



# Winds of Change Blowing for Craft Brewers

BY  
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For those who follow developments in the law and craft brewing with equal passion, every year has its share of substantial issues. This year has been no exception, with a pending Supreme Court case; a substantial upswing in federal trade practice enforcement activity; a massive rewrite of U.S. Tax and Trade Bureau (TTB) labeling and advertising regulations; and prospects for extending the biggest cuts in the excise tax on beer since the repeal of Prohibition.

## 1. SUPREME COURT UPDATE

As *The New Brewer* readers know (see the article in this space in the March/April 2019 issue), last fall the U.S. Supreme Court decided to hear a case that could substantially impact the way alcohol beverages are distributed in the U.S. *Tennessee Wine & Spirits Retailers Association v. Blair* involves the legality of Tennessee's "dual-residency" requirements for off-premise retail licensees. Under current law, an applicant for such a license must have been a resident of Tennessee for at least two years, and certain renewal requests must show residency for at least 10 years. Every shareholder of a corporate licensee must meet those requirements. Challenged by an arm of retail giant Total Wine & More along with another retailer, a district court in Tennessee, and then the U.S. Court of Appeals for the Sixth Circuit, both held the residency requirements unconstitutional under the "Dormant" Commerce Clause. The Tennessee Wine & Spirits Retailers Association ("Association") appealed to the Supreme Court, supported by dozens of states.

The case raises the question of whether the non-discrimination principles applied to winery direct-shipping laws in the 2005 *Granholm v. Heald* decision also apply to state laws regulating wholesalers and/or retailers. Since the March/April article was written, the Supreme Court held oral argument on the case, with tantalizing hints of which way the Court may be leaning.

Attorneys representing the Association and the states (the Illinois attorney general) pressed hard for their "big win"—that state laws regulating wholesalers and retailers are immune from

any Commerce Clause scrutiny. Should this position prevail, even an obviously protectionist or irrational law will face no federal court scrutiny under the Commerce Clause. The Justices' questions suggested strong skepticism of the proposition that state laws regulating wholesalers and retailers are immune from Commerce Clause scrutiny. Multiple Justices were critical of the notion that the 21st Amendment shielded protectionist laws from scrutiny. Perhaps most directly, Obama-appointed Justice Sonia Sotomayor, in a discussion with the Association's counsel, seemed to reject the idea that *Granholm* limited its non-discrimination principle to producers and products. Following oral argument, supporters of the Association and the states could not feel good about the chances of the Court embracing their argument for virtually unfettered states' rights to regulate alcohol beverages.

Predicting Supreme Court decisions is always a risky endeavor. Nevertheless, based on the oral argument, it seems likely that the Court will reject the notion that state laws regulating wholesalers and retailers are completely immune from Dormant Commerce Clause scrutiny. But the Court also seems likely to craft a test for lower courts to evaluate whether state alcohol laws are discriminatory in future cases. That leaves for another day the issues beyond residency that go to the heart of current state regulations of alcohol distribution: those related to direct-to-consumer shipping, physical presence requirements, and the three-tier system.

A final decision from the Supreme Court is expected by the end of June.

## 2. FEDERAL TRADE PRACTICE ENFORCEMENT UPSWING

The TTB has substantially ramped up enforcement of its trade practice (exclusive outlet, tied house, commercial bribery, and consignment sale) regulations. The provision of additional funding from Congress and a more focused TTB suggest that brewers now face a substantially altered federal enforcement environment. In addition, the TTB continues to announce cases under its excise tax and related authority over producer operations, with a steady stream of "offers-in-compromise" (OIC), usually settlements

that include a description of alleged violations and a monetary payment to the government.

While craft brewers may hope that their companies are small enough to fly under the radar, even a casual review of the OICs announced in the past year demonstrate that no industry member is immune to TTB attention. Small wineries, beer wholesalers, small distilleries, and a small beer importer have all entered into OICs in the past year. On the trade practice front, these settlement payments have included:

- \$900,000 in April 2018 paid by small beer importer Warsteiner Importers.
- \$325,000 in November 2018 by Illinois beer wholesaler Elgin Beverage.
- \$1.5 million in December 2018 by Florida beer wholesaler Eagle Brands.

In addition, an investigation of small California winery and wine importer sales to a single New York wholesaler resulted in no fewer than 11 wineries and importers agreeing to a one-day suspension of their TTB basic permits (the federal "license" held by wineries, distillers, and wholesalers). While this may not seem significant, under federal law the TTB can only permanently revoke a permit after it has first been suspended. In essence, these companies now have one strike against them in a two-strike system. All actions stemmed from alleged violations of the TTB's consignment sale regulations, with the TTB alleging that by shipping to their wholesaler without an expectation of payment until the wholesaler sold the wine, the wineries and importers engaged in prohibited consignment sales. According to public statements by the attorneys representing the wholesaler in question, the companies agreed to suspensions of their permits because they are small "mom-and-pop" operations without the means to stand up to the TTB.

These developments require a renewed focus on compliance and a greater understanding of a brewer's obligations and rights. Under the new normal, even infractions considered minor by the TTB's regulatory personnel (e.g., failure to update information on a permit or brewer's notice) can be leveraged in settlement discussions. Similarly, the industry norm of relying on oral assurances from "friendly" regulators—federal and state—may provide little legal protection in an enforcement action.

The TTB will likely continue its renewed focus on enforcement unless restrained by some outside force. Not only has the agency received additional funds for enforcement, the Trump administration has proposed giving the TTB independent criminal enforcement authority and additional duties that are currently the responsibility of the Bureau of Alcohol, Tobacco, Firearms and Explosives. Thus, brewers face a greater likelihood of criminal prosecution for trade practice and other Federal Alcohol Administration (FAA) Act regulations. Brewers do not need a "basic permit," only a brewer's notice, and are therefore less exposed to the TTB's enforcement threat of permit suspension.

Craft brewers should be vigilant about compliance with TTB regulations. Extra attention is required if a brewery owner also holds winery or distillery permits to engage in other manufacturing activities; wholesaler permits to distribute beer or other alcohol beverages; or importer permits to engage in importation activities.

### 3. TTB PLANS TO "MODERNIZE" LABELING AND ADVERTISING REGULATIONS

On November 26, the TTB published Notice 176, a 131-page "notice of proposed rulemaking" in the *Federal Register*. Notice 176 is the first formal step in the process of amending existing agency regulations. The TTB proposes wide-ranging

updates to regulations governing labeling and advertising of beer, wine, and spirits. Public comments on the proposed regulations may be made through June 26. As painful as reading draft regulations may be, Brewers Association members should designate a key employee to become familiar with the proposed changes and consider commenting on Notice 176.

Proposed changes include:

- Amendments to modernize and clarify existing labeling regulations, including a solid effort to incorporate decades of TTB decisions and guidance documents into formal regulations so that industry members can find guidance in one place;
- New concepts that reflect changes in the alcohol beverage marketplace;
- An effort to reconcile the authority of the TTB and the Food and Drug Administration (FDA);
- Consolidation of advertising regulations for all beverage categories to replace current regulations that apply separately to beer, wine, and distilled spirits.

The Brewers Association has reviewed Notice 176 to identify broad issues affecting craft brewers that are appropriate for industry comments. For example, proposed changes would allow the use of keg collars only if the kegs have permanent labels or embossed information identifying the brewer, which could make keg fleets difficult

or impossible to manage. In a positive vein, the BA supports several TTB clarifications, such as rules governing personalized labels, which are a popular marketing tool for craft brewers.

A challenging legal issue that the BA will address is the overlapping jurisdiction of the TTB and the FDA. Beer is "food" under federal law, and the FDA has jurisdiction over ingredient safety, good manufacturing practices, and other aspects of brewery operations and products. (See Technical Brewing on page 11 for more information.) Brewers who produce ciders and certain beers that do not fit the definition of "malt beverage" in the FAA Act are familiar with FDA labeling regulations. Brewers who require formulas to produce "non-traditional" beers may have noticed a disclaimer on the TTB formula that obligates the brewer to comply with applicable FDA regulations. But regulation of labeling and advertising by separate federal agencies creates anomalies. The BA will advocate for changes to protect brewers who rely on TTB approval of labels and seek distinctive lines between TTB and FDA jurisdiction. The goal will be to ensure fairness and consistency so that brewers are not trapped by ambiguities arising from the fact that two agencies have authority over the same products.

While the TTB will certainly provide a lengthy transition period to make adjustments in any existing labels and brands, officials need to hear directly from brewers about the effects of proposed changes on individual brand portfolios. A spreadsheet available on [BrewersAssociation.org](http://BrewersAssociation.org) summarizes key sections of the TTB proposal. The breadth of the proposed changes will require extensive analysis of comments by TTB officials. Hundreds of comments on various aspects of the proposed new regulation are expected from brewers, distillers, vintners, consumers, and a range of advocacy organizations. A final rule may take a year or more to complete following the close of the comment period.

### 4. CRAFT BEVERAGE MODERNIZATION AND TAX REFORM ACT EXTENSION

The BA is actively engaged with other industry associations to seek a permanent reduction in the excise tax rates on beer and other alcohol beverages enacted in 2017. Reduced tax rates for spirits, wine, and beer will expire at the end of 2019.

On February 6, Reps. Ron Kind (D-WI) and Mike Kelly (R-PA) introduced H.R. 1175, the Craft Beverage Modernization and Tax Reform Act of 2019 in the House. The legislation quickly attracted a bipartisan group of more than 50 cosponsors. On February 13, Senators Ron Wyden (D-OR) and Roy Blunt (R-MO) introduced a companion bill, S. 362, in the Senate.

The House and Senate bills would make the reduced alcohol beverage excise tax rates (and tax credits for wineries) enacted in 2017 permanent. The BA focused part of its Hill Climb in mid-May on gaining a majority of House and Senate members as cosponsors.

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Not everyone in the nation's capital supports reduced taxes on alcohol beverages. Congress faces enormous pressure to fund existing federal health care programs, which provide coverage to more than 100 million Americans. In December, several senior House members circulated draft health care reform legislation funded in part by raising the federal distilled spirits excise tax to \$16 per proof gallon and equalizing beer, wine, and other alcohol excise taxes at that higher rate.

As these developments play out over the next year, we may see changes translate into the marketplace. While some of these developments may benefit America's small, independent brewers, ignoring the winds of change blowing from courts, regulators, and legislatures is a hazardous game, and being ill-informed about major developments is something no business can afford to do.

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