

## THE THREE-TIER SYSTEM

The distribution system designed by most states to regulate alcohol has been identified as the “Three-Tier System.” Since its inception, it has proved to be a practical and effective method of distribution consisting of the supplier, the wholesaler and the retailer. It came to life after the 18th Amendment of the U.S. Constitution ushered in Prohibition, the result of a free-market system where alcoholic beverages were sold through only the supplier and the retailer.

Suppliers of the pre-Prohibition era, although small, tended to be more profitable. There was a monopoly among those that had ownership ties to taverns and saloons, where they pushed their brands exclusively. They competed for control of these “tied-houses,” urging retailers to increase sales at a social cost that was considered by some as going beyond religious and cultural enforcement. Some states enacted prohibition laws, later declared unconstitutional, to deal with excessive consumption and the “free-wheeling” tactics used by the suppliers. In 1919, Prohibition advocates like the American Temperance Union and the Anti-Saloon League successfully urged the U.S. Congress to enact the National Prohibition Act (18<sup>th</sup> Amendment.) And a year later, the Volstead Act was designed to enforce Prohibition. The legislation dramatically changed the conditions under which alcohol was sold and consumed. But it could not end the sale of all alcohol. Public drunkenness increased and the crime rate doubled that of the pre-prohibition period. Like any unpopular law, it was unenforceable.

Discussion in Congress began to change, with the focus leaning more towards the employment and revenue potential rather than just moral and religious issues. On April 1,

1933, Congress passed the Cullen-Harrison Act which redefined “intoxicating liquors” to exclude beer with less than 3.2 percent alcohol. Ratification of the 21<sup>st</sup> Amendment followed later that year, repealing Prohibition all together. Section 2 gives states the right to regulate the manufacture, distribution, sale and use of alcoholic beverages. And to avoid “tied-house” practices of the pre-Prohibition era, the “Three-Tier System” was born.

States took one of two paths, one by way of state monopoly, and the other by the licensure and regulation of suppliers, distributors and retailers in the private sector. The insulator of choice was the wholesaler, balancing the multiple interests of suppliers and retailers. It is the wholesaler’s responsibility to purchase products from a supplier company to sell and deliver to retail establishments. They support regulations and community standards that discourage overindulgence, drunk driving and underage drinking. Wholesalers are in most instances the primary collectors of state excise taxes. Today, beer is sold in the private sector in all states, and the beer industry alone has collected \$27.5 billion in revenues nationwide.

This distribution system is significant because smaller retailers are provided more of an even playing field and have access to more products. It further adds additional insurance against monopolistic control of larger more dominant suppliers engaging in anti-competitive practices. As the “middleman” of the beer industry, the wholesaler, being within the jurisdiction of the state, is more responsive and sensitive to local social influences, laws and regulations than would be a non-resident supplier at a national level. And, it is easier for a state to enforce the laws. States have immediate jurisdiction over all the operations and personnel of the wholesaler.

There has been some concern that history might repeat itself. Technological advances have increased temptations to escape the “Three-Tier System.” Payment of excise and sales taxes, for example, can be evaded with the use of a computer and a credit card. Laws and regulations against sales to underage youth are being bypassed in cyberspace. For this reason, it has been held that the 21<sup>st</sup> Amendment should remain strong in retaining state authority over the distribution of licensed beverages.

In summary, the “Three-Tier System” has made possible efficient and effective control of alcoholic beverages. It helped create a stable beer industry and protects it from monopolistic practices. The system provides revenue protection so that every tier in the system benefits economically, even the consumer.