



## February 2020 Newsletter

### Direct shipment of wine is not a good test for all alcohol products? By Pamela Erickson

Although the 21st Amendment was created to allow each state to craft its own regulations for alcohol, there has been an effort to make uniform wine shipping laws. In the last few months, a lot of energy has gone into proposing a "uniform law" for direct shipment of wine from wineries to out-of-state customers. It is designed to deal with problems of non-compliance and enforcement. Some may hope that it will spur the development of similar "uniform laws" for other alcohol products and allow retailers to ship out of state. But, a "uniform law" that allows direct shipment of wine from wineries will not guarantee that direct shipment, in general, is safe and effective for other alcohol products. The danger is that public officials may be lulled into thinking that if it works for wine, it should work for any other form of alcohol sold by any type of licensee.

**(Note:** Currently, the National Conference of Commissioners on Uniform State Laws is drafting a proposed uniform law called "Registration and Licensing of Direct-to-consumer Sales of Wine and the Prevention of Illegal Sales Act." The "uniform law" would be offered to states for consideration, but they are not obligated to adopt it.)

All but 5 states allow some kind of direct shipment of wine by wineries. Complaints about wine shipping have been sporadic primarily due to a lack of state compliance efforts. Many states adopted new laws allowing wineries to ship their products, but no new resources were provided for enforcement. As a result, compliance resources remained focused on traditional licensees where the state has clear jurisdiction. Very



recently, a few states, such as Michigan and Illinois, have started doing checks and found a high level of non-compliance, especially from unlicensed retailers.

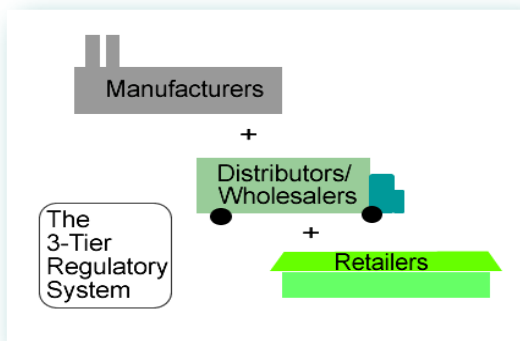
Some of the main concerns about direct shipping involve preventing sales to minors, tax evasion, counterfeit/tainted products and the difficulty and cost of enforcement. Here are some important points:

**1. The system involving direct shipment of only wine by wineries is not a fair test of alcohol direct shipment safety for youth because underage kids typically don't drink traditional wine.** Thus, the reason wine shipment might be viewed as safe for them may be that youth simply don't buy wine products. However, the definition of wine continues to evolve with new products that may be more appealing to kids than traditional merlots or chardonnays. A study by Michael Siegel, et al, found that "Beer and spirits were the alcohol of choice among youth; 68.9% said they drank beer and 68.7% reported to have drunk spirits. These were followed by flavored alcoholic beverages (49.9%) and wine (31.6%)." Kids drink more on a single occasion than adults as they are not connoisseurs, but interested in the intoxicating effects.

**2. Youth are price sensitive and tend towards instant gratification.** For youth, wine which is shipped directly from out of state to homes is pricey and may not be immediate. According to an annual report on direct shipping, the average bottle price for direct shipment of wine in 2019 was \$40.70 and in some states, delivery will take several days. Not only are underage youth not traditionally connoisseurs of fine wine, but they are more price sensitive than adults. So, these were past reasons kids have not ordered wine from the internet. However, the delivery model is changing to immediate gratification and may challenge these assumptions. Every kid seems to have access to an iPhone these days. Moreover, if cheaper beer and spirits were available for order and delivery, it seems likely that youth would make use of that

service. It would be fairly easy to use fake ID or have an older youth sign for the product if the shipper actually asks for an adult signature. And, recent information suggests that many times the package is merely left at the door with no signature obtained.

**3. Direct shipment does not have the same safeguards as the three-tiered system in terms of preventing counterfeit/tainted products and avoiding tax evasion.** The three-tier system--designed for the sale of all alcohol products-- has major benefits. It is a closed system of product sale whereby a licensed manufacturer can only sell to a licensed distributor/wholesaler who can only sell to a licensed retailer.



This system prevents the entrance of illegally sourced products to the market and; thus, stops the trafficking of products that are unsafe or counterfeit. Since the wholesaler must track each bottle and can, recalls are amazingly swift in pulling products before harm is done. Other countries experience deaths and injuries from tainted alcohol. A few years ago, over 30 people died in the Czech Republic from a tainted spirits product that came on the market and the government had no effective way to easily locate it and pull it from the store shelves other than shutting down the entire industry. In the US, the wholesaler collects the excise tax which results in almost 100% tax collections. Other countries such as the United Kingdom lose as much as 1/3 of the potential tax revenue due to a lack of a closed system. By allowing sale outside this system, we are vulnerable to problems of tainted/counterfeit product and tax evasion.

**4. Enforcement is costly and difficult.** States have failed to provide funds for enforcement which has resulted in little effort to check compliance. Those few instances where compliance was checked found widespread non-compliance. For example, investigations have revealed that shippers have failed to check ID, left

alcohol at the door without the required signature, and taxes were not collected. And a number of shipments involved those not licensed to do so such as retailers or wineries without shipping licenses. The Illinois Liquor Control Commission issued over 100 cease-and-desist letters to retailers, wineries and fulfillment centers in 2015. A study done by researchers at the University of North Carolina concluded that "age verification procedures used by Internet alcohol vendors do not adequately prevent online sales to minors."

There is some indication that states are increasing their efforts to enforce winery delivery requirements. Texas became the first state to do a complete audit of all 1,600 direct wine shipper licensees. Texas already requires extensive quarterly or monthly reporting. They announced in July of 2019 that the audit would begin in September. It involves, at least, 6 auditors and will take several months. A few other states have also launched enforcement efforts.

However, once violations are found, then what? It is close to impossible to enforce state regulations on an out-of-state entity. You could suspend or revoke a license, but the entity could just ship illegally as some do now or just ship to all the other states. Since the product goes to a residence, how would the regulatory agency even find out about it? Many states license the winery and the shipper separately. Since the shipper performs tasks within the state, sanctions on them may be more effective. The shipper, in turn, would require compliance from shipping customers.

States would be wise to look at other solutions that don't require development of a secondary "direct delivery" system that is costly and doesn't provide the protections of the three-tiered system. For example, Utah is considering a process whereby you can order via the internet and pick up the products at a nearby liquor store. Some new delivery services also work through a local company. This way, products go through a licensed retailer instead of going outside of the three-tier system. Consumers have the ability to obtain products from out-of-state without the state having to permit a system that presents substantial enforcement risks.

**5. Can states afford to operate a secondary system of direct delivery that represents a sizeable part of the market?** There is evidence that larger wineries and retailers are increasingly interested in using this sales channel. Some have interpreted the recent decision by the Supreme Court in the Tennessee wine

case as opening the door for retailers to ship directly to consumers. Direct shipment by small wineries was not envisioned as an alternative for all licensees. Instead, it was originally crafted at the behest of very small wineries that claimed they had great difficulty getting their product to market. It was viewed as an exception to the rules to help small operators get to the point where they would be able to use a distributor. However, today's arguments are different because large producers and retailers also want to ship direct to homes.

States need time to investigate their direct delivery experiences and create solutions. They may want to consider some interim measures such as allowing on-line ordering with shipment to a nearby store. They may want to work with local retailers many of which have special order provisions. Over the years, we have evolved a very safe, state-based regulatory system that has the ability to adapt to changing conditions. We should continue to work within that system to see if we can safely get the products to legal consumers that want them.

**Designing a large secondary system of direct delivery increases the risk to public safety, creates greater access for youth, involves non-payment of taxes and increases the potential for counterfeit activity. We can do better than that.**

#### Sources:

1. "Illinois sends over 100 cease and desist letters," by Jeff Carroll, VP of Compliance, ShipCompliant, February 2, 2015, <http://www.dramshopexpert.com/compliance-issues-with-direct-shipment-of-alcohol-to-customers/>
2. "Wine Direct Shipping Research and Analysis," November 2015, A report prepared for the Michigan Beer & Wine Wholesalers Association by The Hill Group, Inc., a management consulting firm based in Carnegie, Pennsylvania.
3. "Internet Alcohol Sales to Minors," by Rebecca S. Williams and Kurt M. Ribisl, September 2012, Arch Pediatr Adolesc Med. 2012;166(9):808813. doi:10.1001/archpediatrics.2012.265
4. Siegel, Michael, et al. "Brand-Specific Consumption of Alcohol Among Underage Youth in the United States," Alcoholism: Clinical and Experimental Research, 2013, 1-9. doi: 10.1111/acer.12084.
5. <https://www.cdc.gov/alcohol/fact-sheets/underage-drinking.htm>
6. <https://www.sovos.com/shipcompliant/resources/wine-dtc-report/>
7. "An Analysis of the Structure and Administration of State and Local Taxes Imposed on the Distribution and Sale of

Beer," Prepared for the National Beer Wholesalers Association, by Washington National Tax, KPMG LLP, Washington, DC, March 2009

8. Tobiassen, Robert, The "Fake Alcohol" Situation in the United States: The Impact of Culture, Market Economics, and the Current Regulatory System, available at <http://www.centerforalcoholpolicy.org>

9. Beverage- and Brand-Specific Binge Alcohol Consumption among Underage Youth in the U.S, Timothy S. Naimi, M.D., M.P.H., Associate Professor,<sup>1,2</sup> Michael Siegel, M.D., M.P.H., Professor,<sup>1</sup> William DeJong, Ph.D., Professor,<sup>1</sup> Catherine O'Doherty, M.P.H., Student,<sup>1</sup> and David Jernigan, Ph.D., Associate Professor<sup>3</sup> Published online 2014 May 30. doi: 10.3109/14659891.2014.920054

10. Tennessee Wine and Spirits Retailers Assn. v. Russell F. Thomas, Executive Director of the Tennessee Alcoholic Beverage Commission, et al. Certiorari to the United States Court of Appeals for the Sixth Circuit No. 18-96. Argued January 16, 2019--Decided June 26, 2019.