

FREE THE GRAPES!

TO ENSURE CONSUMER CHOICE IN FINE WINE

Reflecting on the 5th Anniversary of *Granholm v. Heald*

By Free the Grapes!

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How Did This All Start?

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Since 1990, the number of American bonded wineries has tripled and total wine consumption has increased 32% to 670 million gallonsⁱ. With at least one winery in each state, wine country tourism has helped to satisfy America's growing interest in wine.

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But heightened tourism exposed weaknesses in wine distribution. In fact, only 17% of wineries are distributed nationally, and 54% of them were unable to find a wholesaler in states where they actively sought representation, according to a 2003 membership study by Wine Institute, a public policy trade association representing 900+ California wineries.

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Most wineries are small, family-owned and operated and direct-to-consumer sales offered them a pressure relief valve to satisfy consumer demand. And emerging wineries could "seed" new state markets prior to seeking broader distribution through a wholesaler, who had the infrastructure and sales teams to cost-effectively distribute wines to restaurants and retailers.

But the middle wholesaler tier consolidated from more than 5,000 wholesaler companies in the 1970s to around 500 today, while the number of wines introduced each year is estimated to exceed 130,000ⁱⁱ. Wineries, wholesalers and consumers fit a classic "hourglass" shape, where the flow of products from producers is constricted in a narrowing middle tier before it gets to consumers. And the two ends – wineries and consumers – are growing in sheer number.

Consumers in tasting rooms increasingly asked, "Where can I buy your wine?" The answer was frequently, "only here at the winery."

Wineries and Wholesalers Respond

Wineries and state legislatures responded by formalizing so-called 'reciprocity' statutes which allowed wineries to ship wine directly to consumers in states with similar statutes. By 2001 there were 13 "reciprocal" states, but the "model direct shipping bill" (introduced in 1997) was increasingly used because it satisfied state alcohol regulators and tax collectors. It allowed states to have the option of collecting tax revenues, as well as to receive winery reports on shipments. It also required wineries to accept the jurisdiction of the recipient state, and required that packages be marked, "Contains Alcohol: Adult signature (over 21) required for delivery." The model bill began to replace reciprocal statutes for these reasons, and it worked and continues to work very effectively. No state has ever rescinded direct shipping based on non-compliance.

On the other hand, wholesalers responded by passing felony legislation, first in Florida in 1997. They incorrectly assumed a "zero sum game," that direct shipments were lost sales revenue even though the practice helped to build demand for wines the middle tier was less effective at serving: small lot production wines, single vineyard-designated wines, large format bottles, etc. The Wine & Spirits Wholesalers of America, the wholesalers' national trade association, raised the ante for wineries with the felony legislation because the Federal government will not issue a basic winemaking permit to anyone with a felony. The WSWA's threats were captured in their own phrase, "ship the wine, do some time," and their use of "sales to minors" was a red herring that was debunked by common sense, and later by the U.S. Federal Trade Commission, the U.S. Supreme Court, and state alcohol regulator testimony.

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The idea of a national coalition of consumers and wineries was born in 1997 by the Napa Valley Vintners, a trade association of Napa Valley wineries. Although their efforts with Wine Institute to prevent passage of the felony legislation in Florida were unsuccessful, Floridians rallied to the cause in surprising large numbers. In May 1998, Free the Grapes! was formed as a grassroots coalition of wineries, consumers and retailers to support legal, regulated direct shipping. The wine industry's campaign gelled that year as consumer outreach through Free the Grapes! began working in concert with the legal representatives at Coalition for Free Trade (formed in 1997) and the industry's legislative representatives at Wine Institute, Family Winemakers of California and WineAmerica. This three-pronged approach has been in place for 12 years.

Lawsuits Lead to US Supreme Court

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The state of Florida sued retailers in 1996, which was followed by lawsuits in 10 states filed by wineries and consumers both. As the lawsuits wove through the courts, different U.S. Circuit Courts "split" on their rulings. The New York and Michigan cases were ultimately argued before the U.S. Supreme Court on December 7, 2004. Coalition for Free Trade, the non-profit legal foundation largely responsible for the USSC strategy, represented the Michigan plaintiffs, including wine writers Ray & Eleanor Heald. The state of Michigan represented the defendant: Michigan's Governor Jennifer Granholm.

The Granholm v. Heald Ruling and its Implications

States can "regulate" but cannot "discriminate," wrote the Justices, ruling that discrimination based solely on a winery's location was unconstitutional. Michigan's wineries could ship to Michigan consumers, but that same privilege did not extend to out-of-state wineries. The implication was that any state statute with "site-based" discrimination could be struck down as unconstitutional (and reciprocal statutes might not pass this test).

Every national news network covered the ruling, which was a big win for wineries. But state legislation was necessary to "level up or down" – to either allow intra-state and interstate shipments or ban all shipments. The model direct shipping bill – referenced in the U.S. Supreme Court's questions and ruling – was the solution that satisfied regulators, consumers, and lawmakers. Ultimately 75% of states passed their version of the bill by March 2010.

The ruling has been expanded beyond winery direct-to-consumer shipments. For example, retailers have applied the ruling in lawsuits in Texas and elsewhere to allow retailer-to-consumer shipments. Even wholesalers have used *Granholm v. Heald* to support their efforts in cases not related to consumer shipments.

According to Wine Institute, state legislative and regulatory changes since *Granholm v. Heald* generally fall into four categories:

1. Implementing Model Direct Shipping Permit Bill: Transition of "reciprocal" states to "limited direct/permit" states – the model bill is now used in 35 states.
2. Level Up/Down: Transitions to bring states into compliance with the ruling by either allowing or prohibiting both intra-state and interstate wine shipments.
3. Streamlining: Simplifying existing statutes and removing overly burdensome regulations. For example, Virginia and Georgia removed vintner background check requirements for licensure, New Hampshire eliminated its annual license fee, Minnesota's statutes were changed to align with a court ruling allowing wine advertising, and Texas simplified its reporting requirements.
4. Self-Distribution: Addressing whether states allow wineries to ship directly to retailers and restaurants.

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For Wineries and Consumers, What has Changed?

A lot. Nearly every state has been affected in some way by the U.S. Supreme Court ruling, and wineries now have the option of shipping to consumers in states that represent 83% of total U.S. wine consumption.



Key Changes for Wineries Since USSC Ruling

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	2004	2010
Legal Shipping States for Wineries	27	37
Percentage Consumer Market Available ⁱⁱⁱ	51%	83%
Number of U.S. Wineries ^{iv}	4,356	6,705
Number of States with Wineries	50	50
Number of States Unaffected by USSC Ruling		4

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Wine lovers have benefited in several ways. The breadth of wines available to consumers has improved as tools and processes have established direct-to-consumer shipments as a legitimate and important sales channel for wineries. In fact, this helped to fuel the proliferation of wines made *exclusively* for consumer-direct sales. Also, the convenience of periodic wine club sampling programs, e-commerce and other consumer-friendly tools have benefited the overall market.

And while 13 states continue to ban winery-to-consumer shipments, the top four banned states represent most of the difference (based on U.S. table wine consumption^v).

Prohibited States Ranked by Consumption:

Consumption Rank/Prohibited State	
5—New Jersey	} 13%
7—Massachusetts	
10—Pennsylvania	
18—Maryland	
28—Alabama	} 17%
30—Kentucky	
33—Oklahoma	
36—Delaware	
40—Arkansas	
43—Utah	
45—Montana	
46—Mississippi	
49—South Dakota	

The two primary market place drivers of wine direct shipping do not appear to be changing: the middle tier continues to consolidate and consumers continue to show greater interest in wine. IMPACT^{vi} newsletter estimates that the top 10 largest wine and spirits wholesalers in 2010 enjoy a market share of 59%; total wholesaler revenues have risen from \$32 billion to \$44 billion (2004 vs. 2010). Simultaneously, the number of wineries continues to grow in the US and worldwide; per capita wine consumption and aggregate consumption continued to rise in 2010, and the U.S. is predicted to soon be the largest wine market by volume.

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Challenges Remain

While *Granholm v. Heald* ruled that site-based discrimination was unconstitutional, wholesaler-supported legislation since 2005 has erected other barriers and forms of discrimination:

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1. Capacity Caps: Bans shipments from wineries based on production size. As of 3/31/2010: AZ, litigation before 9th Circuit; KY, 50k gallons; MA, overturned 30k gallon cap by 1st Circuit on 1/14/2010; OH, 250k gallons.
2. Mandatory Winery Visit Requirement: Prohibits shipments unless consumer first visits winery premises. As of 3/31/2010: AZ, requirement upheld by court; IN, upheld by court; KS, new off-site just passed; KY, struck down by court; RI, required.
3. Wholesaler Exclusions: Prohibits wineries with existing wholesaler representation from direct-to-consumer shipping. As of 3/31/2010: GA, removed through new legislation; LA, partially clarified; IN, required; MA, overturned by 1st Circuit ruling 1/14/2010.

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Moving forward, another challenge is perceptual. Outdated attitudes toward direct shipping continue to be at odds with winery and consumer experience, and even more out of sync than before with the dynamics of the marketplace. Shipments are not “lost sales” for wholesalers. Even the chairman of the largest wine and spirits wholesaler was quoted in IMPACT^{vii} newsletter as saying that, “{direct shipments have}...not hurt us in any way.” Direct shipping is accommodating a marketplace that continues to be supported by wine country tourism, but is now energized by social networks and the acceptance of wine by the Millennial generation.

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ⁱ Wine Institute from U.S Tax and Trade Bureau. <http://www.wineinstitute.org/resources/statistics/article124>

ⁱⁱ U.S. Federal Trade and Tax Bureau, 2009.

ⁱⁱⁱ Adams Wine Handbook 2007.

^{iv} www.wineinstitute.org

^v Adams Wine Handbook 2007.

^{vi} IMPACT newsletter, April 1-15, 2010.

^{vii} IMPACT newsletter, December 2009. Interview by publisher Marvin Shanken of Harvey Chaplin, chairman of Southern Wines & Spirits.