



Securing Access in a Diverse Society
JUSTICE FOR ALL
Kentucky Bar Association ★ 2015 Annual Convention

ALCOHOL BEVERAGE CONTROL LAW

Sponsor: Young Lawyers Division
CLE Credit: 1.0
Thursday, June 18, 2015
10:50 a.m. - 11:50 a.m.
Elkhorn A-D
Lexington Convention Center
Lexington, Kentucky

A NOTE CONCERNING THE PROGRAM MATERIALS

The materials included in this Kentucky Bar Association Continuing Legal Education handbook are intended to provide current and accurate information about the subject matter covered. No representation or warranty is made concerning the application of the legal or other principles discussed by the instructors to any specific fact situation, nor is any prediction made concerning how any particular judge or jury will interpret or apply such principles. The proper interpretation or application of the principles discussed is a matter for the considered judgment of the individual legal practitioner. The faculty and staff of this Kentucky Bar Association CLE program disclaim liability therefore. Attorneys using these materials, or information otherwise conveyed during the program, in dealing with a specific legal matter have a duty to research original and current sources of authority.

**Printed by: Evolution Creative Solutions
7107 Shona Drive
Cincinnati, Ohio 45237**

Kentucky Bar Association

TABLE OF CONTENTS

The Presenter	i
Alcoholic Beverage Control Laws	1
Introduction	1
The Three-Tier System	1
Relevant Kentucky Statutes	5
Relevant Kentucky Case Law	6
House Bill 168	7
Senate Bill 81	8
Suggested Reading.....	9

THE PRESENTER



Stephen G. Amato
McBrayer McGinnis Leslie & Kirkland PLLC
201 East Main Street, Suite 900
Lexington, Kentucky 40507
(859) 231-8780
samato@mmlk.com

STEPHEN G. AMATO is a member of McBrayer McGinnis Leslie & Kirkland PLLC in Lexington and focuses his practice in the areas of litigation, alcohol beverage control law, and employment law. Mr. Amato received his B.A. from Transylvania University and his J.D. from the University of Kentucky College of Law. He is a member of the Fayette County and Kentucky Bar Associations, the Kentucky Guild of Brewers, Defense Research Institute and the National Association of Licensing and Compliance Professionals.

I. INTRODUCTION

Since the end of Prohibition, states have traditionally dealt with the issue of Alcoholic Beverage Control ("ABC") laws in one of two ways, either through full state regulation of the sale of alcohol or through a three-tier system of production, distribution and sale. With the abuses of the industry fresh in their minds, policymakers after Prohibition set about finding ways to keep alcohol from becoming a societal problem through careful regulation. In Kentucky, the three-tier system is paramount, and that principle has been consistently affirmed by key court cases and legislation. These materials will provide an overview of the three-tier system in Kentucky with discussions of relevant cases and legislative changes.

II. THE THREE-TIER SYSTEM

A. What It Is

1. The three-tier system divides the alcoholic beverage industry into three distinct segments, each restricted to a particular service:
 - a. Producers – brewers/distillers.
 - b. Distributors.
 - c. Retailers.
2. The three-tier regulatory system is based on an understanding that vertical integration in the industry (brewers/distillers owning distributors and retailers) could create entities so incredibly powerful that they could effectively be beyond the influence of alcohol regulation. One of the side effects of this power would be to erode ABC laws and consistently push for deregulation.
3. No one tier controls another.
 - a. Tied-house laws – These laws ensure that the two top tiers can't control or influence the bottom tier. Retailers can operate on a level playing field

independent of the suppliers and distributors. Tied house laws:

- i. Prohibit each tier from owning an interest in another tier; and
 - ii. Prohibit suppliers and distributors from giving a retailer anything of value.
 - b. Franchise laws – designed to level the playing field between suppliers and distributors and, similar to tied-house laws, protect the independence of distributors
4. The system is likened to an hourglass instead of a pyramid – distribution, the center tier, is the constriction point that controls the flow of the system. Distributors are mandated to have an in-state presence. Retailers and distributors are the most subject to local accountability through:
- a. Compliance checks.
 - b. Audits.
 - c. Community pressure.

B. The Legitimacy of the Three-Tiered System

- 1. Granholm v. Heald, 544 U.S. 460 (2005).
 - a. New York and Michigan had laws that allowed in-state wineries to ship wine directly to buyers, but prohibited out-of-state wineries from doing so. Out-of-state wineries and wine collectors sued.
 - b. Plaintiffs argued the dormant Commerce Clause prohibited the states from interfering with interstate commerce via these laws.

Commerce Clause grants Congress power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Dormant Commerce Clause doctrine suggests that states can't make anticompetitive laws against out-of-state entities without Congressional permission.

- c. States argued that the Twenty-first Amendment gives them pretty much *carte blanche* to regulate alcohol as they see fit.

Twenty-first Amendment, Section Two: "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."

- d. Court held in favor of plaintiffs under Commerce Clause argument:
 - i. "The Twenty-first Amendment's aim was to allow States to maintain an effective and uniform system for controlling liquor by regulating its transportation, importation, and use."
 - ii. "The decision to invalidate the instant direct-shipment laws also does not call into question their three-tier systems' constitutionality."
 - iii. "State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent."
 - iv. States "have broad power to regulate liquor under §2 of the Twenty-First Amendment."

- 2. Manuel v. State of Louisiana, 982 So.2d 316 (La. App. 3 Cir. 4/30/2008).

Without the three-tier system, the natural tendency historically has been for the supplier tier to integrate vertically. With vertical integration, a supplier takes control of the manufacture, distribution, and retailing of alcoholic beverages, from top to bottom. The result is that individual retail establishments become tied to a particular supplier. When so tied, the retailer takes its orders from the supplier who controls it, including naturally the supplier's mandate to maximize sales. A further consequence is a suppression of competition

as the retailer favors the particular brands of the supplier to which the retailer is tied-to the exclusion of other suppliers' brands. With vertical integration, there are also practical implications for the power of regulators. A vertically integrated enterprise-comprising manufacture, distribution, and retailing-is inevitably a powerful entity managed and controlled from afar by non-residents.

The three-tier system was implemented to counteract all these tendencies. Under the three-tier system, the industry is divided into three tiers, each with its own service focus. No one tier controls another. Further, individual firms do not grow so powerful in practice that they can out-muscle regulators. In addition, because of the very nature of their operations, firms in the wholesaling tier and the retailing tier have a local presence, which makes them more amenable to regulation and naturally keeps them accountable. Further, by separating the tiers, competition, a diversity of products, and availability of products are enhanced as the economic incentives are removed that encourage wholesalers and retailers to favor the products of a particular supplier (to which whole-saler or retailer might be tied) to the exclusion of products from other suppliers."

C. Modern Trends

1. Every tier has experienced serious consolidation.
2. Policy questioning of whether either of the two systems (three-tier or state-based regulatory) are necessary.
3. Craft brewers and distillers and small-farm wineries have exploded.
4. All seek exemptions from regulations to distribute or sell their products themselves.

III. RELEVANT KENTUCKY STATUTES

A. KRS 243.157 – Microbrewery License

1. Permits licensee to sell malt beverages produced on the premises for on-premises and off-premises purposes without a distributor.
2. Must have:
 - a. Retail drink license.
 - b. Retail package license.
3. Subject to reporting requirements.

B. KRS 243.155 – Small Farm Winery License

1. Permits small farm winery to make and bottle wines, bottle wines produced at other small farm wineries, hold tastings subject to limits per patron, sell wine by the drink or by the package on the premises or at events, etc.
2. If it is sold or consumed, it must be in wet territory.

C. These Two Licenses Are Exceptions to the Three-Tier System

1. Allowing suppliers/producers to skip distributors and retailers entirely and become retailers themselves.
2. Vertical integration of small producers is allowed under this system.
3. There is an explosion of microbreweries and small farm wineries, so this does put larger suppliers at a disadvantage, leading to some erosion of the three-tier system. So far, however, retailers haven't seemed to mind so much.

D. KRS 243.0305 – Licensed Distillers Souvenir Package Sales

Distiller in wet territory that has a gift shop may sell souvenir packages at retail to visitors of legal drinking age.

1. Limited to three liters per day per person.

2. Even though the liquor can be delivered directly from the distillery to the gift shop, it is still invoiced to the wholesaler and from the wholesaler back to the distiller. This preserves the tier system on paper in this instance.

E. KRS 244.602-.606 – Beer Franchise License

1. No brewer or importer can require or request a distributor to pay the brewer, nor can they accept any money from the distributor in exchange for the right to distribute the alcohol.
2. Marketing fees are okay, though.
3. Prevents brewers from basically ever terminating or failing to renew a contract with a distributor absent severe breaches listed under the statute.
4. Basic intention of the statute is to keep distributors and brewers at arms' length and preserve the three-tier system.

IV. RELEVANT KENTUCKY CASE LAW

A. Huber Winery, et al v. Wilcher, et al, 488 F.Supp.2d 592 (6th Cir. 2006)

Kentucky had a statutory scheme that prohibited out-of-state wineries from acting as distributors, even though in-state wineries were allowed to do so. In the wake of Granholm, plaintiffs filed suit against the state over the laws. The state quickly worked to amend the laws, requiring all sales of alcohol to be in-person with no direct shipping.

1. District court nullified new laws, effectively opening up direct shipping, subject to a two-case limit.
2. Sixth Circuit affirmed, holding that in-person sales effectively gave in-state sellers an advantage over out-of-state sellers and was illegal under the holding in Granholm.
3. Collapsed the supplier/distributor tiers slightly where wineries are concerned.

B. Maxwell's Pic-Pac, Inc. v. Dehner, 739 F.3d 936 (6th Cir. 2014)

Kentucky bars grocery and convenience stores from selling package liquor and wine, even though drug stores and others can

do so. Plaintiff argued that this violated Equal Protection under both the U.S. and Kentucky Constitutions.

1. District Court agreed with the plaintiffs, but Sixth Circuit reversed.
2. "We conclude that reasonably conceivable facts support the contention that grocery stores and gas stations pose a greater risk of exposing citizens to alcohol than do other retailers. A legislature could rationally believe that average citizens spend more time in grocery stores and gas stations than in other establishments; people typically need to buy staple groceries (for sustenance) and gas (for transportation) more often than items from retailers that specialize in other, less-frequently-used products. Consider the district court's pharmacy example. Kentucky could believe that its citizenry visits grocery stores and gas stations more often than pharmacies – people can survive without ever visiting a pharmacy given that many grocery stores fill prescriptions."
3. Court once again gives great deference to state control over liquor laws.

V. HOUSE BILL 168

- A. HB 168 was Signed by Governor Beshear on March 20th
- B. Amends KRS 243.110 to Prohibit Brewers from Holding Distributor's License. Relevant Text:

"(2) (a) Each kind of license listed in KRS 243.040(1), (3), or (4) shall be incompatible with every other kind listed in KRS 243.040(1), (3), or (4), and no person holding a license of any of those kinds shall apply for or hold a license of any other kind listed in KRS 243.040(1), (3), or (4).

(b) A brewery holding a license listed in KRS 243.040(6) or (9) shall not apply for or hold a license listed in KRS 243.040(3) or (4)."

- C. This Is a Direct Codification of the Three-Tier System where Breweries are Concerned, Nullifying the Ability of Brewers to Self-Distribute

1. KRS 243.040(1) – Brewer's License – Supplier/Producer.
2. KRS 243.040(3) – Distributor's License.
3. KRS 243.040(4) – Non-quota retail malt beverage package license.
4. KRS 243.040(6) – Out-of-state malt beverage supplier's license.
5. KRS 243.040(9) – Limited out-of-state malt beverage supplier's license.

VI. SENATE BILL 81

- A. SB 81 Failed to Pass the General Assembly this Session
- B. This Bill Had Multiple Provisions Affecting Kentucky ABC Laws
 1. Expanded sampling privileges at distilleries to three ounces per customer per day (tripling the current amount).
 2. Enabled small farm wineries to enter into "custom crush" agreements to produce wines for each other.
 3. Allowed distillers to give away by-products or non-alcoholic merchandise at a distillery tour.
 4. Allowed local option elections for:
 - a. Distilled spirit souvenir package sales by local distilleries.
 - b. Allowing by the drink sales at marinas.
 - c. Small farm wineries or golf courses.
 5. Created a sampling license that includes both free and paid samples.
 6. Allowed souvenir package sales at distillers in moist precincts that have authorized those sales.
 7. Permitted small farm wineries to sell unmarketable byproducts to distillers (pomace to be made into brandy).

- C. SB 81 Would Have Given More Generous Privileges to Distillers, Bringing Them More in Line with Small Farm Wineries and Breweries

VI. SUGGESTED READING

Raymond B. Fosdick & Albert L. Scott, Toward Liquor Control (1933):

The importance of this book in alcoholic beverage control cannot be understated. Most laws and even court opinions spring from the provisions of this book and remain relevant in modern times. The book provides policy background and regulatory frameworks still in use today.

NOTES

