

BEFORE THE HOUSE LIQUOR CONTROL COMMITTEE
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Good morning, Chairman Taylor, Chairman Costa, and members of the committee. Thank you for the opportunity to speak with you today to discuss the issues surrounding the radical proposal made by the brewers of Pennsylvania. I'm speaking on behalf of the PA Beer Alliance, the trade group of the independent wholesale beer distributors of Pennsylvania. We are proud to be a vital part of the PA beer system that brings Pennsylvania's consumers outstanding price, variety and access.

Initially I'd like to talk about the Granholm issue. Granholm, decided in 2005 by the United States Supreme Court, ruled that the laws of a state cannot treat in-state businesses engaged in beverage alcohol better than they treat out-of-state businesses in beverage alcohol. This may seem to be a standard statement of then-existing constitutional law. However, prevailing thought had been that the 21st Amendment, which gives the states much greater latitude in regulating activity in the alcohol sphere, permitted the states to treat in-state businesses better than out-of-state businesses. The court ruled that the 21st Amendment did not permit better treatment.

As you know, certain sections in the PA Liquor Code do treat in-state breweries better than out-of-state breweries. Specifically, in-state breweries have always been free to self-distribute all of their sales within Pennsylvania and need not use a wholesale distributor. If an in-state brewer chooses to use a wholesaler, the in-state brewer need not give a contract with "distributing rights" which secures the wholesale distributor's ability to protect the brand after it invests resources in the development of the brand. By

contrast, all out-of-state brewers, before shipping any product into Pennsylvania, must give a wholesale distributor a contract with distributing rights to its products.

After the Supreme Court ruling in *Granholm*, the Pennsylvania Beer Alliance worked for several years to bring Pennsylvania beer law into compliance with *Granholm*. Some brewers in Pennsylvania vigorously opposed the initiative, and prevented legislative action on this point. We are glad to see that the Brewers of PA now realize the need to bring Pennsylvania law into compliance with *Granholm*.

I'd now like to speak about the four principal issues the PBA objects to in the brewers' proposal: the authorization for all brewers to self-distribute up to 75,000 barrels, the ability to terminate contracts without cause, the requirement to renegotiate contracts every five years, and the 10% tax by the brewers on the sale of a brand.

First of all, the ability of a brewer of any size – including the largest – to self-distribute is without precedent in the United States. I cannot understand the rationale for such a broad, sweeping self-distribution exception, and do not understand the method of calculation. Obviously, as a simple statement of constitutional law, there must be a rational basis for legislation to be enacted. I have not heard any rationale for permitting brewers of any size the general right to self-distribute 75,000 barrels, but maybe the Brewers of PA will explain it to us today.

What may be helpful is a limited self-distribution exception, either for brewers of a certain size or perhaps for all brewers in certain narrowly-defined situations. What is most common across the United States -- a concept the PBA could support -- is allowing true small brewers to self-distribute. (As you can see from the attached list, PA has many true small brewers in addition to the much larger brewers.) We recognize that a brewer

starting up with perhaps nothing more than a good product may have a difficult time getting to market. It may have limited capital resources, limited name recognition outside of their own locale, and no presence in the marketplace that would cause a wholesale distributor to agree to distribute the product. In those cases, if limited to the true small brewer, we can support self-distribution by the small brewer. As people in the industry recognize, the skill sets of a brewer differ greatly from that of the wholesale distributor. Once a small brewer grows to a certain size, it is working against its own self-interest to continue in the distribution business, so should then transition to using a wholesale distributor in the marketplace. While there is disagreement about the maximum size of a brewer to allow the self-distribution exception, we believe that the correct cut-off is 2,000 barrels production. We believe this is consistent with many other states and good industry practices.

Let's now talk about the Brewers of PA proposal to require payment to the brewer of 10% of the value of any brand sold by a wholesale distributor. As explained by my fellow testifiers sitting with me today, the development of a start-up brewer's brand in the marketplace requires the wholesale distributor to invest human capital, time and money. Once that is done and the brand is prospering, why should the brewer be entitled to this 10% tax on the value that the wholesale distributor created? By this logic, the wholesale distributors should be entitled to 10% of the purchase price if the brewer or the brand is purchased by another brewer.

The other major issues we disagree with are the ability of a brewer to terminate without cause agreed-upon contracts (usually the brewer's form contract) and the mandate to renegotiate every five years. I will defer to my wholesale distributor

colleagues testifying today to explain to you the impact on their businesses that such exceptions present, but want to emphasize our very strong objection to them.

I'd like to turn now to several other areas that I believe may be fertile areas for working with our brewery partners in improving the beer sections of the Liquor Code.

We have spent some time this summer meeting with representatives of the brewers of PA and listening to their concerns and needs in 2013. Five years ago we went through a similar process, spent many hours discussing and meeting over a period of several months attempting to address some of these same issues, but ultimately were not able to reach agreement with the brewers. Hope springs eternal, and with the latest discussions, we believe we have some greater insight as to current needs and I'd like to address some of those issues.

We recognize the need for self-distribution by brewers of all sizes in certain circumstances. If a brewer terminates a wholesale distributor for cause, there is an immediate need to get the product to market so we recognize the need for some self-distribution. In other circumstances, perhaps a collapse of a wholesaler's facility because of snow (which we have seen in PA), there would also be need for some brewer self-distribution. These can be narrowly defined in limited circumstances.

On the topic of termination for cause itself, we believe that there may be a need for some change to the process for terminating agreements for cause. Pennsylvania brewers who have chosen to give primary contract rights to wholesale distributors have always had the ability to terminate for cause, but some have had difficulty doing so. We believe there is some potential for discussing changes to this and it would address a stated need of the brewers.

The Pennsylvania brewers also spoke of the need to have signed contracts. We understand the issue, and are willing to work with them on coming up with an acceptable proposal.

We have expressed to the Brewers of PA our willingness and cautious optimism about talks in these areas. As of today we have met with them twice recently, and will continue to seek common ground to achieve our respective needs, all with an eye to the best interests of our common goal – serving the PA consumer.