Wine Institute Position Summary

Federal Trade Commission Workshop
"Possible Anticompetitive Efforts to Restrict Competition on the Internet" - Wine Sales Panel
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Wine Institute is the public policy advocacy group representing over 600 California wineries and affiliated businesses responsible for over 80% of our nation's wine production and 90% of exports. On behalf of our members, I am pleased to be participating in the upcoming panel. Wine Institute will be filing a more detailed formal written statement in the near future.

Restrictions to thwart competition in interstate wine sales has been a fundamental concern of our membership for decades. Such restrictions impact consumer choice and hurt small family-owned wineries. The ability of consumers to have reasonable access to the wines of their choosing has been and will continue to be the foundation of our public policy efforts in this area until all such restrictions have been eliminated.

While the internet has been a driving force in escalating the level of discussion surrounding interstate direct-to-consumer wine sales, the effort to change state laws to allow for such shipments actually began in the mid-1980's, prior to the widespread use of internet technology. A brief background is helpful in explaining how Wine Institute developed its current policies.

THE IMPORTANCE OF TASTING ROOMS TO WINERY OPERATIONS: Most wineries in the United States begin their sales and marketing efforts primarily through their on-premise tasting rooms. These facilities typically sell only the wines produced by the winery, along with various wine related accessories and winery promotional items. A unique aspect of the wine industry is that a visit to winery tasting rooms has become much more than just a shopping experience; an entire "wine country" travel industry has developed in which consumers from around the country regularly visit the winegrowing regions.

This access to new consumers is the means by which most wineries have launched their brands. While most early visitors usually came from within the state, out-of-state visitors typically come to represent the expanding part of any winery's tasting room sales. The challenge was to find a way to allow consumers to buy the wines they had tasted when visiting the winery. This is especially important because in a 1998 survey of our members, only 17% of the wineries indicated that they had distribution in all 50 states through the 3-tier system.

THE IMPORTANCE OF THE WINE MEDIA TO WINERY OPERATIONS: Unlike most consumer goods, wine has generated an entire trade and consumer-based media. These publications include magazines, television, radio, newspapers, newsletters and more recently internet-based newsgroups. Wine oriented consumers have access to myriad publications that talk about, critique, review and rate wines on a regular basis. This in turn leads to consumers seeking out ways in which they can purchase the wines they are hearing about in the various media they encounter.

Wineries depend on such media exposure in order to expose consumers to their ever-changing portfolio of products. Unlike most industries where product lines remain constant from year-to-year, wine is an agricultural product that can vary with every harvest. Consumers have come to rely upon the wine media to make recommendations and observations on the various wines that are available. Since most wine media, (especially that which appears on the internet) is national in scope, it is inevitable that some consumers are going to find themselves searching for wines that are not readily available to them in their local markets. This exposure to new products often leads consumers to contact a winery directly, wishing to make a purchase.

HOW DOES THE 3-TIER DISTRIBUTION SYSTEM AFFECT CONSUMER CHOICE? A number of state laws and regulations developed since the repeal of prohibition are protectionist, discriminatory and anti-competitive. Wine Institute has worked carefully with our membership in order to craft solutions to some of the more onerous ones which do not undermine the ongoing role of state regulators and local wholesalers and retailers. It has been our position that "we need to augment the 3-tier system, not replace it." There remain some aspects of the state alcohol regulatory systems that we feel create unnecessary hurdles for those trying to sell wine in the states and, therefore, should be repealed. A brief examination of some of these issues will help clarify our position:

Monopoly protection legislation: 22 states have passed some form of legislation that further regulates the contractual relationship between a supplier and a wholesaler in a manner different than that for other general business contracts. These laws vary from relatively minor requirements (such as requiring all contracts to be in writing) to the very extreme. An example of the more extreme would be the law that defines in statute that termination can occur only for good cause and then very narrowly defines good cause to the benefit of the wholesaler. Business transfer provisions and territorial provisions (such as disallowing dual distributorships) are other examples. Such laws make it very difficult for wineries to do business in a market; and more importantly, they make it almost impossible for a winery to do business in a market where their wholesaler is underperforming.

Preferential treatment of local industry: Despite US Supreme Court decisions in the past that have ruled preferential taxes and treatments of local wine industries to be unconstitutional, a number of states continue to maintain such practices. As an example, Arkansas allows for local wineries to sell their products in grocery stores, while out-of-state wines are only available in package stores. Missouri and Washington both have imposed taxes on all wines (including out-of-state wines) which are then used exclusively to benefit the marketing and promotion of their in-state wine industries.

Restricted access to retail on- and off-sale markets: State laws require that an out-of-state supplier wishing to sell at retail in a state must go through several hurdles. All states require that a winery must sell their product to an in-state wholesaler (in the case of certain "control states", that wholesaler is in fact the state itself). Trends in the marketplace make finding a wholesaler more difficult. The October 15, 2002 issue of *Wine Spectator* states "...[t]here were 2,188 wineries in the United States as of 2000, up from 579 in 1975, reports the Bureau of Alcohol Tobacco and Firearms. The vast majority of those wineries each produce less than 25,000 cases a year. In contrast, WSWA had 450 members in 1975, down to only 170 today." If a winery is able to find a wholesaler who wishes to sell their product, then a number of other restrictions may arise, depending upon the state. Some common requirements would be: label and brand registration, price posting requirements, wholesaler "franchise " requirements (see above), registration and licensing of company sales agents, and other various requirements.

***Restricted access on direct-to-consumer sales*:** 26 states ban out-of-state wineries from shipping their wines directly to consumers in those states. Of those 26, four (FL, KY, MD, TN) make it a felony for a winery to ship. Two others (IN, NC) make it a felony for a retailer to ship, but would charge a winery with a misdemeanor and require a referral to the ATF for further action. One additional state (GA) does allow for some limited legal direct shipments, but makes a violation of state laws a felony.

SOLUTIONS TO THE CONSUMER CHOICE ISSUE: It is important to note that while 26 states ban out-of-state wineries from shipping, 24 states and the

District of Columbia now allow for limited, legal direct shipments. This is the result of ongoing work by the wine industry, and provides various models for how the issue could be resolved in other states. In all cases the amounts of wine that can be shipped is limited, and provisions exist to prevent delivery to minors. While not all legislation that has passed has resulted in successful systems, a brief discussion of the various measures will help clarify the opportunities available to solve the problem.

Reciprocal Shipping Legislation: First passed in California in 1985, reciprocal shipping legislation was the first stab at creating a "trade agreement" between the states regarding direct-to-consumer wine shipments. The legislation in effect creates a grid of states (currently 13) in which wineries can ship directly to out-of-state consumers who wish to place an order either in person at the tasting room; via the internet, phone or fax; or via a catalogue. With specific regard to the internet, Minnesota has a unique reciprocity law that allows for shipments, but expressly prohibits any order placed over the internet. Reciprocal shipping statutes have been the solution preferred by wineries because they allow consumers the widest choice while imposing the fewest extra reporting and compliance requirements.

Limited Direct Shipping/Permit Legislation: This type of legislation grew out of the legislative debate surrounding the passage of reciprocal shipping legislation, and incorporates most of the compromises that helped to satisfy the concerns of state regulators. Typical provisions of these bills include winery permits, payment of taxes, and some reporting requirements. Some of these laws have made a distinction between wineries by only allowing shipments from wineries not already doing business in the state, while others have chosen to only allow shipments when the consumer is physically present at the winery tasting room when placing the order. Just the opposite of the Minnesota statute cited above, Pennsylvania this year passed a law that is also unique in that it ONLY allows sales placed over the internet - it does not allow for phone, fax or catalogue sales.

The Role of the Common Carrier: For any system to work, it is important that the common carrier is a part of the solution. The wine industry has worked with common carriers to ensure that strict standards are imposed on the delivery of wine packages in order to avoid delivery to minors. For example, Wine Institute has a contract with Federal Express requiring that all wine be shipped only by wineries that have signed a written contract that requires them to label all packages "Contains Alcohol; Adult Signature (over 21) Required". Further, wineries must prove that they have obtained the appropriate licenses before that can ship into the permit states. Common carriers are also working with the states where required in providing monthly reports on the products being shipped into the state. These safeguards can only work in states with legal direct shipping, where the packages can be correctly marked and employees can be trained on how to expedite the special handling requirements.

***Beware of False Solutions*:** A few states have passed legislation that, on paper, appears to help consumers wishing to receive direct shipments but, in fact, have not proven to be very successful. Some states (GA and LA for example) have forbidden shipments from wineries that have wholesaler representation in the state. These statutes serve to frustrate consumers. Just because a product is offered for sale in a state, does not mean that every consumer has the same access to that product. Often, hard to find wines may only be available through on-sale accounts, or in a major metropolitan area. In such cases, a consumer in a more remote part of the state might not have reasonable access to the wine at retail, and would choose to order it over the internet. Wineries often encounter consumers who are very confused in these situations - "they know they can order legally from the winery next door - why can't they order from us" is a common refrain.

Other states have tried to shift the regulatory burden onto consumers. In Montana and other states a consumer can obtain a "connoisseurs permit" to receive wine after paying appropriate taxes. The major common carriers have not added Montana to their list of approved states, however, because they have no way of knowing at the time of pickup if the consumer is in fact in compliance with all of the requirements. A similar situation occurred this year when Arizona passed a provision allowing consumers visiting out of state to personally take wine to a common carrier for shipment home. Federal Express, for example, has a policy that only licensees can ship using their system - therefore no Arizona consumers can avail themselves of the new law.

THE ROLE OF THE INTERNET IN WINE SALES: In the restrictions and solutions outlined above, each in its own way is related to the internet. Other than the Minnesota and Pennsylvania statutes cited, the internet is not specifically mentioned. It is simply one of the multiple tools that a winery can use to expedite a sale to consumers.

The internet did, however, play a major role in increasing and expanding the debate surrounding the direct shipment of wine. During the dot.com bubble, myriad players were present in the marketplace offering various schemes and approaches to "solving the direct shipping problem". The bulk of those players are no longer in business. It should be noted, however, that those entities which are still active and viable currently have taken very different approaches. Some have developed along the model of utilizing the 3-tier distribution chain by partnering with local wholesalers and retailers. These companies have the advantage of being in more states, but are limited to selling only products that are available through the wholesale distribution channel. Others have developed on a model of only doing business in the legal shipping states. These companies have the advantage of carrying a broader array of wines, but are limited in their distribution scope.

The internet is not used only as an ordering tool in the wine business. Many wineries have websites that are informational only. They talk about their wines, they may even give price and ordering information, but the actual order process requires another form of contact such as telephone or fax. It is likely that more on-line ordering will be possible in the future, but the costs and the technology gap preventing such sites will probably mean that it will be years before all wineries are "on line" for consumer orders.

CONCLUSIONS: Wine Institute is confident that working with states to craft legislation that balances consumer demand for choices and the regulatory requirements that create a safe and orderly marketplace is the right path for the future. Seventeen years ago no state had passed legislation. We now have almost half of the states on record with some type of curative legislation on the books. Some of the existing laws can be improved; bad laws must be repealed so that, ultimately, it will be the consumer who is the winner.