

Entrepreneurship and Governance in the Scotch Whisky Knowledge Commons

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The Scotch whisky industry is centuries-old and steeped in tradition. Indeed, “it has long been used as a symbol of Scottishness” (Baxter 1985: 77). Recently, distillers in other countries have adopted the Scotch whisky process and have successfully imitated single malt Scotch whisky. Legally, they cannot call their product “Scotch” unless it was made in Scotland, so, instead, it is whisky in the style of Scotch or peat malt whisky. The increased competition from these non-Scottish distilleries caused quite a stir. While at first it was proclaimed that these liquors would never hold a candle to the true Scotch, Japanese and Australian spirits won acclaim and even surpassed some Scottish bottles in worldwide spirits awards (World Whiskies Awards n.d.) and single malt guides (Roskrow, Smith, and Jackson 2015). As early as 2003, a Japanese single malt earned gold medal status (Kageyama 2017). By 2008, a Japanese single malt was named the best in the world (Yan 2014), and in 2014 an Australian single malt earned that honor (World Whiskies Awards n.d.). Japanese whiskies are showing up as a category of their own on the spirits menus of high-end restaurants in the United States, signaling that consumers have accepted the newcomer as a status drink.

The development of a Scotch whisky industry in places other than Scotland resulted in Scottish producers fiercely defending their legally protected geographic indication for “Scotch.” Such exclusion of competing producers is traditionally analyzed using rent-seeking theory, but the case of Scotch whisky is more complicated. This chapter will provide a case study of entrepreneurial history in the Scotch whisky market using the framework of Governing Knowledge Commons focusing

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specifically on the attempts of the entrepreneurs to legitimize their entry into the product category of Scotch. The category of Scotch, especially single malt Scotch was developed and given credence by a small group of Scottish distillers at considerable cost. These distillers, thus, invested in an exclusionary knowledge commons between the producers and the consumers who value the spirit. On the one hand, Scottish producers understandably want to protect this investment and wish to maintain the quality of this shared resource. On the other hand, the exclusionary nature of this commons serves to restrict access to the shared resource and has limited the amount of innovation allowed. This trade-off between maintenance of and access to the shared resource will be the focus of this chapter.

8.1 SCOTCH WHISKY AS A KNOWLEDGE COMMONS

The Governing Knowledge Commons (GKC) Framework described by Dekker and Kuchař (Introduction) is useful to analyze Scotch whisky. This framework, developed by Frischmann, Madison, and Strandburg (2014), is an adaptation of the Institutional Analysis and Development (IAD) framework earlier developed by Elinor Ostrom and colleagues for governing common pool resources such as fisheries and water sources. Frischmann, Madison, and Strandburg (2014) modify the IAD Framework to make it more generalizable to the variety of knowledge commons. They describe a knowledge commons as “the institutionalized community governance of the sharing and, in some cases, creation, of information, science, knowledge, data and other types of intellectual and cultural resources” (2014: 3). We present the case of Scotch whisky, especially single malt Scotch, as a cultural knowledge commons.

8.1.1 *Resource Characteristics*

The resource studied is the knowledge commons surrounding high-quality single malt Scotch. To the Scots, this reputation is a source of national pride, indeed Scotch is referred to as *aqua vitae* or “water of life.” The market for Scotch, then, is cultural in nature. What *is* and what *is not* Scotch is determined in the minds of consumers and producers. In this way, the category of Scotch is a “jointly produced” resource (Dekker and Kuchař, Introduction). In order to better understand the cultural nature of this resource, we will provide a very brief introduction to the history of how producers and consumers developed the single malt category of Scotch into a premium beverage.¹

On the production side, distilleries produce a private good, single malt whisky, that goes beyond mere production to create a product category that serves as a point

¹ For more extensive treatments of the history of Scotch whisky, see Storrie (1962); Tedlow and Jones (1993); Dietz (1997); Lyons (2003); Driver (2014); and Gordon (2014).

of reference for quality. It took hundreds of years for single malt Scotch to attain this status, and the niche market for single malt Scotch is a relatively recent development. How, then, did single malt Scotch obtain its high-quality reputation?

The first official record of Scotch production is found in the Scottish Exchequer Rolls in 1494 (Lyons 2003). From the beginning, a sense of origin was an important characteristic (Driver 2014). Early Scotch production was characterized by single malt distillation in small pot stills for local consumption, but the invention of the continuous still in the 1830s made possible larger, more efficient production processes and blending of Scotch (Storrie 1962). As their names imply, continuous stills distill the spirit on a flow basis; they employ two separate columns for the process and allow for blending of several whiskies. Pot stills, on the other hand, process each batch separately in a single pot, so these are used for single malt Scotch production.² The new technology resulted in a more consistent quality for Scotch and allowed for the development of a new profession in blending (Gordon 2014). In 1877, the formation of the Distillers Company by six distilleries transformed the cottage industry into a more modern commercial endeavor capable of distribution beyond the local level (Gordon 2014). Further cooperation among distillers began in 1912 with the formation of the Wine & Spirit Brand Association, which morphed into the Scotch Whisky Association in 1942 (SWA n.d., *Story of Scotch*).

On the demand side, consumption of Scotch was first used for medicinal purposes, but the technical advances in the 1800s led to an increase in the quality of the spirit as a result of blending (Driver 2014). The blended Scotches were very popular due to the predictability from year to year that blending affords. Blends were also more palatable to non-Scots than single malts, which according to conventional wisdom were “too intense, flavorful, or complex for the English and other foreigners” (Roskrow, Smith, and Jackson 2015: 219). Tedlow and Jones (1993) explain how demand for whiskies including Scotch exploded in the 1880s when vineyards in Europe were destroyed by the phylloxera beetle and consumers switched from wine to whisky. The authors point out that Scotch gained further prestige from Queen Victoria who visited distilleries and promoted the industry.

It is widely noted that the popularity of blended Scotch reached America when US soldiers returned home from World War II having been exposed to the drink while in the United Kingdom (see, e.g., Storrie 1962; Tedlow and Jones 1993; Driver 2014). In America, Scotch had an “import cachet” relative to domestic whiskies

² The U.K. Statutory Instruments (2009) define the following categories of Scotch: (1) Single Malt Scotch Whisky: distilled in one or more batches at a single distillery, from water and malted barley and no other cereals, in pot stills; (2) Single Grain Scotch Whisky: distilled at a single distillery and is not a Single Malt Scotch Whisky or a Blended Scotch Whisky; (3) Blended Malt Scotch Whisky: a blend of two or more Single Malt Scotch Whiskies distilled at more than one distillery; (4) Blended Grain Scotch Whisky: a blend of two or more Single Grain Scotch Whiskies distilled at more than one distillery; and (5) Blended Scotch Whisky: a blend of one or more Single Malt Scotch Whiskies with one or more Single Grain Scotch Whiskies.

(Driver 2014: 349), but single malt Scotch had not yet been established as a premier spirit. As liquor connoisseur and author wrote in 1948, “Nobody drinks single malt” (Embury, Hess, and Saunders 1948); blended Scotch was all there was at that time.

Scotch was revolutionized with the introduction of the “single malt” category as a premier whisky to international markets in the 1960s. W. Grant and Sons gets credit for pioneering the sale of single malts outside of Scotland (see Driver 2014; Gordon 2014; ScotchWhisky.com n.d., *Glenfiddich*). The Scotch industry had been facing declining demand, and the Grants were facing competition from larger firms buying up independent distillers. In response, W. Grant and Sons introduced their unique triangular shaped bottle, designed to reflect “[w]ater, air and malted barley. A trinity expertly crafted to make a Glenfiddich whisky” (Glenfiddich n.d., *Our History*). The Grant family also began to focus on the single malt category.

One story has it that the distillery had a contract dispute with its grain supplier; and with no grain whisky with which to blend, they decided to bottle the malt whisky by itself (Mennie 2018). Their Glenfiddich distillery was only equipped with pot stills, as they purchased the grain whisky for blending from a distillery that used continuous stills. The Grants went on a marketing blitz, advertising the product as a craft good from the mists of history (not unwarranted, as prior to the industrial revolution and the invention of the continuous still, single malt *was* the only kind of Scotch). Given that Scotch takes time to age, Grant and Sons were able to establish “a ten year first mover advantage” in single malts (MacLean 2016: 18). The Grants expanded their sales to international markets through duty-free stores. Suddenly Scotch whisky had a newly popular category and an entirely new distribution structure. In this way, the Grants can be classified as entrepreneurs who went against convention as described by Young Back Choi (Chapter 5). To this day, W. Grant and Sons remains under the control of the original family (Roskrow, Smith, and Jackson 2015: 219). While the Grants were the first movers, “[c]onsumers loved it, so other producers followed suit” (Mennie 2018). Soon firms such as Glenlivet, Macallan, and Glenmorangie also marketed their own unique single malts (Driver 2014).

This newly marketed category of single malt began to serve as the exemplar of the Scotch industry, and, it can be argued, of whiskies in general. Dekker and Kuchař (2016) develop a theory of exemplary goods to explain how quality distinctions emerge as part of the competitive process. Among whiskies, Scotch, especially single malt, is an exemplar – a standard by which other whiskies are judged and one which other whiskies want to imitate, as the Japanese and others have attempted. According to the head of the Scotch Whisky Association, “Scotch remains THE aspirational spirit, the whisky that everyone, all over the world, wants to drink” (Scotch Whisky Association 2018).

That the country of origin is such a distinguishing signal of the quality of the spirit leads us to conclude that Scotch is also a kind of “credence good.” Andersen and Philipsen (1998) provide a theory of credence goods in which the credence

characteristics of the good are difficult to ascertain both before and after purchasing the good. A consumer cannot tell for sure if the spirit is Scottish just by looking at the product. Likewise, given that award-winning Scotch-like spirits are also produced in other countries, the Scottish nature cannot perfectly be determined by tasting the spirit. Andersen and Philipsen (1998) conclude that consumers may often rely on third-party verification of the quality of credence goods. Producers have an incentive to pursue that third-party credentialing in order to give consumers reason to believe in the quality of their product. The community of actors help to define and maintain that credentialing.

8.1.2 Attributes of the Community

The Scotch community is comprised of consumers around the globe, whisky reviewers and awarding organizations, non-Scottish producers, Scottish producers (organized by the Scotch Whisky Association), and the governments of the United Kingdom (UK) and the European Union (EU). The producers and consumers alike coproduce the category of Scotch.

Consumers contribute to this commons by participating in the culture surrounding Scotch. Learning about and enjoying Scotch is communal in nature, much like the example of the culture of appreciation for opera described by Benzecry (2009). Building on the model for cultural affiliation presented in Becker (1953), Benzecry (2009) describes how opera fans are passionate about the art, in part, “as a result of their belief that opera is something that needs to be learned in order to be properly enjoyed” (134). People come to learn about and appreciate opera through informal, formal, and experiential means. Likewise, Scotch involves a learning curve that consumers enjoy. The distilleries provide formal and experiential educational opportunities in their tours and tastings. There is even a “Scotch Whisky Experience” attraction in Edinburgh that was developed by nineteen Scotch companies in the 1980s to promote the heritage of Scotch (The Scotch Whisky Experience n.d.). This attraction includes a museum, tours, tastings, and a Scotch school where students can earn a “Certificate of Expertise recognised by the Scotch whisky industry.” Informally, consumers learn from each other and from bartenders in bars and pubs. Consumers also learn about quality from whisky reviewers who rate the different spirits and from worldwide whisky awards recognition.

Whisky reviewers and awarding organizations add to the knowledge commons by providing signals of quality. Scotch drinkers rely on these ratings much like wine drinkers look for high ratings from, say, Robert Parker. A signal that Japanese and Australian whiskies have gained acceptance in the community is that a popular guide has included “new world whisky” as a section for non-Scottish distillers beginning with their sixth edition published in 2010 (Roskrow, Smith, and Jackson 2015: 393).

The highly rated and award-winning non-Scottish producers today include the Suntory company in Japan and Sullivans Cove distillery in Australia. Suntory's adoption of the production process for blended Scotch began in the 1920s with Masataka Taketsuru who apprenticed in Scotland and brought the craft of blended whisky back home (McNeill 2019). In Australia, Bill Lark recognized that the abundance of natural resources and the climate made Tasmania a perfect fit for whisky and his efforts led to the repeal of distillery prohibition in Tasmania in the 1990s and the development of the whisky industry there (Frost 2014).

The large number of small and large Scottish producers are organized by the Scotch Whisky Association (SWA), which is dominated by the large firms. The purpose of the Scotch Whisky Association "is to safeguard the Scotch Whisky category and prevent unfair competition" (Scotch Whisky Association n.d., *What We Do*). Thus, the SWA maintains the knowledge commons in part by restricting access to it. Acting as a standard setting enterprise, the SWA helped to develop the governance structure described in the next section surrounding the geographic indication protection that is backed by the UK and (until Brexit) the European Union governments. The SWA employs a staff of lawyers that handle legal cases and trademark cases protecting the Scotch commons. The geographical indication protection is the system that producers use to validate the hidden credence characteristics (Andersen and Philipsen 1998) of their Scotch to consumers in order to mitigate the asymmetrical information problem regarding quality.

8.1.3 *Rules-in-Use*

The reputation of Scotch is non-rival (non-subtractable), in that all producers can benefit from it at the same time, but only if it is used appropriately. If lower-quality whiskies were sold under the Scotch name, that would dilute the value of the common resource. For example, Gordon (2014) explains how in the late 1800s, after the introduction of continuous stills allowed the industry to mass produce, there was a glut of lower-quality Scotch offered for sale that damaged the reputation of the industry. The quality of Scotch improved after the passage of the Immature Spirits Act of 1915 that was part of the temperance movement to reduce drunkenness in society (Lady Astor 1923; Weir 1988). The Act sought to reduce the supply of low-quality liquor by requiring that spirits be aged for 2 (and then later 3) years (Gordon 2014). This restriction did rid the market of cheap liquor, but it had the unintended consequence of creating a better quality product that future consumers demanded.

One goal of the knowledge commons is to preserve the high-quality reputation of Scotch whisky. To protect this resource, the Scottish producers have developed a formal governance scheme revolving around laws of geographic indication that have successfully turned this resource into an exclusive "collective monopoly right" (Rangnekar 2004: 1). The evolution of similar reputational protections in the Hungarian wine industry is analyzed by Megyesi and Mike (2016). While they do

not utilize the more generalized Frischmann, Madison, and Strandburg (2014) modification of the IAD Framework, they use Ostrom's general model to conclude that the commons literature is useful in studying business organizations' attempts in collective reputations. These reputational rules surrounding Scotch have roots in a tradition of shared values and have evolved from rules-in-use to become rules-in-form.

Distillers cannot call their product "Scotch" unless it was made in Scotland using a specific process. Producers in Scotland have invested resources in the Scotch designation as a signal of the quality of their spirit. Consumers also have a vested interest in the exclusive nature of its reputation because consumption of single malt Scotch distinguishes them as whisky connoisseurs. Thus, the Japanese and Australian entrepreneurs face social and institutional barriers as they enter the industry. If they could adopt the name "Scotch," they could more easily signal to consumers the high quality of their product.

O'Connor (2006) provides a comprehensive history of geographic protection law. He explains that initially two specific designations were protected by law (O'Connor 2006: 22). "Indications of source" merely specified where the product was made, for example, "Made in the USA." The more stringent designation of "appellation of origin" specified the region of production, but also indicated that there is something special about that particular region that makes the product unique, for example, "Gorgonzola cheese." This type of designation, then, included some reputational capital as a cultural phenomenon. In theory, the purpose of the geographical indications protection is twofold: (1) "the protection of consumers from false and misleading information" and (2) "the protection of producers from unfair competition" (O'Connor 2006: 123).

Geographic indications (GIs) are legally different from two other types of designations, namely, trademarks and generic names. Mantrov (2014) explains that sometimes a geographic designation is included in a trademark, such as "Philadelphia cream cheese" (2014: 45), which does not mean it is made in Philadelphia. The purpose of the trademark is to differentiate one product from another, and usually trademarks are owned by a single entity. In contrast, a GI is open to anyone in the geographic area. Generic names, such as "French bread," do not imply any link to a geographic area, although it may be the case that the product originated in the particular geographic area of the same name (Mantrov 2014: 101). Products protected by GIs can lose that protection if, over time, consumers come to view the name as referring to the product generally, as opposed to having a tie to the particular geographic area. Such was the case with "Camembert" cheese and "London Gin" (Mantrov 2014: 103). Scotch producers are vigilant in protecting the classification of the geographic indication so that "Scotch" does not devolve into a generic name.

The World Intellectual Property Organization (WIPO) promotes the benefits of geographic indication protection, arguing that GIs help producers "in developing

collective brands” that differentiate their product (World Intellectual Property Organization n.d.). Consumers are usually willing to pay more for a differentiated higher-quality product. The WIPO concludes that protection of geographic indications can lead to “competitive advantage, more added value, increased export opportunities [and] a strengthened brand” (World Intellectual Property Organization n.d.).

Of interest for this chapter are the current protections of the Scotch whisky designation at the international level by the World Trade Organization (WTO), at the regional level by the EU, and at the national level by the UK. International protection of geographic indication is provided by the Agreement on Trade-Related Aspects of International Property Rights (TRIPs Agreement) included in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). The TRIPs Agreement contains rules for the geographical indications related to all products generally, as well as specific rules pertaining to wines and spirits and to wines separately. The higher level of protections for wines and spirits was especially pushed for by the European Commission at Uruguay (Schloder (1996) as cited in O'Connor 2006: 56, fn 84). The extra provisions in Article 23 (World Trade Organization 1994), relating to the spirits industry prevents the non-Scottish distillers from promoting their spirit as “Scotch” or even as “Scotch-style.”

Long before the TRIPs Agreement was approved at the international level, European countries protected geographical indications. As O'Connor (2006: 123) explains, the formation of the European Union standardized these diverse long-standing national protections and made them applicable in all member states. Currently, the general rules protecting geographic indications at the European level are found in Regulation 110/2008 that “lays down rules on the definition, description, presentation and labelling of spirit drinks as well as on the protection of geographical indications of spirit drinks” (European Union 2008). Included in these regulations are the various characteristics (ingredients, proof levels, processes, etc.) and geographic origin that must be met for spirits. For example, the regulations delineate the production methods that must be used for “Gin” versus “Distilled Gin” versus “London Dry Gin.” Despite the differences, London Dry Gin is not registered for geographic indication protection, but merely refers to a style of distillation. Those spirits that are registered for geographic indications, such as Scotch whisky, are protected against any “practice liable to mislead the consumer as to the true origin of the product” (European Union 2008).

Under EU law, individual countries that have products with registered geographic indications must have a “technical file” and a “verification scheme.” Scotch’s technical file was submitted by the UK in 2013 and it includes the definition of the product and details about the minimum standards for production. The technical file, then, defines “what is Scotch” from a legal perspective. For example, Scotch whisky may not include added enzymes, must be made from malted barley, must be aged in oak casks, and must be produced and aged in Scotland (Department for

Environment, Food and Rural Affairs 2013). Single malt Scotch must be both produced and bottled inside the country.

The technical file also summarizes the links between Scotch and Scotland that form the basis of the geographic indication. One such factor is the abundance of peat, important in the flavoring of Scotch. Another is that the geology of Scotland, influenced by ancient seismic activity, has resulted in especially distinct sources of water that vary with the type of rock in the area. Another important factor is the climate. Eastern Scotland's climate is prime for growing the barley and wheat for use in Scotch production and the moistness of the climate where the Scotch is aged, is optimal. Interestingly, Japanese whisky producers also credit Japan's "clean and tasty ground water" and "four distinct seasons" for their success (Kageyama 2017); and Tasmania, Australia is described as having "just about everything you need to make good whisky: water, barley, even peat (although it's different to that found in Scotland)" (The Whisky Exchange n.d.).

Physical conditions are not the only important link between Scotch production and Scotland. The technical file also outlines the "[s]kills and processes developed in Scotland and handed down over the centuries [that] also have a significant effect on the quality and character of Scotch Whisky" (Department for Environment, Food and Rural Affairs 2013: 14). These include the skills of the distillers and blenders and the quality of the stills and casks. In sum, "[i]t is the combination of human and natural factors which contribute to the reputation, character and quality of Scotch Whisky" (Department for Environment, Food and Rural Affairs 2013: 17). These human factors are what distinguishes Scotch from the Japanese and Australian spirits. Japan and Australia may have similar climates, water, and peat, but they are not part of the knowledge commons created and shared by Scottish distillers and consumers of Scotch.

Along with the technical file, the UK also had to submit a verification scheme to the EU. Introduced in 2014, the verification scheme is the enforcement mechanism for ensuring that all Scotch that is sold is in compliance with the specifications in the technical file. Verification is overseen by the Commissioners of Her Majesty's Revenue and Customs (HMRC). Any firm involved with the production of Scotch must register with the HMRC, and staff from the bureau make periodic inspections of the facilities to ensure compliance. The initial fee is 1,630 pounds per production process, so a firm that both ferments and distills would pay twice the fee (HM Revenue and Customs 2014: 22). Even firms involved with blending and bottling outside of Scotland must register and be inspected, although they face a lower fee (520 pounds) since the processes being verified are simpler (HM Revenue and Customs 2014: 22). The total annual cost of implementing the verification scheme is estimated to be 350,000 pounds (Scotch Whisky Association 2014).

In addition to international and European Union level protection, Scotch Whisky has long enjoyed protection at the national level in the United Kingdom, most recently by the Scotch Whisky Regulations of 2009. These regulations were

developed upon the recommendations of the Scotch Whisky Association (MacLean 2016: 32). Like the EU technical file, these regulations spell out in detail the production requirements that must be met in order for a spirit to legally be called Scotch, the first of which is “‘Scotch Whisky’ means a whisky produced in Scotland” (U.K. Statutory Instruments 2009). These most recent regulations even include the specific requirement that single malt Scotch be produced using a pot still, the method already used by the large companies. It is rumored that the pot still requirement was targeting Loch Lomond Distillery, the second largest family-owned Scotch producer, which did not use this method, and was not a member of the Scotch Whisky Association who supported passage of the law (Hansell 2009). In 2014, Loch Lomond was bought out by a private equity group (ScotchWhisky.com n.d., *Loch Lomond*.), and has since joined the SWA.

The SWA summarizes the many ways to infringe on the geographic indication protection. Descriptions such as “Scotch like” or “Scotch style” are expressly forbidden, as is the use of Scottish themed names or pictures (such as tartan or bagpipes) in the marketing of a non-Scotch spirit. Use of an identical label for both Scotch and a non-Scotch spirit is also outlawed. In non-English-speaking export markets, even the use of the English language on a label may imply that the product is from Scotland, when it is not. If the spirit is actually a blend of Scotch with a local spirit, the use of the phrase “Blended with Scotch” can be interpreted as an attempt to mislead the consumer into thinking the product is true Scotch. Some producers may attempt to mislead consumers about the age of the spirit, so the regulations prohibit the use of numbers on the labels unless they truly reflect the number of years the spirit has aged in the cask.

A recent case brought and won by the SWA involved a US distillery in Virginia. The Virginia Distillery Company imports aged malt whisky from Scotland, blends it with single malt made in Virginia, and then finishes it in port, cider, beer, or chardonnay casks (Virginia Distillery Company n.d.). They call their series Virginia Highland Whisky, which has won Best American Blended Malt from the World Whisky Awards for the past three years. The use of Highlands in the name, however, garnered the attention of the SWA. The case has since been settled, with the Virginia Distillery Company agreeing to stop using the Highlands name once current stocks are depleted (Scotch Whisky Association 2019a).

The SWA supported and welcomed the verification scheme, claiming that it “ensures that every part of the Scotch Whisky supply chain, from distiller to consumer, within Scotland or beyond, is mapped by the industry, registered with the U.K. Government and inspected to ensure it complies fully with all the rules on the production of Scotch” (Scotch Whisky Association 2014). According to Magnus Cormack, Scotch Whisky Association Director of Legal Affairs,

[t]he value of the brand Scotch whisky is really incalculable. At the moment Scotch whisky can only be produced in Scotland. If the geographic description Scotch

whisky came to mean simply that it was just a type of whisky which could be distilled anywhere, that would be a disaster for the Scottish economy and for the British economy. It's what happened to London Gin. At one time it was only produced in London – now it just means a type of gin which is produced worldwide, and London distillers have missed out on an opportunity. So I think the value of protecting Scotch whisky is essential. But for a protected name, there would be no industry.

(Bennett 2015)

Of course, these protections of quality only make sense if consumers perceive Scotch as a superior drink. Producers and consumers jointly co-create the reputation of Scotch. These protections illustrate the trade-off between maintaining the knowledge commons and allowing access to the shared resource.

All of the Scotch protections refer to geography, not ownership. The largest producer of Scotch, Diageo, who produces more than one-third of all Scotch in the world, is headquartered in London, and the second largest producer of Scotch is Pernod Ricard, a French company (Whisky Invest Direct n.d.). Other distilleries are owned by Japanese, Cuban, Italian, and South African companies (Roskrow, Smith, and Jackson 2015). These foreign ownerships all came about via mergers. While we know of no example of a foreigner obtaining a license to open a distillery in Scotland from scratch, there do not appear to be barriers to foreign entry.

8.1.4 *Valuable Commons or Rent-Seeking Scheme*

As mentioned earlier, Japanese and Australian whiskies have attained ratings and won awards traditionally reserved to single malt Scotch; therefore, these could be seen as at least substitutes for traditional Scotch. Why then, shouldn't they be called Scotch? To answer that question, we can turn to political economy to describe how the members of the Scotch community interact in the action arena of the GKC framework. As Meloni and Swinnen (2013) explain using the wine industry, European regulation resulted from political pressures from countries and producers seeking to protect their monopolistic rents. The same has happened in the Scotch whisky industry. What began as a communally governed craft commons has turned into a vast protection scheme for large industrial producers.

As Wenzel (2012) has pointed out in his analysis of the *Appellation d'Origine Contrôlée* system for French wine, Tullock's (1967) rent-seeking model can be useful here. In this case, the rent-seekers are the members of the Scotch Whisky Association, dominated by the large producers. It serves as the primary lobbying group for the industry and supported passage of the Scotch regulations. The stricter production regulations passed in 2009 not only protect Scottish producers from foreign competition, but also make it harder for small independent firms to compete with the larger corporations. The large firms are better situated to comply with the

stricter regulations and indeed may have purposely supported the inclusion of a certain technology, the pot still requirement, to target the smaller Loch Lomond. The structure of the fees for the verification visits also benefits the large producers. The Scotch Whisky Association maintains that the cost of inspections “is being shared across the Scotch Whisky industry” (Scotch Whisky Association 2014), but by charging a flat fee per visit, the smaller producers are relatively harder hit.

McChesney (1987) extends the economic theory of regulation to provide an active role for politicians in extracting rents. He uses the example of “firms’ fixed-cost investments in brand-name capital or reputation” (112). The brand name provides a quality signal to consumers and allows the firm to earn a price premium and economic rent. Government regulators, in McChesney’s model, can threaten to intervene in the market by passing “legislation to have administrative agencies guarantee quality or truthful information by imposing minimum quality standards or mandatory information-disclosure regulations” (113). Threatened firms would pay up to the brand name rent in order to prevent the legislation from being passed.

The EU requirement that all geographic indications be documented with a technical file and enforced by a verification scheme provides a way for the regulators to extract rents as McChesney’s (1987) model predicts. As discussed earlier, the British government now has responsibility for regular inspection of the Scotch producers costing about 350,000 pounds per year. Firms that do not comply will lose their geographic indication and will no longer be able to market their product as “Scotch.” The Scottish producers, organized by the SWA, agreed to this rent extraction.

The successful rent-extraction in the Scotch industry can be contrasted to that of London Dry Gin. Remember that Magnus Cormack, the SWA Director of Legal Affairs, lamented that the producers of London Dry Gin missed an opportunity to protect its brand. The gin producers seem to think otherwise. London Dry Gin was traditionally made in London, but the producers never applied for geographic designation status, so the term “London Dry Gin” refers to a specific production method, rather than place. In contrast, a gin that had geographic indication protection is Plymouth Gin; it can only be made in Plymouth, England. Interestingly, the sole producer of Plymouth Gin, the French company Pernod Ricard, declined to renew their protected status once the new regulations required a costly technical file and verification scheme. According to a company spokesperson, the “definition of GI has changed” and they “realised it’s not in the best interest of Plymouth Gin” to retain it (Blackledge 2014). That the company was not interested in retaining its GI is not surprising. As the sole producer of Plymouth Gin, Pernod Ricard owns the trademark to the name so other producers may not market a Plymouth Gin (Evans 2014). Pernod Ricard does not need to succumb to the new regulations and pay for the now required inspections in order to maintain their economic rents. The regulators, however, tried to maintain the chance for rent-extraction.

The Department for Farming, Agriculture and Rural Affairs (DEFRA) says it will push to secure the future of Plymouth Gin's GI status. A spokeswoman said: "Spirit drink geographical identification provides a boost for the UK economy, with products commanding premium prices around the world – our biggest GI Scotch Whisky is worth around £4.3bn in exports to the UK. We are supporting the industry to help them secure the future of Plymouth Gin's GI."

(Blackledge 2014)

In this case, the rent-extractors did not prevail.

Wenzel (2012) argues that the French wine industry suffers from the transitional gains trap described by Tullock (1975). There, the initial gains from obtaining the *Appellation d'Origine Contrôlée* system have been fully capitalized into the land values, and Wenzel argues that keeping the system in place is stifling innovation. The industry has passed a tipping point where maintenance of the commons takes priority over access to the commons. We use the new entrepreneurial history literature in the next section to explore whether the Scotch Whisky Association can escape that trap. Entrepreneurs in foreign countries and within Scotland are trying to alter the knowledge commons but face barriers due to the evaluative criteria set out in the 2009 Scotch whisky technical file. More recent evaluative criteria come from the whisky award and rating organizations. More importantly, consumers evaluate the spirits and vote with their dollars. Scotch's worldwide volume market share has fallen since 2008, while Japanese whisky has gained market share over the same time period (Chaudhuri 2019). All of these evaluative criteria may provide a feedback loop enabling entrepreneurs to succeed.

8.2 NEW ENTREPRENEURIAL HISTORY OF SCOTCH WHISKY

Wadhvani and Lubinski (2017) "propose to reinvent entrepreneurial history as a research field," defining it "as the study of the creative processes that propel economic change" (769). These processes are: "(i) envisioning and valuing opportunities, (ii) allocating and reconfiguring resources, and (iii) legitimizing novelty" (769). All three of these processes are evident in the case of entrepreneurship in the Scotch whisky industry.

The political economy of Scotch described above results in a closed cultural knowledge commons that hampers innovation and change by restricting the right to contribute to the commons. Ostrom and Hess (2007: 52) include the "right to contribute" as a relevant property right. For example, the knowledge commons of Wikipedia is enhanced in value by the ability of users to contribute to the articles. In contrast, entrepreneurs who see opportunity in stretching the boundaries of Scotch are often stymied by the status quo. Producers of Scotch do not have the right to alter the legal definition of Scotch, say, to include whisky made in Japan or Australia. As Andersen and Philipsen (1998: 9) point out, "innovation per definition involves

a degree of novelty” that creates uncertainty about quality. The Scotch Whisky Association attempts to preserve the certainty of the high-quality reputation of Scotch, as currently defined, at the expense of possible quality improvements. As was the case with French wine, maintenance of the Scotch commons now takes priority over access.

In addition to discouraging novelty from abroad, the closed commons also limits entrepreneurial activity within Scotland. One of the largest Scotch producers, Diageo, was reined in by the Scotch Whisky Association in the early 2000s when it changed its recipe in order to meet high export demand. Since it takes so long to produce and age Scotch, it is difficult for producers to nimbly respond to changes in demand. Diageo found that it could not meet foreign demand for its single malt Scotch, Cardhu, in 2002. Its solution to this problem was to blend Cardhu with 12-year old malts from other distilleries that it owned. This product was presented as “pure malt” Scotch. They planned to use their old distillery name, Cardow, for the single malt version (MacLean 2016: 131) because traditionally, only single malt Scotch carry the name of the distillery. Unfortunately, Diageo used packaging and labeling that was very similar to that used for the single malt Cardhu, thus a “quality scandal” over the credence characteristic (Andersen and Philipsen 1998) ensued. “The resulting dispute saw threats of legal action and a rival company, W. Grant and Sons, wrote to every Member of the Scottish Parliament, accusing Diageo of ‘gambling on might being right’” (BBC News 2004). One of these Parliament members even reached out to Prime Minister Tony Blair for assistance (Chaudhuri 2018). Diageo tried to appease the complainants by changing the color of the bottle, and including more explicit explanations to consumers. In the end, the Scotch Whisky Association intervened and Cardhu Pure Malt was discontinued. Diageo, then, was unable to legitimize the novelty of its product. This Cardhu controversy and the rift it caused within the SWA set the stage for the development of stricter definitions and regulations for Scotch, which finally culminated in the Scotch Whisky regulations of 2009. In fact, these regulations stipulate that

The name of a distillery mentioned in Schedule 1 must not be used as a brand name, or as part of a brand name of a Scotch Whisky, or be used in a similar fashion in terms of its

positioning or prominence, unless the whisky has been wholly distilled at that distillery.

(U.K. Statutory Instruments 2009: 7)

and

A person must not label, package, sell, advertise or promote any Scotch Whisky in a way that includes ... the phrase “pure malt” or any derivation of that phrase.

(U.K. Statutory Instruments 2009: 9)

Scottish distillers and Scotch consumers both have a stake in protecting the high quality of Scotch from dilution. Remember that the glut of low-quality Scotch in the late 1800s damaged the reputation of the whole industry.

In 2018, Diageo again tried to innovate by proposing to age its Scotch in casks previously used for its tequila production (Chaudhuri 2018). That is, it engaged in “envisioning and valuing opportunities” and “allocating and reconfiguring resources” (Wadhvani and Lubinski 2017). Not surprisingly after the Cardhu Pure Malt incident, the legitimacy of this novelty was questioned. Their request was discouraged by the legal affairs director of the SWA at the time. Note that the 2009 Scotch Whisky technical file only stipulates that the finishing cask be made of oak, nonetheless, according to the rules-in-use the tequila casks defied convention (see Choi, Chapter 5). Diageo also proposed creating new flavored infusion and low-alcohol blends of Scotch to meet current consumer tastes, but these changes were not welcomed either. Earlier, in 2016, Eden Mill Distillery and Brewery tried to use chocolate malt in their Scotch, but was also struck down by the SWA (Chaudhuri 2018). In response to these defeats, Diageo created an internal task force to examine potential reforms to the technical file to allow for more entrepreneurship (Chaudhuri 2018, 2019).

There may be optimism in Scotland, however, as the relatively new (appointed in 2017) chief executive of the Scotch Whisky Association, Karen Betts, seems to be open to a reassessment of the regulations (Hopkins 2018). Beginning in 2016, W. Grant and Sons, the same company that pioneered single malts and fought against Cardhu Pure Malt, accomplished what Diageo could not. They began introducing “experimental” lines under the Glenfiddich brand including single malts finished in unconventional casks previously used for India Pale Ale, ice wine, and rum (Glenfiddich n.d., *Experimental Series*). While Diageo has not experimented again with infusions, they have recently partnered with Home Box Office (HBO) to successfully introduce the Game of Thrones Single Malt Scotch Whisky Collection, a limited edition line of single malts packaged with themes from the show (Alindahao 2018).

Finally, in 2019 the use of different types of casks was approved as an amendment to the Scotch whisky technical file. Now, distillers may age Scotch “in casks previously used to make wine, beer or spirits so long as these haven’t been made using stone fruits, and they haven’t had fruit or other flavoring added after fermentation or distillation” (Chaudhuri 2019). According to Betts, “This amendment provides clarity and some additional flexibility on the range of casks in which Scotch Whisky can be matured. The change is consistent with Scotch Whisky’s heritage and traditions, and strengthens our foundations into the future” (Scotch Whisky Association 2019b).

This new openness to change may be analyzed using the GKC framework described in the introduction to this volume as well as in Frischmann’s chapter (Chapter 4). The patterns of interactions among participants in the Scotch action

arena led to some transactions being deemed repugnant (calling Japanese whisky Scotch) and others being deemed as valuable (aging Scotch in different casks). This feedback then gets transmitted back into the resource characteristics to change what is and is not Scotch, and the rules-in-use and rules-in-form get changed accordingly. Within these new rules, then, the Scottish entrepreneurs are “envisioning and valuing opportunities, allocating and reconfiguring resources, and legitimizing novelty” (Wadhvani and Lubinski 2017: 769).

Entrepreneurs in the United States are innovating with respect to the aging process. The UK and EU regulations require Scotch to be aged (in Scotland) for at least three years, but a new technology has been developed that speeds up this process from years to days. Flash-aging involves pressure and vibration in steel vats with pieces of wooden casks thrown in for flavor (Greenblatt 2013). Initially used for bourbon production, this technology has been used for other spirits, including a Scotch-like whisky. The company Lost Spirits imports unaged Scotch from Scotland and then flash-ages it in California. They call their product a “peated malt” under the tongue-in-cheek brand name “Abomination” (Lost Spirits n.d.). Abomination won Wizards of Whisky’s American Craft Whiskey of the Year in 2019 (Haruta 2019).³ The consumers and whisky reviewers, thus, are more flexible in their acceptance of these novelties than the traditional Scottish producers and the SWA. To the extent that the consumption side of the commons values these nontraditional spirits, Scotch may cease to be seen as the lone prestige drink. If that happens, then the legal protections and other rules-in-form will be useless.

One recent innovation in blended Scotch has been perceived as potentially damaging to the prestige reputation. In October 2019, Glenlivet partnered with a London bar to create “The Glenlivet Capsule Collection,” a limited edition of Scotch cocktails served in small biodegradable pods made of seaweed (Pomranz 2019). Consumers pop the pod into their mouths and bite down to release the cocktail. While Glenlivet maintained it was trying to be true to the entrepreneurial bent of its founder, many industry commentators mocked the pods. “An overarching criticism of the whiskey pods was that the capsules would ‘cheapen’ the mystique of the Glenlivet brand and ruin the experience of drinking whiskey” (Warren 2019). Specifically, part of the Scotch experience is to smell the spirit and sip it slowly. None of this experience is available with the pod. As one critic put it “As soon as you treat it like tequila or cheap hooch, your brand is dead” (Warren 2019).

The entrepreneurial innovations described above provide an illustration of the analysis of institutional evolution presented by López in Chapter 3. Lopez amends Ostrom’s IAD framework to include Searle’s (1995) institutional theory. Institutions can be regulative (rules that govern actions in an existing arena) or constitutive

³ Wizards of Whisky awards were created by noted whisky reviewer Dominic Roskrow and they purposely exclude “large established distilleries in Scotland, Japan, or Kentucky” in order to “highlight smaller world distillers and distilleries from non-traditional areas.”

(rules that create new action arenas). Lopez uses Searle's concept of "status functions," a special type of constitutive rule that is important to include in the Ostrom's action arena. When Scottish or foreign entrepreneurs innovate, they are attempting to alter the status function of Scotch. Given the high value producers and consumers place on the reputation and exclusiveness of Scotch, it is not surprising that attempts to alter the status function are sometimes met with resistance. Successful innovations are those that are able to alter the shared understandings that surround Scotch.

Remember, the shared understanding of Scotch embodies Dekker and Kuchař's (2016) explanation of exemplary goods. Scotch, especially single malt, is a category unto itself. The Japanese and Australian versions, and the new experimental and flavored Scotches can be seen as "border-line cases" (247) that do not quite fit into the Scotch category. The current definition of the single malt category, however, appears to be changing as a result of the competitive process. Foreign whisky and the new flavored Scotch are the newcomers that may "challenge the existing market categories or shared understandings of the good" (Dekker and Kuchař 2016: 254). Both foreign and Scottish entrepreneurs face cultural and legal obstacles to legitimizing their innovations. These entrepreneurs are attempting to change the shared social infrastructure of the Scotch knowledge commons.

Dekker and Kuchař (2016) further explain that exemplary goods "teach" consumers about the quality of the good "even when we cannot always fully describe or articulate what that quality consists of." In this way, "exemplary goods and practices contain tacit knowledge about the dos and don'ts that is often hard to codify" (10). One example of the tacit "dos and don'ts" for Scotch Whisky is that traditionally only single malts bear the name of the distillery, a "do" that was encoded with the 2009 regulations passed in the aftermath of the Cardhu controversy. The Japanese and Australian distillers faced a huge "don't" by not being able to label their whisky as Scotch after they painstakingly replicated the Scotch process. Despite the similar climate and purity of water and ingredients used by these foreign distillers, only whisky made in Scotland may be called Scotch. Scottish producers maintain that there is tacit knowledge involved with the Scottish culture passed down from generation to generation that is impossible to replicate in other countries.

8.3 IMPLICATIONS AND CONCLUSION

This edited volume is built upon four building blocks, as Dekker and Kuchař explain in the book's Introduction. "First, a market is a form of a culture" (9). We have described the cultural aspects of Scotch whisky and we have argued that single malt Scotch is an exemplary good with credence characteristics. We have used the GKC framework to analyze Scotch as a knowledge commons, which is part of the second building block. Thirdly, our political economy case study examines the "intellectual and legal infrastructures" in Scotch, including the protection of geographic indications that is protected by law and the Scotch Whisky Association.

Finally, we explore how “the shared intellectual infrastructure is produced and reproduced by entrepreneurs who sustain and marginally change these shared infrastructures through breaking rules, slight evasions, and through justification” (9). Specifically, we examine entrepreneurial processes from Scottish and foreign producers who are attempting to alter the definition of Scotch to legitimize their innovations. Because of the closed nature of the Scotch knowledge commons (backed by the geographic indication protection), these foreign entrepreneurs do not have the full “right to contribute” to the knowledge commons that Ostrom and Hess (2007) stress as important.

Prendergast (Chapter 2) uses the example of the “industrial commons” that is relevant for Scotch. All of the actors in the community – distillers, consumers, judges, reviewers, governments – contribute to what is and what is not considered as Scotch. While the legal definition is maintained in the technical file required by the European Union for geographic indication protection, the cultural definition is more flexible. Scotch can be seen as an example of the “delicate ecosystem” Prendergast (Chapter 2) describes, consisting of “webs of technological know-how, operation capabilities and specialised skills.” Since the community of actors all contribute to the Scotch knowledge commons, Kealey and Ricketts’ (Chapter 1) example of a “contribution good” is also applicable. Once new technologies (such as the continuous still) or new processes (like aging in tequila casks) are contributed, all have access to this knowledge.

In the case of Scotch there remains the tension between access to the Scotch commons and maintenance of the shared resource of the Scotch reputation. On the one hand, producers and consumers wish to maintain the high-quality reputation of the Scotch experience. On the other hand, open access to that resource can dilute the quality, so some actors, like foreign distillers, are shut out. The incumbent Scottish distillers, in particular, have a vested interest in protecting their brand.

The geographic indication system developed, first as rules-in-use and now as rules-in-form, as the craft industry of single malt emerged. W. Grant and Sons were the first movers with their revival of the ancient single malt tradition in response to declining demand for blended Scotch. Consumers bought into the exemplary nature of single malt and other Scottish distillers soon followed suit. As Wadhvani and Lubinski (2017: 779) explain, “new entrepreneurial history highlights the cumulative entrepreneurial processes across multiple actors and over time.” Without the buy in of consumers and other large Scottish distillers, Grant’s single malt venture may have been short-lived.

The prestige of the Scotch experience was initially enhanced by the closed nature of the cultural knowledge commons. At first, the Scotch Whisky Association and predecessors fostered the development of the commons by organizing the producers, educating consumers, and coordinating the communal effort to raise quality standards. Over time, however, the closed nature of the commons under the SWA has served to inhibit innovation that may benefit the commons. While some progress

has been made within Scotland with regard to the acceptance of entrepreneurial activity, the foreign distillers are still left out. It remains to be seen whether Japanese and Australian whiskies will gain acceptance into the existing commons, or, as the number of awards won by foreign whisky continues to increase, they will develop their own knowledge commons.

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