

# Alcohol in the 21<sup>st</sup> Century Store

By Jarrett Dieterle



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## Introduction

The COVID-19 pandemic saw to-go and delivery alcohol dominating the news headlines of the drinks industry. Restaurants were granted the newfound ability to offer to-go margaritas, and more liquor stores were able to deliver bourbon bottles and six-packs. Overall, the number of states allowing alcohol delivery from both on-premises and off-premises alcohol retailers increased substantially.<sup>1</sup>

While the push for states to extend or permanently codify more types of alcohol delivery continues, policymakers should be careful not to ignore the humble brick-and-mortar store. Despite the pandemic's reordering of the delivery economy, most Americans still take trips to a physical store to buy their weekly groceries and beverages.<sup>2</sup> Yet physical retailers in the alcohol space are subject to a host of outdated laws and regulations governing where and how alcohol can be sold—and who can sell it.

The alcohol industry has shown notable pluck in surviving pandemic shutdowns and supply chain disruptions. The sector produces a significant amount of manufacturing jobs, and its economic benefits for local communities is well documented.<sup>3</sup> This laudable growth trajectory, however, has largely been in spite of the legal structure governing alcohol.

For the industry to continue expanding and meeting consumer demands in the dynamic craft drinks era, lawmakers and regulators across America will need to rethink outdated alcohol rules and find safe, sensible ways to update them. One place to start is in the neighborhood store.

## Are Government Alcohol Stores Still Viable?

The amount of retailing options for most goods is immense. For instance, if a consumer wishes to purchase a TV, their options are nearly endless, including Best Buy, online retailers or sites like Craigslist.

Alcohol stands in stark contrast. This dissonance is particularly jarring in the 17 “control states.”<sup>4</sup> These states control the sale of alcoholic beverages at the wholesale or retail level, using a tightly structured government-run system.

Outside of some niche examples, such as national park gift shops, government-run alcohol stores are one of the few modern situations in which the government acts as a retailer

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tasked with selling private consumption goods. Perhaps unsurprisingly, control state systems have struggled to keep up with innovations in the alcohol marketplace.

For example, during the pandemic, control state stores in many locales shut down completely, spurring residents to cross state lines to acquire alcohol—a pattern directly at odds with social distancing and stay-at-home guidance.<sup>5</sup> Control states have also been slower to onboard innovations like alcohol delivery than private retailers.<sup>6</sup>

Control states proved especially vulnerable to pandemic disruptions.<sup>7</sup> That is partly because many control states have only a small handful of state-run warehouses through which they wholesale all the state's spirits.<sup>8</sup> These warehouses are limited in capacity by nature, and often make once-weekly deliveries to retailers instead of more regular drop-offs.<sup>9</sup>

These limitations also mean that control states traditionally have more limited product selections than non-control states.<sup>10</sup> This can be most deleterious for local craft alcohol brands. If a local craft distillery wants its products sold in a state-run store, it is forced to pitch them to the government control boards that have final authority of what is sold. In the event the product is not approved, the distillery faces the prospect of being locked out of its home state market entirely.<sup>11</sup>

Another recent trend has been the string of high-profile scandals involving the sale of rare whiskeys in control states. In Virginia, a former state Alcoholic Beverage Control Administration employee sold insider information about which state-run stores were expected to receive new shipments of hard-to-find whiskeys.<sup>12</sup> Similarly, top officials in the Oregon Liquor and Cannabis Commission were caught siphoning off select rare bottles for themselves and influential state lawmakers.<sup>13</sup>

Efforts in various control states to privatize their government-run system have percolated in recent years. So far, few of these efforts have gained much traction. As one example, lawmakers in Pennsylvania introduced a bill last year to end the government-run alcohol monopoly.<sup>14</sup> Despite over 75 percent of Pennsylvanians favoring privatization, the bill failed to advance.<sup>15</sup>

It is no secret that control state systems generate enormous profits that often go to a state government's general fund or to local municipalities.<sup>16</sup> In turn, government unions representing state-run alcohol store employees or government units that benefit from the revenue generation resist any efforts to reduce the government's role in alcohol.<sup>17</sup>

Despite these interests, it is becoming increasingly clear that control states are struggling to keep up in the modern era. Government-run alcohol stores are generally slower to innovate and less able to adapt to changing market conditions. Lawmakers will therefore need to find ways to reform control state systems if they hope to maintain their viability in the years ahead.

## What Type of Alcohol Can Be Sold in Stores?

Even in states where private retailers are permitted to sell alcoholic beverages, there remain significant discrepancies regarding what types of alcohol can be sold where. In several states, for example, grocery stores are still not permitted to sell wine or beer.<sup>18</sup> In places like Indiana, convenience stores are allowed to sell beer, but only if it is warm; licensed liquor stores are the sole entities granted the privilege of selling chilled beer.<sup>19</sup>

Another issue is where products such as canned cocktails can be sold. The alcoholic seltzer market has been exploding in recent years, showing some of the most growth of any category in the drinks industry.<sup>20</sup>

Many consumers may be unaware that so-called canned cocktails can actually be made with different bases of alcohol. Known in the drinks industry as ready-to-drink beverages



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### Government-run equals big government profits.

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(RTDs), these alcoholic drinks are often served in cans with carbonation. Many of the popular mass brands are malt-beverage based, although wine coolers and spirit-based RTDs have been increasing in prevalence.<sup>21</sup>

Given that some states only permit certain types of retailers to sell certain types of alcohol, questions have arisen about where RTDs can be sold. For instance, in a control state where distilled spirits are sold through state-run stores but beer is sold at grocery stores, where do spirit-based RTDs fit in?

All told, 47 states allow grocery and convenience stores to sell malt-beverage-based RTDs, but far fewer allow the sale of spirit-based RTDs in such stores.<sup>22</sup> (Distinctions between where types of alcohol can be sold are also seen outside RTDs. Large fireball whiskey bottles made with distilled spirits, for instance, are sold at different retail outlets in some states than mini-bottles of fireball, which are made with malt-beverage alcohol.<sup>23</sup>)

Although wine and spirits traditionally have higher alcohol by volume (ABV) levels than many beers, that is not always the case in the RTD market. A spirit-based RTD can have a 5 percent or 6 percent ABV level—on par with a wine cooler—or they could range higher.<sup>24</sup>

The various ways in which state legal regimes handle RTDs is almost infinitely variable. In Idaho, for example, the law distinguishes between alcoholic products above and under 14 percent ABV.<sup>25</sup> Products under that threshold constitute “low proof spirit beverages” and are treated like wine, which means grocery stores can sell them.

In Ohio, alcoholic drinks under 21 percent ABV can be sold at such stores.<sup>26</sup> In Michigan, products can be sold in grocery stores if they are packaged in a metal container and under 13.5 percent ABV (or under 10 percent ABV for any other type of container).<sup>27</sup>

In contrast, other states do not distinguish based on ABV level. Under current California and Texas law, spirit-based RTDs are treated like traditional distilled spirits, meaning that only those retailers that are licensed to sell liquor can sell them. The disparity in the number of wine and beer outlets versus liquor stores in these states—there are only around 3,000 package liquor stores in Texas, compared to tens of thousands of beer and wine outlets—can significantly handicap consumer access to such products.<sup>28</sup>

As noted, determining how to treat products like spirit-based RTDs can be particularly important in control states. Because many control states have only a few warehouses for housing alcohol products, there is little room to store additional products like RTDs that are growing in popularity. This is one reason why states like Vermont have recently passed laws taking spirit-based RTDs out of the state warehousing system and allowing them to be sold in any location where beer and wine are sold.<sup>29</sup>

Determining how and where various types of alcoholic products can be sold is likely to remain an ongoing issue in state capitals across the country. In California, pending legislation would allow spirit-based RTDs under 10 percent ABV to be sold in the same places as beer and wine.<sup>30</sup> In Texas, a bill was recently introduced that would allow spirit-based RTDs under 17 percent ABV to be sold by beer and wine retailers.<sup>31</sup>

The modern consumer demands greater access and ease when it comes to shopping. Requiring a shopper to enter a government-run store for vodka after a grocery run appears to be increasingly untenable in today’s marketplace.

Expanding consumer choice by clearing away difficult-to-understand distinctions should be a focus for policymakers in the coming years. Instead of the complicated and highly nuanced alcohol stores of yesteryear—which may or may not carry a particular product, depending on what state you live in—alcohol should seek to move toward a single-stream model where consumers have a bevy of available options.



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## Where Can Alcohol Be Placed Inside a Store?

Another recent phenomenon in the alcohol space is the rise of so-called “crossover products,” which are alcoholic beverages made by companies that have not traditionally made such products. For instance, PepsiCo recently launched Hard Mountain Dew, a spiked version of Mountain Dew.<sup>32</sup> Coca-Cola joined the fray with its Topo Chico Hard Seltzer.<sup>33</sup>

PepsiCo’s advertising campaign for Hard Mountain Dew may urge drinkers to “freak out responsibly,” but one of the main freak-outs has been inside the grocery store.<sup>34</sup> That is because non-traditional companies entering the alcohol space raises questions regarding a number of long-held assumptions about alcohol retailing.

One of the longstanding prohibitions in alcohol retailing is the restriction on “slotting fees,” which are monetary incentives for retailers to carry or give preference to a certain alcoholic product.<sup>35</sup> This can include alcohol producers or wholesalers paying retailers to display certain products in more visible places on a shelf. The import of these restrictions is that the placement of alcohol products in a store is supposed to be determined by the retailer without undue outside influence.

Any alcohol producer or wholesaler found violating these rules can be subject to strict enforcement penalties from the federal Alcohol and Tobacco Tax and Trade Bureau or state alcohol regulators. Slotting fee prohibitions, however, are not prevalent outside the alcohol industry, which raises concerns over whether soft drink companies making crossover products could sidestep these restrictions.

These concerns do not appear to be totally unwarranted, as numerous images have circulated of grocery stores in which products like Hard Mountain Dew have been displayed next to kids’ toys.<sup>36</sup> Whereas beer, wine and liquor are usually confined to the alcohol aisle, it is unclear whether cross-over products might start appearing alongside energy drinks and water bottles.

Slotting fee restrictions trace their heritage back to concerns over so-called “tied-houses” in the immediate post-Prohibition era.<sup>37</sup> At that time, policymakers were worried that large alcohol producers would exert undue influence over alcohol retailers, coercing them to carry certain products over others, resulting in a tied-house. By barring slotting fees, the government could theoretically mitigate the means by which retailers could be cajoled into preferencing some products over others.

These types of rules may have made sense a century ago, but they struggle to reflect the modern marketplace. Today’s alcoholic beverage market is as fragmented as it has ever been, with consumers showing a distinct preference for diversity and choice in the drink aisle.<sup>38</sup> Recently, Virginia became the first state to consider legislation specifically aimed at this issue, clarifying that crossover beverages could not be sold next to soft drinks inside grocery stores.<sup>39</sup>

Allowing alcoholic products to be displayed in more parts of the store—or even permitting producers or wholesalers to create unique display arrangements or provide modest financial incentives for displaying alcohol—will not inherently result in widespread societal harm. Hardly any other product is subject to such restrictions, and stores strictly prohibit any alcohol sales to consumers under 21.

To the extent that slotting fee prohibitions continue to exist, however, alcoholic beverages should be treated equally. Allowing one type of product to skirt slotting fee restrictions merely because it began outside the alcohol industry makes little sense and creates a host of unintended consequences. Whatever the rules, similar products should be treated in a similar way, and as more entities expand into the alcohol space, modern grocery store layouts will become more contentious.

### KEY TAKEAWAY

**Today’s alcoholic beverage market is as fragmented as it has ever been, with consumers showing a distinct preference for diversity and choice in the drink aisle.**

## How Does Alcohol Get to the Store?

A final issue involves how alcohol arrives at the store. In most retailing sectors, logistical innovations such as centralized warehousing and transshipping are commonplace mechanisms that stores use to keep their shelves stocked. These practices, however, remain largely prohibited in the alcohol realm.<sup>40</sup>

Centralized warehouses, often found in industrial parks, are located in a geographically strategic area and serve multiple nearby stores. Retail outlets usually stand in more expensive urban or suburban areas, meaning they are limited in size and the amount of inventory they can house. Centralized warehousing allows access to large amounts of inventory whenever shelves need to be restocked.

Transshipping occurs when one retail outlet ships goods directly to another retail outlet—rather than having to first ship the product back to the warehouse and then to the new store. Allowing stores to ship products directly to one another can enhance supply chain efficiency, especially if two retail outlets under common ownership are located near each other and one is running low on a certain product.

Both centralized warehousing and transshipping are illegal in many states when it comes to alcoholic products.<sup>41</sup> Texas forbids alcohol retailers from storing beer anywhere except on the retailing premises, which effectively forecloses the possibility of off-site warehousing.<sup>42</sup> Illinois prohibits both off-site alcohol storage and transfers between outlets.<sup>43</sup> Washington State allows a limited amount of wine to be transferred between stores, but no other type of alcohol.<sup>44</sup>

The three-tier system of alcohol distribution further complicates this issue by requiring that all three tiers of the alcohol market—producers, wholesalers and retailers—be legally separate entities. This means that, in many locales, only wholesalers can warehouse and store alcohol—not retailers.<sup>45</sup> In control states, the government often operates the state's only alcohol warehouses, or uses a very small number of authorized agent warehouses to store all liquor sold in the state.<sup>46</sup>

It is reasonable to wonder why centralized warehousing and transshipping cannot expand to alcohol. While largescale reforms to the three-tier system may not occur in the near future in most states, marginal updates to state laws that allow retailers more flexibility to store and transfer products are common-sense reforms that could ease supply-chain disruptions and frustration in the alcohol marketplace.

## Conclusion

The various brick-and-mortar retailing issues outlined in this paper—not to mention the rise of alcohol delivery—show that the alcohol marketplace is rapidly changing. Whatever one's feelings about these changes, the reality is that these issues are here to stay.

Modern public policy problems deserve modern public policy solutions, and alcohol's place and status inside the store is evolving. A baseline principle of equity and streamlined access can provide a lodestar for lawmakers in the year ahead, as well as a forward-thinking posture focused on clearing away antiquated structures that arbitrarily hamper innovation in the growing drinks sector.

The alcohol marketplace is facing pressing issues that deserve real, thoughtful attention from lawmakers, not band-aids thrown on a near 100-year-old legal edifice. The years ahead will determine whether governments rise to meet the challenge.



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## About the Author

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