

Buying and Selling a Craft Brewery in the United States

Article By:

Thomas P. Conaghan

The craft beer business has never been hotter, with market share now approaching 8 per cent by volume in the United States and margins that have attracted the attention of private equity and venture capital investors, and even large brewers.

The Current Climate

There is likely to be an increase in the number of M&A and other deals in the craft beer business over the next decade, for several reasons.

First, the age of the first generation of craft beer founders and owners will force them to consider succession planning. In some cases, one or more family members present the most attractive option, but not all owners will have interested or qualified family members ready to take over the business. For such businesses, a sale presents a compelling option.

Second, even if a founder wishes to “stay in the game” either by him/herself or through a family member, smaller and/or passive investors may want or need to monetize their investment after years of patience. Given the growing maturity of the industry, more and more breweries will find themselves in this situation. In some cases, a founding owner can easily buy out other investors, but this may prove impossible if the value of the other investors’ equity exceeds what the founding owner can afford and borrow. Remember, too, that allocating all of the primary owner’s capital in an internal buy out can leave the business undercapitalized and therefore vulnerable in an increasingly competitive market.

Third, increasing growth may require additional capital beyond the reach of the original owners. Today’s excellent craft beer growth rates will likely not last forever, so making substantial investments now in production capacity and other competitive tools, such as more marketing, a bigger salesforce, etc., may ultimately drive an owner towards a sale or other partnership.

Regulatory Considerations

An important factor in planning and executing the purchase or sale of a craft brewery arises from the maze of alcohol beverage regulatory requirements imposed on the industry. These factors can substantially influence deal structuring and, in some cases, can put up an unsurmountable roadblock

to a proposed transaction.

Permits and Licenses

The craft brewery business involves various permits, licenses, and other approvals from both the federal government (mostly the Alcohol & Tobacco Tax & Trade Bureau (TTB)) and from almost every state in which the brewer conducts business. Alcohol regulatory authorities will be reluctant to issue a license to any owner, officer or director with a criminal record or some other significant background “flaw”, e.g., an ongoing tax dispute with the Internal Revenue Service.

Every brewery will hold at least one TTB-issued Brewer’s Notice and a license in the state(s) in which it operates. Craft brewers that distribute in many states or have multiple locations, e.g., a brewpub chain, will hold many more licenses and permits. As these government approvals are necessary to legally operate the business, transaction planning must ensure that the proposed change does not result in a gap in licensing, at least not in materially important jurisdictions.

A host of factors influence the license transition process, and the licensing process itself may influence transaction structuring generally. For example, the license transition process for an ownership change by way of a stock/equity sale is much easier to accomplish in most jurisdictions than a change achieved through an asset sale. While only one consideration among many, alcohol licensing considerations standing alone generally favor stock sales over asset sales in the alcohol beverage market.

A buyer should conduct its own internal due diligence to identify any potential obstacles to licensing, prior to embarking on an acquisition.

Tied-House Rules

A more common problem arises from the “tied-house” rules separating (albeit unevenly) the various tiers of the industry. Most of these laws and regulations contain broad language prohibiting direct or indirect ownership interests between tiers, particularly between the retail tier and either of the “upper” two tiers of the industry: manufacturing and wholesale distribution. Moreover, few of the laws contain exceptions. Those that do exist are often very particular and require careful evaluation to determine if they might apply.

Tied-house rules present a formidable obstacle to many private equity investors with vast holdings across the country or the world that, quite often, will include hotels, restaurants, grocery stores or other businesses licensed to sell alcohol beverages at retail. Experienced alcohol counsel is essential for the early evaluation of almost any acquisition by a significant private equity investor in order to detect and, if necessary, evaluate and resolve any potential tied-house issues raised by the transaction.

Even if no tied-house issue exists at the time of the craft brewery investment, a private equity investor would be wise to recognize and understand how ownership of a brewery may impact future potential investments in the retail or wholesale sphere.

Tax

For craft brewers, another important consideration involves the availability of the small brewer tax

rate and, perhaps, other special benefits that a potential buyer may not qualify to receive.

Virtually all craft brewers today qualify for the federal small brewer excise tax rate on a 60,000 barrel allowance. Acquisition by a private equity investor or a brewery that results in all brewers within the same “controlled group” producing more than two million barrels (regardless of where) would, however, make the acquired craft brewer ineligible to receive this benefit. Even a sale to, or merger with, another small brewer can have a significant excise tax consequence, as each “controlled group” is entitled to just one 60,000 barrels allowance at the lower excise tax rate.

Distribution Considerations

Distribution presents another area for unique due diligence in the alcohol beverage market. A private equity investor with no distribution network of its own will not likely do much to change existing distribution channels when acquiring an individual craft brewery. A private equity investor employing a buy and build strategy, however, or undertaking a transaction involving multiple packaging breweries, any distribution synergies, or the lack thereof, can present a real problem.

By conventional wisdom at least, consolidated distribution of multiple brands represents the best option in most jurisdictions, most of the time. In the typical transaction, an acquirer of a business wants to quickly consolidate distribution networks, achieving considerable synergies in the process. But the beer “franchise” laws enacted by many states do not permit easy consolidation, even where the new owner only purchases the assets of a craft brewery and specifically does not purchase or assume the contracts of the craft brewery changing hands.

Owing to the operations of these franchise laws, a potential buyer cannot expect the same quick synergies a buyer in another industry might enjoy. Instead, while consolidation may be relatively easy in some jurisdictions, in many others the process will require either negotiating a voluntary transfer of the brand or proceedings to determine the “fair market value” owed to the distributor losing the brand as a result of the change in brand ownership. The details will vary substantially from state to state, so conducting early due diligence on this aspect of a transaction will avoid surprises and maximize the ability to achieve at least some consolidation in the wake of closing.

Key Points

The business of craft brewing continues to grow and evolve. That growth has, and will, continue to attract investments both from inside and outside the brewing industry, and, as first-generation owners will seek to monetize their hard work. For the owners and employees involved, the sales decision can be emotional and stressful. With careful work by experienced counsel, however, at least the legal aspects of the transaction can move forward in an orderly fashion.

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National Law Review, Volume V, Number 112

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