

Life After the Supreme Court Decision

We get to help decide what it means



SARA SCHORSKE, and Alex Heckathorn are members of CSA—Compliance Service of America Inc., which specializes in licensing and compliance for the wine and beer industries.

Two court decisions affecting the wine industry made news recently, and both will have long-term effects on the wine business in this country. As usual we'll attempt to give you the broader view of what these two legal milestones mean to the wine industry and your compliance future—and what role you may have in shaping that future.

First, the US Supreme Court gave wineries a resounding victory on the issue of direct shipping. The high court decision did not itself actually change any state laws or privileges, but it made significant changes inevitable. Now the great direct shipping battle moves to the state legislatures to determine the specific real-world effects of the Supreme Court decision.

Second, the California Court of Appeal finally issued its long-awaited decision upholding California's law limiting the use of geographic brand names of viticultural significance. While on its face the law applies only to brand names referring to Napa or any viticultural areas within Napa County, the decision has far-reaching implications for the regulation of wine labeling and the protection geographic names have

SHORT COURSE

- ▶ The Supreme Court changed no laws, it simply declared discriminatory trade laws unconstitutional.
- ▶ The decision's specific real-world effects will be decided in state legislatures.
- ▶ Growing public support for direct shipping can now be mobilized to create change.
- ▶ The decision will probably create unforeseen changes beyond the direct shipping arena.
- ▶ Unlike litigation, legislative change can be influenced by individuals. Get involved!

over the rights of brand owners.

The rest of this column will be devoted to discussing what the future holds for the industry in the wake of the Supreme Court decision. For more information on the geographic brand name decision, see the sidebar.

THE DIRECT SHIPPING DECISION, AND ITS EFFECT

Without a doubt the decision of the US Supreme Court on direct shipping created a major watershed in the regulation of wine and beverage alcohol. Whether you believe that the Court was actually leading or simply following public opinion, there is no

doubt that the ruling has unleashed a potent set of social and economic forces that will change the regulation and marketing of alcoholic beverages. As the battle now shifts from the courts to the legislatures, and the gavel passes from the judges to the politicians, these powerful forces will reshape the destiny of the wine industry—and not just for direct shipping.

But first, let's focus on the future of direct shipping. What did the Supreme Court decision accomplish? The Supreme Court did not legalize direct shipping nationwide. The deci-

sion merely prohibits discrimination by the states. In other words, it held that if a state allows an in-state winery to ship to consumers, then out-of-state wineries should be afforded the same privilege. In the words of the court: "If a state chooses to allow direct shipment of wine, it must do so on evenhanded terms."

The decision does not invalidate any state law or favor any particular remedy for discrimination; it neither requires the states to allow direct shipments of wine across the board, or to uniformly prohibit them. But the decision does require states with discriminatory regulations to take some kind of stand. They must either permit direct shipping by out-of-state wineries, or rescind the valued privilege now enjoyed by their domestic wine industry, to cure the discrimination.

ACTION AND REACTION IN STATES THAT WERE MOST AFFECTED

In the early aftermath of the decision, two states whose discriminatory schemes are now unconstitutional announced their intentions to shut down direct shipping by their native wineries rather than grant similar privileges to out-of-state vintners. On the day of the decision, the chair of the Michigan LCC promptly announced that she would seek legislation to ban all direct shipments, even intra-state shipments by Michigan wineries. A few weeks later, the Indiana ATC also advised Indiana wineries that they were no longer allowed to ship to consumers, reversing a long-standing policy.

The extreme positions taken by these two states at first struck terror

into the hearts of many small vintners. But in a surprise turn of events, the ominous statements galvanized unexpected support for direct shipping into effective action. In hindsight, the emphatic reactions by the two states seem to have actually done a great service to the wine industry, by polarizing public opinion and inciting more reasonable factions to take action.

What has happened in Michigan is an instructive case history of how the battle lines are being drawn and what forces are coming to the table. When the LCC announcement was made, the Michigan wineries immediately cried that the proposed ban on direct shipping was "a life or death issue." A sympathetic media, especially the Detroit Free Press, which had recently published an exposé on the distributors' influence over the MLCC, rallied the public to the cause of free trade and protecting the in-state wineries. Politicians quickly stepped in to try to mediate the dispute, and wine country legislators organized a series of meetings with the wineries' and the distributors' trade organizations to find a solution.

Consumers in Michigan also organized their own "grassroots" group called Wine Consumers Across Michigan (WineCAM.org) "because wine consumers need a voice at the table to remind Michigan's government and wine distribution monopoly that they need to serve the interests of our state's consumers." This group's membership is 100% consumers, and it has no financial ties to any tier of the wine industry.

The outcry over MLCC's initial position has made its way to the top. Michigan's Governor Jennifer Granholm has recently indicated her willingness to sign a direct shipping law, saying, "I think you can achieve the purposes of the regulatory system, and still allow personal consumption, and ordering over the Internet. I think you can achieve a balance."

Other states affected by the Supreme Court decision are taking a more moderate approach to correcting their discriminatory laws. For example, New York's governor has come out in favor of direct shipping. (At press time, legislation passed that state's Assembly and was signed into law thus legalizing direct reciprocal

shipping interstate as well as existing intrastate, for wineries.)

THE RIPPLE EFFECT IN OTHER STATES

As a result of the Supreme Court decision on the issue of direct shipping, change is in the air, even in states whose laws were not examined by the Supreme Court case. Public support for change in alcohol marketing, which has grown slowly in recent years but lacked a focus and a realistic outlet until now, is finally coming into its own. As a result, many states not directly affected by the decision are considering direct shipping legislation.

The Supreme Court decision did not directly outlaw reciprocal shipping laws, but it did indicate that such laws were part of a discriminatory patchwork of laws affecting the interstate shipment of wine. In response, many of the reciprocal states are considering replacing their reciprocity statute with a permit system for direct ship-

ments of wine. Wine industry trade organizations are currently working out the details of how such legislation should be drafted and carried in the various states.

THE NEXT CHALLENGES FOR DIRECT SHIPPING

Now that the direct shipping battle has moved to the state legislatures, the goal will be to get as many states as possible to adopt permit laws allowing wineries to ship to consumers. In the last ten years, several states have already created direct shipping permits. Some are relatively user-friendly, but others are so complex, burdensome, or expensive that not even a single winery has ever applied for one. Arizona's direct shipping permit is a case in point.

The industry's next challenge will be to get a simple and relatively uniform permit process approved in most states. Unfortunately, independent legislative action in each state is likely to result in a patchwork of com-

If you're looking for expert licensing help, you've found it.

CSA★

800-400-1353

www.csa-compliance.com

continued

pletely different laws. Those laws will probably have differing requirements for obtaining the permit, keeping sales records, and reporting and paying local taxes.

In the worst-case scenario, it may end up being just as complicated to direct-ship nationwide as it now is to ship through the three-tier system to all fifty states. Wineries may need a specialized employee or an expert consultant just to handle the paperwork!

Another challenge facing the wine industry is controlling the annual cost to wineries for exercising the hard-won privilege. The annual fees for the permits are likely to be high, as tightly budgeted ABCs and cash-strapped states hungrily look on these permits as a source of revenue. The cost of holding 30 or 40 permits, on top of the administrative costs of handling the extra record keeping and paperwork, may be prohibitive. Consequently, small wineries may be forced to limit their direct shipping to a few markets and turn down consumers in other states.

Hopefully, as the process of legalizing direct shipping proceeds, winery groups and individual industry members will participate in a timely and effective enough manner to assure favorable results.

HAVE WE OPENED A PANDORA'S BOX?

We may soon see effects of the Supreme Court decision that go beyond the winery direct shipping arena. More forces for change have been unleashed by the Supreme Court decision than could have been predicted, and it seems now that a new balance between control and deregulation is coming to the alcoholic beverage industry.

As direct shipping for wineries is legitimized in the states, it will raise the question of whether retailers should be permitted to ship direct and further, why wholesalers are even necessary.

While every winery will obviously not want to supply every grocery store or restaurant directly, the big retailers are not likely to miss the opportunity to increase their competitiveness by dealing with suppliers directly. Costco, the largest wine retailer in America, has already filed suit against the

Washington Liquor Control Board on anti-trust grounds; the case is scheduled for trial in March 2006.

Whether through further litigation or legislative action, retailers and large suppliers are likely to try to expand the impact of the Supreme Court decision to further their goals. The high court decision invalidated discriminatory direct shipping laws; the retailers will extrapolate it to question other laws that protect local business interests while preventing them from using modern business efficiencies to give the consumer the best possible prices.

The strong public response to Michigan's extreme position shows how far America's social and economic environment has shifted toward free commerce sentiment. Although the wholesale tier may always be with us, its previously unquestioned control over alcoholic beverage distribution may be a thing of the past.

In the beginning of the 20th century, alcohol consumption was associated with serious social problems. In large part, the three-tier system was established to control the evils of intemperance and to reduce the influence that organized crime had amassed in the beverage alcohol trade during Prohibition.

At the time of its creation, the existence of a strong middle tier worked well to insulate retailers from excess marketing pressure by suppliers, and the additional markup kept alcoholic beverage prices high enough to slow down sales, while adding to state revenues through excise taxes. But now, times have changed and so has the American society. The old-fashioned belief in the evils of alcohol consumption and the more modern concerns about underage access are no longer sufficient to stop the forces of free commerce. The public wants choice and competitive prices on all products.

THE "BRAVE NEW WORLD" OF FREE TRADE

Both the courts and the marketplace appear ready to cast off the shackles of the traditional three-tier system and allow beverage alcohol to move toward becoming "an ordinary article of commerce" in a free trade system. Sounds great from a consumer's point of view! Ask any winery owner or execu-

utive if he thinks free trade in wine is good thing, and he is likely to agree.

Wineries have tended to think of "free trade" as conveying them the right to ship their wine direct to consumers, free from burdensome compliance regulations, excise and sales taxes, and the distributors' piece of the action. But truly "free trade" will bring many unexpected changes to an industry that has been protected from unrestrained competitive forces by regulation. Are we ready for wine to become an "ordinary article of commerce?"

Let's briefly look at some of the likely implications if wine were to become an ordinary commodity like breakfast cereal, potato chips, or paper towels.

- In a freer trading environment, large retailers will certainly flex their massive buying power to get the best deals possible. Consequently, many wineries may gain access to new customers, but decide they can't afford to sell to them—and then have to sit

and watch their larger competitors fill those same shelves.

- Distributors have often carried smaller wineries on the profit margins from their sales of the larger brands, and used their customer relationships to leverage shelf placements for lower volume products. Without that kind of distribution support, will a thousand brands continue to bloom in our industry?

- Lumping wine in with other ordinary products may expose our industry to commercial practices we like just as little—or even less—than the three-tier straitjacket we must work within today. Retailers routinely get slotting allowances (similar to "rental" payments for shelf space) from other commodities. If that practice became common in the wine business, guess who would own the shelves?

- Although wine may always have an inherent mystique and value beyond such common grocery items, the line between "us" and "them" may

A Word About the COURTS AND BRAND NAMES OF VITICULTURAL SIGNIFICANCE

THE SECOND IMPORTANT LEGAL DECISION of recent days placed the protection of geographic identity above commercial property rights. All wineries using geographic brand names should take an interest in this result, and its possible implications for you.

The case revolved around two brand names, Napa Ridge and Napa Creek, which Bronco Wine Company had purchased from other producers. Because the brands had been used on approved COLA's prior to July 7, 1986, an exception in federal regulations allowed Bronco to use these viticulturally significant brands on non-Napa County wines. But the wines' huge success raised fears that consumers were being misled about their origin. The required appellation statements on the labels obviously did not correct the confusion.

In 2000, at the urging of a vintner's group, the California legislature passed a law designed to close the federal loophole and specifically stop the use of Bronco's Napa brand names on wines made from grapes grown outside Napa County. Bronco fought back in court, but following three separate appeals, including a failed US Supreme

Court bid, the state has prevailed. Bronco's use of the Napa brand names on non-Napa wines has been ruled misleading and not entitled to any free speech or property rights protection.

WHY THIS CASE IS IMPORTANT

We have reported the trend toward increased protection of geographical names for several years. Federal regulations limiting the use of brand names with viticultural significance have been in place over fifteen years, and every year more geographical names are affected. Now TTB is even rejecting COLA applications for previously approved labels with geographic brand names.

This court case invites states to create even stricter controls. Some besides California already regulate geographic references on labels. Oregon, for example, requires higher percentages for labeling claims than federal regulations do. Encouraged by the Bronco decision, many more states may now decide to regulate the use of viticulturally significant names to protect "the valuable reputation of a wine growing region" within their borders.

be blurred more easily than we may imagine. The unprecedented success of Two Buck Chuck proved how interested consumers are in buying wine based on more conventional definitions of "value."

You see, free trade is a Darwinian world in which only the fittest survive. The strict regulatory scheme that has seemed to mostly hamper wineries has also shielded us from some of the harsher realities of competition. Maybe "free trade" is not really what we want. As a representative of the


California Wine Institute recently said: "We should watch what we wish for, we just might get it."

LET'S DO MORE THAN CROSS OUR FINGERS

While the direct shipping issue was being adjudicated in the courts, there was little any member of the wine industry could do to affect the outcome, except perhaps to make contributions to the lawyers' paychecks and hope for the best. Now that the action has moved to the state legisla-

tures, there is a lot each of us can do, at least in our own home state.

Especially in states that currently have a discriminatory direct shipping scheme, it is essential that in-state wineries contact their elected representatives to urge them to preserve the privilege, and to keep any new permit affordable and simple to obtain. Wherever you live, encourage your state to adopt model legislation being developed by winery trade organizations. Every state's decisions in this regard not only affect winery access to consumers in that state, but also potentially set precedents for action in other states.

And don't be too hasty to campaign for "free trade." While greater flexibility in wine distribution is almost inevitable at this point, it is clearly not in our industry's best interests for wine to begin to be viewed as an ordinary article of commerce. Let's agree to handle this issue with delicacy and forethought, for the good of wineries, distributors, and consumers alike. 

Questions or Comments?

Please send your replies to feedback@vwm-online.com.