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CLASS C LIQUOR LICENSES FOR MICROBREWERS

House Bill 4719 (Substitute H-1)
First Analysis (7-3-97)

Sponsor: Rep. Michael Griffin
Committee: Commerce

THE APPARENT PROBLEM:

Since the end of Prohibition in December 1933--by which time thirty-six states had ratified Amendment 21 to the United States Constitution which repealed Amendment 18 (sometimes called the Volstead Act) passed in 1918--the problem of controlling liquor manufacture, distribution, and sale has rested with the states. That work is done by the Michigan Liquor Control Commission located in the Department of Consumer and Industry Services.

In Michigan, as in most states, there is a system-wide regulatory framework designed to decentralize, monitor, and control liquor traffic. That regulatory framework delineates and preserves three separate and distinct functions in the process: manufacturer (distillers/brewers); wholesaler (distributors/suppliers); and, retailer (sellers in grocery and party stores, bars, restaurants, etc.). The three-function regulatory framework is oftentimes called the "three-tier system." The laws that have been enacted under the overarching three-tier system have been designed to prohibit a person in one of the tiers from having a financial, ownership or leasehold interest in a business located in one of the other two tiers; and, which prohibit a person located in one tier from aiding and assisting a person in one of the other two tiers. Generally, the regulatory scheme is designed to prevent vertically integrated monopolies or cartels in the manufacture, distribution, and sale of liquor. Critics of the traditional regulatory approach favor more flexibility in the three-tier system, and they point out that the recent proliferation of small breweries in the beer manufacturing industry require less uniform regulatory approaches.

This systematic regulatory approach has been justified for more than fifty years, because liquor (defined as beer, wine, mixed spirit drinks, and spirits) has the ability to intoxicate, thereby threatening the health and safety of individuals, families and communities. Because liquor can also be addictive, the states have argued the need for strict oversight of supply, in order to monitor consumer demand. U.S. per capita consumption of alcohol has been monitored since the 1830s, and has been increasing since Prohibition ended, although levels of consumption have not exceeded those recorded before the Volstead Act went into effect.

Michigan issues three types of beer manufacturing licenses. A brewer can produce any amount and sell to wholesalers, but cannot sell by the glass. A microbrewer is limited to 30,000 barrels a year (there are 14 cases of beer in a barrel), can sell to wholesalers, by the glass at a pub or restaurant on premises or for takeout, but can sell only the beer it makes. A brewpub can produce 5,000 barrels a year, and among other requirements must have a restaurant on the premises where sales are limited to on-premise consumption, and also must obtain federal licensing, local approval and a liquor license. Michigan currently licenses 4 brewers, 12 microbrewers, and 22 brewpubs.

The inception and growth of small breweries is a recent phenomenon. For example, until 1995 just four manufacturers--Stroh in Detroit, August Brewing Co. in Harbor Springs, Motor City Brewing Works in Detroit, and Roffey in Holland--held state brewers' licenses; six microbrewers were also licensed in the state, including Frankenmuth Brewing in Frankenmuth; and, seven brewpubs had applications pending before the Liquor Control Commission. By 1996, one year later, there were 21 small operational breweries, while an additional 22 breweries were waiting to open, their permits pending before the Liquor Control Commission.

The growth is a nationwide phenomenon. The Wall Street Journal reported in 1995 that some "microbreweries were becoming regional breweries" as the industry was growing up. The article also reported that large manufacturers like Anheuser-Busch Co. and Miller Brewing Co. had obtained ownership interests in some of the microbreweries. According to the Michigan Craftbrewers Association, the first post-prohibition microbrewery opened in California in 1976; twenty years later there are over 700 microbreweries, brewpubs, and regional specialty breweries in North America.

As the beer industry expands and differentiates to include microbreweries and local brewpubs, critics have noted the inflexibility and also questioned the usefulness of a decades-old regulatory framework that was created to prevent the crime cartels that flourished during Prohibition. In addition to posing a challenge to the economic viability of the framework, proponents also question the health and social standards implicit in the regulatory scheme. They argue that in an era when individual choice is often seen as more important than public health and social welfare considerations (which, in the case of liquor control, many consider to be based on outdated, paternalistic assumptions) consumer preference and customer satisfaction should take precedence. While Michigan's law currently prohibits microbrewers from serving other than their own beer in restaurants near their breweries, proponents point out that 35 states and territories allow microbreweries to serve their guests wine, beer, and mixed spirits, according to the North American Brewers Resource Directory.

THE CONTENT OF THE BILL:

Under the Michigan Liquor Control Act, a microbrewer is defined in section 2bb as one who produces less than 30,000 barrels of beer per year (increased from 20,000 barrels by Public Act 440 of 1996, which took effect on December 19, 1996), and who may sell that beer to customers for consumption on or off the brewer's premises. House Bill 4719 would amend the act to allow a microbrewer to hold a class C license, which would allow the licensee to also sell wine, mixed spirit drinks, and spirits for consumption on the premises. The bill specifies that the class C premises would have to be contained within or be physically directly connected to the microbrewer's licensed premises, and that the restauranteur or franchisee not be named on or hold interest in a microbrewery.

MCL 436.31

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that House Bill 4719 has no state or local fiscal impact. (7-2-97)

ARGUMENTS:

For:

Some small beer manufacturers wish to sell a full range of liquor products in the restaurants that serve as adjuncts to their brewing businesses. In 1996, the Michigan Craftbrewers Association estimated that fully 82 percent of microbrewers and brewpubs had or soon would open full-menu restaurants in additional to their brewing operations. House Bill 4719 would allow these businesses to offer a full range of liquor products and give restaurant customers greater choice in alcohol consumption.

For:
The Michigan Craftbrewers Association, representing about half of the state's microbrewers and brewpubs, completed a report in 1996 to estimate the economic impact of the emerging craft brewery industry in Michigan. The association estimated beer sales in that year to be $36,629,662, but noted that sales would increase to nearly $58 million if its member breweries were at full capacity. The report notes 1,544 jobs in the industry, and based on a $10/hour wage, it estimates a combined payroll of more than $32 million. Based on production and sale of 59,950 barrels of beer in full-menu restaurants, the association estimates that its members pay more than $5.7 million annually in state excise, sales, single business, and income taxes. Overall, the association estimates the economic impact of the craft brewery industry to be nearly $198 million annually.

Response:
During the past decade, the number of Michigan liquor wholesalers has decreased from about 250 to 129. As the liquor industry restructures, many workers are losing their jobs.

Against:
Allowing manufacturers of beer also to sell liquor (in addition to their own beer) further erodes the three-tier regulatory system by blurring the functions of manufacturer and retailer. The three-tier system (manufacturer/wholesaler/retailer) enables regulators to prevent cartels and vertically integrated monopolies from forming in the liquor industry. It is feared that this bill will "open the floodgates" to more and more exceptions, until the system ceases to exist.

Response:
In order to preserve the distinction between the manufacture and retail functions within the three-tier regulatory system, committee amendments would allow a microbrewer to hold a class C license only when the premises are contained within or are physically directly connected to the licensed premises of the microbrewer, and the restauranteur or franchisee is not named on and does not hold an interest in a microbrewery.

Against:
The separate functions in the three-tier regulatory system enable efficient and independent tax verification by the state. Both instate and out-of-state beer manufacturers must be licensed and must pay excise taxes on the product they supply, reporting the amount of beer they sell to the Michigan Liquor Control Commission. Distributors of the beer at the wholesale level report all shipments they receive from the suppliers to the Michigan Liquor Control Commission, and in doing so allow the commission to verify the suppliers' reports. Under this system, the state collects more than $40 million in

revenue from beer excise taxes each year. More than 40 percent of those taxes are paid by one supplier, Anheuser-Bush, which holds an out-of-state manufacturer's license. To the extent that the bill would contribute to the breakdown of the three-tier system, it would also weaken this independent tax verification system.

Against:

If the Liquor Control Act is amended to allow microbrewers to have liquor licenses, then large liquor manufacturers who dominate the industry would likely seek parity, claiming they too deserve the right to own restaurants with liquor licenses.

POSITIONS:

The Michigan Liquor Control Commission has reviewed House Bill 4719, but has taken no position. (7-2-97)

The Michigan Licensed Beverage Association supports the bill. (7-2-97)

The Local Color Brewing Company supports the bill. (7-2-97)

The Michigan Beer and Wine Wholesalers Association opposes the bill. (7-2-97)

Anderson Distributing opposes the bill. (7-2-97)

A representative of the Kalamazoo Brewing Company testified in opposition to the bill. (7-2-97)

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