



Government Affairs Extra

Legal and Policy Issues Surrounding Taprooms

BY
ART DECELLE

Rapid growth in the number of small and independent breweries that rely on taproom sales has received a lot of attention—not all of it positive—across the beer industry. Any disruptive change in a mature product market is news.

Until the unprecedented growth in the number of very small and independent craft brewers, taproom sales went largely unnoticed. Competing retailers, beer wholesalers, and even well-established craft brewers were pleased with steadily growing craft beer sales and consumer demand. As demand has leveled out and competition has increased, taprooms are receiving increased scrutiny.

The U.S. beer industry is shaped in part by a unique combination of laws and policies that add legal and political forces to ordinary market dynamics. Rules vary from state to state with a federal overlay that can create even more confusion.

One recurring, confounding issue in the beer industry is that government regulation simply cannot keep up with changes in the national economy, technology, and other fundamentals of the 21st century business environment. A continuing concern of government at all levels is industry integrity and the effects of an alcohol beverage licensee on surrounding communities. Those concerns are addressed in the approval processes of state licenses and the federal Brewer's Notice issued by the Alcohol and Tobacco Tax and Trade Bureau (TTB).

That taprooms exist because of a "legal loophole" is simply a myth. By nature, a brewery has a substantial physical presence. A brewery with a taproom is licensed at a highly visible location with loading docks, tanks, and complex plumbing and circuitry. Diagrams of the operation are on file with regulators along with fingerprints and more than enough information to file a mortgage application for each owner and officer on the permit or license.

Every brewery owner has substantial obligations imposed by the terms of several licenses. He or she must exercise direct supervision over production and retail activities and pay taxes on a regular schedule throughout the year. The entire business is directly subject to penalties that could

be imposed by the TTB, state ABCs, state and local police agencies, or all of the above. Few other businesses operate under such an extraordinary regulatory phalanx.

From a practical perspective, legal considerations are critical in assessing whether a taproom is the best business decision for a new or growing brewery. Each state licensing law authorizing brewery taprooms and brewpubs operations has its own nuances. Some laws severely limit the economic viability of brewery taprooms and potential for growth. Brewery owners are best served by gaining a full understanding of their state's licensing requirements.

Some states follow the federal model, treating brewers as manufacturers and authorizing retail sales on the brewery premises. Several states have complex exceptions that permit brewers to operate wholly-owned retail establishments at locations other than the licensed brewery.

Longstanding Florida law allows taprooms at breweries provided they enhance the state's tourism industry, which means they must schedule regular public tours. In addition, a lengthy exception to the tied house law allows a brewery to obtain up to eight retail licenses "for the sale of alcoholic beverages on property consisting of a single complex, which property shall include a brewery and such other structures which promote the brewery and the tourist industry of the state." Virginia has analogous laws authorizing retail sales in proximity to breweries. (Think of Busch Gardens and Sea World when they were owned by Anheuser-Busch.)

If one looks at competing industry segments, wine and spirits suppliers and distributors have embraced tasting rooms and expanded sales opportunities. Policy changes that the wine and spirits industry supported over the last two decades are paying off for all three industry tiers today. Change did not occur overnight. A familiar pattern of litigation and legislative battles accompanied the amendments to state licensing and tied house laws. But direct shipping, tasting opportunities, expanded retail privileges, and wine and spirits trails are examples of policies that ultimately fostered growth for the industry overall.

Current beer industry dynamics are creating pressure on state lawmakers and regulators.

Established wholesale and retail interests seek to restrict the retail privileges of brewers. Successful local craft brewers are seeking to expand retail privileges to create a base for their brands and to add a profit center to their breweries. One of their biggest challenges is to quell the growing concern over taprooms.

The Brewers Association's analysis of TTB data shows that direct sales to consumers at brewpubs and brewery taprooms combined were on track to hit three million barrels in 2018. That number must be divided by more than 5,000 breweries with taprooms. The total national volume also includes substantial volume at A-B and MillerCoors taprooms, two of which (St. Louis and Golden) have hundreds of thousands of visitors annually. The average taproom sales volume is approximately 7,500 case equivalents (CE) and the median is estimated by the BA to be 4,800 CEs. Keep in mind that 75 percent of craft brewers in the U.S. produce less than 1,000 barrels or 13,700 CEs annually.

Taprooms are often viewed as a threat to the viability of beer distributors, although the size and scope of most taprooms is a rounding error when compared to the volumes of most U.S. distributors. In most counties in the U.S., close to 100 percent of the beer is sold by two wholesalers to all retail customers. Large urban markets may have three or four full-service wholesalers. If the current trend in brewery sales continues, taproom sales might change the amount of beer that is sold by licensed distributors to 95 percent by the time people born this week turn 21. Taprooms are a different business model, but they are certainly not a threat to distributors, many of whom sell millions of cases annually.

Retailers are also concerned over taprooms, particularly in states where license quotas and other limitations exist. Conflicts even exist among craft brewers in states where breweries with limited capacity are authorized to operate primarily as retail outlets. These commercial and political issues are likely to lead to continued changes in brewery licensing criteria in the foreseeable future.

State and local officials possess significant discretion in licensing proceedings. In addition to existing licensing requirements, barriers to new projects can arise through frequent changes in



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state laws to accommodate new projects and in response to political pressure from established interests. Several state licensing laws in key states have been amended twice in the same legislative session.

To the extent possible, steps should be taken to confirm that all of the commercial activities needed to sustain a viable business are authorized under state and local law. All necessary government authorizations must also be obtained in advance so that the new enterprise can commence operations in a predictable timeframe.

If you are considering the addition of a taproom, a cautious approach is needed. Prior to making financial or other commitments involving breweries, property, or other assets, state requirements should be reviewed and fully understood. Any questions that are not clearly addressed in the text of laws and regulations should be clarified with the relevant state ABC and/or local government with jurisdiction over a prospective brewery or retail site.

Art DeCelle is an attorney in the Alcohol Regulatory and Distribution Group of McDermott Will & Emery LLP, which advises the Brewers Association on a wide range of legal and public policy challenges facing craft brewers. He can be reached at adecelle@mwe.com.

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