

2021 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1265

2021 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee Room JW327C, State Capitol

HB 1265
1/20/2021

Microbrew pubs

(8:02) Chairman Lefor opened the hearing on HB 1265.

Representatives	Vote
Chairman Lefor	P
Vice Chairman Keiser	P
Rep Hagert	P
Rep Jim Kasper	A
Rep Scott Louser	P
Rep Nehring	P
Rep O'Brien	P
Rep Ostlie	P
Rep Ruby	P
Rep Schauer	P
Rep Stemen	P
Rep Thomas	P
Rep Adams	P
Rep P Anderson	P

Discussion Topics:

- Sale and delivery of brewery-sealed containers
- Retailers licensed in the state
- Effects on beer wholesalers

Rep D Ruby~District 38. Introduced the bill. Attachment #1866.

Bryan Schmidt~Owner & Brew Master-Souris River Brewing. Attachment #1813.

Janet Seaworth~Executive Secretary & Legal Counsel-ND Beer Distributors' Association.
Attachment #1869.

Pat Ward~Representing ND Wholesale Liquor Dealers testified

Rep D Ruby moved to amend 8 barrels to 4 barrels verbally.

Rep Schauer second.

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Voice vote~Motion carried.

Chairman Lefor closes the hearing. A request for the bill to be held.

Additional written testimony: Attachments #1873 & 1883

(9:07) End time.

Ellen LeTang, Committee Clerk

House Bill 1265
Industry, Business and Labor Committee
January 20, 2021

Good morning Chairman Lefor and members of the House IBL Committee, my name is Dan Ruby and I am a Representative from District 38 and am here to introduce House Bill 1265.

House Bill 1265 seeks to give Brew Pubs more options to bottle, market and distribute limited quantities of their beers in ways that are not available to them. The changes in this bill are similar to those that a tap room can now do so this is not new ground we're breaking. The idea for this bill came when I was at a local brew pub in Minot and one of the owners was venting about the limitations and inconsistencies of the current laws related to breweries. He sells his beer by the glass and off-sale by the growler. He also offers bottled beers from other companies, which he gladly does so his customers have multiple options. He pointed to the cooler and said he can sell anyone's beer by the 12 ounce can or bottle but not his own. Tap Room companies can but the main reason the brew pubs can't is because they have a licensed kitchen which disqualifies them as a tap room.

Tap rooms are licensed as a manufacturer with certain benefits and brew pubs are retail operations with the ability to manufacture their products. So either way they are both manufacturers. Having these differing distinctions causes inconsistencies in how similar businesses operate. We have had bills in the past that dealt with the problems with the three-tier system. In the three-tier system a manufacturer can't distribute or retail, a distributor can't retail or manufacture and a retailer can't manufacture or distribute. Domestic wineries, distilleries, brew pubs and tap rooms are provided limited participation in each of the tiers. Past bills have tried to allow limited ownership in more than one tier but those bills failed. One way companies are getting around the system is to set up different structures. Some license kitchens separately with different areas within a building and run a tap room so they get around the current laws. Others set up a tap room and have a food truck outside the premises. It can be done, and it accomplishes exactly what the opponents say they don't want to happen. But

they can't stop it so they fight these types of changes by claiming that we need to prevent the graying of the three-tier system. It is gray all across the country in several types of alcohol producers. Some states don't even use the three-tier system. The US Supreme Court says that the three-tier system is constitutional but is not a requirement for the businesses that manufacture, distribute or retail alcohol.

For a little history, the three-tier system was created after prohibition was ended to control monopolistic practices by large manufacturers. However, a massive Belgium-based conglomerate named InBev owns Budweiser beer as well as many others. They may or may not be a monopoly yet, but they are a massive company that has no interest in starting small brew pubs or tap rooms where they would be limited to the provisions in our law or the changes in this bill. The three-tier system did not prevent them from getting so massive nor have the relaxing or eliminating of the three-tier system led to one of the massive companies from operating and dominating with their own brew pubs, tap rooms, wineries or distilleries. You will hear from distributors that this will create massive problems and will give unfair advantages to brew pubs. I would like you to consider how improving the business opportunities for these locally owned, North Dakota small businesses is going to harm a company like InBev or any of the distributors in this state. If the brew pubs are successful and build the demand for their product, they will be valuable customers to these very distributors. Mr. Chairman and members of the committee, this bill is pro-business by removing antiquated burdensome regulations that will only help North Dakota's business climate. I urge a Do Pass recommendation and will stand for questions.

Testimony in support of HB1265

As an owner of a small microbrew pub that would be strongly impacted by this bill, I would like to encourage the committee members to support and pass this HB1265.

Like the rest of the country, the craft beer industry is growing in North Dakota with a 2019 economic impact of \$267 million (as per the Brewer's Association). However, despite having one of the highest beer consumption rates per capita in the country, craft beer production in our state is the lowest in the country. The reason for this discrepancy is associated with the difficulties in starting a brewery in our state. As a small microbrew pub owner, one of the biggest potential growth areas which we have difficulty accessing is getting our product out to consumers that do not come in to our establishment. This has been exacerbated in the past year with the restrictions placed on indoor dining and the time is right to correct this problem.

The difficulty in getting product out to customers is a result of the hyper-competition artificially created by current state law. Requiring all off-premise sales of beer produced at a local microbrew pub to other licensed retailers to pass through a wholesaler means that I cannot sell my product to retailers that may be interested in it. I can only tell them about it, and then ask them to remember to ask their distributor salesman when they make their next sales call. As such, I have no control over the success of my brand and have to leave it up to someone who has no personal interest in my brand to pitch it. For the distributor sales team that is responsible for selling my product, mine is only one of a wide portfolio of products that they are responsible for promoting. And as their primary concern is increasing overall sales numbers, they are going to be naturally biased towards popular, well-established brands which they see as likely to sell faster. In essence, this means our current state law requires me to compete with brand such as Budweiser at the level of my distributor before I can get my product to external customers at other retail accounts.

This built-in bias towards large, established brands (owned and operated out of state or out of country) has a severe negative impact on local new and small breweries and microbrew pubs trying to establish themselves in our state. The changes represented in HB1265 would remove this bias against small, local businesses like mine, thereby giving me and others like me a chance to succeed and grow the North Dakota economy.

It is worthy of note that allowing small microbrew pubs to succeed and grow is highly unlikely to have a negative impact on beer wholesalers in our state. They can continue to sell the established brands while I grow my business. Eventually, if my brand succeeds in gaining market popularity, it is in my own interest to then ask a distributor to takeover the external sales of my products and rely on their established sales and logistics teams. But you need not simply trust that to happen. The quota limits established in HB1265 will ensure that I hand off those responsibilities as the popularity of my brand

grows. This is also shown by other states that have allowed small breweries and brew pubs to self-distribute (usually limited based on production volumes) and still have robust beer wholesale systems in place. Indeed, taproom brewers in North Dakota have been allowed this right with no harm to the wholesalers.

It is also worth noting that the changes described in HB1265 will be limited to small companies like mine that are trying to establish themselves, not the large brewers. This is established in two ways: by the stipulated limits on how much product can be distributed without a wholesaler, as well as the definition of microbrew pub itself, which limits the volume produced.

Finally, other small businesses in North Dakota that produce alcoholic beverages are allowed to directly sell their products to retailers while they are still small, whether they produce beer, wine or spirits. The changes contained in HB1265 will allow microbrew pubs to get themselves established in the market just as other alcoholic beverage manufacturers can. The net effect is greater choice for beer consumers and increased likelihood of business success for new microbrew pubs with little to no negative impact on established systems within the state.

I therefore ask for you to support and pass HB1265.

Sincerely,

Bryan Schmidt
Brewmaster and owner
Souris River Brewing
Minot, ND

HB 1265

Testimony before the House Industry Business and Labor Committee
January 20, 2021

Mr. Chairman, members of the House Industry Business and Labor Committee,

My name is Janet Seaworth, I am Executive Secretary and Legal Counsel for the North Dakota Beer Distributors Association, a trade organization representing North Dakota's family owned and operated beer distributors. Last year, we celebrated our 75th anniversary. We now have distributors that are in their 4th generation of family ownership. We appear today in opposition to HB 1265. We believe this bill is unwarranted and proposed ill-advised exceptions to the three-tier system. We are concerned that key provisions of the bill may be challenged by out-of-state of brewers and retailers who may want the same privileges. It also creates an unfair playing field for the other 1,600 North Dakota retailers.

As this committee knows, the backbone of alcohol regulation, in all 50 states and on the federal level, is the three-tier system. The three-tier system of alcohol distribution is comprised of manufacturers (brewers), distributors, and retailers (taverns, bars, liquor stores). No tier controls another. Distributors separate manufacturers and retailers to ensure moderation and stability and prevent manufacturers from exerting pressure on retailers to sell their alcohol – thus ensuring the orderly and transparent distribution and sales of alcohol. With the exception of brew pubs and small brewers, each tier is limited to its service focus.

Brew pubs are specialty retailers. HB 1265 concerns brew pubs, which are retailers that have the special privilege of brewing their own beer. They hold a retail license and sell other alcohol direct to the public. They are not production brewers.

Allowing brew pubs to sell up to five gallon kegs turns these specialty retailers into production brewers. Currently, brew pubs may sell product manufactured on the premises for off-premise consumption in brewery sealed containers up to three gallons and the amount they may sell to any person is limited to a case of beer per day. That's already generous. MN and MT only allow the sale of growlers for off-premise consumption. HB 1265 seeks to allow brew pubs to sell unlimited amounts of additional packages, up to sixth barrel (5.16 gallon) kegs, for off premise consumption. That is contrary to the intent to allow a local tavern the special privilege of brewing its own beer for enjoyment inside the restaurant or bar. Allowing brew pubs to operate as production brewers, bottling and selling all packages while holding a retail license, creates a constitutional issue because large out-of-state breweries are prohibited from holding a retail license. Further, allowing brew pubs to sell direct to retail would allow them to operate in all three tiers. This exposes our laws to serious and expensive legal challenges by out-of-state breweries and retailers that are not afforded the same regulatory exceptions that ND brew pubs are afforded.

Out-of-state brewers and retailers may challenge the regulatory exceptions afforded brew pubs. The law is clear that states may not discriminate between in-state and out-of-state

brewers and retailers. In 2005, the U.S. Supreme court in Granholm v. Heald, 544 U.S. 460, examined Michigan and New York laws that allowed in-state alcohol producers to sell direct to the public but prohibited out-of-state producers from doing so. The court struck down those laws as unconstitutional and ruled that states may not discriminate between in-state and out-of-state alcohol producers. We are concerned that this bill would run afoul of the commerce clause for similar reasons – if a brew pub is allowed to morph into a brewer while holding a ND retail license, an out-of-state brewer may argue that they are being discriminated against under ND law because they are prohibited from holding the same retail license. In 2019, the Granholm rule was extended to the retail tier in Tennessee Wine and Spirits Retailers Assn. v. Thomas, 139 S. Ct. 2449 (2019). Since the Tennessee case, there have been over a dozen lawsuits filed testing laws that allow in-state retailers to do things that out-of-state retailers may not.

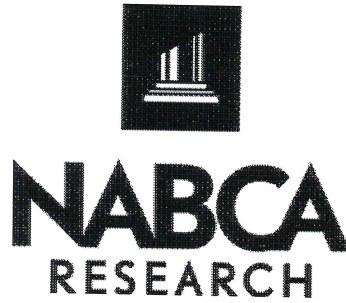
Expanded retail and new distribution privileges for brew pubs are not warranted. It does not appear that these expanded retail and distribution privileges are warranted. The Brewers Guild did not ask for this bill and the brew pub that instigated the bill does not even have the capacity to produce enough beer to fill distributor orders or engage in any significant self-distribution. Even among small brewers, for whom self-distribution is allowed, only a few do it. Under these circumstances, we struggle to understand why this bill is needed. If, as we have been led to understand, COVID is somehow a justification for the deregulation of alcohol in this manner, we would urge you to carefully consider whether the Covid-19 crisis should ever drive the government to permanently change regulatory measures intended to safeguard the public. Temporary de-regulation may have its place, but Covid-19 should not be used as an excuse to disrupt the alcohol regulatory system.

In closing, it does not seem reasonable to us to allow legislation that is unnecessary, that erodes the three-tier system, that provides a potentially unconstitutional in-state preference, and that unfairly discriminates against existing retailers. We urge you to vote no on HB 1265.

Thank you.

Janet Demarais Seaworth
Executive Secretary and Legal Counsel
North Dakota Beer Distributors Association

For more information about the three-tier system of alcohol distribution, watch the NBWA/WBAE Three-Tier Education Video at <https://www.youtube.com/watch?v=tqaFin7FhUo>



The Three-Tier System: A Modern View

NABCA attempts to provide accurate and up-to-date information on alcohol policy topics. As such, white papers should be considered working documents; snapshots of the current status of an issue or subject. Papers are reviewed regularly and updated. We welcome clarification or additional information on the topic of this paper. Please contact NABCA at communications@nabca.org to provide knowledgeable and credible comments or suggestions. Thank you.

For additional information on the three-tier system, please read Safe and Sound, a publication from Public Action Management.

With the passage of the 21st amendment ending national prohibition, states were given the authority to regulate alcohol as they saw fit. The states developed a structure of checks and balances that provided safe alcohol to the consumer while ensuring a simple method to collect tax revenue. This is known as the three-tier system.

The three-tier system is simple in theory: **manufacturers** provide alcoholic products to **wholesalers**, who distribute the products to **retailers**, who sell to the consumers. No one entity can be involved in more than one tier under most state models and each tier is regulated and licensed separately.

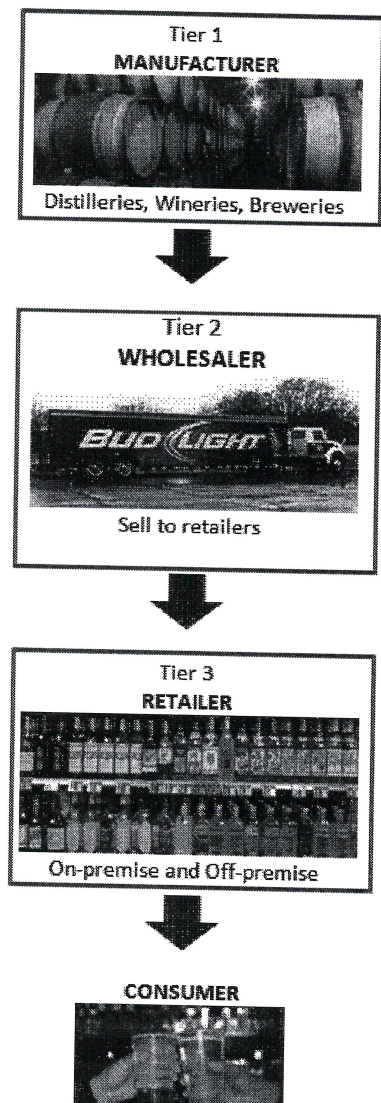
Benefits of the Three-Tier System

The three-tier system offers many benefits to society with the most prominent falling into four categories: regulatory, economic, commercial, and public health.

Regulatory Benefits

Within the three-tier system, each tier becomes responsible for ensuring that the laws and regulations set forward by the government are executed. All parties must comply with those laws and each is responsible to the other. These laws and regulations provide safeguards that there are lawful trade practices and safe handling of alcoholic beverages before it gets to consumers. This transparent regulatory scheme elevates consumer confidence because the three-tier system ensures that only licensed distributors and retailers will be able to provide and sell alcoholic beverages.

The Three-Tier System





An example of the system's effectiveness can be illustrated in the 2008 recall of certain products by the Sam Adams brewery. The recall was initiated due to glass shards found in bottles. The recall was quick and without major issues because of each tier's responsibility in tracking alcohol products across distribution channels.

Economic Benefits

The economic benefits of the three-tier system positively impacts society in several ways. Tens of billions of tax dollars are provided to federal, state, and local governments by manufacturers, wholesalers, and retailers in the alcohol industry. Because of the checks and balances created within the three-tier system, there is less risk of untaxed, potentially tainted "black market" alcohol passing to the consumer. The tax money provided by the system goes to education, infrastructure improvements, and other areas that benefit all citizens.

Commercial Benefits

Commercial benefits of the three-tier system clearly are numerous. For manufacturers, they are given equal access to the marketplace that they would not receive under other systems. This allows for large corporations as well as craft distillers and brewers to reach consumers. Rather than be dwarfed by larger competitors, smaller manufacturers receive greater opportunities to increase sales through distributors with retailers nationwide. As a result, consumers have more choices to a variety of alcoholic products.

Public Health Benefits

Because of the checks and balances created by the three-tier system, several public health and safety benefits are present. As each party must be licensed and accountable for alcoholic products, this prevents tainted alcohol from entering the marketplace. This is a major issue in other countries that do not follow the three-tier system, including the United Kingdom.

Additionally, the system prevents the marketplace from being dominated by major companies who can use tactics to increase alcohol sales. For example, a major reason for national prohibition in America was the behavior of saloon owners who used influence to solicit customers to overdrink and overspend on alcohol, causing a negative impact on families and creating numerous public health issues.

The United Kingdom has experienced many negative consequences because of inexpensive and readily available alcohol, and at times tainted alcohol. The system has played an important role in preventing such problems in the United States. As described in the “Safe and Sound” publication on alcohol regulation and the three-tier system:

This structure prevents marketplace domination by large companies that would seek to greatly increase alcohol sales through aggressive practices, or by controlling the entire alcohol distribution chain, from manufacturer to consumer.

Threats to the Three-Tier System

The benefits of the three-tier system are obvious but there remains a threat to the structure in the form of deregulating the alcohol industry. Deregulation is seen by its advocates as a way to increase state revenue and replace what they consider to be an out-of-date system.

A deregulated alcohol industry would remove marketing restrictions and can lead to the dominance of certain companies in a geographic area, eliminating consumer choice. There is also potential for tainted alcohol to get into the distribution stream as the checks and balances of the three-tier system would be removed.



The United Kingdom has gone through piecemeal deregulation over the last several decades, causing a range of issues in the country. These include, increases in alcohol-related crime, bar intoxication, and deaths related to alcohol. Grocery stores have been seen as a major factor with promotional efforts and “loss leader” tactics; a strategy whereby a product (such as alcohol) is sold below cost to stimulate sales of other products.

Despite best efforts, the movement toward alcohol deregulation and a change in the three-tier system does not have widespread public support. A 2012 survey by the Center for Alcohol Policy found that:

- 72% believe states should regulate alcohol as a unique good
- 81% support states determining their own laws and regulations regarding alcohol
- 76% support the states’ right to regulate the manufacture, sale and distribution of alcohol

Not just the public but also the alcohol industry is in favor of the three-tier system. Manufacturer MillerCoors reiterated its commitment to the system as a model that “offers significant commercial and societal value” and that a “vibrant three-tier system is critical to their mutual future success.” The National Beer Wholesalers Association has commented several times about the importance of the system and noted in a press release on small brewers that the “independent Three-Tier system works to ensure that consumers have access to the widest selection of beer styles and brands.” Executive Director John Bodnovich of American Beverage Licensees, an association of alcohol retailers, noted that the United States alcohol market is “balanced on the principles of the three-tier system.”

Additionally, the platform of The Presidents' Forum of the Distilled Spirits Industry specifically mentions support for the "distribution of alcoholic beverages through the existing three-tier system."

Conclusion

The three-tier system has been an effective method of alcohol regulation and distribution in the United States since the end of Prohibition. The structure creates important public health safeguards while streamlining the tax revenue process. Products made unlawfully have a difficult time making it to the marketplace within the confines of this arrangement. Deregulation continues to threaten it, but the public at large sees the three-tier system as impactful and just as necessary as it was almost a century ago.



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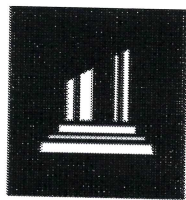
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<<http://brewingsomefun.com/2011/06/07/three-tier-system-doctrine-by-millercoors/>>



NABCA

RESEARCH

4401 Ford Avenue, Suite 700, Alexandria, VA 22302-1433
Tel: 703-578-4200 | Fax: 703-820-3551

Representative Mary Adams

My name is Randy Kieffer, president of Dakota Sales Co., a beer and beverage wholesaler located in Grand Forks. I am writing you to ask that you Do Not Pass HB 1265.

The North Dakota Beer Distributors Association opposes ND 1265 bill as unnecessary and ill-advised exception to the three-tier system. HB 1265 would allow expanded retail and distribution privileges that are beyond what is intended for brew pubs. Three-tier-exemptions, like retail privileges, were intended to help start-up businesses, not disrupt on-premise bars, restaurants and taverns. These additional privileges for brew pubs create an unfair playing field for other retailers—our customers. We are also concerned that the key provisions of the bill may be challenged by global brewers who may want the same privileges.

Brew pubs are specialty retailers and are already accorded privileges that no other industry members enjoy. Brew pubs hold retail licenses and are accorded the special privilege of brewing their own beer on the premises. They are not production brewers. They are retailers—also selling all other alcohol direct to the public. These are privileges that no other industry members enjoy. Large brewers are prohibited from holding a wholesale or retail license; Manufacture (large brewers) must sell to distributors; ND distributors may only distribute beer to retail; and retailers may only sell to the public.

Current law allows microbrew pubs to sell beer manufactured on the premises for off-premise consumption in containers up to three gallons and not more than 288oz of beer per day per person. That's already generous. MN and MT only allow the sale of growlers for off-premise consumption. These limitations help ensure that the retailer does not turn into a production brewer. A brew pub is not a brewer, it is a retailer, with the special privilege of brewing its own beer. HB 1265 removes the limitation on the amount that can be sold per person and increases the container size to 5 16/100. In other words, the pub could sell packages up to 5 gallons. That hardly follows the original intent to allow a pub to manufacture its own in-house product for the enjoyment on the premise. If brew pubs were allowed to operate as production brewers, bottling and selling all packages while holding a retail license, that would just turn that retailer into a brewer and create a commerce clause issue because large out-of-state breweries are prohibited from holding a retail license. Further, allowing brew pubs to sell direct to retail would allow them to operate in all three tiers.

Some find it hard to understand the difference between brew pubs and small brewers. The focus should be on the tier, Pubs are retailers and brewers are manufactures. They must stay in their lane. In addition to the fairness of permitting a few brew pubs further privileges not enjoyed by the thousands of other industry members in North Dakota, including ND's 1600 retailers, we oppose the bill, most importantly, because it exposes our laws to serious legal challenges by out-of-state breweries that are prohibited from holding a retail license.

I urge you to vote No for HB 1265

Randy Kieffer

Bill Actions for HB 1265

Introduced by Rep. D. Ruby, Becker, Boschee, Kasper, B. Koppelman, Mock, M. Ruby, Toman

Introduced by Sen. O. Larsen, Meyer, Oban

A BILL for an Act to amend and reenact section 5-01-14 of the North Dakota Century Code, relating to microbrew pubs.

Date	Chamber	Meeting Description	Journal
01/11	House	Introduced, first reading, referred Industry, Business and Labor Committee	<u>HJ 200</u>
01/20	House	Committee Hearing 08:00	
02/08	House	Request return from committee	<u>HJ 519</u>
		Withdrawn from further consideration	<u>HJ 519</u>