becoming monopolized).

168. Press Release, Brewer's Association, *supra* note 44.

169. *Industry Fast Facts*, *supra* note 46.

170. Jeff Spross, *What Beer Reveals About Monopoly Power*, THE WEEK (Nov. 9, 2017), <http://theweek.com/articles/736059/what-beer-reveals-about-monopoly-power> (on file with *The University of the Pacific Law Review*) (explaining how AB InBev used a wholly-owned subsidiary to purchase an interest in popular beer rating website Ratebeer).

in the market is AB InBev's attempted acquisition of Grupo Modelo in 2013.<sup>171</sup> The Justice Department blocked the acquisition by instituting an antitrust lawsuit, citing anti-competitive motives related to price.<sup>172</sup> The DOJ reinforced its openness to antitrust law in protecting the beer market again in 2016 when AB InBev attempted to acquire SABMiller.<sup>173</sup> The DOJ forced AB InBev to, among other things, divest its stake in MillerCoors before the transaction could continue.<sup>174</sup> In a statement following the suit, the DOJ also promised to further scrutinize any future acquisitions by AB InBev.<sup>175</sup> Following the completed transaction, over 90 of the beer market is controlled by AB InBev and MillerCoors in most local markets.<sup>176</sup>

Several key laws empower the federal government to enforce antitrust laws.<sup>177</sup> The Sherman Act comprehensively outlaws monopolization and attempted monopolization; the Federal Trade Commission Act outlaws unfair methods of competition; and the Clayton Act prohibits transactions that may substantially lessen "competition, or tend to create a monopoly."<sup>178</sup> The two antitrust suits mentioned above were filed under the Section 7 of the Clayton Act based on the apparent anticompetitive effects of the mergers.<sup>179</sup>

To halt the further consolidation of the U.S. beer market, the DOJ should review transactions of all Big Beer conglomerates, not just AB InBev, under a strict antitrust analysis.<sup>180</sup> Focusing on the local anticompetitive effects of acquisitions in regional markets would prevent consolidation.<sup>181</sup> Similar to the DOJ's involvement in the AB InBev-SABMiller transaction, focusing on the effects of an acquisition on a regional level can show that the transaction may substantially lessen competition in a given area.<sup>182</sup> This is further evidenced by the over 90% control by Big Beer in some local markets.<sup>183</sup>

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171. Davidson, *supra* note 49.

172. *Id.*

173. U.S. DEP'T OF JUSTICE, *supra* note 162.

174. *Id.*

175. *Id.*

176. Jim Koch, *Is it Last Call for Craft Beer?*, N.Y. TIMES (Apr. 7, 2017), <https://www.nytimes.com/2017/04/07/opinion/is-it-last-call-for-craft-beer.html> (on file with *The University of the Pacific Law Review*).

177. *The Antitrust Laws*, FED. TRADE COMM'N, <https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws> (last visited Jan. 5, 2017) (on file with *The University of the Pacific Law Review*).

178. 15 U.S.C. § 18 (2012).

179. Complaint at 3, U.S. v. Anheuser-Busch InBev SA/NV & SABMiller (D.D.C. July 20, 2016) (No. 1:16-cv-01483) [hereinafter SABMiller Complaint]; Complaint at 5, U.S. v. Anheuser-Busch InBev SA/NV & Grupo Modelo (D.D.C. Jan. 31, 2013) (No. 1:13-cv-00127) [hereinafter Grupo Modelo Complaint].

180. See U.S. DEP'T OF JUSTICE, *supra* note 162 (describing how the DOJ used an antitrust analysis to prevent a complete merger of AB InBev and SABMiller).

181. *Id.* (explaining that the DOJ focused on the AB InBev-SABMiller acquisition's effects on local markets when deciding to block the acquisition).

182. *Id.*

183. SABMiller Complaint, *supra* note 179, at 16.



If the DOJ upholds its promise to further review any of AB InBev's craft brewery acquisitions, it would promote competition and variety in the marketplace.<sup>184</sup> Halting the spread of Big Beer into the craft beer sector would not only allow craft beer to continue to thrive but would afford it the opportunity to grow un-harassed by the pressures of encroaching Big Beer.<sup>185</sup>

Examining the factors the DOJ relied on in its two previous antitrust suits against AB InBev gives insight into how antitrust laws can be used to protect competition in the beer market.<sup>186</sup> In both cases, the DOJ primarily relied on the same factors in deciding whether to initiate litigation because the acquisition would substantially lessen competition.<sup>187</sup> The DOJ cited four negative impacts the proposed acquisition would have on the beer market: price control, concentration of the market, elimination of head-to-head competition, and distribution effects.<sup>188</sup>

### *1. Price Control*

Through a long chain of connected factual findings, the DOJ showed that the merger of Big Beer companies affects the prices of beers both in regional markets and across the nation.<sup>189</sup> Beer is different enough from other types of alcohol that a monopolist in the beer market would be able to raise prices without the risk of losing customers to another alcohol market.<sup>190</sup> Demand in the beer market is also location driven, thus customers are unlikely to venture to other geographical markets due to price hikes.<sup>191</sup>

Furthermore, brewers categorize beers in the market according to price: sub-premium, premium, and high-end.<sup>192</sup> The "high-end" segment generally consists of imported and small craft beers, while other domestic beers make up the lower tiers.<sup>193</sup> Large breweries attempt to maintain price gaps between beers in each tier to limit competition between the segments.<sup>194</sup> It is in this aspect that competition,

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184. U.S. DEP'T OF JUSTICE, *supra* note 162.

185. *See id.* (showing the federal government's willingness to use antitrust measures to prevent anticompetitive conduct by large breweries in the beer market).

186. *See* SABMiller Complaint, *supra* note 179 (using four factors to argue the anticompetitive effects of the mergers are illegal under the Clayton Act); Grupo Modelo Complaint, *supra* note 179 (applying the same four factors).

187. *See generally* SABMiller Complaint, *supra* note 179, at 12–13 (listing the factors the DOJ used in their antitrust analysis of the merger); Grupo Modelo Complaint, *supra* note 179, at 10–11 (same).

188. Competitive Impact Statement at 10, U.S. v. Anheuser-Busch InBev SA/NV & SABMiller (D.D.C. July 20, 2016) (No. 1:16-cv-01483) [hereinafter SABMiller CIS]; Competitive Impact Statement at 1–2, U.S. v. Anheuser-Busch InBev SA/NV & Grupo Modelo (D.D.C. Jan. 31, 2013) (No. 1:13-cv-00127) [hereinafter Grupo Modelo CIS].

189. SABMiller CIS, *supra* note 188, at 7–8; Grupo Modelo CIS, *supra* note 188, at 6–7.

190. SABMiller CIS, *supra* note 188, at 6; Grupo Modelo CIS, *supra* note 188, at 6.

191. SABMiller CIS, *supra* note 188, at 7.

192. *Id.* at 6.

193. SABMiller Complaint, *supra* note 179, at 9; Grupo Modelo Complaint, *supra* note 179, at 9.

194. SABMiller Complaint, *supra* note 179, at 6.

especially from the high-end segment, is an important constraint on market prices.<sup>195</sup>

Big Beer typically employs national pricing strategies and AB InBev, world's largest brewer, leads the way.<sup>196</sup> As the industry leader, AB InBev announces its price increases for the upcoming year using an intentionally transparent plan in attempt to get other competing brands to follow.<sup>197</sup> Notably, MillerCoors, the nation's second-largest brewery, has routinely followed the same plan.<sup>198</sup> As Big Beer companies raise their prices, high-end and craft brewers become a threat through "price gap compression."<sup>199</sup> Because Big Beer deals mostly in the sub-premium and premium tiers, as the price gap between premium and high-end lessens, consumers are more likely to switch to high-end beers.<sup>200</sup> In response to this price constraint, one of AB InBev's stated goals is to "slow the volume trend of High End Segment and [not] let the industry transform."<sup>201</sup>

To summarize the chain of findings, the isolation of regional beer markets from outside competition allows price increases without the loss of business and a high variety of prices between markets.<sup>202</sup> Competition from independent, high-end and craft breweries is one of the few and important restraints on AB InBev's unilateral price-setting power.<sup>203</sup> The DOJ relied on the likely anticompetitive effects and resulting price hike in blocking the AB InBev-SABMiller merger.<sup>204</sup>

## 2. Market Concentration

The DOJ used market concentration as an indicator of "the level of competitive vigor in a market and the likely effects of a merger."<sup>205</sup> It reasoned, "[t]he more concentrated a market, and the more a transaction would increase concentration in a market, the more likely it is that the transaction would result in harm to consumers by meaningfully reducing competition."<sup>206</sup> Under the DOJ's antitrust metrics, the U.S. beer market is considered highly concentrated.<sup>207</sup>

In both of the DOJ's antitrust suits against AB InBev, the agency found that the mergers would significantly increase the concentration in each relevant

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195. *Id.* at 7.

196. Grupo Modelo CIS, *supra* note 188, at 7.

197. SABMiller Complaint, *supra* note 179, at 6.

198. *Id.*

199. Grupo Modelo Complaint, *supra* note 179, at 15.

200. *Id.*

201. *Id.*

202. SABMiller CIS, *supra* note 188, at 7.

203. SABMiller Complaint, *supra* note 179, at 7.

204. *Id.* at 3.

205. *Id.* at 3.

206. *Id.* at 11.

207. *Id.*

regional market.<sup>208</sup> Under the Clayton Act, the mergers and acquisitions were found presumptively anticompetitive based on the existing market concentration and the significant increase in concentration that would follow.<sup>209</sup> Practically speaking, the DOJ examined the business' total post-merger market share to determine the anticompetitive effects and influence on the regional market.<sup>210</sup>

### *3. Elimination of Head-to-Head Competition*

In the Complaints of both antitrust suits, the DOJ reasoned that eliminating head-to-head competition would substantially lessen competition in both national and regional markets, in violation of the Clayton Act.<sup>211</sup> The DOJ's analysis here is similar to that of market concentration, but it examines the actual post-merger effects of consolidation and the elimination of competition,<sup>212</sup> as opposed to merely creating a presumption from statistics.<sup>213</sup> In practice, the consolidation will result in two breweries under the direction of one organization, AB InBev.<sup>214</sup> The DOJ stated the lack of head-to-head competition would negatively impact beer prices, product innovation, and consumer choice.<sup>215</sup>

Where two competing companies existed previously, the common ownership of the two brands will likely result in a unilateral price increase under AB InBev's price control plan.<sup>216</sup> Further, the merger would stifle innovation because AB InBev effectively owns the competing brand and has no incentive to develop a competing product.<sup>217</sup> This is exemplified in the Grupo Modelo suit, where the DOJ concluded that if the merger were to occur, AB InBev would lack the economic motive to develop a competing Mexican-style craft brand.<sup>218</sup> Lastly, less competition and innovation results in a smaller variety of products in the market.<sup>219</sup> Ultimately, the DOJ considered the effects of the impending elimination of head-to-head competition on price, choice, and innovation in instituting the antitrust suits.<sup>220</sup>

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208. *Id.*; Grupo Modelo Complaint, *supra* note 179, at 13.

209. SABMiller Complaint, *supra* note 179, at 11; Grupo Modelo Complaint, *supra* note 179, at 12.

210. SABMiller CIS, *supra* note 188, at 8.

211. SABMiller Complaint, *supra* note 179, at 11; Grupo Modelo Complaint, *supra* note 179, at 18.

212. Grupo Modelo Complaint, *supra* note 179, at 20.

213. *See* SABMiller Complaint, *supra* note 179, at 3 (explaining that a "market concentration" analysis looks at the data on market concentration to predict likely anticompetitive effects if a merger were to happen).

214. SABMiller CIS, *supra* note 188, at 8.

215. Grupo Modelo Complaint, *supra* note 179, at 20.

216. *Id.* at 19.

217. *Id.*

218. *Id.*

219. SABMiller Complaint, *supra* note 179, at 3.

220. *Id.* at 11–12; Grupo Modelo Complaint, *supra* note 179, at 18–19.

#### 4. Limiting Distribution

In the antitrust suit against AB InBev and MillerCoors, the DOJ examined the merger's anticompetitive effect of limiting high-end and craft distribution.<sup>221</sup> In 2014, over 85% of the beer sold in the United States was distributed by a MillerCoors affiliated wholesaler, AB InBev affiliated wholesaler, or a distributor owned by AB InBev.<sup>222</sup> Furthermore, AB InBev has multiple financial incentive programs and contractual provisions meant to promote exclusivity with distributors that sell AB InBev beer.<sup>223</sup> AB InBev beers account for almost 90% of the volume of sales of an affiliated distributor.<sup>224</sup> The remaining sales volume is composed of high-end craft brewers with limited sales and high operating costs.<sup>225</sup>

If AB InBev acquires MillerCoors, it is likely that AB InBev would use the same anticompetitive tactics to promote exclusivity of MillerCoors beer.<sup>226</sup> The two largest brewing companies would promote exclusivity of their brands to the detriment of competing high-end brands.<sup>227</sup> While distribution seems like a topic better left for Congress, the anticompetitive effects of a merger on distribution are but one factor the DOJ considered in bringing the antitrust suit.<sup>228</sup>

#### B. Why Antitrust is a Viable Solution

Both cases mentioned above use nearly identical solutions to prevent the anticompetitive effects of the mergers.<sup>229</sup> The DOJ required the acquiring company to divest assets and ownership interests in portions of the businesses operating in the U.S.<sup>230</sup> The remedy attempts to maintain and encourage competition in the U.S. beer market by ensuring that the divested businesses remain viable competitors in the market.<sup>231</sup> Preserving the independence of breweries promotes competition and acts as an important price constraint on Big Beer.<sup>232</sup> The DOJ also imposed certain conditions on AB InBev's distribution incentives and practices to limit the negative

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221. SABMiller Complaint, *supra* note 179, at 12.

222. SABMiller CIS, *supra* note 188, at 10.

223. SABMiller Complaint, *supra* note 179, at 3.

224. SABMiller CIS, *supra* note 188, at 9.

225. SABMiller Complaint, *supra* note 179, at 7.

226. *Id.* at 3.

227. *Id.* at 12.

228. *Id.* at 12.

229. *See generally* Proposed Final Judgment, U.S. v. Anheuser-Busch InBev SA/NV & SABMiller (D.D.C. July 20, 2016) (No. 1:16-cv-01483) [hereinafter SABMiller Proposed Final Judgment]; Final Judgment, U.S. v. Anheuser-Busch InBev SA/NV & Grupo Modelo (D.D.C. Jan. 31, 2013) (No. 1:13-cv-00127) [hereinafter Grupo Modelo Final Judgment] (using the same four-factored analysis to partially block the Grupo Modelo merger).

230. SABMiller CIS, *supra* note 188, at 2; Grupo Modelo CIS, *supra* note 188, at 2.

231. SABMiller CIS, *supra* note 188, at 16.

232. Grupo Modelo CIS, *supra* note 188, at 10.

impact on high-end beers.<sup>233</sup>

Lastly, the DOJ required AB InBev to provide advanced notice of any plan to acquire a brewer or distributor to the Antitrust Division to determine whether the acquisition is likely to substantially lessen competition.<sup>234</sup> While the two antitrust suits were instigated against Big Beer companies, this provision applies generally to breweries of any size.<sup>235</sup> The lack of limiting language shows that the DOJ is open to performing the antitrust analysis on acquisitions of any size, including craft breweries.<sup>236</sup>

## VI. STATE REGULATIONS

Federal antitrust law is only the first step in preventing market consolidation.<sup>237</sup> States should still overhaul the existing regulatory system to accommodate the new craft beer industry by creating a truly independent three-tier distribution system and revamping franchise laws to match the current state of the industry.<sup>238</sup> Section A discusses the necessity of revising three-tier laws to fit today's market.<sup>239</sup> Section B explores methods of amending franchise laws to fit the modern three-tier model.<sup>240</sup>

### *A. Retain and Adjust the Three-Tier System*

The three-tier distribution system plays a critical role in leveling the playing field for breweries, as well as ensuring that we do not revert back to the old ways of the tier-house.<sup>241</sup> The three-tier distribution system is imperative to protecting the interests of craft beer and promoting variety and competition, while also keeping Big Beer at bay.<sup>242</sup> Nevertheless, the three-tier system should be reconfigured so that the middle tier—distributors—are truly independent.<sup>243</sup>

The current three-tier distribution system allows intermixing of brewers and distributors, which borders on vertical integration.<sup>244</sup> While AB InBev's above

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233. SABMiller CIS, *supra* note 188, at 15.

234. SABMiller Proposed Final Judgment, *supra* note 229, at 28; SABMiller CIS, *supra* note 188, at 25.

235. *Id.*

236. SABMiller Proposed Final Judgment, *supra* note 229, at 28; SABMiller CIS, *supra* note 188, at 25 (qualifying the reporting requirements with numbers, rather than being AB InBev specific).

237. *Infra* Part VI.

238. *Infra* Part VI.A–B.

239. *Infra* Part VI.A.

240. *Infra* Part VI.B.

241. *See* Sorini, *supra* note 21 (discussing the legislative purpose of the three-tier system, as well as its other advantages).

242. *Let's Make Sure We Are Talking About the Same Things*, *supra* note 24.

243. *Compare* Bartz, *supra* note 53 (illustrating how most distributors are aligned with one of two big brewers and legal incentive programs employed by AB InBev affect the independence of distributors).

244. *See* Koch, *supra* note 176 (stating that the current system has allowed 90% of distributors to be

mentioned distributor incentive program<sup>245</sup> was eventually blocked for anticompetitive effects as part of the DOJ's review of the SABMiller acquisition, it is an otherwise legal program.<sup>246</sup> Although the incentive program was prohibited in this instance, the piecemeal review process would be ineffective in catching all instances of this type of incentive conduct.<sup>247</sup>

While the three-tier system is imperative to promoting competition and should not be repealed, states should apply more strict statutes regulating relationships between the three-tiers, especially brewers and distributors.<sup>248</sup> Disallowing any financial interest, either directly or indirectly, would further the goal of having a true independent distributor who is free from coercion by large brewers.<sup>249</sup> The freedom to act independent from coercion or undue influence from large corporate brewers would remove another entrance barrier to the craft beer market and give small breweries the opportunity to expand, with the help of distributors.<sup>250</sup>

### *B. One Size Franchise Law Does Not Fit All*

While franchise laws still protect distributors against abuses from large brewers, the system is antiquated and does more harm than good by stifling small craft brewers.<sup>251</sup> Today, large brewers in Big Beer still hold enough power to represent similar threats, but distributors have decreased in number and increased in size to gain some of their own power.<sup>252</sup> Now, small brewers are at a disadvantaged tier when it comes to bargaining power, and the laws should reflect this shift.<sup>253</sup>

The simplest solution is to provide an outright exemption to the beer franchise laws for brewers who produce below a certain volume.<sup>254</sup> The exemption would allow small brewers the flexibility to modify terms or change distributors to receive the best possible access to the market.<sup>255</sup> If a state finds a complete exemption too extreme, following an approach like the state of New York by

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controlled by two Big Beer companies).

245. Bartz, *supra* note 53.

246. SABMiller Complaint, *supra* note 179, at 3.

247. *See id.* (requiring the DOJ and court to look into specific practices of AB InBev to determine whether the conduct was anticompetitive).

248. *See Anhalt, supra* note 55, at 195 (advocating for strict three tier laws, as well as anti-coercion laws).

249. *Id.* at 197.

250. *See id.* (“[T]he current laws regulating distribution often inhibit new and small breweries’ abilities to reach new markets by limiting the opportunity to self-distribute to retailers and directly sell to consumers”).

251. Burt Watson, *Franchise Laws: Leveling the Playing Field*, BREWERS ASS’N (Dec. 17, 2014), <https://www.brewersassociation.org/insights/franchise-laws/> (on file with *The University of the Pacific Law Review*).

252. Hindy, *supra* note 88.

253. *Id.*

254. *See id.* (illustrating one example of an exemption enacted in New York).

255. *Id.*

creating special carveouts in the franchise laws may be more appropriate.<sup>256</sup> New York's carveout for small brewers allows them to terminate a contract by paying fair market value for distribution rights, which is less restrictive than traditional franchise laws and cheaper than litigation.<sup>257</sup>

Another solution may be to relax the laws on direct-sale and self-distribution.<sup>258</sup> While some states have already allowed direct-sale, self-distribution, or both, ensuring that all small breweries have the opportunity to sell their own product makes establishing themselves in the market place an easier feat.<sup>259</sup> Allowing breweries to sell their own products solves the issue of distributors' lack of interest in new brewers with little value.<sup>260</sup> Exempting only small brewers will allow them to establish themselves in the market and subsequently move on to third-party independent distributors, becoming a functioning member of the three-tier system.<sup>261</sup>

Although large brewing companies present threats the alcohol regulatory system was designed to safeguard against, small craft breweries break the mold.<sup>262</sup> Exempting small brewers from the three-tiered scheme and beer franchise laws alleviates regulatory suppression and affords them a chance to grow.<sup>263</sup> Providing an exemption to the regulatory system for craft brewers is vital to the survival of the industry.<sup>264</sup>

## VII. CONCLUSION

The trend of craft breweries selling to Big Beer is a direct result of the American alcohol regulatory scheme.<sup>265</sup> The existing three-tier distribution system and beer franchise laws have become dated and out of touch with the realities of the rapid growth of small craft breweries in the current market.<sup>266</sup> The antiquated system is advantageous to Big Beer conglomerates, who utilize any benefit they can to retain a large market share.<sup>267</sup>

In order to ensure the survival of the craft beer industry and promote its culture

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256. Watson, *supra* note 251.

257. *Id.*

258. Sorini, *supra* note 21.

259. *Id.*

260. Anhalt, *supra* note 55, at 184.

261. Sorini, *supra* note 21.

262. See Sorini, *supra* note 21 (explaining that craft brewers do not have the same amount of resources as Big Beer).

263. Anhalt, *supra* note 55, at 184.

264. *Id.*

265. *Supra* Part IV.C (explaining how the regulations can come together to inhibit the growth of craft breweries).

266. *Supra* Part II (showing the recent trend of large growth in the craft sector).

267. *Supra* Part IV.B (discussing how current laws allow Big Beer and distributors to use the regulatory system to their advantage).

of variety, diversity, and competition, both federal and state governments must work to prevent the monopolization and consolidation of the market.<sup>268</sup> To halt the increasing consolidation of the market, the DOJ should utilize existing antitrust measures that it has recently applied to review and scrutinize transactions of Big Beer conglomerates for monopolistic or anticompetitive effects.<sup>269</sup> In the meantime, states should revamp their own regulatory systems to give small craft brewers an opportunity to succeed.<sup>270</sup> Retaining and even tightening down on the three-tier system to eliminate as much intermingling of the tiers as possible ensures the distribution tier is truly neutral and independent—vital qualities to guarantee that craft brewers are able to compete effectively and each retailer has a large variety of beer.<sup>271</sup> Lastly, exempting small brewers from the distribution and franchise laws and allowing them to sell their own products would eliminate the inherent advantage given to large brewers and distributors.<sup>272</sup> While the distribution laws are slowly evolving to accommodate the modern industry,<sup>273</sup> moving on from the post-Prohibition era regulations in a manner that benefits the growing craft beer sector will ensure that the beer industry continues to be competitive and provides consumers with a wide variety of their favorite drink.<sup>274</sup>

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268. *Supra* Part V (advocating for the federal use of antitrust law to stop further market consolidation); *supra* Part VI (advocating for a reworking of state regulations to minimize legal inhibitions on craft brewers).

269. *See* SABMiller Complaint, *supra* note 179 (using antitrust to block a merger between AB InBev and SABMiller); Grupo Modelo Complaint, *supra* note 179 (using antitrust to block a merger between AB InBev and Grupo Modelo).

270. *See supra* Part VI (advocating for changes the three-tier system and franchise laws).

271. Anhalt, *supra* note 55, at 197.

272. *Supra* Part VI.B.

273. Sorini, *supra* note 21 (discussing the evolution of alcohol regulation over time to meet the dominant market demands).

274. *Let's Make Sure We Are Talking About the Same Things*, *supra* note 24.