



1300 I STREET, SUITE 125
P.O. BOX 944255
SACRAMENTO, CA 94244-2550

Public: (916) 445-9555
Telephone: (916) 445-4909
Facsimile: (916) 327-7154
E-Mail: jacobappelsmith@doj.ca.gov

February 3, 2010

Advisory To: California Beer Manufacturers and Importers

Re: Distributor Agreements

The California Attorney General's Office has received complaints and inquiries regarding the actual or threatened exercise of control of licensed beer wholesalers by persons not holding a wholesaler license issued by the Department of Alcoholic Beverage Control (the ABC). The purpose of this industry advisory is to provide guidance under existing law as to the types of contractual provisions the Attorney General's Office deems to be unenforceable under California law and the types of conduct this office considers to be in violation of California law.

Over the past year-and-a-half, the Attorney General's Office has reviewed distributor agreements between beer manufacturers and wholesalers, including documents relating to the negotiations of those agreements. We have also reviewed market share statistics, trade press reports, proposed promotions between manufacturers and wholesaler licensees, and met with members of the industry. This review has revealed serious threats to the ability of the distribution tier of licensees to maintain the independence of their business operations.

Of utmost concern to the Attorney General's Office is the independence of each licensee and, consequently, the identification and designation on the respective license of all persons with any direct or indirect control, ownership, or interest in a licensee. Licensure is the foundation of California's regulatory system of alcoholic beverages, and it is fundamental to the State's regulatory control under Section 2 of the Twenty-first Amendment and Section 22 of Article XX of the California Constitution. California's licensing system requires separation between manufacturer, wholesaler, and retailer licensees in the production, distribution, and sale of alcoholic beverages.

Business and Professions Code Section 23300 is one of several statutes within a comprehensive set of laws enacted to codify the principle of independence and to preserve the

separation between the three tiers of licensees. See also Business and Professions Code sections 23355, 24040, 25500 *et seq.* and 25600. Section 23300 states:

No person shall exercise the privilege or perform any act which a licensee may exercise or perform under the authority of a license unless the person is authorized to do so by a license issued pursuant to this division.

This means that any person with an interest in or control over a business licensed by the ABC must hold the applicable license, even if that person is licensed in a different capacity by the ABC.

The privileges of a distribution license include the authority to make management, personnel, pricing, and product decisions. They also include the authority to control the distribution of funds, to profit from the sale of alcoholic beverages, and to control the sale or transfer of ownership of the licensed business. Such decisions made or controlled by nonlicensees constitute violations of the Business and Professions Code.

The immediate concern of the Attorney General's Office is the relationship between beer manufacturers and the wholesalers who distribute their products. In 2008 and 2009, this office expressed concerns with the far-reaching consequences of certain distributor agreements that give manufacturers an improper level of control over the businesses and operations of licensed wholesalers. The Attorney General's Office deemed certain provisions of these agreements to be in violation of California law and unenforceable. Upon subsequent review of other manufacturer-proposed distributor agreements, we find that they too contain provisions that grant manufacturers unlawful control over licensed wholesalers.

These contractual provisions represent an improper attempt by manufacturers to control licensed wholesalers in violation of California's longstanding statutory and regulatory policies enacted to ensure orderly market conditions through the licensing system. A non-licensee manufacturer's control of a licensed wholesaler creates material risks to competition in the wholesale industry given the fact that the wholesaler may distribute products in direct competition with those of the manufacturer. Unlawful attempts to control the business of a single wholesaler by multiple, competing manufacturers significantly threatens the wholesaler's independence, the State's regulatory structure, and an orderly market for the production, distribution, and sale of alcoholic beverages.

Given that the Attorney General's Office has now been presented with multiple manufacturer-proposed distributor agreements that raise common concerns, and that these agreements are spreading throughout the industry, we provide the following regulatory guidance identifying the types of contractual provisions that we deem to be unenforceable:

1. Manufacturers having control or approval rights over personnel decisions of a wholesaler, including, but not limited to, hiring decisions, compensation arrangements, duties and responsibilities, allocations of time and communications with retailers, and termination decisions;
2. Manufacturers having approval rights over a wholesaler's business plan;
3. Manufacturers having the right to impose, without mutual agreement of the parties, a material and substantive change to wholesaler standards, or a material and substantive amendment to an agreement with a wholesaler, in either case relating directly or indirectly to a wholesaler's business or operations;
4. Manufacturers having the right to prohibit a wholesaler from distributing any brand of another manufacturer, or otherwise exercising control over a wholesaler's decisions regarding any brands of another manufacturer; and
5. Manufacturers having the right to control or approve a wholesaler's acquisitions or divestitures of businesses or product lines, or a change in control of a wholesaler or a wholesaler's business, in either case including, but not limited to, a manufacturer's right of first refusal to purchase or right to appoint a designee purchaser.

We consider any attempt to enforce these provisions to be an unlawful, prohibited exercise of control by a manufacturer over an independently licensed wholesaler. We also consider it unlawful for manufacturers to engage in conduct intended to induce a wholesaler to enter into a contract that is contrary to California or federal law, including any contract purporting to waive compliance with any provision of the California Alcoholic Beverage Control Act, or any regulation, ruling, directive, or opinion issued by the ABC.

For purposes of this industry advisory, "manufacturer" includes any holder of a beer manufacturer's license, any holder of an out-of-state beer manufacturer's certificate, and any holder of a beer and wine importer's general license.

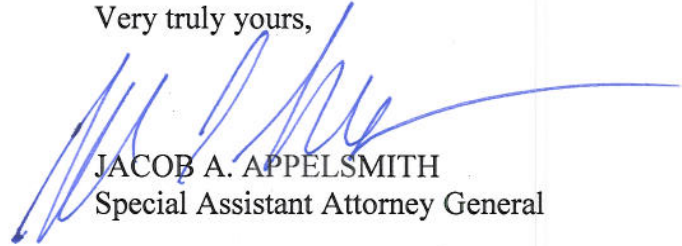
If a manufacturer takes any such actions as described above, or otherwise exercises the privileges of holding a wholesaler license without holding such license, the Attorney General's Office will review that action and take whatever steps are appropriate under California law. Such review would include, but not be limited to, unlawful business practices that violate Business and Professions Code section 17200, which includes the inducement of a person to enter into a contract requiring that person to violate section 23300, and California laws relating to anti-trust and franchising. This office has a particular concern that the coercive effect of these distributor agreements, which give manufacturers a high level of control over the distributors'

February 3, 2010

Page 4

businesses and operations, could ultimately result in a detrimental impact upon competition in this industry, particularly as to small and craft breweries, and we intend to monitor that issue closely.

Very truly yours,

A handwritten signature in blue ink, appearing to read 'Jacob A. Appelsmith', is written over the typed name and title.

JACOB A. APPELSMITH
Special Assistant Attorney General

For EDMUND G. BROWN JR.
Attorney General