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COMMENT

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BREWING BETTER LAW: TWO PROPOSALS TO  
ENCOURAGE INNOVATION IN AMERICA'S  
CRAFT BEER INDUSTRY

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*The craft beer industry is one of the most innovative industries in America. Craft brewers blend tradition, regional tastes, and artistry to make some of the best beers in the world. Against all odds, the craft brewing business has boomed in an outmoded and ill-fitting regulatory environment. As more countries—and multinational brewers—follow in the footsteps of American craft brewers by cultivating their own fledgling markets, the fragile international dominance of our industry is threatened by our own stifling rules.*

*This Comment proposes two methods that state and federal governments can use to spur competition and thus innovation. First, the federal excise tax should match the size of the brewer. Tax rates must be reduced to lower a significant barrier to entry for the smallest brewers. Second, all states should allow brewpubs to operate with direct sales and reasonable barreage limits. Barreage limits threaten growth without furthering a legitimate regulatory purpose. These two small changes in federal and state law will lower barriers to entry, improve the odds of success for existing craft brewers, and create more competition—innovation follows. Importantly, for the regulators and legislators, these changes can coexist harmoniously with the current, post-Prohibition moral framework.*

INTRODUCTION ..... 1466  
I. A LEGAL HISTORY OF BREWING: FROM NEAR BEER  
TO CRAFT BEER ..... 1472

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A. <i>Alcohol Regulation After Prohibition</i> .....	1472
B. <i>The Rise of Craft Beer</i> .....	1477
C. <i>What Is Craft Beer?</i> .....	1479
II. ELIMINATING BARRIERS TO ENTRY: LOWERING TAXES	
ON SMALL BREWERS .....	1480
A. <i>The History and Policy of Beer Taxation</i> .....	1480
B. <i>Current State of the Law</i> .....	1481
C. <i>The Problems with the Current System of Taxation</i> .....	1482
D. <i>A Proposed Solution and Its Effects</i> .....	1484
III. CREATING A HEALTHY PROFIT: GUARANTEEING SUCCESS	
FOR BREWPUBS .....	1486
A. <i>The Central Importance of the Brewpub</i> .....	1486
B. <i>The Current Law</i> .....	1489
C. <i>Commonsense Solutions That Satisfy the Three-Tier System</i> .....	1490
CONCLUSION .....	1493

## INTRODUCTION

Our hunter–gatherer ancestors grew fond of beer many thousands of years ago.<sup>1</sup> As that fondness grew into obsession, an agricultural society bent on brewing was born.<sup>2</sup> In other words, human civilization may owe a debt to beer. In terms of the fundamentals, not much has changed since the invention of beer.<sup>3</sup> Although the brewing process may have lost much of its mystique with the advent of modern science,<sup>4</sup> it certainly has not diminished in

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<sup>1</sup> See Abigail Tucker, Smithsonian Magazine, *The Beer Archaeologist*, SMITHSONIAN.COM (Aug. 2011), <http://www.smithsonianmag.com/history/the-beer-archaeologist-17016372/?no-ist> [<http://perma.cc/X4UF-YQQC>] (explaining how a scientist, Dr. Patrick McGovern, has dated the world's oldest known barley beer to 3400 BCE, about 2000 years after the world's oldest known grape wine).

<sup>2</sup> See Solomon H. Katz & Mary M. Voigt, *Bread and Beer: The Early Use of Cereals in the Human Diet*, EXPEDITION, Aug. 1986, at 23, 27 (suggesting that because fermentation of cooked barley and wheat led to altered consciousness and better nutrition, humans began domesticating wild grains—the de facto basis of civilization—in order to brew more beer). *But see* William K. Stevens, *Does Civilization Owe a Debt to Beer?*, N.Y. TIMES (Mar. 24, 1987), <http://www.nytimes.com/1987/03/24/science/does-civilization-owe-a-debt-to-beer.html> [<https://perma.cc/QJ4BL6QQ>] (explaining that others have questioned the Katz-and-Voigt hypothesis since “[s]trong motivation would have been required to break away from the hunting–gathering way of life . . . because . . . [it] provided a higher and more reliable standard of living”).

<sup>3</sup> See CHARLIE PAPAIZIAN, *THE COMPLETE JOY OF HOMEBREWING* 10 (4th ed. 2014) (“Nevertheless, the fundamental factors that have influenced the taste of American beer and that of beer throughout the world haven’t changed in more than 4,500 years!”).

<sup>4</sup> See WILLIAM BOSTWICK, *THE BREWER’S TALE: A HISTORY OF THE WORLD ACCORDING TO BEER* 2, 221 (2014) (describing how Louis Pasteur—in his 1876 treatise, *Studies on Fermentation*—was the first person to scientifically explain the function of yeast and its effect on brewing, something that was, until that point, considered almost magic).

popularity. According to a recent survey, beer accounts for approximately 40 of the 55.4 liters—or 10.5 of the 14.6 gallons—of alcoholic beverages consumed per capita around the globe.<sup>5</sup> Based on those dominating numbers, the global beer industry netted \$33 billion in profits in 2014.<sup>6</sup> To get a sense of the massive scale of one of the global players, the newly merged<sup>7</sup> Anheuser-Busch InBev–SABMiller rivals Nestlé as one of largest consumer products companies in the world—based solely on the sale of beer.<sup>8</sup>

America is no different than the rest of the world in its long-and-storied love affair with beer. In Philadelphia, for example, brewing “dated from the 1600s and originated with William Penn.”<sup>9</sup> Perhaps excepting the South, most states have very similar brewing stories dating from similar times because of their shared English provenance.<sup>10</sup> Americans still enjoy a good brew, at least comparatively, ranking just outside of the top ten countries in beer consumption per capita.<sup>11</sup> According to the Beer Institute, a beer industry lobby, and the National Beer Wholesalers Association, a beer distribution lobby, America’s brewing industry contributes about \$252 billion in total economic impact per year.<sup>12</sup> In addition to that economic impact are approximately \$37 billion in

<sup>5</sup> See *Booze Around the World*, ECONOMIST (July 25, 2015), <http://www.economist.com/news/business/21659754-booze-around-world> [<https://perma.cc/CV2M-N5JX>] (depicting in a graph global alcohol “intake per head of the drinking-age population”). This equates to about 113 twelve-fluid-ounce bottles of beer a year.

<sup>6</sup> See Corey Stern, *These 4 Companies Produce Almost Half of the World’s Beer. . . and Make 74% of the Profits*, BUS. INSIDER (June 24, 2015, 4:47 PM), <http://www.businessinsider.com/beer-industry-consolidation-2015-6> [<https://perma.cc/PB38-LYMW>] (citing data that Anheuser-Busch, InBev, SABMiller, Heineken, and Carlsberg “control about 74%[] of the industry’s . . . global profits”).

<sup>7</sup> Tara Nurin, *It’s Final: AB InBev Closes on Deal to Buy SABMiller*, FORBES (Oct. 10, 2016, 7:55 PM), <http://www.forbes.com/sites/taranurin/2016/10/10/its-final-ab-inbev-closes-on-deal-to-buy-sabmiller> [<https://perma.cc/KLQ5-9DAW>].

<sup>8</sup> See Tripp Mickle & Saabira Chaudhuri, *AB InBev’s SABMiller Deal Still Faces Hurdles*, WALL STREET J. (Nov. 11, 2015, 7:32 PM), <http://www.wsj.com/articles/ab-inbev-sabmiller-formalize-106-billion-deal-1447230611> [<https://perma.cc/VQ8S-665D>].

<sup>9</sup> AMY MITTELMAN, *BREWING BATTLES: A HISTORY OF AMERICAN BEER* 20 (2008).

<sup>10</sup> See, e.g., BOSTWICK, *supra* note 4, at 176 (quoting a letter from Captain Thomas Walduck—“a traveler and military man stationed in British Barbados”—in which he wrote that “the first thing ye English do, be it in the most remote part of ye world . . . is to set up a tavern or drinking house”); MITTELMAN, *supra* note 9, at 9 (“Beer was never as popular in the Southern colonies or states because of its propensity to spoil in warm weather.”).

<sup>11</sup> See Raziye Akkoc, *Beer Sales Around the World – Who Drinks the Most?*, TELEGRAPH (Nov. 18, 2014, 2:08 PM), <http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/leisure/11237013/Mapped-Beer-sales-around-the-world-who-drinks-the-most.html> [<https://perma.cc/R38P-8KBP>] (showing that American drinkers consume seventy-three liters per capita, trailing traditional beer-drinking countries—such as the Czech Republic, Germany, Austria, Ireland, and Belgium—but ahead of the United Kingdom).

<sup>12</sup> See *State Legislative and Congressional District Data*, BEER SERVES AM., <http://www.beerservesamerica.org/state-and-congressional-district-data> [<https://perma.cc/N52Z-BJXA>] (click on “Economic Impact Report”; then select “view” to download report) (calculating that the brewing

federal, state, and local business-and-personal taxes, as well as \$11 billion in federal, state, and local consumption taxes.<sup>13</sup> While some may prefer wine or harder liquors, beer still remains the undisputed king of the American fridge and barroom.<sup>14</sup>

Most important in the current United States beer scene is the craft beer movement. The craft beer revolution of the mid-1960s<sup>15</sup> is a certified national phenomenon that shows no signs of slowing down.<sup>16</sup> The numbers indicate that America's affections seem to be shifting from "Big Beer" (like Bud, Miller, and Coors), which has dominated the beer scene since the 1950s,<sup>17</sup> back toward smaller local and regional brewers.<sup>18</sup> In some ways, the craft movement is really a return to America's pre-Prohibition roots.<sup>19</sup>

Even if the numbers are not persuasive, some anecdotal examples may be. Budweiser has recently taken the craft beer threat more seriously in a very public way. Budweiser's aggressive advertisements on America's biggest advertising stage, the Super Bowl,<sup>20</sup> were singularly focused on challenging the values of

industry directly creates approximately 50,000 jobs and another 936,000 throughout the wholesaling and retailing sectors).

<sup>13</sup> *Id.*

<sup>14</sup> See MITTELMAN, *supra* note 9, at 1 ("Some 84 million Americans drink beer. This is more people than drink milk, according to some estimates."); Zac Auter, *Beer Reigns as Americans' Preferred Alcoholic Beverage*, GALLUP (Aug. 3, 2016), <http://www.gallup.com/poll/194144/beer-reigns-americans-preferred-alcoholic-beverage.aspx> [<https://perma.cc/BJ8W-54DN>] (finding that "[b]eer continues to edge out wine [and] liquor as [the] preferred alcoholic drink").

<sup>15</sup> See TOM ACITELLI, *THE AUDACITY OF HOPS: THE HISTORY OF AMERICA'S CRAFT BEER REVOLUTION* 9-11 (2013) (placing the beginnings of the craft beer movement in the 1960s at Fritz Maytag's Anchor Brewery).

<sup>16</sup> *But see* Jim Koch, *Is It Last Call for Craft Beer?*, N.Y. TIMES (Apr. 7, 2017), <http://www.nytimes.com/2017/04/07/opinion/is-it-last-call-for-craft-beer.html> [<https://perma.cc/9J9N-9ZKJ>] (detailing sluggish growth, consolidation of brewers and wholesalers, and Big Beer's craft acquisitions as serious threats to craft beer's continuing viability).

<sup>17</sup> See ACITELLI, *supra* note 15, at 8 ("By the start of 1959, the five largest breweries produced over 28 percent of the beer Americans consumed, a jump of ten percentage points since the end of World War II. That market share would grow to nearly half within a decade . . .").

<sup>18</sup> See, e.g., *Economic Impact*, BREWERS ASS'N, <https://www.brewersassociation.org/statistics/economic-impact-data> [<https://perma.cc/38XZ-3LZ5>] (finding that in 2014, craft breweries contributed \$55.7 billion in total economic impact and 115,000 American jobs at breweries and brewpubs); *Stats & FAQs*, BREWERS ASS'N, <https://www.brewersassociation.org/press-room/stats-faqs> [<https://perma.cc/4A4C-UM6F>] (determining that craft beer accounted for 12.3% by volume and 21.9% of the market share of the United States beer market in 2016, an increase in both metrics since 2015).

<sup>19</sup> See Bart Watson, *U.S. Passes 4,000 Breweries*, BREWERS ASS'N (Sept. 28, 2015), <https://www.brewersassociation.org/insights/4000-breweries> [<https://perma.cc/EP38-RVSB>] (stating that, as of September 2015, there were more than 4000 craft breweries in America—only 131 fewer than the record seen in 1873—and that most Americans live within ten miles of a local brewery).

<sup>20</sup> See Andie Hagemann, *Super Bowl 50 Most-Watched Program in TV History*, NFL, <http://www.nfl.com/news/story/oap300000634876/article/super-bowl-50-mostwatched-program-in-tv-history> [<https://perma.cc/HN3D-8QSF>] (last updated Feb. 8, 2016, 6:26 PM).

the craft beer industry and craft beer itself.<sup>21</sup> Additionally, Budweiser added multiple craft brewers to its stable of brands.<sup>22</sup> Miller has, ever since its acquisition of Coors, created its own “craft beer” brand hidden under the guise of Blue Moon.<sup>23</sup>

Finally, consider the success of two craft beer vanguards. Both Yuengling, a once-weary survivor from the regional brewer days, and Sierra Nevada, a 1980 upstart craft brewer, have eclipsed the one-million-barrel mark and have made billionaires of their owners.<sup>24</sup> The American craft beer industry rightfully is the envy of the global beer market.<sup>25</sup>

Craft beer is important to America both economically and culturally. Unfortunately, the law has largely ignored craft beer’s impact. Only a few articles addressing specific state laws, international comparative law, and brewpubs have ever addressed the craft beer phenomenon.<sup>26</sup> Of course, there is much more at

<sup>21</sup> See Brad Tuttle, *Budweiser Doubles Down by Mocking Craft Beer Again in Super Bowl Ad*, TIME: MONEY (Feb. 6, 2016), <http://time.com/money/4210344/budweiser-super-bowl-50-ad-mock-craft-beer> [<https://perma.cc/9M9L-R6AQ>] (describing Bud’s 2016 Super Bowl advertisement, which said that Bud is “not small” and its beer is “not a fruit cup” (capitalization omitted)); see also budweiser, *Budweiser USA: #BestBuds | 2015 Budweiser Clydesdale Beer Run*, YOUTUBE (Jan. 23, 2015), <https://www.youtube.com/watch?v=EIUSkKTUftU> [<https://perma.cc/4GUG-Q5ZH>] (depicting a Clydesdale horse, the Bud mascot, intimidating a shopper into putting down craft beer and buying Budweiser).

<sup>22</sup> Anheuser-Busch InBev recently added Wicked Weed to its stable of craft brands, which includes Elysian, Devils Backbone, Blue Point, and Karbach Brewing Co. John Kell, *Anheuser-Busch InBev Just Bought Its 10th Craft Brewer*, FORTUNE (May 3, 2017), <http://fortune.com/2015/05/03/abinbev-tenth-craft-brewer-deal> [<https://perma.cc/A2MH-EN4L>].

<sup>23</sup> Blue Moon has been so well-hidden that it was alleged that Miller’s use of the label caused consumer confusion. Complaint at 3, *Parent v. MillerCoors LLC*, No. 3:15-cv-1204-GPC-WVG (S.D. Cal. June 16, 2016). As a result, the company was the subject of a consumer class action in California concerning alleged fraudulent advertising. *Id.*; see also ACITELLI, *supra* note 15, at 206 (quoting craft beer industry players as saying that this type of business model, “phantom micros” or “phantom crafts,” is “a particularly insidious—and ingenious—threat in the marketplace”).

<sup>24</sup> KEN GROSSMAN, *BEYOND THE PALE: THE STORY OF SIERRA NEVADA BREWING CO.* 45 (2013); see also Brendan Coffey, *Sierra Nevada Founder Grossman Becomes Billionaire on Pale Ales*, BLOOMBERGPURSUIITS (Jan. 20, 2015, 4:59 AM), <http://www.bloomberg.com/news/articles/2015-01-20/sierra-nevada-founder-grossman-becomes-billionaire-on-pale-ales> [<https://perma.cc/46KC-U5VT>] (explaining that Ken Grossman is now “the head of the country’s second-largest craft brewery, becoming a billionaire in the process, according to the Bloomberg Billionaires Index”); Brendan Coffey, *Yuengling Tapping Thirst for Craft Beers*, BLADE (Dec. 23, 2012), <http://www.toledoblade.com/Nation/2012/12/23/Yuengling-Billionaire-Beats-Sam-Adams-With-Craft-Brews.html> [<https://perma.cc/ATZ5-22F3>] (“As the company’s value soared in the past decade amid a surge in demand for craft brews, Yuengling became a billionaire.”).

<sup>25</sup> See GROSSMAN, *supra* note 24, at 97 (“For the past 30 years, the US brewing industry has been the global leader in brewing innovation and has seen the establishment of thousands of new brands . . . . The American brewing revolution serves as a model that is being emulated around the world and has affected the global beer marketplace in amazing ways.”).

<sup>26</sup> See Kincaid C. Brown, *Michigan Craft Beer Legislation*, MICH. B.J., July 2015, at 54; Josh Hunsucker, *Read My Lips, No Inappropriate Beer Taxes: Chapter 96 Amends the Definition of Beer, Protecting Craft Brewers*, 44 MCGEORGE L. REV. 543 (2013); Tammy Lam, Note, *Brew Free or Die? A Comparative Analysis of U.S. and E.U. Craft Beer Regulations*, 23 CARDOZO J. INT’L & COMP. L. 197 (2014); David R. Scott, Comment, *Brewing Up a New Century of Beer: How North Carolina Laws*

the intersection of craft beer and the law than merely these few topics. One could imagine articles addressing stabilization and regulation of the hop market,<sup>27</sup> bottling and process technology,<sup>28</sup> and the monopolies held by large brewers and wholesalers.<sup>29</sup> This Comment seeks to amend the deficiency by addressing another important aspect at the core of the craft beer movement: innovation.<sup>30</sup> While innovation may be measured in many ways, this Comment will focus only on the creation of new beer recipes.

Before focusing on how to create those new recipes, however, there is one important question left to answer: does America need more craft beer? To many consumers, a list full of different bottles and a bevy of taps seems to be enough to sate even the most insatiable beer connoisseur. But several reasons cut against this argument. First, to keep America's craft brewing edge, America must not favor entrenched competitors but instead keep its brewers in constant competition. Generally, any changes that reduce barriers to entry allow for more competition, lower prices, and better quality.<sup>31</sup> Second, comparing the craft beer industry to the wine industry, beer still lags far behind wine in overall producers,<sup>32</sup> even though beer is a much bigger industry by volume sold.<sup>33</sup> This indicates that craft beer has not yet hit its

*Stifle Competition in the Beer Industry and How They Should Be Changed*, 3 WAKE FOREST J.L. & POL'Y 417 (2013); Andrew Tamayo, Comment, *What's Brewing in the Old North State: An Analysis of the Beer Distribution Laws Regulating North Carolina's Craft Breweries*, 88 N.C. L. REV. 2198 (2010); Justin M. Welch, Note, *The Inevitability of the Brewpub: Legal Avenues for Expanding Distribution Capabilities*, 16 REV. LITIG. 173 (1997).

<sup>27</sup> The hop market is one of those rare markets in which there is only one profitable (or even desired) use: beer. See GROSSMAN, *supra* note 24, at 77-79 (discussing the volatility of the hop market based on crop size and its pressure on craft brewers who are usually spot buyers and therefore most affected by the shifting fortunes of the market).

<sup>28</sup> The questions here would be who is researching bottle technology, can craft brewer's experiment with it, and is it widely accessible for adoption. See, e.g., *id.* at 225 (noting that a switch from twist-off to pry-off caps exponentially improves shelf stability and flavor of the beer).

<sup>29</sup> See Mickle & Chaudhuri, *supra* note 8 (estimating that before their merger, Anheuser-Busch InBev and SABMiller together controlled 30% of the global market for beer).

<sup>30</sup> See *Craft Brewer Defined*, BREWERS ASS'N, <https://www.brewersassociation.org/statistics/craft-brewer-defined> [<https://perma.cc/SPP8-6C84>] ("The hallmark of craft beer and craft brewers is innovation.").

<sup>31</sup> See MATTHEW MITCHELL & CHRISTOPHER KOOPMAN, MERCATUS CTR. GEORGE MASON UNIV., MERCATUS ON POLICY: BOTTLING UP INNOVATION IN CRAFT BREWING: A REVIEW OF THE CURRENT BARRIERS AND CHALLENGES 1 (2014), <https://www.mercatus.org/system/files/MitchellKoopman-CraftBrewing-MOP.pdf> [<https://perma.cc/MKG4-VFLM>] ("Startups in the craft brewing industry face formidable barriers to entry in the form of federal, state, and local regulations. These barriers limit competition and innovation, reducing consumer welfare.").

<sup>32</sup> Compare *Stats & FAQs*, *supra* note 18 (showing that there were 5301 breweries in 2016), with Wines & Vines Staff, *Number of Wineries Grows to 8,391 in North America*, WINES & VINES (Jan. 27, 2014), <http://www.winesandvines.com/template.cfm?section=news&content=127266> [<https://perma.cc/6SEC-C487>] (stating that there were 7762 wineries in the United States in 2013).

<sup>33</sup> See Doug Schwalm, *Taxation and the Economic Impacts of Alcohol* ("By 1990, just over 50 percent of ethanol consumed in the United States was in the form of beer, with the rest being almost equally split between wine and spirits."), in SOCIAL AND ECONOMIC CONTROL OF ALCOHOL: THE 21ST

market saturation point. Surely, one would not argue that wine lists have become too long; many restaurants see these tomes as a point of pride. What meaningful differentiation could be made for craft beer? Third, the craft brewing industry not only creates more jobs but also spurs tourism.<sup>34</sup> Craft beer is one of the last vestiges of regional culinary diversity left in America and should be supported solely on that basis. Finally, after venture capital left its mark in the mid-1990s craft beer IPO craze, the craft brew bubble righted itself.<sup>35</sup> This is a sustainable industry that has continued to see double-digit growth.<sup>36</sup> The government should not impede the creation of good jobs in small businesses around the country.

The reason for focusing on recipe creation is simple. Recipes are the lifeblood of the craft beer movement. When one thinks of craft beer's effect on the American beer industry, one naturally thinks of the many exciting twists craft brewers have taken on traditional recipes. Take, for example, the India Pale Ale. The IPA was first popularized in nineteenth-century Britain as an alternative to the heavy—and sometimes poisonous—stouts and porters.<sup>37</sup> Now, whether it is a black IPA, rye IPA, or otherwise “IPA-ized” beer, IPAs are ubiquitous.<sup>38</sup> What was “bitter” is now—positively—“hoppy.” Consider as well the modern pumpkin beer, a recalibration of an American ale born of rebellion and necessity, which has a very similar creation story to the IPA.<sup>39</sup> The innovative recipe, which differentiates a craft brewer from the

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AMENDMENT IN THE 21ST CENTURY 19, 20 (Carole L. Jurkiewicz & Murphy J. Painter eds., 2008) [hereinafter *SOCIAL AND ECONOMIC CONTROL OF ALCOHOL*].

34 For example, Asheville, North Carolina now holds itself out as having more breweries per capita than any other city in the United States and advertises that fact to promote tourism. *See Beer Scene*, ASHEVILLE, <http://www.exploreasheville.com/foodtopia/beer-scene> [<http://perma.cc/FH44-G2Q4>] (boasting about having roughly 100 local beers).

35 *See* ACITELLI, *supra* note 15, at 265-67, 294 (discussing how Wall Street's entrance into craft beer created beer “of dubious quality” and ended in “The Great Shakeout,” as well as how those brewers who survived the Great Shakeout fared in the early 2000s); BOSTWICK, *supra* note 4, at 233 (“Between 1996 and 2000 three hundred recently opened breweries shut down.”).

36 *See National Beer Sales & Production Data 2015*, BREWERS ASS'N, <https://www.brewersassociation.org/statistics/national-beer-sales-production-data> [<https://perma.cc/X9WS-A7H8>] (calculating that craft beer sales grew 12.8% in 2015). *But see National Beer Sales & Production Data 2016*, BREWERS ASS'N, <https://www.brewersassociation.org/statistics/national-beer-sales-production-data> [<https://perma.cc/FHL6-NSYB>] (determining that 2016 growth in the industry was only 6.2% by volume).

37 *See* BOSTWICK, *supra* note 4, at 135-36 (discussing the rise of the IPA in England, where it was first marketed as the “healthy, temperate” alternative to “rich, thick stouts and porters”).

38 *See* Bart Watson, *What's the Next IPA?*, BREWERS ASS'N (Aug. 12, 2015), <https://www.brewersassociation.org/insights/the-next-ipa> [<https://perma.cc/FN5D-D7XF>] (discussing the meteoric rise and influence of the IPA on America's craft brewers and showing that Americans consumed seven million barrels of this craft style in 2015).

39 *See* BOSTWICK, *supra* note 4, at 178-79 (telling how early American brewers used pumpkin, spruce, and molasses—among other strange ingredients—to make beer); BUFFALO BILL'S BREWERY, <http://buffalobillsbrewery.com> [<https://perma.cc/2DCP-P3FJ>] (claiming that it created “America's Original Pumpkin Ale” in 1985 using “real pumpkin and spices”).

bubbly sea of Big Beer's lagers, is what sets the craft brewer apart. What primarily brings people back is not the price, the packaging, or the availability, but the taste.<sup>40</sup> The craft brewer is an artisan, combining the brewer's art, modern science, and time-tested tradition in the process of creation. For this Comment's purposes, it matters not what the next great recipe might be,<sup>41</sup> but how we can encourage the recipe to exit the ether and enter the bottle before it is lost forever.

There are two main ways in which new recipes can be created, and each of the proposals in this Comment aims to encourage those methods of recipe creation. The first option is creating new breweries. Lowering a barrier to entry should encourage the establishment of new breweries, which create new recipes and new house flavors.<sup>42</sup> The first proposal thus aims to lower one significant barrier, excise taxes on the smallest breweries. The second option is to create more profitable and longer-lasting breweries, which tend to experiment and expand their repertoires. The second proposal—legalizing brewpubs or, at least, legalizing direct sales from breweries to patrons—puts more money directly in the pockets of brewers and may encourage long-term investment and experimentation. After discussing the basic backdrop of beer regulation, this Comment will delve into each proposal.

## I. A LEGAL HISTORY OF BREWING: FROM NEAR BEER TO CRAFT BEER

### A. *Alcohol Regulation After Prohibition*

Of all the products humans have devised, alcohol is the only one that has been the subject of two constitutional amendments.<sup>43</sup> Over our country's history, attitudes about alcohol have swung wildly from life-giving necessity to banned substance and finally back to acceptable social drink.<sup>44</sup> Beer floats

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<sup>40</sup> See ACITELLI, *supra* note 15, at 110-11 (describing craft beer as a "connoisseur thing"); *id.* at 120-21 (illustrating the conception of a beer tasting event that featured craft beer at the Brickskeller in Washington, D.C.); *id.* at 264 (explaining that craft beer appealed to foodies); *id.* at 296-98 (quoting a speech at the 2002 Craft Brewers Conference during which it was stated that "craft brewers [we]re [brewing] 'beer as wine'").

<sup>41</sup> One industry observer guesses that blondes, Kölsches, goldens, sours, or goses might be the next big seller. Watson, *supra* note 38.

<sup>42</sup> New breweries bring with them, as a matter of course, new flavors just by using different water, supplies, equipment, and environment. See, e.g., BOSTWICK, *supra* note 4, at 173-74 (describing how one home brewer's "house flavor"—that is, the one constant flavor across all beers made—is smoky because he uses traditional methods over an open wood fire to brew beer).

<sup>43</sup> See U.S. CONST. amend. XVIII, *repealed by* U.S. CONST. amend. XXI.

<sup>44</sup> See Carole L. Jurkiewicz & Murphy J. Painter, *Why We Control Alcohol the Way We Do* (constructing a historical timeline from the first European settlement until the end of Prohibition in the United States, delineating the variation in American attitudes and laws on liquor), *in* SOCIAL

on the social and political currents of America and is subject to the ever-changing status of alcohol in our culture.<sup>45</sup> The height of fear and social disapproval of alcohol was undoubtedly during the Eighteenth Amendment's ratification and Prohibition, when the sale of alcoholic beverages was completely abolished nationwide.<sup>46</sup> Soon, America realized that even if Prohibition was a grand experiment, it was a failed one.<sup>47</sup> John D. Rockefeller, Jr., a staunch teetotaler, recognized the fact, saying, "[T]he regrettable failure of the Eighteenth Amendment has demonstrated the fact that the majority of the people of this country are not yet ready for total abstinence, at least when it is attempted through legal coercion."<sup>48</sup> Even if Prohibition was not the answer to alcohol regulation, American government was reluctant to return to an ineffective pre-Prohibition scheme. A compromise between complete control and laissez-faire pre-Prohibition laws was necessary. The Twenty-First Amendment handed the problem of alcohol regulation to the states, but it provided no overall direction toward implementation.<sup>49</sup>

John D. Rockefeller, Jr., through the influential study he funded, attempted to fill the regulatory gap. Rockefeller, Jr. asked Raymond Fosdick, a lawyer, and Albert Scott, an engineer "who ha[d] also devoted much time and thought to the intensive study of social and religious movements," to define the aspirations

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AND ECONOMIC CONTROL OF ALCOHOL, *supra* note 33, at 1, 3-5; *cf.* MITTELMAN, *supra* note 9, at 1 ("In early modern Europe people considered beer essential for good health."). In fact, today, a large portion of the country does not drink. *See* Auer, *supra* note 14 (surveying American attitudes toward alcohol and finding that about 35% of Americans state they abstain from alcohol).

<sup>45</sup> America has still not reached a consensus on a unified social, moral, or cultural definition of alcohol. On the one hand, alcohol is revered in American culture. It is an integral part of many holidays and is seen as a rite of passage into adulthood. On the other hand, state and federal governments regulate alcohol as if it were a dangerous toxin and place strong, moral disapprobation upon it. This clash of society, morality, and law may be the key to understanding the strange state of alcohol regulation. *See* Abraham M. Buchman, *Foreword* to SOCIAL AND ECONOMIC CONTROL OF ALCOHOL, *supra* note 33, at xiii, xiii-xv (discussing the intersection of religion, culture, and the law as it relates to alcohol control); Jurkiewicz & Painter, *supra* note 44, at 14 ("Today, as in the past, alcohol remains a controversial and divisive topic. Its use is inextricable from concerns about health, crime, and politics.").

<sup>46</sup> *See* U.S. CONST. amend. XVIII, § 1 ("After one year from the ratification of this article the manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States and all territory subject to the jurisdiction thereof for beverage purposes is hereby prohibited."), *repealed by* U.S. CONST. amend. XXI.

<sup>47</sup> *See* RAYMOND B. FOSDICK & ALBERT L. SCOTT, TOWARD LIQUOR CONTROL 4-5 (Ctr. for Alcohol Policy 2011) (1933) ("[U]p to the adoption of the Prohibition Amendment of 1920 . . . we have attempted to impose on law a burden which law by itself is not equipped to carry . . . Permanent advance in human society cannot be brought about by night-sticks and patrol wagons. Men cannot be made good by force.").

<sup>48</sup> John D. Rockefeller, Jr., *Foreword* to FOSDICK & SCOTT, *supra* note 47, at xiii, xiii.

<sup>49</sup> *See* U.S. CONST. amend. XXI, § 2 ("The transportation or importation into any state, territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.").

and policies of a new era of alcohol regulation.<sup>50</sup> More than eighty years later, this study, entitled *Toward Liquor Control*, is considered to have “done more to shape modern American alcohol policy than any other book except the Bible.”<sup>51</sup> *Toward Liquor Control* not only motivated officials’ policy choices during the period immediately after Prohibition but also remains a strong influence today.<sup>52</sup> Its arguments still undergird modern state laws and motivate state legislators.<sup>53</sup>

The proposed regulatory scheme advocated by Fosdick and Scott was a state-controlled monopoly on alcohol retail—in the best case—or, at least, a three-tier licensure system.<sup>54</sup> Both proposals were meant to incorporate six aspirations, the most important of which was to drive out the “criminal element” in alcohol manufacture, distribution, and sale.<sup>55</sup> But, even before the mob came to the fore during Prohibition, a more pernicious problem existed. Many suppliers of alcohol either had direct control of retail outlets or used various coercive tactics that straitjacketed retailers into selling as much of one brand as possible.<sup>56</sup> This so-called bare profit motive was thought to be both a dangerous restraint of the free market and a cause of alcoholism and its related social ills.<sup>57</sup> For its part, the federal government passed a “tied-house” statute, which prohibits meddling by producers in retailers’ affairs.<sup>58</sup> Today, every state has layered on its own tied house restrictions in one fashion or another.<sup>59</sup>

In addition, every state has adopted one of the plans that Fosdick and Scott suggested. A minority of states has chosen to create a state-controlled monopoly

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<sup>50</sup> Rockefeller, Jr., *supra* note 48, at xiv.

<sup>51</sup> Jim Petro et al., *Introduction to FOSDICK & SCOTT*, *supra* note 47, at vii, vii.

<sup>52</sup> *Id.* at vii-xi.

<sup>53</sup> *Id.* at x.

<sup>54</sup> See FOSDICK & SCOTT, *supra* note 47, at 24-68 (proposing two systems to control beer, wine, and liquor—either regulation by license or “the authority plan,” which allowed the state a monopoly over wholesale or retail of alcohol).

<sup>55</sup> See *id.* at 9-10 (envisioning, as well, moderate use of alcohol, prohibition of saloons, decreased alcohol industry influence on government, other limitations on the sale of liquor, and a solution to regulation of alcohol).

<sup>56</sup> See *id.* at 29 (blaming drunkenness, in part, on tied houses, which were motivated to sell as much alcohol as possible because they could only sell one brand). The so-called tied-house problem still exists in many other parts of the world. See GROSSMAN, *supra* note 24, at 95 (“In other parts of Europe and the world, it’s common practice for brewers or distributors to cut exclusive deals with bars and restaurants and provide tables, chairs, [etc.] . . . in exchange for exclusivity in the brands the retailer sells.”).

<sup>57</sup> FOSDICK & SCOTT, *supra* note 47, at 29.

<sup>58</sup> See 27 U.S.C. § 205(a) (2012) (“It shall be unlawful for any person engaged in business as a distiller, brewer, [etc.] . . . to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such retailer in interstate or foreign commerce . . .”).

<sup>59</sup> Each state prohibits, in some form, a manufacturer from “providing an item of value to a retailer.” Susan C. Cagann, *Contents Under Pressure: Regulating the Sales and Marketing of Alcoholic Beverages*, in SOCIAL AND ECONOMIC CONTROL OF ALCOHOL, *supra* note 33, at 57, 65.

over the wholesale or retail of certain types of alcohol.<sup>60</sup> Since it is state-run, this method gives the state governments the most control over what is sold, when it is sold, who can buy it, and in what amounts. Although this plan led to less consumption, some states remained unwilling to exercise this amount of control.<sup>61</sup>

Instead, the remaining states rejected the monopoly system and imposed Fosdick and Scott's three-tier licensing system.<sup>62</sup> The three-tier system goes a step further than tied-house laws and requires manufacturers, wholesalers, and retailers to be distinct entities.<sup>63</sup> A retailer, for example, may not also hold a license as a producer and vice versa. In other words, this system creates an unassailable buffer between producer and retailer by requiring independent wholesalers. While there have been challenges to this arrangement,<sup>64</sup> the strength of the wholesalers' lobby<sup>65</sup> has predictably stalled any major change to the system.<sup>66</sup> It is within the wholesalers' interests to keep their protected statuses as middlemen, even though changes in the market may have mitigated their necessity.<sup>67</sup> Exceptions exist. Some states have allowed the melding of

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60 New Hampshire, Pennsylvania, and Utah control both the wholesale and retail levels for the sale of wine, fortified wine, and liquor. Evan T. Lawson, *The Future of the Three-Tiered System as a Control of Marketing Alcoholic Beverages*, in SOCIAL AND ECONOMIC CONTROL OF ALCOHOL, *supra* note 33, at 31, 33. Mississippi and Wyoming control only the wholesale level for the same products. *Id.* Idaho, Michigan, Montana, North Carolina, Ohio, Oregon, Vermont, and Washington control the wholesale and retail levels for fortified wine and liquor sales. *Id.* Alabama, Iowa, Maine, Virginia, and West Virginia only control the wholesale level for the same products. *Id.*

61 See Terrel L. Rhodes, *Policy, Regulation, and Legislation*, in SOCIAL AND ECONOMIC CONTROL OF ALCOHOL, *supra* note 33, at 79, 83 (“[W]hen states move from a *control* system to a *licensure* system . . . overall sale[s] of alcoholic beverages increase[] significantly.”).

62 Lawson, *supra* note 60, at 33-34.

63 *Id.* at 31.

64 See, e.g., Scott, *supra* note 26, at 432-35 (advocating for a complete abolition of the three-tier system because of the creation of wholesaler monopolies and restrictions on consumer choice); David White, *Wholesale Robbery in Liquor Sales*, N.Y. TIMES (Apr. 3, 2011), <http://www.nytimes.com/2011/04/04/opinion/04white.html> [<https://perma.cc/UR8W-RDD7>] (attacking the wholesaler lobby for raising consumer prices by 18-25% and restricting consumer choice).

65 See Amanda Becker, *Law and Lobbying Firms Pump Millions of Dollars into Midterm Campaigns*, WASH. POST (Nov. 1, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/10/29/AR2010102905908.html> [<https://perma.cc/RDF9-29JC>] (determining that the National Beer Wholesalers Association was among the top donors in the 2010 election cycle, contributing about \$7 million to “Democratic and Republican candidates ‘who understand the importance of state-based alcohol regulation’”).

66 Furthermore, state legislatures may not embrace the change since this directly contradicts the three-tier system. To break the power of the wholesaler is to essentially abandon the system and revert to private control. See FOSDICK & SCOTT, *supra* note 47, at 29 (describing the licensure system as a means to control the “tied house” problem by fully separating the manufacturer and retailer).

67 See MITCHELL & KOOPMAN, *supra* note 31, at 4 (“While initially justified on public interest grounds, the three-tier system has created an entrenched interest (distributors) that now has a financial stake in seeing that these policies persist.”).

producer-and-retailer or producer-and-wholesaler for small-scale brewers.<sup>68</sup> These exceptions will be addressed further in Part III.

The last segment of the system is the “beer franchise law.” These laws regulate the contractual relationship between the producer and the wholesaler and adjust contract law to favor the wholesaler.<sup>69</sup> While these laws vary by state, in general they are built on the mistaken assumption that brewers are large and national while wholesalers are small and local.<sup>70</sup> Based on this assumption, these laws’ default provisions require “good cause” for termination, sixty- or ninety-day notice-and-cure provisions, and exclusive territory grants to wholesalers.<sup>71</sup> Thus, once a new, small brewer makes a deal with a large, established wholesaler—which is necessary in the many states that do not allow direct sales or self-distribution—the contract is almost impossible to escape, and the wholesaler retains the power to be the sole seller of a brand in its territory.<sup>72</sup>

In response to the failure of Prohibition, the government switched from full-scale abolition to relatively tight state or private control. What is most important is what was left out: beer. Notably, in both of Fosdick and Scott’s systems, beer remained separate; it could be sold at nonstate stores without direct government oversight.<sup>73</sup> Beer was considered the more temperate alternative to strong wine or liquor and was encouraged as a substitute beverage.<sup>74</sup> For this reason, Fosdick and Scott theorized that beer should be widely available, licensing should be liberal, and beer should be available to drink both on-premises, with or without food, and off-premises.<sup>75</sup> While alcohol was generally subject to strict control, beer remained an exception.

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<sup>68</sup> See, e.g., *Brewery Sales and Sampling Laws*, BREWERS ASS’N, <https://www.brewersassociation.org/government-affairs/laws/brewery-sales-and-sampling-laws> [<http://perma.cc/NB4F-9BVX>] (gathering state law on direct brewery-to-customer sales).

<sup>69</sup> Marc E. Sorini, *Beer Franchise Law Summary*, BREWERS ASS’N, <https://www.brewersassociation.org/wp-content/uploads/2015/06/Beer-Franchise-Law-Summary.pdf> [<http://perma.cc/9Y8G-EL2Q>].

<sup>70</sup> See *id.*; White, *supra* note 64 (explaining that America’s “two largest wholesalers—Southern Wine & Spirits and Republic National Distributing Company—have revenues of about \$13 billion”); see also Koch, *supra* note 16 (showing that fewer than 3000 wholesalers remain and that “in most local markets over 90 percent of the beer is controlled by distributors . . . one of which is dependent on AB InBev for most of its volume, and the other on Miller Coors”); cf. Lawson, *supra* note 60, at 36–37 (detailing how wine and liquor wholesalers have greatly consolidated and showing that the top twenty wholesalers control 67.9% of the entire American market).

<sup>71</sup> Sorini, *supra* note 69.

<sup>72</sup> See GROSSMAN, *supra* note 24, at 105 (discussing Sierra Nevada’s inability to cancel distributor contracts made in the 1980s, which have become detrimental to its business today); Scott, *supra* note 26, at 432–35 (arguing that the effects of franchise laws and wholesaler territory monopolies are higher prices and decreased consumer choice).

<sup>73</sup> See *supra* notes 54–55.

<sup>74</sup> The name of the study may implicitly give this away: *Toward Liquor Control*, not *Toward Alcohol Control* or *Toward Beer Control*. See, e.g., FOSDICK & SCOTT, *supra* note 47, at 21 (determining that there should not be restrictions on sales of beer of 3.2% alcohol by volume (ABV) or less since it was not intoxicating).

<sup>75</sup> See *id.*

### B. *The Rise of Craft Beer*

Craft beer is the industry that never should have been.<sup>76</sup> Somehow, a small group of innovators beat the odds and created sustainable businesses in the face of Big Beer's stifling dominance. The craft beer movement, according to its most recent historian, Tom Acitelli, can be traced to Fritz Maytag and Anchor Brewing in the mid-1960s.<sup>77</sup> The movement is currently in its so-called fourth wave.<sup>78</sup> Instead of lingering long on craft beer's history,<sup>79</sup> this Comment will focus on the legal-regime changes that most directly contributed to the growth of the craft beer movement.

Changing law was key to the growth of the craft beer industry.<sup>80</sup> Changes in two legal regimes, one at the federal level and one at the state level, were most responsible for the rise of the craft beer industry.<sup>81</sup>

First, on October 14, 1978, President Jimmy Carter signed into law a new provision in the tax code that legalized the home production of beer and wine.<sup>82</sup> Up to a specified gallon amount, aspiring craft brewers could ply their trade at home for personal consumption.<sup>83</sup> While multiple sources show that Americans were experimenting with home brew before legalization because of government non-enforcement,<sup>84</sup> the legalization of homebrewing conceivably

<sup>76</sup> See ACITELLI, *supra* note 15, at 77-78 (“[W]e can almost step back and see the American craft beer movement as a doomed venture by 1979 and 1980, one that was by no means assured of stumbling out of the decade of stagflation and oil crises . . .”).

<sup>77</sup> See *id.* at 9-11.

<sup>78</sup> See *id.* at 86-104 (detailing the first wave as Anchor, the second wave as New Albion and Sierra Nevada, the third wave as contract brewers and better-financed crafts, and the fourth wave as the current generation).

<sup>79</sup> For a full recitation, see generally *id.*

<sup>80</sup> Even now, it is more important for the craft brewer to be a lobbyist than to be a lawyer. See Welch, *supra* note 26, at 214 (“[F]or those of you who do not want to sacrifice your finances at the altar of good beer, you may find better odds with a lobbyist than with a lawyer.”).

<sup>81</sup> See James Fallows, *Jimmy Carter: Not the King of Beers? (Updated)*, ATLANTIC (Aug. 19, 2010), <http://www.theatlantic.com/politics/archive/2010/08/jimmy-carter-not-the-king-of-beers-updated/61599> [<https://perma.cc/N4RQ-KB4M>] (debating whether President Jimmy Carter's legalization of homebrewing or California, Oregon, and Washington's legalization of brewpubs should get more credit for the craft brew revolution). Ken Grossman of Sierra Nevada offers a different perspective. He believes that the three-tier system was essential to craft beer's growth in America because it facilitated entrance by smaller breweries. See GROSSMAN, *supra* note 24, at 94-95 (comparing United States regulations to those in the United Kingdom, where brewers may own 2000 pubs, thus restricting competition). Grossman's theory is that the separation of the wholesale and retail channels from Big Beer control allowed smaller brewers to compete equally for distribution and shelf space. See *id.* at 94-96 (noting that “the vertical integration of manufacturer and retailer . . . has generally stymied the growth of small and independent breweries”).

<sup>82</sup> Pub. L. No. 95-458, § 2(b), 92 Stat. 1255, 1255-56 (1986) (codified at I.R.C. § 5053(e) (2012)).

<sup>83</sup> See I.R.C. § 5053(e) (exempting beer produced for home use from taxation if it does not exceed 200 gallons per year and if there are two or more adults in the household).

<sup>84</sup> See GROSSMAN, *supra* note 24, at 19-21 (stating that Grossman began homebrewing in 1969 and purchased materials from a homebrew shop); see also ACITELLI, *supra* note 15, at 57-58 (“The federal Bureau of Alcohol, Tobacco, and Firearms essentially adopted a hear-no-evil, see-no-evil approach

had three substantial effects on the craft movement. Primarily, this legislative change legitimized and legalized covert homebrewers' activities.<sup>85</sup> Secondly, it opened up a substantive dialogue between homebrewers and professionals, which eased the transition between avid homebrewers and professional brewer.<sup>86</sup> Finally, it helped grow homebrew shops and their suppliers.<sup>87</sup> Newer, better, and bigger homebrew supply shops brought amateur brewers one step closer to professional brewing, especially when amateurs could buy professional-grade ingredients and equipment. One blogger theorizes that this act of "deregulation" allowed the craft brew movement to accelerate, noting that "90% of craft beers began as home brews."<sup>88</sup> Although this theory contains a kernel of truth, more significant changes were at work at the state level.

Second, and more importantly, various states legalized brewpubs. In 1982, both California and Washington legalized the brewpub, with Oregon following suit in 1983.<sup>89</sup> The first brewpub was built in Yakima, Washington by a Big Beer veteran who had always dreamed of having his own brewery—in a repurposed opera house.<sup>90</sup> Data indicates that the real acceleration in craft brewing did not occur in the year after the legalization of homebrewing but in 1983 on the West Coast.<sup>91</sup> Further proof rests in the fact that about two-thirds of all craft breweries in existence began as, or continue to be, brewpubs.<sup>92</sup> Currently, the states with the most craft breweries (in absolute number) are California, Oregon, Colorado, and Washington—three of these states are the familiar first adopters of legal brewpubs.<sup>93</sup> This is not a coincidence but a direct consequence of the change in law. With these federal and state laws, craft beer was primed for its modern explosion in popularity and our examination here.

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to enforcement, and there is no record of any American, including those who ran homebrewing shops, being arrested for homebrewing when it was illegal.”).

<sup>85</sup> See *supra* note 84.

<sup>86</sup> See ACITELLI, *supra* note 15, at 80 (discussing how the legitimization of homebrewing created an open dialogue between homebrewers and professionals).

<sup>87</sup> See *id.* (arguing that the legitimization of homebrewing meant that the homebrew shop could access better ingredients with less risk).

<sup>88</sup> See Fallows, *supra* note 81. But see ACITELLI, *supra* note 15, at 84 (“President Carter’s signature . . . did little beyond freeing homebrewing suppliers from fear of a federal raid and allow[ed] enthusiasts to congregate more openly.”).

<sup>89</sup> See Fallows, *supra* note 81.

<sup>90</sup> See ACITELLI, *supra* note 15, at 84-85 (explaining the creation of “Grant’s Pub,” the first post-Prohibition brewpub in America).

<sup>91</sup> See Fallows, *supra* note 81.

<sup>92</sup> See *id.* Currently, brewpubs represent about 40% of all craft brewers in America. *Number of Breweries*, BREWERS ASS’N, <https://www.brewersassociation.org/statistics/number-of-breweries> [<https://perma.cc/CH2W-5CNS>] (showing that in 2015, there were 1730 brewpubs out of a total 4504 craft breweries).

<sup>93</sup> *State Craft Beer Sales & Production Statistics, 2015*, BREWERS ASS’N, <https://www.brewersassociation.org/statistics/by-state> [<https://perma.cc/A6XS-PVH6>]. California, Washington, and Oregon have 518, 305, and 228 craft breweries, respectively. The only other states that eclipse 200 are Colorado, New York, and Michigan with 284, 208, and 205 craft breweries, respectively. *Id.*

### C. What Is Craft Beer?

Craft beer is important, but what is it? Answering this question first requires a definition of who makes craft beer. “Craft brewery” is an umbrella term that encapsulates the entire industry. According to the brewers—through their lobbying body, the Brewers Association—a craft brewery is a brewery that (1) produces six million barrels or fewer annually; (2) is less than 25% owned or controlled by another “alcohol industry member” that is not also a craft brewery; and (3) brews most of its alcohol volume from traditional or innovative brewing ingredients.<sup>94</sup> Craft breweries can be broken down into microbreweries, brewpubs, and regional breweries. A microbrewer is a very small brewery that produces less than 15,000 barrels per year and sells at least 75% of that offsite.<sup>95</sup> By contrast, a brewpub is a brewery that sells 25% or more of its beer onsite and brews “primarily for sale in [its] restaurant and bar.”<sup>96</sup> Finally, a regional brewery is merely a larger microbrewery, fitting the same definition but selling more than 15,000 barrels per year.<sup>97</sup>

Beyond these somewhat technical definitions are the aspirations that bind craft brewers together as a movement. Craft brewers are driven by innovation, usually based on traditional ingredients—like malted barley, hops, and spices—in novel ways.<sup>98</sup> Craft brewers are relatively small in size, committed to quality, and devoted to methods and recipes steeped in centuries-old tradition.<sup>99</sup> For example, both Yards and Dogfish Head have recreated beer from our nation’s founding and from ancient civilizations.<sup>100</sup> Innovative craft

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<sup>94</sup> *Craft Brewer Defined*, *supra* note 30; *see also* BOSTWICK, *supra* note 4, at 188 (explaining that the definition of craft beer was recently changed—raising the cut-off six million barrels from two million—to accommodate Boston Beer Co.).

<sup>95</sup> *See Craft Beer Industry Market Segments*, BREWERS ASS’N, <https://www.brewersassociation.org/statistics/market-segments> [<https://perma.cc/N4EQ-6BTW>]; *United States Breweries*, BREWERS ASS’N, <https://www.brewersassociation.org/directories/breweries/?type=micro&term=United%20States&searchby=country> [<https://perma.cc/2K2G-GCFG>] (select “Pennsylvania” as “State”; then filter by “Microbreweries”) (listing Pennsylvania microbreweries, such as Stoudts, Pizza Boy, and Philadelphia Brewing).

<sup>96</sup> *See Craft Beer Industry Market Segments*, *supra* note 95; *United States Breweries*, *supra* note 95 (select “Pennsylvania” as “State” and filter by “Brewpub”) (providing examples of brewpubs in Pennsylvania, such as Appalachian, 2nd Story, and Tired Hands).

<sup>97</sup> *See Craft Beer Industry Market Segments*, *supra* note 95; *United States Breweries*, *supra* note 95 (filter by “Regional”) (providing examples of regional breweries, such as Anchor, Boston Beer, Sierra Nevada, Rogue, and Shipyard).

<sup>98</sup> *Craft Brewer Defined*, *supra* note 30.

<sup>99</sup> *See* ACITELLI, *supra* note 15, at 103 (describing the craft beer industry as bound by a philosophy of “small, independent, and traditional” brewers).

<sup>100</sup> *See Ales of the Revolution*, YARDS BREWING COMPANY, <http://yardsbrewing.com/ales-of-revolution> [<https://perma.cc/8XUY-WMLB>] (showcasing three Yards beers based on recipes used by Thomas Jefferson, George Washington, and Benjamin Franklin); *Ancient Ales*, DOGFISH HEAD, <http://shop.dogfish.com/ancientales> [<https://perma.cc/8M2A-MZ6W>] (highlighting Dogfish Head’s work with Dr. Patrick McGovern to recreate nine ancient beers based on old recipes and molecular evidence from international historical sites).

brewers have also created new favorites, such as the IPA and pumpkin ale, by adding a twist to old recipes.<sup>101</sup>

## II. ELIMINATING BARRIERS TO ENTRY: LOWERING TAXES ON SMALL BREWERS

### A. *The History and Policy of Beer Taxation*

“The history of the American brewing industry is a history of a battle between control and individual freedom. The federal government sought to control the industry by taxation while brewers sought the freedom to pursue their economic livelihood.”<sup>102</sup> Taxing alcohol has been a governmental mainstay. Almost every ancient civilization has taxed alcohol.<sup>103</sup> America’s own income tax, the collective bane of most Americans’ Aprils, is a rather recent addition when compared to the taxation of alcohol.<sup>104</sup> After independence and the adoption of the Constitution, the next order of business for Alexander Hamilton and George Washington was to institute a federal tax on whiskey to pay off government debts.<sup>105</sup> That first effort at taxation ended in the 1793 Whiskey Rebellion without much money collected.<sup>106</sup> Notably absent was any excise tax on the other domestic alcohol, beer, because Hamilton thought the tax was unnecessary to preserve good health and could be harmful to the fledgling brewing industry.<sup>107</sup>

While the alcohol tax has endured, its purpose has changed. The income tax contributed to the erosion of brewers’ once-unassailable nineteenth-century standing as a primary federal government revenue-producer<sup>108</sup> and signaled a shift in purpose of alcohol taxation from revenue creation to consumption control.<sup>109</sup> The purpose of taxation is now twofold: to correct negative externalities, a so-called

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<sup>101</sup> See *supra* notes 37–39 and accompanying text.

<sup>102</sup> MITTELMAN, *supra* note 9, at 4.

<sup>103</sup> See Jurkiewicz & Painter, *supra* note 44, at 2 (“Alcohol regulation arose in historical times as societies became more cultured, and was first instituted in ancient Greece, Mesopotamia, Egypt, and Rome . . .”).

<sup>104</sup> See *Brief History of IRS*, IRS, <https://www.irs.gov/uac/brief-history-of-irs> [<https://perma.cc/QPH2-R9MH>] (last updated Sept. 28, 2016) (stating that the first income tax was instituted during the Civil War, but that the current income tax was instituted only in 1913 with the passage of the Sixteenth Amendment).

<sup>105</sup> See MITTELMAN, *supra* note 9, at 15 (explaining that, as part of the deal for assuming state liabilities from the Revolutionary War, the federal government would exact an excise tax on distilled spirits, which came with The Excise Act of 1791).

<sup>106</sup> See *id.* at 15–16.

<sup>107</sup> *Id.* at 15.

<sup>108</sup> See *id.* at 81–83 (showing how the rise of the income tax in funding the federal government diminished the brewers’ lobbying powers and eventually led to Prohibition).

<sup>109</sup> See FOSDICK & SCOTT, *supra* note 47, at 69 (“The fundamental objective [of alcohol taxation] should be not revenue but rational and effective social control.”).

Pigovian tax, and to discourage consumption, a byproduct of Prohibition-era attitudes.<sup>110</sup> The problem for craft beer is that this dual purpose does not apply as strongly to its industry as it does to other alcohol producers.

### B. *Current State of the Law*

Instead of dealing with the enormous number of state and local taxes, this Comment will focus on commonsense suggestions for the federal system. Focusing on the federal system only requires convincing one legislative body instead of fifty. Furthermore, evidence suggests that most of the tax revenues and funding for government programs addressing alcohol stem from the federal government, not the states.<sup>111</sup> In other words, the federal system is where the liability rests and the assets exist.

Currently, federal law distinguishes excise tax rates based on the amount of barrels brewed per year. For those who produce more than 2 million barrels<sup>112</sup> per year, the tax rate is \$18 per barrel.<sup>113</sup> For those brewers producing up to 2 million barrels per year, the tax rate is \$7 per barrel up to 60,000 barrels.<sup>114</sup> After 60,000 barrels, the rate returns to \$18 per barrel.<sup>115</sup> Thus, the federal government recognizes three sizes of brewers: 60,000 barrels and below, 2 million barrels and below, and over 2 million barrels.

Beyond the actual taxes are the compliance costs attached to calculating and paying the myriad of federal, state, and local taxes.<sup>116</sup> This could affect where a brewer wishes to locate his brewery. Moreover, these compliance costs are dizzying.<sup>117</sup> The danger of these costs creating an “anticommons” in the alcohol industry has been understood since immediately after Prohibition.<sup>118</sup> Compliance

<sup>110</sup> Schwalm, *supra* note 33, at 24. *But see* MITTELMAN, *supra* note 9, at 182 (elucidating that the neo-temperance movement of the 1980s and 1990s was interested in offsetting tax losses with more revenue from “sin taxes”).

<sup>111</sup> *See* Rhodes, *supra* note 61, at 83 (noting that “alcohol prevention programs accounted for only 4 percent . . . of policy activity in the states during the last thirty years of the twentieth century”).

<sup>112</sup> Whenever the term “barrel” is used in this part of the tax code, it refers to a standard size of thirty-one gallons. *See* 27 C.F.R. § 25.151 (2016) (laying out the tax rate for barrels containing not more than thirty-one gallons).

<sup>113</sup> *Id.*; *see also* MITTELMAN, *supra* note 9, at 183 (calculating that the 1991 change in excise tax doubled from \$9 to \$18 a barrel, coming out to about 32¢ per six-pack).

<sup>114</sup> *See* 27 C.F.R. § 25.152.

<sup>115</sup> *Id.*

<sup>116</sup> *See* FOSDICK & SCOTT, *supra* note 47, at 72 (“Upon the repeal of the Eighteenth Amendment, federal, state, and many local governments will doubtless proceed to impose all kinds of manufacturers’ and retail taxes and licenses upon the liquor business. The rush to pass new tax laws is already underway.”).

<sup>117</sup> *See, e.g.*, MITCHELL & KOOPMAN, *supra* note 3167, at 3 (“[S]tarting a microbrewery in the state of Virginia requires as many procedures as starting a small business in China or Venezuela, countries notorious for their excessive barriers to entry.”).

<sup>118</sup> *See id.* at 3-4 (comparing this type of taxation on the beer industry to the “robber barons” of the Rhine river in the Middle Ages); *see also* FOSDICK & SCOTT, *supra* note 47, at 72 (finding

costs benefit established competitors and disproportionately burden new, smaller players.<sup>119</sup> While compliance costs will not be considered in any further detail here, these costs must factor into any policymaker's assessment of the fairness and effectiveness of the alcohol taxation scheme.<sup>120</sup>

### C. *The Problems with the Current System of Taxation*

Taxing craft beer does little to serve the dual purposes of the current tax scheme: correcting negative externalities and discouraging consumption. It is difficult to justify taxation that is not fulfilling its purpose, especially when it stifles industry and limits the availability of domestic jobs. In short, the taxation problem is two-fold as it relates to craft beer: the tax rate is too high for its stated purposes and the distinctions between brewery production levels do not match the current state of the craft brew industry.

First, the taxation barely serves its Pigovian purpose. Pigovian taxes make users pay the government to correct the externalities created by their consumption. Alcohol undoubtedly has deleterious social effects, such as drunk driving, cirrhosis, and broken families,<sup>121</sup> but it is unfair to assume that craft beer is equally to blame. Big Beer, not craft brewers, depend upon pushing consumption to realize efficiencies of scale.<sup>122</sup> Rather, craft brewers focus on creating quality, super-premium beer meant to be savored.<sup>123</sup> But, it is being taxed as if it were built upon the same model as Big Beer: a single, unoffending offering to

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that the "inconsistent mass of conflicting and overlapping tax legislation . . . [with] wasteful duplication and conflicting policies in administration may render inefficient and ineffective the whole tax structure").

<sup>119</sup> See MITCHELL & KOOPMAN, *supra* note 31, at 4 ("Even though many of the regulations surveyed above (licensing, permitting, prior agency approval for formulas, etc.) raise costs on all firms regardless of their size, the costs of compliance tend to be particularly burdensome for newer and smaller operators. That means many large, established firms benefit from these rules since they raise their rivals' costs." (footnote omitted)).

<sup>120</sup> Compliance costs, even though they effectively change the level of taxation from the brewer's perspective, will not be addressed in this Comment. But, the federal government has considered it in a limited capacity. A majority of Senators support the Brewers Association's suggestion to reduce biweekly tax filings to the federal government for 90% of brewers based on their size. Press Release, Brewers Ass'n, Majority of U.S. Senators Support Beer Tax Reform (Sept. 26, 2016), [https://brewersassociation.org/press\\_releases/majority-U-S-Senators-Support-beer-tax-reform](https://brewersassociation.org/press_releases/majority-U-S-Senators-Support-beer-tax-reform) [<https://perma.cc/8NLH-WJRR>].

<sup>121</sup> See Schwalm, *supra* note 33, at 25-27 (canvassing current studies on the economic impact of alcohol on mortality, medical expenses, productivity, and crime).

<sup>122</sup> See ACITELLI, *supra* note 15, at 25-26 (showing that the Big Beer business model was built on profit margins created from economies of scale).

<sup>123</sup> For example, Matthew Reich, former owner of New Amsterdam, said that craft beer is "not for the six-pack drinker. It's the beer to have if you're having one. With dinner." *Id.* at 121. Some of these beer styles, like those based on Belgian recipes, are technically a meal replacement. See BOSTWICK, *supra* note 4, at 54 (discussing the basis of the Belgian-abbey-style ales and their purpose as "[b]rewed for sustenance").

please the masses.<sup>124</sup> The Pigovian head of the taxation scheme only weakly supports taxing craft beer.<sup>125</sup>

The second aim of taxing beer is to artificially inflate prices to limit consumption. Studies have shown that a higher total price is one of the most effective ways to curb alcohol consumption.<sup>126</sup> As super-premium beer that is sold at steep prices, craft beer—by its very nature—discourages consumption, without the need for added taxation.<sup>127</sup> The thirty-two cents imposed on a six-pack of craft beer does little to change consumer choice at the margins for craft beer drinkers. Furthermore, studies show that beer is the least price sensitive form of alcohol.<sup>128</sup> Taxes at the margins are less effective in changing consumer behavior when it comes to beer. Finally, the craft beer business model does not rest on efficiencies of scale, so the price likely will never significantly decrease based on pure market factors.<sup>129</sup> Thus, taxes are serving a diluted purpose when it comes to a \$12 to \$15 six-pack of craft beer or an \$18 750 milliliter bottle.

The only purpose left standing is government revenue creation. Revenue creation through alcohol taxation is not supported by policy or many Americans. Modern alcohol policy does not rest on a rationale of pure revenue creation.<sup>130</sup> Revenue creation is merely a byproduct of the other purposes of taxation. Moreover, taxing beer is highly regressive and affects the poorest consumers and the poorest producers most dramatically.<sup>131</sup> Thus, regressive taxation has always been—at least—a politically unwise choice. Even with a substance as polarizing

<sup>124</sup> See *id.* at 230-31 (quoting a 1951 article in *Modern Brewery Age*, which found that Americans wanted “an agreeable, mild hop flavor and no bitter aftertaste”).

<sup>125</sup> In any event, it is also unclear whether the Pigovian purpose of these taxes could ever truly be realized. Not only is it difficult to compute accurately the cumulative negative social effects of alcohol, but it is also even more challenging to calculate alcohol’s positive impacts.

<sup>126</sup> See Jurkiewicz & Painter, *supra* note 44, at 9 (detailing how minimum markup laws help to ensure that the price of alcohol does not make it more accessible); Rhodes, *supra* note 61, at 87 (stating that one way, empirically, to limit consumption is through raising the total price).

<sup>127</sup> Although price controls by states have been deemed unconstitutional by *Healy v. Beer Institute*, 491 U.S. 324, 324 (1989), market-imposed prices surely are not.

<sup>128</sup> See Schwalm, *supra* note 33, at 21 (calculating the price sensitivity of beer at -0.35, whereas wine price sensitivity is -0.68 and liquor price sensitivity is -0.98).

<sup>129</sup> See German Estevez Rutishauser et al., *A Perfect Storm Brewing in the Global Beer Business*, MCKINSEY & COMPANY (June 2015), <http://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/a-perfect-storm-brewing-in-the-global-beer-business> [<https://perma.cc/VZ8Z-R83Q>] (stating that “economies of scale are less important in the” super-premium segment, which includes all craft beer). Regardless, craft brewers do not have enough production to benefit from economies of scale in the same way as Big Beer. For example, in 2014, the entire craft industry was smaller than the Bud Light brand. Jason Notte, *Goodbye, Bud Light and Miller Lite, Here Come Session IPAs*, MARKETWATCH (Mar. 27, 2015, 6:00 AM), <http://www.marketwatch.com/story/goodbye-bud-light-and-miller-lite-here-come-session-ipas-2015-03-27> [<https://perma.cc/VM2L-F8PW>].

<sup>130</sup> See Rhodes, *supra* note 61, at 85 (arguing that taxation has never been the main form of alcohol control though it has become “frequent and widely accepted”).

<sup>131</sup> See Jurkiewicz & Painter, *supra* note 44, at 13 (“[S]uch taxes are regressive forms of taxation that unduly target the middle class and blue collar workers . . .”).

as alcohol, most Americans do not support an increase in taxation as a means of control, much less for mere revenue.<sup>132</sup> Taxation as a means of control may be palatable, even if it is one of the least effective means.<sup>133</sup> However, if it is only being used as a means for revenue creation, approval for taxation dissipates.

There are additional problems in how the government has chosen to distinguish between producers. Although distinguishing between sizes is admirable, current distinctions do not match the market. By number, the largest single segment of the craft beer industry is the microbrewery—breweries that produce less than 15,000 barrels of beer a year.<sup>134</sup> Microbrewers, however, only account for 16% of the total volume of beer produced in the craft market, trailing well behind the much bigger regional brewery segment of the market, which captures upward of 70%.<sup>135</sup> If the current distinctions are intended to grant a tax break to the smallest brewers, the barrelage line between microbrewers and regional brewers has been misjudged.

#### D. *A Proposed Solution and Its Effects*

Despite the current tax challenges, there is light on the horizon. Still before Congress is the Craft Beverage Modernization and Tax Reform Act of 2017.<sup>136</sup> The bill proposes that the excise tax should be reduced to \$3.50 per barrel, instead of \$7, for the first 60,000 barrels for any brewer under 2 million barrels annually.<sup>137</sup> It also proposes a cut of \$2, down to \$16, for all brewers under 6 million barrels annually.<sup>138</sup> For any brewer of over 6 million barrels annually—only the few biggest brewers at the top—the rate would remain at

<sup>132</sup> See Rhodes, *supra* note 61, at 90 (finding that, based on poll data, only 43% of Americans support an increase in alcohol taxation as a means of alcohol control).

<sup>133</sup> In theory, raising taxes should increase total price. But reality tells a different story. The real price of alcohol has actually declined, so taxes are not effectively raising total price. See *id.* at 85 (“The actual price of alcohol has declined since 1970 in relation to cost of living and cost of non-alcoholic beverages.”); see also Jurkiewicz & Painter, *supra* note 44, at 13 (“[A] recent study succinctly pointed out that raising alcohol taxes is not as effective as having a wide variety of active and enforced alcohol regulations . . .”).

<sup>134</sup> This does not include brewpubs that produce less than 15,000 barrels a year. See *Number of Breweries*, *supra* note 92 (calculating that, as of 2015, there were 2596 microbreweries in America, which accounted for approximately 58% of the total market); see also *Federal Excise Tax*, BEER INST., <http://www.beerinstitute.org/policy-issues/excise-tax> [<https://perma.cc/ME6X-HED6>] (“More than 90 percent of all federally-permitted brewers produce fewer than 7,143 barrels annually . . .”).

<sup>135</sup> See *National Beer Sales & Production Data 2015*, *supra* note 36 (click on “Production” tab) (showing that regional brewers account for approximately 78% of craft beer production, that microbrewers account for 16%, and that brewpub and contract brewers account for approximately 6%).

<sup>136</sup> Craft Beverage Modernization and Tax Reform Act of 2017, S. 236, 115th Cong. (2017); Craft Beverage Modernization and Tax Reform Act of 2017, H.R. 747, 115th Cong. (2017).

<sup>137</sup> S. 236 § 201(b)(1)–(2).

<sup>138</sup> *Id.* § 201(a)(1)(A)(i).

\$18 per barrel.<sup>139</sup> This is an encouraging starting point, but it still suffers from a lack of fine calibration.

Before proposing how to more finely tune this bill, it is helpful to examine its benefits. The bill still creates big savings for small brewers. For brewers making less than 60,000 barrels, they stand to save as much as \$210,000 annually in taxes.<sup>140</sup> The biggest brewers—assuming production of exactly 6 million barrels a year—stand to save about \$12 million annually. Clearly, these savings could be used for significant investment and growth. Further, given that craft beer only accounts for 12.2% of the beer industry by volume, only a modest amount of revenue will be diverted from the Treasury.<sup>141</sup>

To truly encourage craft beer growth and innovative recipes, the bill should be amended to make distinctions that more accurately reflect the market. A better scheme would distinguish between brewers who produce up to 15,000 barrels, 60,000 barrels, and 6 million barrels. Microbrewers—those who brew less than 15,000 barrels annually—should be granted the greatest tax reductions. As production increases, the system may gradually impose higher taxes as the brewery grows throughout its lifecycle.<sup>142</sup> At that point, taxes per barrel could revert to the current rates.

This alternative scheme can do the most good at the least cost while easing brewers into higher taxes as they grow. Microbrewers are the smallest and most vulnerable members of the industry. For microbrewers, unlike Big Beer, taxation is a high barrier to entry. Although microbrewers are the largest craft brewer group, by absolute number, they account for only a small portion of the industry by volume.<sup>143</sup> Reduced taxes specifically targeting microbrewers will be felt by the most breweries with the least effect on government revenue. Finally, a progressive system is needed to gradually acclimatize small brewers to increasingly onerous tax burdens. Because brewers pay taxes upon sale, taxes come out of their wholesale price to distributors. Gradually increasing taxes incentivizes craft brewers to build their business beyond 15,000 barrels because they will have less reason to fear that taxation will seriously lower their bottom lines.

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<sup>139</sup> *Id.* § 201(a)(1)(A)(ii).

<sup>140</sup> A quick calculation bears this out. These brewers would save \$3.50 per barrel on 60,000 barrels, equaling \$210,000 saved on taxes.

<sup>141</sup> See *National Beer Sales & Production Data 2015*, *supra* note 36 (documenting that 24,076,864 barrels of craft beer were sold in 2015). While hundreds of millions of dollars in lost revenue might seem significant, it pales in comparison to the \$3.2 trillion that the federal government collected in 2015. Office of Mgmt. & Budget, *Historical Tables*, WHITE HOUSE: PRESIDENT BARACK OBAMA, <https://obamawhitehouse.archives.gov/omb/budget/Historicals> [<https://perma.cc/GEB7-WHH3>] (click on “Table 1.1—Summary of Receipts, Outlays, and Surpluses or Deficits (-): 1789–2021”).

<sup>142</sup> As the craft beer industry fully matures, more amendments may be needed to match brewery models.

<sup>143</sup> While microbrewers account for only 16% of craft beer by volume, they comprise 58% of craft breweries. See *supra* notes 134–35 and accompanying text.

There is abundant anecdotal evidence that tax breaks ease the burden for startup craft brewers. For instance, a tax break early in the craft beer movement was instrumental in jumpstarting that movement.<sup>144</sup> Significant tax savings not only makes the industry more attractive to would-be brewers and their financial backers but also helps brewers build steady, sustainable growth.<sup>145</sup> That money could be used to upgrade equipment, hire new talent, or even finance leasehold improvements.

According to Ken Grossman, every little bit of money can count in the brewing business.<sup>146</sup> His early forays into starting his own business were built on pushing the boundaries of his aging, cramped equipment and facilities.<sup>147</sup> He wasted much time and money repairing or reworking equipment.<sup>148</sup> Because of his careful business planning and luck, he was able to survive, but other startups likely will not be so lucky.<sup>149</sup> Lowering taxes for the smallest brewers benefits the industry by lowering a barrier to entry and creating more competition. Competition begets innovation. Most importantly, tax breaks will neither disservice the purposes of taxation nor thwart the federal government out of an excessive amount of revenue. But this is only one part of the recipe for innovation.

### III. CREATING A HEALTHY PROFIT: GUARANTEEING SUCCESS FOR BREWPUBS

#### A. *The Central Importance of the Brewpub*

Brewpubs are the lynchpin of the craft beer movement.<sup>150</sup> During the formative 1990s, brewpubs—not microbreweries—were the dominant form of

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<sup>144</sup> See ACITELLI, *supra* note 15, at 63 (citing a federal tax break from nine to seven dollars per barrel “on the first sixty thousand barrels” for brewers with no more than “two million barrels annually” as a “godsend” to the initial growth of craft brewers).

<sup>145</sup> See, e.g., *Craft Beverage Modernization & Tax Reform Act (S. 1562, H.R. 2903) Infographic*, BEER INST., <http://www.beerinstitute.org/policy-issues/craft-beverage-modernization-tax-reform-act> [<https://perma.cc/H26S-79RM>] (arguing that lower taxes will, in addition to growing the industry, have downstream effects on job growth throughout beer, agriculture, and business).

<sup>146</sup> See GROSSMAN, *supra* note 24, at 99-101.

<sup>147</sup> See *id.* (sharing Grossman’s experiences buying old dairy equipment, a soda bottling line, and making his own grain grinder—all of which periodically broke down, causing intense anxiety and a lot of lost time).

<sup>148</sup> See *id.*

<sup>149</sup> See *id.* at 45-60 (discussing Grossman’s reliance on family and friends for funding and the fact that banks refused to fund his venture because regional breweries were dying and craft beer was not yet popular).

<sup>150</sup> See *supra* text accompanying notes 89-93 (explaining the elemental importance of the brewpub to the creation of the craft beer phenomenon).

craft brewing in America.<sup>151</sup> Bill Owens, Bert Grant, and Ken Grossman are among the “legendary pioneers” of the craft beer movement that first popularized the brewpub form in post-Prohibition America.<sup>152</sup> Finally, by 2012, microbreweries caught up with brewpubs.<sup>153</sup> Now, brewpubs are second to microbrewers in both number and overall production, but brewpubs still account for approximately 37% of the craft breweries in operation.<sup>154</sup> Brewpubs are still an important part of the market as well as a viable, much needed form of business. There are many reasons why this style of brewing up a business has been popular.

First, brewpubs provide a source of revenue that is not so intricately tied to the success of a new beer. A startup that has more than one way to make money is less risky. In fact, statistics show that brewpubs have a higher rate of success than restaurants. While about 60% of restaurants close within their first three years, only 46% of brewpubs close within their first three years.<sup>155</sup> The brewpub is a safer way to open a brewery and spread risk.

Second, brewpubs allow the brewer to constantly, albeit informally, survey reactions to different recipes for new brews. The ability to keg a small batch of beer, bring it to the bar, and ask for customer reactions on the spot is invaluable to understanding the market.<sup>156</sup> Unlike Big Beer, most small breweries neither have the resources nor the knowledge to perform formal surveys on their new products. Therefore, the brewpub remains one of the only options for a small brewer to test recipes on the market and prove its worth to distributors and retailers.<sup>157</sup>

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151 See ACITELLI, *supra* note 15, at 198 (“[M]ore than 360 [brewpubs] were in operation by the spring of 1995, besting the number of craft breweries by more than three to two.”).

152 *Id.* at 198.

153 *Number of Breweries*, *supra* note 92.

154 *National Beer Sales & Production Data 2015*, *supra* note 36 (click on “Production” tab); *Number of Breweries*, *supra* note 92.

155 Bart Watson, *The Brewpub Advantage*, BREWERS ASS’N (Feb. 17, 2016), <https://www.brewersassociation.org/articles/the-brewpub-advantage> [<https://perma.cc/W6WX-QYBP>].

156 See *Dogfish Head Brewing & Eats*, DOGFISH HEAD CRAFT BREWED ALES, <http://www.dogfish.com/eats/brewpub/index.htm> [<https://perma.cc/47XE-GLXK>] (“Because the batches were small, Sam [Calagione, the founder of Dogfish Head,] could afford to indulge his off-centered whims. He’d wander into the brewpub’s kitchen and grab a handful of raisins, a cup of maple syrup or a scoop of roasted chicory.”); cf. Cyrena Nouzille, *Six Tactics for Keeping Your Brewpub Relevant in a Changing Environment*, BREWERS ASS’N (May 31, 2016), <https://www.brewersassociation.org/articles/six-tactics-keeping-brewpub-relevant-changing-environment> [<https://perma.cc/29A3-NT6Q>] (“Daily, direct access to the consumer allows a brewpub to stay in tune with how its brand is perceived.”).

157 Of course, brewers may also bring samples to retailers to allow them to try the beer themselves. However, many states severely restrict the size of the samples through tied-house laws. For example, the District of Columbia requires an additional permit to give out a 12-ounce sample. *Brewery Sales and Sampling Laws*, *supra* note 68 (click on “Choose a State”; then select “District of Columbia”). Idaho only allows a 1.5 ounce sample in a designated tasting area. *Id.* (click on “Choose a State”; then select “Idaho”). And Illinois only allows three samples, up to two ounces each, per person, per day. *Id.* (click on “Choose a State”; then select “Illinois”). In essence, these laws prohibit a brewer from giving a bar a free keg to see how the beer sells for a week. Thus, one of the brewpub’s

Third, brewpubs are an effective way to informally market beer. If a brewpub has good food, people may come for the food but stay for the beer. Once customers enter the brewpub, they become a captive audience. Brewpubs also create a low-stakes environment for testing a new brewery's offerings. Instead of investing in a six-pack of beer, customers can order a tasting paddle or try a few small samples of the beer to find one that suits their taste. This sample may not only persuade customers to buy a full glass<sup>158</sup> but also introduce reluctant consumers to beers they may never otherwise try on their own initiative.<sup>159</sup> Allowing direct interaction between the brewer and its customers is essential to creating growth through a word-of-mouth following.

Fourth, because brewpubs allow producers to sell directly to the customer, they retain more profits. Bill Owens, the owner of Buffalo Bill's, chose the brewpub model for just this reason. As he stated, "For \$130 worth of ingredients, I can make a \$2,500 profit . . . . A glass of lager . . . costs seven cents. I sell it for a dollar and a half. Compare my profit on a bottle of commercial beer—forty cents."<sup>160</sup> From Bill's calculations, the profits under the brewpub model are over three times larger than profits from selling to consumers through retailers. Such profits are a boon for small brewers who may be barely surviving from one batch to the next. But these profits are also why some wholesalers are so dead set against the expansion of the brewpub model: the brewers receive the wholesalers' cut.<sup>161</sup>

Fifth, in states that allow a brewpub to make off-premises sales, brewpubs can also be retail outlets for beer. In many ways, it is difficult for a small brewer to persuade a distributor to carry its brand and even more difficult for that distributor to persuade retailers to do the same.<sup>162</sup> This problem is somewhat

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only ways to prove success to a retailer is through its own brewpub sales. For a full list of state laws on sampling, see *id.*

<sup>158</sup> See Tim Brady, *The Value of Fractional Pours*, BREWERS ASS'N (Mar. 16, 2016), <https://www.brewersassociation.org/articles/the-value-of-fractional-pours> [<https://perma.cc/U5HL-8PJQ>] (making the case for allowing free or reduced price samples because, according to Tim Brady's informal experiment at the Whetstone Station Restaurant, Brewery & Bier Garten, 71% of customers go on to buy the beer).

<sup>159</sup> See *id.* (showing that the average number of beer brands on a check rose from two to four after a brewpub implemented four-ounce pours on every draft beer available).

<sup>160</sup> ACITELLI, *supra* note 15, at 98.

<sup>161</sup> See White, *supra* note 64 ("The wholesaling industry's survival depends on maintaining today's highly regulated system.").

<sup>162</sup> See, e.g., GROSSMAN, *supra* note 24, at 92, 102-03 (describing the need to self-distribute in Sierra Nevada's early days and the difficulties in finding a distributor to sell its beer to retailers); *Georgia Brewers and Wholesalers Agree on Bill to Allow Direct Sales*, GOOD BEER HUNTING: SIGHTLINES (Jan. 26, 2017), <http://goodbeerhunting.com/sightlines/2017/1/26/georgia-brewers-and-wholesalers-agree-on-bill-to-allow-direct-sales> [<https://perma.cc/KF5L-P6N2>] (quoting Bob Sandage, owner of Wrecking Bar Brewpub, as saying that limited direct on- and off-premises sales would allow "the small breweries to make revenue that would allow them to grow faster and easier"); see also *MS Breweries One Step Closer to Direct Beer Sales*, WLOX, <http://www.wlox.com/story/34671001/ms-breweries-one-step-closer-to-direct-beer-sales> [<https://perma.cc/N6XP-56L5>] (last updated Mar. 5, 2017, 11:47 PM) (quoting

alleviated if craft brewers sell the beer for off-premises consumption—whether in cans, bottles, or growlers.<sup>163</sup> For these five reasons, the brewpub makes a strong argument against the current state of the law.

Finally, brewpubs are not merely meant to be standalone businesses. Many brewers do not dream of just owning a brewpub. Brewpubs are a launching pad for a brewer and his or her brands. A brewpub is a calculated investment by a brewer for growth. States have not taken this into account, and, as a result, they have created laws that fail to support the structure necessary for brewpub success.

### B. *The Current Law*

As mentioned previously, all states follow a system that—in its structure—does not allow a producer to simultaneously be a retailer.<sup>164</sup> But since the brewpub exists, this cannot always be the case. Almost all states allow brewpubs in some form,<sup>165</sup> and only two states have no brewpub license.<sup>166</sup> Even though brewpubs are generally allowed, the brewpub is viewed as a limited, and jealously guarded, exception to the tied-house rule and the three-tiered system—explaining some of the more confusing restrictions imposed on brewpubs that are not imposed on normal breweries.<sup>167</sup>

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David Reese, brewmaster at Chandeleur Island Brewing Company, as saying that on- and off-premises sales would help them “grow,” “create jobs,” and “create more revenue”).

<sup>163</sup> See David Schechter & WFAA, *North Texas Craft Breweries Team Up in Legal Battle vs. State*, WFAA8ABC (Sept. 18, 2015), <http://legacy.wfaa.com/story/news/local/texas-news/2015/09/18/north-texas-craft-breweries-team-up-legal-battle-vs-state/72429740> [<https://perma.cc/4K6L-WYFJ>] (citing one craft brewer as saying that his sales would increase by 50% if he was able to sell retail six-packs out of his brewery).

<sup>164</sup> See *supra* text accompanying note 59.

<sup>165</sup> The following states allow brewpubs, with limitations noted in parentheses: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida (but not permitted to sell offsite or distribute), Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland (2000-barrel limit), Massachusetts, Michigan, Minnesota (3500-barrel limit), Mississippi (no off-premises sales), Missouri, Montana, Nebraska, Nevada (taproom only), New Hampshire, New Jersey (no more than 10,000 barrels), New York (five separate locations per person, 5000-barrel limit per premise and 20,000-barrel limit total), North Carolina, North Dakota (10,000-barrel limit), Ohio, Oregon (may only self-distribute if under 5000-barrel limit, if over 200,000-barrel limit cannot sell liquor), Pennsylvania, Rhode Island, South Carolina (2000-barrel limit), South Dakota, Tennessee, Texas (10,000-barrel limit), Utah, Vermont, Virginia, Washington (2400-barrel limit and no off-premise sales), West Virginia, Wisconsin, Wyoming. See *Brewery Sales and Sampling Laws*, *supra* note 68.

<sup>166</sup> Brewpubs in New Mexico may only get a restaurant license. *Id.* Oklahoma limits sales at a brewery to 3.2% or less ABV; all the rest must go through a wholesaler. *Id.* This means that a brewpub must sell its beer to a wholesaler, which must sell the beer back to the brewpub before the brewpub is able to sell the beer to the consumer.

<sup>167</sup> Cf. Richard Newman, *Modified N.J. Rules Aid Craft Brewers*, NORTHJERSEY.COM, <http://archive.northjersey.com/news/business/modified-n-j-rules-aid-craft-brewers-1.1289302> [<https://perma.cc/J3HE-LFSH>] (last updated Mar. 15, 2015, 11:17 AM) (discussing changes in New Jersey laws regarding

There are five major problems with the restrictions that states have placed on the brewpub format. First, and most obviously, forbidding brewpubs is a serious problem. New Mexico's and Oklahoma's laws create uncertainty over the legality of the second-most popular form of craft breweries in the country.<sup>168</sup> Not surprisingly, Oklahoma is second to last in the nation in breweries per capita.<sup>169</sup> Second, some states limit the brewpub permit to allow only the sale of beer or wine—but not hard liquor by the glass—making brewpubs less competitive with restaurants, which typically are permitted to sell liquor.<sup>170</sup> Third, some states severely limit how much beer a brewpub may brew and serve per year.<sup>171</sup> Fourth, some states do not allow direct, off-premise sales to customers, either through growlers or six-packs from brewpubs.<sup>172</sup> Fifth, and finally, some states allow growler sales but do not allow the same type of sale when poured from draft into a can of the same size.<sup>173</sup> These restrictions on brewpubs limit the potential of craft beer and can be easily solved through commonsense solutions.

### C. Commonsense Solutions That Satisfy the Three-Tier System

The first problem is whether to allow the brewpub format at all. As a basic matter, every state should allow brewers to sell beer directly to consumers when it is served in the brewer's restaurant. Technically, this practice does not violate the policy behind the three-tier system. Fosdick and Scott acknowledged that the three-tier system was meant to address the excessive drinking of liquor in saloons, not the drinking of beer and wine with meals.<sup>174</sup> Furthermore, Fosdick and Scott distinguish between those alcohols that are

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direct brewery sales to consumers and stating that “[o]ne of the things you don’t touch in New Jersey is liquor laws”).

<sup>168</sup> See *Number of Breweries*, *supra* note 92.

<sup>169</sup> See *State Craft Beer Sales & Production Statistics, 2015*, *supra* note 93 (calculating that Oklahoma has 0.5 breweries per 100,000 adults with only fourteen breweries in the entire state).

<sup>170</sup> See, e.g., *Brewery Sales and Sampling Laws*, *supra* note 68 (click on “Choose a State” dropdown menu; select “Oregon”; then click on “Retail Provisions”) (noting that Oregon prohibits brewpubs from selling liquor).

<sup>171</sup> See, e.g., *id.* (click on “Choose a State” dropdown menu; select “Maryland” or “South Carolina”; then click on “Retail Provisions”) (noting that Maryland and South Carolina limit brewpubs to production of only 2000 barrels a year).

<sup>172</sup> See, e.g., *id.* (click on “Choose a State” dropdown menu; select “Florida”; then click on “Retail Provisions”) (noting that Florida does not allow retail sales for consumption offsite or to distributors).

<sup>173</sup> See Ronnie Crocker, *State Seizes Bar's Beer-Can Machine*, SAN ANTONIO EXPRESS-NEWS (Oct. 4, 2015), <http://www.expressnews.com/business/local/article/State-seizes-bar-s-beer-can-machine-6549798.php> [<https://perma.cc/TY3D-2VAB>] (detailing how the state of Texas seized a machine from a bar that makes “crowlers”—32-ounce aluminum cans filled with beer—since the canning process was too close to manufacturing canned beers and thus required the bar to obtain a manufacturing license to use the machine, even though the machine was merely an alternative to the accepted growler-pouring process).

<sup>174</sup> See FOSDICK & SCOTT, *supra* note 47, at 21-22 (advocating that wine and beer should not be strictly regulated when sold in a restaurant with a meal).

naturally fermented, like beer and wine, and those that are distilled, like whiskey and bourbon.<sup>175</sup> Their rationale was to encourage beer and wine consumption in place of distilled liquors, which were thought to be much more dangerous.<sup>176</sup> For them, both beer and wine sales, for on- and off-premises consumption, were subject to a more liberal permit system, not the strict licensure system.<sup>177</sup> This sort of alcohol consumption falls outside of the three-tier system as envisioned by Fosdick and Scott and adopted by the states. This technical exception does not threaten the three-tier system. All states should allow brewpubs.

Second, if states allow the brewpub model, they should allow on-premises sales of wine and spirits, not just beer. If states limit the sale of other types of alcohol, they risk dooming the brewpub's competitiveness and breaking one of the guiding principles of the three-tier system—the rule against tied houses. If a brewpub is not treated as a regular restaurant for liquor-licensing purposes, it loses its ability to compete effectively in the market.<sup>178</sup> In Wisconsin, the state stripped the brewpub One Barrel Brewing of its liquor license, resulting in a 10% loss of its revenue stream.<sup>179</sup> Not only are such actions unfair as compared to other restaurants—the restaurants that brewpubs compete with for consumers—but these actions also set brewpubs up for failure.<sup>180</sup> Why should one restaurant be treated differently than another regarding the sale of liquor just because that restaurateur also happens to brew beer?

Further, not allowing the sale of all types of alcohol brings up fears of the tied house all over again. Remember, tied houses are “establishments under contract

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<sup>175</sup> See *id.* at 20 (“The distilled liquors are thus seen to be in a class by themselves, with an alcoholic strength far in excess of wines and beers. This difference should be made the basis of a radical difference in treatment under the law.”).

<sup>176</sup> *Id.* at 21.

<sup>177</sup> *Id.* at 22.

<sup>178</sup> See, e.g., Chris Bucher, *Liquor License Helps Business Boom at Hops & Leisure*, GMTODAY (Sept. 22, 2016), [http://www.gmtoday.com/news/local\\_stories/2016/09222016-liquor-license-helps-business-boom-at-hops-&-leisure.asp](http://www.gmtoday.com/news/local_stories/2016/09222016-liquor-license-helps-business-boom-at-hops-&-leisure.asp) [<https://perma.cc/FR4B-2CXQ>] (discussing a brewpub in Oconomowoc, Wisconsin whose owner stated that the lack of a liquor license “dramatically hurt” his business and that his sales have been up 30% since he received one); Jonathan Kauffman, *New S.F. Brew Pubs Head for Loophole in Liquor Licenses*, S.F. CHRON., <http://www.sfchronicle.com/bayarea/article/New-S-F-brew-pubs-head-for-loophole-in-liquor-6548504.php> [<https://perma.cc/544A-Z32Z>] (last updated Oct. 4, 2015, 12:02 PM) (quoting brewpub owners in San Francisco, who stated that a liquor license is necessary to “compete in a very competitive market”).

<sup>179</sup> Bryan Kristensen, *What's on Tap: 'Golden Age of Craft Brewing' Threatened by Restrictive Liquor Licensing*, BADGER HERALD (Sept. 29, 2015), <https://badgerherald.com/artsetc/2015/09/29/whats-on-tap-golden-age-of-craft-brewing-threatened-by-restrictive-liquor-licensing> [<https://perma.cc/Q8GF-UED8>].

<sup>180</sup> See Daniel B. Kline, *The Real Markup on Your Bar Tab Revealed*, MOTLEY FOOL (Nov. 15, 2014, 6:11 PM), <https://www.fool.com/investing/general/2014/11/15/the-real-markup-on-your-bar-tab-revealed.aspx> [<https://perma.cc/QAN8-K6L3>] (explaining markups on alcohol in bars and restaurants and noting that liquor is the “worst deal for consumers”—thus, the most profitable for the restaurateur or bar owner).

to sell exclusively the product of one manufacturer.”<sup>181</sup> By forcing bartenders to sell only one type of product, the only way to make more money is to sell more alcohol. This bare profit motive is thought to have caused most of society’s alcohol-related problems.<sup>182</sup> Restricting brewpubs to selling only their beer is essentially legislating a tied house into existence. To alleviate that problem, brewpubs should be allowed to sell all types of alcohol. Such a legislative scheme may even be beneficial for states because of increased revenues from alcohol sales, food sales, and various business taxes. Since brewpubs make more profit by selling their own beer,<sup>183</sup> they will sell their own beer in place of more intoxicating wine or liquor. This effectively replaces liquor consumption with beer consumption, something Fosdick and Scott thought was desirable.<sup>184</sup> In short, brewpubs should be able to sell their own beer and other types of alcohol both to thwart the danger of a tied house and prevent financial ruin.

Third, states should not limit the amount of beer brewed to arbitrarily low amounts. As a preliminary matter, states do not limit the production of craft breweries that are not linked to a restaurant.<sup>185</sup> What rationale could a state possibly have to limit production just because a brewery is incidentally attached to a restaurant? One explanation comes from the story of Thomas Schlafly’s attempt to raise the barrelage limits for brewpubs in Missouri. Schlafly was immediately met with opposition by an Anheuser-Busch lobbyist who said that he “was seeking to make an inordinate amount of beer.”<sup>186</sup> Anheuser-Busch emerged victorious, restricting Schlafly’s original demand of 60,000 barrels to only 10,000 barrels.<sup>187</sup> Unreasonable opposition by other industry players is not a policy justification for barrelage limits for brewpubs. If states simply are concerned about breaking the three-tier system, legislators should realize that brewpubs are not meant to be limited to their bars, but are a means to grow a bigger business. More barrels and more sales benefit the state in terms of taxes, jobs, and tourism. States should treat brewpubs in the same way they treat breweries: no barrel limits.

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<sup>181</sup> FOSDICK & SCOTT, *supra* note 47, at 29.

<sup>182</sup> *See id.* at 10 (outlining how the saloons’ “big profits” had “stimulated sales poverty and drunkenness”).

<sup>183</sup> *See, e.g.,* ACITELLI, *supra* note 15, at 98 (quoting Bill Owens as saying that he makes double the profit on beer he brews and sells himself compared to beer he buys from others and sells).

<sup>184</sup> *See* FOSDICK & SCOTT, *supra* note 47, at 19-23 (recommending liberalization in the sale of light wines and beers to replace consumption of hard liquor).

<sup>185</sup> States may, however, impose larger fees or different licenses depending on size. *See Barrel Cap Law*, BREWERS ASS’N, <https://www.brewersassociation.org/government-affairs/laws/barrel-cap-laws> [<https://perma.cc/JC5X-7K7G>] (presenting a fifty-state survey of state licensing laws for brewers).

<sup>186</sup> Welch, *supra* note 26, at 181 (quoting *Missouri Compromise: State Legislature Will Raise Brewpub Production Ceiling to 10,000 Barrels*, MOD. BREWERY AGE, May 24, 1993, at 1).

<sup>187</sup> *Id.*

Finally, at the very least, states should allow off-premises sales through six-packs, growlers, and “crowlers.”<sup>188</sup> Again, selling beer was never technically a part of the three-tier system, which was meant to restrict liquor sales. Furthermore, once states have recognized the so-called exception of the brewpub, there is no legitimate control-reason to limit sales if a retailer would not be similarly limited. In other words, the state has already made the brewpub a combination of producer and retailer, so it should allow the brewpub to fully function as both. Off-premises sales provide start-up brewers direct distribution to customers, leading to decreased shipping costs and higher profit margins. Sales for consumption off-premises contribute solidly to a craft brewer’s bottom line and do not put the public at greater risk. With these five proposals, state governments can ensure the success of their craft brewers without breaking the three-tier system. Successful craft brewers bring a myriad of benefits—most importantly, innovation.

#### CONCLUSION

Craft brewing is one of the most innovative American industries in existence. It continues to grow exponentially and create much-needed jobs in the American economy. While it may continue to grow without a decrease in regulation, it cannot achieve its true potential without certain, commonsense changes to the regulatory environment. New recipes will be created, but, without legislative changes, the world may miss out on the new recipe that changes the entire fabric of the brewing industry.

To create a more conducive environment for innovation, the only needed changes are lower taxes on the smallest brewers and a reasonable state system for starting and growing brewpubs. This will create more financially stable brewers. Even better, none of these commonsense proposals challenge the current values of the federal taxation system or the state control systems. Whether Americans want to challenge the eighty-year-old research, ideas, and philosophy that motivated state governments in the mob-dominated post-Prohibition period can be left for another day.<sup>189</sup> Luckily, with these proposals, we do not have to wait that long to enjoy tasty, refreshing, and innovative brews.

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<sup>188</sup> See *supra* note 173.

<sup>189</sup> See, e.g., Rhodes, *supra* note 61, at 82 (arguing that the legislation of the period immediately following Repeal was essentially based on class drinking trends, reflecting “the drinking habits of the population more than any overriding presumptions about moral behavior,” and that “[t]he difference in type of alcoholic beverage and the realities surrounding its manufacture, transportation, and clientele were reflected in the development of each sector of the control systems that emerged across the country”).

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