**Case No. 23-35010**

*In the*

# United States Court of Appeals

*for the*

# Ninth Circuit

CITY BEVERAGES, LLC,
a Missouri limited liability company with its principal place of business in Washington,
d/b/a Olympic Eagle Distributing,
*Plaintiff-Appellee,*

v.

CROWN IMPORTS, LLC,
a Delaware corporation with its principal place of business in Illinois,
d/b/a Constellation Brands Beer Division;
CONSTELLATION BRANDS, INC.,
a Delaware corporation with its principal place of business in New York,
*Defendants-Appellants.*

*Appeal from the United States District Court for the Western District of Washington (Tacoma),*
*Case No. 3:22-cv-05756-DGE · Honorable David G. Estudillo, District Judge*

## CALIFORNIA FAMILY BEER DISTRIBUTORS' BRIEF AS *AMICUS CURIAE* IN SUPPORT OF APPELLEE CITY BEVERAGES, LLC SEEKING AFFIRMANCE OF THE DISTRICT COURT'S INJUNCTION

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# CORPORATE DISCLOSURE STATEMENT

Pursuant to the Federal Rules of Appellate Procedure 26.1 and 29(a)(4)(A), *Amicus Curiae* California Family Beer Distributors, a non-profit corporation organized under the laws of California, hereby states that it has no parent companies, subsidiaries, or affiliates that have issued shares to the public.

Dated: March 22, 2023

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# STATEMENT OF AUTHORSHIP

Pursuant to Federal Rule of Appellate Procedure 29(a)(4)(E), *Amicus Curiae,* California Family Beer Distributors ("CFBD"), provides the following statement. No party's counsel has authored the brief in whole or in part, as counsel for CFBD has authored it in its entirety. No party or party's counsel has contributed money that was intended to fund preparing or submitting the brief. No person, other than CFBD, its members, or its counsel, has contributed money that was intended to fund preparing or submitting the brief.

Date: March 22, 2023

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# IDENTITY AND INTEREST OF *AMICUS CURIAE*

*Amicus Curiae* California Family Beer Distributors[1] ("CFBD") was founded in 2020 as an organization of independent, family-owned beer distributors based in California. CFBD works to promote a fair and equitable system to protect family businesses' ability to provide consumer variety and access to the market for all. Many of its members have been operating in their local markets for 50, 75, or even 100 years. CFBD believes that local, family-owned distributors are more familiar with their communities' culture and beer preferences and can distribute localized products that meet consumers' needs.

This case implicates the substantial interests of CFBD members and raises urgent policy concerns. CFBD was formed to protect its family-owned member companies, and their employees, from forced consolidation leading to monopolies in the beer distribution industry. CFBD was also formed to advocate for and create a fair regulatory environment that protects consumers, distributors, retailers, and the communities they serve, and CFBD also works to ensure access to

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[1] Pursuant to Federal Rule of Appellate Procedure 29(a)(2) and Ninth Circuit Rule 29-3, all parties have consented to the filing of this *amicus curiae* brief.

market for brewers and beverage producers of all sizes, such as small craft brewers.

Recently, some of California's independent family-owned beer distributors have been forced out of their businesses by giant out-of-state corporations using unfair business practices. These corporations are actively taking away family beer distributors' local business by unfairly terminating contracts and forcing the sale of certain brands. California's small family businesses do not have the financial ability to spend millions in legal fees and years litigating with these massive companies. The impacts are devastating, with legacy and decades-old family distributors being destroyed, along with the livelihoods of their employees, who often no longer have jobs. What remains is approaching a monopoly in the beer industry, resulting in less competition and reduced variety for consumers, as one or two distributors have the power to decide which products make it to retailer shelves.

CFBD members make substantial investments—often in the millions—in the warehouses, trucks, employees, and advertising and marketing for their suppliers' products. State franchise laws were enacted to protect franchisees/distributors and retailers from unfair

treatment by suppliers/franchisors. Franchise laws, properly applied, prevent suppliers/franchisors from unfairly and inequitably terminating distributors/franchisees and thereby usurping their considerable investments.

For the reasons set forth below, CFBD supports Appellee City Beverages, LLC, and urges the Court to affirm the District Court's *Brewers Association* issuing a preliminary injunction, pending a trial on the merits of this action.

# INTRODUCTION

CFBD submits this *amicus curiae* brief in support of Appellee City Beverage, LLC's ("Olympic Eagle") Answering brief, which urges this Court to affirm the District Court's preliminary injunction.

This *amicus curiae* brief addresses three fundamental issues pertinent to the injunction issued by the District Court, and pertinent to family beer distributors.

First, CFBD will address the devastating impacts of supplier terminations on family-owned distributors, their employees, and their communities. These impacts support the District Court's finding of "irreparable harm" in the absence of a preliminary injunction.

Second, CFBD will address the "public interest" at stake in the current action, which also weighs heavily in favor of maintaining the District Court's preliminary injunction. This discussion will address the ongoing rapid consolidation in the beverage distribution industry, anticompetitive behavior, and reduced choice for consumers.

Third, CFBD will help clarify how state franchise protections apply here. The franchise law requires, among its three part test, a

"substantial association" between the franchisee and franchisor.[2] On that point it is important to note that distributors and suppliers alike often refer to distributorships as "houses," i.e., a "AB House" or a "Miller Coors House." In the very recent words of Constellation's President: "Our world has changed; this beer industry has changed. You are not an AB [Anheuser-Busch] house with Constellation. You are not a Molson Coors house with Constellation. **You are a Constellation house.**"[3]

This appeal raises the important issue of whether Olympic Eagle has become "substantially associated" with Constellation's brands. Resolution of this issue is critical to CFBD's members because it will

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[2] To find the existence of a "franchise," Washington's Franchise Investment Protection law also requires that the franchisee: (A) "is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan prescribed or suggested in substantial part by the grantor or its affiliate"; and (B) "pays, agrees to pay, or is required to pay, directly or indirectly, a franchise fee." (RCW § 19.100.010, subd. (a).) However, these additional elements have not been contested in this case.

[3] Justin Kendall, BREWBOUND, *Brewbound ICYMI: Sierra Nevada Starts a Riot* (March 10, 2023), available at brewbound.com/news/brewbound-icymi-sierra-nevada-starts-a-riot (emphasis added)(last visited March 16, 2023).

provide clarity on the extent of their protection under general franchise laws.

The District Court erred by incorrectly applying vague and cursory language from a Ninth Circuit memorandum opinion applying California law (*Gabana Gulf Distribution, Ltd. v. GAP Int'l Sales, Inc.*, 343 F.Appx. 258 (9th Cir. 2009) ("*Gabana*") and a Washington case following that opinion (*Atchley v. Pepperidge Farm, Inc.*, 2012 WL 6057130 (E.D. Wash. Dec. 6, 2012) ("*Atchley*"). This brief will address the District Court's misunderstanding of California franchise law.

More fundamentally, Constellation is attempting to have it both ways on the substantial association question. Like many large suppliers, Constellation requires Olympic Eagle to use its "best efforts" to market Constellation's brands (4-ER-679 at ¶ 3.1) and grants an extensive license to use Constellation-owned trademarks and copyrights in that marketing effort (4-ER-689 at ¶ 8(a)). Olympic Eagle has complied in good faith, including by splashing giant advertisements for Constellation's flagship brands, Modelo and Corona, on its own trucks. (Olympic Eagle's logo on those same trucks is practically a footnote by

comparison.) (3-ER-413 to 417.) It has also used Constellation's brands in local advertising campaigns. (3-ER-410.)

This, again, is all industry practice. But now, despite referring to Olympic Eagle, among others, as a "Constellation house," Constellation is attempting to disclaim this association altogether, and absurdly represented that Olympic Eagle "has made no effort to associate itself with Constellation's trademarks" (3-ER-363 at lines 9-10) when that integral association is *exactly* what Constellation's contract requires.

Constellation cannot require one thing in its contract and even pronounce it to the beer public, and then come before this Court to say with a straight face there is no "substantial association" between the supplier and distributor. The District Court's preliminary injunction should also be affirmed on franchise law grounds.

## I. SUPPLIER TERMINATIONS INFLICT IRREPARABLE HARM

When a major supplier terminates a family-owned distributor, the impact is devastating and far-reaching on the distributor, its employees, and the community. The termination often brings a cascading series of events that can drive a distributor out of business. This impact supports

the District Court's finding that there would likely be "irreparable harm" in the absence of a preliminary injunction.[4]

A. Supplier Terminations Upend Economies of Scale

In distribution, scale is essential. That is especially true in beer distribution. When a beverage distributor has a major supplier, the high volume from that supplier offsets the very high, and largely fixed, costs of storage, transport and labor required to get products to retailers. In fact, the delivery costs do not materially increase when the distributor scales up and adds "golden cases" of other suppliers to its product line.[5] Conversely, when a major beer brand terminates a

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[4] The evidence and authority provided by Olympic Eagle is confirmed by the experiences of other beer distributors – Peter Heimark, former Chairman of the National Beer Wholesalers' Association and Chief Executive Officer of Indio, California-based Heimark Distributing has stated that Constellation's termination of Heimark Distributing "could have been the end of us" and necessitated laying off approximately 100 employees. (See Jessica Infante, *Incoming NBWA Chair Peter Heimark Discusses Terminations, Consolidation, Executive Order*, BREWBOUND (Oct. 5, 2021), available at brewbound.com/news/incoming-nbwa-chair-peter-heimark-discusses-terminations-consolidation-executive-order (last visited March 16, 2023).)

[5] Cases above and beyond those necessary to pay for the required distribution infrastructure are known as "golden cases" in the alcohol distribution industry, and as the name indicates, are a key component of profitability. (Kary Shumway, *Beer Business Finance: The Economics of 'Craft-on-Craft' Acquisitions*, BREWBOUND (June 12, 2019), available at brewbound.com/news/beer-business-finance-the-economics-

distributor, the loss of volume instantly reverses the economies of scale. Now, without the underlying revenue base, the distributor may *lose* money with many (or all) deliveries, as its expenses exceed revenues.

### B. Supplier Terminations Force the Loss of A Distributor's Product Placement Rights, Eroding The Distributors' Goodwill with Suppliers and Retailers

Termination by a major brand can have additional cascading effects on a distributor's business by eroding its goodwill with retailers and suppliers.

Retailers designate distributors who provide the most products to a store as "shelf set captains." (4-ER-639 to 640 at ¶¶ 44-46.) Shelf set captains decide how their beers will be displayed on a retailer's shelves—such as placement at a customer's eye level or near the cooler door handle. (4-ER-640 at ¶ 45.) Being a shelf set captain enables a distributor to maximize the sales of all the beer brands it carries. (Id.) It

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of-craft-on-craft-acquisitions (last visited March 16, 2023).) Undervaluation of golden cases has been identified by industry experts as one reason why the contractual fees paid to distributors upon termination under-compensate the distributor. (Justin Kendall, *New Belgium Notifies Wholesalers in Southern California, Chicago Area of Termination; Goal to Partner with Reyes*, BREWBOUND (July 28, 2020), available at brewbound.com/news/new-belgium-notifies-wholesalers-in-south-california-chicago-area-of-termination-goal-to-partner-with-reyes (last visited March 16, 2023).)

enables a distributor to place smaller brands and newer products on a retailer's shelf. (Id.)

Suppliers naturally prefer to work with distributors that are granted "shelf set captain" status. This enables the suppliers to get their own products in the most desirable shelf positions. When a distributor loses that status, it makes the distributor less valuable to suppliers.

Termination by a major brand also sharply undercuts a distributor's goodwill with retailers. Retailers may wonder what the distributor did to warrant such a termination. (After all, "good cause" is often required for termination.) They also may question a distributor's organizational capacity and efficiency.

In the present case, if Olympic Eagle is terminated and can no longer sell Constellation brands, it will be delivering many fewer products, and may lose its designation as "shelf set captain." (*See* 4-ER-639 to 640 at ¶¶ 44-54.) This will also mean that Olympic Eagle will not be able to place as many smaller brands or newer products on retailers' shelves. (4-ER-640 at ¶¶ 52-54.) This will make Olympic Eagle a less desirable option for suppliers.

Constellation's termination of Olympic Eagle will hurt Olympic Eagle's standing, reputation, and goodwill among other suppliers as well as retailers. The cascading effects can easily drive a distributor out of business altogether.[6]

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[6] Industry experts have estimated that the fees paid to distributors upon termination, which are meant to compensate the distributor for the "fair market value" of the distribution rights, often under-compensate the distributor by "30-50%." (Zoe Licata and Justin Kendall, *Last Call: Beer Institute Blasts Reduced RTD Taxes in Vermont; Ippolito Christon Warns of 'Convenience Terminations*,' BREWBOUND (June 17, 2022), available at brewbound.com/news/last-call-beer-institute-blasts-reduced-rtd-taxes-in-vermont-ippolito-christon-warns-of-convenience-terminations (last visited March 16, 2023).) This under-compensation is caused by multiple factors, including the failure to properly value golden cases (discussed above), as well as the presence of only a single buyer and seller, weaker franchise protections in some jurisdictions, the relative power of supplier, the cost of legal challenges, and fundamental misunderstandings regarding the value of distribution rights. (Justin Kendall, *New Belgium Notifies Wholesalers in Southern California, Chicago Area of Termination; Goal to Partner with Reyes*, BREWBOUND (July 28, 2020), available at brewbound.com/news/new-belgium-notifies-wholesalers-in-south-california-chicago-area-of-termination-goal-to-partner-with-reyes (last visited March 16, 2023).) Indeed, terminated distributors have identified the prohibitive costs of litigating against large beer suppliers as a primary reason why there are not more cases such as the one currently before the Court. (Justin Kendall, *Constellation Brands Forces Distributor Change in Northern San Diego County*, BREWBOUND (June 7, 2018), available at brewbound.com/news/constellation-brands-forces-distributor-change-northern-san-diego-county (last visited March 16, 2023).)

## II. THE PUBLIC INTEREST IN A COMPETITIVE THREE-TIER DISTRIBUTION SYSTEM HEAVILY FAVORS THE PRELIMINARY INJUNCTION

Washington, like California, follows a "three-tier" beer distribution system. Under this system, manufacturers or brewers (the first tier) sell to distributors (the second tier), which in turn sells to retailers (the third tier). There used to be a healthy, competitive market among California independent beer distributors in the second tier.

In recent years, one mega-distributor (the Reyes Beer Division of Reyes Holdings, Inc., hereinafter "Reyes") has been rapidly taking over the distribution market nationally and in California. Reyes is the nation's ninth largest privately held company.[7]

Reyes' takeover threatens the vitality of the distribution market and harms consumer choice. Through mergers, acquisitions, forced consolidations, and collusion with large manufacturers including Constellation, Reyes now controls a 55% market share of all beer sold in California, compared to just 25% in 2018. (See chart below, taken from

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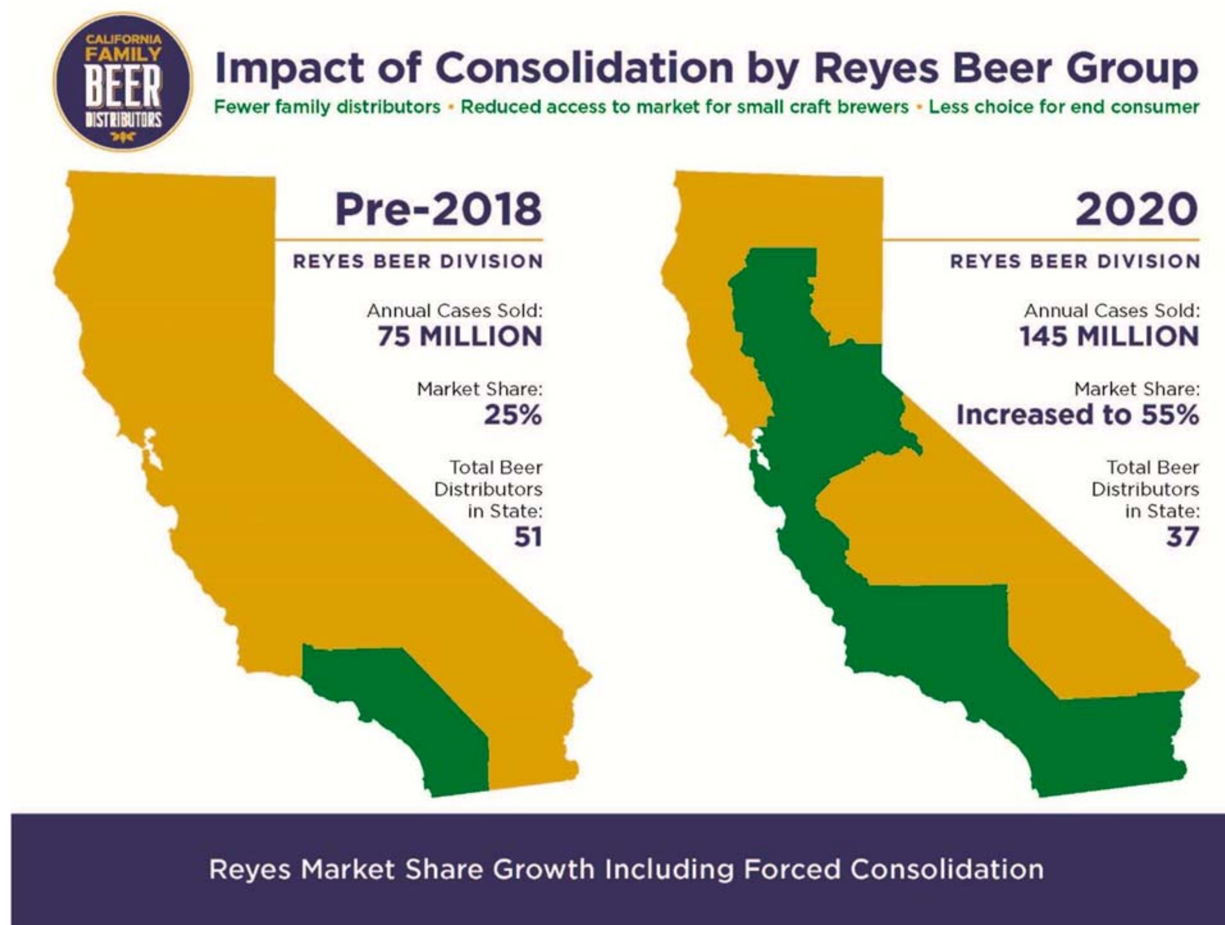
[7] (Kate Bernot, *Reyes Comes for the King*, GOOD BEER HUNTING (July 10, 2020), *available at* https://www.goodbeerhunting.com/sightlines/2020/7/10/distributor-bets-hard-seltzer-and-mexican-imports-can-dethrone-ab-inbev.)

Appendix 1, CFBD's Letter to the federal Alcohol and Tobacco Tax and Trade Bureau dated August 18, 2021 (at Exhibit B thereto); also available at regulations.gov/comment/TTB-2021-0007-0279.)




Washington is at risk of following what happened in California. If Constellation is allowed to terminate Olympic Eagle, the successor distributor's market share will grow to as much as 60 to 70 percent in the affected market. (3 ER 371-375, at ¶¶ 13-16; Declaration of Shawn

Bai in Support of Plaintiff's Opposition to Defendants' Motion to Stay Proceedings (Dkt. No. 65, Feb. 13, 2023), at ¶ 9, City Beverages LLC v. Crown Imports LLC, No. 3:22-CV-05756-DGE (W.D. Wash.), attached hereto as Appendix C.)

Reyes is accomplishing its takeover through collusion with large manufacturers—and most prominently, with Constellation itself. Antitrust authorities, at the federal and state levels, have begun to scrutinize Reyes' (and Constellation's) conduct.

Reyes' rapid and forced consolidation of the beer distribution industry is eroding a competitive distribution market. It threatens the existence of many smaller breweries and craft beers, which may no longer have the access to market that would be facilitated by a diverse range of distributors. It is harming consumer choice.

### A. Reyes Is Taking Over the Market by Colluding with Constellation

Constellation has been rapidly terminating its long-standing distributors to deliver its business to Reyes. (See Appendix 1, at Exhibits A and B thereto.) Constellation's termination of Olympic Eagle is yet another step towards domination of the market by a handful of distributors.

## B. Smaller and Craft Breweries are at Particular Risk

Small craft breweries are particularly threatened by the accumulation of market power in the hands of a few distributors. In California, after Reyes uses its market power to force smaller distributors to sell, Reyes then uses that power and lack of distribution alternatives to force brewers to abandon their contracted-for rights with smaller distributors. Reyes also controls brewers' access to retailers. As one industry observer noted, distributors exert "tremendous influence over what ends up on store shelves."[8]

Further, the Brewers' Association, a trade group of small and independent craft brewers, recently stated in its comment to the United States Department of the Treasury (in response to President Biden's executive order regarding the need for increased competition in multiple sectors, including the beer industry) that Reyes has formed an anticompetitive "duopoly" in the California beer distribution market. (Justin Kendall and Jessica Infante, *Brewers Association Communicates Additional Competitive Challenges Facing Craft*

[8] Kate Bernot, *Reyes Comes for the King*, GOOD BEER HUNTING, cited above.

*Brewers in 2nd Letter to Treasury*, BREWBOUND (Oct. 1, 2021), available at brewbound.com/news/brewers-association-communicates-additional-competitive-challenges-facing-craft-brewers-in-2nd-letter-to-treasury (last visited March 16, 2023).)

Constellation, in turn, stands to gain as craft beer competitors are barred entry by Reyes or other dominant distributors. None of this is good for consumers.

### C. Antitrust Authorities Are Examining Distribution Consolidation

For all the above reasons, federal and state antitrust authorities have begun scrutinizing the rapid and monopolistic takeover of beer distribution. In 2020, the Federal Trade Commission and the Antitrust Division of the U.S. Department of Justice became involved. (Ron Knox, *Rollups: Monopoly on Tap*, THE AMERICAN PROSPECT (May 25, 2022), available at prospect.org/power/rollups-monopoly-on-tap (last visited March 16, 2023).) The California Attorney General is conducting a separate antitrust inquiry into the industry. (Id.)

In response to the Biden Administration's executive order seeking information about anticompetitive practices in beer markets, multiple entities expressed their concerns about the consolidation of the beer

wholesale market. Among them was California Family Beer Distributors, which noted that "Reyes is building a monopoly in California" and requested that the Department of Treasury "investigate and take prompt, decisive action." (See Appendix 1, at page 4.)

### D. Concentrated Distributor Market Power Threatens the Three-Tier System

Many states (including Washington and California) have instituted a "three-tier" alcohol distribution system in which suppliers, distributors, and retailers are kept "distinct and apart" from each other. (*E.g.*, *Cal. Beer Wholesalers Ass'n v. Alcoholic Beverage Control Appeals Bd.*, 5 Cal.3d 402, 407 (1971).)

A major goal of this separation is to avoid the "overly aggressive marketing" and "excessive sales" of alcoholic beverages created by "vertical integration" (i.e., when one entity controls the manufacture, distribution, and local sales of alcoholic beverages). (*E.g.*, Cal. Bus. & Prof. Code § 25500.1.)

The Ninth Circuit has recently addressed the importance of a three-tier system. (*Retail Digital Network, LLC v. Prieto*, 861 F.3d 839 (9th Cir. 2017).) The Court specifically discusssed how this policy can be undermined by commercial actors who exert "undue and undetectable

influence" over entities within the other tiers. (Id. at 850.) Thus, a three-tier system requires that suppliers and retailers remain substantively (and not just formally) independent from distributors.

Three-tier systems are increasingly threatened by the forced consolidation of the industry. A single mega-distributor with high market share is increasingly able to co-opt and control the actions of even major suppliers, like Constellation, as well as retailers (by increasingly dictating terms for distribution, display, and sale of valued brands). The "undue and undetectable influence" increasingly wielded by a distributor like Reyes (or the potential successor to Olympic Eagle if its termination is not enjoined) constitutes a direct threat to the three-tier system and its fundamental public policies. (*See Retail Digital Network*, 861 F.3d at 850.)

### E. The Public Interest Overwhelmingly Favors Affirmation of the Preliminary Injunction

All the above public policy interests weigh heavily in favor of affirming the District Court's preliminary injunction. Constellation's termination of Olympic Eagle is an assault on competition in the beer distribution industry. It harms consumers. It erodes the effectiveness of the three-tier system for the manufacture, distribution, and sale of

alcoholic beverages. These claims deserve preservation by injunction, pending a trial on the merits.

## III. THE DISTRICT COURT ERRED BY REJECTING OLYMPIC EAGLE'S FRANCHISE LAW CLAIM, BECAUSE OLYMPIC EAGLE IS REQUIRED BY CONTRACT TO BE "SUBSTANTIALLY ASSOCIATED" WITH CONSTELLATION'S COMMERCIAL SYMBOLS AND TRADEMARKS.

In the District Court, Olympic Eagle contended that a preliminary injunction was also warranted under Washington franchise law. However, the District Court concluded that Appellee Olympic Eagle had not shown a "high likelihood of success" on its franchise law claim. (Order, 11:6-8.)

In this case, however, the District Court misread a cursory Ninth Circuit memorandum opinion relating to California franchise law. (Order, 9:22-10:22; *see Gabana Gulf Distribution, Ltd. v. GAP Int'l Sales, Inc.*, 343 F.Appx. 258 (9th Cir. 2009) ("*Gabana*").) *Gabana* was then followed by a Washington district court. (*Atchley v. Pepperidge Farm, Inc.*, 2012 WL 6057130 (E.D. Wash. Dec. 6, 2012) ("*Atchley*"). Here, the District Court (as did the district court in *Atchley*) based its analysis upon a misreading of *Gabana*. (Order, 9:18-11:8.)

In this section of the brief, CFBD will address the incompatibility between California franchise law and the District Court's misreading of *Gabana*.

Under California law, distributors who otherwise meet the general "franchise" test are included within the scope of franchise law protections. In fact, the California legislature specifically identified *distribution* as one type of franchise arrangement. (*E.g.*, Cal. Corp. Code § 31005, subd. (a)(1) (a "franchise" includes an agreement granting one entity "the right to engage in the business of offering, selling, ***or distributing*** goods") (emphasis added); § 31011, subd. (a) (recognizing the business of wholesaling as one type of franchise investment).) The California Franchise Investment Law was specifically designed to protect the investments made by distributors and other franchisees, when such distributors make investments in marketing and growing the franchisor's brands. (*E.g.*, Cal. Corp. Code §§ 31000, 31001.)

Additionally, opinions of the California Commissioner of Corporations regarding the extent of franchise law protections are entitled to "great weight." (*Kim v. Servosnax, Inc.*, 10 Cal.App.4th 1346, 1353 (1992).) "While the responsibility for statutory interpretation

ultimately rests with the court, the Guidelines, as interpretation of a statute by the officials charged with its administration, are entitled to great weight." (*Thueson v. U-Haul Int'l, Inc.*, 144 Cal.App.4th 664, 671 (2006) (following the Commissioner's guidance on the definition of "franchise fee").)

As discussed below, the Commissioner's guidance, as applied to the instant case, would necessitate a finding that Olympic Eagle's operations are "substantially associated" with Constellation's trademarks.

This Court now has an opportunity to clarify *Gabana*. Under an accurate franchise analysis, Olympic Eagle has a "high likelihood of success" on its franchise law claim, providing a separate basis for affirming the preliminary injunction.

### A. The Test for "Franchise" and the "Substantial Association" Prong

Washington's Franchise Investment Protection Act ("FIPA") is modeled on California franchise law. (*See Red Lion Hotels Franchising, Inc. v. MAK, LLC*, 663 F.3d 1080, 1089 (9th Cir. 2011); *East Wind Express, Inc. v. Airborne Freight Corp.*, 95 Wash.App. 98, 104 (1999) (applying franchise law case determined under California law).

However, the FIPA includes additional protections not seen in California law (*Red Lion*, 663 F.3d at 1089), and as discussed below, the FIPA provides even <u>broader</u> definition of "franchise."

Under the FIPA, a "franchise" is defined as:

"An agreement, express or implied, oral or written, by which:

(i) A person is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan prescribed or suggested in substantial part by the grantor or its affiliate;

(ii) The operation of the business is **substantially associated** with a trademark, service mark, trade name, advertising, or other commercial symbol **designating, owned by, or licensed by the grantor** or its affiliate; and

(iii) The person pays, agrees to pay, or is required to pay, directly or indirectly, a franchise fee."

(RCW § 19.100.010, subd. (a).)

The District Court's analysis was limited to the "substantial association" prong of the test. (Order, 9:18-11:8.) The question presented here, therefore, is whether the operation of Olympic Eagle's

business is "**substantially associated**" with any "**trademark, service mark, trade name, advertising, or other commercial symbol**" that is "**owned by**" or "**licensed by**" Constellation. (Emphases added.)

As discussed below in Part C, only the District Court's misreading of cursory language from *Gabana* prevented the proper application of this test.

### B. Beer Distributors Are Required by Contract to Be "Substantially Associated" with a Major Supplier's Commercial Symbols

A distributor's "substantial association" with a major supplier's trade names and trademarks is often clear and self-evident. The present case is no exception.

Like many major suppliers, Constellation has contractually required Olympic Eagle to use its "best efforts" in marketing Constellation's beer brands.[9] The agreement granted Olympic Eagle the right to use Constellation's names and trademarks for the "advertising,

[9] Olympic Eagle agreed to "exert its best efforts" to maximize the market for Constellation's beers. (4-ER-679 at ¶ 3.1.) It also agreed to "vigorously promote" Constellation's beers by "applying all necessary financial and operation resources" to achieve these sales goals. (4-ER-681 at ¶ 3.5.) Such resources, of course, include a distributor's own trucks.

display and sale" of Constellation beer. (4-ER-689-90 at ¶ 8.) Over many years, Olympic Eagle has complied with these requirements by spending several million dollars on local advertising. (3-ER-410 at ¶¶ 20-22.) Constellation's Vice President testified how a distributor's required market spend on "point of sale advertising, posters, media buays [and] in store displays" "increase consumer awareness of the Brands [and] the goodwill associated" with them. (3-ER-337, at ¶ 7.) For example, Olympic Eagle splashes giant advertisements for Constellation's Modelo and Corona brands across its trucks (to the exclusion of, for example, any other brands being carried within those trucks). Olympic Eagle's logo also appears, but in much smaller form, on those same trucks. (3-ER-413 to 417.) Thus, by design, wherever Olympic Eagle goes, its own customers (i.e., retailers) associate Olympic Eagle with Constellation's brands. This is standard practice in the industry for large suppliers.

But Constellation now seeks to disclaim the long-lasting "substantial association" it has mandated between Olympic Eagle and Constellation's brands. Before the District Court, Constellation absurdly stated that Olympic Eagle "has made no effort to associate

itself with Constellation's trademarks." (3-ER-363 at lines 9-10.) This is obviously incorrect.

In Constellation's own words to its distributors, many of whom also carry other brands: "You are not an AB [Anheuser-Busch] house with Constellation. You are not a Molson Coors house with Constellation. **You are a Constellation house**."[10] (Emphasis added.)

Constellation's assertions to the District Court must be disregarded.

### C. The District Court Misread *Gabana*

As noted above, the District Court erred by improperly applying brief language in a Ninth Circuit memorandum opinion applying California law (*Gabana*), which was then followed by the Eastern District of Washington (*Atchley*). (Order, 9:22-10:22) However, the District Court's misreading of *Gabana* fails to adequately reflect the broad meaning of "substantial association" under California franchise law.

---

[10] (Justin Kendall, *Brewbound ICYMI: Sierra Nevada Starts a Riot*, BREWBOUND, cited above.)

1. The Test for "Franchise" under California Law

California's test for the existence of a "franchise" is nearly identical to Washington's. In California, a "franchise" exists when: "(1) A franchisee is granted the right to engage in the business of offering, selling, ***or distributing*** goods or services under a marketing plan or system prescribed in substantial part by a franchisor; and (2) The operation of the franchisee's business pursuant to such plan or system is ***substantially associated*** with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate; and (3) The franchisee is required to pay, directly or indirectly, a franchise fee." (Cal. Corp. Code, § 31005, subd. (a); emphasis added.)

2. The "Substantial Association" Element under California Law

As a starting point, the California Commissioner of Corporations has issued detailed guidance regarding the application of the "substantial association" element. (See Commissioner's Release 3-F: When Does an Agreement Constitute a 'Franchise' (June 22, 1994) ("Commissioner's Release 3-F") available at https://dfpi.ca.gov/commissioners-release-3-f/ (also attached hereto as

Appendix 2).) The Commissioner's opinions are entitled to "great weight" under California law. (*Kim v. Servosnax, Inc.*, 10 Cal.App.4th 1346, 1353 (1992).)

The Commissioner has specified: "[T]he objective of the [California Franchise Investment] Law is to deal with a multiplicity of business arrangements . . . . Therefore, if the franchisee is ***granted the right to use the franchisor's symbol***, that part of the franchise definition [i.e., substantial association] is satisfied even if the franchisee is not obligated to display the symbol." (Commissioner's Release 3-F, at https://dfpi.ca.gov/commissioners-release-3-f/ (emphasis added).) Also: "[F]or the operation of the franchisee's business to be substantially associated with the symbol, it must be communicated to the customers of the franchisee." (Id.) Simply put, Olympic Eagle was "granted the right to use [Constellation's symbols, trademarks, etc.]" and these symbols were communicated to Olympic Eagle's customers. (4-ER-689-90 (Distribution Agreement ¶ 8(c)); 3-ER-495 (local market spend on advertising and promotion).) No more is required under California law.

Moreover, the Commissioner has also stated: "In resolving the question whether there is a substantial association between [the

franchisee's] business and [the franchisor's] commercial symbol, it is necessary to consider whether that commercial symbol is brought to the attention of the [franchisee's] customers to such an extent that the customers regard the [franchisee's] establishment as ***one in a chain identified with the licensor***." (Id. (emphasis added).) Again, under the present circumstances, Constellation's commercial symbols (Modelo, Corona, etc.) are clearly brought to the attention of Olympic Eagle's customers, the retailers, who necessarily regard Olympic Eagle as "one in a chain identified with" Constellation.

Consistent with the Commissioner's guidance, the California Court of Appeal has applied the "substantial association" element in a broad and inclusive manner. *See Kim v. Servosnax, Inc.*, 10 Cal.App.4th 1346 (1992). Under the analysis in *Kim*, Olympic Eagle is "substantially associated" with Constellation's trademarks.

In *Kim,* the owner of an office building ("Nicolet") contracted with a food service provider ("Servo") to operate a cafeteria within the building. (*Kim*, 10 Cal.App.4th at 1350.) Servo built out the cafeteria space, purchased and installed equipment, opened the cafeteria for

business, and then operated it for several weeks. (Id.) No name, logo, or symbol identified the cafeteria with Servo whatsoever. (Id.)

Servo then licensed the right to operate the cafeteria to Agnes Kim ("Kim"). (Id.) Servo controlled the menu and pricing for its cafeteria and made routine inspections. (Id.) Kim, like all of Servo's licensees, was <u>not permitted</u> to use Servo's name or any derivative thereof in the operation of the cafeteria. (Id.)

Servo terminated the agreement before the agreed five-year term had passed. (Id. at 1350-52.) Kim sued Servo, alleging that she had been its franchisee. (Id. at 1352.) Servo agreed that the first and third elements of a franchise were met, but disputed "substantial association." (Id. at 1353.)

The issue before the Court of Appeal was whether "the operation of [Kim's] business" was "substantially associated" with Servo's "trademark, service mark, trade name, logotype, advertising, or other commercial symbol" designating Servo or its affiliate.

The Court of Appeal began: "As a general matter, remedial or protective statutes such as the Franchise Investment Law are liberally construed," and that each element of the franchise test "should be

construed liberally to broaden the group of investors protected by the law and to carry out the legislative intent." (Id. at 1356 (underline added).)

The Court of Appeal found that the "customer" in this scenario was Nicolet, the owner of the office building. Thus, Servo, the alleged franchisor, contracted with Kim, the alleged franchisee, to provide services to Nicolet, the office building customer. (Id.)

Within this framework, the Court of Appeal concluded that, *despite the absence of any of Servo's logos or marks whatsoever at the office building*, Kim was "substantially associated" with Servo's "trademark, service mark, trade name, logotype, advertising, or other commercial symbol." (Id. at 1356-58.)

The Court's analysis is revealing. The Court found Kim was "intimately associated with Servo in the mind of the location owner" (i.e., in the mind of Nicolet, the office building customer). (Id. at 1357 (underline added).) Because Nicolet, as the customer, viewed Kim as linked to Servo, Kim was "substantially associated" with Servo's "trademarks," etc., and thus, the "substantial association" element was met. (Id. at 1357-58.)

At the same time, the Court of Appeal also recognized that the relevant "customer" might not be the office building, but rather, could be the employees who came into the cafeteria (i.e., the ultimate consumers). (Id. at 1358.) But the Court of Appeal's conclusion was based upon the customer (Nicolet's) subjective association of Kim with Servo. As the Court concluded: "In any event, Servo's name would be communicated to the host companies [i.e., Nicolet, the owner of the office building] in connection with the offer of its services." (Id.)

The outcome in *Kim* is one application of the California Franchise Commissioner's statement that "[i]n resolving the question whether there is a substantial association between [the franchisee's] business and [the franchisor's] commercial symbol, it is necessary to consider whether that commercial symbol is brought to the attention of the [franchisee's] customers to such an extent that the customers regard the [franchisee's] establishment as one in a chain identified with the licensor." (Id.)

Under *Kim*, two relevant entities might "substantially associate" a franchisee with the franchisor's symbols. First, because the direct customer, Nicolet, "substantially associated" Kim with Servo, this was

sufficient to meet the element under the franchise law. However, another relevant entity is the ultimate consumer of the franchisee's/franchisor's goods, in this case, the customers at the cafeteria. The Court in *Kim* found that because one of these two entities did "substantially associate" Kim with Servo, the "substantial association" element was met.

Unlike those in *Kim*, the "substantial association" facts are simple in this appeal. Constellation allowed—in fact, required—Olympic Eagle to use its commercial symbols (Modelo, Corona, etc.) to advertise and market its products. Olympic Eagle used those Constellation marks with its customers, the retailers, through in store and other advertising and promotional activities.

3. The District Court Misread *Gabana*

*Gabana* involved a situation that was entirely different from the present one. In *Gabana*, the distributor (Gabana) was specifically forbidden from using the supplier's (Gap's) trademarks in its operations in any way. *Gabana*, 343 F.Appx. at 259.

The memorandum opinion's terse reasoning was: "The district court correctly concluded that . . . the contract between Gabana and

Gap was not a franchise agreement under California law. The undisputed facts show that Gabana was merely a distributor or wholesaler of Gap *products*, but was not substantially associated with Gap's *trademarks*." *Gabana*, 343 F.Appx. at 259 (italics in original).

Thus, in *Gabana*, the distributor was merely shipping a supplier's products to retailers, and then collecting money from the retailers for those goods. This is quite different from the instant case, in which the retailers cannot help but view Olympic Eagle as "one in a chain identified with" Constellation. (*See* Commissioner's Release 3-F, at https://dfpi.ca.gov/commissioners-release-3-f/.)

4. *Atchley* Then Followed *Gabana*

The District Court's finding, that no "substantial association" had been shown, also cited an unreported district court opinion (*Atchley v. Pepperidge Farm, Inc.*, 2012 WL 60517130 (E.D. Wash. Dec. 6, 2012)). In *Atchley*, the Eastern District of Washington similarly misapplied *Gabana*. (Id. at **8-9.) The *Atchley* court concluded that a distributor's "substantial association" with a supplier could not be premised largely on the delivery of that supplier's products—but rather, had to involve some other type of "association" with the supplier's "trademarks." (Id.)

(The analysis leaves unclear who must be "associating" the distributor with the supplier's "trademarks," and it also leaves unclear how such "trademarks" are different from the supplier's "products.")

Here, the District Court misapplied *Gabana* by taking it entirely out of context. This Court should rectify that.

For all the reasons discussed herein, the retailers who purchase Constellation's brands from Olympic Eagle "substantially associate" Olympic Eagle with these brands, particularly Modelo and Corona. When Olympic Eagle drives into the retailer's driveway, in a trailer or truck *covered* in Modelo or Corona marks, the retailer cannot help but associate Olympic Eagle with Constellation's brands.

# CONCLUSION

For the foregoing reasons, Amicus urges the Court to affirm the District Court's issuance of a preliminary injunction.

RESPECTFULLY SUBMITTED this 22nd day of March, 2023.

By: */s/ Mark K. Slater*
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# CERTIFICATE OF COMPLIANCE FOR BRIEFS (FEDERAL NINTH CIRCUIT FORM 8)

I am the attorney or self-represented party. Pursuant to FRAP 32(a)(7)(b), this brief contains 5,950 words, including 72 words manually counted in any visual images, and excluding the items exempted by FRAP 32(f). The brief's type size and typeface comply with FRAP 32(a)(5) and (6).

I certify that this brief *(select only one)*:

☐ complies with the word limit of Cir. R. 32-1.

☐ is a **cross-appeal** brief and complies with the word limit of Cir. R. 28.1-1.

☒ is an **amicus** brief and complies with the word limit of FRAP 29(a)(5), Cir. R. 29-2(c)(2), or Cir. R. 29-2(c)(3).

☐ is for a **death penalty** case and complies with the word limit of Cir. R. 32-4.

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☐ it is a joint brief submitted by separately represented parties.

☐ a party or parties are filing a single brief in response to multiple briefs.

☐ a party or parties are filing a single brief in response to a longer joint brief.

☐ complies with the length limit designated by court order dated.

☐ is accompanied by a motion to file a longer brief pursuant to Cir. R. 32-2(a).

Dated: March 22, 2023

*/s/ Mark K. Slater*
Mark K. Slater
Attorney for Amicus Curiae

# APPENDIX OF EXHIBITS

# APPENDIX OF EXHIBITS

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# APPENDIX A

CFBD's Letter to the
federal Alcohol and Tobacco
Tax and Trade Bureau
dated August 18, 2021 (at
Exhibit B thereto); also
available at
regulations.gov/comment/
TTB-2021-0007-0279

1100 11th Street, Suite 10
Sacramento, CA 95814
CaliforniaFamilyBeerDistributors.com

August 18, 2021

Amy Greenberg
Director, Regulation and Rulings Division
Alcohol and Tobacco Tax and Trade Bureau
1310 G Street, NW, Box 12, Washington, DC 20005

**RE: Docket Number TTB-2021-0007, Notice No. 204**

Dear Ms. Greenberg,

California Family Beer Distributors ("CFBD") is pleased to respond to the Request for Information by the Department of the Treasury's Alcohol and Tobacco Tax and Trade Bureau regarding the current market structure and competitive conditions in the California wholesale beer market. CFBD represents independent, family-owned beer distributors based in California. Many of our members have been operating in their local markets for 50, 75, or even 100 years.

**Reyes Has Aggressively Consolidated the California Beer Wholesale Market in Just Three Years**

California follows the "three-tier" beer distribution system. Under this system, manufacturers or brewers (the first tier) sell to wholesalers (the second tier), which in turn sell to retailers (the third tier). There used to be a healthy, competitive market among California independent beer wholesalers in the second tier.

In recent years, one distributor has utterly changed the wholesale market in California, threatened the health of the California wholesale beer market, and harmed consumer choice. Through mergers, acquisitions, and forced consolidations, the Reyes Beer Division of Reyes Holdings, Inc. ("Reyes") now controls a 55% market share of all beer sold in California, compared to just 25% in 2018. Reyes' actions have resulted in approximately 18,000,000 cases taken from independent distributors in 2020 alone. Exhibits A and B illustrate the growth of Reyes' market share in California between 2018 and 2021.

Between 2018 and 2021, Reyes acquired at least Redding Distributing Company, Elyxir Distributing LLC, Bay Area Beverage Company, Claypool Distributing Company, W.A. Thompson, Inc., and DBI Beverage Inc.'s beverage distribution business in California.[1] The consolidation also saw major brands such as Constellation, Boston Beer, Diageo, and Sierra Nevada removed from California's independent distributors in forced sales. Independent distributors that were not acquired by Reyes are struggling to survive. Mission Beverage Co. folded into Ace Beverage Co., which eventually went out of business; Triangle Distributing Co. sold its business; Bottomley Distributing Co., Inc.'s profits were

[1] *Press Release*, REYES HOLDINGS, https://www.reyesholdings.com/news/press-releases (last visited Aug. 16, 2021); see Kate Bernot, *Reyes Comes for the King – California Distributor Bets Hard Seltzer, Mexican Imports Dethrone AB InBev in the Golden State*, GOOD BEER HUNTING, Jul. 10, 2020, https://www.goodbeerhunting.com/sightlines/2020/7/10/distributor-bets-hard-seltzer-and-mexican-imports-can-dethrone-ab-inbev (last visited Aug. 12, 2021) (reporting that Reyes has bought up 10 distributors in California in under two years).

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reduced by 70%; and many jobs were lost in this process.[2] There were 51 beer distributors in California before 2018, and now there are 37.[3]

In 2020, the Federal Trade Commission and the Antitrust Division of the U.S. Department of Justice estimated that Reyes distributed approximately one-third of all beer sold in California in 2019.[4] On December 15, 2020, Alcohol Justice, a state and national alcohol industry watchdog, requested the California Attorney General to investigate Reyes' antitrust violations because "the distributor is aggressively taking over smaller competitors."[5] This consolidation is effectively reducing the state's wholesaler market to two distributors, Anheuser-Busch InBev and Reyes. Anheuser-Busch InBev does not typically take smaller brands that may compete with its own offerings, and those smaller brands are also just ignored by Reyes. This is happening now.

**Reyes and Beer Manufacturers Have Orchestrated Forced Sales**

Beer distribution contracts in California typically allow a manufacturer to terminate its wholesaler without cause upon 30 days written notice. During the notice period, the outgoing wholesaler may choose to sell its distribution rights to a different wholesaler for fair market value, subject to the manufacturer's approval. This once promoted healthy competition among wholesalers, but now Reyes and major manufacturers, including Diageo, Constellation, Boston Beer, Sierra Nevada, are abusing that process to consolidate distribution rights into Reyes.

Between 2018 and 2021, Reyes orchestrated numerous "fire sales" with manufacturers, picking up brand distribution rights from independent distributors across California at below fair market value.[6] These distributors were terminated in droves, despite having decades-long relationships with the brands and remarkable sales records, and were forced to sell their rights to Reyes at below fair market value.

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[2] Exhibit A.

[3] Exhibit B.

[4] Joint Comment of the FTC Staff and DOJ Antitrust Division Staff to the Hon. Jim Wood Concerning California Assembly Bill 1541 (2020), https://www.ftc.gov/system/files/documents/advocacy_documents/joint-comment-ftc-staff-doj-antitrust-division-staff-california-state-assembly-concerning-california/v200008_california_beer_distribution_advocacy_2020.pdf.

[5] Letter from Bruce Lee Livingston, Alcohol Justice, to the Hon. Xavier Becerra Re: Request for independent investigation of Anheuser-Busch InBev and Reyes Holdings, LLC beer distribution antitrust violations, https://www.alcoholjustice.org/images/downloadables/ABI/AG-Becerra-Alcohol-Justice-Antitrust-request-1.pdf. (Dec. 15, 2020).

[6] *See, e.g.,* Matagrano Inc. v. Sierra Nevada Brewing Co., San Mateo County Superior Court Case: 21-CIV-02364, Complaint, ¶¶ 9-13 (alleging that Sierra Nevada terminated Matagrano without cause and unilaterally transferred Matagrano's rights to another distributor without Matagrano's consent and for below market price); Couch Distributing Company, Inc. v. Diageo Beer Company USA, Northern District of California Case: 5:21-cv-00842-VKD, Complaint, ¶¶ 8, 10, 16 (alleging that Diageo terminated its twenty-five-year relationship with Couch despite Couch's "excellent job distributing Diageo's product" and forced Couch to sell its rights "under duress of termination" to "the largest beer distributor in both California and the United States" for below fair market value).

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Most of them had to swallow the loss as legal battles are often too expensive for these family-owned businesses.[7]

Reyes' pattern of forced consolidation is illustrated in Classic Distributing and Beverage Group, Inc.'s lawsuit against Diageo.[8] Diageo terminated Classic without cause on June 15, 2020, despite Classic's decade-long spotless performance.[9] Industry news outlets reported Diageo's decision to move Classic's distribution rights to Reyes just two hours after Classic received oral notice of the termination, and before any formal, written termination notice was delivered.[10] Then, on June 26, 2020, Diageo informed all retailers in Classic's territory that Reyes would be replacing Classic, even though Classic had not agreed to sell its rights to Reyes or anyone else.[11] Not surprisingly, Reyes offered to purchase Classic's rights at only a fraction of the fair market value.[12]

Similar forced consolidations of Constellation, Boston Beer, and Sierra Nevada brands also took place during the same period.[13] But unlike its rival Anheuser-Busch InBev[14], Reyes has for now dodged scrutiny under antitrust laws, even though it was selling 1.6 times as much beer in California as Anheuser-Busch InBev in 2020.[15] As noted by Good Beer Hunting, "Reyes—the country's ninth-largest privately held company—faces no roadblocks in buying up distributors."[16]

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[7] *See e.g.,* 1. Markstein Beverage Co. has sold the distribution rights for Constellation Brands in Northern San Diego County to Reyes Beverage Group, INSIDE BEER (Jun. 8, 2018), https://inside.com/campaigns/inside-beer-2018-06-08-6862 (last visited Aug. 12, 2021) (reporting that the president of the outgoing distributor wrote to employees that "we also felt that a prolonged legal dispute was not in our best interest").

[8] Classic Distributing and Beverage Group, Inc. v. Diageo Beer Company USA, Central District of California Case: 2:20-cv-06684-DMG-KS.

[9] *Id.*, at ¶¶ 9-11, 15.

[10] *Id.*, at ¶ 20.

[11] *Id.*, at ¶ 21.

[12] *Id.*, at ¶ 23.

[13] *See* Exhibit A; Jessica Infante, *Diageo Moves Brands From Couch, Matagrano to Reyes in Northern California*, BREWBOUND, Nov. 2, 2020, https://www.brewbound.com/news/diageo-moves-brands-from-couch-matagrano-to-reyes-in-northern-california/; Matagrano Inc. v. Sierra Nevada Brewing Co., *supra*, Complaint, ¶¶ 9-13; Couch Distributing Company, Inc. v. Diageo Beer Company USA, *supra*, Complaint, ¶¶ 8, 10, 16.

[14] United States v. Anheuser Busch InBev, D.C. District Case: 16-1483.

[15] Kate Bernot, *Golden Opportunity – California Tensions over Consolidation, Stay-At-Home Orders, Cannabis Provide National Case Studies*, Good Beer Hunting (Jan. 19, 2021), https://www.goodbeerhunting.com/sightlines/2021/1/19/california-tensions-over-consolidation-covid-cannabis (last visited Aug. 12, 2021).

[16] Kate Bernot, *Reyes Comes for the King – California Distributor Bets Hard Seltzer, Mexican Imports Dethrone AB InBev in the Golden State*, GOOD BEER HUNTING, Jul. 10, 2020, *supra* note 1.

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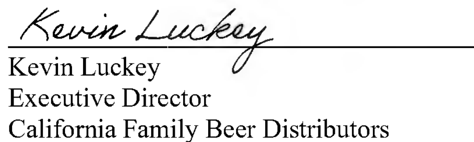
Reyes' actions in California also worry the craft brewers in the state. The Executive Director of California Craft Brewers Association reportedly wrote to Good Beer Hunting that "[a] consolidated middle tier that provides less access to the marketplace for small breweries is not healthy. It is an issue that is important to the CCBA and our members."[17]

**Conclusion**

We thank you for the opportunity to provide information regarding the current threat to competition in the beer marketplace. Reyes is building a monopoly in California, with consumers bearing the brunt of the market deterioration. CFBD urges the Department of the Treasury to investigate and take prompt, decisive action. We look forward to answering any questions or providing additional input as needed.

Sincerely,

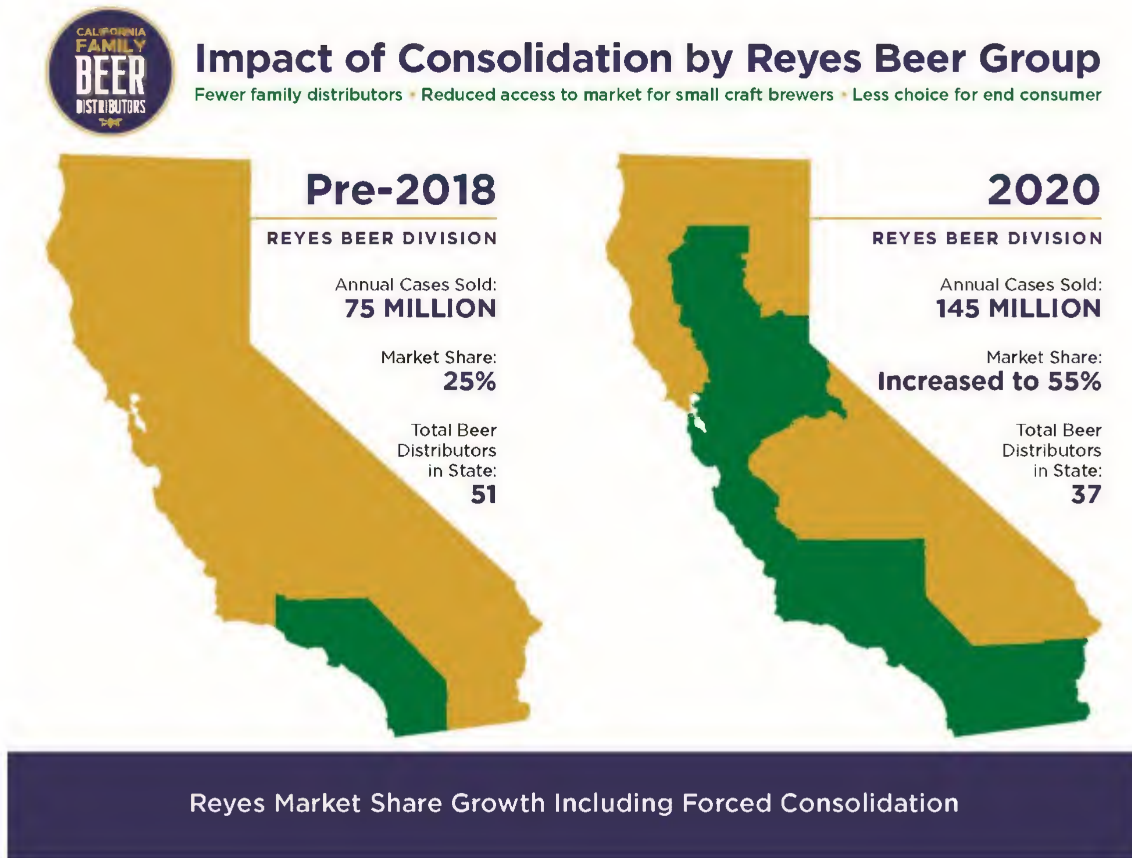


Kevin Luckey
Executive Director
California Family Beer Distributors

[17] Note 15, *supra*.

Exhibit A

Exhibit B



# APPENDIX B

When Does an Agreement Constitute a 'Franchise' (June 22, 1994) ("Commissioner's Release 3-F") available at https://dfpi.ca.gov/commissioners-release-3-f/

# Commissioner's Release 3-F: When Does an Agreement Constitute a "Franchise"

**Pete Wilson**, Governor
**Date:** June 22, 1994

**Gary Mendoza,** Commissioner

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This release provides guidance based on interpretive opinions which may be of assistance in determining whether an agreement constitutes a "franchise," "area franchise" or "subfranchise" under Sections 31005(a), 31008, 31008.5 and 31010, respectively, of the Franchise Investment Law (Corporations Code Section 31000 et seq.) ("the Law"), the offer of which may be subject to the registration requirements of Section 31110, unless the transaction is exempted by Sections 31100 through 31104 (or by a rule of the Commissioner of Corporations), or unless excepted from the definition of a franchise under Section 31005(c). An offer of a franchise subject to registration under the Law or exempted from such registration by Section 31100 or 31101 of the Law, is excluded from the definition of "security" in Section 25019 of the Corporate Securities Law of 1968 (Corporations Code Section 25000 et seq.).

1. **FRANCHISE**
   1. **ELEMENTS:**
      Four elements are essential for an agreement to constitute a "franchise" within the definition of Section 31005, subdivision (a), of the Law:
      1. A right must be granted to the franchisee to engage in the business of offering, selling or distributing goods or services;
      2. The right must be granted to engage in the business under a marketing plan or system prescribed in substantial part by the franchisor;
      3. The operation of the franchisee's business must be substantially associated with an advertising or other commercial symbol designating the franchisor or an affiliate of the franchisor, such as a trademark, service mark, trade name or logotype; and
      4. The franchisee must be required to pay, directly or indirectly, a fee or charge,

known as a "franchise fee," for the right to enter into the business.

However, the percentage of gross revenues of a business that is attributable to the "franchise" agreement may not be a factor in determining whether the agreement in question is a "franchise." (Comm. Op. No. 74/9F.)

2. **ANALYSIS OF EACH ELEMENT**
   1. **Franchisee Engaged in Business**
      For an agreement to be a "franchise," the franchisee must be granted the right to engage in the business of offering, selling, or distributing goods or services; but an agreement which grants the franchisee the right to engage in a business identified with the franchisor's commercial symbol is no less a franchise by reason of the fact that the franchisee previously, on his own and without reference to the franchisor's plan and symbol, had been engaged in the particular line of business. (Comm. Op. No. 72/29F.) Furthermore, the franchisee must be granted the right to offer, sell, or distribute goods or services to others rather than solely to the franchisor. (Comm. Op. Nos. 74/11F, 82/3F.) Also, the grant of the right by the franchisor to franchisees to solicit others to join in the franchise operation, or to solicit sales of other franchises, constitutes the right to engage in business. (PL/22F.)

      If the agreement does not grant the franchisee the right to engage in business, it is not a franchise. Thus, an agreement by which a person designated as "franchisee," for a fee which is designated as "franchise fee," is given the right to participate in the profits of a business, but who is given no right to operate or participate in the operation of the business, is not a franchise, but is a profit participation arrangement or investment contract which may be subject to the qualification requirements of the Corporate Securities Law of 1968. (Comm. Op. No. 72/27C.)

   2. **Marketing Plan or System**
      For the agreement to constitute a "franchise," the business in which the franchisee is granted the right to engage in must be operated under a marketing plan or system prescribed in substantial part by the franchisor.

      1. **No Marketing Plan**
         If no marketing plan or system is prescribed and the franchisee is left entirely free to operate the business according to the franchisee's own marketing plan or system, the agreement is not a franchise. Thus, a distribution agreement by which a manufacturer or wholesaler for a fee grants the right to a distributor or retailer to sell a trade-marked product purchased from the manufacturer or wholesaler is not a franchise if the distributor or retailer may sell the product according to its own plan without express or implied limitations on the method or mode of sale, but this is not the case where the agreement includes the soliciting of others to purchase further "franchises" which may itself constitute a marketing plan. (Comm. Op. No. 71/25F.)

      2. **Interpretation in Line with Objective of the Law**
         In making the determination whether there is a prescribed marketing

plan or system, it is necessary to keep in mind the objective of the Law to deal with a multiplicity of business arrangements created by the franchisor and presented to the public as a unit or marketing concept, and for all of which the franchisor ostensibly assumes responsibility by causing these arrangements to be operated with the appearance of some centralized management and uniform standards regarding the quality and price of the goods sold, services rendered, and other material incidents of the operation. The marketing plan or system prescribed by the franchisor is one of the important means by which the appearance of centralized management and uniform standards is achieved. (Comm. Op. No. 73/39F.)

3. **Significant Provisions**
If the franchisor in his advertising to prospective franchisees claims to have available a successful marketing plan, the element of a marketing plan presumably will be present. In other cases, provisions contemplating a nation- or area-wide distribution grid on an exclusive or semi-exclusive basis, possibly with multiple levels of jurisdiction such as regional and local distributorships, and an arrangement designed to establish uniformity of prices and marketing terms are significant. Control reserved over terms of payment by customers, credit practices, warranties and representations in dealings between franchisees and their customers, suggest a uniform marketing plan. Provisions concerning collateral services, which may or may not be rendered, or prohibiting or limiting the sale of competitive or non-competitive goods are consistent with, though certainly not in and of themselves determinative of, a prescribed marketing plan. Significance attaches to provisions imposing a duty of observing the licensor's directions or obtaining the licensor's approval with respect to the selection of locations, the use of trade names, advertising, signs, sales pitches, and sources of supply, or concerning the appearance of the Licensee's business premises and the fixtures and equipment utilized therein, uniforms of employees, hours of operation, housekeeping, and similar decorations.

The implementation of these and other similar directions by procedures for inspection by, and reporting to, the franchisor with respect to the conduct of the franchised business, and the right of the franchisor to take corrective measures, possibly at the expense of the franchisees, are indicative of the franchisor's control over the franchisees' operations and, consequently, of a marketing plan prescribed by the franchisor. A comprehensive advertising or other promotional program of the franchisor with or without an obligation on the part of the franchisees to bear part of the expense of such program, is indicative of a marketing plan prescribed by the franchisor, especially if the advertising or promotional material identifies the locations of the franchisees, and the more so if individual advertising or promotional activities by franchisees

are prohibited or require the prior approval of the franchisor. Furthermore, the ability of the franchisor to control the essential decision making process of a franchisee's business, such as through a majority ownership interest in the business or by appointing a majority of the members of a committee that is responsible for making important decisions relating to sales, marketing, merchandising, personnel, etc., is indicative of a marketing plan prescribed by the franchisor. (Comm. Op. Nos. 75/2F, 79/2F; OP 4736F.

4. **Prescribed "In Substantial Part"**
   Close questions of interpretation are presented by agreements which grant to a person the right to engage in business subject to some restrictions but with a measure of freedom regarding the plan or system under which the grantee's business is to be operated. Section 31005(a) provides that to be a franchise, the marketing plan or system must be prescribed by the franchisor "in substantial part." Whether the directions given to the franchisee in the agreement are "substantial" in this sense, is a question which necessarily must be determined, with respect to each agreement, based upon an evaluation of all provisions contained therein and the effect which these provisions have as a whole on the ability of the person engaged in the business to make decisions substantially without being subject to restrictions or having to obtain the consent or approval of other persons. This determination may be made in the light of applicable principles of general law and of customs prevailing in the particular trade or industry.

5. **Marketing Plan "Prescribed" by Implication**
   A marketing plan or system may be "prescribed" within the meaning of Section 31005(a), although there may be no obligation on the part of the franchisee to observe it, where a specific sales program is outlined, suggested, recommended, or otherwise originated by the franchisor. Thus, a sales program may be "prescribed" by the franchisor where the franchisor supplies the franchisee with sales aids or props, such as demonstration kits, films, or detailed instructions for personal introduction and presentation of the product, possibly including the text of a sales pitch and especially where such a program is supported by training material, courses, or seminars. (Comm. Op. No. 71/61F.) By such means, a non-mandatory program may attain the level of a "prescribed" program, particularly where there are negative covenants against the use of specified modes of distribution such as a prohibition of sales to retail stores.Therefore, a provision in the agreement that the franchisee is to be considered an independent contractor or that the franchisor is not concerned with the means employed by the franchisee to make sales or with the manner in which the business of the franchisee is conducted does not preclude the possibility that the franchisor's business is operated pursuant to a marketing plan or system prescribed in substantial part by the franchisor. be a franchise.

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(Comm. Op. No. 73/40F.)

6. **Normal Routines No Marketing Plan**
   On the other hand, the requirement of a marketing plan or system prescribed in substantial part by the franchisor is not satisfied merely because an agreement imposes upon the operator of a business procedures or techniques which are customarily observed in business relationships in the particular trade or industry, even though, to some extent, they may restrict the freedom of action or the discretion of the operator. Thus, an obligation imposed on a distributor to use his best efforts to make or increase sales of the licensor's product is too general a requirement to amount to a marketing plan or system. Where a television station is Licensed to produce a copyrighted games show, there is no marketing plan or system merely because the station is required to follow the format of the show and use props provided by the licensor. (Comm. Op. No. 71/42F.)

   Where a restaurant is authorized to be conducted under a trade name without the imposition of any other marketing plan or system, a requirement that public liability insurance be maintained in a certain amount does not characterize the agreement as a franchise because such a requirement is not a substantial limitation and is normal and customary in an agreement where the licensor may be exposed to liability as a result of the Licensee's operation of the business. Likewise, where a manufacturer is Licensed by an inventor to make and sell a patented device subject to a royalty reserved by the inventor, or where a retail store is Licensed to distribute trade-marked articles subject to a royalty reserved by the manufacturer, it would be customary to require maintenance of records and accounts by the Licensee for verification of the royalty due under the agreement. Also, specifications to be observed by a Licensee in the manufacture of a patented device designed to protect the quality of the product are normal in such circumstances. These requirements in and of themselves do not amount to a marketing plan or system. (Comm. Op. Nos. 73/2F, 73/35F; but see, Comm. Op. No. 73/39F.)

7. **Some Examples**
   The Commissioner of Corporations' opinions have considered the presence of a marketing plan in light of the following provisions in an agreement:

   - Prescribing or limiting resale prices (Comm. Op. Nos. 72/11F, 73/5F, 73/47F; PL/27F);
   - Restrictions on use of advertising or mail order business (Comm. Op. No. 73/47F);
   - Requiring display racks (Comm. Op. No. 73/9F);
   - Giving detailed directions and advice concerning operating techniques (Comm. Op. Nos. 72/11F, 72/20F, 73/17F);

- Assigning exclusive territory (Comm. Op. Nos. 72/45F, 73/20F, 73/25F, 73/30F);
- Providing for uniformity or distinctiveness of appearance (Comm. Op. Nos. 72/10F, 72/21F, 73/26F, 73/27F, 73/29F);
- Limiting sale of competitive products (Comm. Op. Nos. 72/3F, 72/25F, 73/30F);
- Limiting use of products (Comm. Op. No. 74/6F); Requiring approval of advertising and signs (Comm. Op. Nos. 72/4F, 72/45F);
- Prohibiting engaging in other activities (Comm. Op. No. 75/6F);
- Providing training sessions (Comm. Op. Nos. 72/25F, 72/34F, 72/42F);
- Assigning contract (Comm. Op. No. 74/7F);
- Use of manual (Comm. Op. No. 72/42F);
- Providing "trade secrets" (Comm. Op. No. 74/8F).
- While any one of the examples of restrictions may not amount to "a marketing plan or system prescribed in substantial part by a franchisor," several such restrictions taken together may be sufficient to amount to such a plan or system.

3. **Substantial Association with Franchisor's Commercial Symbol**
To constitute a franchise, the operation of the franchisee's business must be substantially associated with the franchisor's commercial symbol, such as a trademark, service mark, trade name, or logotype. An agreement is not a franchise, though it prescribes a detailed marketing plan or system for the operation of the business authorized thereby, if that business is not substantially associated with a commercial symbol of the franchisor or its affiliate.

Again, the objective of the Law is to deal with a multiplicity of business arrangements presented to the public as a unit or marketing concept operated pursuant to a uniform marketing plan and under a common symbol. Therefore, if the franchisee is granted the right to use the franchisor's symbol, that part of the franchise definition is satisfied even if the franchisee is not obligated to display the symbol. (Comm. Op. No. 73/20F.)

Moreover, in line with the objective of the Law, for the operation of the franchisee's business to be substantially associated with the symbol, it must be communicated to the customers of the franchisee. A commercial symbol which a supplier of goods or services only uses on its invoices or in its advertising to distributors, but which the supplier does not permit the distributors to show in dealing with their customers, is not in the eyes of the public substantially associated with the operation of the supplier. (Comm. Op. Nos. 71/16F, 73/18F.)

However, where the trademark is communicated to the customers of the supplier, the appearance of a unified operation is established and it is immaterial whether the advertising containing the trademark is originated, distributed, or paid for by the supplier or by the distributor. In resolving the

question whether there is a substantial association between the Licensee's business and the licensor's commercial symbol, it is necessary to consider whether that commercial symbol is brought to the attention of the Licensee's customers to such an extent that the customers regard the Licensee's establishment as one in a chain identified with the licensor. (Comm. Op. Nos. 73/5F, 78/1F.) Thus, in one case, the shape devised by a franchisor for the franchisees' restaurants amounted to a commercial symbol. (PL/37F.) In another case, the various manufacturing plants with which the franchisor entered into service contracts with, and which were later assigned to the franchisees, were considered "customers" of the franchisees. Since the franchisor communicated its name to these customers as a result of negotiating the service contracts and by being a named party to the service contracts, it was concluded that the franchisees' businesses were substantially associated with the commercial symbol of the franchisor. (Comm. Op. No. 74/7F.)

4. **Franchise Fee**
   For the agreement to constitute a franchise, the agreement must call for the payment of a franchise fee by the franchisee.

   1. **Definition**
      Section 31011 of the Law contains a broad definition of "franchise fee." That section includes in the definition any fee or charge that a franchisee is required to pay or agrees to pay for the right to enter into a business under a franchise agreement. In accordance with this definition, any fee or charge which the franchisee is required to pay to the franchisor or an affiliate of the franchisor for the right to engage in business is a franchise fee regardless of the designation given to, or the form of, such payment.

      Whether or not a fee or charge is "required" and whether it is made "for the right to enter into a business," is a mixed question of fact and law.

   2. **Types of Franchise Fees**
      A franchise fee may be payable in a lump sum or in installments. The amount of the installment payments may be made to depend on gross receipts or net profits in the form of a royalty, or it may be charged on units of merchandise ordered or sold by the franchisee. Thus, the franchise fee may be contained in the price charged by the franchisor or an affiliate of the franchisor for goods or services supplied to the franchisee or in the rental fee payable by the franchisee for business premises or equipment rented from the franchisor or an affiliate of the franchisor.

   3. **Bona Fide Wholesale Price of Goods**
      Under Section 31011, there is an exception from the definition of franchise fee for a payment on account of the purchase of goods in an amount not exceeding the bona fide wholesale price of such goods. This exception is based on the rationale that no substantial prejudice

will come to a person buying a business and paying only the bona fide wholesale price for merchandise which that person proposes to sell in the business. Under these circumstances, such a payment is not deemed to be made for the right to enter into the franchised business. (Comm. Op. No. 73/20F.)

In line with this rationale, "bona fide wholesale price" means the price at which goods are purchased and sold by a manufacturer or wholesaler to a wholesaler or dealer where there is ultimately an open and public market in which sales of the goods are effected to consumers of the goods. "Bona fide wholesale price" does not include the price of goods for which there is no such open and public market, and where the goods are sold primarily to a person engaged in their redistribution. (PL/20F; Comm. Op. Nos. 71/52F, 73/1F, 74/2F.)

4. **Goods**

The bona fide wholesale price exception is applicable only to the purchase of goods which the franchisee is authorized to distribute by the franchise agreement and the exception does not apply to payments which the franchisee is required to make under the franchise agreement in return for benefits other than goods, such as payment for real estate or services or rental payments. Furthermore, the exception is not applicable to fixtures, equipment or other articles which are to be utilized in the operation of the franchised business, such as display cases, tools, equipment, and, in the case of a restaurant franchise, such items as table linen, napkins, flatware and other service utensils. However, Commissioner's Rule 310.011.1 (10 C.C.R. Sec. 310.011.1) exempts from the registration requirement of Section 31110 the offer or sale of a franchise which is subject to registration solely because the agreement obligates the franchisee to pay a sum of not exceeding $1,000 annually on account of the purchase price or rental of fixtures, equipment or other tangible property to be utilized in, and necessary for, the operation of the franchised business, if the price or rental fee so charged does not exceed the cost which would be incurred by the franchisee acquiring the item or items from other persons in the open market. (Comm. Op. No. 74/6F.)

Moreover, Commissioner's Rule 310.011 (10 C.C.R. Sec. 310.011) exempts from the registration requirements of Section 31110 the offer or sale of a franchise which is subject to registration solely because the franchisee is required, directly or indirectly, to make a payment, no matter for what purpose, as long as on an annual basis the payment does not exceed $100. This exemption is additional to the exemption contained in Rule 310.011.1.

Under Section 31011, the exception with respect to "goods" does not include an idea or program, whether or not the idea or program is offered or distributed by word of mouth through instructions or lectures,

in the form of written or printed material or by a combination of both. Rather, the communication of such an idea or program is in the nature of a service to which the exemptions under Section 31011 and Rule 310.011.1 are not applicable. (PL/17F.)

5. **Quantity of Goods**
Under Section 31011, the bona fide wholesale price exception is further limited to apply only if no obligation is imposed upon the purchaser to purchase or pay for a quantity of such goods in excess of that which a reasonable business person normally would purchase by way of a starting inventory or supply, or to maintain a going inventory or supply. Since a payment for such purchases is made by the franchisee not because the franchisee has a need for the goods, it is reasonable to conclude that the purchases are only to secure the right of selling the goods under the franchise agreement, and for that reason the payment constitutes a franchise fee. (Comm. Op. Nos. 73/1F, 73/10F.)

6. **Question of Fact**
Whether the price which the franchisee under the agreement is required to pay for goods exceeds their bona fide wholesale price (or exceeds it by an amount in excess of that allowed by Rules 310.011 and 310.011.1) is a question of fact. Also a question of fact is, whether the quantity of goods the franchisee is required to purchase or pay for exceeds what a reasonable business person normally would purchase as a starting inventory or supply, or to maintain a going inventory or supply. The Commissioner will not resolve these questions in an interpretive opinion since such opinions are limited to the interpretation and determination of legal questions arising under the Law. (See, Commissioner's Release No. 61-C.)

   However, there are some legal considerations applicable to the determination of the bona fide wholesale price as follows:

   1. The bona fide wholesale price of goods which are sold under a trademark or other commercial symbol may vary depending on the degree to which such trademark or symbol has attained public acceptance. The price charged for trade-marked articles does not necessarily exceed their bona fide wholesale price when non-trade-marked articles of equal or comparable quality are wholesaled at a lower price because products with little or no market identification usually have a lower bona fide wholesale price than items, though of comparable quality, which have a marketing history and a ready identity in the market place. Therefore, if, as a matter of fact, at the time of the franchise agreement the trade-marked articles command a premium price in the market place by virtue of the trademark, the premium is not necessarily a franchise fee. (Comm. Op. No. 71/2F.) However, sales to distributors who are all within the common enterprise or

marketing system is not sufficient to substantiate the ultimate marketability and market identification of the product and, consequently, do not serve to support the bona fide wholesale price of the product being sold. (Comm. Op. No. 73/1F.)

2. The bona fide wholesale price of goods may vary at different levels of the distribution system or depend on the quantity of goods sold. Thus, a variance in the price paid by franchisees selling goods at different levels of distribution, such as jobbers selling to wholesalers and wholesalers selling to retailers, does not necessarily lead to the conclusion that the higher price paid by franchisees on the lower level constitutes a franchise fee. In a layered system of distribution, the price paid by a person engaged in distribution of the goods on one level may be a bona fide wholesale price, though it may be at variance with the bona fide wholesale price paid for the same goods by a distributor on another level. (Comm. Op. Nos. 71/53F, 73/41F.)
3. The fact the price of goods is negotiable may defeat a claim of the bona fide wholesale price exception. When the sales price is negotiable, the sellers are unable to contend that sales are being made at the bona fide wholesale price since sales prices will vary according to the ability of the purchaser to negotiate. (Comm. Op. No. 74/10F.)
4. Under Section 31153 of the Law, the franchisor has the burden of proving that the price at which goods are sold to the franchisee does not exceed the bona fide wholesale price of such goods. Similarly, the franchisor must prove the facts to support any other exemption, such as those under Rules 310.011 and 310.011.1.

7. **"Required" to Pay**
The Law does not include in the definition of "franchise fee" payments which the franchisee is not required to make but which are optional and required only if the franchisee elects to purchase, lease or rent merchandise, equipment or other property from the franchisor or an affiliate of the franchisor. In the absence of an obligation or a condition in the franchise agreement compelling action on the franchisee's part, or the necessity for undertaking such obligation in order to successfully operate the business, voluntary payments are not "required" under the agreement and, therefore, are not included within the statutory definition of "franchise fee." Also, voluntary payments, presumably, are not made for the right to enter into a franchised business and for that reason do not come within the definition.However, while a truly optional payment is not a franchise fee, a payment by a franchisee, though nominally optional, may in reality be essential; this is especially so if the franchisor intimates or suggests that the payment is essential for the successful operation of the business.

8. **Payments to Franchisor or Others**
Payments which the franchisee is required to make under the franchise

agreement for the account of the franchisor are equivalent to payments made to the franchisor. Thus, it makes no difference whether payments for the rental of premises are required to be made by the franchisee to the franchisor as the owner and lessor of the premises, or to a third-party owner where the franchisor is the lessee and the franchisee the sublessee.

Also, payments required in the franchise agreement to be made by the franchisee for advertising and promotion to enhance the good will of the franchisor's business, even though the advertising and promotion also benefit the franchisee's business, may be deemed made for the account of the franchisor, especially where the agreement gives the franchisor discretion to determine the manner and content of the publicity. (PL/38F, PL/43F.)A payment to, or for the account of, third parties not affiliated with the franchisor is not a "franchise fee" within the meaning of Section 31011, even though the franchisee is required by the agreement to make such payment and even if the franchisor collects it from the franchisee on behalf of the third party; provided that such payment is not made for the right to enter into the business. However, under Section 31101(c)(1)(G) of the Law, if the agreement is a franchise as a result of other payments required of the franchisee amounting to a franchise fee, the obligation to make payments to the franchisor, in whole or in part, on behalf of third parties must be disclosed in writing by the franchisor.

9. **Some Examples**
   The Commissioner's opinions have considered the following types of payments as constituting a "franchise fee":

   - Performance guarantee or deposit (Comm. Op. Nos. 72/25F, 73/10F, 75/6F);
   - Deposit of money (Comm. Op. Nos. 73/15F, 74/3F, 74/5F, 74/6F);
   - An initial or set-up fee (Comm. Op. Nos. 72/23F, 73/15F);
   - Fee for advertising (Comm. Op. Nos. 72/11F, 73/17F);
   - Nonrefundable bookkeeping charge (Comm. Op. No. 72/13F);
   - A payment for training and school expenses (Comm. Op. Nos. 71/60F, 73/39F);
   - Royalty or percentage of gross receipts (Comm. Op. Nos. 72/47F, 73/23F, 73/24F);
   - Charges for sales kits, brochures, programs, forms, decals, shirts, displays and announcements (Comm. Op. Nos. 71/49F, 73/29F, 82/1F);
   - Rental or lease fee (Comm. Op. Nos. 73/26F, 73/50F);
   - Payment for services, such as consulting or management fees (Comm. Op. Nos. 73/25F, 73/41F, 77/1F, 79/2F).

2. **SUBFRANCHISE**

According to Section 31010 of the Law, "franchise," unless otherwise stated, includes a "subfranchise." "Subfranchise" is defined in Section 31008.5 to mean an agreement by which a franchisor for a consideration grants to a subfranchisor the right to sell or negotiate the sale of franchises in the name or on behalf of the franchisor. Section 31009 of the Law defines a "subfranchisor" as a person to whom a subfranchise is granted.

Therefore, when an agreement with a distributor constitutes a franchise, the distributor's agreement granting to a sub-distributor the right to appoint lower level sub-distributors for a consideration is a subfranchise, which is also subject to the registration requirement of Section 31110. (Comm. Op. Nos. 73/1F, 73/39F.) Thus, the same agreement may constitute both a franchise and a subfranchise, which means that a person may be both a franchisee and a subfranchisor under the same agreement. (Comm. Op. No. 92/1F.) However, the definition of subfranchise does not require the subfranchisor to also be a franchisee and the agreement constituting a subfranchise may be a totally separate and independent agreement.

"Consideration" for purposes of a subfranchise is not limited to the payment of a fee, as it is under the definition of franchise in Section 31005(a) of the Law. Instead, "consideration" is construed to mean any payment or other legal consideration. Accordingly, an expenditure required on account for sales and technical assistance, or training and supervision, constitutes "consideration" for purposes of the statutory definition. (Comm. Op. No. 92/2F.)

(It should be noted that the Law was amended in 1988 to transfer the definition of "area franchise" to "subfranchise" and to give "area franchise" a new definition.)

3. **AREA FRANCHISE**
According to Section 31010 of the Law, "franchise," unless otherwise stated, includes an "area franchise." "Area franchise" is defined in Section 31008 of the Law to mean any franchise between a franchisor and a franchisee whereby the franchisee is granted the right to operate more than one unit within a specified geographical area.

4. **CONCLUSION**
This release provides some insight into the complexity one faces when attempting to answer the question of whether an agreement involves an offer or sale of a franchise. The practitioner should review the opinions and, when the question is unclear, either request an interpretive opinion under Section 31510 of the Law (and pursuant to the requirements of Commissioner's Release No. 61-C) or file an application for registration of an offer of a franchise pursuant to Section 31110 of the Law.

WILLIAM KENEFICK
Assistant Commissioner
Office of Policy

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- Online Escrow Companies
- File a Complaint
- Search for DBO Licensees

- Search for DBO Actions, Orders and Administrative Hearing Decisions
- Consumer Alerts
- Consumer Advisories
- Resources and Online Tools
- Submit a Public Records Request

## News and Information

- Payday Lending Data
- Consumer Finance Lender Data
- Mortgage Lender Data
- Financial Data on Banks/Other Financial Institutions
- Bank Officer and Director Compensation Data
- DBO Press Releases
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# APPENDIX C

3 ER 371-375, at ¶¶ 13-16; Declaration of Shawn Bai in Support of Plaintiff's Opposition to Defendants' Motion to Stay Proceedings (Dkt. No. 65, Feb. 13, 2023), at ¶ 9, City Beverages LLC v. Crown Imports LLC, No. 3:22-CV-05756-DGE (W.D. Wash.)

HONORABLE DAVID G. ESTUDILLO

UNITED STATES DISTRICT COURT
DISTRICT OF WASHINGTON
TACOMA DIVISION

CITY BEVERAGES, L.L.C, d/b/a Olympic Eagle Distributing, a Missouri limited liability company with its principal place of business in Washington,

Plaintiff,

v.

CROWN IMPORTS LLC d/b/a Constellation Brands Beer Division, a Delaware corporation with its principal place of business in Illinois; CONSTELLATION BRANDS, Inc, a Delaware corporation with its principal place of business in New York,

Defendants.

CASE NO.: 3:22-cv-05756-DGE

**DECLARATION OF SHAWN BAI IN SUPPORT OF PLAINTIFF'S OPPOSITION TO DEFENDANTS' MOTION TO STAY PROCEEDINGS**

1. I Shawn Bai, declare as follows:

2. I am the Chief Financial Officer of Olympic Eagle Distributing ("Olympic Eagle"), a job I have held since 2003. The facts in this declaration are based on my personal knowledge and, if called to testify, I could and would competently testify to these facts.



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1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26

3. In a letter dated September 8, 2022, Crown Imports LLC doing business as Constellation Beer Brands informed Olympic Eagle that it would be terminating the distribution agreement effective in 60 days. Constellation gave no reason for the termination.

4. After this Court issued a temporary restraining order on November 8, 2022, Constellation rescinded the termination notice and the status quo of our relationship has been maintained. Olympic Eagle ended 2022 with sales of Constellation products up 10.6 percent from the prior year, exceeding our agreed upon sales target with Constellation by more than 30 percent. So far in 2023, Olympic Eagle's sales of Constellation products have increased by 20 percent from the same period in 2022.

5. As discussed below, however, the status quo has not been preserved with other relationships in our business, including with our lenders, our employees, and our competitors. The ongoing uncertainty over the future of Olympic Eagle's Constellation business is harming our ability to compete with rival distributors like Columbia Distributing ("Columbia").

6. Shortly after we received the notice from Constellation, we were contacted by the CEO for our largest competitor, Columbia, who said his company was the preferred successor for our Constellation distribution rights.

7. Columbia is represented by the same law firm, Tousley Brain, that is representing Constellation in this lawsuit. I have reason to believe Columbia has agreed to pay Constellation for legal fees incurred in this lawsuit. Columbia, formally known as Coho Distributing, is owned by a private equity firm, Meritage Group.

8. Columbia, with the backing of its private equity owners, has been aggressively acquiring distribution rights to substantially grow its market share. Columbia will directly benefit from a



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delay in resolving this litigation, as discussed below, because of the difficulties it creates for Olympic Eagle to effectively compete for new product or territory rights and to retain or hire new employees.

9. Based on data from a commercial service IRI, current market shares for Olympic Eagle's territory based on dollar sales volume are approximately as follows: Olympic Eagle at 33.8 percent; Columbia at 56.7 percent, and Odom Distributing ("Odom") at 9.5 percent. If Columbia succeeds in acquiring our Constellation rights, the market shares would change to be approximately as follows: Olympic Eagle at 25.1 percent; Columbia at 65.4 precent, and Odom 9.5 percent. This estimate allocates an "all other" category of smaller brands distributed evenly between Columbia and Odom tracked by the IRI data, an assumption that I believe understates Columbia's market share. I believe Columbia's market share in the territory Olympic Eagle services will likely exceed 70%. Market share data for Olympic Eagle's territory from IRI is summarized as Exhibit A.

10. Columbia's market power will make it very difficult for Olympic Eagle to acquire brands or to attract and retain employees. Columbia distributes products for every major supplier in Olympic Eagle's territory except Anheuser-Busch. In a post-termination world, Anheuser-Busch would represent 90% of Olympic Eagle's sales with the company's next largest 3 suppliers representing 2%, 2% and 1% of sales respectively, which is a similar product mix that forced a number of California wholesalers that Constellation terminated to sell their businesses.

11. Since June 13, 2011, Olympic Eagle's primary lender has been JP Morgan Chase ("Chase"). Chase has informed Olympic Eagle that because of Constellation's actions to



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terminate Olympic Eagle without cause, the company's loan is in default, a status that will not change until this lawsuit is resolved.

12. The heightened bank scrutiny that accompanies Olympic Eagle's loan default status makes it unlikely we can increase our Chase line of credit and eliminates the possibility of acquiring funding on reasonable terms from other lending sources while the lawsuit is pending.

13. The pending lawsuit has weakened our ability to grow to compete with Columbia. For example, last month we were offered the opportunity to bid on a territory contiguous to our own about which we have been in periodic discussions since the summer of 2012. We could not take advantage of this opportunity because of our inability to borrow additional funds from Chase. The bank said it was nearly impossible to support a bid for additional territory given the uncertainty of our litigation with Constellation and our financial leverage.

14. Delays to the outcome of our Constellation litigation also make it very problematic to conduct long term strategic planning. In late 2021, Olympic Eagle engaged Precision Distribution Consulting, Inc. to help the company solve warehouse capacity issues including space optimization and possible new facility design and location due to our projections that we will outgrow our current warehouse. All aspects of the project have been put on hold because without Constellation, a very large supplier with significant volume growth, the need to plan for additional warehouse space is unnecessary.

15. Capital spending for items not previously obligated because of long lead times such as cars, tractors and trailers, and equipment that breaks or is part of a program the company previously obligated to undertake are on hold because of the uncertainty due to the Constellation litigation.



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16. All of Olympic Eagle's 240 employees are aware of Constellation's attempted termination and the litigation which followed. Approximately 20% of our commercial driver licensed (CDL) employees approached delivery management and inquired about the status of their employment as they were concerned Olympic Eagle would lose Constellation distribution rights.

17. We have also had drivers and salesmen approached by Columbia Distributing about employment with Columbia as a direct result of this litigation.

18. While Olympic Eagle prides itself on providing competitive wages and a superior work environment, it is difficult to compete with the uncertainty created by delays in resolving this litigation. In this labor environment employees have unprecedented options and not knowing whether there may be headcount reductions as a direct result of a potential Constellation termination may cause Olympic Eagle employees to seek other job opportunities instead of waiting for this litigation to be resolved.

19. Like most companies Olympic Eagle has job openings and the uncertainty of additional litigation delays could impair our ability to attract strong candidates for jobs as we replace employees who leave due to natural attrition (retire/relocate/change careers), move to a competitor or supplier (our last Constellation Brand Manager was hired by Constellation in December 2021) or add positions for strategic reasons. There is no way to measure this phenomenon as potential employees will simply not apply to fill our open positions.

20. Constellation is a publicly traded Fortune 500 company with over $6 billion in revenue, 9,000 employees and operations throughout the United States. It has not identified any harm if discovery proceeds on a normal schedule. While Constellation suggests discovery will impact



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our customers, both parties to this litigation are incentivized to treat our retail partners in the same professional manner as we have in the past and Olympic Eagle is committed to doing so.

21. Columbia is backed by a private equity firm. Olympic Eagle is a family-owned business. As described above, Columbia benefits from a stay of this lawsuit because any continued delay in its resolution weakens Olympic Eagle's ability to compete in our market.

22. I declare under penalty of perjury, that the foregoing is true and correct.

Executed this 13th day of February, 2023.

By Shawn Bai
Shawn Bai



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# Exhibit A

| Geography:Olympic Eagle SupersplusRiteAid_36.0 | Current | | Current Market Share | | | Post Constellation Termination Market Share (Projected) | | |
|---|---|---|---|---|---|---|---|---|
| Beer Category and Top 10 Brewers Latest 52 Weeks Ending 1/1/23 | Dollars | $ Share of Category | Olympic | Columbia | Odom | Olympic | Columbia | Odom |
| BEER | $ 98,508,807 | 100.0 | | | | | | |
| ANHEUSER-BUSCH INBEV | $ 24,694,148 | 25.1 | 25.1 | | | 25.1 | | |
| MILLERCOORS | $ 16,561,881 | 16.8 | | 16.8 | | | 16.8 | |
| MARK ANTHONY BRANDS INC | $ 10,240,050 | 10.4 | | 10.4 | | | 10.4 | |
| CONSTELLATION BRANDS | $ 8,610,036 | 8.7 | 8.7 | | | | 8.7 | |
| BOSTON BEER CO | $ 7,155,567 | 7.3 | | 7.3 | | | 7.3 | |
| PABST BREWING CO | $ 3,854,127 | 3.9 | | 3.9 | | | 3.9 | |
| GEORGETOWN BREWING CO | $ 2,454,085 | 2.5 | | 2.5 | | | 2.5 | |
| SCHILLING CIDER COMPANY | $ 2,254,136 | 2.3 | | 2.3 | | | 2.3 | |
| HEINEKEN USA INC | $ 1,982,993 | 2.0 | | 2.0 | | | 2.0 | |
| DESCHUTES BREWERY | $ 1,906,874 | 1.9 | | 1.9 | | | 1.9 | |
| ALL OTHER | $ 18,794,911 | 19.1 | | 9.5 | 9.5 | | 9.5 | 9.5 |
| Total Market Share | | | 33.8 | 56.7 | 9.5 | 25.1 | 65.4 | 9.5 |

## CERTIFICATE OF SERVICE

I hereby certify that March 22, 2023, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

*/s/ Mark K. Slater*
Mark K. Slater
Attorney for Amicus Curiae