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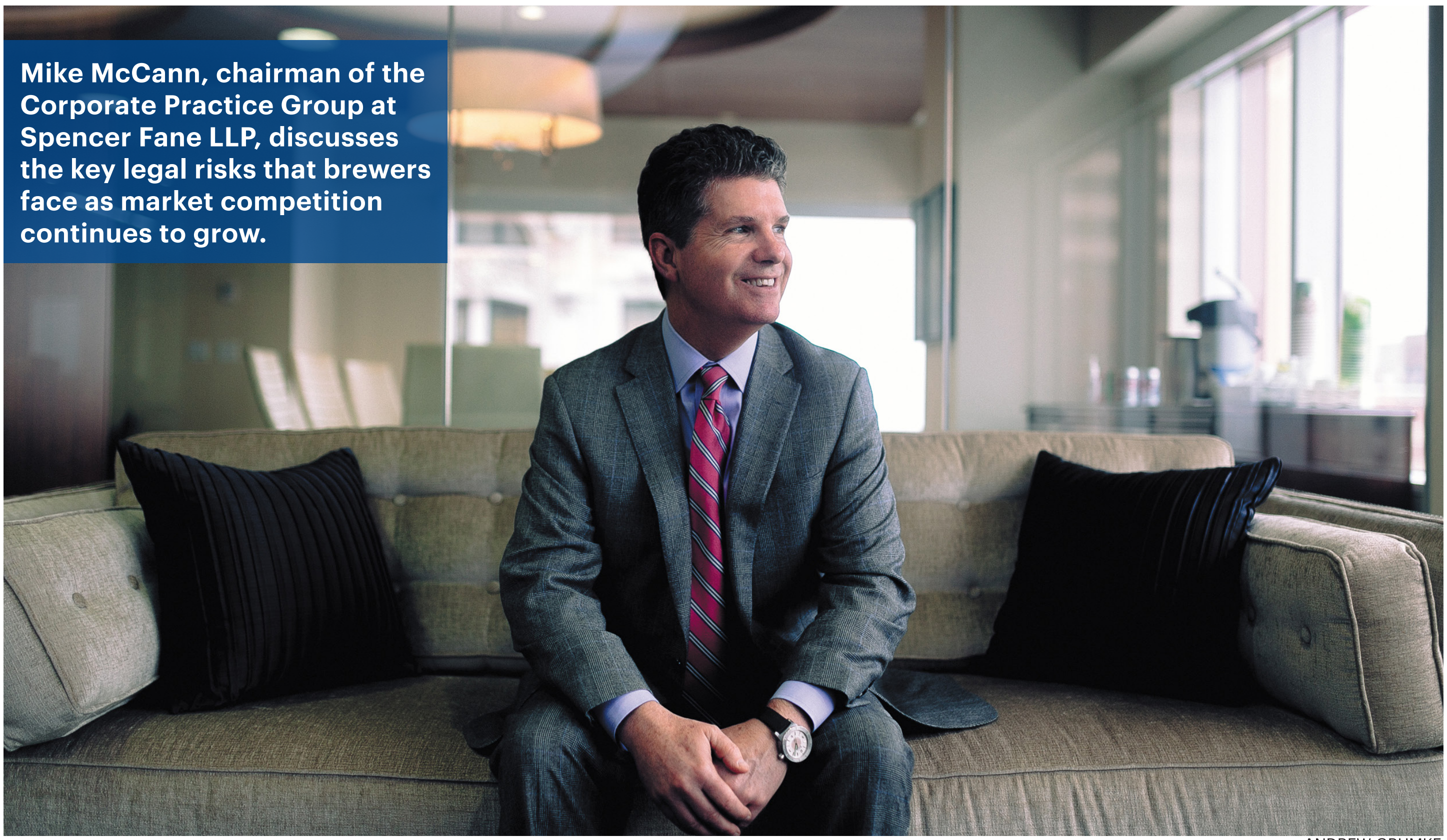
Increasing craft beer competition creates legal pitfalls



Mike McCann, chairman of the Corporate Practice Group at Spencer Fane LLP, discusses the key legal risks that brewers face as market competition continues to grow.

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With the number of craft breweries growing by 16.6 percent in 2016 and demand for interesting new beers as high as ever, it creates some serious challenges for brewers thinking about the long-term value of their businesses.

Most small craft breweries are started with limited budgets, causing them to make difficult decisions on where money is allocated. Too often, they ignore basic legal aspects that help create a strong foundation for the business, said Mike McCann, chairman of the Corporate Practice Group at Spencer Fane LLP in Kansas City. That leads to seriously expensive legal bills down the road, or even worse, a huge loss in value when it comes time for an entrepreneur to sell the business and retire.

McCann has represented several craft breweries going through business sales over the years, including the sale of Boulevard Brewing Co. to Duvel Moortgat in 2013 and several

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craft brewery sales to huge brewers like Anheuser-Busch and Miller-Coors. He's seen all the major mistakes entrepreneurs make when setting up their businesses. The two biggest are not keeping accurate records of investors and not adequately filing trademarks on beer brands.

Craft brewers have been really innovative in finding ways to fund their ventures with money from unaccredited investors, but McCann said he often runs into situations where they were sloppy in keeping records of what they were giving in exchange for that investment. Or maybe they have a key employee who was told they would "take care of them" when the time was right, but that employee has a different idea of what that means than the founder did. Those issues can lead to major legal problems down the road.

"You need to have a strong bedrock foundation for your company," he said. "Make sure you're doing everything legally and have clear records of who owns what."

Aside from the ownership and fundraising issues, the biggest problem facing craft breweries are the legal issues surrounding brands and trademarks. Messing this up will directly impact the price you get for your craft brewery when you decide it's time to retire, McCann said.

"What you're selling at the end of the day is your brand," he said. "If you don't have any protected rights in your brand, then you really don't have anything to sell. That's the key focus here."

Say you've founded a successful brewpub and you decide to sell it to a third-party buyer. What that third party plans to do with your brand will dictate the price they're willing to pay for your business. For instance, if they're planning to just keep it as a local neighborhood brewpub, that's going to be a much lower price than a buyer who wants to invest in expanding the brand regionally or nationally. A neighborhood brewpub might see growth of about 3 or 4 percent a year, but a regional brewery could see 10 to 20 percent growth a year. The price for a successful local brewery might be five to 10 times annual earnings, while craft breweries with potential for regional or national expansion have gone for 30 times annual earnings.

"If someone is saying they're willing to buy your brand for a huge multiple, the reason they're paying you is to be able to roll out your beer everywhere in the U.S.," McCann said. "But if you've got to tell them there is someone in key markets with better rights to your brand names, the purchaser will basically say you need to sort that out. Then you need to go try to buy the rights from these companies, when they know you need them."

It's also expensive to trademark every single brand you put on a beer, especially in a market where brewers are constantly releasing limited-edition, seasonal or one-off beers. Typically those beer brands aren't trademarked, but if they take off and become a core beer, then a brewer wishes they would have acted earlier on protecting the brand with a trademark, because there are lots of copycats out there.

"The worst thing to do is to pick a distinctive name, then put a bunch of marketing money into that brand only to find out somebody else is using that name elsewhere," he said. "Maybe they have a federally registered trademark and then you end up with a cease-and-desist order. Also, if you don't do your homework on the front end, you might only find out five years later, after you put all this money into marketing the brand, that someone else is using a similar brand. That's going to be a real inhibitor for you selling your brand, because a buyer isn't going to be able to roll it out in regions where competitors are using a confusingly similar name."

McCann said the trick is to use really distinctive name brands to let you try out a product on the market, and then if it sticks you have a better chance of successfully creating a strong federal trademark. If you know it's going to be a core brand from the start, then do all the research up front to ensure the strength of your trademark.

"I think with a startup brewery it's understood that you need to manage your legal spend, but protecting your brand and your trademarks has to be a really key element," he said. "It's something you just can't overlook or you're not generating any value for yourself."