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Crafting a Model State Law for Today's Beer Industry

Brian D. Anhalt*

INTRODUCTION

Archaeologist Patrick McGovern hypothesizes that alcohol started the “engine of society,”¹ but today’s state laws are causing this engine to run rough.² As history reflects, beer quickly took hold as an important part of American culture: Thomas Jefferson was a homebrewer, the Continental Congress provided a daily ration of beer to soldiers in the American Revolutionary War, and the Mayflower landed in Massachusetts, rather than the Hudson River area, in part because of a shrinking supply of beer.³ The beer market has grown to a \$100 billion business, and its

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1. Michael Kan, *Did a Thirst for Beer Spark Civilization?*, INDEPENDENT (Jan. 15, 2010), <http://www.independent.co.uk/life-style/history/did-a-thirst-for-beer-spark-civilization-1869187.html>.

2. See Ben Bullard, *Craft Brewers Challenge Texas Law over Distribution Rights*, PERS. LIBERTY (Dec. 16, 2014), <http://www.personal.liberty.com/craft-brewers-challenge-texas-law-distribution-rights>.

3. See AMY MITTELMAN, BREWING BATTLES: A HISTORY OF AMERICAN BEER 6–22 (2008); see also Kenneth G. Elzinga, *Beer*, in THE STRUCTURE OF AMERICAN INDUSTRY 85, 85 (Walters Adams & James W. Brock eds., 10th ed. 2001).

prominence has spurred regulation.⁴ Current regulations in many states are outdated, and thus stifle competition and reduce the variety of beer available for consumers.⁵

The modern three-tier structure of American beer regulations separates breweries, distributors, and retailers into three distinct tiers.⁶ Breweries may sell only to distributors, distributors to retailers, and retailers to consumers.⁷ To regulate the relationships between the three tiers, states have enacted beer franchise laws,⁸ limits on self-distribution to retailers,⁹ and limits on selling directly to consumers.¹⁰ Before states enacted beer franchise laws, a small number of large breweries dominated the market, holding a natural bargaining advantage over a large number of small distributors.¹¹ Beer franchise laws attempted to

4. *National Beer Sales & Production Data*, BREWERS ASS'N, <https://www.brewersassociation.org/statistics/national-beer-sales-production-data> (last visited Nov. 14, 2015) (valuing the “overall beer market” in 2014 at \$101.5 billion); see Elzinga, *supra* note 3, at 85.

5. See, e.g., Bullard, *supra* note 2.

6. Barry Kurtz & Bryan H. Clements, *Beer Distribution Law as Compared to Traditional Franchise Law*, 33 FRANCHISE L.J. 397, 400 (2014); Gregory E. Durkin, Note, *What Does Granholm v. Heald Mean for the Future of the Twenty-First Amendment, the Three-Tier System, and Efficient Alcohol Distribution?*, 63 WASH. & LEE L. REV. 1095, 1097 (2006).

7. Kurtz & Clements, *supra* note 6, at 400; Durkin, *supra* note 6, at 1097.

8. See, e.g., GA. CODE ANN. § 3-5-31(b)(3) (2014); ME. STAT. tit. 28, § 1407 (2014); see also Andrew Tamayo, Comment, *What's Brewing in the Old North State: An Analysis of the Beer Distribution Laws Regulating North Carolina's Craft Breweries*, 88 N.C. L. REV. 2198, 2213 (2010).

9. See, e.g., S.C. CODE ANN. § 61-4-940(A) (2014) (“A manufacturer or brewer of beer, ale, porter, or other malt beverages or a person who imports these products produced outside the United States must not sell, barter, exchange, transfer, or deliver for resale beer to a person not having a wholesale permit.”); see also Tamayo, *supra* note 8, at 2231–35. Self-distribution limits restrict a brewery’s ability to directly distribute to retailers, preventing breweries from bypassing the second-tier distributors. See Tamayo, *supra* note 8, at 2231–35.

10. See, e.g., MONT. CODE ANN. § 16-3-230 (2015) (“[A]ll beer that is to be distributed in Montana . . . must be . . . shipped, either directly or via a licensed storage depot, to a licensed wholesaler.”); see also Shirley Chen, Student Article, *Craft Beer Drinkers Reignite the Wine Wars*, 26 LOY. CONSUMER L. REV. 526, 527 (2014) (comparing the constitutional limits on direct shipping for wine sellers with direct-sale limits for breweries).

11. See Tamayo, *supra* note 8, at 2213. Direct-sale limits restrict a brewery’s ability to sell beer directly to consumers. See, e.g., MONT. CODE ANN. § 16-3-213 (“Except as provided for small breweries . . . it is unlawful for

correct this bargaining differential by requiring the inclusion of statutorily mandated distributor protections in franchise agreements.¹² These laws reflected the market conditions at the time of their enactment.¹³

Subsequent to states enacting these protections, the dynamic of the beer industry changed, but the regulations remained the same.¹⁴ The rising popularity of craft beer led to an expansion in the number of small breweries.¹⁵ As small breweries grew in number, other factors led to a consolidation of market power in the distribution market, causing most breweries to lose their bargaining advantage in franchise negotiations.¹⁶ Despite the shift of market power in favor of distributors, many states left the mandated protections for distributors in place.¹⁷ Consequently, these market changes left beer-industry laws outdated and ill-equipped for the current market environment, disadvantaging craft breweries bargaining for franchise agreements with distributors.¹⁸

In addition to disadvantaging breweries in franchise negotiations, the current laws regulating distribution often inhibit

any brewer or breweries or beer importer to have or own any permit to sell or retail beer at any place or premises. It is the intention of this section to prohibit brewers and beer importers from engaging in the retail sale of beer.”).

12. Kurtz & Clements, *supra* note 6, at 402–07; Tamayo, *supra* note 8, at 2213 (“This protection of distributors was seen as necessary to further ‘the goal of fragmented, weak players that [are] unable to wield political and marketing power’ and, in turn, to maintain the vitality of the three tier system.” (alteration in original) (quoting Evan T. Lawson, *The Future of the Three-Tiered System as a Control of Marketing Alcoholic Beverages*, in SOCIAL AND ECONOMIC CONTROL OF ALCOHOL: THE 21ST AMENDMENT IN THE 21ST CENTURY 31, 33 (Carole J. Jurkiewicz & Murphy J. Painter eds., 2008))).

13. See Tamayo, *supra* note 8, at 2202 (noting that the laws were enacted in response to the concentration of market power in large breweries and their bargaining advantage over distributors).

14. *Id.* (stating that since the enactment of the beer franchise laws, the beer industry has significantly changed, but distributors have resisted changes to the law).

15. *Id.*

16. *Id.*

17. See *id.* at 2231–32.

18. *Id.* at 2218 (“As distributors have moved from small family-owned operations to much larger corporations, many small brewers question the rationale for the laws when the distributors have more bargaining power than they do.”).

new and small breweries' abilities to reach new markets by limiting the opportunity to self-distribute to retailers and directly sell to consumers.¹⁹ New and small breweries often struggle to form distribution agreements: they have not yet built retailer and consumer bases, and so their brands lack value and require significant investment by a distributor.²⁰ At the same time, state laws prevent breweries from directly selling to consumers and self-distributing to retailers to build those bases to lessen the need for distributor investment.²¹ If a distributor will not distribute the beer, and if the brewery cannot directly sell its beer to consumers or self-distribute to retailers, then the brewery cannot reach new markets.²²

To improve competition in the market and to promote the variety that today's consumers demand, modifications must be made to beer franchise laws, self-distribution laws, and direct-sale laws in order to equalize the bargaining relationship. While states should maintain the three-tier system to prevent abuses by large breweries, they should exempt small breweries, and allow small breweries to self-distribute and sell directly to consumers. States should also exempt small breweries from the beer franchise laws. These proposals reflect the realities of the modern beer market and promote competition and variety.

Part I of this Comment discusses the craft beer revolution and its impact on the current beer market with the significant increase in the number of breweries. Part II summarizes the development of modern beer regulations in America, including the three-tier system, beer franchise laws, self-distribution laws, and direct-sale laws. Part III proposes a model law to remedy the problems caused by the current regulations, including exemptions for small breweries.²³ These solutions would meet consumers' demands and create an economically healthy beer market.

19. *See id.* at 2231–35.

20. *See id.* at 2233–35.

21. *See id.*

22. *See* Chen, *supra* note 10, at 541 (explaining that craft breweries may be unable to continue their business if they experience difficulty in “not be[ing] picked up by” distributors and being unable to sell directly to consumers).

23. The full text of the author's proposed model law is contained in an Appendix. *See infra* pp. 213–14

I. BEER IN AMERICA: THE INDUSTRY AND THE ADVENT OF CRAFT BEER

The close relationship between beer and society that had existed in Europe survived the migration to America²⁴ and has today culminated in the craft beer revolution.²⁵ American colonists brought the tradition of beer to the New World.²⁶ At first, Americans produced beer locally, and typically in the home.²⁷ Industrialization in the nineteenth century then allowed for the development of commercial brewing,²⁸ and by 1900, there were 1,816 breweries in the United States.²⁹ However, by 1978, that number had dwindled to eighty-nine breweries³⁰ because of a

24. See MITTELMAN, *supra* note 3, at 5–6 (outlining the history of beer in Europe and its transportation to Colonial America).

25. *Number of Breweries*, BREWERS ASS'N, <http://www.brewersassociation.org/statistics/number-of-breweries> (last visited Nov. 15, 2015) (detailing data on the prevalence of craft breweries); see also *Craft Brewer Defined*, BREWERS ASS'N, <http://www.brewersassociation.org/statistics/craft-brewer-defined> (last visited Nov. 15, 2015) (defining criteria for craft breweries).

26. See MITTELMAN, *supra* note 3, at 6 (stating that the first American settlers came from societies of beer drinkers and that all European ships to America provided beer provisions).

27. *Id.* at 6–7. Home production was made possible by beer's simple ingredients: (1) barley or grain; (2) hops; (3) cultured yeast; and (4) water. See Elzinga, *supra* note 3, at 85. Some families served beer to the public out of their homes, creating the first American drinking establishments. MITTELMAN, *supra* note 3, at 7 (explaining that home production was the norm because of transportation difficulties and that home production evolved into "rudimentary drinking establishments"). The popularity of these establishments grew, and by the eighteenth century, most colonists in Connecticut, for example, were no more than three miles from such places. *Id.* at 9.

28. K. Austin Kerr, *The American Brewing Industry, 1865-1920*, in *THE DYNAMICS OF THE INTERNATIONAL BREWING INDUSTRY SINCE 1800*, at 176, 176–77 (R. G. Wilson & T. R. Gourvish eds., 1998). Before the American Industrial Revolution, most breweries were small, local business. *Id.* at 176. Brewing, like other industries such as food-processing, benefited by using industrial processes. *Id.* at 177. The industrial revolution allowed for the development of large "shipping brewer[ies]", such as Pabst and Anheuser-Busch. *Id.* at 176–77. The industrial processes allowed these breweries to vertically integrate, establish substantial factories, and create complex national distribution systems. *Id.* at 177. These breweries benefited from the increased access to capital and the development of a complete national railway. *Id.* Increased scientific knowledge solved quality-maintenance issues, allowing for longer transportation. *Id.* at 178–79.

29. *Number of Breweries*, *supra* note 25.

30. *Id.*

“merger-acquisition trend,”³¹ as well as the impact of economies of scale.³²

As the number of breweries decreased, one brewery opened that would spark a change in the industry. The 1976 opening of New Albion Brewery marked the end of this decline and the beginning of the craft beer revolution.³³ The founder, Jack McAuliffe, brewed with recycled dairy equipment and Pepsi-Cola syrup drums.³⁴ While the brewery closed six years later, it left its mark as “the most important failed brewery in the industry’s history” by inspiring other entrepreneurs to start craft breweries.³⁵ By 1995, the number of breweries climbed to 858.³⁶ And by 2013, craft breweries represented 98% of the then-almost 3,000 breweries established.³⁷ As of late 2015, the number of

31. Elzinga, *supra* note 3, at 92. There were about 170 horizontal brewery mergers between 1950 and 1983. *See id.* During this time period, the government took action to stop some mergers on antitrust bases and thus forced breweries to focus improvement efforts on creating efficiencies in the production process. *Id.*

32. *Id.* at 94. Economies of scale refers to the reduction in production costs per beer that large breweries realize as a result of large-scale production, which generates efficiencies, such as a closer-to-capacity operation of bottling lines and various automation savings. Elzinga, *supra* note 3, at 97.

33. MITTELMAN, *supra* note 3, at 186 (“Most industry observers consider New Albion to be the country’s first micro-brewer.”).

34. Devin Leonard, *Jack McAuliffe, Father of American Craft Brew, Brings Back New Albion Ale*, BLOOMBERG BUSINESSWEEK (Mar. 29, 2013), <http://www.businessweek.com/articles/2013-03-29/jack-mcauliffe-father-of-american-craft-brew-brings-back-new-albion-ale>.

35. *Id.* at 291 (quoting MAUREEN OGLE, *AMBITIOUS BREW: THE STORY OF AMERICAN BEER* (2007)). In 2013, the Boston Beer Company helped to revive New Albion Ale, and Jack McAuliffe’s daughter is working to continue production independently as New Albion Brewing Company. *About Us*, NEW ALBION BREWING CO., <http://www.newalbionbrewing.com/about-us> (last visited Nov. 16, 2015).

36. *Number of Breweries*, *supra* note 25.

37. *Brewers Association Announces 2013 Craft Brewer Growth*, BREWERS ASS’N. <https://www.brewersassociation.org/press-releases/brewers-association-announces-2013-craft-brewer-growth/> (last visited Nov. 16, 2015). The rise in popularity of craft beer has led to large breweries developing what the Brewers Association has termed “crafty” beer. *Craft vs. Crafty: A Statement from the Brewers Association*, BREWERS ASS’N, (Dec. 13, 2012), <https://www.brewersassociation.org/press-releases/craft-vs-crafty-a-statement-from-the-brewers-association>. Many large breweries have attempted to imitate the beer of actual craft breweries. *Id.* For instance, MillerCoors, a—for now—joint venture between brewing behemoths SABMiller and Molson

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breweries had rapidly grown to over 4,000.³⁸

The modern brewing industry contains both macrobreweries and craft breweries.³⁹ The largest breweries are the macrobreweries, which each produced an average of seventy-nine million barrels of beer in 2012.⁴⁰ In 2013, there were fewer than thirty macrobrewery entities, with Anheuser-Busch InBev and MillerCoors Brewing Company as perhaps the most prominent examples.⁴¹ In contrast, the Brewer's Association⁴² defines a craft brewery as a brewery that: (1) produces six million barrels of beer or less annually; (2) is mostly independently owned; and (3) uses mostly "traditional or innovative" ingredients in its beers.⁴³ Craft breweries can be further defined⁴⁴ as microbreweries,⁴⁵

Coors, produces Blue Moon Belgian Wheat Beer, and Anheuser-Busch InBev produces Shock Top. *Id.*; *Great Beers*, MILLERCOORS, <http://www.millercoors.com/Our-Beers/Great-Beers.aspx> (last visited Nov. 17, 2015).

38. Bart Watson, *U.S. Passes 4,000 Breweries*, BREWERS ASS'N (Sept. 28, 2015), <https://www.brewersassociation.org/insights/4000-breweries/>.

39. *Craft Brewer Defined*, *supra* note 25.

40. *Id.* (defining large domestic producers as those shipping 10 million barrels or more).

41. *Number of Breweries*, *supra* note 25; *Brewers Association Lists Top 50 Breweries of 2014*, BREWERS ASS'N (Mar. 31, 2015), <https://www.brewersassociation.org/press-releases/brewers-association-lists-top-50-breweries-of-2014/>.

42. The Brewers Association is a trade group that promotes craft beer and homebrewing. *Purpose*, BREWERS ASS'N, <http://www.brewersassociation.org/brewers-association/purpose> (last visited Nov. 20, 2015).

43. *Craft Brewer Defined*, *supra* note 25. To be "independently owned," less than 25% "of the craft brewery [may be] owned or controlled (or equivalent economic interest) by an alcoholic beverage industry member that is not itself a craft brewer." *Id.* A "traditional" brewery is one "that has a majority of its total beverage alcohol volume in beers whose flavor derives from traditional or innovative brewing ingredients and their fermentation." *Id.*

44. *See Craft Beer Industry Market Segments*, BREWERS ASS'N, <http://www.brewersassociation.org/statistics/market-segments> (last visited Nov. 20, 2015).

45. Microbreweries sell at least 75% of their beer off-site from the brewery and produce less than 15,000 barrels of beer each year. *Id.* In 2014, there were 1,871 microbreweries—a 28% increase from 2013. *See Number of Breweries*, *supra* note 25. Wisconsin's Central Water Brewery is—for now—an example of a microbrewery, which went from producing 750 barrels in its first year to being on pace to produce 14,000 barrels in 2014. Chelsey Lewis, *Central Waters Serves Up Tasty, Eco-conscious Beer*, WIS. TRAILS, <http://www.wisconsintrails.com/travel/central-waters-serves-up-tasty-eco-conscious-beer-b99228417z1-251506411.html> (last visited Nov. 20, 2015). Smaller microbreweries that sell less than thirty barrels a year are

brewpubs,⁴⁶ contract brewing companies,⁴⁷ and regional craft breweries.⁴⁸

Breweries franchise with distributors (also known as wholesalers), who are responsible for the transportation of beer from the brewery to the retailer.⁴⁹ Since the 1970s, distributors have consolidated, which can, in part, be attributed to the distributor response to large breweries' consolidations.⁵⁰ In 1970, there were approximately 6,000 distributors, shipping an average of 20,000 barrels each year, but this average has now increased to 150,000 barrels.⁵¹ The largest distributors ship around 10 million

sometimes referred to as nanobreweries. Jack Kleban & Ingeborg Nickerson, *The U.S. Craft Brew Industry*, in 18 PROC. INT'L ACAD. FOR CASE STUD. no. 1, 33, 35 (2011), <http://www.alliedacademies.biz/Public/Proceedings/Proceedings%20IACS%20Proceedings%20Spring%202011.pdf>; cf. Mark Garrison, *Pint Sized*, SLATE (Dec. 12, 2012, 5:19 PM), www.slate.com/articles/business/drink/2012/12/nanobrewing_how_tiny_beer_making_operations_are_changing_the_industry.html (noting that the Brewers Association has not provided an official definition of a nanobrewery).

46. Brewpubs are establishments that encompass both a restaurant and a brewery, and sell 25% or more of its beer at their facility. *Craft Beer Industry Market Segments*, *supra* note 44. In 2014, there were 1,412 brewpubs—up 10.3% from 2013. *Number of Breweries*, *supra* note 25.

47. Contract brewing companies hire another brewery to produce all or some of their beer. *Craft Beer Industry Market Segments*, *supra* note 44. For instance, CB Craft Brewers contracts with breweries, such as Three Heads Brewing and Keuka Brewing Company, that are unable to produce on a large enough scale. *Contract Beers*, CB CRAFT BREWERS, <http://www.cbcraftbrewers.com/our-beers/contract-beers> (last visited Nov. 20, 2015).

48. Regional craft breweries, which make up the majority of the craft-brewing industry, each produce between 15,000 barrels and 6,000,000 barrels of beer annually. *Craft Beer Industry Market Segments*, *supra* note 44. In 2014, there were 135 regional craft brewers. *Number of Breweries*, *supra* note 25. This number is 13.4% higher than that in 2013. *Id.* A well-known regional craft brewery is the Delaware-based Dogfish Head, which produced around 200,000 barrels in 2013. Chris Furnari, *Dogfish Head up 17 Percent in 2013*, BREWBOUND (Jan. 17, 2014, 4:37 PM), <http://www.brewbound.com/news/dogfish-head-up-17-percent-in-2013>.

49. See DOUGLAS GLEN WHITMAN, STRANGE BREW: ALCOHOL AND GOVERNMENT MONOPOLY 41 n.1 (2003) (describing the franchise relationship); *What Is a Beer Distributor?*, NAT'L BEER WHOLESALERS ASS'N, <http://www.nbwa.org/about/what-is-a-beer-distributor> (last visited Nov. 20, 2015).

50. Tamayo, *supra* note 8, at 2218 (describing distributors as moving from “small family-owned operations to much larger corporations”); see WHITMAN, *supra* note 49, at 2025.

51. Bart Watson, *Franchise Laws: Leveling the Playing Field*, BREWERS ASS'N (Dec. 17, 2014), <http://www.brewersassociation.org/insights/franchise-laws>.

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barrels per year—more than any brewery produces, except for the three largest macrobreweries.⁵² Between 2000 and 2010, the five largest distributors increased their market share from one-third to one-half.⁵³ These data indicate a trend of distributors shifting from small businesses to larger corporations.⁵⁴

Meanwhile, the craft brewery market is composed of several growing segments.⁵⁵ This trend of growth is a reverse of the decline in number that breweries generally experienced between the early 1940s and the late 1970s.⁵⁶ But while this decline in total number of breweries has reversed since the 1970s, an opposite trend seems to have affected the beer distributor market, with distributors' average shipping amount greatly increasing as the total number of distributors has declined.⁵⁷ Lawmakers have considered the contractual relationship between breweries and distributors in developing beer laws.⁵⁸

II. MODERN REGULATION OF BEER: THE THREE-TIER SYSTEM AND BEER FRANCHISE LAWS

The modern three-tier system that separates breweries, distributors, and retailers is influenced, at least in part, by the desire of temperance advocates to promote regulations that would moderate some of alcohol's ill-effects on society.⁵⁹ States supplement the three-tier system with beer franchise laws that provide contractual protections for distributors, including franchise protections related to territory, termination, transfer, damages and procedure, and operations.⁶⁰ By separating

52. *Id.*

53. See ALIA AKKAM & KRISTEN WOLFE BIELER, *DECADE IN REVIEW 2000-2009*, at 4 (2010), http://www.bevnetwork.com/pdf/jan10_decade.pdf; see also Watson, *supra* note 51 (“[T]he top two beer wholesalers now control roughly 10% of the beer market. This is in stark contrast to the past, when there were more beer wholesalers who were, on average, much smaller.”).

54. Tamayo, *supra* note 8, at 2218.

55. See *Number of Breweries*, *supra* note 25.

56. *Id.*

57. See *id.*

58. See *infra* Part II (explaining the development of beer distribution regulations in the United States).

59. Tamayo, *supra* note 8, at 2209–10 (describing John D. Rockefeller's effort to implement regulation after prohibition, including the three-tier system).

60. Kurtz & Clements, *supra* note 6, at 402–08 (explaining the

breweries, distributors, and retailers into three tiers, the three-tier system prevents self-distribution and direct-sale by breweries, but some states have created exemptions.⁶¹

A. *The Roots of Beer Regulation in the Temperance Movement: The Three-Tier System*

The temperance movement of the early twentieth century fertilized the roots of modern beer regulation.⁶² Advocates of the temperance movement proposed the development of the three-tier system after the prohibition on alcohol was lifted.⁶³ The new regulatory system was intended to prevent abuses by breweries.⁶⁴ Despite implementers' good intentions, opponents to this system argue that it lamentably increases prices within the alcohol market.⁶⁵

The temperance movement started as a church-sponsored movement, and its advocates fought to control alcohol consumption by various means, including regulation.⁶⁶ Much of the public viewed breweries as “mischievously increasing consumption, causing the drunkenness and financial ruin of citizens.”⁶⁷ Specifically, the movement sought to discourage direct relationships between breweries and retailers—termed “tied houses”—where breweries owned the retail establishments

development of the beer franchise laws and that the laws function within the context of the three-tier system).

61. Tamayo, *supra* note 8, at 2231 (categorizing self-distribution as a favorable alternative for craft brewers to the three-tier system).

62. See David R. Scott, Comment, *Brewing Up a Century of Beer: How North Carolina Laws Stifle Competition in the Beer Industry and How They Should Be Changed*, 3 WAKE FOREST J.L. & POL'Y 417, 420–21 (2013) (detailing a temperance study and its proposal for the accepted three-tier system and other rejected proposals); Tamayo, *supra* note 8, at 2208–09 (describing the same).

63. See Scott, *supra* note 62, at 421–22.

64. See *id.* at 422.

65. See, e.g., WHITMAN, *supra* note 49, at 9.

66. 11 THE NEW ENCYCLOPEDIA BRITANNICA 622 (15th ed. 2002) (“The movement spread rapidly under the influence of the churches.”); see Tamayo, *supra* note 8, at 2207–08 (describing how pre-Prohibition temperance advocates sought to “promote temperance [by] raising the price of the licenses that were required to legally sell alcohol”).

67. Scott, *supra* note 62, at 420–21 (explaining that these attitudes resulted from breweries owning retailers and providing financial incentives to sell more product).

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directly or where breweries induced retailers to carry the breweries' brands exclusively.⁶⁸ Tied houses were thought to allow breweries to coercively influence retailers in a manner that caused public disruption.⁶⁹ To address these large brewery abuses, John D. Rockefeller, Jr., a temperance advocate and son of the oil tycoon, commissioned a study devising alcohol regulation plans for states to implement.⁷⁰ The study advocated for a three-tier system, which was subsequently adopted by almost all states.⁷¹

The three-tier system operates by dividing breweries, distributors, and retailers into different tiers, and is enforced by requiring separate licenses at each level.⁷² The first tier consists of breweries, which produce the beer.⁷³ Breweries are required to sell their beer to distributors.⁷⁴ Distributors comprise the second tier, and act as intermediaries between breweries and retailers by transporting and refrigerating the beer.⁷⁵ Retailers compose the third tier, selling directly to consumers after purchasing the beer from distributors.⁷⁶ States typically prohibit entities from operating at more than one tier.⁷⁷ Thus, this system generally prevents breweries from self-distributing to retailers or selling directly to consumers.⁷⁸ To help enforce this regulatory system, many states created alcohol agencies to help with the enforcement of the three-tier system.⁷⁹

68. *See id.* at 419–21.

69. *See id.* at 421.

70. *Id.* For the report itself, see RAYMOND B. FOSDICK & ALBERT L. SCOTT, *TOWARD LIQUOR CONTROL* (1933).

71. Scott, *supra* note 62, at 418, 422.

72. Granholm v. Heald, 544 U.S. 460, 466 (2005).

73. Kurtz & Clements, *supra* note 6, at 400.

74. Tamayo, *supra* note 8, at 2204.

75. *Id.*; *What Is a Beer Distributor?*, *supra* note 49.

76. Tamayo, *supra* note 8, at 2204.

77. *See, e.g., id.* (describing North Carolina's three-tier system).

78. *See id.* at 2200–01. Self-distribution refers to breweries bypassing the second tier and selling directly to retailers, instead of using distributors. *See infra* Section II.B.2. On the other hand, direct selling or direct-sale refers to breweries selling to consumers, bypassing both the second and third tiers. *See infra* Section II.B.3.

79. *See* NAT'L HIGHWAY TRAFFIC SAFETY ADMIN., *THE ROLE OF ALCOHOLIC BEVERAGE CONTROL AGENCIES IN THE ENFORCEMENT AND ADJUDICATION OF ALCOHOL LAWS* 3 (rev. Jul. 2005), <http://docplayer.net/942334-The-role-of-alcohol-beverage-control-agencies-in-the-enforcement-and-adjudication-of->

Opponents of the three-tier system argue that its structure negatively impacts the alcohol industry. Specifically, they cite the “double markup” effect, where, as beer passes through the tiers, distributors and retailers “mark up” the price to create their own profit.⁸⁰ For instance, a brewery might sell a six-pack of beer to a distributor for \$8.00. To make a profit, the distributor might sell that same-six pack to retailers for \$9.00. The retailers might then sell the six-pack to the consumer for \$10.00. The principles of supply and demand dictate that as the price increases, the quantity demanded decreases.⁸¹ For that reason, fewer consumers would be willing to buy the six-pack at \$10.00 rather than at the original \$8.00 price. Therefore, some argue that consumers purchase less beer because of the increased price associated with the “double markup” effect.⁸²

Whether the three-tier system is essential to preventing large brewery abuses, as advocates argue,⁸³ or unnecessarily increases the price of beer while lowering demand, as opponents argue,⁸⁴ it is clear that by adopting the three-tier system, states have greatly influenced their beer markets.

B. *Laws Supplementing the Three-Tier System*

Lawmakers have implemented a variety of beer regulations, in addition to the three-tier system, that generally favor distributors.⁸⁵ Beer franchise laws supplement the three-tier

alcohol-laws.html.

80. See WHITMAN, *supra* note 49, at 9 (explaining that the double markup problem, a natural product of any non-integrated industry, is made even worse by franchise termination laws).

81. *Id.* Demand is the amount of beer that consumers are willing to purchase at a series of prices during a certain period of time. See DAVID E. O’CONNOR & CHRISTOPHER FAILLE, BASIC ECONOMIC PRINCIPLES: A GUIDE FOR STUDENTS 31 (2000). The law of demand dictates an inverse relationship between the quantity demanded of the beer and the price of the beer. See *id.* As a result, the quantity demanded by consumers at a particular price decreases as the price of beer increases. See *id.* at 31–32.

82. See, e.g., WHITMAN, *supra* note 49, at 9 (arguing that due to the double markup problem, “consumers are worse off because they pay more for the product and buy less”).

83. See Tamayo, *supra* note 8, at 2210–11.

84. See WHITMAN, *supra* note 49, at 1.

85. Kurtz & Clements, *supra* note 6, at 402.

system with contractual protections for distributors.⁸⁶ These protections include mandated exclusive territory grants, termination protections, transfer protections, damages and procedural protections, and operational protections.⁸⁷ States also supplement the three-tier system through laws that limit self-distribution and direct-sale by breweries.⁸⁸

1. *Beer Franchise Laws*

Many states supplement the three-tier system with other forms of regulation, including beer franchise laws.⁸⁹ Beer franchise laws regulate the franchise relationships between the first-tier brewery-franchisors and the second-tier distributor-franchisees.⁹⁰ This franchise relationship is defined through contractual agreements, which are regulated by franchise statutes specific to the beer industry.⁹¹

Most of the beer industry's franchise laws developed in the 1970s and reflect the market conditions of that time.⁹² In the 1970s, market power was consolidated in a decreasing number of breweries, while there remained a growing and considerable number of distributors.⁹³ This change provided breweries with a bargaining advantage over small, often family-owned,

86. See *id.* at 402–07 (explaining that legislatures enacted protections to correct an “inherent imbalance of power” between breweries and distributors); see also WHITMAN, *supra* note 49, at 7–8. For examples of state statutory protections of the brewery-distributor relationships, see Illinois's Beer Industry Fair Dealing Act and Texas's Beer Industry Fair Dealing Law. 815 ILL. COMP. STAT. 720/1–10 (2014); TEX. ALCO. BEV. CODE ANN. § 102.71–102.82 (West 2013).

87. See Kurtz & Clements, *supra* note 6, at 402.

88. See Tamayo, *supra* note 8, at 2231–35.

89. See Kurtz & Clements, *supra* note 6, at 402.

90. See Tamayo, *supra* note 8, at 2213. The term “franchise” is used to refer to various relationships. See WHITMAN, *supra* note 49, at 41 n.1. The narrower use refers to “product-license” and “trade-name” franchise relationships. *Id.* However, as used in this Comment, it can also refer to when businesses create a contractual relationship for the distribution of products. *Id.*

91. See Kurtz & Clements, *supra* note 6, at 397–99.

92. See Tamayo, *supra* note 8, at 2213 (noting that states enacted the beer franchise laws “to protect what were then small, family-owned distributors” from large breweries in the 1970s).

93. See Watson, *supra* note 51. The number of breweries dropped from 766 in 1935 to eighty-nine in 1978. *Number of Breweries*, *supra* note 25.

distributors.⁹⁴ Breweries had more economic power and greater choice of distributors, allowing them to better influence the outcome of the franchise negotiations.⁹⁵ If a brewery was unsatisfied with the terms offered by a distributor, the brewery had several other distributors it could bargain with for a better agreement.

Beer franchise laws worked to correct the natural imbalance in bargaining power between breweries and distributors by creating statutorily mandated protections for distributors.⁹⁶ These regulations attempted to prevent breweries from controlling the outcome of the franchise negotiations.⁹⁷ These protections generally took five forms. First, many states enacted territorial protections that required breweries to provide distributors with exclusive sales territories.⁹⁸ Second, transfer protections limited breweries' abilities to prevent distributors from transferring distribution rights.⁹⁹ Third, termination protections limited breweries' abilities to prematurely terminate agreements, and also limited breweries' abilities to not renew an agreement.¹⁰⁰ Fourth, damages and procedural mandates provided protections when a brewery terminated, failed to renew, or refused to transfer an agreement, with breweries typically forced to pay "reasonable compensation" regardless of the circumstances, and additional damages when good cause was absent.¹⁰¹ Fifth, many states enacted operational protections related to the discontinuance of a particular line of beer and to prevent discrimination between

94. See Kurtz & Clements, *supra* note 6, at 402 (stating that many legislatures passed laws to correct the imbalance that existed between breweries and distributors).

95. See Watson, *supra* note 51. Still today, the largest macrobreweries wield uneven power in franchise relationships with beer distributors. See Kurtz & Clements, *supra* note 6, at 399.

96. Cf. Kurtz & Clements, *supra* note 6, at 402–07 (describing the various types of statutory protections states have adopted in order to address "an inherent imbalance of power").

97. *Id.* at 402.

98. *Id.* at 402–03; see, e.g., MICH. COMP. LAWS § 436.1401(1) (2015).

99. Kurtz & Clements, *supra* note 6, at 403–04; see, e.g., OR. REV. STAT. § 474.045 (2013).

100. Kurtz & Clements, *supra* note 6, at 404–06; see, e.g., OR. REV. STAT. §§ 474.011, 474.015; 4 DEL. ADMIN. CODE § 46 (2013).

101. Kurtz & Clements, *supra* note 6, at 406–07; see, e.g., IDAHO CODE § 23-1110 (2015); N.M. STAT. ANN. § 60-8A-9(E) (LexisNexis 2015).

franchisees.¹⁰² While each state's laws differ, many commonalities can be found between the states' mandated protections for distributors.

a. *Territorial Protections*

Most states require a brewery to provide an exclusive sales territory to a distributor.¹⁰³ As a result of the exclusive grant, no other distributors are allowed to distribute the brewery's product in that geographic area.¹⁰⁴ Mandatory exclusive sales territories are uncommon in franchise agreements outside of the beer context;¹⁰⁵ this mandatory nature in the beer industry is a reflection of the legal environment in which states enacted these laws.¹⁰⁶ Due to concerns over anticompetitive effects, courts have long held that exclusive sales territories to violate federal antitrust laws unless state law mandated the exclusive grant.¹⁰⁷ Faced with this "all-or-nothing choice," many states opted to require exclusive territory grants in the beer industry for various reasons.¹⁰⁸

102. 2 W. MICHAEL GARNER, FRANCHISE AND DISTRIBUTION LAW AND PRACTICE § 16:2 (Thomson Reuters/West 2009); see, e.g., R.I. GEN. LAWS § 3-13-5(5) (2012) ("No supplier shall . . . [i]mpose, attempt to impose, or enforce against a wholesaler any requirement, standard of performance, or term, including the terms of sale of malt beverages sold to the wholesaler, which is discriminatory as compared with the requirements, standards, or terms imposed by the supplier on other similarly situated wholesalers within this state.").

103. See Kurtz & Clements, *supra* note 6, at 402; see, e.g., MICH. COMP. LAWS § 436.1401(1) ("A [brewery] shall grant to each of its wholesalers an exclusive sales territory, as agreed upon between the wholesaler and [brewery], within which the wholesaler shall be the exclusive distributor of the specified brand or brands of the [brewery].").

104. See WHITMAN, *supra* note 49, at 23.

105. See Kurtz & Clements, *supra* note 6, at 402–03. Outside of the beer context, franchisors are generally allowed to grant exclusive territories to their franchisees, but most often such rights are not granted. *Id.*

106. See WHITMAN, *supra* note 49, at 25.

107. See *id.* (citing *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)) (stating that the United States Supreme Court had held exclusive territories to be per se illegal unless required by state law).

108. *Id.* (stating that around half of states' laws mandating exclusive territories were enacted in the "all-or-nothing" legal environment). Prior to 1977, courts generally held exclusive sales territories to violate the Sherman Act, 15 U.S.C. § 1 (2012), unless required by state law. *Id.* Thus, state laws either required or prohibited exclusive sales territories. *Id.* As a result, beer

States enacted territorial protections to provide two benefits for distributors. First, these laws protected distributors from the “spillover effects” of their efforts to improve product value.¹⁰⁹ Distributors are often responsible for promoting and advertising a brand of beer.¹¹⁰ Economists argue that in non-exclusive distribution agreements, distributors’ incentives to improve the brand are reduced because some distributors may “free ride” on the investments of other distributors.¹¹¹ This free riding problem may dissuade some distributors from making the investments necessary to build brand loyalty—an effect known as the “shirking problem.”¹¹² For instance, when a distributor promotes a product, sales might increase, and those new customers associate their purchase with the brand of beer rather than a specific distributor; thus, when a distributor promotes in a non-exclusive territory, the distributor does not exclusively realize the benefits of its investment.¹¹³ Some of the sales created by the advertising go to other distributors that did not pay for the advertising.¹¹⁴ A law mandating an exclusive territory for the distributor may reestablish the investment incentive.

In addition to recreating the incentive to promote, economists argue that distributors potentially benefit from the ability to charge a higher price when selling beer to retailers, which cannot be “undercut” by competing distributors.¹¹⁵ Other economists

franchise laws have generally reflected this mandatory nature. *Id.* For example, Alabama requires that “[e]ach supplier of beer . . . grant in writing to each of its wholesalers an exclusive sales territory.” ALA. CODE § 28-9-3 (2014). The Supreme Court has since overturned *Arnold* and held that exclusive territorial agreements are not per se illegal, recognizing that “[i]nterbrand competition . . . is the primary concern of antitrust law,” rather than intrabrand competition. *Conf’l T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 52 n.19, 57–59 (1977).

109. *See* WHITMAN, *supra* note 49, at 23.

110. *See id.* at 12.

111. *Id.*

112. *Id.*

113. *See id.*

114. *See id.* (“Other wholesalers can free ride off the work of those wholesalers who improve the profitability of a brand name they share.”).

115. *Id.* at 24 (citing Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 283 (1975)) (referencing Posner’s characterization of distributors as “cartels” and explaining that exclusive territories reduce exposure to other distributors).

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argue this is not truly a benefit because raising prices only leads consumers to purchase less beer, and thus distributors make less money overall if the price is too high.¹¹⁶ Besides affecting sales, some breweries also argue these protections provide distributors with too much control over brand management, allowing distributors to decide which brands to distribute and which brands to leave in the warehouses.¹¹⁷ Opponents to these mandates make similar criticisms of other protections, including transfer protections.

b. *Transfer Protections*

Providing more expansive protections than typically seen in other industries, most states have enacted transfer protections to limit a brewery's ability to prevent a distributor from transferring its distribution rights to another distributor.¹¹⁸ For example, in Rhode Island, "[n]o supplier shall, by the terms of an agreement or otherwise, unreasonably withhold or delay approval of any assignment, sale, or transfer of the stock of a [distributor]."¹¹⁹ Though less common, these protections are not unheard of in other industries.¹²⁰ The protections are often viewed with less hostility than other protections because the terms of the franchise agreement also transfer, and in that sense, business can continue as usual.¹²¹

116. *See id.*

117. Steve Hindy, Opinion, *Free Craft Beer!*, N.Y. TIMES (Mar. 29, 2014), <http://www.nytimes.com/2014/03/30/opinion/sunday/free-craft-beer.html> (opining that state laws allow "distributors to select brands and manage them however they want—selling those they choose to sell, while letting other brands sit in their warehouses").

118. *See Kurtz & Clements, supra* note 6, at 403–04; OR. REV. STAT. § 474.045 (2013) ("No supplier shall interfere with, prevent or unreasonably delay the transfer of the wholesaler's business or any interest therein if the wholesaler has provided . . . written notice . . . and the transferee meets reasonable standards and qualifications.").

119. R.I. GEN. LAWS § 3-13-6 (2012).

120. *See Kurtz & Clements, supra* note 6, at 404 (stating that transfer protections in the beer industry "tend to exceed" transfer protections generally found in franchisee laws).

121. *Id.* (stating that transfer protections are "less contentious" because the franchisor still receives royalties and generally only the remaining terms are transferred, allowing breweries to evaluate the distributor relationship at renewal).

c. *Termination Protections*

Many states mandate termination protections, which prevent breweries from prematurely terminating franchise agreements or failing to renew them without good cause.¹²² Most states mandate only a good cause requirement, but some states require further protections for distributors.¹²³ For example, Wisconsin limits how breweries and distributors may define good cause for termination and non-renewal.¹²⁴ The Wisconsin statute limits good cause to when a distributor commits “material fraudulent conduct,” makes “substantial misrepresentations,” commits a felony, sells the beer outside of the authorized territory, or becomes insolvent or institutes bankruptcy proceedings or otherwise liquidates the business for the benefit of creditors.¹²⁵ This statutory good cause standard is meant to supersede broader contractual definitions.¹²⁶

Outside of the beer industry, franchise laws rarely mandate a superseding, heightened good cause standard.¹²⁷ Proponents argue this protection prevents “opportunism” by breweries.¹²⁸ They present a rationale similar to the one underlying territorial protections: distributors must invest time and money in a brewery’s brands,¹²⁹ and if a brewery prematurely terminates a contract, the distributor does not earn its expected return on its initial investment of time, effort, and money because the benefits of the investment are realized when the brand is later distributed through a different distributor.¹³⁰ Violations of this protection can sometimes lead to litigation in which case distributors benefit from another set of protections.¹³¹

122. *Id.*

123. *See id.* at 406.

124. *See id.*

125. WIS. STAT. § 125.33(10)(4)(c)(1)-(4) (2014).

126. *See* Kurtz & Clements, *supra* note 6, at 405.

127. *See id.* at 406.

128. WHITMAN, *supra* note 49, at 10.

129. *Id.*

130. *Id.* at 10–11 (noting that a brewery might either “appropriate” value by terminating a contract and transferring the network established to a different distributor that is willing to accept “less-desirable terms,” or “strong-arm price concessions” by threatening to find a new distributor).

131. *See* Kurtz & Clements, *supra* note 6, at 406–07 (describing dispute resolution protections and statutory damages provisions).

d. *Damages and Procedural Protections*

When there is conflict or litigation, distributors often benefit from various statutory damages and procedural protections.¹³² Damages protections permit a distributor to recover damages when a brewery, without good cause, terminates an agreement, does not renew an agreement, or refuses to transfer an agreement.¹³³ For example, in Idaho, if the brewery terminates without good cause, the distributor receives fair market value of the distributor's expenses related to that brand.¹³⁴ Even if a brewery has "good cause," Idaho still requires the payment of "reasonable compensation" to distributors¹³⁵—a practice uncommon outside of the beer industry.¹³⁶ These damages protections work in conjunction with procedural protections, such as venue and choice of law requirements favoring distributions, to incentivize compliance with franchise agreements.¹³⁷

e. *Operational Protections*

States have also enacted operational protections for distributors, requiring breweries to comply with stringent procedures in their operations.¹³⁸ Some operational protections

132. *See id.*

133. *See id.*

134. IDAHO CODE § 23-1110(2) (2015).

135. *Id.* § 23-1110(1). The statute requires reasonable compensation for "the laid-in cost to the distributor of the inventory of the supplier's products, including any taxes paid on the inventory by the distributor, together with a reasonable charge for handling of the products." *Id.*; *see also* N.M. STAT. ANN. § 60-8A-9(E) (LexisNexis 2015) (providing distributors the right to recover treble damages when agreements are terminated in bad faith or not for good cause).

136. *See* Kurtz & Clements, *supra* note 6, at 406–07.

137. *See id.* at 406 (describing statutes imposing procedural protections, such as venue and choice of law requirements favoring the distributor); *see, e.g.*, CAL. BUS. & PROF. CODE § 25000.6(a) (West Supp. 2015) ("A provision in an agreement between a beer manufacturer and a beer wholesaler for the sale and distribution of beer in this state, which restricts venue to a forum outside this state, is void with respect to any claim arising under or relating to the agreement involving a beer wholesaler operating within this state.").

138. *See* GARNER, *supra* note 102, § 16:2; R.I. GEN. LAWS § 3-13-5(5) (2012) ("No supplier shall . . . [i]mpose, attempt to impose, or enforce against a wholesaler any requirement, standard of performance, or term, including the terms of sale of malt beverages sold to the wholesaler, which is discriminatory as compared with the requirements, standards, or terms

relate to the discontinuance of a particular line of beer and termination of a contract.¹³⁹ In Massachusetts, a brewery must provide at least 120 days' notice before discontinuing the sale of a beer to a distributor.¹⁴⁰ Likewise, in Illinois, a brewery may not terminate unless it has good cause and provides "written notice."¹⁴¹

While some protections focus directly on the relationship between a specific brewery and distributor, other protections, such as nondiscrimination statutes, focus more broadly on a brewery's relationship with multiple distributors.¹⁴² For instance, in some states, breweries are prevented from discriminating between distributors.¹⁴³ In Wyoming, a brewery may not "discriminate, either directly or indirectly, in price, programs, or terms of sale offered to franchisees" where the discrimination would harm competition or give a competitive advantage to a distributor.¹⁴⁴ Equal treatment of franchisees is a basic tenet of franchise law and is premised on keeping "Pandora's box to litigation" closed.¹⁴⁵

Overall, beer franchise laws have provided distributors in the beer industry with protections greater than those seen in other industries.¹⁴⁶ The protections reflect the market conditions when states implemented the laws.¹⁴⁷ When the laws were implemented, distributors were comparatively weak from an

imposed by the supplier on other similarly situated wholesalers within this state.").

139. *Id.*

140. MASS. GEN. LAWS ch. 138, § 25E (2010) ("The notice of discontinuance of sale shall be furnished by the manufacturer, importer or wholesaler to the wholesaler being discontinued at least one hundred and twenty days before the effective date of such discontinuance.").

141. 815 ILL. COMP. STAT. 720/3-4 (2014) (stating that "no brewer or beer wholesaler may cancel, fail to renew or otherwise terminate an agreement unless the party intending that action has good cause for the cancellation" and that notice "shall be in writing").

142. *See* GARNER, *supra* note 102, § 16:2.

143. *Id.*

144. WYO. STAT. ANN. § 12-9-104(v) (LexisNexis 2015).

145. *See* COLEMAN R. ROSENFELD, *THE LAW OF FRANCHISING OF THE FLORIDA AND UNITED STATES SUPREME COURT BARS* § 57, at 68 (1970) ("It is a cardinal rule that the franchise contract must be kept inviolate. In order to so maintain the contract, the basic and fundamental rule is to treat each franchisee equally." (footnote omitted)).

146. *See* Kurtz & Clements, *supra* note 6, at 405-07.

147. *See* Tamayo, *supra* note 8, at 2214.

economic standpoint, and these protections strengthened the bargaining position of distributors.¹⁴⁸ However, the beer franchise laws do not stand by themselves in protecting the three-tier system and distributors.¹⁴⁹

2. *Self-Distribution Laws*

Many states limit breweries' abilities to self-distribute beer to protect the validity of the three-tier system.¹⁵⁰ Self-distribution occurs when a brewery distributes directly to retailers and bypasses the second-tier distributors.¹⁵¹ State laws regarding self-distribution vary, but can be broadly categorized into the five following groups: (1) no breweries may self-distribute;¹⁵² (2) small craft breweries may self-distribute;¹⁵³ (3) almost all craft breweries may self-distribute;¹⁵⁴ (4) all breweries may self-distribute;¹⁵⁵ and (5) breweries may self-distribute through retailers in which the brewery has a financial interest.¹⁵⁶ As of 2014, fourteen states, plus D.C., did not allow self-distribution, while thirty-six states allowed for self-distribution in some form.¹⁵⁷

Alabama, for example, strictly adheres to the three-tier system, forbidding all breweries from "sell[ing] any alcoholic beverages direct to any retailer."¹⁵⁸ Maine is slightly less

148. See Kurtz & Clements, *supra* note 6, at 407.

149. See *infra* Section II.B.2.

150. See Tamayo, *supra* note 8, at 2231–35.

151. See *id.* at 2231.

152. See, e.g., DEL. CODE ANN. tit. 4, §§ 512B, 512C (West Supp. 2014) (allowing brewpubs and microbreweries to sell beer directly to customers on their licensed premises, but mandating that distribution off-premises be handled by wholesalers).

153. See, e.g., ARIZ. REV. STAT. ANN. § 4-205.08(D)(4) (2014).

154. See, e.g., 235 ILL. COMP. STAT. 5/5-1(a) (2014) (allowing breweries that produce up to 930,000 gallons per year to sell a limited amount directly to retailers).

155. See, e.g., ALASKA STAT. ANN. §§ 04.11.130(b)(2), 04.11.150 (West 2014) (allowing brewers to sell beer to "a person who is licensed under this title," which includes "package store" licensees).

156. See, e.g., ARIZ. REV. STAT. ANN. § 4-205.08(D)(3), (4)(a).

157. Bart Watson, *Dr. Statelaws: Or How I Learned to Stop Worrying and Love Self-Distribution*, BREWERS ASS'N (Apr. 22, 2014), <https://www.brewersassociation.org/insights/dr-statelaws-or-how-i-learned-to-stop-worrying-and-love-self-distribution> [hereinafter *Dr. Statelaws*].

158. ALA. CODE §§ 28-3A-6(b), 28-9-1 (2014) (stating the intent of the

restrictive, allowing craft breweries that produce up to 50,000 gallons a year to self-distribute.¹⁵⁹ Other states allow most craft breweries to distribute directly to retailers.¹⁶⁰ For example, in Illinois, a craft brewery producing less than 930,000 gallons of beer each year may apply for an exemption to self-distribute no more than 232,500 gallons of its beer.¹⁶¹ California has removed the second-tier requirement altogether and allows all breweries to sell directly to any person allowed to purchase beer.¹⁶²

While many states have focused their exemptions on a brewery's annual production, other states, such as Arizona, have changed their rules to no longer prohibit breweries from possessing a financial interest in retailers or distributors.¹⁶³ Others allow craft breweries to have a financial interest in retailers or distributors through which the brewery can distribute.¹⁶⁴ For instance, in Minnesota, breweries that produce up to 20,000 barrels may have a financial interest in a distributor that sells only that brewery's products.¹⁶⁵ Similarly, in Arizona, a "microbrewery" may distribute beer to retailers that are "under common ownership" with the brewery.¹⁶⁶

statute is, in part, to "maintain a sound, stable, and viable three-tier system of distribution of beer to the public").

159. ME. STAT. tit. 28-A, § 1355-A(3)(B)(2) (2014).

160. See, e.g., N.J. STAT. ANN. § 33:1-10 (West 2014) (allowing breweries of any size to self-distribute to retailers, provided the brewery holds the correct license).

161. 235 ILL. COMP. STAT. 5/3-12(18)(A) (2014) ("A class 1 brewer licensee, who must also be either a licensed brewer or licensed non-resident dealer and annually manufacture less than 930,000 gallons of beer, may make application to the State Commission for a self-distribution exemption to allow the sale of not more than 232,500 gallons of the exemption holder's beer to retail licensees per year.>").

162. CAL. BUS. & PROF. CODE § 23357(a) (West Supp. 2015) (stating that licensed breweries are allowed to sell to any person holding a license to sell beer and may offer beer for consumer purchase at the brewery).

163. See, e.g., ARIZ. REV. STAT. ANN. § 4-205.08(D) (2014) (allowing microbreweries up to seven retail licenses to operate off-site retail locations within the state).

164. See, e.g., MINN. STAT. § 340A.301(9)(g) (2014).

165. *Id.*

166. ARIZ. REV. STAT. ANN. § 4-205.08(D)(3), (4) (stating that a microbrewery may sell to any retail licensees that are "under common ownership . . . in any amount" and to other licensed retailers up to 93,000 gallons). The statute defines a microbrewery as a brewery that produces not more than 6,200,000 gallons per year. *Id.* § 4-205.08(D)(2).

The reason many states have enacted a self-distribution exemption to the three-tier system is to correct the small brewers' dilemma in which distributors lack much incentive to promote or distribute small brands.¹⁶⁷ Distributors lack incentive because a new craft brewery's brand often has little initial value.¹⁶⁸ These craft breweries have not yet established relationships with retailers and consumers.¹⁶⁹ Supporters of the exemption argue that through self-distribution, breweries can create value by self-promoting their brands, which makes the brands more attractive to prospective distributors.¹⁷⁰ Data have suggested that states with self-distribution have a higher number of craft breweries per capita and have higher beer production levels.¹⁷¹ The National Beer Wholesalers Association ("NBWA")¹⁷² has lobbied against these laws, seeking to limit any exemptions to laws prohibiting self-distribution.¹⁷³ Some state laws reflect a compromise of both positions; for example, in Kentucky, while "microbreweries" may sell beer on-site for off-site consumption, the microbrewery must have an agreement with a distributor if it wants to distribute its product to other retail sites.¹⁷⁴

167. See Tamayo, *supra* note 8, at 2232–33.

168. *Id.* at 2233.

169. See *id.*

170. *Id.* (citing Abram Goldman-Armstrong, *Buy a Truck!: The Self-Distribution Option*, AM. BREWER, Summer 2009, at 6, 6–7).

171. Dr. Statelaws, *supra* note 157. There is a statistically significant gap in the number of craft breweries per capita in states with self-distribution and those without self-distribution. In 2013, states with self-distribution had 1.41 craft breweries per 100,000 people over the age of 21, while states without had 0.77. *Id.* Along the same lines, production of those breweries is higher in states with self-distribution: states with self-distribution had an average of 2.51 gallons produced per person over the age of 21 in 2013, while states without had an average of 1.05 gallons produced. *Id.*

172. The National Beer Wholesalers Association represents around 3,300 beer distributors. NAT'L BEER WHOLESALERS ASSOC., 2014-2015 REPORT 1 (2014), https://www.nbwa.org/sites/default/files/NBWA_2014-2015_Report_1.pdf.

173. Michelle Minton, *Avoid a Beer Monopoly By Setting the Market Free*, COMPETITIVE ENTER. INST. (Dec. 11, 2012), <http://cei.org/onpoint/avoid-beer-monopoly-setting-market-free> (describing the NBWA as "vehemently opposed [to] any relaxation of the mandatory three-tier system," that lobbied Illinois lawmakers to minimize a self-distribution exemption to breweries producing less than 15,000 barrels each year and distributing 7,500 barrels or less independently each year).

174. KY. REV. STAT. ANN. § 243.157 (West 2014). The statute defines

Exemptions to the distribution laws take many forms.¹⁷⁵ Each exemption allows certain breweries to get around the problem of distributors lacking incentive to distribute new brands.¹⁷⁶ Although distributors are generally opposed to these exemptions,¹⁷⁷ some states have maintained self-distribution exemptions in addition to a similar exemption to the three-tier system, which allows for sales made directly to consumers.¹⁷⁸

3. *Direct Sale*

In addition to limiting self-distribution, most states limit the ability of breweries to sell beer directly to consumers.¹⁷⁹ Direct selling differs from self-distribution because self-distribution allows a brewery to distribute directly to retailers, while direct selling allows a brewery to sell directly to consumers.¹⁸⁰ Generally, there are six categories that states fall into with respect to laws governing the direct sale between breweries and customers: (1) breweries may not directly sell to consumers;¹⁸¹ (2) breweries may provide consumers limited “samples,” with or without charge, to be consumed on-site;¹⁸² (3) breweries may sell to consumers on-site to be consumed off-site;¹⁸³ (4) breweries may operate brewpubs;¹⁸⁴ (5) only “small” craft breweries may directly sell to consumers;¹⁸⁵ and (6) all breweries may directly sell to consumers.¹⁸⁶ Some states have adopted more than one of these

“microbreweries” as a brewery that produces less than 25,000 barrels a year. *Id.* § 243.157(1)(a).

175. Compare ARIZ. REV. STAT. ANN. § 4-205.08(D)(4)(b) (2014) (allowing only small breweries to self-distribute to retailers), with ALASKA STAT. ANN. § 04.11.130(b)(2) (West 2014) (allowing all breweries to self-distribute to retailers).

176. See Tamayo, *supra* note 8, at 2232–33.

177. See Minton, *supra* note 169.

178. See *infra* Section II.B.3.

179. See, e.g., MONT. CODE ANN. §§ 16-3-213 to -214 (2015) (allowing breweries to provide only “samples,” with or without charge, on the premises where it is produced).

180. See Tamayo, *supra* note 8, at 2232–33 (discussing self-distribution).

181. See, e.g., MISS. CODE ANN. § 67-3-46(2) (2014).

182. See, e.g., ALA. CODE § 28-3A-6(h) (2014); MONT. CODE ANN. § 16-3-213(2).

183. See, e.g., KAN. STAT. ANN. § 41-308b(a)(3) (West 2014).

184. See, e.g., *id.* § 41-308b(a)(5).

185. See, e.g., ME. STAT. tit. 28-A, § 1355-A(2)(D) (2014).

186. See, e.g., CAL. BUS. & PROF. CODE § 23357(a) (West Supp. 2015).

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approaches.¹⁸⁷ For example, Kansas allows for brewpubs while also permitting small breweries to sell beer to consumers for off-site consumption.¹⁸⁸

In regulating distribution and sale, states must still remain cognizant of constitutional protections in drafting the exemptions. In *Granholm v. Heald*, the United States Supreme Court addressed a direct-selling regulation in the wine industry, holding that state laws violate the Dormant Commerce Clause when they allow direct sale by in-state wineries, but not by out-of-state wineries.¹⁸⁹ The Court reasoned that state laws run afoul of the Dormant Commerce Clause if they “mandate ‘differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.’”¹⁹⁰ The decision prevented reciprocal agreements where in-state manufacturers could directly sell to consumers, but out-of-state manufacturers could directly sell only if their home state reciprocally allowed those in-state manufacturers to directly sell.¹⁹¹ Some attorneys have argued that *Granholm* applies to the beer context and that some existing state beer laws violate this ruling.¹⁹² For example, one commentator has argued that a Pennsylvania provision violates this rule by allowing in-state breweries to directly sell, but not allowing out-of-state breweries to do the same.¹⁹³

Similar to self-distribution, direct-sale exemptions take many different forms.¹⁹⁴ In attempting to regulate breweries’ direct sales to consumers, some states might create Dormant Commerce Clause problems, such as those seen in the wine industry.¹⁹⁵ The relevancy of the direct-sale issue has increased as technology has

187. See, e.g., KAN. STAT. ANN. § 41-308b (providing for brewpubs as well as direct sale of beer to be consumed off-site).

188. *Id.*

189. 544 U.S. 460, 466 (2005).

190. *Id.* at 472 (quoting *Or. Waste Sys., Inc. v. Dep’t of Env’tl. Quality*, 511 U.S. 93, 99 (1994)).

191. See *id.* at 472–76.

192. See, e.g., David Scott, *Don’t Forget the Beer*, [May 28, 2013] COMPETITIVE ENTER. INST.: ONPOINT 182, at 1, available at http://heartland.org/sites/default/files/david_scott-_dont_forget_the_beer.pdf.

193. See *id.* (citing 47 PA. CONS. STAT. § 4-431 (2012)).

194. Compare ALA. CODE § 28-3A-6(h) (2014) (allowing breweries to provide on-site samplings and tastings), with IOWA CODE ANN. § 123.124 (West 2014) (allowing small breweries to directly sell to consumers).

195. See Scott, *supra* note 192.

developed.¹⁹⁶

C. *The Influence of the Internet*

With the growth of e-commerce, a craft beer black market has developed.¹⁹⁷ If a state does not allow breweries to sell directly to consumers or self-distribute to retailers, and if no distributor will distribute a brewery's beer, then consumers are severely limited in their ability to purchase the product.¹⁹⁸ Some consumers have turned to illegally selling and purchasing beer on the Internet.¹⁹⁹ In 2013, an individual was charged after selling five cases of Heady Topper brand beer for \$825 on Craigslist—a beer that normally is sold for \$72 a case.²⁰⁰ Similarly, eBay auctioneers attempted to sell Russian River Brewing's Pliny the Elder beer—normally selling for \$5 a bottle—for between \$15 and \$50 a bottle.²⁰¹ The “Alcohol Policy” of eBay states that it does not generally permit alcoholic beverages to be sold, but eBay may, at its own discretion, allow sales by pre-approved sellers.²⁰² This policy parallels state laws that prohibit the resale of beer by unlicensed sellers.²⁰³ Thus, most online beer companies ship only to a limited number of states through private shipping companies.²⁰⁴ Because consumers' options are limited, they often

196. See *infra* Section II.C.

197. Lisa Rathke, *Craze for Coveted Craft Brews Creates Black Market*, ASSOC. PRESS (Dec. 6, 2013, 10:54 PM), <http://bigstory.ap.org/article/craze-coveted-craft-brews-creates-black-market>.

198. See Chen, *supra* note 10, at 541–42.

199. *Id.* at 542; Rathke, *supra* note 197.

200. Rathke, *supra* note 197. Heady Topper, produced by The Alchemist brewery, is rated one of the top beers in the world by Beer Advocate. *Id.* It is sold only in select bars and package stores in Vermont. Kristi Palma, *How to Get Your Hands on Heady Topper Beer*, BOSTON (Sept. 16, 2014, 4:57 PM), <http://www.boston.com/travel/new-england/road-trip-where-find-the-wildly-popular-heady-topper-beer/KbDEBQe020VHFOa0NxrZI/gallery.html>.

201. Rathke, *supra* note 197.

202. *Alcohol Policy*, EBAY, <http://pages.ebay.com/help/policies/alcohol.html> (last visited Dec 13, 2015). Slightly more restrictive, Craigslist prohibits the sale of alcohol on its website without exemption. *Prohibited*, CRAIGSLIST, <http://www.craigslist.org/about/prohibited> (last visited Dec. 13, 2015). Additionally, the United States Postal Service does not allow shipment of alcohol in the mail. *Shipping Restrictions*, USPS, <https://www.usps.com/ship/can-you-ship-it.htm> (last visited Dec. 13, 2015).

203. See, e.g., ALA. CODE § 28-3A-3(a)(6) (2014).

204. See *Beer of the Month Clubs*, HALF TIME BEVERAGE, <http://www.half>

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struggle to legally purchase certain brands of beer.²⁰⁵

The inability to purchase certain types of beer is problematic because consumers are demanding increased variety in beer.²⁰⁶ A 2012 study reported that 71% of beer drinkers responded that they enjoy having variety in the style of craft beer they drink.²⁰⁷ In response to this demand, the number of new beer releases increased by 113% between 2012 and 2013.²⁰⁸ Further, in the first eight months of 2014, variety pack sales of beer increased by 21%.²⁰⁹ Current laws are preventing consumers from better enjoying their desired variety.²¹⁰

In its general form, the three-tier system separates breweries, distributors, and retailers onto three separate tiers.²¹¹ Beer franchise laws supplement the three-tier system by providing contractual protections for distributors, including those related to territories, termination, transfer, damages and procedure, and operations.²¹² The three-tier system, when strictly applied, prevents self-distribution and direct-sale by breweries.²¹³ However, some states have created a range of exemptions.²¹⁴ The growth of e-commerce compounded by distribution difficulties for craft breweries has led to the development of an online black market for craft beer.²¹⁵ This Comment proposes a model state

timebeverage.com/beer-club.html (last visited Dec. 13, 2015). Half Time Beverage ships to twenty-one states as well as D.C. *See id.* Courts have reasoned that state laws can apply to out-of-state companies selling beer online to consumers in that state. *See, e.g.,* State v. Beer Nuts, Ltd., 29 S.W.3d 828, 838 (Mo. Ct. App. 2000).

205. *See* Chen, *supra* note 10, at 541–42.

206. *See* David Eisenberg, *Mintel: Millennials Demand More Variety*, BREWBOUND (Jan. 30, 2014, 2:24 PM), <http://www.brewbound.com/news/mintel-millennials-demand-more-variety> (describing a study revealing shifting tastes in alcoholic beverages, with a focus on Millennials).

207. Bart Watson, *A Cheers to Craft Beer Choices*, BREWERS ASS'N (Aug. 19, 2014), https://www.brewersassociation.org/insights/craft_beer_choices/.

208. Eisenberg, *supra* note 206.

209. Eric Gorski, Blog, *Variety Pack Sales Jump as Beer Drinkers Seek Choices*, DENVER POST: FIRST DRAFTS (Sep. 14, 2014, 12:00 PM), <http://blogs.denverpost.com/beer/2014/09/14/craft-beer-variety-packs/13879/>.

210. *See* Chen, *supra* note 10, at 541–42.

211. Tamayo, *supra* note 8, at 2200–01.

212. *See* Kurtz & Clements, *supra* note 6, at 402–07.

213. *See* Tamayo, *supra* note 8, at 2200–01.

214. *See id.* at 2231–35.

215. *See* Rathke, *supra* note 197.

law to remedy these problems.²¹⁶

III. THE MODEL LAW: CORRECTING REGULATIONS TO PROMOTE VARIETY AND COMPETITION

Many states' current beer regulations fail in two respects. First, states' regulations do not promote the variety in beer selection that consumers are demanding.²¹⁷ At the same time, many state laws do not promote competition—a basic tenet of the American economic system.²¹⁸ To correct these problems, four considerations need to guide states' modifications. First, regulations must correct distributors' bargaining advantages over craft breweries that result from the mandated protections.²¹⁹ Second, state legislators must be cognizant of a remaining rationale behind certain protections: distributors make investments in brands with the expectation of a return on investment.²²⁰ Third, beer regulations must also consider that most macrobreweries still retain a natural bargaining advantage over distributors.²²¹ Finally, regulations must provide consumers with sufficient access to beer through self-distribution and direct-sale, while also alleviating breweries' concerns about choosing between pursuing growth and maintaining exemption qualifications.²²² These four considerations will shape regulations to reflect the current market and best promote variety and competition.

216. See *infra* Appendix.

217. See Bullard, *supra* note 2.

218. O'CONNOR & FAILLE, *supra* note 81, at 31–32 (stating that the law of demand dictates an inverse relationship between the quantity demanded of a product and the price of the product). Because current regulations increase the price of beer, the quantity demanded decreases. See *id.*

219. See *supra* Section II.B.1.

220. See WHITMAN, *supra* note 49, at 10–13 (stating that distributors' typical investment in beer brands includes providing brand promotion and advertising to retailers, supplying “useful information” about the beer, “assuring reliable and frequent deliveries,” and utilizing correct storage and refrigeration procedures).

221. See Kurtz & Clements, *supra* note 6, at 399 (stating that power in franchise relationships most often tips in favor of large breweries like Anheuser-Busch InBev and MillersCoors, who “dominate” the beer market with 80% control over United States sales).

222. See *supra* Sections II.B.1 & II.B.2.

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These proposed changes are discussed in more depth below, as they are molded in this Comment's proposed model law.²²³ This model retains the three-tier system to prevent large-brewery abuses.²²⁴ The proposal, however, exempts small breweries, allowing them to self-distribute to retailers and directly sell to consumers.²²⁵ The Model Law also exempts small breweries from the beer franchise mandates that require exclusive grants of territories and termination protections.²²⁶ State agencies would set the specific exemption limits.²²⁷ By making these changes, states would promote both the variety and competition necessary to foster a healthy beer market.

A. *Retention of the Three-Tier System*

Lawmakers enacted the three-tier system to prevent abuses by large breweries, including breweries' coercive influence on retailers.²²⁸ Due to the consolidation of power amongst the largest macrobreweries,²²⁹ this potential for abuse still exists today. As a result, the Model Law maintains the three-tier system and supplements it with additional anti-coercion provisions and prohibitions on financial interests between tiers.²³⁰ The division of entities into separate tiers diminishes the opportunity for large breweries to inappropriately influence both distributors and

223. The Model Law is not intended to be an overview of an entire alcohol regulation but rather is meant to illustrate remedies to the problems harming competition and reducing variety in the beer industry. In order to draw a model law, the following examples use "plain English terms," which might result in an oversimplification of certain sections. Additionally, state regulation often depends on the market of the individual state, and this individualized-approach requirement might also result in oversimplification for certain sections.

224. See *infra* Section III.A.

225. See *infra* Section III.C.

226. See *infra* Section III.B.

227. See *infra* Section III.B.2.

228. See WHITMAN, *supra* note 49, at 3–6 (noting that the three-tier system was intended to prevent direct relationships between breweries and retailers, which were thought to encourage excessive alcohol consumption).

229. See Kurtz & Clements, *supra* note 6, at 399 (stating that breweries, such as Anheuser-Busch InBev and MillerCoors, retain a large amount of market power which allows them to "dominate the beer distribution relationship").

230. See *infra* Section III.A.2 (providing the three-tier system provisions of the Model Law).

retailers.²³¹

1. *Problems in Eliminating the Three-Tier System*

The three-tier system is still the best way to prevent large brewery abuses. Alternative remedies do not translate well into legislation and are not more effective at stopping the abuses.²³² Eliminating the three-tier system would only expand the potential for abuses from the brewery–distributor relationship to the brewery–retailer context.²³³ Additionally, such an elimination is not politically feasible because of the NBWA’s political influence.²³⁴ Consequently, the Model Law retains the three-tier system and supplements it with other protections.

The three-tier system was intended to prevent two abuses: (1) direct relationships—termed “tied houses”—between breweries and retailers;²³⁵ and (2) coercion and undue influence on retailers outside of the context of financial ownership by breweries.²³⁶ “Tied houses” and undue influence often resulted in retailers exclusively carrying one brewery’s brands.²³⁷ Opponents of the three-tier system argue that these abuses can be better prevented by other means,²³⁸ but these arguments are without merit.

231. See WHITMAN, *supra* note 49, at 3–6 (describing the function of the tiers as preventing breweries from exerting too much influence on the market).

232. See Ross Appel, *Is a Mandatory Three Tier System Necessary?*, KOMLOSSY L., P.A. (Jan. 27, 2014), <http://komlossylaw.com/threetier>.

233. For example, it could lead to large breweries extending to retailers their current practice of offering “incentives” for distributors to exclude other breweries’ products. See *A-B Expands Wholesaler Plan, Incentives*, ST. LOUIS BUS. J. (Apr 3, 2008, 5:19 PM), <http://www.bizjournals.com/stlouis/stories/2008/03/31/daily73.html?page=all> [hereinafter *A-B Wholesaler Plan*]; Tripp Mickle, *Craft Brewers Take Issue with AB InBev Distribution Plan*, WALL ST. J. (Dec. 7, 2015, 2:16 PM), www.wsj.com/articles/craft-brewers-take-issue-with-ab-inbev-distribution-plan-1449227668.

234. *Disbursements, National Beer Wholesalers Association Political Action Committee Filing #992573*, SUNLIGHT FOUND.: INFLUENCE EXPLORER, <http://realtime.influenceexplorer.com/filings/992573/SB/> (last updated Jan. 18, 2016) [hereinafter *Disbursements*] (providing campaign finance data for the National Beer Wholesalers Association for federal and state elections, including candidates and organizations that received money).

235. See WHITMAN, *supra* note 49, at 3–6.

236. See *id.*

237. *Id.* at 3–4.

238. See Appel, *supra* note 232.

Opponents argue that states should instead prohibit financial ownership of retailers by breweries and regulate coercive behavior by prohibiting “slot fees” that ensure complete ownership of a store’s shelf space and a bar’s taps.²³⁹ While prohibiting ownership interests between breweries and retailers can prevent tied houses, such changes would fail to protect retailers from coercion and undue influence.²⁴⁰ Prohibiting slot fees that ensure complete ownership of a store’s shelf space and a bar’s taps would not translate well to legislation because this proposal raises several problematic questions. For instance, what would be the proper amount of breweries a retailer must then buy from? How should the law be enforced? Would the law include rural retailers that might face increased transaction costs by purchasing from more breweries? What would be the consequences for violations, which often would be unintentional in an industry frequently affected by mergers and acquisitions?²⁴¹ The transactional costs alone would outweigh any benefits. Because of associated costs and implementation difficulties, prohibiting ownership and slot fees is far from the ideal approach.²⁴² Even if the legislature could appropriately detail the requirements, effectiveness would prove to be troublesome.

In addition to the likely political problems, these alternatives, even if implemented, would fail to adequately impact large brewery abuses. First, in states prohibiting the purchase of taps, these changes have failed to prevent the purchase of bar taps.²⁴³

239. *See, e.g., id.* (arguing that the three-tier system is no longer needed because tied-houses can be prevented through prohibiting financial relationships and through legislation such as prohibitions of slot fees).

240. *Contra id.* (reasoning that the three-tier system is no longer needed, but incorrectly characterizing the three-tier system as having only the purpose of preventing tied-houses rather than also preventing coercion and undue influence).

241. *See* PHILIP H. HOWARD, *TOO BIG TO ALE? GLOBALIZATION AND CONSOLIDATION IN THE BEER INDUSTRY 1* (May 2013), http://www.academia.edu/3590129/Too_Big_to_Ale_Globalization_and_Consolidation_in_the_Beer_Industry (noting that four firms account for 70% of the beer revenues, which resulted from a trend of consolidation through mergers, acquisitions, and joint ventures).

242. *But see* Appel, *supra* note 232.

243. *See* Daniela Galarza, *UPDATE: Beer Brewer Exposes Illegal Pay-to-Play Tap Practice on Twitter*, *EATER: BEER HERE* (Oct. 14, 2014, 2:38 PM), <http://www.eater.com/2014/10/14/6976865/beer-brewer-expose-illegal-committed-taps-twitter> (describing Pretty Things Beer’s frustration with

Many bars allegedly require breweries to make illegal tap payments “under the table.”²⁴⁴ Additionally, by removing the three-tier system, the alternatives allow large breweries’ coercive behaviors to further extend from the distributor tier to the retailer tier.²⁴⁵ Anheuser-Busch InBev, a large macrobrewery, uses its voluntary program to incentivize distributors to exclusively distribute its products.²⁴⁶ Despite the inability to have a financial interest in a distributor, Anheuser-Busch InBev still succeeded in pressuring 59% of its distributors to exclusively distribute its beer in 2008.²⁴⁷ These exclusive-distribution incentives were part of a larger program that allows distributors to accumulate cash-redeemable points for taking certain marketing actions.²⁴⁸ In 2015, Anheuser-Busch InBev implemented yet another exclusive distribution incentive program for its 500 distributors with the goal of doubling distributor participation in the next three years.²⁴⁹ Large breweries have succeeded with these incentive tactics²⁵⁰ despite anti-coercion statutes.²⁵¹ Laws further

Boston bars allegedly requiring breweries to buy lines, which is prohibited by the Alcohol and Tobacco Tax and Trade Bureau).

244. *See id.* (noting one bar owner’s characterization of the pay-to-play practice as common with some companies).

245. *See A-B Wholesaler Plan, supra* note 233 (announcing an expansion of Anheuser-Busch InBev’s incentive program, which includes voluntary distributor “alignment” through exclusive distribution); *see also* WHITMAN, *supra* note 49, at 3–4 (describing historical tied houses).

246. *A-B Wholesaler Plan, supra* note 233; *see also* Mickle, *supra* note 233.

247. *A-B Wholesaler Plan, supra* note 233; *see also* Mickle, *supra* note 233.

248. Leo Jakobson, *The 2013 Grand Motivation Master Winner: Anheuser-Busch*, INCENTIVE MAG. (Jan. 21, 2014), <http://www.incentivemag.com/News/Industry/The-2013-Grand-Motivation-Master-Winner—Anheuser-Busch>.

249. Mickle, *supra* note 233 (noting the goal of doubling participation from the current 38% participation rate). After the program was implemented, the president of Deschutes Brewery announced that one of its distributors had dropped Deschutes’ brands. *Id.* Fears over Anheuser-Busch InBev’s influence continues to grow, where as of early 2016, Anheuser-Busch was awaiting a decision by the United States Justice Department as to whether it would approve the merger between Anheuser-Busch InBev and SABMiller (excluding SABMiller’s share of MillerCoors). Thomas Buckley, *SABMiller Buys Case for AB InBev Takeover as Africa Sales Gain*, BLOOMBERG BUS. (Jan. 21, 2016, 2:07 AM), www.bloomberg.com/news/articles/2016-01-21/sabmiller-beer-shipments-beat-estimates-on-latin-america-africa.

250. *See id.*

regulating these incentive programs would become highly intrusive, as their success would depend on extensive restrictions into the corporate affairs of large breweries. Eliminating the three-tier system would only expand the potential for abuses from distributors to retailers by allowing direct interactions between breweries and retailers.²⁵² These concerns are a reality in states that have completely removed the second-tier requirement, such as California, where the United States Justice Department, as of late 2015, is investigating whether Anheuser Busch InBev's acquisition of two distributors makes it too difficult for craft breweries to get their brands on store shelves.²⁵³

In addition to the likely being ineffective, eliminating the three-tier system is also not politically feasible.²⁵⁴ The NBWA advocates for the continued mandatory separation of the three tiers because the system requires the use of distributors, which provides business for its constituent companies.²⁵⁵ Since 1989, the NBWA has donated over \$40 million to political campaigns.²⁵⁶ A quarter of that money has been contributed at the state level²⁵⁷—the level where three-tier systems have been

251. See, e.g., MICH. COMP. LAWS § 436.1403(3) (2015); see also MARC E. SORINI, BEER FRANCHISE LAW SUMMARY 2 (2014), <https://www.brewersassociation.org/wp-content/uploads/2015/06/Beer-Franchise-Law-Summary.pdf>.

252. Cf. *A-B Wholesaler Plan*, *supra* note 233 (detailing the influence Anheuser-Busch InBev has on distributors through direct relationships). This influence could expand to retailers if direct relationships are permitted, as was the case with tied houses in the past. WHITMAN, *supra* note 49, at 3–4.

253. Tripp Mickle, *Anheuser Says Regulators Have Questioned Pending Distributor Buyouts*, WALL ST. J. (Oct. 12, 2015, 10:09 PM), www.wsj.com/articles/anheuser-says-regulators-have-questioned-pending-distributor-buyouts-1444702179. Currently, Anheuser-Busch InBev owns seventeen of its 500 distributors. *Id.*

254. See *Disbursements*, *supra* note 234. In addition to making campaign contributions, the NBWA has spent a significant amount lobbying the federal legislative branch since 2012. *Id.*

255. See *What Is a Beer Distributor?*, *supra* note 49.

256. *National Beer Wholesalers Assn*, SUNLIGHT FOUND.: INFLUENCE EXPLORER, <http://staging.influenceexplorer.com/organization/national-beer-wholesalers-assn/4703da042a7047eba2bdf4850105d6d6?cycle=2010> [<https://web.archive.org/web/20150507132328/http://influenceexplorer.com/organization/national-beer-wholesalers-assn/4703da042a7047eba2bdf4850105d6d6>].

257. *Id.*

implemented and thus where they could be reformed. With this amount of influence on policy, eliminating the three-tier system would be politically difficult.

The alternative remedies would fail to prevent the large brewery abuses that the three-tier system successfully reduces. Added to the problem of these alternative remedies' ineffectiveness, the remedies do not translate well into legislation²⁵⁸ and are not politically feasible. The NBWA maintains political influence and supports the three-tier system.²⁵⁹ Because the three-tier system remains the best way to prevent large brewery abuses, and is politically feasible, the Model Law retains it but supplements it with other provisions.

2. *The Three-Tier System in the Model Law*

To minimize abuses by large breweries, states should retain the three-tier system.²⁶⁰ The Model Law supplements the system by prohibiting financial ownership between tiers in order to prevent manipulation of the regulatory structure.²⁶¹ Along these lines, the Model Law also includes anti-coercion provisions.²⁶² Together, these provisions would sufficiently prevent large-brewery abuses.

The Model Law begins by establishing the three-tier system:

A. Three-Tier System: Malt or brewed beverages are distributed through a three-tier system. The tiers are enforced through a licensing system:²⁶³

258. See Appel, *supra* note 232.

259. See *National Beer Wholesalers Assn, supra* note 256; *What is a Beer Distributor?*, *supra* note 49.

260. See *supra* Section III.A.1 (describing the problems with completely removing the three-tier system, including the potential for large brewery abuses); see *infra* Model Law § A.

261. See *infra* Model Law § B.

262. See *infra* Model Law § C.

263. Similar language can be found in many enacted statutes. See, e.g., ARK. CODE. ANN. § 3-5-1101(b) (2014) ("Regulation . . . is considered necessary . . . [t]o promote and maintain a sound, stable, and viable three-tier system of distribution of beer to the public."); 235 ILL. COMP. STAT. 5/6-1.5 (2014) ("[T]he primary purpose of this Act is to protect the health, safety, and welfare of this State through the sound and careful control and regulation of the manufacture, distribution, and sale of alcoholic liquor through a 3-tier regulatory system.").

(1) A brewery's license allows for the production and manufacture of malt or brewed beverages. The holder of a brewery's license may only sell to holders of a distributor's license, except as otherwise stated in this statute.

(2) A distributor's license allows for the sale or delivery to retailers of malt and brewed beverages that the distributor purchased from holders of a brewery's license.

(3) A retail license allows for direct sales to consumers.

These provisions establish the three tiers and regulate breweries through a licensing system.²⁶⁴ This basic structure sufficiently minimizes large brewery abuses because it prevents direct relationships between powerful breweries and small retailers, and thereby reduces the potential for a brewery to take advantage of a retailer.²⁶⁵ For instance, the distinct tiers limit Anheuser-Busch InBev's ability to coerce retailers to exclusively sell its products, as the brewery does with many of its distributors.²⁶⁶

In addition to enacting the three-tier system, the Model Law also prohibits the following financial interests:

B. Prohibition of Financial Interest:²⁶⁷

264. A full version of a statute based on the Model Law would differentiate certain brewery licenses for different types of establishments. *See, e.g.*, WIS. STAT. § 125.295 (2014) (stating the department should issue separate brewing permits to brewpubs, allowing them to manufacture and serve the beer on the premises subject to certain restrictions). For example, brewpubs operate with a brewery and restaurant, and thus different restrictions are needed for brewpubs than are needed for a traditional brewery. *See id.* (providing specific requirements for packaging, container size, transportation, and off-site sale).

265. *See* WHITMAN, *supra* note 49, at 3–4.

266. *See A-B Wholesaler Plan, supra* note 233.

267. Existing state law with similar provisions can be found in section 563.022(14)(a)-(b) of Florida's Statutes (stating that no brewery "may have an interest in the license, business, assets, or corporate stock of a licensed distributor nor shall such entity sell directly to any vendor in this state") and in chapter 235, act 5, section 6-4.5(b)-(c) of the Illinois Compiled Statutes (stating that "no person licensed as a manufacturer of beer . . . shall have any prohibited ownership interest, directly or indirectly, in a person licensed as a

(1) No brewery may have a direct or indirect financial interest in a distributor or a retailer, except as otherwise provided in this statute.

(2) No distributor of brewed or malt beverages may have a direct or indirect financial interest in a brewery or retailer, except as otherwise provided in this statute.

(3) No retailers of brewed or malt beverages may have a direct or indirect financial interest in a brewery or retailer, except as otherwise provided in this statute.

These prohibitions prevent ownership interests between the tiers, precluding companies from manipulating the tier system through self-owned entities in multiple tiers rather than merely having direct operations at those tiers.²⁶⁸ Without these provisions, financial ownership would act as a proxy for operating outside of the three-tier system.²⁶⁹ These provisions expand the effectiveness of the three-tier system and minimize large brewery abuses by reducing large brewery control over distributors and retailers.

While the three-tier system's prohibition of ownership prevents direct influences by large breweries, anti-coercion provisions are needed to reduce the impact of voluntary incentive programs that large breweries, such as Anheuser-Busch InBev, use to facilitate exclusive distribution from distributors.²⁷⁰ While such provisions²⁷¹ are not sufficient replacements for the tier-system in preventing abuses by large breweries, they function as

distributor" and that "no person licensed in this State as a distributor . . . shall have any prohibited ownership interest, directly or indirectly, in a person licensed as a manufacturer of beer").

268. See, e.g., FLA. STAT. § 563.022(14)(a)-(b) (2014) (prohibiting manufacturers from having an interest in distributors); see also WHITMAN, *supra* note 49, at 3–4.

269. Instead of distributing to retailers, large breweries could potentially buy a distributor and then exclusively distribute through its self-owned distributor. In this sense, the brewery would effectively operate outside of the three-tier structure.

270. See *A-B Wholesaler Plan*, *supra* note 233.

271. See, e.g., MICH. COMP. LAWS § 436.1403 (2015) (providing for both the three-tier system and other anti-coercion provisions).

an important supplement. The Model Law includes these additional anti-coercion provisions.²⁷² Because there is a broad range of possible anti-coercion provisions, the following provisions are illustrative rather than exhaustive:

C. Prohibition on Undue Influence and Coercion:²⁷³

A brewery is prohibited from the following:

- (1) Coercing, or attempting to coerce, any distributors to accept delivery of beer not ordered or that was properly cancelled.
- (2) Coercing, or attempting to coerce, any distributor to perform an illegal act by threatening to amend, cancel, terminate, or refuse to renew a franchise agreement.
- (3) Coercing, or attempting to coerce, a distributor to limit its right to sell competing brands of beer unless sale would materially impair the quality of service.

These provisions add another layer of protection to the three-tier system because they target “coercive” behavior by regulating the actions of breweries towards distributors.²⁷⁴ These changes protect distributors’ investments in breweries’ brands. The three-tier system’s ownership prohibition between tiers prevents a brewery from owning or operating as a distributor, but it, of course, does not prevent direct dealings between two tiers.²⁷⁵ Consequently, coercion provisions prevent breweries from taking advantage of these direct relationships.²⁷⁶ For example, a provision in the Model Law prohibits a brewery from coercing a distributor into accepting the delivery of beer that the distributor did not order.²⁷⁷ The three-tier system, by itself, could not

272. *See infra* Model Law § C.

273. Similar existing provisions can be found in subsections (a) and (d) of section 436.1403(3) of Michigan’s Compiled Laws (prohibiting breweries from forcing distributors to accept delivery of unordered beer and limiting distributors’ rights to sell competitive brands).

274. *See, e.g.*, MICH. COMP. LAWS § 436.1403(3) (using the word “coerce” to describe prohibited brewery conduct).

275. *See supra* Section III.A.

276. *See, e.g.*, MICH. COMP. LAWS § 436.1403(3)(a)-(c).

277. *See infra* Model Law § C(1).

prevent such abuses.²⁷⁸

These provisions would adequately prevent problematic large brewery abuses by establishing the three-tier system, preventing financial ownership between tiers, and prohibiting undue influence and coercion.²⁷⁹ The Model Law would prevent tied houses by establishing the three-tier system and prohibiting financial ownership between tiers.²⁸⁰ Through these provisions, breweries would not be able to directly own retailers.²⁸¹ Additionally, all three provisions would work to prevent other coercive behavior outside of the context of tied houses.²⁸² The anti-coercion provisions, for example, would prevent breweries from coercing distributors into accepting cancelled orders, performing illegal acts, and limiting their right to sell competing brands. The Model Law succeeds where the alternatives fail; the three-tier system minimizes the potential for abuse by limiting direct relationships between breweries and retailers.²⁸³ Large breweries, such as Anheuser-Busch InBev, would not have the same direct relationship with retailers that they rely on for their successful distributor-incentive programs.²⁸⁴ Through these provisions, the Model Law would prevent tied houses and would reduce other coercive behaviors.

B. *Small Brewery Exemptions to the Beer Franchise Laws*

States should provide small breweries with exemptions to the termination and territory protections of beer franchise laws. These mandated protections do not reflect the current market conditions, as many states have not substantively updated their regulations to reflect the craft beer revolution.²⁸⁵ When the beer franchise laws were enacted, the economic strength of a small number of large breweries overshadowed the very limited

278. *See supra* Section III.A.

279. *See infra* Model Law §§ A-C.

280. *But see* Appel, *supra* note 232 (arguing that the three-tier system is unnecessary to prevent tied houses).

281. *See infra* Model Law § B.

282. *See, e.g.*, MICH. COMP. LAWS § 436.1403 (2015) (applying to non-tied-house relationships between breweries and distributors).

283. *See infra* Model Law § A.

284. *See A-B Wholesaler Plan, supra* note 233.

285. *See, e.g.*, ALA. CODE § 28-3A-6 (2014).

economic power of many small, family-owned distributors.²⁸⁶ Given the disparity in number and economic strength, breweries had more choice over which distributors to contract with and greater influence over franchise negotiations.²⁸⁷ The rationales for these protections have disappeared since most of them were enacted.²⁸⁸ By exempting small breweries from the termination and territory protections, the Model Law improves competition and returns control to breweries' hands,²⁸⁹ while still alleviating concerns with large brewery opportunism.

1. *The Disappearing Rationale Behind Mandated Protections*

Since states implemented termination and territory protections, the market and legal environments have changed.²⁹⁰ By not updating these laws as the protections' rationales disappeared, states have created an uneven bargaining environment.²⁹¹ This uneven bargaining environment has removed brand control from breweries.²⁹² The removal of brand control is especially problematic because breweries cannot often afford to engage in litigation to remedy conflicts with distributors, the result being that competition in the market is reduced.²⁹³

As has been discussed above, today's market differs greatly from that of the 1970s.²⁹⁴ Approximately ninety-eight percent of breweries are craft breweries, who, by definition, are small in size.²⁹⁵ As the number of breweries has shot up from a low of eighty-nine in 1978, the market power of distributors has

286. Tamayo, *supra* note 8, at 2213.

287. *See id.* With more economic power and choice over franchisees, large breweries are able to present take-it-or-leave-it offers. *See id.*

288. *Id.* at 2217–18.

289. *See infra* Sections III.B.1 & III.B.2.

290. Tamayo, *supra* note 8, at 2202.

291. *Id.* at 2217–18 (explaining that the relationships between breweries and distributors have changed and that some “traps for unwary craft breweries” exist).

292. *See* Hindy, *supra* note 117 (stating that states' laws allow “distributors to select brands and manage them however they want—selling those they choose to sell, while letting other brands sit in their warehouses”).

293. *See, e.g., id.* (recalling when the Brooklyn Brewery was forced to settle because it could not afford litigation costs).

294. *See supra* Section II.B.1.

295. *Number of Breweries, supra* note 25.

consolidated.²⁹⁶ The average shipping amount increased by 130,000 barrels during this time period.²⁹⁷ As distributors' relative economic strength has grown, the vast majority of breweries is now small craft breweries lacking comparable economic clout.²⁹⁸ Yet, the statutorily mandated protections for these distributors stayed in place, even with the disappearing market rationale.²⁹⁹

In addition to the disappearing market rationale, the legal environment influencing states' enactment of territory protections has changed.³⁰⁰ States enacted the territory protections when the legality of such grants depended on whether state law mandated them.³⁰¹ Legislators determined that it was better to always have the exclusive territory grants rather than never have them.³⁰² Today, exclusive territory grants can be legal even when not mandated by state law.³⁰³ Consequently, in addition to the disappearing market rationale, another reason for the mandated exclusive territory grants—the all-or-nothing legality—no longer applies in the current legal environment.³⁰⁴

With the former rationales disappearing, the mandated

296. *Id.*; see Tamayo, *supra* note 8, at 2217–18.

297. Watson, *supra* note 51 (stating that between 1970 and 2014, the average annual shipments per distributor has increased from 20,000 barrels to 150,000 barrels).

298. *See id.* (stating that the “average brewer today looks nothing like the brewing industry in the 1970s,” that the number of breweries passed 3,000 in 2013—most of which are “tiny”—and that the average brewing amount is less than 1,000 barrels each year).

299. *See id.* (“[C]urrent industry dynamics and market power relationships are markedly different than they were in the past. This matters, since many beer regulations were crafted in an era when brewers were big and wholesalers were small.”).

300. *See* WHITMAN, *supra* note 49, at 25 (stating that before 1977, “[e]xclusive territories were illegal under federal antitrust law *unless* they were mandated by state law”).

301. *Id.* (stating that the Supreme Court held exclusive territories to be per se illegal and that federal antitrust law made such territories illegal unless required by state law); *see* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

302. *See id.*

303. *Id.* (stating that in 1977 the Supreme Court reserved course on on the per se rule against exclusive territory agreements it had announced a decade earlier); *see* Continental T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

304. *Id.*

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distributor protections cause an uneven bargaining environment for small breweries.³⁰⁵ Most modern distributors have a bargaining advantage over craft breweries because of distributors' statutorily mandated protections and their comparatively greater natural economic strength.³⁰⁶ The statutory protections necessitate the inclusion of highly favorable terms for the distributors—terms not common in other industries.³⁰⁷ The franchise agreement's deck is accordingly stacked against craft breweries.³⁰⁸ By mandating the protections, the terms are not part of a larger give-and-take negotiation. To illustrate: if a brewery desires certain favorable terms, it cannot offer one of the mandated provisions as a concession because it is already automatically included. As a result, the brewery may have to concede some other favorable term. The uneven bargaining environment results in highly favorable franchise agreements for distributors.³⁰⁹

Adding distributors' economic strength to the bargaining equation sets craft breweries back further.³¹⁰ For whatever terms are left over to negotiate, distributors can often bargain for even more favorable terms because craft breweries have minimal distribution options—especially new, small craft breweries.³¹¹ Small breweries have less influence and distribution options because their comparatively small productions are less valuable than large breweries' productions.³¹² Additionally, small, new

305. See Kurtz & Clements, *supra* note 6, at 402–07; Tamayo, *supra* note 8, at 2217–18.

306. See Kurtz & Clements, *supra* note 6, at 402–07; Tamayo, *supra* note 8, at 2217–18.

307. See Kurtz & Clements, *supra* note 6, at 405.

308. See *id.* at 402–07; see also Tamayo, *supra* note 8, at 2217–18. Instead of using a blank slate to negotiate, the slate often has permanent etches of territorial protections, transfer protections, termination protections, damages and procedural protections, and operational protections. Kurtz & Clements, *supra* note 6, at 402–07. Even ignoring that many distributors come to the table with more economic strength than most craft breweries, craft breweries still automatically begin negotiations at a disadvantaged point because of the protections. See *id.*

309. See *id.* at 402.

310. See Tamayo, *supra* note 8, at 2218.

311. See *id.* at 2233 (arguing that self-distribution allows a small brewery to show distributors that the brand will be profitable in the market, resulting in a favorable contract with a signing bonus).

312. See Kurtz & Clements, *supra* note 6, at 408. However, this

craft breweries' brands lack value because they have not developed consumer bases and because distributors risk receiving a smaller return on their requisite investment.³¹³ Consequently, the bargaining differential creates a number of issues for craft breweries.

The bargaining differential often results in a lopsided franchise agreement that removes brand control from breweries.³¹⁴ One brewer recently wrote in a New York Times op-ed that the termination and exclusive territory protections allow distributors to choose which brands are distributed and which brands stay in the warehouse.³¹⁵ Distributors have this control because termination protections require breweries to meet a high good cause standard to terminate an agreement.³¹⁶ Even with good cause, some states still require a brewery to pay termination damages.³¹⁷ This control problem is further complicated by exclusive territory mandates because breweries cannot turn to other distributors if their brands are being distributed in an undesirable fashion or, as highlighted by the op-ed, not distributed at all.³¹⁸ Small breweries often have difficulty addressing this disadvantage.³¹⁹

disadvantage is not true of the large, macrobreweries, such as Anheuser-Busch InBev, who influenced 59% of its distributors to exclusively distribute its beer in 2008. *See A-B Wholesaler Plan, supra* note 233. Anheuser-Busch InBev is able to use its economic strength to exert control over the operations of distributors. *See id.*

313. *See* Tamayo, *supra* note 8, at 2232. Distributors are partially responsible for the promotion of a brand. *See* WHITMAN, *supra* note 49, at 12. With new brands that have not developed a consumer base, distributors have to make more investments in advertisement. *Id.* This investment is an extra cost added to the risk of trying to sell a brand that does not have regular customers. *See id.*

314. *See* Hindy, *supra* note 117.

315. *Id.*

316. *See* Kurtz & Clements, *supra* note 6, at 405 (comparing beer franchise laws with franchise laws of other industries to conclude that similar good-cause requirements are generally not mandated).

317. *See, e.g.,* IDAHO CODE § 23-1110 (2015) (stating that in the event that a franchise agreement is terminated or not renewed by a brewery, the distributor is entitled to "reasonable compensation for the laid-in cost to the distributor of the inventory of the supplier's products").

318. *See* Hindy, *supra* note 117.

319. *See id.* (recounting how Brooklyn Brewery had to settle rather than continue with a lawsuit challenging the franchise agreements because it did not have adequate litigation funds).

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As a result of craft breweries' inherently small size, they often lack the funds to challenge distributors in lawsuits.³²⁰ The brewer who penned the above-referenced op-ed also recollects the legal difficulty that his brewery faced: when attempting to terminate a contract that provided his brewery could leave "with or without cause," his distributor challenged the provision as inconsistent with the statutorily mandated protections.³²¹ The brewery settled out of concern about further legal costs.³²² Even though the brewery settled out of court, it was still left with \$300,000 in legal fees.³²³ Craft breweries, being economically smaller than macrobreweries and most distributors, often cannot afford to litigate disputes with distributors.³²⁴

The "double markup" effect inflates this problem, reducing small breweries' competitiveness in the market.³²⁵ Both the distributor and the retailer "mark up" the price.³²⁶ While the brewery might charge \$8.00 for a six-pack of beer, the consumer may end up paying \$10.00 for the same pack. This problem impacts small craft breweries more than it does macrobreweries.³²⁷ Macrobreweries are often able to lower their prices because of economies of scale.³²⁸ Production benefits are associated with large-scale production, which reduces

320. *Id.* ("[M]any small breweries lack even a fraction of the resources needed to take on a big distributor in court.")

321. *Id.*

322. *See id.*

323. *Id.* One brewery even turned to crowdfunding to assist with legal costs. *Sue TABC: Operation Six Pack to Go!!*, INDIEGOGO, <https://www.indiegogo.com/projects/sue-tabc-operation-six-pack-to-go#!> (last visited Jan. 29, 2016) (raising \$34,852 to sue the Texas Alcoholic Beverage Commission to allow the on-site sale of beer for off-premise consumption, but failing to reach its \$100,000 goal).

324. By definition, craft breweries produce small amounts of beer. *See Craft Brewer Defined*, *supra* note 25. Being small in size, craft breweries do not benefit from an economy of scale reducing their production costs per beer. *See Elzinga*, *supra* note 3, at 97–98. Smaller production and comparatively high production costs often result in less money being available for litigation. *See Hindy*, *supra* note 117.

325. *See* WHITMAN, *supra* note 49, at 9–10 (identifying the "double markup" effect as an impediment to competition within the beer industry).

326. *See id.*

327. *See* Elzinga, *supra* note 3, at 97–98 (describing how large breweries are better able to control production costs than are smaller breweries).

328. *Id.*

macrobreweries' costs per beer.³²⁹ The resulting increase in craft beer prices makes craft breweries less competitive than they might otherwise be.³³⁰ The small brewery exemptions in the Model Law would restore competition to the market.

2. *Small Brewery Exemptions from Territory and Termination Protections*

The Model Law exempts small breweries from the territory and termination protections.³³¹ Because the rationales behind these protections no longer apply, the Model Law improves competition by creating exemptions. The small-brewery exemptions reduce the double markup effect, return some control to breweries, and retain protections against macrobrewery opportunism.

Exemptions for small breweries, when correctly done, improve competition in the market.³³² If exclusive territory grants and termination protections are no longer mandated by statute, distributors compete to sell a certain brand to retailers in a particular region.³³³ This regional competition minimizes the double markup effect: distributors would not have the same latitude to increase the price of beer as it passes to the third tier because distributors would be competing for sales.³³⁴ If the distributor increases the price too much, the retailers could buy

329. *Id.* at 95.

330. An opponent might respond that consumers may be willing to pay a premium for craft beer. But with the rise of large breweries' imitations of craft beers, consumers may be confused about which brands are actually craft beer. *See Craft vs. Crafty, supra* note 37. This confusion results in competition between craft breweries, who are impacted by relatively high costs, and large breweries' imitation craft beer, which is not so impacted. *Id.* The competition puts craft breweries at a disadvantage. *See* WHITMAN, *supra* note 49, at 9. Additionally, the increased cost may deter new customers who are not interested in paying a premium to experiment with a new brand.

331. *See infra* Model Law §§ D-E.

332. *Cf. Scott, supra* note 62, at 426–29 (discussing how North Carolina's beer distribution regulations fail to promote competition).

333. *See id.* (arguing that exclusive territory grants allow for a distributor monopoly to develop, effectively eliminating competition at both the brewery–distributor level and the brewery–retailer level).

334. *See id.* at 426–27 (reasoning that when products are substitutes, there will be competition between distributors).

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the brand from another distributor.³³⁵ Small brewery exemptions force distributors to compete with other regional distributors, reducing the double markup effect and improving competition. With lower overall prices for consumers, this change would increase sales and increase distributors' overall profits as a result.³³⁶

Opponents of eliminating mandated protections argue that competition between two brands of beer is sufficient competition for the market.³³⁷ However, when two brands of beer are not "substitutes" for each other, the law does not promote the same level of competition.³³⁸ Two brands are "substitutes" when a consumer would easily substitute one for the other.³³⁹ Prices increase when two distributors are not competing for customers.³⁴⁰

Additionally, the elimination of the mandates alleviates some breweries' concerns that distributors with exclusive territories have the power to decide which brands are distributed and which brands are not distributed.³⁴¹ In a non-exclusive distribution region, a brewery may turn to a different distributor if one distributor inadequately distributes a brand.³⁴² The removal of the mandate returns some product control to breweries.³⁴³

Because these exemptions return some control to breweries,

335. *See also id.* at 431 (stating the current mandates and three-tier systems have created a lack of evidence that any growth has occurred in North Carolina's brewing industry and have resulted in a price increase of 18% to 25%).

336. *See id.* at 431 (discussing how the three-tier system creates artificially high prices).

337. *See id.* (explaining that the current laws cause "artificial price increases" that benefit large breweries and harm small craft breweries, whose beer is generally already more expensive).

338. *See* Scott, *supra* note 62, at 427 (noting that Natty Greene's beer is not a substitute for Miller Lite, which means that their respective distributors will not compete with each other for customers).

339. *Id.* (suggesting that "Miller Lite and Bud Light may be substitute products").

340. *Id.* at 426–27 (providing an example where one distributor carries Bud Light and another carries Miller Lite, which causes them to compete for the business of retailers).

341. *Cf.* Hindy, *supra* note 117 (reciting the problems faced by Brooklyn Brewing when a distributor failed to meet the breweries' expectations because of the lack of brand control for the brewery).

342. *Cf. id.*

343. *Cf. id.*

opponents express concern about brewery opportunism.³⁴⁴ However, by creating these exemptions, terms currently mandated by law are not necessarily excluded, but become part of a larger “give-and-take” negotiation between the brewery and distributor. Consequently, distributors concerned about specific brewery opportunism can still bargain for the formally mandated protections. If a distributor wants an exclusive territory grant, then it may have to agree to an additional term beneficial to the brewery. These exemptions create a more even bargaining environment for franchise negotiations and correct the problems caused by the mandates, but still allow for distributors to bargain for protection against brewery opportunism. The Model Law includes the following provisions exempting small breweries:

D. Termination Mandate:³⁴⁵

- (1) An independently-owned³⁴⁶ brewery that produces less than [amount] barrels of beer and whose sales constitute [amount] percent or less of the distributor’s total annual brand sales may terminate or not renew any agreement with a distributor with or without having good cause for such termination or nonrenewal. In all other circumstances, a brewery may terminate only with good cause as contractually defined between the parties.

344. See WHITMAN, *supra* note 49, at 10–11 (stating that a brewery might “appropriate” value by terminating a contract and transferring—or threatening to—the network established to a different distributor that is willing to accept “less-desirable terms”).

345. This provision is loosely based on language from New York’s current beer statute. See N.Y. ALCO. BEV. CONT. LAW § 55-c(4)(c) (McKinney 2014). A somewhat similar provision can be found in Nevada’s statutes. See NEV. REV. STAT. § 597.160(2) (2014) (exempting breweries that produce under 2,500 barrels per year from its termination protection provision).

346. The definitional section of the statute would define an independent brewery similar to how the Brewers Association does: An independent brewery is one where three-quarters or more of the brewery is owned or controlled by entities that meet the production exemption set by the Alcohol Board. This definition would eliminate a large brewery end-run of the exemption’s production limitations through purchasing craft breweries. States would also have the option to measure production cumulatively of all entities involved in the ownership structure if, depending on the particular market involved, there is a likelihood of abuse of the exemption through small-brewery conglomeration.

(2) Any brewery meeting the good-cause exemption in subsection (1) is not subject to liability provided that the brewery provides [amount] days' notice and prior to the termination, pays the distributor the fair market value of the distribution rights that will be lost or diminished by the termination.

(3) Disputes are subject to arbitration.

E. Territorial Protection:³⁴⁷ A brewery shall grant each of its distributors an exclusive sales territory. This subsection does not apply to an independently-owned brewery that sells less than [amount] barrels of beer or malted beverages annually.

H. Agency Authority:³⁴⁸

(1) The Alcohol Board shall formulate the qualifications for exemptions from the termination and territorial protections as set out in sections D and E.

Under the termination mandate exemption, the Model Law exempts breweries that produce less than a certain number of barrels of beer and that constitute less than a certain amount of a distributor's sales. This section also includes a limitation based on the amount the brewery constitutes of the distributor's total sales because this amount indicates the brewery's level of control in its relationship with the distributor. The more a brewery represents of the total sales, the more influence the brewery has in the distribution relationship because of the distributor's heavy reliance on those sales. In the event of conflict, the Model Law mandates arbitration to prevent expensive litigation.³⁴⁹ The

347. Existing state law with somewhat similar provisions can be found in section 12-47-406.3(8) of Colorado's Revised Statutes, which exempts craft breweries completely from franchise mandates.

348. Some states have vested rulemaking authority in state alcohol agencies. *See, e.g.*, CAL. BUS. & PROF. CODE § 25750 (West Supp. 2015) ("The department shall make and prescribe those reasonable rules as may be necessary or proper to carry out the purposes and intent of [California's constitutional amendment concerning alcohol beverage control]" and this statute).

349. For a real-life example of such expensive litigation, see Hindy, *supra* note 117.

territorial protections exemption focuses only on the production levels because the exemption works to reduce the double markup effect through distributor competition.³⁵⁰ By focusing on production levels, the exemption limit is a proxy for the breweries' economic strength and reduces the chance of brewery opportunism.³⁵¹ The Model Law provides state agencies with the authority to set the specific parameters of the small brewery exemptions.³⁵² Agencies have the expertise necessary to develop appropriate limitations and grace periods based on the particular needs of their states. An agency will determine this by examining what best serves the underlying purposes of the exemptions.³⁵³

Unless there is a specific market issue in a particular state, there is no need to exempt small breweries from the transfer protections and the operational protections. The transfer protections are viewed with less hostility because the terms of the contract remain intact following such a transfer.³⁵⁴ The operational protections for non-discrimination provisions should remain mandatory, as is typical in franchise law.³⁵⁵ Its rationale lies in preventing litigation,³⁵⁶ which still applies in the modern beer market.³⁵⁷ As a result, the exemptions should focus on the territory and termination protections.

To account for the changes in the market, small breweries should be exempted from the territory and termination protections. This change creates a more level bargaining field by returning some control to small breweries. The changes also

350. See WHITMAN, *supra* note 49, at 9–10.

351. See *id.* at 10–11.

352. See *infra* Model Law § H(1).

353. Determining the specific exemption will require agencies to look at the bargaining differential between distributors and breweries in that state and provide an exemption to the point where breweries' and distributors' economic power is fairly balanced.

354. See Kurtz & Clements, *supra* note 6, at 404 (noting that transfer protections are “less contentious” because the franchisor still receives royalties and generally only the remaining terms are transferred, allowing breweries to reevaluate the distributor relationship at renewal).

355. See ROSENFELD, *supra* note 145, § 57, at 68.

356. See *id.* (stating that operational protections against discrimination are necessary to keep “Pandora’s box to litigation” closed).

357. See, e.g., Thom Vogelhuber, *Dogfish Head v Glunz; No Settlement in Sight*, GUYS DRINKING BEER (Nov. 19, 2012), <http://www.guysdrinkingbeer.com/glunz-v-dogfish-head-no-settlement-in-sight>.

improve competition and reduce the double markup effect. These exemptions benefit the market, but should be supplemented by changes to laws limiting self-distribution and direct-sale changes.

C. *Self-Distribution and Direct-Sale Exemptions*

Self-distribution and direct-sale laws should provide more liberal exemptions for craft breweries. The same changes should be made to both types of laws because both present the same problem: small breweries frequently cannot find a distributor to distribute their beer because their brands initially lack value.³⁵⁸ Small breweries are unable to self-remedy this problem because many states' laws prohibit or strictly limit direct-sale to consumers³⁵⁹ and self-distribution to retailers.³⁶⁰ Exemptions for small breweries would allow those breweries to build brand value, making their beer more attractive to distributors. Liberal exemptions would benefit consumers, breweries, and distributors alike.³⁶¹

Consumers' ability to purchase certain beer brands is constrained because of limits on self-distribution and direct-sale.³⁶² The distributor bears significant investment costs and risks not receiving its expected return on investment because new breweries lack consumer and retailer bases—a problem compounded by the minimal exposure received through advertising.³⁶³ Consumers cannot purchase a brewery's beer

358. See Tamayo, *supra* note 8, at 2232–33.

359. See, e.g., MONT. CODE ANN. § 16-3-213(2) (2015) (allowing direct sale only in the form of samples to be consumed on a brewery's premises).

360. See, e.g., DEL. CODE ANN. tit. 4, §§ 512B, 512C (West Supp. 2014) (allowing brewpubs and microbreweries to sell beer directly to customers on their licensed premises, but mandating that distribution off-premises be handled by wholesalers).

361. Consumers benefit through better variety and lower prices. See Chen, *supra* note 10, at 541. Breweries benefit by building brand value. See Tamayo, *supra* note 8, at 2235. Distributors benefit by knowing ahead of time which brands are likely to be successful. See *id.* Additionally, when breweries negotiate contracts on a balanced field, breweries will still most often distribute through a distributor because distributors are often able to operate more efficiently than could a brewery by itself. See WHITMAN, *supra* note 49, at 23.

362. See Tamayo, *supra* note 8, at 2232 (discussing how “small and unknown brewers often find it difficult to access distribution networks”).

363. See *id.* at 2235.

when no distributor will distribute it and when the brewery is unable to directly sell to consumers or self-distribute to retailers.³⁶⁴ Self-distribution and direct-sale allowances create a legal route to market and reduce instances of black-market sales.

Even amidst lobbying opposition from distributors, some states have exempted craft breweries from the limitations on self-distribution³⁶⁵ and direct sales³⁶⁶—albeit not without problems.³⁶⁷ These exemptions allow breweries to develop brand value, making brands more attractive to distributors.³⁶⁸ However, these exemptions present a new problem: when a craft brewery no longer qualifies for the exemption,³⁶⁹ the brewery must choose between pursuing growth and limiting production to continue self-distribution and direct-sale.³⁷⁰ If the brewery continues to grow and surpasses the exemption limit, then the brewery can no longer self-distribute or directly sell. If a brewery values self-distribution and direct-sale more than it does growth or does not have a network developed, then the brewery must halt its production and limit its growth.³⁷¹ This dilemma must be carefully considered by state legislatures or agencies determining the appropriate cut-off point.

The Model Law is drafted to mitigate this issue. A grace period remedies the problem a brewery faces when forced to halt growth to develop a distribution network.³⁷² Under a statute including a grace period, once the brewery crosses the exemption limitation, it has a certain amount of time to end its self-distribution and direct selling, and to establish franchise agreements with distributors. This window is necessary to allow a

364. See Chen, *supra* note 10, at 541–42.

365. See, e.g., 235 ILL. COMP. STAT. 5/5-1(a) (2014).

366. See, e.g., ME. STAT. tit. 28-A, § 1355-A(2)(D) (2014).

367. DEL. CODE ANN. tit. 4, §§ 512B(a), 512C(a).

368. See Tamayo, *supra* note 8, at 2232–35. A brewery is able to build brand value by building a customer base. See *id.*

369. For example, a brewery reaches the exemption limit once it reaches the production point (or whatever measure the state law uses) set by the state agency.

370. See Scott, *supra* note 62, at 428 (discussing the difficulties of small breweries slightly over exemption limit).

371. Or, a brewery might be forced to rush franchise negotiations with distributors, resulting in unfavorable terms.

372. See *infra* Model Law § G.

brewery time to react to sudden business changes—changes likely in a quickly growing and volatile craft beer market.³⁷³ A brewery may experience rapid growth,³⁷⁴ or it may be faced with unexpected closure.³⁷⁵ The amount of time needed to develop a distribution network is unpredictable.³⁷⁶ Forcing a brewery to invest in developing a distribution network too early could hamper its development.³⁷⁷ The grace period alleviates breweries' concerns about rushing distribution network establishment.

These proposals are supported by empirical data. States with self-distribution exemptions for smaller breweries have experienced a statistically significant increase in the number of craft breweries per capita and an increase in production.³⁷⁸ These changes have improved the market in many states that have implemented them.³⁷⁹ Exemptions help to promote variety and competition in the market.³⁸⁰

The Model Law provides the following self-distribution and direct-sale exemptions:

F. Self-Distribution and Direct-Sale Exemptions:

Any brewery meeting the qualifications specified by the

373. See Thierry Godard, *The Economics of Craft Beer*, SMARTASSET (Aug. 12, 2015), <https://smartasset.com/insights/the-economics-of-craft-beer>.

374. See Daniel Fromson, *Idea of the Week: Mapping the Rise of Craft Beer*, NEW YORKER (June 6, 2013), <http://www.newyorker.com/news/news-desk/idea-of-the-week-mapping-the-rise-of-craft-beer> (identifying two breweries—Blackstone Brewery and Karbach Brewing—that grew by over 1,100% between 2011 and 2012).

375. See Bart Watson, *Closings Signal Competition, Not Problems*, BREWERS ASS'N (Sep. 25, 2014), <https://www.brewersassociation.org/insights/closings-signal-competition-not-problems>.

376. See Godard, *supra* note 373 (quoting one brewer who warned that although distributors are interested in selling craft beer, “there are too many craft breweries for the distribution channel to handle effectively,” and that breweries are subjected to the “question of whether [distributors] have room in their portfolio”).

377. See Candice Moon, *Top 10 Legal Mistakes Made by Craft Breweries*, CRAFT BREWING BUS. (Sep. 9, 2014), <http://www.craftbrewingbusiness.com/business-marketing/top-10-legal-mistakes-made-craft-breweries>.

378. See generally MISS. BREWERS GUILD PROJECT, LEGISLATION REVIEW, BENCHMARKING, AND ECONOMIC IMPACT STUDY (2014); see also *Dr. Statelaws*, *supra* note 157 (explaining that states with self-distribution have 1.41 craft breweries per 100,000 people over the age of 21, while states without have .77).

379. See, e.g., *id.* at 13.

380. See *Dr. Statelaws*, *supra* note 157.

Alcohol Board may act as a distributor and/or directly sell beer of its own production to consumers.³⁸¹

G. Grace Period: When a brewery no longer meets the qualification, the brewery is entitled to a grace period, to either requalify or end its self-distribution and direct-sale. The Alcohol Board shall formulate the grace period.

H. Agency Authority:

(2) The Alcohol Board shall formulate the qualifications for the self-distribution and direct-sale exemptions set out in section F. The Alcohol Board shall also formulate the grace period set out in section G.³⁸²

These provisions exempt any small brewery that meets the qualifications propounded by the state alcohol agency. Once a brewery outgrows these qualifications, it receives a grace period to develop a distribution network or slow its production and maintain the right to self-distribute and directly sell to consumers. The specific qualifications are determined by the state agency focusing on alcohol regulation, as prescribed in the Model Law.³⁸³

The qualifications for the exemption should focus on the point when breweries are able to build enough brand value where distribution presents a normal amount of risk for the distributor.³⁸⁴ The qualification could likely be established with data collected through an economic survey. The factors might include what the market considers an acceptable risk and return, coupled with historical data on when craft breweries have

381. Similar provisions can be found in section 04.11.130(b)(2) of the Alaska Statutes (allowing all breweries to self-distribute) and in chapter 235, section 5/5-1(a) of the Illinois Compiled Statutes (allowing breweries producing up to 930,000 gallons annually to self-distribute).

382. Similar language in an existing statute used for a different purpose can be found in section 25750(a) of the California Business and Professions Code.

383. See *infra* Model Law § H(2).

384. As a result, the exemption qualification for self-distribution, direct-sale and the beer franchise laws would not necessarily be the same amount. There may be a point where a brewery has built enough brand value to attract distributors, but has not yet developed enough economic strength to effectively bargain with distributors.

typically succeeded in forming franchise agreements. The latter factor might look at the number of customers and the amount of advertising the brand has received. In addition, determining the length of the grace period would likely involve analyzing the average time it takes to convert from self-distribution and direct-sale to establishing a distribution network through independent distributors.

It might be argued that instead of exemptions, craft breweries should merely have their own regulatory regime under which they apply for a separate license. However, these exemptions constitute a small portion of the overall beer regulations. An entirely new system just for small breweries would be duplicative and would lead to interpretative confusion. Non-lawyer brewers are the audience for these statutes—individuals often without the resources to hire an attorney.³⁸⁵ A debate over intended and unintended differences between the statutes would create confusion about the interpretation of the statutes. Using the exemption system reduces duplication of laws and the potential for confusion.

The direct-sale and self-distribution exemptions benefit breweries, distributors, and consumers. Breweries that lack the size and value to contract successfully with distributors have an alternative method of distribution. The exemptions also benefit distributors because the exemptions allow breweries to build and prove their brand's value, minimizing the risk posed to distributors by outlaying resources on fledgling breweries of uncertain value. Consumers benefit because they have access to a greater variety of beer at lower prices. The Model Law's exemptions promote variety and competition in the market.

CONCLUSION

Current regulations stifle competition and reduce variety in the beer market. The three-tier system should be retained to prevent abuses by large breweries. However, because craft breweries' brands often lack value, state laws should provide self-distribution and direct-sale exemptions for craft breweries. At the same time, state laws should also provide craft breweries with

385. See Moon, *supra* note 377 (discussing the need for counsel to assist breweries navigate their legal environments).

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exemptions from the statutorily mandated protections to balance the bargaining relationship. There is a growing need for these changes to benefit both breweries and distributors, but the changes require both sides to come to the table and compromise. As the president of the Brewers Association recently remarked, “[t]here’s beer at the table. Why aren’t we both sitting around that table?”³⁸⁶

386. Charlie Papazian, *Beer Franchise Law Reform*, BREWERS ASS’N (May 28, 2014), <https://www.brewersassociation.org/news/beer-franchise-law-reform>.

APPENDIX: THE MODEL LAW

A. **Three-Tier System:** Malt or brewed beverages are distributed through a three-tier system. The tiers are enforced through a licensing system:

(1) A brewery's license allows for the production and manufacture of malt or brewed beverages. The holder of a brewery's license may only sell to holders of a distributor's license, except as otherwise stated in this statute.

(2) A distributor's license allows for the sale or delivery to retailers of malt and brewed beverages that the distributor purchased from holders of a brewery's license.

(3) A retail license allows for direct sales to consumers.

B. **Prohibition of Financial Interest:**

(1) No brewery may have a direct or indirect financial interest in a distributor or a retailer, except as otherwise provided in this statute.

(2) No distributor of brewed or malt beverages may have a direct or indirect financial interest in a brewery or retailer, except as otherwise provided in this statute.

(3) No retailers of brewed or malt beverages may have a direct or indirect financial interest in a brewery or retailer, except as otherwise provided in this statute.

C. **Prohibition on Undue Influence and Coercion:** A brewery is prohibited from the following:

(1) Coercing, or attempting to coerce, any distributors to accept delivery of beer not ordered or that was properly cancelled.

(2) Coercing, or attempting to coerce, any distributor to perform an illegal act by threatening to amend,

cancel, terminate, or refuse to renew a franchise agreement.

(3) Coercing, or attempting to coerce, a distributor to limit its right to sell competing brands of beer unless sale would materially impair the quality of service.

D. Termination Mandate:

(1) An independently-owned brewery that produces less than [amount] barrels of beer and whose sales constitute [amount] percent or less of the distributor's total annual brand sales may terminate or not renew any agreement with a distributor with or without having good cause for such termination or nonrenewal. In all other circumstances, a brewery may terminate only with good cause as contractually defined between the parties.

(2) Any brewery meeting the good-cause exemption in subsection (1) is not subject to liability provided that the brewery provides [amount] days' notice and prior to the termination, pays the distributor the fair market value of the distribution rights that will be lost or diminished by the termination.

(3) Disputes are subject to arbitration.

E. Territorial Protection: A brewery shall grant each of its distributors an exclusive sales territory. This subsection does not apply to an independently-owned brewery that sells less than [amount] barrels of beer or malted beverages annually.

F. Self-Distribution and Direct-Sale Exemptions: Any brewery meeting the qualifications specified by the Alcohol Board may act as a distributor and/or directly sell beer of its own production to consumers.

G. Grace Period: When a brewery no longer meets the qualification, the brewery is entitled to a grace period, to either requalify or end its self-distribution and direct-sale. The Alcohol Board shall formulate the grace period.

H. Agency Authority:

(1) The Alcohol Board shall formulate the qualifications for exemptions from the termination and territorial protections as set out in sections D and E.

(2) The Alcohol Board shall formulate the qualifications for the self-distribution and direct-sale exemptions set out in section F. The Alcohol Board shall also formulate the grace period set out in section G.