# REVIEW OF IOWA CODE CHAPTER 123

## FINAL RECOMMENDATIONS

FEBRUARY 1, 2017

ALCOHOLIC BEVERAGES DIVISION
State of Iowa

IOWA economic development

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February 1, 2017

The Honorable Terry E. Branstad
Governor of Iowa
The Honorable Kim Reynolds
Lieutenant Governor of Iowa
Iowa State Capitol
Des Moines, IA 50319

Dear Governor Branstad and Lieutenant Governor Reynolds,

With this letter, we present to you our final recommendations from our comprehensive review of Iowa's alcohol laws. On August 10, 2016, you tasked our agencies with working in partnership to perform an unprecedented review of Iowa's alcohol laws and identify opportunities to improve commerce, cut red tape, and create regulatory clarity while protecting public health and public safety.

In the spirit of Executive Order 80, we convened a working group of stakeholders representing all three tiers of the alcoholic beverages industry, public safety, and the general public. The working group held a series of eight public meetings and heard testimony from Iowa and national alcohol manufacturers, wholesalers, and retailers, as well as public health and public safety representatives, prevention advocates, law enforcement officials, and members of the public.

After review of the testimony, consideration of the requested changes, and working group discussion, we present five recommendations for your consideration. We feel that these recommendations will create greater economic opportunities for our local entrepreneurs, make it easier and more efficient for Iowans to conduct business with state government, make Iowa's alcohol laws easier to understand and enforce, and result in public policy that continues to protect the health and safety of Iowans.

We thank you for the opportunity to lead this effort.

Stephen Larson
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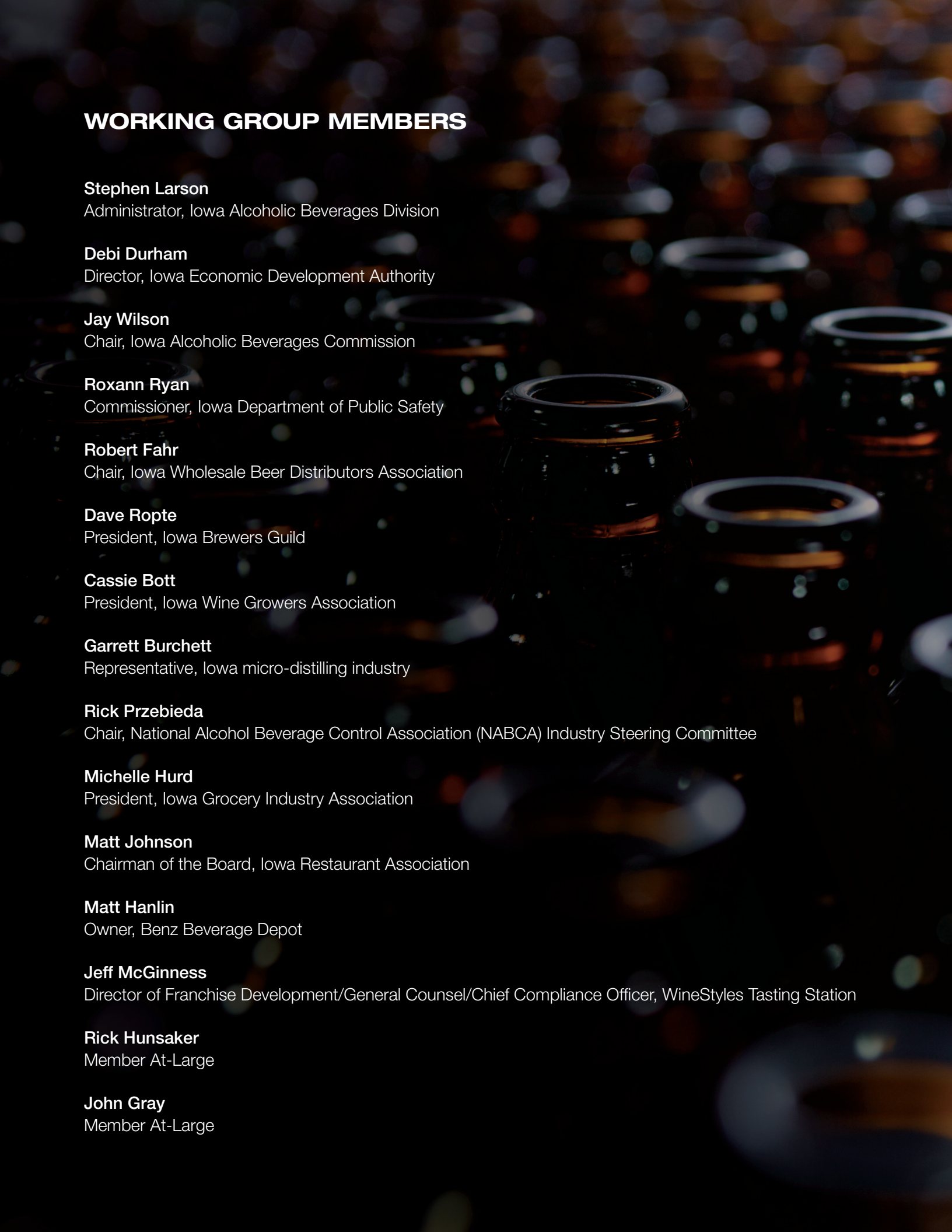

## WORKING GROUP MEMBERS

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## EXECUTIVE SUMMARY

On August 10, 2016, Governor Branstad and Lt. Governor Reynolds tasked the Iowa Alcoholic Beverages Division, in partnership with the Iowa Economic Development Authority, with conducting an unprecedented comprehensive review of Iowa's alcohol laws (Iowa Code chapter 123). The review was to focus on identifying ways to cut red tape and streamline governmental services, to allow greater economic opportunities for local entrepreneurs in the alcoholic beverages industry, such as vintners, craft brewers, and micro-distillers, and to adapt Iowa's alcohol laws to meet emerging trends, such as e-commerce, new business models, and new consumer demands, all while ensuring that the health and safety of Iowans is protected.

In the spirit of Executive Order 80, a working group was convened consisting of stakeholders representing all three tiers of the alcoholic beverages industry, public safety, and the general public. Over the course of eight public meetings, the working group heard testimony from Iowa and national alcohol manufacturers, wholesalers, and retailers, as well as public health and public safety representatives, prevention advocates, law enforcement officials, and members of the public.

Requests for law changes were received from interested parties and reviewed by the working group. Based upon those discussions and review of testimony heard during the public meetings, the following recommendations for changes to Iowa's alcohol laws are made:

1. Create greater parity among Iowa beer, wine, and spirits manufacturers.
2. Streamline licensing for Iowa beer manufacturers and wholesalers.
3. Allow a limited expansion of off-premises retail privileges for retailers manufacturing beer.
4. Increase collaboration between the Iowa Alcoholic Beverages Commission and the Iowa Wine and Beer Promotion Board.
5. Endorse a further review of licensing, administrative actions, and administrative appeals for reform opportunities.

These recommendations will create the opportunity for improved commerce in the state, make it easier and more efficient for Iowans to conduct business with state government, make Iowa's alcohol laws clearer and easier to both understand and enforce, and result in public policy that continues to protect the health and safety of Iowans.

# THE LANDSCAPE OF ALCOHOL IN IOWA

The regulation of alcohol in Iowa, like in all 50 states, is based upon the regulatory framework known as the three-tier system. The three tiers are comprised of manufacturers, wholesalers, and retailers, and are required to maintain levels of separation – manufacturers create alcohol products and sell them to wholesalers, who in turn sell those products to retailers, who then sell them to the public. This system was developed at the end of Prohibition with the intention of eliminating "tied houses," which were prevalent pre-Prohibition and led to many societal ills. Under these tied houses, a manufacturer also owned a retailer (commonly known at the time as a saloon), creating a direct path to market for the manufacturer's product. The retailer would be pressured to generate high sales, often leading to overconsumption by consumers. Tied houses were one of the leading causes for Prohibition to be enacted.

After the repeal of Prohibition by the 21st Amendment, states were given the authority to regulate alcohol within their borders. Some states chose to adopt the control model, meaning that the state occupied and controlled one or more tiers of the three-tier system. In March 1934, Iowa chose to become a control state, assuming direct control over the wholesale and retail sale of all alcohol except beer. This meant that at the very beginning of alcohol regulation in the state, Iowa did not maintain a pure three-tier system with strict separation of the tiers.

Over the years, the legislature and various governors have shown their approval of a blended three-tier system in Iowa by enacting laws allowing for cross-tier privileges. Examples of this include a law change in 1981 that allowed native breweries to obtain a single retail permit allowing for on- or off-premises retail sales from their manufacturing location; a 1989 law change that allowed certain retailers to obtain a new beer manufacturing permit and sell the beer they made for on-premises consumption (commonly referred to today as brewpubs); a 2010 law that created a permit allowing native wineries to ship their product directly to consumers; and a 2010 law that created micro-distilleries, distilleries that have a production cap of 50,000 proof gallons annually and have a retail privilege allowing the sale of the product they manufacture for off-premises consumption.

*Over the years, the legislature and various governors have shown their approval of a blended three-tier system in Iowa by enacting laws allowing for cross-tier privileges.*

Today, Iowa beer, wine, and spirits manufacturers all enjoy some form of cross-tier privileges. Native breweries and native wineries have both wholesale and retail privileges. As noted above, micro-distilleries have retail privileges. And brewpubs have the ability to sell the beer they manufacture directly to consumers for on-premises consumption, bypassing the wholesale tier entirely. All of this culminates in Iowa's unique, blended version of the three-tier system.

The alcoholic beverages industry has positive economic impacts on the state of Iowa. In Fiscal Year 2016, the Iowa Alcoholic Beverages Division reverted over $105 million to the General Fund for appropriation by the legislature, over $21 million to the Iowa Department of Public Health for substance abuse and prevention education programs, and almost $4 million to cities and counties across the state. A pair of studies commissioned by the Iowa Economic Development Authority's Wine and Beer Promotion Board showed that in 2012 the full economic impact of Iowa wine and wine grapes was $420 million, and that in 2014 the economic impact of the Iowa craft beer industry exceeded $100 million. A 2013 report by the National Beer Wholesalers Association showed that the economic impact of Iowa beer distributor operations, investment, and community involvement totaled over $447 million.

Unfortunately, alcohol has also had negative impacts on the state. In 2015, alcohol-impaired driving fatalities accounted for 24 percent of all driving fatalities, and the average blood alcohol content of those involved in alcohol-impaired fatalities was 0.206, nearly 2.5 times the legal statutory limit of 0.08. The Centers for Disease Control estimated that in 2013 binge drinking cost Iowans nearly $2 billion through insurance, health care, and other associated costs, as well as productivity loss.

*This is a reminder that alcohol is a unique commodity that requires regulation. Though Iowa's alcohol laws have remained mostly static for decades and warrant a review, it is crucial to remember that alcohol regulation in the state has been largely successful under those laws, and that any attempts to make changes to the laws must ensure that the health, safety, and welfare of Iowans is maintained.*

# RECOMMENDATIONS

## *Create greater parity among Iowa beer, wine, and spirits manufacturers.*

### Background

Under current law, a person seeking to manufacture spirits in Iowa can obtain a manufacturer's license and/or a micro-distilled spirits permit. A manufacturer's license allows for the manufacture, storage, and sale at wholesale of spirits to the Iowa Alcoholic Beverages Division and to customers outside of the state. A holder of a manufacturer's license is not allowed to engage in retail sales at the manufacturing location, nor allowed to provide tastes of the product it manufactures to visiting consumers.

*By creating a more level playing field for all alcohol manufacturers in the state, greater opportunities for economic success are created.*

A person holding a micro-distilled spirits permit may manufacture micro-distilled spirits, which are spirits fermented, distilled, or, for a period of two years, barrel matured on the licensed premises of the micro-distillery. Micro-distilled spirits also include blended or mixed spirits comprised solely of spirits fermented, distilled, or, for a period of two years, barrel matured at a micro-distillery. To be considered a micro-distillery, a business must have an operational still which, combining all production facilities of the business, produces and manufactures less than 50,000 proof gallons of distilled spirits on an annual basis.

A micro-distillery is allowed to sell to a person per day a maximum of 1.5 liters (or two 750 mL bottles) of the micro-distilled spirits it manufactures for off-premises consumption. Also, in conjunction with a tour of the micro-distillery, a person may be provided free of charge no more than two 0.5-ounce tastes of each brand of micro-distilled spirits manufactured by the micro-distillery. A micro-distillery is prohibited from selling micro-distilled spirits by the glass for on-premises consumption at the micro-distillery. Micro-distilleries are also prohibited from selling their product at wholesale to customers outside of Iowa without also obtaining the manufacturer's license.

### Recommended Action

In order to create greater parity among Iowa beer, wine, and spirits manufacturers, we recommend eliminating the micro-distilled spirits permit and amending the privileges allowed by a manufacturer's license. Specifically, we recommend that the manufacturing license:

- Continue to allow unlimited production of spirits;
- Continue to allow the sale of spirits at wholesale to the Iowa Alcoholic Beverages Division and to customers outside of the state;
- Be amended to allow, either as an inherent privilege of the manufacturer's license or through an additional license, the retail sale for on- and off-premises consumption of spirits so long as the manufacturer ferments, distills, or, for a period of two years, barrel matures the spirits on the licensed premises; and
- Be amended to allow complimentary tastes to be provided in conjunction with a tour of the manufacturing premises and pursuant to the Iowa Alcoholic Beverages Division's administrative rules regarding tasting.

We feel that these changes will bring the privileges of spirits manufacturers into line with privileges currently enjoyed by beer and wine manufacturers. For instance, beer and wine manufacturers currently have no cap on production; the micro-distilled spirits permit imposes a production cap of 50,000 proof gallons annually. Beer and wine manufacturers also do not have a cap on the amount of their manufactured product they can sell for off-premises consumption from the manufacturing location; micro-distilled spirits permit holders are limited to 1.5 liters per person per day, and holders of a manufacturer's license cannot engage in retail sales. By obtaining a separate permit, beer and wine manufacturers are able to sell the products they manufacture to consumers by the glass for on-premises consumption at the manufacturing location; spirits manufacturers cannot.

The discrepancies among privileges for beer, wine, and spirits manufacturers create unnecessary confusion for prospective entrepreneurs, current manufacturers, regulators, and the general public. The prohibition on sales for on-premises consumption and the limitation on the amount allowed to be sold for off-premises consumption by spirits manufacturers puts those businesses at an economic disadvantage compared to beer and wine manufacturers. By creating a more level playing field for all alcohol manufacturers in the state, greater opportunities for economic success are created, and the Iowa Alcoholic Beverages Division is able to more easily ensure regulatory compliance.

## *Streamline licensing for Iowa beer manufacturers and wholesalers.*

### Background

Under current licensing structure, a person seeking to manufacture beer in Iowa has four licensing options: a class "A" beer permit, a class "AA" beer permit, a special class "A" beer permit, and a special class "AA" beer permit. The single-A permits allow for the manufacture of beer up to 6.25 percent alcohol by volume, and the double-A permits allow for the manufacture of beer that is more than 6.25 percent alcohol by volume, but not more than 15 percent alcohol by volume. A person wishing to only wholesale beer and high alcoholic content beer must also obtain a class "A" beer permit or class "AA" beer permit, respectively.

*This will result in a simpler, more efficient licensing structure for beer manufacturers and wholesalers in the state.*

The annual permit fee for a class "A" or special class "A" beer permit is $250. The annual fee for a class "AA" or special class "AA" beer permit is $500. A person must complete a separate application and post a $5,000 surety bond payable to the state for each type of permit. In other words, a person wishing to open a native brewery and manufacture both beer and high alcoholic content beer must complete two separate applications, post two $5,000 bonds, and pay a total of $750 in order to obtain the required class "A" and class "AA" beer permits.

### Recommended Action

We recommend combining the class "A" and class "AA" beer permits and the special class "A" and special class "AA" beer permits, thus wrapping the high alcoholic content beer manufacturing/wholesaling privileges into the class "A" and special class "A" beer permits. The annual fee for the new class "A" and special class "A" beer permits should be $750. This ensures that the licensing fees from the class "AA" and special class "AA" beer permits are still captured. We also recommend that the bond amount required to be posted as part of obtaining a class "A" or special class "A" beer permit be $10,000. This ensures that the same bond amount as currently required for holders of both class "A" and class "AA" and special class "A" and special class "AA" beer permits is maintained.

Current licensing data shows that:

- Out of a total of 46 class "A" beer permits currently active and operating as a beer manufacturer, only 10 permit holders do not also hold a class "AA" beer permit;
- Out of a total of 40 class "AA" beer permits currently active and operating as a beer manufacturer, only 2 permit holders do not also hold a class "A" beer permit;
- Out of a total of 40 class "A" beer permits currently active and operating as a beer wholesaler, only 3 permit holders do not also hold a class "AA" beer permit;
- Out of a total of 35 class "AA" beer permits currently active and operating as a beer wholesaler, only 1 permit holder does not also hold a class "A" beer permit.
- Out of a total of 30 special class "A" beer permits currently active, only 8 permit holders do not also hold a special class "AA" beer permit; and
- Out of a total of 22 special class "AA" beer permits currently active, only 1 permit holder does not also hold a special class "A" beer permit.

While this recommendation will result in higher fees for a small number of permit holders, it will also result in less time needed by the applicant to complete the permit applications, less time needed by local authorities and the Iowa Alcoholic Beverages Division to process applications, and a simpler, more efficient licensing structure for beer manufacturers and wholesalers in the state.

## *Allow a limited expansion of off-premises retail privileges for retailers manufacturing beer.*

### Background

Retailers holding a class "B" beer permit or class "C" liquor license have the option of also obtaining permits allowing for the manufacture of beer and/or high alcoholic content beer (special class "A" and special class "AA" beer permits, respectively). This business model is commonly referred to as a brewpub.

Brewpubs are currently allowed to sell the beer they manufacture at retail for on-premises consumption without the beer going through the wholesale tier of the three-tier system. However, any beer manufactured that is intended to be sold at retail for off-premises consumption, such as in growlers, must be delivered to, or picked up, by a beer wholesaler. The beer must come to rest at the beer wholesaler's licensed premises and then be purchased back from the brewpub before returning to the brewpub's licensed premises.

### Recommended Action

We recommend allowing brewpubs to sell the beer they manufacture at retail for off-premises consumption without the beer having to be sold to a beer wholesaler and bought back. We also recommend limiting this expanded privilege so that the beer not required to be sold to a beer wholesaler that is intended for off-premises consumption may only be used to fill growlers. Any beer manufactured and intended to be sold at retail for off-premises consumption in cans or bottles should be required to still be sold to, and bought back from, a beer wholesaler.

*Limited expansion of off-premises retail privileges will provide greater efficiency while maintaining adherence to the three-tier system.*

During testimony before the working group, brewpub owners described how the majority of their off-premises retail sales were growlers. They also described the inefficiency and added cost of having a beer wholesaler stop at their business to pick up a limited amount of product, take it to the beer wholesaler's licensed premises, and then return the product to the brewpub. This inefficiency was echoed by beer wholesalers. We feel our recommendation of a limited expansion of off-premises retail privileges will provide greater efficiency while maintaining adherence to the

three-tier system by not allowing one business model to operate completely independently of one of the tiers.

## *Increase collaboration between the Iowa Alcoholic Beverages Commission and the Iowa Wine and Beer Promotion Board.*

### Background

The Iowa Alcoholic Beverages Commission is a five-member body responsible for alcohol policy-making and advising the administrator of the Iowa Alcoholic Beverages Division. Not more than two members of the commission may be the holder of, or have an interest in, a permit or license to manufacture, wholesale, or sell at retail beer, wine, or spirits.

Iowa Code § 15E.116 creates the Iowa Wine and Beer Promotion Board, which consists of three members appointed by the director of the Iowa Economic Development Authority. One member represents the Iowa Economic Development Authority, one member represents Iowa wine makers, and one member represents Iowa beer makers. The board is responsible for advising the Iowa Economic Development Authority on the best means to promote Iowa-made wine and beer.

*Increased collaboration between the two bodies will allow a greater understanding of both the economic and regulatory issues affecting the alcoholic beverages industry in Iowa.*

### Recommended Action

We recommend that a designee of the administrator of the Iowa Alcoholic Beverages Division serve as an ex officio member of the Iowa Wine and Beer Promotion Board. Similarly, we recommend that a designee of the director of the Iowa Economic Development Authority serve as an ex officio member of the Iowa Alcoholic Beverages Commission.

Given the two separate, but important, functions of the Iowa Alcoholic Beverages Commission and the Iowa Wine and Beer Promotion Board, we feel that this increased collaboration between the two bodies will allow a greater understanding of both the economic and regulatory issues affecting the alcoholic beverages industry in Iowa and result in better policies put forth by both bodies.

## *Endorse a further review of licensing, administrative actions, and administrative appeals for reform opportunities.*

### Background

During the November 29th working group meeting, time was allotted for presentations to the working group by law enforcement officials. Judy Bradshaw, director of the Iowa Law Enforcement Academy, provided an impassioned testimony, describing her previous experience with Iowa's alcohol laws when she served as the police chief of the Des Moines Police Department.

Director Bradshaw described the frustration of the police department, the city council, and neighborhood citizens when a nuisance establishment would have its alcohol license or permit denied at renewal by the city council only to have the denial overturned by an administrative law judge. She expressed dismay at the ability of a licensee/permittee to continue to operate after a tragic incident, such as a shooting. She also questioned whether civil penalty amounts enumerated in Iowa Code chapter 123 were in alignment with the severity of crimes being committed.

## Recommended Action

We recommend an endorsement of the Iowa Alcoholic Beverages Division performing a further in-depth review of laws pertaining to alcohol licensing, administrative actions, and administrative appeals.

Director Bradshaw's points are well taken, and have been echoed by other law enforcement officials and local authorities across the state. We feel that laws pertaining to the eligibility to hold an alcohol license or permit, the balance of power at the local and state level to approve or deny a license/permit application, financial liability requirements, compliance training requirements, limitations on business interests, civil penalty and fee amounts, and allowable actions during the appeal process are all topics that warrant further review.

Given the depth and complexity of these topics, a lengthier timeframe for review is necessary than the initial timeframe established for this working group's efforts. Additionally, this subject matter will also require the expertise and input of new stakeholders familiar with the issues, such as local law enforcement, local authorities, and community leaders and organizations, among others. As such, we envision a new coalition being built to assist in the review process with a goal of submitting a report of recommendations to the Governor and Lt. Governor and the Iowa legislature on or before January 1, 2018.

# ACKNOWLEDGEMENTS

The Iowa Alcoholic Beverages Division and the Iowa Economic Development Authority recognize and thank the following individuals who contributed their time, expertise, and input to this review effort:

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All other individuals who attended the working group meetings

## REFERENCE MATERIALS

All supplemental informational items referenced in this report, as well as all materials used throughout the working group's review effort (i.e. agendas, meeting minutes, presentations, and handouts) are stored electronically on the website Basecamp. Access to these materials will be granted upon request. To request access, please email Tyler Ackerson (**ackerson@iowaabd.com**).

ALCOHOLIC BEVERAGES DIVISION
State of Iowa

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