Sightlines

Golden Opportunity — California Tensions over Consolidation, Stay-At-Home Orders, Cannabis Provide National Case Studies

Words by Kate Bernot
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California's beer industry is essentially a large country within a large country: The Golden State represents about 11% of the overall U.S. beer market. But its influence exceeds its sheer size.

That's because the state is supremely diverse: No single ethnic or racial group constitutes a majority. California is often a bellwether, and at the start of a year that has little precedent, what happens to the beer industry in the nation's most populous state offers some glimpse of what's ahead.

Three of the most critical topics for the California brewing industry this year have implications nationally: distributor consolidation, public health regulations as a result of COVID-19, and a maturing (legal) cannabis market. Those three throughlines will shape the trajectory of the Golden State's brewing industry before its ripple effects reverberate across the country.

AN OPPOSING FORCE

Distributor consolidation in California accelerated in 2020, capping a two-year stretch in which Reyes Beverage Group acquired 10 wholesalers up and down the state. Through four significant acquisitions last year, Reyes added 12.65 million case equivalents in California—nearly as much Coors Banquet as was sold in the entire U.S. in 2019. Reyes owes its success in the state largely to its alignment with Constellation Brands and Mark Anthony, which make popular products like Modelo and White Claw.

Reyes' moves present an example of distributor consolidation that's occurring across the country in other significant markets like Chicago. The Windy City now essentially has a large Anheuser-Busch-InBev-aligned distributor, a Molson-Coors-aligned distributor (which also handles Constellation's portfolio and is a Reyes subsidiary), and a handful of small boutique distributors.

Against this backdrop, there has been new backlash to the consolidation in the industry's middle tier. The past two months have seen organized and potentially legal opposition, beginning with the formation in December 2020 of a new trade group called California Family Beer Distributors (CFBD). Comprising eight founding companies, all of which are independent AB-InBev- and Molson-Coors-aligned wholesalers, the group formed with the intent "to protect our family-owned member companies from forced consolidation leading to monopolies in the industry," according to its website.

In 2020, Reyes wholesalers were selling 1.6 times as much beer in California as AB-InBev-aligned (ABI) distributors, controlling 43% of all beer sold in the state, per Beer Marketer's Insights. CFBD is attempting to counter some of Reyes' weight in the state, which has come at the expense of rival ABI distributors.

Critics of distributor consolidation say Reyes' seemingly inexorable momentum and growth are slowly giving it control of the majority of shelves—and with it, control of drinkers' access to choice, and outsized influence in setting shelf resets. The fear is that one or two companies—Reyes and AB InBev—will have an outsized influence on which beers the majority of drinkers see in coolers. That's already true; the question is whether it's illegal. Are retailers giving shelf space to White Claw and Modelo because of Reyes' muscle, or because those are the top two best-selling brands in the state? It's a question also relevant to other Reyes-dominant geographies, including the greater D.C. area, home to Reyes' second-largest distributor cluster.

CFBD has another ally in its push against consolidation: Alcohol Justice, an advocacy group with the mission to "protect the public from the impact of the alcohol industry's negative practices." (Its critics refer to it as a neo-Prohibitionist organization.) In December, Alcohol Justice called upon the California Attorney General's office to open an investigation into wholesaler consolidation. This was a reaction to news that AB InBev intended to buy up Los Angeles-based Ace Beverage; if this were to occur, Alcohol Justice argues, it would create a California duopoly of Reyes and AB InBev that would have "anti-competitive effects," such as restricting smaller breweries' access to market.

Access to market for smaller breweries has been the chief concern surrounding distributor consolidation nationally for years. Yet there remain many avenues by which small breweries sell their beer to drinkers in the Golden State. Stone Distributing is the largest craft-beer-centric distributor in the U.S., selling beer across 40,000 square miles of California; other independent distributors operate in the state as well. And since March, California regulators have also loosened certain alcohol laws to allow breweries to offer home delivery and drive-thru windows.

In a written response to GBH, the California Attorney General's office says it cannot comment on a potential or ongoing investigation in order to protect the integrity of such an investigation. On Dec. 6, President-elect Joe Biden named California AG Xavier Becerra as his nominee for secretary of health and human services; what this means for any potential investigation is unclear.

But plenty of eyes are watching, including the California Craft Brewers Association (CCBA). The CCBA has brand-new leadership guiding it through these complicated waters: Executive director Lori Ajax took over for outgoing director Tom McCormick on Jan. 4.

“A consolidated middle tier that provides less access to the marketplace for small breweries is not healthy. It is an issue that is important to the CCBA and our members,” Ajax told GBH via email. “We will continue to seek fair legislative and regulatory treatment for California breweries.”

As Beer Marketer’s Insights put it in a Dec. 16 newsletter, “antitrust is in the air” in California.

PUBLIC HEALTH VS. PUBLIC DEFIANCE

As in other states, California’s regulatory response to COVID-19 has come under scrutiny from business owners who say restaurants and bars can’t survive if they comply with the restrictions. Businesses across the state have asserted that certain statewide and local policies like a Southern California regional stay-at-home order are unfair, illegal, or an affront to their rights.

In mid-December, the CCBA joined San Francisco’s Cellarmaker Brewing Company in suing Gov. Gavin Newsom, alleging an executive order discriminated against breweries and unfairly favored wineries. Under a July 1, 2020 directive allowing a gradual reopening of businesses, breweries are required to offer full meal service to operate a taproom; wineries are not required to offer full meals in their tasting rooms.

It’s impossible to say what the distinction is between the two types of alcohol producers. In July, when *The Press Democrat* asked Sonoma County’s health officer about the distinction in COVID-19 transmission risk between breweries and wineries, she said she “hadn’t even given it a thought.”

The CCBA’s lawsuit, Ajax said, will “highlight an arbitrary distinction made between the same manufacturing businesses in the alcohol industry and ensure breweries have a fair and safe pathway to reopen in the year ahead.”

Breweries are counting on fair regulation to be able to survive. According to a CCBA survey, the results of which were released in April of last year, the state’s 1,040 craft breweries saw an average 43% decrease in overall sales when shelter-in-place orders began. That number came during a peak in COVID cases that spurred the shelter-in-place orders; as current COVID cases in the state rise and have again led to similar restrictions, sales are likely suffering a repeat dip (though to what extent is not yet known).

According to the CCBA, the average California brewery sells 50% of its beer through its own taproom, and 20% through bars or restaurants, the vast majority of which can currently only provide takeout service. California restaurants have faced the highest closure rate nationwide, according to Yelp’s Local Economic Impact Report, released in September. And Nielsen data shows just 15% of Californians have been out to drink between Dec. 11 and Jan. 10.

While the majority of breweries are following Gov. Newsom’s orders, breweries including Pacifica Brewery and Mike Hess Brewing have held protests or reopened in defiance. Hess Brewing is an especially vocal and important figurehead for this pushback, given that founder Mike Hess is on the CCBA’s board of directors. Hess told NBC 7 San Diego that the brewery’s employees have “the same right to work as employees of any other business, large or small,” and that Gov. Newsom’s orders were "issued without regard for our constitutional rights, the document that governs this land."

Asked to respond to Hess’ very public stance against the state’s health directives, Ajax didn’t address his actions directly, but told GBH that “The CCBA encourages its members to adhere to local and state health orders. Meanwhile, CCBA will continue its efforts to ensure a pathway for breweries to safely reopen, re-employ and rebuild over the next year.”

With businesses, jobs, and literal lives on the line, the CCBA only hinders its work by starting the new year—under new leadership—on a visibly divided front. As we saw last year, anti-alcohol forces will find any example of breweries or bars flouting public health guidance and use it to advocate for further crackdowns on those establishments.

THE CANNABIS TRADE-OFF?

California is the world's largest cannabis market. With four years of recreational legalization under its belt, a large, diverse market like California's offers a useful snapshot for the five other states that, in November, legalized cannabis use in some form. Currently, 15 states have fully legalized the substance. And with a Democrat-majority Congress taking control this year, it's increasingly likely that federal legalization is a matter of not if, but when, according to Rachel Gillette, partner and chair of the Cannabis Law Practice at Greenspoon Marder, a national law firm.

In California, COVID-19 created social conditions that were a boon to cannabis sales. That's because cannabis is "an at-home scenario for most people," says Jessica Lukas, senior vice president of commercial development at BDSA, a market research and analytics company that focuses on the cannabis industry.

According to BDSA, 40% of Californians over the age of 18 said they consumed cannabis in some form in 2020, up from 35% in 2019. Total dollar sales of cannabis—recreational and medicinal—in California grew roughly 20% in 2020 compared to 2019.

Lukas attributes this to a few factors:

- Cannabis spans recreational and medicinal occasions: People are consuming it to get high, but they're also consuming it to treat anxiety, depression, pain, and insomnia, which have been exacerbated by the pandemic.
- As people spend more time at home, there are fewer social barriers to using cannabis; there's no fear of appearing high in public where you could face awkward social situations with colleagues or friends.
- These conditions mean existing cannabis users can partake more frequently: 60-65% of cannabis consumers in California who smoke via inhalables like pre-rolled joints, vape pens, or flower cannabis, do so at least once daily. Edible use increased in 2020, with close to 55% of Californians who consume cannabis edibles doing so daily, up from 40% a year ago.

Does this come at the expense of alcohol? To date, there has been no compelling evidence to suggest that legal cannabis sales steal from beer's "share of buzz." But a protracted economic recession could change that, especially if the U.S. unemployment rate remains above its seasonally adjusted average.

"Among people who were consuming cannabis, the ones who were buying less beer once they started to buy cannabis tended to have lower incomes on average," Michael Uhrich, former chief economist of the Beer Institute, and current founder and chief economist of Seventh Point Analytic, told GBH in April. "Then there was another group of people starting to use cannabis who were also buying more beer and had higher incomes."

The economic reality makes sense: If a person has lots of disposable income, they don't need to trade off between alcohol and cannabis. But if they're lower-income, trade-offs are a necessary decision.

"Yes, there is a risk, but you have to assess [the size of] that risk," Lukas summarizes. "The majority of cannabis consumers continue to say it is not increasing or decreasing their alcohol consumption."

What she's keeping an eye on for 2021 is how quickly states whiplash from regulating cannabis as a controlled substance to deeming it an essential, medical business. That could further cement many consumers' use of cannabis for therapeutic or wellness reasons, including for anxiety, insomnia, and stress relief. (All of which appear to have increased as a result of the pandemic.) In Illinois, for example, cannabis went from being illegal to an essential business in just four months, between December 2019 and March 2020. Of the nine states where recreational cannabis was legal in March, only Massachusetts deemed cannabis a non-essential business. Not only is that an economic boon to cannabis versus alcohol producers, but it's a win in terms of public perception.

"There is this government regulatory benefit of being deemed an essential business," Lukas says. "We're going to shut down restaurants, bars, and all these other things, but cannabis is still open just like grocery stores and drug stores."

How long the effects of the pandemic endure will have huge implications for the cannabis industry, which has seen an uptick from wellness-conscious consumers spending more time at home. What this does for beer sales long-term is something California may be able to tell us in the future.

About Sightlines

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