

October 14, 2011

Which Brands are Accelerating?

Dear Client:

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ANOTHER PITFALL OF SKIN IN THE GAME: GENERAL STATE FRANCHISE LAWS

There's been a lot of discussion around the industry this week around the notion of distributors making payments to brewers who are entering a new market. We have covered all sides of the issue, including possible issues with state alcohol laws. But there yet another legal issue: in some states, if a franchisee pays a supplier, the transaction falls under the state's general franchise law. I'm not talking about beer franchise laws, but general franchise laws.

Attorney Drew Jaglom explains:

"Many states have general business franchise laws, and the Federal Trade Commission has a Rule on Franchising, that apply when a distributor is given the right to distribute a brand and there is (a) a prescribed marketing plan or method of operation, (b) a right to use a trademark and (c) a franchise fee.

"Virtually every brewer contract I've seen has enough detail as to what is required that it would be viewed as a 'prescribed marketing plan' and the distributor always gets rights to use the brands' trademarks in POS and promotions. If there is a requirement to pay something to the brewer for the right to distribute, then you've got a franchise fee as well. If you are a franchise, then there are detailed disclosure and registration requirements that apply state by state, basically similar to what goes in a securities prospectus. My guess is that isn't something most brewers are going to want to do.

"That being said, conceptually there isn't a big difference between a distributor paying to buy a brand from an outgoing distributor in the market, which happens routinely, and paying for a brand that is just entering the market, which is less common. In both cases, you are

paying for anticipated incremental profits from the brand. And in the case of a craft brewer moving from self-distribution to a wholesaler, it is really the same thing, with the brewer in fact being the outgoing distributor.

"The only difference is that for an existing brand, there is a history in the market from which you can project those future profits, and for a new brand you have to base it on experience in other markets or forecasts made on some other basis. The lack of a history doubtless increases the risk that you won't meet the projections, but to turn wonky for a moment, that just increases the discount rate applied to the projected revenues, and reduces what a distributor should be willing to pay. It doesn't really change the conceptual notion that an incoming distributor is receiving distribution rights that are worth something. It just may be harder to determine what that something is. And it begs the question of whether a distributor introducing a brand into a market deserves to be paid something for the services it provides in a launch, which may be greater than for an existing brand."

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Until tomorrow, Harry

"There are no facts, only interpretations."
-Friedrich Nietzsche

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