Comments of Wine Institute
Possible Anticompetitive Efforts to Restrict Competition on the Internet
Federal Trade Commission

Wine Institute is the public policy trade association representing over 600 California wineries and affiliated businesses. California's 847 wineries and 4,400 grape growers create 145,000 full-time equivalent jobs for $4.3 billion in wages in wineries, vineyards, and other affiliated businesses throughout the state. Tourism expenditures are $1.2 billion with 10.7 million visitors. Wineries and vineyards are predominantly family-owned and operated businesses that are active in local community affairs. The winegrowing community pays approximately $1 billion in taxes and makes charitable contributions estimated at $62 million annually.[1]

Economic theory suggests that the structure of an industry affects its behavior and performance. Wine distribution in the United States is based on a structure that is both political and economic, driven as much by community values dating back to the days before Prohibition, as well as by industry influences and consumer interests. In truth, alcoholic beverage distribution, and wine distribution in particular, varies widely from jurisdiction to jurisdiction, with some areas providing a more competitive environment, more business and product choices, and more consumer accessibility than others. While the Commission must realize by now that the path that a wine bottle takes from winery to consumer is anything but direct, Wine Institute would like to provide it with additional information for why that is so. Although the internet, as a medium for commerce, can take wine to a willing buyer in much more direct fashion, it is not universally accepted whether facilitating commerce in wine on the internet should be pursued. Wine Institute suggests that it should, and that a state's legitimate justifications can be met without restricting e-commerce.

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[1] Wine Market Council, http://www.winemarketcouncil.com/california_data.asp

The FTC's request for information on anticompetitive conduct in sales of wine on the internet raises all of the issues regarded as part of the distribution system. The past two decades present striking contrasts in doctrine, enforcement policies, and social attitude. While Wine Institute understands that the Commission's request for specific information on internet sales should not trigger a debate on the distribution system in general, the comments from panelists reveal that it is extremely difficult to focus on the internet as a means of commerce because the issue brings to the table the very debate on alcoholic beverage distribution systems that are occurring now in the courts, legislatures, and media. In that respect, we provide some historical information for the purpose of assisting the Commission in its understanding and perspective of direct shipments of wine.

Perfect competition describes a market where consumer interests are controlling and where producers respond to consumer tastes by producing what buyers want at the lowest price. The market is efficient in the sense that no rearrangement of production or distribution will improve the position of any consumer or seller (without negatively impacting someone else). In a world of perfect competition, there are many firms selling a homogenous product so that no single firm can influence the market to a greater extent than any other, and hence all firms must accept the market price for their product. One of the results of the 21st Amendment has been the creation of 50 separate jurisdictions with 50 different approaches to alcoholic beverage distribution. Some states choose to exert control through a series of licenses, while other states went to greater lengths.[2] This variation in wine regulation prevents the wine industry from maturing in the same manner as other goods and services. While industries such as book retailers are far ahead in terms of electronic commerce and fulfillment, the wine industry can only point to patterns and generalities and an inability to even attempt traversing the last mile because in many jurisdictions, the industry cannot take the first step.[3] Nothing short of a lengthy treatise can begin to summarize the subtleties of wine distribution in all fifty states.

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[2] See "Alcoholic Beverage Control States" for a list of Control State jurisdictions at http://www.wineinstitute.org/reflib/pub/otherstate/controlstates.htm.

[3] In Minnesota, a wine reciprocity state, Minn. Stat. § 340A.417 expressly prohibits the taking of orders on the internet: In part, the statute reads:

Direct shipping is an element of perfect competition in that it suggests that a rearrangement of distribution will improve the position of the wine consumer. The internet, and its convenience for consumers, provides a medium ideally suited to better the consumer's position with better choices and accessibility to brands, and to wineries who would be able to model a new distribution scenario that would permit wineries, large and small, to connect more directly to its customers. To most winemakers, their product is not homogeneous, but uniquely theirs, with a character that sets it apart from other wine products. Much of the wine business is subject to price points, marketing, and volume, but for much of the wine industry, issues of access and availability play a large part in the success or failure of a wine brand.

340A.417 Shipments into Minnesota

(a) Notwithstanding section 297G.07, subdivision 2, or any provision of this chapter, a winery licensed in a state which affords Minnesota wineries an equal reciprocal shipping privilege, or a winery located in Minnesota, may ship, for personal use and not for resale, not more than two cases of wine, containing a maximum of nine liters per case, in any calendar year to any resident of Minnesota age 21 or over. Delivery of a shipment under this section may not be deemed a sale in this state.

(b) The shipping container of any wine sent under this section must be clearly marked "Alcoholic Beverages: adult signature (over 21 years of age) required.".

(c) **No person may** (1) advertise shipments authorized under this section, (2) by advertisement or otherwise, solicit shipments authorized by this section, or (3) **accept orders for shipments authorized by this section by use of the Internet.** No shipper located outside Minnesota may advertise interstate reciprocal wine shipments in Minnesota. (emphasis added)

Wine Institute adds that the legislative purpose that is served by an anti-internet provision is most perplexint, as telephonic and mail orders are perfectly acceptable in Minnesota.

1980: Before Direct Shipping Legislation[4] and the Birth of Reciprocal Wine Shipments

In 1980, only a handful of states even bothered to legislate in the area of direct interstate wine shipments. There were a few states, such as Alaska, which did not prohibit such shipments in limited quantities for personal use, but for the most part, the 21st Amendment left in its wake a plethora of laws and regulations concerning the sales and importation of wine into another state with very little regard for interstate commerce direct to consumers.[5]

As a concept, reciprocity began in the mid-1980's as a means of addressing a simple need: i.e., of permitting wineries to ship limited quantities of wine to consumers in those states that afforded a similar shipment privilege.[6] These laws were, in effect, interstate treaties that recognized the mutual rights of wineries in participating states to "disintermediate" from established distribution channels for the purpose of delivering limited quantities of wine direct to the consumer. Well before the coming of the internet, these reciprocity statutes were intended not to fuel a debate on the efficiencies of the three-tier system, but to respond to a need by wineries willing to sell and consumers willing to buy wine in small quantities without requiring the winery to engage itself with the consumer state's distribution system and its encumbrances. The model legislation called for a maximum of two cases of wine per month to any one consumer, and that an adult signature be required at the time of delivery. These laws were promoted and passed with varying degrees of success, but it is significant to note that these legislative

[4] Wine Institute uses the term "direct shipping" to mean the practice of shipping wine to consumers. It is a term which should not connote unlawful activity.
[5] Some states, like California, had laws that permitted wine to be brought in from out of the country but not wine from other states.
[6] A memo from a common carrier sent in error raised the interest of the California wine industry to seek legislation that would permit small quantities of wine to be shipped direct to consumers. The goal of Wine Institute in 1985 was to pass such laws in those states with a significant wine producing industry to allow for mutual shipment privileges to consumers in cooperating states. California was the first state to pass reciprocity legislation. Colorado soon followed.

proposals were introduced, debated and in 13 states enacted in the open with wholesaler awareness and with minimal opposition.[7]

The wholesale tier, relatively absent from the debate when such bills were introduced in the 1980s, became much more forceful in opposition to such legislation at about the same time that the internet began to emerge as a commerce tool. At a time when many industries were focusing on the long range effects of the internet on market share and competition, the issue of direct wine shipments acquired nationwide attention. Opponents and proponents took their case to the press and to the internet, and a number of web sites today provide information and advocacy on one side of the issue or the other.[8] With the internet claiming a stake in the future of world business, the paradigm began to shift for many industries, including alcoholic beverages. With the internet came the notion that distribution systems may actually have built-in inefficiencies that, if removed, could result in better prices, more availability, and easier access.

Post-Internet Direct Shipment Legislation

As the world focused on the internet, direct shipment legislation moved away from the reciprocity legislative model.[9] Wholesaler opposition, coupled with the increasing market pressures brought about by the internet on all industries, caused Wine Institute to alter its legislative model to respond to more focused opposition arguments, but also to tailor a legislative model that would take a much less parochial approach to direct shipments.

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[7] Thirteen states currently enforce reciprocity legislation. California, Colorado, Hawaii, Idaho, Illinois, Iowa, Minnesota, Missouri, New Mexico, Oregon, Washington, Wisconsin, and West Virginia have such laws. For more information, see http://www.wineinstitute.org/shipwine/analysis/intro_analysis.htm.

[8] See Appendix A for web resources.

[9] In the ideal world, Wine Institute would have liked to see "mirror image" reciprocal legislation passed in all states that agree to reciprocal shipments. Unfortunately today, we have a situation where some states are simply more reciprocal than others. Variations in provisions such as permissible quantities, permissible solicitation or advertising, licensing, and reporting, even within reciprocity states, require cooperating states to determine how reciprocal one state is to the other and what privileges apply.

While reciprocity addressed the needs of wineries alone,[10] the new legislative model took into account the impact of the internet on other product and distribution sectors and includes the ability of retailers and other products such as beer and spirits to take advantage of the benefits of the internet to increase visibility and availability across all alcoholic beverage product lines.

Political pressures resulted in a number of shifts in strategies and alliances. Currently, twenty four states permit some level of direct shipment.[11] The past five years have also brought us the 21st Amendment Enforcement Act, providing state attorneys general with access to federal courts to enforce alcoholic beverage distribution laws, and several states have increased the penalties for unlawful direct shipments to a felony. On Monday, November 4, 2002, President Bush signed into law H.R. 2215, which includes provisions responsive to recent airline restrictions and allow wine purchased at wineries to be shipped home instead of being carried on the plane. Requiring that the consumer be physically present at the selling winery, and further requiring that the shipping container be properly marked to require an adult signature upon delivery, H.R. 2215 validates and adds to existing laws such as the reciprocity legislation as an acceptable method of facilitating direct-to-consumer shipments.

These efforts, held up by various forces on both sides of the issue as victories or setbacks, add to the mix that the Commission must wade through to determine whether there's any reason to engage the resources of the FTC. Notwithstanding the ongoing litigation that raises the Constitutional issues, the consumer and electronic citizen of this country has, for the last decade, undergone significant changes in the ways that it perceives the internet and uses its features. Over the years, there is a fixed geography and roadmap that have been built into U.S. wine distribution systems. These distances, so quickly traversed via the internet, need not upset traditional sales paths. Rather, the internet can be used to

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[10] Reciprocity laws only apply to wine. Beer and spirits have no equivalent law.
[11] Please refer to our web site at http://www.wineinstitute.org/shipwine for a map and further information.

enhance traditional distribution of wine and can coexist without realizing the predictions of tax and revenue fraud or providing additional avenues for minors to acquire wine.

In every debate regarding direct shipping, the arguments have centered around several common issues. Those opposed to direct shipping legislation raise the following issues:

- Underage drinking
- Difficult to enforce against out-of-state vendors; state budgets
- Tax evasion
- Orderly Distribution System
- 21st Amendment

Wine Institute would like to briefly address these issues.

Underage Drinking:

Wine Institute acknowledges the serious problem of underage drinking. Opponents such as the Wine and Spirits Wholesalers of America claim that underage drinking is a serious issue that is only exacerbated by direct shipment provisions. However, even WSWA has professed a belief that web sites such as wineshopper.com were the answer to direct shipments, not objecting to the delivery aspects used by the company and instead embracing the business model employed (WineShopper.Com worked within the three-tier framework of those states that it chose to do business in).[12] In 1999, with their

[12] In 1999, the Wine and Spirits Wholesalers of America publicly supported WineShopper.Com as a solution to the "direct shipping problem." Wholesalers have not opposed delivery mechanisms but only those facets of the business that fall outside established distribution channels.

endorsement of WineShopper.Com, it appeared that even the Wine and Spirits Wholesalers of America were not opposed so much to the fulfillment methods, but to the manner of sale. As long as the method of consummating the transaction was through the use of three-tier distribution, it did not matter that the delivery methods were identical to those of reciprocity states, i.e., by common carrier with adult signature required.

Enforcement agencies have not been able to quantify the impact of the internet on underage sales. Despite heavy law enforcement activity in states like Michigan, there is still a lack of empirical data to show that internet sales contribute to the problem of underage drinking.[13] As suggested by others, Wine Institute acknowledges that that there

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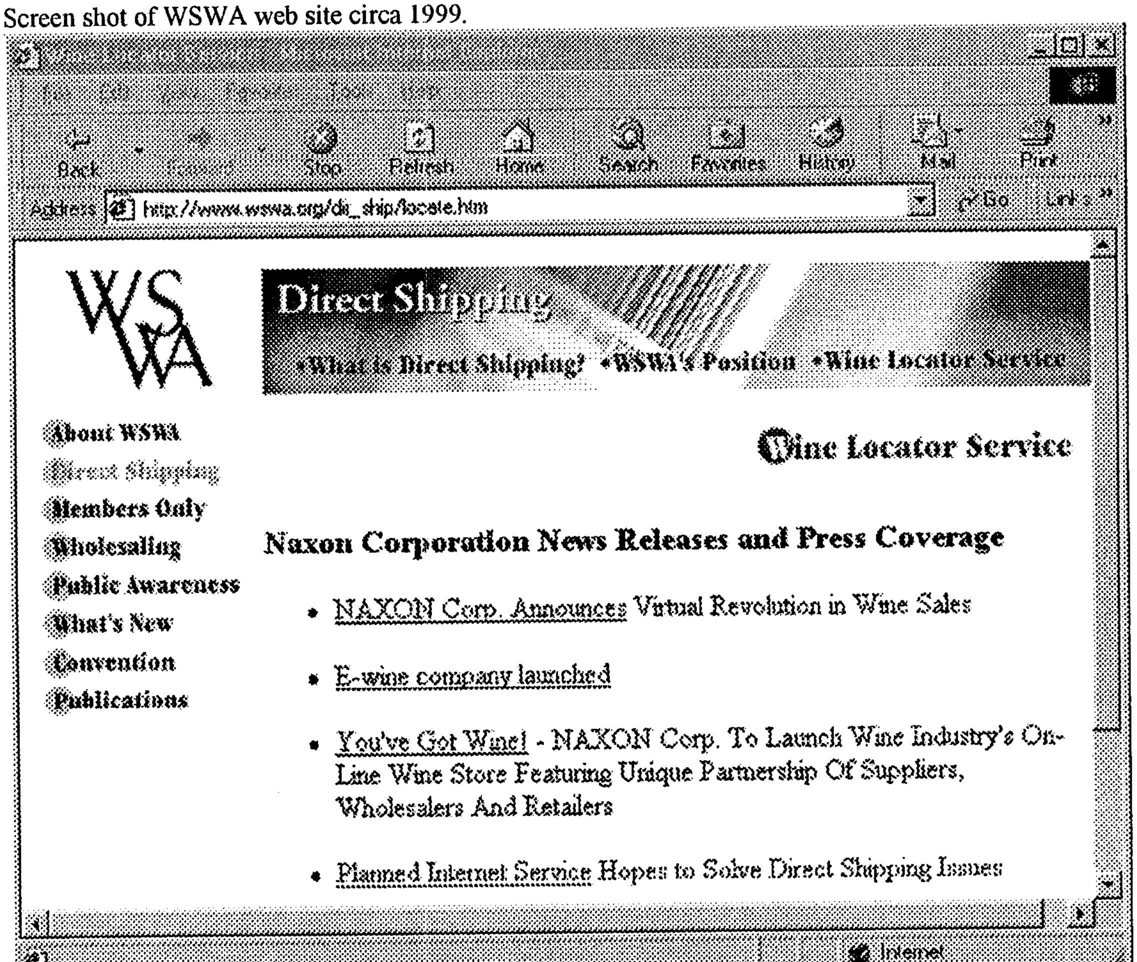
Screen shot of WSWA web site circa 1999.



[13] Of note is the U.S. Supreme Court discussion of First Amendment rights in its discussion in 44 Liquormart v Rhode Island (1996) ***517 U.S. 484; 116 S. Ct. 1495; 134 L. Ed. 2d 711*** :

are a large number of legitimate physical outlets through which an underage individual can more immediately obtain possession of alcoholic beverages. Direct shipment provisions have included safeguards to protect against this most important state interest, and these provisions are in force in those states that permit such shipments.

Enforcement Difficulties:

Some jurisdictions justify preferences based on their seeming inability to enforce against the out-of-state shipper, who remains out of reach of long-arm statutes and operates at the edges of the law. Twenty-four states currently permit direct shipments of wine without the predicted crippling blow to the state economy from having to create or infinitely expand the enforcement infrastructure to administer their direct shipment laws. In those states that permit limited direct shipments, consumers are able to gain access to those products that may not be available in their area.

Further, states have not been without federal enforcement tools at their disposal. ATF's 1996 policy on direct shipment enforcement embodied in ATF Ruling 96-3 and the Twenty-First Amendment Enforcement Act passed in October, 2000, have been available to state enforcement authorities and been virtually unutilized since their publication.

"As is evident, any conclusion that elimination of the ban would significantly increase alcohol consumption would require us to engage in the sort of "speculation or conjecture" that is an unacceptable means of demonstrating that a restriction on commercial speech directly advances the State's asserted interest. Edenfield, 507 U.S. at 770. n18 Such speculation certainly does not suffice when the State takes aim at accurate commercial information for paternalistic ends."

Tax Evasion

There was an allegation that wineries and others that ship to a consumer unlawfully are smugglers and evade taxes. Wine Institute and its members have agreed to legislative models where the winery collects and remits all excise and sales taxes that would be due from the sale of wine over the internet. As with complaints about enforcement difficulties, Wine Institute believes that states can design regulatory regimes that protect consumers without restricting competition on the internet. Legislative safeguards can be built in to statutes that would be able to address tax and oversight issues. Delivery issues can be addressed with carrier training and age verification. These are not novel ideas and have been adopted by many states that permit limited direct shipments.

Orderly Distribution System:

Some state officials claim that there is an overpowering public value to an orderly distribution system for alcoholic beverages. Wine Institute has sought to legislate a means to direct shipment rather than to litigate because our organization believes that each state projects its own attitudes and values through the distribution laws that it enacts. Our members realize that while many of the economic conditions for alcoholic beverage laws no longer exist today, changes should be made with the approval of law makers in the presence of a distribution system that will remain structurally sound.

But orderly distribution systems may not serve consumers, and these needs should be balanced with the need for full and fair competition and the consumer quest for access. Wine Institute, for example, has opposed legalizing slotting fees because our members believe that such practices put retailer independence at risk and could lead to anticompetitive conduct. Slotting allowances in the alcoholic beverage industry are currently prohibited by law.[14] Our members recognize that the wine industry has been fortunate not to have been exposed to the abuses that can be generated by such practices as slotting allowances, "pay-to-stay" fees,[15] and "category captains."[16] To a great extent, the success of the wine industry, and indeed to the number of brands that are presented to the consumer for purchase in some more open markets, is in large part due to "tied-house" protections enacted by the federal government[17] and by states.

Wine Institute suggests that states should be able to articulate a clear policy that it wishes to achieve through its statutes and regulations, but should be flexible in adopting the least intrusive method to accomplish the state policy so that consumers and wineries are not deprived of a competitive sales environment. To the extent that wine distribution statutes and regulations have an impact on competition, states should be in a position to not only justify the intrusion on free competition, but be able to measure the results of such laws in accomplishing the state's objectives.

21st Amendment

Much has been said about the current state of litigation and the power of the State that comes with the 21st Amendment. Opponents to direct shipping have been categorical in their statements that rights granted to the states by the Amendment are unconditional. Wine Institute will defer Tracy Geneson's and Clint Bolick's comments regarding the litigation aspects of direct wine shipments, but we would like to share with the Commission our view that state rights granted under the 21st Amendment are far from absolute, and the once-thought unfettered power of the state has been interpreted and

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[14] 27 CFR § 6.152

[15] "Pay-to-stay" fees are monies paid to a retailer by a supplier for the privilege of keeping its products on the retailer's shelves.

[16] A "category captain" is generally a dominant supplier designated by a retailer as an information resource in managing product selection and allocating shelf space.

[17] See regulations administered by the Bureau of Alcohol, Tobacco, and Firearms at 27 CFR Part 6, 8, 10, and 11.

tempered in several decisions of the U.S. Supreme Court and U.S. appellate courts. We will cite three U.S. Supreme Court cases that illustrate that the Twenty-First Amendment indeed has limitations.

- ***The Twenty-First Amendment Does Not Give States the Right to Impose Alcoholic Beverage Resale Price Maintenance in Violation of the Commerce Clause***

While cited by direct shipment opponents for the proposition that states have unrestricted power to regulate alcoholic beverages within their own boundaries, the Supreme Court of the United States in the case of California Retail Liquor Dealers Association v Midcal Aluminum, Inc., 445 U.S. 97; 100 S. Ct. 937; 63 L. Ed. 2d 233; 1980 U.S. LEXIS 86; 1980-1 Trade Cas. (CCH) P63,201 ruled that the Twenty-First Amendment did not bar application of the Sherman Act to California's wine pricing system. In dispute in Midcal was a California statute that required all wine producers and wholesalers to file fair trade contracts or price schedules with the state. The pricing scheme was found to constitute a form of resale price maintenance in violation of the Sherman Act, despite the argument that the pricing scheme was a proper exercise of state rights under the Twenty-First Amendment.[18]

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18 "More difficult to define, however, is the extent to which Congress can regulate liquor under its interstate commerce power. Although that power is directly qualified by § 2, the Court has held that the Federal Government retains some Commerce Clause authority over liquor. In William Jameson & Co. v. Morgenthau, 307 U.S. 171 (1939) (per curiam), this Court found no violation of the Twenty-first Amendment in a whiskey-labeling requirement prescribed by the Federal Alcohol Administration Act, 49 Stat. 977. And in Ziffrin, Inc. v. Reeves, supra, the Court did not uphold Kentucky's system of licensing liquor haulers until it was satisfied that the state program was reasonable. 308 U.S., at 139.

"The contours of Congress' commerce power over liquor were sharpened in Hostetter v. Idlewild Liquor Corp., 377 U.S. 324, 331-332 (1964).

"To draw a conclusion ... that the Twenty-first Amendment has somehow operated to 'repeal' the Commerce Clause wherever regulation of intoxicating liquors is concerned would, however, be an absurd oversimplification. If the Commerce Clause had been pro tanto 'repealed,' then Congress would be left with no regulatory power over interstate or foreign commerce in intoxicating liquor. Such a conclusion would be patently bizarre and is demonstrably incorrect."

- ***The Twenty-First Amendment Does Not Grant to States the Right to Discriminate in Interstate Commerce by Creating And Enforcing Protectionist Preferences***

A state tax statute that imposed an ad valorem excise tax on alcoholic beverages imported into the state, while at the same time exempting some local in-state products, was the subject of constitutional review in the 1984 U.S. Supreme Court case of Bacchus Imports, Ltd. v Dias, 468 U.S. 263; 104 S. Ct. 3049; 82 L. Ed. 2d 200; 1984 U.S. LEXIS 135; 52 U.S.L.W. 4979. The state of Hawaii argued that even if the statute violated the Commerce Clause, that it is saved by the Twenty-First Amendment. The Court, when addressing the meaning of the Amendment, stated:

> "Despite broad language in some of the opinions of this Court written shortly after ratification of the Amendment, more recently we have recognized the obscurity of the legislative history of § 2. See California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97, 107, n. 10 (1980). No clear consensus concerning the meaning of the provision is apparent. Indeed, Senator Blaine, the Senate sponsor of the Amendment resolution, appears to have espoused varying interpretations. In reporting the view of the Senate Judiciary Committee, he said that the purpose of § 2 was "to restore to the States ... absolute control in effect over interstate commerce affecting intoxicating liquors. ..." 76 Cong. Rec. 4143 (1933). On the other hand, he also expressed a narrower view: "So to assure the so-called dry States against the importation of intoxicating liquor into those States, it is proposed to write permanently into the Constitution a prohibition along that line." Id., at 4141."

"The Court added a significant, if elementary, observation: "Both the Twenty-first Amendment and the Commerce Clause are parts of the same Constitution. Like other provisions of the Constitution, each must be considered in the light of the other, and in the context of the issues and interests at stake in any concrete case." Id., at 332. See Craig v. [***246] Boren, supra, at 206.

n11 In *Nippert v. Richmond, 327 U.S. 416 (1946)*, the Court commented in a footnote:

"[Even] the commerce in intoxicating liquors, over which the Twenty-first Amendment gives the States the highest degree of control, is not altogether beyond the reach of the federal commerce power, at any rate when the State's regulation squarely conflicts with regulation imposed by Congress. ..." *Id., at 425, n. 15.*

The Court concluded that the principles underlying the Twenty-first Amendment did not outweigh Commerce Clause principles that would otherwise be offended. The Court specifically stated:

> "The central purpose of the provision was not to empower States to favor local liquor industries by erecting barriers to competition."

In finding that the statute violated a central tenet of the Commerce Clause and was not supported by any clear concern of the Twenty-first Amendment, the Court rejected the State's claim and struck down the statute.[19]

Much of the current direct shipment litigation is based on the premise that unfair preferences in violation of the Commerce Clause have been established by states, in that the states permit shipments to consumers from within the state, but prohibit the same shipments from without.

- ***The Twenty-First Amendment Does Not Give States the Right to Abridge First Amendment Freedoms***

Likewise, the Twenty-First Amendment cannot be used as a shield to justify speech restrictions in violation of the First Amendment. In 1996, the U.S. Supreme Court in <u>44 LiquorMart v Rhode Island</u> ruled that the Rhode Island price advertising provision was not saved by the state's assertion that the Twenty-First Amendment sanctioned such an exercise of power. At issue was a Rhode Island statute that prohibited advertisements that would provide the public with information about retail prices of alcoholic beverages. The litigation arose from a $400 fine assessed against 44 Liquormart, a Rhode Island retailer, for an advertisement that the retailer ran in a Rhode Island newspaper in 1991. The ad, which did not state the price of any alcoholic beverages but did include prices for

[19] Following Bacchus, excise tax preferences were eventually repealed. However, the industry still faces discrimination in the marketplace through statutory preferences that take various forms. Additional taxes to fund in-state products, such as those in Washington and Oregon, still exist today. In Arkansas, state law permits Arkansas wineries to sell wines of their own production in grocery stores within the state, but prohibit other winery brands from being sold.

peanuts, potato chips, and mixers, included the word "WOW" in large letters next to pictures of vodka and rum bottles.

In its discussion of the Twenty-first Amendment and rights that it confers upon the states, the Court stated as follows:

> "In its examination of Rhode Island's statute, the Court of Appeals erroneously concluded that the Twenty-first Amendment provided an "added presumption in favor of the validity of the state regulation." 39 F.3d at 7-9 (internal quotation marks omitted). The Twenty-first Amendment cannot save an otherwise invalid restriction on speech.
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> "Nothing in the Amendment's text or history justifies its use to alter the application of the First Amendment. "Our prior cases have made clear that the [Twenty-first] Amendment [*533] does not license the States to ignore their obligations under other provisions of the Constitution." Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 712, 81 L. Ed. 2d 580, 104 S. Ct. 2694 (1984). See also Larkin v. Grendel's Den, Inc., 459 U.S. 116, 122, n. 5, 74 L. Ed. 2d 297, 103 S. Ct. 505 (1982) ("The State may not exercise its power under the Twenty-first Amendment in a way which impinges upon the Establishment Clause of the First Amendment"); Craig, supra, at 206 ("Neither the text nor the history of the Twenty-first Amendment suggests that it qualifies individual rights protected by the Bill of Rights and the Fourteenth Amendment where the sale or use of liquor is concerned" (internal quotation marks omitted)). The Twenty-first Amendment does not trump First Amendment rights or add a presumption of validity to a regulation that cannot otherwise satisfy First Amendment requirements."

The U.S. Supreme Court has not viewed the power conferred upon the states by the Twenty-first Amendment as limitless, and as these cases illustrate, the exercise of such power must be consistent with other provisions of the Constitution. As with the result in Midcal, it is proper for the FTC to review anticompetitive conduct even in light of Twenty-first Amendment claims, and Wine Institute welcomes the FTC's involvement in the future so that the state's interest in temperance and orderly distribution does not take the form of state action that sanctions anticompetitive conduct to the detriment of the wine consumer.

Monopoly Protection Laws: Anticompetitive Legislation in Twenty-Two States

Anticompetitive harm in the alcoholic beverage industry can take many forms, but one form in particular is a main source for the reluctance of some wineries to enter out-of-state markets. Monopoly protection laws, at one point referred to as "franchise security laws," impose terms that define the relationship between winery and wholesaler beyond what may be agreed to by contract, and can include, among other things, provisions that would require: (1) notice to a wholesaler of "good cause" as narrowly defined by the legislature to modify or terminate a winery/wholesaler relationship; (2) a period where a wholesaler can cure the cause that is complained of; (3) administrative remedies available to a wholesaler who believes the relationship modification or termination was not justified by cause; (4) territorial provisions where a wholesaler must be assigned an exclusive territory; and (5) legal or administrative causes of action and damages provisions.. In most cases, these laws exist in spite of their anticompetitive impact and are enacted despite advocacy comments from FTC staff in opposition to passage.

In contrast to the 24 states that allow some form of direct shipment, 22 states have enacted these laws for alcoholic beverages.[20] Fifteen of these states have provisions containing territorial provisions.[21] Monopoly Protection laws exempt a single industry from the antitrust laws, and the FTC has expressed its disfavor of such legislation in the past.[22]. The FTC has additionally provided comments on the effects of vertical restrictions on competition in the wine industry in other instances, including comments to the Nevada Legislature, A.B 569 (June 12, 1987) (franchise agreements between liquor

[20] States that have enacted some form of monopoly protection for wine include Alabama, Arkansas, Connecticut, Delaware, Georgia, Idaho, Kansas, Maine, Massachusetts, Michigan, Missouri, Montana, Nevada, New Jersey, New Mexico, North Carolina, Ohio, Tennessee, Vermont, Virginia, Washington, and Wisconsin.

[21] Alabama, Arkansas, Connecticut, Georgia, Kansas, Maine, Michigan, Missouri, Montana, New Mexico, North Carolina, Ohio, Tennessee, Virginia, and Wisconsin.

[22] See the letter by Andrea Foster, Acting Director, and Harold E. Kirtz, Senior Litigator, of the Atlanta Regional Office of the Federal Trade Commission, dated March 22, 1999, located at http://www.ftc.gov/be/v990003.htm.

suppliers and wholesalers); Economic Matters Committee, Maryland House of Delegates, Wine Cooler Fair Dealing Act (Mar. 11, 1987); Council of the District of Columbia, Council Bill 6-442, The Wine, Beer and Spirits Franchise Act of 1986 (Aug. 29, 1986); Rhode Island Legislature, Distilled Spirits and Vinous Beverages Fair Dealing Law (May 3, 1985); Virginia Senate Committee on Rehabilitation and Social Services, H.B. No. 1301, Wine Franchise Act (Feb. 8, 1985); California Department of Alcoholic Beverage Control, Proposed Changes in Regulations (May 5, 1984); Michigan State Legislature, Michigan Liquor Control Act (Apr. 4, 1984); and the Oregon Legislature, H.B. 2961 (May 20, 1983).

These bills do not get introduced in a vacuum, and do not favor competition or protect consumers. As offensive as these provisions are to competition, and despite FTC participation, monopoly protection laws continue to get introduced and enacted.

Conclusion

Wine Institute defers to the testimony and statements of those in favor of limited direct shipments. The internet, as a medium to bring willing buyers in contact with willing sellers, is a powerful tool that needs to be protected as a legitimate means of business. State interests in revenue and taxation and in preventing underage individuals from acquiring wine are legitimate interests that can be addressed by legislative provisions. Wine consumers in some jurisdictions do not have the accessibility to some brands nor the legal choice to obtain them. Internet sales enhance, rather than replace, established three-tier distribution systems and other distribution systems enacted by states.

During each debate, attempts to quantify these arguments have generated counter-arguments that at times challenge the credulity of even the most hardened advocate. The bottom line for Wine Institute, however, takes us back to the fundamental principles that reciprocity was founded on. Wine Institute has not advocated the downfall of the three-tier system. Rather, it has simply maintained direction in resolving, by legislation, the question of how to get limited quantities of wine direct to a consumer.

To the extent that the dialogue is a comment on the three-tier system, Wine Institute can state that competition as well as the number of tiers varies from locality to locality. While efforts to preserve the three-tier system call into question the value of the system in protecting societal interests, in many localities, three-tier simply does not exist. In California, for example, wineries are free to sell wine direct to consumers either at their tasting rooms, the winery web site, or at retail facilities away from the production location. Even in this single-tier environment, wineries have not abandoned the alternative three-tier model, but rather have leveraged its retail ability to sell direct with the economies of scale that are served by three-tier distribution systems.

Direct shipping provisions reveal just a small portion of the competition spectrum for alcoholic beverage sales in the U.S. The great differences between beer, wine, and spirits distribution have generated pockets of full competition for some, but not necessarily all, alcoholic beverage products. Each product category is sold in distinctively different ways, and each product category is faced with different competitive factors that affect the success and viability of a brand or product line.

Wine Institute appreciates the FTC's interest in direct wine sales over the internet, and is pleased to submit these comments with the hope that the Commission can review and appreciate some of the market pressures that wineries and other sales tiers must face to compete, and we hope that this understanding will translate into more meaningful dialogue in the future for this and other issues that require antitrust and anticompetition scrutiny. We hope that our comments, as well as the comments of others, can provide the FTC with the analytical framework needed for future antitrust scrutiny of direct shipment issues. We invite the FTC to engage in the debate, and to assess whether consumers could be better served while at the same time serving the interests of the state in exercising its regulatory power over alcoholic beverages.