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Changes to alcohol distribution laws put some franchise protections on ice

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Massachusetts franchise protection laws may be the furthest thing from our minds while enjoying a cold beverage this summer, but recent legal developments have changed the way that alcoholic beverages make their way from distilleries, wineries and breweries to our tables.

These changes, while not readily apparent to consumers, mark an interesting turning point in the byzantine set of laws that govern liquor sales in Massachusetts.

Massachusetts law concerning sale of alcohol

The laws governing the distribution and sale of alcohol in Massachusetts date back to the end of Prohibition in 1933.

Like many other states, Massachusetts utilizes a three-tier system for the distribution of alcohol. The hallmark of the three-tier system is the strict separation between alcohol producers (the first tier), wholesale distributors (the second tier), and retailers, such as restaurants and liquor stores (the third tier).

With limited exceptions in Massachusetts, alcohol producers may sell their products only to wholesale distributors, which then sell the products to retailers. Only retailers may sell to consumers.

Before Prohibition, "tied-house" systems were prevalent, whereby alcohol producers would set up bars and saloons and supply them with equipment and whatever else was needed to operate. Bars would agree to sell only one producer's product and were often required to meet quotas imposed by those producers.

The purpose of the three-tier system, which Massachusetts and many other states adopted after the 21st Amendment was enacted, is to prevent tied house arrangements. Tied houses were once thought to lead to a variety of social ills, including excessive alcohol sales and consumption, encouraged by bars to meet sales requirements imposed by producers.

The recent developments in Massachusetts law that are the focus of this article concern the relationship between alcohol producers and wholesalers. Massachusetts is one of about 20 states in which this relationship is governed by franchise laws, which limit the ability of alcohol producers to terminate their wholesalers once a business relationship has been established.

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In 1971, the Legislature enacted G.L.c. 138, §25E, to redress economic imbalances in the relationship between alcohol producers and their wholesalers. The statute provides that if an alcohol producer sells a particular brand item to a Massachusetts wholesaler for more than six months, the producer may not thereafter discontinue sales of that brand item to the wholesaler, absent good cause.

Good cause is narrowly defined and has proven to be a difficult standard to meet. Section 25E was intended to provide security to in-state alcohol wholesalers, seeing as though a wholesaler's business could be wiped out if a producer abruptly refused to sell the wholesaler certain beverage brands.

Massachusetts enacts G.L.c. 138, §25E½

Massachusetts lawmakers voted to reform Section 25E at the end of the 2020 legislative session to give craft beer brewers more flexibility in their relationships with wholesalers.

The Legislature passed a bill that allows a brewery that produces less than 250,000 barrels of beer (or 3.445 million cases) over a 12-month period to terminate its relationship with a wholesaler at any time with 30 days' notice, with or without cause. The barrelage cap covers nearly every craft brewery in Massachusetts apart from Boston Beer Co., makers of Samuel Adams. Gov. Charlie Baker signed the bill in January and it is now codified at G.L.c. 138, §25E½.

Section 25E½ came about as a result of a compromise between craft brewers and beer distributors in Massachusetts and followed a nearly decade-long legislative fight. The statute absolves small breweries of the strict requirements of Section 25E and allows them more flexibility in choosing their wholesale partners.

The statute also provides some protection for wholesalers. A brewery that terminates the rights of a wholesaler to distribute its brands must compensate the wholesaler for the fair market value of the distribution rights for the brands. If the brewery and the wholesaler cannot agree on the compensation due, the wholesaler or the brewery may request that the amount of compensation be determined by binding arbitration.

This new law already is the subject of several pending lawsuits. In a Superior Court complaint filed in March, distributor Atlantic Importing Co. challenged the rights of Jack's Abby Brewing to terminate Atlantic as its wholesale distributor under the statute.

Atlantic is also challenging the constitutionality of Section 25E½ on the basis that it deprives distributors of a right to a jury trial.

Further complicating matters is a lack of clarity in the statute as to whether it applies retroactively, so as to preempt previous binding agreements between brewers and distributors.

To date, the Alcoholic Beverages Control Commission has yet to weigh in on these issues.

Continuing affiliation doctrine clarified

Section 25E½ applies only to breweries, so wine and spirits makers that sell their products to Massachusetts wholesalers are still bound by the franchise requirements of Section 25E.

One of the most frequently litigated issues involving Section 25E is the fate of a wholesaler's franchise rights when a wine or spirit brand is sold to a new owner. It is well-established in Massachusetts that alcohol franchise obligations attach to the producer, not to the brand. When a producer sells a brand to a new owner in an arm's length transaction, the new owner generally is not required to assume the prior producer's obligations to its Massachusetts wholesaler.

But what happens when there is not a clean break between the operations of the prior producer and the new owner?

Massachusetts courts have long held that the prior producer's obligations to an in-state wholesaler under Section 25E may be imputed to the new owner of the brands if there is a "continuing affiliation" between the two entities.

However, the case law offers little guidance concerning the nature of the relationship that would amount to a continuing affiliation under Section 25E. The Appeals Court provided some clarity on this issue in *Martignetti Grocery Co. v. Alcoholic Beverages Control Comm'n*, 96 Mass. App. Ct. 729 (2019).

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In *Martignetti*, the plaintiff had been the Massachusetts distributor of Meiomi wines, a brand produced by Copper Cane, until Copper Cane sold the brand to Constellation Brands. After the closing, Constellation discontinued sales of Meiomi wines to Martignetti. Martignetti filed an action under Section 25E on the basis that Copper Cane's franchise obligations should be imputed to Constellation due to Copper Cane's continued involvement with the brands for a period of time after the sale.

The Appeals Court disagreed, however, and held that although Copper Cane "continued to be involved in winemaking, bottling, and advertising, such activities are not indicative of the type of continuing affiliation that would require Constellation to assume the Copper Cane's Section 25E obligations to its Massachusetts wholesalers." *Id.* at 737.

The court recognized, instead, that an arm's-length sale of an alcoholic beverage brand and its assets between suppliers, which did not leave the seller in the position of controlling the purchaser's sales of the brand to downstream wholesalers, did not result in a transfer of Section 25E obligations between those suppliers.

Producers and aggrieved wholesalers will continue to litigate the guideposts of the continuing affiliation doctrine, but the *Martignetti* decision provides some clarity.

The decision also creates a heavier burden for an aggrieved wholesaler to prevail on a claim that a producer's Section 25E obligations to sell a certain brand to the wholesaler should be imputed to a new brand owner.

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