WineAmerica
The National Association of American Wineries

WineAmerica Newsletter – December 2008

From The President's Desk

November 2008 was month of great impact on our industry. The election of a new President and Congress, a landmark court decision on direct shipment in Massachusetts, a very important and successful WineAmerica meeting in Georgia, a continuing world financial meltdown and worsening recession. The importance of all this change is still a little hard to judge. This new environment presents many challenges including potential taxes or fees, maintaining our partnership with government on research and other key issues alive and functional, and pushing ahead with direct shipping opportunities. As we prepare for the new year, WineAmerica staff will be sorting through these items and developing strategic approaches to maximize favorable outcomes for the American wine industry.

A huge federal deficit and a recession is a scary notion as there is always a tendency to look towards increases in "sin taxes." We will counter this tendency by stressing the regressive nature of excise tax increases and the highly detrimental effect that increasing the wine tax might have on the now approximately 5,000 wineries which themselves are having trouble with the credit shutdown.

Meeting

The November Board Meeting and Retreat will be discussed in more detail elsewhere in this newsletter. I have just a few highlights. It was a high energy meeting with a lot of give and take addressing key issues important to WineAmerica, especially membership recruitment. One unusual item was an open poll of attendees to indicate key reasons justifying membership and commitment to WineAmerica. By a considerable margin, the leading reason why Board members believe in WineAmerica membership is the importance of forcefully addressing national public policy issues. Although benefits like insurance, FedEx discounts and label help are important drivers of membership, there was a clear realization that WineAmerica plays a critical role in representing America's wineries. This National policy role was key to the Board, both for maintaining membership and for dedicating the considerable time and resources that being a board member requires. This result came as a bit of a surprise since it has been a long-held view that benefits are more important than policy issues when it comes to membership. If the Board poll is genuinely reflective of membership opinion, it is heartening because of the significant resources the organization dedicates to policy.

Food Safety

One of the first actions of the newly elected Congress, not yet sworn in, was the selection of liberal Congressman Henry Waxman (D-CA) to replace John Dingell (D-MI) as Chairman of the House Energy and Commerce Committee. This committee has jurisdiction over food safety issues and his selection will certainly shift the committee's perspective. Dingell had proposed a $2,000 per plant charge to fund food safety which would have had a potentially disastrous impact on small wineries and other small businesses. We see little benefit in funding food safety through per plant fees. We will work diligently for an exemption to such proposed fees both because wineries are regulated by TTB and because wineries already pay excise taxes. These two factors distinguish wineries from other food processors and packers. Alternatively, we will try to eliminate the proposed fees because food safety is not merely a concern of food processors, but

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rather is a concern of the entire population. Costs should accordingly be distributed through the general tax system rather than unfairly borne by producers as a fee which would likely have an undue impact on smaller operators.

Excise Taxes

With the economy in deep trouble, the Federal government rolling out huge new spending programs, and almost all States facing recession caused deficits, we are very concerned about possible excise tax increases. For some reason there is a tendency to look to alcohol excise taxes or other "sin" taxes as an easy way to meet budget gaps. This is shortsighted.

Excise tax is normally accessed either as a user fee (tires and gasoline) to reimburse the societal costs associated with use of the product, as a means of reducing demand for a product because the product is considered detrimental to society (tobacco), or as a luxury tax (sailboats and cars above a certain price). These rationales do not fit wine. Wine is generally consumed by a very wide range of the public and is not strongly concentrated in high income households. An increase in excise tax for wine, beer and spirits would be clearly and strongly regressive, falling disproportionately on lower and middle income people.

In addition wine, consumed in moderation, is generally healthful. Across the board reductions in consumption of wine can only be considered a benefit if abuse is reduced. The available evidence appears to indicate that price increases on wine, as would be necessary if the tax is increased, have a greater effect on moderate and healthful consumers of wine than on abusive consumers, thus reducing the healthcare benefits that accrue from moderate consumption. Tax increases and efforts to reduce overall consumption of wine could, therefore, easily be counterproductive leading to higher rather than lower societal costs.

Increased wine taxes are also devastating to wineries because of the limiting factor of price points. If a price point is $9.99 it is extremely difficult to revise that price point upward over the short term. The end result is that an increase in wine excise tax of, for example, 25¢ per bottle would come directly out of winery margins. With the exponential growth of small wineries across the country in recent years bolstering rural economies by providing jobs and economic activity, it would be counterproductive to rural growth to try to increase government revenues at the expense of America's wineries.

A significant amount of wine, beer and spirits sales occur in restaurants and taverns – so called "on-premise" sales. These businesses have been severely hurt by the recession. It makes no sense to selectively increase taxes on these businesses as a substitute for a more general tax increase which would impact the public in a more even-handed manner.

Massachusetts Direct Shipment Decision

On November 19, the long awaited federal court decision in the Massachusetts direct wine shipment case was issued striking down the 30,000 gallon capacity cap distinction in their law. The state law allowed wineries producing more than 30,000 gallons per year to sell directly to consumers only if they did not have current distribution in the state. Wineries producing less than 30,000 gallons per year were explicitly allowed both direct shipping rights and self distribution rights.

Exactly what this case means is

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> *It would be counterproductive to rural growth to try to increase government revenues at the expense of America's wineries*

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not yet clear. The judge is still pondering the remedy. Furthermore, the case is complicated by strong findings that the legislature had a discriminatory intent in establishing the production cap without providing a rationale. The opinion highlights explicit efforts by state legislators to protect Massachusetts wineries and wholesalers in crafting the direct shipping legislation. Indeed, the court identifies what it calls "damning" evidence of protectionist intent. Even though the Massachusetts law appears neutral on its face, the court believed the legislature was really trying to put window dressing on a law it believed was discriminatory. Could more neutral capacity cap distinctions with adequate rationale survive judicial scrutiny? The answer is not obvious. This precedent will probably be very helpful in deterring other states such as Florida from passing direct shipment legislation with capacity caps. It may also be helpful in pushing states with capacity cap limitations on direct shipping such as Arizona, Ohio and Kentucky to eliminate those caps to avoid lawsuits. Already there has been a good response from the Boston Herald which stated in a November 24 editorial: "lawmakers ought to concentrate on passing a new law that favors consumers over the powerful wholesale lobby."

Court Invalidates Massachusetts Direct Shipping Capacity Cap Law

by Cary Greene

As most of you already know, on November 19, 2008, a federal District Court in Massachusetts struck down as unconstitutional a Massachusetts direct shipping statute passed by the Massachusetts legislature over the veto of then Governor Mitt Romney. Brought by the Family Winemakers of California, the lawsuit that led to the decision was well-briefed and carefully articulated. The result is a generally thoughtful and insightful decision containing several interesting details discussed below.

The Massachusetts law had allowed in-state and out-of-state wineries producing less than 30,000 gallons annually to sell wine to wholesalers, retailers and consumers (including via direct shipping). It also allowed wineries producing more than 30,000 gallons annually to direct ship to consumers if they had not "contracted with or . . . been represented by a [Massachusetts] wholesaler . . . for the preceding 6 months." Producers over 30,000 gallons that chose to direct ship could not distribute to Massachusetts wholesalers or retailers. Interestingly, fruit and agricultural wine did not count toward the 30,000 gallon total. *See Family Winemakers of California v. Jenkins*, No. 06-11682 (D. Mass. Nov. 19, 2008).

Family Winemakers begins by walking through the facts in such a way as to make the statute's unconstitutionality seem obvious. The opinion obliquely suggests that the statute was carefully negotiated by the Massachusetts wholesaler's association to ensure that most wine produced out-of-state would go through the state's three-tier system – not because the three-tier system was effective, but in order to protect in-state jobs. The decision highlights the comments of a state Senator who vigorously pushed the passage of the law by offering his fellow Senator's a list of in-state wineries to show that they all produced less than 30,000 gallons.

The court also identified legislative history that suggested that the exclusion of fruit and agricultural wine from the 30,000 gallon limit was directly related to the fact that Massachusetts' largest wine producer made apple wine and "could reach 30,000"gallons in a given season. Likewise, the decision notes that state Senator's recognized that producers over 30,000 gallons were unlikely to choose the direct shipping option because "they can't move that much wine. So they are going to

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Massachusetts Decision, continued

use the wholesale market." According to the court, one legislator commented that the law was "really still giving an inherent advantage indirectly to the local wineries." *Id.* Considering constitutionality under the dormant Commerce Clause usually turns on whether a state is trying to give local products preference by discriminating against interstate commerce, it is understandable that the opinion refers to the factual history as "damning."

Several interesting facts about the wine industry unrelated to the Massachusetts law are also noted in the opinion. Citing a TTB declaration, the opinion notes that there are currently 5,912 wineries in the United States. Of these, only 627 wineries produce more than 30,000 gallons, and only 2,800 produce less than 30,000 gallons but more than one gallon of wine. This means there are more than 2,500 wineries producing less than one gallon of wine annually.

Family Winemakers may have broad repercussions for how future direct shipping legislation is debated and enacted. For instance, it is not clear that the court believed all capacity cap laws were unconstitutional. What appears to have clinched the decision was the evidence suggesting that the legislature was really trying to put "facially neutral" capacity cap window dressing on a law it intended to be discriminatory.

The court has not yet issued a final order specifying a remedy. It could require Massachusetts to "level up" and open its borders to direct wine shipments, or allow the state to "level down" and limit wineries to the state's three-tier system. We also do not yet know whether the state will appeal the decision.

Election Results May Present New Public Policy Challenges

by Jennifer Mongomery

The election of Senator Barack Obama as America's 44th president not only made history and ushered in a new cast of characters, but also altered the existing landscape of Capitol Hill with changes in Congressional leadership, committee chairmanships and federal agency heads. These changes, many still in flux, will have an impact on Congressional and federal priorities, and in turn, on the wine industry public policy agenda.

One of the changes that surely will have an immediate affect on the industry's legislative agenda is the passing of the gavel of the House Energy and Commerce Committee to Democrat Rep. Henry Waxman (CA). Presidential election results were barely tallied before Waxman challenged long-time committee Chairman, Rep. John Dingell (D-MI), for control of the powerful committee. It was a move that caught most everyone off-guard, including Dingell, and when it came to a vote within the Democratic Caucus it pitted the liberal faction of the party against the moderate and conservative lawmakers in the party. In the end, Waxman prevailed and will take charge of the committee when Congress re-convenes in January. Congressman Waxman and Congressman Dingell have very different views on committee issues, so it is safe to assume that the committee's priorities and approaches will change in the new Congress.

The Energy and Commerce Committee has been in the forefront in dealing with the issue of food safety, along with legislation that would implement a $2,000 annual fee on food facilities for bio-terrorism registration – including wineries. This money would then be used to fund stepped-up oversight and inspections by the Food and Drug Administration. WineAmerica has been working with other industry groups to secure an exemption from this fee and will continue to do so.

On the Senate side, the venerable Robert Byrd (D-WV) relinquished his chairmanship of the Appropriations Committee because of continued health problems. That committee will now be chaired by Senator Daniel Inouye (D-HI). As a result there is expected to be some additional

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Election Results, continued

shuffling of committee and subcommittee chairs, but that is still being sorted out.

Other issues that the industry will need to be prepared to address after the first of the year are the possibility of excise tax increases, and protection of mandatory specialty crops funding under the Farm Bill. Immigration is another issue that is on everyone's mind in Washington, but it is not yet clear whether the new administration will push for comprehensive reform right out of the gate or look to take action in increments.

We will continue to advise you as priorities and the direction of the new Congress and Obama administration take shape.

WineAmerica Fall Meeting a Major Success

by Cary Greene

On November 12 through 14, 2008, WineAmerica held its annual fall meeting at the Ridges Resort in Hiawassee, Georgia. Between substantive discussions on a wide array of topics affecting the wine industry, the attendees were able to network and mingle while enjoying a variety of local wines.

The welcome reception featured wines from numerous Georgia wineries and included *vinifera*, hybrid, and native whites and reds. A particularly daring and memorable selection was the Persimmon Creek Riesling Icewine. We can only imagine the challenge of waiting for a late season frost in north Georgia.

The reception also featured a talk by Dr. Scott Angle, Dean of the University of Georgia College of Agriculture and Environmental Science and supporter of Georgia's wine industry addressed the group. Dr. Angle was gracious in welcoming us to Georgia and spoke about his hopes for expanding enological and viticultural research in the state. We wish him the best in his efforts.

The Board discussed WineAmerica's financial health, ways of improving organizational efficiency, and ways of expanding WineAmerica membership through more aggressive marketing, including by member wineries. Setting an aspirational goal of 1,600 members, Chairman Pete Downs (Jackson Family Wines, California) and President Bill Nelson talked about how WineAmerica can develop greater organization clout and effectiveness with members of Congress. The Board also discussed appellation standards. Pete convened a membership committee to develop suggestions with respect to WineAmerica's dues structure and a marketing strategy to expand membership. The membership committee will include Steve Gibson (Haversham Winery, Georgia), who will be chairing the committee, Jim Ballard (James Arthur Vineyards, Nebraska), Ed O'Keefe (Chateau Grand Traverse, Michigan), Naomi Shepherd-Smith (Grande River Vineyards, Colorado), and Cord Switzer (Fredericksburg Vineyards, Texas).

Bill summarized our policy successes over the past year with the Farm Bill and the National Grape and Wine Initiative, and also discussed WineAmerica's financial health. In the coming year, WineAmerica expects to deal with matters as varied as excise taxes, immigration, viticultural appropriations, and state direct shipping. In addition, we are monitoring several TTB rulemakings covering the regulation of allergens, serving facts and appellations of origin. We will also be determining how to manage the political sea-change brought about by the November elections over the next year.

We discussed the fact that WineAmerica has a Political Action Committee ("PAC") to ensure that we continue to cultivate relationships on Capital Hill. A plea was made for individual (non-corporate) donations. Such donations are critical to our ability to be active players in the Congressional sphere. Personal checks made out to the WineAmerica PAC can be sent to the office.

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Fall Meeting, continued

The fall meeting also featured an important panel discussion on how to improve wine direct-to-consumer shipment policy and logistics. The discussion included a summary of state direct shipping law by Jeremy Benson of Free the Grapes, as well as a discussion of how to manage the thicket of state direct shipping licensing by Vikki Wetle (Amity Vineyards, Oregon). Representatives of FedEx discussed their efforts to work with wineries to improve service to more remote locations, and an initiative to expand wine direct-to-consumer shipment to some Canadian provinces. Jeremy also spoke to the group over lunch about Free the Grapes and how it is helping consumers seek changes in state direct shipping law.

Several members also attested to the value provided by the WineAmerica Insurance program, reporting on how it helped them meet their business insurance needs with carefully tailored and expeditious service.

After a bus ride through Georgia wine country, we arrived at the stunning Wolf Mountain Winery where we were treated to a gourmet meal with fine Georgia wines and good company. The selections again included a variety of wine styles produced from vinifera, hybrid, and native grapes.

On the final morning of the meeting, the State Associations Council ("SAC") discussed state legislative, research, and industry successes over the past year. Members from California, Colorado, Georgia, Idaho, Maryland, Michigan, Missouri, Nebraska, New York, South Dakota, Texas, Virginia, and Washington supplied details about the state of the wine industry in their respective states, including facts about the industry's growth and the political climate. It was an entertaining and informative dialogue.

We look forward to our upcoming spring meeting in Washington, D.C. March, 22-25, 2009 and hope you can all attend.

Regulatory News-TTB Introduces Two New Website Tutorials

By Michael Kaiser

The TTB has introduced two new, user friendly tutorials to help guide wineries with regulatory issues: (1) the TTB Wine Industry Compliance Seminar Resource Tool and (2) the Formula Approval Tool.

The TTB Wine Industry Compliance Seminar Resource Tool is an online version of the various periodic wine seminars the TTB holds in different regions of the country. Its focus is to give new industry members an overview of the various federal requirements for wineries. The online wine seminar is divided into eight sections:

1. <u>Seminar Introduction</u>: The introduction gives an overview of the seminar and provides instructions on using the interface.
2. <u>Recordkeeping and Reports</u>: Addresses the different types of reports that TTB requires, and discusses compliance red flags. Topics in this section include Required Records, Recordkeeping Requirements, Report of Wine Premises Operations, and Common Compliance Concerns.
3. <u>Taxes</u>: Provides detailed information on Excise Taxes, Small Domestic Producer Credit, Pay.gov, Special Occupational Tax and Tax Compliance Examination. The information is formatted so that it is easy to locate the forms, guidelines and information resources needed to start or maintain a winery operation.
4. <u>Bonds</u>: Discusses in detail the requirements for bond coverage, the usage of TTB Form 5120.36, and operations versus deferral bond coverage.
5. <u>Changes to Report to TTB</u>: Identifies reportable changes in winery operations, and the required reporting process for addressing them. Changes that must be reported include (a) personnel changes, (b) changes to premises, (c) name changes,

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(d) changes of signature authority, and (e) special applications.

6. Alternations, Custom Crush and Home Winemaking Centers: Provides detailed information on options for entering the wine industry, alternating premises, alternating proprietorships, using custom crush operations, using home winemaking centers, and avoiding common compliance pitfalls related to these operations.
7. Labeling: Provides detailed information on mandatory and optional labeling items, practices that are prohibited in labeling, Certificates of Label Approval and product integrity examinations.
8. Resources: Provides access to websites, URLs, TTB email addresses, phone numbers and other information to help existing and prospective industry members better understand and operate in the wine business.

The Formula Approval Tool allows wine industry members to determine if their products need formula approvals to qualify for label approval. TTB regulations require formulas most commonly when flavoring or coloring materials are added to an alcohol beverage product. The Formula Approval Tool features a "drop down" box that allows you to choose a product to determine if your product requires formula approval.

Both of these new tutorials are readily available on the TTB's website. The Wine Industry Compliance Seminar Resource Tool can be found at http://www.ttb.gov/wine-resource-tool/wine-section-menu.htm. The Formula Approval Tool can be found at http://www.ttb.gov/tutorials/ic2007-4_help.shtml.

New FedEx Express Reroute Service available for Holiday Shipments

As a supplier member of WineAmerica, FedEx offers exclusive discounts to winery members on select shipping. With more than a decade of experience and expertise in wine shipping, FedEx provides convenient tools to manage shipping and track orders.

In response to customer demand, FedEx Express has introduced an address correction/reroute service for Adult Signature Required alcohol packages. In the event an adult is not available to sign at delivery, FedEx Express along with FedEx Ground and FedEx Home Delivery can reroute packages to another local address. This helps ensure your customers receive their packages at a convenient location. At the shipper's request, packages can be rerouted by calling 1.800.GoFedEx 1.800.463.3339. The standard FedEx Express reroute fee or FedEx Ground address correction fee applies. See additional wine shipping tips such as Hold at FedEx Location services and Saturday home delivery at http://www.fedex.com/us/wine/.

To find out more about FedEx and all of WineAmerica's supplier members, including all available discounts, visit the Virtual Trade Show page at http://www.wineamerica.org/membership/virtualtradeshow.cfm.