WineAmerica Newsletter – December 2009

From The President's Desk

Grappling with Failures of the Three Tier System

It is by now clear to almost everyone that the three tier system, developed in the years following the U.S.'s emergence from Prohibition, with its numerous strictures and constraints, is quite incapable of adequately serving the needs of small wineries and, for that matter, the needs of larger wineries with small, boutique brands. I suppose this is really no great shock to anyone reading this newsletter. Nevertheless, the WineAmerica Fall meeting was highlighted by a terrific panel addressing this issue.

Panelists Craig Wolf, President of the Wine & Spirits Wholesalers of America, Jeff Carroll, Vice President of ShipCompliant, and Ted Jansen, President of Inertia Beverage Group moderated by WineAmerica's Cary Greene engaged in a frank and open discussion of problems faced by limited quantity brands and possible solutions. Naturally, the three panelists had different ideas about how to address the problems but each acknowledged the limitations of the current system and each offered fascinating, and mostly compatible, new ideas about how to move forward. I am sure everyone listening to the panel took away different insights but to sum up, Craig Wolf concentrated on methods to facilitate the development of productive relationships between small brand owners and smaller wholesalers, but made clear that regardless of the effectiveness of the distribution system, smaller brands face a competitive market. Ted Jansen, relying to some extent on his experience—he recently worked for Expedia—explained how the Internet has brought incredible change to old business models like travel booking. He articulated how Inertia is developing a fresh approach to wine distribution using a hybrid of direct Internet based sales with three tier fulfillment. Jeff Carroll focused on the legal and policy hurdles smaller brands face under the current distribution system and explained how ShipCompliant facilitates direct-to-consumer, three-tier marketing and sales generally for limited quantity brands.

Our membership at the meeting strongly engaged the three panelists in a lively question and answer exercise from which both the panelists and the membership gained new insight.

Conservation

Another highlight of the meeting was a presentation by former National Resources and Conservation Administrator—a department of the U.S. Department of Agriculture (USDA)—Bruce Knight addressing potential opportunities for grants and assistance through the environmental conservation provisions in the 2007 Farm Bill. There are lots of conservation dollars that can be tapped by wineries in a wide variety of ways. Bruce and his partner Mark Rey also a former USDA official are interested in presenting workshops

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to state organizations to provide interested grape growers with the information, insight and tools to take advantage of these opportunities.

State of the Wine Market

The always fascinating and informative John Gillespie of consulting firm Wine Colleagues was kind enough to return to WineAmerica's Fall meeting and walk us through market conditions as well as a detailed profile of the American wine consumer. One of the more interesting aspects of his analysis, the large "Millennial" generation, born in the late 1970's and 80's, contains more core wine consumers than marginal wine drinkers. This is important because the vast majority of wine sales are made to Boomer core consumers, and Boomers have *never* had more core than marginal consumers. This bodes well for growth in the wine market in the United States as these Millennials begin to earn more and further develop their affinity for wine.

Food Safety

We've been providing updates on the ongoing battle over food safety legislation since the Summer and are happy to report some progress. The bill is seeking to overhaul the food safety system in the U.S. Since wine falls within the technical definition of "food," we've been inadvertently swept up in the legislation.We're seeking language, together with a coalition of other alcohol beverage trade groups, that would exempt us from this food safety overhaul. Our principal argument has been that our products are already heavily regulated by the Alcohol & Tobacco Tax & Trade Bureau (TTB) and that the product safety system for alcohol has worked well. We prevailed in obtaining an exemption from the bill in the House and have been seeking the same sort of exemption in the Senate.

We are happy to report that we are making progress, although not without problems. The Senate Health Education Labor and Pensions Committee issued its version of the food safety bill in November. While the bill contained an exemption, the language is far more narrow and dysfunctional than the one contained in the House bill, and might allow for dual regulation by TTB and the Food and Drug Administration (FDA). We are working to fix the language before the bill progresses to the Senate floor and are having meetings this week to make our case for improving the Senate bill.

Sales Tax Reform

The forces are coming into alignment for possible sales tax reform. As a New York Times editorial (November 26) stated, cash strapped states lose billions of dollars per year in revenues because most, though not all, on-line merchants are not required to collect sales tax on purchases or forward the proceeds to the states. New York State is currently engaged in a battle with Amazon.com over whether Amazon must collect the taxes due on purchases by New York State consumers. Over the years, the National Governor's Association has taken a position that: "Congress should support state efforts to simplify their sales tax systems by passing legislation to require remote sellers to collect sales taxes in states that are part of the State Sales and Use Tax Agreement."

Why does this matter? Because one of the likely potential gains from Congressional action could be a simplification of existing state collection regimes on wine purchased through direct shipment. This could reduce the burden for wineries who are licensed direct shippers in states and localities that require collection and remission of sales taxes. While not a cure for all wine shipping problems, sales tax compliance is currently much more difficult than excise tax compliance. For example, shipping to New York State is complicated by the fact that wineries must sort out which locality is owed taxes and how much when calculating sales tax. A single unified percentage tax payment would be much more appealing for wineries as well as tax collectors.

WHO

We are expecting the World Health Organization to release its draft strategy shortly. When it comes out we will send an e-zine to membership.

WineAmerica By-Laws Amendment

The Board approved a ballot to amend the By-Laws at our Fall meeting and we need your votes to approve the ballot change. You can find the ballot at http://wineamerica.org/membership/docs/Revised_By-Laws_Ballot%20_Nov_2009.pdf. The ballot explains why each change is necessary and how it will improve our Association. One of the ballot measures could save us a substantial amount of money, but we can only make use of this cost savings with the approval of our membership.

We need a lot of votes! So here's the link to the ballot again:http://wineamerica.org/membership/docs/Revised_By-Laws_Ballot%20_Nov_2009.pdf

WineAmerica Recruiting

The collapse of the economy last year hit WineAmerica hard. Dues collections and membership fell off as wineries struggled with a difficult financial situation. We are working diligently to regain our lost members and recruiting new wineries. This effort is showing some progress as the economy improves. We are used to operating on a tight budget and constantly work to get the most out of the funds we have available, but there are limits to the amount of savings that can be achieved without severely cutting back on functions and services.

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This is a critical time for American wineries as threats of greater regulation (food safety), fees (food safety and TTB) and increases in Federal excise taxes must be addressed. Our national organization of wineries, with membership across virtually every state is uniquely able to work with Congress to demonstrate the local impact of policies affecting your business. Collectively, the American wine industry is stronger than its constituent parts and WineAmerica, *your voice in Washington*, needs the support of American wineries to make the case for good winery policy.

WineAmerica depends on our current members to explain the importance of the only national wineries association to their peers and to urge them to help share the burden of protecting the political and policy interests of America's wineries. We need your help.

Fall Meeting Panel Addresses Three-Tier System

by Cary Greene

Back in June, we published an article on Rethinking the Three-Tier System (at 4, June 2009 Newsletter). In the article, we argued that it was beneficial to think through the existing distribution system and find reasonable compromises with our industry partners to make the system work better. We observed, "[i]t should be noted that rethinking the three-tier system to find a more practical distribution mechanism probably means changing state laws in a fairly dramatic manner, something which is not likely to happen quickly. On the other hand, it's important to consider whether there are ways forward that can reduce the friction between the tiers, and perhaps create the conditions for instituting new laws that work better for wineries."

At our Fall meeting in Texas we tried to move that process forward by hosting a panel featuring Craig Wolf, President of the Wine & Spirits Wholesalers of America (WSWA), Jeff Carroll, Vice President of ShipCompliant, and Ted Jansen, President of Inertia Beverage Group. As Bill notes in his President's column this month, the discussion was lively, honest, and productive. The panelists answered some tough questions, and also shared and listened to some important stories that could point the way to a better distribution system.

Supplier members like ShipCompliant and Inertia are clear eyed about the challenges we face and practical in working to find solutions that can fit the needs of our industry. The experiences they shared expressed how thoughtfully they are taking on these tangled issues of wine sales and distribution while trying to navigate state laws that often serve as road blocks to progress. Their efforts, and the relationships they are developing at all tiers of the wine business, are gradually moving us in the right direction.

Likewise, it is evident that WSWA, in agreeing to join us on our territory, wants to work with us where it can. While their first mission is to their members, our panel discussion

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made clear that WSWA recognizes that the presence of 6,000 American wineries has changed the balance of power and will continue to do so in the years to come. They are also quite interested in finding positive solutions such as arrangements with smaller wholesalers and other possible alternatives.

Progress will no doubt be in fits and starts. One of the most important stories the panel heard was about a relationship one of our members tried to establish with a local wholesaler. The winery didn't produce enough product to attract a full service wholesaler, so, being creative, they negotiated to have a local wholesaler act in a limited capacity on their behalf—to make deliveries only. What the wholesaler failed to anticipate was the uproar he would face from his sales force. The winery's brands would be essentially competing against his sales force, and the sales force was adamantly against a dual track arrangement. In other words, what at first may look like a good alternative may in fact prove unworkable.

Even if we achieve a working distribution system of the kind we talked about back in June—make better use of modern logistical and technological systems, better account for the needs of smaller wineries, and develop new distribution models—the practical realities of a competitive marketplace will still confront us. The difference, as we see it, between then and now is that while the three-tier system largely dictates which wine gets shelf space now, a reformed system would allow customers to drive choice. Wineries should be allowed to sell to the customers they have cultivated, whether those customers are wholesalers, retailers, or consumers. If wineries fail to reach customers, that failure should be their own, not one imposed on them by the logistics of the distribution system.

As we said back in June, "[a]t this point, the steps are obviously preliminary and tentative—perhaps nothing new will emerge from the effort. But there is a desire to find common ground and to develop business models that can work for WineAmerica members. It's at least a start." With our first panel discussion behind us, we are perhaps a step further in the right direction. We have many more ahead of us.

Regulatory News: December 2009

TTB Issues Response to Recent News Articles on Champagne Labeling

From the TTB Newsletter dated November 25, 2009

Recently, several groups have made statements that contradict TTB's efforts to protect consumers from false and misleading labeling as well as our efforts to uphold international agreements and the laws of the United States as they apply to the labeling of semi-generic wines, in particular, champagne.

Following years of negotiations, the United States and the European Union (EU) signed an agreement on trade in wine on March 10, 2006. In the agreement the U.S. committed to seeking to change the legal status of the semi-generic names to restrict their use solely to wines originating in the applicable EU member state with certain exceptions, in particular, a "grandfather" provision. Under the "grandfather" provision, any person or their successor of interest may continue to use a semi-generic name on a label of wine not originating in the EU provided the semi-generic name appeared on a Certificate of Label Approval (COLA) that was issued prior to March 10, 2006. It should be noted that the requirement to use the name in direct conjunction with an appropriate appellation of origin disclosing the true place of origin must have been satisfied in order to have received the "grandfathered" Certificate of Label Approval. The legislative proposal to change the legal status of the EU semi-generic names was enacted December 20, 2006.

The Internal Revenue Code of 1986 (IRC) defines each semi-generic name as a name of geographic significance that is also a designation of class and type for the wine. The IRC further states that a semi-generic name may be used to designate wine of an origin other than that indicated by its name, only if there appears, in direct conjunction with the designation, an appropriate appellation of origin disclosing the true place of origin and the wine so designated conforms with the standard of identity. These provisions of law ensure that the consumer will not be misled regarding what the product consists of or where it came from.

One of the recent statements claimed that TTB was considering a change in label rules that would end the use of "Champagne" on any label other than those from Champagne, France. TTB has no intention to undermine the provisions of the agreement reached with the EU or the provisions of the IRC.

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Washington, DC

Please mark your calendars for the 2010 annual meeting

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