Right Distribution Is Key To Successful Beer Remedies

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In an indirect way, today's craft beer renaissance in the United States was made possible by prohibition. The Eighteenth Amendment to the Constitution, normally referred to as prohibition, was in part a reaction to the system of "tied houses" that dominated the alcohol retail market. Brewers at the time exerted tremendous exclusive control over retailers and used that control to pressure sales without concern for the safety of customers or the general public. When prohibition was repealed, the states were tasked with putting in place systems that would prevent a repeat of this harmful state of affairs. The answer was simple: They created a three-tiered system where independent distributors stand between brewers and independent retailers.

The three-tiered system was put in place to prevent brewers from having too much control over what consumers purchase. Truly independent distributors and retailers want to sell beer driven by consumer demand, and do not want to be beholden to one or two powerful brewers. Consumers can seek out whatever beer tastes the best, and retailers can get a diverse array of brands from their independent distributor.

However, large beer brewers are actively working to reverse the benefits of a three-tiered system by exerting control over distribution. To be sure, craft brewers are raising alarm bells over Anheuser-Busch InBev SA/NV (ABI) incentive programs that significantly reward distributors whose ABI sales reach 98 percent of their total volume. Besides employing its incentive programs, ABI has become the largest and fastest growing distributor in the United States. ABI is also adding retailer locations at a fast clip so it is involved in all three tiers in various locations around the country.

Recently, ABI has employed a strategy of actually purchasing craft brewers in an effort to destroy the craft brews that do not sell out. Indeed, ABI recently announced purchases of Four Peaks Brewing and Breckenridge Brewery. ABI's purchases of craft brewers harm the remaining independent craft brewers in a round about way. Distributors carry craft brews to meet retailers and its consumers demand for craft brews, but with these craft brew purchases, ABI can replace independent craft brands currently carried by a distributor for ABI-owned craft brands. ABI's move into craft brews allows distributors to meet the demand for craft beer while also hitting ABI incentive targets. Accordingly, distributors will likely carry fewer independent craft brews in the future.

It's no wonder that the consumer fallout from the merger of the two largest beer makers in the world, ABI and SABMiller PLC, hinge on what happens with beer distribution. Last month's Senate hearing on the deal rightly focused on distribution issues, as did the U.S. Department of Justice during its investigation and challenge of ABI's previous purchase of Grupo Modelo. The DOJ has previously stated that "[e]ffective distribution is important for a brewer to be competitive in the beer industry."

There are significant competitive concerns about the deal because it will provide both ABI and SABMiller the incentive and ability to further exert control over distribution. As Sen. Amy Klobuchar, D-Minn., stated at the hearing on the merger, MillerCoors needs to be as independent after the merger as it is today. And ABI will be in greater control of a tremendous global profit pool that it can turn towards increasing its ownership of distributors and craft brewers in the United States.

ABI CEO Carlos Brito repeatedly said during the Senate hearing that the deal will have no impact on the U.S. market because of ABI's proposed divestiture of SABMiller's interest in the MillerCoors joint venture. But the only way that will be true is if the DOJ secures three very important remedies to safeguard independent distributorship.

First, the DOJ must ensure there are no terminations of independent distributors by parties to the merger. A termination or threat of termination by ABI or Molson Coors would effectively shut down a distributor's business and disrupt other brewer's access to market.

Second, there must be conduct rules in place that prevent ABI as well as Molson Coors from exerting its power to shut independent craft and importers out of distributors or creating incentives for distributors to not sell beer brewed by other breweries. ABI's incentive programs are extremely problematic for competition, especially when they are accumulating a craft beer portfolio that can allow distributors to drop independent craft brewers without angering craft seeking customers. This is an issue that is currently plaguing the craft beer industry, and there is no reason to not address it during the DOJ's review of this enormous deal.

Third, the DOJ needs to force ABI to divest or at a minimum greatly reduce and cap its ownership of distributors. This is an issue that ABI's CEO repeatedly danced around during the Senate hearing - first appearing to commit to a 10 percent cap and then clarifying that they will stop at "around" 10 percent, possibly 11 percent or 12 percent. Brito's justification for owning distributors was to learn from them, but it is unclear why ABI needs 12 percent or possibly more of U.S. distributors in order to do so. There is no competitive reason to own so many distributors, which are solely beholden to ABI and not to market demand.

Today's craft beer renaissance depends on open and independent distribution, and independent distribution depends on the DOJ getting it right on remedies.