

HOUSE LIQUOR CONTROL COMMITTEE
FRANCHISE REFORM/GRANHOLM issues

Public Hearing held at Upper Merion Township Building, 175 West Valley Forge Road, King of Prussia, Pennsylvania, on Thursday, August 29, 2013, commencing at approximately 10:03 a.m., before Janice D. Burness, a Registered Professional Reporter, Certified Court Reporter (NJ), and Notary Public, pursuant to notice.

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1 APPEARANCES:

2 Chairman John Taylor

3 Chairman Paul Costa

4 Representative Mike Regan

5 Representative Brian Ellis

6 Representative Mike Vereb

7 Representative John Payne

8 Representative Frank Burns

9 Representative Scott Petri

10 Representative Chris Sainato

11 Representative Ted Harhai

12 Representative John Sabatina

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14 COMMITTEE STAFF PRESENT:

15 Marcia Lampman, Executive Director

16 Lynn Benka Davies, Executive Director

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TESTIFIERS

John Beljan
Stockertown Beverage

Francis X. O'Brien, Esquire
Pennsylvania Beer Alliance

Matt Funchion
Penn Distributors

Bill Covalesski
Brewers of Pennsylvania and Victory Brewing Company

Ted Zeller, Esquire
Brewers of Pennsylvania

David A. Casinelli
Yuengling Brewery

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1 CHAIRMAN TAYLOR: Good morning, everyone.
2 I'm Representative John Taylor from
3 Philadelphia, and chairman of the Committee. We'll get
4 under way here in a second. We have a little lop side of
5 the table here.

6 Thanks, everyone, for being here.

7 As you know, this is a discussion about
8 franchise reform, some of the Granholm situations.

9 And I had a little brief discussion with
10 Dave Madden of KYW. It's an interesting challenge to put
11 into KYW-type sound bites exactly what it is that we're
12 discussing and what it means to the average person.

13 So we know that this is complicated. It's
14 not easily articulated. So we're looking forward to
15 really getting into some discussions from everybody in
16 this industry who is affected by our current system and
17 any possible changes.

18 Before I continue, I'll turn it over for a
19 second to my counterpart, Representative Costa.

20 CHAIRMAN COSTA: Thank you, Chairman
21 Taylor, and I thank all of you for being here this
22 morning.

23 As John said, this is a very complex and
24 very interesting subject that we are going to try and
25 tackle today.

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1 And at first glance I have a lot of
2 concerns, and I'm really looking forward to hearing the
3 testimony and I hope my questions are addressed at that
4 time.

5 So thank you all for being here.

6 CHAIRMAN TAYLOR: If we could just start
7 from my far right and have the members introduce
8 themselves, please.

9 REPRESENTATIVE REGAN: Good morning. Mike
10 Regan, 92nd District, York and Cumberland County.

11 REPRESENTATIVE ELLIS: Brian Ellis, 11th
12 District, Butler County.

13 REPRESENTATIVE VEREB: Mike Vereb,
14 150th District, Montgomery County.

15 REPRESENTATIVE PAYNE: John Payne, 106th
16 District, Southeastern Dauphin County.

17 REPRESENTATIVE TOBASH: Mike Tobash, 125th
18 District, Schuylkill and Berks County.

19 REPRESENTATIVE BURNS: Representative
20 Frank Burns, 72nd District, Cambria County.

21 REPRESENTATIVE PETRI: Scott Petri, 178th
22 District, Bucks County.

23 REPRESENTATIVE SAINATO: I'm
24 Representative Chris Sainato from the 9th District in
25 Lawrence County.

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1 REPRESENTATIVE HARHAI: Representative Ted
2 Harhai, 58th District, parts of Westmoreland and Fayette
3 County.

4 CHAIRMAN TAYLOR: Thanks. We have -- I
5 see Representative Briggs in the audience. I know we are
6 in his district.

7 REPRESENTATIVE BRIGGS: Thank you very
8 much and welcome.

9 CHAIRMAN TAYLOR: You're free to join us
10 if you like or you might be safer on that side of the
11 table. It's up to you.

12 With that, we'll get right to it.

13 Our first set of speakers is Matt Funchion
14 from Penn Distributors, John Beljan from Stockertown
15 Beverage, and Fran O'Brien from the Pennsylvania Beer
16 Alliance. They are all together assembled.

17 And, gentlemen, you can proceed when
18 you're ready.

19 MR. BELJAN: I believe I'm first,
20 Mr. Chairman. My name is John Beljan.

21 Good morning, Chairman Taylor, Chairman
22 Costa and Members of the Committee.

23 Once again, my name is John Beljan. I am
24 the president and one of the founders of Stockertown
25 Beverage.

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1 Like so many other start-up businesses in
2 America, Stockertown Beverage was conceptualized over a
3 few cold ones at the kitchen table.

4 As a home brewer, I developed a deep
5 appreciation and passion for craft beer. My business
6 partner shared my enthusiasm for fine beer and also my
7 frustration with the meager selection of specialty beer
8 available in the marketplace.

9 It seemed quite likely that we were at the
10 dawn of a burgeoning craft beer revolution, and we
11 welcomed the opportunity to create our own retail beer
12 distributor specializing in domestic craft and imported
13 specialty beer.

14 We purchased a distributor license in
15 2002, opening our doors and selling beer later that year
16 in a 2,000 square foot space.

17 We stocked our retail shelves with the
18 specialty brands available from wholesalers, but grew
19 increasingly frustrated.

20 Our customers routinely requested high-
21 quality brands that were accessible in other states but
22 not available in Pennsylvania.

23 It was at this time that we expanded our
24 focus becoming an importing distributor with the goal of
25 introducing exciting new brands and breweries to

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1 Pennsylvania consumers.

2 We began as a wholesale distributor in
3 2004 with zero employees and a very tight budget.

4 We purchased my partner's wife's mini van,
5 removed the child safety seat, slapped the required PLCB
6 identification lettering on the doors and began
7 wholesaling. You can't make that up.

8 Lancaster Brewing Company was the first
9 brand we began distributing with the initial distribution
10 territory comprised of four counties.

11 I am proud to say that Stockertown
12 Beverage has grown from that modest beginning into a
13 vital specialty beer distributing company, self-
14 distributing 50 imported breweries and 29 domestic
15 breweries, including 10 Pennsylvania breweries,
16 throughout 26 counties in Pennsylvania.

17 Stockertown Beverage currently has six
18 delivery trucks. We no longer have the van. And employs
19 20 hardworking people dedicated to serving the world's
20 greatest customers.

21 When wholesale distributors commit to the
22 endeavor of distributing a new brand, they are cast in
23 the role of a brand builder. A brand builder wholesale
24 distributor introduces new unknown brands into the
25 Pennsylvania market.

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1 The wholesale distributor then begins the
2 process of launching the new brand to accounts and
3 consumers on a one-to-one grassroots level with the
4 intention of elevating the brand from obscurity to
5 prominence.

6 The initial process usually takes years
7 and involves countless promotional events, in-store
8 samplings, multi-case display programs, on-premise
9 brewery specific promo events and beer festivals, all
10 designed to raise consumer awareness of the new brand and
11 its products.

12 These promotional events are virtually all
13 conducted and paid for by the wholesale distributor.
14 Rarely does a new brewery have marketing, sales
15 representatives or even a marketing budget.

16 Wholesale distributors invest their time,
17 effort and financial resources towards the growth of the
18 brand with the hopes that drastically increased sales
19 years down the road will help the wholesale distributor
20 recoup the promotional resources expended on the brand's
21 behalf.

22 It is also a wholesale distributor's hope
23 that once the brand is established, the brand will supply
24 a brewery representative to provide a regular, frequent
25 contact for accounts. There is no guarantee that this

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1 will occur.

2 Some growing brands never appoint a
3 regional brewery representative and continue to leave all
4 the heavy promotional lifting to the wholesale
5 distributor.

6 It is easy to see that the successful
7 growth of the brand in the market is vitally important to
8 the wholesale distributor, and that the wholesale
9 distributors are the unsung heroes of the craft beer
10 ascendance.

11 Our company's diligence and relentless
12 resolve in seeking out the finest breweries and product
13 have positioned us for strong growth and market
14 performance.

15 This has been achieved by constant
16 cooperation between our company and our brewery
17 partners.

18 We have accomplished these goals through
19 brand building, providing our brewery partners with
20 market feedback, and through continuing education,
21 training and expansion of our sales force.

22 These relationships have been symbiotic
23 with all partners benefiting.

24 The expansion of craft and specialty beer
25 in our Commonwealth has not been created solely by the

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1 craft breweries, but also by a team of dedicated and
2 committed business partners, which undeniably include the
3 wholesale distributors that represent these breweries.

4 In short, we work together, we grow
5 together, we succeed together.

6 This proposed bill will destroy the
7 symbiotic relationship between breweries and wholesale
8 distributors that have greatly benefited the industry and
9 consumers.

10 These relationships have provided
11 breweries and wholesale distributors access to a market
12 thirsty for innovation, quality and variety, and in doing
13 so have created livelihoods that are vitally important to
14 all of our local and regional economies.

15 The success of this industry has never
16 been one-sided, and it should not be permitted to become
17 so.

18 Self-distribution by breweries on the
19 proposed scale represents the dismantling and potential
20 eradication of the three-tier system.

21 The large majority of the breweries we
22 represent do not approach the total annual production of
23 75,000 barrels. In essence, these breweries self-
24 distribute their entire annual production in
25 Pennsylvania.

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1 What method would be employed to account
2 for self-distribution volumes by in-state and out-of-
3 state breweries?

4 Would this even be possible or enforceable
5 by State Police? How many living wage jobs at wholesale
6 distributors would be jeopardized by such a policy?

7 The provision that would allow breweries
8 to abandon distribution agreements if total sales of a
9 brewery's products comprise less than 20 percent of a
10 wholesale distributor's annual sales is unreasonable and
11 could provide breweries with a method for tactical
12 termination.

13 Tactical termination could easily be
14 employed by any brewer eager to change wholesale
15 distributors for any arbitrary reason.

16 Breweries could systematically reduce
17 shipments to a targeted wholesale distributor, thereby
18 ensuring that the brewery's annual sales did not reach
19 the 20 percent threshold with the wholesale distributor.

20 Wholesale distributors would attempt to
21 protect themselves from brand bleed by culling the
22 portfolio.

23 Small independent boutique brands that
24 comprise a small percentage of a wholesale distributor's
25 annual sales will drop to ensure that the remaining

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1 brands are above the 20 percent annual sales threshold.

2 This act of self-preservation by the
3 wholesale distributor will result in brands losing access
4 to the market and consumers denied access to the variety
5 of brands that have helped fuel the enthusiastic growth
6 of craft beer.

7 Contracts between breweries and wholesale
8 distributors unite the two parties so that they may
9 market the brewery's products in the most effective and
10 efficient manner possible, with the ultimate goal of
11 achieving financial success by best serving the
12 consumers.

13 The proposal that would have breweries and
14 wholesale distributors renegotiating the distribution
15 agreements every five or ten years would create an
16 environment that does not foster growth and productivity,
17 but rather inhibits and obstructs growth and
18 productivity.

19 Contracts that were negotiated in good
20 faith between breweries and wholesale distributors must
21 remain as they have been and not be subjected to
22 mandatory routine renegotiation.

23 The current healthy state of craft and
24 specialty beer in the Commonwealth of Pennsylvania is a
25 direct result of the mutual coordinated and comprehensive

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1 efforts of wholesale distributors and their brewery
2 partners.

3 I ask that as you consider and review the
4 current law, please do not remove the equal opportunity
5 and incentive to grow that breweries and their wholesale
6 distributor partners have diligently engaged for success,
7 prosperity and economic growth.

8 Thank you.

9 MR. O'BRIEN: Mr. Chairman, I would like
10 to request that we reserve five minutes of time for
11 rebuttal after the other sides have presented their case.

12 CHAIRMAN TAYLOR: Well, I think what
13 I'm going to try to do, if I can get members -- depending
14 on their timing -- is to go right through testimony, and
15 hopefully everybody sticks around.

16 So if you want rebuttal time, that means
17 you will stay here.

18 MR. O'BRIEN: We'll be here.

19 CHAIRMAN TAYLOR: That's fine with me, as
20 long as you don't ask to rebut the rebuttal, and there we
21 go. That's fine.

22 MR. O'BRIEN: Thank you.

23 Good morning, Chairman Taylor, Chairman
24 Costa, Members of the Committee.

25 I'm Fran O'Brien, legal counsel for the

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1 Pennsylvania Beer Alliance.

2 I think in all the conversation and the
3 very detailed proposal before you we've got to keep a
4 couple of things in mind.

5 Number one, under the Pennsylvania Liquor
6 Code, the brewers have a right to terminate any wholesale
7 distributor for cause.

8 Number two, no Pennsylvania brewer has
9 ever been required to enter into a primary contract for
10 distribution rights.

11 Any Pennsylvania brewer who has given a
12 contract, given primary distribution rights to a
13 wholesaler, has done it because it was in that brewer's
14 best business interest.

15 And anyone who's trying to undo that after
16 the fact is changing the deal.

17 I'd like to talk about the Granholm case
18 briefly. I'd like to talk about the high points of what
19 we object to, and then talk about some topics for
20 discussion.

21 First of all, we've all heard the term
22 Granholm.

23 In 2005, the United States Supreme Court
24 basically said you cannot treat your in-state businesses
25 engaged in the beverage alcohol business better than you

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1 treat out-of-state. No in-state favoritism.

2 And while that may sound like it was a
3 general statement of the law on interstate commerce as it
4 existed at that time and through history; in fact, there
5 was a strong school of thought that if a case was brought
6 involving the regulation of alcohol, because of the 21st
7 Amendment the state had superior power under the 21st
8 Amendment.

9 So you didn't have to worry about the
10 in-state and out-of-state difference if the State
11 determined that it was in the best interest.

12 Well, Granholm settled that and said you
13 must treat the in-state and out-of-state wineries and
14 breweries, et cetera, the same.

15 We all know that our Liquor Code in the
16 beer section has great disparity, and that is the
17 in-state breweries do not have to use a wholesale
18 distributor contract with the primary rights.

19 And that is an open legal issue that we
20 attempt -- we, the Pennsylvania beer wholesalers --
21 attempted several years ago to fix. We were stymied by
22 several in-state breweries. That's past history.

23 We are very happy to see that now the
24 Pennsylvania -- the Brewers of Pennsylvania agree that
25 Granholm must be fixed. So we're happy to see that we're

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1 working together on that issue.

2 Next, I'd like to turn to what I call the
3 high points of the issue that we object to in this very
4 detailed proposal.

5 Number one would be the ability of a
6 brewer of any size -- any size -- the largest to the
7 smallest -- to self-distribute up to 75,000 barrels a
8 year.

9 If my math is right, we're talking about a
10 million cases or case equivalents in the course of a
11 year.

12 We don't see that there is a basis. And
13 if there's a rational basis for allowing the largest
14 breweries an unfettered right to self-distribute that
15 much, we certainly would be interested in hearing it.

16 As I talk later, we believe there should
17 be some consideration of a limit of self-distribution.

18 Number two of the most glaring points that
19 we object to is what I'll call the ten percent tax on the
20 transfer brand.

21 This ten percent charge that a brewer
22 claims he would be entitled to would be upon the transfer
23 of a brand from wholesaler to wholesaler. We again see
24 no rational basis for that.

25 If it's the brewer -- if it's the

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1 wholesale distributor in the marketplace who has been the
2 one with the feet on street doing the brand building of
3 the product, that we created the principal part of that
4 value and we don't see that the brewer has any rational
5 claim to that.

6 By the same logic, if the brewery is sold,
7 the wholesalers who helped build the brand should be
8 entitled to ten percent of that.

9 Or if a brewer sells off a particular
10 brand to another brewery, as happens, we believe that we
11 should be entitled to ten percent of that.

12 So I guess we don't understand the logic
13 of that and certainly object to it.

14 The other two items, the termination
15 without cause and the new contracts every five years, I
16 think my colleagues sitting here at the table, the
17 wholesalers themselves, can speak to that much better.

18 But I do emphasize that we are absolutely
19 against it and those points.

20 And, again, we hit the high points here.
21 There's an awful lot of detail in what we view as very
22 extreme and unprecedented in any of the state's proposal
23 here.

24 There are topics that we do believe can be
25 discussed.

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1 Four or five years ago, the Brewers of
2 Pennsylvania and the beer wholesalers sat down and spent
3 quite a bit of time over a series of meetings and
4 developed a product in conjunction with then House Bill
5 291.

6 We thought we had a deal with them, and at
7 the very end the goal line was changed and the deal fell
8 apart.

9 So we believe that there should be talk,
10 there should be some grounds for agreement on the topic,
11 and we would like to see the House continue the process.
12 And we have done that this summer.

13 Our problem when we see a proposal as
14 extreme as this is to try to understand what the problem
15 is.

16 Pennsylvania, as these gentlemen will tell
17 you, is a great beer state. Pennsylvania is a great
18 craft beer state. We have tremendous brewers that we are
19 proud of, and these two fellows refer to their brewer
20 partners in the highest terms.

21 So I guess we're somewhat at a loss to
22 understand what the problem is, the problems we are
23 trying to fix when we see a proposal this extreme.

24 That being said, number one, we believe
25 there should be an exemption for some limited self-

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1 distribution; first of all, for all breweries of all size
2 and certainly narrowly defined and extreme
3 circumstances.

4 If for some reason the wholesaler cannot
5 deliver, whether, as we have seen in Pennsylvania, a
6 warehouse collapsed in the Northern territories of
7 Pennsylvania because of snow on the roof, there's even
8 self-distribution.

9 If for some other reason the wholesaler is
10 precluded from delivering for a period of time, we
11 believe there is some need for all breweries to get the
12 product to market. We don't dispute that.

13 We further believe that for small brewers,
14 true small brewers and start-ups, that there is a need or
15 they should have the option for self-distribution.

16 As any of them tell you, the skill set
17 involved in brewing and developing the product is a very
18 different skill set from the wholesale distribution
19 business.

20 Jim Koch of Foster's beer was famously
21 quoted as -- presenting an industry speech one time words
22 to the effect that at some point -- what I heard was
23 75,000 barrels -- it is a stupid brewer who is self-
24 distributed, words to that effect; because the skill set
25 and the capital needs and the work flow is very different

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1 when you're dealing with the logistics of the wholesale
2 distribution business versus the brewing of beer and
3 development of beers.

4 Number two, we believe it would be helpful
5 for us to discuss the cause termination, for-cause
6 termination.

7 After our most recent meeting with the
8 Brewers of Pennsylvania this week, we believe that
9 perhaps the problem is focused most particularly on the
10 legions of the true small or start-up brewers.

11 A lot of them either don't have the
12 knowledge level or the time and resources to develop a
13 new contract.

14 The Liquor Code provision regarding
15 for-cause termination basically says put a contract
16 together, and whatever your standards are, that's how you
17 would judge the for-cause termination.

18 So I think brewers need contracts, and not
19 all of them have contracts that would give any reasonable
20 standards.

21 In fact, I think the wholesalers will tell
22 you that most of the contracts that are offered are or
23 signed are the brewer's contracts, whether it's large
24 brewers or small or mid-sized brewers.

25 But we believe there may be some need for

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1 further testament to that process for-cause termination.

2 And the third point we certainly can't
3 dispute is a need to have a signed contract. The Liquor
4 Code requires a signed written contract before the
5 product is delivered under a primary -- under a
6 distribution agreement.

7 We were told stories of people who never
8 signed a contract. And while it is a requirement of the
9 Liquor Code presently, how we would put enforcement teeth
10 into that I don't know.

11 But we certainly agree with them that
12 there should be a signed contract, and we would be
13 willing to work with them on that.

14 One of the outcomes of our meetings
15 recently with the Brewers of Pennsylvania is some
16 conversation about we suggested perhaps having an
17 industry Committee of both sides to sit down and develop
18 a standard form right down the middle contract for
19 distribution, which would be great for the true small
20 brewer to start up.

21 He doesn't have an opportunity or maybe
22 resources and access to lawyers to develop something.

23 It seems to work well with Realtors.
24 Realtor boards have a standard form contract. And we
25 think if we had a generic standard form that the brewers

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1 and the wholesalers can come up with, that may alleviate
2 some of the problem.

3 In closing, I would like to offer a word
4 of caution.

5 We have a system that we believe works,
6 and we have to watch the law of unanticipated
7 consequences.

8 This week we read in one of the industry
9 publications a story about Whole Foods, of which there
10 are a number in Pennsylvania, a supermarket chain,
11 developing its own brewery in California.

12 They are going to start delivering -- or
13 they are going to start brewing and distributing their
14 product in California.

15 When you add the potential for new
16 elements such as that into the marketplace that is
17 evolving -- and right now we're in a vibrant
18 marketplace -- we caution that the law of unanticipated
19 consequences may give results no one wanted.

20 And to that specific point, consolidation
21 of the wholesale level, which we know is an issue for
22 hand craft brewers.

23 As we've explained to them going through
24 their proposal point by point, a number of what -- a
25 number of the issues that -- provisions that they

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1 recommended would, in fact, accelerate and make it more
2 expedient the consolidation of the wholesale level.

3 We recognize that there are -- there's
4 right now a vibrant market -- the Red house AB, the
5 Silver MillerCoors.

6 And there are many other craft houses.
7 And we hear John Beljan speaking to us today; that's
8 exactly what he has.

9 If you adopt a number of these things,
10 you're going to see the rapid acceleration of further
11 consolidation at the beer wholesale distribution level.

12 Right now we believe we have -- our
13 consumers in Pennsylvania enjoy price, variety and
14 access, which is rivaled in few states.

15 We caution that we not upset that and keep
16 our focus on the consumer. And keep working to tweak --
17 not wholesale throw out -- a system that is working.

18 Thank you.

19 MR. FUNCHION: Thank you, Fran and John.
20 Thank you, Chairman Taylor, Chairman Costa and members of
21 the Committee.

22 My name is Matt Funchion, and I am the
23 president and owner of Penn Beer Distributors. We are
24 located on Domino Lane in Philadelphia, Pennsylvania.

25 We employ 125 people, 70 percent of whom

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1 are Teamsters represented by Teamsters Local 830 in
2 Philadelphia.

3 All are family sustaining jobs with health
4 and welfare and retirement benefit packages that are the
5 envy of most industries. We are all very proud of our
6 employees and of the wage and benefit coverages that we
7 provide.

8 Penn Beer Distributors represents over 20
9 brewing suppliers, and we partner with several in-state
10 Pennsylvania craft breweries, including Victory, Troegs,
11 Boxcar, Susquehanna Brewing Company and Prism, as well as
12 others from around the country and the globe.

13 We market, sell and deliver beer to over
14 2,300 retail licensees within our service area.

15 As you know, as beer wholesale
16 distributors or importing distributors we are referred to
17 as the middle tier of the three-tier delivery system.

18 The first tier of the three-tier system
19 are brewers, distillers and vintners, or suppliers. We
20 then fill in the second tier.

21 And the third tier is represented by the
22 many different retail trade channels in Pennsylvania,
23 including beer distributors, restaurants, taverns, delis,
24 supermarkets and sports and entertainment venues.

25 Importantly, we are all true, legitimate

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1 and law abiding Pennsylvania businesses employing
2 Pennsylvanians. Some are multigenerational, and some
3 first generation like me.

4 We are all family run businesses and
5 collectively, and very importantly, we employ over 5,000
6 Pennsylvanians.

7 The three-tier system was developed
8 immediately following the repeal of prohibition.

9 Its intent was to legally and responsibly
10 manage the sale and distribution of alcohol from
11 suppliers through wholesale distributors to retailers and
12 ultimately to the end consumer.

13 Since the repeal of prohibition, the
14 three-tier system has been proven effective and a highly
15 successful method of alcohol sales, distribution and
16 management.

17 Over the years, this prohibition and due
18 to the many responsibilities that we have in our
19 businesses and communities, we have clearly been
20 identified and defined as the service, responsibility and
21 community-dedicated component of this very successful
22 system.

23 The three-tier system is very balanced, it
24 is very fair, and it's very effective and it's been
25 highly successful since its inception.

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1 As beer wholesale distributors we are also
2 responsible for the collection of State sales tax on beer
3 sales and remission of payment of that sales tax to the
4 Commonwealth on a monthly basis.

5 And due to the limited number of entry
6 points under the marketplace to importing distributors,
7 it is very beneficial to the Pennsylvania Department of
8 Revenue with tax collection and audit review.

9 Having explained who we are as beer
10 wholesale distributors, I would like to take a few
11 minutes to express my opinion regarding the proposal of
12 the Pennsylvania Brewers Association.

13 Quite frankly, I don't know exactly why my
14 business partners are going down the road of extreme
15 proposals.

16 And I think that there are more important
17 issues for the legislature to address that more directly
18 impact the citizens of the Commonwealth.

19 Yes, we acknowledge and agree that some
20 change is needed to modernize the three-tier system, and
21 I think that common sense and reasonable minds will
22 prevail.

23 We are working with Pennsylvania Brewers
24 in that regard.

25 And so that the Committee knows, we have

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1 met on two occasions already with the Pennsylvania
2 Brewers in trying to come to common ground and a
3 reasonable compromise with this proposal.

4 As mentioned earlier, in my business we
5 partner with legitimate in-state Pennsylvania brewers,
6 some larger than others, through brand building efforts
7 and significant financial investment, manpower,
8 infrastructure, merchandising, promotion, sampling,
9 displays, et cetera.

10 We have grown these in-state brands to
11 very strong levels in the total beer category and not
12 just craft.

13 In fact, we can all proudly celebrate the
14 fact that Pennsylvania is ranked third in the nation for
15 craft beers.

16 In my business we have had and continue to
17 have very successful and mutually respectful business
18 relationships with all of our suppliers.

19 We established mutually agreed upon goals
20 and objectives. We execute together, and we make
21 adjustments to plan when necessary.

22 Importantly, brewers and wholesale
23 distributors have prospered in the Pennsylvania three-
24 tier system. We have all been successful in a very
25 difficult economic environment.

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1 My immediate and personal response to the
2 proposal of the Pennsylvania Brewers would be as
3 follows.

4 If the Victory Brewing Company or Troegs
5 Brewing arbitrarily decide to self-distribute or
6 terminate without cause, you will materially and
7 significantly impact my ability to continue doing
8 business as a going concern.

9 You will take my business out of the craft
10 beer segment.

11 If you require a renegotiation of the
12 terms every five years, you will diminish the trust that
13 we have built together over the past several years. This
14 trust has been paramount to our mutual success in
15 building brands together.

16 If you require ten percent of proceeds of
17 sale of distribution rights, are you prepared to share
18 the same with us if you sell to another entity?

19 Your proposals significantly erode the
20 very successful retail system.

21 Why? As your wholesale distribution
22 partner, what have we done wrong?

23 I ask these very important questions
24 because your proposals present serious challenges to my
25 ability to sustain my current business model and my

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1 ability to continue aggressive investment behind your
2 brands from which we have all prospered.

3 Ladies and gentlemen, as mentioned, we are
4 all enjoying success while the consumers enjoy the price,
5 variety and access in the beer market in Pennsylvania.

6 Existing laws provide for Pennsylvania
7 brewers to self-distribute, and each of my supplier
8 partners have chosen to go to market with my company as a
9 business partner.

10 Again, we are collectively enjoying
11 success and prosperity in a difficult economic
12 environment.

13 Existing laws also enable Pennsylvania
14 brewers to terminate for cause or for nonperformance.

15 To summarize, Pennsylvania laws supporting
16 the three-tier system of alcohol management are working
17 very well for brewers, wholesale beer distributors,
18 retailers and consumers throughout the Commonwealth.

19 That concludes my comments. I thank you
20 for your time and consideration, and I'm ready to take
21 any questions that anybody will ask.

22 CHAIRMAN TAYLOR: Thank you, gentlemen.

23 If the members don't object, I think that
24 it would be an interesting way to do this is to allow our
25 next three testifiers to come up.

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1 And then perhaps we can put six chairs
2 there, and have a little bit of a free-for-all with some
3 sort of time cap on it.

4 But I think then it's going to come on our
5 side of the table. We'll ask questions of whoever we
6 want to.

7 Any member object to that? Because I just
8 don't want to get involved in questions that the next set
9 of witnesses will answer.

10 REPRESENTATIVE PETRI: Makes sense to me.

11 CHAIRMAN TAYLOR: Okay. All right, thank
12 you.

13 Good morning, gentlemen.

14 MR. COVALESKI: Good morning.

15 Good morning, Chairman Taylor, Chairman
16 Costa, members of the esteemed --

17 CHAIRMAN TAYLOR: Before you -- just
18 identify yourself for our stenographer.

19 MR. COVALESKI: My name is Bill
20 Covaleski. I am president of the Brewers of Pennsylvania
21 Trade Association.

22 And I'm joined today by my colleagues:
23 Ted Zeller, who represents counsel for the Brewers of
24 Pennsylvania, and also David Casinelli, who is the
25 treasurer of the Brewers of Pennsylvania Trade

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1 Association and also the CEO of D.G. Yuengling & Son
2 Brewery.

3 Good morning. We Brewers of Pennsylvania
4 appreciate the opportunity to speak about this most
5 important issue before the honorable members of the House
6 Liquor Committee.

7 This matter involves the Pennsylvania beer
8 franchise laws which have not been updated for 30 years.

9 I am honored and privileged to be here
10 speaking to you today. I feel privileged because I'm
11 only ten miles from where I met my business partner in
12 Worcester Township.

13 Ron Barchet and I founded Victory Brewing
14 Company, and we met, as I said, in Worcester Township it
15 will be 40 years ago next month.

16 In the intervening years, we've put
17 together a company that represents over 215 highly
18 skilled and well-trained employees.

19 We are sending, as we like to refer to it,
20 12-ounce love letters from Pennsylvania to 30 states
21 across the country.

22 And we've built this. This now represents
23 the 26th largest brewery in the United States. And we
24 are proud to be Pennsylvania manufacturers here in front
25 of you today.

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1 Released in January 22nd of this year, the
2 Study of Economic Impact of the brewery industry in the
3 Commonwealth underscores the positive impact of
4 Pennsylvania's breweries.

5 Pennsylvania's senate resolution 2012-216
6 directed the Legislative Budget and Finance Committee to
7 conduct a study which included legislative
8 recommendations to promote the growth of Pennsylvania's
9 brewing industry.

10 According to the study, Pennsylvania
11 breweries have had an estimated direct impact of 1.1
12 billion in 2011.

13 Capital investment in plant and equipment
14 total 782 million over the five-year period since 2006,
15 growing an impressive 318 percent in that time period.

16 Pennsylvania breweries employ nearly 2,000
17 residents full time, and an additional 750 part time. An
18 estimated 2 million tourists contributed total
19 expenditures of 306 million, visited Pennsylvania
20 breweries in 2010.

21 Of important note are the recommendations
22 of the Legislative Budget and Finance Committee; namely,
23 to amend the Pennsylvania beer franchise laws to allow
24 for changes in the industry, including allowing breweries
25 to self-distribute and allowing breweries to pay fair

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1 market to wholesalers to be released from exclusive
2 professional relationships created by current beer
3 franchise laws that hamper a brewery's ability to grow to
4 its full potential and employ as many workers as
5 possible.

6 As you may know, the three-tier system of
7 beer distribution in Pennsylvania, the beer franchise
8 law, creates a state-mandated middleman monopoly. But
9 for few exceptions, this monopoly is unique only to the
10 beer industry.

11 Manufacturers, like the members of our
12 organization, are required to sell beer to the one
13 wholesaler they designate in a geographic region.

14 Then that wholesaler has the exclusive
15 rights, in perpetuity, to sell to all retailers in that
16 area. These retailers, in turn, sell to the end
17 consumer.

18 In Pennsylvania, manufacturers cannot
19 terminate wholesalers unless there is good cause, which
20 lacks definition in the Liquor Code.

21 Termination for good cause typically
22 translates into expensive legislation, and has so
23 historically.

24 There have been instances where
25 wholesalers have aggressively pursued new brands and

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1 brand rights, only to add to their portfolios and keep
2 that brand away from competing wholesalers in the
3 market.

4 Wholesalers have reacted unilaterally to
5 sell their rights to brewery products to another
6 wholesaler without the manufacturer's consent in
7 Pennsylvania.

8 One of our association members just
9 concluded litigation over this very issue which cost them
10 hundreds of thousands of dollars in court costs.

11 The franchise laws dictating these
12 situations have both their faults and historical
13 benefits.

14 The Brewers of Pennsylvania believe in the
15 value and effects of this three-tier system and fully
16 support its existence, while recognizing the system's
17 current flaws that need to be corrected.

18 From a manufacturer's perspective,
19 franchise laws prohibit free trade by creating a monopoly
20 of the manufacturer's product and intellectual property
21 in the wholesaler.

22 The last time Pennsylvania amended these
23 franchise laws was in 1980, and the current laws have
24 failed to address mass industry beer consolidation and
25 changes.

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1 Mass industry beer consolidations started
2 at the top, meaning the manufacturers, and have carried
3 through to the wholesaler tier.

4 Lastly, the three-tier system increases
5 the cost of beer to the general public.

6 Historical benefit of the three-tier
7 system are recognized for prohibiting direct sales by a
8 manufacturer to the consumer.

9 At the close of prohibition, when the
10 three-tier system was conceived of, it was feared the
11 manufacturers would act in an anti-competitive manner,
12 and that would lead to the increased promotion of alcohol
13 consumption.

14 To avoid this concern, franchise laws
15 required the manufacturer to go through a local
16 wholesaler who was more knowledgeable and responsible
17 about the alcohol distribution to the retail outlets.

18 Further, the local wholesalers are
19 directly subject to State law enforcement.

20 Now, the landscape of our national
21 regional brewing industry has changed radically over the
22 past 30 years, as evidenced by the massive consolidation
23 of Belgian owned InBev and Anheuser-Busch, and the merger
24 of MillerCoors under the direction of South African owned
25 SAB.

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1 National consolidation among brewers has
2 reached a point in which a large majority of America's
3 beers are produced by two companies, none of them with a
4 single brewery in Pennsylvania.

5 Growth of these larger national breweries
6 has led to the closure of many regional breweries which
7 simply could not compete with pricing and distribution
8 power achieved by the mega breweries.

9 Compared to these mega breweries, even the
10 breweries of Pennsylvania's largest members -- D.G.
11 Yuengling & Sons, Incorporated and Sam Adams -- are
12 considered at best mid-sized breweries on a national
13 scale.

14 Beer maker Budweiser sells more beer in a
15 week than Yuengling brews in an entire year. It takes
16 the MillerCoors merger two weeks to top Samuel Adams'
17 annual production.

18 These two mega breweries produce more than
19 75 percent of the beer consumed in this great industry.

20 They dominate the market and aggressively
21 attempt to consolidate and regulate the wholesale market
22 by putting pressure on wholesalers to consolidate.

23 These consolidations at the wholesale
24 level ultimately have caused loss of jobs and loss of
25 competition in Pennsylvania.

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1 Since 1990, the wholesaler numbers have
2 decreased by over one-third of the markets around the
3 United States becoming a duopoly, a two wholesaler
4 market; one wholesaler controlled by Anheuser-Busch and
5 InBev merger and the other by MillerCoors, both foreignly
6 owned.

7 The market power of the mega breweries is
8 astounding and transcends their wholesalers.

9 Through its trials and tribulations,
10 Yuengling has taken over 180 years to achieve its current
11 market share.

12 Recently, one mega brewery introduced a
13 brand of beer flavored like a margarita that took only
14 six weeks to obtain a market share larger than Yuengling,
15 which had worked 180 years to achieve its position.

16 Such market power cannot be exerted
17 without the unconditional support of the wholesaler
18 tier.

19 Pennsylvania breweries do not enjoy such
20 support in the wholesale level, and many brands become
21 lost in the shuffle of the wholesalers proliferating
22 brand portfolio.

23 Franchise laws make it impossible for
24 brewers to move to another wholesaler unless it has the
25 resources to fund extensive litigation.

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1 Consolidation at the wholesale level has
2 reversed the bargaining power between breweries and
3 wholesalers.

4 While Sam Adams is one of the largest
5 domestically owned breweries in the United States, they
6 are smaller than two Pennsylvania wholesalers.

7 Nearly all the wholesalers in Pennsylvania
8 are larger than the Pennsylvania breweries they
9 represent.

10 Back in 1980, when they were enacted,
11 franchise laws were developed to protect wholesalers from
12 developing national brewers.

13 That shield has become a sword utilized by
14 wholesalers to maintain a grand portfolio without regard
15 to performance.

16 Wholesalers are immune from the market
17 preference of consumers with all the brands that they
18 have collected. If a wholesaler does not adequately
19 represent a brewery, it is only the brewery's business
20 that is at stake.

21 We, as the Brewers of Pennsylvania, are a
22 mid-sized brewery by Pennsylvania standards -- like
23 Straub in St. Mary's and Troegs in Hershey -- packing
24 beer for sale across the Commonwealth and a number of
25 states.

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1 We are also your neighborhood brew pub.
2 As small independent Pennsylvania brewers, we are gaining
3 ground after significant setbacks.

4 The closures of Schmidt's in Philadelphia,
5 Stroh's in Lehigh, and Kohler in Erie, all within the
6 last 30 years, took jobs from our state.

7 Schmidt's, once the nation's 10th largest
8 brewer, employed 1,400, while producing 3 million barrels
9 of beer.

10 Need we remind this Committee about
11 Rolling Rock, severed from its home in Latrobe by a
12 foreign-owned entity.

13 All of these breweries fell prey to
14 national powers. Despite these challenges, we are proud
15 to have America's largest independently owned breweries
16 call Pennsylvania home.

17 Yes, both Yuengling and Sam Adams are the
18 largest independently owned breweries, but they are
19 responsible for less than one percent of all beer sales
20 nationwide.

21 This is tiny in comparison to the big
22 brewers who are more than 100 times their size.

23 As a result, our products do not command
24 the same focus and energy from wholesalers of products
25 from the mega breweries.

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1 More and more states have started to
2 address this changing industry and amend their franchise
3 laws.

4 Even the surrounding states of Delaware,
5 New Jersey, Ohio and New York have laws in place which
6 address the results of industry consolidation.

7 The Brewers of Pennsylvania propose
8 changes which have been embraced by other states and
9 recommended by the Legislative Budget and Finance
10 Committee.

11 Many of the changes proposed by other
12 states were to remedy constitutional issues created by
13 the United States Supreme Court decision in Granholm
14 versus Heald in 2005.

15 Likewise, the Brewers of Pennsylvania
16 propose to sanitize any Granholm issues created by our
17 current Liquor Code and to preserve distribution of malt
18 beverages through our Pennsylvania partners, the
19 wholesalers, through the three-tier system.

20 Presently, Pennsylvania manufacturers have
21 the benefit of secondary agreements, which should be
22 eradicated in order to prevent any constitutional
23 challenge under Granholm.

24 Secondary agreements are a matter in which
25 Pennsylvania manufacturers can self-distribute or exit a

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1 wholesaler relationship without enduring expensive
2 litigation because of termination for cause.

3 In place of secondary agreements the
4 Brewers of Pennsylvania propose language that allows the
5 brewery to terminate wholesalers without cause as long
6 as the brewery is less than 20 percent of the
7 wholesaler's volume.

8 Any wholesaler which is terminated under
9 the 20 percent exit rule will receive the market standard
10 fair market value for the brand which would be settled by
11 arbitration if the parties could not agree.

12 In addition, any manufacturer would be
13 allowed to self-distribute up to 75,000 barrels of
14 in-state production with no distinction from in-state or
15 out-of-state manufacturers.

16 The 75,000 barrel mark is consistent with
17 the differing malt beverage tax obligations given to
18 breweries of varying scale under the Federal Tax Code as
19 applied to the Pennsylvania population compared to the
20 total U.S. population.

21 Some of our proposals have their origins
22 in previous attempts to fix franchise laws.

23 In 2009 and 2010, the Pennsylvania
24 Legislator, including this Committee, addressed HB291,
25 whose legislation was advocated by the Pennsylvania Beer

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1 Alliance, formerly the Pennsylvania Beer Wholesalers
2 Association.

3 As Pennsylvania brewers detailed several
4 years ago, that legislation would have had an adverse
5 affect on Pennsylvania brewers and their ability to
6 redress distribution issues.

7 At that time, Pennsylvania breweries were
8 told by their wholesales partners that any performance
9 issues should be freely addressed and bargained for in
10 exchange for contracts between the parties.

11 Unfortunately, current Pennsylvania beer
12 franchise laws allow these contracts to be perpetual,
13 permitting some wholesalers to refuse to negotiate
14 modified terms which would update these contracts and
15 address the changing landscape of the brewing industry.

16 As a result, Brewers of Pennsylvania now
17 propose that these distribution agreements be
18 renegotiated every five years to allow those
19 relationships to adapt to industry changes.

20 Our proposal suggests that any failure on
21 the parties to agree will be sent to binding mediation
22 and would not be a reason to terminate the wholesaler.

23 The Brewers of Pennsylvania also propose
24 clear statutory language to consent to any wholesaler-to-
25 wholesaler transaction. The brewer's failure to consent

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1 would not create a private issue of action for
2 wholesalers to sue a brewer.

3 In consideration of consenting to such a
4 transaction, the brewers propose that they would receive
5 ten percent of the brand rights' value exchanged between
6 the wholesalers in such a transaction.

7 Surely the brewers should be compensated
8 for the exchange of their own goodwill at the wholesaler
9 level which will help them invest in marketing brands and
10 neutralize the risks associated with the logistical
11 change from one wholesaler to another.

12 The time is critical to address these
13 important issues facing our industry.

14 Soon consolidation experienced at the
15 manufacturer level will permeate the middle tier of
16 wholesalers of beer. Such a duopoly does not favor
17 innovation, consumer choice or local brewers.

18 Brewers of Pennsylvania stand here as
19 independent brewers employing residents of the
20 Commonwealth and risking their own capital to expand
21 their own facilities.

22 Recently, my company concluded that
23 investing in Pennsylvania was a sound strategy.

24 Since beginning as the dream of two former
25 Montgomery County residents in 1995, Victory now ranks as

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1 the nation's 26th largest brewery, with each barrel
2 brewed and packaged in Downingtown, Pennsylvania.

3 We will be opening a second facility in
4 West Sadsbury Township this October at a cost of over \$30
5 million in anticipation of expanding consumer thirst for
6 distinctive Pennsylvania products.

7 On behalf of my employees, my brewing
8 partners across the Commonwealth, I hope this strategy is
9 sound, as it relies on a stable yet progressive business
10 environment.

11 Such an environment of success can be
12 fostered by this Committee and the Pennsylvania General
13 Assembly at large.

14 Please amend the Pennsylvania beer
15 franchise laws so the regulatory framework under which we
16 must operate is not threatened to undermine our
17 businesses or our employees' futures.

18 Thank you very much for your time this
19 morning.

20 CHAIRMAN TAYLOR: Okay. So as I
21 suggested, if nobody objects, you can just slide over
22 your way.

23 Ted, do you have testimony?

24 MR. ZELLER: No, I don't.

25 CHAIRMAN TAYLOR: Okay. I would like to

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1 start out with Representative Tobash's comments, and I
2 have few questions.

3 Then I'm sure we'll all -- and we were
4 joined by Representative Sabatina before we started.

5 Good morning, John.

6 REPRESENTATIVE SABATINA: Good morning.

7 CHAIRMAN TAYLOR: Representative Tobash.

8 REPRESENTATIVE TOBASH: Thank you,
9 Mr. Chairman. I appreciate being here today. I think
10 we're here in front of the hardest working Committee in
11 the House of Representatives, I might say, who dealt with
12 a lot of issues.

13 CHAIRMAN TAYLOR: Stop pandering.

14 REPRESENTATIVE TOBASH: I just appreciate
15 the Committee being back here right now to deal with
16 another issue as far as the Liquor Code is concerned, and
17 I appreciate the time they spend on this and are
18 dedicated to the issues of the Commonwealth.

19 We did drop this legislation yesterday,
20 House Bill No. -- it's House Bill 1666. And I believe
21 that this bill will continue and strengthen the three-
22 tier system within the Commonwealth of Pennsylvania.

23 I believe it adds protection to the
24 manufacturers and the wholesalers alike.

25 I think it addresses an issue that we have

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1 already discussed briefly, the 2003 Supreme Court
2 decision Granholm, which deals with interstate commerce
3 and equal treatment between in-state entities and out-of-
4 state entities.

5 I think the legislation and the dynamic
6 that we are talking about here today is a matter of then
7 and now. Certainly since prohibition things have changed
8 drastically.

9 Right now in the Commonwealth of
10 Pennsylvania if a brewer develops a product and enters
11 into a primary franchise agreement, they give up that
12 brand perpetually. And perpetually is a long time.

13 I think that when we take a look at other
14 contracts in the Commonwealth that people enter into,
15 it's not reasonable to think that you can forecast what
16 the market might be like for 10, 20 or 50 years.

17 So I think it's important to take a look
18 at the way we enter into these agreements now, and that's
19 what we're trying to do with this legislation.

20 The legislation has a few elements.
21 Number one, it levels the playing field for in and
22 out-of-state brewers.

23 Number two, it allows this good faith
24 negotiation at five-year increments.

25 Number three, it gives the manufacturers

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1 an opportunity to weigh in on the sale of their brand
2 from one wholesaler to another.

3 And it also makes it easier for
4 wholesalers to pass their business on to their family
5 members down the road.

6 It makes some territory requirements, it
7 loosens them up. And it also makes the residency
8 requirements a little bit easier.

9 So overall I think this is an important
10 piece of legislation right now, particularly because of
11 the fact that we're dealing with other Liquor Code issues
12 which made a major impact on both these players, the
13 manufacturers as well as the wholesale distributors in
14 the Commonwealth.

15 So I very much appreciate being here
16 today. I appreciate all of the testifiers in
17 understanding more about this issue as we deal with it in
18 these upcoming days of legislative sessions for the
19 remainder of this year.

20 Thank you very much, Mr. Chairman.

21 CHAIRMAN TAYLOR: Thank you, Mike.

22 Before I turn it over to Representative
23 Costa, as everybody in this room knows, we -- this
24 Committee has been occupied with quite a few issues this
25 past term and even the term before this.

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1 And this is, you know, fairly complicated
2 stuff. But I'm trying to frame these issues, and I want
3 you to think about at least how I'm thinking about it and
4 proceed.

5 I think I can go to testimony by Matt to
6 kind of give a couple of phrases in here that I want you
7 to just think about as we proceed in this discussion.

8 One of the things that Matt says at the
9 end is that, Your will proposal significantly erode a
10 successful system. Why? Why do that?

11 I think on this side of the table we would
12 probably label it here in real life examples of why the
13 system now is not currently providing you with a good
14 business environment.

15 On the other hand, Matt also says that, If
16 people like Victory and Troegs decide to self-distribute
17 or terminate without good cause, you affect our
18 business.

19 It's true. Why is that different in beer
20 than any other business in America? And I want to get an
21 answer to that.

22 Why is that unique to beer? Why are we
23 statutorily involved in that to clamp down?

24 Anybody can enter into any kind of
25 contract they want, but we made the law to make sure that

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1 these contracts forever and things like that. So with
2 those two -- and I'm not going to ask you to do that.

3 But in the course of the other members'
4 discussion, at least from my end, I want to realize the
5 reasons as to why it should change and on the other hand
6 why is this so unique to beer.

7 Representative Costa.

8 CHAIRMAN COSTA: Thanks again,
9 Mr. Chairman.

10 I will try to be real brief. I do have a
11 lot of quick questions, and I will try to get through
12 here quickly.

13 My first issue -- and John makes a great
14 point -- why are we regulating contracts?

15 From the beginning, I thought why are we
16 getting involved in micro managing. I talked to several
17 of you here and several of people back home to try to get
18 the answers.

19 But one of the questions I came up with or
20 which was brought to my attention was about contracts.

21 And, Fran, you brought up about the
22 brewers are the ones that make the contract.

23 What about -- I've heard stories that
24 there are new brewers that are happy as hell that anybody
25 would take their product. And that contract -- they are

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1 stuck in that contract forever. Forever.

2 You know, that's a concern, and I do
3 understand that.

4 But is there an ability for a brewer to --
5 if he reaches a certain plateau and he becomes successful
6 like Bill and then he becomes successful -- to
7 renegotiate? Or is that once you sign the contract, is
8 that contract forever?

9 MR. O'BRIEN: No, the contract does not --
10 contract laws don't depend upon the size of the brewery
11 or the age or the years in operation. Their contract is
12 their contract.

13 But they have the ability to make -- Matt
14 could tell you what Anheuser-Busch does all the time. A
15 lot brewers will issue annual or every couple of year
16 changes to contracts and ask the people to sign them and
17 they sign them.

18 CHAIRMAN COSTA: Does that also happen
19 with the small brewers?

20 MR. O'BRIEN: I don't know whether they
21 make those changes or try to get those changes.

22 CHAIRMAN COSTA: Now, you said there's
23 cause. There has to be cause for termination of a
24 contract.

25 What if the brewer and the ID cannot come

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1 to an agreement? Does it go to arbitration? If they
2 can't come to an agreement on what a separation agreement
3 is.

4 MR. O'BRIEN: No. The procedure under
5 current law, the brewer has to decide whether it wants to
6 simply terminate, and then the wholesaler would have to
7 decide whether it has a collateral basis for going into
8 court.

9 The statute gives the local Court of
10 Common Pleas jurisdiction to hear and the power to grant
11 injunction in those circumstances.

12 CHAIRMAN COSTA: That is my next
13 question. How often -- I mean, how many times does that
14 happen?

15 MR. O'BRIEN: There was just one recently,
16 a West Coast brewer who obviously had to have a contract
17 in Pennsylvania.

18 He decided to start sending to another
19 wholesaler that -- other than the one it was working
20 with. The first one it had is not one of our members.

21 And they had a paper trail. It was
22 basically here's what we expect of you, here's what is
23 required, and here's how you're not doing it. We put you
24 on notice.

25 And they took -- basically took all the

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1 e-mails back and forth, the history of correspondence,
2 and put that on to their answer.

3 And ultimately, the wholesaler had to drop
4 the case.

5 CHAIRMAN COSTA: Now, Matt --

6 MR. BELJAN: Excuse me.

7 CHAIRMAN COSTA: I'm sorry.

8 MR. BELJAN: Representative Costa, it's
9 also done in the amicable arena. This has been made up
10 to be adversarial.

11 We relinquish brands. We have been asked
12 to sell brands to other wholesalers to consolidate. So,
13 you know, they want to go with the Bud network or they
14 want to go with the MillerCoors network.

15 We are an independent craft network -- we
16 are not a network -- craft company.

17 But these exchanges are not as far apart
18 as you're being led to believe. We've been involved in
19 several, and I've only been in business for nine years.

20 So it's not an adversarial relationship 90
21 percent of the time. And knock on wood, we have never
22 been in court.

23 CHAIRMAN COSTA: While you have the mic,
24 one of the other questions I have is, sure, there's a lot
25 of different craft brewers that come to you.

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1 MR. BELJAN: It's not getting me the mic.
2 It's getting away from it.

3 CHAIRMAN COSTA: I mean, they are all not
4 like you; they're all not very successful like Victory,
5 or Church brew out our way.

6 How many times have brewers come to you
7 and it's just hasn't worked? Where it's not your fault
8 or their fault, it's just their product doesn't --

9 MR. BELJAN: Sly Fox would be a perfect
10 example. We had Sly Fox in the Lehigh Valley. We had it
11 for four counties.

12 It was a canned product at the very
13 beginning when we started before craft was accepted in
14 cans. It did very poorly for us.

15 The owner and I had lunch, and we signed
16 off on it for free. So it does happen.

17 CHAIRMAN COSTA: Does this cost you money
18 if that happens?

19 MR. BELJAN: We lost money on that
20 transaction.

21 Because in the first couple of years you
22 don't make any money or you make -- you know, there's so
23 much brand building involved and so much effort, you
24 know, especially with the infrastructure.

25 You had asked -- if I could answer that

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1 now -- if I have the money, why franchise laws, you know,
2 for alcohol or beer distributors.

3 We are site specific. I have one product
4 or one series of products. I sell alcohol, which is
5 regulated by the State of Pennsylvania and the government
6 of the United States.

7 So it's not like a trucking company. If I
8 lose my Wal-Mart contract, I go down the road and pick up
9 a K-Mart contract and bid on that.

10 My family owned a construction company in
11 the State of Pennsylvania. We bid on Penn Dot work, we
12 bid on SEPTA work. We would go to New Jersey. We would
13 go to Maryland. We were prequalified.

14 Stockertown Beverage does not have that
15 ability. I can't go to New Jersey without getting a
16 license, without getting a brand.

17 There was talk about franchise laws being
18 changed in New Jersey, but there's still franchise laws.
19 It's -- you know, let's not throw the baby out with the
20 bath water here.

21 Can improvement be made? I think
22 improvement can be made with everything. All right.

23 So, you know, but there are reasons why
24 these franchise laws were enacted, and those reasons have
25 not done gone away.

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1 Any other questions?

2 CHAIRMAN COSTA: No. I'm going to move on
3 to Matt.

4 Matt, you are fortunate enough to have
5 Victory. What percentage of Victory is your business?

6 MR. FUNCHION: Roughly three-and-a-half to
7 four percent.

8 CHAIRMAN COSTA: And the requirement here
9 is 20 percent. That's a large market.

10 Again, God bless you, Bill. You are very
11 successful and I'm very happy for you. I wish you
12 continued success with your expansion.

13 But that 20 percent number is pretty
14 darned high. Again, I have used Church brew in my area,
15 you know, Sean Casey. We had a discussion the other day
16 and he's with your distributor.

17 We figured by his sales he's at 0.25.
18 He'll never get to 20 percent. I mean, I wish him well,
19 but to get to 20 percent -- I mean, even you are very
20 successful, you are not doing anything even close to 20
21 percent.

22 MR. BELJAN: Can I make a couple of
23 comments to that, please?

24 CHAIRMAN COSTA: Sure.

25 MR. BELJAN: And also to follow-up on

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1 John's comments about some of these exchanges that have
2 occurred. I'll give you a couple of examples of what's
3 occurred in our business.

4 For example, the initial partnership
5 between Penn Beer Distributors and Victory Brewing
6 Company.

7 Eight years ago, Bill's products were
8 being distributed by Ed Friedland in Philadelphia.

9 Bill wanted to make the move, change
10 direction and go to a -- I guess a more heavily
11 structured infrastructure to further distribute and sell
12 the brand.

13 I was able to go and talk respectfully and
14 professionally with Ed Friedland, and we negotiated a
15 sale of the Victory rights of the Victory brand in
16 Philadelphia County. And then we secured that and we
17 paid for it.

18 And then we -- Bill decided he wanted --
19 Bill was self-distributing in Chester County and decided
20 he wanted to -- we even talked about it together and
21 decided a different idea would be the further
22 acceleration of the growth of the brand to partner with
23 us in Chester County.

24 So we were able to do that with Bill,
25 which means we also worked out an arrangement where we

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1 paid for the rights in Chester County with Bill.

2 And we were also able to negotiate a
3 footprint through Lower Montgomery County so that we
4 could be contiguous into Chester County with a wholesaler
5 and have Victory in Lower Montgomery County.

6 The same thing happened with Troegs.
7 Chris Trogner wanted to make a change with his
8 distribution partner.

9 A couple of years later we were able to
10 negotiate that professionally and respectfully with the
11 selling wholesaler, and we were able to match up that
12 way. A very, very successful means of production.

13 So I just wanted to make a comment on
14 that.

15 And I'm sorry. Your other question?

16 CHAIRMAN COSTA: About the percentage.

17 MR. BELJAN: Okay. So, yeah, in terms of
18 the percentage of the business, yes, it's four percent
19 now. Could it get to 20 percent? Absolutely.

20 The growth pattern that we are on now,
21 we've grown the brand 15-fold since our partnership
22 began.

23 CHAIRMAN COSTA: But that is the
24 partnership, both you and Bill.

25 MR. BELJAN: Yes, absolutely.

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1 CHAIRMAN COSTA: Obviously he has to have
2 a good product.

3 MR. BELJAN: Yeah, absolutely.

4 I fully acknowledge it's been a very
5 mutually successful partnership.

6 We have been great business partners. We
7 have friendships that have formed between our two
8 companies at our level with Bill and Matt and also the
9 rest of our employees on both sides. It's been terrific.

10 CHAIRMAN COSTA: Have you had many
11 products that failed?

12 MR. BELJAN: No, sir. No, sir.

13 CHAIRMAN COSTA: Good for you.

14 Ted, I asked you this last night. I want
15 to ask you again.

16 Why are we getting involved in these
17 contracts?

18 MR. ZELLER: Actually, the point is to get
19 you not involved with the contracts.

20 It's -- you know, you heard from the
21 wholesalers maybe we can define cause better. Well,
22 really shouldn't that be in the contract?

23 One of the statements of cause right now
24 is that if you breach a material term in the agreement
25 between the manufacturer and the wholesalers, that's good

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1 cause to terminate.

2 Really with our proposal that's -- we're
3 not asking you to legislate the terms of the contract.
4 We are just asking you to legislate that once every five
5 years they sit down at the table and negotiate.

6 I found it real interesting in one of the
7 testimony -- I made a note of it -- that they cannot be
8 subject to mandatory routine negotiations. I mean, isn't
9 that what a free market is about, to negotiate
10 contracts?

11 Let's just take it to the flip side.
12 These contracts are in perpetuity. And we do have those
13 unsophisticated brokers, and they are the one-page
14 agreements. And maybe one day they grow to be a
15 Victory.

16 That wholesaler does not have to
17 renegotiate that contract that could be on that one-page
18 agreement.

19 There's no terms about how to market; what
20 are the performance standards; what are the goals; how
21 many accounts do you have to call on per week; Class A
22 accounts, B accounts, C accounts.

23 If the bill that was just introduced that
24 says five years, negotiate every five years, and it said,
25 well, just renegotiate every 100 years, do you think we'd

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1 have an objection on the other side? I don't think so.

2 CHAIRMAN TAYLOR: Could I just add, what
3 if we just said we're silent on that legislatively? You
4 can enter into any kind of contract you want.

5 If a brewer wants to enter into a contract
6 forever, he can do it. If he wants to enter into it for
7 one year, he should do it.

8 Can somebody explain to me where that
9 concept came from and why that needs to continue; that as
10 soon as you sign up, you are signed up forever.

11 And where is that? Is that in any other
12 industry whatsoever? I mean, why we do need that if you
13 can contract --

14 MR. ZELLER: I agree with you 100
15 percent. The current Liquor Code requires that any
16 contract is in perpetuity.

17 MR. FUNCHION: Well, if I could make a
18 comment on that as well.

19 I think that the fact of the matter is
20 that, as Representative Costa just mentioned, we do this
21 together. We invest together.

22 Bill makes a terrific product. We have
23 got a solid successful infrastructure of getting that
24 product to market. We collectively make investments
25 together in building the brands that we partner with.

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1 And so all of that investment, all of that
2 infrastructure, all of those jobs, if all of a sudden
3 that partnership is terminated for no cause or because
4 somebody doesn't come to an agreement on a five-year
5 renegotiation, then in my particular case it impacts my
6 infrastructure, yes, four percent of my business.

7 But it impacts my infrastructure with
8 equipment, with people, with jobs that I've invested in
9 along the way with Bill.

10 And if all of a sudden that goes away --

11 CHAIRMAN TAYLOR: I understand that, Matt,
12 but just like any other contract.

13 So, I mean, whatever you negotiate -- I
14 guess I'm speaking for myself now -- you know, we did
15 have this in existence and we were trying to formulate a
16 plan -- whatever that you and Victory negotiate should be
17 fine with the government.

18 And you build all of that into the
19 contract. What you do; what he does; what it's worth;
20 how long is the term. Like any other contract in any
21 other business.

22 And I just -- I don't even know the
23 advantage to either one of you, really, for this forever
24 stuff. I mean, I guess it could work against you, too.
25 So I don't know -- do you understand the difference of

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1 what I'm asking?

2 MR. FUNCHION: I don't fully -- I don't
3 have enough information or knowledge of how contract
4 works -- how contracts work in other industries, so I'm
5 not going to...

6 MR. O'BRIEN: But the five-year re-up, no
7 state, no other state has the kind of provision. And the
8 contracts in other states where there are franchise
9 contracts are perpetuity. That's always been the way it
10 is.

11 CHAIRMAN TAYLOR: I mean, it doesn't make
12 sense.

13 MR. BELJAN: Why doesn't it make sense to
14 you?

15 CHAIRMAN TAYLOR: Why should it be a
16 contract forever?

17 MR. BELJAN: It's not -- I mean, everyone
18 is making it forever. Forever is a long time, especially
19 towards the end.

20 That being said, it gives the wholesaler
21 protection as we grow the brand.

22 This is being made into a one-sided
23 discussion that, you know, the brewer produces beer and
24 their success is just based on their product. And that's
25 the furthest thing from the truth.

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1 that the Supreme Court said Granholm is absolutely viable
2 and legal and constitutional.

3 It serves great public purposes, and
4 there's not another system around that can do the same
5 for the benefit for the Commonwealth and its people.

6 But at the same time, if you say that you
7 can --

8 CHAIRMAN TAYLOR: Let him answer that.

9 MR. ZELLER: I never met Mr. Beljan
10 before. I understand he does a great job. And the
11 gentlemen that are sitting here today I submit to you are
12 not the problem.

13 So this is not personal. I'm not trying
14 to make it personal.

15 CHAIRMAN TAYLOR: We can make it
16 personal. We would like to know what the problem is. We
17 want to know what to do.

18 MR. ZELLER: I'm going to give you -- for
19 example, I just dealt with a call on -- what's today?

20 Thursday -- I believe it was Monday with a
21 brewer that I represent that wants to go to Mr. Beljan's
22 house right now. He wants to move his brand to
23 Mr. Beljan's house.

24 And the only thing that's keeping him from
25 already being with Stockertown Beverage is because the

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1 wholesaler that currently has his brand is threatening to
2 sue him over it. That happened on Monday.

3 I've dealt with cases -- termination
4 cases -- I just dealt with a large case --

5 CHAIRMAN TAYLOR: Again, can I ask you
6 about the contract itself?

7 MR. ZELLER: Sure.

8 CHAIRMAN TAYLOR: Because you probably
9 draft them, right? So in the document itself is it
10 silent on term because of the statute?

11 MR. ZELLER: Well, what I've started to do
12 is to put terms in the contract. They are not
13 enforceable right now because of all of these kinds of
14 franchise laws which are in perpetuity.

15 But if we have with the province of a
16 great legislature that would in some put a term and enact
17 that, my contracts that were in place then would
18 effectively have terms.

19 CHAIRMAN TAYLOR: What if we didn't have a
20 term and you negotiated -- that brewer comes and you
21 negotiated -- the wholesaler negotiates whatever they
22 want to negotiate?

23 MR. ZELLER: That's great. It just erode
24 -- just take away the perpetuity part of the Liquor
25 Code. That's our whole point. We are trying to fix

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1 something.

2 CHAIRMAN COSTA: You're going down the
3 path that I was.

4 Bill, I wanted to get to you. I could see
5 you're chomping on the other side.

6 When you first -- you self-distributed at
7 the beginning, as you said, correct?

8 MR. COVALESKI: That is correct.

9 CHAIRMAN COSTA: And then you decided to
10 go to an ID. So Matt was your first group that you went
11 with?

12 MR. COVALESKI: Penn Distributors was not
13 the very first wholesaler I went with, but it's been a
14 very good relationship.

15 CHAIRMAN COSTA: I mean, did you negotiate
16 with them or did you use them in and decide to leave
17 them? Or did you just --

18 MR. COVALESKI: Like Erie Brewing Company
19 was self-distributed in the territory of Chester County.

20 And as Matt has identified, we came to
21 terms on the transaction in Philadelphia, and it was
22 logistically important to also tackle Chester County at
23 the same time. So we came to a deal on that.

24 CHAIRMAN COSTA: Now, when you first
25 signed your contract with Matt, did you have the Brewers

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1 Association help you and say, These are the things you
2 need to look at, or -- and because what I want to know --
3 to Ted also -- can you then -- and John asked it too --
4 when you sign a contract or when you advise the brewers
5 to sign a contract, can you say it terminates -- almost
6 like a prenuptial -- you know, if we get to 2015, and
7 we've met this criteria, we renegotiate?

8 Can you put that in the contract? Or if
9 we don't get to this, we terminate and we have the
10 ability to go somewhere else?

11 I mean, it would have to be, obviously, a
12 contract that's agreed to by both sides, when we don't
13 have to worry about the issue about it being in
14 perpetuity.

15 MR. ZELLER: I'll let Bill speak to what
16 type of contract he had with them first.

17 But I can put that term in there -- and I
18 have put similar terms in there -- but right now that
19 would be unenforceable with the current legislation.

20 CHAIRMAN COSTA: It's unenforceable by our
21 laws?

22 MR. ZELLER: Correct. Because the Liquor
23 Code mandates that the contract has to be in perpetuity.

24 MR. BELJAN: Excuse me a second. Does the
25 word perpetuity appear anywhere in the Liquor Code?

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1 MR. ZELLER: No, it doesn't. It's a
2 common knowledge that the contracts are in perpetuity.

3 You heard Mr. O'Brien, and his counsel as
4 well said, around the nation the franchise laws requires
5 these contracts to be in perpetuity.

6 MR. BELJAN: The word is being
7 superimposed in this discussion.

8 CHAIRMAN TAYLOR: Okay. Well, let's get
9 to where -- what does it say? Why are we saying it is in
10 perpetuity if it isn't?

11 MR. O'BRIEN: It says you must enter into
12 a written agreement and you may cancel it for cause.

13 REPRESENTATIVE PETRI: Frank, if I could
14 jump in here a minute, because you guys are really
15 confusing all of us. Okay?

16 And I know you guys know the law very well
17 and you're jostled on this issue, but I think we are
18 trying to figure it out.

19 Because effectively what you're saying to
20 me -- what one side said to me is, hey, the law sets up a
21 contract limitation. We can't get out -- we can't set up
22 our own distribution.

23 If I understand, doesn't the law say that
24 you have to have a distributor, right? They have to have
25 a distributor.

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1 MR. O'BRIEN: They don't have to have a
2 distributor. They are brewers. They are the ones who
3 are pushing this proposal forward. This is Pennsylvania
4 Brewers, and they don't have to have a distributor.

5 REPRESENTATIVE PETRI: They can self-
6 distribute, but -- help us out. What specifically --
7 because I don't have the code with me. What specifically
8 does it say word for word, as best you can? Somebody's
9 got it.

10 MR. O'BRIEN: On which point?

11 REPRESENTATIVE PETRI: On the issue of
12 perpetuity.

13 MR. O'BRIEN: It doesn't say perpetuity.

14 It says you must have a written agreement
15 before distributing if you are out of state, or if you
16 choose -- if you are in state and you choose to have a
17 written agreement with primary rights, then it can be
18 terminated for cause.

19 REPRESENTATIVE PETRI: Okay. So how many
20 of the agreements that are out there have term provisions
21 in them?

22 MR. ZELLER: Of primary agreements?

23 REPRESENTATIVE PETRI: Yeah.

24 MR. ZELLER: Effectively zero. Because
25 you have to enter into a written agreement and you can

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1 only terminate for cause.

2 And one of the causes is not because your
3 term is ending from a year perspective; it's effectively
4 in perpetuity.

5 And there's case law on that, I mean, from
6 throughout the United States that that is the concept of
7 why we are saying in perpetuity.

8 REPRESENTATIVE PETRI: Really? Are there
9 buyout provisions in there?

10 In other words, that if an agreement is
11 terminated or you move, that you will pay X dollars or
12 whatever, you know, some sort of formula, generally?

13 MR. ZELLER: I have those in my contracts
14 that I offer to my brewers now.

15 REPRESENTATIVE PETRI: And do distributors
16 sign them?

17 MR. ZELLER: When you go to a new state.

18 REPRESENTATIVE PETRI: Let's say
19 Pennsylvania.

20 MR. ZELLER: A new territory.

21 REPRESENTATIVE PETRI: The guys that are
22 sitting opposite you. They sign those provisions that
23 have a term and a buyout or something of that nature.

24 MR. ZELLER: It's only a buyout in a right
25 of first refusal situation when we go to sell to the

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1 wholesaler, and you not might not like -- we might not
2 like the wholesaler that they are selling to, you might
3 have another idea.

4 I have a trigger that there's a right to
5 first refusal, that the brewer can buy the brand back for
6 what the wholesaler is selling it to the other wholesaler
7 and move it to another wholesaler.

8 But we just -- I just got done litigation
9 which -- sitting next to me -- G.D. Yuengling & Son spent
10 several hundred thousand dollars, and whether that right
11 of first refusal was effective was an issue in the
12 litigation.

13 And in addition, the wholesaler had
14 refused to sign the updated contract, and that was an
15 issue in the litigation.

16 And this wholesaler was selling to another
17 wholesaler, and we did not want to approve that
18 transaction. And that wholesaler maintained in legal
19 pleadings that we actually have no right to consent.

20 REPRESENTATIVE PETRI: Who won?

21 MR. ZELLER: It was resolved. It was
22 several hundred thousand dollars.

23 REPRESENTATIVE PETRI: Who would have won
24 in your opinion?

25 MR. ZELLER: I liked my case.

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1 REPRESENTATIVE PETRI: I like your case,
2 too, on a factual basis. I think you'd win.

3 MR. ZELLER: Yeah. It's a difficult
4 concept to tell Mr. Yuengling that, you know, the family
5 name on his bottle for over 180 years, that what the
6 wholesaler was saying that he had no right to decide who
7 was going to deliver that product.

8 That was a tough conversation to have.

9 REPRESENTATIVE PETRI: I bet they are. So
10 it was resolved.

11 Do we know of any cases, Pennsylvania
12 cases, where they've decided the issue -- let's say there
13 was a term in the contract, as Representative Costa said,
14 it ends in 2015. Has anybody ever litigated that?

15 MR. ZELLER: No.

16 REPRESENTATIVE PETRI: Why not?

17 MR. ZELLER: Because of the terms of the
18 contracts. We all know that they're in perpetuity.

19 MR. O'BRIEN: But I think to suggest that
20 they are all in perpetuity ignores the fact that most of
21 the changes and the moves are resolved on a business
22 basis. People make agreements.

23 So to say that all contracts -- that's not
24 accurate to say that. It's only a small percentage that
25 get into these disputes.

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1 REPRESENTATIVE PETRI: Are you aware of
2 any case where someone has had a term contract with,
3 like, an ending date and that was litigated?

4 MR. O'BRIEN: I'm not aware. No, I agree
5 with Ted, that the contracts --

6 REPRESENTATIVE PETRI: Can I put you on
7 the spot? If there was one and somebody said -- let's
8 say two parties enter into an agreement with this
9 gentleman. I enter on January 1, 2015. He says no. I
10 go to court.

11 In your opinion, who wins?

12 MR. O'BRIEN: I've never been much of a
13 better on horse races.

14 REPRESENTATIVE PETRI: I was trying to put
15 you on the spot.

16 Can you think of any reason why the court
17 wouldn't rule in my favor that that contract ends? It
18 says it ends.

19 MR. O'BRIEN: If parties agree, I think
20 courts generally will look at the intents of the
21 parties. Obviously you can't contravene stated law, but
22 I think courts go out of their way to go with the intent
23 of the parties.

24 REPRESENTATIVE PETRI: Okay. One last
25 question that I have, and then I'll -- I'm still

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1 confused, but that's okay.

2 If I went to the form book, obviously in
3 my law library, I'm not going to find it in any
4 Bongiovanni, I'm not going to find it any Dunlap-Hanna or
5 anywhere else.

6 So you guys are the ones that are drafting
7 these agreements.

8 How many different versions are there, you
9 know, and how much do they vary, and where do they vary?

10 MR. O'BRIEN: Buyers and sellers each has
11 its own preferred brewer and wholesaler, but there are an
12 infinite number of variations.

13 But the good ones will have some sort of
14 standard of conduct provision.

15 MR. FUNCHION: If I may, I can offer a
16 recommendation, a proposal, to try to clear some of this
17 up.

18 Every one of us, we have different
19 contracts with each of our brewing suppliers. Every
20 contract virtually provides for deficiency termination.
21 And so when there is a deficiency -- well, let me back up
22 a little bit.

23 Through our relationships and through our
24 contract obligations we all sit down on an annual basis
25 and we develop mutually agreed upon business goals;

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1 performance standards in the marketplace that we have to
2 abide by, performance standards from our suppliers that
3 they have to abide by.

4 Mutually agreed upon business plans,
5 execution plans, standards, that we are responsible for
6 in executing our sales, marketing and service of the
7 trades.

8 It also provide for a deficiency
9 termination. Deficiency termination -- problems are
10 identified if you cannot work through those issues.

11 Conversations should be had across the
12 table between the brewer and the wholesaler identifying
13 those problems and developing plans with agreed upon
14 timetables for correction of those deficiencies in the
15 marketplace, service, marketing, community relations,
16 whatever, stock rotation, presentation of product.

17 If those issues are identified, the
18 timetable is laid out for that wholesaler and/or brewer
19 to fix whatever is wrong on each side, those steps are
20 available and in place.

21 And if respectful business partners are
22 addressing the issues in that regard -- which we both
23 have the ability to do -- then I'm going to say that nine
24 times out of ten, or maybe even a higher degree, of
25 success rate is prevalent.

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1 And then if litigation is necessary from
2 there -- after exhausting efforts to mutually fix the
3 problem -- then litigation may come into play.

4 I honestly don't know of any litigation
5 that may have occurred due to deficiency.

6 And I would think that a brewer who is not
7 happy with a particular wholesaler would be because of
8 reasons of deficient performance of expected standards in
9 the marketplace.

10 So I think that that system is in place to
11 correct problems that might be in a relationship.

12 And I think that maybe as a proposal or a
13 consideration to the Committee, perhaps sharpening up the
14 teeth of that cause language in the code would be of
15 assistance in the whole process.

16 And also sharpening the teeth of cause
17 language in our contracts with our brewers.

18 I think that --

19 REPRESENTATIVE PETRI: Just let me follow
20 up on one thing.

21 What is typical -- say in your contract,
22 what's the typical dispute resolution? Is it the Court
23 of Common Pleas? I know under the statute it is. But do
24 you do mediation, arbitration, a combination?

25 And, Ted, you can answer it, too, because

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1 I know from your perspective there may be forms you want.

2 MR. ZELLER: Yeah. The franchise law is
3 always -- I mean, does Pennsylvania specifically specify
4 jurisdiction as the Court of Common Pleas? That's where
5 you are going to wind up. It potentially could be moved
6 to federal court.

7 REPRESENTATIVE PETRI: And it's usually
8 going to be either where the defendant is, right?

9 MR. ZELLER: Correct.

10 REPRESENTATIVE PETRI: Or where the
11 contract is executed?

12 MR. ZELLER: Correct.

13 REPRESENTATIVE PETRI: So you can have
14 home court advantage. One side or the other is going to
15 have the home court advantage.

16 MR. ZELLER: Yeah. Usually wholesalers
17 have the home court advantage, absolutely.

18 REPRESENTATIVE PETRI: As the
19 manufacturer.

20 MR. ZELLER: Yes. No, no, as the
21 wholesaler.

22 REPRESENTATIVE PETRI: This is the
23 wholesaler.

24 MR. ZELLER: Yeah, because that's where
25 the products are being delivered or their business is

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1 being conducted.

2 REPRESENTATIVE PETRI: Do you represent
3 some really tiny brewers as well?

4 MR. ZELLER: Yes.

5 REPRESENTATIVE PETRI: Do you find that
6 they have less bargaining power than the big guys?

7 MR. ZELLER: Oh, yes, yes. And the tiny
8 brewers -- I mean, Mr. O'Brien is exactly right. They
9 are unsophisticated at the start.

10 I mean, it's like, oh, yeah, Here's your
11 territory agreement. Go deliver my beer in these --
12 well, sometimes they get statewide rights in both.

13 I find that crazy, because then, you know,
14 they're just -- the wholesaler doesn't -- there's no
15 wholesaler, really, that covers the whole state.

16 So then they wind up depotting it across
17 to other wholesalers in the state, adding cost to each
18 level. And so sometimes their beer is astronomically
19 priced.

20 There are some of our Pennsylvania members
21 that are regretting the wide territories that they gave.

22 So these are the issues.

23 What we are trying to design in our
24 legislation is to drive this to negotiation of the
25 contract.

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1 Because sharpening could cause all of
2 those types of things that are very difficult
3 conversations to have with the wholesalers and the
4 brewers and come to an agreement.

5 And when you start trying to define the
6 root cause -- which is exactly what I think you are not
7 trying to do -- and that is legislate what the
8 performance should be between the wholesaler and the
9 brewer.

10 CHAIRMAN TAYLOR: We need to move on to
11 Representative Sabatina.

12 Do you one?

13 MR. O'BRIEN: Representative, could I just
14 sort of respond to one more point of Representative
15 Petri's?

16 I mean, if we are talking about
17 litigation. I don't know that the incidence of
18 litigation is any worse in this business than any other
19 business. It's just that in this business the litigation
20 issue is being brought up.

21 CHAIRMAN TAYLOR: Representative Sabatina.

22 REPRESENTATIVE SABATINA: Thank you,
23 Mr. Chairman.

24 I'm almost as confused as Representative
25 Petri, I think.

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1 My first question is for Mr. Covaleski.

2 Mr. Covaleski, you begun to say that
3 Mr. Funchion was not the first wholesaler you went to.
4 Is that correct? Did I hear that correctly?

5 MR. COVALESKI: That is a correct
6 statement.

7 Bear in mind, that wholesaler
8 relationships between brewers and wholesalers are
9 territorially defined. So it's specific to the area in
10 which you're being serviced.

11 REPRESENTATIVE SABATINA: Okay. My
12 question is, is did you enter into an agreement with
13 another wholesaler prior to that?

14 MR. COVALESKI: It's a little bit
15 complex. I'll walk you through it.

16 In the territory of Chester County, which
17 Mr. Funchion's company, Penn Distributors, represents us
18 in, we were not represented by another wholesaler
19 previously.

20 In the territories of Philadelphia County
21 we were represented by another wholesaler previously in
22 our relationship.

23 REPRESENTATIVE SABATINA: Okay. So it's
24 different territories.

25 MR. COVALESKI: Correct.

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1 REPRESENTATIVE SABATINA: Okay. Did you
2 escape from the first Philadelphia wholesaler, I guess?

3 MR. COVALESKI: The escape was, again, as
4 Matt had said himself, it was something that we two
5 partners came together in order to create a transaction
6 that the other wholesaler agreed to was a good beneficial
7 opportunity for them.

8 So the Granholm rights and transfer of
9 Granholm rights.

10 REPRESENTATIVE SABATINA: So you and the
11 other wholesaler agreed to dissolve this perpetual
12 contract, I guess is my question?

13 MR. COVALESKI: That's correct. It's a
14 purchase of brands to trigger the transfer.

15 REPRESENTATIVE SABATINA: Okay.

16 My second question I guess is for the
17 attorneys, Mr. Zeller and Mr. O'Brien, is for cause --
18 termination of these contracts for cause -- I know and
19 there's been suggestion to sharpening and more
20 specifically define what for cause is.

21 But I'll say that for cause I guess --
22 it's a broad term.

23 And has there been any instances in
24 litigation where deficient performance or low success of
25 a brewer has qualified as good cause?

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1 In other words, if the brewer is not
2 happy, he says to the wholesaler, You are not
3 distributing properly, you're not selling my brand
4 properly, I will can do better elsewhere?

5 Or vice versa, the wholesaler is saying,
6 you know, Your beer stinks. I don't want to distribute
7 it anymore.

8 Wouldn't that be cause? Wouldn't that be
9 good cause?

10 MR. ZELLER: I mean, there has been
11 instances of performance issues where terminations have
12 been effective. It's just the price of that litigation,
13 the smaller brewers are not -- don't want to take that to
14 court.

15 And just so you know, wholesalers actually
16 are allowed -- if our beer stinks, wholesalers are
17 actually allowed to terminate us at any time.

18 They're not -- they don't have to have
19 cause to terminate us. They can just say, We don't want
20 to represent you anymore.

21 MR. O'BRIEN: That was the point I was
22 going to make.

23 It's a business decision. And if the
24 wholesaler says, Okay, I'm going to give you back the
25 primary rights, then the supplier -- the brewer is free

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1 to take it where he wants.

2 But if there is an issue of the quality of
3 the product or, you know, the extent of the portfolio or
4 something, that the brewer does not have the right of
5 coming up with what they have to do.

6 MR. ZELLER: Yeah. And they actually --
7 it says in the code that the wholesalers -- there's terms
8 actually imposed in the contract in the code that says
9 that the wholesalers are allowed to choose what brands
10 they want to represent or not represent of your products.

11 But that's just for primary agreements
12 again.

13 Pennsylvania breweries can use secondary
14 agreements, which actually allow them to exit without
15 paying fair market value to a wholesaler right now.

16 And it allows them -- also the secondary
17 agreements allows them to self-distribute without any
18 barrel limits whatsoever in the State of Pennsylvania.

19 So we've actually kind of tried to make it
20 a more even approach. We put barrel limits on these
21 self-distribution amounts.

22 And we've also said, well, If we exit
23 without cause, you know, we are going to pay you fair
24 market value of the brand.

25 That's why -- you know, to say these are

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1 novel concepts is not really the case.

2 MR. O'BRIEN: Well, again, I think it
3 comes down to the parties having a contract that covers
4 the needs of the arrangement, that they live by it and
5 where they have to be unraveled.

6 Most of the time we never hear about it
7 because it's parties sitting down and just discussing it
8 and making a business-like decision on it. They don't
9 end up in litigation.

10 CHAIRMAN TAYLOR: We've got Representative
11 Vereb and then Representative Tobash.

12 REPRESENTATIVE VEREB: Thank you, Mr.
13 Chairman.

14 How many wholesalers are in each
15 territory? John was trying get to the point of -- in the
16 Philadelphia market, for example. How many distributors
17 are in Philadelphia?

18 MR. COVALESKI: Five. Six.

19 REPRESENTATIVE VEREB: And the perpetuity
20 --

21 MR. FUNCHION: I'm sorry. You asked the
22 question how many wholesalers?

23 REPRESENTATIVE VEREB: So if I have
24 beer -- if I'm a brewer and I want to sell the beer and I
25 want my product in Philadelphia, what are my choices to

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1 have a distributor?

2 MR. BELJAN: There's probably about eight.

3 REPRESENTATIVE VEREB: Eight?

4 MR. BELJAN: Can I answer? Can I help
5 here?

6 There's small -- see, in this environment
7 there's craft distributors that have flourished that have
8 gone out and signed up, say, a brewery like yourselves.

9 We self-distribute in 26 counties, which
10 alleviates -- Mr. Zeller was talking about subbing or
11 depots.

12 We don't do that. And that is something
13 that throughout the years has been negotiated by certain
14 breweries.

15 So if I wanted to depot your product or
16 sub -- I'm sorry. If I wanted to depot or sub your
17 product, I need your permission.

18 So these contracts are negotiated in good
19 faith and by business manners.

20 REPRESENTATIVE VEREB: Please do me a
21 favor. You're getting -- just answer my question.

22 MR. BELJAN: Sure.

23 REPRESENTATIVE VEREB: I am a brewer --
24 with all due respect -- and I want my product to grow in
25 the Philadelphia market.

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1 What are my logical business choices? How
2 many wholesalers -- not the little guys.

3 MR. O'BRIEN: The difference may be how
4 many are located within the city versus how many serve
5 the city.

6 MR. FUNCHION: I'll give you a direct
7 answer to that.

8 There's Origlio Beverage. There's
9 Muller. You have Origlio Beverage. There's Coors,
10 Yuengling, Corona, Heineken, a number of other brands.
11 Muller is a Miller wholesaler.

12 There's Penn Beer Distributors. There's
13 the West Beer Company. And there's Stockertown Beverage.
14 There's Schenck. And there's Bella Vista Beverage.

15 So basically seven that do business
16 directly as wholesalers in the metro Philadelphia
17 marketplace.

18 REPRESENTATIVE VEREB: Thank you.

19 The perpetuity issue. It sounds,
20 Mr. Chairman, that we have two lawyers on either side of
21 an issue and lawmakers trying to figure out -- especially
22 being lawyers on the Committee here.

23 We do have problems in legislation since
24 everyone agrees perpetuity isn't in the Liquor Code, then
25 it really is perpetuity. I mean, that's what everybody's

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1 been saying. You can use the word or not use the word.

2 But I agree, I have never heard of a
3 contract that doesn't have an enforceable ending date.
4 There is just no case law defining dates.

5 Is this something we should look at? If
6 we are in the business of competition, should we not look
7 at it? Since we all -- that's one thing you will agree
8 with, the word perpetuity is not in the code.

9 We get, certainly from a brewer's
10 perspective, that perpetuity exists. So how --

11 MR. O'BRIEN: Well, I guess I default to
12 the less you put in the code, the less contract language,
13 that the better off everyone is.

14 Let the parties work out what the terms
15 are of their business arrangement and not get involved in
16 legislating contracts in the Liquor Code.

17 REPRESENTATIVE VEREB: Then should it be
18 legislate more clearly deficiency?

19 MR. O'BRIEN: I think that's most
20 appropriately a subject of contracts, and because the
21 definition of the code references standards, et cetera,
22 the parties agree to.

23 So let's let the parties agree to, you
24 know, whether it's number of calls, the number of taps,
25 whatever the standards are, and it's in the code.

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1 MR. COVALESKI: If I might offer some
2 insight to your question, Representative Vereb.

3 I used the term ambiguous regarding good
4 cause in my testimony today.

5 And we had a great opportunity to listen
6 to Matt describe the actual good cause and pure procedure
7 in the process as it relates to brewers and wholesalers
8 that come to a disagreement or are trying to, you know,
9 perhaps create an exit to good cause.

10 The thing of it is, is though the term
11 perpetual may not be mentioned in the code, the fact that
12 the only trigger mechanism for an exit or transfer is
13 good cause creates that ambiguous element that a brewer
14 must get through in order to have a term to their
15 contract.

16 So there is a lot of talk about what good
17 cause is for good reason.

18 The reason that I think that we are here
19 trying to analyze this and cause solutions for it is that
20 with ambiguous good cause, effecting a contract that is
21 then perpetual, or creating a contract that is then
22 perpetual, good cause becomes a legal argument to all.

23 And as I presented in my testimony today,
24 we have two wholesalers here in the State of Pennsylvania
25 that have higher evaluations than the two largest brewers

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1 here in Pennsylvania.

2 So in terms of big or small, I think you
3 can see that there's quite a difficulty, hardship and
4 conflict presented for brewers who access termination for
5 good cause.

6 REPRESENTATIVE VEREB: In respect to the
7 Chairman, thank you for the privilege of letting me being
8 able to ask a couple questions.

9 Just, you know, I think one thing that's
10 been lost so far this morning -- and you're not going to
11 like what I have to say; that's where I'm going to get up
12 and leave -- is consumers.

13 I think it's bizarre. And I think there's
14 an issue with how our PA brewer products does not make it
15 to all of our establishments or have the ability to make
16 a deal with respect to what's offered in bars and
17 restaurants.

18 And I hope that whatever we do -- it's not
19 just the Yuenglings of the world and the Victorys of the
20 world, or even the smaller ones.

21 I think that when I talk to two of the
22 major restaurants right over the bridge here in my
23 district, there's a lot of people that have specific
24 desires for certain drafts.

25 And the deals are so much better and so

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1 much more significant on other brands that they are not
2 willing to work out or give up a tap to some of the other
3 PA brewers.

4 So I hope this debate gets resolved. We
5 would love to get it resolved without legislation, but
6 unfortunately we have been waiting and waiting and
7 waiting. That's why legislation has been introduced.

8 So I appreciate, Mr. Chairman, and the
9 ability to ask questions, and look forward to working
10 with all.

11 MR. O'BRIEN: Mr. Chairman, if I could
12 respond.

13 CHAIRMAN TAYLOR: I'll give you another 30
14 seconds.

15 MR. O'BRIEN: The issue of worth or the
16 value of the business to the wholesaler as being worth
17 more than certain brewers, we disagree with that and
18 would like to see the basis for making a statement like
19 that.

20 CHAIRMAN TAYLOR: Well, we are always free
21 to accept or ignore. People don't believe what we say
22 all the time and we don't believe what they say.

23 And to note the confusion here, just for
24 the audience and others, we have -- the line is between
25 Bill and Matt here between the two sides, right? They

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1 are on opposite sides and yet they are partners, so...

2 And I will say that in discussions of the
3 many, many things over the years with Dominic Origlio, he
4 one time said to me, he said, You folks are trying to
5 legislate a business you don't understand.

6 I said, That's right. We do that every
7 day in every type of business. We do the best we can.
8 That's the way we are all set up.

9 Representative Payne.

10 REPRESENTATIVE PAYNE: Thank you,
11 Mr. Chairman.

12 And for those at the table, you would like
13 to know that I just negotiated a minute of time away from
14 the maker of the bill, but I thought of a question when
15 Vereb was talking.

16 We've skirted around the issue a little
17 bit -- and I'm glad to see you two guys just shake hands
18 there and it's kind of funny.

19 But the reality is the person, Bill, that
20 you had first and you wanted to upgrade and go to another
21 person to distribute your product, not just maybe in the
22 Philly area better, but outside of Philly.

23 There was compensation to that first -- I
24 mean, everybody skirted that word, but there was
25 compensation to that first person to, quote, unquote, get

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1 out of that forever contract.

2 You guys both agreed to it, you're both
3 happy, it both worked. And so was the person that got
4 bought out must be happy because they don't have an
5 attorney here either.

6 Here's where I'm going with that.

7 The system works. I'm kind of wondering
8 whether we need to just clarify that contracts aren't --
9 even though it's assumed they are forever, perpetuity --
10 that we have language that just says that it's not to be
11 considered for 3,000 years.

12 You know, that any liquor contract in
13 Pennsylvania can have a date set by parties they agree
14 to, rather than have, since nothing is said, it's assumed
15 it's forever.

16 And I will say, having worked in the
17 private sector for 30 years and negotiated contracts with
18 lots of people, there was never a contract forever. I
19 mean, all of our parents told us nothing's forever.

20 So it's kind of shocking to sit here and
21 say -- I don't know if that's good for either side,
22 including the first person that you negotiate and bought
23 out -- if you just have that deal and you work together
24 and shake hands and you have a business model. Isn't
25 what that America is about?

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1 And at the end of the day isn't that what
2 we are trying to do, is what Representative Vereb said,
3 is take care of the customer, take care of our
4 consumers?

5 So thank you, Mr. Chairman.

6 CHAIRMAN TAYLOR: Representative Tobash.

7 REPRESENTATIVE TOBASH: Thank you,
8 Mr. Chairman.

9 And, boy, we spent an awful lot of time
10 talking about these contracts and how we might be able to
11 alter it or how you as parties you may be able to alter
12 it.

13 I just want to switch gears for just a
14 quick moment here and get back to one of your comments in
15 your testimony, John.

16 You talked about being the brand builder
17 for these products. And I can appreciate that, and I
18 know the consumers appreciate that as well.

19 But can you tell me, do the manufacturers
20 and brewers contribute to that growing of that brand? Do
21 the manufacturers contribute to growing their brand?

22 MR. BELJAN: In what way?

23 REPRESENTATIVE TOBASH: I mean, do they
24 help you with marketing? Do they help you with
25 promotions?

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1 MR. BELJAN: In the beginning, besides the
2 brands that we signed up, the answer to that would be
3 no. As we built them and built those brands, the answer
4 to that question is sometimes.

5 We do have breweries that have reps in our
6 area. They also cover the whole State of Pennsylvania,
7 upstate New York. We have gotten help as we've grown the
8 brands.

9 Typically with most of our brands we're in
10 the top tier of the wholesalers in the United States. We
11 have several brands that we're in the top ten. We get no
12 help.

13 So it's kind of a hodge-podge. I'm not
14 trying to skirt your question. It's just a very hard
15 question to answer. I can't directly answer it.

16 REPRESENTATIVE TOBASH: So from your
17 perspective, you get little or no help from the brewers
18 and manufacturers on building the brand.

19 MR. BELJAN: Certain ones. But the ones
20 that are more successful -- I mean, it depends.

21 That's why in my testimony I also used the
22 word symbiotic. I mean, success would be for both
23 parties to try equally. That's not always the case.
24 When it is the case, some of those brands would be more
25 successful, or should be.

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1 REPRESENTATIVE TOBASH: Can I ask that
2 question to the manufacturers?

3 Bill, do you think you help grow your
4 brand aside from the efforts of your -- of the
5 wholesaler?

6 MR. COVALESKI: Absolutely. I can see
7 John's perspective on this. I would not say he is
8 incorrect.

9 But at the same time, there is sometimes
10 unequal marketing support that goes into the
11 brewery/wholesaler relationship. So you're going to see
12 complexions of all models.

13 Neither party can essentially disavow with
14 its the involvement from the other participant, the other
15 tier.

16 For example, in the territory that we
17 share with Penn Distributors I have three dedicated staff
18 members within that territory.

19 And that's, you know, a commitment that my
20 brewery finds to be appealing and intelligent for the
21 type of market support and penetration we are hoping to
22 accomplish with Penn.

23 So there's going to be many different
24 complexions of this.

25 MR. FUNCHION: If I may comment?

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1 REPRESENTATIVE TOBASH: Sure.

2 MR. FUNCHION: Again, I would echo Bill's
3 remarks. As I -- all of my comments have suggested that
4 we collectively have built and grown these brands
5 together in a very, very successful partnership.

6 And I think that the marketing support
7 level really depends on the size of the brewer.

8 Bill provides manpower and marketing and
9 media support to some degree in our marketplace, as does
10 Chris Trogner, and I know that Yuengling does.

11 So I think it just depends on the size of
12 the brewer and their capacity to invest additional bodies
13 in the marketplace. But we build the brands together.

14 REPRESENTATIVE TOBASH: I was going to ask
15 Mr. Casinelli, and I think he would certainly agree that
16 Yuengling helps build their brand. It's not only done
17 through the wholesaler.

18 MR. CASINELLI: Yeah. As Matt
19 articulated, we basically sit with our wholesalers and
20 put business plans together, which we develop budgets
21 that are shared on a cooperative basis.

22 You know, so we do that collaborative with
23 our wholesalers.

24 But I would also, you know, share that
25 there are other costs associated on our side as the

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1 manufacturers; not just the building a brand through
2 marketing or manpower, which a lot of us do do.

3 But obviously there's a lot of costs and
4 capital up front; expenditure and infrastructure and
5 building facilities.

6 Noted earlier, Bill's got a new facility
7 coming online for over \$30 million. And you talked about
8 the economic impact and the capital cost.

9 But there's an extreme amount of capital
10 invested on the brewer's side as well before we ever take
11 a case of beer to market.

12 So I would just ask that everybody
13 remembers that as well.

14 REPRESENTATIVE TOBASH: Okay. So that
15 would be my next question.

16 From the perspective of these contracts on
17 the brewers' side, if there was a sale between Wholesaler
18 A and Wholesaler B, okay, the way it stands right now, do
19 you have the ability to weigh in on that transaction?

20 Ted, you mentioned the first right of
21 refusal.

22 MR. ZELLER: Yeah. I mean, in the last
23 piece of litigation that I handled, which concluded
24 earlier or late last year or earlier this year, I can't
25 remember, time is moving fast, but that's basically you

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1 have the first refusal, and then we had no say as to
2 where the branding is going.

3 REPRESENTATIVE TOBASH: And now this is an
4 admission that it's a partnership where you work it
5 through at building a brand.

6 But would there be compensation on your
7 part when the brand was sold from one to the other?

8 MR. ZELLER: No, no.

9 REPRESENTATIVE TOBASH: So you invest in
10 building your brand as well as the wholesaler, but the
11 wholesaler reaps the benefits solely then.

12 MR. ZELLER: And I don't think -- you
13 don't really have a understanding the value of these
14 brand rights.

15 You're talking usually say for every
16 6-and-half-a-million, 6 million cases distributed, the
17 brand value that might -- one wholesaler pay another
18 wholesaler would be \$100 million. Okay?

19 That just -- that's what the value of
20 these brand rights are. And not one penny goes to the
21 brewer in that transaction.

22 REPRESENTATIVE TOBASH: I'm going to
23 switch again to you, Matt, if that's okay.

24 How long has Penn Beer Distributors been
25 in business? How long has it been in existence?

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1 MR. FUNCHION: Penn Beer has been in
2 existence since the early 1960s, but I have had ownership
3 for the last 14 years.

4 REPRESENTATIVE TOBASH: Fourteen years.
5 Have you increased your SKUs in that
6 period of time? Do you represent a lot more?

7 In other words, do you have these
8 perpetuity rights and a lot more products?

9 MR. FUNCHION: Yes. It increased
10 significantly, yes.

11 REPRESENTATIVE TOBASH: How many do you
12 have now?

13 MR. FUNCHION: Well over a thousand. I
14 can't give you an exact. A thousand SKUs in
15 Philadelphia.

16 REPRESENTATIVE TOBASH: So you have a
17 thousand brands that you have --

18 MR. FUNCHION: That's correct. That's
19 correct.

20 REPRESENTATIVE TOBASH: -- in perpetuity.

21 In this period of time it's my
22 understanding that there has been a lot of consolidation
23 of wholesalers.

24 MR. FUNCHION: That's correct.

25 REPRESENTATIVE TOBASH: So you've got

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1 consolidation, so fewer people representing you.

2 And I think, it's my understanding at this
3 point in time, in the industry there's actually more
4 manufacturers than there are importing distributors.

5 Do you know if that's the case?

6 MR. FUNCHION: I don't know that -- I
7 don't know that number, to be honest. But probably --
8 the way that the brewers have -- you're talking about
9 nationally?

10 REPRESENTATIVE TOBASH: I'm talking about
11 the State of Pennsylvania.

12 MR. FUNCHION: Oh, the State of
13 Pennsylvania.

14 REPRESENTATIVE TOBASH: Yeah.

15 MR. FUNCHION: I don't know that.

16 REPRESENTATIVE TOBASH: So I think we have
17 seen -- Bill, can you expand on that a little for me?

18 MR. COVALESKI: Yes, Representative
19 Tobash, I'd be happy to.

20 I have in front of me the testimony that
21 the Brewers Association, the national trade association,
22 has provided for today.

23 There is a chart, Figure 3, with the
24 number of breweries versus the wholesalers. It shows a
25 period of 2008 and 2010.

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1 It marks the first time since the late
2 19th century that there were more breweries and suppliers
3 than there are beer wholesalers.

4 And their statement is that, Given the
5 current trends, this will be the case for the foreseeable
6 future.

7 In fact, they quote research done by the
8 Independent Group Consulting that has predicted by the
9 year 2020, 200 to 225 beer wholesalers will do 90 percent
10 of the beer wholesale volume nationally.

11 In that same climate, of course, we have
12 seen 409 suppliers, breweries, open in the United States
13 in 2012.

14 Going a little bit forward on that, if I
15 might, there's also a statistic from the Independent
16 Beverage Group that in looking at just one distribution
17 option, the MillerCoors network of beer distribution,
18 what they found was over the past five years, an average
19 number of SKUs carried by the wholesalers in that group
20 has increased from 250 to 550.

21 That's the average increase over a five-
22 year period.

23 REPRESENTATIVE TOBASH: So the question at
24 the beginning of the hearing was why do you want to
25 change things that are working?

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1 Well, the market is changing. It's fair
2 to say that the market is certainly changing in this
3 regard.

4 And I think that there's probably some
5 consternation here around the fact that, hey, I've got
6 somebody -- Penn Beer Distributors has obviously done a
7 very good job. They haven't lost any brands. But who's
8 their favorite?

9 MR. FUNCHION: If I could also add a
10 comment to that.

11 REPRESENTATIVE TOBASH: Sure.

12 MR. FUNCHION: Yes, things are changing,
13 and lots of consolidation at the wholesaler level and
14 brewery growth and SKU growth.

15 But significant changes have occurred at
16 the wholesaler level as well from an investment
17 standpoint to managing and protect those changes.

18 For example, in my company, we as recently
19 as January of this year, we hired five new people.

20 An entire new sales team to specifically
21 manage our craft beer portfolio to make sure that these
22 brands, these additional SKUs and brewing suppliers are
23 getting the attention that they deserve and that we want
24 them to have, and that we want to make sure that we are
25 properly represented in the marketplace.

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1 So what does that mean from a percentage
2 basis? That is basically just about a 20 percent
3 increase in sales force in my company to address the
4 growing SKU and growing supplier change within our
5 businesses.

6 And that's probably -- I know that it's
7 very consistent with the rest of the wholesalers in the
8 state that are going through the same changes in their
9 business.

10 Some have invested a whole lot more than
11 others, depending on the level of affordability and
12 investing in their businesses.

13 REPRESENTATIVE TOBASH: Okay, thanks.

14 MR. O'BRIEN: Representative, may I
15 respond to part of that?

16 REPRESENTATIVE TOBASH: Sure.

17 MR. O'BRIEN: First of all, I understand
18 your question about the industry trends.

19 We received this week financial analysis,
20 national stockbroker type of a financial industry study,
21 which said they believe that the craft brew segment, the
22 growth over the last five years, they pinpoint that it's
23 starting to plateau.

24 I mean, we would be happy to share that
25 with the Committee.

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1 We are not looking to throw cold water on
2 it, but we don't believe that the world is unanimous on
3 whether this skyrocketing is going to continue.

4 REPRESENTATIVE TOBASH: Thanks.

5 And I'll just close. And, again, I
6 appreciate everyone's testimony here.

7 Getting back to you have 1,000 SKUs in
8 your shop and that's very admirable. You know,
9 congratulations.

10 But I'm sure that there's somebody in here
11 that might feel like they're a redheaded step-child of
12 you've got an operation like that, and want an
13 opportunity to negotiate for a contract at some point in
14 time.

15 So again, the question of why we do we
16 need that? We need to have this conversation now. I
17 think that's one of the main points of why we're having
18 it. So thanks.

19 MR. FUNCHION: The way that we address
20 that -- we have no redheaded stepchildren in our
21 business.

22 And the way that we address that is that
23 we have very, very specific goals and targets and
24 objectives.

25 We know where we think collectively with

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1 our brewing partners where those brands and packages are
2 going to work, in which house, and we execute that and it
3 works.

4 MR. O'BRIEN: How many different brands do
5 you have, not SKUs?

6 MR. FUNCHION: Oh, my gosh. Off the top
7 of my head, I don't know.

8 MR. O'BRIEN: Of course, the SKU is a
9 different package, so it may be one brand, 20 different
10 SKUs.

11 REPRESENTATIVE TOBASH: The fact of the
12 matter is you are here and you're testifying on behalf of
13 your trade organization. I'm sure that you're, you know,
14 at a pinnacle of being -- having a good business model.

15 The case may very well be that not
16 everyone has your business acumen or ability to
17 distribute the products as these manufacturers' ability.

18 Thank you again.

19 CHAIRMAN TAYLOR: You know,
20 Representative, you're going to hear from a redheaded
21 step-child who is going to be upset with your
22 characterization. You've got to be careful.

23 I have one more question. We'll go
24 another five minutes or so, assuming no other members
25 have questions.

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1 And I just have something that I wrote
2 down. I think either John or Fran must have mentioned,
3 you talked about consolidation of wholesalers.

4 And the suggestion was that any type of
5 change in the current statute will accelerate
6 consolidation.

7 Can you just elaborate, whoever said
8 that? I'm not sure.

9 MR. FUNCHION: I'm sorry, Chairman. Would
10 you repeat that?

11 CHAIRMAN TAYLOR: I don't think it was
12 you. I think it was either John or Fran that said that
13 any changes in the three-tier system or in the franchise
14 laws is going to help accelerate consolidation of
15 wholesalers.

16 Maybe I have that wrong. That is, the
17 rapid consolidation.

18 MR. O'BRIEN: Well, I know I tried to make
19 a point. I'll use as an example the every five-year
20 contract.

21 Major brewers buy and sell brands by
22 smaller brewing companies, and they then want to align
23 their footprint.

24 So we'll say Brewer A has Matt as his
25 distributor in Philadelphia. Well, Brewer B uses John.

PUBLIC HEARING, 8/29/13

1 So Brewer A buys his brand.

2 Well, now in Philadelphia that brewer has
3 Matt for some of its products and John for some of its
4 products. That brewer wants to align and deal with just
5 one wholesalers.

6 So rest assured, five years from now, if
7 they can just open the door and move, one of the two of
8 them is going to go from John over to Matt.

9 So that further consolidates.

10 And we've seen this with large brewers who
11 have bought and sold a brand and have to deal the
12 wholesalers in the marketplace.

13 CHAIRMAN TAYLOR: Miller and Bud or Coors,
14 I don't know if that would make any difference if that
15 was any one of these others.

16 MR. O'BRIEN: No. But for someone in
17 John's situation, you know, you lose a couple of brands
18 that way.

19 And, you know, John doesn't have the base
20 size that the larger ones generally would be, so you are
21 going to end up losing there to MillerCoors. And that's
22 an example that's out there in public. MillerCoors --

23 CHAIRMAN TAYLOR: But that was more of
24 a consolidation in the breweries, right, not
25 consolidation --

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1 MR. O'BRIEN: Well, in the marketplace
2 they would rather deal with one wholesaler in the market.

3 And a lot of places -- some places if they
4 have Miller in one wholesaler and Coors in another, and
5 rest assured, somebody is going to lose a big brand at
6 the five-year anniversary if that goes into law.

7 So it's those kinds of things that will
8 accelerate the consolidation at the wholesaler level that
9 we have the same concern that the brewers happen to
10 have.

11 We don't want to see everything down to
12 what they refer to as the duopoly, just two wholesalers
13 in the market.

14 We believe, as we have in Philly, a
15 vibrant -- Buena Vista, John, and some other wholesalers.

16 CHAIRMAN TAYLOR: That answers my
17 question.

18 Bill, do you want to add?

19 MR. COVALESKI: Well, the only thing I
20 would offer in response to that, or in addition I should
21 say, Chairman Taylor, is that I appreciate Mr. O'Brien's
22 response. It's a reasonable response to the situation.

23 But it does assume somewhat of a static
24 space where there are not more suppliers being added at a
25 dramatic rate.

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1 So I would say, you know, that Matt spends
2 his day selling Victory beer. I spend my day brewing
3 Victory beer. Neither of us have a crystal ball to
4 predict the further.

5 But I would submit to this group that the
6 testimony given by the Brewers Association is as close to
7 a crystal ball as we are going to get at this point in
8 time regarding both the breweries and the consolidation
9 of wholesalers.

10 I think that it shows that it's a dynamic
11 space and not a static space for these types of
12 discussions to be had.

13 CHAIRMAN TAYLOR: Okay. With that, we are
14 going to end today.

15 I would just sort of acknowledge to the
16 rest of the alcohol industry that we know that this is
17 not a topic that just these folks are concerned with.

18 We know that there's concerns by all the
19 stakeholders in the alcohol industry, and we'll hear from
20 them as well.

21 And I'm sure this is not the last time
22 we'll be talking about this topic.

23 So we'll see all of you in Harrisburg very
24 shortly. Thanks.

25 (Hearing concluded at 12:06 p.m.)

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CERTIFICATION

I, JANICE D. BURNES, Registered Professional Reporter, Certified Shorthand Reporter, hereby certify that the foregoing is a true and accurate transcript of the hearing on the date and place herein before set forth.

I further certify that I am neither attorney nor counsel for, not related to nor employed by any of the parties to the action; further, that I am not a relative or employee of any attorney or counsel employed in this case, nor am I financially interested in this action.



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