University of the Pacific Law Review

Volume 52 | Issue 4 Article 10

1-10-2021

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I. INTRODUCTION

Both the federal government and the various state governments regulate the sale and distribution of alcohol in the United States. From a macro perspective, alcohol laws can be grouped into three distinct periods: before Prohibition, during Prohibition, and after Prohibition. Prohibition was created by the Eighteenth Amendment, which was ratified on January 16, 1919, and prohibited "the manufacture, sale, or transportation of intoxicating liquors within, the

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importation thereof into, or the exportation thereof from the United States and all territory subject to the jurisdiction thereof for beverage purposes."[1] Prohibition ended on December 5, 1933, with the ratification of the Twenty-first Amendment (which repealed the Eighteenth Amendment).[2]

This Article focuses on the period after Prohibition. Obviously, much has changed in the U.S. alcohol market since Prohibition ended. The author believes that the way alcohol is currently regulated in the U.S. does not reflect the current realities of the modern-day alcohol market. Moreover, the author generally disapproves of regulating alcohol differently than non-alcoholic articles of commerce and strongly disapproves of not treating all alcohol suppliers the same under the law—be they suppliers of different types of alcohol (e.g., winery v. brewery) or of the same type (e.g., large brewery v. small brewery). The author maintains that disparate treatment of both alcohol and alcohol suppliers is outdated, unwarranted, potentially unconstitutional, and certainly bad public policy.

This Article explores modern alcohol regulation in the U.S., maintains it is well past time to amend our nation's antiquated alcohol laws, and proposes a number of changes the author believes will benefit those who sell alcohol and those who purchase alcohol. More specifically, this Article focuses on how beer distribution is regulated in the U.S. Part I of this Article provides an overview of the laws regulating the distribution of beer in the U.S., with a specific focus on two common types of state laws: laws mandating a Three-Tier System ("TTS") and Beer Franchise Laws ("BFLs"). Part II addresses problems with these two types of state laws from both a legal perspective and from a public policy perspective, ultimately arguing that though pursuing their interests via the courts is a potential strategy for breweries, pursuing their interests via state legislatures is much more promising because TTS laws and BFLs are simply bad public policies. The author takes no issue with regulating alcohol differently than regulating non-alcohol products when such regulation is rationally related to a legitimate state interest (e.g., minimum drinking age laws that are rationally related to public health, safety, and welfare) but firmly objects when disparate treatment of alcohol is simply a manifestation of rent seeking. The author believes TTS laws and BFLs are precisely that: rent-seeking laws benefitting beer wholesalers at the expense of beer suppliers, retailers, and consumers. Part III recommends certain state legislative reforms.

II. MODERN REGULATION OF ALCOHOL DISTRIBUTION IN THE U.S.

In the United States, the federal government and the various state governments regulate the alcohol industry. That said, outside of a few areas over

1. U.S. CONST. amend. XVIII, § 1.
2. U.S. CONST. amend. XXI, § 1.

which the federal government has powers,[3] alcohol regulation predominantly resides with the states.[4] With the passage of the Twenty-first Amendment, which ended Prohibition, states were left to craft alcohol laws as they saw fit.[5] As such, how alcohol is distributed in the U.S. varies nationwide.[6] This Article explores two types of state beer laws common in the U.S.: TTS laws and BFLs.

A. The Three-Tier System

The vast majority of states follow what is known as the "Three-Tier System," which, as the name suggests, designates three tiers within the chain of alcohol

3. For example, the federal government has mandated a minimum drinking age of 21. *See* 1984 National Minimum Drinking Age Act, 23 U.S.C. § 158 (2021).

4. "The police powers of the Federal government are limited to regulating matters which are connected with one of the powers expressly granted to the government by the U.S. Constitution, and which do not infringe on the police powers of the states. This means that the Federal government lacks the power to regulate liquor sales by one citizen to another within the territorial limits of a given state, or to prescribe liquor-related business within any state. Because of the commerce clause, however, the Federal government can and does regulate the importation and interstate transportation of intoxicating liquors; *see* the Federal Alcohol Administration Act of 1935, 27 U.S.C. §§ 201 *et seq.* The federal government also has the power to regulate liquor sales in D.C., and where it has exclusive authority such as on government owned military reservations, and with Indian tribes. In all other situations, the states' police power controls alcoholic beverage law. The federal government has, however, used financial incentives built into its funding of highways to establish a national minimum drinking age. *See* 23 U.S.C. § 158." *Alcohol*, CORNELL L. SCH., LEGAL INFO. INST., https://www.law.cornell.edu/wex/alcohol (last visited Apr. 16, 2021) (on file with the *University of the Pacific Law Review*); *see* Granholm v. Heald, 544 U.S. 460, 488 (2005) ("The Twenty-first Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system.") (citing Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980).

5. *E.g.*, MINN. STAT. ch. 340A (2020).

6. "The U.S. Alcoholic beverage industry is very complex and highly regulated, and the laws currently in place find their roots in the time of prohibition and its repeal. Prohibition (18th Amendment to the US Constitution) was repealed through ratification of the 21st Amendment to the US Constitution in 1933 and the FAA (Federal Alcohol Administration) Act in 1935. Before Prohibition, producers of spirits and beer served small geographic areas and frequently owned the retail outlets. The government was concerned with these 'tied house' practices; by virtue of having a partial or total ownership of retailers, suppliers coerced retailers to favor their brands. Consequently, the three tier system framework was adopted, including banning unfair inducements to retailers. The Federal government was granted authority to license importers, manufacturers, wholesalers, and warehouses (not retailers). The FET (Federal excise tax) was established and Consumer deception laws (false advertising banned) and standards/ requirements for labels and formula approval were developed. Federal regulations are administered by TTB (Alcohol and Tobacco Tax and Trade Bureau) and the FDA (Food and Drug Administration). Within the designed framework the States were given power to regulate sale and distribution of alcohol within their state. Each state adopted different rules and regulations that de facto resulted in 50 different regulatory frameworks for alcoholic beverage companies. Most states have liquor control boards that regulate the alcoholic beverage industry in their state. They require out of state entities (shipper) to maintain certain state-specific licenses and/or permits in order to sell products in the state. In some states, regulations can extend down to the municipality-level. Given that spirits, wine and beer are not regulated equally and have very different rules and regulations, it is fair to say that the US has over 200 different regulatory frameworks for alcoholic beverage companies to comply with." *Alcoholic Beverage Industry: Three-Tier System*, PARK STREET, https://www.parkstreet.com/wine-spirits-industry-background/ (last visited Apr. 15, 2021) (on file with the *University of the Pacific Law Review*).

distribution: producers,[7] distributors,[8] and retailers.[9] To be a member of one of the tiers, a business must be licensed by its respective state. Under the TTS, licensed producers may sell only to licensed distributors, who, in turn, sell only to licensed retailers. No business may be licensed in more than one tier or have any financial interest/stake in a tier other than its own.[10]

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7. The author also uses the word *suppliers* to mean *producers*.

8. The author also uses the word *wholesalers* to mean *distributors*.

9. "After Prohibition ended in 1933, states were in need of a better system to regulate the manufacture and distribution of alcohol. They needed a way to discourage large breweries from monopolizing the industry, and to ensure that products were being made and transported safely. In Minnesota, like many others, the result was the establishment of three different tiers of alcohol-related businesses—manufacturers, distributors, and retailers—each with their own set of privileges and responsibilities . . . . The three-tier system was created in hopes of more effectively regulating alcohol sales than the disastrous Prohibition laws that preceded them. The system obligates manufacturers to utilize a licensed wholesaler to distribute their products to retailers, save and except for limited rights of self-distribution granted to small breweries and farm wineries." *The Great Debate: The Three-Tier System Is Fundamentally Broken*, THE GROWLER (Jan. 27, 2020), https://www.growlermag.com/the-great-debate-the-three-tier-system-is-fundamentally-broken/ (on file with the *University of the Pacific Law Review*). "What is the 'three-tier system'? In its purest form, the three-tier system is a market regulation concept whereby each 'tier' of alcohol manufacture, wholesale (distribution), and retail must remain completely separate from the others. That is, a manufacturer cannot have an ownership or business interest in a distributor or a retailer and all the vice versas you can imagine. As the California Supreme Court put it, '[m]anufacturing interests were to be separated from wholesale interests, wholesale interests were to be segregated from retail interests. In short, business endeavors engaged in the production, handling, and final sale of alcoholic beverages were to be kept distinct and apart.' *California Beer Wholesalers Assn., Inc. v. Alcoholic Beverage Control App. Bd.*, 5 Cal. 3d 402, 407 (1971). Most states have some version of these regulations to keep each tier independent of the others, mainly for the purpose of prohibiting tied houses and the anti-competitive results and temperance issues they raise. There are many variations on this theme among the states, since the Twenty-First Amendment gave the states the power to create their own regulatory schemes." Daniel Croxall, *Let's Make Sure We Are Talking About the Same Things: Tied-House Laws and the Three-Tier System*, CRAFT BEER L. PROF (Feb. 6, 2017), https://www.craftbeerprofessor.com/2017/02/lets-make-sure-talking-things-tied-house-laws-three-tier-system/ (on file with the *University of the Pacific Law Review*). "This is how we get our booze in America—it's the process through which most alcoholic drinks are taxed and sold in the United States. It ultimately boils down to this: with some exceptions, all beer, wine, and spirits must be sold by their supplier (say, a brewery or winery or an importer of booze) to a wholesaler (AKA a distributor), who sells those beverages to a retailer (like a bar, restaurant, or bottle shop), who then sells them to you (hi there). Those are the namesake three tiers to keep track of: (1) supplier, (2) wholesaler, (3) retailer." Mike Reis, *Beer Issues: What's up with the Three-Tier System?*, SERIOUS EATS (Aug. 9, 2018), https://drinks.seriouseats.com/2014/01/craft-beer-three-tier-system-pros-cons-distributor-retailer-debate.html (on file with the *University of the Pacific Law Review*).

10. "Under the three-tier system, manufacturers (Tier 1) sell to licensed importers, distributors and control boards. Brand owners could be manufacturers or entities that contracted with a manufacturer. Federal Excise Taxes are collected when goods leave the premises of the manufacturer or the bonded facilities of an importer. Licensed importers and distributors (Tier 2) act in cooperation with the federal and state governments; they help ensure that alcohol beverage taxes are reliably collected. Importers, distributors and control boards are only allowed to sell to licensed retailers. Licensed outlets like liquor stores, bars or restaurants (Tier 3) ensure that alcohol is sold to those who are of legal age to purchase it. Acting like a safety net, the three-tier regulatory system provides for 'checks and balances' in the way that alcohol is distributed and sold throughout the system, from one licensed tier to another. If alcohol is sold outside of the three-tier system, the government loses revenue from alcohol beverage taxes. No individual or entity except the state regulator itself is allowed to own and operate more than one tier of the system (tied house rules)." *Alcoholic Beverage Industry: Three-Tier System*, *supra* note 6. *See, e.g.*, *Minnesota's Three-Tier System of Liquor Regulation*, MINN. HOUSE REPRESENTATIVES RES. DEP'T (Mar. 2015), https://www.house.leg.state.mn.us/hrd/pubs/ss/ss3tier.pdf (on file

Separating retailers from other tiers was a response to the desire of lawmakers, at the time Prohibition ended, to end the presence of "tied houses"[11] and vertical integration (and, thus, the prospect of monopolies) by brewers and to advance the cause of temperance.[12] Tied houses, which were common in the U.S. before Prohibition,[13] were drinking establishments that sold a certain alcohol producer's drinks exclusively, in exchange for the financial incentives offered by the producer to the establishment.

This Article discusses the TTS generally and two specific aspects of the TTS: limits on self-distribution by breweries and prohibitions of direct-to-consumer ("DTC") shipments of beer.

Self-Distribution. A number of states, including even those employing the TTS, give breweries the option to self-distribute up to a certain production point. For example, in Texas, "independent brewers that produce less than 225,000 barrels annually may sell product for on-premises consumption, up to 5,000

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11. "In simple terms, a tied-house is any retail outlet that is beholden to a particular alcohol manufacturer for any reason. The concept can be illustrated by traditional pubs or saloons prior to Prohibition. Large alcohol manufacturers would provide such retailers with low-interest loans, free draft systems, and even direct payments in exchange for favorable or monopolistic treatment from that retailer. In some cases, a manufacturer might own every retail outlet in town, which outlets would then sell only that manufacturer's product. So the result of tied houses is a decrease in competition and consumer choice, while providing retailers with every incentive to oversell alcoholic beverages (particularly those made by the retailer's benefactor). After Congress repealed Prohibition in 1933 through the Twenty-First Amendment, every state in the union enacted some version of laws designed to prohibit and minimize tied-houses." Croxall, *supra* note 9.

12. *See* Cal. Beer Wholesalers Ass'n v. Alcoholic Beverage Control Appeals Bd., 5 Cal. 3d 402, 407–09 (1971) ("Following repeal of the Eighteenth Amendment, the vast majority of states, including California, enacted alcoholic beverage control laws. These statutes sought to forestall the generation of such evils and excesses as intemperance and disorderly marketing conditions that had plagued the public and the alcoholic beverage industry prior to prohibition. By enacting prohibitions against 'tied-house' arrangements, state legislatures aimed to prevent two particular dangers: the ability and potentiality of large firms to dominate local markets through vertical and horizontal integration and the excessive sales of alcoholic beverages produced by the overly aggressive marketing techniques of larger alcoholic beverage concerns. The principal method utilized by state legislatures to avoid these antisocial developments was the establishment of a triple-tiered distribution and licensing scheme. Manufacturing interests were to be separated from wholesale interests; wholesale interests were to be segregated from retail interests. In short, business endeavors engaged in the production, handling, and final sale of alcoholic beverages were to be kept 'distinct and apart.' . . . In Harris v. Alcoholic Beverage, etc., Appeals Board (1964) 61 Cal.2d 305, 38 Cal.Rptr. 409, 392 P.2d 1, we noted that the California Legislature had 'inferentially declared that the public policy is best served if all persons engaged in the handling of alcoholic beverages, whether manufacturing, wholesaling, importing or retailing be kept distinct and apart . . . . Among the purposes of such prohibitions is the prevention of integration of wholesale and retail outlets, and the imposition of quotas on retailers.'") (internal citations omitted).

13. "Following the Civil War, the Court considered a steady stream of alcohol-regulation cases. The postwar period saw a great proliferation of saloons, and myriad social problems were attributed to this development." Tenn. Wine & Spirits Retailers Ass'n v. Thomas, 139 S. Ct. 2449, 2463 (2019). "By 1872, about 100,000 had sprung up across the country, and by the end of the century, that number had climbed to almost 300,000. This increase has been linked to the introduction of the English 'tied-house' system. Under the tied-house system, an alcohol producer, usually a brewer, would set up saloonkeepers, providing them with premises and equipment, and the saloonkeepers, in exchange, agreed to sell only that producer's products and to meet set sales requirements. To meet those requirements, saloonkeepers often encouraged irresponsible drinking. The three-tiered distribution model was adopted by States at least in large part to preclude this system." *Id.* at 2463 n.7 (internal citations omitted).

barrels annually. Brewers that produce less than 125,000 barrels annually may self- distribute up to 40,000 barrels annually."[14]

DTC Shipments. Of those states that allow alcohol producers to ship alcohol directly to consumers, most of them limit such rights to wineries,[15] meaning only a minority of states allow breweries to ship beer directly to consumers.[16]

B. Beer Franchise Laws

Another major component of state alcohol laws are those that govern the relationship between an alcohol producer and an alcohol wholesaler with which it enters into a distribution agreement. In most states, once a producer (or importer) engages a wholesaler, then that wholesaler enjoys exclusivity with respect to its

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14. *The Beer Alliance of Texas Supports Our State's Long-Standing Three-Tier System*, BEER ALLIANCE TEX., http://www.beeralliance.com/legislation.php (last visited Apr. 16, 2021) (on file with the *University of the Pacific Law Review*). *See* TEX. ALCO. BEV. CODE ANN. §§ 57, 62A.02 (West 2021). *See generally* Press Release, *Governor Abbott Signs Legislation Allowing Beer-To-Go Sales in Texas*, OFF. TEX. GOVERNOR, (June 15, 2019), https://gov.texas.gov/news/post/governor-abbott-signs-legislation-allowing-beer-to-go-sales-in-texas (on file with the *University of the Pacific Law Review*).

15. "Currently 45 states allow wineries to receive and fulfill orders directly from their residents." Delaney McDonald, *Can I Ship Beer Directly to Consumers? An Overview of DtC Shipping for Breweries*, SOVOS (Dec. 9, 2020), https://sovos.com/blog/2020/12/09/can-i-ship-beer-directly-to-consumers-an-overview-of-dtc-shipping-for-breweries/ (on file with the *University of the Pacific Law Review*).

16. For a state-by-state list of DTC laws, *see Beer Direct-to-Consumer Shipping Rules*, SOVOS, https://www.sovos.com/shipcompliant/resources/dtc-beer-shipping-compliance-rules-by-state/ (last visited Apr. 16, 2021). "Though most states permit wineries to ship directly to consumers (DTC), few states allow breweries, distilleries, and retailers to make DTC shipments . . . . As of August 2020, 10 states and Washington, D.C. permit breweries to ship DTC: Alaska (allowed by state law but prohibited in many dry communities); Kentucky (licenses available pending finalization of rules/regulations); Nebraska; Nevada; New Hampshire; North Dakota; Ohio; Oregon; Vermont; Virginia; Washington, D.C." Gail Cole, *States Where Breweries, Distilleries, Retailers, and Wineries Can Ship DTC*, AVALARA (Aug. 4, 2020), https://www.avalara.com/blog/en/north-america/2020/08/states-where-breweries-distilleries-retailers-and-wineries-can-ship-dtc.html (on file with the *University of the Pacific Law Review*). "The majority of states have statutory provisions that allow for out-of-state manufacturers to ship alcoholic beverages directly to consumers. The majority of states restrict the direct shipments to wine. Out of the 54 states, territories and commonwealths, Alabama specifically prohibits the direct shipment of alcoholic beverages to consumers. Guam, Puerto Rico and the U.S. Virgin Islands do not have statutes that specify that direct shipments are allowed. Arkansas requires that a consumer must be present at the time of purchase unless shipping from a small farm winery licensee. Delaware requires that shipments must be delivered to a wholesaler, then delivered to consumer by a retail license. Mississippi provides that a consumer may purchase at winery and have the shipment sent to in-state package retailer. Rhode Island requires that the consumer must be present at purchase to ship the alcohol to the consumer. Utah authorizes consumers to purchase wine through a wine subscription program, but the shipments must be delivered to a state store or package agency. Six states—Florida, Hawaii, Kentucky, Nebraska, New Hampshire and Rhode Island—and the District of Columbia authorize the direct shipment of all spirits as specified. Eight states allow the direct shipment of beer and wine as specified: Delaware, Massachusetts, Montana, North Dakota, Ohio, Oregon, Vermont and Virginia. Connecticut and New Jersey allow shipments of wine, cider and mead. New Mexico authorizes the shipment of wine and cider, while Oregon allows the shipment of beer, wine and cider. The remaining states only allow direct wine shipments." Heather Morton, *Direct Shipment of Alcohol State Statutes*, NCSL (July 22, 2020), https://www.ncsl.org/research/financial-services-and-commerce/direct-shipment-of-alcohol-state-statutes.aspx (on file with the *University of the Pacific Law Review*).

geographic region, and it is extremely difficult for the producer to end the relationship, absent "good cause." Such laws are known as "Beer Franchise Laws."[17]

If a producer wishes to end the relationship, the burden is on said producer to prove "good cause."[18] Moreover, notice is normally required to be given by the producer to the wholesaler, which then has the opportunity to cure/remedy the defect and, thus, avoid termination of the agreement.[19] For limited reasons, a producer might have the ability to terminate for good cause without advance notice.[20] Effectively, producers are typically locked into exclusive distribution

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17. For an excellent compilation of state-by-state Beer Franchise Law information, *see generally* Marc E. Sorini, *Beer Franchise Law Summary*, BREWERS ASS'N, https://www.brewersassociation.org/wp-content/uploads/2015/06/Beer-Franchise-Law-Summary.pdf (last visited Apr. 16, 2021) (on file with the *University of the Pacific Law Review*). As an example of a state Beer Franchise Law, *see, e.g.*, N.C. GEN. STAT. ANN. § 18B-1300 to -1309 (West 2020).

18. "Meaning of Good Cause. – Good cause for altering or terminating a franchise agreement, or failing to renew or causing a wholesaler to resign from such an agreement, exists when the wholesaler fails to comply with provisions of the agreement which are reasonable, material, not unconscionable, and which are not discriminatory when compared with the provisions imposed, by their terms or in the manner of enforcement, on other similarly situated wholesaler by the supplier. The meaning of good cause set out in this section may not be modified or superseded by provisions in a written franchise agreement prepared by a supplier if those provisions purport to define good cause in a manner different than specified in this section. In any dispute over alteration, termination, failure to renew or causing a wholesaler to resign from a franchise agreement, the burden is on the supplier to establish that good cause exists for the action." N.C. GEN. STAT. ANN. § 18B-1305(a) (West 2020). "Absence of Good Cause. – Good cause for alteration, termination or failure to renew a franchise agreement does not include: (1) The failure or refusal of the wholesaler to engage in any trade practice, conduct or activity which would violate federal or State law. (2) The failure or refusal of the wholesaler to take any action which would be contrary to the provisions of this Article. (3) A change in the ownership of the supplier or the acquisition by another supplier of the brewery, brand or trade name or trademark, or acquisition of the right to distribute a product, from the original supplier. (4) Sale or transfer of the rights to manufacture, distribute, or use the trade name of the brand to a successor supplier. (5) Failure of the wholesaler to meet standards of operation or performance that have been imposed or revised unilaterally by the supplier without a fair opportunity for the individual wholesaler to bargain as to the terms, unless the supplier has implemented the standards on a national basis and those standards are consistently applied to all similarly situated North Carolina wholesalers in a nondiscriminatory manner. (6) The establishment of a franchise agreement between a wholesaler and another supplier, or similar acquisition by a wholesaler of the right to distribute a brand of another supplier. (7) The desire of a supplier to consolidate its franchises." *Id.* at § 1305(d).

19. "Notice of Cause. – At least 90 days before altering, terminating or failing to renew a franchise agreement for good cause, the supplier must give the wholesaler written notice of the intended action and the specific reasons for it. If the cause for the alteration, termination or failure to renew is subject to correction by the wholesaler, and the wholesaler makes such correction within 45 days of receipt of the notice, the notice shall be void." *Id.* at § 1305(b).

20. "Termination for Cause without Advance Notice. – A supplier may terminate or fail to renew a franchise agreement for any of the following reasons, and the termination shall be complete upon receipt by the wholesaler of a written notice of the termination and the reason: (1) Insolvency of the wholesaler, the dissolution or liquidation of the wholesaler, or the filing of any petition by or against the wholesaler under any bankruptcy or receivership law which materially affects the wholesaler's ability to remain in business. (2) Revocation of the wholesaler's State or federal permit or license for more than 30 days. (3) Conviction of the wholesaler, or of a partner or individual who owns ten percent (10%) or more of the partnership or stock of the wholesaler, of a felony which might reasonably be expected to adversely affect the goodwill or interest of the wholesaler or supplier. The provisions of this subdivision shall not apply, however, if the wholesaler or its existing partners or stockholders shall have the NC General Statutes - Chapter 18B Article 13 5 right to purchase the interest of the offending partner or stockholder, and such purchase is completed within 30 days of

agreements in perpetuity, unless they pay the wholesaler fair market value of the distribution rights. The rules contained in BFLs may not be altered or waived by the parties' agreement. In other words, BFLs supersede the parties' agreement.[21]

Marc E. Sorini, General Counsel of the Brewers Association, summarizes BFLs as follows:

> A full-fledged beer franchise law will usually:
>
> 1. Define franchise agreements to include informal, oral arrangements, making any shipment to a wholesaler the start of a franchise relationship.
>
> 2. Prohibit coercive brewer practices, most often including actions in which a brewer (a) requires the wholesaler to engage in illegal acts, (b) forces acceptance of unordered beer, or (c) withholds shipments in order to impose terms on the wholesaler.
>
> 3. Require "good cause" or "just cause" before a brewer can terminate a wholesaler.
> - The burden is generally on the brewer to demonstrate cause for termination.
> - "Good cause" is usually defined to include a significant breach of a "reasonable" and "material" term in the parties' agreement.
>
> 4. Dictate that a brewer give prior written notice (60 or 90 days is common) to a wholesaler before termination is effective, with the notice detailing the alleged deficiencies that justify termination.
>
> 5. Grant wholesalers an opportunity to cure the deficiencies alleged in a termination notice, with termination ineffective if a wholesaler cures the defect(s) or presents a plan to cure the defect(s).
> - "Notice-and-cure" requirements usually are waived under certain circumstances. These most often include a wholesaler's (a) insolvency, (b) conviction or guilty plea to a serious crime, or (c)

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the conviction. (4) Fraudulent conduct by the wholesaler in its dealings with the supplier or its products. (5) Failure of the wholesaler to pay for the supplier's products according to the established terms of the supplier. (6) Assignment, sale or transfer of the wholesaler's business or control of the wholesaler without the written consent of the supplier, except as provided in G.S. 18B-1307." *Id.* at § 1305(c).

21. "The provisions of this Article shall be part of all franchise agreements as defined in G.S. 18B-1302 and may not be altered by the parties. A wholesaler's rights under this Article may not be waived or superseded by the provisions of a written franchise agreement prepared by a supplier that are in any way inconsistent with or contrary to any part of this Article. The rights of a wholesaler under this Article shall remain in effect regardless of a provision in a written franchise agreement prepared by a supplier that purports to require arbitration of a franchise dispute or that purports to require legal remedies to be sought in a different jurisdiction." N.C. GEN. STAT. ANN. § 18B-1308 (West 2020).

loss of a license to do business. Many franchise laws also permit expedited termination where a wholesaler (d) has acted fraudulently or (e) has defaulted on a payment under the agreement despite a written demand for payment.

6. Require wholesalers to provide brewers with notice of any proposed change in ownership of the wholesaler, giving the brewer an opportunity to object. The brewer's approval of an ownership change cannot be "unreasonably" withheld.

- Brewers usually have little or no right to block a transfer to a previously designated family successor.

7. Create remedies for unfair termination, generally granting wholesalers the right to receive "reasonable compensation" following termination.

- Most beer franchise laws grant wholesalers the right to seek an injunction that, if granted, would quickly halt termination proceedings pending the resolution of wrongful termination claims. The forum for such relief can be either a state court or the state's alcohol control authorities.
- Although arbitration of the entire dispute is not required, and sometimes prohibited, disputes over what constitutes "reasonable compensation" often must be arbitrated at the request of a party.
- Even if the franchise law prohibits arbitration, an arbitration clause in the parties' written agreement is likely enforceable under the Federal Arbitration Act if the parties reside in different jurisdictions.

8. Declare any waiver of franchise law protections void and unenforceable.

9. Set a date that the law becomes effective. Some franchise agreements may predate franchise acts' effective dates, likely making the franchise law inapplicable to that agreement.

In addition to the extremely common provisions described above, other terms may:

10. Require beer franchise agreements to be in writing.

11. Mandate that sales territories be exclusive.

- Wholesalers may face substantial penalties for making deliveries outside their designated territory, and such conduct may permit expedited termination by the brewer.
- Territorial designations may need to be filed with state liquor

control authorities.

12. Restrict a brewer's ability to dictate prices, with restrictions that often go beyond the strictures of antitrust law. Common provisions prohibit brewer price fixing, require brewers to file and adhere to periodic price schedules, and ban price discrimination between wholesalers within the state.

13. Provide that the prevailing party in a termination dispute will be compensated for its attorneys fees.

14. Bind succeeding brand owners to existing franchise agreements, although some permit not-for-cause termination after a change in brand ownership, as long as compensation is paid.

15. Impose a good faith obligation on both parties. Under modern contract law, this good faith obligation is already implied in all contractual relations.

16. Impose specific obligations on wholesalers, occasionally specified to include a duty to properly rotate stock, maintain tap lines, and comply with other reasonable quality control instructions.

Most states have enacted at least a few laws that regulate brewer-wholesaler relations. In some, beer wholesalers are covered by a franchise law protecting all alcohol beverage wholesalers. In a few states, beer wholesalers are protected by franchise laws that apply to a variety of franchise relationships, from beer to burgers. Still others partially regulate beer franchise relationships through their alcohol control laws by, for example, requiring exclusive territories as a condition for licensing. Finally, a few states and the District of Columbia have, to date, left brewer-wholesaler relations essentially unregulated, thereby allowing the franchise relationship to be governed exclusively by the terms of the parties' agreement, to be enforced under general contract law principles.[22]

This Article examines legal and policy issues surrounding the TTS and BFLs. Before proceeding, a few disclaimers are in order.

First, although the author believes that (a) state alcohol laws should be subjected to stricter scrutiny than rational basis review ("RBR") and that (b) RBR is arguably too deferential to justify its inclusion as a legitimate test of

22. Sorini, *supra* note 17.

constitutional scrutiny, such arguments are not explored below. For purposes of this Article, the author accepts that courts will continue to employ RBR with regard to any claims about the constitutionality of the TTS and BFLs.

Second, this Article does not explore the issue of a state's favoring in-state alcohol producers over out-of-state alcohol producers, a timely topic well deserving of its own article

Third, this Article does not argue that a tiered alcohol-distribution system should not exist. Indeed, if an alcohol supplier feels selling via wholesaler is the right move, then it should certainly be free to do so. Rather, this Article maintains solely that such a system should not be mandated by the law.

Finally, this Article is not meant to suggest that brewers should replace any portion of their current, increasingly successful strategy of pursuing incremental gains with respect to their interests via state legislatures with pursuing such interests via litigation. On the contrary, the author believes a legislative strategy is vastly more promising than pursuing gains via the judicial system, even though the author believes laws mandating a TTS and BFLs should be struck down by courts.

III. PROBLEMS WITH TODAY'S BEER LAWS

From both a legal and public policy perspective, the TTS and BFLs are problematic. Legally, the author maintains that these laws are, in several ways, potentially unconstitutional. In terms of public policy, the author believes these antiquated laws do not reflect the realities of the modern-day U.S. alcohol market and that, as a result, they stifle competition and harm alcohol sellers, alcohol retailers, and alcohol consumers.

That said, the author is under no illusion that the legal claims discussed in this Article will be met with open arms by today's courts. On the contrary, absent a return to the *Lochner* era, these legal arguments are very unlikely to make any headway. Particularly if judged against the extremely deferential RBR, there is no good reason to be optimistic the potential claims discussed below will prevail. Decades of precedent support this conclusion. David Bernstein writes:

> Since the 1950s, federal equal protection clause challenges to state economic regulations have been subject to a very forgiving rational basis test. In essence, if a court can come up with any rationale as to why a challenged law may operate to any degree in the public interest, the law passes the rational basis test and will be upheld—even if there is no evidence that the legislature that passed the law relied upon, or even considered, the rationale advanced by the court.[23]

23. David Bernstein, *Do laws That Embody 'Naked Economic Protectionism' Violate the Equal Protection Clause?*, WASH. POST (Sept. 14, 2015), https://www.washingtonpost.com/news/volokh-conspiracy/wp/2015/09/14/do-laws-that-embody-naked-economic-protectionism-violate-the-equal-protection-

Also, Attorney Jarrett Dieterle writes:

> In modern times, courts frequently uphold economic legislation that arbitrarily benefits certain economic actors over others, with some courts even going so far as to hold that economic protectionism is a proper purpose of governmental action that sits squarely within a state's police powers. The switch from scrutinizing economic regulations to ensure they were not "arbitrary, unreasonable, or discriminatory," to rubber-stamping such infringements for "any hypothetical reason" occurred during the U.S. Supreme Court's New Deal era.
>
> Specifically, in the case of *Williamson v. Lee Optical*, the U.S. Supreme Court "withd[rew] from policing economic legislation," reversing what Barnett characterizes as "150 years" of "traditional police powers jurisprudence." Barnett has summarized the switch as follows:
>
> *[W]here does modern "anything goes" rational basis scrutiny come from? . . . [It comes from] the 1955 Warren Court case of Williamson v. Lee Optical in which Justice Douglas replaces the realistic actual rational basis scrutiny that was employed by the lower court with a formalist hypothetical rational basis that is satisfied so long as a judge can imagine any possible rational basis for a statute.*
>
> Recently, however, there has been renewed legal scholarship critiquing the move away from more rigorous scrutiny of economic regulations, along with several recent judicial opinions that have resuscitated this pre-New Deal variety of economic liberty jurisprudence.
>
> For example, in the D.C. Circuit case of *Hettinga v. United States*, involving the regulation of milk under federal law, Judges Janice Rogers Brown and David Sentelle issued a concurring opinion criticizing the judiciary's abdication of even modest scrutiny of economic regulations. They summarized the history of economic liberty jurisprudence as follows:
>
> *[T]he judiciary's [modern] refusal to consider the wisdom of legislative acts—at least to inquire whether its purpose and the means proposed are "within legislative power"—[would] lead to only one result: "[R]ights guaranteed by the Constitution [would] exist only so long as supposed public interest does not require their extinction." . . . [T]he [Supreme C]ourt ratified minimalist review of economic regulations, holding that a*

clause/ (on file with the *University of the Pacific Law Review*).

> *rational basis for economic legislation would be presumed and more searching inquiry would be reserved for intrusions on political rights.*
>
> This resuscitation has happened in state courts, as well. In *Patel v. Texas Dep't of Licensing and Regulation*, the Supreme Court of Texas, in an opinion authored by Justice Don Willett, struck down a protectionist licensing scheme for eyebrow threaders. After recounting the judicial history that lead [sic] to the current anything-goes version of the rational basis test for economic liberty concerns, the court adopted what it termed "rational basis with bite," which demands "actual rationality, scrutinizing the law's actual basis, and applying an actual test."[24]

However, were the courts to do away with RBR (a topic for another day) or even just judge these claims against a rational basis with a bite standard, these claims prospects would certainly increase. Notwithstanding the realistic prospects for pursuing these claims via litigation, these legal claims against the TTS and BFLs are explored in this Part. The author believes they are at least worthy of consideration and discussion, in hopes that they will one day be accepted by courts.

By contrast, while brewers have made minimal gains via litigation or the threat thereof,[25] they are increasingly making progress via their respective state legislatures.[26] If craft beer continues its upward trajectory, one should expect more such legislative successes. So, though the author feels the TTS and BFLs are constitutionally problematic, the reality is that courts have shown little

24. Jarrett Dieterle, *Differing Levels of Scrutiny for Economic Regulations: "Anything Goes" Rational Basis v. Rational Basis "With Bite,"* FEDERALIST SOC'Y (Apr. 26, 2017), https://fedsoc.org/commentary/fedsoc-blog/differing-levels-of-scrutiny-for-economic-regulations-anything-goes-rational-basis-v-rational-basis-with-bite (on file with the *University of the Pacific Law Review*).

25. *See, e.g.*, Rubin v. Coors Brewing Co., 514 U.S. 476 (1995) (ruling that the Federal Alcohol Administration Act, which prohibited disclosing alcohol content of beer on labels or in advertising, infringed a brewer's free-speech rights); Authentic Beverages Co. v. Tex. Alcoholic Beverage Comm'n, 835 F. Supp. 2d 227 (W.D. Tex. 2011) (ruling in favor of brewery on certain free-speech claims); *see also* Samuel A. Rubert, *Florida Beer: Busch Gardens and an End to the "Tourism Exception,"* RUBERT L. (June 10, 2015), https://www.rubertlaw.com/blog/2015/06/florida-beer-busch-gardens-and-an-end-to-the-tourism-exception/ (on file with the *University of the Pacific Law Review*); Geoff Tracy, *I Fought for — and Won — the Right to Advertise Happy Hour in Virginia*, WASH. POST (Apr. 26, 2019), https://www.washingtonpost.com/opinions/local-opinions/i-fought-for—and-won—the-right-to-advertise-happy-hour-in-virginia/2019/04/26/08a956be-651b-11e9-82ba-fcfeff232e8f_story.html (on file with the *University of the Pacific Law Review*); John Trump, *Brewery Law Compromise Spurred by Lawsuit*, CAROLINA J. (June 3, 2019), https://www.carolinajournal.com/news-article/brewery-law-compromise-spurred-by-lawsuit/ (on file with the *University of the Pacific Law Review*).

26. In 2019, the Texas Legislature passed a law approving beer-to-go sales. *See* Paul Flahive, *Texas Breweries Can Finally Sell You Beer-To-Go Sunday*, TEX. PUB. RADIO (Aug. 30, 2019), https://www.tpr.org/technology-entrepreneurship/2019-08-30/texas-breweries-can-finally-sell-you-beer-to-go-sunday (on file with the *University of the Pacific Law Review*). Additionally, breweries in a number of states have successfully lobbied for legalizing on-site growler sales. *See* Nick Sibilla, *Florida (Finally) Legalizes 64-Ounce Growlers*, FORBES (May 18, 2015), https://www.forbes.com/sites/instituteforjustice/2015/05/18/florida-finally-legalizes-64-ounce-growlers/?sh=13a1526146ef (on file with the *University of the Pacific Law Review*).

indication they will strike down these laws in the near future, if ever. Therefore, the best option for alcohol producers to more fully open the market to them is to lobby for legislative changes, by convincing the public and their state legislators that the TTS and BFLs are simply bad public policies.

IV. LEGAL ARGUMENTS

State alcohol regulations are enacted pursuant to a state's Tenth Amendment police powers, generally, and in conjunction with a state's authority to regulate the sale and distribution of alcohol per the Twenty-first Amendment, specifically. Most challenged exercises of states' police powers with regard to alcohol regulation have been upheld by courts, given the broad authority to regulate alcohol that states were given by the Twenty-first Amendment. Dieterle writes:

> In fact, the language of the 18th Amendment is remarkably similar to that of the 21st Amendment, except that the 21st Amendment gave prohibitory powers over alcohol to *states* rather than to the federal government. The 18th Amendment prohibited the "manufacture, sale, or transportation," as well as the importation and exportation, of "intoxicating liquors" within the United States, whereas the 21st Amendment prohibits the "transportation or importation into any state" of "intoxicating liquors" if doing so was "in violation of the laws thereof." As legal scholars like Baylen Linnekin have noted, the 21st Amendment "basically transferred the language from federal prohibition and made it essentially state prohibition," giving states near plenary power over alcohol. Unsurprisingly, state governments rushed to fill the gap left by Prohibition's repeal, resulting in a dizzying array of state laws concerning spirits. Many state constitutions mirror South Carolina's in explicitly laying out the state's comprehensive ability to legislate and regulate alcohol, underscoring the broad powers enjoyed by states in this area.[27]

But a state's exercise of its police power pursuant to the Twenty-first Amendment, no matter how broadly created, cannot violate any requirement of the U.S. Constitution, and the author believes some common state alcohol laws violate a number of Constitutional protections—thus exceeding state police power.[28]

27. Jarrett Dieterle, *Applying Heightened Scrutiny to Protectionist Alcohol Laws*, FEDERALIST SOC'Y (Apr. 26, 2017), https://fedsoc.org/commentary/fedsoc-blog/applying-heightened-scrutiny-to-protectionist-alcohol-laws (on file with the *University of the Pacific Law Review*).

28. Though not explored in this article, the author believes the TTS and Beer Franchise Laws pose several potential problems with various state constitutional provisions, including Equal Protection clauses and Due Course of the Law clauses. Additionally, these laws pose potential problems with more obscure state

Of course, the fact that a right is abridged does not make it unconstitutional. Even the most fundamental rights can be abridged. Private property can be taken via eminent domain. Liberty can be taken via imprisonment, for example. Life can be taken via capital punishment. So in the case of alcohol producers, the key constitutional determinant is not whether their rights are abridged but rather whether the government is justified in abridging those rights. This Section explores the former (the abridgements/deprivations) and then examines the latter (whether such abridgements/deprivations are constitutionally justified).

Before judging the TTS and BFLs against specific parts of the U.S. Constitution, it must be noted that the U.S. Supreme Court has stated a TTS is "unquestionably legitimate."[29] For many, such a declaration by the nation's highest court would surely put an end to the legitimacy of any constitutional challenge to the TTS. For two reasons (and even though the author believes courts are not at all likely to strike down the TTS or BFLs, for that matter), the author disagrees.

First, the Supreme Court can change its mind. Precedent is not immune from reversal, no matter how long-standing it is. Second, there are indeed constitutional problems with the TTS and BFLs, and just because these laws have been around for decades, it is never too late to rule them unconstitutional. In the author's view, the TTS and BFLs should be held in violation of a number of clauses of the U.S. Constitution. The following is a very brief overview of some constitutional clauses implicated by the TTS and BFLs and the reasons these laws should not (yet almost certainly will) survive even the lenient rational basis standard of judicial review.

A. Due Process Clause: Liberty of Contract and Property

By interfering with their liberty to contract freely in the marketplace, the TTS and BFLs violate the Fourteenth Amendment's substantive due process rights of alcohol producers. Mandating a TTS does this by forcing suppliers into contractual relationships they might not otherwise choose, while BFLs do this by giving distributors rights that might conflict with what the parties might otherwise negotiate. In other words, alcohol producers are forced into contractual relationships, and those relationships' contractual terms are largely subservient to contractual terms imposed on the parties by a legislature. Liberty of contract is abridged by each of these alone. Together, the abridgement is even greater. Of course, how much leeway legislatures have to impair a party's freedom to contract is a topic of much debate.[30] The author asserts that such freedom in the

constitutional provisions, such as the North Carolina Constitution's Fruits of their Labor Clause and Exclusive Emoluments Clause.

29. *See* Granholm v. Heald, 544 U.S. 460, 489 (2005) (citing North Dakota v. United States, 495 U.S. 423, 432 (1990)) ("We have previously recognized that the three-tier system itself is 'unquestionably legitimate.'").

30. *See generally* Michael Pillow, *Liberty over Death: Seeking Due Process Dimensions for Freedom of*

alcohol space should receive more protection than courts currently allow.

Specifically with regard to the TTS and BFLs, an interesting question arises: since the TTS forces suppliers to sell via wholesalers and BFLs impose upon these relationships protections for wholesalers that trump any contrary contractual provisions between the parties, do these laws create a situation in which suppliers do not freely enter into these contracts? If so, these laws should be deemed violative of the substantive due process rights of suppliers. Regarding the Sixth Circuit's *EJS Properties, LLC v. City of Toledo* holding,[31] Michael Pillow writes:

> The court acknowledged that "[t]he right to contract is a long recognized liberty interest." It characterized the developer's vague argument as a "right to be free from government interference with the occurrence of a wholly discretionary condition precedent." It concluded that since the contracts were freely entered, no constitutionally protected liberty interest had been identified.[32]

By contrast, because the author believes that being forced to sell to a distributor means a supplier is not freely entering into a contract, liberty interests should squarely be in play.

Likewise, property interests are potentially impaired. By forcing alcohol suppliers to sell alcohol to distributors, as opposed to directly to retailers or consumers, an argument can be made that a potential Takings Clause violation occurs. The alcohol produced and sold by a supplier is the supplier's physical property, and requiring suppliers to sell solely via wholesalers can impact suppliers' opportunities to realize the full fruits of their labor, thereby affecting their revenues. Thus, arguably, a regulatory taking occurs in violation of the Fifth Amendment.

Contract, 8 FLA. A&M U. L. REV. 39, 39 (2012) ("Presumably there is widespread acceptance for the notion of freedom of contract as a fundamental part of our legal, government and economic systems. In at least a general way, the freedom of, or liberty to, contract is enshrined as a right. Likewise, few would question that this freedom is subject to certain limitations under common law as well as modern constitutional jurisprudence. Questions revolve around the contours of this right and particularly the extent to which this right emanates from or is protected under the United States Constitution."); *id.* at 51–52 ("Even if freedom of contract were considered a right entitled to constitutional protection, it is impossible at this juncture to conceive that it could ever attain 'fundamental right' status for substantive due process purposes. The best that one could hope for is 'rational basis' review. That being said, the Supreme Court has also demonstrated that even a 'rational basis' review can sometimes be invoked to protect a liberty interest based on substantive due process. Recognition of the right, accompanied by at least rational scrutiny, might further ensure that courts more clearly determine that 'public policies' truly exist before disrupting negotiated contracts along with the underlying 'liberty' to enter into such contracts.").

31. 698 F.3d 845 (6th Cir. 2012).

32. Pillow, *supra* note 30, at 49.

B. Equal Protection Clause

The TTS and BFLs violate the equal protection guarantees of the Fourteenth Amendment. Most states legislatively mandate that alcohol producers, but not most non-alcohol producers, sell solely via wholesalers. Moreover, within the TTS, not all alcohol producers are treated the same, as the typical TTS carves out a number of exceptions to its requirements.[33] By treating alcohol producers differently than most other producers and by treating some alcohol producers differently than other alcohol producers, alcohol producers do not receive the equal protection of the law. Likewise, by allowing statutes to supersede private contracts, BFLs treat the alcohol marketplace differently than most other marketplaces.

Unequal treatment of alcohol producers v. non-alcohol producers. Almost all industries other than alcohol do not require producers to sell via wholesalers.[34] Attorney Marc Hyden, Director of State Government Affairs at free-market think tank R Street, writes:

> The ridiculousness of this model is astounding and imminently evident—especially when you imagine if it had been adopted universally for all industries. If it were, then I wouldn't be able to purchase my airline tickets from Delta Airlines. Rather Delta would have to sell its tickets in bulk to a wholesaler who would then sell them to retailers—perhaps like Travelocity—where I could pay for my tickets. Likewise, I couldn't buy my Macbook Air from Apple. The tech company would be compelled to sell their products to a middleman who would then sell them to a retailer like BestBuy. Only then could I purchase the computer. To be clear, there's absolutely nothing wrong with BestBuy or Travelocity (I have shopped at both), but requiring such a convoluted system would be absolutely ludicrous.[35]

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33. *See* Matthew McLaughlin, *Old Beer Laws Are Stifling New Economic Growth. Here's How Mississippi Can Adapt*., RETHINK MISS. (Dec. 10, 2014), https://www.rethinkms.org/2014/12/10/beer-laws-stifling-economic-growth-mississippi-adapt/ (on file with the *University of the Pacific Law Review*) ("Bipartisan legislation has been passed throughout the United States authorizing limited exceptions to the three tier distribution system in order to keep pace with the ever changing market realities while not eroding the three tier system altogether. One of the most common examples of these limited exceptions is to allow breweries to sell limited quantities of products to consumers for on-site consumption and to sell limited quantities of products to consumers for off-site consumption.").

34. For example, some states mandate a wholesaler tier for the tobacco industry. *See* MASS. GEN. LAWS ch. 64C, § 7B (2021). *See also* Dan Abrams, *Tobacco Wholesalers Want in on Recreational Marijuana*, BOS. GLOBE (June 6, 2017), https://www.bostonglobe.com/business/2017/06/06/tobacco-wholesalers-want-recreational-marijuana/KZrEJTW3lTaYr0Uw0tef7N/story.html (on file with the *University of the Pacific Law Review*).

35. Marc Hyden, *Despite Progress, Georgia's Alcohol Laws Are Still a Mess*, R STREET (Dec. 14, 2020), https://www.rstreet.org/2020/12/14/despite-progress-georgias-alcohol-laws-are-still-a-mess/ (on file with the *University of the Pacific Law Review*).

Legislatively requiring alcohol suppliers to sell solely via wholesalers is nonsensical. Wholesalers do not add safety to products. They do not make the products inherently better or more secure or healthier. Rather, they are simply middle parties that add to the time it takes—and the money it costs—for products to reach consumers. Were this not the case—if distributors truly enhanced public health, safety, or welfare—then the TTS would be prevalent throughout various industries, given the dangers that various products pose to consumers. If a state claims that the TTS helps avoid intemperance, surely that state would be in favor of a TTS for, say, butter and candy as well. There is simply no justification for singling out alcohol. The claim that safety concerns justify treating alcohol differently than almost all other non-alcohol products does not hold water, given that other unhealthy and/or dangerous products are not treated the same. Furthermore, as explored below, the fact that states do not treat all alcohol producers the same is, in the author's view, absolutely fatal to any argument that a TTS for alcohol is a valid exercise of a state's police power.

Unequal treatment among alcohol producers. Though the typical TTS law requires alcohol producers to sell solely to distributors (thus foreclosing producers' abilities to sell directly to retailers or to ship directly to consumers), states carve out a number of exceptions to this requirement. The result is that not all alcohol producers, even those within the same space (beer, for example), are treated the same. For example, wineries typically receive certain exceptions not given to non-wineries; brewpubs enjoy protections that non-brewpub brewers do not have; and breweries that do not exceed a particular production amount, unlike those that do, are often allowed to self-distribute. These exceptions, which blatantly discriminate within the alcohol industry, completely gut the supposed public safety justification for the TTS.

Wineries, unlike breweries, are often granted the legal right to self-distribute and to ship directly to consumers. In Oklahoma, for example, wineries can opt for a Winery Self-Distribution License, which grants licensees an array of self-distribution rights.[36] Wineries can also receive a Direct Wine Shipper's Permit, which "allows a winery to ship up to six nine-liter cases of wine annually directly to an Oklahoma resident who is twenty-one (21) years of age or older for such resident's personal use and not for resale."[37]

Brewpubs, which are restaurants that sell beverages brewed on site, are typically allowed to sell beer to customers on site.[38] The same is not true for non-

36. *See* OKLA. STAT. tit. 37A, § 2-157(A) (2021) ("Every winemaker or small farm winery electing to directly sell its wines to retailers, mixed beverage licensees, beer and wine licensees, and restaurants must obtain a winery self-distribution license and pay the applicable license fee and shall register its products and post its prices with the state in the same manner required of the holder of a nonresident seller license.").

37. *See* OKLA. STAT. tit. 37A, § 3-106(A) (2021).

38. OKLA. STAT. tit. 37A, § 1-103(12) (2021) ("'Brewpub' means a licensed establishment operated on the premises of, or on premises located contiguous to, a small brewer, that prepares and serves food and beverages, including alcoholic beverages, for on-premises consumption.").

brewpub breweries. As an example, Oklahoma law gives the following rights to brewpubs:

> A. A brewpub license shall authorize a small brewer to: 1. Manufacture, bottle, package and store beer on the licensed premises; 2. Sell beer produced by the licensee for either on-premises or off-premises consumption to consumers on the brewery premises, or premises located contiguous thereto; 3. Sell beer at public events such as trade shows or festivals; 4. Also hold a mixed beverage license, beer and wine license or caterer's license; and 5. Hold a brewpub self-distribution license.[39]

Small brewers, which are designated according to the number of barrels they produce in a year, are often exempt from state laws that do not allow breweries to self-distribute. Oklahoma law states, "A small brewer is authorized to sell to either licensed distributors or retailers. A small brewer shall elect whether it will distribute through a distributor or self-distribute to retailers; however, a small brewer may not elect to do both simultaneously."[40] Oklahoma offers breweries a "brewer license" or a "small brewer license," the latter of which creates self-distribution exceptions not granted by the former. The law states:

> A. A brewer license shall authorize the holder thereof: 1. To manufacture, bottle, package and store beer or cider on the licensed premises; and 2. To sell beer or cider in this state to holders of beer distributor licenses and to sell beer or cider out of this state to qualified persons.
>
> B. A small brewer license shall authorize the holder thereof: 1. To manufacture, bottle, package and store beer or cider produced by the licensee on licensed premises; 2. To sell beer or cider in this state to holders of beer distributor licenses and retail licenses or to sell beer or cider out of this state to qualified persons; 3. To serve free samples of beer or cider produced by the licensee to visitors twenty-one (21) years of age or older; 4. To sell beer or cider produced by the licensee for either on premises or off-premises consumption to consumers on the brewery premises, or on premises located contiguous thereto; 5. To sell beer or cider at public events such as trade shows or festivals; 6. To

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39. OKLA. STAT. tit. 37A, § 2-132(A) (2021).

40. OKLA. STAT. tit. 37A, § 3-113(A) (2021). Oklahoma law provides three definitions for "small brewer": (1) OKLA. STAT. tit. 37A, § 1-103v1(56) (as amended 2019) ("'Small brewer' means a brewer who manufactures sixty-five thousand (65,000) barrels of beer annually pursuant to a validly issued Small Brewer License hereunder."), (2) OKLA. STAT. tit. 37A, § 1-103v2(53) (as amended 2019) ("'Small brewer' means a brewer who manufactures less than sixty-five thousand (65,000) barrels of beer annually pursuant to a validly issued Small Brewer License hereunder."), and (3) OKLA. STAT. tit. 37A, § 1-103v3(53) (as amended 2019) ("'Small brewer' means a brewer who manufactures less than twenty-five thousand (25,000) barrels of beer annually pursuant to a validly issued Small Brewer License hereunder.").

> purchase wine in retail containers from the holder of a wholesaler license or as specifically provided by law; and 7. To sell, offer for sale and possess wine for on-premises consumption.[41]

The discrepancies cited above are not exclusive, as state TTS laws carve out other exceptions to their general bans against self-distribution.[42] Moreover, though not explored in this Article, state laws outside of TTS laws and BFLs often discriminate against alcohol. Recently, for example, the California Craft Brewers Association sued California Governor Gavin Newsom and California State Public Health Office Sandra Shewry for discriminating against breweries by requiring them, but not wineries, to serve meals in order to remain open during the COVID-19 pandemic. The lawsuit asserts both Equal Protection Clause and Due Process Clause violations. Food & Wine Magazine's Mike Pomranz reports:

> According to the CCBA, when the California Department of Public Health (CDPH) updated its COVID-19 guidance over the summer, the state's 4,000-plus wine tasting rooms were suddenly given the additional privilege not having to serve meals, a change that didn't extend to the state's 1,050 breweries. "Even wineries that share a tasting room with beer manufacturers may continue to sell and serve wine to customers without food, while the beer manufacturer is prohibited from selling beer to the same customers in the same tasting room unless it also sells food," the lawsuit states according to the *Sacramento Business Journal*.
>
> "To date, Defendants have not presented any valid basis for treating beer manufacturers different than wineries," the filing continues. Apparently, one of the few explanations the CDPH did give was that they "determined that mixing between greater numbers of people from differing households was more likely at breweries," the suit states.
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> "When it is time to begin the reopening of businesses in 2021, we need to ensure that a single industry is not arbitrarily divided based on

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41. OKLA. STAT. tit. 37A, § 2-102v1 (as amended 2019). *See also* OKLA. STAT. tit. 37A, § 2-102v2 (as amended 2019).

42. For example, Oklahoma grants certain self-distribution rights via its Charitable Collaboration Brewer License. *See* OKLA. STAT. tit. 37A, § 2-102.1 (2021). *See also* Rubert, *supra* note 25 ("An End of The Tourism Exception: By July 1, 2015 Florida breweries will no longer have to depend on the 'Tourism Exception' to sell beer directly to consumers. Senate Bill 186 amends Florida Statute § 561.221(2)(a). Under the former statute, the State's Division of Alcoholic Beverages and Tobacco (DABT) had the authority to grant a vendor's license to manufacturers of malt beverages (beer), if the property 'promoted the brewery and the tourist industry of the state.' In Senate Bill 186, the Florida legislature struck this requirement as a result of numerous battles between breweries attempting to obtain vendor's licenses, and distributors looking to prohibit breweries from circumventing Florida's stringent three-tiered system.").

> unfounded assumptions," CCBA executive director Tom McCormick said, arguing that, in the eyes of usual CDPH policy, breweries and wineries are seen as identical manufacturing facilities. "We want to ensure that the craft brewing industry has the same privileges and the same pathway as other alcohol beverage manufacturers to reopen, re-employ and re-build next year."[43]

COVID-19's impact raises its own set of questions about the way states treat alcohol versus non-alcohol. If restaurants can deliver to homes during government-mandated lockdowns, why are breweries not permitted to make deliveries? Particularly in light of the need for more distancing options moving forward, public health could benefit from allowing DTC shipments and deliveries by breweries.[44]

C. Commerce Clause

Alcohol crosses state lines. Requiring alcohol producers to sell only to distributors, as opposed to retailers or consumers, adds time and cost to alcohol distribution. Moreover, distributors have more control over alcohol distribution, including decisions about marketing and advertising, than they would have were suppliers not required to use them. Impeding the free flow of interstate goods clearly impacts interstate commerce in violation of the Dormant Commerce Clause, an implied clause that restricts the ability of states to regulate interstate commerce,[45] over which the federal government has exclusive regulatory power by virtue of the Commerce Clause—which states Congress has the power "[t]o regulate commerce with foreign nations, and among the several states, and with

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43. Mike Pomranz, *California Breweries Sue for Equal Treatment with Wineries Over COVID Dining Rules*, FOOD & WINE (Dec. 18, 2020), https://www.foodandwine.com/news/california-craft-brewers-association-sues-governor-newsom (on file with the *University of the Pacific Law Review*). *See also* Daniel Croxall, *Craft Beer, COVID-19, and the Constitution: The California Craft Brewers Association and Several Independent Craft Breweries Sue Governor Newsom and the CDPH for Treating Craft Breweries Differently than Wineries*, CRAFT BEER L. PROF (Dec. 17, 2020), https://www.craftbeerprofessor.com/2020/12/craft-beer-and-the-constitution-the-california-craft-brewers-association-and-several-independent-craft-breweries-sue-governor-newsom-and-the-cdph-for-treating-craft-breweries-differently-than-wineri/ (on file with the *University of the Pacific Law Review*). Complaint, Cal. Craft Brewers Ass'n v. Newsom, No. 8:20-cv-02372, 2020 WL 7416758 (C.D. Cal. Dec. 17, 2020).

44. *See generally* John Sharp, *Alabama's Craft Breweries Push for Home Deliveries During 'Stay-at-Home' Order*, AL.COM (Apr. 11, 2020), https://www.al.com/business/2020/04/alabamas-craft-breweries-push-for-home-deliveries-during-stay-at-home-order.html (on file with the *University of the Pacific Law Review*); Shauna Stuart, *Alabamians Could Have Wine, Beer, Liquor Shipped to Homes Under New Bill*, AL.COM (Feb. 3, 2021), https://www.al.com/life/2021/02/alabamians-could-have-wine-beer-liquor-shipped-to-homes-under-new-bill.html (on file with the *University of the Pacific Law Review*).

45. *See generally The Dormant Commerce Clause*, L. SHELF EDUC. MEDIA, https://lawshelf.com/coursewarecontentview/the-dormant-commerce-clause/#:~:text=The%20%E2%80%9CDormant%E2%80%9D%20Commerce%20Clause%20ultimately,federal%20legislation%20regulating%20the%20activity (last visited Apr. 16, 2021) (on file with the *University of the Pacific Law Review*).

the Indian tribes."[46]

James J. Molnar writes that "anti-direct shipment laws are antiquated relics of Prohibition contrary to current Constitutional jurisprudence and representative of economic protectionism that detrimentally impacts interstate commerce, and thereby violate the Commerce Clause."[47] Though Molnar's words are found in an article about interstate direct shipping of alcohol, the argument Molnar makes should be equally applicable to intrastate direct shipments. Today's increasingly interconnected and digital marketplace is hampered by laws requiring alcohol to pass through an extra party before reaching the end consumer, regardless of whether those laws target out-of-state shippers or in-state shippers. "With the advent of global trade and the Internet, Americans enjoy extraordinary access to a revolutionary marketplace. The Internet presents a new frontier for the free flow of products and ideas. As corporations and governments scramble to embrace this revolution, today's commerce is faster and freer than ever before," writes Molnar.[48] The TTS system is a clear obstacle to such commerce.

D. Freedom of Speech

Forcing alcohol producers to sell only to distributors curtails producers' abilities to sell, market, and advertise as they see fit. Their ability to participate freely in the alcohol marketplace is, thus, fettered. Though some, perhaps most, would maintain such a burden is at best incidental, the author believes this burden infringes on alcohol producers' fundamental rights to speak as they see fit—a clear violation of the First Amendment.

1. Judicial Scrutiny

This Article maintains that, regardless of which of the above constitutional claims are advanced by brewers, the TTS and BFLs should be struck down under RBR (and, at least with regard to the Free Speech claim, under Intermediate Scrutiny, which applies to commercial speech).[49] There is no legitimate state interest in these laws and, even if there were, they are not rationally related to advancing such interest(s). Though such laws might have passed constitutional review in the period after the repeal of Prohibition, they no longer should for the alcohol market today has changed too drastically, particularly given: (a) the quantity and size of the nation's producers, distributors, and retailers; (b) the

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46. U.S. CONST. art. I, § 8, cl. 3,

47. James J. Molnar, *Under the Influence: Why Alcohol Direct Shipment Laws Are a Violation of the Commerce Clause*, 9 U. MIAMI BUS. L. REV. 169 (2001).

48. *Id.*

49. Though not examined in this article, an argument can be made that scrutiny higher than RBR should be employed, at least with respect to the substantive due process claim.

dramatic rise in e-commerce; and (c) most recently, the changes brought about and the challenges created by the COVID-19 pandemic.

a. Legitimate State Interest?

The claimed general justification for the TTS from its inception is that it is meant to protect public health, safety, or welfare. More specifically, those in favor of the TTS chiefly claim that it avoids problems associated with "tied houses," such as intemperance, anti-competitiveness, and organized crime, and mitigates other problems, such as the sale of alcohol to minors. Alcohol consultancy Compliance Service of America writes, "In an attempt to prevent the vertical integration of ownership which supported intemperate consumption, tied house legislation was enacted. The most fundamental purpose of tied house laws was the creation and preservation of the three tier system."[50] In fact, TTS laws are known as "tied-house laws,"[51] and courts have unanimously accepted the tied houses argument as a legitimate state interest justifying the TTS.[52] Protecting public health and safety is certainly a legitimate state interest; it is the very

50. *Tied House: Pillar of Alcohol Regulation*, COMPLIANCE SERV. AM., https://www.csa-compliance.com/articles/tied_house-_pillar_of_alcohol_regulation (last visited Mar. 15, 2021) (on file with the *University of the Pacific Law Review*).

51. Croxall, *supra* note 9 ("So what are 'tied-house laws'? These laws and regulations are those enacted by the state legislatures or promulgated by the state agencies for the purpose of creating and enforcing that state's version of the three-tier system.").

52. *See* ALCOHOLIC BEVERAGES DIV., STATE OF IOWA, ALCOHOLIC BEVERAGE CONTROL STUDY 20 (2018), https://www.legis.iowa.gov/docs/publications/DF/967633.pdf (on file with the *University of the Pacific Law Review*) ("The Iowa Supreme Court in the Auen case . . . stated in its holding that the purpose of prohibiting tied house arrangements is 'to prevent monopoly or control by manufacturers or distributors of the retail outlets for the sale of intoxicating liquors.' The Iowa Supreme Court went on to state 'the legislative intent for the enactment of section 123.45 was to maintain the independence of the various levels of the liquor industry and to prevent tied-house arrangements.' The Merriam-Webster dictionary defines tied house as a British term meaning 'a business house that is under contract to buy from a particular firm; especially a public house rented from or mortgaged to a brewery with whom the proprietor is pledged to do all of his liquor buying.' During the era when tied houses flourished prior to Prohibition, it was common for the tied house to offer free lunch and check-cashing services in order to encourage spending on alcoholic beverages at the saloon. Large beer manufacturers competed with one another through the acquisition of these retail establishments, serving only their product and encouraging excessive consumption. The societal ills resulting from these tied houses were a major contributing factor to Prohibition."); *see also* Tex. Alcoholic Beverage Comm'n v. Live Oak Brewing Co., 537 S.W.3d 647, 649–50 (Tex. App. 2017) ("The public policy of this state is to maintain and enforce the three-tier system and thereby to prevent the creation or maintenance of a 'tied house.' A 'tied house' for these purposes means 'any overlapping ownership or other prohibited relationship between those engaged in the alcoholic beverage industry at different levels.'") (internal quotation marks and citations omitted); Neel v. Tex. Liquor Control Bd., 259 S.W.2d 312, 316–17 (Tex. App. 1953) ("We need not dwell upon the evils of the 'tied house.' It is obvious that one result of such control could be the creation of a monopoly for certain brands of liquors as well as dictating prices. The importance of preventing such control is reflected by a report of the United States Department of Commerce in 1941 titled State Liquor Legislation wherein on page 20 it is stated: 'The liquor control legislation enacted in the several states since the repeal of the Eighteenth Amendment to the Federal Constitution has uniformly attempted to prevent a recurrence of the evils that were prevalent before prohibition when the large liquor interests controlled, through vertical and horizontal integration, the productive and distributive channels of the industry.'").

essence of a state's police power. Dieterle writes that "given alcohol's intoxicating tendencies, it's rarely difficult for states to justify their restrictions over the alcohol trade based on legitimate public health and safety concerns." Dieterle then quotes the U.S. Supreme Court:

> The police power of the state is fully competent to regulate the [alcohol] business, to mitigate its evils, or to suppress it entirely. There is no inherent right in a citizen to thus sell intoxicating liquors by retail. It is not a privilege of a citizen of the state or of a citizen of the United States. As it is a business attended with danger to the community, it may, as already said, be entirely prohibited or be permitted under such conditions as will limit to the utmost its evils. The manner and extent of regulation rest in the discretion of the governing authority.[53]

The California Supreme Court describes the creation of TTS laws (i.e., tied-house laws) as follows:

> Following repeal of the Eighteenth Amendment, the vast majority of states, including California, enacted alcoholic beverage control laws. These statutes sought to forestall the generation of such evils and excesses as intemperance and disorderly marketing conditions that had plagued the public and the alcoholic beverage industry prior to prohibition. By enacting prohibitions against "tied-house" arrangements, state legislatures aimed to prevent two particular dangers: the ability and potentiality of large firms to dominate local markets through vertical and horizontal integration and the excessive sales of alcoholic beverages produced by the overly aggressive marketing techniques of larger alcoholic beverage concerns.
>
> The principal method utilized by state legislatures to avoid these antisocial developments was the establishment of a triple-tiered distribution and licensing scheme. Manufacturing interests were to be separated from wholesale interests; wholesale interests were to be segregated from retail interests. In short, business endeavors engaged in the production, handling, and final sale of alcoholic beverages were to be kept "distinct and apart."
>
> In the era when most tied-house statutes were enacted, state legislatures confronted an inability on the part of small retailers to cope with pressures exerted by larger manufacturing or wholesale interests. Consequently, most of the statutes enacted during this period (1930-

53. Crowley v. Christensen, 137 U.S. 86, 91 (1890).

> 1940) manifested a legislative policy of controlling large wholesalers; the statutes were drafted in sufficiently broad terms, moreover, to insure the accomplishment of the primary objective of the establishment of a triple-tiered system. All levels of the alcoholic beverage industry were to remain segregated; firms operating at one level of distribution were to remain free from involvement in, or influence over, any other level.[54]

Regarding the relationship between tied houses and TTS laws, Associated Beer Distributors of Illinois writes:

> At the turn of the 20th century, the beer industry was booming. Local brewers often had ownership ties to the taverns - selling to them on extended credit terms, furnishing them with equipment and supplies, charging low or no interest, and paying rebates for pushing their brand or carrying it exclusively. This relationship became known as "tied-houses." Competition for control of the retail outlets was fierce and tremendous pressure was exerted on retailers to maximize sales without regard to the well being of customers or the general public. These abusive practices led to a campaign for laws prohibiting all drinking. In 1919, the 18th Amendment to the United States Constitution was passed beginning a 14-year dry spell known as Prohibition. In 1933, the 21st Amendment to the United States Constitution repealed Prohibition and also gave states the authority to regulate the production, importation, distribution, sale and consumption of alcohol beverages within their own borders. A new regulatory system known as the Three-Tier System was created. This system was established to eliminate tied-house abuses.[55]

Proponents of the TTS also maintain that it advances a state's legitimate interest in competition in the alcohol industry. Brandt Erwin, Vice President of the Minnesota Beer Wholesalers Association writes:

> This separation among the tiers provides a level playing field for small

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54. Cal. Beer Wholesalers Ass'n v. Alcoholic Beverage Control Appeals Bd., 5 Cal. 3d 402, 407–08 (1971) (citations omitted).

55. *The Three Tier System*, ASSOCIATED BEER DISTRIBUTORS ILL., http://www.abdi.org/the-three-tier-system (last visited Mar. 21, 2021) (on file with the *University of the Pacific Law Review*); *see also* Reis, *supra* note 9 ("It all started in 1933. When Prohibition was repealed, power was given to the states to regulate the sale of alcohol within their boundaries. The three-tier system offered trifold taxation capabilities and promised to help prevent the establishment of monopolies. You see, if breweries are allowed to own their distribution and retail outlets, it's easy for the biggest companies to wield their financial clout to stifle competition. To see what that can look like, open your history books. The beer industry in mid-20th century Britain became dominated by 'tied houses'—retail establishments owned or controlled by breweries. These pubs had a tendency to serve only the beers associated with their controlling brewery (shocking, right?). Without places to sell their beer, the little guy struggled, and much of the British beer industry fell under the control of just six breweries. So, there's something to the idea of encouraging competition with a three-tier system. But because every state in the U.S. gets to make their own rules, each has its own quirks, exemptions, and variations.").

> businesses in our state, enabling them to compete against global behemoths and create jobs. Among other things, the three-tier system is designed to prevent any industry member, particularly large suppliers, from monopolizing distribution and retail sales. This system benefits consumers by providing unprecedented choice and variety and benefits new market entrants by lowering the barrier to entry. The three-tier system also has brought us strong consumer safeguards and helped the beer market grow and thrive like never before. This system keeps consumers safe from the dangerous sale of contaminated alcohol, which is a major public health risk in other countries. For example, the strict record-keeping requirements that distributors are obligated to retain allow for a recall to occur expeditiously should a contaminated product be discovered. Independent beer distributors are licensed by the state and federal governments and source high-quality beer only from federally-registered brewers and sell it only to state-licensed retailers. These safeguards also protect against potentially dangerous business practices while ensuring the safety of products for consumers. For example, these laws prohibit a supplier from terminating a distributor, the majority of which are local, family-owned businesses, because a distributor refuses to violate federal or state alcohol laws – such as selling to unlicensed retailers or engaging in deceptive or irresponsible business practices, designed to favor only certain suppliers to the exclusion and detriment of other suppliers. Such conduct, which was commonplace before Prohibition, has a negative impact on each member of the industry, as well as consumers. Prior to Prohibition, the over-eagerness of some brewers to dominate the market led to a situation where they would bankroll retail locations, usually saloons, and contractually require the staff to serve only products of their particular brewery. This was a major barrier for access to the marketplace for competitors and restricted the variety available to consumers. Following Prohibition, each state, through thoughtful deliberation, adopted its own regulatory framework that has led to a system that prevents monopolies by alcohol companies, holds bad actors accountable and guarantees competition among suppliers, distributors, and retailers. This system facilitates a competitive marketplace open to all brands—big and small.[56]

The author sees these proffered state interests as problematic from two perspectives: (1) such interests are illegitimate because they are not truly what the TTS and BFLs are really meant to advance in today's marketplace; and (2) even if one accepts these interests as legitimate justifications for the TTS and BFLs, these laws are not rationally related to those interests. Both of these issues

56. *The Great Debate: The Three-Tier System Is Fundamentally Broken, supra* note 9.

are discussed in the next Section.

Despite the justifications advanced by TTS proponents, legislating separate, distinct commercial tiers for alcohol distribution should not be considered a valid exercise of a state's power to regulate alcohol under the Twenty-first Amendment. Likewise, there is simply no legitimate state interest in statutory BFLs. The basis for this position is simply that the TTS and BFLs are not about protecting public health, at least not anymore. Rather, they are simply legislative means to protect the economic interests of distributors.

The TTS is not about protecting the public. The reality is that the TTS is not standing as a bulwark against organized crime, monopolies, predatory pricing, or any other alleged tied-house "evil" but rather is protecting the economic interests of the wholesalers, which have aggressively lobbied state legislatures to continue the wholesaler's regulatory fiefdom.[57] *Charles K. Cowdery* writes:

> Most opposed are distributors, regulators and legislators. Distributors stand to lose the most from any change. Instead of having business bestowed on them by law, they will have to work for it. Regulators and legislators favor the *status quo* because, well, they always do, and distributors are generous with campaign cash.[58]

The same is true regarding BFLs. These laws are not about protecting the public. Rather, BFLs empower distributors with protections beyond what they might receive from their contractual agreements with suppliers. These laws, which began sprouting up in the 1970s, were enacted to counter the power that, at the time, big suppliers wielded over smaller distributors. According to attorney Marc Sorini:

> A majority of the states have enacted full-fledged beer franchise laws. Although it is not hard to detect a whiff of protectionism in these

57. Anecdotally, attorney Jeffrey C. O'Brien writes, "Some years ago, I attended a panel presentation regarding the future of the three-tier system. One of the panelists was a lawyer and lobbyist for beer wholesalers in another state. When posed asked why wholesalers oppose most, if not all, legal reforms offered by manufacturers, he was brutally honest: 'we like the way the current system works because we make a lot of money under it.'" *The Great Debate: The Three-Tier System Is Fundamentally Broken*, *supra* note 9. According to O'Brien, "Opponents of liquor law reforms aimed at removing restrictions from the manufacturers have cited the need to preserve the three-tier system as a sufficient objection. As if preservation of this system is now the objective in and of itself. Preservation of the three-tier system has, in essence, become the battle cry of maintaining the wholesalers' leverage in the marketplace." *Id.* James J. Molnar's sentiments about the true reasons for laws that discriminate against direct alcohol shipments by out-of-state sellers should apply to the real reasons for the TTS and BFL's: "The proponents of anti-direct shipment justify their decisions with 'boilerplate' appeals to temperance and public good. As these laws are challenged, courts should recognize these arguments as mere pretexts. Political convenience, powerful lobbies, and slick packaging are not justifications for laws that benefit a select few and injure many." *See* Molnar, *supra* note 47, at 190.

58. Charles K. Cowdery, *Do We Still Need the Three-Tier System for Alcohol?*, R STREET (June 24, 2016), https://www.rstreet.org/2016/06/24/do-we-still-need-the-three-tier-system-for-alcohol/ (on file with the *University of the Pacific Law Review*).

> enactments, their stated purpose is to correct the perceived imbalance in bargaining power between brewers (who are presumed to be big and rich) and wholesalers (who are presumed to be small and local). Temperance concerns are also cited.[59]

Attorney Evan Pitchford writes:

> Beer franchise laws stem from a decades-old period when relatively few national-level breweries (like Budweiser and Miller) were able to exert significant power over the beer distribution industry, which at the time was chiefly comprised of numerous small mom-and-pop outlets. As an example, the macrobreweries would impose stringent requirements for their distributors that necessitated significant investment (such as construction and maintenance of a sophisticated refrigerated warehouse), but there was nothing to protect the distributor when the macrobreweries decided to switch to a competitor, leaving the distributors with little recourse to recoup their investment. To protect the distributors from this predicament, strong state franchise laws were enacted that made it difficult for the breweries to terminate contracts with distributors.[60]

But today's market is entirely different. The days of smaller, weaker distributors are gone. In its place is a system that bestows undue power upon large, powerful distributors. Pitchford continues:

> At their most draconian, beer franchise laws can marry a brewer to a distributor even if the brewer only sends a small initial amount of beer to the distributor for resale without any written agreement whatsoever. In some cases distributors can even have the power to transfer the distribution rights to successors-in-interest without the brewer's consent. In many states, a brewer can only cancel a distribution contract for "good cause," which may not include failure to reach sales quotas. Further, many states require a brewer, in order to break a distribution contract, to pay the wholesaler Fair Market Value ("FMV") for the lost business. Of course, these rules have shifted a significant share of power to the distributors.[61]

In reality, the TTS and BFLs are not about protecting public health and safety but, rather, are meant to protect the economic interests of alcohol

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59. Sorini, *supra* note 17.

60. *CKE Attorneys Attend Craft Brewers Conference in Nashville*, CONKLE, KREMER & ENGEL, https://www.conklelaw.com/tag/beer-franchise-laws (last visited Mar. 9, 2021) (on file with the *University of the Pacific Law Review*).

61. *Id.*

distributors.[62] And, specifically regarding the TTS, it can be argued that mandating three tiers of alcohol distribution is simply a way for states to earn more money, meaning the protectionism is not limited to distributors but extends to state coffers, as well. Hyden writes, "While its supporters struggle to defend it, it seems that the real reason for its creation is that it gives the state more control over the alcohol industry and gives it more opportunities to tax different levels of the alcohol business—thus generating state revenue."[63] But protectionism in any form—whether favoring in- versus out-of-state businesses, whether favoring some in-state businesses versus other in-state businesses, or whether protecting state coffers—is not a legitimate state interest justifying constitutional infringement.

The South Carolina Supreme Court ruled just that in *Retail Services & Systems, Inc. v. South Carolina Department of Revenue*,[64] holding that economic protectionism (in this case, protecting small businesses) was the only justification for a state law capping the number of retail liquor stores a party can own.[65] As such, according to the South Carolina Supreme Court, the state had exceeded its police power to regulate alcohol. The court held:

> Without any other supportable police power justification present, economic protectionism for a certain class of retailers is not a constitutionally sound basis for regulating liquor sales. See Bacchus Imports v. Dias, 468 U.S. 277, 276 (1984) ("State laws that constitute

62. *See* Molnar, *supra* note 47, at 170 ("However, prompted by the growth of independent wineries that effectively bypassed wholesalers and online alcohol sales, the industry unleashed an aggressive lobbying campaign successfully pushing through laws that made direct shipment a felony. Powerful wholesalers utilized their well-developed lobbies to manipulate state legislatures to act under the guise of the public good and the Twenty-first Amendment. Ultimately, the wholesalers' efforts promulgated more Byzantine liquor laws favorable to their own interests.").

63. Marc Hyden, *Despite Progress, Georgia's Alcohol Laws Are Still a Mess*, NEWNAN TIMES-HERALD (Dec. 14, 2020), https://times-herald.com/news/2020/12/despite-progress-georgias-alcohol-laws-are-still-a-mess (on file with the *University of the Pacific Law Review*). Some view added state revenues and other consequences of mandating a middle tier as a net positive. Tim McKirdy writes, "Robert Tobiassen, a legal consultant and former chief counsel for the Alcohol and Tobacco Tax and Trade Bureau (TTB) believes that national distributors benefit local economies by creating jobs and supplying extra income to state governments via taxes. 'The middle tier of the three-tier system does employ a large number of people and contributes financially to many community charitable efforts,' Tobiassen said, calling the three-tier system 'a good neighbor.' While some might view the added cost as a negative aspect of the system, Tobiassen believes it's advantageous, as it succeeds in lowering the potential for alcohol abuse. 'The lowest possible price is not always the benchmark goal,' he says." Tim McKirdy, *In the Age of Instant Everything, the Three-Tier System Persists, for Better or Worse*, VINEPAIR (Oct. 3, 2018), https://vinepair.com/articles/three-tier-wine-selling-supreme-court/ (on file with the *University of the Pacific Law Review*).

64. 419 S.C. 469, 474 (2017).

65. The majority opinion states, "As noted previously, Respondents' experienced counsel repeatedly stated to this Court during oral arguments that the only justification for these provisions is that they support small businesses." *Id.* at 475. The footnote to this reads, "I note that this argument was exclusively relied upon during oral arguments by Respondents' very experienced counsel, not just as a consequence of the Court's questioning. Counsel was not prohibited from propounding any other basis for the regulation, and therefore should be held to his statements to the Court that this is a protectionist statute." *Id.* at 475 n.7.

> mere economic protectionism are . . . not entitled to the same deference as laws enacted to combat the perceived evils of an unrestricted traffic in liquor."); McCullough v. Brown, 41 S.C. 220, 247–48, 19 S.E. 458, 472–73 (1894), overruled on other grounds by State ex rel. George, 41 S.C. at 254, 20 S.E. at 233 (holding that if a statute regulating alcoholic liquors is enacted for economic purposes rather than "as a police regulation of the business of selling intoxicating liquors," it is unconstitutional).[66]

Reacting to the court's ruling, Dieterle writes:

> The South Carolina Supreme Court's majority and dissenting opinions in *Retail Services* reflect the fissure between the currently dominant anything-goes version of rational basis and the growing support to restore a rational basis "with bite" test for economic legislation. The *Retail Services* majority simply extended this recent trend of heightened scrutiny for economic regulations into the realm of alcohol, holding that promoting raw economic protectionism is not a legitimate objective of government.[67]

According to Dieterle:

> Although state powers are at an apogee in the realm of alcohol regulation, *Retail Services* has shown how, in at least some states, the government's power over booze may still be subject to certain limitations. If more courts begin to conclude that some ends—such as promoting economic protectionism—remain beyond state governments' proper police powers, it could usher in an era of booze-related economic liberty litigation. Whether more courts follow the South Carolina Supreme Court's lead remains to be seen, but many state booze laws across the country would certainly provide ripe targets for challenge.[68]

Indeed, other state courts have held a state's police power regarding alcohol is not without restriction. Dieterle writes about an earlier decision:

> Like the South Carolina Supreme Court in *Retail Services*, the Texas Supreme Court rejected economic protectionism as a proper end of government: "*Government's conception of its own power as limitless is*

66. *Id.* at 474.

67. Dieterle, *supra* note 24.

68. Dieterle, *supra* note 27. According to Dieterle, "The case may be a portent for oppressive and protectionist alcohol-regulation regimes across the country, and a sign that the recent revival in economic liberty jurisprudence could be coming to the world of booze." Jarrett Dieterle, *Could Economic Liberty Litigation Free the Booze?*, FEDERALIST SOC'Y (Apr. 24, 2017), https://fedsoc.org/commentary/fedsoc-blog/could-economic-liberty-litigation-free-the-booze (on file with the *University of the Pacific Law Review*).

> *hard-wired. But under the Texas Constitution, government may only pursue constitutionally permissible ends. Naked economic protectionism, strangling hopes and dreams with bureaucratic red tape, is not one of them.*" In other words, the Texas Supreme Court restored at least some constitutional safeguards against arbitrary and discriminatory economic regulations, and held that the state's police powers were not unlimited.[69]

More recently, the U.S. Supreme Court commented on states' use of the police power to regulate alcohol. In *Tenn. Wine & Spirits Retailers Ass'n v. Thomas*, the Court stated:

> Nor have States historically enjoyed absolute authority to police alcohol within their borders. As discussed earlier, far from granting the States plenary authority to adopt domestic regulations, the Court's police-power precedents required an examination of the actual purpose and effect of a challenged law. For these reasons, we reject the Association's overly broad understanding of §2.[70] That provision allows each State leeway to enact the measures that its citizens believe are appropriate to address the public health and safety effects of alcohol use and to serve other legitimate interests, but it does not license the States to adopt protectionist measures with no demonstrable connection to those interests.
>
> . . . .
>
> Recognizing that §2 was adopted to give each State the authority to address alcohol-related public health and safety issues in accordance with the preferences of its citizens, we ask whether the challenged requirement can be justified as a public health or safety measure or on some other legitimate nonprotectionist ground. Section 2 gives the States regulatory authority that they would not otherwise enjoy, but as we pointed out in *Granholm*, "mere speculation" or "unsupported assertions" are insufficient to sustain a law that would otherwise violate the Commerce Clause. Where the predominant effect of a law is protectionism, not the protection of public health or safety, it is not shielded by §2.[71]

Perhaps it once was, but today, the TTS is simply about protecting the economic interests of alcohol distributors, not about protecting health, safety, or welfare. Minnesota attorney Jeffrey C. O'Brien writes:

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69. Dieterle, *supra* note 24.

70. The Court was referring to § 2 of the Twenty-first Amendment to the U.S. Constitution.

71. Tenn. Wine & Spirits Retailers Ass'n v. Thomas, 139 S. Ct. 2449, 2473–74 (2019) (citations omitted).

> The basis for alcohol regulation in Minnesota is to regulate alcohol manufacture and sale as a public safety issue. Thus, when looking at proposed reforms, the key question should not be "how would the new law affect the three-tier system?", but rather "does this new law create a public safety issue," with the understanding that causing manufacturers to make more money (and wholesalers to make less) is not a public safety issue.[72]

Neither are BFLs about public safety. Were this not true, surely these laws would have been enacted in the days after the repeal of Prohibition as opposed to the 1970s. Instead, they began to come on the scene at the height of brewers' power with respect to distributors. And, as previously noted, that framework has fundamentally shifted. In short, the TTS and BFLs do not have a "demonstrable connection" to public health, safety, or welfare that would justify them as valid exercises of states' Twenty-first Amendment power to regulate alcohol.

b. Rational Relationship to Legitimate State Interest?

Even if one accepts these proffered state interests as legitimate, the TTS and BFLs are not rationally related to these interests given the realities of today's alcohol marketplace. These laws do not protect public health, safety, or welfare and do not promote competition. Moreover, states have other ways to advance such public interests, ones that infringe far less on suppliers' and consumers' private interests.

Public health, safety, and welfare. If the goal is to raise the price of alcohol to reduce the amount of consumption, a better way to do this would be a direct tax, rather than the indirect tax that results from the markup of each tier. Also insufficient is the subsidiary proffered justification that the TTS guards against the illicit direct sale of alcohol to minors. With regard to requiring suppliers to sell solely to wholesalers and, as such, to prohibiting suppliers from DTC shipments, such an argument should be rejected. There is no reason to think that the absence of a middle tier would increase the likelihood of underage alcohol sales. "States can effectively secure tax revenues and prevent underage purchases through the simple mechanisms already in place," writes Molnar.[73] With regard to sales by retailers, whether retailers purchased from a distributor or directly from a supplier in no way affects retailers' decisions to sell or not sell to a given customer. What happened before the product reached the retailer is simply immaterial to what happens at the point of sale. As for DTC shipments, which would bypass a distributor and retailer and involve only the consumer and the

72. *The Great Debate: The Three-Tier System Is Fundamentally Broken*, *supra* note 9.

73. *See* Molnar, *supra* note 47, at 190.

supplier, the consumer is still purchasing from one party, except that the party is not a retailer. Just as a retailer can check a customer's identification, a supplier can require age verification as a precondition of sale.[74]

Competition. Were the TTS and BFLs no longer in effect, other laws, such as federal antitrust laws, would be sufficient to deal with all of the other purported dangers that these laws are meant to avoid—such as anti-competition, selling alcohol to minors, organized crime, and predatory pricing. Moreover, were these laws repealed, the far more likely scenario is that competition would increase, and consumers would end up with more, not fewer, choices.

In the author's view, the TTS and BFLs simply do not bear a rational relationship to the proffered state interests these laws are meant to advance. For this reason alone, they should not stand.

V. POLICY ARGUMENTS

Regardless of the prospects for any potential legal arguments against the TTS and BFLs, state legislatures should do away with them because they are simply terrible public policies in today's alcohol marketplace. The author asserts the following (non-exclusive list) of policy arguments against the TTS and BFLs.

A. The TTS Hurts Suppliers, Retailers, and Consumers

The TTS adds time and cost to alcohol delivery.[75] Adding time and cost to a product would not be undesirable if, for example, the extra time and money enhanced the product or made it safer. But the TTS does no such thing(s). Rather, it is simply a massive hidden tax on retailers and consumers.[76] "It is a grossly

74. *Id.* at 179–80 ("One argument posited by states and wholesalers is that direct shipments make underage purchases of alcohol easier. This emotionally charged argument is supported by reports of underage purchases and high profile sting operations. Nevertheless, this argument has little merit. First, the stings were conducted mostly in states that ban direct shipment, where delivery people lack the training utilized in states where shipment is legal. For instance, in California, which does not ban direct shipment, the Department of Alcoholic Beverage Control reported minimal complaints about minors buying alcohol through home delivery. Additionally, Mothers Against Drunk Driving, a well-known organization opposed to under-aged drinking, withdrew its support from federal legislation proposing restrictions on Internet sales of alcohol. The group's president said the fight was not about sales to minors, but rather factions in the alcohol industry fighting among themselves. Secondly, with the average wine budget being $7 to $10, online wine marketers focus on selling value added and upscale products in order to make a profit. Thus, online merchants target wine collectors, gift purchasers, and upper income wine consumers. These customers are willing to spend more. It seems unlikely that a teen will seek out that highly recommended red Burgundy or a rare Rochioli Pinot Noir. Third, one online merchant described what a teen ordering online faces as: higher cost, a long wait, a credit card and 'lying multiple times.' A local liquor store only requires a teen to lie once, if the teen is carded.").

75. Reis, *supra* note 9 ("Wholesalers are another hand that needs to get paid. This can result in higher prices to the end consumer and less profit for the producers. Beer is generally best consumed fresh. Requiring that beer be sold through a wholesaler ensures that more time will pass between brewery and glass.").

76. McKirdy, *supra* note 63 ("After Prohibition's repeal in 1933, state governments devised a new set of distribution laws that aimed to tackle the nation's drinking problem by increasing the price of alcohol. Called the 'three-tier' system, it added cost by ensuring alcohol flowed from producer to consumer through a minimum

inefficient system, one that adds to the price of drink at each step," says Kevin R. Kosar.[77] Hyden writes, "By cutting out superfluous steps and middlemen, producers could avoid extra costs, taxes and markups—passing the savings on to the consumer by providing less expensive products."[78]

Moreover, the increasingly digital nature of retail shopping lends itself better to a system of DTC shipments than a system that requires a wholesaler. Speaking about the TTS, attorney Mark Arnold writes, "The rise of the internet and direct delivery companies such as Amazon has undermined this rigid distribution system."[79] A middle distribution tier simply stands in the way of suppliers and consumers in today's increasingly internet-based alcohol market.

Finally, the COVID-19 pandemic has revealed more ways the TTS is an obstacle to alcohol suppliers and consumers. Societies in mandatory lockdowns (which will not last forever) and societies with a need for greater social distancing (which perhaps will last forever), need more flexible options for getting consumers the products they desire. Undoubtedly, allowing breweries to sell alcohol directly to retailers and allowing them to sell on site, or ship directly, to consumers provides immeasurably more flexibility than does a TTS system that allows none of these options to breweries.

B. Both the TTS and BFLs are Anti-Competitive

By requiring suppliers to sell solely to distributors and by then giving distributors statutory protections they otherwise might not enjoy, TTS laws and BFLs stand in the way of suppliers' abilities to participate in the alcohol marketplace freely and impact the overall marketplace for alcohol distribution.

In addition, the TTS system can serve as a significant barrier to entering the market in the first place. According to Kevin Kosar, "Distributors frequently refuse to carry their (distilleries and breweries) beverages, leaving these small

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of three separate businesses. Unfortunately, for responsible and modern consumers, each layer by necessity marks up the price.").

77. Kevin R. Kosar, *Let It Flow: Chipping Away at the Three-Tier Alcohol System*, AM. ENTERPRISE INST. (Aug. 18, 2011), https://www.aei.org/economics/public-economics/let-it-flow-chipping-away-at-the-three-tier-alcohol-system/ (on file with the *University of the Pacific Law Review*). Using wine as an example, Tim McKirdy writes, "At each tier, companies must apply a percentage markup to the price of a bottle in order to remain profitable. Distributors generally double the price they pay for a bottle, while retailers add a further 150 percent to the price. In other words, if a winery sells a bottle for $5, distributors sell the same bottle for $10, and retailers for $15." McKirdy, *supra* note 63. Charles K. Cowdery writes, "Those most in favor of change are producers and large retailers. Why shouldn't Wal-Mart or TGI Fridays buy directly from Diageo? They do it with every other product – even pharmaceuticals, which arguably are more dangerous than booze. Producers of all sizes favor eliminating the middleman and his markup. So do most retailers." Cowdery, *supra* note 58.

78. Hyden, *supra* note 35.

79. Mark Arnold, *Constitutional Requirements for Distribution of Alcohol*, HUSCH BLACKWELL (Oct. 15, 2018), https://www.foodandaglawinsights.com/2018/10/constitutional-requirements-for-distribution-of-alcohol/ (on file with the *University of the Pacific Law Review*).

businesses shut out of the retail market."[80] Mike Reis writes, "New breweries may have a difficult time landing a distribution contract without first establishing their place in the market. In states where self-distribution is not allowed, this leads to a bit of a Catch-22."[81]

Moreover, the TTS and BFLs alter the decision of suppliers with regard to how they produce, market, and sell alcohol. According to Reis, "Some decision-making in retail establishments is dictated by 'distributor politics.' Retailers making decisions based on their relationships with distributors can skew the free market sale of beer."[82] Hyden writes, "While I have no doubt that the three-tier alcohol model has become a financial boon for the state's coffers, it's an unnecessary impediment and doesn't benefit consumers . . . . it interferes in the market and hamstrings companies from pursuing more innovative, efficient approaches."[83] As a result, the TTS and BFLs ultimately can limit consumer choice.

C. The Reason BFLs Were Enacted No Longer Exists

Given the enormous shift that has occurred in the makeup of the alcohol markup, the very factual premise for BFLs is gone. The worry that big suppliers would exert undue influence on small wholesalers is, thus, no longer warranted. In fact, the reality is now true, at least with respect to the smaller breweries. There is no risk of a small number of big producers exerting undue power over a limited number of weaker distributors. In fact, the opposite is the case.[84]

The market is nothing like it was in the early days post-Prohibition. The National Beer Wholesalers Association ("NBWA") reports:

> The industry structure has changed significantly over the past 30 years. In 1983, there were 49 breweries. At the end of 2019 there were 6,400 reporting brewers, and by the end of CY 2019, the most recent data show there were 11,584 TTB permitted breweries in the United States—an all-time high. Note that not all permitted breweries are open and/or operational. The TTB issued 1,469 new permits in CY 2019 and some

80. Kosar, *supra* note 77.

81. Reis, *supra* note 9.

82. *Id.*

83. Hyden, *supra* note 35.

84. The State of Iowa's Alcohol Beverages Division writes, "One of the basic tenets of Iowa's tied house language was the prevention of the significant pressure and power a manufacturer once held over a retailer. This power was most notable prior to Prohibition in the form of a brewery-owned saloon. In the modern alcoholic beverage marketplace, retailers have gained significant power and pressure on the three-tier system is coming from below. Tied house has been effectively turned on its head in many cases. This is evidenced by nationwide retail-driven trade practice violations and the desire for retailer-specific private label products. Retailers are arguably exerting control over the alcoholic beverage marketplace. Whether Iowa's tied house laws and trade practice rules in chapter 16 of 185 Iowa Administrative Code address this possible shift in power is debatable." ALCOHOLIC BEVERAGE CONTROL STUDY, *supra* note 52, at 18.

> states now have more breweries than the enitire [sic] country had in 1990.[85]

The chart below lists the number of breweries in the U.S. in various years (starting with the last year of Prohibition), according to data compiled by the Brewers Association.[86]

YEAR	**NUMBER OF U.S. BREWERIES**
1932	0
1933	331
1935	766
1941	857
1955	239
1960	188
1970	138
1975	110
1978	89
1985	110
1990	284
1991	312
1995	858
2000	1,566
2005	1,447

85. *Industry Fast Facts*, NAT'L BEER WHOLESALERS ASS'N, https://www.nbwa.org/resources/industry-fast-facts (last visited Mar. 15, 2021) (on file with the *University of the Pacific Law Review*).

86. *National Beer Sales & Production Data*, BREWERS ASS'N, https://www.brewersassociation.org/statistics-and-data/national-beer-stats/ (last visited Mar. 21, 2021) (on file with the *University of the Pacific Law Review*).

YEAR	NUMBER OF U.S. BREWERIES
2010	1,813
2013	3,162
2015	4,847
2019	8,386

So there are more U.S. breweries than ever, but the vast majority of them are small brewers. Jonathan Tepper writes, "While the number of breweries has never been higher, the total number of breweries is a completely misleading metric. Consider how irrelevant they are to the average American: Over half of all breweries brew less than 1,000 barrels and represent less than 1 percent of all volume."[87]

According to the NBWA, "More than 95 percent of all breweries make fewer than 15,000 barrels (465,000 gallons) per year and account for about 3 percent of total volume."[88] The NBWA writes, "Since 2009 more than nine percent of the market volume has shifted from large brewers and importers to smaller brewers and importers."[89] It is worth noting that the number of beer retailers in the U.S. has grown of late too. NBWA writes, "The number of retail outletts [sic] that sell alcohol has grown significantly since the end of the 2008-2009 recession. Total alcohol outletts [sic] have gone from 531,705 in 2008 to 643,142 in 2019. CY2019 saw the first year of decline in total beer retail accounts since 2008."[90] In the author's view, there is an indirect relationship between the number of beer retailers and the threat of "tied houses" and vertical integration. The increasing reality is that the amount of choice in today's alcohol market—choice among beers and among beer retailers—weakens the already-weak fears of an alcohol market that does not mandate three tiers.

As for the number of distributors, the NBWA writes, "Beer distribution has seen significant changes as well. Over the years, the number of traditional beer distributors has fallen from 4,595 in 1980 to around 3,000 in 2019."[91] Even this lower number might seem like a large one, were it not for the fact that the vast

87. Jonathan Tepper, *Big Beer's Illusory Appeal*, AM. CONSERVATIVE (Sept. 13, 2019), https://www.theamericanconservative.com/articles/big-beers-illusory-appeal/ (on file with the *University of the Pacific Law Review*).

88. *Industry Fast Facts*, *supra* note 85.

89. *Id.* Citing statistics from *Beer Marketer's Insights, 2020*, the NBWA reports that outside of the five largest beer brewers/importers in the U.S., all other brewers/importers in the U.S. accounted for 21% of the market in 2019.

90. *Id.*

91. *Id.*

majority of U.S. distributor markets are duopolies.[92] "Small brewers start small and stay small, while distributors and Big Beer control the market," writes Tepper.[93] Ron Knox explains how the two biggest U.S. beer manufacturers control U.S. beer distribution:

> Today, two powerful brewers continue to dominate the American beer market. Combined, Anheuser-Busch InBev and Molson Coors (called MillerCoors until this year) sell around 65 percent of all beer in the U.S. That's about as powerful a duopoly as exists in American industry—but it's still less than what it was 15 years ago, when 80 percent of the industry sat in the hands of the two big brewers. Myriad factors contributed to the duopoly's slump, perhaps in particular the rise of independent craft breweries, which now account for around 12 percent of the industry. Despite the popularity of craft beer, the two global beer titans have managed to maintain their grip on the industry largely by influencing how beer is distributed and what is found on store shelves. Almost 90 percent of beer sold in most places in America is handled by distributors whose primary customer is one of the two big brewers, giving AB InBev and Molson Coors outsize control over which beers appear on bar taps and in retail coolers. Meanwhile, the two companies have purchased about 20 smaller "craft" beer brands—brands that then fill taps and shelves where independent brews might otherwise appear.[94]

One specific way that these two breweries and distributors exert power—a way that serves as a significant barrier to entry to small brewers—is through the system in effect for stocking alcohol in the largest retailers. Knox writes:

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92. *See* Marc Sorini, *Understanding the Three-Tier System: Its Impacts on U.S. Craft Beer and You*, CRAFTBEER.COM (Mar. 6, 2017), https://www.craftbeer.com/craft-beer-muses/three-tier-system-impacts-craft-beer (on file with the *University of the Pacific Law Review*) ("Even the largest brewers have, for many years, owned their own distribution affiliates in select markets, as generally permitted by the laws of many states. This was relatively benign in the days – decades ago – when three, four, and even five full-service beer distributors covered a given market. But today most markets are served by just two mainline beer distributors; a 'red' distributor affiliated with Anheuser-Busch/InBev and a 'blue/silver' distributor affiliated with MillerCoors. In this current duopoly, vertical integration by one of the two major domestic brewers either forces all other brewers and importers into a single distributor (hardly a competitive situation) or traps brewers and importers with a distributor owned by one of their largest competitors. So although self-distribution by brewers is not anticompetitive per se, it certainly threatens to have such an impact when practiced by the country's dominant brewers. Recognizing this, the United States Department of Justice recently required Anheuser-Busch/InBev to cap its branch ownership at 10 percent of its total U.S. beer volume as a condition to the Department's approval of the acquisition of SABMiller's non-U.S. assets (in the U.S. those assets were purchased by MolsonCoors)."). For an article discussing the duopoly in U.S. beer supply, *see* Tepper, *supra* note 87.

93. Tepper, *supra* note 87.

94. Ron Knox, *Break Up Budweiser and Molson Coors Too. The Beer Industry Needs Trustbusting.*, SLATE (July 9, 2020), https://slate.com/business/2020/07/break-up-big-beer.html (on file with the *University of the Pacific Law Review*).

> The barriers for craft brewers stretch all the way to the store shelves. In a nearly unbelievable agreement between megaretailers and the beer industry, nearly every chain supermarket, drug store, liquor store, and big box in America relies on representatives or wholesalers for either AB InBev or Molson Coors to design and stock their beer aisles. This system, called "category captains" in the retail industry, ensures that any small craft brewer that wants shelf space must first pitch its product to the beer duopoly, which might, out of maybe some sense of generosity, recommend that retailers stock it. It's a preposterous system. And in a world where AB InBev and Molson Coors themselves own multiple craft brands, those category captains can simply recommend to retailers their own brands—providing customers with the illusion, but certainly not the reality, of choice. In a memo to its members, the Brewers Association lamented that "many breweries must operate knowing that a person employed by a direct competitor will substantially or entirely determine the outcome of these critical decisions."[95]

Such a system puts many breweries in a bind, assuming they want to grow and also want to handle their own distribution, for it effectively puts them in a zero-sum situation. Either the brewery chooses to limit its production to within its state's barrelage cap for self-distribution or it exceeds the cap and is forced to contract with a distributor that might not advance the brewer's interests. Breweries should simply not have to choose one or the other. A healthier, fairer system would enable a brewery to choose both.[96]

In short, distributors in today's beer market are big and powerful. The same is true with regard to the markets for other types of alcohol. BFLs were created to protect small distributors from big suppliers, but due to the massive shift in both the quantity and size of suppliers (more and smaller) and distributors (fewer and bigger), the latter do not deserve protection from the former, regardless of whether they ever did.[97] And since the justification for BFLs no longer exists, the

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95. *Id.*

96. *Id.* ("The beer industry, like so many others, demonstrates the failure of modern antitrust to prevent monopolies from both growing and abusing their power. The solution, then, must be structural. The antitrust agencies should stop any further consolidation in the industry. Smaller brewers should be allowed to compete freely, rather than simply angling for a Big Beer buyout because it is the only way to expand beyond their narrow confines. That AB InBev can own even one beer distributor feels wrongheaded; it goes against the intent of many state systems to block vertical ownership as a way to resist monopoly power. Enforcers should force AB InBev to divest itself of its wholly owned distributors, and they should end the system of exclusivity and franchise relationships that limit the number of distributors and the ability for independent brewers to switch if they're getting a bad deal. And the category captain system is wildly inappropriate; regulators should step in to ensure retailers and distributors unbeholden to the major breweries are responsible for choosing which beers customers find on store shelves.").

97. *See* Sorini, *supra* note 92 ("A few aspects of the current regulatory system, however, are the source of greater consternation among many craft brewers. Perhaps the most contentious subject involves so-called beer 'franchise laws.' Passed mostly in the 1970s and 1980s, these laws emerged at a time when the newly-emerged national breweries dwarfed beer distributors, which at the time were mostly small mom and pop

same is true for a TTS's requirement that beer suppliers above a certain barrelage cap sell solely via wholesalers. As such, the TTS and BFLs simply do not make sense in today's alcohol market; and more than not making sense, they are detrimental to the overall health of the market.

What, then, would the harm be if the TTS and BFLs were not mandated? If suppliers were no longer required to sell via wholesalers, what would happen? Would this lead to increased alcohol consumption? There is no evidence indicating it would. Would retailers suddenly become beholden to big breweries, leading to a revival of the purported "evils" of tied houses? Given the increasing number of breweries, it is hard to envision that retailers would succumb to such a fate. Moreover, even if tied houses emerged, how is this a result that justifies forcing alcohol suppliers into contractual relationships with distributors? The author sees no reason to object to the existence of retail shops or bars owned even entirely by breweries. If a consumer does not want to drink at a particular brewer's bar, the consumer can simply choose not to and most likely, given the nature of our competitive marketplace, could instead patronize another brewer's retail establishment. Would competition suffer? The opposite is much more likely to be true. If our nation's increasing number of breweries were free to seek outlets to distribute their beers—whether via retailers and/or via direct shipments to consumers—the end result surely would be a much more dynamic, competitive alcohol marketplace.

Likewise, if the relationship between a supplier and its distributor were governed by the legal contractual terms the parties freely agreed upon, what ill(s) would ensue? There is no reason to think consumers would be harmed in any way. If anything, freeing alcohol suppliers to market and distribute their beers as they see fit might lead to more beer, fresher beer, and less costly beer for its consumers.[98]

In the author's view, were the TTS and BFLs no longer legally required, public health, safety, and welfare would not be harmed in the slightest, and competition would not suffer. Alcohol suppliers would be free to contract with distributors, and their contractual relationships with such distributors would be governed by the terms those parties willingly agree to; and the common law and statutory laws, such as federal antitrust law, would be sufficient to deal with any activities that actually harm the marketplace for alcohol.

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operations. As such, these laws provide special and often un-waivable legal protections to beer distributors to protect the arbitrary termination of their right to distribute a brand. But beer distributors have continued to grow and consolidate, with most mainline (i.e., distributors of one or more major national brands) distributors today dwarfing the vast majority and, in some cases, even the very largest craft brewers. Tipping the scales of justice towards these big businesses in their relation to craft brewers strike many as unfair and has led to calls for reform of these laws to provide more brand mobility to smaller brands. Naturally, distributors have resisted such calls for reform.").

98. *Id.* ("self-distribution provides emerging brewers with opportunities to develop the market for their products.").

VI. RECOMMENDATIONS

For all of the reasons stated above, the author recommends, and encourages state legislatures to enact, the following regulatory reforms:

A. Repeal the TTS Requirements

Legislatures should do away with mandating that suppliers sell solely to distributors, thus allowing self-distribution (including DTC shipments) by breweries. If a brewery wishes to sell via a distributor, it will still have the freedom to do so. But the choice should be for the brewery. If a legislature does not do away with its TTS altogether, the author recommends some incremental changes: (a) *Increase barrelage limits for self-distribution.* Increasing the production cap would give many breweries a greater ability to grow their brands, while also maintaining control over distribution of those brands. (b) *Legalize on-site sales of growlers.* Compared to buying an equivalent volume of alcohol in cans or bottles, growlers make much more sense, both economically and environmentally.[99]

B. Repeal BFLs

Common law is more than adequate to govern the private, contractual relationships between suppliers and distributors, just as it is for other contracts. The common law can sufficiently handle any possible contract-based claim a distributor brings against a supplier, including claims of fraud, innocent misrepresentation, duress, mistake, or undue influence. Moreover, judges can determine whether any contractual provision is unconscionable. Distributors need no more than these protections, which are firmly established via states' common law of contracts. Even if BFLs did not create the anti-competitive and anti-freedom-of-contract problems that they do, they still would not be worthy of the added statutory protections they provide to distributors.

VII. CONCLUSION

The TTS and BFLs are outdated state alcohol laws that primarily serve the economic interests of alcohol wholesalers, at the expense of alcohol suppliers, retailers, and consumers. They pose a range of constitutional problems, and they are simply bad public policies. Legal challenges are highly unlikely to prevail for

99. *See generally* Aaron Goldfarb, *Don't Tread on My Growler*, ESQUIRE (Sept. 19, 2013), https://www.esquire.com/food-drink/drinks/a24773/growler-state-laws-0913/ (on file with the *University of the Pacific Law Review*); Jonathan, *Why Do States Have Laws Restricting Breweries from Filling Growlers?*, BOTTLESTORE, https://blog.bottlestore.com/why-do-states-have-laws-restricting-breweries-from-filling-growlers/ (last visited Mar. 11, 2021) (on file with the *University of the Pacific Law Review*).

the foreseeable future, so beer suppliers, retailers, and consumers should focus chiefly on advocating for legislative repeal. In today's alcohol marketplace, the TTS and BFLs do not protect public health, safety, or welfare and do not advance competition. Instead, they simply serve as an obstacle to a more vibrant, more efficient marketplace for beer. Indeed, other laws are sufficient for protecting public health, safety, or welfare and for advancing competition, so state legislatures should repeal TTS laws and BFLs. Doing so will increase the chances for greater competition in the alcohol marketplace and for more variety, fresher beer, and lower costs for beer consumers.