

HB

34

HFIN

FILE

ALASKA STATE LEGISLATURE



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Representative Gabrielle LeDoux

Sponsor Statement for House Bill No. 34 "An Act relating to sales of wine by a winery licensee."

Wine production in Alaska has only begun to develop. Wineries in Alaska are "mom and pop" businesses. Under current state law, none of these wineries can sell or ship a bottle of wine to a customer within the state unless the customer is on the premises. Currently, out-of-state wineries can ship their product into the state of Alaska. This bill evens the playing field for small wineries in Alaska by enabling them to participate in direct sales to a niche market.

This bill will allow the holder of a winery license to ship less than five gallons of wine to an individual provided that the shipping address is not located in an area that has not prohibited or limited the importation or possession of alcoholic beverages. According to the Alaska Department of Revenue, in FY 2005 there were six wineries that produced approximately 1,900 gallons of wine and contributed approximately \$4,750 in taxes.

Alaskan wine is a value-added premium product, which is well suited to internet and phone sales. The intent is for small, local winery operations to take advantage of a very specialized market.

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: HB 34
 (H) Publish Date: 1/30/07

Revision Date/Time (Note if correction): _____ Dept. Affected: Public Safety
 Title Sales of wine by a winery licensee RDU Statewide Support
 Component ABC Board
 Sponsor Representative Ledoux
 Requester House Labor & Commerce Component No. 2690

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

There will be no fiscal impact on the Department of Public Safety.

Prepared by: Douglas B. Griffin Phone 269-0351
 Division Alcoholic Beverage Control Board Date/Time 1/26/07 10:11 AM
 Approved by: Commissioner Walt Monagan Date 1/26/2007
 Agency Department of Public Safety

LEGISLATIVE RESEARCH REPORT

FEBRUARY 10, 2006



REPORT NUMBER 06.123

BEER AND WINE PRODUCTION IN ALASKA

PREPARED FOR REPRESENTATIVE GABRIELLE LEDOUX

BY ROGER WITHINGTON, LEGISLATIVE ANALYST

You asked for information regarding breweries and wineries in Alaska. Specifically, you wished to know the number of breweries and wineries operating in Alaska, and an estimate of the number of gallons produced and sold by each business.

According to Johanna Bales, Revenue Audit Supervisor with the Tax Division of the Alaska Department of Revenue, there are currently ten breweries in Alaska that produced approximately 1.2 million gallons of beer, and six wineries that produced approximately 1,900 gallons of wine during FY 2005.¹ Table 1 provides a list of our breweries and wineries.

Unfortunately, Alaska Statute 43.05.230, Disclosure of Tax Returns and Reports, prevents Ms. Bales from providing us with production and sales figures specific to each producer. In addition, of these businesses that have a website, none posted production and sales figures. Based on the Alcoholic Beverage Tax set forth in AS 43.60, Alaska breweries contributed approximately \$42,000 in taxes, while the in-state wineries contributed approximately \$4,750.²

¹ Johanna Bales, Revenue Audit Supervisor with the Alaska Department of Revenue, Tax Division, can be reached at 907-269-6628.

² All in-state breweries meet the definition of a small brewery set forth in AS 43.60.010.

Table 1: Alaska Breweries and Wineries		
Operation Type	Operation Name	Location
Breweries	The Glacier Brewhouse - Brews Brothers	Anchorage
	Moose's Tooth Brewing Co - Chugach Beverages LLC	Anchorage
	Midnight Sun Brewing Co	Anchorage
	Sleeping Lady Brewing Company	Anchorage
	Silver Gulch Brewing & Bottling Inc	Fairbanks
	Haines Brewing Company Inc	Haines
	Horner Brewing Company	Homer
	Alaskan Brewing, LLC	Juneau
	Kodiak Island Brewing Company L	Kodiak
	Great Bear Brewing Co – Pioneer Peak Brewing Co	Wasilla
Wineries	Denali Winery – U-Brew Wineries Inc	Anchorage
	Kodiak Island Winery	Chiniak
	Great Land Wines Ltd	Haines
	Bear Creek Winery, LLC	Kachemak
	Alaska Wilderness Wines	Kodiak
	Valley Winery LLC	Wasilla
Notes:	The businesses listed above were licensed with the Alaska Department of Revenue (DOR) during FY2005. Business are not required to be licensed with the DOR until they actually produce and sell alcohol. According to the Alaska Alcoholic Beverage Control Board (ABC), there are three additional business that are licensed for FY2006: the Mother Lode (Brewpub) in Anchorage, Alice's Champagne Palace (Brewpub) in Homer, and the Copper River Brewery in Cordova. Please keep in mind that a license from the ABC does not guarantee that the business will produce and sell alcoholic beverages.	
Source:	Johanna Bales, Revenue Audit Supervisor with the Alaska Department of Revenue, Tax Division, 907-269-6628.	

Attached, please find an excerpt from the Alaska Department of Revenue, Tax Division's *FY 2005 Annual Report of Operations* that provides summary information on Alaska's Alcoholic Beverage Tax.

I hope you find this information to be useful. Please do not hesitate to contact us if you have questions or need additional information.

The New York Times

PAUL HENNING / AP/WIDEWORLD
Consider
BORAT

May 16, 2005

Supreme Court Strikes Down Bans on Wine Shipments
By DAVID STOUT

WASHINGTON, May 16 - The Supreme Court ruled today, in a case of interest to millions of wine-drinkers and those who make a living in the multibillion-dollar industry, that people can buy wine directly from out-of-state vineyards.

In a 5-to-4 decision that struck down laws in New York and Michigan, and by extension calls into question the laws in 22 other states, the court held that laws that discriminate against out-of-state vineyards violate the Constitution's Commerce Clause, which empowers Congress to regulate interstate commerce.

"Laws such as those at issue contradict the principles underlying this rule by depriving citizens of their right to have access to other states' markets on equal terms," the majority held, in an opinion by Justice Anthony M. Kennedy.

Today's ruling does not leave state lawmakers powerless to regulate direct shipments of alcohol, but if they do so they must not favor their own states over other states. Indeed, Nida Samona, the chairwoman of the Michigan Liquor Control Commission, told The Associated Press that her commission would urge lawmakers to bar direct shipments for both local and out-of-state wineries.

Today's ruling is of intense interest not only to the states - 26 of which already allow direct shipment from out-of-state wineries - but also to the wholesale liquor industry, which fears eventually being left out of what is now a state-run three-tier system: liquor producer to licensed wholesaler to licensed retailer.

The worry for liquor wholesalers has been that if the justices ruled that consumers could buy wine directly from out-of-state producers, so might liquor retailers be able to do so, at least in theory.

Today's decision, in the cases of *Granholm v. Heald*, No. 03-1116, from Michigan, and *Swedenburg v. Kelly*, No. 03-1274 from New York, had to do with interpretation of the Constitution, the intent of the 1933 Amendment that ended Prohibition and changing personal tastes in the age of the Internet.

When the case was argued before the justices on Dec. 7, lawyers for New York and Michigan asserted that the Prohibition-ending 21st Amendment to the Constitution gave states such wide authority over the importation of alcohol that it trumped the principle embodied in the Commerce Clause: that the states may not, without Congressional authorization, discriminate against one another.

New York's and Michigan's lawyers insisted then that the goals of preventing minors' access to alcohol and assuring that the states could collect taxes from out-of-state shippers justified their states' statutes. Solicitor General Caitlin J. Halligan of New York told the justices that the case "goes to the very core of the 21st Amendment."

Justice Kennedy responded - tellingly, it would appear from today's ruling - that "it also goes to the very core of the Commerce Clause."

Justice Kennedy wrote today that the real object of the Michigan and New York statutes was not protection of minors but rather to give in-state wineries a competitive advantage over those in other states. Justice Kennedy, who was joined by Justices Antonin Scalia, David H. Souter, Ruth Bader Ginsburg and Stephen G. Breyer, said New York and Michigan "provide little evidence for their claim that purchasing wine over the Internet by minors is a problem."

"The 26 states now permitting direct shipments report no such problem, and the states can minimize any risk with less restrictive steps, such as requiring an adult signature on delivery," the majority said. Moreover, the majority said, the states could devise tax-collection procedures without resorting to discrimination in interstate commerce.

"In all but the narrowest circumstances" the states violate the Commerce Clause if they erect barriers to help in-state business at the expense of outsiders, the majority said in describing the Commerce Clause as "essential to the foundations of the Union."

The majority observed that "the current patchwork of laws - with some states banning direct shipments altogether, others doing so only for out-of-state wines, and still others requiring reciprocity - is essentially the product of an ongoing, low-level trade war."

Chief Justice William H. Rehnquist and Justices John Paul Stevens, Sandra Day O'Connor and Clarence Thomas dissented.

Justice Stevens conceded that the New York and Michigan laws would be "patently invalid" if they regulated sales of "an ordinary article of commerce," not wine. "But ever since the adoption of the 18th Amendment and the 21st Amendment, our Constitution has placed commerce in alcoholic beverages in a special category," Justice Stevens wrote. (The 18th Amendment ushered in the era of Prohibition and, some social historians have said, the bootleggers and speak-easies that accompanied it.)

"Today, many Americans, particularly those members of the younger generations who make policy decisions, regard alcohol as an ordinary article of commerce, subject to the same market and legal controls as other consumer products," Justice Stevens wrote. "That was definitely not the view of the generations that made policy in 1919 when the 18th Amendment was ratified or in 1933 when it was repealed by the 21st Amendment."

That alcoholic beverages are something apart in the world of commerce is obvious from what happened after Prohibition ended, Justice Stevens went on: "So-called 'dry states' entirely prohibited such commerce; others prohibited the sale of alcohol on Sundays; others permitted the sale of beer and

wine but not hard liquor; most created either state monopolies or distribution systems that gave discriminatory preferences to local retailers and distributors."

Small local wineries were elated by today's ruling. "This is the best day for wine lovers since the invention of the corkscrew," Clint Bolick, counsel for the Institute for Justice, which represented local wineries, told The Associated Press. "It demonstrates that in the era of the Internet the court will vindicate the principles of free trade that made this country great."

And Juanita Swedenburg, the Middleburg, Va., vintner who sued to overturn the New York law, told The A.P. that the ruling was "a boon for America's wine-loving consumers who like to have various wines from throughout the nation."

The laws overturned today are not identical. Michigan's statute flatly prohibited direct shipments by out-of-state wineries. New York's permitted such shipments in theory - as long as the winery maintained a physical presence in New York, including a warehouse to store wines before sale. No out-of-state winery has qualified for this exception in the 35 years that the law has been on the books.

Among the other states that ban direct shipments from out-of-state wineries are Connecticut, Delaware, Pennsylvania, New Jersey, Vermont, Massachusetts and Florida. A few states even make importing a felony. (A map showing the wine laws throughout the country can be viewed on the Institute for Justice's Web site, www.ij.org.)

In issuing their ruling today, the justices reversed the United States Court of Appeals for the Second Circuit, which had affirmed the New York law, and it upheld the Court of Appeals for the Sixth Circuit, which had voided the Michigan law.

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U.S. Supreme Court Rules on Direct Shipping

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By Matthew J. Lewis and David E. Stoll of Farella Braun & Martel LLP

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On May 16, 2005, the United States Supreme Court struck down direct shipping laws in Michigan and New York holding that the laws in both States discriminate against interstate commerce in violation of the Commerce Clause, and that the discrimination is neither authorized nor permitted by the 21st Amendment.

For wineries and wholesalers, *Granholm v. Heald* is notable for different reasons. For wineries, the case makes clear that States' powers to regulate alcohol under the 21st Amendment are not absolute, and that States must treat in-state and out-of-state wineries the same when it comes to the direct shipment of wine. For wholesalers, the decision reaffirmed the legitimacy of the three-tier system and did not establish a right to direct ship.

While the decision is a clear victory for those in favor of direct shipping, the real impact will only be known once we see how States choose to rewrite their laws to respond to the decision, and how the lower courts apply the decision to future challenges to the three-tier system.

Background: The Battle for Shelf Space in a Consolidating Industry

In striking down the Michigan and New York laws, the U.S. Supreme Court recognized the significant and ongoing consolidation in the wine industry. Fewer wineries and fewer distributors now control a larger than ever portion of the wine market, making it increasingly difficult for small wineries to distribute their wines.

At the same time that large wineries and distributors are consolidating, the number of small wineries in the United States is proliferating rapidly, making competition for retail shelf space even fiercer. Furthermore, as the Court noted, even if small wineries could find distributors for their wine in States that prohibit direct shipping, the distributor's mark-up would render such sales through the three-tier system economically infeasible.

As a result, more and more small wineries are turning to direct sales – via the tasting room, mailing list and over the Internet -- as the principal means to sell their wine. This is especially true given the recent technological advancements allowing for the sale of wine over the Internet, without the need for any physical contact with the customer at all.

The States' Powers Are Not Absolute

The States put forth three main arguments to justify discriminatory restrictions on out-of-state wineries: preventing the direct sale of alcohol to minors, improving the ability of states to collect sales tax, and that alcohol is simply different than other articles of commerce. None of these arguments persuaded the Court.

With regard to preventing the direct sale of alcohol to minors, the Court found that minors are less likely to consume wine as opposed to other forms of alcohol, and that minors have easier and quicker means to obtain alcohol than direct purchase through the mail. Moreover, less restrictive means are available to prevent the direct sale of alcohol to minors through the mail; such as requiring an adult signature for delivery and a label stating the requirement on the package itself.

With regard to the collection of sales tax, the Court found that if licensing and self-reporting provide adequate tax collection safeguards for wine distributed through the three-tier system, such mechanisms should work for direct shipments as well. States could require a license as a condition of direct shipping, with a requirement for licensees to submit sales reports and pay sales taxes. Notably, this is the approach recommended by the National Conference of Legislatures in their Model Direct Shipping Bill.

The third justification – that States' should be able to discriminate with regard to commerce in alcohol because alcohol is a unique article of commerce—is harder to dismiss. Concerns about the evils of alcohol abuse are so strong in our nation's history that a State's right to regulate the commerce of alcohol is enshrined in the Constitution itself. Despite acknowledging the unique history of alcohol in the United States, and that States have near absolute power to regulate the commerce of alcohol, the Court refused to allow the States to do so in a discriminatory manner. If a State desires to restrict the commerce of alcohol, it must do so in a way that does not differentiate based on whether a business is located in state or not.

The 21st Amendment and its Limitations

As clear as the Court was in holding that States' may not discriminate against out-of-state wineries with regard to the direct shipment of wine, the Court was equally clear in upholding the validity of the three-tier system and the States' rights to regulate or even ban the commerce of alcohol. The Court noted that the three-tier system is "unquestionably legitimate" and that the 21st Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system.

States' powers to regulate commerce in alcohol are limited only by other provisions of the Constitution itself. In this case, the Court held the Commerce Clause—which stands for the proposition that States cannot treat businesses differently based on whether the business is located in or out of state—trumps the 21st Amendment. According to Justice Kennedy, "if a State chooses to allow direct shipments of wine, it must do so on evenhanded terms."

Unintended Consequences: Are Reciprocal Laws Unconstitutional?

Although the ruling focuses on two States' laws that clearly discriminate against out-of-state wineries, the decision likely renders unconstitutional the direct shipping laws of other States whose laws are not commonly viewed as discriminatory. Good examples are those States with so-called reciprocal laws—laws that allow direct shipping only from States who in turn allow direct shipping into their State.

Ironically, California is a prime example of a State whose reciprocal direct shipping laws are now arguably unconstitutional under *Granholm v. Heald*. In fact, the Supreme Court in its ruling specifically mentioned California's reciprocal laws as illustrating the type of fragmented, alliance-driven patchwork of laws that has led to discrimination against out-of-state wineries. As the Court stated: "The current patchwork of laws—with some States banning direct shipments altogether, other doing so only for out-of-state wines, and still others requiring reciprocity—is essentially the product of an ongoing, low-level trade war."

Anticipating a challenge, the California Family Winemakers and the Wine Institute, among others, are already working on direct shipping amendments to replace the existing reciprocal laws in California with laws allowing for direct shipping from all States, regardless of reciprocity.

More Questions Than Answers: What Now?

It is worth repeating that the Court's decision does not authorize direct shipping. In fact, for those States that prohibit all direct shipping, the ruling has no direct affect because such laws treat in-state and out-of-state wineries the same. For those States whose laws do discriminate in one form or another, as stated by the Wine Institute, these states will have to take some legislative or regulatory action to address the discrimination issue and to build a framework for shipments to be made.

The ruling does suggest that requiring a physical presence in-state as a condition to direct ship is unconstitutional. This calls into question state laws that require in-state retailers, who buy from wholesalers, to buy from wholesalers located in-state. Costco is currently challenging such a law, among others, in the State of Washington. Also called into question are laws that allow in-state wineries, but not out-of-state wineries, to sell directly to restaurants and other retailers located in-state. Such a law currently exists in California, and if repealed, would adversely affect many California wineries that rely heavily on local retail direct sales.

Another broader question is in those States where the legislature requires all alcohol sales to go through a licensed entity, can these States require that the licensee maintain a physical in-state presence? From one perspective, the Court suggests it strongly disfavors state statutes that require in-state business operations. On the other hand, the three-tier system's middle tier is highly dependent on the in-state business requirement, and the Court went out of its way to declare the three-tier system as "unquestionably legitimate."

Although these positions seem at odds with each other, one way to reconcile them might be to reinterpret the Court's holding to be that States may not discriminate against out-of-state wineries *unless they have a good reason for doing so*. Thus far, the States' arguments have not been persuasive. It remains to be seen whether the lower courts will allow certain types of discrimination to survive if the States are able to provide strong enough justifications for doing so.

For example, what if States focused regulations on production amounts rather than the location of the winery? If States could assure wholesalers that the largest wineries would have to use the three-tier system, the wholesalers' interests might be satisfied. For smaller wineries, their low production could qualify them for an exemption from the three-tier system and allow them to direct ship.

The Opportunity and the Danger: Legislative Free for All

For all the noise this case has generated, the only thing we know for sure is that many States legislatures will be called on to rewrite their direct shipping laws. This presents an opportunity for wineries to push for legislatures to open their laws to direct shipping. However, it also presents a danger that the powerful wholesalers' lobby will convince State legislatures to impose more onerous restrictions on direct shipping than already exist, or to shut direct shipping down completely. Even in states like California where the wineries are at their strength, direct shipping proponents have an uphill battle to push through any legislation without the support of the wholesalers' lobby.

As part of any new legislation, many believe the wholesalers' lobby will push hard to include onerous paperwork, licensing and fee requirements in an attempt to make it as inconvenient and expensive as possible to direct ship. The more onerous the paperwork, the license requirements and the fees, the less wineries stand to gain.

 FARELLA BRAUN & MARTEL LLP

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For Your Information: March 30, 2004

Related Documents:

FTC Staff: New York Direct Shipment of Wine Bills Would Promote E-commerce and Consumer Welfare

Bills Remove a Significant Barrier to Greater E-Commerce

In response to requests from three New York state legislators, the staffs of the Federal Trade Commission's Office of Policy Planning, Northeast Regional Office, and Bureaus of Competition, Consumer Protection, and Economics have provided comments regarding three bills that would allow out-of-state vendors to ship wine directly to New York consumers if the vendors comply with certain regulatory requirements. According to the staff comments, the bills would promote e-commerce and give New York residents access to a greater variety of wines at lower prices, while allowing the state to satisfy its other public policy goals.

Todd Zywicki, Director of the FTC's Office of Policy Planning, stressed that the bills would help consumers. "Based on our empirical research, the bills could allow consumers to save significantly on more expensive wines. The bills would also give consumers access to thousands of wines from around the country," he said. Asheesh Agarwal, Assistant Director of the Office of Policy Planning, added that the bills would promote e-commerce. "By eliminating the requirement that out-of-state sellers maintain a physical presence in New York, the direct shipping bills would eliminate the single largest regulatory barrier to expanded e-commerce in the wine industry," he said.

The comments, available on the Commission's Web site, were sent to William Mageo, Chairman of the State Assembly Agriculture Committee; John R. Kuhl, Jr., Chairman of the State Senate Committee on Transportation; and Dean G. Skelos, Deputy Majority Leader of the State Senate. The comments analyze three New York bills, Assembly bill 9560-A, Senate bills 6060-A and 1192.

The staff comments first summarize the FTC's experience studying the direct shipment of wine to consumers, including a comprehensive report issued last July and congressional testimony delivered last October. The comments then analyze the pending bills, describing the regulatory requirements on shippers and common carriers. The comments conclude that the bills would allow consumers to purchase a greater variety of wines at lower prices.

The comments then summarize the experiences of states that currently allow interstate direct shipping of wine. The comments note that these states generally report few if any problems with direct shipments to minors, or with collecting taxes from those shipments. The comments also note that the bills contain all of the safeguards recommended by both the National Academy of Sciences and FTC staff, such as requiring an adult signature at the point of delivery. Finally, the comments discuss the implications of physical presence requirements for e-commerce generally, stating that "if extended to other industries, physical presence requirements could seriously imperil the growth of e-commerce."

In concluding its comments, the FTC staff said, "Based on an extensive review of the evidence, FTC staff believes that, if enacted, any of the bills would enhance consumer welfare and would allow New York to meet its other public policy goals."

The Commission vote authorizing staff to file the comments was 5-0. The comments represent the views of the staff of the FTC's Office of Policy and Planning, Bureaus of Competition, Consumer Protection, and Economics, and Northeast Regional Office, and not necessarily those of the Commission or any individual Commissioner.

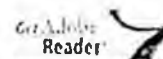
Copies of the document mentioned in this release are available from the FTC's Web site at <http://www.ftc.gov> and also from the FTC's Consumer Response Center, Room 130, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. Call toll-free: 1-877-FTC-HELP.

MEDIA CONTACT:

Mitchell J. Katz
 Office of Public Affairs
 202-326-2161

Comments of the Staff of the Federal Trade Commission Office of Policy Planning, Bureau of Competition, Bureau of Consumer Protection, Bureau of Economics, and Northeast Regional Office (March 2004) to the Chairman, Assembly Agriculture Committee, Chairman, Senate Committee on Transportation and Deputy Majority Leader, New York Senate, Concerning New York Assembly bill 9560-A, and Senate bills 6060-A and 1192. (V040012)

- Text of the Staff Comments [PDF 67KB]



STAFF CONTACTS:

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Office of Policy Planning
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(FTC File No. V040012)

(<http://www.ftc.gov/opa/2004/03/nywine.htm>)

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WASHINGTON, D.C. 20580

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Bureau of Competition
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Bureau of Economics
Northeast Regional Office

March 29, 2004

William Magee
Chairman, Assembly Agriculture Committee
Legislative Office Bldg, Room 641
Albany, NY 12248

John R. Kuhl, Jr.
Chairman, Senate Committee on Transportation
Legislative Office Bldg, Room 310
Albany, NY 12247

Dean G. Skelos
Deputy Majority Leader, Senate
503 State Capitol Bldg
Albany, NY 12247

Re: Assembly bill 9560-A, Senate bills 6060-A and 1192

Dear Chairmen Magee and Kuhl, and Deputy Majority Leader Skelos:

The staffs of the Federal Trade Commission's Office of Policy Planning, Bureau of Competition, Bureau of Consumer Protection, Bureau of Economics, and Northeast Regional Office are pleased to respond to your requests for comments on New York Assembly bill 9560-A, and Senate bills 6060-A and 1192. These bills would allow out-of-state vendors to ship wine directly to New York consumers if the vendors comply with certain regulatory requirements, such as labeling delivery packages and reporting sales to state authorities. In letters dated February 10 and 25, 2004, you asked us to examine the bills, and specifically to discuss the information regarding "the opponents' arguments related to sales to minors and harm to the three-tier system, as well as the proponents' arguments regarding the positive impact for consumers and state revenues."¹ You also referenced pending litigation.²

¹ This letter expresses the views of the FTC's Office of Policy Planning, Bureau of Competition, Bureau of Consumer Protection, Bureau of Economics, and Northeast Regional Office. The letter does not necessarily represent the views of the Commission or of any individual Commissioner. The Commission has, however, voted to authorize us to submit these comments.

² See *Swedenburg v. Kelly*, 358 F.3d 223 (2d Cir. 2004) (upholding New York's direct shipping regulations).

We believe that, if enacted, all three bills would enhance consumer welfare and allow New York to meet its other public policy goals. By allowing interstate direct shipping, the bills could allow New York residents to purchase a greater variety of wines at lower prices. Senate bill 1192 would provide the greatest benefits by allowing both out-of-state wineries and retailers to obtain out-of-state shipper's licenses. In addition, by requiring vendors and common carriers to comply with various regulatory requirements, similar to those adopted in other states, all three bills would allow New York to limit shipments to minors and to collect taxes on out-of-state shipments. Finally, the bills would remove one of the largest barriers to greater e-commerce in the wine industry. We base our analysis on a recent FTC staff report that extensively analyzed the direct shipping issue, and on the Commission's testimony at a recent congressional hearing (copies of both attached). A summary of our analysis is below:

- Variety. Direct shipping allows consumers to purchase many wines that are not available in nearby bricks-and-mortar stores. An FTC staff study found that 15% of a sample of popular wines available online were not available from retail wine stores within ten miles of McLean, Virginia. Direct shipping also gives consumers easier access to thousands of labels from smaller wineries.
- Prices. Depending on the wine's price, the quantity purchased, and the method of delivery, consumers can save money by having wine shipped directly to them. Because shipping costs do not vary with the wine's price, consumers can save more money on more expensive wines, while less expensive wines may be cheaper in bricks-and-mortar stores. The FTC staff study suggests that, if consumers use the least expensive shipping method, they could save an average of 8-13% on wines costing more than \$20 per bottle, and an average of 20-21% on wines costing more than \$40 per bottle.
- Sales to minors. The states that permit interstate direct shipping generally report few or no problems with shipments to minors. These states have generally adopted less restrictive means of regulating interstate direct shipments, such as requiring that package delivery companies obtain an adult signature at the time of delivery. The pending bills contain these same types of safeguards.
- Taxes. Several states collect taxes on interstate direct shipments. States such as New Hampshire have sought to achieve voluntary compliance through less restrictive means, such as by requiring out-of-state suppliers to obtain permits. Most of these states report few or no problems with tax collection.
- E-commerce. State bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine. Approximately half the states prohibit or severely restrict out-of-state suppliers from shipping wine directly to consumers. Many of these same states, however, allow intrastate direct shipping, such as from in-state wineries and retailers.

For these reasons, we believe that, if enacted, the bills would enhance consumer welfare and allow New York to meet its other public policy goals.

Interest and Experience of the Federal Trade Commission

The FTC is charged by statute with preventing unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.³ Under this statutory mandate, the Commission seeks to identify business practices and regulations that impede competition without offering countervailing benefits to consumers. In particular, Commission staff have often assessed the competitive impact of regulations involving alcohol distribution. For example, the staff has analyzed franchise laws that grant wholesalers preferential contract rights. In Illinois, the staff examined a bill that would have prevented suppliers from terminating contracts with wholesalers except for good cause, and suggested that the bill would harm consumers by limiting suppliers' flexibility in changing distributors.⁴ In North Carolina, the staff noted that a bill that would have tightened exclusive territorial arrangements between wineries and wholesalers would likely diminish consumer welfare.⁵ Another type of state regulation deters wholesalers from cutting prices. In Massachusetts, FTC staff discussed the consumer benefits of a proposal that would have repealed regulations requiring wholesalers to post prices on a monthly basis and to adhere to those posted prices for an entire month.⁶

FTC staff have also studied the direct shipping issue. In October 2002, the Commission held a workshop to evaluate possible anticompetitive barriers to e-commerce in wine and many other industries.⁷ At the workshop, FTC staff heard testimony from all sides of the wine issue, including wineries, wholesalers, and state regulators. The staff also gathered evidence from package delivery companies, the Alcohol and Tobacco Tax and Trade Bureau ("TTB"), and regulators in states that allow direct shipping. Finally, FTC staff conducted the first empirical study of a wine market in a state that banned interstate direct shipping. The study examined the wine market in McLean, Virginia ("McLean study"), and compared the prices and choices that consumers could find in area stores to those available online. The authors chose McLean as a relevant retail area because the socio-economic status of many residents in McLean (and northern Virginia, generally) made it likely that several local bricks-and-mortar outlets would

³ Federal Trade Commission Act, 15 U.S.C. § 45.

⁴ FTC Staff Letter to Illinois Sen. Dan Cronin (Mar. 31, 1999), at <http://www.ftc.gov/bc/v990005.htm>.

⁵ FTC Staff Letter to North Carolina Sen. Horton and Rep. Miller (Mar. 22, 1999), at <http://www.ftc.gov/bc/v990003.htm>.

⁶ FTC Staff Statement to the Commonwealth of Massachusetts Alcoholic Beverages Control Commission (June 26, 1996), at <http://www.ftc.gov/bc/v960012.htm>.

⁷ Public Workshop: Possible Anticompetitive Efforts to Restrict Competition on the Internet, 67 Fed. Reg. 48,472 (2002). The workshop's homepage is at <http://www.ftc.gov/opp/e-commerce/anticompetitive/index.htm>, its transcript is at <http://www.ftc.gov/opp/e-commerce/anticompetitive/021008antitrans.pdf>, and all of the panelists' written statements are at <http://www.ftc.gov/opp/e-commerce/anticompetitive/agenda.htm>.

cater to sophisticated wine drinkers.⁸ In July 2003 FTC staff issued a comprehensive report on the direct shipping issue ("Wine Report"),⁹ and in October 2003, the Commission testified at a related congressional hearing.¹⁰

Analysis of Pending Bills

All three bills would allow out-of-state vendors to ship wine directly to New York residents if those vendors satisfy certain regulatory requirements. Under Senate bill 1192, both out-of-state manufacturers and retailers could obtain an out-of-state shipper's license if those vendors hold a license to sell or manufacture wine in another state, and if that other state affords New York's vendors reciprocal treatment. To obtain an out-of-state shipper's license, vendors must pay an annual fee of \$125 and present New York's state liquor authority with a copy of a current license from the other state. A license allows vendors to ship wine directly to New York residents who are 21 years or older.

Senate bill 1192 imposes several requirements on out-of-state shippers. In sending the wine, the shipper must ensure that the delivery package has a conspicuous label noting that the package contains alcohol and requires an adult signature for delivery, and the shipper must require common carriers to obtain an adult signature at the time of delivery. In addition, the shipper must provide the state liquor authority with annual reports that include, among other information, the total volume of shipments into New York and the purchaser's name and birth date. The shipper must pay all state and local sales and excise taxes, keep records for three years, and consent to New York's jurisdiction for enforcement purposes. Finally, the bill gives the state liquor authority the power to suspend or revoke an out-of-state shipper's license.

Assembly bill 9560-A and Senate bill 6060-A have similar provisions, with a few important exceptions. These bills would allow only out-of-state wineries, not retailers, to obtain out-of-state shipper's licenses, and in addition to a license, an out-of-state winery would have to obtain a "certificate of authority" and a "registration as a distributor." The bills also cap wine shipments at two cases per month to any New York resident. Finally, the bills directly require common carriers to verify the age of recipients.

⁸ See Wine Report at 18 n.81. It is likely that, in larger markets, bricks-and-mortar retailers may offer somewhat more choices, and that in smaller markets, bricks-and-mortar retailers may offer somewhat fewer choices.

⁹ FTC Staff Report, *Possible Anticompetitive Barriers to E-Commerce: Wine* (July 2003), at <http://www.ftc.gov/os/2003/07/winereport2.pdf>.

¹⁰ See Prepared Statement of the FTC Concerning "E-Commerce: The Case of Online Wine Sales and Direct Shipment," Before the Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce, United States House of Representatives (October 30, 2003), at <http://www.ftc.gov/os/2003/10/031030ecommercewine.htm>.

I. The Bills Would Allow Consumers to Purchase a Greater Variety of Wines

The bills would substantially increase the variety of wines available to consumers. Through direct shipping, and particularly through the Internet, consumers can conveniently purchase many wines that are not available in nearby bricks-and-mortar stores. The Internet effectively expands the geographic market by allowing online vendors to compete nationally. An individual online store may feature more products than many bricks-and-mortar retail locations. More importantly, the total number of varieties available online may surpass the total number available in bricks-and-mortar stores that are within a reasonable distance of a particular consumer. As a result, direct shipping can give consumers convenient access to many more wines, including popular labels. Using the *Wine and Spirits* list of the top 50 most popular wines in America, the McLean study found that 15% of the wines available online were not available from retail wine stores within ten miles of McLean. For the bottles that were unavailable in the McLean vicinity, 8 out of 15 came from among the 20 most popular bottles.¹¹ In addition to popular wines, direct shipping also gives consumers access to thousands of smaller labels from around the country.

Bricks-and-mortar retailers may not have the demand or shelf-space to justify keeping a large variety of wines in stock. According to a trade association, domestic wineries produce approximately 25,000 wine labels, and even in a large market like Illinois, only slightly more than 500 of these labels are available through the three-tier system.¹² Moreover, smaller wineries may be unable to distribute their wines through the three-tier system. One court found that Florida's interstate direct shipping ban "has the practical effect of preventing many small wineries from selling their wine in Florida. This result occurs because it is not cost-effective for the smaller out-of-state wineries to acquire a Florida wholesaler."¹³ Another court found that the three-tier system "may lock most [out-of-state producers] out of any access to Texas markets, even if they are willing to take on the additional costs. Such discrimination is especially felt by small, family-run wineries with limited production."¹⁴

Consumers are likely to value having a variety of wines from which to choose. One wine magazine, for example, reviews over 10,000 different wines annually. Similarly, an economist

¹¹ See Wine Report, App. A. The FTC's Bureau of Economics contributed to the Wine Report, and the McLean study, which is attached to the report, has been published as Alan E. Wiseman and Jerry Ellig, *How Many Bottles Make a Case Against Prohibition?* (Bureau of Economics, Federal Trade Commission, Working Paper No. 258, March 2003).

¹² See Wine Report at 24.

¹³ *Bainbridge v. Bush*, 148 F.Supp.2d 1306, 1311 n.7 (M.D. Fla. 2001), *vacated on other grounds*, *Bainbridge v. Turner*, 311 F.3d 1104 (11th Cir. 2002).

¹⁴ *Dickerson v. Bailey*, 212 F.Supp.2d 673, 694-95 (S.D. Tex. 2002), *aff'd*, 336 F.3d 388 (5th Cir. 2003).

testified that “the value to consumers of direct wine shipments com[es] primarily from access to wines that are not available in their communities.”¹⁵

II. The Bills Could Allow Consumers to Purchase Wine at Lower Prices

Depending on the wine's price, the quantity purchased, and the method of delivery, consumers can save money by purchasing wine online. Because shipping costs do not vary with the wine's price, consumers can save more money on more expensive wines, while less expensive wines may be cheaper in bricks-and-mortar stores. The McLean study suggests that, if consumers use the least expensive shipping method, they could save an average of 8-13% on wines costing more than \$20 per bottle and an average of 20-21% on wines costing more than \$40 per bottle. In addition, direct shipping lets consumers avoid the “cost” of spending time to travel to a bricks-and-mortar store.¹⁶

Moreover, even if consumers choose to buy wine from a bricks-and-mortar retailer, direct shipping still encourages price competition between online and offline sources. In states that allow direct shipping, the Internet allows wineries and other merchants across the nation to compete with local bricks-and-mortar retailers. The Internet helps consumers comparison shop and lets suppliers compete in geographic markets that otherwise may be closed to them, perhaps due to the three-tier system or franchise laws.¹⁷ This competition likely forces down prices. One court found that the ban on interstate direct shipping constituted “economic protectionism, negatively impacting Texas consumers because of more limited wine selection and higher prices.”¹⁸ Likewise, a Nobel laureate in economics has explained how direct shipping benefits consumers:

consumers benefit from free markets operated with the minimum government regulation required for consumer protection. . . . The restrictions on direct

¹⁵ See Daniel L. McFadden, Written Statement 2, at <http://www.ftc.gov/opp/e-commerce/anticompetitive/panel/mcfadden.pdf>. On the importance of variety, see Thomas B. Leary, *The Significance of Variety in Antitrust Analysis*, 68 ANTITRUST L.J. 1007 (2001). Some, however, have determined that consumers already have enough choices. See Statement of Juanita D. Duggan Concerning “E-Commerce: The Case of Online Wine Sales and Direct Shipment” 18, Before the Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce, United States House of Representatives (October 30, 2003) (“The average retail store in most States carries between 300 and 500 different wine brands at any given moment. Can you imagine selecting from that many toothpastes or contact lenses or cars?”).

¹⁶ See generally Clifford Winston, *Conceptual Developments in the Economics of Transportation: An Interpretive Survey*, 23 J. ECON. LIT. 57, 77 (Mar. 1985) (discussing costs of travel time).

¹⁷ See, e.g., Public Comments, American Bar Association, Section of Antitrust Law at 10, at <http://www.ftc.gov/opp/e-commerce/anticompetitive/comments/aba.pdf>.

¹⁸ *Dickerson v. Bailey*, 212 F.Supp.2d 673 (S.D. Tex. 2002), incorporating *Dickerson v. Bailey*, 87 F.Supp.2d 691, 709-10 (S.D. Tex. 2000), *aff'd*, 336 F.3d 388 (5th Cir. 2003).

purchase of premium wines and their interstate shipment that have been adopted by a number of States are, I believe, another example of abuse of the regulatory process to protect concentrated economic interests, going far beyond the minimum regulations needed to maintain the integrity of taxation and to protect minor consumers.¹⁹

Because all three bills permit direct shipping, all would increase competition and allow consumers to find lower prices. Of the three bills, Senate bill 1192 would increase competition the most by allowing out-of-state retailers, as well as wineries, to obtain out-of-state shipper's licenses. This additional competition likely would allow consumers to find even lower prices. The McLean study found that "the lowest online prices overwhelmingly come not from wineries, but from out-of-state retail outlets that have web-accessible inventories."²⁰

To provide New York consumers with the greatest benefits, the bills should ensure that licensing procedures for out-of-state vendors are not overly burdensome. For example, to ship into New York, Assembly bill 9560-A and Senate bill 6060-A require out-of-state wineries to obtain a "certificate of authority" and a "registration as a distributor" in addition to an out-of-state shipper's license. All three bills require out-of-state vendors to pay an annual fee of \$125. Such restrictions may constrain competition. Depending on the volume of purchases in a state, even seemingly small fees can deter smaller wineries from shipping wine.²¹ In addition, some states have created complex licensing procedures and regulations that deter suppliers and package delivery companies from shipping wine to those states. Furthermore, all three bills allow out-of-state vendors to obtain New York licenses only if those vendors are located in states that afford New York's vendors reciprocal treatment. This restriction will prevent some out-of-state vendors from shipping to New York residents, thereby somewhat limiting competition and consumer choice. To obtain the greatest benefits from competition, a policy should ensure that permit procedures, fees, and regulations are reasonably calculated to meet the state's legitimate regulatory goals.

III. States that Permit Interstate Direct Shipping of Wine Generally Report Few or No Problems with Direct Shipments to Minors

Although direct shipping can provide consumers with important benefits, policymakers have expressed concern that direct shipping might exacerbate the problem of underage drinking. As FTC staff recognized in the Wine Report and in other documents, underage alcohol use

¹⁹ See Daniel L. McFadden, Written Statement 1, at <http://www.ftc.gov/opp/e-commerce/anticompetitive/panel/mcfadden.pdf>.

²⁰ Wine Report at App. A 25 n.22.

²¹ See Wine Report at 41.

imposes significant costs, in both human and economic terms.²² In the context of the direct shipping of wine, however, the evidence shows that the states that permit interstate direct shipping generally report few or no problems with shipments to minors.

A. Evidence from States That Allow Direct Shipping

FTC staff contacted officials from many states that allow interstate direct shipping and asked them whether they had experienced problems with shipping to minors. These states generally report few, if any, problems with direct shipping to minors. Most of them do not believe that interstate direct shipment of wine to minors is currently a serious problem, although several of them believe that it is possible for minors to buy wine online. None of them report more than isolated instances of minors buying or even attempting to buy wine online.²³ State regulators uniformly expressed greater concern about underage access to alcohol through traditional avenues.

The state officials offered many possible explanations for their experiences. Several state officials opined that minors are more interested in beer and spirits than wine.²⁴ New Hampshire concluded that minors are less likely to purchase wine online because of the extra expense of ordering over the Internet.²⁵ This conclusion corresponds with the McLean study, which found that when transportation costs are included, lower-end wines are more expensive when purchased over the Internet than through the three-tier system.²⁶ Minors would have to pay a hefty premium, from 33-83%, to purchase a bottle of wine costing less than \$20 online and have it delivered to them via 2nd Day Air. Similarly, several state officials also commented that, based on their experience, minors were much more likely to buy alcohol through offline sources than over the Internet.²⁷ In a 2002 survey, large percentages of high school students, from 68-95%, said that it is "fairly easy" or "very easy" to get alcohol.²⁸

²² See *id.* at 26-38; FTC, *Self-Regulation in the Alcohol Industry: A Review of Industry Efforts to Avoid Promoting Alcohol to Underage Consumers* App. A, pp. iii-iv (Sept. 1999), at <http://www.ftc.gov/reports/alcohol/alcoholreport.htm>.

²³ See Wine Report at 26-40.

²⁴ See *id.* at 32 (chart summarizing state responses), App. B (letters from state officials). See also Wall Street Journal, Editorial, *The Carafe is Half Full*, WALL ST. J., July 3, 2003, at A10 (arguing that teenagers are not interested in expensive wines, and that "[t]hirty states allow wine shipments within their borders without a surce in teen drinking").

²⁵ *Id.* at App. B (New Hampshire letter).

²⁶ See *id.* at App. A.

²⁷ See *id.* at App. B (California testimony; letters from New Hampshire and Wisconsin).

²⁸ See *id.* at notes 47-50 and accompanying text.

Of course, the fact that states have received few complaints about direct shipments to minors does not establish that minors are not purchasing wine online. As noted by a Michigan Assistant Attorney General, minors who buy wine online are unlikely to report their purchases to the authorities, and neither the package delivery company nor the supplier may know or care that they are delivering wine to a minor.²⁹ FTC staff cannot rule out the possibility that minors are buying wine online undetected by state officials.

Nevertheless, the staff is aware of no systematic studies assessing whether direct shipping increases alcohol consumption by minors. FTC staff found only one study that might address the impact of direct shipping of wine on underage drinking. This study examines the impact of "home delivery" of keg beer and other alcohol on underage drinking from such traditional retailers such as local liquor stores.³⁰ Although the study raises important issues of concern, it provides little information upon which to assess interstate direct shipping of wine. The study does not specifically address online sales, interstate direct shipment via package delivery companies, or wine. For example, one of the study's key findings is that "[o]utlets providing delivery services were more likely to sell keg beer." Moreover, the study itself states that "data presented here do not reveal the frequency of delivery use or whether delivery purchases served as a primary source of alcohol," and the study does not assess whether home delivery or direct shipping increases underage alcohol consumption above the level that would occur without those channels.³¹

The data from state compliance checks, or stings, in theory could provide additional evidence on the impact of interstate direct shipping on underage drinking. Several states have conducted stings on interstate direct shipments of wine. Typically in these stings, states provide a minor with a credit card to see whether the minor can purchase wine online, and whether the supplier or package delivery company will refuse to deliver it to the minor. These data, however, are also inconclusive. Stings and anecdotes have shown that minors are able to buy wine online, but there are not enough data from which to conclude that minors can buy wine more or less easily online than offline. For instance, Michigan found that "[a]bout one in three websites contacted" (roughly 33%) agreed to sell alcohol to the minor with no more age verification than a mouse click, and that UPS delivery people did not properly verify the recipients' ages.³² On the other hand, New Hampshire has run compliance checks in the past but

²⁹ See Testimony of Irene Mead 196, at <http://www.ftc.gov/opp/e-commerce/anticompetitive/021008antitrans.pdf>.

³⁰ Linda A. Fletcher et al., *Alcohol Home Delivery Services: A Source of Alcohol for Underage Drinkers*, J. STUD. ALCOHOL 61: 81-84 (2000).

³¹ The National Academy of Sciences cites this study, and only this study, for the proposition that "[s]urveys of underage purchase of alcohol over the Internet or through home delivery show that small percentages (10 percent) of young people report obtaining alcohol in this manner." See *Reducing Underage Drinking: A Collective Responsibility* 174-75 (2004). As noted in the text, however, the cited study does not discuss the Internet or sales from out-of-state vendors.

³² See Wine Report at 35.

did not report any problems with interstate direct shipping to minors.³³ Moreover, the bricks-and-mortar sting data show comparable results. These stings typically find that minors are able to buy alcohol between 15-30% of the time. In Michigan, minors were able to buy alcohol 55% of the time after showing a valid Michigan license that identified the customer as a minor.³⁴ Ultimately, there are little data indicating whether a retail clerk is a more or less reliable gatekeeper than a common carrier's delivery person. Of course, efforts should be made to minimize underage purchases of alcohol, both online and offline, and New York's bills incorporate safeguards against direct shipping to minors.

B. Less Restrictive Regulatory Tools

Many states have decided that they can prevent direct shipping to minors through non-discriminatory, less restrictive means than a complete ban. For example, some states have applied the same types of safeguards to direct shipments that already apply to bricks-and-mortar retailers, such as requirements that package delivery companies obtain an adult signature at the time of delivery. In addition, several states, including Nebraska, New Hampshire, and Wyoming, require out-of-state suppliers to register and obtain permits (a permit can be conditioned on the out-of-state supplier's consent to submit to the state's jurisdiction). None of these states reported any problems with interstate direct shipping to minors.³⁵

New York's bills contain these types of safeguards. In sending the wine, the shipper must ensure that the delivery package has a conspicuous label, and the common carrier must obtain an adult signature at the time of delivery. In addition, the shipper must register with the state and consent to jurisdiction within New York for enforcement purposes. Finally, the bills give the state liquor authority the power to suspend or revoke an out-of-state shipper's license. Notably, New York's bills contain all of the safeguards recommended by both the National Academy of Sciences, which recommended "tightening access" rather than banning interstate direct shipping, and FTC staff.³⁶

To the extent that minors do buy wine online, some argue that they lack adequate enforcement tools against out-of-state suppliers. They contend that the states cannot readily inspect the records of out-of-state suppliers, and that because of jurisdictional constraints, "there is no easy way to shut [out-of-state suppliers] down if violations occur." They also argue that out-of-state suppliers have little incentive to prevent sales to minors, in part because of enforcement difficulties, but also because individual states can only punish out-of-state suppliers with the loss of a small part of their market, not the loss of a license. They note that, in contrast,

³³ See *id.* at App. B (New Hampshire letter).

³⁴ See *id.* (noting a success rate of 30% in bricks-and-mortar stings); Letter from Tina Schultz, National Alcohol Beverage Control Association, to FTC 2-4 (Jan. 31, 2002) (citing state statistics).

³⁵ See Wine Report at App. B (letters from Nebraska, New Hampshire, and Wyoming).

³⁶ See Wine Report; NAS, Reducing Underage Drinking: A Collective Responsibility 174-75 (2004).

they can readily inspect in-state wholesalers and retailers on-site, run compliance checks, and punish violators with the loss of a license, fines, and other penalties.³⁷

States, however, have a variety of legal remedies against out-of-state suppliers that ship to minors. The Twenty-First Amendment Enforcement Act gives state attorneys general the power to bring civil actions in federal court for injunctive relief against out-of-state suppliers that violate the state's liquor laws.³⁸ At the time the law took effect, in 2000, state authorities agreed that the Act would help them enforce their laws against out-of-state suppliers. The National Alcohol Beverage Control Association ("NABCA"), an association of state regulators, stated that the Act would "provide state governments with an effective tool to use in preventing the illegal interstate flow of alcohol beverages, some of which finds its way into the hands of underage drinkers."³⁹ NABCA also said that the Act would help states "overcome the jurisdictional hurdles" in enforcing their laws.⁴⁰ Finally, TTB, which has authority to revoke a winery's basic permit, will assist states in combating significant violations of state law.⁴¹

States also can request assistance from other states' alcohol agencies. New Hampshire will punish suppliers licensed in New Hampshire if another state proves that the supplier is shipping wine illegally into that state.⁴² Likewise, when officials in Louisiana learn of a violation, they have a duty to notify both TTB and the state that licensed the violator, and to "request those agencies to take appropriate action."⁴³

Overall, the evidence shows a few clear results. States that permit interstate direct shipping have adopted various procedural safeguards and enforcement mechanisms to prevent sales to minors. These states generally say that direct shipping to minors currently is not a serious problem, and that they have received few or no complaints about direct shipping to minors. The McLean study suggests that an interstate shipping ban primarily deprives consumers of access to lower-cost sources of high-end, expensive wines, and to a larger variety

³⁷ See Wine Report at 29-30.

³⁸ 27 U.S.C. § 122a (2002); Letter from Sheryl L. Walter, Acting Assistant Attorney General, U.S. Department of Justice, to Hon. Dennis Hastert, Speaker, U.S. House of Representatives 2 (May 3, 2001); *Bolick v. Roberts*, 199 F.Supp.2d 397, 442 (E.D. Va. 2002) (addendum), *vacated on other grounds*, *Bolick v. Danielson*, 330 F.3d 274 (4th Cir. 2003).

³⁹ Letter from James M. Goldberg, counsel for NABCA, to Jonathan Ruseh, Special Counsel for Fraud Prevention, U.S. Department of Justice 2 (Mar. 19, 2001), attached as an enclosure to the Walter letter.

⁴⁰ *Id.* See also Wine Report at App. B (noting that Illinois could use the Act).

⁴¹ ATF, Industry Circular No. 96-3, Direct Shipment Sales of Alcohol Beverages (Feb. 11, 1997), at http://www.atf.treas.gov/pub/ind_circulars/ic_96-3.htm.

⁴² N.H. REV. STAT. ANN. § 178:14-a(VIII) (2000).

⁴³ LA. REV. STAT. ANN. § 26:359(G) (West 2001).

of all wines. FTC staff has seen no evidence indicating whether higher prices for these types of fine wines would curtail consumption significantly either among the general populace, minors, or problem drinkers. There is, therefore, apparently no empirical evidence that bans on interstate direct shipping promote temperance. Because New York's bills contain the same types of recommended safeguards as those adopted by states that allow interstate direct shipping and report few problems, it is likely that New York will experience few, if any, problems with direct shipments of wine to minors.

IV. States that Permit Interstate Direct Shipping of Wine Generally Report Few or No Problems with Tax Collection

Some states also have adopted less restrictive means of protecting tax revenues while permitting direct shipping, such as by requiring out-of-state suppliers to obtain permits and to collect and remit taxes.⁴⁴ New York's bills incorporate these types of requirements. Of these states, most report few, if any, problems with tax collection. Nebraska, for example, reports that they "have also not, as yet, had any problems with the collection of excise tax[es]."⁴⁵ North Dakota reports that "Taxes are collected. No problems to date that we are aware of."⁴⁶

To the extent that states have problems with out-of-state suppliers, they have addressed the problem in less restrictive ways than banning all interstate direct shipping. New Hampshire, for example, works with out-of-state suppliers:

[T]he State of New Hampshire Liquor Commission collects an 8% fee on all shipments into the State of New Hampshire. When the NH Liquor Commission discovers an improper shipment we contact the company and inform them of the laws in NH. Once the company learns of NH laws they normally get a permit or stop shipping into NH. The NH Liquor Commission is working with out-of-state supplier[s] and encouraging them to obtain a permit.⁴⁷

Furthermore, to the extent that out-of-state suppliers fail to comply voluntarily, states can report problems to TTB or other states, or use the Twenty-First Amendment Enforcement Act. On the other hand, there is no evidence showing that states must ban interstate direct shipping, rather than adopting a less restrictive alternative, to raise revenue.

Finally, regardless of whether states permit or prohibit interstate direct shipping, there is no reason to believe that legalized direct shipping would increase tax evasion. It is unlikely that

⁴⁴ See, e.g., LA. REV. STAT. ANN. § 26:359(B)(1); N.H. REV. STAT. ANN. § 178:14-a(V); NEV. REV. STAT. § 369-462.

⁴⁵ See Wine Report at App. B (Nebraska letter).

⁴⁶ See *id.* (North Dakota letter).

⁴⁷ See *id.* (New Hampshire letter).

states would increase illegal interstate direct shipping by creating procedures that would allow out-of-state suppliers to ship legally and pay taxes. Michigan, for example, reports that many out-of-state suppliers ship wine illegally into Michigan, and that those suppliers do not pay taxes to Michigan. Michigan, however, already prohibits out-of-state suppliers from shipping wine into Michigan, and out-of-state suppliers that ship into Michigan are already breaking the law. By legalizing direct shipping and requiring shippers to pay taxes as a condition for receiving a license, states could allow interstate direct shipping from out-of-state suppliers that comply with the law. If suppliers who currently ship illegally continue to ship illegally, then the level of tax evasion would remain unchanged, but if some suppliers who currently ship illegally decide to ship legally, then tax evasion would fall. Moreover, if interstate direct shipping increases overall commerce in wine, overall tax revenue could rise.⁴⁸

V. The Bills Would Promote E-Commerce and Interstate Commerce

The Internet lets consumers purchase an unprecedented array of goods and services from the convenience of their homes. Consumers can find thousands of goods, from thousands of suppliers around the country, and have those goods delivered to their doors. State bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine. In states that ban interstate direct shipping, the bans prevent consumers from conveniently purchasing wine from suppliers around the country.⁴⁹

The direct shipping issue has broader implications for interstate e-commerce. In many industries, including many professional and financial services, states require that potential suppliers maintain a physical office within the state, or that they hire state residents.⁵⁰ Under current New York law, for example, out-of-state wineries can obtain a license to distribute and sell alcohol in New York only if they “comply with the licensing requirements of [New York] Law, including establishing and maintaining a physical presence in New York.”⁵¹ These requirements ostensibly allow states to maintain tighter regulatory control over the supplier, but they also significantly raise the cost to online suppliers to doing business within a particular state. They deprive online suppliers of one of the main efficiency benefits of e-commerce, the ability to provide goods and services over large distances without the need for a substantial, far-flung physical presence. They also demonstrate how seemingly neutral restrictions can deprive online firms of a legitimate competitive advantage. State physical presence laws apply equally

⁴⁸ See *id.* at 39-40.

⁴⁹ See, e.g., Virginia Postrel, *A Look at Wine Sales over the Internet Shows the Price of Some Regulations in the Name of Consumer Protection*, N.Y. TIMES, July 17, 2003, at C2 (criticizing bans on interstate direct shipping as a barrier to e-commerce).

⁵⁰ At the workshop, FTC staff examined potentially anticompetitive barriers to e-commerce in many other industries: auctions; automobiles; caskets; contact lenses; cyber schools; online legal services; real estate, mortgages, and financial services; retailing; and telemedicine and online pharmaceutical sales. See Workshop Homepage, at <http://www.ftc.gov/opp/e-commerce/anticompetitive/index.htm>.

⁵¹ *Swedenburg v. Kelly*, 358 F.3d 223, 228-29 (2d Cir. 2004).

to in-state and out-of-state firms. In reality, though, these requirements impose disproportionate costs on online firms by diminishing or eliminating one of their advantages. Moreover, online firms, unlike bricks-and-mortar firms, may not enjoy the full financial benefits of maintaining an in-state office, because only part of their client base will reside in any particular state.

On the other hand, there is little evidence that in-state office requirements are necessary to advance consumer protection goals. For instance, there is little evidence that in-state office requirements reduce the incidence of consumer fraud by "fly-by-night" operators who deceive consumers and then disappear. FTC staff have ample experience demonstrating that deceptive lending can harm consumers, particularly for low-income and unsophisticated borrowers.⁵² There is, however, no necessary correlation between a lender's propensity to deceive consumers and the presence or absence of in-state offices or personnel. In a number of the most significant deceptive lending cases brought by the Commission, the lenders operated in-state offices.⁵³

Physical presence is not necessary to ensure accountability.⁵⁴ Nor is the issue of enforcement unique to wine. As with catalogue sales or online sales of other products, a variety of general laws and regulations protect consumers and provide legal remedies. Consumers can use general contract and tort law, as well as other specific state consumer protection laws and federal laws, to seek legal redress against out-of-state suppliers. State enforcement agencies can use a variety of legal tools, such as the Twenty-First Amendment Enforcement Act and cooperation with other states' enforcement agencies. Moreover, federal agencies, including the FTC, TTB, and Department of Justice, have authority to bring enforcement actions against sellers who violate the law. At best, physical presence requirements are an expensive, inefficient means of getting an incremental increase in regulatory authority. At worst, if extended to other industries, physical presence requirements could seriously imperil the growth of e-commerce.

Finally, your letter asked us to comment on arguments regarding "harm to the three-tier system." The FTC's statutory mandate, of course, is to promote competition and consumer welfare, not producer welfare. Having said that, the evidence suggests that expanded e-commerce would improve market conditions by giving wineries (including New York wineries), the first tier of the system, extra distribution outlets. Moreover, expanded e-commerce likely would not spell the end of bricks-and-mortar wholesalers or retailers. Because of shipping costs, consumers generally can find lower prices for less expensive wines in bricks-and-mortar stores.

⁵² See Prepared Statement of the Federal Trade Commission on Efforts to Combat Unfair and Deceptive Subprime Lending, before the Senate Special Committee on Aging 4-8, February 24, 2004, at <http://www.ftc.gov/os/2004/02/02242004subprimelendingtest.pdf>.

⁵³ See, e.g., *The Associates*, No. 1:01-CV-00606 (N.D. Ga. 2001); *First Alliance Mortgage Co., et al.*, No. SACV 00-964 DOC (Eex) (C.D. Cal. 2000); *Mercantile Mortgage Co.*, No. 02-5079 (N.D. Ill. 2002).

⁵⁴ *Cf. Swedenburg*, 358 F.3d at 237-38.

In states that permit interstate direct shipping, such as California and Illinois, wholesalers and retailers continue to enjoy the bulk of sales.⁵⁵

Conclusion

Based on an extensive review of the evidence, FTC staff believes that, if enacted, any of the bills would enhance consumer welfare and would allow New York to meet its other public policy goals. FTC staff also believes that Senate bill 1192 would provide greater benefits to consumers than Assembly bill 9560-A or Senate bill 6060-A, because that bill would allow both out-of-state wineries and retailers to obtain out-of-state shipper's licenses.

Respectfully submitted,

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⁵⁵ See Daniel L. McFadden, Written Statement 2, at <http://www.ftc.gov/opp/e-commerce/anticompetitive/panel/mcfadden.pdf> ("If direct interstate wine shipments were reopened, I would foresee some competitive pressure on distributors and retailers, primarily from direct wine sales to large retailers, but no substantial restructuring of the industry. I find it particularly sad that the anti-interstate shipping legislation that has been passed is so disproportionate in its negative impact on consumers relative to the very modest protection it provides to traditional distributors and retailers").