

# BREWING UP A NEW CENTURY OF BEER: HOW NORTH CAROLINA LAWS STIFLE COMPETITION IN THE BEER INDUSTRY AND HOW THEY SHOULD BE CHANGED

DAVID R. SCOTT†

*Beer is America's beverage. Pretty much everything in America that's important is around beer.*<sup>1</sup>

Beer is everywhere. From our homes to TV shows, advertisements, restaurants, and of course the local brewery; we are surrounded by beer. There were 2,403 breweries in operation for at least part of 2012 in the United States.<sup>2</sup> The majority of these were brewpubs,<sup>3</sup> which are breweries that brew and sell beer on their own premises but typically do not distribute their beer elsewhere.<sup>4</sup> Another forty-six percent were microbreweries.<sup>5</sup> In fact, it has been estimated that the majority of Americans, including North Carolinians, live within ten miles of a brewery.<sup>6</sup> As of 2012, North Carolina is home to eighty-two breweries,<sup>7</sup> a notable increase from the forty-six in operation in

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† David Scott is a 2012 graduate of the Wake Forest University School of Law. After graduation, he worked as a Legal Associate with the Cato Institute's Constitutional Studies department.

1. BEER WARS (Ducks in a Row Entertainment Co. 2009).

2. *Number of Breweries*, BREWERS ASS'N, <http://www.brewersassociation.org/pages/business-tools/craft-brewing-statistics/number-of-breweries> (last visited Apr. 1, 2013).

3. *Id.*

4. *Market Segments*, BREWERS ASS'N, <http://www.brewersassociation.org/pages/business-tools/craft-brewing-statistics/market-segments> (last visited Apr. 1, 2013).

5. *Number of Breweries*, *supra* note 2. Microbreweries are those with an annual production of less than 15,000 barrels, while craft breweries are those with annual productions of less than six million barrels. *Market Segments*, *supra* note 4; *Craft Brewer Defined*, BREWERS ASS'N, <http://www.brewersassociation.org/pages/business-tools/craft-brewing-statistics/craft-brewer-defined> (last visited Apr. 1, 2013).

6. *Craft Brewer Defined*, *supra* note 5.

7. *Brewers Almanac 2013: Active Brewer Permits by State*, BEER INST., <http://www.beerinstitute.org/br/beer-statistics/brewers-almanac> (last updated Mar. 28, 2013) [hereinafter *Brewers Almanac*].

2009,<sup>8</sup> and Asheville, North Carolina has had the distinction of being named the number one beer destination in the country.<sup>9</sup>

While the importance of beer in American culture is unquestionable, few truly know the storied history of beer, particularly in the regulatory realm. Most Americans are aware of the Prohibition years, but the regulatory environment that has surrounded the brewing industry for the seventy-nine years since remains a mystery to many. When asked how beer gets from the brewery to the consumer, many will likely respond with an answer such as “on a truck.”<sup>10</sup> However, the distribution of beer is not such a simple task, as the brewing industry remains tightly regulated on the federal, state, and local levels. It may come as a surprise that, while the federal government does play some role, much of the regulation does not come from Washington, D.C. but is, instead, largely a product of state law.<sup>11</sup>

In ending Prohibition, the Twenty-First Amendment left control of alcohol primarily to the states.<sup>12</sup> Virtually every state has adopted a three-tier distribution system, as well as a franchise law regulating the relationships between brewers and wholesalers.<sup>13</sup> The three-tier distribution system provides a framework in which alcohol producers (brewers) can only sell their products to wholesalers.<sup>14</sup> Wholesalers, in turn, can only sell to retailers, who are finally able to sell to the end consumer.<sup>15</sup> The three-tier distribution system is a product of state law, which frequently provides for certain exceptions to the general rule, most common of which is the brewpub exception.<sup>16</sup> On a number of occasions, the Supreme Court of the United States has upheld the three-tier

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8. *Id.*

9. Jeri Rowe, *North Carolina Brews Reputation for Good Beer*, GREENSBORO NEWS & REC., Aug. 6, 2009, at A2.

10. BEER WARS, *supra* note 1.

11. *See* Granholm v. Heald, 544 U.S. 460, 488 (2005); NAT’L INST. OF HEALTH, ALCOHOL POLICY INFO. SYS., ABOUT ALCOHOL POL’Y, *available at* [http://alcoholpolicy.niaaa.nih.gov/About\\_Alcohol\\_Policy.html](http://alcoholpolicy.niaaa.nih.gov/About_Alcohol_Policy.html) (“Ratification of the 21st Amendment gave States the authority to either permit or prohibit importation or sale of alcoholic beverages within their borders . . .”).

12. *Granholm*, 544 U.S. at 488.

13. Andrew Tamayo, *What’s Brewing in the Old North State: An Analysis of the Beer Distribution Law Regulating North Carolina’s Craft Breweries*, 88 N.C. L. REV. 2198, 2201 (2010).

14. *Id.* at 2200–01.

15. *Id.*

16. *Id.* at 2201.

distribution system as an “unquestionably legitimate” use of the power granted to the states in the second clause of the Twenty-First Amendment.<sup>17</sup>

While the Twenty-First Amendment leaves alcohol regulation primarily to the states, federal law is not entirely absent from the industry. Most notable is the federal prohibition of so called “tied houses.”<sup>18</sup> The federal tied house statute essentially prevents a brewer from entering into an arrangement with a retailer which results in the alcoholic beverages of other producers being excluded from sale by the retailer.<sup>19</sup> Among the arrangements prohibited by the federal statute is the situation in which the producer has a financial interest in the retailer.<sup>20</sup> The arrangement must have some relation to interstate commerce in order to fall under the purview of the federal statute, but most states have enacted their own tied house statutes as well.<sup>21</sup>

The laws of North Carolina are not much different from any other state in the Union. With the stated purpose of “[m]aintain[ing] stability and healthy competition in the malt beverage industry,”<sup>22</sup> the North Carolina legislature has established a three-tier distribution system for the distribution of beer within the state.<sup>23</sup> Additionally, North Carolina has enacted its own version of a tied house statute which, similar to the federal statute, prohibits the brewer from having a financial interest in a retailer.<sup>24</sup>

With this Note, I do not seek to engage in the debate over the constitutionality of the three-tier system. That issue is well settled by the United States Supreme Court, and the outcome is not likely to change anytime soon. Rather, I argue that the three-tier system is a poor public policy choice, contrary to the North

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17. *Granholm*, 544 U.S. at 489 (quoting *North Dakota v. United States*, 495 U.S. 423, 432 (1990)).

18. 27 U.S.C. § 205(b) (2000).

19. *Id.* § 205(a)–(b).

20. *Id.* § 205(b).

21. Evan T. Lawson, *The Future of the Three-Tiered System as a Control of Marketing Alcoholic Beverages*, in *SOCIAL AND ECONOMIC CONTROL OF ALCOHOL: THE 21ST AMENDMENT IN THE 21ST CENTURY* 31, 33 (Carole L. Jurkiewicz & Murphy J. Painter eds., 2008).

22. N.C. GEN. STAT. § 18B-1300 (2011).

23. *See* § 18B-1104 (discussing brewery permits); § 18B-1109 (discussing wholesaler permits); § 18B-1001 (discussing retailer permits).

24. § 18B-1116 (2011).

Carolina legislature's stated goals of the system, and is anti-competitive and harmful to the state's craft brewing industry. Simply because the North Carolina legislature is constitutionally permitted to enact the three-tier system does not mean that it should. In arguing against the three-tier system, I will first engage in a discussion of the history of the alcohol laws in America and how the three-tier system came about. I will then analyze the three-tier system from the focal point of the stated purpose of the alcohol distribution laws in North Carolina, in particular, whether the stated purpose is a legitimate end of government and whether the laws accomplish their goals. I will then seek to lay a blueprint for a more efficient and market-oriented approach to alcohol distribution. While I will focus primarily on North Carolina, much of my argument extends to every other state as well.

## I. HISTORY OF BEER AND ITS REGULATION

From ancient Greece, Mesopotamia, and Rome, to the early American Colonies, to modern day, there have been regulations on the production, sale, and consumption of beer.<sup>25</sup> The laws have not always been in the temperance realm, as one might expect. Most American colonies required towns, under threat of fine, to license individuals to sell alcohol.<sup>26</sup> While laws have changed with public sentiment towards alcohol over time, it is the public sentiment of nearly a century ago that has shaped many of the modern laws concerning beer distribution.

Our study of the history of beer laws begins with the temperance movement, which led to Prohibition. Prior to Prohibition, like today, alcohol was largely regulated by the states.<sup>27</sup> To combat the perceived ills associated with alcohol, states and localities experimented with systems from licensing to outright prohibition.<sup>28</sup> Before the 1920s, the brewing industry was primarily divided between brewers and retailers, with only a few wholesalers.<sup>29</sup> Without extensive regulations concerning the

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25. Carole L. Jurkiewicz & Murphy J. Painter, *Why We Control Alcohol the Way We Do*, in *SOCIAL AND ECONOMIC CONTROL OF ALCOHOL: THE 21ST AMENDMENT IN THE 21ST CENTURY* 1, 2-3 (Carole L. Jurkiewicz & Murphy J. Painter eds., 2008).

26. Lawson, *supra* note 21, at 46.

27. *Id.* at 32.

28. *Id.*

29. *Id.*

interactions of brewers and retailers, brewers exerted a large degree of influence over retailers in the form of ownership by requiring the retailers to only carry the brewer's own brands, and by providing financial incentives.<sup>30</sup> In owning some retailers and providing financial incentives to others to sell more of the brewer's products, the public perceived brewers as mischievously increasing consumption, causing the drunkenness and financial ruin of citizens.<sup>31</sup> The growing negative perceptions of tied houses and alcohol in general helped to usher in the Eighteenth Amendment and the beginning of Prohibition in January 1918.<sup>32</sup>

Less than fifteen years later, the Twenty-First Amendment ended Prohibition.<sup>33</sup> The Amendment consists of two operative provisions. The first simply repeals the Eighteenth Amendment.<sup>34</sup> The second provision provides that “[t]he transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.”<sup>35</sup> The Supreme Court of the United States has long interpreted the second provision to provide the states “virtually complete control” over regulation of the production and sale of alcohol within their borders.<sup>36</sup>

With the end to Prohibition in sight, and control of alcohol likely to fall back into the hands of each individual state, John D. Rockefeller, Jr., a lifelong temperance advocate and son of oil tycoon John Rockefeller, commissioned a study by Raymond B. Fosdick and Albert L. Scott entitled *Toward Liquor Control* in order to develop plans for states to use to control alcohol.<sup>37</sup> Published in 1933, the study concluded that the best option would be state-run monopolies over the sale and distribution of alcohol.<sup>38</sup> Realizing state-controlled monopolies would be rejected by many states,

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30. *Id.*

31. *Id.*

32. U.S. CONST. amend. XVIII (repealed 1933).

33. U.S. CONST. amend. XXI.

34. *Id.*

35. *Id.*

36. *Granholm v. Heald*, 544 U.S. 460, 488 (2005) (quoting *Cal. Retail Liquor Dealers Ass'n. v. Midcal Aluminum, Inc.*, 445 U.S. 97, 110 (1980)).

37. Lawson, *supra* note 21, at 33.

38. *Id.*

Fosdick and Scott also set forth a licensing plan.<sup>39</sup> However, without regard to which method a state would adopt, *Toward Liquor Control* found the prohibition of tied houses to be essential to alcohol control, advocating for a three-tier system by inserting a mandatory wholesale level between brewers and retailers.<sup>40</sup> Doing so would help to eliminate devices “calculated to place the retail establishment under obligation to a particular distiller or brewer” and thus eliminate the financial incentives thought to be encouraging retailers to promote excess consumption.<sup>41</sup> Despite having the authority to adopt its own laws in relation to alcohol, most states, including North Carolina, have adopted virtually the same basic framework for alcohol distribution, the three-tier system Fosdick and Scott advocated.<sup>42</sup>

## II. THE NORTH CAROLINA FRAMEWORK

While the framework of North Carolina laws regulating the distribution of beer can be stated summarily—brewers must sell to wholesalers, who can only sell to retailers, who can then sell to consumers—the laws establish much more than this simple three-tier structure. North Carolina laws create the three-tier system by requiring separate licenses for brewers,<sup>43</sup> wholesalers,<sup>44</sup> and retailers.<sup>45</sup> The brewing permit only allows the holder to sell to wholesalers, unless the brewer’s production is less than 25,000 barrels a year, in which case the holder is eligible to obtain a wholesaler permit for his own beer.<sup>46</sup> Additionally, any brewer may obtain a retailer’s permit to sell his products at the brewery itself, as long as the sale of alcohol is not otherwise prohibited by local law.<sup>47</sup> Holders of wholesaler permits may sell to retailers and other wholesalers, as well as to their own employees, and may furnish alcohol to guests for promotional purposes, but are subject to additional regulations by the Alcoholic Beverage Control

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39. *Id.*

40. *Id.*

41. RAYMOND B. FOSDICK & ALBERT L. SCOTT, *TOWARD LIQUOR CONTROL* 43 (1933).

42. *Id.* at 31.

43. N.C. GEN. STAT. § 18B-1104 (2011).

44. § 18B-1109.

45. § 18B-1001.

46. § 18B-1104(7).

47. *Id.*

Commission (“ABC”).<sup>48</sup> Retailers are the only licensees permitted to sell to the end consumer, with the exceptions just stated.<sup>49</sup>

North Carolina has its own version of a tied house statute.<sup>50</sup> Under the statute, brewers and wholesalers are prohibited from having any direct or indirect interest in a retailer.<sup>51</sup> Furthermore, it is illegal for a brewer or wholesaler, directly or indirectly, to require a retailer to purchase alcoholic beverages from him “to the full or partial exclusion of any other alcoholic beverages offered for sale by other persons.”<sup>52</sup> Finally, it is illegal for a brewer or wholesaler to give or lend to any retailer “any money, service, equipment, furniture, fixtures or any other thing of value.”<sup>53</sup>

North Carolina also has an entire section of statutes governing the relationship between brewers and wholesalers.<sup>54</sup> In order for a brewer to sell his products to a wholesaler, the ABC must be given notice of the franchise agreement between the parties and the brands to be sold.<sup>55</sup> The agreement must specify the territory in which the wholesaler is permitted to sell the products.<sup>56</sup> Brewers are only permitted to sell a particular brand to one wholesaler in any given territory, and the wholesaler is not permitted to sell the brewer’s products outside of the designated territory.<sup>57</sup> Additionally, brewers are legally restricted in the manner in which they can alter or terminate their franchise agreements with wholesalers.<sup>58</sup> Brewers may only materially alter, terminate, or fail to renew a franchise agreement with a wholesaler for good cause.<sup>59</sup> Before doing so, the brewer must provide the wholesaler with written notice ninety days in advance of the alteration or termination detailing the cause of the alteration or

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48. § 18B-1109.

49. *See* § 18B-1001.

50. *See* § 18B-1116.

51. *Id.*

52. *Id.*

53. *Id.*

54. §§ 18B-1300 to -1309.

55. § 18B-1303.

56. *Id.*

57. *Id.*

58. § 18B-1304(2).

59. *Id.*

termination and allowing the wholesaler forty-five days to correct the cause.<sup>60</sup>

### III. POLICY RATIONALE FOR THE THREE-TIER SYSTEM

In analyzing the North Carolina alcohol distribution laws, a good starting point is the legislative purpose behind the laws. In creating the laws regulating the relations between brewers and wholesalers, the North Carolina legislature has stated that the laws are necessary to, among other things, “(1) Maintain stability and healthy competition in the malt beverage industry in this State. (2) Promote and maintain a sound, stable and viable three-tier system of distribution of malt beverages to the public.”<sup>61</sup> In enacting legislation to allow special event permits, the North Carolina legislature stated that “craft brewers . . . could serve as an economic engine throughout North Carolina and create jobs and serve as a tourist draw” and that the law “will help grow [the brewing] industry in a similar fashion as similar actions taken by the North Carolina General Assembly have helped grow North Carolina’s wine industry.”<sup>62</sup> From these statements we can essentially find two main intentions of the laws surrounding the brewing industry: to maintain “healthy competition” and to promote the growth of the industry.

One cannot help but find ironic that, in conjunction with the large number of government funded programs aimed at curbing alcohol consumption and abuse, the North Carolina legislature is at least purporting to enact legislation with the intention to promote and grow the brewing industry. In seeking to grow the brewing industry, is the legislature not also seeking to increase alcohol consumption? In order for the brewing industry to grow, either alcohol consumption must grow, or people must substitute beer for other alcoholic beverages. Since the North Carolina legislature has cited what it perceives to be its successes in promoting the wine industry, and the wine industry most certainly has enjoyed substantial growth in recent years,<sup>63</sup> the

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60. § 18B-1305(b).

61. § 18B-1300.

62. See Act of July 31, 2009, 2009 N.C. Sess. Laws 377 (codified at N.C. GEN. STAT. § 18B-902 (2009)).

63. See *Brewers Almanac*, *supra* note 7, at *Per Capita Wine Consumption by State 1994 to 2011*.



more feasible attitude of the legislature is to encourage greater alcohol consumption. (Surely the legislature could not be so bold as to tout the progress of the wine industry at the same time it seeks to encourage the consumption of beer in the place of wine.) Prohibition in the United States ended in disgrace, and few today seek to prohibit the sale and consumption of alcohol on a large scale, but does that mean the government should instead seek to encourage alcohol consumption? The negative effects of alcohol abuse are well known and documented, so why would the government enact legislation to promote increased alcohol consumption?<sup>64</sup> On the other hand, the benefits of moderate alcohol consumption are also well known and documented, so why would the government wish to stifle an individual's choice to consume alcohol?<sup>65</sup> As the World Health Organization put it, "[a]lcohol gives pleasure as well as pain, and any government which fails to acknowledge that fact is unlikely to take the people with it."<sup>66</sup>

We are left then with the question of what the legislature should seek to promote in regards to the brewing industry, if anything at all? The answer, I contend, is quite simple, the same thing any government in a free market should seek to promote—competition and a fair marketplace—something which three-tier proponents and the North Carolina legislature claim to promote but, in reality, is the opposite of the effect of the three-tier system. The brewing industry should be allowed to prosper and falter on its own merits as any other industry would. Brewers do not need special legislation to promote the growth of their industry. The craft brewing industry that the North Carolina legislature seeks to promote has flourished in recent years and will flourish even more with the burden of the three-tier system lifted from its back. The large collection of laws and regulations surrounding the brewing industry simply creates an uncertain regulatory environment which siphons the attention and finances away from the brewer's products and marketing and into attorneys' fees and regulatory compliance.

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64. See, e.g., M. Grønbaek, *The Positive and Negative Health Effects of Alcohol—and the Public Health Implications*, 265 J. INTERNAL MED. 407 (2009).

65. See, e.g., *id.*

66. Jurkiewicz & Painter, *supra* note 25, at 1.

#### IV. DOES THE NORTH CAROLINA LEGISLATURE'S POLICY ACCOMPLISH ITS PURPOSE?

Having analyzed the stated purpose behind North Carolina's three-tier distribution system, we must next determine whether the laws actually accomplish their stated purpose. Let us first analyze whether the laws accomplish the goal of promoting competition in the brewing industry before turning our attention to whether the laws promote the growth of the industry.

##### *A. Promoting Competition*

With the goal to "maintain . . . healthy competition" in the brewing industry, the North Carolina legislature has enacted a series of laws governing the relationships between brewers and wholesalers.<sup>67</sup> Yet, all that is needed to see that the statutes are not truly designed to promote competition is a simple reading of the statutes themselves. To begin with, the legislature has prohibited a brewer from selling a given brand to more than one wholesaler in any given territory.<sup>68</sup> In order for there to be competition there must be more than one competitor. By prohibiting brewers from selling to more than one wholesaler in a given territory, the legislature has given wholesalers a monopoly over the brand for the given territory. Sure, the argument can be made that there is competition among wholesalers for the business of the brewers. However, this argument only holds true for the initial franchise agreement made by the brewer, as other statutes greatly restrict the brewer's ability to move between wholesalers once an initial franchise agreement has been struck. Furthermore, the level of competition must not only be viewed at the brewer to wholesaler level, but also at the wholesaler to retailer level. By giving wholesalers monopolies over the brands of beer they carry, the legislature has effectively eliminated competition among wholesalers for the business of retailers for each particular brand.

One might argue that there is competition among the various wholesalers operating in a particular area for the business of the retailers as a whole as opposed to for a specific brand. For instance, wholesaler X may carry Bud Light products while

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67. N.C. GEN. STAT. § 18B-1300 (2009).

68. § 1303(a).

wholesaler Y may carry Miller Lite and will thus be in competition for the business of retailers (assuming one wholesaler does not obtain the rights to carry both brands). While this argument may hold to some degree, it does not go very far. Not all beers are equally substitutable. While Miller Lite and Bud Light may be substitute products for many, thus allowing for competition between our two hypothetical wholesalers, to consumers wishing to drink a beer from any of North Carolina's craft breweries such as Natty Greene's or Highland Brewing Company, Miller Lite and Bud Light certainly will not be substitute products. A proponent of the North Carolina system would argue that there will be competition between the wholesaler carrying Natty Greene's and the wholesaler carrying Highland Brewing Company products. But again this argument can only go so far. The differences between two microbrews are vastly greater than the differences between the major beers, i.e., Bud Light and Miller Lite, making them less substitutable, and for truly niche beers (of which there are many) such as Foothills Sexual Chocolate or Bells Hopslam, which have cult followings, there can be no substitute. The wholesalers who are lucky enough to have a franchise agreement for those brands are able to wield a considerable amount of power over the retailers who wish to carry those products. In addition, many consumers are partial to particular brands of beer, thus minimizing the substitutability of different beers. Ultimately, each brand of beer is a unique product and the North Carolina legislature has effectively given monopolies to wholesalers for each brand.

Further adding to the lack of competition is the difficulty for new and small brewers to get their products to market. While small breweries are allowed to self-distribute in North Carolina, by creating a mandatory three-tier distribution system for breweries who produce over 25,000 barrels a year, the legislature has created a market dominated by the use of wholesalers. Many retailers do not wish to be burdened with dealing with multiple self-distributing breweries. The inconvenience placed on retailers by self-distribution in a world dominated by mandated wholesalers necessitates the use of wholesalers for many small breweries who do not have the power to require wholesalers to carry their products. Much like the retailer who does not wish to be burdened with self-distributing breweries, wholesalers may not wish to be burdened with carrying the products of a small unknown brewery, thus increasing the difficulties of new and small breweries to sell

their products and compete in the market. Further, the ability of brewers who produce less than 25,000 barrels a year to self-distribute does not help those who produce over 25,000 barrels a year, who, although slightly larger in size, may not have built up sufficient market power to entice wholesalers to carry their products.

Another requirement of competition is that parties must be able to freely move between competitors. The North Carolina statutes prevent a brewer from altering in a material way, terminating, or failing to renew a franchise agreement with a wholesaler except for good cause.<sup>69</sup> Not included in the definition of good cause is the brewer finding another wholesaler who is willing to provide the brewer with a more rewarding agreement, more willing to promote the brewer's products, or better suited at convincing a wide range of retailers to carry the brewer's products.<sup>70</sup> Prohibiting brewers from freely moving between wholesalers is the exact opposite of competition. The provisions limiting the ability of brewers to alter or terminate agreements with wholesalers can be seen as doing only one thing, stifling competition among wholesalers for the business of brewers, among wholesalers for the business of retailers, as well as among brewers for the business of consumers. For true competition to exist in the beer industry, the agreements between brewers and wholesalers must be regulated like any other contract, allowing brewers to not renew the contract for any reason, including finding a different wholesaler with a more competitive offer.

In order to effectively compete with one another, brewers must be able to pit their products against each other. The laws of North Carolina allow brewers to put on tasting events in order to directly reach the consumer<sup>71</sup> but greatly limit the brewer's ability to pit his product against another product in the eyes of retailers. The North Carolina tied house statute prohibits brewers from giving to retailers anything of value and provides the ABC with the power to make exceptions to this rule.<sup>72</sup> The ABC has promulgated regulations permitting brewers to give to retailers

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69. § 1304(2).

70. *See* § 1305.

71. 04 N.C. ADMIN. CODE 02T.0713(b) (2011).

72. N.C. GEN. STAT. § 18B-1116 (2011).

free of charge “no more than three gallons of any brand of malt beverages.”<sup>73</sup>

Suppose a new brewer wishes to get his name into the marketplace and convince retailers to carry his products. How might he go about doing this? Retailers who sell draft beer have only so many draft towers available. The retailer may be reluctant to purchase a new product and take the risk of the product not selling well. Thus, a brewer may find it in his interest to provide the retailer with a few free kegs of beer so that the retailer can see how well the product will sell compared to other products the retailer carries before he invests his own money in the new product. However, North Carolina law prohibits this arrangement.<sup>74</sup> While the new brewer’s best option for convincing retailers to give his product a chance to compete against existing brands may be to provide a sample to the retailer, as is custom in many industries, he is statutorily prohibited from doing so because of the prohibitively low limit set by the ABC for how much free beer a brewer can provide retailers.<sup>75</sup> Thus, new brewers may find themselves with an even larger struggle in establishing their brand name as a result of the North Carolina regulations than would otherwise be the case.

### *B. Promoting Industry Growth*

Having established that one is hard pressed to see the North Carolina statutes as promoting competition, we must now analyze whether the statutes accomplish the second intention of the legislature: promoting industry growth. There has been a recent explosion in the number of breweries in North Carolina. In 2004, there were thirty-eight breweries in the state.<sup>76</sup> By 2010 that number had risen to fifty-four.<sup>77</sup> However, an increase in breweries does not necessarily correlate with industry growth, as measured

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73. 04 N.C. ADMIN. CODE 02T.0713(b)(1)(A) (2011).

74. *See id.*

75. The typical keg size is 15.5 gallons. Even a small 1/6th barrel keg is roughly five gallons, which makes it illegal for the brewer to provide the retailer with a standard sample of his product. *What Sizes of Keg Is Draft Beer Available In?*, MICRO MATIC, <http://www.micromatic.com/beer-questions/sizes-keg-draft-beer-available-aid-11.html> (last visited Apr. 1, 2013).

76. *Brewers Almanac*, *supra* note 7, at *Active Brewer Permits by State*.

77. *Id.*

by production. Between 2000 and 2010, the state saw an increase in consumption from 5,590,081 barrels to 6,109,484 barrels, an increase of just over 9%.<sup>78</sup> However, during that same time period, the state saw an 18% increase in population.<sup>79</sup> In light of the population increase, it appears that the brewing industry in North Carolina should be expanding faster than it is. In fact, between 2000 and 2010, per capita beer consumption in North Carolina decreased from 21.5 gallons to 20 gallons.<sup>80</sup> To be fair, the decrease occurred entirely between the years 2006 and 2010, leaving the question of what role the recession has played in the decrease as opposed to other factors.<sup>81</sup>

Anyone who has spoken with owners or brewers of any of North Carolina's craft breweries will certainly be quick to point out that nearly all of the breweries are enjoying increased demand for their products, resulting in rapid expansion and the inability to keep up with the demand. However, can this phenomenon be attributed in any part to the laws of North Carolina? One must first realize that while certainly not without revision, the three-tier structure has been in place in North Carolina since the repeal of Prohibition. One is hard pressed to find any changes in the North Carolina laws in the last decade or so which can be pointed to as being responsible for the increase in breweries. Secondly, we must realize that the increase in demand for craft and microbrews is not a North Carolina trend, but rather is a national phenomenon. In 2012, the craft brewing industry nationwide enjoyed a growth of 15% by volume and 17% by dollar sales.<sup>82</sup> In that same year, total beer sales in the United States were up only 0.9% by volume.<sup>83</sup> Similarly, in 2009, the craft beer industry enjoyed growth of 7.2% in volume and 10.3% in dollar sales.<sup>84</sup> Meanwhile, that same year, beer sales as a whole were down 2.2%.<sup>85</sup> These numbers indicate a

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78. *Brewers Almanac*, *supra* note 7, at *Beer Shipments by State 1976 to 2012*.

79. *Brewers Almanac*, *supra* note 7, at *US and State Populations 1994 to 2011*.

80. *Brewers Almanac*, *supra* note 7, at *Per Capita Beer Consumption by State 1994 to 2012*.

81. *Id.*

82. *Facts*, BREWERS ASS'N, <http://www.brewersassociation.org/pages/business-tools/craft-brewing-statistics/facts> (last updated Mar. 18, 2013).

83. *Id.*

84. *Brewers Association Announces 2009 Craft Brewer Sales Numbers*, BREWERS ASS'N (Mar. 8, 2010), <http://www.brewersassociation.org/pages/media/press-releases/show?title=brewers-association-announces-2009-craft-brewer-sales-numbers>.

85. *Id.*

clear trend in recent years for an increased demand in craft beers over the mass-produced beers which have dominated the market since the repeal of Prohibition and the institution of the three-tier distribution system. This trend is largely attributable not to the three-tier system, but rather to the legalization of brewpubs across the nation in the 1980s and 1990s, leading consumers to discover and demand beers other than the bland, watered-down lagers which were the only beers on the market for much of the post-Prohibition era.<sup>86</sup>

In addition to the lack of any evidence of the North Carolina system promoting growth of the brewing industry, it is estimated that the three-tier distribution system results in retail prices that are eighteen to twenty-five percent higher than they would be without the system.<sup>87</sup> Higher prices are not only reflected in craft beer but also mass produced beer as well as wine and liquor, so the system does not on its face harm the craft brewing industry in comparison to other alcoholic beverages. But upon a closer examination, one can see how artificial price increases benefit the large scale brewers to the detriment of the smaller craft brewers. Craft beer is greatly more expensive than the mass-produced beers such as Budweiser, Miller, and Coors.<sup>88</sup> This naturally puts craft brewers at a competitive disadvantage. The disadvantage only grows larger with the increase in price of beer as a result of the three-tier system, which increases the cost prohibitiveness of craft beers for many consumers. Take for instance a twelve pack of Highland Brewing Company's Cold Mountain Winter Ale, which sells in the neighborhood of twenty dollars, nearly twice the price of Budweiser or Miller. If the three-tier system adds twenty-five percent to the cost of beer, that same twelve pack would cost sixteen dollars in a world without the three-tier system. The Cold Mountain would still be a much more expensive product than the Budweiser or Miller, which would have decreased by twenty-five percent as well, but the decrease in price would make the Cold Mountain more affordable and conscionable to purchase to the average consumer wishing to try a

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86. See Matt Emery, *Jimmy Carter, Semantics, and Homebrews*, THE BARBEERIANS (Aug. 20, 2010), <http://www.barbeerians.com/2010/08/jimmy-carter-semantics-and-homebrews>.

87. David White, Op-Ed., *Wholesale Robbery in Liquor Sales*, N.Y. TIMES, Apr. 4, 2011, at A21, available at <http://www.nytimes.com/2011/04/04/opinion/04white.html>.

88. See BEER WARS, *supra* note 1.

local craft beer. With the recent success of the craft brewers in gaining market share on the large brewers, there can be no doubt that if craft beers were to come down in price closer to the prices consumers are accustomed to paying for the mass produced beers, the craft beer market would enjoy even greater success, thus diluting the market dominance of the major brewers who are still able to wield some control over wholesalers and retailers that was sought to be eliminated by the three-tier system and tied house statutes.<sup>89</sup>

## V. WHAT DO THE LAWS PROMOTE?

If the laws of North Carolina do not promote competition or growth within the brewing industry, what, if anything, do they promote? Simply put, the North Carolina laws regulating the sale of beer foster an environment advantageous to wholesalers at the expense of brewers, retailers, and consumers.

As mentioned earlier, under the laws of North Carolina, wholesalers enjoy a form of monopoly protection. Wholesalers not only do not have to worry about competition in their given territories for the brands that they carry, but they also do not have to worry about competition from other wholesalers for the competition of the brewers they do business with, due to the restrictions which the laws place on brewers in their ability to terminate or alter franchise agreements. The monopoly protection afforded to wholesalers in North Carolina, and similarly in most other states, may help explain why the number of wholesalers operating in the United States has consistently dropped from its peak of over 17,000 just after Prohibition to just over 2,000 in 2010.<sup>90</sup> Even over the time period spanning from 1979, when the number of brewers was at an all time low of forty-four nationwide, to 2010 when the number of brewers had expanded to nearly 2,131, the number of wholesalers was more than cut in half.<sup>91</sup> Is it possible that wholesalers have simply become larger and more efficient in the natural course of their business? Of course. But having laws helping to keep out new

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89. See S. Berghoff et al., *Tapping into the Craft-Beer Industry*, STUMPTOWN BREWERY, <http://www.stumptown.com/articles/mgmtbeer.html> (last visited Apr. 1, 2013).

90. *Brewers Almanac*, *supra* note 7, at *Breweries and Wholesalers 1887 to 2012*.

91. *Id.*



competition and strengthen the positions of the strongest and largest wholesalers certainly does not hurt either.

The protection afforded to beer wholesalers by the legal system should come as no surprise in light of the activity of wholesalers in the political process. The National Beer Wholesalers Association operates the nation's third largest political action committee,<sup>92</sup> which "works to support elected leaders and candidates for federal office who support a pro-beer distributor agenda."<sup>93</sup> Since 2000, the National Beer Wholesalers Association Political Action Committee has spent nearly \$20 million supporting candidates for federal office.<sup>94</sup> Additionally, North Carolina has its own Beer and Wine Wholesalers Association with the mission to "promote and protect the general business interests of beer and wine distributors in North Carolina."<sup>95</sup> It is a bit ironic, in light of the studies which show the increased costs associated with the three-tier system, that the North Carolina Beer and Wine Wholesalers Association purports to "provide the critical link in the American beer [and] wine distribution system for providing adult consumers with the choice they desire *at a great value*."<sup>96</sup> With the monopolies and corresponding large amount of economic activity created for those in the wholesale business by legislatures, it should come as no surprise that the brewing industry has established large associations for political activity and preserving their role in the brewing industry.

## VI. HOW THE NORTH CAROLINA LEGISLATURE CAN IMPROVE THE LAWS

While others have advocated for changes to the three-tier system to make it more competitive and friendly to small brewers,<sup>97</sup> I advocate for a complete repeal of the system. Included

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92. White, *supra* note 87.

93. NBWA PAC, NAT'L BEER WHOLESALERS ASS'N., <http://www.nbwa.org/nbwapac> (last visited Apr. 1, 2013).

94. *Nat'l Beer Wholesalers Ass'n*, OPENSECRETS.ORG (Feb. 24, 2012), <http://www.opensecrets.org/pacs/lookup2.php?cycle=2012&strID=C00144766>.

95. *What is NCBWWA?*, N.C. BEER & WINE WHOLESALERS ASS'N, <http://www.ncbwwa.org> (click "About Us" on left hand column then click "What is NCBWWA?") (last visited Apr. 1, 2013).

96. *Id.* (emphasis added).

97. *See, e.g.*, Tamayo, *supra* note 13, at 2200–01.

in the repeal must be the prohibition against brewers, wholesalers, and retailers from holding a permit of more than one of those three types, the tied house statutes, and the laws regulating the franchise agreements between brewers and wholesalers.

Repealing the mandated three-tier system does not necessarily mean that wholesalers will die off. Without wholesalers, all brewers would be forced to self-distribute, resulting in great costs to the brewers and great inconvenience to retailers who carry products from many breweries who would have to take delivery from each brewery individually. The likely result of the repeal of the three-tier distribution system would be a more efficient and cost effective wholesale division. With an increase in competition, wholesalers will be forced to become more in tune with the needs of brewers, retailers, and ultimately consumers. Additionally, many wholesalers may be established directly by the brewers, thus making them more in touch with the needs of brewers and allowing brewers to better react to consumer demands. Larger breweries may find it cost efficient to self-distribute, resulting in increased profits and decreased retail costs. Other breweries may find it advantageous to partner with other local breweries to distribute their products. Still others will find it necessary to use independent wholesalers in a similar fashion to the current system. Whatever the means by which each brewery distributes his product, it will be his choice and the most efficient method for him to get his goods to the consuming public.

Without taking into account the federal tied house statute, eliminating North Carolina's own tied house statute would open the door for large breweries such as Anheuser-Busch to stifle competition from other brewers at many bars and restaurants. However, stifling competition in a few retail outlets will not eliminate the demand for craft beer. If a number of retail outlets become strictly Anheuser-Busch or strictly Miller-Coors outlets overnight, the profitability of a competing retail outlet selling craft beers would instantly skyrocket. By eliminating the barriers which currently restrict brewers' ability to influence retailers, smaller breweries will be better apt to get their products on shelves and in bars. Without the restrictions on the items which brewers can give away to retailers, these small brewers will be able to better entice retailers to take a chance with their products, thus increasing market access and competition. The increased demand for specialty beer retail outlets and the increased competition

provided by small brewers wishing to make a name for themselves will supply the check against domination by large breweries.

The time has come for all states, not just North Carolina, to move on from the post-Prohibition laws strangling the brewing industry. In repealing the three-tier structure and moving toward a market centered approach, North Carolina can establish itself as a leader in moving toward market competitiveness and make itself a friend to brewers and consumers alike, thus truly accomplishing the legislature's stated goal of using the craft brewing industry to create jobs and provide a tourism draw into the state.