

## PENNSYLVANIA SENATE LAW & JUSTICE COMMITTEE

Hearing of AUGUST 10, 2011

TESTIMONY OF MARK M. WILCOX

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When explaining his support for direct to consumer wine shipping, the Chief of Staff for one of the longtime members of this committee commented to me recently: “All the complaints I ever get about the LCB have to do with wine, not with spirits.” I’m sure that everyone on this committee has his or her own list of complaints from constituents about the LCB, and I will bet that if you think about your own list, the comment will ring true.

What is it about wine? I’d like to start with some remarks suggesting why wine is different, and why a broad rather than restrictive shipping bill is necessary if the legislature really hopes to reduce the great unhappiness that Pennsylvania’s liquor monopoly generates among wine lovers across the state.

**A growing and dynamic world wine market.** First, the wine world has changed enormously over the last generation. It has become a huge, dynamic, worldwide market, in which a government-run monopoly is simply not nimble enough to provide adequate service as its citizens’ sole source of wine.

If I may be permitted, a graphic illustration may help show the scope of the changes in the wine world over the past 30 years. Growing up in Wellsboro, in Tioga County, I developed my interest in wine along with my father, who collected not just wine, but books about it. Here’s a book called California Wine, which my father bought when it was published in 1973. At the end they were able to put all the California red wine producers on a chart covering two pages, and all the white wine producers on another chart the same size. There it is – the whole California wine industry in 1973. According to the Wine Institute, by 1993 there were 1,683 wineries in the United States, more than half of them in California. By 2010, the Wine Institute counted 7,626 wineries in the United States, of which more than 3,300 were outside California.

Change abroad has been just as dramatic. In 1987, Robert Parker published a Wine Buyer’s Guide with 3,000 wines described over 700 pages. By the third edition in 1993 he was up to 7,500 wines and 1150 pages. But that evolution only begins to suggest the variety that’s out there for wine lovers now. In Parker’s first edition, all of South America got two paragraphs; Australia, two pages. New Zealand and South Africa weren’t even mentioned. Now each of these countries has hundreds or thousands of well-made wines on the market.

I import wines from small, artisan producers in Europe, mostly in France. Here’s the 2010 Guide Hachette, covering France only. It rates 10,000 wines from 6500 producers, and these wines were culled from 35,000 blind tastings. In fact, while the United States is the fourth largest wine producer in the world, it represents only about 10% of the world’s production.

Of course, the State Stores now carry wines from all around the world, and the natural bureaucratic response is to say: “We get plenty of wines from everywhere, and we can get some more. How many different wines do you need?” But that misses the point entirely. Pennsylvania’s wine lovers don’t just want wine someone put in the State Store. They want wines they have discovered, or that friends or writers or online blogs have recommended. They want a particular vintage. They want mature wine whose provenance can be guaranteed. They want wine from a small vineyard or a shop they visited, or wine with a personal meaning to them.

In short, they want a level of personal freedom that nearly everyone else enjoys, but that has been absent in Pennsylvania for decades.

The reality is that in this huge and constantly changing market, Pennsylvania's LCB cannot hope to satisfy its citizens' needs as the sole source for wine. If it is wise, the legislature will not ask it to try. There is, of course, much discussion now about ending the Commonwealth's liquor monopoly entirely, and there are plenty of reasons not to have one. But if Pennsylvania keeps its State Stores, the right direct shipping law can offer its citizens much more freedom, and greatly reduce dissatisfaction with a continuing state monopoly.

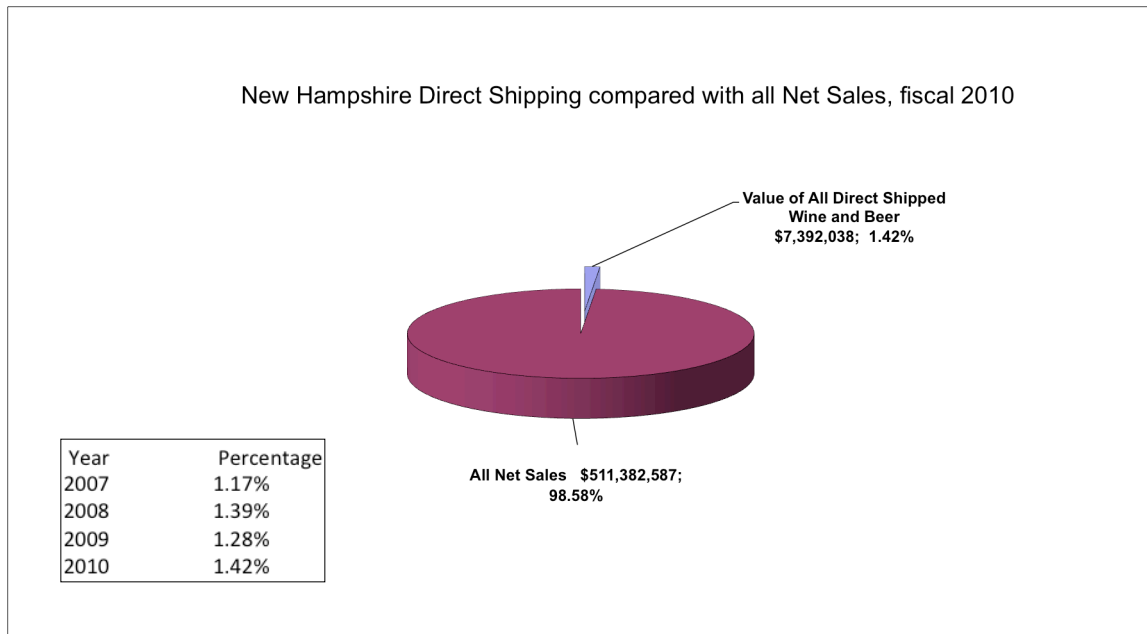
What kind of direct shipping bill? It's interesting -- ever since the Granholm decision in 2005, those who preferred the world before the decision have tried creative ways to limit its impact. Massachusetts passed a volume cap for shippers that just happened to cover all the in-state wineries, but very few from out of state. New Jersey closed to direct shipment entirely, but gave its wineries a pass for direct sales on the premises. Other states have tried other restrictions. But both Massachusetts' and New Jersey's restrictions have been declared unconstitutional by the First and Third Circuit Courts of Appeals, respectively; and other states' restrictions share the same constitutional defects.

Now, as the issue of direct shipping comes up again in Pennsylvania, we see another list of suggestions for restricting it. One proposal would confine shipping to wine producers only. Another would add an 18% tax on top of the sales tax. Another brings back the cap idea. And yet another would forbid shipment of any wine that the LCB has in its stores. Before commenting on the various proposals to limit direct shipping in one way or another, I want to make one overriding point: The Commonwealth has nothing to fear from a broad shipping bill -- one without any of these restrictions -- and New Hampshire's twelve years of experience proves it.

**The New Hampshire Experience.** Far from proving a threat to New Hampshire's State Store system and the revenue stream that comes from it, allowing direct to consumer shipment of wine there has proved a real boon. Let me describe the New Hampshire system briefly.

- In New Hampshire, as in Pennsylvania, the state buys and resells all wine and liquor. The state retails wine and liquor directly to its citizens, through State-owned stores. It wholesales to restaurants, hotels, and certain supermarkets. The only exception is what comes in through the Direct Shipper program.
- The program is a broad one. As for who may ship, New Hampshire law is the same as in S.B. 886 and the same as the bills pending in the House: it allows shipping by wineries, importers, retailers and wholesalers licensed in other states. New Hampshire collects an 8% fee on all such shipments.
- New Hampshire allows direct shipment of a wine whether or not the State also sells the wine. In fact, more than 150 producers whose wine the State sells are also registered as direct shippers. All the state requires of such producers is that if they ship more than 100 cases of a wine into the state, they offer to sell a comparable quantity to the state at wholesale prices.
- As with all the bills pending in Pennsylvania, New Hampshire direct shippers must use licensed carriers, must require an adult signature, and must clearly mark the packages to show they contain alcohol. They must report the wine they ship and they must allow audits.

What does New Hampshire's ten years of experience tell us? First – and maybe most importantly for those who see direct shipment as the beginning of the end in Pennsylvania – while the law gives its citizens significant flexibility, the volume of this business represents only a miniscule part of the total value of wine sold in the state: just over one percent. Here's a chart showing the amount of direct shipping in New Hampshire:



New Hampshire's experience also shows that a state can effectively regulate and collect tax on direct-to-consumer shipments. Finally, as has proven to be the case in dozens of states around the country, New Hampshire's experience shows that a properly regulated direct-to-consumer system does not increase the problem of access to alcohol by minors. In short, Pennsylvania should not worry about a broad shipping law. The state's revenue will go up, not down; and this will be the case without adding unconstitutional restrictions.

#### **Proposed limitations on Direct Shipment.**

**“Producers only.”** Now I will address some of the proposed restrictions on direct shipping. First, the proposal that only producers can ship direct. While that is not part of the LCB's recommendation -- their recommended shipping rules would apply to all out of state wine – it is a part of S.B. 790, and it is a restriction that local retailers have pushed in other states, sometimes successfully.

This proposal deeply undermines the consumer benefits that directing shipping bills are supposed to provide. Because wine produced abroad is always sold in the US by someone other than the producer, this restriction would completely eliminate all imported wine from direct shipment. All ten thousand of the wines in the Guide Hachette, all the wines I and others discover and import from small artisan producers in France, Italy, and Germany – all of that would be eliminated, as would all the wine from Chile, Argentina, Australia, New Zealand, and South Africa. In fact, ninety percent of the world's wine is cut out with such a limitation, though the idea is supposed to be to enhance consumers' personal choice.

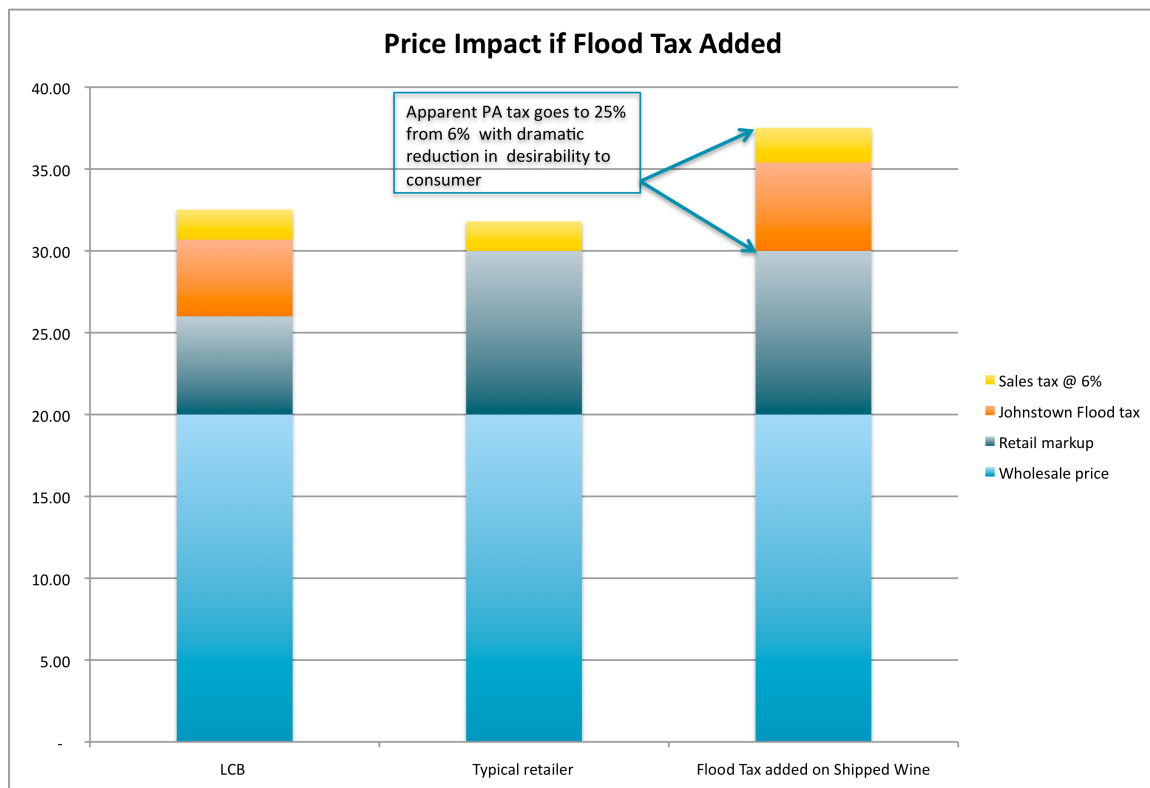
Equally importantly, “producer only” provisions cannot be squared with the Granholm ruling. Granholm made discrimination against all out-of-state wine illegal, not just some out-of-state wine. I have attached as an appendix to this testimony some excerpts from the Granholm case that make this clear. I’ll just quote one of them now:

“States have broad power to regulate liquor under § 2 of the Twenty-first Amendment. This power, however, does not allow States to ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers. If a State chooses to allow direct shipment of wine, it must do so on even-handed terms.”

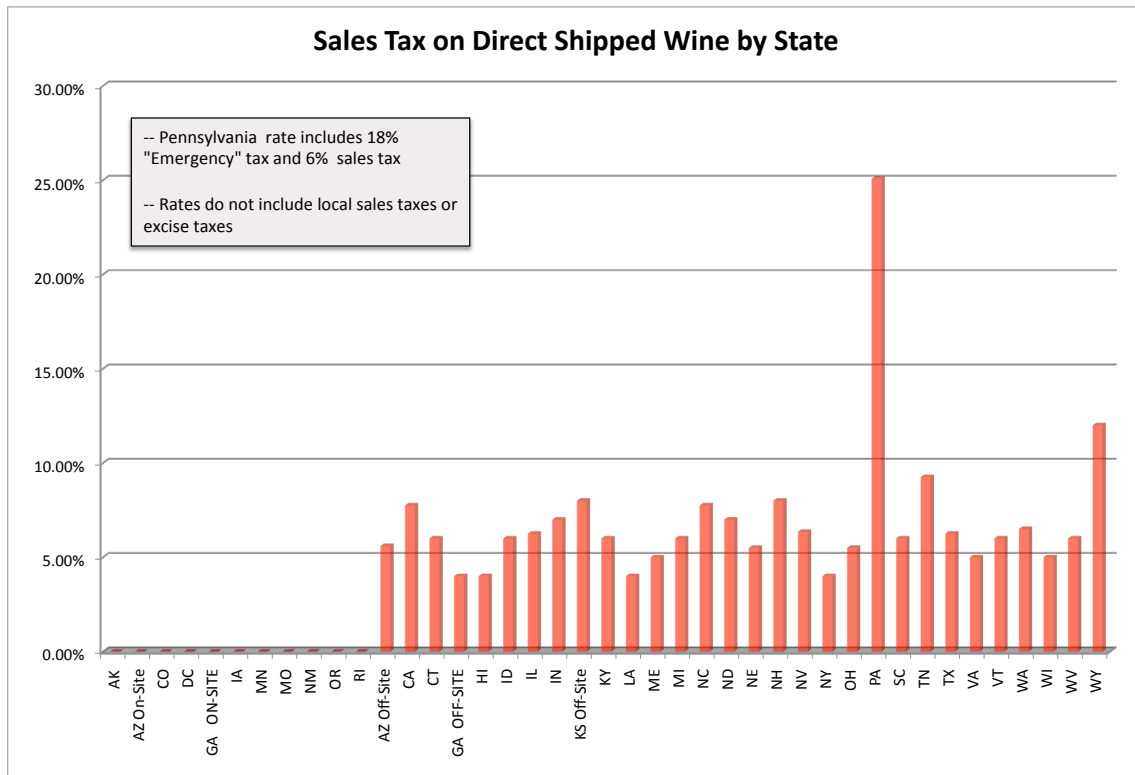
Restricting direct shipping to producers would not only sharply curtail its benefits to Pennsylvania’s citizens, it would run afoul of Granholm’s even-handedness requirement. None of the direct shipping bills pending in the House contains this restriction, and I would urge that it be removed from this one.

**Adding the Johnstown Flood Tax.** Adding an 18% tax to the Pennsylvania sales tax would take the tax rate on shipped wine up to 25% (or 27% with local sales taxes added). As a practical matter, a tax rate like that would take away with one hand what is given with the other. If Pennsylvania imposes a twenty-four or twenty-five percent tax on wine where other states impose between five and eight, we make wine delivered everywhere else far more attractive than wine delivered here. Such a provision would severely undermine any wine sales subject to it.

I recognize that the “Emergency Tax of 1934” is part of the LCB’s pricing formula, but that is something very different. The Johnstown Flood tax is an invisible part of the Commonwealth’s retail markup – a markup that *with this tax imbedded* is very similar to the usual markup in wine shops across the country. Here’s an illustration:



If Pennsylvania's sales tax on direct-shipped wine is in the normal range, say 5% to 8%, from the perspective of a retail consumer considering shipment to PA, the only impact is that Pennsylvania will collect the sales tax instead of the state from which the wine is shipped. On the other hand, if Pennsylvania demands a rise of 25% as the price for making that shipment, that consumer will look for other approaches, and the odds are that Pennsylvania won't see any tax revenue at all. What is more, with a rate like that, Pennsylvania would be completely out of step with every other state that permits direct shipping. Using data collected by the Wine Institute, I have put together a graph showing the sales tax rates in the other states that permit direct to consumer wine shipping, versus Pennsylvania's if we add the Johnstown flood tax:



Frankly, just having a 75-year-old “Emergency Tax” is embarrassing. It reminds us how resistant this state has been to change and how much our system is an artifact of a bygone era. I would suggest that the last thing we should want is to put this tax front and center in a law designed to bring our liquor system into the twenty-first century. It simply doesn't make sense for Pennsylvania to bring the Flood Tax along as part of its effort to modernize.

A broad direct shipping law with a reasonable tax rate would represent a win for everyone. Those who want to keep the State Store system would have less citizen unhappiness to deal with. Wine lovers across the Commonwealth would finally have some of the freedom that citizens of other states have had for years. And if the results in other states are any guide, the Commonwealth's revenues would go up, not down. I urge the Senators to support a broad direct shipping bill with a reasonable tax rate.

Thank you for the opportunity to make these remarks.

## APPENDIX

Excerpts from the Supreme Court decision in Granholm v. Heald. (All citations to other authority are omitted from these excerpts)

- Time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.” This rule is essential to the foundations of the Union.
- The mere fact of nonresidence should not foreclose a producer in one State from access to markets in other States. States may not enact laws that burden out-of-state producers or shippers simply to give a competitive advantage to in-state businesses.
- The current patchwork of laws – with some States banning direct shipments altogether, others doing so only for out-of-state wines, and still others requiring reciprocity – is essentially the product of an ongoing, low-level trade war. Allowing States to discriminate against out-of-state wine “invite[s] a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause.”
- State laws that discriminate against interstate commerce face “a virtually *per se* rule of invalidity.”
- Section 2 of the Twenty-first Amendment . . . does not allow States to regulate the direct shipment of wine on terms that discriminate in favor of in-state producers.
- The aim of the Twenty-first Amendment was to allow States to maintain an effective and uniform system for controlling liquor by regulating its transportation, importation, and use. The Amendment did not give States the authority to pass nonuniform laws in order to discriminate against out-of-state goods, a privilege they had not enjoyed at any earlier time. . . . The argument that “the Twenty-first Amendment has somehow operated to ‘repeal’ the Commerce Clause” for alcoholic beverages has been rejected.
- [T]he Court has held that state regulation of alcohol is limited by the nondiscrimination principle of the Commerce Clause. “When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry.
- State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent.
- States have broad power to regulate liquor under § 2 of the Twenty-first Amendment. This power, however, does not allow States to ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers. If a State chooses to allow direct shipment of wine, it must do so on even-handed terms.