Enhancing Consumer Choice and Competition in American Beer Markets: An Analysis of Vertical Restraints on Craft Brewer Entry and Growth

by

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Abstract

Craft breweries have never been more prominent in the American beer industry. Nevertheless, major distribution networks remain dominated by large brewing conglomerates, and many consumers do not have access to a wide variety of craft beers. This situation is largely the product of “three-tier” distribution systems, which were designed in the post-Prohibition era to prevent vertical integration between brewers and retailers.

This paper identifies three primary vertical restraints on market entry and growth for craft brewers: large brewing conglomerates’ anti-competitive practices in influencing wholesalers’ brand portfolios, franchise laws restricting a small brewer’s ability to alter or terminate their contract with a wholesaler and unprecedented consolidation in the corporate brewing sector. It conducts an evaluation of potential policies to mitigate such restraints and thereby expand choice and competition in American beer markets. It recommends that brewers comprising a small proportion of a distributor’s business be exempted from state franchise laws.

Keywords: beer; alcohol policy; beer distribution; United States; franchise laws; three-tier system
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Craft Brewer
In the United States, a craft brewer produces fewer than 6 million barrels of beer annually, is less than 25 percent owned or controlled by a company that is not itself a craft brewer and generally brews their beer with traditional ingredients (e.g. malted barley).\(^1\) Craft beer is contrasted with mass-produced lagers (e.g. Budweiser, Miller, Coors, Molson Canadian, Labatt Blue, Heineken, Corona), which typically make use of adjunct grains like rice and corn as a cost-saving mechanism, as well as with “phantom craft” brands produced by major brewing conglomerates (AB InBev’s Shock Top and MillerCoors’ Blue Moon) and former craft brands now owned wholly (Goose Island, Elysian) or in part (widmer, Redhook, Kona) by a non-craft brewery.

Microbrewer
A market segment within the craft beer sector; defined as a brewer producing fewer than 15,000 barrels annually.\(^2\) Of the roughly 7,300 craft breweries currently operating in the United States, about 4,500 fall into this category.

Three-Tier
The dominant system of distribution for beer and other alcoholic beverages in the United States, three-tier provides for the legal separation of producers (Tier I), distributors (Tier II) and retailers (Tier III). It is a state-based system designed to prevent vertical integration (i.e. “tied house” arrangements) between brewers and liquor stores, bars, restaurants, etc.

Wholesaler
In alcohol transactions: a business, government agency or other entity responsible for distributing products from producers to retailers. For the purposes of this project, a beer wholesaler refers to an independent, privately-owned distributor in the United States, representing Tier II in the three-tier model.

\(^1\) Brewers Association 2020
\(^2\) ibid
Chapter 1.  Introduction

In the late 20th century, American craft brewing exploded. After more than 40 years of corporate consolidation and product homogenization had left the United States with just 89 breweries owned by 40 companies – ten of whom controlled 93 percent of the domestic beer market – the Carter administration fortuitously legalized homebrewing in 1979, opening the floodgates to a flurry of innovation and experimentation.\textsuperscript{3} Entrepreneurs and microbrewers quickly capitalized on this newfound freedom, introducing American palettes to a variety of traditional European ales and pre-Prohibition recipes that had been buried under the advent of mass-produced lagers, as well as new styles altogether. Within a decade after the legalization of homebrewing, the number of breweries in the U.S. doubled, with many of the most iconic brands in American craft beer – Goose Island, Deschutes, Great Lakes, Brooklyn Brewery, Rogue Ales, North Coast Brewing, Wynkoop – opening in a single year (1988). Today, there are more than 7,000 craft breweries across the country, representing every state, Puerto Rico and the District of Columbia. A negligible share of industry volume just 25 years ago, craft sales now account for 13 percent of the U.S. beer market, contributing 550,000 jobs and $79.1 billion annually to the American economy.\textsuperscript{4}

Yet, dark clouds loom on the horizon. American consumption of beer has been steadily waning for the past four years, with younger generations increasingly turning to wine, spirits, seltzers and cannabis.\textsuperscript{5} Even as craft beer’s market share continues to grow at the expense of the largest breweries, the sector may be nearing an inflection point as it competes for a smaller overall proportion of American consumers. North of the border, this market contraction is already under way: in 2019, beer accounted for 39.7 percent of Canadian alcohol sales, down from more than 50 percent just 15 years ago, despite a rapid rise in the number of breweries over the same period.\textsuperscript{6}

\textsuperscript{3} Noel 2018, p. 7-10  
\textsuperscript{4} Brewers Association 2019  
\textsuperscript{5} Giammona and Reinicke 2019  
\textsuperscript{6} Marotta 2020
Moreover, consumer access to the increasing variety of beer remains highly uneven, with several states and metropolitan areas accounting for a disproportionate share of brewery openings and craft beer sales. Others have been much slower to realize the socioeconomic benefits of expanded consumer choice, including the increased tourism, business activity and local job creation spurred by the development of a vibrant craft brewing scene. In the United States today, the relative variety of beers available to prospective patrons is profoundly shaped by the existence of a dominant three-tier distribution system, which exists de jure or de facto in every state as well as the District of Columbia and provides for separation of the manufacturing (e.g. brewing), wholesaling (distribution) and retailing (liquor store, bar, restaurant, etc.) tiers in alcohol transactions.

**Figure 1: Basic Operation of Three-Tier System for Beer**

![Diagram of three-tier system for beer]

*Note: Several exceptions to this structure exist. On-premise consumption at breweries, i.e. through taprooms or brewpubs, represents direct producer-to-consumer sales. Moreover, 36 states allow some form of producer self-distribution, often with a maximum annual output limit (see Appendix B), wherein a brewer can bypass Tier II and sell products directly to Tier III. Such exceptions will be discussed in greater detail in later chapters.*

This paper identifies three primary institutional pressures on the structure and operation of state distribution tiers, each of which acts as a vertical restraint on the ability of small breweries to sell their products to American consumers:

- The ability of large brewing conglomerates, particularly Anheuser-Busch InBev (AB InBev) and Molson Coors, to exert considerable influence over the brand portfolios of distributors and disincentive them from carrying competing products.

- Beer franchise laws, which severely restrict small breweries’ ability to alter or terminate their contract with a distributor and thereby discourage upstart brands from entering new markets and reaching more consumers.

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7 Gohmann 2016
• Unprecedented corporate consolidation in the global beer market throughout the past three decades, ultimately leading to increased acquisitions of successful American craft brands by multinational conglomerates.

As antitrust economists Francine Lafontaine and Margaret Slade have documented, such vertical restraints and contract limitations on producers tend to reduce consumer well-being by generating upward pressure on retail prices and downward pressure on service levels, in this case the relative variety of beers available in a given market. The three factors cited above will be examined in greater detail in Chapter 2, with relevant examples to illustrate their impact on consumer choice in the American beer industry. It should be noted that these factors are neither mutually-exclusive nor autonomous from one another. Moreover, in each state, the relative importance and precise manifestation of each may vary.

This research project will primarily address the state of consumer choice and market competition in New Jersey. In many ways, the state represents a ‘typical' American jurisdiction with respect to the distribution and retailing tiers, both of which are privately operated. As such, it provides a useful case to examine possible policy options for a variety of American beer markets where competition remains insufficient.

The policy problem examined herein is as follows: Many American beer consumers, including in New Jersey, do not have significant access to a wide array of craft options. The analysis proceeds in Chapter 2 through a literature review of the three vertical restraints stated above, followed in Chapter 3 by an explanation of the primary research methodologies utilized for this project. Chapter 4 examines alternative models for regulating the distribution and retailing of beer through three jurisdictional case studies: British Columbia, Washington State and New York-New Jersey. Chapter 5 summarizes the results of interviews with industry stakeholders and analysts. Chapter 6 builds on the implications of the previous two chapters, identifying four potential policy options to enhance consumer choice and competition in American beer markets. After providing a

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8 Lafontaine and Slade 2008
9 New Jersey is one of 33 “open” states, where private businesses in the manufacturing, distribution and retailing tiers secure licenses to operate. This system is contrasted with the 17 “control” states, as well as Maryland’s Montgomery County, that directly control the importation, wholesale and often retail of alcohol within their borders. In most cases, however, this monopoly does not extend beyond distilled spirits, with the Pennsylvania Liquor Control Board (PLCB) also controlling wine and Utah selling all beverages over 5% alcohol by volume (ABV) in state-run stores.
framework for consistent criteria and measures in Chapter 7, these four policy options are evaluated in Chapter 8. The analysis culminates in a policy recommendation in Chapter 9, including best practices for effective implementation. Finally, Chapter 10 offers concluding thoughts on the broader implications and limitations of this study.
Chapter 2. Background

This chapter will examine three primary institutional pressures on the structure and operation of state distribution tiers in the United States, with respect to their impact on consumer choice and competition in American beer markets. First, a brief history of the three-tier system, both legally mandated and de facto, will be provided, along with an analysis of large producers’ ability to exert considerable influence on the brand portfolios and distribution practices of wholesalers. Second, the implications of controversial beer franchise laws, which act as a vertical restraint on brewers’ ability to alter or terminate their distribution contracts with a wholesaler in each sales territory, for market entry and competition will be discussed. Third, large brewing conglomerates’ (often colloquially referred to as “Big Beer”) shifting strategy vis-à-vis craft beer will be analyzed in the context of two parallel trends: unprecedented consolidation in the global beer market over the course of the late 20th and early 21st centuries and, in the domestic market, Big Beer’s recent acquisition and aggressive expansion of dozens of American craft brands. This latter trend, while perhaps an acknowledgement of American beer drinkers’ increasingly-diverse tastes, signals an erosion of competition and undermines the craft beer movement’s longstanding emphasis on authenticity, innovation and local identity. Finally, this chapter will conclude with an overview of contemporary debates in beer distribution and regulation, with a focus on major trade associations and interest groups.

2.1. Distribution & Competition

In pre-Prohibition America, it was common for bars, pubs and other alcohol-serving establishments to sell only one brand of beer. These “tied house” arrangements between producers and retailers (sometimes directly owned by the brewery or distillery in question) permitted patrons to consume large quantities of alcohol at low prices and virtually eliminated competition in entire towns or neighbourhoods of a city.\(^{10}\)\(^{11}\) This system served to exacerbate a wide range of social ails, including endemic liver cirrhosis, deaths from intoxication, traffic collisions, public and domestic violence, political corruption and

\(^{10}\) Between 1900 and 1913, alcohol consumption per capita in the United States increased by nearly a third, reaching its highest level (2.6 gallons per capita of the drinking-age population) since the Civil War. See Blocker (2006).

\(^{11}\) Burns and Novick 2011
organized crime.\textsuperscript{12} With the advent of Prohibition in 1920 came the end of the legal tied house in the United States, as well as the destruction of hundreds of American breweries.\textsuperscript{13} Those who did survive lawfully, mainly by transitioning into the production of non-alcoholic malt beverages and colas, emerged to an entirely different distribution landscape.

The 21st Amendment to the United States Constitution is best remembered for repealing the 18th Amendment, i.e. ending Prohibition. However, equally important is its second clause, which devolved the power of regulating alcohol importation, distribution and sales to the states rather than the federal government.\textsuperscript{14} This is crucial for understanding the three-tier distribution system, which entrenches legal separation of the producer, wholesaler and retailer in alcohol transactions, not as a single overarching structure but rather a collection of state frameworks with their own regulatory quirks and major players. A minority of states, including New Jersey, are perhaps more aptly described as \textit{de facto} rather than \textit{de jure} three-tier, as alcoholic beverage control laws may permit individuals and businesses to hold multiple licenses across the three tiers and, in the case of beer, permit producers to self-distribute up to a certain annual output limit (e.g. 300,000 barrels in New Jersey; 25,000 in North Carolina; 3,000 in Arizona; etc.).\textsuperscript{15}

In practice, private wholesalers dominate the market for beer distribution regardless of whether legally mandated three-tier exists. Amidst a flurry of mergers and acquisitions in the corporate brewing sector, the American beer wholesaling tier has undergone an unprecedented industry consolidation of its own,\textsuperscript{16} with large distributors aligning their brand portfolios with one major supplier in exchange for an exclusive sales territory over the supplier’s brands.\textsuperscript{17} Big Beer may contend that, by eliminating incentive problems

\footnotesize{\begin{itemize}
\item \textsuperscript{12} ibid
\item \textsuperscript{13} Tremblay and Tremblay 2005
\item \textsuperscript{14} U.S. Constitution, amend. XXI, sec. 2
\item \textsuperscript{15} Sorini 2017
\item \textsuperscript{16} Popov 2019
\item \textsuperscript{17} Typically, a handful of distributors dominate beer sales to retailers in any given territory, with those carrying primarily AB InBev brands colloquially known as “red” wholesalers and those carrying primarily MillerCoors brands known as “blue” wholesalers. Constellation Brands – which distributes Corona, Modelo and Pacifico in the United States – and its network of “gold” wholesalers have also proven major players following the company’s 2013 acquisition of Grupo Modelo’s American beer business from AB InBev. In addition to concerns over their impact on market entry for both new wholesale businesses and smaller brewers, such exclusive dealing arrangements also
\end{itemize}
between producers and wholesalers, these exclusive dealing arrangements enhance the economic efficiency of distributing their brands to retail establishments, but such deliberate attempts at vertical integration impede market access for both small brewers seeking wider distribution and prospective entrants in the wholesaling industry. Simply put, craft breweries by definition lack the scale and market share to plausibly support a major wholesaler on their own or even in conjunction with other craft brands, thereby forcing them to compete for limited warehouse space in distribution networks dominated by major conglomerates. Moreover, the pervasiveness of mandated exclusive territories for distributors has had a dampening effect on the quantity and variety of craft beer brands sold. Such mandates afford “protections to wholesalers to shirk in providing product investment as the threat of removing exclusivity and introducing additional wholesalers if an existing wholesaler under-performs [is] removed.”

Thus, in any given state where a brewery wishes to widely distribute its products, it must sign a new contract with one or more wholesalers in that state, each of which thereby gains an exclusive franchise over distribution of the brand(s) within a certain territory (e.g. a metropolitan area or a county). Intuitively, the breweries best poised to navigate this complex business landscape are national and multinational companies with easily recognizable brands, and in practice, the three-tier system has rarely ensured the independence of the distribution tier from large producer influence. In states across the country, Anheuser-Busch and MillerCoors have repeatedly entered exclusive contracts with wholesalers, inducing loyalty from such businesses in their brand portfolios and systematically shutting smaller breweries out from major distribution networks. Perhaps the most infamous example of this came with Anheuser-Busch’s 100 Percent Share of Mind initiative, a distributor incentive program that took effect in the mid-1990s in response to craft beer’s initial surge and its diversifying effect on wholesaler brand portfolios.

Anheuser-Busch graded its distributors’ portfolios from A to E. ‘A’ distributors carried only Anheuser-Busch products and were eligible for incentives. ‘E’ distributors carried competing brands – most likely Sam Adams, Sierra Nevada, or Heineken – and got nothing. In some cases, ‘E’ distributors got worse than nothing: Anheuser-Busch might threaten to

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18 Burgdorf 2019
19 ibid, p. 408

imply an increased potential for tacit collusion and price coordination among the largest producers. See Miller and Weinberg (2015) for a more detailed discussion of this phenomenon, with empirical evidence drawn from average retail price increases in the wake of the MillerCoors joint venture.
withdraw a contract, effectively putting a distributor out of business. Of its nearly one thousand distributors, Anheuser-Busch already had exclusivity with about 40 percent [...] With 100 Percent Share of Mind, [it] hoped to push that figure toward 70 percent.  

Miller quickly followed suit with its Fair Share initiative. In direct contradiction to the principle of independence enshrined in the three-tier distribution model, the program granted the company veto power over any acquisitions or divestments its distributors made as well as significant leverage over hiring and discretionary spending.

AB InBev’s recent acquisitions of craft brands like Goose Island, Elysian and 10 Barrel have further impeded distribution opportunities for small brewers, which in turn impedes their ability to reach retailers. Multinational conglomerates can now dominate tap handles and liquor store shelves while maintaining the appearance of consumer choice. In one notable case, undercover regulators for the Washington State Liquor and Cannabis Board exposed a modern variant of a tied house at three major music venues in Seattle. The Board found that Anheuser-Busch, “working through a third-party distributor, entered into sponsorship contracts at the three venues to achieve a monopoly position” over their beer lists. To the layman, a draft selection of Widmer, Redhook, Goose Island, Elysian, 10 Barrel, Stella Artois, Budweiser and Bud Light might appear diverse, but AB InBev merely capitalized on the lack of transparency in branding to furtively eliminate competition at a major retailer. Such de facto tied houses are far from exceptional in the United States, as loyal Anheuser-Busch and MillerCoors distributors often act as the companies’ brand ambassadors in their relations with retailers. In this way, exclusive arrangements are replicated at every stage in the supply chain, with consumer choice suffering as a result.

2.2. Beer Franchise Laws

The wholesaler counterpart to Big Beer’s anti-competitive practices is the continued existence of franchise laws in most states, a principal point of contention between craft brewers and distributors in the practical operation of three-tier systems. Beer franchise laws differ in their obligations, territorial protections and termination provisions, but their overriding feature is the following: wholesalers enjoy an asymmetric power to alter or terminate their distribution contracts with brewers, and brewers are required to grant

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20 Noel 2018, p. 84
21 Person 2016
For a company with the legal resources and market sway of AB InBev, beer franchise laws are little more than a technicality. Distributor incentive programs like 100 Percent Share of Mind, promotional perks and sponsorship agreements further undermine such laws’ original intent by incentivizing distributors, at the behest of large producers, to unceremoniously drop competing brands from their sales portfolios. Conversely, craft breweries have little recourse in the event a wholesaler underachieves or engages in distribution practices that hinder the success of their business (e.g. selling expired beer, storing products in subpar conditions, stalling deliveries, etc.). Lacking the financial means to enter a prolonged legal dispute, many are left with no choice but to leave state markets entirely. Bell’s, a Michigan-based brewery that has grown to become the seventh largest craft brewer by volume in the United States, has twice withdrawn its products from entire states: first in 2006 after its Chicago wholesaler planned to sell the rights to distribute its brands and again in 2019 when its Richmond, Virginia wholesaler was acquired by a subsidiary of Reyes, the single-largest beer distributor in the country. In both instances,

22 Kurtz and Clements 2014, p. 402-403
23 Peerless Beverage Company 2020
24 The seven counties are Bergen, Essex, Hudson, Morris, Passaic, Sussex and Union, five of which figure among the 50 most densely-populated counties in the United States.
25 Noel 2018, p. 405
26 ibid, p. 85-88
27 Hindy 2014
28 Gribbins 2019
Bell's opposed the sale of their brand distribution rights to a company they had never signed a contract with, one they feared would not sufficiently represent their business interests. Yet, because of antiquated beer franchise laws, Bell's and other craft breweries remain at the mercy of the distribution tier.

This inherent asymmetry in beer distribution contracts presents a significant barrier to consumer choice in many regions of the country, acting as a vertical restraint on the ability of small brewers to control their own products’ expansion potential. Since the early 1970s, when the first state franchise laws for beer were implemented, the National Beer Wholesalers Association (NBWA) has argued that such vertical restraints, in combination with three-tier requirements, promote consumer choice and competition in the beer industry. That is, franchise laws’ restrictions on the ability of brewers to terminate, alter or decline to renew their contract with a wholesaler protect distributors’ investment of “capital and labor in the creation of new markets for craft beers and the expansion of markets for existing products.”

An empirical analysis of the American craft beer industry paints a far different picture. In modelling the effect of vertical restraints in beer distribution, across all 50 states and the District of Columbia between 1980 and 2016, Jacob Burgdorf finds that state franchise laws decreased net market entry by 0.32 to 0.52 breweries per million people per year, a substantial figure in an industry where mean entry over the sample period was 0.88 breweries per million people per year. Moreover, in states that also restrict self-distribution, there is a compounded effect on industry output: craft beer production growth in such states was reduced by 0.150 to 0.186 barrels per hundred people per year. “The findings of this study,” Burgdorf concludes, “suggest that while franchise and distribution protections were legislated to shield wholesalers from brewers with market power, they had the effect of encouraging opportunism by wholesalers and increasing the cost of brewing, thus inhibiting the growth of the craft brewing industry.”

29 National Beer Wholesalers Association 2020
30 Burgdorf 2018, p.16
31 ibid, p.17
2.3. Corporate Consolidation in the Global Beer Market

In recent years, Big Beer’s distribution strategy vis-à-vis craft beer has shifted dramatically, largely due to forces beyond the control of even the largest domestic brands. Amidst a renaissance in North American microbrewing over the last several decades, the global beer market has been gradually carved up by ever-expanding multinational conglomerates, more aggressive in their aspirations and less tied to country or region than ever before (See Appendix A). German economists Ina Verstl and Ernst Faltermieer have likened this process of corporate consolidation to a global game of Monopoly, wherein valuable commodities are finite, success can only come at another’s expense and the game can only conclude when one player controls all the wealth.

Unlike other industries, for example soft drinks and spirits, which revolve around brands, the brewing industry tended to deal in national markets, each with their own players, dominant brands and beer styles, which were the manifestations of their respective beer cultures. This particular feature played into the hands of acquisitive brewers. If they bought the leading brewer in a country, they controlled that market.32

In the United States, this has resulted in two multinationals – Anheuser-Busch InBev (AB InBev) and Molson Coors – controlling nearly two-thirds of the domestic beer market. The result of numerous mergers and acquisitions since the late 1980s, most notably the 2004 merger between Belgian beer giant Interbrew and Brazillian beer giant AmBev followed by the 2008 takeover of American icon Anheuser-Busch, AB InBev currently commands about 30 percent of the global beer market (41 percent of the U.S. market) and counts more than 500 brands around the world.33 In 2016, the conglomerate merged with its primary rival, SABMiller, a British-South African multinational that owned such brands as Miller, Fosters, Pilsner Urquell and Castle. Prior to the merger, MillerCoors was a joint venture in the United States between SAB Miller and Canadian-American multinational Molson Coors (itself created in 2005 when Molson merged with Coors). As part of its antitrust settlement with the Department of Justice, AB InBev was forced to divest all of SAB Miller’s MillerCoors holdings in the U.S. as a condition for completing the $107 billion

32 Verstl and Faltermieer 2016, p.14
33 Anheuser-Busch InBev 2019, p. 17
sale. MillerCoors thereafter became a wholly-owned subsidiary of Molson Coors, as well as the second largest brewery in the U.S.

This process of consolidation in the global beer market has incited fundamental concerns about the future of craft beer, both as an industry and an ethos. InBev’s 2008 acquisition of Anheuser-Busch – for years the world’s single largest brewer by volume but one that had largely failed to become a global brand due to its rather singular focus on the American market – not only cemented the multinational’s (thereafter known as AB InBev) supremacy in the United States but enabled further acquisitions across the country, especially of upstart craft brands. Indeed, the current composition of AB InBev’s “High End” portfolio is hardly accidental. Throughout the last decade, the company has targeted craft breweries

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34 Nurin 2016
35 As of January 2020, Molson Coors has discontinued the MillerCoors name and rebranded as the Molson Coors Beverage Company, with its American and Canadian divisions collectively referred to as Molson Coors North America.
36 National Beer Wholesalers Association 2018
37 Nurin 2017
with either a strong cultural presence in a major metropolitan area (e.g. Seattle’s Elysian Brewing, Los Angeles’ Golden Road, Houston’s Karbach Brewing), an established reputation for originality and innovation among craft beer aficionados (Wicked Weed, 10 Barrel, Devil’s Backbone), or both (Chicago’s Goose Island).

In the first case, AB InBev’s strategy is obvious: by acquiring one of the largest, most recognizable craft brands in a major city, the company mitigates the threat of regional roadblocks to its national dominance and adds yet another proven success to its portfolio – with most consumers none the wiser to the brewery’s change in ownership. The second case is more complex but arguably just as concerning for the future of consumer choice. On the one hand, AB InBev’s acquisition of cutting-edge breweries like Wicked Weed, a pioneer in the growth of sour, wild and funky ales, signals its recognition of American beer drinkers’ expanding palettes. This is precisely the argument the conglomerate has made in repeatedly seeking to dilute the distinction between craft and Big Beer: As long as consumers enjoy variety in the styles of beer offered to them, it is irrelevant who owns such beers or where they are produced.38

However, the company’s emphasis on standardization and economies of scale is antithetical to the painstaking experimentation – and often repeated setbacks – that have helped craft brewers realize innovative beer in the first place. The High End has rapidly captured a substantial segment of the ‘premium’ beer market, enabled by concentrated output in one or two best-selling styles from each of its constituent brands as well as the extraction of these brands from their original production facilities and local identities:

By 2017, Anheuser-Busch, a company that had no credible craft brands six years earlier, was the nation’s second-largest producer of craft beer […] Half of Anheuser-Busch craft production was Goose Island, and the great majority of that beer was made at Anheuser-Busch’s Baldwinsville and Ft. Collins breweries. That led to a subtle but astonishing fact: much of the beer from the nation’s second-largest craft beer company was coming from the same tanks as Bud Light.39

Thus, the consolidation of AB InBev’s global empire has coincided with a seismic shift in Anheuser-Busch’s domestic business calculations. Whereas the company previously sought to counteract craft beer’s rise primarily by stifling competitors’ access to major

38 The High End 2017
39 Noel 2018, p. 337-38
distribution networks and introducing its own premium – or, as they are often derisively referred to, “phantom craft” – brands, the world’s largest brewery now embarks on a strategy of divide-and-conquer, capitalizing on craft beer’s cultural resonance to identify successful brands for acquisition and aggressive expansion.40,41

2.4. Contemporary Debates

The intricate tapestry of state laws and regulations surrounding alcohol distribution in the United States is an area of public policy that lies well beyond the purview of mainstream discourse. As Josh Noel quips, “Few things could be less interesting to most beer drinkers than the politics of distribution.”42

Indeed, under three-tier distribution models, the mere existence of intermediary wholesalers – which not only store and transport beer between producers and retailers, but also market brands at the point-of-sale through marketing and merchandising (e.g. tap handles, glassware, coasters, umbrellas, apparel, etc.) – is a rather illusory concept, one that consumers largely fail to consider in the final retail price of a pint or in the particular selection of beers available to them at their local bar, supermarket, etc. This information asymmetry between consumers and industry stakeholders arguably works to the advantage of wholesalers and large brewers alike; the former because of the inherent insulation it provides their industry from public scrutiny, even as it has experienced tremendous consolidation in recent decades and grown to become one of the most powerful lobbying forces in America;43 the latter because AB InBev, MillerCoors and increasingly Constellation Brands have a largely symbiotic relationship with their respective network of loyal distributors, extending their brand reach to every corner of the country and, in the consumer’s mind, further detaching beer from its place of origin.

40 Acitell 2017, p. 389
41 Of the countless brands Anheuser-Busch has introduced or refined to directly compete with craft beer, Michelob and Shock Top have been the sole veritable staples. MillerCoors, for its part, produces the hugely-successful Blue Moon, a Belgian-style witbier marketed as America’s “No. 1 craft beer” despite repeated protests from the craft industry. See https://www.businessinsider.com/blue-moon-craft-rebrand-for-millennials-2016-3?op=1 and https://business.time.com/2012/12/27/trouble-brewing-the-craft-beer-vs-crafty-beer-cat-fight/ for more.
42 Noel 2018, p. 292
43 The Center for Responsive Politics 2020
In 1980, there were 4,600 wholesalers in the country, and most markets had four or five competing wholesalers. Today, fewer than 3,000 remain, and in most local markets over 90 percent of the beer is controlled by distributors for these same two companies — one of which is dependent on AB InBev for most of its volume, and the other on MillerCoors.44

Behind the scenes, the National Beer Wholesalers Association (NBWA), a trade association representing nearly 3,000 distributors across all 50 states and the District of Columbia, advocates for legislation designed to strengthen three-tier mandates, beer franchise laws and other state-based alcohol regulations that preserve the primacy of an independent distribution system. Its political action committee (PAC) represents the largest lobbyist in the licensed beverage industry, as well as the second-largest donor overall in the 2018 midterm elections.45 On the flip side, the Brewers Association (BA), a not-for-profit trade association of more than 5,400 craft brewers and 46,000 Homebrewers Association members, operates primarily as an educational forum and think tank, producing economic reports on the American beer industry as well as resources for current and prospective brewers. Its PAC, formed in 2019, has contributed about $77,000 to federal candidates during the current election cycle, a significant figure to be sure but one that pales in comparison to the $2.45 million and $425,000 the NBWA and Anheuser-Busch have donated, respectively, thus far.46

44 Koch 2017
45 The Center for Responsive Politics 2020
46 Federal Election Commission 2020
The BA’s recent foray into more direct political action signals its intent to combat the tremendous influence the NBWA, and wholesalers in the wine and spirits industries for that matter,\textsuperscript{47} enjoy among elected officials in Washington, though it faces a daunting uphill

\textsuperscript{47}Wine and Spirits Wholesalers of America (WSWA), the NBWA’s counterpart in wine and spirits wholesaling, and Southern Glazer’s Wine and Spirits, by far the largest distributor of wine and
battle in that regard. As opposed to the NBWA’s emphasis on preserving state franchise laws and other legal safeguards for wholesalers, the BA believes such laws create an “artificial restraint” on distribution: “Franchise laws were enacted to protect wholesalers from the undue bargaining power of their largest suppliers. Applying those laws to the relationship between a small brewer and the wholesaler is unfair and against free market principles.” Among its other legislative priorities, the BA works to promote lower excise taxes on beer, transparency in labeling and direct brewer-to-consumer sales (i.e. through taprooms and brewpubs) for producers lacking the financial resources or brand reputation to access distribution networks. Perhaps its most tangible impact has been the Independent Craft Brewer Seal, a consumer advocacy initiative whereby craft brewers can certify their independence from Big Beer through an overturned bottle printed on their brand packaging. Just three years after the Seal’s creation, more than 4,000 breweries – collectively representing 85 per cent of the United States’ craft beer volume – now display the ubiquitous symbol on their bottles, cans, growlers, etc.  

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48 Spirits in North America, both figure among the top-five PACs by total campaign contributions in the licensed beverage industry.  
48 Brewers Association 2020  
49 Ibid
Figure 4: Independent Craft Beer Seal displayed on a bottle of Two Hearted Ale, an American-style IPA from Bell’s Brewery in Comstock, Michigan

50 Picture provided by author
Chapter 3. Methodology

This paper’s primary research began with a series of case studies drawn from three different North American jurisdictions, each of which exemplifies an alternative institutional model for managing the distribution of beer and other alcoholic beverages. Washington, to date the only state in the U.S. to have essentially dismantled the dominant three-tier model of liquor distribution that has prevailed throughout the country since the end of Prohibition and the passage of the 21st Amendment, was examined as a quintessential case in alcohol liberalization, albeit with substantial excise taxes still in place. Conversely, in every Canadian province except Alberta, the import and distribution of alcoholic beverages is monopolized by a crown corporation or agency. Provincial liquor stores often co-exist with private retailers, especially in the sale of beer, but by design these businesses cannot compete with the government on price point. The practical operation of this distribution monopoly was examined with respect to British Columbia. Finally, New York’s relatively lenient brewing and retailing regulations as well as its partial repeal of controversial franchise laws tying breweries to a specific distributor have encouraged new entrants into the industry and facilitated small producers’ increased market share vis-à-vis major brewing conglomerates. In this way, the Empire State represents an apposite alternative to New Jersey’s stringent operating requirements and limited distribution opportunities for craft brewers.

Following these three case studies, I conducted 5 semi-structured interviews with industry analysts and representatives of key stakeholder groups in the North American beer market, including:

- Bart Watson, Ph.D., Chief Economist for the Brewers Association (BA) and Certified Cicerone®
- Marc Sorini, J.D., a longstanding partner at McDermott Will & Emery, LLP specializing in regulatory and litigation issues facing the alcoholic beverage industry
- Lawrence Plummer, Ph.D., Associate Professor of Entrepreneurship at Western University’s Ivey Business School and analyst of the North American beer industry
- A veteran representative of the American beer wholesaling industry, who chose to remain anonymous for this project
- A general manager of an upscale restaurant in Vancouver, British Columbia, who chose to remain anonymous for this project
There were no additional exclusion criteria beyond those germane to the research objectives of this study. Each interview lasted up to 60 minutes, and all information obtained therein was only utilized for the purposes of this Capstone project.

Interviewees had the option of remaining anonymous throughout the reporting stage, with all personally identifying information kept confidential by the principal investigator. Audio recordings of interviews were destroyed upon completion of the project. All prospective interviewees were informed about the purpose and research objectives of the study. Prior to beginning an interview, all participants were provided with a standardized informed consent document outlining the potential benefits and risks inherent to their participation, confidentiality measures, data stewardship plan, dissemination of results and their right to withdraw from the interview at any point. Consent was obtained verbally at the start of each interview. Participants had the opportunity to read through the informed consent form at least 24 hours in advance of the interview.
Chapter 4.  Case Studies

4.1. Washington: A Pioneer in Alcohol Liberalization

As previously noted, the 1933 passage of the 21st Amendment to the United States Constitution—ending a 13-year federal prohibition on alcohol production and sales and devolving jurisdiction over alcohol transportation and importation to the states—created a policy window for American legislators to implement novel regulatory programs in an industry that had often escaped government oversight in the pre-Prohibition era. Yet, without exception, states adopted largely compatible regulatory regimes that collectively came to be known as the three-tier distribution model, entrenching the separation of producers, wholesalers and retailers in alcohol transactions. Slight variations and idiosyncrasies exist in the functional operation of each state’s three-tier system, and in 17 “control” states as well as Montgomery County, Maryland, the distribution and/or retailing tiers for distilled spirits are operated by state agencies or contractors. However, on the whole and certainly with respect to beer distribution, the three-tier model reigns supreme throughout the United States.

In 2011, voters in Washington State marked an unprecedented challenge to this status quo with the passage of Initiative 1183, a statewide referendum to remove the legal requirement for alcohol producers to sell their beverages through intermediary distributors. Washington had previously maintained an 80-year monopoly on liquor distribution, in addition to acting as its primary retailer in the form of state-run liquor stores. Beyond dismantling the three-tier distribution requirement, Initiative 1183 signalled the end of this government monopoly and opened the door for a rapid expansion in private retailing. Washington today has some of the most liberal alcohol retail licensing laws in the United States, with a wide variety of beer and wine routinely available at convenience stores, grocers and gas stations and distilled spirits sold in bulk at big-box retailers (Target, Walmart, etc.) and warehouse clubs (Costco). Indeed, between 2011 and 2014 alone,

51 Under the Initiative, sales of distilled spirits are now limited to stores with at least 10,000 square feet, a regulation that has been criticized for providing an unfair competitive advantage to Costco and other large retailers.
the number of retail stores selling liquor in the state more than quadrupled from 329 to 1,406, in addition to 1,000 new licensed establishments for on-premise consumption.\textsuperscript{52}

Expanded consumer choice has come at a cost. Thanks to a substantial increase in retail liquor sales taxes, ostensibly designed to offset losses in government revenue following liberalization, Washington residents now pay by far the highest effective excise rate on liquor in the United States (US$32.52 per gallon, nearly 50 percent higher than the $21.98 charged in Oregon, the country’s second highest rate).\textsuperscript{53} It is also unclear what effect, if any, Initiative 1183 has had on local brewers’ business calculations with respect to distribution, as Washington’s franchise laws remain in place despite the lack of a legally mandated three-tier system for beer. Arguably, the primary beneficiaries of privatization appear to be large retailers who can now directly negotiate volume discounts with wineries and distillers. This is particularly pertinent to the unique case of Costco, who poured nearly $21 million into the “Yes on 1183” campaign and can now offer 1.75-litre bottles of spirits at significantly lower prices than generic liquor stores.\textsuperscript{54}

While prices were found to increase as hypothesized given the large taxes (for the USA) that were imposed to make up for revenues lost from ending the control system the variability of such increases, particularly across store types, was surprising in that two store types, Liquor Superstores and Wholesale Stores [i.e. Costco], had non-significantly lower prices for the 1.75 L size. This suggests that these stores were able to obtain lower prices from wholesalers or producers, or to bypass wholesalers in some cases, and were able to mark-up these products with lower margins, perhaps partly reflecting lower business costs, than other types of stores.\textsuperscript{55}

Initiative 1183 was staunchly opposed by wholesalers within and beyond Washington, with the National Beer Wholesalers Association and Wine & Spirits Wholesalers of America contributing $500,000 and $5.8 million, respectively, to Protect Our Communities,\textsuperscript{56} a political action committee (PAC) formed to oppose the referendum on the grounds of public safety concerns. Indeed, with Initiative 1183 proponents promising consumers expanded variety and availability of alcohol, many media outlets and members of law enforcement raised alarm about the prospect of increased alcohol abuse, domestic

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\textsuperscript{52} Washington State Office of Financial Management 2015
\textsuperscript{53} Kimball 2019
\textsuperscript{54} Washington Liquor State Licensing, Initiative 1183 (2011)
\textsuperscript{55} Kerr, Williams and Greenfield 2015, p. 658
\textsuperscript{56} Washington Liquor State Licensing, Initiative 1183 (2011)
violence, underage drinking and especially impaired driving. In the years following liberalization, this has failed to transpire: between 2011 and 2013, DUI collisions and arrests in Washington actually dropped by 9 and 11 percent, respectively, with similar declines in the number of arrests for underage liquor possession and sales to minors. A parallel trend can be observed with respect to alcohol-related traffic collisions: even as Washington’s population has grown substantially over the course of the past decade, the annual number of crashes, fatalities and injuries has held relatively constant.

Certainly, without further data available to control for other social and political changes over the same timeframe, one cannot directly attribute these phenomena to Initiative 1183. The bottom line, however, is that Washington voters both dismantled their state’s longstanding liquor monopoly and moved decisively towards a two-tier system for alcohol distribution, without reducing consumer choice or public safety in the process.

57 Protect Our Communities 2011
58 Mercier 2013
59 Washington Traffic Safety Commission 2018
Figure 5: Annual Alcohol-Related Motor Vehicle Crashes and Fatalities, Washington State (2010-2017)

<table>
<thead>
<tr>
<th>Year</th>
<th>Fatal Crashes: Alcohol-Impaired Driver Involved&lt;sup&gt;60&lt;/sup&gt; (Rate per 100,000 people)&lt;sup&gt;61&lt;/sup&gt;</th>
<th>Total Fatalities: Alcohol-Impaired Driver Involved (Rate per 100,000 people)</th>
<th>Serious Injury Crashes: Drinking Driver Involved&lt;sup&gt;62&lt;/sup&gt; (Rate per 100,000 people)</th>
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</thead>
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<tr>
<td>2010</td>
<td>135 (2.00)</td>
<td>152 (2.25)</td>
<td>393 (5.83)</td>
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<tr>
<td>2011</td>
<td>121 (1.77)</td>
<td>135 (1.98)</td>
<td>395 (5.79)</td>
</tr>
<tr>
<td>2012</td>
<td>114 (1.65)</td>
<td>127 (1.84)</td>
<td>407 (5.90)</td>
</tr>
<tr>
<td>2013</td>
<td>117 (1.68)</td>
<td>127 (1.82)</td>
<td>326 (4.68)</td>
</tr>
<tr>
<td>2014</td>
<td>103 (1.46)</td>
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<tr>
<td>2015</td>
<td>97 (1.35)</td>
<td>110 (1.54)</td>
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<td>2016</td>
<td>120 (1.65)</td>
<td>131 (1.80)</td>
<td>331 (4.54)</td>
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<tr>
<td>2017</td>
<td>127 (1.71)</td>
<td>135 (1.82)</td>
<td>365 (4.92)</td>
</tr>
</tbody>
</table>

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60 Defined by the Washington Safety Commission as a “fatal crash involving a driver with a BAC [blood alcohol content] of 0.08 or above, as confirmed by a BAC report submitted directly from the state toxicology lab”

61 U.S. Census Bureau, Population Division, 2019

62 Defined by the Washington Safety Commission as a “serious-injury crash involving a driver who had been drinking any alcohol, as assessed by an investigating officer […] Currently, toxicology reports with BAC data are not used to identify serious-injury crashes, as such results for these crashes are not reported consistently”
4.2. British Columbia: Canada’s Crown Corporation Model

While Washington has liberalized liquor transactions in recent years, its neighbour to the north retains one of the most extensive government monopolies on alcohol distribution and retailing in North America. Canada’s crown corporation model offers a useful contrast to the United States’ largely privatized three-tier system, exemplifying a case of historical divergence between two countries that are often indelibly linked through geography, trade and common cultural characteristics. Like the U.S., Canada experimented with various forms of alcohol prohibition in the early 20th century, though never to the extent of a decade-plus ban applied throughout the country. Indeed, Canada’s only experience with a federal prohibition akin to the American case was a temporary wartime measure from 1918 to 1920, with some provinces choosing to remain dry long afterwards.

Deference to provincial jurisdiction over alcohol regulation has continued up until the present day. As in the U.S. with state-level implementation of three-tier distribution systems, most Canadian provinces have adopted similar regulatory regimes that can be collectively treated as a single model. Under this model, every province and territory apart from Alberta has monopolized the distribution of alcoholic beverages within its borders through a government-controlled “crown corporation,” which also acts as the sole importer of alcohol from other provinces as well as internationally. New Brunswick and the three territories (the Yukon, Northwest Territories and Nunavut) go even further, owning and operating all retail establishments for off-premise liquor sales. For the vast majority of Canada’s population, including the three most populous provinces of Ontario, Québec and British Columbia, alcohol retail sales resemble a quasi-monopoly insofar as private liquor stores are permitted to co-exist alongside government outlets, but by design, they cannot compete on price point.

British Columbia is an illustrative case in this regard, having significantly expanded private liquor retailing in recent decades but nonetheless maintaining government control over wholesaling through its century-old Liquor Distribution Branch (BCLDB).  

63,64 Macdonald et

63 1921 would prove a precipitous year for alcohol regulation in Canada, as both British Columbia and Québec established provincially-owned corporations – the BC Liquor Distribution Branch (BCLDB) and La Société des alcools du Québec (SAQ), respectively – to monopolize the import and distribution of alcohol. Most other provinces followed suit later in the decade.

64 Stockwell et al. 2009
al. describe the practical implications of this “hybrid” system, at least for consumers, as follows:

The private liquor stores obtain most of their alcohol directly from the government distribution network at a cost of 16% below the retail prices of the government store [...] The average prices overall are expected to be higher in the private stores since mark-ups for alcohol are typically in the range of 17-32% of wholesale costs.  

Thus, in choosing to purchase alcohol at one of the province’s nearly 700 private liquor stores – less than half the number in neighbouring Alberta, a province with about 600,000 fewer residents – British Columbians face a trade-off between (a) significantly higher prices than they would pay for the same products at BC Liquor Stores and (b) potentially greater availability of rarer or premium alcohols, as well as any additional marketing advantages such as longer operating hours, expanded refrigeration space or geographic convenience. Still, many of these competitive advantages – whereby private liquor stores cater to niche or premium markets - have been eroded in recent years as the BCLDB has removed the wholesale price discount private retailers previously enjoyed and expanded operating hours and refrigeration space in BC Liquor Stores. Such measures, in the absence of a centralized liquor distribution branch, would potentially offer a positive step towards more genuine competition between private and government stores, but as it stands, BC Liquor Stores can and do operate retail at a loss thanks to the significant financial cushion their wholesale arm provides.

Restaurant, bar and nightclub owners and managers have been doubly impacted by the BCLDB’s distribution monopoly, forced to navigate long delays and limited inventory when placing liquor orders – only to pay the same retail prices as consumers. Even in the case of locally-produced beer and wine, where some direct-to-retail sales (e.g. draft kegs) are permissible, licensed establishments must still file an invoice with the BCLDB and pay applicable distribution taxes. This system effectively keeps the provincial government’s monopoly over the distribution tier intact for all alcoholic beverages, resulting in higher prices and less choice for licensed establishments and consumers alike.

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65 Macdonald et al. 2012, p. 642  
66 Fraser Institute 2012  
67 BC Liquor Distribution Branch 2015  
68 Little 2018
What this means for BC’s craft beer industry is that small brewers must compete for a tightly-regulated number of tap handles – the City of Vancouver, it should also be noted, currently enforces a moratorium on new licenses for alcohol-primary establishments – and limited shelf space in both government and private liquor stores. Moreover, Canadian trade regulations impose significant excise taxes on interprovincial beer sales, typically limiting the number of out-of-province craft brands sold in provincial liquor stores to just a handful of larger suppliers. This growing disconnect between producer growth – from 2015 to 2019 alone, the number of Canadian breweries increased from 383 to 972 – and supply chain shortages has signalled alarm throughout the country’s craft beer industry, with many fearing an imminent market contraction. Increasingly, small brewers may be forced to rely on direct taproom and brewpub sales to survive, as provincial distribution monopolies prove insufficient to guaranteeing sustainable retail market sales.

Ultimately, such concerns over deflated consumer choice and inflated pricing may be inconsequential, or at the very least secondary, to the broader logic of centralized liquor control boards and agencies. The underlying assumption of any government monopoly over alcohol transactions, whether in distribution or retailing or both, is that alcohol represents an atypical consumer good that must be tightly regulated to ensure responsible consumption. In the United States, this approach has generally been limited to distilled spirits, with Pennsylvania extending its control system to wine and Utah monopolizing the sale of all beverages containing greater than 5 percent alcohol by volume (ABV). In a sense, the latter case represents the closest American approximation of the Canadian distribution model, although Utah’s unique sociocultural profile – 61 percent of Utahns are members of the Church of Jesus Christ of Latter-day Saints, whose scripture forbids the consumption of alcohol – arguably makes the state a difficult source for comparison. Beyond its control system, Utah maintains some of the most restrictive alcohol consumption laws in the U.S., including a statewide ban on commercial sales after 1:00am, a considerably lower blood alcohol content (BAC) limit for operating a vehicle than anywhere else in the country (0.05%, vs 0.08% in all other states), a state statute tying the number of licensed liquor stores to the state

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69 City of Vancouver 2020
70 Marotta 2020
71 ibid
72 Winslow 2019
73 Hinckley 2006, p. 2-5
74 Beyond its control system, Utah maintains some of the most restrictive alcohol consumption laws in the U.S., including a statewide ban on commercial sales after 1:00am, a considerably lower blood alcohol content (BAC) limit for operating a vehicle than anywhere else in the country (0.05%, vs 0.08% in all other states), a state statute tying the number of licensed liquor stores to the state
Canada, meanwhile, has largely devolved jurisdiction over the distribution and importation of all alcoholic beverages, including beer, to provincial crown corporations with an explicit mandate to both generate government revenue from the sale of alcohol and promote its responsible consumption, i.e. through public education programs and social services aimed at deterring sales to minors and intoxicated persons. On the first point, there is little debate. Certain groups may legitimately contend that a private wholesaling (i.e. three-tier) or direct producer-to-retailer (two-tier) system would represent a far more efficient distribution model, or perhaps that the government should not be in the business of profiting from alcohol transactions in the first place. Yet, the fact remains the Canadian beer industry alone generates $5.7 billion annually in government revenue, in no small part because federal taxes, provincial taxes and liquor board markups collectively account for 47 percent of the average retail price for beer sold in Canada, one of the highest effective excise rates in the world.

The second point is more contentious: Macdonald et al. contend that BC’s hybrid system of government and private retailing likely creates more “negative health consequences” than either approach would in isolation, insofar as the former stores cater to “price-sensitive” consumers whereas the latter largely appeal to niche, specialty and late-night market segments, ultimately making alcohol more accessible for both demographic groups. This is not to suggest that a pure government monopoly over alcohol distribution and retailing, akin to the systems already in place in New Brunswick and the three territories, would be preferable. Indeed, consumers in such regions notoriously face the double-bind of scarce availability and meteoric prices, a situation that has given rise to black markets, bootlegging and illicit interprovincial sales. However, if indeed a fundamental objective of Canada’s control model is to reduce the prevalence of alcohol consumption in public life, however dubious that objective may be, most provincial crown corporations’ current approaches appear disingenuous.

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population (one for every 48,000 residents) and, until 2017, mandatory “Zion Curtain” partitions in restaurants and bars to block patrons’ view of alcoholic beverages being poured and prepared.

75 British Columbia Liquor Distribution Branch 2020
76 Hermus 2018
77 Edwards 2017
78 The Canadian Press 2015
4.3. New York and New Jersey: A Tale of Two States

Despite their commercial and cultural interdependence, New York and New Jersey offer a useful study in regulatory contrasts on the issue of beer distribution. Whereas the Empire State has proactively fostered consumer choice in local beer markets through alcoholic beverage control policies designed to dismantle barriers to competition, its neighbour to the south has frequently impeded the growth of its craft brewing industry through archaic sumptuary laws and deference to the state’s consolidated wholesaling industry.

The persistence of numerous dry towns throughout New Jersey, a holdover from laws prohibiting alcohol consumption and sales in historically evangelical Protestant communities, is also common to other parts of the United States. At the same time, New Jersey is a Legislative Home Rule State whose constitution impedes Trenton’s ability to “pass any private special or local laws [...] Regulating the internal affairs of municipalities formed for local government and counties,”79 thereby allowing localities considerable leeway to further regulate the sale and consumption of alcohol as well as the availability of alcohol retail licenses in their jurisdiction.

These dry towns cannot legally bar a brewery from operating within their city limits – as alcohol manufacture licenses, unlike retail licenses, are issued by the state rather than municipalities – but the lack of alcohol-serving establishments in a microbrewery’s immediate vicinity inevitably reduces their local distribution opportunities. Moreover, brewers located in dry towns cannot operate a taproom for direct-to-consumer sales, a tremendous detriment to their financial sustainability.80 Perhaps unsurprisingly, of the nearly three dozen dry towns in New Jersey,81 just four are currently home to a craft brewery.82

79 New Jersey State Constitution 1947, Article IV, Section VII, Part 9
80 Typically, revenue per barrel for beer sold in taprooms is four to five times higher than beer sold to a distributor, and with 74 percent of American breweries producing fewer than 1,000 barrels annually, these direct-to-consumer sales represent a crucial component of upstart breweries’ business models. See https://www.brewbound.com/news/beer-business-finance-breaking-down-the-taproom-focused-brewery-model and https://www.craftbrewingbusiness.com/featured/economics-tap-room-vs-distribution-craft-breweries/ for more on financial modeling and economics in the craft beer sector.
81 O’Brien 2016
82 The New Jersey craft breweries located in dry towns are as follows: The Referend (Pennington), Devil’s Creek (Collingswood), King’s Road (Haddonfield) and Lunacy (Haddon Heights).
This fact, in conjunction with a variety of other legal peculiarities pertaining to the operation of breweries in the state, has subjected New Jersey’s nascent craft beer industry to a dizzying array of municipal ordinances and state legislation, creating considerable discrepancies in consumer choice between towns. Despite its rich brewing history stemming back to the colonial era as well as its geographic contiguosity with two of the largest metropolitan areas in the country, New Jersey ranks just 45th in the U.S. for number of breweries per capita, 38th in economic impact of craft beer per capita and 47th in gallons of craft beer production per adult.

On the other hand, New York’s regulatory environment has proven immensely advantageous for craft brewers, particularly under the current administration. Governor Andrew Cuomo, since assuming office in 2011, has repeatedly touted the state’s craft beer industry as a source of local pride and job creation. Between 2012 and 2018, the number of New York breweries increased nearly fivefold from 95 to 434, in large part due to legislative reforms simplifying market access for craft producers. These include tax credits for local hops cultivation, expanded taproom allowances (unlike in New Jersey, New York breweries, wineries, cideries and distilleries can offer any New York-made alcoholic beverage by the glass at their production facilities or off-site branches, without a separate license), combined manufacturing licenses allowing businesses to produce more than one craft beverage (e.g. beer and cider) at a single location and the introduction of a “farm brewery” license modelled on existing winery regulations. Under this latter legislation, “craft breweries that use ingredients grown in New York [may] conduct onsite tastings, open restaurants, engage in self-distribution, and open up to five no-fee off-site branch stores anywhere in the state.” In the five years following its creation in 2013,

83 State of New Jersey 2019
84 Until 2012, New Jersey craft brewers could not operate a taproom for on-premise consumption and, to this day, all patrons must complete a facility tour before a brewery can legally serve them. The state also caps the number of “special events,” i.e. live music or televised sports, a brewery can host at 25 per year and prohibits them from partnering with food trucks or other vendors to offer food at the location.
85 Brewers Association 2019
86 New York State 2017
87 New York State Brewers Association 2020
88 N.Y. Alco. Bev. Cont. Law § 51-a
89 New York State 2018
more than 200 craft breweries in the state were issued this “farm brewery” license, and in-state hops cultivation nearly doubled between 2014 and 2016 alone.90

Perhaps no legislative reform has been as impactful for the New York craft beer industry as the 2012 amendment of state alcoholic beverage control laws governing distribution contracts between brewers and wholesalers. Under this reform, any brewer producing fewer than 300,000 barrels of beer annually and accounting for three percent or less of a wholesaler’s annual business, “measured in case equivalent sales of twenty-four -- twelve ounce units,” is exempt from state franchise laws and may therefore terminate their distribution contract with a wholesaler upon payment of the fair market value for their brand rights in the relevant sales territory.91 This exemption, commonly known as a small brewer “carve-out” from state franchise laws and their binding provisions, was the first of its kind in the United States, and it has drastically reduced the New York wholesaling industry’s influence over which brands are available at major retail establishments. By allowing brewers that do not comprise a significant portion of a wholesaler’s sales volume to terminate distribution contracts without the arduous legal process of demonstrating “good cause,”92 the legislation corrected an inherent power imbalance in state franchise laws and amended New York beer regulations to be more reflective of contemporary industry trends.

The vast majority of beer regulations were formed with either the problems of pre-Prohibition alcohol distribution and/or the heavily concentrated (and further concentrating) beer industry of the post-war period as context. In other words, the rules were created with the idea that most breweries were big and regional/national, and most wholesalers were small and local. With breweries now outnumbering wholesalers – and the concentration of those two industries going in opposite directions – might some of these rules be due for a re-think?93

Other states have followed suit with their own small brewer carve-outs, albeit under different parameters. Arkansas, for example, caps the annual barrelage limit at 30,000 for

90 ibid
92 Prior to the Cuomo Administration’s 2012 implementation of the small brewer carve-out, this scenario had already befallen one of New York’s largest craft breweries, Brooklyn Brewery, in a $300,000 settlement with a distributor that had been selling expired beer (See: Hindy 2014). For the vast majority of microbrewers, this financial sum would be insurmountable.
93 Watson 2014
brewers exempt from state franchise laws,94 whereas in Illinois any in-state brewer whose “annual volume of beer products supplied to a wholesaler represents 10 percent or less of the wholesaler’s total annual volume for all beer products” may terminate their distribution contract with the wholesaler upon payment of “reasonable compensation.”95 Crucially, New York’s carve-out equally exempts out-of-state brewers, facilitating consumer access to a wide variety of craft options from around the country. Treated collectively, the state’s regulatory environment for beer strikes a strong balance between fostering a vibrant in-state craft brewing sector and promoting genuine competition in the marketplace.

94 Ark. Code Ann. §§ 3-5-1102(12)(B); 3-5-1403(13)
95 815 Ill. Comp. Stat. 720/7
Chapter 5. Interview Results

5.1. Structure and Operation of Distribution Tier

Interviewees generally agreed that the three-tier system – or rather, systems, as each state exercises jurisdiction over the manufacture, wholesale and retail of alcohol within its borders, with notable regulatory divergence between states in how their distribution systems are structured and operated – arose to prevent the vertical integration that existed in the American beer, wine and distilling industries prior to Prohibition. By preventing large national or multinational corporations from coopting local retail industry, i.e. “tied house” arrangements where bars and restaurants only sold brands from one producer, the creation of independent distribution tiers would stem the flow of cheap alcohol and curtail price undercutting. That being said, considerable confusion and disagreement surrounds the precise timeline for when and how such systems were formally established. Marc Sorini, a longstanding partner at McDermott Will & Emery, LLP who specializes in regulatory and litigation issues facing the alcoholic beverage industry, rejects the popular narrative that three-tier arose immediately after Prohibition and instead contends it was a piecemeal, state-by-state, commodity-by-commodity process which gained traction in the post-World War II era after “tied house laws” preventing a producer or distributor from owning a retailer (i.e. legally mandated two-tier separation) proved inadequate to address the growing trend of distillers and large breweries seeking “systematic vertical integration” with their distributors. To this day, about 8 percent of Anheuser-Busch’s volume is distributed through wholly-owned and operated wholesaling subsidiaries, a potential pitfall of state laws allowing for a significant degree of brewery self-distribution (see Appendix B), and the company has publicly stated its intent to directly own at least 10-12 percent of its distribution network.  

When asked whether three-tier generally promotes or hinders consumer choice and welfare in the American beer market, interviewees emphasized the need to develop a nuanced understanding of how each state system operates in practice and what exceptions to intermediary wholesaling, if any, exist. Bart Watson, Chief Economist for the Brewers Association, aptly describes three-tier for beer as “50 [distribution] models” and

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96 Bennett 2016
“150 if not more” when one includes all beverage alcohol. Still, other interviewees fell decidedly on one side of the issue in assessing its overall impact. A representative of the beer wholesaling industry argued that independent distributors deserve a great deal of credit for fostering consumer choice, particularly in New Jersey where “more than 1500 brands of beer [are] available in a good-sized liquor store”; not only because they provide craft breweries with the labour, equipment and connections to help their beers reach retail shelves and tap handles but also because they offer numerous additional services to increase brand recognition:

The more you learn about wholesalers, the more you realize they’re the brand-makers. They don’t just distribute beer. They give advice on displays, print signs, pump up brands […] They’re logistics firms, marketing companies, communications and advertising agencies. They do a lot more than just drive trucks to hold beer […] Most branded merchandise in a restaurant, bar or tavern – whether it’s a Jägermeister refrigerator, shot glasses, special Glenfiddich bottle holder or a coaster that says Bud on it – was provided by the wholesaler… and usually at the expense of the wholesaler.

Conversely, Sorini believes mandatory three-tier laws represent a “straitjacket” for small and upstart breweries that cannot possibly command the attention and support from mainline distributors that their larger competitors routinely receive:

The problem is, because we’ve developed this three-tier model with just a couple of distributors serving any given territory, if AB [Anheuser-Busch] gets to monopolize just one of them that creates a dangerously anticompetitive situation. I think at this point you can make the case for mandatory three-tier distribution for the biggest brewers, but not for anybody Sam Adams’ size or smaller. And that’s consistent with the original post-Prohibition architecture. You hear all this nonsense about how the system’s been working effectively for 80 years, but that’s just not true.

Indeed, Sorini points out that consolidation and increased lobbying power in the American wholesaling tier coincided with the rise of regional, national and even international brands, which increasingly undermined the business case for local self-distribution and reoriented entire consumer markets around loyal distribution networks for each of the largest breweries. These parallel trends of market consolidation in the distribution and upstream producer tiers have reversed the original imbalance that franchise laws and other wholesaler protections were designed to remedy (i.e. breweries’ perceived bargaining power over independent distributors) and instead left small brewers at the mercy of two-pronged behemoths (e.g. Anheuser-Busch and its national network of “red” distributors).
Beyond this structural barrier to competition, Watson identifies the relative lack of regulation governing contracts between distributors and large breweries as a potential affront to consumer choice, not only in terms of distributors’ overall brand composition but also in terms of much they are required to spend on promotions, advertising and merchandising for their major brands.

5.2. Vertical Restraints in the American Beer Industry

Throughout the interview process, franchise laws proved the most contentious contemporary feature of beer distribution in the United States, with a representative of the American wholesaling industry defending the practice as a necessary incentive for distributors to invest capital and labour resources in the growth of a brand – particularly craft beers, whose consumer recognition and sales performance may not inspire complete confidence at the outset – and representatives of the craft brewing industry instead viewing such laws as an onerous obstruction to consumer choice and market competition.

In response to the potential for franchise laws to unduly restrict craft breweries’ growth potential or strip them of the ability to control their own brands, the representative of the wholesaling industry believes such laws are frequently misunderstood, with craft brewers overemphasizing “worst-case scenarios” (e.g. in New Jersey, Dogfish Head brand rights being sold from one distributor to another in a mandated exclusive territory without the brewer’s consent) rather than appreciating the broader logic of aligning producer and wholesaler incentives. Moreover, they posit that conflicts between breweries and their distributors generally arise from poor sales performance, in which case their contract can be terminated through good-faith negotiation rather than a lengthy litigation process:

Most brand changes are because a brewer isn’t happy with the service they’re getting and that’s translated to sales: ‘My beer isn’t selling well, so the wholesaler must not be doing its job.’ By the same token, if the beer’s not selling well, the wholesaler’s probably more than happy to work something out to let it go.

Sorini emphatically disagrees with this perspective, arguing that franchise laws enable “brand collectors,” i.e. distributors that take advantage of mandated exclusive territory laws and relative immunity from contract termination to add craft brands to their portfolio primarily as a means of “locking them out from competing distributors” rather than realizing their full growth potential. This phenomenon is particularly pronounced in regional markets.
where a small number of large wholesalers, usually tied to AB InBev, MillerCoors or Constellation Brands, dominate retail sales. He proposes that the abolition of franchise laws, for any brewery that does not exert “unfair bargaining power” over a wholesaler’s brand portfolio, would be tremendously beneficial in mitigating vertical restraints on small brewers’ access to distribution networks and thereby expanding consumer choice in markets where it is currently lacking:

I’m a big supporter of small brewer carve-outs. I personally think the small brewer carve-outs should be set at a much higher percentage [of wholesalers’ portfolios] and should ignore any barrelage issue. If you take the franchise laws at their word, which is that they’re designed to equalize an otherwise unequal bargaining power situation, then that bargaining power should be measured by how dependent the particular distributor is on a brewer. And if you’re less than 20 percent of the distributor’s business, you don’t have an unfair bargaining power with that distributor, and you should be exempt. Period.

For his part, the Ivey Business School’s Lawrence Plummer views the barriers to distribution faced by small brewers as less a direct product of three-tier and more so a consequence of an oversaturated industry where the number of breweries in the United States has exponentially increased in recent years despite a gradual decline in American beer consumption. That is, if beer continues to lose alcoholic beverage market share to wine, spirits and seltzers – particularly amongst younger generations – craft breweries will increasingly find themselves competing against large conglomerates, as well as imports, for scarce space on tap handles and retail shelves. Plummer believes the true casualty of this imminent industry contraction may prove to be larger craft breweries with aspirations of regional or national growth, as most microbreweries appear content to concentrate their distribution in local markets or – in some cases – confine sales to their own taprooms and brewpubs.

5.3. Alternative Distribution Models

While acknowledging the limitations of a three-tier distribution model where a privately-owned wholesaling industry presents vertical restraints on small breweries’ ability to retail their beers in profitable consumer markets (i.e. fridge or shelf space in mainstream liquor stores as well as tap handles in restaurants, bars and nightclubs), four of the five interviewees view this system as a more preferable alternative to government control over
beer distribution, akin to Canadian provincial liquor monopolies such as the BC Liquor Distribution Branch (BCLDB).

Much of the interviewees’ criticism of the control model rests on the idea that American consumers, through the experience of both local prohibitions (e.g. dry towns, counties and parishes) as well as the inefficiencies of state monopolies on liquor retailing, have gradually lost their appetite for greater government involvement in alcohol sales. As the wholesaling industry representative pithily observes, “There are no new control states.” Sorini explains that public discourse surrounding liquor regulation has radically changed since Prohibition: whereas Americans once fiercely debated the morality of producing and consuming alcohol altogether, today the general public and policymakers at various levels of government generally view beer, wine, spirits, etc. as legitimate industries that stimulate tourism and local economic development. Debates surrounding alcohol regulation today largely revolve around realizing such benefits while mitigating the social risks associated with excess consumption. “The logic behind it [the control model],” he goes on to say, “is that you don’t want profit motive in the sale of alcohol, but I don’t think Americans would buy that anymore.”

Sorini also alludes to the recent example of recreational cannabis legalization in 11 states and the District of Columbia, wherein such jurisdictions have licensed commercial retailing of marijuana rather than establishing government-owned stores. This is implicitly contrasted with the case of federal legalization in Canada, where many provinces and territories – including the three most populous: Ontario, Québec and British Columbia – adopted a similar regulatory model to alcohol, monopolizing the distribution and/or retailing of recreational cannabis through provincial crown corporations. Indeed, Plummer suggests path dependence, regulatory complacency and rent-seeking may help explain the persistence of Canada’s provincial liquor monopolies even as American states increasingly liberalize distribution and retailing for wine and spirits, let alone beer. For example, the Liquor Control Board of Ontario (LCBO)’s minimum and uniform pricing model strictly regulates the prices a craft brewery in the province can charge for their

97 In British Columbia, the BCLDB now monopolizes the wholesale and import of not only alcoholic beverages but also recreational cannabis, arguably giving it the most extensive mandate of any provincial liquor control board in Canada.
beers, regardless of whether they are sold in LCBO outlets, The Beer Store\(^98\) or the
absolutely rigged to the benefit of large, mass-produced beers,” forming a blatant barrier
to entry for small producers and upholding a worryingly uncompetitive retail market.

The Beer Store charges extortionist prices just for giving a microbrewery
the right to sell their products there […] On top of that, you walk into a Beer
Store and it’s not like there are aisles and aisles where all the beer’s out on
display. There’s only a board with a list of the beers on sale, and oftentimes
don’t even update the board. So, you as a consumer have to walk
through the door already knowledgeable about which beer you want. The
Beer Store is the worst place for a small brewer to attract potential
customers. Now, I’m very cynical, but that seems to be done on purpose.

Provincial liquor monopolies on alcohol distribution remain especially contentious within
the Canadian restaurant and hospitality industries.\(^99\) A general manager of an upscale
Vancouver restaurant interviewed for this project wholly rejects the notion that government
control over the distribution tier enhances consumer choice and welfare in retail beer
markets, whether for on-premise or off-premise consumption. Echoing a sentiment that
has become common throughout British Columbia’s service industry,\(^100\) the manager
recounted their difficulties in acquiring speciality products through the BC Liquor
Distribution Branch (BCLDB):

It happens all the time where I can’t get a hold of products I want for
months, if ever. I tried to get Amaro Montenegro and that was almost
impossible, because none of the [BC Liquor Stores] I tried ordering from
carried it. I’d like to think that in a competitive market, even if there wasn’t
enough demand to keep it on shelves in stores, it’d still be worth it to carry
a couple bottles for restaurants that do want to offer those specialty
products to their guests. It’s particularly frustrating when I know a private

\(^98\) The Beer Store is a peculiar feature of Ontario’s liquor control system. With more than 450 retail
outlets owned by a consortium of three multinational brewing conglomerates – Molson Coors
(50.9%); Labatt (44.9%), an AB InBev subsidiary; and Sleeman (4.2%), a Sapporo subsidiary –
The Beer Store has enjoyed a quasi-monopoly on beer wholesale and retail in Canada’s most
populous province since the late 1920s. In June 2019, Premier Doug Ford’s Progressive
Conservative government passed legislation to immediately terminate protections granted to The
Beer Store in Ontario’s Liquor Control Act, four years after Kathleen Wynne’s Liberal government
reached a deal with the company to maintain its monopoly on 12- and 24-pack sales in exchange
for allowing a limited number of grocery stores to sell six-packs and single bottles at heavily-
regulated prices.

\(^99\) Restaurants Canada 2017

\(^100\) Uguen-Csenge 2019
liquor store which does carry it, but I’m not allowed to buy from them because that would be illegal.

As for the argument that government liquor monopolies represent a more effective bulwark against large producer influence than private distribution, the manager contends such inequities in retail market access will persist so long as one or two brewing conglomerates are permitted to own the majority of sales volume in a national market – regardless of who operates the distribution tier.

Meanwhile, Watson does not believe a state-run distribution system for beer is inherently better or worse than an independent wholesaling tier. He argues the “devil lies in the details” of its implementation, with some current control states such as New Hampshire demonstrating a commitment to consumer choice and genuine competition between producers (albeit mainly for distilled spirits, rather than beer) and others such as Pennsylvania perceived as more “draconian” in the extent of control they exert over both market access and retail pricing.

I think as long as craft brewers feel they have fair market access then they don’t have a strong opinion one way or another [over who owns and operates the distribution tier]. A state distribution system that they feel gives them an equal opportunity as the large breweries to bring their products to market and put them in front of consumers is ultimately what they’re after.

On the flip side of the control model, two-tier systems for beer distribution also failed to inspire resounding confidence from interviewees, though Sorini approximates this model in suggesting “all but the biggest brewers” should be excluded from mandatory three-tier distribution laws. With respect to Initiative 1183 in Washington, interviewees were quick to point out that the referendum has fundamentally reshaped distribution and retailing for distilled spirits, rather than beer, in the state, with most brewers producing above a certain critical volume threshold still choosing to distribute their products through private wholesalers.

The relevant counterfactual thus becomes: In the absence of the various institutional factors that have lent primacy to their industry for decades – i.e. mandatory three-tier laws; state franchise laws; exclusive dealing arrangements and quasi-vertical integration with the largest producers; a national network of powerful lobbying organizations (with the NBWA as its cornerstone) to aggregate their interests and influence beer distribution policy at all levels of government – would private wholesalers still represent an
economically rational method of distribution for craft brewers seeking to grow their brands? In other words, do craft brewers today face a Hobson’s Choice in weighing the relative benefits of self-distribution vs. distribution through an established wholesaler?
Chapter 6. Policy Options

Drawing from preceding case studies as well as interviews with industry stakeholders and analysts, this section will outline four potential policy options to reform distribution laws in American beer markets with a view towards enhancing consumer choice and competition. See Appendix B for a brief discussion of annual output thresholds for self-distribution of beer, a prominent target of legislative reform for craft brewers but one that nonetheless fails to adequately address the central policy problem of this paper. Other policy options considered during preliminary analyses include:

- Reforms of New Jersey’s taproom regulations, allowing breweries greater leeway to offer beers for on-premise consumption and host licensed events at their facility
- Mandated transparency in beer labeling, e.g. a federal regulation requiring breweries to display both the production location and any parent company ownership on their brand packaging

6.1. Policy Option 1: Eliminate private wholesaling and bring the distribution of all alcoholic beverages, including beer, under state control

A centralized control model for the wholesale and importation of alcoholic beverages merits consideration as a policy option not only due to the United States’ own history with liquor control boards but because other jurisdictions – namely the majority of Canadian provinces – have promoted local craft brewing industries while still maintaining some of the most extensive government monopolies on alcohol distribution in the Western world.

The major arguments in favour of state control over alcohol distribution are twofold: (1) By regulating the quantity of alcohol transported within its borders and supplied in retail establishments, the state can more effectively encourage responsible drinking behaviours and raise substantial public revenue to fund consumer safety initiatives; (2) Because state liquor control boards are perhaps less susceptible than private wholesalers to coercive influence and branding incentives from major brewing conglomerates, a government-monopolized distribution tier can offer consumers a wider variety of craft beer options and more effectively promote the growth of local breweries.
6.2. Policy Option 2: Remove all legal requirements for breweries to distribute their products through intermediary wholesalers

On the opposite end of the spectrum from the control model, Washington exemplifies a prominent recent experiment in alcohol liberalization. In 2011, voters in the state passed a referendum to not only end the Washington State Liquor and Cannabis Board’s longstanding monopoly on liquor distribution and retailing but remove the legal requirement for alcohol producers to distribute their brands through intermediary wholesalers. Interest groups in control states, notably neighbouring Oregon, have since proposed similar referenda,\(^\text{101}\) with others considering dismantling their liquor monopolies through state legislation. Adapting this policy to the New Jersey beer industry would allow all brewers in the state, regardless of size, to distribute their beers directly to retailers and negotiate volume discounts, though private wholesalers would still be permitted to exist.

6.3. Policy Option 3: Exempt craft breweries comprising a small proportion of a wholesaler’s business from state franchise laws (i.e. “carve-out” laws)

In 2012, on the heels of long and costly court cases between breweries and their distributors, New York enacted an unprecedented challenge to the asymmetrical legal power inherent to most beer franchise laws. The amendment to New York’s Alcoholic Beverage Control Law exempted most craft brewers in the state from binding distribution contracts, allowing any brewery producing fewer than 300,000 barrels annually and comprising three percent or less of a wholesaler’s total annual sales volume to terminate their franchise by paying the wholesaler “fair market value” of the brand distribution rights lost in that sales territory.\(^\text{102}\) Essentially, this “carve-out” from New York State beer franchise law, the first of its kind in the United States, represented a compromise between wholesalers seeking to protect their financial investment in storing, distributing and marketing a craft brand and small breweries seeking greater control over where and how their beer is sold. Paying the fair market value of its brand(s) to void its distribution contract with a wholesaler is no easy expenditure for a brewery to undertake, but it remains a far

\(^{101}\) Oregon Privatization of Liquor Sales Initiative (2016)

\(^{102}\) N.Y. Alco. Bev. Cont. Law § 55-c(4)(c)(i)
less daunting proposition than demonstrating ‘good cause’ for termination in a protracted legal battle where the scales are tipped decidedly in the wholesaler’s favour.

6.4. Policy Option 4: Status Quo

Given the extent of wholesaler commitment to the dominant three-tier system of beer distribution in the United States, maintaining the status quo merits consideration as a legitimate policy option. From the perspective of the National Beer Wholesalers Association (NBWA), the continued existence of an independent wholesaling tier in alcohol transactions represents the best way to promote competition and variety in the American beer market, because it “provides the infrastructure, capital and personnel small brewers need to reach a wide network of retailers.”\textsuperscript{103} The three-tier system, under this view, is both more equitable and more efficient than alternative distribution models, as wholesaler services – i.e. warehousing, refrigeration, transportation, quality monitoring of kegs and tap lines – help reduce operating expenses for breweries and retailers alike.

\textsuperscript{103} National Beer Wholesalers Association 2017
Chapter 7. Criteria and Measures

This section develops a consistent framework for evaluating the relative strengths and weaknesses of each policy option outlined in Chapter 6. The Key Objective – Effectiveness – is assigned a double weight, as it directly addresses this paper’s central policy problem.

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<th>Criterion</th>
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<td><strong>Key Objective:</strong></td>
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<td><strong>Effectiveness</strong></td>
<td>Does the policy enhance consumer choice for on- and off-premise sales of beer?</td>
<td>High (20 points): Significant increase (&gt;10%) in availability of craft beer as a proportion of inventory/offerings at mainstream retail establishments</td>
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<td>Medium (10): Modest increase (5-10%) in availability of craft beer as a proportion of inventory/offerings at mainstream retail establishments</td>
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<td>Low (0): Negligible change (&lt;5%) or net decrease in availability of craft beer as a proportion of inventory/offerings at mainstream retail establishments</td>
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<td><strong>Stakeholder Acceptance</strong></td>
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<td>For each stakeholder group:</td>
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<td>(Max 12 points)</td>
<td>How would four key stakeholder groups – craft breweries, large brewing conglomerates, wholesalers and retailers – react to the policy?</td>
<td>Supportive (3 points): the stakeholder group would generally benefit from the policy and therefore support its implementation</td>
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<td>Neutral (2): the stakeholder group would not be significantly affected by the policy and would generally be ambivalent towards its implementation</td>
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<td>Criterion</td>
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| **Political Feasibility**<br>(Max 10 points) | Are government officials and constituents in the state likely to support and implement the policy? | **High** (10 points): Regulatory environment politically and socially amenable to the policy reform; state legislature(s), governor and constituents generally supportive  
**Medium** (5 points): Policy reform likely to encounter some political and/or social resistance; mixed opinions among state legislature(s), governor and constituents  
**Low** (0): Policy reform likely to encounter significant political and/or social resistance; state legislature(s), governor and constituents generally opposed |
| **Efficiency**<br>(Max 10 points) | What effect would the policy have on the average price of beer at mainstream retailers, both for on- and off-site consumption? | **High** (10 points): No change or a decrease in the average price of domestic craft beer in standard retail formats, e.g. pint (16oz) on draft at a mainstream bar or six-packs (6x12oz) for sale at a large liquor store  
**Medium** (5 points): Modest increase (<10%) in the average price of domestic craft beer in standard retail formats, e.g. pint (16oz) on
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<td><strong>Low</strong> (0 points): <strong>Significant increase (&gt;10%)</strong> in the average price of domestic craft beer in standard retail formats, e.g. pint (16oz) on draft at a mainstream bar or six-packs (6x12oz) for sale at a large liquor store</td>
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<tr>
<td><strong>High</strong> (10 points): Most craft breweries, regardless of size, can access major state distribution networks to place their products in mainstream retail establishments</td>
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<td><strong>Medium</strong> (5): Regional craft breweries and some microbreweries can access major state distribution networks to place their products in mainstream retail establishments, but barriers remain for small or upstart brands</td>
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<tr>
<td><strong>Low</strong> (0): Most craft breweries cannot access major state distribution networks to place their products in mainstream retail establishments; significant barriers for small or upstart brands</td>
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| Equity (Max 10 points) | Do craft breweries, regardless of size, have an equal opportunity to place their products in mainstream retail establishments (as opposed to bulk or speciality stores), independent of regulatory decisions? | draft at a mainstream bar or six-packs (6x12oz) for sale at a large liquor store |
Chapter 8. Evaluation of Policy Options

This section synthesizes the research conducted in the Background, Case Studies and Interview Results chapters by assessing the relative strengths and weaknesses of four policy options to alleviate barriers to consumer choice and competition in many American beer markets. These four options, outlined in Chapter 6, are critically evaluated using a points-based system developed in Chapter 7.

8.1. Policy Option 1: Eliminate private wholesaling and bring the distribution of all alcoholic beverages, including beer, under state control

Effectiveness: Medium (10 points)

State-centralized control over alcohol distribution is neither a necessary obstruction nor a boon to consumer choice and competition in American beer markets. Some Canadian provinces, notably British Columbia, have effectively promoted the growth of their local craft brewing industries through provincial crown corporations, with BC-produced beers accounting for 75 percent of the BCLDB’s 2019 beer sales – of which 38 percent were craft sales. On the other hand, liquor monopolies in Canada routinely impede consumers’ access to out-of-province and imported beers. Adopting a central regulator with sole discretion over which brands are distributed from brewers to retailers arguably increases the potential for collusion and price coordination with major suppliers, as in the case of Ontario’s Beer Store where retail beer sales are monopolized by a consortium of the two largest brewing conglomerates in Canada.

Stakeholder Acceptance – Craft Breweries: Neutral (2 points)

American craft brewers, at least as the sector is commonly defined today, have almost never co-existed with government monopolies on the distribution or retailing of beer. Today, the only such control jurisdictions in the United States are Utah, albeit only for beers containing greater than 5 percent ABV, and Montgomery County, Maryland, for all

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104 British Columbia Liquor Distribution Branch 2019
distribution to licensed retailers within county limits.\textsuperscript{105} This fact has reduced the political salience of prospective state beer distribution monopolies, with the American craft brewing industry largely focusing its advocacy approach on reforms to the three-tier system. Ultimately, the Brewers Association argues “state laws should support an independent distribution tier that is unencumbered by undue influence, ownership or control by the largest brewers and ensures access to market for all brewers,” without explicitly taking a position on whether this independent tier should be operated by governments or private businesses.\textsuperscript{106}

\textit{Stakeholder Acceptance – Large Brewing Conglomerates: Neutral (2 points)}

In virtually every regional market of the United States, Anheuser-Busch and MillerCoors have proven adept at building loyal networks of distributors whose brand portfolios are closely aligned with their own, and both companies have publicly reiterated their commitment to the principles of three-tier. That being said, their parent conglomerates – AB InBev and MolsonCoors, respectively – typically enjoy a larger domestic market share in countries like Canada where beer distribution is monopolized wholly or in part by government entities.

\textit{Stakeholder Acceptance – Wholesalers: Staunchly Opposed (0 points)}

By definition, a government monopoly on alcohol distribution would eliminate the need for a private beer wholesaling industry in a given state market. The National Beer Wholesalers Association (NBWA), as well as any affiliated chapters in affected states, would vehemently oppose such a policy.

\textit{Stakeholder Acceptance – Retailers: Opposed (1 point)}

As evidenced in the Canadian crown corporation case, centralized alcohol distribution often creates inefficiencies in provision of products to restaurants, bars, etc. Restaurants Canada laments the fact provincial liquor monopolies and interprovincial trade restrictions present barriers on licensed retailers’ ability to offer their clientele a wide range of beers,

\textsuperscript{105} National Alcohol Beverage Control Association 2019
\textsuperscript{106} Brewers Association 2020
wines and spirits, not only from around the world but even within Canada itself. This consumer choice shortage may be further exacerbated by the lack of wholesale pricing for retailers when they purchase products from the central distribution branch, a situation that persists in most provinces.

**Political Feasibility: Low (0 points)**

With many former control states moving to dismantle their monopoly on the distribution and/or retailing of distilled spirits in recent decades, exceedingly few historical examples of American jurisdictions applying such a monopoly to beer and the presence of a highly-organized beer wholesaling industry that has successfully fought to entrench three-tier distribution laws throughout the U.S. for decades, the political feasibility of this option is virtually non-existent.

**Efficiency: Low (0 points)**

A centralized beer distribution body may streamline transactions with producers and retailers, but monopolies tend to increase deadweight loss and reduce consumer welfare because the monopolist can both supply a lower quantity of goods than would otherwise exist in a competitive market and charge significantly higher prices than its marginal cost of production (i.e. monopoly profit). This phenomenon can be observed in Canada, where consumers pay one of the highest effective tax rates (47 percent) for beer in the world.

**Equity: Medium (5 points)**

A state liquor control board monopolizing the distribution of beer within its borders will likely operate with a strong mandate to promote its local brewing industry, as is currently the case in most Canadian provinces as well as in American control states like Pennsylvania with respect to in-state wineries and distilleries. In this way, government alcohol monopolies’ local product quotas, subsidies and preferential programs can bolster

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107 Restaurants Canada 2017, p. 4
108 ibid, p. 5-14
109 Hermus 2018
110 The Pennsylvania Liquor Control Board’s PA Preferred™ Wine Program and Pennsylvania Spirits Program allow in-state wineries and distilleries, respectively, to guarantee placement for up to 10 of their products in up to 10 government retail stores of their choosing.
in-state craft brewers’ access to consumer markets and reduce the influence of large conglomerates, an especially enticing prospect in a state like New Jersey where craft beer production remains underdeveloped. Still, centralized distribution is an unsustainable means to enhance consumer choice, as out-of-state craft brewers are barred from equitable distribution opportunities and in-state craft brewers are sheltered from genuine market competition.

8.2. Policy Option 2: Remove all legal requirements for breweries to distribute their products through intermediary wholesalers

Effectiveness: Medium (10 points)

In the short term, and certainly with respect to locally-brewed beers, consumer choice and competition are likely to be enhanced by this option, as small brewers previously forced to secure limited distribution space through intermediary wholesalers have the flexibility to sell their products directly to retailers and consumers at free market prices, in packaging formats and quantities that suit their respective business model. In the long term, craft brewers’ growth potential will still be indelibly influenced by the wholesaling industry, as regional, state and metropolitan markets are typically dominated by a handful of large wholesalers with established connections to major retail accounts.\(^{111}\) Two-tier distribution also raises the spectre of exclusive arrangements between large producers and retailers, with Big Beer exerting direct influence over shelf space and tap lists in a manner resembling the Seattle concert venue case (See Chapter 2.1)

Stakeholder Acceptance – Craft Breweries: Supportive (3 points)

While larger craft breweries may still find major distribution networks dominated by large brewing conglomerates, smaller producers (i.e. microbrewers) will benefit immensely from the ability to self-distribute without restriction in local markets. Policy reforms aimed at expanding two-tier or direct-to-consumer sales, moreover, encourage market entry in the craft sector as prospective entrants enjoy a greater guarantee of brand autonomy and accountability in such transactions.

\(^{111}\) Shumway 2017
Stakeholder Acceptance – Large Brewing Conglomerates: Supportive (3 points)

Not only would the removal of three-tier requirements enable large brewing conglomerates to pursue systematic vertical integration with their distribution network (i.e. wholly-owned distributors), but in cases where such companies still choose to distribute through independent wholesalers, they gain additional legal leverage to induce brand loyalty.

Stakeholder Acceptance – Wholesalers: Opposed (1 point)

The American beer wholesaling industry is inherently opposed to state legislation that reduces its political and economic influence. Nevertheless, the lack of legally mandated three-tier in Washington and other states has hardly proven a roadblock to beer wholesalers’ sustained success, with franchise law protections and exclusive dealing arrangements throughout the supply chain upholding three-tier distribution in practice.

Stakeholder Acceptance – Retailers: Neutral (2 points)

Opinions of this reform within the licensed retail industry are likely to vary significantly. While some liquor stores, bars, restaurants, etc. may prefer the convenience of working through a single distributor for all their beer deliveries, others – particularly large chain retailers – can secure higher profit margins by buying directly from brewers.\(^\text{112}\)

Political Feasibility: Medium (5 points)

There are many cases where state alcoholic beverage control laws have been amended through legislative action or public referenda to either explicitly remove three-tier mandates (e.g. Washington’s Initiative 1183) or allow producers to own and operate multiple licenses across the three tiers (e.g. brewpub exemptions allowing a brewery to act as both producer and retailer). However, substantive distribution law reform does not appear to be a pressing or prevalent issue for most Americans, with a 2019 Center for Alcohol Policy survey indicating 75 percent believe states should regulate alcohol sales under a three-tier system.\(^\text{113}\)

\(^{112}\) Sorini 2017  
\(^{113}\) Center for Alcohol Policy 2019
**Efficiency:** High (10 points)

Absent additional excise taxes, this reform is associated with a greater quantity of beer supplied at significantly lower prices, as brewers – particularly large brewing conglomerates – can sell directly to retailers without the vertical restraints and additional input costs imposed by mandating distribution through an intermediary wholesaler.\textsuperscript{114}

**Equity:** Low (0 points)

While ostensibly creating an equal opportunity for all brewers to self-distribute their products, removing three-tier mandates would not fundamentally restructure major distribution networks in most American beer markets, particularly in New Jersey where annual output thresholds for self-distribution already encapsulate every craft brewer in the state. In fact, this reform may \textit{exacerbate} vertical integration and market foreclosure, allowing large brewing conglomerates to directly own distributors and undercut their competitors through volume discounts to retailers. This has already transpired in Washington State with respect to distillers. Furthermore, there is an additional equity concern arising from the removal of three-tier requirements: state laws that allow in-state producers to bypass independent wholesalers or ship directly to consumers but bar out-of-state producers from doing the same potentially violate the Dormant Commerce Clause inferred from Article I of the U.S. Constitution, a debate that has already been the subject of a Supreme Court case in \textit{Granholm v. Heald} (2005).\textsuperscript{115}

\textsuperscript{114} Prior to Initiative 1183, Costco challenged Washington’s three-tier system on the grounds that several of its provisions – including prohibitions on volume discounts for beer and wine, prohibitions on central warehousing of beer and wine by retailers and minimum markups on sales of beer and wine from distributors to retailers – violated federal antitrust law and artificially inflated the final retail price paid by consumers. See Ferraro (2015) for a more detailed synopsis of this case and its aftermath.

\textsuperscript{115} In a 5-4 decision, the Supreme Court struck down liquor control laws in New York and Michigan that allowed in-state wineries to sell directly to consumers, while maintaining mandatory three-tier distribution for out-of-state wineries. The ruling marked a direct challenge to Section Two of the 21st Amendment: “The aim of the Twenty-first Amendment was to allow States the authority to pass nonuniform laws in order to discriminate against out-of-state goods, a privilege they had not enjoyed at any earlier time” \textit{(Granholm v. Heald}, 544 U.S. 460, 484-485).
8.3. Policy Option 3: Exempt craft breweries comprising a small proportion of a wholesaler’s business from state franchise laws (i.e. “carve-out” laws)

*Effectiveness*: High (20 points)

In levelling the balance of power between craft brewers and wholesalers in distribution contract negotiations, carve-out laws restore craft brewers’ control over their brands and promote greater consumer choice in the marketplace. As Burgdorf notes, franchise laws have artificially repressed competition in the craft beer industry, decreasing net market entry by 0.32 to 0.52 craft breweries per million people per year – or, to put it another way, between three and five craft breweries per year in New Jersey today.\(^\text{116}\)

*Stakeholder Acceptance – Craft Breweries*: Supportive (3 points)

Carve-out laws grant craft brewers the flexibility to terminate their contract with a wholesaler whose shipping capacity and/or distribution practices prove an impediment to realizing their growth potential. Such laws are especially beneficial to microbreweries, for whom litigation to resolve disputes with a wholesaler is generally a financial impossibility.

*Stakeholder Acceptance – Large Brewing Conglomerates*: Neutral (2 points)

Typically, large brewing conglomerates in the United States have demonstrated ambivalence about the politics of franchise laws, as their sizable market power, extensive legal resources and near-universal brand recognition affords them a level of insulation from the threat of wholesaler underperformance.\(^\text{117}\)

*Stakeholder Acceptance – Wholesalers*: Opposed (1 point)

The Beer Wholesalers’ Association of New Jersey, as with the New York State Beer Wholesalers Association in the lead-up to the Cuomo Administration’s 2012 reform of New York’s beer franchise laws, would likely resist any legislation that diminishes their members’ control over craft brands within their portfolios. That being said, carve-out laws maintain a guarantee of financial compensation for a wholesaler in the event a brewery

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\(^{116}\) Burgdof 2018, p. 16

\(^{117}\) Noel 2018, p. 312-315
decides to terminate their distribution contract, an assurance that does not exist in the vast majority of industries.

_Stakeholder Acceptance – Retailers:_ Neutral (2 points)

Retailers in New Jersey are unlikely to be meaningfully engaged in public debates surrounding beer franchise law reform, as distribution contracts do not pertain to them directly, though they may indirectly benefit from the elimination of a primary vertical restraint on the state’s current and prospective craft brewers’ market entry and growth.

_Political Feasibility:_ High (10 points)

At their core, legislated carve-outs from state franchise laws represent a compromise between the wholesaling industry’s rational self-interest in protecting their investment in a brand and craft breweries’ desire for greater autonomy over their brands’ distribution. Many states’ franchise laws already include “good faith” provisions designed to mitigate the risk of prolonged legal disputes between brewers and wholesalers over a brand’s distribution rights in a given sales territory, but New York’s carve-out clause offers an exemplary model of objective conditions (i.e. “annual volume less than 300,000 barrels and sales to wholesaler 3% or less of wholesaler’s annual business”) whereby a brewer may terminate their contract with a distributor without the burden of demonstrating “good cause.”

_Efficiency:_ Medium (5 points)

A policy option that promotes market entry and growth of craft brewers via greater flexibility in franchise laws is likely to engender two parallel trends in consumer markets, all else being equal: (1) upward pressure on retail prices as a result of industry premiumization, increased market share for craft beer and the growth of craft-oriented wholesalers; (2) downward pressure on retail prices as a result of greater competition, with the presence of more brewers producing largely substitutable goods driving the craft beer market towards a lower equilibrium. The anticipated net result is a modest increase in the average

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118 Kurtz and Clemens 2014, p. 402
119 Sorini 2014, p. 14
price of domestic craft beer at mainstream retail establishments, whether for on- or off-premise sales.

**Equity: High (10 points)**

Potential equity concerns may arise from a carve-out law that does not exempt all New Jersey craft brewers, whether on the grounds of annual production volume, proportion of a wholesaler’s business or another metric entirely. However, given that the state’s brewing industry remains heavily polarized – Newark is home to one of Anheuser-Busch’s flagship facilities in the United States, producing roughly 400 times more barrels (~10 million) annually than New Jersey’s largest craft brewer, Flying Fish (25,000) – this situation is unlikely to arise.\(^{120}\) Ultimately, carve-out laws are designed to promote greater equality of opportunity for craft brewers, not only in terms of wholesaler relations but in their ability to compete with large producers, and each state law’s provisions can be tailored to the economic realities of its beer market.

**8.4. Policy Option 4: Status Quo**

Because this option, unlike the preceding three, does not imply a policy reform, each criterion will be measured according to anticipated impacts over a three-year period if the current system of beer distribution in New Jersey is maintained.

**Effectiveness: Low (0 points)**

As identified in this paper’s central policy problem as well as its analysis of the current institutional structure and operation of three-tier distribution systems in the United States, consumer choice and competition in American beer markets remain hindered by vertical restraints on craft brewer entry and growth. Furthermore, in the event of a significant market contraction spurred by an oversaturated industry in tandem with declining beer consumption, such restraints may render hundreds, if not thousands, of American craft brewers financially unviable. Failure to reform contemporary distribution regulations, in other words, may leave the industry vulnerable to a significant setback in the decades-long trend of increased consumer choice.

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\(^{120}\) Hilario 2017
**Stakeholder Acceptance – Craft Breweries:** Opposed (1 point)

As has been illustrated throughout this paper, growth opportunities and market entry for craft brewers – as remarkable as the sector’s expansion has been over the last three decades – have been artificially suppressed under three-tier systems, at least in their current manifestation. The Brewers Association, along with most state craft beer guilds and trade associations, consistently emphasizes the need for distribution law reform that gives craft brewers an equal opportunity to compete with large brewing conglomerates and introduce their products to new consumers.

**Stakeholder Acceptance – Large Brewing Conglomerates:** Supportive (3 points)

Under the dominant model of beer distribution in the United States today, large brewing conglomerates – particularly AB InBev, Molson Coors and Constellation Brands – enjoy a symbiotic relationship with the mainstream wholesaling industry, dominating major distribution networks in nearly every corner of the country. Moreover, quirks in many states’ tier licensing laws have allowed conglomerates to distribute their products through wholly-owned and operated distributors, with AB InBev – by far the largest producer of beer in the United States – also acting as its second-largest distributor. The status quo, in short, has proven immensely advantageous for Big Beer.

**Stakeholder Acceptance – Wholesalers:** Supportive (3 points)

The political influence of the American beer wholesaling industry is hard to overstate. Not only does the National Beer Wholesalers Association (NBWA) dwarf all other political action committees (PACs) in the licensed beverage industry, but it is now one of the most powerful interest groups in the country (see Chapter 2.5). For decades, it has successfully lobbied to entrench and preserve the pre-eminence of a private distribution tier in beer transactions, most notably through the passage of state franchise laws and legally mandated three-tier systems. Thus, the contemporary structure and operation of beer distribution has been profoundly shaped by the American wholesaling industry.

**Stakeholder Acceptance – Retailers:** Neutral (2 points)

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121 Bennett 2016
The experience of licensed retailers under three-tier distribution systems has been decidedly mixed. On the one hand, a well-established beer distributor can supply mainstream liquor stores, let alone restaurants and bars, with a reliable inventory at competitive wholesale prices and eliminate the need for retailers to conduct separate transactions with each brewer directly. On the other hand, retailers increasingly seek to offer their customers a wide range of craft brands, not only because a substantial segment of consumers desire them but also because such brands typically carry a higher markup than mass-produced domestic lagers like Budweiser and Coors. A regional supply chain dominated by AB InBev and MillerCoors distributors presents a barrier on retailers’ ability to do so.

*Political Feasibility:* High (10 points)

Three-tier systems, whether legally-mandated or *de facto*, have been a consistent feature of beer distribution in the United States for decades. According to a March 2019 survey commissioned by the Center for Alcohol Policy, 75 percent of Americans view this model as “working well,” though it should be noted that respondents were first provided with a brief description of three-tier as few consumers are familiar with its existence or practical operation.¹²²

*Efficiency:* Medium (5 points)

As a safeguard against overconsumption, underage drinking and counterfeit or bootleg alcohol, the dominant three-tier model of beer distribution in the United States generates both a lower market supply and higher retail prices than would otherwise exist in a two-tier or direct-to-consumer system, insofar as the service provided by an independent wholesaler adds an additional input cost to the final retail price of beer and acts as a vertical restraint on many brewers’ market access.¹²³ On the other hand, independent wholesalers may reduce operating expenses for expanding breweries, providing the necessary labour, vehicles, refrigeration, warehousing and brand marketing to enable large-scale distribution.

¹²² Center for Alcohol Policy 2019
¹²³ Day 2006
Equity: Medium (5 points)

In recent decades, the American wholesaling industry has rapidly adapted to changing consumer tastes by incorporating an increasing number of craft beers into their brand portfolios, a trend largely spearheaded by established regional brewers such as Sierra Nevada, Sam Adams and New Belgium. Many craft breweries, however, still do not have an equal opportunity to sell their products through major distribution channels, as regional, state and metropolitan markets are typically dominated by a handful of large wholesalers whose brand portfolios largely align with one major supplier. Moreover, state franchise laws put small and upstart breweries at a disadvantage in their contract negotiations with wholesalers; with few, if any, viable alternatives to substantially expand their retail footprint, such producers are forced to cede autonomy over their brands by granting wholesalers an exclusive distribution territory in perpetuity.\textsuperscript{124}

\textsuperscript{124} Noel 2018, p. 405
## 8.5. Results Summarized

<table>
<thead>
<tr>
<th>Policy Option 1: State monopoly on distribution</th>
<th>Policy Option 2: Remove all three-tier requirements</th>
<th>Policy Option 3: Carve-out laws for small brewers</th>
<th>Policy Option 4: Status Quo</th>
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<tr>
<td><strong>Key Objective: Effectiveness</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Medium (10)</td>
<td>Medium (10)</td>
<td>High (20)</td>
<td>Low (0)</td>
</tr>
</tbody>
</table>

| Stakeholder Acceptance | | | |
| Craft Breweries: Neutral (2) | Craft Breweries: Supportive (3) | Craft Breweries: Supportive (3) | Craft Breweries: Opposed (1) |
| Large Brewing Conglomerates: Neutral (2) | Large Brewing Conglomerates: Supportive (3) | Large Brewing Conglomerates: Neutral (2) | Large Brewing Conglomerates: Supportive (3) |
| Wholesalers: Staunchly Opposed (0) | Wholesalers: Opposed (1) | Wholesalers: Opposed (1) | Wholesalers: Supportive (3) |
| Retailers: Opposed (1) | Retailers: Neutral (2) | Retailers: Neutral (2) | Retailers: Neutral (2) |

| Political Feasibility | | | |
| Low (0) | Medium (5) | High (10) | High (10) |

| Efficiency | | | |
| Low (0) | High (10) | Medium (5) | Medium (5) |

| Equity | | | |
| Medium (5) | Low (0) | High (10) | Medium (5) |

| TOTAL | 20 points | 34 points | 53 points | 29 points |

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Chapter 9. Recommendation

As explained in the previous chapter’s analysis, small brewer carve-out laws perform well across a variety of relevant indicators, including this paper’s overarching objective to enhance consumer choice and competition in American beer markets. This paper recommends the adoption of a small brewer carve-out from beer franchise laws in all states, including New Jersey, where such provisions do not currently exist. Carve-out reforms exempt craft breweries below a certain production volume and/or comprising a small proportion of a wholesaler’s business from the contract termination restrictions and mandated exclusive territories arising from state franchise laws, allowing them to exit a contract by simply compensating the wholesaler for the fair market value of their brand distribution rights in the applicable sales territory. This policy option recognizes the economic impact of the American beer wholesaling industry by protecting wholesalers’ investments in brand distribution and marketing, while also removing a primary vertical restraint on craft brewers’ market access and growth potential. Craft brewers’ ability to terminate their distribution contract with an underperforming wholesaler will, in turn, incentive wholesalers to devote sufficient resources and infrastructure to the craft beers in their portfolio and discourage the practice of “brand collecting.”

In order to achieve effective implementation, states must ensure their franchise law exemptions accommodate most, if not all, craft breweries in their jurisdiction, with barrelage limits and/or maximum wholesaler portfolio shares reflective of present industry trends. New Jersey, lacking a regional brewer akin to Brooklyn, Ommegang or Matt Brewing, would likely implement a lower barrelage limit than the 300,000 included in New York’s carve-out law; whereas in neighbouring Pennsylvania, a 300,000-barrel limit would fail to include Yuengling, the oldest and largest craft brewery in the United States. In this sense, brand revenue as a percentage of a wholesaler’s annual business may prove a more robust measure of a brewer’s market influence, and an optimal threshold for franchise law exemption would equitably align brewer and distributor incentives in contract negotiations. Finally, effective carve-out laws should apply to both in-state and out-of-state producers, removing the artificial barrier that franchise laws currently impose on small brewers’ distribution potential in out-of-state markets and expanding consumer access to craft beers from around the country.
Chapter 10. Conclusion

Through a comprehensive literature review, jurisdictional case studies and interviews with industry stakeholders and analysts, this paper provides an analysis of the structure and operation of beer distribution in the United States, with a particular focus on vertical restraints limiting craft brewers’ ability to sell their products to consumers. New Jersey is used as an illustrative case in this regard.

The study culminates in a multidimensional assessment of four potential policy alternatives to expand consumer choice and promote competition in American beer markets, with consistent criteria and measures employed to comparatively evaluate their impacts. It recommends the adoption of “carve-out” laws in all states where such legislation does not currently exist, exempting small brewers from state franchise laws binding them to their distributor in a particular sales territory. The exact parameters of this carve-out, such as barrelage or volume output limits and the method of calculating each brewer’s portfolio share, can be tailored to the economic realities of states’ consumer markets for beer.

Limitations to this study primarily stem from the stakeholder interview stage. Though representatives of Anheuser-Busch InBev (AB InBev) and MillerCoors, by far the two largest brewing conglomerates in the United States, were contacted to participate in the project, they did not agree to do so. Moreover, the dearth of reliable state-level data pertaining to the American beer industry, such as brewery market share, updated distribution regulations, interstate beer sales and craft brand composition at licensed retailers proved a significant impediment to a more granular analysis of potential policy impacts.

Finally, it is important to emphasize that, while New Jersey remained the primary focus of my analysis and policy recommendation, many of the institutional factors hindering a fuller realization of consumer choice in the state’s beer market can be equally observed in other American jurisdictions. Indeed, New Jersey’s relative paucity of variety is merely illustrative of a broader phenomenon rather than an exceptional case unto itself, and the implications of this paper should be treated accordingly.
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United States Constitution. Amendment XXI.


Appendix A. Organizational Structure of Anheuser-Busch InBev SA/NV (AB InBev)
Notes:

\(^a\) MillerCoors was created in 2008 as a joint venture in the United States between Molson Coors (which owns the Coors Brewing Company) and SABMiller (which owned the Miller Brewing Company). After SABMiller merged with Anheuser-Busch InBev (AB InBev) in 2016, antitrust regulators at the Department of Justice mandated that the conglomerate divest all its MillerCoors holdings in the United States as a condition for completing the $107 billion sale. MillerCoors thereafter became a wholly-owned subsidiary of Molson Coors. As of January 2020, Molson Coors has discontinued the MillerCoors name and rebranded as the Molson Coors Beverage Company, with its American and Canadian divisions collectively referred to as Molson Coors North America.

\(^b\) The Craft Brew Alliance (CBA) is a publicly-traded brewing company formed in 2008 from the merger of Seattle’s Redhook Ale Brewery and Portland’s Widmer Brothers Brewery. Today, it also includes such brands as Hawai‘i’s Kona Brewing and Portland’s Omission, one of the most popular gluten-free beers in the country. Between 2010 and 2019, the CBA was minority-owned (31.2%) by AB InBev, generating controversy for its continued use of the word “craft” despite its failure to meet the Brewers Association’s definition of a craft brewery. In November 2019, AB InBev bought out the remaining CBA shares for a sum of $220 million and has assumed full ownership of the company as of 2020.

\(^c\) In similar fashion to the conglomerate’s 2016 merger with SABMiller, AB InBev’s 2013 acquisition of Mexico’s largest brewery, Grupo Modelo, attracted the attention of antitrust regulators at the U.S. Department of Justice. Though AB InBev retained control of Grupo Modelo brands (e.g. Corona, Modelo, Pacifico) in foreign markets, it was forced to sell the American rights to such beers to Constellation Brands, now the third-largest brewery in the United States.
Appendix B. Note About Annual Output Limits for Self-Distribution of Beer

Currently, 14 states do not allow any form of self-distribution of beer whatsoever, obliging breweries – regardless of their production capacity or physical and financial capital – to sign a contract with a distributor in any geographic territory where they wish to retail products. This wholesaling requirement can put significant strain on an upstart brewery’s bottom line, as the distributor reaps the gross profit margin – generally between 25 and 30 percent – that would otherwise be retained by the brewery itself.\footnote{Shumway 2017} Moreover, in many of the 36 states where some form of self-distribution is allowed, the maximum annual output threshold pales in comparison to larger craft breweries’ present production capacity.

Michigan, for example, caps the number of barrels a brewery can legally self-distribute at just 1,000 per year,\footnote{Michigan Liquor Control Code of 1998, Section 436.1203(25)(l)} one of the lowest limits in the country and a fraction of the production capacity for Bell’s, Founders and other major craft breweries in the state. For further context, Anheuser-Busch’s brewery in Houston, Texas – just one of its 12 major facilities across the country – churns out more than 14 million barrels annually.\footnote{Anheuser-Busch 2020} Overly-restrictive limits on self-distribution thus force craft breweries to make an artificial choice between expansion and autonomy, hindering their ability to reach new consumer markets on their own terms.

That being said, self-distribution thresholds ultimately do not address the root causes of American consumers’ disparate access to craft beer, including but certainly not limited to the fact the three-tier system fundamentally structures beer distribution networks in almost every corner of the country. Regardless of small breweries’ relative legal ability to distribute their own brands, competition from established and well-connected wholesalers who “have already secured [retail] space due to their long-standing relationships with the accounts” renders the prospect infeasible for smaller producers.\footnote{Shumway 2017} As previously alluded to, greater avenues for small brewer self-distribution can also have the unintended effect

\begin{footnotesize}
\item[125] Shumway 2017
\item[127] Anheuser-Busch 2020
\item[128] Shumway 2017
\end{footnotesize}
of reinforcing vertical integration between large producers and wholesalers, i.e. through wholly-owned and operated distributors that exclusively sell AB InBev brands and dominate retail sales in a given territory.

New breweries face formidable start-up costs and barriers to entry as it is. Self-distribution implies the additional expenses of delivery trucks, warehouse space, loading equipment and labour costs, all in an industry dominated by private wholesalers. Essentially, small breweries who elect to self-distribute face a double-bind: At lower levels of output, it is unlikely they will generate the revenue or recognition to genuinely compete for shelf space at large retail outlets, even if they retain autonomy over their brands in the process. At higher levels of output, they will experience upward pressure on warehousing and delivery expenditures in order to meet increased consumer demand, potentially diverting attention from brewing itself. Beyond a critical production threshold, it either becomes financially unviable for a brewer to significantly expand their operations while still self-distributing129 or they are legally barred from further self-distribution by their state’s annual output limit.

129 This is particularly true in cases where a brewery seeks to expand to an out-of-state consumer market, subject to a different set of regulations in the operation and structure of its three-tier distribution model. Moreover, self-distribution allowances found in many states only apply to in-state brewers, thereby requiring out-of-state brewers to sign an importation and distribution contract with a wholesaler.