



Contract Brewing, Distillery Sales, Alternating Proprietorships, Wine Growlers, and More - How Will New North Carolina ABC Laws Impact Your Business?

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UPDATE

North Carolina Governor Pat McCrory signed House Bill 909 into law on 19 June 2015, which makes several significant changes to North Carolina alcoholic beverage control (“ABC”) laws. The bill includes changes to North Carolina ABC laws governing direct sales by distilleries, powdered alcohol, contract brewing, alternating proprietorships for breweries, and sales of wine in growlers, among other issues. Most of the provisions of the bill are now in effect, although direct sales by distilleries cannot occur until the North Carolina ABC Commission adopts temporary rules to implement the process, which must occur by 1 October 2015. A summary of the bill is below. A link to the bill can be found [here](#).

Section 1 - Antique Spirituous Liquor

The bill allows restaurants, bars, and other entities holding mixed beverage permits to obtain antique spirituous liquor permits and sell antique spirituous liquor to customers. Antique spirituous liquor is liquor that has not been produced or bottled in more than twenty years, is unopened, and is not owned by a distillery. The bill provides a means for retailers to purchase antique spirituous liquor from local ABC Boards, which will purchase the antique liquor from private sellers. This process will enable retailers to obtain mixed beverage tax stamps and pay taxes on antique spirituous liquor, just as they do for other types of liquor. The North Carolina ABC Commission will adopt temporary rules by 1 September 2015 to outline this process.

Section 2 - Powdered Alcohol

The bill bans any form of manufacture, sale, transport, consumption, or possession of powdered alcohol in North Carolina.

Section 3 - Tribal ABC Commission

The bill authorizes the Eastern Band of Cherokee Indians Alcoholic Beverage Control Commission (“Tribal ABC Commission”) to issue commercial ABC permits, such as brewery, winery, and distillery permits, and to issue wine shipper permits, to businesses located in its jurisdiction. The Tribal ABC Commission has sole enforcement authority over these permittees to the extent the regulated conduct occurs in its jurisdiction. The North Carolina ABC Commission can also continue to issue commercial ABC permits to businesses in this jurisdiction.

Section 4 - Distillery Sales

The bill allows distilleries producing less than 100,000 proof gallons per year to sell one bottle of liquor per calendar year to each visitor to the distillery. This is a change from current law, which allows only ABC stores to sell bottles of liquor. Sales of bottles of liquor at the distillery shall be at the same price as sales at ABC stores, including the same taxes. Distilleries will remit applicable taxes to the North Carolina Department of Revenue. Bottles will have labels stating “North Carolina Distillery Tour Commemorative Spirit.” The bill would allow each visitor to purchase one bottle of spirituous liquor per calendar year. Distilleries will be required to maintain electronic records verifying visitor purchases. This provision of the bill takes effect upon adoption of rules implementing the process by the North Carolina ABC Commission, which must occur by 1 October 2015.

Section 5 - Growlers

The bill allows the retail sale of unfortified wine in growlers by ABC permittees holding on-premise or off-premise ABC permits, including restaurants, bars, and grocery stores. This includes growler sales of cider, which is defined as unfortified wine in North Carolina, and also includes any other type of unfortified wine (“traditional wine” with an alcohol content of 16% or less), and potentially mead or sake, if these products meet North Carolina’s definition of “unfortified wine.” This is a change in current law, which allows only the sale of malt beverages, and not cider or wine, in growlers. Restaurants, bars, grocery stores, and other on-premise or off-premise ABC permit holders should ensure that they have applicable on-premise or off-premise unfortified wine permits in order to sell growlers of cider and wine.

Section 6 - Alternating Proprietorships for Breweries

The bill clarifies that North Carolina ABC law allows breweries to enter into alternating proprietorships. The bill clarifies statutory language that an alternating proprietorship, in which the holder of a brewery permit leases or makes its facility available to the holder of another brewery permit, is not a “change in ownership” that would void current North Carolina ABC permits. The bill language describes an alternating proprietorship as an arrangement where a

tenant brewery maintains title to its malt beverage at all states of the brewing process and is responsible for records, label approvals, and taxes. The bill makes clear that affiliated breweries cannot use alternating proprietorships as a means to distribute production quantities among themselves so as to avoid the self-distribution cap of 25,000 barrels per year.

Alternating proprietorships, which are authorized under federal law, allow existing breweries a way to use excess brewing capacity and space and give new breweries a chance to create beer without investing in expensive equipment and building space. Alternating proprietorships also allow for the creation of beer “incubators” where breweries share space and collaborate in the brewing process. North Carolina has several “incubators” in planning, and this law will help facilitate those incubators.

Section 7 (G.S. 18B-1104(3))- Brewery Sales to Bottlers and Other Entities for Distribution in North Carolina

The bill clarifies to whom breweries may sell their product in state and out of state. Current law allows breweries to sell to wholesalers for distribution in North Carolina, or to exporters or nonresident wholesalers (wholesalers located outside of North Carolina) for resale outside of North Carolina. The bill clarifies that breweries can also sell to nonresident wholesalers, nonresident malt beverage vendors, bottlers, or other similar parties for resale in North Carolina, as long as the malt beverages are sold through a licensed North Carolina wholesaler.

The bill appears to contradict G.S. 18B-1110 governing bottlers. Holders of bottler permits are currently authorized to receive, possess, and transport shipments of malt beverages, fortified wine, and unfortified wine from breweries and wineries, and then bottle, sell, deliver, and ship the products in closed containers to wholesalers. Bottlers frequently receive product directly from the brewery or winery itself, rather than from a wholesaler. The bill language appears to require a brewery to first ship the product to a wholesaler before it can be delivered to a bottler.

One reason for this may be to close the apparent loophole in the brewery self-distribution law in G.S. 18B-1104(8), which does not include sales of malt beverages from breweries to licensed bottlers as part of the calculation of the 25,000 barrel self-distribution limit. Note that the statute governing breweries in G.S. 18B-1104(3) says that breweries may only ship to wholesalers (does not say bottlers), but the statute governing bottlers in G.S. 18B-1110 does not require bottlers to receive product from a wholesaler before receiving it from a brewery. This may create a difference in how beer versus wine is handled by bottlers, since the bill only addresses breweries.

Section 7 (G.S. 18B-1104(6a)) - Contract Brewing

The bill clarifies that North Carolina ABC law allows contract brewing between two breweries. This subject has been the sources of much debate and interpretation over the past year among breweries, industry members, and the North Carolina ABC Commission.

Contract brewing in North Carolina has historically existed in many forms. One form is where a

brewery pays another brewery to produce beer for it. This may occur where a smaller brewery lacks the capacity or equipment to produce all the beer it needs, so it contracts with a larger brewery to produce its remaining needs, then purchases the beer from the larger brewery and sells it as its own. Larger breweries with extra space also advertise production capacity, and smaller breweries can contract with the larger brewery to produce special or unique beers that the smaller breweries then sell as their own.

Contract brewing in North Carolina has also existed where a licensed wholesaler paid a licensed brewery to produce beer for it. The brewery produced the beer, kept records, obtained COLAs and labels, and paid taxes. The brewery sold the beer to the wholesaler, who owned the franchise and distribution rights, brand name, and intellectual property rights for the beer, through a contract with the brewery. The wholesaler then marketed the beer to retailers as its own product. The wholesaler's brand distribution rights were protected under the Beer Franchise Law, G.S. 18B-1300*et seq.*, which governs distribution agreements between a brewery and a wholesaler. The wholesaler filed a Distribution Agreement Filing Form with the North Carolina ABC Commission to protect and recognize its brand rights to the beer in the state. (North Carolina law generally prohibits discrimination among wholesalers in G.S. 18B-1304(10), but this does not prohibit a brewery from assigning statewide distribution rights for a brand to a wholesaler.)

Contract brewing has also existed where a bar, restaurant, hotel, or other retail establishment pays a brewery to produce a special beer for it to sell at retail. The brewery then produces the beer and self-distributes it, or distributes it through a wholesaler, to the retailer. North Carolina does not explicitly address this, but it does prohibit a wholesaler (including a brewery that self-distributes) from discriminating among retailers in G.S. 18B-1303(b). Therefore, if other retailers requested the beer that was produced for the first retailer, the brewery/wholesaler would need to offer it without discrimination to the extent it was available.

North Carolina law also prohibits many forms of cooperative advertising between breweries and retailers.

These forms of contract brewing still take place in North Carolina today. The federal Tobacco, Tax, and Trade Bureau ("TTB") also recognizes contract brewing as an "ordinary commercial arrangement."

House Bill 909 would authorize a contract brewing arrangement where North Carolina breweries can "receive in closed containers, and sell at the brewery, malt beverages produced inside or outside North Carolina under contract with the brewery." The producer brewery is responsible for keeping records, obtaining label approvals in its own name, and paying taxes. The purchasing brewery can sell the beer at its brewpub or in its retail outlets located on or adjacent to the brewery. The contract beer shall be made available to wholesalers and retailers without discrimination. The bill provides that affiliated breweries cannot use a contract brewing arrangement as a means to avoid the self-distribution cap of 25,000 barrels per year.

Therefore, the bill makes it clear that contract brewing between two licensed breweries is

allowed. Therefore, a small or start-up brewery in North Carolina can contract with a larger brewery, whether in-state or out-of-state, to produce beer for it, and a larger brewery with excess capacity can contract with a smaller brewery and produce beer for it. The bill does not address other forms of contract brewing as described herein.

Section 8 - Guest Room Cabinet Permits for Certain 18-Hole Golf Courses

The bill authorizes hotels on 18-hole golf courses in areas with a population of 20,000 or more to obtain permits to sell alcohol in minibars.

Conclusion

House Bill 909 makes significant changes to North Carolina ABC law, including providing additional flexibility for breweries, distilleries, and retail permittees. Please feel free to leave a comment on any of these issues, or contact me with any questions.

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