

---

# A KING OF BEERS?

CONCENTRATION OF POWER OVER  
AMERICA'S ALCOHOL MARKETS IS BAD  
FOR CONSUMERS. IT ALSO IMPERILS  
CONSTITUTIONAL AND MORAL  
BALANCES.

A REPORT BY THE  
MARKETS, ENTERPRISE, AND RESILIENCY  
INITIATIVE

---

NEW AMERICA FOUNDATION

December 2012

## CONTENTS

---

EXECUTIVE SUMMARY.....	i
I. A NOTE ON MARKETS AND MORALITY.....	1
II. THE DANGERS OF MONOPOLY.....	3
III. THE MARCH TO MONOPOLY.....	7
IV. GUTTING THE MIDDLE TIER.....	14
V. LAST CALL.....	23
VI. REFERENCES.....	24

## EXECUTIVE SUMMARY

---

In some respects, America's market for beer has never looked healthier. Where fewer than a hundred brewers operated a generation ago, we now can count more than 2,000, producing a mind-boggling variety of beers. Yet just below this drinkers' paradise, we see a market that has never been more closed. Two giant firms — Anheuser-Busch Inbev and MillerCoors — now control some 90 percent of production. At the same time, a few giant retailers — led by Costco — are rolling up control over sales. This concentration is already diminishing real variety in much of the country. Worse, the giants are breaking down a decades-old regulatory regime designed to ensure local control over alcohol sales and to prevent big companies from pushing cheap alcohol onto society. These changes hurt almost all Americans. For consumers, it will become harder to get that special craft beer. For independent brewers, it will become harder to get to market and to scale up business. For society, it will become harder to control where, when, how, and to whom beer and liquor is sold, and at what price.

Almost 80 years ago, after the grand failure of Prohibition, the American people carefully designed a practical way to regulate the sale and consumption of alcohol. Citizens wrote this balanced approach — which promoted responsibility in the community and in the individual — right into the Constitution, in the form of the 21<sup>st</sup> Amendment. Now, a few immensely powerful corporations have taken it upon themselves to reengineer these balances, in order to better serve their private interests. We therefore believe the time has come for federal, state, and local authorities to address this concentration of power and to protect the three-tier system.

## I. A NOTE ON MARKETS AND MORALITY

---

In recent years it has become fashionable on the Right to argue that unconstrained “free market forces” naturally result in morally “good” outcomes. The great moral dangers of our time, so this thinking holds, are posed by those who seek to regulate “the market.” Much of the Left, by contrast, bemoans America’s “everything’s for sale” culture. The only way to promote morally good outcomes, these philosophers contend, is to shield as much of our lives as possible from markets, and thereby avoid any contaminating contact with money and commerce and competition.<sup>1</sup>

These two opposed ideas, each in its own way, are profoundly wrong. To hold that the “free market” is some sort of natural, mechanical deity that automatically establishes a just moral order is to dismiss human reason and the great political lessons of American history. To hold that humans can somehow escape competition and degradation by isolating themselves from markets is to dismiss human nature, to betray a profound ignorance of the pathways of power, and to ignore the political and economic benefits of open markets.

The practical problem is not that both sides miss the mark so widely. It’s that the debate between these two extremes obscures a vital truth: that how we structure a market always affects moral (as well as political) balances; and that the political act of consciously designing a market requires us to confront questions that are largely moral in nature.

Nowhere has this been demonstrated more clearly than in the design of America’s formal markets for beer and alcohol, built with care after the many failures of Prohibition. The 18<sup>th</sup> Amendment aimed to eliminate the sale and public consumption of alcohol. What Prohibition actually encouraged was the systematic corruption of government at all levels and a collapse of respect for the law.

The immediate goal of those who promoted repeal was therefore to reduce this corruption and lawlessness. Their longer-term goals were to empower the individual to develop “self control”<sup>2</sup> and to ensure that the community enjoyed the power to enforce local control over where, how, when and to whom alcohol would be sold.

That’s why citizens used the 21<sup>st</sup> Amendment – which repealed Prohibition – to distribute control over the sale of alcohol among the 48 states, and why the citizens in many of those states then seated the power to regulate alcohol in the individual community. That is also why the citizens of each state carefully divided the market for beer and wine into three tiers, designed to completely separate the activities of the retailer, the distributor, and the brewer and distiller.

This “intentional fractionalization”<sup>3</sup> of the market ensured that no company could consolidate sufficient power to push its product on the individual or the community, or to effectively oppose regulations or taxes. The single most important outcome was precisely to ensure that communities could, with relative ease, adjust their controls as the attitudes of citizens or the social situation changed.

This Report should be viewed as a first attempt to discuss a complex but fundamentally important issue that has been too long ignored or misunderstood by lawmakers. At no point do we intend to imply that any one company or any individual executives is in any way acting outside the law. On the contrary, the problems we describe derive not from bad actions by any company or individual but from flaws and loopholes built into our laws over the course of years. If the reader is to take away one lesson, it is that making markets always also involves moral and political choices. Hence we, as individual citizens and as a society, have a responsibility to regulate our markets consciously, with care, to ensure they deliver the moral and political outcomes we desire.

## II. THE DANGERS OF MONOPOLY

---

The twin spires of St. Barbara's, in Bushwick, Brooklyn, are visible for miles around. Opened in 1910, the cream-and-white Catholic church—a baroque wedding cake of a building—has ever since been a symbol of the neighborhood. But it might also serve as a secular warning.

At the turn of the last century, Bushwick was the center of New York's beer industry. More than 40 breweries called the area home; their lagers (for Bushwick was solidly German at the time) slaked the thirst of workers throughout the Northeast; and their profits built St. Barbara's and a dozen other civic edifices.<sup>4</sup>

Today, many of those grand buildings remain. But the breweries and the vigor of Bushwick have long since fled, and though creative young entrepreneurs have recently begun moving in, claims of community rebirth ring hollow. Bushwick, behind the old facades, is an empty shell.

Think of the contemporary mainstream beer industry as Bushwick.

To an innocent observer, times have never been so good for the American beer drinker. The shelves of your average gas-station convenience store offer not just Bud and Busch and Miller and Coors but Stella and Hoegaarden and Shock Top and Rolling Rock. At any decent grocery, Kirin of Japan sits beside Boddington's of Ireland, Peroni of Italy beside Pilsner Urquell of the Czech Republic. Basses eye Red Hooks in the lea of Goose Islands. Blue Moon looks down on it all, smiling upon this new world of choice.

But, as with the grand edifices of old Bushwick, this world is far more hollow than it first appears. Two companies—Anheuser-Busch InBev (ABI) and MillerCoors—own, produce, control or have distribution rights to all of these brands and dozens more. A market that not long ago was divided among scores of independent regional breweries is now dominated by two global giants, which directly control some 80 percent of beer sales in this country.<sup>5</sup> Four others, Crown Imports/Corona, Pabst, Heineken, and Diageo (which controls Guinness), account for a further 12 or 13 percent.<sup>6</sup> (And to be honest, much of this activity is also governed – albeit somewhat less directly – by the big two. Grupo Modelo, one-half of Crown Imports/Corona, is itself half-owned by ABI. Pabst, for its part, does not in fact brew its own beer: That process is contracted out to MillerCoors.<sup>7</sup>)

All the rest—the nearly 2,000 independent craft breweries that give so much appearance of bustle to the beer market—share less than 6 percent of the market.<sup>8</sup>

From the point of view of the American beer drinker, this is a problem.<sup>9</sup>

First, without true diversity of producers, true diversity of choice is no longer protected by the balancing powers of the open market. ABI and MillerCoors, by virtue of their duopoly power, can manipulate the market to their needs—and consumers often have no recourse, no way to punish this behavior, by taking their custom elsewhere.

Second, by its nature, intense consolidation deforms the entrepreneurial landscape. Innovative newcomers can find it hard to enter any market dominated by a few major

players, and even mid-size established players can find it harder to stay alive. And much of the reason has little to do with Economics 101’s lessons about how large size creates natural economies of scale, lowering per-unit costs and generating other efficiencies. Rather, by virtue of their dominant position, ABI and MillerCoors are able to apply power within the three-tier system in ways that favor them and hinder their smaller competitors.

Third, extreme consolidation among brewers tends to result in the classic problems of higher prices and less real choice. This is not just theory. Immediately after the Brazilian-Belgian company Inbev purchased Anheuser-Busch in 2008, a years-long price war between A-B and MillerCoors came to a sudden end, and the two giants soon began to raise their prices in concert (during the worst economic downturn since the Great Depression).<sup>10</sup> And ABI and MillerCoors continue to expand their holdings. In May 2011, ABI purchased one of the more successful craft brewers, Chicago’s Goose Island, adding this to a portfolio of captive craft labels that includes Red Hook, Widmer, and Rolling Rock. In June 2012, ABI announced an intention to take full control over Mexico’s Grupo Modelo, which brews Corona. (Market dominant firms do not, however, always use their power to drive up prices. On the contrary, as we will see later in this Report, they sometimes use their powers to drive some prices down, for strategic reasons.)

But the consolidation of power over the American market for beer is not merely—or even mainly—a matter that should concern the consumer. Just as disturbing, this consolidation of power now threatens the delicate moral, economic, and political balances struck 80 years ago when the American people abandoned their efforts to entirely ban the sale and consumption of alcohol.

*Ten Popular Brands  
Controlled by ABI or  
MillerCoors:*

- Red Hook
- Widmer
- Goose Island
- Corona
- Old Dominion
- Leinenkugel
- Blue Moon
- Shock Top
- Terrapin
- Rolling Rock

Since the 21<sup>st</sup> Amendment to the Constitution put an end to Prohibition in 1933, commerce in liquor in the United States has been regulated mainly by state and local authorities. Thus the existence of dry counties and blue laws; of states where liquor is sold only in government-run stores, as in New Hampshire; and of states where you can buy hard liquor at the grocery, as in Washington. But all share a common regulatory feature: Liquor producers cannot sell their wares directly to consumers or to retailers. They must go through intermediaries—through distributors and wholesalers.

This three-tier system was designed to prevent a return to the conditions that prevailed before Prohibition. Then, vertical integration of the liquor industry was the norm, and its results—cheap booze, unregulated sales, monopoly practices, the corruption of politics by industry money—had created a national crisis.<sup>11</sup>

To contemporary eyes, trained to associate low prices with giant consolidated retailers like Walmart and Amazon, the three-tier system may appear to be very “inefficient,” and likely to result in higher prices for alcohol than would otherwise exist. But the citizens who designed the three-tier system did not consider the question of efficiency — or any other economic measures — in isolation from politics or society. Rather, their primary aim was

to shape a market in which even a small community could exert effective control over the sale of alcohol. The breaking of the industry into three distinct sets of activities, they believed, would safeguard against the rise of national and local monopolies able to bully or corrupt local governments.

What is more, in practice, the three-tier system has actually proved to be remarkably efficient, as measured both by the variety and quality of the product delivered to consumers, and by price. This is not surprising, given that the system was designed precisely to promote strong competition at all three levels of activity — among brewers, among distributors, and among retailers. In most communities, the actual price paid at retail was engineered outside the market, mainly through the enforcement of minimum pricing laws and the application of taxes.

It is this system of community control and of distributed power that America's two beer goliaths are now attempting to overturn. Having consolidated horizontally about as far as they can go, they are turning their eyes vertically. Production is locked up. The next step is to capture distribution. (That said, wire services over the last two years repeatedly reported rumors that ABI intended to acquire MillerCoors.)

Of the two giants, Anheuser-Busch InBev — by far the larger — also appears to be the more aggressive actor. Since the merger that created the global giant was completed in November 2008, distributors nationwide have reported increasing pressure to stop carrying the products of rival brewers, increasingly heavy-handed efforts to control their management decisions, and other efforts to influence a segment of the industry that the American people — 80 years ago — made clear should be entirely off-limits to such interference. This includes a highly developed effort by ABI to push its distributors to merge with one another, to form fewer and bigger players. The company has even written a “Consolidation Guide” to explain to the members of its “wholesaler family” exactly how they should go about merging with one another and linking the resulting operations more closely with ABI.

The beer goliaths are not alone in their assault on the middle tier of independent distributors. A similar process is being driven — albeit from a different angle — by a few giant chain stores. Costco especially has moved aggressively to overturn the balances established after Prohibition; for instance, by spending more than \$20 million to promote a referendum to privatize and restructure Washington state's regulatory system, in ways that give the company far more direct control over both distribution and sales.<sup>12</sup> (Costco has long been the dominant seller of wine in the United States.<sup>13</sup>)

This radical move by super-giant retailers threatens to worsen one of the main effects of ABI's attack on the three-tier system: a decline in real variety (and even, as a recent BusinessWeek article made clear, quality<sup>14</sup>) in certain locales around the country. The Costco-backed referendum in Washington, for instance, legalized “pay to play” shelving schemes, which allow retailers to charge producers for access to their shelves. Such schemes strongly favor more powerful players, who have the capital to spend to assure such access.<sup>15</sup>

The super-giant retailers are also working hard to clear the way for the introduction of an altogether different sort of danger: much lower prices on some alcoholic products. In Washington State, for instance, the referendum cleared the way for retailers to engage in volume discounting of alcoholic beverages, allowing better-capitalized stores to sell the same product at a lower price. The giant retailers are promoting similar efforts to break down traditional pricing regimes in other states as well, including Connecticut. Although such use of power to lower prices runs directly counter to what most people expect from market dominant firms, this is not an uncommon problem. As we will see in more detail later in this report, giant firms have often used their power to drive down the price of some product or other, as a way to drive smaller retailers from the market or perhaps as part of a strategy to lure more customers into a store, in order to sell them other, more expensive, products.

It's easy to spot who would win from this blitzing of America's traditional beer and alcohol market structure. The move would undoubtedly be good for ABI and Costco executives. It would also serve certain classes of investors. Analysts at giant investing houses, including UBS and Morgan Stanley, strongly support the attempt to take over — or in their parlance, “rationalize” — America's markets for alcohol. They have even put a value on the prospect: \$2 billion in additional earnings.<sup>16</sup>

It's also easy to spot who would lose. Beer consumers stand to be left with about as much as Bushwick has: fading memories of the good days, when they could look forward to more real variety and quality in their beers. The result looks to be even worse for the American citizenry as a whole, who, absent immediate action by their elected representatives, will be forced to watch silently as a few giant companies — two of which, ABI and Miller, are foreign controlled — effectively deconstruct a market system engineered with such great care, for their own financial benefit.

### III. THE MARCH TO MONOPOLY

---

Without an understanding of the beer market prior to the Anheuser Busch-InBev merger, the radical nature of ABI's efforts to "rationalize" the system cannot be fully appreciated. To that end, a little history is in order.

On December 5, 1933, the 21st Amendment to the U.S. Constitution was ratified, ending 14 years of Prohibition. Its operative language was succinct:

*Section 1. The eighteenth article of amendment to the Constitution of the United States is hereby repealed.*

*Section 2. The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.*

The first section made the production, sale, and consumption of alcohol again legal in the United States as a whole.

The second section gave independent control of those activities to the states themselves.<sup>17</sup>

This was done in part simply to ensure the successful ratification of the amendment. Citizens wanted the ability to control when, where, how, and even if alcohol would be sold within their own communities.<sup>18</sup>

But Section 2 was broadly motivated by a genuine desire to construct a system of markets able to prevent some of the demons of the earlier alcohol industry from coming back. Before Prohibition, alcohol interests of all sorts enjoyed sufficient power to overwhelm most local regulators. A prime goal of the authors of the 21<sup>st</sup> Amendment was, therefore, to prevent any recurrence of the "corrupt legislative activities" and "insolent intrusion into our political life" of the pre-Prohibition distillers, brewers, and saloon keepers.<sup>19</sup>

The reformers were especially keen to break up the system of so-called tied houses, through which brewers and distillers subsidized bars in exchange for the exclusive right to sell in them, generating vertical monopolies that stifled enterprise and concentrated corporate political power. Tied houses also tore the social fabric. *Toward Liquor Control*, the seminal 1933 work promoting a sensible end to Prohibition and a new regulatory system for alcohol, put it succinctly:

*The 'tied house' system had all of the vices of absentee ownership. The manufacturer knew nothing and cared nothing about the community. All he wanted was increased sales. He saw none of the abuses, and as a non-resident he was beyond local social influence. The 'tied house' system also involved a multiplicity of outlets, because each manufacturer had to have a sales agency in a given locality. In this respect the system was not unlike that used now in the sale of gasoline, and with the same result: a large excess of sales outlets. Whether or not this is of concern to the public in the case of gasoline, in relation to the liquor problem it is a matter of crucial importance...*

As for the moral issues, quaint though the idea of temperance sounds today, the concerns of that movement were thoroughly justified. Free to market what they wanted how they wanted to whomever they wanted, producers and their tied houses poured cheap booze<sup>20</sup> into communities coast to coast, sweetening the doses with enticements ranging from rebates on drinks to cheap sleeping quarters and even cash loans, and frequently tolerating in-bar gambling and prostitution. Vice and alcoholism tore especially at the more vulnerable segments of society—the poor, the working classes—at a time when even the most rudimentary social safety nets were lacking. This was America’s pre-Prohibition drinking culture, and its resurrection is what Article 21, Section 2 was intended to prevent.

In practice, it did so largely by fostering the three-tier system.

An enormous amount of study and thought had gone into the repeal effort, and one nearly universal conclusion was that breaking up the tied house system was crucial to the safe reintroduction of drinking.<sup>21</sup> How best to do so was a matter of debate: citizens in some states opted to use the government to control alcohol sales, while in other states citizens chose to license private sellers. But citizens in all 48 U.S. states agreed that in no case should alcohol producers be allowed to sell directly to the public, nor to retail outlets. A middleman would be required. Thus was born the three-tier system, in which producers may only sell to independent wholesalers (also known as distributors), who may only sell to retailers.

As envisioned by the architects of the 21<sup>st</sup> Amendment, in the years following repeal, almost all states that resumed alcohol sales also passed companion laws that enforced a three-tier market structure, using the licensing of distributors as a way to separate the production of alcohol from its sale in bars and stores. (In a few states, the sale of beer was not thus regulated, largely because at that time, the small size of most breweries meant they already relied on distributors to get their goods to market. As will be shown, this old loophole has become a major contemporary problem.)

*The three-tier system aimed to address the political, economic, and moral risks of an unfettered alcohol industry.*

The three-tier system was a direct effort to address the political, economic, and moral risks of an unfettered alcohol industry. It aimed to prohibit, by law, vertical integration of the industry, with the goal of making it impossible for alcohol makers to push their products into communities with the freedom they had enjoyed in pre-Prohibition days.

Political order was to be protected by fracturing the industry into multiple levels, each with its own, often competing political aims. Such division of functions, the reformers believed, was the only way to create a “transparent and accountable system” characterized by effective checks and balances. Further, such breaking up of power along both vertical and horizontal lines would make it far easier for communities to design regulations that resulted in a “proper balance” of power at each level of the industry.<sup>22</sup>

Economic order, meanwhile, was to be maintained through the system's creation of a web of markets between producers and consumers. Producers would compete for the attention of wholesalers; wholesalers seeking new offerings would encourage proliferation of producers; retailers wanting variety would encourage wholesalers to diversify their inventories; and customers, given choices, would act on their unpredictable and ever-changing preferences, keeping the engine of commerce ticking over.

Finally, moral order was to be encouraged by cutting the direct line between producer and consumer, by granting state and local authorities the right to regulate sales according to community standards, and ultimately by returning control over the decision as to whether, when, where and what to drink to the individual citizen, who was now expected to exercise "self control" and a reasonable "temperance."<sup>23</sup>

An attractive vision. And, it almost goes without saying, one that never fully materialized. Shorn of their tawdry tied houses, brewers and distillers found new ways to attract clients and offend moralists. Politics was of course not immunized to alcohol industry money; the money just came in different packages. The local and state licensing of wholesale franchises often became a corrupt process. And many individuals failed – then and now – to exercise self-control and temperance. No honest history of the modern alcohol industry can ignore these realities.

But no one ever expected the three-tier system to be perfect. The primary goal was simply to disrupt the ability of well-capitalized firms to concentrate horizontal and vertical control over large swaths of the alcohol industry, either at the national or local level, to a degree that enabled them to wrest ultimate control over the business of selling alcohol from the hands of the community. And that goal was met.<sup>24</sup>

This is not to claim that consolidation did not occur. From a high of 766 two years after Prohibition was repealed, the number of independent American brewers fell steadily to 476 in 1945, 126 in 1965, and 52 in 1975.<sup>25</sup> Nonetheless, vigorous antitrust enforcement ensured that dozens of large, independent beer brewers continued to feed the American market.<sup>26</sup> And no matter how big any of the brewers became, they were still separated from the consumer by more than 4,500 independent wholesalers and innumerable local retailers.<sup>27</sup>

#

In the 1970s two pieces of legislation were passed that unloosed the forces that have led to the revolutionary transformation of America's beer industry.

On December 12, 1975, the Consumer Goods Pricing Act became law.

And on October 14, 1978, Congress approved House Resolution 1337.

The Consumer Goods Pricing Act made it more difficult for producers to set the prices of their goods at retail, a practice widely instituted during the Great Depression to prevent price wars.<sup>28</sup> The logic of the CGPA was simple: The practice of allowing producers to set

their own prices limited certain types of price competition, and so could be viewed as “hurting” consumers in an economic sense.<sup>29</sup> This thinking also resulted in a drastic move away from enforcement of a related pricing law, the Robinson-Patman Act of 1936, which was designed to ensure that no big retailer or producer could engage in systematic price discrimination to favor some of its customers and disfavor others. But as with most laws that affect markets, the CGPA and the de facto abandonment of Robinson-Patman had unintended consequences, both in the economy at large and in the beer industry. No longer required to set across-the-board prices for their goods, breweries instead learned how to use price discrimination to manipulate the much smaller wholesalers, extracting more favorable terms, brand support, and profit by offering lower prices to wholesalers that did their bidding. Breweries could, for instance, threaten to charge one wholesaler more than another for some especially popular brand of beer, as a way to force that wholesaler to drop a competitor. Conversely, brewers were now free to offer lower prices to a wholesaler in exchange for a promise to push a given brand more forcefully than the brands of a competitor. This ability to use pricing to “discriminate” among wholesalers gave producers another valuable return: detailed knowledge of what any particular wholesaler considered to be its minimum acceptable margins. The brewers were then free to use this information to whittle steadily away at the slice of pie left for the wholesalers.

*One change in law revitalized competition. Another change in law made monopolization a threat again.*

H.R. 1337, meanwhile, made it legal to brew beer at home — to a limit of 100 gallons per adult, or 200 gallons per household, per year — without a license.

Home brewing had long bubbled away nicely in the shadows of America’s drinking industry, especially during Prohibition and the back-to-basics revival in the 1960s. But now home brewing quickly surged into the mainstream. The American Homebrewers Association was founded in December 1978, less than two months after legalization; its first national competition was held just six months after that, in May of 1979. A subculture was becoming a culture, and enterprise soon followed. The 1980s saw a boom in licensed, professional craft brewing, with the founding (among others) of such well-known brands as Sierra Nevada (1980), Samuel Adams (1984) and Harpoon (1986). Smaller brands and brewpubs added to the mix.

So on one hand, a change in law had revitalized competition in the industry and dramatically increased the diversity and quality of consumer choice. On the other, a change in law had opened the door to monopolization: Big brewers had been freed to use price discrimination to undercut competitors or to coerce wholesalers into keeping competitors off the market. Had nothing more been done, it is possible to imagine the two acts balancing each other out, with the most dramatic effects of price discrimination matched by aggressive enforcement of antitrust.

But something more was done. In January 1981, Ronald Reagan became president, and at his administration’s direction the Justice Department cut back enforcement of U.S. antitrust law. Slashed budgets for both the Justice Department and Federal Trade Commission

further limited antitrust efforts.<sup>30</sup> The result was an unparalleled period of consolidation across virtually all U.S. industries. In banking and investing; in marketing and retail; in steelmaking and construction; in technology and data control; for thirty years, the big few were left free to eat the many.

And so it proved also in the beer industry. In 1980, at least 48 major breweries served the 50 states; today, again, there are *two*.<sup>31</sup> The beer industry, however, is unique in that the consolidation process was accompanied by a boom in the launch of new, tiny ventures. Hence the apparent paradox of today's beer industry: that it is simultaneously a riotous jungle of thousands of brands, and a barren desert ruled by a duopoly.

#

To get a sense of how the abandonment of antitrust enforcement affected the beer industry, consider the following four quick case studies of consolidation—and how the four resulting giants were themselves then consolidated:

Stroh Brewery Company, founded in 1850, entered the 1980s as the eighth-largest brewery in the nation. But after a sleepy first 130 years, during which it marketed a single brand, director Peter Stroh had come to recognize that "it's either grow or go." And released from regulatory constraints by the new Reagan regime, grow they would. In 1981, Stroh bought Schaefer, a big New York regional, and moved to seventh. Two years later, Stroh took over Schlitz, vaulting to fourth place. Recognizing the potential of craft beers, Stroh bought Augsburger in 1989. G. Heileman, then the fifth-largest brewer in America, followed in 1996. (Its top brand: Colt 45 malt liquor. Heileman also produced Pabst Blue Ribbon on contract.) During this time Stroh also formed partnerships to make and market its products in India and Japan, launched several new specialist labels of its own, and contracted with (among others) Boston Brewing, to make some of its Samuel Adams, and Pete's, to make its Wicked Ale. Its position as a major player, perhaps even as a challenger to what had become the Big Three (Anheuser Busch, Miller, and Coors), seemed assured.

Coors had long been famously cautious, even secretive, in its business dealings. And it seemed to have worked. As the Reagan era began, Coors was the fourth-largest brewer in America, with a reputation for high quality and an almost chic image in the vast East Coast market as a great beer you could buy only west of the Mississippi. Which was true until 1981, when Coors finally crossed the river. That signaled the beginning of a decade of aggressive growth, including the introduction of budget beers Keystone and Keystone Light and the launch of Killian's Irish Red, a defunct Irish brand that Coors bought the right to brew in the States. The introduction of Zima (a clear, citrusy, carbonated malt beverage marketed as an alternative to beer) in 1992 seemed to signal an expansion into non-beer products. But even as that market grew, Coors took its core business international in 1994 with the purchase of El Águila in Spain and the founding of Jinro-Coors in South Korea. The following year saw the introduction of Coors-owned SandLot Brewery at Coors Field; the main product, Blue Moon, would go on to great success. And in 1997, Molson, Foster's, and Coors partnered to bring the Silver Bullet to Canada for the first time. With 10.7 percent of the market, Coors was now number three.

Miller entered the 1980s riding the tremendous success of its innovative Miller Lite brand. Already the second-largest brewer in America, the company was determined to topple Anheuser-Busch from the top spot, and started its effort by purchasing the distribution rights to Löwenbrau, a venerable German marque that soon chipped away 10 percent of Anheuser's Michelob market. With varying success, Miller then attempted to take on other Anheuser brands by introducing the "value priced" Milwaukee's Best and Meisterbrau lines and the premium-priced Miller Genuine Draft. In 1988, the company entered the craft market with the purchase of Jacob Leinenkugle, and in 1992 it bought distribution rights to and 20 percent of Canada's Molson. Distribution rights to Foster's and several other top imports followed later in the decade. Still number two, Miller had nonetheless increased its share of the market to a sturdy 21 percent.

Anheuser-Busch, like Coors, was run by a family famous for its intensely private control of its business. (Its president as the 1980s began was August Busch III, the fifth successive member of the clan to hold that post.) The company entered the Reagan era as the number one brewer in America, and despite aggressive competition, it spent the next decade consolidating that position. Although a 1994 partnership with Red Hook got A-B a foothold on the craft-brew side of the business, it grew mainly by leveraging its size, particularly via internal brand diversification, and by forcefully expanding its presence abroad. A 1986 partnership with Guinness brought it to Ireland; 1993 saw it move into Japan with a partnership with that country's number one, Kirin. That same year, A-B bought 50 percent of Mexico's giant Grupo Modelo, instantly giving it the dominant position both in Mexico and in the American market for Mexican imports. Also that year, Anheuser bought its first 5 percent stake in China's top brewer, Tsingtao, on its way to an eventual 27 percent holding (A-B sold off its Tsingtao stock in pieces in the 2000s.) Two years later, the company bought 80 percent of a second Chinese brewer, Zhongle, and secured the majority position in a new company there, Budweiser Wuhan. The 1996 purchase of 11 percent of Compania Cervecerias in Argentina gave A-B a strong foothold in South America. (One analyst noted at the time that "Argentina is next to Brazil...and on a long-term basis, Brazil is very much in Anheuser's plans." This would prove true, although not for another decade and not in the expected way.) As the 1990s drew to a close, Anheuser-Busch remained by far the top brewer in the United States, having captured a whopping 50 percent of the market and having doubled its annual production in less than 20 years, from 50 million barrels in 1980 to 100 million in 1997.<sup>32</sup>

*Anheuser Busch's  
annual production  
more than doubled  
in less than 20 years.*

It is a testament to the size of the global beer market that even those eye-popping mergers left vast opportunities for other companies to play the same game. Three are of interest here.

In 1987, two of Belgium's leading brewers, Artois and Piedboeuf, joined together as Interbrew. For fifteen years Interbrew quietly bought up dozens of other brands, and by 2001 it was the second-largest brewer on the planet.<sup>33</sup>

In 1999, Brazil's two largest brewers, Antarctica and Brahma, joined forces as AmBev, instantly dominating that country's market and moving quickly to buy up smaller brands throughout South America.<sup>34</sup>

And throughout the 1990s, South African Breweries, virtual monopolists at home with 98 percent of market, moved decisively into Eastern Europe, Russia, India, and China, establishing a formidable position on three continents.<sup>35</sup>

So the 1990s drew to a close with four major players in America and three abroad — seven giant brewing conglomerates for six billion people. The contest to own the world's beer market had entered its endgame.

In 1999, Stroh was split up and sold off.<sup>36</sup>

Six players left.

In 2002, South African Breweries bought Miller, creating SABMiller.

Five left.

In 2004, Interbrew and AmBev merged, forming InBev.<sup>37</sup>

Four.

In 2007, Molson Coors and SABMiller created the joint venture MillerCoors to produce and distribute their products in the United States as a single entity.<sup>38</sup>

Three.

And in 2008, in a blockbuster \$52 billion deal, InBev bought Anheuser-Busch, forming Anheuser-Busch InBev.<sup>39</sup>

Two.

One?

The idea that ABI might purchase MillerCoors has in fact been floated various times.<sup>40</sup> But even in the lax antitrust environment that prevails, it is almost impossible to imagine both Washington and Brussels approving a merger that would allow a single company to directly control some 80 percent of the domestic beer market and indirectly control closer to 90 percent. This means that the Big Two have, for all intents, reached the limit for horizontal expansion, and that the only direction to go now is vertical. Which, of course, is one reason the companies now target the second tier—the *central* tier—of the three-tier system. The distributors are in their sights.

## IV. GUTTING THE MIDDLE TIER

---

The vital role that wholesalers and distributors have played in promoting the rise of craft brewing in America is not hard to understand. These small firms have a natural interest in seeking out new brews that will please local tastes, thereby boosting their bottom lines.<sup>41</sup> They also have the means to help even the smallest of upstart brewers to get to market, in the form of refrigerated warehouses, delivery trucks, and close relationships with local retailers and bars. In a sense, the wholesalers and distributors serve as the most important independent brokers within the open market system. No doubt, the wholesalers and distributors do have their flaws; just ask any brewer. They have their own set of interests and rarely, if ever, treat smaller brewers like kings. But there is little doubt that, overall, both the drinker and the small producer benefit greatly from the existence of these many competing middlemen.

The effort to co-opt this distribution function — and therefore to control the process of deciding which beers flow through the distribution system, in what quantities, and at what price — takes two main forms. One is directed from above, by big retailers like Costco. The most successful of these efforts was Costco’s \$23 million effort in 2011 to convince voters in Washington state to undo the state’s traditional beer and liquor distribution system.<sup>42</sup> Similar efforts are underway in Oregon and Connecticut, among other states.

The other assault on distribution is directed from below, by the giant brewers, especially ABI. Both ABI and MillerCoors have for years insisted on mutually exclusive distribution agreements with their wholesalers—that is, a MillerCoors wholesaler cannot sell ABI products, and vice versa.<sup>43</sup> But ABI, as will be seen, is attempting to make its wholesalers exclusive of *all* competitive brands, including well-established craft-beer makers or newcomer microbrews. And that is unprecedented.<sup>44</sup>

Of the two assaults on the middle tier, the one run by the big brewers is the more extreme. Which is a big change from only a few years ago. Prior to the 2008 takeover, Anheuser-Busch was generally considered a supporter of the three-tier laws and a reliable partner to the wholesalers. “Tough but fair” is a phrase used by several wholesale-business sources to describe their dealings with the Busch family dynasty while that company remained independent.<sup>45</sup> The beer purse is large; the system worked; everyone was making money. No need to rock the boat. (ABI today continues to insist, officially, that it still supports the three-tier system. ABI’s actions, as we will see in more detail below, make plain that the giant does not support the three-tier system as originally conceived after Prohibition.)

To understand the nature of ABI today it is necessary to go back to the 1999 decision by the Brazilian government not merely to approve but to fund the merger between local beer giants Brahma and Antarctica, which created a nationally-dominant company called Ambev. As *The Economist* convincingly demonstrated in an article from that time, the deal was part of an overt state strategy to protect large swaths of Brazil’s economy from being taken over by foreign multinational corporations.<sup>46</sup> The strategy called not merely for a defensive circling of wagons, but an offensive, imperial push out into foreign markets —

one that would be supported by generous loans from the Brazilian national development bank and other state institutions.

The brains behind this particular part of Brazil's push out into the world were mainly bankers, especially from the private Banco Garantia, which *Forbes* once dubbed "the Brazilian version of Goldman Sachs."<sup>47</sup> Garantia already controlled AmBev, the Brazilian beer giant, and AmBev's chief, Carlos Brito, was a protégé of Garantia honcho Jorge Paulo Lemann. Brito is an engineer by training, and he brought an engineer's concern for precision, efficiency, and performance to the firm's financial results, if not its products. He also brought legendary ambition.<sup>48</sup>

The next step in the story of ABI came in March 2004, when headlines announced that the Belgian firm Interbrew had purchased Ambev, making itself the biggest brewing company in the world. Initially, most of the executive positions were in fact filled by Belgians from Interbrew. This was the crew that had made Interbrew number two in the world, by buying up solidly second-tier regional brands. But by the end of 2005, less than two years after the deal had closed, the Belgians were out at the top and Brito and his Brazilian executives were in.<sup>49</sup>

Almost immediately, the team set its sights on Anheuser-Busch, the doughty but grizzled king of beers. During the negotiations to buy A-B, Brito made it clear that if successful, he intended to retool the American company completely. For starters, the Busch family would have to leave. (The message was obvious enough, but InBev made sure to get public legal clarification that they could, indeed, replace the entire board of managers without cause.<sup>50</sup>) This they did after the deal went through, leaving only August Busch IV around to help with the transition—and that only with the title of non-executive director and an official role as consultant. Busch left the company for good in 2011.<sup>51</sup>

*The goal is to eliminate the presence of competitive brands in ABI's markets.*

The deal was closed in the summer of 2008, and Anheuser-Busch InBev was born. At headquarters in St. Louis, the changes were immediate.<sup>52</sup> Executive offices were literally torn out and replaced by an open floor with matching desks. The private jet fleet was put on the block. Company cars disappeared. So did 1,400 jobs, retiree life insurance, and contributions to the employee pension plan. Managerial pay was reduced to equal-or-less-than the average for similar jobs in other industries, with bonuses tied strictly to performance. Salaried workers lost little perks like two free cases of Bud per month. Even Blackberries were confiscated. Profit at all costs was the new imperative.

And so, after eliminating everything it could at home, ABI began to execute its plan to squeeze more out of the increasingly nervous distributors, and to solidify its control over the entire industry, from head (if you will) to dregs.

In practice, ABI is applying a two-pronged approach to its efforts to capture complete control over the distribution of ABI products. In those states where brewers can own distributorships, ABI is moving aggressively to buy them up. In states where this is illegal,

ABI is pressuring its distributors to consolidate and to follow ABI's recommended business practices. These range from reducing craft beer volume to publicly supporting ABI's legal and lobbying efforts to weaken the three-tier system.

In other words, ABI seeks direct control over distribution wherever possible, and settles for indirect control where necessary. The goal in both instances is the same: to gain more control over pricing of its products and more control over more of the activities in the chain leading from grain to glass. More specifically, the intent is to be able to deliver a full suite of ABI-owned or ABI-controlled products to any particular retailer, bar, or restaurant; to eliminate to as great a degree as possible the presence of competitive brands in ABI's markets; to realize all available economies of scale; to tie the production, distribution and marketing of ABI brands into a more streamlined whole; to control a greater share of the total amount of beer sold; and to make more money from every bottle.<sup>53</sup>

In his March 8, 2012, earnings call to top investors, Brito appeared to lay out precisely how this profit strategy would work:

*In 2008, we could say that the gap between [ABI's own] sub-premium and premium [brands] was around—let's say between 27 percent and 30 percent, okay? And now it's more around 23 percent. So we have made some strides in narrowing that gap. And we've said time and again that we think at least 15 percent, 20 percent, is something that we should have as a target.... We've created a healthy problem for people in that we have to think about premium-and-above brands, and that's what we're doing with Bud, Bud Light, Ultra, Stella and some high-end premium brands of ours like Shock Top, Leffe, Hoegaarden and so on. Those are the brands that we'd like to sell.*

In other words, having cobbled together a big suite of premium beers, and having raised the price of their budget brands close to that of their flagship premiums, the next step is to jack up the price of premiums closer to that of their high-end beers. ABI will present people with the "healthy problem" of choosing between its budget, premium, and high-end brands, all priced as high as the market will bear. It's a task made easier by ABI's denial of shelf space to alternative brews.

That this rationalization would come at the expense of an 80-year-old system of social and political regulation of alcohol in America, ABI appears to believe, is worth the tradeoff.

#

Given the history of the 21<sup>st</sup> Amendment, it may seem bizarre that brewers anywhere in the United States can directly own distributors. In fact, the practice is legal in about 15 states. This is largely a historical accident: as mentioned above, after Prohibition was repealed, in many states the beer industry naturally fell into the three-tier pattern, because the brewers of that era were all too small to make self-distribution a viable practice. Later, when consolidation among brewers took off, not all states enshrined strict separation between tiers in law.

Yet for a long time even the biggest of brewers tended to resist such direct vertical integration into the distribution business, even where it was legal. This was largely due to the fact that distribution is a challenging, tight-margin enterprise. The people who run distribution businesses have to manage hundreds or thousands of accounts, manage large staffs, maintain a fleet of delivery trucks, store products in expensively refrigerated warehouses, and get new stock onto shelves and remove the expired stuff (usually eating the cost as they do so). In many instances, distributors are also expected to maintain the taps at their contracted bars and restaurants. In short, they run a very complex show.

Back when they were separate companies, Miller and Coors typically allowed the distributors to keep that business, and MillerCoors has largely continued this practice (even while, of course, strongly pushing distributors to follow its preferred business model). Anheuser-Busch, when it was controlled by the Busch family, for years ran a few of its own distributorships, generally in the big urban markets. But the general practice was to allow distributors to run their own business. By contrast, ABI has made self-distribution a cornerstone of its growth plan. Since the merger, it has bought two wholesalers (with annual sales of 25 million cases) and will soon add a third.<sup>54</sup>

At the same time, as we will see in more detail later, ABI has also been very effective at gaining greater indirect control over distributors, even in those states that expressly outlaw vertical integration.

As mentioned, the switch is driven in large part by desire to increase profits and to restrict sales of smaller competitors. But it appears to be driven by another factor, as well, which is the revolutionary push by big-box retailers to expand both by increasing their horizontal control over sales and by gaining more direct and indirect control over the traders and manufacturers that supply them. In industry after industry in America, the rise of super-giant retailers has resulted in a dramatic shift of power away from even the largest of manufacturers.<sup>55</sup> Brewers can expect nothing different.

And so ABI's push into distribution is not so much an end in itself as a means to be able to protect its interest in a coming showdown with super-giant retailers, a showdown that will be inevitable in a post-three-tier world.

*ABI is no longer just the largest brewer in America. It is also the largest distributor.*

ABI expects that world to exist soon. In 2009, in a meeting with analysts from investment bank UBS, ABI's Brito revealed the company's belief that it will one day make 50 percent of its sales directly to big retailers.<sup>56</sup> Nervous spokespeople quickly declared that his statements had been misinterpreted, that ABI "has no plans to force consolidation" of the production and distribution tiers, and that its view is that such consolidation should happen naturally and "voluntarily over time."

Meantime, ABI's direct control of distribution is adding up fast. The company currently owns 14 distributorships in 10 states: New York, California, New Jersey, Ohio, Massachusetts, Colorado, Oregon, Oklahoma, Kentucky and Hawaii. It is part owner of two more, in Chicago and Miami. It will soon own a 17th, in Seattle.<sup>57</sup>

Combined, the 16 existing ABI distributors already move about 130 million cases per year.<sup>58</sup> There are ABI-owned distributors in four of the five largest states by population; these alone comprise nearly 30 percent of the nation's people.

This means that ABI is no longer just the largest brewer of beer in America. *It is also the largest distributor.*

The threat this represents—to the open market, to consumer choice, to local control of the alcohol market and the social norms protected by the three-tier system—is sufficiently serious that several states<sup>59</sup> have recently moved to close the loopholes that allowed self-distribution. Others have placed maximum brewing-capacity limits on the practice — in order to provide small craft brewers with more flexibility in how they reach the market, while keeping the major brewers under stricter control. (ABI has challenged such laws as discriminatory, and in October won a ruling allowing it to retain a 30 percent stake in the largest distributor in the Chicago market.) It is very late in the long game, but with the federal government utterly capitulating on anti-trust enforcement in production, a few states are finally reasserting their right to regulate alcohol on the distribution and sales fronts.

#

Of course, as long as ABI is free to exercise all the other forms of indirect control at its disposal, the value of these state-by-state victories will remain limited.

And indeed, no matter how effective these state actions prove to be in arresting ABI's efforts to take direct control over distribution, the giant continues to push on another front. In those states where ABI is prohibited from outright ownership of distributors, it is doing the next most efficient thing, which is to capture de facto control over them.

ABI (and MillerCoors) already enjoy an extraordinary number of ways by which to do so. Foremost is the so-called "equity agreement" that distributors must sign with brewers to lay out each sides' rights and responsibilities. With the rise of the mega-brewers, those agreements have become, in the words of one industry expert, "the most one-sided agreement that you could draft."

The big brewers typically use these agreements to reserve the right to price their goods as they alone see fit. And as we saw earlier, they use such price discrimination as both carrot and stick, punishing some distributors with higher unit costs and rewarding favored ones with discounts. Brewers also use these agreements to reserve the right to suggest retail prices to their distributors, in effect using distributors to propagate their own business aims.

In some states, citizens have succeeded in reducing or eliminating such forms of price discrimination. The Arkansas general assembly, for instance, recently passed a law designed to "ensure consistent manufacturer's pricing of beer, ale, and malt beverages across the state."<sup>60</sup> But big beer is still armed with many other weapons. Brewers can, for instance, use the agreements to reserve the right to approve or disapprove the purchase of

one distributorship by another. Looking to grow by acquiring an existing franchise? Better make sure your plans match your brewer's. Looking instead to sell out and retire? Forget about selling to anyone who carries competitors' brands—the big brewers have the de facto right to block the sale of your own business. Want to replace a franchise manager or bring in a new equity partner? Not without your big brewer's approval.

Then there's the immense advantage of mere size. In a more open and competitive market, distributors could use their exit option to temper brewer demands. But the market is no longer open and competitive, and distributors have no exit option. To refuse to do business with one or the other of the Big Two is to refuse to do business, period. And so distributors sign. They give up all the normal rights businesses can expect, even though by law they remain nominally "free."

And yet for ABI, that's still not enough.

The opening statement of ABI's 2011 *Wholesaler Family Consolidation Guide* (further excerpted in footnote 53) makes the company's aims plain:

*We will continually work to strengthen our A-B wholesaler system and improve our businesses.*

*We believe voluntary consolidation within our system is inevitable and will increase, led by wholesalers who want to succeed with Anheuser-Busch.*

*The guide contains the latest legal/tax changes, adjusts for current system size and profitability and clarifies our positions on various issues and details the four characteristics of an Anchor Wholesaler, one who:*

- 1. Excels in our collective performance measures*
- 2. Has management depth capable of expanding leadership influence*
- 3. Has the financial capability to acquire a business and still compete aggressively*
- 4. Most important, demonstrates alignment with us*

Alignment? The guide explains:

*There are many aspects of an aligned wholesaler, and an explicit focus on our portfolio of brands is paramount. Those who are aligned with us only acquire brands that compete in segments under-served by our current portfolio and that bring incremental sales, not brands that have a negative impact on the A-B portfolio.*

In the report's section defining the "Anchor Wholesaler Criteria," alignment is defined even more bluntly. An aligned distributor "shares A-B's long-term vision for how to operate successfully and grow business in conjunction with A-B's strategy." In other words: an aligned distributor does what ABI tells it to. (Or, officially, is legally free to do what ABI tells it to.)

But just in case wholesalers are still unclear as to what they should be gleaning from the *Consolidation Report*, ABI includes a quiz that'll tell them whether they have what it takes to be an anchor wholesaler. Question 1: "Do you share the same vision as A-B on issues of

importance to the industry, including support on legislation that can affect our competitive position?”<sup>61</sup> (Note that the “competitive position” is “ours.” Whether that “ours” refers to ABI and its distributors or to ABI alone is unclear, but also immaterial. There is a single “competitive position” to be supported by the anchor wholesalers, and it is defined by ABI — the precise opposite of what an *actually competitive* wholesale market would produce.) The third question on the quiz makes ABI’s anti-market aims absolutely plain: “Are you selling competitive products in a fellow A-B wholesaler’s territory?” Independently managed, mutually competitive distributorships are good for consumers — but bad for Anheuser-Busch InBev.

The report follows up with five sections on the implementation of ABI’s vision. “A-B’s Role in Consolidation,” “Transaction Structures,” “Financing Options,” “Equity Agreement Process,” and “Key Contacts” outline the financial benefits of alignment and the many, many ways in which ABI can help make it happen, from marketing and accounting consultancy to direct investment by WEDCO, ABI’s Wholesaler Equity Development Corporation.

Profit, support, the backing of a big company: It’s all there for the asking. Distributors just have to agree to the terms. Alternatively, they can continue to run their businesses as they see fit and in so doing destroy their relationship with their dominant supplier. The choice — so to speak — is easy.

#

In essence, ABI has set up a form of “tournament” designed to force its distributors to compete with one another for the favor of the giant. This tournament concept — first formalized by economist (and George W. Bush advisor) Edward Lazear — upends the standard business relationship by which equal work earns equal reward, and replaces it with one in which every individual is treated differently. In theory, such tournaments are supposed to encourage those who are competing to work more efficiently and to provide higher quality service. In practice, the tournament system can become a form of highly coercive, even autocratic control, in which citizens and small firms are subjected to the most arbitrary of decisions.<sup>62</sup>

*The net effect is less real choice, and more political concentration of power.*

Tournaments have also proven to be both economically and socially ruinous. Differentiating the reward allows the firm that controls the market to extract maximum profit from the smaller firms that rely on them for basic goods and/or access to the market. And by keeping the rules of the tournament hidden and arbitrary, market masters make unified resistance almost impossible.

Defenders of the tournament system often claim that it works well for the consumer. The idea is that the beer drinker will be rewarded with lower costs at the cash register, as the market master uses its power to squeeze every last penny of profit out of the distributor system. But in fact, only the market master wins. In the beer industry specifically, as tournaments drive many distributors out of business, and drive those who remain to work more and more for ABI’s direct benefit, the net effect will be less real choice, more political

concentration of power, and — as Brito’s comments on ABI’s pricing plans already made clear — higher costs.

Something else Brito told an audience at the Stanford School of Business rings of the truth about ABI’s practices. “In our company,” he said, “we think that to be fair with people is to treat different people in different ways.”<sup>63</sup>

Hardly an American value at all.

#

Prognostication is a tricky business, and when billions of dollars are potentially at stake, the naysayers will say their nays loudly. Any predictions of disaster stemming from ABI’s efforts to undermine the 21st Amendment will be met by megatons of arguments to the contrary, by ABI and others.

But there is a real-world example that offers a glimpse of the hard reality of a consolidated alcohol industry, in which a poorly regulated market has resulted in a few giants pushing more and more alcohol onto consumers. It’s the United Kingdom.

When America’s reformers set out to design their new markets for alcohol in the 1930s, the U.K. was regarded as the great success story of the temperance movement. In the 20 years after 1913, the consumption of hard alcohol had fallen 60 percent while consumption of beer had fallen 41 percent, even though the country had never experimented with any sort of prohibition. As the authors of *Toward Liquor Control* noted at the time, “the record in improvement in temperance in England is exceeded by no country except Denmark.”<sup>64</sup>

During the 1960s, however, the U.K. government freed grocers to sell beer and wine like any other product. As the grocery industry consolidated — today four firms control more than 80 percent of the U.K. market — they adopted the practice of selling alcohol below cost. This practice of “loss-leading” cut the real cost of of grocery-purchased alcohol by up to 70 percent between 1980 and 2007. Not surprisingly, this led both to more purchases and more drinking at home rather than at the traditional pubs. This in turn led to laws to help out the pubs, which have served as the anchors of town-center commercial districts. The result was a 2005 law that allowed pubs to stay open to all hours: Drinking as commercial-district revitalization plan.<sup>65</sup>

The result is a culture of rampant alcohol abuse and the social ills that come with it. The phenomenon is so vividly apparent, and drunken debasement on English streets has become such a familiar scene, that numbers are almost unnecessary. But here are a few: rates of cirrhosis and other liver diseases have doubled in the U.K. since 1995. Since the 1960s, the rate for men age 35-44 has increased eight-fold; for women in that group, seven-fold. One-quarter of U.K. children aged 15-16 report drinking heavily at least once a month. Overall, the U.K. has some of the highest rates of binge and heavy drinking in the world. There are, of course, multiple reasons for the epidemic. But most experts agree that the easy availability of alcohol, cheaply and at all hours, is a major contributor.<sup>66</sup> And the country’s politicians think so, too. All the major parties have similar alcohol-market reforms, including setting minimum prices for alcohol, on their platform.

The U.S. has so far not reached anything like the U.K.'s level of problem drinking. But the pieces of a U.K.-style unwinding of alcohol regulation are coming together. Massive chains like Costco and Walmart increasingly dominate the American food and drink markets, and they want to buy directly from producers, cutting out the distribution tier. As noted earlier, the reforms they push often aim to give them the ability to engage in price discrimination and various forms of discounting.<sup>67</sup> These retailers are also becoming increasingly adept at competing directly against producers through the house brands — Costco, for instance, recently entered the business of marketing “craft” beer under its Kirkland label. Meanwhile, the influence of the large retailers on local and state politics is hard to overstate: They are everywhere among the largest employers and largest taxpayers, and thereby tie together a broad constituency that otherwise would not have common interests. Their specific interest in direct alcohol distribution — albeit from a different perspective than ABI and MillerCoors — constitutes a further blow to the stability of the three-tier model.

Nor can we expect the large brewers to remain for very long focused only on expanding horizontally and vertically, while raising prices. At some point, there is a very good chance that these firms will also begin to use their immense power to promote greater consumption. For a taste of what Americans can expect in the future, it may be of use to turn to Brazil, where the people who now control America's beer market have enjoyed a de facto monopoly for well more than a decade.

Consider, for instance, the recent news that Ambev plans to roll out “branded bars across Brazil as it seeks to ramp up sales of its Brahma, Skol and other beers.”<sup>68</sup> Or consider the fact that Brazil's federal government recently voted to overturn a 10-year-old law that prohibited the sale of beer at soccer stadiums, as a way to reduce violence and hooliganism. The government did so only reluctantly, after the International Federation of Association Football (FIFA), which organizes the World Cup, demanded that Brazil do so in time for the 2014 championship, to be held in that nation. As the head of FIFA, Jerome Valcke, put it, “Alcoholic drinks are part of the FIFA World Cup, so we're going to have them. Excuse me if I sound a bit arrogant but that's something we won't negotiate.”

Valcke then sought to assure his hosts that this act of social aggression was not really being perpetrated by foreigners. “Our partner here,” he said, speaking of ABI, long one of FIFA's biggest sponsors “is in fact a Brazilian company.”<sup>69</sup>

Big, it seems, sooner or later gets what it wants.

## V. LAST CALL

---

The three-tier system is nearly 80 years old. It is not obsolete. The wisdom that went into its design still holds. The threat of vertical consolidation remains a threat. The right of local communities to regulate alcohol as they see fit is still a right worth protecting.

In the days before Prohibition it was the public that bore the cost of unfettered capital in alcohol. And it was the public that saw its institutions undermined by crime and graft when Prohibition was in place. The 21st Amendment and the three-tier system were the hard-earned, well-considered response to both of these disastrous eras.

Private interest — its power consolidated in a few immense world-spanning corporations that brew and retail beer and alcohol — now seeks to break apart that system. Rationalization of the second tier, vertical integration of brewer and distributor, maximization of profit opportunities — call it what you will, the giant investment banks estimate that the realization of this grand strategy means about \$2 billion to ABI.<sup>70</sup> To ABI investors, that is. To the 300 million people of this country not in that group, it means that ABI values the 21st Amendment at about seven bucks a head—less than the cost of a six-pack of Bud.

When Americans passed the 21<sup>st</sup> Amendment they explicitly condemned any system of “absentee ownership” that separated de facto control from community. Today, by contrast, America’s markets for alcohol are governed by corporations that are not even based in the United States — hence in effect by people who will not have to live with the social and economic consequences of this power.

The response is plain. Federal, state, and local legislators must redouble their efforts to protect the three-tier system and aggressively investigate any credible allegation of unfair trade practices by brewers and retailers. And the president must order the Justice Department to cast a far more skeptical eye on alcohol industry consolidation, among producers and distributors alike. (A good place to start would be ABI’s effort to purchase the remaining half of Corona, not yet a done deal.) Consolidation of money and power is already so advanced that today, law alone can keep the near-total dominance of the industry by a handful of firms from becoming total dominance in fact.

The alternative for these public representatives is to let private interests continue to erode alcohol law until it is as hollow as the abandoned buildings of Bushwick. They will then have presided over the final gutting of a once-vibrant body politic.

## VI. REFERENCES

---

- <sup>1</sup> Steve Forbes, *The Freedom Manifesto: Why Free Markets are Moral and Big Government Isn't*, New York, Crown, 2012; Michael Sandel, *What Money Can't Buy: The Moral Limits of Markets*, New York, Farrar, Straus, and Giroux, 2012.
- <sup>2</sup> John D. Rockefeller, Foreword, in *Toward Liquor Control*, Raymond Fosdick and Albert Scott, New York, Harper & Brothers, 1933, p. xiv.
- <sup>3</sup> Carole Jurkiewicz and Murphy Painter, "Why We Control Alcohol The Way We Do," in *Social and Economic Control of Alcohol*, Boca Raton, CRC Press, 2008, p. 9.
- <sup>4</sup> "History of Bushwick," Government of New York City, accessed December 11, 2012, <http://www.nyc.gov/html/bkncb4/html/about/history.shtml>
- <sup>5</sup> "Anheuser-Busch InBev is the leading global brewer," ABInBev, accessed December 11, 2012, [http://www.ab-inbev.com/go/about\\_abinbev/#boxes](http://www.ab-inbev.com/go/about_abinbev/#boxes); "About Us," SABMiller, accessed December 11, 2012, <http://www.sabmiller.com/index.asp?pageid=792>
- <sup>6</sup> Phil Howard and Ginger Ogilvie, *Concentration in the U.S. Beer Industry*, Michigan, Michigan State University, August 2011.
- <sup>7</sup> "About Us," Crown Imports, accessed December 11, 2012, <http://www.crownimportsllc.com/aboutus/aboutus.htm>; Julie Wernau, "Former Pabst execs bitter about shift in philosophy under new owners," *Chicago Tribune*, June 4, 2011.
- <sup>8</sup> Brewers Association lists 1,940 U.S. craft brewers in 2011, responsible for 5.7 percent of all U.S. beer sales. "Craft Brewing Statistics," Brewers Association, accessed December 11, 2012, <http://www.brewersassociation.org/pages/business-tools/craft-brewing-statistics/facts>
- <sup>9</sup> Sandeep Vaheesen, "Halting Beer's March to Monopoly: The Likely Anticompetitive Effects of Anheuser-Busch InBev's Proposed Acquisition of Grupo Modelo," American Antitrust Institute, November 2012.
- <sup>10</sup> "Rising Prices Hint at Oligopoly," Dealbook, *New York Times*, August 27, 2009.
- <sup>11</sup> Fosdick and Scott, see note 2.
- <sup>12</sup> "Big Win for Costco; Got 60% of Votes After Big Spend," Beer Marketer's Insights, November 9, 2011, accessed December 11, 2012 [http://www.beerinsights.com/index.php?option=com\\_php&Itemid=17&aid=15985&pagesize=20&recordstart=0](http://www.beerinsights.com/index.php?option=com_php&Itemid=17&aid=15985&pagesize=20&recordstart=0)
- <sup>13</sup> "The High Quality Mass Market Retailer," *Wine Business*, May 2007.
- <sup>14</sup> Devin Leonard, "The Plot to Destroy America's Beer," *Bloomberg Businessweek*, October 25, 2012.
- <sup>15</sup> Erica Barnett, "Liquor Privatization: The Fallout," *Seattle Met Politics*, August 21, 2012.
- <sup>16</sup> "Positive meeting with management," UBS Investment Research—Anheuser-Busch InBev research wing, 2009 ("Management elaborated on the mid-term opportunity of further US distributor consolidation or increasing direct distribution. For historical reasons, ABI does direct distribution for 7% of its volumes and management believes this could in theory increase to as high of 50% of US volumes based on current legislation (compared to 20% estimated at the time of the acquisition). At the least, we believe this is a powerful negotiating tool with distributors."), [http://s3.amazonaws.com/zanran\\_storage/www.milwaukeeworld.com/ContentPages/16030284.pdf](http://s3.amazonaws.com/zanran_storage/www.milwaukeeworld.com/ContentPages/16030284.pdf); "Another Billion? Time to look at U.S. Distribution Profits," Morgan Stanley—Anheuser-Busch InBev research wing, November 2011 ("The 'next big thing' that will take U.S. margins to Brazilian levels? ABI's US\$2.25bn BUD cost savings program might be nearly over, but its wholesalers SG&A [selling, general and administrative expenses] is c. US\$5bn. Our deep-dive investigation shows ABI could use its scale to cut this and retain part of the benefit—even without owning the wholesalers. The company could also help wholesalers grow profits via mix and pricing, while extracting a

---

higher share of value—a win-win situation. In all, our bull case sees ABI in the US growing EBITDA [earnings before interest, taxes, depreciation, and amortization] by US\$2bn through 2015...”)

<sup>17</sup> The federal government supplements state control in a number of areas, mainly through the Bureau of Alcohol, Tobacco, Firearms and Explosives, which is housed in the Justice Department.

<sup>18</sup> The American people had twice before expressed through Congress their desire to empower the state and local community to regulate the sale of alcohol. The Wilson Act of 1890 stated that the Commerce Clause did not apply to the sale of alcohol within any particular state. The Webb-Kenyon Act of 1913 clarified that the states also enjoyed the power to regulate so-called “direct sales” and shipment of alcohol by out-of-state dealers to individual citizens within the state.

<sup>19</sup> Fosdick and Scott, p. 10, see note 2.

<sup>20</sup> Why low prices in a monopolistic system? Because tied houses were the product of *vertical*, not horizontal, monopoly. Every brewery had one house in every neighborhood it served (thus the “large excess of sales outlets” referred to in *Toward Liquor Control*), and competition between them was fierce. This put strong downward pressure on prices. At the same time, however, the brewers themselves were sufficiently powerful to head off most forms of local regulation, price control, and taxes. Also see Chapter 2, “The Rising of Liquid Bread” in *Last Call*, Daniel Okrent, New York, Scribner, 2010.

<sup>21</sup> Fosdick and Scott’s work certainly influenced many state legislators. But the book was itself the product, in large measure, of interviews with lawmakers and lawmen, in which they solicited their thoughts on how best to practically repeal Prohibition.

<sup>22</sup> Jurkiewicz and Painter, p. 8, see note 3.

<sup>23</sup> Rockefeller, p. xiv, see note 2.

<sup>24</sup> The three-tier system was not designed specifically to raise the price of beer and alcohol—the structure of the system actually fostered competition, including price competition. But it made it easier for communities to increase the cost of drinking through other means, such as taxes. It did so by breaking the industry into smaller players who were less able to exert control over the political process.

<sup>25</sup> *2011 Brewers Almanac*, The Beer Institute, accessed December 11, 2012, <http://www.beerinstitute.org/statistics.asp?bid=200>

<sup>26</sup> For example, Schlitz, then the second-largest American brewer, was ordered in 1966 to sell Burgermeister, a California brewery it had acquired, and its shares of Canada’s Labatt, on antitrust grounds. The monopolistic threat perceived by regulators appears laughable by today’s libertine standards; Burgermeister represented just 5.6 percent of Schlitz’s total sales. Ironically, in 1982 Schlitz appealed to antitrust law in an effort to block a hostile takeover by rival Stroh’s. U.S. Department of Justice *United States Attorneys Bulletin*, November 25, 1966; “Schlitz Loses Appeal on Stroh,” *New York Times*, April 9 1982.

<sup>27</sup> “Beer Industry Fact Sheet,” National Beer Wholesalers Association, November 2011, [http://nbwa.org/sites/default/files/2011\\_Industry\\_Fact\\_Sheet\\_0.pdf](http://nbwa.org/sites/default/files/2011_Industry_Fact_Sheet_0.pdf)

<sup>28</sup> The change also allowed big retailers to engage in “loss leading,” which is when they price a product at or below what they paid for it wholesale. Although this practice may at first glance seem irrational, retailers use such deals to lure shoppers into their stores to buy other products, and to harm less well-capitalized retail competitors who can’t afford to lose money on each sale.

<sup>29</sup> Barry C. Lynn, *Cornered*, New York, John Wiley & Sons, 2010.

<sup>30</sup> “Antitrust Law,” *West’s Encyclopedia of American Law*, accessed December 11, 2012, <http://iris.nyit.edu/~shartman/mba0101/trust.htm>

<sup>31</sup> *2011 Brewers Almanac*, see note 24.

<sup>32</sup> *International Directory of Company Histories*, St. James Press, 1997.

---

<sup>33</sup> *International Directory of Company Histories*, St. James Press, 2003; Paul Meller, “Anonymous Interbrew Takes On the King of Beers,” *New York Times*, August 12, 2001.

<sup>34</sup> *International Directory of Company Histories*, St. James Press, 2004.

<sup>35</sup> “Heritage,” South African Brewers, accessed December 11, 2012

<http://www.sab.co.za/sablimited/content/en/page39>

<sup>36</sup> “Stroh Selling Its Beer Brands to Pabst and Miller,” *New York Times*, February 9, 1999.

<sup>37</sup> Paul Meller, “Executive Says Merged Brewer Can Be Leader in Many Markets,” *New York Times*, March 4, 2002.

<sup>38</sup> Andrew Martin, “Merger for SABMiller and Molson Coors,” *New York Times*, October, 10 2007.

<sup>39</sup> Micheal J. de la Merced, “InBev to Buy Anheuser-Busch for \$52 Billions,” *New York Times*, July 14, 2008.

<sup>40</sup> Beer Business Daily, February 8, 2011, accessed December 11, 2012,

[http://www.beernet.com/publications\\_daily.php?id=2327](http://www.beernet.com/publications_daily.php?id=2327)

<sup>41</sup> Smaller retailers tend to share this interest in seeking out new and alternative sources of supply. Super-giant retailers, like Costco, however, have a great number of tools at their disposal by which to profit even while delivering less real choice. This includes their ability to use price discrimination to manipulate suppliers, their ability to pit house brands against the brands of the big suppliers, and their ability to shelve product where they want.

<sup>42</sup> Initiative 1183 (passed November 8, 2011) undid the state’s monopoly on liquor sales, allowing big-box stores—those with more than 10,000 square feet of retail space—to sell liquor. Wine and liquor may also now be stored in retailers’ warehouses, rather than needing to be stored and delivered to retail outlets by wholesalers. And wine and liquor producers may now engage in price discrimination, offering discounts to high-volume sellers and higher prices to small sellers. The expectation by many in the beer industry, including the National Beer Wholesalers Association and many Washington craft brewers, is that these changes will soon apply to the beer market, as well. ABI evidently believes so: It is finalizing the purchase of a major Seattle beer distributorship. Washington Initiative 1183.

<http://wei.secstate.wa.gov/osos/en/voterswithdisabilities/Documents/I-1183.txt>; “Costco Wins: Now What?” Beer Business Daily, November 10, 2011, accessed December 11, 2012

[http://www.beernet.com/publications\\_daily.php?id=2536](http://www.beernet.com/publications_daily.php?id=2536); “I-1183: Some opinions from the beer industry,” Washington Beer Blog, November 2, 2011, accessed December 11, 2012

<http://www.washingtonbeerblog.com/i1183-some-opinions-from-beer-industry/>; Melissa Allison, “Voters Kick State Out of Liquor Business,” *Seattle Times*, November 8, 2011.

<sup>43</sup> Technically, ABI and MillerCoors can’t insist on exclusive relationships with distributors; doing so would violate Treasury Department rules and some state laws. In practice they have managed to establish exclusive relationships with suppliers through highly restrictive franchise agreements. Such arrangements became much more common after the 2007 merger of Miller and Coors.

<sup>44</sup> MillerCoors is less active today than ABI in pushing consolidation. In part this is because their distributors went through a wave of consolidation a decade ago. But fundamentally, the two companies have different models of profit-making vis-a-vis distribution. MillerCoors has found it profitable to ride along as their distributors aggressively pursued the craft beer market—a rising tide lifting all boats, as the phrase goes. ABI, as detailed below, is moving aggressively in the opposite direction, pressuring its distributors to drop any brands it considers competitive, and to sharply reduce their craft beer portfolios.

<sup>45</sup> For reasons that will become clear, no wholesaler would speak on the record.

<sup>46</sup> *The Economist*, “Flag of Convenience,” August 5, 1999.

<sup>47</sup> “The World’s Billionaires: Jorge Paulo Lemann,” *Forbes*, <http://www.forbes.com/profile/jorge-paulo-lemann/>

---

<sup>48</sup> “Who’s Who,” ABInBev, accessed December 11, 2012, [http://www.ab-inbev.com/go/investors/overview/who\\_is\\_who.cfm](http://www.ab-inbev.com/go/investors/overview/who_is_who.cfm)

<sup>49</sup> Matt Moffett, “InBev’s Chief Built Competitive Culture,” *Wall Street Journal*, June 13, 2008.

<sup>50</sup> “InBev’s Pursuit of Anheuser-Busch,” *St. Louis Post-Dispatch*, July 14, 2008.

<sup>51</sup> Susan Berfield, “The Fall of the House of Busch,” *Bloomberg Businessweek*, June 30, 2011; Todd C. Frankel, “As Expected, Busch IV Leaving A-B InBev’s Board,” *St. Louis Post-Dispatch*, March 28, 2011.

<sup>52</sup> David Kesmodel and Suzanne Vranica, “Unease Brewing at Anheuser as New Owners Slash Costs,” *Wall Street Journal*, April 29, 2009.

<sup>53</sup> They are also careful to state that this is *not* their *official* plan, for such a plan would invite all manner of government inquiry into their behavior. The following text is taken verbatim from their 2011 Wholesaler Family Consolidation Guide, a document sent to their independent distributors to let them know where ABI is headed:

*We ask all wholesalers to use the guide’s self assessment tool to objectively consider their capabilities and goals. Wholesalers who aspire to be an Anchor Wholesaler can identify any gaps they have in these qualities and build a plan to address them. Some wholesalers might remain committed to their current market, but realize further acquisitions are not right for their business. Others might decide now is the best time to consider whether a sale is in their best interest. Those types of choices, of course, will be for all wholesalers to make for themselves.*

<sup>54</sup> Who is the Largest Beer Distributor in U.S.?” *Beer Business Daily*, April 18, 2012, [http://beernet.com/publications\\_daily.php?id=2640](http://beernet.com/publications_daily.php?id=2640)

<sup>55</sup> Charles Fishman, *The Wal-Mart Effect: How the World’s Most Powerful Company Really Works*, New York, Penguin, 2006.

<sup>56</sup> Jeremiah McWilliams, “Will Anheuser-Busch InBev Shake Up its U.S. Distributors,” *St. Louis Post-Dispatch*, June 24, 2009; UBS Investment Research—Anheuser-Busch InBev, “Positive meeting with management,” June 2009 (“For historical reasons, ABI does direct distribution for 7% of its volumes and management believes this could in theory rise to as high of [sic] 50% of U.S. volumes based on current legislation (compared to 20% estimated at the time of the acquisition).”).

<sup>57</sup> “Who is the Largest Beer Distributor in U.S.?” see note 54.

<sup>58</sup> *Ibid.*

<sup>59</sup> Illinois allowed minority ownership of distributors by big brewers to continue, hence ABI’s continued stake in its Chicago branch. Many states, including Illinois, give small brewers a common-sense exemption that lets them to self-distribute as long as they remain below a given annual production volume, thousandths of that of the big players.

<sup>60</sup> Recent developments in Arkansas present a case study of ABI’s consolidation practices. After the Anheuser-InBev merger, the state’s distributors came under increasing pressure from St. Louis to consolidate their operations and focus exclusively on the company’s brands. Distributors felt that ABI was using its veto power to shape consolidation deals in its own favor. They also suspected that ABI was practicing intensive price discrimination to help force the deals their way—giving deep discounts to some distributors in order to build their market share and charging others higher prices in order to eat into their margins. Ironically, anti-trust law prevents distributors from discussing supplier pricing among themselves—making it all but impossible for the distributors to prove that price discrimination was occurring. As a result, the Arkansas’s wholesaler trade group instead pursued legislation that would simply make price discrimination illegal. ABI fiercely fought that move, going so far as to draft a letter stating opposition to the proposed law “signed” by the distributors themselves. (Distributors who, in fact, supported the law were then invited to call ABI and identify themselves so their names could be taken off the letter and, presumably, put on ABI’s enemies list.) Ultimately, ABI was forced to reveal its pricing practices in Arkansas. Differences of as much as \$5 per case—which typically cost about \$15 wholesale—were giving tremendous

---

advantages to favored distributors and severely harming others. The Arkansas law passed, and price discrimination is now illegal in the state.

<sup>61</sup> The quiz goes on to ask, among other things, “Are you in alignment with ABI Field recommendations with regard to maintaining a competitive organization, in-market spend requirements, new package introductions, etc.? Do you have a defined, specific succession plan? Do you have senior management who are mobile and able to relocate to other markets if opportunities arise? Do you have a corporate staff infrastructure established that can consolidate back office functions in subsequent acquisitions? Do you have access to ready sources of capital (personal equity, bank financing, other third party sources)?”

<sup>62</sup> Lina Khan, “Obama’s Game of Chicken,” *The Washington Monthly*, Nov/Dec 2012; Barry C. Lynn, “Killing the Competition,” *Harper’s*, February 2012.

<sup>63</sup> “InBev’s Chief Built Competitive Culture,” see note 48.

<sup>64</sup> Fosdick and Scott, p. 25, see note 2.

<sup>65</sup> Another reason for the switch was to encourage drunks to head home whenever they chose—staggered staggering—rather than all at once, right after a final binge at last call. But thanks to the fact that more and more large grocers now stay open 24/7, the drinker can easily pick up a few more for home.

<sup>66</sup> Pamela S. Erickson, “The Dangers of Alcohol Deregulation: The United Kingdom Experience,” Campaign for a Healthy Alcohol Marketplace, 2009.

<sup>67</sup> Most states explicitly outlaw such practices with general or alcohol-specific “below cost” sales prohibitions, or in effect with minimum-markup laws.

<sup>68</sup> Louise Lucas, “AmBev to Launch Bars Across Brazil,” *Financial Times*, November 25, 2012.

<sup>69</sup> “FIFA tells Brazil it must have beer at World Cup,” *Reuters*, January 18, 2012.

<sup>70</sup> “Another Billion? Time to look at U.S. Distribution Profits,” see note 16.