

TALKING POINTS FOR WHY A COMMERCE CLAUSE EXEMPTION IS BAD FOR THE WINE BUSINESS

WineAmerica – April 2011

Bad Policy

- H.R. 1161 takes the drastic step of allowing states to discriminate against interstate commerce in alcohol beverages.
- This (1) undermines the free-market system enshrined in the Constitution, (2) reverses 100 years of court precedent, and (3) reverses 100 years of federal legislation (the Wilson Act) prohibiting discrimination of interstate commerce in alcohol.
- States should not be given a Congressional blessing to pass discriminatory and protectionist alcohol laws. There is no valid policy reason for doing so.
- The bill's primary function is to allow outright discrimination against out-of-state alcohol beverages. While it seemingly exempts producers from some forms of discrimination, states can easily devise discriminatory laws around the exemption.
- Contrary to important Supreme Court decisions that prohibit discriminatory, retaliatory and extraterritorial (laws that infringe on the regulatory authority of other states) alcohol laws, H.R. 1161 would allow states to attack interstate free market structures, including:
 - Taxes—states could raise taxes on categories of products (*i.e.*, Zinfandel) produced only out-of-state;
 - Registrations—states could develop onerous brand and wholesaler registration requirements (*i.e.*, twice monthly filings) that dis-incentivize delivery of interstate products; and
 - Labeling—states could impose discriminatory labeling standards (*i.e.*, actual producer must be shown on brands made from bulk wine) on categories of products produced only out-of-state.
- H.R. 1161 picks winners (wholesalers) and losers (everyone else) in an intra-industry fight.

Harms Consumers

- The Federal Trade Commission (FTC) stated with respect to H.R. 1161's predecessor bill that it was a bad idea because existing wholesaler protections are ineffective from a policy perspective and harm consumers. H.R. 1161 would protect and reinforce these existing anti-consumer laws.

Increases Litigation

- The bill scrambles settled court precedent and new limits would have to be tested and established through litigation. Rather than reduce litigation, H.R. 1161 increases its likelihood.

Hinders Growth of Wineries & Grape growers

- The existing Constitutional framework establishes clear rules that wineries have used to modernize state law to promote greater product access through an accountable regulatory framework.
- This legal modernization has unleashed a dynamic rural industry. Despite the recession, mom and pop wineries and grape growers continue to develop, producing both rural economic growth and jobs.
- In the last 20 years the number of wine wholesalers has declined from roughly 7,000 to 700 while the number of wineries has increased from roughly 1,600 to 7,000.

Conclusion

- Exemptions from federal laws usually result in important unintended consequences and blatant abuse.
- New federal legislation is not needed to help states accomplish their legitimate regulatory goals. For example, states can control price, limit the locations and hours of operation of alcohol beverage retailers, establish restrictions on marketing and advertising materials, mandate ID checks, prohibit consumption by various classes of consumers, and conduct random compliance inspections.
- States already have broad authority to regulate the sale of alcohol beverages, collect taxes and promote temperance. Courts have upheld these powers.



WineAmerica
The National Association of American Wineries

March 30, 2011

Dear Member of Congress:

The so-called Community Alcohol Regulatory Effectiveness Act of 2011 ("CARE Act"), H.R. 1161, was recently reintroduced at the behest of the National Beer Wholesalers Association (NBWA) and the Wine and Spirits Wholesalers of America (WSWA). Beer, wine and spirits producers and importers are united in our opposition to this unnecessary and misguided legislative effort. We urge you to reject H.R. 1161.

Proponents of H.R. 1161 claim that this bill is necessary to retain a state's right to regulate wine, beer and distilled spirits, to end an "avalanche" of litigation, and to stem the tide of "deregulation." These assertions could not be further from the truth.

Suppliers Support States' Rights

Suppliers support states' rights to regulate alcohol pursuant to the Twenty-First Amendment. But we, as well as the courts and Congress, also recognize that the powers vested to the states under the Twenty-First Amendment are not absolute and must be balanced with other provisions of the Constitution, such as the Commerce Clause. The wholesalers want to change this.

The state-based system of alcohol regulation has evolved since Prohibition into a framework that successfully promotes responsible business practices and a competitive business environment. By exempting state alcohol laws from review under the Commerce Clause of the Constitution, this wholesaler legislation would undermine the free-market system enshrined in the Constitution and reverse 100 years of court precedent. Furthermore, it repeals the vitally important section of the Wilson Act that requires equal treatment of out-of-state products. The nation benefits from the Commerce Clause and wholesalers should embrace its principles, not seek to barricade themselves from the Constitution.

States Attorneys General have not endorsed H.R. 1161

In March 2010, the National Association of Attorneys General (NAAG) sent a letter to then Chairman Hank Johnson supporting the Twenty-First Amendment and a state's right to regulate alcohol beverages. Despite misrepresentations by some "CARE Act" advocates, the letter did not endorse the wholesaler bill. In fact, ten AG's felt compelled to send letters clarifying that they do not support such legislation.

There Is No "Avalanche" of Litigation

Since the U.S. Supreme Court decided the Granholm case in 2005, there have been 39 suits filed in federal courts (which is a normal response to a Supreme Court decision), including two challenges filed

by wholesalers. Most of these cases challenged laws that allowed in-state wineries to ship directly to in-state consumers, but prohibited out-of-state wineries from doing the same. On March 7, 2011, the United States Supreme Court declined to review one of the last major cases—a challenge to Texas state law—effectively ending litigation that the wholesalers say justifies their legislation. The wholesalers’ praise of this Supreme Court action is inconsistent with their own support for H.R. 1161, which strips courts of their power to make precisely these kinds of balancing judgments. With most of these cases already settled, legislation like H.R. 1161 would scramble court precedent and actually increase new litigation and require the courts to revisit many long-settled issues.


The Deregulation of Wine, Beer and Distilled Spirits Is Not Occurring

The real world impact of the court cases referenced above has been minimal. Courts are not deregulating alcohol by their decisions and we challenge proponents to point to any state that has been brought to the brink of deregulation as a result of them. In more than half of these cases, state laws have been upheld. Where they have been overturned, state legislatures, not the courts, have enacted new laws that have passed constitutional scrutiny. With over 4,000 laws on the books, state regulators continue to have broad and extensive powers to regulate, including the ability to impose and monitor pricing controls, suspend or revoke licenses for illegal behavior, impose excise taxes, establish restrictions on hours of operation and conduct mandatory I.D. checks, to name a few.

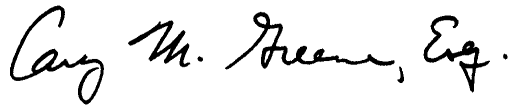
We urge Congress not to unravel a successful regulatory structure to the detriment of consumers, the industry, and the federal interest in a fair, competitive, and orderly marketplace for wine, beer and distilled spirits. Please reject H.R. 1161 and similar legislative efforts.

Best regards,

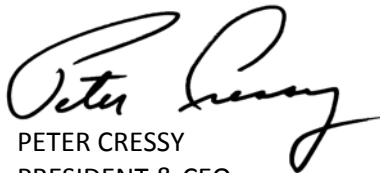
Sincerely,



CHARLIE PAPIAZIAN
PRESIDENT
BREWERS ASSOCIATION



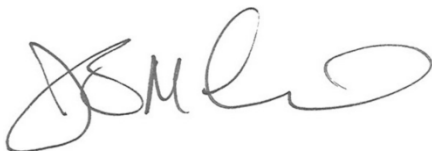
CARY M. GREENE, ESQ.
CHIEF OPERATING OFFICER &
GENERAL COUNSEL
WINE AMERICA



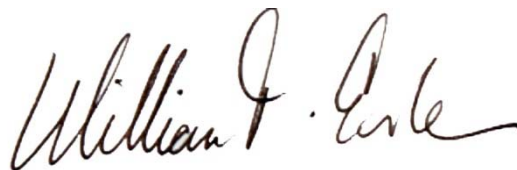
PETER CRESSY
PRESIDENT & CEO
DISTILLED SPIRITS COUNCIL OF THE UNITED STATES



ROBERT P. KOCH
PRESIDENT & CEO
WINE INSTITUTE



JOSEPH S. MCCLAIN
PRESIDENT
BEER INSTITUTE



WILLIAM T. EARLE
PRESIDENT
NATIONAL ASSOCIATION OF
BEVERAGE IMPORTERS

What Scholars Have to Say About the CARE Bill

By Cary Greene

Yes, I'm another one of those pesky lawyers in this exciting edition of *The CARE Act, the Sequel*. Since you've already gotten much of the background, (if you haven't read the outstanding breakdown by Wendell Lee of Wine Institute, <http://shipcompliantblog.com/blog/2011/04/12/hr-1161-the-great-constitutional-head-fake/>, you should—it's the best summary of the bill I've read to date), I figured I'd start in a somewhat different place.

Of course, I could do a case law analysis of the CARE bill that counters my Wine & Spirits Wholesalers of America colleague Karin Moore's spirited defense of H.R. 1161, <http://shipcompliantblog.com/blog/2011/04/06/the-commerce-clause-the-care-act-and-clarity/>. After all, I was quoted on this page last year as saying about H.R. 5034, the virtually identical predecessor of H.R. 1161, that:

[t]here are many cases other than *Granholm* that elucidate how states can regulate interstate commerce in alcohol. As revised, [the CARE bill] would undermine or reverse dozens of court decisions. By scrambling settled case law, [CARE] will cause years of re-litigation to try and figure out exactly what the new limits are. The fact is courts have not done anything to jeopardize core Twenty-first Amendment powers. State laws run into Constitutional trouble when they try to do something underhanded like fix prices or give an unfair market advantage to certain licensees or products. [CARE] allows states to blatantly discriminate against out-of-state products without any concern for Twenty-first Amendment core purposes. From a policy standpoint, I'm not sure why that would ever be a good thing.

But I thought I'd make better use of your time by giving you an insider's outside look. There's been a lot written about alcohol regulation and the CARE bill this past year, and sitting through this long battle here in D.C., I've had the opportunity to read most of it. I thought I'd let you sift through some of the best evidence-based economic and legal reports that have implications for the CARE bill, and let them explain why it's bad for American wineries (whom of course WineAmerica represents), bad for states, bad for the federal government, and bad for "we the people."

In the last year, the Federal Trade Commission ("FTC")—a federal agency charged with ensuring free and fair market competition—and the Office of the Comptroller for the State of Maryland—a state tax agency responsible for regulating alcohol beverages in Maryland—have issued comprehensive reports that: (1) show definitively that states are finding methods to regulate alcohol that enhance regulatory enforcement with respect to both tax payment and minor access; (2) show definitively that states are using these methods to make the regulatory system more fluid and consumer friendly; and (3) most importantly, that these evidence-based methods often have little to do with wholesalers or the mechanics of the three-tier and control systems.

In addition, a respected economist at the Mercatus Center of George Mason University analyzed the consumer impact of CARE and its likely negative effect on broader federal policymaking. If you're interested in the debate over H.R. 1161, these three summaries are well-worth your time.

Federal Trade Commission Working Paper

Working with the first version of the CARE bill (it's been through at least three iterations), FTC expressed serious doubts about the bill's advisability. *See* <http://www.ftc.gov/be/workpapers/wp304.pdf>. Their basic argument boils down to the fact that state mandated wholesaler protections are anticompetitive and harm consumers:

There is a vast economics literature which explores the competitive effects of these state restrictions of alcohol distribution and of contractual relationships between alcohol producers and distributors. This literature provides evidence that generally supports the conclusion that these state regulations are associated with harm to consumers in the form of higher prices and reduced output.

FTC concludes that while wholesaler protections may reduce overall consumption, they do not promote temperance since such protections:

...have no measurable effect on drunk driving accidents and various measures of teen drinking. On the other hand, laws that directly target drunk driving and underage drinking appear to reduce these behaviors.

In other words, since the benefits of mandated wholesaler protections are minimal and largely theoretical and the harms to consumers are substantial and measurable—namely, higher prices and restrictions on availability—the CARE Act is a bad idea:

...constraining antitrust enforcement through the proposed legislation would result in lower consumer welfare for alcoholic beverage consumers with no offsetting reduction in social harms.

In FTC's view, the basic purpose of the bill—to have the Twenty-first Amendment trump free markets—is fundamentally flawed since federal laws banning anticompetitive wholesaler practices *should* trump rhetorical regulatory justifications that aren't supported by evidence:

...our results suggest a socially beneficial role for antitrust challenges to...anticompetitive state regulation; any policy that would make future challenges more difficult is likely to be harmful.

Maryland Comptroller's Direct Wine Shipment Report

The Direct Wine Shipment Report issued by the Maryland Comptroller, http://www.comp.state.md.us/DWS_Complete.pdf, reveals several ineluctable facts: (1) state regulation of direct-to-consumer shipping is effective; (2) the safety protocols written into state direct shipping laws prevent deliveries to minors; and (3) bonding and reporting requirements give states the tools for effective tax collection on wine shipments.

You'll notice, of course, that what this shows is that alcohol regulation can be simple, effective, consumer friendly, and far different than the traditional three-tier system.

As the Comptroller states, tax collection concerns can be addressed by requiring licensees to file "returns and tax payments...similar to other licensees and permittees who sell and deliver alcoholic beverages in the State." As for the effect on minors: "[t]here is no evidence that underage drinking has increased or decreased as a result of direct wine shipment."

This isn't to say that states shouldn't be concerned or mindful of minors, but they should only use tools that are effective in limiting availability. In the case of direct shipping, the Comptroller's recommendations are common sense and utilize both technology and old fashioned human contact:

Best practices for preventing underage access are: (1) require a permit for a common carrier delivering wine...; (2) require both the direct wine shipper and common carrier to affix a shipping label...; (3) require a common carrier to obtain an adult signature using age verification procedures.

By using free market incentives and disincentives—follow our rules and you get to keep your license—the Comptroller's report takes a practical approach to alcohol regulation.

To be sure, the Comptroller is somewhat hesitant to establish a precedent that could lead to further changes to the three-tier system, but it is to the report's credit that it honestly assesses existing direct-to-consumer wine shipping laws, and sifts through the evidence to reach the conclusion that wine direct shipping can be safely regulated.

The report suggests the alternative to wholesaler fear mongering, *i.e.*, H.R. 1161, is reason—offering evidence based policy and law that can more effectively reduce alcohol abuse and minor access, while at the same time making the system more consumer friendly. Hopefully, it will serve as a template for further studies.

Mercatus Center Testimony

Similar to the Maryland Comptroller's report, the written testimony submitted to the Judiciary Committee prior to the H.R. 5034 hearing by respected economist Jerry Ellig, a senior research fellow at George Mason's Mercatus Center and a former FTC official,

offers a sober view of the major strides states have made over the last two decades, establishing targeted, evidence-based strategies that reduce underage and abusive consumption. See <http://mercatus.org/publication/competitionconsumer-welfare-and-state-alcohol-regulation>. As the report explains, the Supreme Court's *Granholm v. Heald* decision—holding that state direct-to-consumer shipping laws must respect the Constitution's free market principles—did not change these trends. Mr. Ellig explains:

...it is clear that there has been no upsurge in underage access, drinking, or alcohol abuse since the *Granholm* decision in 2005. In fact, the percentage of affirmative responses on virtually all of the questions about alcohol use and abuse has fallen by several percentage points since 2005. In other words, the evidence shows that *Granholm* has not hurt state efforts to reduce abuse of alcohol.

Professor Ellig goes further to suggest that the drastic and unnecessary Commerce Clause exemption proposed by the CARE Act would establish bad precedent in other ways:

...the alcohol industry is hardly unique in believing that it can offer an important reason it should receive special treatment under the law. Creating such an exemption would likely open the door for many other special interest requests for exemptions from federal laws, the Commerce Clause, and perhaps other parts of the U.S. Constitution as well.

According to Professor Ellig, automobile, casket, contact lens, and legal service providers have all testified before FTC about the “uniqueness” of their products among consumer goods:

If Congress actually demonstrates its receptivity to such special pleading by passing a law making blanket exceptions to the Commerce Clause or federal laws for alcohol, it can expect a steady stream of requests from other industries for special treatment.

He sums up his findings as follows:

The argument that America faces a widespread and systemic problem that justifies a significant change in the federal legal standard applicable to state alcohol laws is nothing but an assertion. Underage drinking and alcohol abuse are declining, and they have continued to decline since the 2005 *Granholm* decision that is alleged to be the source of significant problems.”

All this suggests that the CARE bill is the wrong signal at the wrong time. Markets in consumer goods have moved in favor of consumer choice and product specialization the last two decades and the alcohol beverage industry is no exception. The problem is that while underlying winery laws have been improved, and a market in direct-to-consumer wine shipping has been established,

the broader alcohol beverage distribution system has barely adapted. The rift between law and market is becoming wider than ever, and, at least as suggested by H.R. 1161, it is this rift and the change it necessitates that wholesalers fear.

States should not be afraid of evidence-based modifications that can make their regulatory systems function more effectively and in line with market and consumer needs. The CARE bill, however, sends the signal that states should freeze their alcohol distribution laws in amber and pretend the market is as it was 30 years ago.

The evidence shows that Congress should not encourage this kind of special pleading.