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A Manifesto For Change In The Wine Industry

Posted by Tom Wark on Mar 16, 2010

This blog reaches upwards of 25,000+ unique individuals monthly. Half of those work in or around the wine industry. This Manifesto is meant for them. If it leads to discussion, anger, contemplation or results—any of that would be a fine outcome.

A MANIFESTO OF REFORM AND CHANGE TO THE WINE INDUSTRY
Let us concede that as a culture early embedded with a mistrust of alcohol and with a history of such abusive practices surrounding the sale and use of alcohol that a national prohibition on drink was instituted, that we as a society have an interest in establishing rules and regulations that act as a deterrent to the kind of misuse of alcohol that causes societal problems and community disruption.

Let's further concede that among the most defining qualities of the American character is a profound devotion to promoting and pursuing a dynamic economy that favors entrepreneurial activity and the rapid embrace of technology in the service of economic expansion and customer service.

Given these concessions, one must conclude that systems in place today to control the sale and distribution of alcohol needs severe reform.

The framework for the sale and distribution of alcohol across the United States, substantially unchanged from when it was realized nearly 75 years ago, continues to serve the purpose of a bygone era, simultaneously and naturally undermines the creation of a dynamic producer community, fails to serve consumers who operate within an economy that did not exist when the current alcohol distribution system was realized, and has evolved into a vehicle for political and industry domination by a small group whose primary interest is in seeing no reform to the rules and regulations of the industry they control.

The “Three Tier System” no longer positively serves the alcohol beverage industry nor, most importantly, the American consumer. If it is not reformed to account for modern models of distribution of goods and the “expectations of access” that the modern consumer has embraced, then the following will, and is beginning to, occur:

1. The fraternity of alcohol regulators across the country will become nothing more than the regulations-packing muscle for a consolidating middle tier of wholesalers that operates more and more like the Mafia Commissions of old—causing, in turn, distrust and disrespect by other members of the alcohol beverage industry whose actions the regulators are charged to oversee.

2. Promising and innovative producers of wine, beer and spirits that support local agriculture and industry will be stifled in their effort to market new products that consumers want.

3. States will lose the opportunity to collected substantial amounts of tax revenue as producers, retailers and consumers disregard laws on purchasing and shipping of alcohol that can’t be enforced and that serve only to prop up unneeded middlemen.

Happily, the reforms that are needed to bring alcohol sales and distribution out of the 1930’s and into the 21st century, that will continue to respect a cultural conviction that alcohol needs to be carefully regulated, that will respect the dynamic and entrepreneurial nature of the American economy, that defers to the modest demands that today’s consumer have with respect to product access and that appreciates the creation of a national market for goods are all well understood.

It only takes a collection of producers, retailers and consumers to demand the reforms be put in place.

ORIGINAL REASONSFOR REGULATION

Upon repeal of national prohibition, 50 states found it necessary to create a means for regulating alcohol within their borders. The passage of the 21st Amendment put that burden in the state's lap with section 2 of that amendment:

"The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

The primary goals that drove the creation of state-based alcohol regulations and a new regulatory framework in the 1930's post-Repeal era was to prevent the problems of the past that led Americans to embrace Prohibition as a drastic solution. Prior to Prohibition, the problems that were visited on communities and families by over-consumption were encouraged by any number of industry harmful practices. Excessive drinking and the conditions that encouraged excessive drinking primarily occurred inside the "Saloon".

In the Saloon, patrons were able and encouraged to drink to excess. This encouragement primarily resulted from "Tied Houses". The Tied-House system was one in which the saloon owner was not independent, but rather dependent upon or even working on behalf of a single alcohol producers that generally were beer producers. The brewer often provided the saloon with the means and tools necessary to open and operate such an establishment. Competition among producers led to the saloon being the place where free beer was provided, free goods were given away, and gambling and prostitution were provided. Saloons often stayed open night and day. Alcohol consumption increased drastically, and with it the harm that comes with over consumption. The problems associated with the saloon culture, buttressed by the Tied House System, were a key driver behind the call for Prohibition.

When Prohibition ended in 1933, nearly every state sought to achieve the same results as they structured a new system to regulate the now legal sale, distribution and consumption of alcohol:

1. Prevent the creation of conditions (Tied-Houses) that promoted over consumption

2. Prevent producer domination and control over retail outlets.

3. Assure unadulterated products did not infest the marketplace.

4. Assure the collection of tax revenue on the sale of alcohol.

5. Use alcohol to promote local production of alcohol and benefit the state economy.

In nearly every state, the Three Tier System, by which producer must sell to wholesalers who in turn are responsible for selling to retailers and restaurants, was part of the mechanism by which states sought achieve the above goals in the 1930s.

Today, these goals are usually expressed in terms of temperance, tax collection and an orderly market. Most recently the Illinois Liquor Control Commission, in denying Anheuser Busch the opportunity to distribute its own product directly to Illinois retailers, laid out what it's own "Three Tier System" of alcohol regulation was mean to achieve:

"IT ISHEREBY DECLARED:
1.Preserving Illinois' three-tier distribution system of alcoholic liquor is a fundamental objective of the Liquor Control Act and the Illinois Legislature for reasons of public policy.

2. The threeTier distribution system supports state interests in liquor tax collection, the maintenance of an orderly market, and the protection of the public against unsafe alcoholic liquor.

3. The three-tier system further protects against vertical monopolies and economies of scale (ed.note: meaning Tied Houses and Producer domination of the market) that would lead to the introduction of cheap alcoholic liquor into the marketplace. In this way, the three-tier system promotes temperance and assists in the control and limitation of the irresponsible consumption of liquor as required by the Liquor Control Act.

It is legitimate to ask whether the above goals are still legitimate or if they are instead goals that don't address the reality of alcohol in today's society. It is also legitimate to ask if the three tier system, created and implemented nearly 80 years ago, is capable of achieving, or even the proper vehicle for achieving, goals of alcohol regulation today when the economic and cultural circumstance in no way resemble those of the 1930s when the Three Tier Systems was created and put in place.

A DIFFERENTWORLD
The only way to evaluate the effectiveness of the Three-tier system is to

understand the world that existed when it was introduced in the 1930s.

First, consider wine. In 1934 Yale University professor Yandell Henderson testified before congress on the differences between types of alcohol. Of wine in the United States he said:

"We are not a wine-drinking people nor likely to acquire a taste for wine within any brief period…Wine is, and will probably continue to be, drunk so little that it may almost be omitted from consideration."

The professor was correct. At the time of Repeal when the three-tier system was created, American did not drink wine. They drank beer and spirits. At the time of repeal, fewer than 100 wineries remained in operation. Even in 1986 California had no more than 713 bonded wineries. At Prohibitions end, California's vineyards were primarily planted with inferior grapes meant to be able to withstand long trips in freight cars to supply home winemakers outside California. For more than 35 years after the end of Prohibition, wine was primarily drunk in its fortified form and had its reputation as a beverage of moderation and a dinnertime beverage upended by its use as an intoxicant that began during Prohibition and continued well past Repeal.

Consider Logistics. In 1933 there was no FedEx, no UPS, no overnight shipment of goods. Shipment of goods was done primarily by rail. Refrigerated rail cars were uncommon. The logistics infrastructure for wine country tourism where consumers could be introduced to different brands did not exist and would not emerge for decades.

Consider Communications. In 1933 there was no such thing as instant access to information. People got their information primarily from local radio and local publications. The Sears catalog was the primary means of communicating to Americans the commercial possibilities that existed across the country. The telephone was in relatively few American homes.

Consider the marketing of wine. For years after prohibition, very few American wine brands were known to all Americans. A general lack of interest in wine prevented the establishment of brands of national note. Small wineries located in California, New York and the Midwest served only a small local clientele. Simply put, there was no market other than a local one for small artisan wine brands Finally, for many years alcohol wholesalers outnumbered wineries. In 1970 there were 500 wineries in the U.S. versus 5000 wholesalers.

These were the circumstances that existed when today's alcohol regulatory system was put in place in the 1930s. There was no thought of America as a wine drinking nation. There was no consideration given to the idea of instant communications, easy cross country shipping or 1000s of national wine, beer and spirit brands when the three-tier system was created. The minds of the founders of the three-tier system were infected by the experience of the pre-Prohibition Tied House, abusive and irresponsible marketing and the kind of over consumption that recommended an end to drinking itself. There was no a person alive in 1933 that could have imagined in their wildest dreams what the American consumer, American marketplace, logistics or technology could become. How is it possible that a system of alcohol regulation, sales and distribution created in 1933 could possibly accommodate circumstances in 2010?

TODAY'S WORLD

The biggest mistake made by supporters of the Three-Tier System today is believing and disseminating the lie that this system of alcohol distribution is in any way responsible for today's diversity of wine, beer and spirit brands. The fact is, technological innovation, a highly efficient logistical infrastructure, an American consumer with more leisure time looking for artisan products, and the communications revolution have all led to the development of a culture that prizes unique and personal products. The diversity of wines, beers and spirits in the American marketplace exists in spite of the Three Tier System. In fact, the three-tier system is a remarkably inferior method of meeting the needs of today's consumers that are seeking unique alcohol products.

Consider the world of Wine today, compared to wine in the 1930s. Today there are over 6,000 wineries in the United States with producers in every state. This increase in domestic brands has been driven by a huge increase in consumer interest in wine and particularly consumer interest in small artisan brands. At the same time, the number of imported wines has also increased. Unlike in the 1930s when wines from France, Italy and German accounted for nearly all imported wine, today we have wines from numerous countries across the globe.

At the same time, wine country tourism has exploded making places like Napa Valley, Sonoma County, Santa Barbara, Paso Robles, the Finger Lakes, Walla Walla in Washington, the Willamette Valley in Oregon, the wine trail in Michigan, the Texas Hill Country and numerous other locations across the country the destination for millions of visitors every year that want to visit small wineries and enjoy the wine country lifestyle. Increasingly, these visitors want to vicariously return to their wine country destination via the regular consumption of the wines they discovered while in these regions.

While wine and artisan alcohol products have exploded in the consciousness of Americans, so too has our ability to learn about them. Instant communication via the Internet means anyone anywhere in the country now has access to any information they need about any wine or wine region from anywhere in the world. And Americans are hearing about more and more wines and artisan alcohol products all the time via Social networking sites, wine blogs, online wine information forums and bulletin boards, as well as the proliferation of video and audio-based information distributed on the internet.

It turns out also that the development of a highly efficient logistics infrastructure allows Americans everywhere to be able to order and have delivered to them overnight even the most obscure wine and artisan alcohol products. UPS and FedEx as well as other carriers make use of a hugely expanded fleet of air, rail and motor transport possibilities so that no product is out of reach of any American.

However, none of these circumstances were ever imagined by those who designed the three-tier system in the 1930s. So it should be no surprise that a three-tier system of alcohol distribution built for a society and industry of the 1930s not only can't work well in 2010 but also is actually responsible for thwarting commerce in 2010. The three-tier system is the culprit that keeps thousands of brands of wine, beer and spirits off shelves across the country. More importantly, the entrenched nature of the three-tier system has created a powerful, vocal, effective and dangerous middle tier of wholesalers that has the power to assure that no substantial change is made to this system.

PROBLEMSTHAT OCCUR WHEN 1933 MEETS 2010

The three tier system generally requires that in order for a product to get into a state's market it must first, by law, be sold to a wholesaler licensed in that state. According to this system, retailers and restaurants may generally only purchase their inventory from wholesalers in that state. Consumers generally may only purchase wine and alcohol from their home state's retailers and restaurants, with some exceptions for direct shipment from out-of-state and in-state wineries. This entire system is kept in place by complex of state laws administered by state alcohol regulatory bodies also designed in the 1930s.

What happens when this kind of highly restrictive and archaic distribution system bumps up against the realities of a consuming class that has come to value diversity of products and has expectations of being able to access the literally hundreds of thousands of products that they are introduced to by virtue of instantaneous and unlimited communications?

1. Stifling Economic Success of Wine and Alcohol Producers Although through instant communications and the development of a efficient form of information distribution a winery can create an instant demand for its products across the country, that demand is often left unsupplied because the three tier system conspires against wineries being able to address the demand they create. If a winery in Oregon, for instance, has communicated with a restaurant and retailer in New York, each of which would like to buy ten cases of wine, the winery must first, by law, find a wholesaler willing to represent their brand in New York, buy those twenty cases of wine, then get them to the retailer and restaurant. But as many wineries have learned, getting any one of the increasingly small number of wholesalers in a given state to agree to represent them is extremely difficult. And there is no law that says wholesalers must take on brands that want to sell wine in a state.

As a result 1000s of domestic brands never make their way onto the shelves of different states' retailers and on to the wine lists of many states' restaurants. As a result, consumers don't have access to these products. A winery in Oregon promising a wholesaler in Texas that it could sell 25 cases of wine per year in that state if the wholesaler only bought and sold their wines is laughed at because wholesalers want nothing to do with managing brands that deliver so little revenue. But for the winery, selling those 25 cases per year in Texas might mean quite a lot. But they are out of luck. The three-tier system requires that this out-of-state winery only sell through a wholesaler.

This wasn't such a problem directly after repeal of Prohibition when the number of wineries in the U.S. was small and wholesalers quite numerous and there was little demand for artisan products. But times have changed.

In the past, when confronted with the claim that small wineries are being shut out of states, wholesalers have said they'll take on any winery that wants representation. This was a mere rhetorical devise used to deflect criticism of the system. Ask any number of wineries who want distribution in a number of states but can't get a wholesaler to take them on.

The result of the difficulty in wineries bringing product to market via the wholesaler controlled three-tier system has been to retard the economic growth of artisan wines in the United States, severely restrict retailers and restaurants from creating offerings that distinguish them from their competition by virtue of a different product mix, and to create a severe imbalance of brand penetration across the country. The state-mandate that producers and retailers/restaurants not be allowed to do business directly with one another, but instead must buy and sell via a middleman wholesaler, is the single greatest road block to creating a modern alcohol distribution system that serves social policy, consumers, the states and business.

2. Difficulty and Impossibility of Putting Producers
and Consumers Together It took millions of dollars, numerous lawsuits and a Supreme Court decision to finally open the eyes of state legislatures that direct to consumer sales of wine across state borders was not something to prevent for the purposes of protecting in-state commerce. Today 38 states allow some form of direct shipment from in-state and out-of-state wineries. However, in numerous states barriers have been erected to dissuade wineries from selling direct to consumers who want their wines.

Often times there are severe limitations on how much
a winery may sell to consumers. Some states only allow wineries of a certain size to sell wine direct to consumers. In some cases the cost of a license to sell direct into a state is extraordinarily high. And many states have made the necessary remittance of sales and excise taxes by direct shippers an extraordinarily complex process. As a result, though 83% of the American populace may legally have wine shipped to them, from a producer, only 31% of producers have obtained licenses to ship direct to any state. Some may suggest that this means that wineries really never were interested in shipping wine direct to consumers. shipping actually dissuade wineries from shipping it and, in the process, frustrate their wine-consuming citizens.

Shutting Off Real Access to the True Marketplace for
Wine in America. The most efficient way today for wine lovers to obtain the wines they want from among the hundreds of thousands of brand available in the United States is by
purchasing from retailers via the Internet.

While a wine lover in Texas may not have access to
the wines they want because wholesalers have not imported it into the state, the winery does not ship to that state or because the winery does ship but is sold out. However, the chances are good that somewhere in the United States there is a wine retailer who has that wine, is willing to make it available on their Internet site and is willing to ship it. However, today 36 states representing 73% of the U.S. population prohibit out-of-state retailers from shipping wine directly to residents in their state. This means that the vast majority of wines available in the American marketplace are not available to the vast majority of Americans.

When the three-tier system was put in place in the

1930s, this prohibition was not a problem. It was incredibly difficult to ship wine efficiently across the country, very little wine that set itself apart from any other fortified wine that was the norm was available, and even less was desired. This is decidedly not the case today. If Americans were able to purchase wines from retailers in other states and able to have it shipped directly to them, the true American market place for wine would for the first time be at the disposal of consumers.

In addition to frustrating consumers who have read about or been told about unique wines they cannot obtain locally, the prohibition on retailer to consumer shipping in most states has also had another important effect: small, independent, customer-oriented wine retailers who are perfectly situated and ready to serve an increasing population of consumers looking to access the kinds of wines the specialty retailer stocks, are economically disadvantaged by seeing a serious impediment erected between them and their potential customers.

One has to ask, what harm is done in allowing a consumer in, say, Maryland to buy wine from a retailer in New York? Harm done to local retailers certainly isn't the case. Would the Maryland wine lover really pay the expensive shipping charges and give up the pleasure of instant gratification if they could buy the specific wine they want at a local store. It's unlikely. Furthermore, by prohibiting the shipment of wine by out of state retailers to Marylanders, the state dismisses the possibility of receiving tax revenue that retailers have said they would happily pay to other states that allow them to ship. In other words, this prohibition amounts to a Lose-Lose-Lose proposition: Consumers lose, retailers lose and states lose.

DARKSIDE:POLITICAL CORRUPTION AND BLACK MARKETS

Besides stifling commerce, deterring entrepreneurial activity and hindering consumer access to the products they want, a 1930's era set of regulations has also led to other dark outcomes that the creation of the Three Tier System was actually supposed to prevent.

Wholesaler Control and Political Domination

Being in the middle of the three-tier system and being handed a mandate by the state that all alcohol sales flow through them, wholesalers have been given complete control over which products come into state and which products retailers and restaurants are able to buy in a given state. This places enormous gate-keeping power in the hands of the licensed wholesalers. Today, wholesalers have complete control over which products may be sold in their state. This would not be a problem if there were any significant competition among wholesalers. But there isn't any more.

When a state mandates that one sector of an industry, wholesalers, are in complete control of the flow of goods, the quickest way to turn that mandate into a working oligopoly and into enormous profits for the few is to severely reduce the number wholesalers competing against each other. This is exactly what has happened over time in nearly every state as a result of wholesaler consolidation accomplished through buyouts, bankruptcy and mergers.

In the vast majority of states no more than two or three wholesalers control the wine market. In Illinois it is Southern Wine and Spirits and Judge & Dolph. In Texas it is Glazers and Republic. In California it is Southern Wine & Spirits and Youngs Market. These oligopolies have resulted in the creation of billion dollar companies with primary and ultimate control over which wines are allowed into the state and putting all but the largest producers at their mercy, all the while accumulate enormous political power.

At the same time, wholesalers, because they are the only source of the product that retailers are allowed to put on their shelves, find themselves with the ability to coerce retailers and restaurants simply by not coming by to take a store's wholesale order if, by chance, that retailer or restaurant steps out of line on political issues, patronizes a new upstart wholesaler or doesn't buy enough of the particular wine the wholesaler believes they should be buying.

Critical to maintaining the wholesalers' privileged place in the three tier system is the maintenance of the system itself and the maintenance of the state mandate that all alcohol flow through the wholesalers before getting on the store shelves and on wine lists. They fight for and generally achieve this primarily goal through political pressure and lobbying in each and every state. And they are very good at it.

The wholesalers' political power has been obtained and maintained primarily through campaign contributions and the access to politicians those contributions purchase. Between 2000 and 2010, wholesalers have contributed more than $66 million dollars to state-political campaigns. At the state level, where laws are passed concerning alcohol distribution, wholesalers have purchased access into the law making process by virtue of having the kind of income to fund campaigns of nearly every state legislator. It's rare that a state politician not be given campaign contributions by wholesalers. The result of this political largess has been to see laws passed that grant the wholesaler amazing protections from competition and assurance that the three tier system is kept in place in a way that their privileged place is preserved.

Through their political influence wholesalers have arranged for winery-to-consumer shipping bills to be killed, diluted to the point of ineffectiveness and even repealed. They have been able to convince legislators to strip consumers of long held rights to buy wine from out of state retailers. They have been able to pass “Franchise Laws” that make it impossible for wineries to change wholesalers if they are not satisfied with the work they do. And they have been able to prevent all but the smallest wineries from being able to self distribute their own wines in most states.

In one instance in Michigan, wholesalers were able to write a bill prohibiting all retailers in and outside the state from shipping wine direct to Michiganders, get the director of the state’s liquor control commission to endorse it, find a legislator to introduce it and ram it through a legislative committee without any notice to any other parties and do all this in literally a few days. It was the height of corruption political payback and yet no legislator blinked an eye. The political power of Michigan’s wholesalers was complete. There was no protection of consumers even considered. This kind of political power is not unusual. In fact it is the norm in most states.

Among the chief concerns of those who designed the new alcohol regulatory structures after repeal of Prohibition and put in place the three-tier system of alcohol distribution was that political corruption be absent from the control and regulatory agencies that would administer the new laws and that no single entity could exert undue influence over other players in the alcohol industry. There was considerable concern that the corruption that defined the Prohibition era and pre-Prohibition era not infect the new regulatory structure. Today, we see the structures put in place to achieve this are completely controlled by one element of the three-tier system: wholesalers. There is very little difference between the power held by the producers before Prohibition that allowed them to control tavern owners and retailers through Tied House abuses and the power held by the wholesalers today that allow them to control what producers do and how retailers operate. The only difference is that today, wholesalers have control also of what happens in their state houses where laws concerning alcohol sales and distribution are written.
The only way to dilute this kind of dangerous and corrupting power is to do what happened in the 1930s: Restructure and reform.

Forcing the Creation of a Black Market in Fine Wine
The surest way to encourage the creation of a black market in any given product is to prohibit businesses from supplying a demand that exists for legitimate and legal goods. This is what has happened in the arena of fine wine by virtue of allowing little or no reform to the three tier system in over 70 years—even

in the face of monumental changes in the American wine market and demand for fine wine across the country. It should be no surprise that a thriving black market that goes around government rules and regulations has emerged. Because of the limiting nature of the three-tier system and its archaic rules, the vast majority of the hundreds of thousands of wines available in the entire American marketplace are always unavailable to local retailers. However, with the communications and media resources available to wine lovers, knowledge of the products that are available to consumers elsewhere is well known. While one wine may not be distributed in State X and therefore is not available on the retail shelves there, the same wine is available in State Y. Consumers know this after only searching the Internet for a minute or two. Consumers in State X see that the wine they want is available in State Y and that retailers are selling it at their website.

Yet, in most cases it is illegal for consumers to purchase the wine from that out-of-state retail stores and have the wines shipped to them. Still, today's educated, well-informed, Internet-connected wine lovers want these wines they see available in other states but not in their own.

Even in those states where wineries may ship, but retailers may not, it is often the case that wineries are sold out of desirable wines. But, these wines can often be found at retail stores in other states or at auction houses. So, consumers could buy the wines they want…if only it was legal to have them shipped into their state from an out of state retailer.

Where imported wines are concerned, the situation is worse because there is no winery from which they can try to buy it and importers of foreign are near universally prohibited from shipping across state lines. The only place consumers can find the imported wines they want is from a local retailer. But if that imported wine isn't available locally, they can usually find it at the website of a retailer in another state. But only 13 states allow out of state retailers to ship to their residents. The consumer is out of luck.

While this dilemma exists for wine loving consumers, it is also a dilemma for wine stores who want to serve these consumers but may not because laws in so many states prohibit direct to consumer shipping from retailers. Retailers look around the various states and see enormous demand that goes unsupplied.

One thing is certain: the reasons given for preventing consumers from being able to have wine shipped to them from out-of-state retailers—the danger of minors using direct sales to obtain wine, problems getting retailers to pay state taxes on the wines they ship into states, and competition for in-state retailers—are bogus and have been proven to be bogus. What's worse, consumers and retailers alike understand that when these arguments are made, usually by wholesalers and the politicians they helped get elected with campaign contributions, they are being made not out of a real concern, but rather as a way to protect themselves from competition. This kind of politics leads to consumers and retailers losing all respect for the regulatory framework and eventually ignoring the law altogether. And so, a black market is created.

Although it is against the law, consumers find that many retailers will ship into their states nonetheless because the retailers lose respect for laws that serve no purpose other than to protect the politically connected. Although it is often against the law for consumers to buy wine in one state and drive it across the border into their own, they do so regularly because they have no respect for laws that serve only to protect the politically connected. This black market exists today and will continue to flourish as long state laws prohibit simple and safe and regulated direct shipment, be it from wineries or retailers.

What's unfortunate is that it turns out both retailers and wineries would happily pay a state's sales and excise tax for the right to ship directly to consumers in those states. By allowing this, rather than prohibiting it for the protection of local wholesalers and retailers, the state forgoes significant amounts of tax revenue. At the same time, the state creates prohibitions it can't possibly enforce and makes criminals out of its citizens and vendors who would all much prefer to live within the limits of a law that fairly regulated the sale of a beverage that is entirely legal to possess.

It's important to note that the prohibitions on direct sales and shipping by retailers, and on wineries in some states, is not directed against an illegal product like marijuana or cocaine. We are talking about a legal product here: wine.

The only way to stop and overcome this black market and to give consumers what they want, allow the market in wine to operate efficiently and allow states to collect much needed tax revenue is to do what happened in the 1930s: Restructure and reform.

FIXING ABROKEN SYSTEM

It should be no surprise to anyone that a system of alcohol distribution and sales conceived in the 1930s before overnight carriers existed, before the Internet existed, and before a wine culture existed is not functioning 75 years later to serve consumers, the industry or the state. Nor should it be a surprise that a legally mandated system that grants middlemen near total control over market access for products has morphed into a system that also protects these same middlemen from competition.

The question is how to fix the system so that its original goals are achieved while also taking account of enormous changes to our society, culture, and economy? There is a way.

Again, the original goals that motivated those who designed the post-Prohibition alcohol regulatory structures in the 1930s included:

1. Prevent the creation of conditions (Tied-Houses) that promoted over consumption.

2. Prevent producer domination and control over retail outlets.

3. Assure unadulterated products did not infest the marketplace.

4. Assure the collection of tax revenue on the sale of alcohol.

5. Use alcohol to promote local production of alcohol and benefit the state economy.

Today, these goals tend to be expressed by noting that the three-tier system provides for the encouragement of temperance, tax collection and an "orderly market". These remain legitimate goals today (The exception is promoting local production of alcohol if it leads to discrimination of out of state commercial interests). Yet, not listed here is another important goal: support for market conditions that do not discourage entrepreneurial activity or consumer access to legal products.

The primary condition that does the most today to discourage entrepreneurial activity and consumer access to alcohol products is the legal mandate that exists in most states that all alcohol flow through a state-licensed wholesaler before arriving on retail shelves and in restaurants. Today in most states, alcohol must be "imported" into a state by middlemen, and then sold to retailers and restaurants. As a result, you have the following conditions in place.

1. While producers are required to sell their products to a wholesaler in order to enter a state's market, wholesalers are not required to import the goods of any producer that wants to enter a state's market. This allows wholesaler to control consumers' access to a product, often denying them that access even if they desire it: This amounts to a highly inefficient marketplace and ignores demand.

2. Retailers and restaurateurs in a state are unable to distinguish their product offering from their competitors, a primary tool in marketing and a primary way to address the total market for any particular product category.

3. Wholesalers, because they control access to the goods alcohol retailers need to conduct business, control the retailer's destiny. Wholesalers can put any retailer at a disadvantage by simply not taking their orders in a timely manner or choosing not to sell them the products they want.

4. Because wholesalers are granted complete control over the wines that are imported into a state's market, they have control over all but the most popular producers, allowing them to charge outrageous prices for their distribution services. Today, for example, it is common for wholesalers to demand at least 50% off the retail price when they purchase goods from suppliers.

5. Because most states prohibit consumers from purchasing and having shipped to them wine from out-of-state retailers and instead force them to only buy products that wholesalers in the state have chosen to import and deliver to local retail shelves, consumers are legally forbidden from obtaining the products they want without breaking the law. This is a particular problem when consumers can easily use the Internet to find an out-of-state retailer that sells the product they want. Consumers and retailers, knowing the prohibition on sales and shipping is merely in place to for illegitimate protectionist reasons, are less likely to respect the laws and engage in black market sales and purchasing.

In order to address these particular problems and bring the sale and distribution of alcohol into the 21st century where it can flourish under controlled and regulated conditions, every State needs to immediately undertake the following reforms:

Reform #1:Allow Producers and Importers to Self Distribute Their Products Across State Lines

No other single reform of the alcohol distribution system and its regulatory structure would do more to prevent the problems that have arisen under the current system where states require products to be sold to a wholesaler middleman before making their way to retail shelves.

How It Would Work: Producers and importers that desire to self distribute their products to retailers and restaurants outside their home state would be required to register and obtain a permit from the states into which they want to sell their products. By holding such permits they would agree to submit themselves to the legal and regulatory jurisdiction of that state. They would be required to show state authorities their federal permit as well as their home state permits before obtaining a license or permit to self distribute in a given state. They would be required to report to the states the businesses to which they self distribute the wines in a given period. They would be required to remit excise and other appropriate taxes or fees to the state into which they self distribute their products. If Price Posting is a requirement in the state into which they want to self distribute, then this too would be a requirement. Producers and Importers would also have to show all federal label approvals for the products they wantto self distribute into a state. Finally, retailers would be required to report to their states all products they procure via self-distribution from producers and importers.

Achieving Goals: Since “tied house laws” prohibiting producer ownership of and producer influence over retailers and restaurants would still be in place, there would be no more fear of producer domination with self distribution than there is under state-mandated wholesaler distribution. In addition, nothing about self-distribution suggests consumers would be induced to drink more alcohol. Taxes would be remitted to the state assuring no tax revenue concerns. Since reporting by producers and retailers would be in place, adulterated products that show up in the marketplace could be traced back to their source quickly.

The Results of Reform: The primary result of allowing wineries and importers to forego the use of wholesalers and self distribute their own wines in different states would be to finally give suppliers fair access to all markets where there is a demand for their wines or where they’d like to create a demand for their wines. Without wholesalers playing the legally mandated gatekeeper role for which products are able to be sold in states, a true market for wine products will be created. Self-Distribution rights for suppliers would also remove the enormous market corrupting power wholesalers wield in nearly every state. Retailers would finally be given the chance to stock their shelves with all the different products they think their consumers desire, while producers and importers could discover and build an authentic set of markets for their products rather than be at the mercy of a small set of wholesalers who can’t and never could see the true market for these products.

Some will argue that by allowing producers and importers cut wholesalers out of their supply chain we will see jobs lost in the wholesale sector of the market. Wholesaler jobs will likely be lost. However, Wholesalers will remain the primary vehicle for distributing goods in any given state. The example of California, where wineries and importers may self distribute and where the wholesale tier remains strong bears out this claim.

In the end, providing wineries, importers and
retailers with the self distribution option allows for the long term and contemporary goals of the alcohol regulatory system to be met while modern technological, logistical and market conditions are accounted for also.

Reform #2:Allow Wineries, Importers and Retailers to Ship Direct To Consumers AcrossState Lines

Allowing Wineries, Importers and particularly
retailers to sell and ship wine directly to consumers across state lines is the only way to structure the alcohol regulatory system to take account of changes that have happened in the wine market in the past 75 years.

How It Would Work: Wineries, importers and retailers who want to sell and ship wine directly to consumers would apply and pay for an annual permit to ship direct to consumers in those states where it wants to ship its products and inventory directly to consumers. Shippers would submit to the regulatory and legal jurisdiction of the states into which they have a permit to ship. Licensed shippers would submit to state authorities regular reports on what and how much they shipped into the state. Shippers would pay to the state all appropriate taxes and fees. All shipments directly to consumers would be come in a box that is marked as containing alcohol and requiring an adult signature. All shippers would be required to contract with their delivery agents to obtain an adult signature before delivering the wine.

Achieving Goals: Twenty years experience of limited direct shipping by wineries has demonstrated that delivery safeguards as well as the habits of minors make it highly unlikely that the direct shipping channel will be used by minors to obtain alcohol. Because states can require that taxes be paid, the states will see increased tax revenue. Reporting to the states by shippers will assure regulators will be able to create an orderly market that is regulated. Because this transaction is between shipper and consumer, there is no risk of producers or retailers or importers dominating or having undue influence over any other sector of the Industry. Consumers could easily identify the source of any suspect or adulterated products since they would know exactly from whom they procured the wine.

The Results of Reform:
The primary result of this reform would be to allow the now very large population of wine lovers to access the products they want, something they cannot do in most states either because direct shipment from all sources is prohibited or because direct shipment from retailers and importers is

prohibited. Until a rational and non-protectionist argument can be made that consumers ought not be able to access the legal products they want, this issue of consumer access to products should to be paramount.

States would realize significant additional tax
revenue on the purchase of products that until this reform is enacted would be desired and either obtained via the black market or not obtained at all. This reform would also eliminate the black market. Retailers and producers and importers all have demonstrated that when given the opportunity they happily adhere to laws and regulations that allow them to fulfill legitimate demand. There is no reason to believe they won't do so when direct shipping laws for retailers and wineries into place in more states.

By allowing direct shipping entrepreneurship would be
encouraged. Wineries and importers in all states would be given a new sales channel by which to support their aspirations to build a profitable business that creates more jobs. Retailers would be given the opportunity to be the supplier for wine lovers who cannot find the products they want locally in stores or via direct shipment from wineries and importers. This new sales channel for retailers will go a long way toward addressing pent up demand for products that local stores choose not to sell or are not even made available by wholesalers.

Finally, allowing direct shipment is the only way to
address a demand for artisan wines that has exploded over the past 20 years. With more than 6000 wineries in the United States and many more outside who import into the country, with an efficient means of communications and information distribution that makes these wines known to wine lovers across the country, and with a logistics infrastructure that allows the quick and safe delivery of goods, the now huge population of wine lovers can be supplied. These changes in technology and the marketplace are the primary differences between the commercial markets for alcohol today versus seventy-five years ago when the regulatory framework was put in place.

THECONSEQUENCES OF IGNORING REFORM OF THE ALCOHOL SALES AND DISTRIBUTION SYSTEM

There is no reason to believe that the upward arc of
discovery and desire that has defined Americans' relationship to artisan alcohol products will be deflated anytime soon. In fact, every year we see more and more interest in wine, more ways to enjoy it, more wine regions attracting visitor and more craft brewers and artisan producers of wine and spirits emerging to address this increasing interest among consumers in artisan alcohol products. If the current restrictive and archaic distribution system remains unreformed, many businesses will fail, consumers and members of the industry

will revert to using a black market approach to wine and courts will be clogged as the different interests in alcohol distribution use the judicial system to get around the political power wholesalers possess in states where change needs to be made.

It is important to note also that without a move to reform and re-regulate the three tier system to account for a modern economy and technology, it is not unlikely that wholesalers will use their power to actually make the three tier system even less friendly to consumers, producers and retailers. Already, beer wholesalers who see the tide rising against the archaic system they are at the center of are asking congress to enact laws that will make the three-tier system nearly impossible to challenge. They will be asking their allies in congress to protect discriminatory state laws from court challenges. They will work to end the gains that have been made in direct shipping. And they will ask congress to exempt the three tier system and alcohol regulations from anti-trust claims. To-date, it has only been court challenges that have served to weaken the three-tier system even a little.

Finally, it is clear that the largest wholesalers are looking to consolidate their tier even further, reducing the number of wholesalers in each state and making the largest even more powerful. As this occurs, new small wineries, craft brewers and artisan spirit producers will find it increasingly difficult to find wholesaler representation in different states. And if they do find representation it will be on terms that are dictated by the all-powerful wholesalers. This will dissuade entrepreneurs from entering the business.

Finally, consumer will be impacted the most and most frustrated. If reform and reregulation is not undertaken, if retailers, for example are not allowed to supply demand via direct shipment and if producers and importers are not allowed to market and sell their products across state lines, consumers will be relegated to looking in through the window as the products they discover on the Internet, via social networking and on their travels are off limits to them simply because wholesalers have the muscle to protect themselves from competition and the realities of a modern marketplace.

CONCLUSIONS: Regulatory Change is in the best interests of the marketplace, the state and consumers.

Clearly it is possible to continue to achieve the goals of a regulated marketplace for wine and other alcohol products while adapting through re-regulation to a world and an economy completely different from that when the current system for alcohol sales and distribution was created in the 1930s. Given the changes that technology, logistics, information systems and the evolution of the American consumer have wrought on nearly every other industry, it is hard to imagine why change has not come to the alcohol distribution industry.

Yet, imagination is not necessary in this case. The structure of the Three Tier System with states mandating wholesalers control what products will be allowed into a state and therefore what products consumers may buy has led to a true domination of the industry by politically connected wholesalers. That domination has largely put producers, importers, retailers and consumers at the mercy of wholesalers and distorted the nature of the alcohol beverage market. Most important to understand is that it is the nature of the three-tier system that has created this unbalanced, unhealthy and unfair situation.

Despite this perversion of the marketplace and despite the radical cultural, social, economic and commercial changes that have occurred since Repeal, the goals that drove the creation of the three-tier system continue to exist. The ambition today must be to continue to achieve these goals by finding new ways to regulate the sale and distribution of alcohol.

Success in re-regulating the sale and distribution of alcohol depends on taking into account current technology, current consumer demand and all the while keeping an eye on the goals of encouraging temperance and moderation, creating an orderly market and assuring the collection of taxes. Allowing self distribution across state lines by wineries and importers and allowing direct-to-consumer shipping by wineries, retailers and importers must be the goal of re-regulation if all sectors of the alcohol beverage industry and consumers are to be equally considered.

The kind of disruption these reforms would cause would primarily affect the wholesale tier of the industry. But given the near absolute control over the sale and distribution of alcohol that wholesalers have been able to obtain, it should be no surprise their numbers would be most affected by leveling the playing field for the rest of the industry and giving the new and growing group of wine lovers the chance to legally pursue their interest in artisan beverages.

While the solutions outlined here are well known to the industry, there is no central organization working to achieve them. The reason for this is, again, the three-tier system. In order for such changes to be made, general consensus among wineries, retailers, importers and consumers would be necessary. Unfortunately, when change has been attempted, the weight of the opposition to change, namely wholesalers, has been so great as to cause discouragement as well as the expenditure of millions of dollars. And even after this, the change that has occurred, primarily in the area of direct shipping, has been hampered by regulations created at the wholesalers' request that has actually deterred wineries and retailers from undertaking any new privilege to ship direct.

Fear also plays a role in preventing a real movement for change from occurring. Privately many retailers and wineries admit that they will not stand up for the kind of change that is needed for fear of retaliation by the one group that has the power to significantly disrupt their business if they speak out: wholesalers.

Wine lovers too have watch the spectacle of overwhelming consumer support for allowing direct shipping be ignored as politicians who, funded by wholesalers with enormous campaign contributions, vote against even modest direct shipping proposals. Consumers have gotten excited about the introduction of a bill to allow them to buy from out of state retailers and wineries, only to see that bill diluted to exclude retailers from the privilege. And they have seen wholesalers, local retailers and politicians make absurd and counter-intuitive arguments about protecting minors as the reason why they should not have the right to purchase rare and hard to find wines.

All this disappoints and discourages not only industry supporters of the kind of change outlined here, but consumers too.

Still, if any real and productive change is going to come to the business of selling and distributing alcohol, the case for that change and a path toward change must be explored, rationalized and laid out. All of the above is meant to make that case.