WISCONSIN LEGISLATIVE COUNCIL
STUDY COMMITTEE MEMORANDUM

TO: MEMBERS OF THE STUDY COMMITTEE ON ALCOHOL BEVERAGES ENFORCEMENT

FROM: Parker Conover, Legal Intern, and Melissa Schmidt, Senior Staff Attorney

RE: History of Modern State Alcohol Beverages Regulatory Structures and Examples From Neighboring States

DATE: July 17, 2018

The Study Committee on Alcohol Beverages Enforcement is directed, in part, to compare the regulatory and enforcement structures of alcohol law enforcement efforts in other states. This memorandum is intended to provide members with information about the development of such structures. Specifically, this memorandum details the origins of modern state alcohol beverages regulatory structures. It also provides examples of current regulatory structures in Illinois, Minnesota, Iowa, and Michigan.

THE ORIGIN OF MODERN STATE REGULATORY STRUCTURES: THE ROCKEFELLER STUDY

After Prohibition was repealed by the Twenty-first Amendment, states were tasked with regulating the alcohol beverages industry. In an effort to prevent the negative effects of alcohol, John D. Rockefeller, Jr. commissioned a study[1] to evaluate how states could best regulate the alcohol industry. This study became the basis for state regulatory structures for alcohol beverages.[2] Generally, the study concluded that state regulatory structures should not stimulate the demand for alcohol, but instead, meet the normal demand. Specifically, the study noted that this balance guards against bootlegging while also guarding against consumer exploitation:

[1] Published as: Raymond B. Fosdick & Albert L. Scott, *Toward Liquor Control* 2 (The Center for Alcohol Policy 2011) 1933.

[2] Andrew D'Aversa, *Brewing Better Law: Two Proposals to Encourage Innovation in America's Craft Beer Industry*, 165 U. Pa. L. Rev. 1465, 1472-76 (2017).

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> Our recommendation in regard to the liberalization of the control of light beers and wines may seem to some too extreme …. We are convinced, however, that without this degree of liberalization there is no escape from the bootlegger …. On the other hand, our recommendation in regard to state control … may seem too bold and idealistic … But we firmly believe that any system of control which does not attack the private profit motive … [has] not dug to the root of the difficulty …. [Raymond B. Fosdick & Albert L. Scott, *Toward Liquor Control* 96 (The Center for Alcohol Policy 2011) 1933.]

In order to strike this balance, the study evaluates two options for the structure of state alcohol beverages regulation and enforcement: (1) regulation by license; and (2) the authority plan. All states chose to utilize regulation by license. However, some states' also chose regulatory structures that blend regulation by license and the authority plan. States that blend the two are categorized as "control states." States that only use regulation by license are categorized as "open states." [*Id.* at 2-3, 9-10.]

The Rockefeller Study's "Regulation by License"

The study proposed a system of state regulation by license. Regulation by license divided the alcohol industry into manufacturers and retailers. A business could only be a manufacturer or a retailer. This separation guarded against tied-houses, which were popular before Prohibition. A tied-house occurred when a retailer had an exclusive contract with a manufacturer. Many people argued that tied-houses diminished consumer choice and gave incentive to retailers to overserve.

The study proposed that any system of licensure should be overseen by a single state licensing board. The state licensing board, supported by local agencies, would have statewide authority to issue licenses. Additionally, the board would have the "widest possible discretion in regard to the issuance of regulations." As noted above, states that only utilize regulation by license are generally categorized as "open states." [*Id.* at 28.]

The Rockefeller Study's "Authority Plan"

Under the Rockefeller Study's proposed authority plan, a state would monopolize retail liquor sales. All retail stores would be owned and managed by the state. The state would purchase alcohol beverages directly from manufacturers and then sell the alcohol beverages to the public at retail stores. State management of retail liquor sales would ensure that demand for alcohol would not be stimulated, because there would be no private profit incentive from the retail sale of alcohol beverages. The study noted: "no individual connected with the retail sale would gain one penny . . . nor would his employment be imperiled if he failed to show good sales returns, as might be the case in private trade." [*Id.* at 51.]

The study suggested a model administrative structure for states to use, while emphasizing that states needed flexibility in how they chose to administer alcohol regulations. The state monopoly on distribution, retail sales, or both would be controlled by the State Alcohol

Control Authority ("SACA") which would be a public corporation. SACA would be overseen by a small, governor-appointed board of directors. The board would support the managing director of SACA who would oversee seven principal units: (1) division of retail shops and agencies; (2) division of permits; (3) treasury; (4) bureau of inspection; (5) central purchasing bureau; (6) bureau of personnel; and (7) bureau of records and statistics. States that have chosen to monopolize any aspect of the alcohol industry are now generally referred to as "control states." [*Id*. at 45.]

MODERN ALCOHOL BEVERAGES REGULATIONS

Almost all states utilize a tiered licensure structure to regulate the alcohol beverages industry. This structure of tiered licensure is similar to the Rockefeller study's proposed structure of regulation by license, except modern states utilize a "three-tier" licensure structure instead of the two-tier structure suggested in the Rockefeller study. Instead of having two only tiers – manufacturers and retailers – most modern state alcohol beverage regulatory structures have three tiers: (1) manufacturer; (2) distributor; and (3) retailer.[3] Of the states that utilize a three-tier license structure to regulate alcohol beverages, some states also monopolize one, or part of one, of the tiers. A state monopoly on all of or part of a tier stems from the Rockefeller study's authority plan.

As noted above, whether a state utilizes a three-tier regulatory structure with no state monopoly, or a three-tier structure with a state monopoly in one or more tiers generally groups a state into one of two categories: "open states" or "control states."

Open States

An "open state" generally uses licensure to regulate the entire industry. In most open states, there are three tiers (or categories) of licensure: (1) manufacturers or producers; (2) wholesalers or distributors; and (3) retailers. Manufacturers make the alcohol beverages. Distributors buy alcohol beverages from manufacturers in bulk, store it, and then distribute it to retailers. Retailers buy the alcohol beverages from distributors and sell them directly to consumers. Within these tiers, there are generally classes of licenses for three major types of alcohol beverages: (1) distilled spirits (spirits); (2) fermented malt beverages (beer); and (3) wine. If a state licenses all of the three tiers listed above, the state's enforcement is generally referred to as a "three-tier system."[4]

Control States

In a "control state," rather than license all three tiers, the state directly engages in either the distribution tier, retail tier, or both. The state may operate a monopoly on at least one type

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[3] States created an additional third tier for distributors. Distributors would have large amounts of capital at risk giving them strong incentive to avoid regulatory sanction. [Evan T. Lawson, *The Future of the Three-Tiered System as a Control of Marketing Alcoholic Beverages, in Social and Economic Control of Alcohol: The 21st Amendment in the 21st Century* 33 (Carole J. Jurkiewicz & Murphy J. Painter eds., CRC Press 2008).]

[4] D'Aversa, at fn. 1, 1473-74.

of alcohol beverage in distribution, retail sales, or both. Control states that do not monopolize retail sales often have some sort of licensure system so that alcohol beverages are still regulated after distribution. For instance, in Iowa, the government is the sole distributor of spirits, but licenses private beer and wine distributors. Iowa is generally categorized as a control state.[5]

The *Map of State Monopolies*, provided below, is a map illustrating control states' monopolies, specifically which tier and which type of alcohol beverage is under a state monopoly.

Map of State Monopolies[6]

[Evan T. Lawson, *The Future of the Three-Tiered System as a Control of Marketing Alcoholic Beverages, in Social and Economic Control of Alcohol: The 21st Amendment in the 21st Century* 33 (Carole J. Jurkiewicz & Murphy J. Painter eds., CRC Press 2008).]

<u>EXAMPLES OF STATE ALCOHOL BEVERAGES REGULATORY STRUCTURES</u>

Below is a brief description of the alcohol beverages regulatory structures found in Illinois, Minnesota, Iowa, and Michigan.

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[5] *Id.*

[6] "High alcohol beverages" and "moderate alcohol beverages" generally refer to spirits. "Wholesale" is synonymous with distributor and distribution.

Illinois

Illinois is considered an open state, because it licenses manufacturers, distributors, and retailers. [235 Ill. Comp. Stat. 5/5-1 (1934).]

Administration

Illinois has a commission dedicated to the regulation of alcohol beverages: the Illinois Liquor Control Commission (ILCC), which is located within the state's Department of Revenue. The ILCC consists of seven members: the chairman and six commissioners, who are appointed by the governor. The secretary of the ILCC, who is also appointed by the governor, keeps a record of all proceedings, transactions, communications, and official acts of the ILCC; is the custodian of all records; and performs such other duties as the ILCC may prescribe. The executive director, also appointed by the governor, oversees the three staff-level divisions of the ILCC: the Administrative Division; the Legal Division; and the Investigative Division. Additionally, there are local liquor commissioners who are authorized to issue temporary licenses or temporarily revoke existing licenses, conduct inspection of licensed properties with or without law enforcing officers, and to receive local license fees. [235 Ill. Comp. Stat. 5/3-1, 5/3-12, 5/4-4 (1934); Ill. Admin. Code tit. 2, s. 2075 (2003).]

The ILCC's Administrative Division reviews and issues state liquor licenses. Additionally, this division works jointly with the Illinois Department of Revenue to collect delinquent taxes from licensees. [235 Ill. Comp. Stat. 5/6-3.]

Enforcement

The ILCC's Investigative Division conducts routine inspections of licensed premises. Additionally, in conjunction with state and local enforcement agencies, the division utilizes underage purchasers to ensure retailers are checking identification cards (IDs) before selling alcohol beverages. Local enforcement agencies can also apply for grants from ILCC to fund their own compliance tests. Teams of division agents who conduct these inspections and tests are headquartered throughout the state. These agents report violations to the central office for adjudication. [235 Ill. Comp. Stat. 5/6-16.1; Illinois Liquor Control Commission, https://www2.illinois.gov/ilcc/about/Pages/What-We-Do.aspx (last visited Jul. 5, 2018).]

The ILCC meets 18 times a year to adjudicate the most serious cases reported to the central office. Generally, these cases affect the health and safety of the community. Additionally, the chairman and commissioners hear appeals brought by licensees who wish to challenge local licensure decisions. [235 Ill. Comp. Stat. 5/7-9, 5/3-12 (1934).]

Minnesota

Minnesota is generally considered an open state for regulation of alcohol beverages because it licenses manufacturers, importers, wholesalers, and retailers. However, it also has an element of the control state model, because some municipalities have a local monopoly on the retail sale of spirits. [Minn. Stat. s. 340 (2017).]

Administration

Minnesota's Division of Alcohol and Gambling Enforcement (AGED), located within the Department of Public Safety, regulates alcohol beverages in the state. The AGED director is appointed by the commissioner of the Department of Public Safety. AGED currently has a staff of 19 full-time positions, including six special agents and three special liquor investigators. Additionally, a law enforcement liaison coordinates with local law enforcement agencies. AGED has a role in some types of licensing, such as farm winery licenses and caterers' permits, but the majority of licenses are processed and issued at the local level. AGED serves more as a record keeper of the licenses issued by local bodies, keeping a central record of issued licenses. [Minn. Stat. s. 340A.201 (2017); League of Minnesota Cities, *Informational Memo: Liquor Licensing and Regulation* (2017).]

Enforcement

AGED special investigators conduct inspection and compliance visits to ensure licensed liquor establishments comply with the state liquor laws and rules, including prohibitions on trade practice violations and illegal advertising promotions. Additionally, AGED coordinates with local law enforcement agencies to ensure compliance with alcohol beverages laws. [John Bodnovich, *American Beverage Licensees*, *Background on IA, IL, MI, and MN* (July 2018).]

Iowa

While Iowa may be considered a control state because it has a monopoly on the distribution of spirits, it also uses licensure to regulate the rest of the alcohol beverages industry. Iowa licenses manufacturers, beer and wine distributors, and retailers. Distribution of spirits is monopolized by the state, so no licenses are issued for this activity.

Administration

Iowa's Alcoholic Beverages Commission, which is located within the State's Department of Commerce, regulates the alcohol beverages industry. The commission is comprised of five governor-appointed members. No more than two of these members may be the holder of or have an interest in a permit or license to manufacture spirits, wine, or beer, or to sell spirits, wine or beer at wholesale or retail. The commission oversees and advises the Alcoholic Beverages Division ("ABD"). For example, the commission may review and affirm, reverse, or amend all actions of the ABD.

The ABD is headed by an administrator, who is appointed by the governor. The administrator manages the ABD. The ABD grants alcohol beverage permits and licenses, and generally regulates the alcohol industry. Additionally, the ABD is the state distributor of spirits. All retailers must purchase their spirits from the ABD. [Iowa Code ss. 123.4, 123.9, and 123.9 (2018).]

Enforcement

Instead of the ABD enforcing state liquor laws, the Department of Public Safety is the primary beer, wine, and spirits law enforcement authority. The ABD and county and city officials, including law enforcement entities, support the Department of Public Safety in enforcement. Primarily, the ABD provides information about the types of licenses businesses hold. [Iowa Code s. 123.14 (2018).]

Michigan

Similar to Iowa, Michigan is considered a control state because it is involved in the distribution of spirits. Michigan also uses licensure to regulate the rest of the alcohol beverages industry: manufacturers, beer and wine distributors, and retailers. The state tracks and must approve each distributor's purchases from spirit manufacturers, although the state never has actual possession of the spirits. Manufacturers must sell to one of four authorized distribution agents, or wholesalers. After a transaction is complete, the state receives a share of the revenue. [Mich. Comp. Laws ss. 436.1231, 436.1206, 436.1403, and 436.1305 (2018).]

Administration

The Michigan Liquor Control Commission ("MLCC"), which is located within the State's Department of Licensing and Regulatory Affairs, administers Michigan's alcohol beverages laws. MLCC has five commissioners who are appointed by the governor. No more than three of the commissioners may be of the same political party. Three of the commissioners are administrative commissioners who deal primarily with policy. The other two commissioners are hearing commissioners who deal with hearings for liquor law violations. MLCC is supported by four staff-level divisions: the Executive Services Division; the Financial Management Division; the Licensing Division; and the Enforcement Division. A business manager, who is selected by the MLCC, oversees all four divisions. [Mich. Comp. Laws ss. 436.1209 and 436.1211 (2018).]

The Executive Services Division provides staff support services to the MLCC. Staff within this division assist in writing commission orders, process administrative rules, analyze proposed legislation, draft declaratory rulings, and respond to inquiries from the governor and director of the Department of Licensing and Regulatory Affairs. [Brief Overview Michigan Liquor Control Commission, https://www.michigan.gov/lara/0,4601,7-154-10570_58884---,00.html. (last visited Jul. 5, 2018).]

MLCC's Financial Management Division provides support for the commission in all areas of financial management and accounting. It collects in excess of half a billion dollars annually in sales dollars, taxes, fees, and other monies for the State of Michigan; properly accounts for and provides reports on these monies; transfers these monies to the appropriate agencies; and manages the Liquor Purchase Revolving Fund for the State of Michigan. [*Id.*]

MLCC's Licensing Division processes requests for licenses. The division administers the annual license renewal process for all licensees; verifies licensee insurance; and processes special license applications, requests for new and temporary permits, and permissions. [*Id.*]

Enforcement

MLCC's Enforcement Division investigates applicants for new licenses and transfers of ownership or location of existing licenses, as well as complaints against licensees. Additionally, the Enforcement Division inspects licensed establishments to ensure compliance with the Liquor Control Code and commission rules. The division also advises and assists law enforcement agencies in liquor law enforcement at the local level and conducts training of law enforcement officers. [Mich. Comp. Laws s. 436.1217 (2018).]

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