

Alcohol Regulation as a Model for Cannabis Regulation: The Benefits and Drawbacks

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The rapid evolution of the cannabis industry in the United States poses many unique questions, the most interesting of which is what cannabis regulation will look like under federal legalization. Although (legal) cannabis is a brand new industry, it is not the first time the United States has come out of a prohibition era. The cannabis industry can learn from the regulatory schemes governing the alcohol industry to assist with a smoother transition into an era where recreational use of cannabis is no longer a taboo in our society. This article provides an overview of the current regulatory systems for both industries, the key regulatory agencies, the merits of the alcohol industry's three-tier system as a model for cannabis, and the applicability of direct-to-consumer (DTC) alcohol laws to cannabis.

Current Alcohol and Cannabis Regulation

Alcoholic beverages are regulated at the federal, state, and local levels in the United States. The key federal agencies are the Treasury's Alcohol and Tobacco Tax and Trade Bureau (TTB) and the Food and Drug Administration (FDA). By far, TTB plays the most dominant role, and its implementing regulations include permitting, product labeling, product formula, and advertising requirements.

Alcoholic beverages are also subject to the Food, Drug, and Cosmetic Act's adulteration and misbranding provisions. The FDA has generally agreed with TTB through memoranda of understanding that TTB will be the lead agency for labeling, formula, and ingredient requirements.

Because the 21st Amendment (which ended Prohibition in 1933) included special deference to state laws regarding alcohol, federal alcohol regulations do not automatically pre-empt state regulations as they do for other heavily regulated products. As such, states play a key role in alcohol regulation by requiring permits for producers, distributors, wholesalers, retailers, transporters, etc.; collecting taxes; and enforcing commercial trade practice requirements.

Federal and state alcohol laws impose a "three-tier system" in which alcohol is first sold by a producer or importer to a distributor or wholesaler, and then to a retailer. Vertical integration has been prohibited, and, traditionally, producers could not bypass distributors or wholesalers.

Despite the three-tier system, a growing number of state DTC laws allow alcoholic beverage producers and/or

retailers to ship product DTC through a common carrier or deliver product DTC via last-mile delivery services or by their own employees. These laws are most common for wine, but less so for beer and spirits.

Cannabis, unlike alcoholic beverages, remains illegal at the federal level, and is currently only regulated at state and local levels. Some states prohibit cannabis businesses completely, while others allow for medical use only. Nineteen states and Guam allow for recreational cannabis sales.

Similar to alcohol, a cannabis product's route to market is completely dependent on the state in which a business is operating. Within states, the cannabis distribution chain is similar to alcohol: most states license all elements of the supply chain, from cultivation and manufacturing to transportation and retail. Unlike alcohol, while some states prohibit vertical integration in the cannabis industry by imposing more of a three-tier system, many more states either require vertical integration (more common in medical markets) or allow the industry to choose by offering licenses to the same company for different tiers. This flexibility has allowed producers a direct route to their customers, but it has also allowed dominant multi-state operators to grow their footprint across the cultivation, manufacturing, distribution, *and* retail sectors.

Cannabis DTC services are currently geographically limited to the area around the retailer doing the delivery (similar to pizza delivery). Due to its federal illegality, manufacturers cannot ship cannabis via USPS or other major common carriers.

Key Regulatory Agencies

As described above, TTB is the lead federal regulatory agency for alcoholic beverages, with FDA playing an important, but minor role. Although state agencies play a more dominant role in the day-to-day operations of alcoholic beverage companies, TTB regulations provide some uniformity that makes it easier for companies to comply with state laws. For example, TTB's labeling and formula requirements allow alcoholic beverage companies to more easily market brands across the country and many states simply require applicants to provide TTB approvals when registering.

Typically, state alcoholic beverage commissions, or similarly named agencies, are the primary state regulators, with some overlapping authorities with departments of revenue (for tax-related laws) and police departments (for enforcement support).

With respect to any future federal legalization, many states and cannabis companies alike would prefer to see a regulatory model similar to alcohol, whereby deference would be given to the states to regulate the industry within their borders according to the will of their voters and representatives. Ideally, the federal government would play a minimal role in the cannabis industry, by enforcing federal permitting and excise tax collection, as well as labeling obligations. In that scenario, one federal agency, such as TTB, could take the lead and other agencies, such as the FDA, could provide supporting and advisory roles, depending on each agency's particular expertise and background. To the extent federal legislation does not make clear which agency is in the lead role, TTB, FDA, and other applicable federal agencies could formally agree to clear and delineated regulatory oversight responsibilities among themselves.

At the state level, it makes sense to combine adult-use cannabis and alcoholic beverage industry oversight in the

same agency. If adult-use cannabis is going to be regulated in a manner similar to alcoholic beverages, including by looking to existing alcoholic beverage statutes and regulations, it would be counterproductive to have different agencies taking different views on substantially similar laws related to each industry.

The Three-Tier System

The three-tier system was designed, in part, to prevent foreclosure by a vertically integrated dominant producer and to stimulate competition. While there are benefits to the three-tier system, by its very nature it restricts a producer from direct access to retailers and consumers. Large distributors may tend to focus on their largest suppliers, so smaller and newer manufacturers may find that large distributors refuse to distribute their brands or may not pay as much attention to marketing their brands if they agree to sell them.

Given the varied approach states currently take regarding distribution and the desire for traceability and security in cannabis transport, it may make sense to adopt some hybrid model for the cannabis industry at the federal level. For instance a federal agency could offer producer, distributor, and retailer licenses, but not restrict on licensee from holding interests in another license category.

DTC Shipments and Deliveries

DTC technology has advanced to such a point, however, where most of the tax collection and diversion concerns are easily addressed. It is likely that as such technology continues to advance and more third-party companies offer services to assist with age verification, licensing, and tax compliance, we will see more states pass laws addressing this new model of alcohol sales.

Federal legalization will bring about interstate shipment of cannabis products, and the DTC industry in cannabis should learn lessons on age-verification and security from the alcoholic beverage sector. While it may not be one of the first developments in the federally legal cannabis regime, we expect DTC regulation to become a major component of the cannabis framework given that today's consumers have grown accustomed to the world of on-demand delivery and shipment that so many other industries already provide them.

Our Cannabis Practice provides advice on issues related to applicable federal and state law. Marijuana remains an illegal controlled substance under federal law.

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