



WineAmerica Newsletter – January 2009

From The President's Desk

New Year's greetings and wishes for a successful 2009.

2008 is over and we all fervently hope for a strong recovery and solid economic times in 2009. Perhaps this is overly optimistic, but things should get better. There was some good legislative news in 2008, mainly the passage of a landmark Farm Bill with significant funding for specialty crops. But once again, the badly needed reform of immigration law restrictions that could stabilize the hiring of workers from foreign countries failed in the hyper political environment of Washington. All things considered, it was rather remarkable that the farm bill actually contained increases in spending for specialty crops. It was passed in an environment of great fiscal constraint at the federal level.

Prospects for 2009 are clouded by the arrival of a new President, with a change in party, and a very different dynamic at the Congressional level. Vast changes in the nature of business in Washington are surely in store. WineAmerica has a long list of new faces in Congress and in the nascent administration to get to know. On top of all this change rests the economic environment

with virtually unprecedented government intervention. It provides both challenges and opportunities. We will need to fight hard to retain USDA commitment to agricultural research and in particular funding for grape related research at the ARS and the Viticulture Consortium. New science generated by research generates tremendous payback in economic development and activity. Perhaps we will be successful in leveraging the current positive change in attitudes towards government investment to increase research funding as a means of building a stronger and more sustainable American agriculture. We will have to make the case to very skeptical critics.

AgJobs, the legislation to reform agricultural guest workers, is being revised—addressing some possible inequities—and positioned for another strong effort. It is critical that the country move from simplistic “look the other way” or “build higher and stronger fences” policies to squarely and fairly address the needs of farmers, farm workers and the overall economy. This will still be a highly politicized battle, but a strong coalition, the Agricultural Coalition for Immigration Reform which

includes WineAmerica, will take up the fight and try to get Congress to act.

While we are happy with the results of the 2008 Farm Bill there is still a great need to preserve those gains through equitable implementation by USDA and Congressional committees. Our specialty crop provisions such as specialty crop block grants, the Specialty Crop Research Initiative, value added grants and others are complex and require vigilance to ensure that the USDA does not undermine Congressional intent. Furthermore, it is already clear that forces in USDA and Congress are tempted to reallocate specialty crops money to other pet priorities which have not been funded. It is frustrating to have to keep building and maintaining defenses after Congress decisively acts to increase resources devoted to specialty crops, but that seems to be the situation we now face.

Excise Taxes

Notwithstanding the very difficult fiscal environment of state governments, it is not a good time for federal or state governments to increase wine excise taxes.

Actually, it is never a good time to do that because wine excise taxes

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do not fit the policy criteria for taxes on specific products. Excise taxes are generally considered to be bad policy in a free economy because they single out particular businesses for harsh treatment.

There are three main exceptions: (1) user fees such as taxes on motor fuel or tires to pay for roads used by those taxpayers, (2) taxes on luxury items such as expensive cars or certain jewelry as a means of making the tax code more progressive thereby selectively taxing those most able to afford it, and (3) taxes to shape consumer patterns away from detrimental behavior such as tobacco consumption. None of these applies to wine.

Moderate wine consumers, by far the predominate kind of wine consumers, do not increase costs to society. To the contrary, moderate wine consumption significantly reduces health care costs. Wine is consumed by a broad range of the population and not selectively by the richest. Finally, wine consumption is hardly detrimental behavior. Moderate consumers of alcohol are significantly healthier than both abstainers and very heavy consumers. Furthermore, relatively new information demonstrates that the antioxidants present in red wine have significant beneficial effects against a wide variety of diseases. Thus, it is clear that increasing the excise tax on wine represents bad public policy. From an economic perspective, it would also severely harm the rural renaissance being led by the growth of wineries, throughout the

country. Wineries contribute much to rural economies through employment, investment and additional tourism. WineAmerica has produced a position paper on excise taxes providing more detail. It is included later in this newsletter. Electronic versions are available on request.

Direct Shipping

A good article on Direct Shipping opportunities and problems appears in the January issue of Wine Business Monthly. The focus of the article, based on a survey conducted by Wine Business Monthly, WineAmerica and Ship Compliant is the frustration caused by complex state compliance restrictions put in place in the wake of the 2005 *Granholm* Supreme Court decision. It quotes me as saying that “[a] simple functional mechanism for wineries to sell wine directly to consumers in other states remains a distant goal. The aftermath of the *Granholm* decision has been an arbitrary, almost Kafkaesque, patchwork of expensive, mindlessly complex and inefficient state permit requirements.” It is indeed unfortunate that shipping has evolved into such an intricate and difficult maze. Ultimately, it will be necessary to find a means to simplify this process and allow direct shipping of wine by wineries to develop into a reasonably regulated but functional mechanism for wineries to sell their products. A second article covering the survey will appear in the February 2009 Wine Business Monthly.

In an important, cogent and well reasoned federal Court of Appeals decision, the Sixth Circuit in late

December ruled that Kentucky’s on-site age verification and purchase requirement for shipping wine to consumers was discriminatory and a violation of the Constitution’s Commerce Clause. This decision goes beyond the *Granholm* Supreme Court decision which ruled on so called “facially discriminatory,” statutes that directly apply different standards to in-state and out-of-state wineries, to consider a statute where the same standard is applied to both domestic and out-of-state wineries. The court held that such a statute could be “discriminatory in practical effect.” The Sixth Circuit found that Kentucky law made it impractical for most consumers to purchase from out-of-state small wineries and therefore violated the Constitution. The court accordingly affirmed a district court opinion and remedy allowing all wineries producing no more than 50,000 gallons of wine per year to ship directly to consumers in Kentucky. WineAmerica hopes that this decision will provide inoculation against state mischief in erecting seemingly even handed barriers to direct shipment. A more detailed article on the Kentucky decision is included in this Newsletter.

Every new year has its challenges. 2009 presents many more than the typical changeover year. WineAmerica will need to be a nimble, strong and forceful organization to ensure that the interests of America’s wineries are effectively promoted in the upcoming year. Your membership and involvement in our organization are critical to its abilities. Thank you for your continued support.

Court Invalidates Massachusetts Direct Shipping Capacity Cap Law by Cary M. Greene

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.

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 ship directly 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 wholesalers’ 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 explained how the direct shipping right for producers over 30,000 gallons was never intended to be a viable option, or as one legislator put it, “they can’t move that much wine [via direct shipment]. So they are going to 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.” 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.”

Family Winemakers may have broad repercussions for how future direct shipping legislation is debated and enacted. It is not clear from the decision that the court believed all capacity cap laws are unconstitutional. The court believed that even though the Massachusetts law appeared neutral on its face, the legislature was really trying to put window dressing on a law it intended to be discriminatory. This likely contributed to the court’s finding that the law was unconstitutional.

The court issued a final order specifying a remedy on December 18, 2008. It requires Massachusetts to “level up” and open its borders to direct wine shipments provided a winery obtains a state shipping license. It is not clear whether the state will seek a stay of the order and appeal the decision.

Kentucky's Face-to-Face Purchase Requirement Declared Unconstitutional by Cary M. Greene

On December 24, 2008, the Sixth Circuit Court of Appeals issued a significant decision in the wine direct-to-consumer shipping case *Cherry Hill Vineyards, LLC v. Lilly*, No. 07-5128, slip. op. (6th Cir. Dec. 24, 2008). The case arose out of a lawsuit alleging that Kentucky's wine shipping law was unconstitutional.

miles to purchase wine in-person." According to the court, this had the effect of giving "small Kentucky wineries [the] benefit [of] less competition from out-of-state wineries."

In finding that Kentucky's law "discriminates in practical effect" the Sixth Circuit in *Cherry Hill* employed a different standard than

visit the winery once," after which they could continue to have wine shipped to their homes.

Both the *Baude* and *Cherry Hill* decisions are available on our website (www.wineamerica.org) under the *State Issues* heading on the *Issues and Policy* page.

What this means from a legal

Kentucky's law requiring in-person purchases made it "logistically infeasible for most consumers to purchase wine from out-of-state small farm wineries"

Kentucky's face-to-face purchase restriction had required consumer's to visit a winery each time the consumer wanted to ship wine home. In affirming a lower court opinion, the Sixth Circuit in *Cherry Hill* held that state laws requiring consumers to "travel to the winery each time he or she wishes to execute a purchase" to ship wine home have the "practical effect" of discriminating against out-of-state wineries. *Cherry Hill* specifically objected to Kentucky's law because in-person visits were required even when "a winery has established a relationship with an individual consumer . . . and has verified their age and shipping address." This made Kentucky's law "logistically infeasible for most consumers to purchase wine from out-of-state small farm wineries," especially because it is "impractical for customers to travel hundreds or thousands of

that used in the August 7, 2008 Seventh Circuit Court of Appeals decision out of Indiana, *Baude v. Heath*, 538 F.3d 608 (7th Cir. 2008). In *Baude*, the Plaintiffs "waged the suit as a 'facial' challenge to the statute," leading the court to limit its analysis to whether Indiana's in-person purchase statute discriminated against interstate commerce "on its face." This is significant because, according to *Baude*, the burden of establishing a statute is constitutionally discriminatory "on its face" is high. As suggested by *Cherry Hill*, the burden is lower where the Plaintiff can show that although a statute is neutral "on its face" it still discriminates against interstate commerce "in practical effect." It is also notable that unlike Kentucky's in-person purchase requirement, Indiana's law did not require repeat visits, but instead required consumers "to

standpoint is not terribly clear. While some published reports seem to take the view that there is a conflict between the *Baude* and *Cherry Hill* decisions, it is possible to distinguish the cases based on the way they were argued and on the statutory differences. There are certainly a number of variables at work in both decisions, and scenarios where the Sixth and Seventh Circuit might agree on the underlying constitutional questions.

From a practical standpoint, in-person purchase restrictions are not likely to disappear from the legislative mix when it comes to wine shipping legislation. We certainly will continue to fight to establish statutes that allow wineries a broad range of shipping rights, but it is important to recognize that the question of face-to-face limitations is still constitutionally unsettled.

Wine Law Topics – Zoning

by Cary M. Greene

We've been hearing a great deal of talk recently about how zoning affects winery operations. The topic was brought up by numerous members of WineAmerica's State Associations Council at our annual meeting in November. And in recent months, there have been at least two articles addressing zoning issues for wineries and other "value add" operations in the *Washington Post*. In October, the *Post* summarized the problems of one dairy outside Baltimore trying to get approval to build a creamery on its farm. In December, the *Post* examined the problems of one Virginia winery that can't get approval to build its production facility at its vineyard.

For those of you unfamiliar with zoning and its vicissitudes, it's helpful to look at the heart of the problem to see where conflicts arise and how they have been successfully resolved in the past. Zoning conflicts are typically resolvable once local authorities have allowed winery development—when the question is, for instance, how many events a winery can hold. The real sticking point is usually a preliminary question, before vineyards and wineries are well-established.

This is really a two-fold question about both winery production and sales. Local authorities can usually place vineyards within the "agricultural" zoning box without much difficulty. But it is not necessarily intuitive that wine production and sales are also

"agricultural." This creates a conflict when new wineries wish to build wine production and tasting room facilities at existing vineyards. As the *Post* put it in the case of "value added" dairy production, "[d]oes a creamery that makes butter and cheese qualify as farming or as manufacturing? And how much say should neighbors have in how farmers farm?"

Without going too deeply into the weeds, it has been our experience that local authorities have an easier time seeing production and sales as agricultural when they are tied to local fruit production. Oregon provides an instructive example.

In 1989, almost simultaneously, Oregon passed a law that tied wine production and sales to development of on-site and contiguous vineyards, and the Oregon Supreme Court issued *Craven v. Jackson County*, 779 P.2d 1011 (Or. 1989). *Craven* helpfully clarifies how winery production and sales can validly be defined as "farm use or commercial activity in conjunction with farm use."

The *Craven* court explained that wineries and tasting rooms should not always be defined as "farm uses." This, the court argued, could establish precedents that lead to absurd results such as permitting "a shopping mall or supermarket as a farm use so long as the wares sold are mostly the products of a farm someplace."

According to *Craven*, "farm use" zoning should be employed with the direct goal "of preserving land in productive agriculture."

Craven states that wineries and tasting rooms may be considered activities "in conjunction with farm use" and accordingly, broadly speaking, "agricultural," if "the commercial activity... enhance[s] the farming enterprises of the local agricultural community to which the... land hosting the commercial activity relates." In other words, if "the agricultural and commercial activities"—i.e., grape-growing, wine production and sales—"must occur together in the local community" they are all justifiably "agricultural." Indeed, the *Craven* court reasonably concludes that such wine production and tasting room sales "may reinforce the profitability of operations and the likelihood that agricultural use of the land will continue."

Oregon's thriving wine industry may credit at least some of its success to this compromise. The interests of local wineries were successfully balanced against the concerns of local authorities without imposing undue burdens. Oregon law gave both sides believable sign-posts that they could point to in defining wine production and sales as "agricultural." Wineries and tasting rooms that were legitimately linked to the growth of local agriculture could be permitted in "agricultural" zones. Wineries and tasting rooms that were not, could not.

WineAmerica Position Paper on Excise Taxes

January 2009

As the United States faces a severe economic and public finance crisis, cash strapped states and perhaps the federal government are considering increasing excise taxes on wine, beer and spirits. Tax policy is an extremely complex area because the economic effects of changes can be widespread, unpredictable and have seriously adverse effects on certain economic players. Nowhere is this more significant than excise taxation, which by definition is product specific rather than broad based.

Excise tax increases affect consumer demand for particular products. Consequently, the economic prospects of those who produce, market and rely on those products for their livelihood are affected by revisions to excise tax rates.

Increasing Wine Excise Taxes Is Questionable Policy

Typical reasons to increase excise taxes are: (1) as a user fee (tires and gasoline) to reimburse the societal costs associated with use of the product; (2) as a means of reducing demand for the product because it is considered detrimental to society (tobacco); or (3) as a luxury tax (sailboats and cars above a certain price). None of these justifications can be rationally applied to make a case

for an increase in wine excise taxes.

1. User-Fee

Consumers of wine typically are moderate consumers, and as such do not impose net costs upon the domestic health care system. Increasing excise tax as a so-called “user fee” would, therefore, not make good policy sense. Indeed, the 2005 Dietary Guidelines Advisory Committee—a committee of experts formulated to advise the Secretaries of HHS and USDA—states that 95 percent of Americans who drink wine consume only light-to-moderate amounts. Studies have indicated that light to moderate consumption, especially of wine, is associated with certain health benefits.

The Guidelines Advisory Committee stated: “[s]tudies conducted around the world consistently show that alcohol has a favorable association with total mortality among middle-aged and older adults. A meta-analysis on all-cause mortality using approximately 50 studies demonstrated an inverse association between moderate drinking and total mortality under all scenarios. On average, the relative risk of all-cause mortality associated with moderate drinking was approximately 0.80. The J-shaped curve, with the lowest mortality risk occurring at the level

of one to two drinks per day, is likely due to the protective effects of moderate alcohol consumption on CHD [coronary heart disease] and ischemic stroke, the first and third leading causes of death in the United States, respectively.” (citations omitted).

2. Detrimental Product

Wine production is an important tool for growing rural economies. It provides employment, investment opportunity and economic stability. Taken together with wines’ cultural association as a complement to food and a healthy lifestyle—not inebriation—it would be misleading to classify wine consumption as “detrimental to society.”

3. Luxury Tax

Wine is not a true “luxury” item as it is typically consumed by Americans across the economic spectrum. Average moderate wine consumers would be the first to reduce consumption following an excise tax increase. Imposing such a tax would accordingly negate the health benefits that result from moderate consumption, but fail to achieve the intended purpose of a luxury tax, namely, targeting consumers most able to afford it. Because wine is not a luxury good, taxing the consumption of wine by typical consumers is regressive and does not target those consumers most able to afford it.

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Increasing Wine Excise Taxes Will Seriously Damage the Economic Prospects of America's Farm Based Family Wineries

In addition to the policy reasons outlined above, a change in excise tax would also have a devastating economic impact on wineries, other industry members, and consumers.

Grape Overproduction. If wine consumption drops because of increased wine taxes, grape overproduction will result in devastating decreases in grape prices. Vineyards are an expensive, long-term investment in a perennial crop not easily converted to other types of agricultural uses. The only viable use of wine grapes is to make wine.

Exaggerated Cost. Wine excise taxes are applied at the producer level, thus the impact of a wine excise tax increase, if passed along to the consumer, would be exaggerated by wholesaler and retailer standard percentage markups. The excise tax rate increase would accordingly be felt by consumers not at the cost of the excise tax, but at more than double that dollar value.

Loss of Profitability. Because wine is sold at specific price points to attract targeted demographics

of consumers, excise tax changes are difficult to pass on to the consumer. This is particularly true given the way mandatory distribution channels exaggerate excise tax increases. Following an excise tax increase, wineries are likely to absorb the additional excise tax payment for at least several years until a new price point is established. Under these circumstances excise tax increases come directly from the winery's bottom line. We estimate that a 75¢ per gallon increase in wine taxes would have the effect of reducing a typical middle level wine producer's gross sales by as much as 5 percent, possibly eliminating most of the producer's profit **margin**.

Undermines Rural Development. Increasing excise taxes will seriously undermine the ability of new and growing wineries to establish and strengthen their business and to build a strong agricultural base. The number of wineries across the country has been growing dramatically, more than doubling in the last decade. These wineries are important contributors to the rural economy. Economically damaging wineries through poor tax policy would seriously undermine the small family farming and rural economic development renaissance driven in large part by the exponential

growth of small wineries across the country.

Hinders Growth. Excise tax increases on wine have an important detrimental economic effect on wineries. Small wineries have limited access to credit—particularly in the current economic climate. The cash necessary to pay increased excise taxes will come directly out of the available capital for expansion and therefore will severely limit industry growth. Wineries that have no access to loans to help pay for an excise tax increase may cease to exist.

Conclusion

For these reasons, an increase in wine excise tax is both poor tax policy and economically harmful to small businesses and rural areas. Such a tax change would not achieve a definable positive policy purpose and would ultimately lead wineries to make an impossible choice—maintaining market share with a loss of profitability, or higher prices and loss of unit volume. Given the inherent economic and cultural benefits of wine, wineries should not be forced into making such a choice.

WineAmerica is the national trade association of American wine producers with more than 800 member wineries in 48 states

Direct Shipping News Michigan Legislature Votes to Eliminate Retailer Shipping

Last month, the Michigan legislature passed a bill prohibiting in-state and out-of-state retailers from shipping to local consumers.

The legislation was prompted by a federal court decision striking down a state law that had prohibited only out-of-state

retailers from shipping into Michigan. The bill now awaits the governor's signature for final passage.

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Regulatory News

Misleading Information Circulated About U.S. Produced Champagne

The Office of Champagne, the U.S. representative of the *Comité Interprofessionnel du Vin de Champagne* (CIVC), the trade association that represents French Champagne grape growers and wine houses has been circulating misleading letters to US sparkling wine producers requesting that they surrender any COLAs using the term “champagne.” The letter states that domestic wine maker’s possessing inactive “champagne” COLAs should surrender them to TTB. As TTB recently made clear, this is not TTB policy. Under a March 2006 US-European wine agreement, “champagne” and other semi-generic terms may continue to be used if a wine maker received a COLA approval for the brand before March 10, 2006. This “grandfather” provision allows wineries to obtain new semi-generic COLAs provided the brand name and semi-generic term do not change. There is no provision in the agreement that requires a wine maker to surrender semi-generic COLAs that have become inactive. Surrendering a COLA that uses the term “champagne” (or any other semi-generic wine) to TTB may result in a winery losing their right to future approvals under the “grandfather” provision.

TTB has issued an official notice concerning this matter. For the official TTB position please refer to the notice located at: http://www.ttb.gov/newsletters/archives/ttb_newsletter120508.html

TTB Regulatory Rule Update

As a new administration takes office, much of TTB’s regulatory agenda from last year is still pending. For example, TTB is currently deliberating allergen

and serving facts label requirements. We have seen indications that Final Rules on both of these subjects will be issued sometime in 2009.

TTB also is deliberating proposed changes to the AVA approval process. At issue is the establishment of a “grandfathering” clause that would allow wineries using brands containing geographic references identical to new AVAs to continue using their brands so long as (1) the winery received a COLA approval at least five years before the AVA petition was filed and (2) the winery used the brand in actual commercial use for at least three of the five years. TTB also is examining the implementation of new standards for “nesting” appellations, that is, AVAs entirely enclosed within an existing or proposed AVA. TTB is proposing that “nesting” AVAs not be considered part of the larger AVA because of distinctiveness.

It has come to our attention that TTB also intends to submit a Notice of Proposed Rulemaking in January that will suggest an expiration date for all COLAs approved on a going-forward basis. As of this writing, it is unclear what the details of the proposed rule will be. We will have more information for WineAmerica members as it becomes available.

Reminder: Checking Label Status

You can check the status of your label submissions in the *Members Only* section of our website (www.wineamerica.org). This allows you to see when your labels have been submitted, as well their approval status. To check the status of your labels, follow the *Member Only* link on the left side of the WineAmerica homepage. After you login, click on the *Label Approval Status* link. Please contact us if you have any questions.