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**PUBLIC PROTECTION CABINET
DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL**

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COPY

November 21, 2014

VIA CERTIFIED MAIL AND EMAIL

Anheuser-Busch, LLC
C/O Richard H. C. Clay, Esq.
Dinsmore & Shohl, LLP
101 South Fifth Street, Suite 2500
Louisville, Kentucky 40202

RE: Transfer application for Kentucky Quota Distributor's License for proposed premises located at 4221 Airpark Drive, Owensboro, Kentucky 42301

Dear Mr. Clay:

Pursuant to the court's order of temporary injunction in *Anheuser-Busch, LLC v. Stephanie Stumbo, Malt Beverage Administrator, Department of Alcoholic Beverage Control, et. al*, Franklin Circuit Court Case No. 14-CI-001282, please be advised that Anheuser-Busch, LLC's, ("AB") transfer application for a quota distributor license in Davies County Kentucky has been conditionally approved. The state director disagrees with the court's conclusion that this license application is substantially complete and with the court's denial of her statutory discretion to consider this application. Nevertheless, the director believes that the citizens of Kentucky are not served by a protracted legal battle at this time.

Items Required for License Transfer and Lawful Operation of the Licensed Premises

Several items are necessary before AB can lawfully operate at the Owensboro licensed premises. As the court observed, AB has not provided a required executed deed and none of the five hundred plus (500+) impacted brands have been legally registered or approved.

This application is complicated by the required license surrenders by the seller, Hand Family, LLC ("Hand") at the Owensboro premises. In addition to the malt beverage distributor's license, Hand must also surrender its distilled spirits and wine wholesaler's license for the Owensboro premises, so many distilled spirits and wine brands are also impacted. Hand still must complete paperwork and be legally approved by the Department, to remove distilled spirits, wine and beer brands from the Owensboro premises to be sold from its different licensed location in Hopkinsville. Logistically, the application involves three (3) different licenses, two (2) different



premises, and over five hundred (500) different product brands of malt beverage, distilled spirit and wine, that must be registered, un-registered, moved to a new location, or dropped.

Both AB and Hand have failed to provide necessary documentation and information to enable the Department to logistically complete the proposed transfer. Both have filed incomplete, inaccurate or unexecuted necessary documents. Licensing staff have not been able to perform necessary duties due to incomplete and missing information and documents. It is for this reason, and AB's refusal to provide information relevant to discretionary factors, that the Department has not considered the application to be substantially complete.

Hand must submit detailed inventory lists of distilled spirits, wine and malt beverage products owned by it for brands/products not being acquired or retained by AB. By letter dated November 5, 2014, to AB, the Department identified the need for correct and executed ABC 714 Forms for AB's registration of beer brands being transferred from Hand to AB. By separate letter dated November 5, 2014, to Hand, the Department additionally identified several problems with distilled spirits, wine and beer brands that Hand Family, LLC is transferring to other licensed Hand distributorship locations or dropping entirely. After Hand does so, the Department needs to know the detailed inventory to be moved and date that Hand intends to move product from the Owensboro premises to its Hopkinsville premises.

The additional information and needed corrections identified in the two (2) referenced November 5, 2014, letters to AB and to Hand will not be required for issuance of the license to AB, but will be required for legal AB operations at the Owensboro licensed premises. If brand information can be provided to the Department in advance of the closing, this would facilitate processing and avoid operational disruptions at the Owensboro premises. Copies of those letters are attached for your convenience.

Concerns Regarding Issuance of License

The AB application to expand its distributorship licensure in Kentucky is the most controversial in Department memory. Protestors have raised concerns regarding the large producer's apparent efforts to create a vertical monopoly in other states. This allows for potential diminution of product distribution options and limits access for a share of the market by other national and local producers, especially craft brewers. Protestors have also pointed out that the degree of market share controlled by large brewers like AB, has already led to anti-trust scrutiny by the United States Justice Department. The question on this application is not limited to whether there is a willing seller and a willing buyer. In its Order, the court acknowledged that AB's application and the protests filed against it raised many legitimate public policy issues "that deserve public debate." As the state director of the Malt Beverages division for all of Kentucky, the director's responsibility to grant or deny the application requires an all-inclusive consideration of the impact of her decision not only on Kentucky's entire alcoholic beverage industry, but also the public's interest. The state director believes these considerations are required in addition to considering the 36 year old decision in *Kentucky Alcoholic Beverage Control Board v. Anheuser-Busch, Inc.*, 574 S.W.2d 344 (Ky. App. 1978).

While Kentucky case law holds that the statutes contain no *per se* prohibition on a brewer also holding a malt beverage distributors license, they do not hold that a grant or transfer of a distributor's license to a brewer is automatic even if an application is "substantially complete." Kentucky statutes expressly mandate that the administrator consider each license application on its individual merits to determine in her sound discretion whether a grant of the license application is in the public interest. In exercising that discretion, KRS 243.450(2) directs the

director to specifically examine certain factors: “public sentiment in the area; number of licensed outlets in the area; potential for future growth; type of area involved; type of transportation available; and financial potential of the area.”

The state director acknowledges that authority to directly address public policy concerns rests with Kentucky General Assembly. However, one way in which the General Assembly addresses alcoholic beverage public policy is to provide the state director with authority to determine whether any application is in the “public interest.” *Alcoholic Beverage Control Board v. Woosley*, 367 S.W.2d 127, 128 (Ky. 1963); *Bickett v. Palmer-Ball*, 470 S.W.2d 341, 345 (Ky. 1971); *Moberly v. Bruner*, 382 S.W.2d 406, 408 (Ky. 1964). The court’s order prevented the application from being fully considered.

Based on the information before her, including the incomplete application and the information submitted in protest of that application, the state director has grave concerns regarding the issuance of this license.

Despite mischaracterizations, the state director’s consideration of whether to approve the sale and issue this license has never been about whether a brewer can hold a distributorship license, but rather, *should* a producer/brewer hold such a license in light of the public interest and impacts on Kentucky consumers and businesses. The Department does not desire to over-regulate or implement practices that would stifle the alcohol industry in the Commonwealth. The issue is neither partisan nor political, but is truly a Kentucky economic and consumer protection issue. The consideration process of such a transfer is not anti- Anheuser-Busch, LLC, but is in fact, a pro-industry practice that seeks to facilitate and maintain expansion within the alcohol industry as a whole. Based upon the limited information obtained during this application submission and the controversy surrounding this transfer and potential impacts on Kentucky consumers and business, what this licensure issue is really about is:

- Preservation of existing Kentucky businesses and jobs at a time when the Commonwealth needs them the most;
- Kentucky consumers having access to all available products and increased choice selections, not reduced product selections; such as the reported 195 brands being dropped—therefore no longer available from this service area because of this transfer;
- Assuring producers both out of state and in state have access to markets to get their products to Kentucky consumers to support and assure their growth, including our growing Kentucky’s craft breweries. This is key to the assurance that product brands or brands of malt beverages can gain access in Kentucky and get to our Kentucky consumers. Brewers like Yuengling and several craft brewers have encountered barriers to gaining market access;
- Protecting independent retailers and Kentucky’s small retailers;
- Protecting independent beer distributors which are critical to assure consumer access but most importantly to grow our craft brewers; and
- Preventing a loss of state revenue.

The Kentucky alcoholic beverage industry is one of our state’s signature industries. One that Kentucky not only needs to promote and preserve, but also to protect. This is true across all tiers and sectors of the industry from our producers-distilleries, wineries and our craft breweries to the independent suppliers and retailers. All are important to maintain quality, selection and access for and to Kentucky’s citizens/consumers. To do this Kentucky must maintain a balanced

business climate- one that fosters an environment for all sectors, all size industry and one that is encouraging to businesses. While Kentucky wants to maintain AB's success and presence in our state this should not be done at the expense of independent businesses. It is these industry partners who are as critical to Kentucky's economy and alcoholic beverage industry as any one particular player. They collectively employ vast numbers of Kentuckians, account for large community investment, tax revenues and have been in the Commonwealth serving their communities and growing the industry for decades.

Even before AB filed its application, AB informed the Department of its desire to eliminate full distribution services from the Owensboro facility and conduct operations for the territory from its Louisville Branch operation. This intention was affirmed when AB submitted its initial revised Territorial Agreement showing its Louisville operation address for product brand registrations for Daviess County. While the state director believes the plan of operation would be a form of "warehousing" prohibited by Kentucky law, if AB or any other large producer owned distributorship moves distribution operations, like sales, inventory orders, accounting and payroll functions somewhere else, for example to a Louisville distributorship branch or St. Louis corporate offices, it will result in almost all of the current jobs in Owensboro being radically scaled back or eliminated. This does not satisfy the public interests of Kentucky.

Kentucky's franchise/territorial agreement laws provide that only one distributor is permitted to sell a brewer's brand in a geographic area designated by contract. AB purports to hold a 47.6 percent market share of ALL U.S. beer sales to retailers. This means that the distributor of AB products will have an almost exclusive 50% market share of all beer sales in the area. Further AB will only distribute AB owned or its subsidiary owned products, thus not satisfying public interests of Kentucky.

Industry dynamics have drastically changed in the last two (2) decades since the *George Wiedemann Brewing Company* and *Anheuser-Busch, Inc.* holdings. At the time of those decisions, there were many different brewers and resulting competition in the U.S. market. Recent corporate mergers and consolidations have left only two (2) major brewers owning about 75% of all beers brands sold in U.S. market: ABI and Miller Coors. As a result, there are only two main competing distributorships in most Kentucky territories: an independent distributor aligned with AB, and an independent distributor aligned with Miller/Coors.

In the last several years, Kentucky has experienced considerable growth of its microbrewery industry. Kentucky only had two (2) licensed microbreweries in 2002. This number has exploded to twenty-eight (28) microbreweries, most occurring in the last few years. Kentucky microbreweries rely on existing Kentucky distributors' infrastructure to have their products distributed to Kentucky retailers for sales for broader customer access. Kentucky microbreweries have limited distributorship options available in most territories. Unlike brewery owned distributorships, independently owned distributors will carry products from multiple producers such as Kentucky craft breweries.

Kentucky microbreweries and non-resident craft brewers have filed protests against AB's application citing alleged anticompetitive practices of an AB owned distributor: refusing to distribute other products and pressuring its AB aligned distributorships who do chose to diversify by doing so. The Department's records reflect AB has implemented this exclusionary practice in its Louisville distributorship where it refuses to carry any competing brand of beer and intends to do so in Owensboro. AB's submitted brand registrations reflect that the proposed Owensboro AB distributorship will only carry AB products. As previously stated, both AB and Hand are

dropping approximately 195 non-AB brands currently being marketed to the community by seller, Hand.

As the result, Kentucky microbreweries and small craft beer producers will have limited or no market access in Owensboro and the surrounding area. One independent distributor cannot logistically carry all other non AB brands on the market. The burgeoning Kentucky microbrewery industry will likely lose market access and sales resulting in lost Kentucky industry, lost growth and capital investment, lost jobs, and lost tax income. Kentucky consumers will continue to lose choice of brands and will likely see increased cost.

Concerns exist in regard to industry practices which pressure independent distributors with ties to a specific producer to block access of a competitor producer's products to Kentucky consumers. Like Kentucky microbreweries, out-of-state craft brewers will have limited or no market access in Owensboro and surrounding counties since only one major distribution network would be left. Many craft brewers require territorial agreement terms which provide that the distributor will not sell a competitor craft product. If a competitor craft beer is carried by the Miller Coors aligned distributor, that distributor may not be available to a competing craft producer. Small craft producers do not have the necessary capital or resources to promote and self-distribute craft products out to all retailers in a territory. Similarly, small distributors do not have resources to adequately market and service craft brands for sufficient market saturation. Currently, some Louisville retailers do not have access to certain craft brands available to retailers in other parts of state. Some craft brewers may have left the state because they did not have access to the Louisville market due to the brewery owned branch there. As a result, Louisville has less consumer choice which can result in increased consumer price due to fewer available products.

Breweries'/producers' territorial agreements also give certain approval rights to the producer regarding whether an independent distributor can sell to new owners or have new management succession. In this particular application, AB refused to provide information as to whether AB has strategic plans to purchase and consolidate other Kentucky independent distributorships to increase AB's geographic territories for distribution of AB brand products in Kentucky. Such industry practices permit the brewery to refuse business sales or succession so as to become the exclusive brewery owned distributor for their brands throughout Kentucky which would result in even less competition for the state.

Conditional Approval

As directed by the court, AB's transfer application for issuance of a Quota Distributors license is hereby conditionally APPROVED.

As the court observed, you do not have an executed deed and none of the five hundred plus (500+) impacted brands have been legally registered or approved. As part of your application, you represented that an executed deed and completed, executed brand registration (ABC Form 714 & ABC Form 715) forms would be tendered at time of sale closing.

KRS 244.585(3) provides that, "no brand of malt beverage may be sold in the Commonwealth of Kentucky without prior written approval of the brewer and supplier filed with the department." See also, KRS 244.606. As explained above, the state director will not condition issuance of the license on the additional information and needed corrections identified in the two referenced

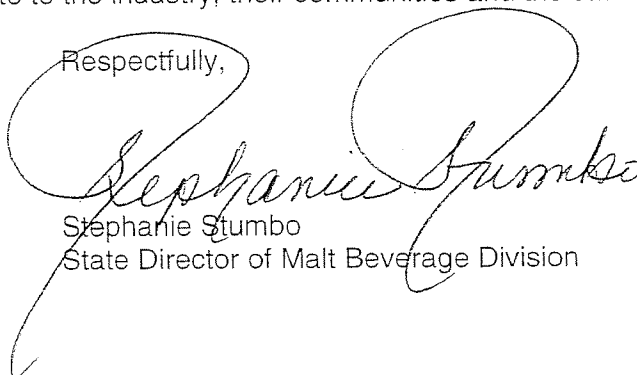
November 5, 2014, letters to AB and Hand. However, the additional information and corrections will be needed for AB and Hand to legally operate and sell the affected brands.

Please advise of the closing date and when AB plans to tender the executed deed. The Department will conduct the final inspection on that date to ensure that all distilled spirits, wine and unregistered malt beverages have been removed from the premises. At that time, the Department will issue the Quota Distributors license to AB for the proposed Owensboro premises.

If you have any questions, please contact the Department.

Again, the state director supports Anheuser-Busch LLC and their presence in Kentucky. Kentucky wants AB to have continued success and record sales in the Commonwealth. However, as the regulator and a public servant, the state director also has an obligation to equally advocate for the preservation and growth of all industry sectors, large and small, and for independent businesses, as all contribute to the industry, their communities and the state.

Respectfully,

A handwritten signature in cursive script, reading "Stephanie Stumbo". The signature is written in black ink and is positioned above the printed name and title.

Stephanie Stumbo
State Director of Malt Beverage Division

cc: Hand Family, LLC
Local ABC Administrator
ABC Investigator
Attachments