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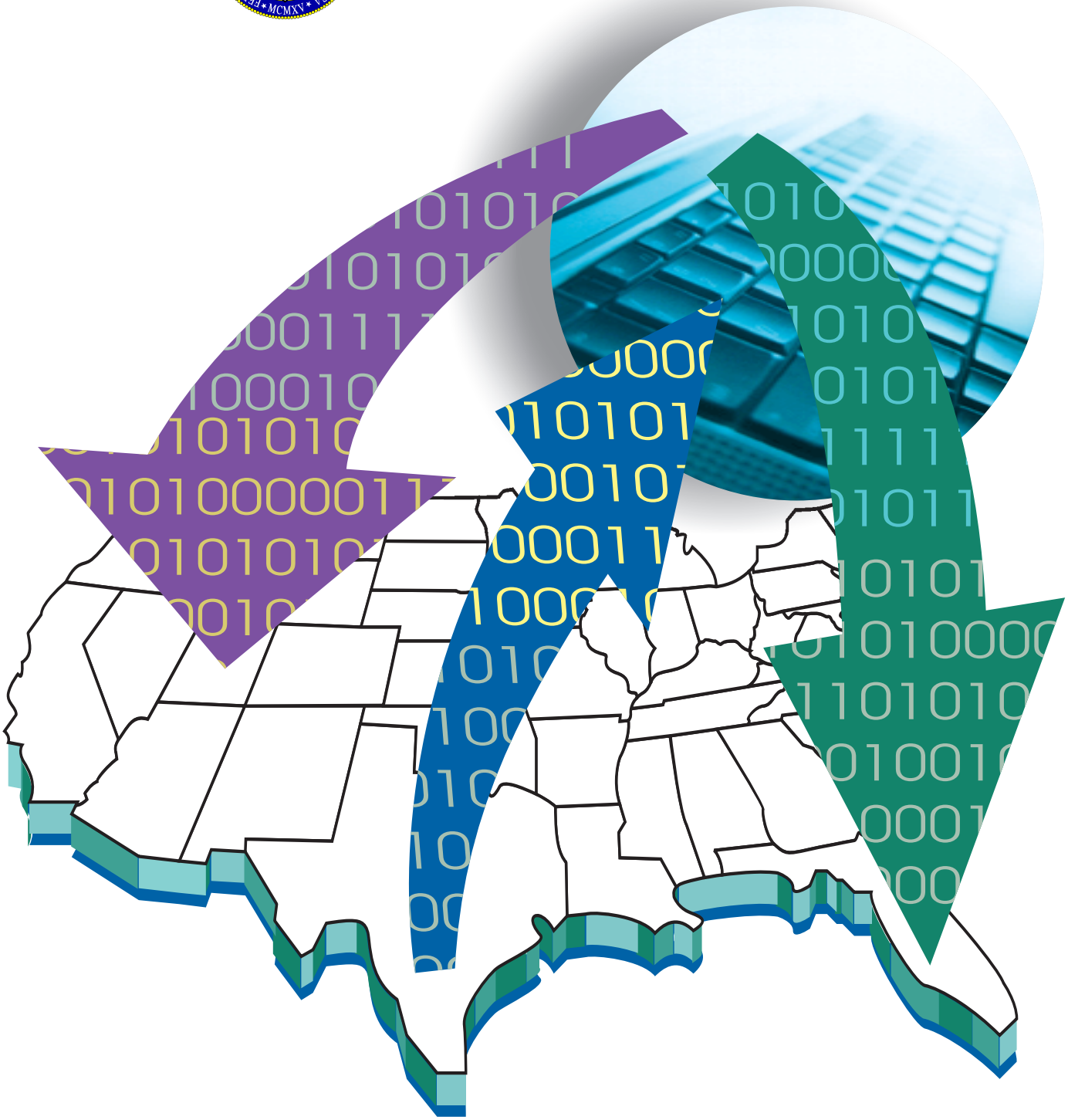
# Possible Anticompetitive Barriers to E-Commerce: Wine

A Report from the Staff of the Federal Trade Commission

JULY 2003



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Report Contributors
Jerry Ellig, Deputy Director, Office of Policy Planning
Asheesh Agarwal, Office of Policy Planning
John Delacourt, Office of Policy Planning
Mark Nance, Office of Policy Planning
Maureen Ohlhausen, Office of Policy Planning
Alan Wiseman, Bureau of Economics
Denis Breen, Bureau of Economics
Debra Holt, Bureau of Economics
Daniel Hosken, Bureau of Economics
Van Brantner, Bureau of Economics
Sara Harkavy, Bureau of Economics
C. Lee Peeler, Deputy Director, Bureau of Consumer Protection
Janet Evans, Bureau of Consumer Protection
Rachel Hertzman, Bureau of Competition

Inquiries
Please direct inquiries concerning this report to:
Jerry Ellig, (202) 326-3528, or jellig@ftc.gov,
Asheesh Agarwal, (202) 326-3558, or aagarwal@ftc.gov.



Acknowledgment
R. Ted Cruz, the former Director of the Office of Policy Planning, oversaw much of this report prior to leaving the FTC.

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**Possible Anticompetitive**
**Barriers to E-Commerce:**

# Wine

## Introduction

Heralded by many as the next industrial revolution, the Internet is transforming the nation's economy. The Internet lets consumers purchase an unprecedented array of goods and services from the convenience of their homes. Local markets are becoming national and international as consumers can find and purchase thousands of goods from thousands of suppliers online, and have those goods delivered to their doors. The product choices range from contact lenses to cars and even caskets. Moreover, perhaps for the first time, consumers can also conveniently purchase a wide array of services from distant sources. For example, consumers can obtain legal and medical advice, realtor services, and education from out-of-state online suppliers. In many instances, these consumers may find lower prices and a greater variety of goods and services online than in bricks-and-mortar stores.

Although the Internet can provide consumers with important benefits, online commerce may raise regulatory concerns. Many states have passed laws regulating e-commerce to promote other important public interest objectives, such as protecting consumers from deception and fraud by unscrupulous vendors. These actions, however, also may shield local merchants from out-of-state competition. For example, some states require that online vendors maintain a physical office in the state, while other states completely prohibit online sales or shipments of certain products, such as new cars direct from a manufacturer. Many states also require that out-of-state suppliers obtain an in-state license before selling particular goods, like caskets or contact lenses, or services, like medical or legal advice. Some observers question whether the attendant higher prices and loss of variety might outweigh the consumer protection benefits.

This dichotomy currently exists in the wine industry. The Internet allows suppliers, particularly smaller wineries, to market and ship their wines directly to consumers, thereby circumventing the traditional distribution network of wholesalers and retailers. Through the direct shipment of wine, online sales may provide consumers with lower prices and greater variety; on the other hand, direct shipping may let minors buy alcohol and consumers avoid taxes. These concerns have led many states to prohibit or severely restrict the direct shipment of wine to consumers. In recent years, however, many state legislatures, as well as Congress and the courts, have re-examined the rules governing direct shipping.

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To inform these debates, this report assesses the impact on consumers of barriers to e-commerce in wine.[1] It also surveys the alternative policies adopted by many of the states that permit their citizens to order and receive wine from out-of-state sources. Clearly, other public interests are at stake besides the consumer interests in low prices, product variety, and convenience, and states must weigh policy choices for themselves. Policymakers, however, need to have accurate information about the nature and scope of the relevant tradeoffs, including the likelihood of any perceived risks. As the FTC and Department of Justice have stated in other contexts, "Without a showing of likely harm, restraining competition in a way that is likely to hurt consumers by raising prices and eliminating their ability to choose among competing providers is unwarranted."[2]

## Summary

In October 2002, the Federal Trade Commission held a workshop to evaluate possible anticompetitive barriers to e-commerce in wine and many other industries.[3] This report is the first of several reports in which Commission staff will examine such barriers in each of these industries. Each report will analyze the competitive and consumer protection aspects of the possible anticompetitive barriers, including regulations and business practices. An analysis of such barriers is particularly timely in the wine industry, because many states, some in response to court decisions, currently are reviewing their laws regarding the distribution of wine. Moreover, Congress recently held a hearing that focused on the e-commerce issues facing three industries, including wine.

At the workshop, Commission staff heard testimony from all sides of the wine issue, including wineries, wholesalers, state regulators, and a Nobel laureate in economics.

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[1] This report represents the views of the staffs of the Office of Policy Planning, Bureau of Economics, Bureau of Competition, and Bureau of Consumer Protection, and does not necessarily represent the views of the Commission or any individual Commissioner. The Commission has, however, voted to authorize the staff to publish this report.

[2] Letter from the FTC and Department of Justice to the American Bar Association's Task Force on the Model Definition of the Practice of Law 7 (Dec. 20, 2002), at http://www.ftc.gov/opa/2002/12/lettertoaba.htm. *See also* Letter from the FTC and Department of Justice to the Rhode Island Legislature 9 (Mar. 29, 2002), at http://www.ftc.gov/be/v020013.pdf ("In general, the antitrust laws and competition policy require that a sweeping private restriction on competition be justified by a valid need for the restriction and require that the restriction be narrowly drawn to minimize its anticompetitive impact. These requirements protect the public interest in competition").

[3] Public Workshop: Possible Anticompetitive Efforts to Restrict Competition on the Internet, 67 Fed. Reg. 48,472 (2002). The other industries were: auctions; automobiles; caskets; contact lenses; cyber-charter schools; online legal services; real estate, mortgages, and financial services; retailing; and telemedicine and online pharmaceutical sales. More information is available at the workshop's homepage, at http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm. The workshop's transcript is cited as "Tr.," and is available at http://www.ftc.gov/opp/ecommerce/anticompetitive/021008antitrans.pdf. All of the panelists' written statements are available at http://www.ftc.gov/opp/ecommerce/anticompetitive/agenda.htm.

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Commission staff also gathered evidence from a wide variety of published sources, such as studies and court decisions, and from other sources, such as package delivery companies and the Bureau of Alcohol, Tobacco, Firearms, and Explosives (now the Alcohol and Tobacco Tax and Trade Bureau). Finally, FTC staff studied the wine market in a state that until recently banned direct shipment of wine to consumers from out-of-state sources, and, as a result, banned most online wine sales. In particular, the study examined the wine market in McLean, Virginia, and compared the prices and choices that consumers could find in area stores to the prices and choices that consumers could find online.

After extensive review, Commission staff concludes that states could significantly enhance consumer welfare by allowing the direct shipment of wine to consumers. Through direct shipping, online wine sales offer consumers lower prices and greater selection. Of course, the direct shipping debate involves other public policy goals, such as tax collection and prevention of sales to minors. To accomplish these goals, many states have adopted measures that are less restrictive than an outright ban on interstate direct shipping, and these states generally report few or no problems with tax collection or direct shipments to minors. The less restrictive means include requiring an adult signature at the point of delivery and requiring out-of-state suppliers to obtain a permit.

The staff's main findings are summarized below:

- Consumers can purchase many wines online that are not available in nearby bricks-and-mortar stores. The McLean study found that 15% of a sample of wines available online were not available from retail wine stores within ten miles of McLean. Similarly, testimony unambiguously reveals that, by banning interstate direct shipments, states seriously limit consumers' access to thousands of labels from smaller wineries.

- Depending on the wine's price, the quantity purchased, and the method of delivery, consumers can save money by purchasing wine online. Because shipping costs do not vary with the wine's price, consumers can save more money on more expensive wines, while less expensive wines may be cheaper in bricks-and-mortar stores. The McLean study suggests that, if consumers use the least expensive shipping method, they could save an average of 8-13% on wines costing more than $20 per bottle, and an average of 20-21% on wines costing more than $40 per bottle.

- State bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine. More than half the states prohibit or severely restrict out-of-state suppliers from shipping wine directly to consumers. Many of these same states, however, allow intrastate direct shipping, such as from in-state wineries and retailers.

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- Many other regulations impede e-commerce in wine. These include prohibitions on online orders, very low ceilings on annual purchases, bans on advertising from out-of-state suppliers, requirements that individual consumers purchase "connoisseurs' permits," and requirements that delivery companies obtain a special individual license for every vehicle that might be used to deliver wine.

- Citizens are concerned about the direct shipment of wine to minors. Some states have chosen to address this concern in part by banning direct shipment of wine to all consumers, or banning direct shipment from out-of-state sellers. Others have opted for alternatives that are less restrictive than an outright ban.

- The states that permit interstate direct shipping generally report few or no problems with shipments to minors. Some states have applied the same types of safeguards to online sales that already apply to bricks-and-mortar retailers, such as requirements that package delivery companies obtain an adult signature at the time of delivery. Some states also have developed penalty and enforcement systems to provide incentives for both out-of-state suppliers and package delivery companies to comply with the law.

- Several states that allow interstate direct shipping also collect taxes from those shipments. By requiring out-of-state suppliers to obtain permits, states such as New Hampshire have sought to achieve voluntary compliance with their tax laws. Most of these states report few, if any, problems with tax collection. Other states with reciprocity agreements forego taxing interstate direct shipments altogether.

For these reasons, FTC staff concludes that consumers could reap significant benefits if they had the option of purchasing wine online from out-of-state sources and having it shipped directly to them. Consumers could save money, choose from a much greater variety of wines, and enjoy the convenience of home delivery. Indeed, in states that are litigating the constitutionality of direct shipping bans, several courts have found that the bans deprive the state's consumers of lower prices and greater variety. In addition, many states appear to have found means of satisfying their tax and other regulatory goals that are less restrictive than an outright ban. These states generally report few or no problems with shipments to minors or with tax collection.

The direct shipping debate has raised a wide variety of other issues, such as alternate policies for combating alcohol sales to minors, whether or how states should tax wine shipped directly to consumers, and the scope of the states' authority under the Twenty-First Amendment to prohibit interstate direct shipping. This report does not offer a comprehensive analysis of the entire direct shipping debate. Commission staff concludes only that online wine sales offer consumers lower prices, more choices, and greater convenience, and states that permit direct shipping have employed a variety of tools to accomplish their tax and other regulatory goals.

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Finally, the staff's conclusions have general implications for e-commerce. Anticompetitive state regulations can insulate local suppliers from online competition and deprive consumers of lower prices and greater selection. Although states have legitimate regulatory goals in protecting consumers, they may have less restrictive alternatives that would allow online competition and, ultimately, provide the greatest benefits to consumers.

## I. Current Status of Online Wine Sales

Online wine sales are a small but growing percentage of the wine market. From 1994-99, consumers doubled the amount of money they spent having wine shipped directly to them to around $500 million, or about 3% of the total spent on wine.[4] According to some private estimates, online wine sales could account for 5-10% of the market within a few years.[5]

This section describes the current legal regime governing online wine sales. It describes the traditional "three-tier" distribution network, state and federal regulation of direct shipping, and the lawsuits that are challenging many states' restrictions. This section also discusses the nationwide problem of underage drinking, which underlies much of the debate surrounding direct shipping.

### A. The Three-Tier System

In the United States, most wine is distributed through the three-tier system. Under this system, a wine producer first must obtain a basic permit from the Bureau of Alcohol, Tobacco, Firearms, and Explosives (now the Alcohol and Tobacco Tax and Trade Bureau) ("TTB"[6]), which allows the producer to sell wine.[7] The producer then sells its wine to a licensed wholesaler, who pays excise taxes and delivers the wine to a retailer. The retailer, in turn, sells the wine to a consumer and, where applicable, collects sales taxes. Most states prohibit vertical integration between the tiers.[8]

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[4] Alix M. Freedman & John R. Emshwiller, *Vintage System: Big Liquor Wholesaler Finds Change Stalking Its Very Private World*, WALL ST. J., Oct. 4, 1999, at A1. *See also* Vijay Shanker, Note, *Alcohol Direct Shipment Laws, the Commerce Clause, and the Twenty-First Amendment*, 85 VA. L. REV. 353, 353 n.5 (Mar. 1999) (discussing other estimates).

[5] Mark Swartzberg & Jennifer F. Solomon, Salomon Smith Barney, *Clicking on Wine: Will E-Commerce and Other Forces Increase U.S. Consumer Access to Wine?*, at 18 (Mar. 17, 2000) (equity research report).

[6] *See* TTB Homepage, at http://www.ttb.gov/.

[7] 27 U.S.C. § 203 (2002).

[8] *See generally* Bainbridge v. Turner, 311 F.3d 1104, 1106 (11th Cir. 2002); Dickerson v. Bailey, 212 F.Supp.2d 673, 679 n.11 (S.D. Tex. 2002), *aff'd*, No. 02-21137, slip op. at 2 (5th Cir. June 26, 2003); C. Boyden Gray, Written Statement 2, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/gray.pdf.

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The three-tier system developed after the passage of the Twenty-First Amendment, which repealed Prohibition in 1933, as a means for states to regulate alcohol distribution.[9] By requiring producers to sell wine through wholesalers, states hoped to collect taxes more efficiently and to limit alcohol sales to minors. States also hoped to prevent organized crime from gaining control of alcohol distribution.[10] Finally, some states may have sought to promote temperance by keeping the price of alcohol artificially high.

Over the years, as demand has increased for individualistic, hand-crafted wines, the number of wineries has grown dramatically, from between 500-800 in 1975 to well over 2,000 today.[11] Many of these new wineries produce relatively small amounts of wine, often less than 2,000 cases annually, whereas large wineries can produce over 300,000 cases annually.[12]

While the number of wineries has increased, the number of wholesalers has fallen, from several thousand in the 1950s to a few hundred today.[13] Some smaller wineries complain that they have problems getting wholesalers to carry their labels, and blame wholesaler consolidation.[14] Thus far, FTC staff has not seen any systematic data, either from the workshop or elsewhere, indicating whether wholesaler market shares have become so highly concentrated as to threaten competition in relevant geographic markets.[15] In any event, to the extent that some smaller wineries may have problems getting wholesalers to carry their labels, those problems may simply reflect fixed costs that make it uneconomical for a wholesaler to carry lesser-known wines that are available only in small quantities.[16]

Regardless of wholesaler concentration, many states impede competition between wholesalers. Many states have enacted franchise laws that favor wholesalers by granting them

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[9] U.S. CONST. amend. XXI, § 2.

[10] *See* Gray, *supra* note 8, at 2; Shanker, *supra* note 4, at 355-56.

[11] *See* Gray, *supra* note 8, at 4; Tracy Genesen, Written Statement 5, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/genesen.pdf; David Sloane, Written Statement 1-2, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/sloane.pdf.

[12] Susan Lorde Martin, *Changing the Law: Update from the Wine War*, 17 J. L. & POL. 63, 68-69 (2001).

[13] Freedman & Emshwiller, *supra* note 4, at A1; K. Lloyd Billingsley, *Ship the Wine in its Time* 1 (August 2002), at http://www.pacificresearch.org/pub/sab/techno/winedistribution_brief.pdf.

[14] *See, e.g.*, Sloane, *supra* note 11, at 2.

[15] Of course, concentrated market shares do not necessarily prove that a market is not competitive, but they may warrant a more thorough examination of entry barriers and other factors. *See* U.S. Department of Justice, Merger Guidelines (1982), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,102.

[16] *See* Dickerson v. Bailey, 212 F.Supp.2d 673, 694-95 (S.D. Tex. 2002), *aff'd*, No. 02-21137, slip op. at 2 (5th Cir. June 26, 2003).

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preferential contract rights.[17] In the past, FTC staff has submitted comments outlining the anticompetitive nature of some of these restrictions. For example, in Illinois, the staff analyzed a bill that would have prevented suppliers from terminating contracts with wholesalers except for good cause, and suggested that the bill would harm consumers by limiting suppliers' flexibility in changing distributors.[18] In North Carolina, the staff noted that a bill that would have tightened exclusive territorial arrangements between wineries and wholesalers would likely diminish consumer welfare.[19] Another type of state regulation deters wholesalers from cutting prices. In Massachusetts, FTC staff discussed the consumer benefits of a proposal that would have repealed regulations requiring wholesalers to post prices on a monthly basis and to adhere to those posted prices for an entire month.[20] All of these types of restrictions inhibit competition within the three-tier system.

## B. Direct Shipping

### 1. State Legal Regimes

Another factor affecting the three-tier system is the growth of direct shipping. Direct shipping refers to wineries or retailers shipping wine directly to consumers outside the three-tier system, usually to their home or work via a package delivery company such as FedEx Corporation ("FedEx") or United Parcel Service of America, Inc. ("UPS"). Approximately twenty-four states allow some form of interstate direct shipping, with varying degrees of restrictions.[21] Most states, approximately thirty, permit intrastate direct shipping.[22]

Of the states that allow interstate direct shipping, thirteen are classified as "reciprocity" states.[23] These states let consumers receive wine directly from suppliers in the other reciprocity

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[17] Steve Gross, Written Statement 2-3, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/gross.pdf; Boyd Allen Byers, *Making a Case for Federal Regulation of Franchise Terminations – A Return-of-Equity Approach*, 19 J. CORP. L. 607, 626-27 (1994).

[18] FTC Letter to Illinois Sen. Dan Cronin (Mar. 31, 1999), at http://www.ftc.gov/be/v990005.htm.

[19] FTC Letter to North Carolina Sen. Horton and Rep. Miller (Mar. 22, 1999), at http://www.ftc.gov/be/v990003.htm.

[20] FTC Statement to the Commonwealth of Massachusetts Alcoholic Beverages Control Commission (June 26, 1996), at http://www.ftc.gov/be/v960012.htm.

[21] *See generally* Genesen, *supra* note 11, at 1-2; Gross, *supra* note 17, at 3-4; Shanker, *supra* note 4, at 355-59; Martin, *supra* note 12, at 81-92; Katy McLaughlin, *Merlot by Mail: Ordering Wine Online Gets Easier,* WALL ST. J., Aug. 21, 2002, at D1; Wine Institute, Direct Shipment Laws by State for Wineries (last modified Oct. 2, 2002), at http://www.wineinstitute.org/shipwine/analysis/intro_analysis.htm.

[22] Martin, *supra* note 12, at 94.

[23] *See generally* note 21.

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states. The reciprocity states typically restrict or prohibit direct shipment from non-reciprocity states, and typically regulate some aspects of wine shipments from other reciprocity states. For example, most of the reciprocity states limit the volume of wine shipments that a consumer may receive to anywhere from one to twenty-four cases annually, and many of them require that the shipping container clearly indicate that only a sober adult is authorized to receive the shipment.[24] Other reciprocity states impose unique restrictions. Minnesota, for instance, specifically prohibits orders over the Internet.[25] Missouri limits out-of-state shippers' ability to advertise within the state.[26]

In approximately eleven of the non-reciprocity states, consumers may receive direct shipments subject to various restrictions ("limited importation" states).[27] Many of these states restrict the volume of wine that consumers may import, require that out-of-state suppliers obtain special permits, or impose other specific restrictions. For example, in Nebraska, out-of-state suppliers must obtain a shipping license for $500,[28] and in Wyoming, out-of-state shippers must remit a 12% tax on wine shipments.[29] Montana requires that a consumer obtain a state-issued "connoisseur's permit" for $50 to receive out-of-state shipments.[30]

The remaining twenty-six states prohibit most interstate direct shipments ("closed" states).[31] Seven of these states make it a felony for out-of-state suppliers to ship wine directly to consumers, and most of the others make it a misdemeanor.[32] Some of these states let suppliers ship wine indirectly to consumers through special order procedures. In Pennsylvania, for example, a consumer can order wine online from an out-of-state supplier, but then must pick it

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[24] *E.g.*, Hawaii letter (App. B); MO. REV. STAT. § 311.462; IDAHO CODE § 23-1309A (Michie 2002). For a discussion of state letters to FTC staff, see note 133 and accompanying text.

[25] MINN. STAT. § 340A.417. *See also* Gross, *supra* note 17, at 4.

[26] MO. REV. STAT. § 311.462.

[27] *See generally* note 21.

[28] NEB. REV. STAT. §§ 53-123.15, 53-124 (2001).

[29] WYO. STAT. ANN. § 12-2-204 (2001). *See also* Wyoming letter (App. B).

[30] MONT. CODE ANN. § 16-4-901 (2001).

[31] *See generally* note 21.

[32] *E.g.*, Sloane, *supra* note 11, at 3.

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up himself at a state-controlled retailer.[33] Many of these states also permit intrastate direct shipping.[34]

## 2. Litigation

In recent years, wine consumers and others have filed at least seven federal lawsuits challenging the constitutionality of state statutes that prohibit interstate direct shipping, but allow intrastate direct shipping.[35] These lawsuits – in Florida, Indiana, Michigan, New York, North Carolina, Texas, and Virginia – principally argue that the statutes facially violate the dormant Commerce Clause, on the grounds that the statutes favor in-state suppliers over out-of-state suppliers, and that the states have less restrictive means of satisfying their regulatory goals.[36] The states respond, among other things, that the statutes are valid under the Twenty-First Amendment, which gives states broad latitude to regulate alcohol distribution, and that the states lack sufficient regulatory control over out-of-state suppliers.[37] To date, the courts have split over the statutes' constitutionality. Most of the cases are ongoing.

Commission staff takes no position on the constitutional issues raised in the lawsuits. The staff has, however, considered the courts' factual findings in evaluating the statutes' impact on consumers.

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[33] PA. STAT. ANN. tit. 47 § 4-488 (2002).

[34] Beskind v. Easley, 197 F.Supp.2d 464, 467 n.6 (W.D. N.C. 2002), *aff'd in part, vacated in part*, 325 F.3d 506, 519-20 (4th Cir. 2003).

[35] Bainbridge v. Turner, 311 F.3d 1104 (11th Cir. 2002) (Florida); Bridenbaugh v. Freeman-Wilson, 227 F.3d 848 (7th Cir. 2000) (Indiana), *cert. denied*, 532 U.S. 1002 (2001); Heald v. Engler, No. 00-CV-71438-DT (E.D. Mich. Sept. 28, 2001) (Michigan); Swedenburg v. Kelly, 232 F.Supp.2d 135 (S.D. N.Y. 2002) (New York); Beskind v. Easley, 325 F.3d 506 (4th Cir. 2003) (North Carolina); Dickerson v. Bailey, 212 F.Supp.2d 673 (S.D. Tex. 2002), *aff'd*, No. 02-21137, slip op. at 2 (5th Cir. June 26, 2003) (Texas); Bolick v. Roberts, 199 F.Supp.2d 397 (E.D. Va. 2002), *vacated*, Bolick v. Danielson, 330 F.3d 274 (4th Cir. 2003) (Virginia). A lawsuit in Washington challenges that state's shipping restrictions, although Washington allows some interstate direct shipping. *See* Mast v. Long, No. CS-01-00298, 2002 WL 31039421 (E.D. Wash. Sept. 9, 2002).

[36] *See, e.g.*, *Beskind*, 325 F.3d at 517 ("Against the backdrop of its general prohibition of direct shipment of alcoholic beverages, North Carolina's authorization of in-state direct shipment of wine – which has the effect of increasing access to wine produced only in North Carolina – cannot credibly be portrayed as anything other than local economic boosterism in the guise of a law aimed at alcoholic beverage control").

[37] *See, e.g.*, *Bridenbaugh*, 227 F.3d at 849 ("This case pits the twenty-first amendment, which appears in the Constitution, against the 'dormant commerce clause,' which does not").

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## C. Recent Congressional Action

In the past few years, Congress has enacted two provisions regarding direct shipping.[38] In 2000, Congress enacted the Twenty-First Amendment Enforcement Act, which gives state attorneys general the power to bring civil actions in federal court for injunctive relief against out-of-state suppliers that violate the state's liquor laws.[39] Congress passed the law in response to concerns that some states were unable to enforce their laws against out-of-state suppliers.[40]

In 2002, Congress enacted a provision that permits limited direct shipping in certain circumstances.[41] The provision lets an adult consumer have wine shipped directly to his home if he places the order in person at a winery, the shipping container requires an adult's signature, and "the purchaser could have carried the wine lawfully into the State . . . to which the wine is shipped."[42] Congress passed this provision in response to concerns that some airlines, as part of heightened security measures, were preventing passengers from carrying wine onto planes.[43] The measure will remain in effect "[d]uring any period in which the Federal Aviation Administration has in effect restrictions on airline passengers to ensure safety."[44] Some observers suggest that this provision allows consumers to import wine into states that ban interstate direct shipping, while others disagree.[45] FTC staff takes no position on the proper interpretation of this provision. In any event, because the provision permits direct shipping only when the consumer orders the wine in person at a winery, the provision likely will have only a limited impact on the wine market.

Finally, Congress is also examining the consumer welfare aspects of direct shipping laws. In September 2002, the House Committee on Energy and Commerce, through its Subcommittee on Commerce, Trade, and Consumer Protection, held a hearing entitled "State Impediments to E-

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[38] For an overview of federal regulation related to the shipping of alcohol, see ATF, Industry Circular No. 96-3, Direct Shipment Sales of Alcohol Beverages (Feb. 11, 1997), at http://www.atf.treas.gov/pub/ind_circulars/ic_96-3.htm.

[39] 27 U.S.C. § 122a (2002).

[40] Letter from Sheryl L. Walter, Acting Assistant Attorney General, U.S. Department of Justice, to Hon. Dennis Hastert, Speaker, U.S. House of Representatives 2 (May 3, 2001).

[41] 27 U.S.C. § 124 (2002).

[42] *Id*.

[43] Rich Cartiere, *Congress Approves Limited Direct Shipping for Winery Visitors to More States*, WINE MARKET REP., Oct. 4, 2002, at 1.

[44] 27 U.S.C. § 124(a).

[45] Cartiere, *supra* note 43, at 1-2.

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Commerce: Consumer Protection or Veiled Protectionism?" That hearing focused on the e-commerce issues in three industries: auctions, contact lenses, and wine.[46]

## D. Underage Alcohol Use

Much of the public debate surrounding online wine sales focuses on the problem of underage drinking. In 2002, approximately 20% of eighth graders, 35% of tenth graders, and 49% of twelfth graders reported that they had used alcohol one or more times within the previous thirty days.[47] While underage drinking rates have declined substantially over the past decade,[48] most minors still report that they have easy access to alcohol. In 2002, approximately 68% of eighth graders, 85% of tenth graders, and 95% of twelfth graders said that it is "fairly easy" or "very easy" to get alcohol.[49] Underage alcohol use imposes significant costs, in both human and economic terms.[50] Although the numbers are very difficult to quantify, one study estimated that, in 1996, the total cost of underage drinking – including traffic crashes, violent crime, burns, drowning, suicide attempts, fetal alcohol syndrome, alcohol poisoning, and treatment – was $52.8 billion.[51]

All states have laws preventing the sale of alcohol to minors. Under the current regulatory regime, parents and retail outlets serve as the "front line forces" in the effort to prevent underage access to alcohol. State and local authorities enforce these laws using stings and other tools. The alcohol industry supplements these efforts through a variety of means, such as by training servers

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[46] *State Impediments to E-Commerce: Consumer Protection or Veiled Protectionism?: Hearing Before the Subcomm. on Commerce, Trade, and Consumer Protection of the House Comm. on Energy and Commerce*, 107th Cong. (2002), *available at* http://energycommerce.house.gov/107/hearings/09262002Hearing732/hearing.htm.

[47] L.D. Johnston et al., *Ecstasy Use among American Teens Drops for the First Time in Recent Years, and Overall Drug and Alcohol Use Also Decline in the Year after 9/11* Table 2, University of Michigan News and Info. Serv. (December 16, 2002), at http://monitoringthefuture.org/data/02data.html#2002data-drugs.

[48] *See id.*

[49] *Id.* at Tables 12-13.

[50] FTC, *Self-Regulation in the Alcohol Industry: A Review of Industry Efforts to Avoid Promoting Alcohol to Underage Consumers* App. A, pp. iii-iv (Sept. 1999), at http://www.ftc.gov/reports/alcohol/alcoholreport.htm ("FTC's Self-Regulation Report").

[51] David T. Levy et al., *Costs of Underage Drinking* (1999) (report prepared for the U.S. Department of Justice, Office of Juvenile Justice and Delinquency Prevention), at http://www.udetc.org/documents/costunderagedrinking.pdf. *See also* Irene Mead, Written Statement 9-10, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/mead.htm.

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and providing point-of-sale materials that discuss age restrictions on alcohol purchases at retail outlets. TTB also helps combat significant violations of state law.[52]

There is wide agreement that underage drinking represents a serious national problem. During the workshop, however, there was debate over the extent to which wine, as opposed to other forms of alcohol, contributes to that problem. Some contend that minors are more interested in beer and spirits, and that "[j]uveniles who want to indulge in alcoholic beverages do not order premium wine over the Internet and then wait two or three days for it to arrive."[53] Wholesalers concede that minors typically do not buy expensive wines, but argue that minors may buy cheaper wines, such as jug wine.[54] The data show that minors drink wine, although less often than beer or spirits.[55] Based on survey data, a previous FTC report concluded that "[w]hen youngsters first start drinking, they consume primarily beer and wine coolers; by twelfth grade, students use all types of alcohol, although beer use is most common."[56] FTC staff has not found data showing what kinds of wines minors drink, such as whether they select jug or premium wines.

## II. Methodology in Studying Online Wine Sales

With these issues in mind, FTC staff gathered a substantial amount of data regarding online wine sales. At a workshop in October 2002, Commission staff heard testimony from all sides of

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[52] Although the states shoulder the primary responsibility for preventing underage alcohol use, over the years the FTC, using its statutory authority to protect consumers from "unfair or deceptive acts or practices," 15 U.S.C. § 45, has undertaken a number of studies and law enforcement actions to combat underage drinking. In 1990, for example, FTC staff began to investigate alcohol promotions that could attract minors. Press Release, FTC, FTC Chairman Presents View of FTC in the 1990's to Adweek Conference (Apr. 23, 1990), at http://www.ftc.gov/opa/predawn/F93/jds-ftc.txt. In 1991, the FTC settled charges with an alcohol manufacturer that marketed a flavored wine product as a wine cooler or other low-alcohol beverage, thus appealing to minors, even though the product contained substantially more alcohol. *See* Press Release, FTC, Canadaigua Wine Co. Agrees to Advertising, Packaging Changes for Cisco Fortified Wine To Settle FTC Charges (Mar. 12, 1991), at http://www.ftc.gov/opa/predawn/F93/cisco.txt. Additionally, in 1999, at the request of Congress, the Commission issued a report that evaluated alcohol industry self-regulatory efforts to avoid promoting alcohol to underage consumers. *See* FTC's Self-Regulation Report, *supra* note 50.

[53] Billingsley, *supra* note 13, at 6. *See also* Letters from Illinois and Washington (App. B).

[54] Gray, Tr. 176-77.

[55] FTC's Self-Regulation Report, *supra* note 50, at App. A, Fig. 2.

[56] *Id*. at App. A, p. ii.

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the wine issue, including wineries, wholesalers, and state regulators.[57] The following people testified at the workshop:

> Tracy Genesen, Legal Director, Coalition for Free Trade (a non-profit foundation, composed of small wineries and others, that is suing to invalidate many states' bans on interstate direct shipping);
>
> C. Boyden Gray, Outside Counsel for the Wine & Spirits Wholesalers of America (a trade association for wine wholesalers);
>
> Steve Gross, Director of State Relations, Wine Institute (an advocacy group that represents more than 600 California wineries);
>
> William H. Hurd, State Solicitor, Office of the Attorney General, Virginia (a formerly closed state that has been litigating the constitutionality of its ban);
>
> Daniel L. McFadden, Professor of Economics, University of California at Berkeley (an economist who received the Nobel Prize for his studies of consumer behavior, and who also owns a small vineyard);
>
> Irene Mead, Assistant Attorney General, Michigan (another closed state that is currently litigating the ban, and that also has run numerous compliance checks to determine whether out-of-state suppliers are illegally shipping wine into the state);
>
> Murphy Painter, President, National Conference of State Liquor Administrators (an association of state administrators who oversee wine distribution); and
>
> David Sloane, President, American Vintners Association (a trade association that represents 650 smaller wineries from 48 states).

FTC staff also specifically invited representatives from the largest online wine retailer, which declined to testify. Finally, the staff invited comments from the general public.[58] Many consumers and small winery owners, as well as a state regulator, submitted written statements.[59]

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[57] The transcript of the wine panel is available at http://www.ftc.gov/opp/ecommerce/anticompetitive/021008antitrans.pdf. At the start of the wine panel, the moderator, Commissioner Orson Swindle, noted that its goal was to focus on "enhancing consumer welfare rather than the constitutional perspective." Swindle, Tr. 166.

[58] Public Workshop: Possible Anticompetitive Efforts to Restrict Competition on the Internet, 67 Fed. Reg. 48,472 (2002).

[59] *See* Public Comments, at http://www.ftc.gov/opp/ecommerce/anticompetitive/comments/index.html.

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Next, FTC staff reviewed a large amount of published material. This material included studies, articles, industry reports, court decisions, and the panelists' written testimony and supplemental statements. The staff also reviewed many of the filings in the court cases, including expert reports regarding consumer welfare, tax collection, and sales to minors. Likewise, the staff examined relevant materials from other federal agencies, including the Department of Justice, the Department of Health and Human Services, and TTB. The staff also incorporated into its analysis previous work at the Commission regarding alcohol sales to minors.[60]

After evaluating this material, Commission staff sought additional information on certain issues. On the issue of consumer welfare, the staff conducted its own study of a wine market in Virginia, a state that until recently banned interstate direct shipping. On the issues of underage sales and tax collection, the staff contacted many of the reciprocity and limited importation states about their experiences. The staff also reviewed testimony from a California alcohol regulator who testified before California's legislature. Finally, the staff received information from FedEx and UPS about their delivery procedures for verifying a recipient's age.

## III. Analysis of Online Wine Sales

Having reviewed this information, FTC staff concludes that state bans on interstate direct shipping represent the single largest regulatory barrier to expanded online wine sales. The staff also concludes that online wine sales give consumers the opportunity to save money and to choose from a much greater variety of wines. The staff notes that many states have adopted less restrictive means of satisfying their regulatory goals, and that these states generally report few or no problems with shipments to minors or with tax collection.

### A. Bans on Interstate Direct Shipping Represent the Single Largest Regulatory Barrier to Online Wine Sales

State bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine. All of the panelists at the workshop, and most of the public comments, focused on the direct shipping issue. In the closed states, the bans prevent consumers from conveniently purchasing wine from suppliers around the country.[61] In closed states that have special order procedures, consumers can purchase a variety of wines from around the country, but because the wine must pass through another distribution level, the restrictions may deprive consumers of most of the benefits of e-commerce, such as the convenience of home

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[60] *E.g.*, FTC's Self-Regulation Report, *supra* note 50.

[61] *See* Dickerson v. Bailey, 212 F.Supp.2d 673, 694-95 (S.D. Tex. 2002), *aff'd*, No. 02-21137, slip op. at 2 (5th Cir. June 26, 2003).

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delivery and some cost savings. In the closed states that allow intrastate direct shipping,[62] consumers can gain the benefits of e-commerce, but only for a limited variety of wines.

While interstate direct shipping bans represent the largest regulatory barrier to e-commerce in wine, even among the reciprocity and limited importation states, many other regulations impede e-commerce. For instance, Minnesota flatly prohibits online orders.[63] In Louisiana, out-of-state wineries can ship into the state only if they do not already have a contract with a Louisiana wholesaler.[64] Many of these states sharply limit the volume of wine that consumers may receive from out-of-state suppliers. Wisconsin and other states limit consumers to no more than one case (nine liters) per year,[65] whereas other states satisfy their regulatory objectives with far higher limits.[66] Many of these states also exclude retailers from their reciprocity provisions.[67]

Furthermore, some of these states regulate direct shipments to deter companies from even trying to ship wine into the state. For example, some package delivery companies will not deliver wine to Montana, because they do not want to try to verify whether a Montana customer has a connoisseur's permit.[68] They will not deliver to Connecticut for the same reason.[69] According to the Wine Institute, package delivery companies also will not deliver wine to Massachusetts, partially because Massachusetts requires each individual delivery truck to get a license to deliver alcohol, and will not give a license to an entire fleet of trucks.[70]

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[62] There are approximately ten such states, including six of the seven states (all but Virginia) that are litigating or have litigated the constitutionality of their state statutes, as well as Maine, Massachusetts, New Jersey, and Ohio. *See* Section I.B, *infra*; Wine Institute, Who Ships Where (last modified Oct. 9, 2002), at http://www.wineinstitute.org/shipwine/shipping_carriers/who_ships_where.htm.

[63] MINN. STAT. § 340A.417.

[64] LA. REV. STAT. ANN. § 26:359(B)(1)(i) (West 2003).

[65] WIS. STAT. § 125.68 (2002); Hawaii letter (App. B).

[66] *See*, *e.g.*, IDAHO CODE § 23-1309A (Michie 2002) (allowing two cases per month).

[67] Sara Schorske, *Q&A on Direct Shipping*, VINEYARD & WINERY MGMT., Jan./Feb. 2001, at 12.

[68] *See* Gross, *supra* note 17, at 5.

[69] Wine Institute, Who Ships Where (last modified Oct. 9, 2002), at http://www.wineinstitute.org/shipwine/shipping_carriers/who_ships_where.htm. *See also* John Foust, Note, *State Power to Regulate Alcohol Under the Twenty-First Amendment: The Constitutional Implications of the Twenty-First Amendment Enforcement Act*, 41 B.C. L. REV. 659, 697 (May 2000) (noting that a customer must obtain a permit in Connecticut); Letter from Steve Gross, Wine Institute, to the FTC (Mar. 3, 2003) (explaining delivery situation).

[70] Letter from Steve Gross, Wine Institute, to the FTC (Mar. 3, 2003) (explaining delivery situation).

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Aside from issues relating to direct shipping, many other state laws inhibit online competition.[71] Missouri and New York bar out-of-state suppliers from advertising within the state.[72] According to the Wine Institute, in Arkansas, local wineries may sell their wares in grocery stores, whereas out-of-state wines may be sold only in package stores, thereby making it more difficult for Arkansas consumers to purchase out-of-state wines that they find online.[73] While perhaps not as limiting as the complete bans on interstate direct shipping, these and other laws reduce consumers' ability to purchase wine from out-of-state suppliers.

## B. The FTC Staff's Study Concludes that Bans on Interstate Direct Shipping Raise Prices and Decrease Selection

To help evaluate the impact of interstate direct shipping bans on consumers, FTC staff studied wine sales in McLean, Virginia. At the time of the study, Virginia prohibited interstate direct shipping. The study compared the prices and choices that consumers could find in McLean-area stores to the prices and choices that consumers could find online.[74] The study is attached to this report as Appendix A.

### 1. Economic Theory

Economic reasoning suggests that online prices could be higher or lower than offline prices. The Internet allows customers to search hundreds of retail outlets nationwide, thereby raising the odds that a consumer will find a better price online than in local stores. Online vendors may charge lower prices if they have lower costs, perhaps because they forego investment in bricks-and-mortar retail locations or can perform some functions more efficiently than traditional middlemen. On the other hand, Internet sellers may command a price premium by differentiating their products or by providing greater convenience. Empirical studies of other industries report

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[71] *See* Sara Schorske, *The "∃-Tier" System: The Cutting Edge of Alcoholic Beverage E-Commerce*, VINEYARD & WINERY MGMT., Nov./Dec. 2000, at 11-13 (discussing franchise laws and certain reporting requirements); Brian Newkirk & Rob Atkinson, *Buying Wine Online: Rethinking the 21st Amendment for the 21st Century* (January 2003), at http://www.ppionline.org/documents/E-Wine_0203.pdf (discussing "at rest" laws and barriers to new wholesalers, such as minimum inventory requirements).

[72] MO. REV. STAT. § 311.462; N.Y. AL. BEV. CON. § 102 (McKinney 2000). In *Swedenburg*, the district court held that the New York statute was unconstitutional. Swedenburg v. Kelly, 232 F.Supp.2d 135, 152 (S.D. N.Y. 2002).

[73] *See* Gross, *supra* note 17, at 3.

[74] Alan Wiseman & Jerry Ellig, *How Many Bottles Make a Case Against Prohibition?: Online Wine and Virginia's Direct Shipment Ban* (2003) (App. A).

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mixed results, with earlier studies suggesting that online prices are higher than offline prices, but more recent studies suggesting the opposite.[75]

Online commerce also raises the possibility of increased product variety. An individual online store may feature more products than many bricks-and-mortar retail locations. More important, the total number of varieties available online may surpass the total number available in bricks-and-mortar stores that are within a reasonable distance of a particular consumer, because the Internet effectively expands the geographic market.[76]

An alternate hypothesis is that any product for which there is customer demand already finds its way into the existing distribution system. As a result, e-commerce may offer consumers few additional options that they actually want. In support of this view, wine wholesalers cite public opinion polls concluding that approximately 85% of alcohol drinkers are satisfied with the selection of beer and wine available from local retailers.[77] They also point to data indicating that, even in limited importation states, consumers use the direct shipping option sparingly.[78]

### 2. Methodology for Study

Largely missing from the wine debate is data or analysis that would allow policymakers to assess the impact of online wine sales on prices and variety. To help bridge this gap, FTC staff gathered data on online and offline wine prices and product variety for a jurisdiction that prohibited interstate direct shipping.[79] At the time the staff gathered the data for this study, the Commonwealth of Virginia banned interstate direct shipping, but allowed direct shipping by in-state wineries, breweries, and retailers (a district court had declared Virginia's ban on interstate direct shipping unconstitutional, but had stayed its order pending an appeal to the Fourth Circuit,

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[75] In auto retailing, for example, a referral site (autobytel.com) facilitates price competition among dealers and lets users pay lower prices than they would have otherwise. *See* Fiona Scott Morton et al., *Internet Car Retailing*, J. INDUS. ECON. 49:4 at 501-19 (Dec. 1, 2001); Florian Zettelmeyer et al., *Cowboys or Cowards? Why are Internet Car Prices Lower?* (Dec. 2001) (National Bureau of Economic Research Working Paper No. 8667), at http:\\www.nber.org/papers/w8667. Some studies of online auto auctions, compact disks, books, and software have found that prices are higher in online markets, but a more recent study of books and compact disks found that online prices are lower. *See* Alan Wiseman, FTC Bureau of Economics, *Economic Perspectives on the Internet* 30-31 (July 2000), at http://www.ftc.gov/be/hilites/economicissues.pdf (citing other studies).

[76] *See* Gross, *supra* note 17, at 5.

[77] Gray, *supra* note 8, at 2.

[78] *See* Murphy Painter, Written Statement 3, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/m_painter.htm; Byrne, Tr. 226-28.

[79] Wiseman & Ellig, *supra* note 74 (App. A).

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and on April 9, 2003, Virginia approved a measure to permit interstate direct shipping).[80] McLean was chosen as a relevant retail area because the socio-economic status of many residents in McLean (and northern Virginia, generally) made it likely that several local bricks-and-mortar outlets would cater to sophisticated wine drinkers.[81]

The study analyzes the prices and labels available to McLean consumers for the 50 most popular wines identified in *Wine and Spirits* magazine's 13th Annual Restaurant Poll, published in April 2002.[82] The study compared the prices and availability of the sample wines on the Internet to the prices and availability in retail wine stores located within a ten-mile radius of McLean between early June and early July 2002. Online prices were calculated with and without the cost of various types of shipping. Offline prices were calculated with and without the cost of automobile mileage, using the federal reimbursement rate.

### 3. Findings

The study found that the Internet offers consumers many wines that are not available in bricks-and-mortar stores. In total, 15 of the 83 wines in the sample (approximately 18%) were unavailable through the Virginia retail outlets searched, whereas only four of the 83 wines in the sample (approximately 5%) could not be found through retail channels online. When excluding those wines that could not be found either offline or online, 12 of the 79 wines – 15% – were not available in bricks-and-mortar stores within ten miles of McLean, but were available online. Moreover, many of these wines include popular labels. For the bottles that were unavailable in the McLean vicinity, 8 out of 15 (approximately 53%) came from among the 20 most popular bottles in *Wine and Spirits*' restaurant poll. Table 1 lists these wines.[83]

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[80] Bolick v. Roberts, 199 F.Supp.2d 397 (E.D. Va. 2002), *vacated*, Bolick v. Danielson, 330 F.3d 274 (4th Cir. 2003); Virginia Acts of Assembly, H.B. 1652 (approved by the Governor on April 9, 2003). *See also* Washington Post, *Ruling on Wine Sales On Hold Pending Appeal*, Apr. 4, 2002, 2002 WL 17587893.

[81] As a result, any estimate of the "variety effect" would likely be conservative and could not be dismissed as driven by the choice of a location where few fine wines would likely be available. While McLean was chosen, any community in northern Virginia that was reasonably close to Washington, D.C. would have been equally appropriate for the study, and given the nature of the data, it is doubtful that the results would differ appreciably in a different market (with the possible exception that the expensive wines might be less available in less affluent areas).

[82] The survey actually identifies 83 individual bottles. The difference between ordinal rankings (the "Top 50") and sample size (83) follows from the fact that *Wine and Sprits* recognizes all relevant bottles that fall under a given winery's varietal when it identifies the most popular Chardonnays, Merlots, and other wines. For example, Cakebread's Chardonnay received 244 points, making it the third most popular wine overall, but *Wine and Spirits* recognized two bottles, the "Napa Valley" and the "Napa Valley Reserve," as "Cakebread Chardonnay," and hence included both in the sample. Of the 83 bottles, 79 were available for retail sale at the time the study was conducted.

[83] The winery popularity ranking was determined by how many mentions per 100 respondents the winery received in the *Wine and Spirits* restaurant poll.

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The study also found that, depending on the wine's price, the quantity purchased, and the method of delivery, the Internet can offer consumers lower prices. In many cases, the online and offline price differences are statistically significant. Excluding transportation costs, the bottles in the sample are, on average, $5.84 (16%) less expensive if purchased online. Including transportation costs, the price effect varies with the quantity purchased, and with whether a consumer chooses to ship via standard ground service, 3rd Day Air, or 2nd Day Air. An online purchaser might save, on average, as much as $3.54 per bottle when buying a whole case and shipping via standard ground service, or pay as much as $7.26 more per bottle on average when buying a single bottle for 2nd Day Air delivery. Table 2 summarizes the relevant price data.

Even including transportation costs, however, consumers can save substantial amounts of money on more expensive wines by buying online. For bottles priced at $20.00 or more, a McLean consumer can save an average of between $4.40 and $7.19 per bottle by buying online, or 5-13%, depending on the shipping method and quantity purchased. For bottles priced at $40.00 or more, a McLean consumer can save an average of between $15.00 and $18.45 per bottle by buying online, or 13-21%, again depending on the shipping method and quantity purchased. If consumers use the least expensive method of direct shipping (ground service), they could save an average of 8-13% on wines costing more than $20.00 per bottle, and an average of 20-21% on wines costing more than $40.00 per bottle. Some individual wines priced below $40 were always less expensive offline.

The following tables summarize these results:

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**Table 1: Wines Unavailable at Bricks-and-Mortar Retail Outlets**

| Winery | Varietal[84] | Wine Label | Bottle Rank |
|---|---|---|---|
| Cakebread Cellars | CA | Napa Valley | 16 |
| Caymus Vineyards | CA | Napa Vly. Special Selection | 49 |
| Duckhorn Vineyards | M | Three Palms | 8 |
| Ferrari-Carano Winery | CH | Alexander Vly. Reserve | 7 |
| Ferrari-Carano Winery | M | Alexander Valley | 22 |
| Ferrari-Carano Winery | SB | Alexander Valley Fume | 40 |
| Jordan Vineyard & Winery | CA | Alexander Valley Estate | 24 |
| Kendall-Jackson Vineyards* | CA | Calif. Proprietors Reserve | 49 |
| Kendall-Jackson Vineyards* | M | Calif. Proprietors Reserve | 15 |
| La Crema (Kendall-Jackson) | P | Russian River Valley | 49 |
| Murphy Goode Estate | SB | Fume Reserve | 49 |
| Robert Mondavi Winery | CA | Napa Valley | 19 |
| Stag's Leap Wine Cellars | CA | SLD Fay | 11 |
| Sterling Vineyards* | M | Central Coast - Vintners Collection | 6 |
| The Hess Collection | CA | Napa Valley (Mt. Veeder) | 9 |

[84] The abbreviations for varietals are as follows: CH = Chardonnay; CA= Cabernet Sauvignon; SB = Sauvignon Blanc; M = Merlot; P = Pinot Noir; and Z = Zinfandel. An asterisk (*) indicates that the bottle could not be found in any online inventories.

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**Table 2: Online Savings or Premium**

| | $ Savings/ Premium, Single Bottle | $ Savings/ Premium, 6 Bottles (per bottle) | $ Savings/ Premium, 12 Bottles (per bottle) | % Savings/ Premium, Single Bottle | % Savings/ Premium, 6 Bottles (per bottle) | % Savings/ Premium, 12 Bottles (per bottle) |
|---|---|---|---|---|---|---|
| **All Wines** | | | | | | |
| No transp. costs | $5.84** | $5.84** | $5.84** | 15.8** | 15.8** | 15.8** |
| Ground | $1.51 | $3.34** | $3.54** | -8.5** | 2.4 | 3.6* |
| 3d Day Air | -$2.44* | $0.70 | $1.35 | -27.2** | -10.3** | -7.0** |
| 2d Day Air | -$7.26** | -0.77 | $0.11 | -48.1** | -18.1** | -13.4** |
| **Under $20** | | | | | | |
| No transp. costs | $1.66** | $1.66** | $1.66** | 9.7** | 9.7** | 9.7** |
| Ground | -$3.14** | -$0.93** | -$0.70 | -2.7** | -9.7** | -7.8** |
| 3d Day Air | -$7.05** | -$3.58** | -$2.89** | -54.3** | -28.3** | -23.2** |
| 2d Day Air | -$11.39 | -$5.04** | -$4.22** | -82.8** | -38.5** | -32.6** |
| **>=$20** | | | | | | |
| No transp. costs | $9.44** | $9.44** | $9.44** | 21.1** | 21.1** | 21.1** |
| Ground | $5.51** | $7.03** | $7.19** | 7.6** | 12.9** | 13.4** |
| 3d Day Air | $1.54 | $4.40* | $5.01** | -3.9 | 5.2** | 7.0* |
| 2d Day Air | -$3.69 | $2.91 | $3.65 | -18.2* | 0.8 | 3.1 |
| **>=$40** | | | | | | |
| No transp. costs | $20.61** | $20.61** | $20.61** | 25.3** | 25.3** | 25.3** |
| Ground | $17.88* | $18.39** | $18.45** | 19.6** | 20.6** | 20.7** |
| 3d Day Air | $13.57 | $15.76* | $16.26* | 12.9** | 16.6** | 17.3** |
| 2d Day Air | $6.97 | $14.28 | $14.99* | 3.0 | 14.3** | 15.2** |

*Significantly greater than zero at the 90% confidence level.
**Significantly greater than zero at the 95% confidence level.

At the most basic level, Virginia's ban on interstate direct shipping harmed consumer choice. Consumers could find only a limited number of wines on store shelves, and the wines

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that were unavailable included some of the more popular bottlings. Moreover, the quantitative findings likely understate the impact of the direct shipment ban on variety. Since the entire 83-bottle sample consisted of the more popular wines, it excluded thousands of lesser-known labels that bricks-and-mortar retailers may not have carried, and that consumers may not have known. In addition, to the extent that individuals had heterogeneous and strongly-held preferences, consumers who sought to purchase these wines may have been significantly worse off if they settled for less-preferred substitutes.

The price calculations also may understate potential consumer savings because the averages for the entire sample and the "$20 and up" category include some wines for which the online price savings are negative – i.e., the wines that are always cheaper offline. A cost-conscious shopper could have saved more money than the figures imply by purchasing online only those bottles that were less expensive online, and then purchasing the remainder at local stores. Finally, to the extent that consumers placed some value on their time, direct shipping lets consumers avoid the "cost" of spending time to travel to a bricks-and-mortar store.[85]

### C. Other Evidence Indicates that Bans on Interstate Direct Shipping Raise Prices

Other evidence also indicates that consumers could save money if they had the option of buying wine online. By buying online, consumers can avoid some of the costs of the three-tier system. According to private estimates, a wholesaler typically marks up a bottle of wine by 18-25%.[86] Some private analysts contend that "wine and spirits have the most expensive distribution system of any packaged-goods industry by far, with margins more than twice those in the food business."[87] In the North Carolina case, the Fourth Circuit stated that "wine sold through the three-tiered system is more expensive than the same or comparable wine sold in-state [directly to consumers] because wine distributed through the three-tiered structure is subjected to two 'mark-ups' in price that local wine does not face."[88] Wholesalers, in contrast, assert that the three-tier system is very efficient.[89] From the materials presented to FTC staff, it is not clear whether wholesalers are efficient or inefficient, but regardless of the actual mark-up imposed by the three-tier system, the Internet gives consumers the option of trying to avoid some of those costs. On the other hand, if the three-tier system is efficient and provides consumers with competitive prices, then consumers will still have the freedom to purchase wine through that route.

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[85] *See generally* Clifford Winston, *Conceptual Developments in the Economics of Transportation: An Interpretive Survey*, 23 J. ECON. LIT. 57, 77 (Mar. 1985).

[86] Freedman & Emshwiller, *supra* note 4, at A1; Billingsley, *supra* note 13, at 4.

[87] Freedman & Emshwiller, *supra* note 4, at A1 (citing statements from Booz Allen & Hamilton Inc.).

[88] Beskind v. Easley, 325 F.3d 506, 515 (4th Cir. 2003).

[89] Freedman & Emshwiller, *supra* note 4, at A1 (citing statements from Juanita Duggan of the Wine and Spirits Wholesalers of America); Gray, *supra* note 8, at 2.

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Moreover, even if consumers choose to buy wine from a bricks-and-mortar retailer, direct shipping still encourages price competition between online and offline sources.[90] In reciprocity and limited importation states, the Internet allows wineries and other merchants across the nation to compete with local bricks-and-mortar retailers. The Internet helps consumers comparison shop and lets suppliers compete in geographic markets that otherwise may be closed to them, perhaps due to the three-tier system or state wine franchise laws.[91] This competition likely forces down prices. In the Texas case, the court found that the ban on interstate direct shipping constituted "economic protectionism, negatively impacting Texas consumers because of more limited wine selection and higher prices."[92]

Likewise, in his written statement, Dr. McFadden explained the prevailing economic view:

> In common with most economists, I believe that consumers benefit from free markets operated with the minimum government regulation required for consumer protection. The history of government regulation of markets is littered with examples of restrictions, ostensibly adopted on behalf of consumers, that instead protect concentrated economic interests at the consumers' expense. The restrictions on direct purchase of premium wines and their interstate shipment that have been adopted by a number of States are, I believe, another example of abuse of the regulatory process to protect concentrated economic interests, going far beyond the minimum regulations needed to maintain the integrity of taxation and to protect minor consumers.[93]

For these reasons, FTC staff concludes that interstate direct shipping would give consumers the opportunity to save money on their wine purchases.

### D. Other Evidence Indicates that Bans on Interstate Direct Shipping Decrease Selection

Besides raising prices, bans on interstate direct shipping decrease consumers' choices. In two recent opinions, federal courts found that, given the costs of the three-tier system, the bans

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[90] *See* Daniel L. McFadden, Written Statement 3, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/mcfadden.pdf.

[91] *See*, *e.g.*, Public Comments, American Bar Association, Section of Antitrust Law at 10, at http://www.ftc.gov/opp/ecommerce/anticompetitive/comments/aba.pdf.

[92] Dickerson v. Bailey, 212 F.Supp.2d 673 (S.D. Tex. 2002), *incorporating* Dickerson v. Bailey, 87 F.Supp.2d 691, 709-10 (S.D. Tex. 2000), *aff'd*, No. 02-21137, slip op. at 2 (5th Cir. June 26, 2003).

[93] McFadden, *supra* note 90, at 1.

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prevent consumers from gaining access to many different wine labels. One court found that Florida's interstate direct shipping ban "has the practical effect of preventing many small wineries from selling their wine in Florida. This result occurs because it is not cost-effective for the smaller out-of-state wineries to acquire a Florida wholesaler."[94] Similarly, another court found that many producers cannot afford to distribute their wines through the three-tier system in Texas:

> Because out-of-state producers must go through Texas-licensed wholesalers and retailers to sell wine in Texas, they suffer higher costs which translate into higher prices . . . [G]iven the small number of Texas wholesalers and the burgeoning number of wineries, the requirement that they go through Texas wholesalers essentially may lock most of them out of any access to Texas markets, even if they are willing to take on the additional costs. Such discrimination is especially felt by small, family-run wineries with limited production.[95]

Aside from the costs of the three-tier system, most retailers simply do not have the shelf space to carry thousands of different wine brands. In its written statement, the American Vintners Association contended that retailers in many markets carry only a small fraction of available wines:

> Today, there are more than 25,000 domestic wine labels – most of which are produced by small wineries. However, even in a robust market like Illinois, only slightly more than 500 of these labels are available through the three-tier system – less than 2 percent of all labels produced by domestic wineries.[96]

Thus, the Wine Institute reports that, as of 1998, only 17% of its members had distribution in all 50 states through the three-tier system.[97] Moreover, even if a wine label is available in one part of the state, say in a large metropolitan area, that label may not be readily available in other parts of the state that may have fewer, or smaller, retailers.[98] Many wine consumers appear to place particular value on variety. One wine magazine, for example, reviews over 10,000 different wines annually.[99] Similarly, Dr. McFadden stated that "the value to

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[94] Bainbridge v. Bush, 148 F.Supp.2d 1306, 1311 n.7 (M.D. Fla. 2001), *vacated on other grounds*, Bainbridge v. Turner, 311 F.3d 1104 (11th Cir. 2002).

[95] *Dickerson*, 212 F.Supp.2d at 694-95.

[96] Sloane, *supra* note 11, at 2.

[97] Gross, *supra* note 17, at 2.

[98] *Id.* at 5.

[99] Sloane, *supra* note 11, at 1.

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consumers of direct wine shipments com[es] primarily from access to wines that are not available in their communities."[100]

Although not an independent basis for FTC staff's conclusions, anecdotal evidence also indicates that the bans limit consumer choice. Prior to the FTC's workshop, numerous consumers in numerous states submitted comments complaining that the bans prevented them from purchasing particular brands of wine.[101] FTC staff received more complaints about interstate direct shipping laws than about any other single restriction or practice in any other industry.[102] In a well-publicized incident, one state's direct shipping ban prevented a sitting governor from receiving a case of wine as payment for a bet. Two governors had bet on Super Bowl XXXVII. The losing governor agreed to send the winning governor avocados, pistachios, fish tacos, and a case of 1999 Reserve Cabernet Sauvignon. Because the winning governor's state banned direct shipping, however, the losing governor could not ship the wine directly to him. The losing governor also could not personally deliver the wine to the winning governor, because that state restricted personal transportation of wine to one gallon per resident, which is less than a case. Ultimately, the governors agreed that the losing governor would have to deliver the wine personally to the winning governor – at a governors' conference in Washington, D.C.[103]

While consumers in many states can use special order procedures to purchase wine, such procedures are at best an imperfect substitute for direct shipping. They are often burdensome and expensive. In Virginia, for example, the state's Alcohol Beverage Control stores would special order a wine only if the consumer agreed to purchase a full case.[104] Similarly, in North Carolina, a consumer must obtain a permit and find willing wholesalers and retailers, or find a supplier willing to pay $102 to get a Non-Resident Wine Vendor Permit.[105] Even with consumer-friendly special order procedures, however, consumers typically must pick up the wine from a bricks-and-mortar store and pay a handling fee, thus foregoing the convenience of home delivery.

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[100] McFadden, *supra* note 90, at 2. For a discussion of the importance of variety, see Thomas B. Leary, *The Significance of Variety in Antitrust Analysis*, 68 ANTITRUST L.J. 1007 (2001).

[101] *See* Public Comments, at http://www.ftc.gov/opp/ecommerce/anticompetitive/comments/index.html.

[102] *See id*. Of the nine public comments about wine, six were from consumers complaining that direct shipping laws restricted their selection.

[103] Carol Emert, *Bush Can't Pop Davis' Bottle: Wine Delivery Snafu Screws up Governors' Super Bowl Bet*, S.F. CHRON., Jan. 30, 2003, at A2; Peter Wallsten, *Fight Rages over Wine-Shipping Rights*, MIAMI HERALD, Apr. 9, 2003.

[104] Bolick v. Roberts, 199 F.Supp.2d 397, 444 (E.D. Va. 2002) (addendum to district court's opinion), *vacated on other grounds*, Bolick v. Danielson, 330 F.3d 274 (4th Cir. 2003).

[105] Beskind v. Easley, 197 F.Supp.2d 464, 467-68 (W.D. N.C. 2002), *aff'd in part*, *vacated in part*, 325 F.3d 506, 510 (4th Cir. 2003).

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For these reasons, states could greatly expand consumer choice by allowing interstate direct shipping.

### E. Many States Have Adopted Less Restrictive Means of Regulating Direct Shipping, and These States Report Few or No Problems with Direct Shipments to Minors

Closed states argue that they have to ban interstate direct shipping to limit sales to minors.[106] These states point to the evidence showing that large numbers of minors both use and have easy access to alcohol. They suggest that interstate direct shipping would contribute to the problem by giving minors another avenue of purchasing alcohol. They also argue that they cannot effectively regulate out-of-state suppliers, and that package delivery companies have neither the incentives nor the means to verify a recipient's age. These states point to numerous compliance checks, or stings, finding that minors can procure wine online. Similarly, the wholesalers point to a study suggesting that home delivery of alcohol increases underage drinking.[107]

On the other hand, wineries and wine consumers argue that there is little evidence that minors actually buy wine online, or that minors can buy wine more easily online than from retail stores. They contend that states have adequate legal redress, through TTB and various statutes, against out-of-state suppliers that ship wine illegally, and that package delivery companies can limit sales to minors by requiring an adult signature from the recipient. They also point out that many closed states allow direct shipping from in-state sources, which suggests that it is possible to establish workable safeguards against deliveries to minors.[108]

In practice, many states have decided that they can prevent direct shipping to minors through less restrictive means than a complete ban, such as by requiring an adult signature at the point of delivery. These states generally report few, if any, problems with direct shipping to minors. The staff, however, is aware of no systematic studies assessing whether direct shipping causes an increase in alcohol consumption by minors. The principal sources of information – data from state compliance checks and one empirical study on home alcohol delivery – are inconclusive on this point.[109] Notably, some states may explicitly pursue a policy of elevating

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[106] *See generally* Mead, *supra* note 51.

[107] Gray, *supra* note 8, at 3. The study is discussed in Section III.E.3, *infra*.

[108] *See generally* Genesen, *supra* note 11, at 2; Gross, *supra* note 17, at 5-6. Approximately ten closed states allow intrastate direct shipping. *See* note 62.

[109] Outside of the direct shipping context, officials have implemented many policies to limit underage drinking. From 1980 to 1993, following the nationwide adoption of 21 as the minimum legal drinking age, underage drinking rates decreased substantially. Since then, underage drinking rates have remained generally steady, challenging educators and local authorities to devise new methods to address this issue. Recent research shows that "norms clarification" (use of data to show minors that, in fact, most youth do not drink to excess) and increased enforcement of legal drinking age laws have been effective. National Institute on Alcohol Abuse and Alcoholism, *A*

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prices above competitive levels to promote temperance. The evidence from the FTC staff study suggests that an interstate shipping ban primarily deprives consumers of access to lower-cost sources of high-end, expensive wines. FTC staff has seen no evidence indicating whether higher prices for these types of fine wines would curtail consumption significantly either among the general populace, minors, or problem drinkers.

### 1. Examples of Less Restrictive Alternatives

As an alternative to banning interstate direct shipment of wine, some states have adopted less restrictive means to satisfy their regulatory objectives. For example, some states register out-of-state suppliers and impose various civil and criminal penalties against violators. Several states, including Nebraska, New Hampshire, and Wyoming, require out-of-state suppliers to register and obtain permits (a permit can be conditioned on the out-of-state supplier's consent to submit to the state's jurisdiction). None of these states reported any problems with interstate direct shipping to minors.[110]

Moreover, in the direct shipping cases, multiple federal courts argued that states have less restrictive enforcement alternatives:

- New York: "The Court concludes that it is doubtful whether the ABC Laws – and particularly the exceptions – are grounded in the promotion of temperance but that, in any event, viable (socially conscious) alternatives to discrimination against out-of-state wineries are available."[111]

- Texas: "The Court agrees with Plaintiffs that for established local interests . . . there are reasonable, nondiscriminatory alternatives, including more narrowly drawn statutes, to the disputed statute's over-inclusive total ban on direct shipping."[112]

- Virginia: "Though the Court finds that enforcement is a valid and important concern, banning direct shipments from out-of-state while permitting the same

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*Call to Action: Changing the Culture of Drinking at U.S. Colleges* (2002).

[110] *See* Letters from Nebraska, New Hampshire, and Wyoming (App. B).

[111] Swedenburg v. Kelly, 232 F.Supp.2d 135, 147 (S.D. N.Y. 2002).

[112] Dickerson v. Bailey, 212 F.Supp.2d 673 (S.D. Tex. 2002), *incorporating* Dickerson v. Bailey, 87 F.Supp.2d 691, 710 (S.D. Tex. 2000), *aff'd*, No. 02-21137, slip op. at 2 (5th Cir. June 26, 2003).

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> activity in-state is not the only means of exercising the state's police power and performing its public safety duty."[113]

Similarly, several federal courts have suggested that registration and labeling requirements could be effective regulatory tools. In the Virginia case, the court wrote that "a state can monitor the direct shipment of goods, including liquor, into the state and require such imports to bear labels to prevent diversion without having to implement a full scale bar to all importation through discriminatory means."[114] In the Florida case, the Eleventh Circuit found that "Florida could license and regulate out-of-state wineries that intend to ship to Florida consumers through a licensing process similar to that employed with in-state wineries."[115] The Eleventh Circuit also stated that "vigorous enforcement of criminal penalties and threats of license revocation could be used to control the sale of alcohol to minors."[116] No court has found that states have no alternative to banning interstate direct shipping to limit sales to minors.

Several federal courts also suggest that the fact that the closed states allow intrastate direct shipping indicates that they likewise could exercise sufficient regulatory control over interstate direct shipping. While the closed states argue that they need to subject out-of-state suppliers to the three-tier system, they do not necessarily apply the three-tier system's full regulatory controls to in-state suppliers. In the Virginia direct shipping case, the court found that the state exercises less regulatory control over in-state direct shippers:

> [O]ff-premises licensees who are also producers and importers may not be required to pass the product through a wholesaler or retailer to deliver the product to consumers, and thus they are subject to less than the full-force and exposure of the three-tier system.[117]

The court in the New York case also suggested that states could apply the same types of measures to limit abuses from interstate direct shipping as from intrastate direct shipping:

> The Court believes that the important goals of temperance and prohibiting the sale of wine to minors can be addressed (in a nondiscriminatory manner) for out-of-state as well as for in-state wineries . . . As Plaintiffs point out, "the exemption for in-state firms undercuts the defense, for the same safeguards can be

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[113] Bolick v. Roberts, 199 F.Supp.2d 397, 446 (E.D. Va. 2002) (addendum to district court's opinion), *vacated on other grounds*, Bolick v. Danielson, 330 F.3d 274 (4th Cir. 2003).

[114] *Id.* at 435 n.29 (citing North Dakota v. United States, 495 U.S. 423 (1990)).

[115] Bainbridge v. Turner, 311 F.3d 1104, 1110 (11th Cir. 2002).

[116] *Id.* (citing FLA. STAT. ANN. §§ 562.11, 562.111).

[117] *Bolick*, 199 F.Supp.2d at 409.

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> taken to ensure compliance of out-of-state products with health and safety concerns."[118]

In the North Carolina case, the Fourth Circuit made a similar statement:

> The fact that North Carolina finds it unnecessary for its Twenty-first Amendment purposes to require in-state wine manufacturers to sell and distribute through a system as tightly regulating as the three-tiered system suggests that it should also find it unnecessary to require out-of-state sources to sell and distribute through the three-tiered system. . . . [T]here is no evidence that North Carolina's movement in the direction of selective deregulation of alcoholic beverages is an exercise of the State's Twenty-first Amendment power to regulate alcoholic beverages in promotion of temperance or any other Twenty-first Amendment interest.[119]

Courts have suggested that in addition to regulating the suppliers, states also could develop statutory systems that would impose similar requirements on package delivery companies as on retail stores. One court concluded that "[t]here is no practical difference from requiring such a procedure and that required of store clerks or bartenders who regularly check customers for valid identification to verify age before allowing the sale of alcoholic beverages."[120] For instance, Michigan requires that retailers make a "diligent inquiry" to verify a customer's age, such as by examining a picture identification.[121] States could impose similar requirements on delivery personnel, including training requirements, along with appropriate penalties. In Illinois, for example, package delivery companies "may face business or criminal offenses for failure to report [alcohol shipments] to the [Illinois Department of Revenue]."[122] Many states go beyond verification and require that package delivery companies obtain an adult signature at the point of delivery.[123]

To the extent that minors do buy wine online, closed states argue that they lack adequate enforcement tools against out-of-state suppliers. Supported by the wholesalers, these states contend that they cannot readily inspect the records of out-of-state suppliers, and that because of jurisdictional constraints, "there is no easy way to shut [out-of-state suppliers] down if violations

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[118] *Swedenburg*, 232 F.Supp.2d at 149.

[119] Beskind v. Easley, 325 F.3d 506, 516-17 (4th Cir. 2003).

[120] Bolick v. Roberts, 199 F.Supp.2d 397, 445 n.41(E.D. Va. 2002) (addendum to district court's opinion), *vacated on other grounds*, Bolick v. Danielson, 330 F.3d 274 (4th Cir. 2003).

[121] Mead, *supra* note 51, at 3.

[122] Illinois letter (App. B).

[123] *See*, *e.g.*, New Hampshire letter (App. B).

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occur."[124] The closed states also argue that out-of-state suppliers have little incentive to prevent sales to minors, in part because of enforcement difficulties, but also because individual states can only punish out-of-state suppliers with the loss of a small part of their market, not the loss of a license.[125] The closed states note that, in contrast, they can readily inspect in-state wholesalers and retailers on-site, run compliance checks, and punish violators with the loss of a license, fines, and other penalties.[126]

Others argue that states do have effective legal remedies against out-of-state suppliers that ship to minors. The Twenty-First Amendment Enforcement Act gives state attorneys general the power to bring civil actions in federal court for injunctive relief against out-of-state suppliers that violate the state's liquor laws.[127] At the time the law took effect, in 2000, state authorities agreed that the Act would help them enforce their laws against out-of-state suppliers. The National Alcohol Beverage Control Association ("NABCA"), another association of state regulators, stated that the Act would "provide state governments with an effective tool to use in preventing the illegal interstate flow of alcohol beverages, some of which finds its way into the hands of underage drinkers."[128] NABCA also said that the Act would help states "overcome the jurisdictional hurdles" in enforcing their laws.[129]

Furthermore, TTB, which has the authority to revoke a winery's basic permit, has stated that it will assist states in combating significant violations of state law:

> ATF [now TTB] could under appropriate circumstances take administrative action against a basic permit where a basic permittee ships alcohol beverage products into a state in violation of the laws of that state. . . . ATF will respond to an official state request for assistance only where a written determination has been made by the chief administrative officer of the state liquor enforcement agency or the State Attorney General that the conduct violates state law and ATF has independently determined that the state law violation has some pronounced

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[124] Gray, *supra* note 8, at 4. *See also* Mead, *supra* note 51, at 5-6.

[125] Mead, *supra* note 51, at 3-6.

[126] *Id.*; William H. Hurd, Written Statement 5-6, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/hurd.pdf.

[127] Walter letter, *supra* note 40, at 2; Bolick v. Roberts, 199 F.Supp.2d 397, 442 (E.D. Va. 2002) (addendum to district court's opinion), *vacated on other grounds*, Bolick v. Danielson, 330 F.3d 274 (4th Cir. 2003).

[128] Letter from James M. Goldberg, counsel for NABCA, to Jonathan Rusch, Special Counsel for Fraud Prevention, U.S. Department of Justice 2 (Mar. 19, 2001), attached as an enclosure to the Walter letter, *supra* note 40.

[129] *Id.* *See also* Illinois letter (App. B) (noting that Illinois could use the Act).

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> impact on the regulatory and/or criminal enforcement scheme of the state in question. That is, ATF will evaluate the conduct in question in relation to the proper exercise of its Federal authority over matters that necessitate Federal intervention.[130]

States also can request assistance from other states' alcohol agencies. New Hampshire will punish suppliers licensed in New Hampshire if another state proves that the supplier is shipping wine illegally into that state:

> Upon notification by authorities in another state which imposes a reciprocal enforcement policy, a New Hampshire licensee proved to be making illegal direct shipments to consumers and licensees in said state shall be subject to action by the liquor commission. Such actions may include fines and suspension and revocation of New Hampshire liquor licenses.[131]

Likewise, when officials in Louisiana learn of a violation, they have a duty to notify both TTB and the state that licensed the violator, and to "request those agencies to take appropriate action."[132]

### 2. Empirical Evidence from States that Allow Interstate Direct Shipping

To gather information on the actual experiences of states that have employed less restrictive alternatives, FTC staff contacted officials from numerous reciprocity and limited importation states and asked them a variety of questions, including whether they had experienced problems with interstate direct shipping to minors. Most of the surveyed states provided written responses. Staff also reviewed testimony from a California alcohol regulator who had testified before California's legislature.

In general, these state officials report that they have experienced few, if any, problems with interstate direct shipment of wine to minors. Most of them do not believe that interstate direct shipment of wine to minors is currently a serious problem, although several of them believe that it is possible for minors to buy wine online. Appendix B contains the written responses of the state officials that provided them, and also contains testimony from the California regulator.[133] The following table summarizes these states' views:

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[130] ATF, Industry Circular No. 96-3, Direct Shipment Sales of Alcohol Beverages (Feb. 11, 1997), at http://www.atf.treas.gov/pub/ind_circulars/ic_96-3.htm.

[131] N.H. REV. STAT. ANN. § 178:14-a(VIII) (2000).

[132] LA. REV. STAT. ANN. § 26:359(G) (West 2001).

[133] The responses are cited based on their state of origin. *E.g.*, "Colorado letter."

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**Table 3: The Experiences of Reciprocal and Limited Importation States**

| State | Summary of Experience |
|---|---|
| California (previous testimony) | "[F]or at least 20 years there was never a problem that was brought to our attention with regard to sales to minors or the importation of a product that was harmful . . . the kids, unfortunately, can find ways to buy it here far, far to[o] easy." |
| Colorado | "Colorado, like many other states, has encountered problems with out-of-state shippers selling and shipping wine . . . We do not have any specifics of shippers shipping directly to minors . . . The complaints we receive are mainly from licensed liquor retailers concerned about competition from unlicensed sources. Investigation of these complaints usually results in a warning to the shipper. We have not taken any legal actions against any shipper." |
| Hawaii (County of Kauai) | Reporting "No, at least not to our knowledge" on any problems with shipments to minors. Also reporting that "Futuristically speaking, it has the potential to become a major problem," but that as of today, "I do not believe it is a serious problem in my county." |
| Illinois | "The Illinois Liquor Control Commission (ILCC) has received no reports regarding minors obtaining wine from out-of-state shippers . . . I do not believe many minors would opt to purchase wine online due to the increased cost over brink-and-mortar [sic] establishments and due to the product itself, as my experience indicates minors would probably choose to purchase other alcoholic products over wine. I believe the direct shipment of wine to minors is (c) not a serious problem." |
| Nebraska | "We have also not, as yet, received any complaints or alleged violations. Therefore, at this time, it does not appear to be a serious problem." |
| New Hampshire | "We suspect there may be some instances where this is occurring but we have very little evidence in this area and do not believe this is a serious problem at this time. . . . Due to the high cost of shipping and the fact that the minor has to wait for the wine to arrive makes purchasing wine at a local retail[er] more desirable." |
| North Dakota | Reporting "No information" on any problems with shipments to minors. |
| Washington | "I can not verify any circumstances that a[n] out of state shipper has shipped wine to a minor. I have heard 3rd and 4th party stories of wine being shipped to a minor using a parents [sic] credit card. . . . I would guess that if a mechanism was in place, it has happened. On a Nation wide basis, I would say it is a problem of concern." |
| West Virginia | "We have received no complaints nor have we issued any violations for direct shipping of wine to minors within West Virginia. . . . I do believe that direct shipping of wine to minors is possible as procedures and methods currently exist." |
| Wisconsin | Reporting "no complaints," and concluding both that online sales to minors is "not a serious problem" and that minors can obtain alcohol more easily through "bricks-and-mortar" stores. |

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|---|---|
| Wyoming | "Retailers and consumers regularly contact our office when they feel a violation of the liquor code has or is occurring. We have not had any complaints brought forward regarding a minor receiving a direct shipment of wine since the July 1, 2001 [law] went into effect." |

Although several of these state officials believe that minors may be able to buy wine over the Internet, none of them report more than isolated instances of minors buying or even attempting to buy wine online. Some of them, such as California, have monitored the issue of alcohol delivery to minors for years or even decades.[134]

These state officials offer many possible explanations for their experiences. Several state officials opined that minors are more interested in beer and spirits than wine.[135] As noted earlier, this view mirrors a previous FTC report, which concluded that "[w]hen youngsters first start drinking, they consume primarily beer and wine coolers; by twelfth grade, students use all types of alcohol, although beer use is most common."[136] In the same vein, a past president of the National Conference of State Liquor Administrators stated that minors rarely buy alcohol via the Internet or through the mail because "kids want instant gratification."[137]

New Hampshire concluded that minors are less likely to purchase wine online because of the extra expense of ordering over the Internet.[138] These conclusions correspond with the McLean study, which found that when transportation costs are included, lower-end wines are more expensive when purchased over the Internet than through the three-tier system.[139] Minors would have to pay a hefty premium, from 33-83%, to purchase a bottle of wine costing less than $20 online and have it delivered to them via 2nd Day Air. New Hampshire's conclusion also comports with economic studies that find that young people purchase less alcohol when prices are higher.[140]

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[134] *See* California testimony (App. B).

[135] Illinois letter; Washington letter (App. B).

[136] FTC's Self-Regulation Report, *supra* note 50, at App. A.

[137] Karen Brooks, *Texas Wineries in an Uproar over Bill; Measure Would Reinforce Restriction on Direct Out-of-State Shipping*, FORT WORTH STAR-TELEGRAM, Mar. 20, 1999, at 1 (quoting Randy Yarbrough, who was also an administrator for the Texas Alcoholic Beverage Commission).

[138] New Hampshire letter (App. B).

[139] Wiseman & Ellig, *supra* note 74 (App. A).

[140] *See* Frank J. Chaloupka et al., *The Effects of Price on Alcohol Consumption and Alcohol-Related Problems* (Aug. 2002), National Inst. On Alcohol Abuse and Alcoholism, at http://www.niaaa.nih.gov/publications/arh26-1/22-34.htm (examining the impact of prices changes on underage consumption of beer). FTC staff have not found studies examining the price-sensitivity of minors for other specific types of alcohol, such as wine.

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Several state officials commented that, based on their experience, minors were much more likely to buy alcohol through offline sources than over the Internet.[141] Likewise, in a 2002 survey, large percentages of high school students, from 68-95%, said that it is "fairly easy" or "very easy" to get alcohol.[142] A California regulator interpreted similar survey data as indicating that minors could easily find alcohol offline.[143]

Of course, the fact that states have received few complaints about direct shipments to minors does not establish that minors are not purchasing wine online. As noted by a Michigan Assistant Attorney General, minors who buy wine online are unlikely to report their purchases to the authorities, and neither the package delivery company nor the supplier may know or care that they are delivering wine to a minor.[144] FTC staff cannot rule out the possibility that minors are buying wine online undetected by state officials.

Two things, however, are clear. First, several states that permit interstate direct shipping have adopted various procedural safeguards and enforcement mechanisms to prevent sales to minors. New Hampshire, for example, requires an adult signature at the time of delivery, permanently revokes the direct shipping permit of anyone who ships wine to minors, and declares him guilty of a class B felony.[145] Second, states that allow interstate direct shipping generally say that direct shipping to minors currently is not a serious problem, and that they have received few or no complaints about direct shipping to minors.

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[141] *See* California testimony; letters from New Hampshire and Wisconsin (App. B). In the same vein, the court in the Texas case found that closed states do not promote temperance by banning direct shipment of out-of-state, but not in-state, wines:

> The Court finds that there is no temperance goal served by the statute since Texas residents can become as drunk on local wines or on wines of large out-of-state suppliers able to pass into the state through its distribution system, and available in unrestricted quantities, as those that, because of their sellers' size or Texas wholesalers or retailers' constraints, are in practical effect kept out of state by the statute.

Dickerson v. Bailey, 212 F.Supp.2d 673 (S.D. Tex. 2002), *incorporating* Dickerson v. Bailey, 87 F.Supp.2d 691, 710 (S.D. Tex. 2000), *aff'd*, No. 02-21137, slip op. at 2 (5th Cir. June 26, 2003).

[142] *See* notes 47-50 and accompanying text.

[143] California testimony (citing studies "that show that 87 percent of our high school seniors have reported that they consume alcohol. About 67 percent of those say that they can buy it. So as to the issue of minors purchasing these products and having it shipped in, I don't think that's going to happen in California, because the kids, unfortunately, can find ways to buy it here far, far to[o] easy") (App. B).

[144] Mead, Tr. 196.

[145] New Hampshire letter (App. B).

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### 3. Other Empirical Evidence

State compliance checks, or stings, are one potentially important piece of evidence that could help determine whether online wine sales increase underage drinking. Several closed states have conducted stings on interstate direct shipments of wine. Typically in these stings, states provide a minor with a credit card to see whether the minor can purchase wine online, and whether the supplier or package delivery company will refuse to deliver it to the minor.[146]

Stings are an integral part of many states' efforts to deter alcohol sales to minors. As noted by a former president of the National Conference of State Liquor Administrators, "every state that has used a minor to do a sting has been able to buy."[147] For example, Michigan found that "[a]bout one in three websites contacted" (roughly 33%) agreed to sell alcohol to the minor with no more age verification than a mouse click, and that UPS delivery people did not properly verify the recipients' ages.[148] Besides Michigan, other states also have found that minors can buy wine online. In South Dakota, a minor who worked in the governor's office made a supervised purchase of wine online using another employee's credit card, and received the wine in an unmarked package.[149] New York and Kentucky have also conducted successful stings.[150]

Several states, such as California, Illinois, and New Hampshire, compared the availability of wine online to the availability of alcohol offline. In terms of the data, many states have conducted stings of bricks-and-mortar retailers. The bricks-and-mortar stings typically find that minors are able to buy alcohol between 15-30% of the time.[151] In Michigan, minors were able to buy alcohol 55% of the time after showing a valid Michigan license that identified the customer as a minor.[152] In examining offline and online stings, there are not enough data from which to conclude that minors can buy wine more easily or less easily online than offline (among other

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[146] *E.g.*, Mead, *supra* note 51, at 2.

[147] Brooks, *supra* note 137, at 1 (quoting Randy Yarbrough).

[148] Mead, *supra* note 51, at 2. Aside from stings, Michigan also has seized 174 illegal direct shipments of alcohol, including high-end and low-end wine, although it is not clear whether any of these shipments were intended for minors. *Id.*; Mead, Tr. 209-10.

[149] Letter from William J. Janklow, Governor of South Dakota, to Scott Eccarius, House Speaker, South Dakota (Mar. 8, 2001). *See also* Gray, *supra* note 8, at 3.

[150] Shanker, *supra* note 4, at 358 n.29.

[151] Letter from Tina Schultz, National Alcohol Beverage Control Association, to FTC 2-4 (Jan. 31, 2002) (citing state statistics). *See also* Texas Alcoholic Beverage Commission, Minor Sting Operations (last updated Dec. 3, 2002), at http://www.tabc.state.tx.us/enforce/minor.htm (discussing Texas' experience with stings); New Hampshire letter (noting a success rate of 30% in bricks-and-mortar stings).

[152] Schultz letter, *supra* note 151.

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reasons, there is far more sting data about offline sales). In the absence of such information, it is difficult to ascertain whether online wine sellers are, or would be, a significant source of alcohol for minors.

The online sting data also provide little evidence about the effectiveness of alternatives to a complete ban on direct shipping.[153] A Michigan Assistant Attorney General, reporting results of a sting, suggested that drivers sometimes deliver alcohol to individuals between the ages of 18 and 21:

> [W]e had UPS deliver all of the purchases, and at best, when there was a sticker saying, "adult signature required," they would make sure the person was 18. They did not make sure that the person was 21, even when it was identified as an alcohol product.[154]

It is also possible, however, that adequate training could have prevented some of the deliveries to minors. Other states offered evidence suggesting that package delivery companies are capable of verifying a customer's age. New Hampshire requires that shippers verify the purchaser's age both at the time of purchase and at the time of delivery; New Hampshire has run compliance checks in the past but did not report any problems with interstate direct shipping to minors.[155]

Unfortunately, there is no systematic empirical data revealing how often couriers obtain a valid adult signature. FTC staff contacted both FedEx and UPS, and neither company keeps such records. Both companies, however, have adopted policies that require their couriers to obtain adult signatures. FedEx's standard customer agreement states that "[e]ach recipient must sign for shipments received and be prepared to provide proof of identification and age at the time the package is received." FedEx's delivery policy sets forth several other requirements for shipping wine:

- All packages containing wine are required to have the Adult Signature sticker affixed it.
- Recipients must be 21 years old and show valid identification.
- Under no circumstances are signature releases honored.

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[153] At the workshop, no one testified that online verification procedures are effective in limiting sales to minors. Some panelists contended that online verification procedures are ineffective because minors can circumvent them if they have access to a credit card. *See* Gray, *supra* note 8, at 3.

[154] Mead, Tr. 197.

[155] New Hampshire letter (App. B).

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- Indirect deliveries are not allowed. Packages are delivered only to the recipient's address.[156]

FedEx also verifies the liquor licenses of its wine shippers, and is working with some states to provide monthly reports on wine shipments.[157]

UPS requires an adult signature for all wine deliveries.[158] For all alcohol shipments, UPS requires that its customers purchase UPS's Delivery Confirmation Adult Signature service. Through this service, the package's barcode tells the courier that an adult signature is required. UPS instructs its drivers to request an identification if the recipient does not appear to be 21 years of age or older. UPS reports that some shippers have tried to ship wine without proper labels, and on these occasions UPS notified those shippers that further infractions could result in termination of UPS's services.

Another potential source of useful information would be empirical studies assessing whether legal interstate direct shipment of alcohol causes an increase in underage drinking. FTC staff found only one study that might address the impact of direct shipment of wine on underage drinking. While not specifically addressing online sales or direct shipment via package delivery companies, this study examines the impact of "home delivery" of alcohol on underage drinking ("the home delivery study").[159] Of the studies presented to FTC staff at the workshop, this is the only one that examines the effect of direct shipping on underage access to alcohol.[160]

The home delivery study analyzes survey responses by high school seniors, 18-to-20 year olds, and liquor stores in fifteen small and mid-sized communities in Wisconsin and Minnesota. "Home delivery" includes any delivery to the home, regardless of the source – an Internet retailer, an in-state or out-of-state winery, or a local retailer (it is not clear from the study if the

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[156] Letter and attachments from Robert Fleishman, outside counsel for FedEx, to FTC (Jan. 31, 2003).

[157] *See* Gross, *supra* note 17, at 4.

[158] Letter and attachments from Cheryl Isenberg, UPS Legal Dep't, to FTC (Mar. 3, 2003).

[159] Linda A. Fletcher et al., *Alcohol Home Delivery Services: A Source of Alcohol for Underage Drinkers*, J. STUD. ALCOHOL 61: 81-84 (2000).

[160] No studies examine the precise issue of online wine sales' effect on underage drinking; to date, "no studies have yet been reported regarding the effect of allowing alcohol to be sold directly over the Internet, telephone, or through the mail." *See* Affidavit of Henry Wechsler in Support of Defendants' Cross Motion for Summary Judgment and in Opposition to Plaintiffs' Motion for Summary Judgment (Aug. 10, 2001), submitted in Swedenburg v. Kelly, 232 F.Supp.2d 135 (S.D. N.Y. 2002). Dr. Wechsler, an expert witness for the defendants in *Swedenburg*, is the director of the Harvard School of Public Health College Alcohol Studies Program. Most other studies consider other aspects of underage drinking, or use data that is too general from which to draw conclusions. *See*, *e.g.*, *Swedenburg*, 232 F.Supp.2d at 148 n.27 (discussing a study that compares aggregate binge drinking rates in reciprocity states versus three-tier states).

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sample actually included any Internet retailers). Ten percent of high school seniors, and 7.3 percent of 18-to-20 year olds, reported buying alcohol for home delivery. Those who drank more frequently or engaged in binge drinking were more likely to have bought alcohol for home delivery. Retail stores selling keg beer were more likely to offer delivery.

Although the findings raise important issues of concern, the study provides little information upon which to assess the impact of interstate direct shipping on underage drinking. As the authors acknowledge, the survey did not ask either age group how much alcohol they purchased for home delivery or how frequently they did so. Accordingly, the study does not indicate whether home delivery is a significant source for either group of minors. Overall, the home delivery study shows that some minors can evade compliance checks and obtain alcohol through home delivery, just as they can through bricks-and-mortar stores. The study does not, however, assess whether home delivery or direct shipping increases underage alcohol consumption above the level that would occur without those channels.

### F. Many States Have Adopted Less Restrictive Means of Regulating Direct Shipping, and These States Report Few or No Problems with Tax Collection

Some states also have adopted less restrictive means of protecting tax revenues while permitting direct shipping, such as by requiring out-of-state suppliers to obtain permits and to collect and remit taxes.[161] Most of these states report few, if any, problems with tax collection. Nebraska, for example, reports that they "have also not, as yet, had any problems with the collection of excise tax[es]."[162] North Dakota reports that "Taxes are collected. No problems to date that we are aware of."[163] To the extent that states have problems with out-of-state suppliers, they have addressed the problem in less restrictive ways than banning all interstate direct shipping. New Hampshire, for example, works with out-of-state suppliers:

> [T]he State of New Hampshire Liquor Commission collects an 8% fee on all shipments into the State of New Hampshire. When the NH Liquor Commission discovers an improper shipment we contact the company and inform them of the laws in NH. Once the company learns of NH laws they normally get a permit or stop shipping into NH. The NH Liquor Commission is working with out-of-state supplier[s] and encouraging them to obtain a permit.[164]

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[161] *See*, *e.g.*, LA. REV. STAT. ANN. § 26:359(B)(1); N.H. REV. STAT. ANN. § 178:14-a(V); NEV. REV. STAT. § 369.462.

[162] Nebraska letter (App. B).

[163] North Dakota letter (App. B).

[164] New Hampshire letter (App. B).

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Some workshop participants argued that out-of-state wine shippers would voluntarily comply with state tax requirements. At the workshop, the Wine Institute, a trade association for wineries, indicated that wineries "will embrace any kind of scheme that would require the payment of taxation if we can simply get access to the markets."[165] The Wine Institute also indicated that it has introduced model legislation in many states that requires tax collection.[166] To the extent that out-of-state suppliers fail to comply voluntarily, states can report problems to TTB or other states, or use the Twenty-First Amendment Enforcement Act.[167] Indeed, TTB issued its Industry Circular in response to complaints that some suppliers were not paying taxes.[168]

Finally, regardless of whether states permit or prohibit interstate direct shipping, there is no reason to believe that legalized direct shipping would increase tax evasion. It is unlikely that states would increase illegal interstate direct shipping by creating procedures that would allow out-of-state suppliers to ship legally and pay taxes. Michigan, for example, reports that many out-of-state suppliers ship wine illegally into Michigan, and that those suppliers do not pay taxes to Michigan.[169] Michigan, however, already prohibits out-of-state suppliers from shipping wine into Michigan, and out-of-state suppliers that ship into Michigan are already breaking the law.[170]

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[165] Gross, Tr. 229.

[166] *Id*. It is unclear how much tax revenue is at stake. The National Conference of State Liquor Administrators ("NCSLA") has estimated that direct shipment costs states "tens of millions of dollars" in lost tax revenue. ATF, Industry Circular No. 96-3, Direct Shipment Sales of Alcohol Beverages (Feb. 11, 1997) (citing NCSLA). Many states that allow interstate direct shipping, however, collect relatively small amounts of revenue from interstate direct shipping. For fiscal year 2001-2002, Louisiana collected $17,000 through direct shipping taxes versus $130 million paid through the three-tier system. Painter, *supra* note 78, at 3. It is not clear whether this relatively low tax collection results from a small volume of interstate direct shipments or from suppliers avoiding taxes, although a Louisiana official suggested that the low collection reflected low demand for interstate direct shipments. *Id*. *See also* Byrne, Tr. 226 ("It is not a lot of commerce" in New Hampshire). In any event, many of the reciprocity states forego tax collection on interstate direct shipments altogether. *E.g.*, Letters from Colorado and West Virginia (App. B).

[167] *See* Section III.E.1, *infra*.

[168] *See* ATF, Industry Circular No. 96-3, Direct Shipment Sales of Alcohol Beverages (Feb. 11, 1997); 27 U.S.C. § 122a (2002); Walter letter, *supra* note 40, at 2. In the Florida lawsuit, the Eleventh Circuit remanded the case to the district court for further factual findings on whether Florida's statutory scheme "is necessary to effectuate the proffered core concern [of collecting excise taxes] in a way that justifies treating out-of-state firms differently." Bainbridge v. Turner, 311 F.3d 1104, 1115 (11th Cir. 2002).

[169] Mead, *supra* note 51, at 7-8.

[170] At the workshop, Michigan did not indicate whether it has tried to use the Twenty-First Amendment Act or TTB against out-of-state suppliers that violate Michigan's law. In a subsequent phone call, Michigan indicated that it had never attempted to use the Act, and had instead relied on Michigan's statutes. Michigan also indicated that it had reached a consent agreement with package delivery companies requiring those companies to seize illegal shipments of alcohol into Michigan.

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By legalizing direct shipping and requiring shippers to pay taxes as a condition for receiving a license, states could allow interstate direct shipping from out-of-state suppliers that comply with the law. If suppliers who currently ship illegally continue to ship illegally, then the level of tax evasion would remain unchanged, but if some suppliers who currently ship illegally decide to ship legally, then tax evasion would fall.[171]

## IV. Recommendations

Based on an extensive review of the empirical data, the testimony at the workshop, and other evidence, FTC staff believes that states could enhance consumer welfare by allowing direct shipping from out-of-state wineries and retailers, as well as from in-state suppliers. State bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine. By allowing interstate direct shipping, states would give consumers the opportunity to save money on their wine purchases, and would let consumers choose from a much greater variety of wines. Consumers also could enjoy the convenience of home delivery.

Policymakers may have other interests in the direct shipping debate besides low prices, product variety, and convenience. In particular, many workshop participants raised concerns about underage alcohol consumption and tax collection. Many states have opted to address these concerns through policies that restrict competition less than an outright ban on direct shipping. For example, many states require that suppliers and package delivery companies comply with stringent requirements, similar to those that apply to bricks-and-mortar retailers, with respect to verifying a customer's age. These states generally report few or no problems with shipments to minors. States also have other less restrictive tools available to them. As several federal courts have discussed, states can develop penalty and enforcement systems to provide incentives for both out-of-state suppliers and package delivery companies to comply with the law. Moreover, states can work with other states to deter and to penalize suppliers that ship wine illegally, particularly to minors. New Hampshire, for example, will punish a licensee if another state proves that the licensee is shipping wine illegally into it. Finally, states can also work with federal authorities, including TTB, to deter and to penalize suppliers that ship wine illegally, particularly to minors.

Some of the states that permit direct shipping have also adopted measures that allow them to collect taxes on interstate wine shipments. The most common measure is to require that out-

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[171] A similar analysis applies to two other problems. Anecdotal evidence indicates that some states have had problems with some wine clubs that ship wine without getting the necessary licenses, and with "brown boxing," a practice whereby some suppliers ship wine in a container that does not indicate that it contains alcohol. *See generally* Carol Emert, *Wineries in State Resort to Bootlegging: Shipping Restrictions Force Many to Rely on Subterfuge*, S.F. CHRON., Feb. 16, 2003, at A1. While the extent of these problems is not clear, no evidence indicates that states would exacerbate them by allowing interstate direct shipping. The fact that some wine clubs and suppliers are willing to break the law does not indicate that states would increase illegal interstate direct shipping by creating procedures whereby other suppliers could ship legally.

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of-state suppliers agree to pay taxes to obtain permits. These states generally report few or no problems with tax collection.

Of course, states will consider a variety of factors when choosing their regulatory structures. It is worth noting, however, then even a less restrictive alternative may still constrain competition to some extent. Even seemingly small fees can deter smaller wineries from shipping wine to a particular state,[172] and some states have created licensing procedures that deter suppliers and package delivery companies from shipping wine to those states. A policy that encourages competition would ensure that permit procedures, fees, and regulations are reasonably calculated to meet the state's legitimate regulatory goals.

## V. Conclusion

This report has focused on the most restrictive regulatory barrier to e-commerce in the wine industry, state bans on interstate direct shipping. Wine is one of several industries where outright bans prevent consumers from purchasing goods and services online from out-of-state suppliers. Others include automobiles, where state auto franchise laws prevent manufacturers from selling new cars directly to consumers over the Internet (or in any other way), and contact lenses, where some states effectively prevent online competition by requiring that consumers purchase replacement lenses only from a licensed optometrist or ophthalmologist, or through a face-to-face transaction.

Besides the outright bans, many industries face a variety of more subtle barriers to e-commerce. In mortgage lending, for example, some states require that out-of-state online vendors maintain an in-state physical office. In other industries, such as the medical and legal professions, states require that out-of-state online vendors have an in-state professional license. The wine industry also faces more subtle barriers to e-commerce, including bans on online orders, very low quantity limits, advertising bans, and overly-burdensome license or permit requirements for individuals, shipping companies, and suppliers.

A complete assessment of barriers to e-commerce in these other industries awaits future FTC staff reports. Nevertheless, the wine debate illustrates several key principles that policymakers should consider as they address the growth of e-commerce:

- **Legacy laws can unintentionally inhibit e-commerce.** In many cases, state bans on interstate direct shipment of wine exist not as a response to e-commerce, but because the three-tier distribution system developed before the Internet even existed. As e-commerce continues to expand, the potential cost to consumers of restrictions will rise. Consequently, legacy laws that inhibit e-commerce merit re-examination.

[172] McFadden, Tr. 228 (noting that even a $200 fee can deter small wineries from shipping).

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- **New laws restricting e-commerce deserve careful scrutiny.** Not all restrictions or penalties for direct shipping are of ancient vintage. Some states, for example, have recently converted interstate direct shipping from a misdemeanor to a felony. On numerous workshop panels, consumer representatives and scholars warned that new restrictions on e-commerce often are driven more by the desire to protect established businesses than to protect consumers. Given this risk, proposals for new restrictions on e-commerce, or harsher penalties for existing violations of the law, deserve careful scrutiny.

- **Not all licensing is created equal.** Some states that permit interstate direct shipping use licenses and permits to make suppliers identify themselves and agree to abide by the state's laws. In these states, licensing appears to have little negative impact on e-commerce. In other states, however, high license fees or cumbersome procedures impede e-commerce by imposing substantial costs on suppliers, delivery companies, and consumers. For states that favor licensing, the key challenge is to craft a licensing regime that is only as burdensome as necessary to satisfy the state's objectives. Reciprocal licensing agreements with other states may provide one means of accomplishing regulatory objectives at lower costs to consumers.

- **States may have alternatives to in-state office requirements.** A common argument for prohibiting interstate direct shipping is that states can only enforce the law against in-state suppliers. This argument also arises in other contexts where states require sellers of goods or services to maintain in-state offices and hire state residents. States may, however, have less burdensome means of regulating out-of-state suppliers. Through permits and cooperation with federal law enforcement agencies and other states' enforcement agencies, states may be able to permit e-commerce while still satisfying their regulatory objectives.

- **Not all "level playing fields" benefit consumers equally.** In the wine context, states could "level the playing field" either by prohibiting all direct shipping or by permitting interstate as well as intrastate direct shipping. The FTC staff study of McLean, Virginia suggests that Virginia consumers will benefit from the Commonwealth's recent decision to achieve policy neutrality by legalizing interstate direct shipping. Virginia's experience illustrates a general principle: although there are many ways to avoid discriminating against a group of suppliers, a pro-consumer approach would attempt to achieve policy neutrality by expanding consumer choice.

By incorporating these principles into the policymaking process, states could develop policies that both satisfy their regulatory objectives and provide consumers with the benefits of e-commerce.

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# APPENDIX A

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# How Many Bottles Make a Case Against Prohibition?

## Online Wine and Virginia's Direct Shipment Ban[1]

**Alan E. Wiseman**
**Assistant Professor of Political Science**
**Ohio State University**
**wiseman.69@osu.edu**

**Jerry Ellig**
**Acting Director**
**Office of Policy Planning, Federal Trade Commission**
**jellig@ftc.gov**

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**Abstract**

This study investigates the effects of the Commonwealth of Virginia's ban on direct wine shipments from out-of-state sellers on wine prices and variety available to consumers in the greater McLean, Virginia area. Our results indicate that Virginia's direct shipment ban reduces the varieties of wine available to consumers and prevents consumers from purchasing some premium wines at lower prices online. Using a sample of 83 wines judged to be "highly popular" in *Wine and Spirits* magazine's annual restaurant poll, we find that 15 percent of wines available online were not available from retail wine stores within 10 miles of McLean during the month the data were collected. The fact that local wine stores may not carry certain wines may result, in part, from other Virginia regulations that affect the structure of the wholesale market. We also find that the lowest quoted online price offered significant cost savings over the lowest local retail price in our survey for many types of wine during the month the data were collected. The extent of any cost savings depends on the price per bottle, the quantity of wine ordered, and the shipping method chosen. For wines costing $20/bottle or more, online purchase of a 12-bottle case could save, on average, 13 percent if shipped via ground. Average savings of up to 21 percent are available on a 12-bottle case of wines costing more than $40/bottle, and purchasers of these wines can save money regardless of the shipping method. Such savings, however, are not consistent for all types of wine; for bottles costing less than $20, consumers would pay an additional 8-83 percent per bottle online. In addition, some individual wines priced below $40 were less expensive in local retail stores.

JEL classifications: 6120, 6333, L110, LO330, L220, L510, L810, L860

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Do current legal regimes encourage or prevent consumers from extracting various benefits from electronic commerce? A growing literature examines how electronic commerce affects the prices and availability of numerous physical goods. Economic theory provides reasons that online prices could be either higher or lower than offline prices, with empirical scholarship reporting mixed results. Online commerce also may increase the variety of products available to consumers, because the products that are not available in bricks-and-mortar stores that are within a reasonable distance or with reasonable search costs may be available online. As with prices, however, the size of the variety effect is an empirical question.

Even if consumers can benefit from cost savings and/or greater variety by shopping online, the current regulatory and legal landscape that governs electronic commerce may affect the degree to which consumers can realize these benefits. This paper tries to assess the manner in which the current legal framework governing wine and alcohol distribution and sales might affect electronic commerce in wine. We provide a modest empirical examination of the potential cost savings and product selection that might be available online to consumers in a particular state in the absence of certain legal restrictions.

The paper is organized as follows. Section 1 provides a brief discussion of the existing literature and commentary on potential cost savings of electronic commerce as well as the policy implications of Internet wine sales. Section 2 discusses, in more detail, the current legal framework that governs interstate alcohol sales and outlines theoretical expectations about what (if any) differences should exist between online and offline wine prices and product inventories. Section 3 discusses the data collection methods employed

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for our price and product variety comparison between online and offline retail channels, and Section 4 presents the findings. Section 5 concludes with a summary, some caveats, and a brief discussion of prospects for future research.

**Section 1: Literature and Policy Issues**

This study adds to the quickly growing body of scholarship that investigates whether consumers can realize nontrivial benefits by shopping online rather than, or in addition to, bricks-and-mortar outlets. Considering the body of existing research, empirical findings are mixed. In auto retailing, for example, users of a referral site that facilitates price competition among dealers (autobytel.com) pay lower prices than they otherwise would have paid (Scott Morton, Zettlemeyer, and Silva-Risso 2001; Zettlemeyer, Scott Morton, and Silva-Risso 2001). Some studies of online auto auctions, CDs, books, and software, in contrast, have found that prices are higher online (Lee 1997, Bailey 1998a, b). A more recent study of books and CDs found that online prices are lower (Brynjolfsson and Smith 2000). Besides price savings, the present study also addresses questions about product variety that consumers may encounter online. Whether these benefits are significant or trivial is an empirical matter, and little scholarship has focused on this particular question.

Studies of prices and product availability in electronic markets are highly relevant to public policy, because many types of regulations may inhibit consumers' ability to purchase specific products online. A recent Federal Trade Commission workshop revealed a wide variety of restrictions affecting the online availability of products as diverse as contact lenses, automobiles, books, real estate, caskets, pharmaceuticals, wine,

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and virtually all types of secondhand merchandise.[2] A better understanding of the costs and benefits of these regulations to consumers could lead to a more informed policy debate.

Along these lines, perhaps no e-commerce topic generates as much controversy as online wine sales. In this debate traditional consumer concerns, such as price and variety, are commonly balanced against other significant public policy goals. In many states, laws prevent or hamper online wine sales by prohibiting out-of-state retailers or wineries from shipping wine directly to customers. Proponents of these laws argue that the economic harm to consumers is slight, and that these laws are necessary to promote temperance, collect alcohol taxes, and prevent underage drinking. (Gray 2002, Hurd 2002, Mead 2002, Painter 2002) Opponents claim that consumers suffer significant harm, and that legitimate concerns about taxation and alcoholic beverage control can be addressed through policies that are less restrictive than an outright ban on direct shipment. (Genesen 2002, Gross 2002, McFadden 2002, Sloane 2002)

Despite a wide array of arguments on both sides, no substantial data (or analysis) has been offered that would allow policymakers to assess the impact of alternative policies on consumers. We seek to remedy part of this gap by comparing online and offline wine prices and product variety for a political jurisdiction where direct shipment from out-of-state wine sellers is prohibited: McLean, Virginia. At the time the data for this study were gathered, the Commonwealth of Virginia banned direct shipment of

[2] See http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm.

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alcoholic beverages to Virginia residents by out-of-state vendors, but permitted direct shipment by in-state wineries, breweries, and retailers.[3]

Drawing on price data from online wine retailers, wineries that sell online, and bricks-and-mortar wine retailers in Northern Virginia, this study offers a snapshot of the retail landscape that a consumer in McLean, Virginia faces when seeking to purchase relatively popular wines in the presence of a ban on direct shipment by out-of-state sellers. By foreclosing online wine purchases from out-of-state sellers, Virginia's direct shipment ban reduces the product selection available to consumers and prevents consumers from purchasing many premium wines at lower prices online.

## Section 2: Legal Regimes and Potential Impacts

### Alcohol Regulation

Unlike most consumer goods that are shipped across state lines, interstate alcohol sales operate under an extremely stringent legal framework. States commonly employ a "three-tiered" system in which manufacturing (i.e., distilling, fermenting, or brewing), wholesaling, and retailing are vertically dis-integrated.[4] The Virginia statute offers a typical justification for the ban on vertical integration:

> The General Assembly finds that it is necessary and proper to require a separation between manufacturing interests, wholesale interests and retail interests in the production and distribution of alcoholic beverages in order to prevent suppliers from dominating local markets through vertical

[3] In March 2002, a federal court declared this law unconstitutional under the Commerce Clause in the belief that it discriminates against out-of-state sellers. Directly following the ruling, the court granted a stay in order to give the state legislature an opportunity to correct provisions of the law found to be unconstitutional. *Bolick v. Roberts*, 199 F. Supp. 2d 397 (E.D. Va. 2002). In the 2003 legislative session, the Virginia General Assembly overwhelmingly approved legislation that would permit out-of-state firms to ship beer and wine to consumers in Virginia if they obtain a permit and remit relevant taxes. This legislation awaits the Governor's signature at the time this study was released. Direct shipment from out-of-state was thus illegal at the time the data for this study were gathered.

[4] The principal exception occurs when states that sell distilled spirits through state-owned liquor stores also choose to perform the wholesaling function, receiving shipments direct from distillers.

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> integration and to prevent excessive sales of alcoholic beverages caused by overly aggressive marketing techniques. (VA Code Sec. 4.1-215.C)

Most wine purchased by Virginia consumers passes through the three-tier system, although in-state wineries are allowed to sell direct to Virginia consumers. Out-of-state wineries must sell to a firm that possesses a license to import wine into Virginia. The importer must then sell to a Virginia wholesaler, who supplies retailers. Wholesalers often also hold licenses to import, and because out-of-state firms cannot obtain Virginia wholesale or retail licenses, their wines must pass through these Virginia businesses before they reach customers (VA Code Sec. 4.1-207).

The direct shipment ban is hardly unique to Virginia. As of July 2002 (when the data for this study were gathered), 23 states allowed interstate direct shipments of wine under certain conditions, whereas 27 prohibited it, with seven states classifying direct wine shipments as a felony.[5] While 27 states prohibited interstate direct sales, only 20 states prohibited intrastate direct sales.[6] In seven states, including Virginia, an in-state

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[5] Of those states that allow interstate direct sales, 13 are classified as "reciprocity" states. These states recognize two-way shipping rights between jurisdictions. Just because a state is reciprocal does not necessarily mean that it permits interstate wine shipments from all states. Rather, reciprocity only guarantees that shipping rights from other reciprocal states are acknowledged. In addition, the shipping rights might be restricted only to other reciprocal states. Similarly, the shipping rights might also depend on the kind of wines being shipped, relative alcohol contents, etc. Besides the states that are reciprocal, ten states allow limited direct wine shipments through personal importation laws that allow consumers to receive wine from another state, subject to certain conditions. In some states this privilege requires written approval from the relevant authorities, involves a very limited amount of alcohol, or is subject to other specific state-by-state restrictions.

While unknown to many consumers, personal importation or transportation laws in several states expressly prohibit bringing alcohol across state lines without going through the appropriate distribution channels. Hence, if a consumer drives cross country with a case of wine in his car, he may unwittingly violate a myriad of state-level alcohol laws during his journey as he enters and exits states. Virginia permits individuals to bring into the state, in their personal possession, one gallon or four liters of alcoholic beverages "not for resale," and new residents can bring in a "reasonable quantity" of alcoholic beverages "not for resale" as part of their household goods. (VA Code Sec. 4.1-310.E) In response to post-9/11 restrictions that have made it more difficult for travelers to bring wine home on airplanes, a new federal law permits individuals who place an order in person at a winery to ship to their residences the same amount of wine that their state law would permit them to physically carry into the state.

[6] Several states that ban direct shipment from out-of-state but permit direct shipment from in-state wineries or retailers have seen their bans challenged as unconstitutional restrictions on interstate commerce. Two

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winery can ship wine directly to an in-state customer, but that same customer cannot legally have wine shipped to his residence from another state.[7] Appendix A provides a state-by-state breakdown of direct wine sales laws as of July 2002.

**Online Prices and Variety: Hypotheses**

Laws that permit direct shipment of wine allow wineries and other merchants to compete with in-state bricks-and-mortar retailers who are supplied by wholesalers under the three-tier system. Direct shipment facilitates Internet wine sales by making it possible for these competitors to send their products directly to consumers instead of through the three-tier system of the state in which the customer lives. Both proponents and opponents seem to regard legal direct shipment as a necessary condition for e-commerce in wine.

Therefore, legalized direct shipping offers consumers access to hundreds of wineries and retailers across the nation, rather than the limited number that a typical consumer would likely seek out and visit in the course of shopping offline. Even if a local bricks-and-mortar retail wine market is highly competitive and includes retailers

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such state bans have been upheld in legal challenges, three have been overturned, and two are pending. *Bainbridge v. Bush*, 148 F. Supp. 2d 1306 (M.D. Fl. 2001), *vacated on other grounds*, *Bainbridge v. Turner*, 311 F.3d 1104 (11th Cir. 2002)(Florida), *Heald v. Engler*, No. 00-CV-71438-DT, slip op. (E.D. Mich. Sept. 28, 2001)(Michigan), *Bolick v. Roberts*, 199 F. Supp. 2d 397 (E.D. Va. 2002)(Virginia), *Beskind v. Easley*, 197 F. Supp. 2d 464 (W.D.N.C. 2002)(North Carolina), *Dickerson v. Bailey*, 212 F. Supp. 2d 673 (S.D. Tex. 2002), *incorporating Dickerson v. Bailey* 87 F.Supp.2d 691 (S.D. Tex. 2000)(Texas), *Swedenburg v. Kelly*, 232 F. Supp. 2d 135 (S.D.N.Y. 2002)(New York), *Mast v. Long*, No. CS-01-00298, 2002 WL 31039421, slip op. (E.D. Wash. Sept. 9, 2002)(Washington).

[7] Our discussions with several wine retailers outside of Virginia reveal that some wine retailers and wineries will ship directly into Virginia, while others will not. When the shipping retailers were asked how this activity was legal under Virginia law, they said that when they sell the wine to the consumer and then arrange shipment via 3rd-party carrier, they are effectively transferring ownership of the wine to the consumer and then helping him "ship it to himself." From a legal standpoint then, these retailers claimed that they were absolving themselves of all legal liability once the consumer purchased the wine, and it was the consumer's responsibility to determine whether state law permits such shipments. According to the winery/retailer, it is in compliance with the law, even if the Virginia consumer is unwittingly breaking the law by shipping wine across state lines to himself. For the purposes of this study, we presume that Virginia's direct shipment ban is a binding constraint – an assumption consistent with the existence of

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offering large inventories, we would expect that a consumer could find some additional varieties and better prices when given the option of searching several hundred retailers nationwide.

Nevertheless, economic theory provides several, often conflicting, expectations regarding whether online prices may be higher or lower than offline prices, and whether online shopping gives consumers access to varieties of products that are not available offline within a reasonable distance of the customer. The following section provides a brief discussion of these different perspectives.

**Potential price effects**

***Why online prices may be lower***

There are four possible reasons why online wine prices generally might be lower than offline wine prices: many more sellers, lower search costs, less market power, and lower cost of the online sales channel. (Smith, Bailey, and Brynjolfsson 1999).

The first, and most obvious, explanation for why consumers are sometimes likely to find lower prices by searching online is that the number of online sellers greatly exceeds the number of local retail sellers – particularly the number of local retail sellers whose inventories a consumer could check with reasonable search costs. The online shopbot we used to gather wine prices, Winesearcher.com, can access more than 700 online retailers and a number of wineries – many more than a consumer likely would visit in person. Even if average prices were the same online and offline, the opportunity to search many more retailers online means that the consumer is more likely to encounter a lower price online.

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high-profile litigation, court findings in that litigation, and the push to remove the ban in the 2003 legislative session.

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Another explanation for why online prices may be lower than offline prices is based on search costs. By reducing the cost of searching price and nonprice attributes, e-commerce could lead to low retail margins and prices online. (Bakos 1997, 2001:71; Wiseman 2001: 28-29) Previous empirical research in other industries has found that online purchases are highly elastic with respect to both online and offline prices (Goolsbee 2001, 2000; Ellison and Ellison 2001; Goolsbee and Chevalier 2002).[8] If wine consumers are price-sensitive, then price-cutting could be a viable business strategy for an electronic wine retailer.

A third economic explanation for why online wine sellers might charge lower prices is that they may be able to circumvent the wholesaler markup paid by offline retailers without incurring substantial alternative costs. Critics of the three-tier system often argue that it may create inefficiencies or create market power for wholesalers by creating barriers to entry (state licensing) and limiting intrabrand competition by requiring producers to give exclusive territories to wholesalers. (Gross 2002:3; Sloane 2002:2) Staff of federal antitrust agencies has often opposed state efforts to strengthen the three-tier system on similar grounds.[9]

In the case of Virginia, for example, licensing may create barriers to entry in several ways. One type of entrant -- the out-of-state business -- simply cannot obtain a Virginia wine wholesaler's license. In addition, the Alcoholic Beverage Control Board

[8] Contrary to this research, Degeratu, Rangaswamy, and Wu (1998) found that online grocery purchasers are less price sensitive than offline grocery purchasers

[9] See, e.g., comments of Federal Trade Commission Staff on proposals in Illinois, North Carolina, and Massachusetts at http://www.ftc.gov/be/v990005.htm, http://www.ftc.gov/be/v990003.htm, and http://www.ftc.gov/be/v960012.htm.

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may decline to grant any type of alcohol license for a variety of reasons, including one that appears to grant substantial discretion; a license can be denied if:

> The number of licenses existent in the locality is such that the granting of a license is detrimental to the interest, morals, safety or welfare of the public. (VA Code Sec. 4.1-222 A.3)

Most available empirical studies find that laws permitting or requiring territorial exclusivity for wholesalers of alcoholic beverages do indeed raise prices. (See, e.g., Jordan and Jaffee 1987, Culbertson and Bradford 1991, Sass and Saurman 1996.) While Virginia law bans exclusive territories, it requires the winery to designate a "primary area of responsibility" for each wholesaler to whom it sells, and the winery can have only one distributor in each territory for a single established brand (Code of Virginia Sec. 4.1-404.). Primary areas of responsibility may have the same effect as exclusive territories if wholesalers generally refrain from selling to retailers outside of their primary area of responsibility.

Some aspects of Virginia's three-tier system might confer market power on wholesalers. Direct shipping allows wineries to circumvent this market power by selling direct to consumers online. In addition, to the extent that online customers purchase wine from retailers rather than wineries, direct shipping could reduce market power by placing retailers and wholesalers in different geographic markets in competition with each other. Online wine prices could thus be lower because they might reflect the more competitive conditions online, whereas offline prices could be higher than online prices if local wholesalers possess market power.

Finally, Internet wine prices may be lower if Internet vendors possess lower cost structures or other efficiency advantages. An Internet retailer or winery may have a

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fundamentally different business model that incurs less of the traditional retail costs (stores, sales personnel, etc.)[10] A winery that sells direct to consumers can also bypass transaction cost inefficiencies created by state alcohol franchise laws, which often make it prohibitively costly for a winery to switch wholesalers.

Considering Virginia again, state law specifies that a winery cannot terminate its agreement with a wholesaler in the absence of "good cause," such as state revocation of the wholesaler's license, bankruptcy of the wholesaler, failure to maintain a sales volume or trend for the brand comparable to that of other Virginia wholesalers that carry the brand, or other factors. The wholesaler must be given 60 days to cure any deficiency, and the state's Department of Alcoholic Beverage Control ultimately determines good cause after a hearing. (VA Code Sec. 4.1-406) Virginia law also requires wholesalers to pay an annual licensing fee of $715-$1,430, depending on volume; local governments are permitted to charge an additional $50 license tax. Wholesalers must also post a surety bond of $100,000. (VA Code Sec. 4.1-223.4) Finally, a wholesaler who wants to import must obtain a wine importer's license that costs $285 annually. (VA Code Sec. 4.1-231.2) To the extent that such restrictions increase risk, increase costs, and reduce distribution flexibility, Internet wine retailers may have a cost advantage if they can obtain wine from wholesalers in states with less burdensome regulations. Alternatively, the winery can avoid the regulatory costs created by wine wholesale franchise laws by

[10] One possibility is that online retailers possess lower costs because they can "free ride" off of pre-sale services, such as wine tastings or wine appreciation classes, provided by bricks-and-mortar retailers. To our knowledge, no scholarship has examined the possibility of free-riding in the context of online wine sales. Interestingly, no parties testifying on the (highly contentious) wine panel at the FTC's October 2002 workshop on barriers to e-commerce raised the free rider issue, although it was discussed on panels dealing other industries, such as automobiles. See http://www.ftc.gov/opp/ecommerce/anticompetitive/agenda.htm.

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selling direct via the Internet. In either case, the retail price of wine on the Internet could be lower.

Online wine prices might also be lower due to direct sales from wineries that enjoy transaction cost efficiencies as a result of vertical integration. Two economics papers (Gertner 1999, Gertner and Stillman 2001) suggest that vertically integrated retailers are more likely to sell direct online because vertical integration can lower coordination costs, help solve externality problems, and mitigate channel conflict. Empirical evidence from retailing is consistent with the hypothesis that manufacturers who are already integrated into retailing initiate direct online sales more quickly than non-integrated apparel producers. If vertical integration produces transaction cost efficiencies for wineries, it is also plausible that some of those efficiencies may be passed through to consumers in the form of lower prices. Wineries selling direct may charge lower prices than bricks-and-mortar retailers, and other online merchants may even feel compelled to match these prices.[11]

***Why online prices may be higher***

The literature on e-commerce offers two hypotheses suggesting why online wine prices could be higher than offline prices: value of consumers' time, and reduced search costs for quality attributes.

If Internet wine sellers are not the lowest-cost suppliers, they may charge a higher price and survive because their customers find the convenience worth the extra cost. In

[11] In Virginia, direct shipment provides the only avenue by which out-of-state wineries could integrate forward into retailing, because all out-of-state wine sold in bricks-and-mortar stores must first pass through independent wholesalers. Indeed, one of the explicitly stated purposes of Virginia's Alcoholic Beverage Control laws is to prevent vertical integration. (The only exception is for in-state wineries, which can make retail sales to customers who visit the winery and can ship directly to customers in Virginia.)

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their discussion of price dispersion, Smith, Bailey, and Brynjolffson (1999: 109) suggest that e-retailers who "make it easier to find and evaluate products may be able to charge a price premium to time-sensitive customers." A similar theory could be advanced to explain why Internet prices could exceed offline prices for identical products. Assume that a subset of consumers have a high value of time and thus incur high search costs if they attempt to compare prices at bricks and mortar stores. These customers would likely be willing to pay a premium for the privilege of not having to search multiple physical stores – and not even having to travel to a single store -- to get their wine. Customers with low search and travel costs might still check the Internet prices as part of their search, but they would likely patronize the lower-priced bricks-and-mortar stores.

Perceived product differentiation presents an alternative reason that online wine sales could be higher than offline prices. By reducing the cost of obtaining information on quality attributes, online sales could increase customers' ability to perceive differences between different varieties of wine. As customers are better able to select wines that match their individual tastes, they become less price-sensitive. Experimental evidence is consistent with this theory (Lynch and Ariely 2000). If online wine buyers make greater use of such information than offline buyers, then online buyers may be less price-sensitive and online prices could be higher.

For either of these theories to work, there must be some impediment that prevents online retailers from competing away their profit margins by offering lower prices to consumers or paying higher prices for their wine supplies. For this reason, these theories may more accurately describe how online pricing works when an electronic market is in

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its infancy and there are few competitors, or when some other barrier prevents the emergence of significant online competition.

**Potential variety effects**

***Why online variety may be greater***

There are three principal reasons that consumers may have access to a greater variety of wines online: larger numbers of retailers, intentional product differentiation, and lower fixed costs of marketing and distribution.

The number of online retailers whose products a consumer could search greatly exceeds the number of local retailers that a consumer could reasonably search. One would expect that access to a substantially larger number of retailers would expand the variety of products from which a consumer could choose.

An economic theory that would predict greater product variety online is based on product differentiation. Electronic commerce can facilitate price competition for products that are close substitutes, thus eroding retail margins (Ellison and Ellison 2001). Product differentiation is a possible strategy for muting price competition (Bakos 1997; 2001:71-72; Lynch and Ariely 2000; Wiseman 2000: 30). For online wine sales, differentiation could take several forms that would increase the available number of labels. For example, online merchants could seek out more obscure labels that were not previously available through bricks-and-mortar stores, or lesser-known labels could become available if wineries found that consumers attach greater cachet to wines ordered direct from the winery.[12]

[12] One far-fetched possibility is that wineries could proliferate the number of labels by developing different blends of grape varieties (and adding other fruit juices for non-purists). Over the long run, vineyards may develop and cultivate a larger number of new varieties of grapes, and additional small wineries with distinctive characteristics may come into existence. Given the early state of online commerce and the

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Even if wineries and e-retailers do not consciously seek to increase differentiation in order to reduce price competition, online wine sales could increase variety simply due to the relative costs of selling wine online vs. through bricks-and-mortar stores. Advocates of direct shipping frequently assert that online wine sales give consumers access to a greater variety of wines than they can obtain by visiting the local retailer (Genesen 2002, Gross 2002, McFadden 2002, Sloane 2002). Even with the best distribution system possible, there are several products that wine producers simply will not sell through channels beyond their tasting rooms (or by other direct means). If a consumer who lives in a state that bans interstate direct wine shipments finds himself in a Napa Valley tasting room, he may find a product that he would like to acquire at home. Yet, he may not be able to obtain the wine from a local retailer because the winery does not sell through a wholesale distributor.

The economic theory implicit in this example is that selling a wine through offline retail stores may entail fixed costs (for the vineyard, wholesaler, and/or retailer) that are prohibitively high for relatively small quantities of a particular wine (McFadden 2002:1). Internet technology dramatically lowers the fixed cost of making consumers aware that a particular product or variety even exists (Bakos 2001: 71). Online sales may thus have lower fixed costs per winery, brand, or variety. While the variable costs (e.g. shipping) may be higher, the fixed costs may be sufficiently lower that wineries may profit from online distribution even if sale through the three-tier system is unprofitable. Under these conditions, online shopping should provide access to greater variety.

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substantial lead times involved in developing new wineries and grape varieties, we expect that online commerce has had little effect on these latter factors to date.

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***Why online variety may be no greater***

An alternative product variety hypothesis is offered by wine wholesalers and alcoholic beverage regulators: any product for which there is customer demand can make its way into the existing distribution system. As evidence they cite public opinion polls revealing that the vast majority of alcohol drinkers are satisfied with the selection of beer and wine available in from local retailers (Gray 2002: 4), and relatively little utilization by wineries of legal direct shipping laws enacted by some states (Painter 2002). In economic terms, these parties are suggesting that fixed costs of getting a particular label into the three-tier system are not high enough to reduce variety to any meaningful extent; therefore, if a winery cannot find wholesalers to carry its wines, consumer demand must be negligible.

**Section 3: Data Sources and Calculations**

There is little empirical information on how access to out-of-state wine sellers through the Internet affects the prices and varieties of wines available to consumers. To address this void, this study analyzes the prices and wine selections offered by stores that identify themselves as wine retailers in the greater McLean, Virginia, area for a pre-identified market bundle of popular wines. McLean was chosen as the relevant retail area for several reasons. First, Virginia bans direct sales, and hence it is an appropriate state for which to consider the effects of direct sales laws on product selection and price. Second, given the socio-economic status of many residents in McLean (and Northern Virginia, generally), it seemed likely that several bricks-and-mortar outlets could be found locally that catered to the needs of a sophisticated wine drinking population. As a result, any estimate of the "variety effect" would likely be conservative and could not be

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dismissed as driven by the choice of a location where few fine wines would likely be available.[13] Due to the choice of locality, our results should be interpreted as a comparison of the online and offline prices and product variety available in a locality likely to have a high demand for "better" wines, rather than an illustration of prices and variety available to a "typical" consumer.

**The wine sample**

In an effort to select an unbiased sample of wines that are likely to be popular among wine drinkers who are likely to frequent wine stores, the wine data for this study was drawn from the 13th Annual Restaurant Poll conducted by *Wine and Spirits* magazine. The findings from this poll were published in their April 2002 issue, which identified the "Top 50 Wines" overall, as well as by varietal. One of the benefits of using the *Wine and Spirits* list, rather than a list compiled by a different publication, is that *Wine and Spirits* actually relies on consumer demand for individual wines in compiling their rankings, rather than "expert" opinions, which may be unrepresentative of the wine-drinking public. More specifically, to determine the "Top 50," the publishers sent out a questionnaire on wine sales to 1,995 restaurants in the United States; 381 restaurants responded. The survey asked (among other questions) what each restaurant's top ten selling wines were in the last quarter of 2001. For each of the ten wines listed on a restaurant's response, *Wine and Spirits* assigned a point value ranging from ten (for the best selling wine) to one (for the tenth best selling wine), which contributed towards its

[13] While McLean was chosen, any community in Northern Virginia that was reasonably close to Washington, DC, would be equally appropriate for this study. Given the nature of the data being considered, it is doubtful that the results presented below would differ appreciably if the market being studied was somewhere other than McLean (with the possible exception that the more-expensive wines might be more difficult to find in less affluent areas).

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list of the most popular wines (which were arranged by varietal). For example, if Winery X held spots 1-3 on Restaurant Y's wine list for its Chardonnay, Cabernet Sauvignon, and Merlot, respectively, then its Chardonnay would receive 10 points, its Cabernet would receive 9 points, and its Merlot would receive 8 points, respectively. The ranking of each wine was determined, then, by summing the scores across all respondents.[14]

Given the list of most popular wines, arranged by varietal, the 50 highest point recipients were selected for price comparisons from the collection of Sauvignon Blancs, Chardonnays, Cabernet Sauvignons, Merlots, Pinot Noirs, and Zinfandels produced by American winemakers. The highest ranked wine in this sample is the Sonoma-Cutrer Vineyards Chardonnay, with 464 points, while the 50th-most popular wine is a five-way tie between Caymus Vineyards' and Kendall Jackson Vineyards' Cabernet Sauvignon, Rodney Strong Vineyards' Merlot, La Crema's Pinot Noir, and Murphy-Goode's Sauvignon Blanc with 41 points each. The complete sample of wines analyzed is listed in Appendix B. As can be seen, focusing our attention on the top 50 point recipients actually identifies 83 individual bottles. The difference between ordinal rankings (the Top 50) and sample size (83) follows from the fact that *Wine and Sprits* recognizes all relevant bottles that fall under a given wineries' varietal when it identifies the most popular Chardonnays, Merlots, etc. For example, Cakebread's chardonnay received 244 points, making it the third most popular wine overall, but Wine and Spirits recognized two bottles, the "Napa Valley" and the "Napa Valley Reserve," as "Cakebread Chardonnay," and hence both were included in our sample.

[14] Questions might be raised over whether this list truly represents the most popular wines in the United States, as some of the best selling wines overall (i.e., "jug" wines) are not in this list. While it may be true that certain best selling (and lower quality) wines are not represented in this sample, we find it unlikely that

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Taking this list of 83 bottles, the relevant wineries were contacted, either by phone or Internet, to determine whether all bottlings were available for retail sale, as well as the year of the most recent vintage. Appendix B identifies four bottles with an asterisk that were either unavailable for retail sale to consumers (i.e., they were only sold to restaurants), had been misnamed by *Wine and Spirits*, or could otherwise not be found online. The remaining 79 bottles, which were identified as being currently available vintages, were used for price comparisons between offline and online retail channels.

**Price and variety searches**

We designed our study so that it would reasonably simulate how a serious wine consumer might shop. The online shopper, of course, can access hundreds of retailers and wineries; the shopbot we used to gather prices, "Winesearcher.com," had access to more than 700 wine stores with online inventory access and also listed wine price data from some wineries. We assumed that legalized direct shipping would permit the McLean consumer to order from any of these online sources.

For offline shopping, it is doubtful that a consumer would physically visit (or even phone) every possible source of wine in the area. Consulting "Yahoo! Yellow Pages," we collected a list of every store identifying itself as a "wine retailer" located within a ten-mile radius of McLean.[15] We assumed that a McLean consumer would search several nearby stores that carry large inventories at attractive prices. To guard against the possibility that even large retailers might not always carry a full array of

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these wines would be among those that serious wine drinkers might consider for regular purchase/consumption.

[15] Because Virginia state law expressly bans the importation of alcohol from other states, we only focused our attention on those stores within the ten-mile radius that were located in Virginia. Several reviewers of this paper who drink wine and live in Northern Virginia doubted that a wine consumer would search all 13 wine retailers we identified. If they are correct, then our price and variety findings likely under-estimate the potential benefits of legalized direct shipping.

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lesser-known wines that they could obtain from wholesalers, we also assumed that the consumer might check a number of smaller, specialty wine shops. The list that emerged consisted of the 13 retail outlets identified in Appendix C; it includes several "wine megastores" (Total Beverage) as well as smaller wine shops.

Our sample does not include general grocery stores (e.g., Giant, Safeway) or club stores (e.g., Costco). However, two of the bricks-and-mortar stores searched were beverage megastores known for carrying very large selections at competitive prices. In the personal shopping experience of the authors and several reviewers of this paper, these megastores' everyday prices tend to be lower than or equal to those of grocery stores, but the grocery stores often beat the megastores' prices on lower-priced wines advertised as weekly specials. Hence, if the exclusion of grocery stores affects our price data, it likely overstates the offline prices for some of the less expensive wines that may have been offered by a grocer at a special, lower price at some point during the period when we collected our data. To assess whether the absence of grocery stores affects our results on variety, we made followup visits to several large grocery stores in McLean to see if they carried any of the wines that were unavailable at the stores in our sample that were listed as wine retailers in the Yellow Pages. They did not.

The first step in collecting price information was to contact the wineries directly and find out what prices the wineries were charging for their bottles. It is obvious, however, that there may be other retail channels available through the Internet that might sell wine for prices lower than those available at wineries.

To collect price data from other Internet-based stores, we engaged Winesearcher.com to collect the lowest online retail prices for each bottle in our sample.

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The store name where each bottle was found, as well as its zip code, was also collected and used in calculating transportation costs. Using the shopbot, prices could be found for each of the 79 bottles. Comparing the Winesearcher.com price and the prices collected directly from the wineries, the least expensive price for each bottle was identified as the "best online price" at the time of data collection.

After collecting price data from out-of-state vendors, our next step was to collect price data for our sample from bricks-and-mortar stores. Prices for the bottles in our sample were collected from the 13 bricks-and-mortar retail outlets in one of two ways. Where the retail outlet had an Internet presence that listed its inventory and respective prices, price data were collected online. While these prices were not checked against physical inventory through on-site visits, for the purposes of this study it was assumed that the prices are identical to those in the store.[16] Those stores that had an appropriate web presence are indicated with an asterisk in Appendix C. Alternatively, for the remaining 10 stores, price data was collected by actually visiting the stores in early July 2002 and checking inventory on the shelves and recording its prices. All price data (on and offline) were collected between early June and early July 2002.

A critic might argue that special "sale" pricing during the month over which data were gathered may have distorted our online vs. offline price comparisons. With a search of more than 700 online stores versus 13 offline stores, the probability of finding a wine available at a sale price online may be greater than the probability of finding the same wine at a sale price offline (if individual online and offline wine merchants offer sale

[16] This assumption has been employed in similar price-comparison studies (e.g., Bailey (1998)).

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prices with the same frequency). Our findings thus may overstate price savings for the customer who is content to wait until a sought-after wine comes on sale in a bricks-and-mortar store. On the other hand, any portion of our results that may stem from the increased probability of finding a wine on sale online counts as a legitimate cost saving for the customer who is unwilling to "time the market" and wait until a desired wine comes on sale offline.

***Taxes and transportation costs***

Retail sales and excise tax differentials could affect our price comparisons. We opted to compare prices without sales taxes, in order to ascertain whether Virginians who comply with all state sales and use tax laws (and would therefore pay these taxes both on wine purchased from out-of-state and on wine purchased locally) can save money buying wine online. While it is possible that shoppers in Virginia would try to evade sales taxes if they were allowed to buy online from out-of-state vendors, Virginia's legislation to remove the direct shipment ban requires shippers to obtain a state permit and remit applicable taxes. Wine industry representatives state that they are more than willing to remit taxes to states that permit them to ship directly to consumers. (See FTC 2002: 229) Hence, in the results that follow, sales taxes are not considered; our cost comparisons assume no cost savings due to sales tax evasion.

Excise taxes may also create price differentials if there are significant differences across states or if other states decline to charge excise taxes on wine exported to Virginia. Virginia's excise tax on wine is 40 cents/liter.[17] We declined to include the Virginia excise tax after discovering that a tax that small does not significantly change the results.

[17] Virginia Code Sec. 4.1-234.

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Some of the online prices may include excise taxes imposed by other states, depending on the particular policy of the state where the wine exporter is located.[18]

To address transportation (i.e., shipping and handling) costs, the following procedure was used. For each bottle that would be purchased online, data were collected from the United Parcel Service website (www.ups.com) on the costs associated with shipping boxes of the appropriate size and weight to represent a single bottle, a half case, and a case of wine from the zip code where the online vendor was located (using a daily pickup service) into McLean, Virginia, under a variety of shipping options.[19] We estimated the cost of shipping larger quantities than a single bottle because an online shopper likely would purchase several bottles or an entire case of a given vintage. There are large economies of scale in shipping. Hence, the per-bottle shipping fee associated with an entire case, or at least multiple bottles, of each selection in the "Top 50" is significantly less than for an individual bottle.[20]

This method may either over- or under-state transportation costs to ship wine into McLean, for several reasons. First, because our search process found the least expensive bottle, and we then calculated the cost of shipping it to McLean, it is possible that we overlooked less expensive bottle price/shipping price combinations. For example, if a slightly more expensive bottle was identified, but it was closer to McLean, so it was much less expensive to ship than a bottle from a more distant location, our selection method would not identify this bottle for analysis. Second, this method ignores the

[18] California, for example, rebates excise taxes on all wine that is exported from the state.
[19] The weight and box dimension specifications were based on one of the authors' personal experience, in a political jurisdiction where direct shipping is legal, with out-of-state wine clubs that used packaging of these dimensions and weight for the bottles that they shipped.
[20] For example, it costs $8.81, $14.23, and $16.45 to ship one bottle from Palo Alto, CA to McLean, VA via standard ground, 3rd-day, and 2nd day shipping respectively. In contrast, if a consumer were ordering an

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possibility that a single retailer might be the lowest-cost seller of more than one wine, and so even a customer who wanted only one or two bottles of a particular wine might reap economies of scale in shipping by ordering several different wines simultaneously from the same seller.

The calculation method also ignores the possibility that online wine retailers might impose handling charges in addition to the shipping costs. Since Virginia bans direct shipment, most of the online retailers do not quote shipping rates to McLean. In addition, most of the online retailers in our sample calculate shipping charges after the order is placed, so we do not have good information about additional handling charges or other markups on shipping charges for any delivery location. Several, however, do post shipping and handling information that is accessible without placing an order, and we checked the shipping and handling costs for ground delivery to Washington, DC, the jurisdiction closest to Northern Virginia that permits direct shipment (albeit limited). None of the online vendors who post such information imposes an additional handling charge. Some quote shipping charges that are higher than our estimate, which may indicate that a handling charge is bundled with the shipping charges as a markup. The typical shipping charge posted on web sites exceeds our single-bottle and six-bottle estimate by about $4-$5. Variances between posted and estimated 12-bottle shipping charges vary widely, from $16 below our estimate to $14 above, with a median of approximately $5. Unfortunately, we do not know whether these figures are typical for all online wine retailers in our sample, given that shipping cost data for the various quantities of wine were published on web sites by approximately six retailers. In

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entire case from a retailer in Palo Alto, the per-bottle shipping charges would be $2.93, $5.40, and $6.98 for standard ground, 3rd-day, and 2nd-day shipping respectively.

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addition, a random search of online retailers listed in the Winesearcher.com database revealed several that do not charge a significant premium above UPS rates when shipping to the reciprocity states. Thus, it is possible that some online retailers charge more for shipping than our estimates indicate, but this may be offset by the other two factors that tend to inflate our online cost estimates. In any event, the per bottle difference is not very large for six- and 12-bottle orders.

For bricks-and-mortar stores, transportation costs were calculated using the standard government reimbursement for automobile travel ($0.365 per mile), multiplied by the round-trip distance of the store from McLean, Virginia, as indicated by Yahoo! Maps. These costs were divided by the various numbers of bottles (1, 6, or 12) we assumed the customer purchases. Readers might argue that this method also might overstate transportation costs because consumers might combine their shopping trips for wine with other errands. While this concern may be valid, it is our belief that this method might actually *understate* the relative costs associated with driving around Northern Virginia (especially in peak travel times, such as rush hour). It goes without saying that this method for calculating transportation costs does not account for the opportunity costs associated with visiting numerous wine stores and searching for the lowest-priced wines. Research in transportation economics suggests that individuals attach widely varying valuations to travel time, suggesting that opportunity costs of visiting bricks-and-mortar wine stores may vary widely across customers (Small, Winston, and Yan 2002).

These weaknesses aside, calculating travel costs solely based on mileage reimbursement seemed like the most systematic method to determine the additional expense associated with purchases made at local retailers. To the extent that this

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procedure understates the true expenses associated with transporting wines in Northern Virginia, the reader should take this matter into account when considering the following results.

Using this imputed transportation cost data, we were able to calculate the total price for each bottle on our list, purchased in various quantities.[21] The total price is the sum of the lowest retail price (online or offline) and the relevant transportation cost associated with delivering it to a home residence (via shipping or driving reimbursement). Descriptive statistics for wine prices and transportation costs are presented in Table 1.[22]

**Section 4: Findings**

The price and availability data do not permit us to make a comprehensive analysis of the effect of the direct shipment ban on consumer welfare. A measurement of overall consumer welfare would require quantity data that are not available, data on factors other than price and variety that consumers value, and data on consumer search patterns. Nor should our calculations be viewed as a "comparative static" analysis of the online and offline market equilibria in the presence and absence of the direct shipping ban. Online prices and variety currently may differ from offline prices and variety, but it is possible that the long-run equilibrium in the absence of the direct shipping ban could involve a different set of prices or different selection as bricks-and-mortar stores alter their prices

[21] We ignore quantity discounts, based on our experience that online and offline retailers usually offer similar quantity discounts for purchase of a whole case.

[22] An interesting feature of the data is that the lowest online prices overwhelmingly come not from wineries, but from out-of-state retail outlets that have web-accessible inventories and are listed on winesearcher.com.

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and product selection in response to online competition. A comprehensive long-run analysis would need to take any such changes into account.

Nevertheless, our data do help us assess whether the direct shipping ban in the short run prevents consumers from accessing various wines or prices they could not otherwise receive. In that sense, our study is similar to the pre-deregulation studies that compared air fares in unregulated intrastate markets with regulated interstate fares for flights of similar length. (See, e.g., Levine 1965.) Our results should be interpreted as an indicator of the potential for direct shipment to offer price and variety benefits to consumers, rather than a quantitative prediction of the size of these benefits if the direct shipment ban were lifted.

**Selection**

While we are considering a relatively small product sample in this study, it is instructive to investigate whether consumers' choices are limited because they are not able to shop online for wine from out-of-state vendors. Table 2 lists the wines that were unavailable in Virginia bricks-and-mortar wine retailers within a 10-mile radius of McLean. In total, 15 of the 83 wines in our sample (approximately 18 percent) are unavailable through the Virginia retail outlets searched. In comparison, only 4 of the 83 wines in our sample (approximately 5 percent) could not be found through retail channels online. When excluding from consideration the one wine unavailable online and the three wines that could not be found online or offline, we find that 12 of the 79 wines available online (15 percent) are not available in bricks-and-mortar stores within ten miles of McLean.[23]

[23] Three of the four wines that were unavailable online could also not be found in bricks-and-mortar outlets (the exception being Rombauer Vineyards' Napa Valley Chardonnay).

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An additional issue emerges when considering the characteristics of some of the bottles that are unavailable in the McLean vicinity. The last column of Table 2 presents the *Wine and Spirits* popularity ranking for each bottle. For the bottles that are unavailable in the McLean vicinity, 8 out of 15 (approximately 53 percent) come from among the 20 most popular bottles, according to *Wine and Spirits'* restaurant poll. This finding may mean that some wineries have neglected to gain state approval for sale of popular labels in Virginia, or that wholesalers or retailers in McLean have neglected to carry some wines that would be popular with the region's consumers, or merely that there are regional differences in demand for various wines.

Clearly, though, the McLean consumers who want to purchase these wines are adversely affected by the direct sales ban. For McLean consumers to acquire these bottles, they would have to either widen their search perimeter beyond the 10-mile radius employed here, request special orders through their local retailers (if such arrangements could be made), or risk breaking the law by having wine shipped directly to their residences by merchants employing 3rd-party shipping agents. Regardless of which avenue they chose, it likely would be less convenient for consumers (from a search cost standpoint) to acquire these bottles through bricks-and-mortar outlets than to use the Internet.

**Price**

Virginia's ban on out-of-state direct wine shipments might also affect the prices available to consumers. To assess the cost differences between shopping online and offline, Table 3a presents the average cost savings and/or cost penalties from shopping online for the entire sample of 67 wines that could be found in Virginia bricks-and-mortar

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outlets. Cost differences were calculated first as the difference between the lowest offline price and the lowest online price found via winesearcher.com, or at a given winery's website. We then recalculated cost differences including transportation costs for a variety of shipping options.

The average figures reported in the tables usually reflect a combination of cost savings for online purchase of some wines and cost penalties for online purchase of other wines. Except for the tables reporting results for the most expensive wines, there are always at least a few wines that are cheaper offline, regardless of shipping method. A consumer who purchased each wine from the least expensive source could thus enjoy greater cost savings than our average percentage figures imply.

As is evident from Table 3a, price comparisons between the Internet and bricks-and-mortar stores favor the Internet, where the average price of a bottle in the sample (not accounting for transportation/shipping and handling costs) is $5.84 less if purchased online.[24] The picture changes, however, if one considers shipping expenses, and the lowest-cost option depends on the quantity ordered and shipping method. Depending on the quantity and shipping method, an online customer might save as much as $3.54 per bottle on average when buying a whole case and shipping via ground, or pay as much as $7.26 per bottle more on average if shipping a single bottle via 2nd Day Air. For the most likely quantities – 6 or 12 bottles – the online consumer saves several dollars per bottle if shipping via ground, but the cost difference when shipping via air is not statistically significant.

[24] We opted to exclude Virginia's 40 cents/liter excise tax on wine from the analysis, because the size of these price differences makes it clear that the excise tax would not significantly alter the results.

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Given that wine is a somewhat perishable product (in the sense that a consumer would not want to expose his bottles to extreme heat or cold) it is likely that many shipments would occur through the faster shipping channels such as 3rd Day or 2nd Day Air, in comparison to standard ground service.[25] Hence, while consumers could obviously acquire some wine cheaper online, the incorporation of transportation costs makes it less clear which channel is dominant for consumers who wish to acquire all of the wines in our sample. Nevertheless, it is worth noting that consumers consistently pay more online only when ordering single bottles.

Another perspective can be gained by considering the cost differences between online and offline sales for the more expensive bottles in the sample. Tables 3b and 3c present the average cost savings from shopping online for wines that have offline retail prices equal to or greater than $20.00 and $40.00, respectively.[26] While the sample size decreases when considering these sub samples, dropping from 67 to 36 for bottles equal to or greater than $20.00, and from 36 to 9 for bottles equal to or greater than $40.00, the potential gains from shopping online increase. For the sample of bottles equal to or greater than $20.00, a McLean consumer has the opportunity to save anywhere from $4.40 to $7.19 per bottle on average by shopping online, depending on the quantity purchased and shipping method employed. (After taking shipping costs into account, only two wines priced at or above $20 are less expensive purchased by the case offline.)

[25] The extent to which consumers would prefer to use a faster shipping method will be affected, in large part, by the time of the year that the wine is being purchased. As noted by one California wine retailer with an online presence (www.beltramos.com) if wine needs to be shipped in very cold or very warm weather, they recommend "the fastest service possible."

[26] Transportation costs were recalculated in the appropriate manner to account for consolidation of orders from identical retail outlets.

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Cost differences for 2nd Day Air, and for purchase of a single bottle via 3d Day Air, are not significantly different from zero.

Alternatively, for bottles that are equal to or greater than $40.00 in price, a McLean consumer can save an average of between $15.00 and $18.45 per bottle by shopping online rather than offline. All of the wines priced at or above $40 are less expensive by the case when purchased online, regardless of shipping method. As with the "Over $20" sample, cost differences for 2nd Day Air are not significantly different from zero, except for purchase of a whole case. Hence, it seems clear that at least for the more expensive products, consumers could experience significant savings if the ban were lifted.

The fact that removing direct shipment bans would favor those consumers who are in the market for more expensive wines is further supported by considering Table 3d, which presents the cost savings and extra expenses from shopping online for only those bottles that are less expensive than $20.00. While average online prices are $1.66 lower than average offline prices, these savings quickly wash away when incorporating the relevant shipping and handling charges. Depending on the quantity and shipping method, consumers stand to pay an average of between $0.94 and $11.39 more per bottle by shopping online rather than in bricks-and-mortar stores.

Tables 4a, 4b, and 4c present the data from a slightly different perspective, showing the proportional online cost savings. The entire sample of wines online would be 3.6 percent less expensive (on average) than buying them in a store if purchased by the case and shipped via UPS ground service. The average single bottle would be almost 48 percent more expensive if purchased online and shipped via UPS 2nd Day Air, and even a

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case would be at least 7 percent more expensive if shipped via air. Alternatively, for the wines priced at $20 and above, it would cost an average of 7 percent to 13 percent less (depending on the quantity) to purchase them online and ship via ground service. Savings are negligible or nonexistent if the consumer chooses 2nd or 3d Day Air. Finally, the consumer can save an average of 13 percent to 21 percent on the "$40 and up" wines, depending on the quantity and shipping method. Once again, this result supports the notion that the typical consumer who seeks higher-priced wines could pay less if the direct sales ban were removed.

Table 4d presents the extra cost of buying bottles less than $20.00 online versus offline. While purchasing the lower priced bottles online can save consumers almost 10 percent of what they would pay in bricks-and-mortar stores, this saving evaporates once shipping and handling costs are incorporated into the equation. Consumers would find themselves paying between 8 percent and 83 percent more when purchasing wine online, depending on the quantity and shipping method.

**Section 5: Conclusion**

While electronic commerce has grown to encompass many business-to-consumer transactions, existing laws and regulations prevent certain industries from carrying out their activities on the Web. Current bans on direct shipment prevent a nationwide virtual wine store from emerging anytime in the near future. This study has discussed the legal framework currently governing alcohol sales and has made a modest attempt to assess whether Virginia's prohibition on interstate direct shipment affects the prices and variety available to Virginia consumers.

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Focusing on consumers in McLean, Virginia, and considering a particular search behavior for a bundle of highly popular wines identified by *Wine and Spirits* magazine, our results suggest that McLean consumers may face higher prices and have access to less product variety than they would in the absence of the direct sales ban. Specifically, approximately 15 percent of the wines in our sample are unavailable in 13 bricks-and-mortar stores identified as wine retailers within 10 miles of McLean, but could be ordered online if direct shipment were legal. The effect on consumers may be more significant than this percentage suggests, for two reasons. First, since the sample consists of the more popular wines, it excludes thousands of lesser-known labels that may not be carried by bricks-and-mortar retailers. Second, to the extent that individuals have heterogeneous and strongly-held preferences, the consumers who sought to purchase these wines may be significantly worse off if they settle for less-preferred substitutes.

Many consumers also forego price savings as a result of the ban on direct shipment. On average, consumers could save money on the wines in our sample if they could acquire them from out-of-state vendors, purchase six or 12 bottles, and have them delivered via standard UPS ground service. This finding does not, however, apply to all wines in the sample. For bottles costing less than $20, consumers stand to spend 8 percent to 83 percent more per bottle when shopping online versus shopping offline once transportation charges are taken into account. For wines costing more than $20/bottle, online purchase would save as much as 13 percent on average, depending on the quantity and shipping method. Average savings of up to 21 percent are available on wines costing more than $40/bottle. Many of these averages obscure differences between the costs of

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individual wines; even for the least expensive shipping method, some individual wines priced below $40 are always less expensive offline.

Similar to the findings on variety, it is important to remember that these results likely understate the potential cost savings that come from shopping online. The method employed for calculating shipping costs from remote vendors was conservative. If wine drinkers obtain economies of scale in shipping by ordering more than one wine at a time from the same online retailer, then the available savings from shopping online are usually larger for the consumer who wants only one or two bottles of a given wine.

It is not clear from the data whether these price savings result from lower search costs, mitigation of market power, or lower costs of online retailers. The price savings are largest for the most expensive wines – precisely the ones more likely to be purchased by wealthy individuals with high search costs or connoisseurs for whom product differentiation would matter most. If online wine retailers succeeded in charging a premium for convenience or for product differentiation, then we would expect to see higher online prices for the more expensive bottles.

In considering these conclusions, a few caveats should be noted. First, it is important to emphasize that these findings are based on a short-run partial equilibrium analysis that does not address how online and offline vendors might alter their prices and product selection if the direct sales ban were lifted. If interstate direct shipment into Virginia were legalized, it is possible that offline retailers would reduce prices or offer access to greater inventory, which would benefit consumers but reduce or eliminate the disparity between online and offline variety and price. It is also conceivable that competition from online retailers might reduce variety available offline if the offline

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segment of the market contracts significantly. (But see McFadden 2002.) Further research, in the form of some sort of event history analysis, could try to address this issue more completely by comparing changes in prices and product variety before and after a state altered its alcohol sales and importation laws.[27] Studies comparing similar geographic markets in states with different alcohol laws would also help to provide information about the differences in marketing and retail institutions under different legal regimes. Our findings suggest that such studies may well be worth pursuing.

Second, given the small sample size and the limited scope of the geographic market being analyzed, one should be aware of the limits on generalizing from these results. Future research could easily address this issue by replicating this analysis with other geographic markets that are subject to restrictive alcohol sales and importation laws, as well as using a larger sample of wines.

Finally, we should emphasize that our results reflect assumptions about consumer search behavior that we believe are plausible, but different assumptions might lead to different results. For example, if serious wine consumers include grocery stores in their search, then it is possible that they might find some lower offline prices than we found – especially if they time their purchases to coincide with grocery stores' weekly advertised specials. If a McLean wine drinker is unlikely to travel as much as 10 miles to some of the specialty wine shops in Northern Virginia, then average offline prices might be higher or variety lesser than our results indicate.

[27] Virginia's governor is currently considering a bill that would legalize interstate direct shipping, and interstate direct shipment bans have also been overturned by courts in North Carolina, New York and Texas. If these states change their policies, their experience could provide data for such analysis.

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These caveats aside, this study adds to the debate over the benefits to consumers from legalizing interstate alcohol sales, which would be necessary to facilitate the development of widespread electronic commerce in wine. Further research will only enhance our understanding of the size and scope of the benefits that consumers stand to gain by the development of an additional electronic marketplace.

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**Table 1: Descriptive Statistics**

| Variable | Mean | Std. Dev. | Min | Max | Obs. |
|---|---|---|---|---|---|
| Lowest Online Price | 25.969 | 20.980 | 7.970 | 129.990 | 79 |
| Lowest Offline Price | 28.290 | 23.916 | 8.490 | 169.990 | 68 |
| Transportation Costs (Buying 1 Bottle) | 1.655 | 2.512 | 0.073 | 7.3 | 68 |
| Transportation Costs per Bottle (Buying 6 Bottles) | 0.276 | 0.419 | 0.122 | 1.217 | 68 |
| Transportation Costs per Bottle (Buying 12 Bottles) | 0.138 | 0.209 | 0.006 | 0.608 | 68 |
| Ground Shipment Costs (Buying 1 Bottle) | 5.960 | 0.583 | 4.530 | 6.300 | 79 |
| 3rd Day Air Shipment Costs (Buying 1 Bottle) | 9.985 | 1.714 | 6.350 | 10.980 | 79 |
| 2nd Day Air Shipment Costs (Buying 1 Bottle) | 13.215 | 1.943 | 8.560 | 14.310 | 79 |
| Ground Shipment Costs per Bottle (Buying 6 Bottles) | 2.834 | 0.685 | 1.493 | 3.248 | 79 |
| 3rd Day Air Shipment Costs per Bottle (Buying 6 Bottles) | 5.532 | 1.294 | 2.557 | 6.287 | 79 |
| 2nd Day Air Shipment Costs per Bottle (Buying 6 Bottles) | 7.033 | 1.617 | 3.232 | 7.940 | 79 |
| Ground Shipment Costs per Bottle (Buying 12 Bottles) | 2.504 | 0.711 | 1.051 | 2.932 | 79 |
| 3rd Day Air Shipment Costs per Bottle (Buying 12 Bottles) | 4.737 | 1.150 | 2.072 | 5.404 | 79 |
| 2nd Day Air Shipment Costs per Bottle (Buying 12 Bottles) | 6.115 | 1.532 | 2.594 | 6.982 | 79 |

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**Table 2: Wines Unavailable at Bricks and Mortar Retail Outlets**

| Winery | Varietal[28] | Wine Label | Bottle Rank |
|---|---|---|---|
| Cakebread Cellars | CA | Napa Valley | 16 |
| Caymus Vineyards | CA | Napa Vly. Special Selection | 49 |
| Duckhorn Vineyards | M | Three Palms | 8 |
| Ferrari-Carano Winery | CH | Alexander Vly. Reserve | 7 |
| Ferrari-Carano Winery | M | Alexander Valley | 22 |
| Ferrari-Carano Winery | SB | Alexander Valley Fume | 40 |
| Jordan Vineyard & Winery | CA | Alexander Valley Estate | 24 |
| Kendall-Jackson Vineyards* | CA | Calif. Proprietors Reserve | 49 |
| Kendall-Jackson Vineyards* | M | Calif. Proprietors Reserve | 15 |
| La Crema (Kendall-Jackson) | P | Russian River Valley | 49 |
| Murphy Goode Estate | SB | Fume Reserve | 49 |
| Robert Mondavi Winery | CA | Napa Valley | 19 |
| Stag's Leap Wine Cellars | CA | SLD Fay | 11 |
| Sterling Vineyards* | M | Central Coast – Vintners Collection | 6 |
| The Hess Collection | CA | Napa Valley (Mt. Veeder) | 9 |

[28] The abbreviations for varietals are as follows: CH = Chardonnay; CA= Cabernet Sauvignon; SB = Sauvignon Blanc, M = Merlot; P = Pinot Noir; Z = Zinfandel. An asterisk (*) indicates that the bottle could not be found in any Internet inventories.

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**Table 3a: Cost Savings (Extra Expenses) per Bottle When Shopping Online for Entire Sample**[29]

| Category | Mean | Std. Dev. | Min. | Max. | Obs. |
|---|---|---|---|---|---|
| Online Savings (no transportation costs) | 5.838** | 10.579 | -2.200 | 83.000 | 67 |
| Online Savings (UPS Ground Service - Buying 1 Bottle) | 1.507 | 11.560 | -8.427 | 82.686 | 67 |
| Online Savings (UPS 3rd Day Air - 1 Bottle) | -2.443* | 11.518 | 13.107 | 78.006 | 67 |
| Online Savings (UPS 2nd Day Air - 1 Bottle) | -7.256** | 10.556 | 16.510 | 68.690 | 67 |
| Online Savings per Bottle (UPS Ground Service - 6 Bottles) | 3.342** | 10.701 | -5.436 | 80.749 | 67 |
| Online Savings per Bottle (UPS 3rd Day Air - 6 Bottles) | 0.7066 | 10.720 | -8.475 | 77.711 | 67 |
| Online Savings per Bottle (UPS 2nd Day Air - 6 Bottles) | -0.767 | 10.748 | -10.128 | 76.058 | 67 |
| Online Savings per Bottle (UPS Ground Service - 12 Bottles) | 3.543** | 10.633 | -5.126 | 80.567 | 67 |
| Online Savings per Bottle (UPS 3rd Day Air - 12 Bottles) | 1.353 | 10.644 | -7.598 | 78.095 | 67 |
| Online Savings per Bottle (UPS 2nd Day Air - 12 Bottles) | 0.11 | 10.668 | -9.176 | 76.517 | 67 |

**Table 3b: Cost Savings (Extra Expenses) per Bottle When Shopping Online for Wines Greater or Equal to $20.00 (Offline Price)**

| Category | Mean | Std. Dev. | Min. | Max. | Obs. |
|---|---|---|---|---|---|
| Online Savings (no transportation costs) | 9.435** | 13.376 | -2.000 | 83.000 | 36 |
| Online Savings (UPS Ground Service - 1 Bottle) | 5.512** | 14.348 | -8.008 | 82.686 | 36 |
| Online Savings (UPS 3rd Day Air - 1 Bottle) | 1.526 | 14.268 | -12.688 | 78.006 | 36 |
| Online Savings (UPS 2nd Day Air - 1 Bottle) | -3.693 | 13.234 | -16.310 | 68.690 | 36 |
| Online Savings per Bottle (UPS Ground Service - 6 Bottles) | 7.027** | 13.446 | -5.200 | 80.749 | 36 |
| Online Savings per Bottle (UPS 3rd Day Air - 6 Bottles) | 4.396* | 13.432 | -8.238 | 77.711 | 36 |
| Online Savings per Bottle (UPS 2nd Day Air - 6 Bottles) | 2.912 | 13.45 | -9.891 | 76.058 | 36 |
| Online Savings per Bottle (UPS Ground Service - 12 Bottles) | 7.194** | 13.371 | -4.907 | 80.567 | 36 |
| Online Savings per Bottle (UPS 3rd Day Air - 12 Bottles) | 5.005** | 13.361 | -7.380 | 78.095 | 36 |
| Online Savings per Bottle (UPS 2nd Day Air - 12 Bottles) | 3.654 | 13.367 | -8.957 | 76.517 | 36 |

[29] For Tables 3a, 3b, 3c and 3d, a double asterisk (**) indicates significance greater than the 95% confidence level. A single asterisk (*) indicates significance greater than the 90% confidence level (two-tailed test).

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**Table 3c: Cost Savings (Extra Expenses) per Bottle When Shopping Online for Wines Greater or Equal to $40.00 (Offline Price)**

| Category | Mean | Std. Dev. | Min. | Max. | Obs. |
|---|---|---|---|---|---|
| Online Savings (no transportation costs) | 20.607** | 23.817 | 7.000 | 83.000 | 9 |
| Online Savings (UPS Ground Service - 1 Bottle) | 17.881* | 24.827 | 2.263 | 82.686 | 9 |
| Online Savings (UPS 3rd Day Air - 1 Bottle) | 13.573 | 24.596 | -1.678 | 78.006 | 9 |
| Online Savings (UPS 2nd Day Air - 1 Bottle) | 6.969 | 23.461 | -6.310 | 68.690 | 9 |
| Online Savings per Bottle (UPS Ground Service - 6 Bottles) | 18.388** | 23.804 | 5.376 | 80.749 | 9 |
| Online Savings per Bottle (UPS 3rd Day Air - 6 Bottles) | 15.762* | 23.683 | 2.772 | 77.771 | 9 |
| Online Savings per Bottle (UPS 2nd Day Air - 6 Bottles) | 14.28 | 23.648 | 1.119 | 76.057 | 9 |
| Online Savings per Bottle (UPS Ground Service - 12 Bottles) | 18.448** | 23.711 | 5.677 | 80.567 | 9 |
| Online Savings per Bottle (UPS 3rd Day Air - 12 Bottles) | 16.262* | 23.628 | 3.204 | 78.095 | 9 |
| Online Savings per Bottle (UPS 2nd Day Air - 12 Bottles) | 14.990* | 23.572 | 1.627 | 76.517 | 9 |

**Table 3d: Cost Savings (Extra Expenses) per Bottle When Shopping Online for Wines Less than $20.00 (Offline Price)**

| Category | Mean | Std. Dev. | Min. | Max. | Obs. |
|---|---|---|---|---|---|
| Online Savings (no transportation costs) | 1.661** | 2.183 | -2.200 | 6.000 | 31 |
| Online Savings (UPS Ground Service - 1 Bottle) | -3.144** | 3.496 | -8.427 | 6.000 | 31 |
| Online Savings (UPS 3rd Day Air - 1 Bottle) | -7.053** | 3.67 | -13.107 | 1.32 | 31 |
| Online Savings (UPS 2nd Day Air - 1 Bottle) | -11.393** | 2.807 | -16.510 | -5.580 | 31 |
| Online Savings per Bottle (UPS Ground Service - 6 Bottles) | -0.934** | 2.414 | -5.436 | 3.316 | 31 |
| Online Savings per Bottle (UPS 3rd Day Air - 6 Bottles) | -3.578** | 2.656 | -8.475 | 1.392 | 31 |
| Online Savings per Bottle (UPS 2nd Day Air - 6 Bottles) | -5.039** | 2.824 | -10.128 | 2.455 | 31 |
| Online Savings per Bottle (UPS Ground Service - 12 Bottles) | -0.697 | 2.362 | -5.126 | 3.644 | 31 |
| Online Savings per Bottle (UPS 3rd Day Air - 12 Bottles) | -2.888** | 2.532 | -7.598 | 1.948 | 31 |
| Online Savings per Bottle (UPS 2nd Day Air - 12 Bottles) | -4.220** | 2.742 | -9.176 | 1.112 | 31 |

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**Table 4a: Proportional Cost Savings (Extra Expenses) per Bottle When Shopping Online for Entire Sample**[30]

| Category | Mean | Std. Dev. | Min. | Max. | Obs. |
|---|---|---|---|---|---|
| Online Savings (no transportation costs) | 0.158** | 0.13 | -0.187 | 0.488 | 67 |
| Online Savings (UPS Ground Service - 1 Bottle) | -0.085** | 0.272 | -0.753 | 0.470 | 67 |
| Online Savings (UPS 3rd Day Air - 1 Bottle) | -0.272** | 0.368 | -1.270 | 0.443 | 67 |
| Online Savings (UPS 2nd Day Air - 1 Bottle) | -0.481** | 0.430 | -1.645 | 0.390 | 67 |
| Online Savings per Bottle (UPS Ground Service - 6 Bottles) | 0.024 | 0.184 | -0.500 | 0.459 | 67 |
| Online Savings per Bottle (UPS 3rd Day Air - 6 Bottles) | -0.103** | 0.251 | -0.846 | 0.442 | 67 |
| Online Savings per Bottle (UPS 2nd Day Air - 6 Bottles) | -0.181** | 0.298 | -1.038 | 0.447 | 67 |
| Online Savings per Bottle (UPS Ground Service - 12 Bottles) | 0.036* | 0.176 | -0.465 | 0.458 | 67 |
| Online Savings per Bottle (UPS 3rd Day Air - 12 Bottles) | -0.070** | 0.230 | -0.744 | 0.444 | 67 |
| Online Savings per Bottle (UPS 2nd Day Air - 12 Bottles) | -0.134** | 0.266 | -0.922 | 0.435 | 67 |

**Table 4b: Proportional Cost Savings (Extra Expenses) per Bottle When Shopping Online for Wines Greater or Equal to $20.00 (Offline Price)**

| Category | Mean | Std. Dev. | Min. | Max. | Obs. |
|---|---|---|---|---|---|
| Online Savings (no transportation costs) | 0.211** | 0.099 | -0.061 | 0.488 | 36 |
| Online Savings (UPS Ground Service - 1 Bottle) | 0.076** | 0.143 | -0.241 | 0.470 | 36 |
| Online Savings (UPS 3rd Day Air - 1 Bottle) | -0.039 | 0.174 | -0.381 | 0.443 | 36 |
| Online Savings (UPS 2nd Day Air - 1 Bottle) | -0.182** | 0.185 | -0.490 | 0.390 | 36 |
| Online Savings per Bottle (UPS Ground Service - 6 Bottles) | 0.129** | 0.106 | -0.156 | 0.459 | 36 |
| Online Savings per Bottle (UPS 3rd Day Air - 6 Bottles) | 0.052** | 0.125 | -0.248 | 0.442 | 36 |
| Online Savings per Bottle (UPS 2nd Day Air - 6 Bottles) | 0.008 | 0.137 | -0.297 | 0.432 | 36 |
| Online Savings per Bottle (UPS Ground Service - 12 Bottles) | 0.134** | 0.104 | -0.147 | 0.458 | 36 |
| Online Savings per Bottle (UPS 3rd Day Air - 12 Bottles) | 0.070** | 0.118 | -0.222 | 0.444 | 36 |
| Online Savings per Bottle (UPS 2nd Day Air - 12 Bottles) | 0.031 | 0.13 | -0.269 | 0.435 | 36 |

[30] For Tables 4a, 4b, 4c and 4d, a double asterisk (**) indicates significance greater than the 95% confidence level. A single asterisk (*) indicates significance greater than the 90% confidence level (two-tailed test).

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**Table 4c: Proportional Cost Savings (Extra Expenses) per Bottle When Shopping Online for Wines Greater or Equal to $40.00 (Offline Price)**

| Category | Mean | Std. Dev. | Min. | Max. | Obs. |
|---|---|---|---|---|---|
| Online Savings (no transportation costs) | 0.253** | 0.122 | 0.078 | 0.488 | 9 |
| Online Savings (UPS Ground Service - 1 Bottle) | 0.196** | 0.136 | 0.025 | 0.470 | 9 |
| Online Savings (UPS 3rd Day Air - 1 Bottle) | 0.129** | 0.142 | -0.034 | 0.443 | 9 |
| Online Savings (UPS 2nd Day Air - 1 Bottle) | 0.03 | 0.147 | -0.107 | 0.390 | 9 |
| Online Savings per Bottle (UPS Ground Service - 6 Bottles) | 0.206** | 0.121 | 0.060 | 0.459 | 9 |
| Online Savings per Bottle (UPS 3rd Day Air - 6 Bottles) | 0.166** | 0.128 | 0.038 | 0.442 | 9 |
| Online Savings per Bottle (UPS 2nd Day Air - 6 Bottles) | 0.143** | 0.133 | 0.017 | 0.432 | 9 |
| Online Savings per Bottle (UPS Ground Service - 12 Bottles) | 0.207** | 0.12 | 0.064 | 0.458 | 9 |
| Online Savings per Bottle (UPS 3rd Day Air - 12 Bottles) | 0.173** | 0.126 | 0.041 | 0.444 | 9 |
| Online Savings per Bottle (UPS 2nd Day Air - 12 Bottles) | 0.152** | 0.13 | 0.021 | 0.435 | 9 |

**Table 4d: Proportional Cost Savings (Extra Expenses) per Bottle When Shopping Online for Wines Less than $20.00 (Offline Price)**

| Category | Mean | Std. Dev. | Min. | Max. | Obs. |
|---|---|---|---|---|---|
| Online Savings (no transportation costs) | 0.097** | 0.136 | -0.187 | 0.334 | 31 |
| Online Savings (UPS Ground Service - 1 Bottle) | -0.272** | 0.267 | -0.753 | 0.228 | 31 |
| Online Savings (UPS 3rd Day Air - 1 Bottle) | -0.543** | 0.347 | -1.270 | 0.050 | 31 |
| Online Savings (UPS 2nd Day Air - 1 Bottle) | -0.828** | 0.365 | -1.650 | -0.278 | 31 |
| Online Savings per Bottle (UPS Ground Service - 6 Bottles) | -0.097** | 0.181 | -0.501 | 0.165 | 31 |
| Online Savings per Bottle (UPS 3rd Day Air - 6 Bottles) | -0.283** | 0.242 | -0.843 | 0.070 | 31 |
| Online Savings per Bottle (UPS 2nd Day Air - 6 Bottles) | -0.385** | 0.277 | -1.030 | 0.012 | 31 |
| Online Savings per Bottle (UPS Ground Service - 12 Bottles) | -0.078** | 0.174 | -0.465 | 0.182 | 31 |
| Online Savings per Bottle (UPS 3rd Day Air - 12 Bottles) | -0.232** | 0.222 | -0.744 | 0.097 | 31 |
| Online Savings per Bottle (UPS 2nd Day Air - 12 Bottles) | -0.326** | 0.257 | -0.922 | 0.056 | 31 |

visited on 1/18/2012

## Appendix A: States and Direct Wine Shipment Laws [31]

### Reciprocal States

| | |
|---|---|
| California | Colorado |
| Hawaii | Idaho |
| Illinois | Iowa |
| Minnesota | Missouri |
| New Mexico | Oregon |
| Washington | Wisconsin |
| West Virginia | |

### Direct Shipments Prohibited (Non-Felony)

| | |
|---|---|
| Alabama | Arizona |
| Arkansas | Delaware |
| Kansas | Maine |
| Massachusetts | Michigan |
| Mississippi | New Jersey |
| New York | Ohio |
| Oklahoma | Pennsylvania |
| South Carolina | South Dakota |
| Texas | Utah |
| Vermont | Virginia |

### Direct Shipments Prohibited (Felony)

| | |
|---|---|
| Florida | Georgia (without permit) |
| Indiana | Kentucky |
| Maryland | North Carolina |
| Tennessee | |

### Legal Under Certain Circumstances

| | |
|---|---|
| Alaska | Connecticut |
| District of Columbia | Georgia (with permit) |
| Louisiana | Montana |
| Nebraska | Nevada |
| New Hampshire | North Dakota |
| Rhode Island | Wyoming |

[31] Information current as of July 2002. Source: www.wineinstitute.org.

## Appendix B: Wine and Spirits "Top Fifty" Wines

| Winery | Varietal[32] | Wine Label |
|---|---|---|
| Beaulieu Vineyard | CA | Napa Valley Tapestry |
| Beaulieu Vineyard | CA | Napa Valley Rutherford |
| Benziger Family Winery | CH | Carneros |
| Beringer Vineyards | CA | Knights Valley |
| Beringer Vineyards | CA | Napa Valley Private Reserve |
| Beringer Vineyards | CH | Napa Vly. Private Reserve |
| Beringer Vineyards | CH | Napa Valley |
| Blackstone Winery | M | California |
| Blackstone Winery | M | Napa Valley |
| Cakebread Cellars | CA | Napa Valley |
| Cakebread Cellars | CH | Napa Valley |
| Cakebread Cellars | CH | Napa Valley Reserve |
| Cakebread Cellars | SB | Napa Valley |
| Cambria Winery & Vineyard | CH | Santa Maria Vly. Katherine's |
| Caymus Vineyards | CA | Napa Valley |
| Caymus Vineyards | CA | Napa Vly. Special Selection |
| Chalk Hill Winery | CH | Chalk Hill |
| Chateau St. Jean | CH | Sonoma |
| Chateau St. Jean | CH | Belle Terre |
| Chateau Ste. Michelle | M | Washington |
| Chateau Ste. Michelle | M | Canoe Ridge |
| Clos du Bois | M | Sonoma |
| Clos du Bois | M | Alexander Valley |
| Cuvaison Winery | CH | Napa Valley Carneros |
| De Loach Vineyards | CH | Sonoma OFS |
| De Loach Vineyards | CH | Russian River Valley |
| Duckhorn Vineyards | M | Napa Valley |
| Duckhorn Vineyards | M | Three Palms |
| Duckhorn Vineyards | SB | Napa Valley |
| Ferrari-Carano Winery | CH | Alexander Vly. Reserve |
| Ferrari-Carano Winery | CH | Alexander Valley |
| Ferrari-Carano Winery | M | Alexander Valley |
| Ferrari-Carano Winery | SB | Alexander Valley Fume |
| Franciscan Oakville Estate | M | Napa Oakville Estates |
| Frog's Leap Winery | SB | Napa Valley |
| Grgich Hills Cellar | CH | Napa Valley |
| J. Lohr Winery | CA | Paso Robles 7 Oaks |
| J. Lohr Winery | CA | Paso Robles Hilltop |
| Jordan Vineyard & Winery | CA | Alexander Valley Estate |
| Jordan Vineyard & Winery | CH | Sonoma Cty. Estate |
| Kendall-Jackson Vineyards | CA | Calif. Vinters Reserve |
| Kendall-Jackson Vineyards* | CA | Calif. Proprietors Reserve |
| Kendall-Jackson Vineyards | CH | Calif. Vinters Reserve |
| Kendall-Jackson Vineyards | CH | Calif. Grand Reserve |
| Kendall-Jackson Vineyards | M | Calif. Vinters Reserve |
| Kendall-Jackson Vineyards* | M | Calif. Proprietors Reserve |

[32] The abbreviations for varietals are as follows: CH = Chardonnay; CA= Cabernet Sauvignon; SB = Sauvignon Blanc, M = Merlot; P = Pinot Noir; Z = Zinfandel. An asterisk (*) indicates that the bottle could not be found in any Internet inventories.

| | | |
|---|---|---|
| La Crema (Kendall-Jackson) | P | Russian River Valley |
| Landmark Vineyards | CH | Sonoma Overlook |
| Markham Winery | M | Napa Valley |
| Murphy Goode Estate | SB | Fume |
| Murphy Goode Estate | SB | Fume Reserve |
| Ravenswood | Z | Sonoma Vitners Blend |
| Ravenswood | Z | Lodi |
| Ridge Vineyards | Z | Lytton Springs |
| Ridge Vineyards | Z | Geyserville |
| Robert Mondavi Winery | CA | Napa Valley |
| Robert Mondavi Winery | CA | North Coast Coastal |
| Rodney Strong Vineyards | CH | Chalk Hill |
| Rodney Strong Vineyards | CH | Sonoma |
| Rodney Strong Vineyards | M | Sonoma |
| Rombauer Vineyards* | CH | Napa Valley |
| Rombauer Vineyards | CH | Napa Valley Carneros |
| Rombauer Vineyards | M | Napa Valley |
| Rutherford Hill Winery | M | Napa Valley |
| Shafer Vineyards | M | Napa Valley |
| Silver Oak Wine Cellars | CA | Alexander Valley |
| Silver Oak Wine Cellars | CA | Napa Valley |
| Simi Winery | CH | Alexander Valley |
| Sonoma-Cutrer Vineyards | CH | Russian River Ranches |
| Sonoma-Cutrer Vineyards | CH | Les Pierres |
| Sonoma-Cutrer Vineyards | CH | Cutrer |
| Stag's Leap Wine Cellars | CA | Napa Valley |
| Stag's Leap Wine Cellars | CA | SLD Fay |
| Stag's Leap Winery | CA | Napa Valley |
| Stag's Leap Winery | M | Napa Valley |
| Sterling Vineyards | CA | Napa Valley |
| Sterling Vineyards | CA | Diamond Mountain Ranch |
| Sterling Vineyards | M | Napa Valley |
| Sterling Vineyards* | M | Central Coast - Vintners Collection |
| The Hess Collection | CA | Calif. Hess Select |
| The Hess Collection | CA | Napa Valley (Mt. Veeder) |
| The Hess Collection | CH | Calif. Hess Select |
| The Hess Collection | CH | Napa Valley |

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## Appendix C: Bricks and Mortar Retailers Searched[33]

1. Total Beverage*
   1451 Chain Bridge Road
   McLean, VA
   703-749-0011
   Mileage: 0.1

2. Sutton Place Gourmet
   6655 Old Dominion Dr
   McLean, VA
   703-448-3828
   Mileage: 0.2

3. Cecile's Wine Cellar
   1351 Chain Bridge Road
   McLean, VA
   703-356-6500
   Mileage: 0.4

4. Arrowine
   4508 Lee Highway
   Arlington, VA
   703-525-0990
   Mileage: 4.0

5. International Wine and Beverage
   4040 Lee Highway
   Arlington, VA
   703-528-2800
   Mileage: 4.5

6. Norm's Beer and Wine
   136 Branch Road SE
   Vienna, VA
   703-242-0100
   Mileage: 4.6

7. Vienna Vintner
   233 Maple Ave E
   Vienna, VA
   703-242-9463
   Mileage: 4.9

8. Classic Wines

[33] An asterisk (*) indicates that the price data was collected from the store's online catalogue.

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9912 Georgetown Pike #C
Great Falls, VA
703-759-0430
Mileage: 7.4

9. Total Beverage Landmark*
6240 Little River Turnpike
Alexandria, VA
703-941-1133
Mileage: 8.2

10. Botstetter's Wine and Gourmet
3690 King Street #J
Alexandria, VA
703-820-8600
Mileage: 8.5

11. Fern Street Gourmet
1708 Fern Street
Alexandria, VA
703-931-1234
Mileage: 8.8

12. Daily Planet Wine and Gourmet*
2004 Mount Vernon Ave
Alexandria, VA
703-549-5051
Mileage: 9.9

13. Rick's Wine and Gourmet
3117 Duke Street
Alexandria, VA
703-823-4600
Mileage: 10.0

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# APPENDIX B

visited on 1/18/2012

# FTC Questionnaire to States

visited on 1/18/2012

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of Policy Planning

December 13, 2002

Via Fax and Mail
Ms. Marilyn Pauley
Wine Administrator
West Virginia Alcohol Beverage Control Administration
322 70th St., S.E.
Charleston, WV 25304

Re: Wine Shipments

Dear Ms. Pauley:

As we discussed, we are sending you a list of questions, attached to this letter, that relate to the issue of direct shipment of wine to individuals. In general, we are interested in your state's experience with shipment to minors, and in whether shipments to minors occur rarely or frequently. We are also interested in your state's experience with collecting taxes from out-of-state shippers.

If you are able to answer the questions in the attachment, or provide any records regarding these issues, we would greatly appreciate it. Ideally, we would like to receive a response by the end of this month, although of course respond at your convenience. If you have any questions, please feel free to call me, at (202) 326-3558, or Jerry Ellig, Deputy Director of the Office of Policy Planning, at (202) 326-3528. Finally, please fax any response to (202) 326-3548, or e-mail it to aagarwal@ftc.gov.

Thank you again for your assistance.

Sincerely,

Asheesh Agarwal
Office of Policy Planning

cc: Jerry Ellig

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**Questions for State Officials Regarding Wine Shipments**

Have you had problems with out-of-state or in-state shippers shipping wine directly to minors? If so, how often, and what were the circumstances?

Does your state conduct stings, and how would you learn about problems other than through stings?

Based on your experience, do you believe that minors in your state are receiving wine through online direct shipments? Do you believe that direct shipment of wine to minors is (a) a serious problem, (b) a problem, or (c) not a serious problem?

What enforcement mechanisms do you have against out-of-state suppliers who ship illegally? Have you ever used them?

Do you try to collect sales or excise taxes on shipments of wine into your state, and if so how effective have you been? Have you have any problems collecting taxes from out-of-state shippers?

Are there any records or data you could provide the FTC regarding these issues?

What is the volume, in terms of amount shipped and dollar value shipped, of wine that is shipped into your state from out-of-state sources? Do you have any data on how large these shipments are as a percentage of all wine sales in your state?

Is there any evidence that it is either easier or harder for minors to obtain wine through direct shipment than from offline sources such as bricks-and-mortar stores?

Is there anything else that you believe the FTC should know regarding the issue of direct shipment of wine, on the topics of sales to minors, tax collection, or anything else?

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# California Testimony

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# *California Legislature*

Senate Select Committee On California's Wine Industry

**Senator Mike Thompson, Chair**

Assembly Select Committee On California Wine

**Assemblymember Valerie Brown, Chair**

Joint Hearing on

# ***"The Future of Direct Shipments of Wine"***

November 10, 1997

Meadowood Resort, St. Helena, CA

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brand is something that, for the most part, people are going to call you and want it. So, you know, that was the difference between a push and a demand brand.

ASSEMBLYMAN WRIGHT: I just didn't know the term, I'm sorry.

MR. RENO: The one comment I'd make that really fuels this for me, really quite honestly, is I believe that the way we sell wine in America is going to change. I mean, if we were to sit here in front of you and say, "Fifty years from now, are we going to sell wine in America the way we're selling it today," I think the answer is obvious--no. So if you look at that time continuum and you start walking it back at yourself, 50, 40, 30, 20, at what point does the change begin? Well, the change can begin right now. It's just a matter of us deciding what the change is and doing it.

SENATOR THOMPSON: Okay, thank you, very much.

The next panel will be the "Regulators": Manny Espinoza from California ABC; Ed O'Toole from U.S. Bureau of Alcohol, Tobacco and Firearms; and Monte Williams from the California Board of Equalization.

While they're coming up, I'd just like to introduce my colleague, Patrick Johnston, who's joined us at the dais from Stockton-Lodi area.

SENATOR PATRICK JOHNSTON: Woodbridge, too.

SENATOR THOMPSON: Woodbridge. Herb, where are you? We'll get a copy of the remark for Herb Schmidt, Patrick. We'll get a copy of your remark about Woodbridge for Herb, he's stepped out of the room.

SENATOR JOHNSTON: Yeah, would you?

SENATOR THOMPSON: Make sure that you mentioned that.

Manny.

MR. MANNY ESPINOZA: Mr. Speaker, Mr. Chairman and Madam Chairman, it's a pleasure to be here.

My name is Manny Espinoza, and my title is the Chief Deputy Director of the California Department of Alcoholic Beverage Control. I'm actually wearing two hats today. Of course, I'm representing ABC, but I'm also here to answer questions concerning our national association which is involved in several discussions on this mail-order alcohol issue. And that association is the National Conference of State Liquor Administrators, which is to license states, and the National Association of Beverage--well, it's called NABCA. I'm not sure what the last two letters stand for, but they represent the control states.

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We met last week in Washington. I'm part of the Joint Committee of the States which--the Joint Committee is represented by members from each of our associations, and we've taken up four issues two years ago to study. And one of them, of course, is the issue of mail-order alcohol. We've been discussing this issue for three years. I think some of those discussions have been very frustrating for me in particular because when they go to the meeting, I'm sometimes seen as the fox in the chicken house. But nonetheless, most of my colleagues see the situation as it's going to happen.

This thing is consumer-driven. So my interest has been, at least for the last three years, is that we need to find a way to get out ahead of this problem and find a way to manage it before this thing starts managing us. And I think with the advent of the sales on the Web, we've been able to achieve a level of consensus on this issue that we didn't have even six months ago.

The Joint Committee last Wednesday approved a motion to ask the lawyer for the committee to draft a piece of model legislation that combines the best parts of the California direct shipment bill. There's another bill that I think you may have seen. It was proposed by Mort Segal, and I think he's representing John Hinman's association. And of course, the piece of legislation that we have down south.

We'd like to see--and there's good parts in all three. We'd like to see the area regarding the shipments to minors perhaps strengthened a bit. And there was good testimony, I think, from the wineries here on the kind of notice that we think is appropriate. The counsel was asked to have the draft ready within the next 30 to 45 days. After which the subcommittee on this issue will meet again sometime in January and review and discuss and hopefully come back to the Joint Committee with a piece of legislation that we can recommend to all of our fellow ABC administrators across the country.

We're looking for solutions. We know, and I can tell you, we're not all on the same page on this issue. I think, in particular, in some states, there's a perception that California's driving this issue very hard and it's a self-serving interest that's being pursued here. But on the other hand, I think we've got some regulators in some states that don't really understand the culture that's at work here. I think that they're sensitive, you know, particularly those states in the Bible Belt, that there's no sympathy for trying to protect shipments into dry areas.

But I do believe the sale-to-minor issue is overblown, and I say that because we've got experience here in California with a piece of legislation that was on the books for a least 20 years. It was repealed two years ago, but it would allow a person to receive a case of wine a

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nth from any part, or from any state regardless of the source. And it was a very simple permit ocess. There was no charge. A consumer who wanted to purchase, or wanted to receive a case of wine a month would merely send in the form. They would name the shipper, they would describe the contents of the shipment, and it would have the name and address of the person that was going to receive the shipment. We would review the form and sign it and send it back, and the form was permission for the shipper to bring it in.

Our experience with that, you know, like I said, for at least 20 years there was never a problem that was brought to our attention with regard to sales to minors or the importation of a product that was harmful.

So, I know there was a couple of questions here. One of the things that's been expressed is the situation with minors. I've got to say that we've got studies that show that 87 percent of our high school seniors have reported that they consume alcohol. About 67 percent of those say that they can buy it. So as to the issue of minors purchasing these products and having it shipped in, I don't think that's going to happen in California because the kids, unfortunately, can find ways to buy it here far, far to easy. I tend to agree that the minor issue really is a part of this equation, at least for us from an enforcement standpoint.

What does concern us, on the other hand, however, is what do we do about products such as, I believe, it's called Everclear? It's about 180 proof. There's other products out there that are made, we believe, more or less for the young consumer market. And I think we've had some experience in the past with regard to Hooper's Hooch. Some of these mudslides and some of these other products that are framed in a way that we think--you know, that the target market is people 17 to 24 years of age. We've got some concerns about those kinds of products being made available on the Net, and it being shipped into minors in the state. However, we hope that the market, I think, itself would be self-correcting in this regard. But I can't say there's a great concern among my fellow administrators throughout the United States on the issue of spirits and some of these specialty items.

Other than that, I'd be happy to answer any questions.

SENATOR THOMPSON: Thank you.

SENATOR MCPHERSON: You said you wanted to strengthen the sale-to-minor laws. I would assume from what you said to do it at the front end and not increase the punishment at the back end. How do you--

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MR. ESPINOZA: Well, yeah, I'm glad you raised that. I think Doug's right when he said that there's a concern among the regulators in the nation about how to reach the person that wants to flaunt the law, you know, even with a permit. So that's number one, and I think they're looking for the House bill as a vehicle to get to this person. Because right now they don't feel comfortable even with a permit bill like we've got to get to the person that wants to flaunt the law and says, "I'm not going to get a permit, I'm going to ship." And right now, there's no mechanism to reach that person.

But what I was talking about is the markings on the case. Making sure that it's clearly marked, there's a red sticker that says something to do with a minor identification. Making sure the shipper doesn't just drop it at the door without a signature from an adult. Those kinds of things we'd like to see in the model bill, and those are the kinds of things that we've directed the counsel to try and beef up.

But I think for the first time, you know, that I've seen on this discussion in three years that's there's a consensus now that maybe we need to move that way.

SENATOR THOMPSON: Any other questions?

ASSEMBLYWOMAN BROWN : I have a question. You said that there was legislation that was on the books. It was repealed two years ago that permitted a case a month. Why was it repealed? What was the thinking behind that?

MR. ESPINOZA: Well, it's a good question. It's a little complex, and my counsel, John Pierce, is here, but it was--Assemblyman Cortese carried the bill. There was some feeling at the time--we had just passed our wine shipping bill, the wine reciprocity bill. We were trying to encourage other states to pass their own bills. Some states were dragging their feet, and I think the feeling at the time by the Assemblyman was that, why should we allow this vehicle that goes above and beyond the wine shipment bill to be made available to wineries outside the state, if they're not willing to reciprocate in their own states with a similar bill. So it was repealed, and it was taken off the books.

But I think the wine shipping bill's working fine now. I'm not sure there's a need. Obviously, a bill that's introduced now would bring it back.

ASSEMBLYWOMAN MAZZONI I understand from your comments, you do not believe that the underage market is a problem?

MR. ESPINOZA: I haven't seen it, and I base that experience on those two things. One, we had this long statute for the last 20 years, and we never had an incident where there was a

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complaint about a minor receiving it. And two, at least in this state, and I have to say most states, if a minor wants to obtain alcohol, they're going to find it, they're going to do it.

ASSEMBLYWOMAN BROWN: They're not going to do it through mail order.

MR. ESPINOZA: Yeah.

ASSEMBLYWOMAN BROWN: Is California involved in any sting operations?

MR. ESPINOZA: No. No, ma'am.

ASSEMBLYWOMAN BROWN: Thank you.

SENATOR THOMPSON: Thank you.

Ed O'Toole.

MR. ED O'TOOLE: I'd like to thank the Senators and the Assemblypersons for the opportunity to speak before you today on behalf of Vikki Renneckar, our District Director in San Francisco.

I've heard the wineries say what they're for. I've heard the direct shippers, who are not wineries, say what they're for. I've heard the wholesaler person say what he's for, and it's probably appropriate that the Bureau say what it's for. And what the Bureau is for, is for compliance with the provisions of the 21st Amendment to the United States Constitution and for compliance with the federal Webb-Kenyon Act. And if that compliance would allow direct shipment, the Bureau has no problem with that, and if that compliance would prohibit direct shipment, the Bureau has a potential problem with direct shipment under those conditions.

The 21st Amendment to the Constitution. I remember earlier in my career I thought I'd never ever hear any member of the alcohol beverage industry have any problem with the 21st Amendment because that is the Amendment that repealed the 18th Amendment establishing national prohibition. But one thing I've learned over my career, and it's with great sympathy, that those who participate in the American alcohol beverage industry, I doubt if you have a more complex marketing system or marketing difficulties to have to deal with. And I think they do a very fine job in meeting their responsibilities.

For as most people will tell you, the 21st Amendment repealed Prohibition; in fact, it did much more other than repeal the 18th Amendment. Number one, it did make the production and commercial sale of alcohol beverages in the United States legal.

Number two, it provided certain core powers to the states which did not exist prior to the 18th Amendment. Among those core powers was the decision of the state whether to stay wet or dry regardless of the commerce clause of the Constitution. And secondly, the 21st Amendment

visited on 1/18/2012

# Colorado Letter

visited on 1/18/2012

# STATE OF COLORADO

**LIQUOR ENFORCEMENT DIVISION**
Department of Revenue

**Business Location**
1881 Pierce Street, Suite 108A, Lakewood, CO 80214
Phone (303) 205-2300
FAX (303) 205-2341

**E-mail:** nhamby@spike.dor.state.co.us

**Website:** www.revenue.state.co.us/liquor_dir/liquor.html

Bill Owens
Governor

Fred Fisher
Executive Director

David C. Reitz
Division Director

December 23, 2002

Asheesh Agarwal
Office of Policy Planning
Federal Trade Commission
Washington, D.C. 20580

Re: Wine Shipments

Dear Mr. Agarwal:

David Reitz has asked me to respond to your inquiry concerning the issue of direct shipment of wine to minors in Colorado.

Colorado, like many other states, has encountered problems with out-of-state shippers selling and shipping wine, as well as other alcohol beverages, directly to consumers in the state. We do not have any specifics of shippers shipping directly to minors.

Our enforcement posture has been to respond to complaints and not take proactive actions such as stings. The complaints we receive are mainly from licensed liquor retailers concerned about competition from unlicensed sources. Investigation of these complaints usually results in a warning to the shipper. We have not taken any legal actions against any shipper.

We do not know the volume, in terms of dollar value, of wines being shipped directly to consumers nor have we attempted to collect any sales or excise taxes on these shipments.

We are aware of the legal actions against shippers that are currently taking place in other states and we are awaiting the results of these cases before determining an appropriate enforcement stance.

CDOR LIQUOR ENF DIV. Fax:3032052341 Jan 7 2003 16:09 P.02

visited on 1/18/2012

I may be contacted at (303) 205-2300 if you need additional information.

Sincerely,

Donald Pace
Investigator

visited on 1/18/2012

# Hawaii Letter

visited on 1/18/2012

BRYAN J. BAPTISTE
MAYOR

ERIC K. HONMA
DIRECTOR

An Equal Opportunity Employer

COUNTY OF KAUAI
DEPARTMENT OF LIQUOR CONTROL
LIHUE CIVIC CENTER, MO'IKEHA BUILDING
4444 RICE STREET, SUITE 120
LIHUE, KAUAI, HAWAII 96766-1340
TEL. NO. (808) 241-6580 FAX NO. (808) 241-6585

January 14, 2003

Asheesh Agarwal
Attorney Advisor
Federal Trade Commission
Office of Policy Planning
6th and Pennsylvania Avenue, NW
Washington, DC 20580

Re: Wine Shipment

Dear Mr. Agarwal:

1. Have you had problems with out-of-state shippers shipping wine directly to minors?

   No, at least not to our knowledge.

2. Does you state (county) conduct stings, and how would you learn about problems other than through stings?

   No we do not conduct stings.

3. Based on your experience, do you believe that minors in your state (county) are receiving wine through online direct shipment? Do you believe that direct shipment of wine to minors is: (a) a serious problem, (b) a problem or (c) not a serious problem?

   While it is not inconceivable, the department has not received any information to this effect. As a result, I do not believe it is a serious problem in my county.



01/14/03 13:29 FAX 808 241 6585 KAUAI LIQUOR CONTROL 001

visited on 1/18/2012

5. Do you try to collect sales or excise taxes on shipment of wine into your state, and if so, how effective have you been? Have you had any problems collecting taxes from out-of-state shippers?

   The recprical wine shipping agreement between Hawaii and the other states does not have tax implications.

6. Are there any records or data you could provide the FTC regarding these issues?

   No record or data.

7. What is the volume, in terms of amounts shipped and dollar value shipped, of wine that is shipped into your state (county) from out-of-state sources? Do you have any data on how large these shipment are as a percentage of all wine sales in your state (county)?

   The recipricaol shipping agreement limits to 9 liters per house hold per year from a winery. We do not monitor the dollar amout shipped in. The wines shipped directly to residents represents a very small percentage of the wines sold in our county. My guess would be that the amount is less than ½ % of total.

8. Is there any evidence that it is easier or harder for minors to obtain wine through direct shipment than from offline sources such as brick-and-mortar stores?

   No data.

9. Is there anything else that you believe the FTC should know regarding the issue of direct shipment of wine, on the topic of sales to minors, tax collection or anything else?

   Yes, recourse against out-of-state shippers of wine shipping wine illegally into my state or shipping wine to minors in my state. Futuristically speaking, it has the potential to become a major problem.

Aloha,

DEPARTMENT OF LIQUOR CONTROL

DEXTER S. SHIMATSU
Investigator

visited on 1/18/2012

# Illinois Letter

visited on 1/18/2012



**To:** Mr. Asheesh Agarwal, Federal Trade Commission

**Fax:** 202-326-3548

**Date:** February 5, 2003

**Pages:** 3, including cover sheet

**Regarding:** Questions for State Officials Regarding Wine Shipments

Dear Mr. Agarwal:

Attached please find the ILCC's response to your Questions for State Officials Regarding Wine Shipments. I sincerely apologize for the delay in our response.

Marko I. Djurisic

# FAX

From the desk of...

**Marko I. Djurisic**
Legal Counsel
Illinois Liquor Control Commission
100 W. Randolph, Suite 5-300
Chicago, Illinois 60601

312-814-2206
Fax: 312-814-2241
www.state.il.us/lcc

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visited on 1/18/2012


## Answers to FTC Regarding Wine Shipments

**Q: Have you had problems with out-of-state shippers shipping wine directly to minors? If so, how often and what were the circumstances?**

A: The Illinois Liquor Control Commission (ILCC) has received no reports regarding minors obtaining wine from out-of-state shippers. Illinois is a "wine reciprocal" state and it is not illegal for an out-of-state supplier to sell directly to Illinois consumers. The ILCC is not currently aware of this reciprocity being abused by minors.

**Q: Does your state conduct stings, and how would you learn about problems other than through stings?**

A: The ILCC is a regulatory agency, not an enforcement agency, and therefore does not possess the authority to conduct stings. All stings would have to be preformed by the Illinois State Police which does conduct compliance checks in Illinois retail establishments through out the state and reports their findings to the ILCC. However, I am unaware of any such stings for out-of-state shippers.

**Q: Based on your experience, do you believe that minors in your state are receiving wine through online direct shipment? Do you believe that direct shipment of wine to minors is (a) a serious problem, (b) a problem, or (c) not a serious problem.**

A: I do not believe many minors would opt to purchase wine online due to the increased cost over brink-and-mortar establishments and due to the product itself, as my experience indicates minors would probably choose to purchase other alcoholic products over wine. I believe the direct shipment of wine to minors is (c) not a serious problem.

**Q: What enforcement mechanisms do you have against out-of-state suppliers who ship illegally? Have you ever used them?**

A: Pursuant to the Illinois Liquor Control Act, 235 ILCS 5/6-29.1, upon determining after investigation that an out-of-state supplier is shipping directly to consumers in Illinois in violation of the law, the ILCC is required to send a certified letter demanding the shipper cease and desist such actions and remove all alcoholic products shipped into the state. If the supplier continues to ship after receipt of the cease and desist letter, the ILCC is required to inform the Illinois Department of Revenue (IDOR) and file a complaint with the States Attorney's office where the alcohol shipment arrived. The ILCC may also notify the Illinois Attorney General's office who may in turn file an injunction in Federal court pursuant to the 21st Amendment Enforcement Act. None of these options have ever been utilized as the ILCC does not have the authority to conduct investigations into violations of 235 ILCS 5/6-29.1 itself, as common carriers doing business in Illinois have to report alcohol shipments to the IDOR, which then submits reports to the ILCC. Although carriers may face business or criminal offenses for failure to report to the IDOR, some do not, and the IDOR to date has not attempted to enforce the law against these carriers in this matter. Therefore, the reports sent to the ILCC, upon which our investigation is dependent are

visited on 1/18/2012


incomplete.

**Q: Do you try to collect taxes or excise taxes on shipments of wine into your state, and if so how effective have you been? Have you had any problems collecting taxes from out-of-state shippers?**

A: As stated, Illinois is a reciprocal wine state. Pursuant to 235 ILCS 5/6-29 wine shipments of up to two cases of per person per year are allowed directly to consumers in Illinois from out-of-state suppliers, provided their state has a similar provision in their state law. Such shipments are deemed not constitute a sale in Illinois and therefore no sales tax are required.

**Q: Are there any records or data you could provide the FTC regarding these issues?**

A: No.

**Q: What is the volume, in terms of amount shipped and dollar value shipped, of wine that is shipped into your state from out-of-state sources? Do you have any data on how large these shipments are as a percentage of all wine sales in your state.**

A: As stated above, the reporting requirements of alcohol shippers into the State of Illinois is handled through the IDOR, and since not every carrier reports, the IDOR would not be able to produce accurate figures. From my experience, however, I would say that out-of-state wine shipments constitute a very small percentage of total wine sales in Illinois.

**Q: Is there any evidence that it is either easier or harder for minors to obtain wine through direct shipment than from offline sources such as brick-and-mortar stores?**

A: There is no evidence one way or the other. Although it is reasonable to assume that wine would be easier to acquire through mail-order shipments than brick-and-mortar establishments, the incidence of minors purchasing wine over other forms of alcoholic liquor is very low in either case.

**Q: Is there anything else that you believe the FTC should know regarding the issue of direct shipment of wine, on the topics of sales to minors, tax collection, or anything else?**

A: No. However, attached please find a copy of the relevant sections of the Illinois Liquor Control Act for your convenience. If you have any other questions regarding Illinois law regarding any of the aforementioned topics, please do not hesitate to contact our office.

visited on 1/18/2012

# Nebraska Letter

visited on 1/18/2012

# STATE OF NEBRASKA

**NEBRASKA LIQUOR CONTROL COMMISSION**
**Forrest D. Chapman**
*Executive Director*
301 Centennial Mall South, 5th Floor
P.O. Box 95046
Lincoln, Nebraska 68509-5046
Phone (402) 471-2571
Fax (402) 471-2814
TRS USER 800 833-7352 (TTY)
web address: http://www.nol.org/home/NLCC/

**Mike Johanns**
*Governor*

December 23, 2002

Asheesh Agarwal
Office of Policy Planning
Federal Trade Commission
6th and Pennsylvania Avenue, NW
Washington DC 20580

Dear Mr. Agarwal:

This letter is in response to your inquiry concerning the direct shipment of wine. I am attaching a copy of LB671 which was passed in 2001.

We currently have issued 49 direct shipper's licenses. Our state does compliance checks (enforcement is provided by the Nebraska State Patrol and local law enforcement entities), but to my knowledge has not done one on this type of license. We have also not, as yet, received any complaints or alleged violations. Therefore, at this time, it does not appear to be a serious problem.

We have also not, as yet, had any problems with the collection of excise tax.

Please call me if you have any questions.

Sincerely,

NEBRASKA LIQUOR CONTROL COMMISSION

Forrest D. Chapman
Executive Director

FDC/mm

cc: Commissioners
File

**Rhonda R. Flower**
*Commissioner*

**Bob Logsdon**
*Chairman*

**R.L. (Dick) Coyne**
*Commissioner*

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visited on 1/18/2012

# New Hampshire Letter

visited on 1/18/2012

**State of New Hampshire**
LIQUOR COMMISSION
Storrs Street
P.O. Box 503
Concord, N.H. 03302-0503

John W. Byrne
Chairman
(603) 271-3132

Anthony C. Maiola
Commissioner
(603) 271-3133

Patricia T. Russell
Commissioner
(603) 271-3131

Jeanne Shaheen
Governor

December 18, 2002

Mr. Asheesh Agarwal
Federal Trade Commission
Office of Policy Planning
6th and Pennsylvania Avenue, NW
Washington, DC 20580

Dear Mr. Agarwal:

Attached to this letter is a response to your letter date December 10, 2002 in reference to a list of questions about direct shipments of wine to minors. The New Hampshire Liquor Commission has answered your question and included additional supporting documentation.

The supporting documentation are a copy of NH Law governing direct shipments (RSA 178:14-a), a list of companies that have improperly shipped into NH, and a current list of all companies that hold a direct shipper permit in NH.

Should you have any question please call me at (603) 271-8543 or email me at jbarbuti@liquor.state.nh.us.

Sincerely yours,

James Barbuti
Liquor Commission Examiner I

visited on 1/18/2012

# NH Liquor Commission

## Questions for State Officials Regarding Wine Shipments

**Have you had problems with out-of-state or in-state shippers shipping wine directly to minors? If so, how often, and what were the circumstances?**

We are not actively investigating any cases in this area nor have we received any complaints in the past year on this issue.

**Does your state conduct stings, and how would you learn about the problems other than through stings?**

The NH Liquor Commission Bureau of Enforcement has in the past done compliance stings against out-of-state shipper who do not hold permits and against shippers who do hold permits.

In the State of NH we have designed the direct shipping program that requires the shipper to verify the age of the purchaser before shipping into NH and requiring the Carrier in NH to verify age f the individual at the time of delivery. The Carrier is required to forward to the NH Liquor Commission on a monthly basis signature information.

**Based on your experience, do you believe that minors in your state are receiving wine through online direct shipments? Do you believe that direct shipment of wine to minors is (a) a serious problem, (b) a problem, or (c) no a serious problem?**

We suspect there may be some instances where this is occurring but we have very little evidence in this area and do not believe this is a serious problem at this time

**What enforcement mechanisms do you have against out-of-state suppliers who ship illegally? Have you ever used them?**

Notwithstanding the provisions of RSA 179:58, any person holding a direct shippers permit under this section who ships liquor, wine, or beer to a person under 21 years of age, shall be guilty of a class B felony and shall have such permit permanently revoked.

At this time the NH Liquor Commission has not had the need to cite any company under this RSA.

**Do you try to collect sales or excise taxes on shipments of wine into your state, and if so how effective have you been? Have you have any problems collecting taxes from out-of-state shippers?**

Yes, the State of New Hampshire Liquor Commission collects an 8% fee on all shipments into the State of New Hampshire. When the NH Liquor Commission discovers an improper shipment we contact the company and inform them of the laws in NH. Once the company learns of NH laws they normally get a permit or stop shipping into NH. The NH Liquor Commission is working with out-of-state supplier and encouraging them to obtain a permit.

**Are there any records or data you could provide the FTC regarding these issues?**

Attached are a database of all companies that have improperly shipped into NH and a listing of all companies that hold permits in NH.

**What is the volume, in terms of amount shipped and dollar value shipped, of wine that is shipped into your state from out-of-state sources? Do you have any data on how large these shipments are as a percentage of all wine sales in your state?**

For Fiscal Year 2002 (July 2001 – June 2002):

Direct Shipping:

| | |
|---|---|
| Fees collected | $ 91,716.64 |
| Sales(Fees/.08) | $1,146,458.00 |
| # of Bottles Shipped | 47799 |

NH Liquor Commission:

| | |
|---|---|
| Sales(in-state) | $148,432,644 |
| Cases | 2,101,189 |

visited on 1/18/2012

**Is there any evidence that is either easier or harder for minors to obtain wine through direct shipment than from offline sources such as bricks-an-mortar stores?**

We have no evidence to suggest it is easier to get alcohol through the internet than through walk up means. Statewide our retail licensee sell alcohol to minors in compliance checks at a rate of roughly 30%. We have no means to assess whether it would be easier to get alcohol through internet means.

**Is there anything else that you believe the FTC should know regarding the issue of direct shipment of wine, on the topics of sales to minors, tax collection, or anything else?**

Due to the high cost of shipping and the fact that the minor has to wait for the wine to arrive makes purchasing wine at a local retail more desirable.

visited on 1/18/2012

# North Dakota Letter

visited on 1/18/2012

RICK CLAYBURGH
COMMISSIONER

STATE OF NORTH DAKOTA
**OFFICE OF STATE TAX COMMISSIONER**
STATE CAPITOL, 600 E. BOULEVARD AVE., DEPT. 127, BISMARCK, NORTH DAKOTA 58505-0599
701-328-2770 FAX 701-328-3700 Hearing/Speech Impaired 800-366-6888 (TTY Relay North Dakota)
http://www.ndtaxdepartment.com

December 18, 2002

Asheesh Agarwal
Office of Policy Planning
Federal Trade Commission
Washington, D.C. 20580

Dear Mr. Agarwal:

This is in response to your December 10, 2002 questionnaire titled "Questions for State Officials Regarding Wine Shipments."

Q. Have you had problems with out-of-state or in-state shippers shipping wine directly to minors? If so, how often, and what were the circumstances?

A. No information.

Q. Does your state conduct stings, and how would you learn about problems other than through stings?

A. No stings have been conducted by the Office of State Tax Commissioner relative to direct shipments.

Q. Based on your experience, do you believe that minors in your state are receiving wine through online direct shipments? Do you believe that direct shipment of wine to minors is (a) a serious problem, (b) a problem, or (c) not a serious problem?

A. No information.

Q. What enforcement mechanisms do you have against out-of-state suppliers who ship illegally? Have you ever used them?

A. The statute allowing for direct shipments includes penalty provisions. See North Dakota Century Code § 5-01-16 (copy provided). We have not used the penalty provisions.

Q. Do you try to collect sales or excise taxes on shipments of wine into your state, and if so how effective have you been? Have you had any problems collecting taxes from out-of-state shippers?

A. Taxes are collected. No problems to date that we are aware of.

Q. Are there any records or data you could provide the FTC regarding these issues?

A. Other than tax returns, the only information available consists of stats reports.

visited on 1/18/2012





Q. What is the volume, in terms of amount shipped and dollar value shipped, of wine that is shipped into your state from out-of-state sources? Do you have any data on how large these shipments are as a percentage of all wines sales in your state?

A. The volume shipped for calendar year 2002 to date is 218.04 gallons. The tax collected to date is $109.16. Total wine sales for the same period equal 544,774.58 gallons. As you can see, the direct shipping total is miniscule.

Q. Is there any evidence that it is either easier or harder for minors to obtain wine through direct shipment than from offline sources such as bricks-and-mortar stores?

A. No information.

Q. Is there anything else that you believe the FTC should know regarding the issue of direct shipment of wine, on the topics of sales to minors, tax collection, or anything else?

A. The State Tax Commissioner is responsible only for administration of the wholesale alcoholic beverage portions of North Dakota Century Code Title 5. This responsibility includes Subsection 5 of Section 5-01-06 – the direct shippers provision. The direct shippers provision in Subsection 5 was added by the 2001 Legislature; therefore, we have limited experience in this area. The remainder of the alcoholic beverage laws, including the issue of minors, in Title 5 are administered through the Attorney General's Office.

If you have any questions, please contact me.

Sincerely,

Joan Y. Galster, Supervisor
Alcohol Tax Section
Phone: 701-328-3139

JYG
Attachment

visited on 1/18/2012

# Washington Letter

visited on 1/18/2012



STATE OF WASHINGTON
WASHINGTON STATE LIQUOR CONTROL BOARD
*3000 PACIFIC AVE SE • P O Box 43093 • Olympia WA 98504-3093 • (360) 664-1600*

*FAX NO. (360) 753-2710*

# FAX COVER SHEET

DATE 12-16-02

TO: ASHEESH ARGARWAL

FAX NO.

FROM: RANDY REYNOLDS

PHONE NO. 360 664 1639

NUMBER OF PAGES INCLUDING COVER SHEET: 3

MESSAGE: ASHEESH, RETURN OF YOUR FAX QUESTIONS

visited on 1/18/2012



12-13-02

Questions regarding wine shipments into Washington.

Asheesh,
I will try to answer your questions in the order you sent them.

I can not verify any circumstances that a out of state shipper has shipped wine to a minor. I have heard 3rd and 4th party stories of wine being shipped to a minor using a parents credit card.

We do conduct stings, but only for inside Washington State. We have not tried a sting involving an outside of Washington shipper.

I would guess that if a mechanism was in place, it has happened. On a Nation wide basis, I would say it is a problem of concern.

Washington only recognizes 13 States that we have a reciprocity agreement with to legally ship directly to a Washington consumer. Even if it is a reciprocal state, it can only come from the producing winery, and that winery must have a shipper's license with us. At this time, we do not have a enforcement mechanism to deal with illegal shippers, other than to send them a letter advising them they are shipping illegally into Washington.

Washington collects taxes from the first Washington distributor who received the product. Any wine that comes into Washington without passing through the three-tier system causes Washington to loose the tax money.

Last fiscal year (July 01 to June 02) almost 49 million liters of wine were shipped into Washington with a value of $11.4 million . This represents wine that was legally shipped into Washington. We do not have an estimate of how much was illegally shipped in.

We have no evidence that it is either easier or harder for minors to obtain wine over the Internet. I would also guess that wine is not the product of choice for minors.

Internet sales of wine that do not go through the three-tier system represent tax loss to the State of Washington.

visited on 1/18/2012

# West Virginia Letter

visited on 1/18/2012

**STATE OF WEST VIRGINIA**
**ALCOHOL BEVERAGE CONTROL ADMINISTRATION**

322 70th Street, SE
Charleston, West Virginia 25304-2900

BOB WISE
GOVERNOR

THOMAS A. KEELEY
COMMISSIONER

BRIAN M. KASTICK
SECRETARY OF TAX & REVENUE

December 30, 2002

Asheesh Agarwal
Office of Policy Planning
Federal Trade Commission
Washington DC 20580

Dear Mr. Agarwal:

Per your request I have completed your questionnaire regarding wine shipments into West Virginia.

As our state does not require shipment reports or payment of taxes for internet sales, the information that is available is very minimal.

If I may be of further service to you please do not hesitate to contact me at (304) 558-2481 extension 242 or by fax at (304) 558-5599.

Sincerely,

Marilyn Pauley
Wine Administrator

attachments

visited on 1/18/2012

**Questions for State Officials Regarding Wine Shipments**

Have you had problems with out-of-state or in-state shippers shipping wine directly to minors? If so, how often, and what were the circumstances?

*Response:* *We have received no complaints nor have we issued any violations for direct shipping of wine to minors within West Virginia.*

Does your state conduct stings, and how would you learn about problems other than through stings?

*Response:* *Our Agency does conduct compliance checks for alcohol licensees, but thus far, has not conducted stings regarding reciprocal shipping of wine to minors.*

*The West Virginia Alcohol Beverage Control Administration's web site allows concerned citizens to submit anonymous complaints regarding alcohol issues within our state.*

Based on your experience, do you believe that minors in your state are receiving wine through online direct shipments? Do you believe that direct shipment of wine to minors is (a) a serious problem, (b) a problem, or (c) not a serious problem?

*Response:* *It is difficult to offer an opinion on the frequency or existence of direct shipping of wine to minors as our Agency does not have any documentation regarding direct shipping violations.*

*I do believe that direct shipping of wine to minors is possible as procedures and methods currently exist.*

What enforcement mechanisms do you have against out-of-state supplier who ship illegally? Have you ever used them?

*Response:* *Currently, no enforcement mechanisms regarding out-of state suppliers are in place or have been used.*

Do you try to collect sales or excise taxes on shipments of wine into your state, and if so how effective have you been? Have you had any problems collecting taxes from out-of-state shippers?

*Response:* *Language contained in the West Virginia State Code declares that delivery of wine obtained from a reciprocal state "shall not be deemed to constitute a sale in this state". Therefore, collection of sales or excise tax is not applicable.*

Are there any records or data you could provide the FTC regarding these issues?

*Response:* *Currently the WV ABCA does not have any documentation regarding these issues.*

visited on 1/18/2012

What is the volume, in terms of amount shipped and dollar value shipped, of wine that is shipped into your state from out-of-state sources? Do you have any data on how large these shipments are as a percentage of all wine sales in your state?

*Response:* *As these shipments are not deemed sales in WV and are not taxable, no documentation is available regarding the volume of direct shipping sales.*

Is there any evidence that it is either easier or harder for minors to obtain wine through direct shipment than from offline sources such as bricks-and-mortar stores?

*Response:* *No evidence is available.*

Is there anything else that you believe that the FTC should know regarding the issue of direct shipment of wine, on the topics of sales to minors, tax collection, or anything else?

*Response:* *As many minors have access to computers, debit and credit cards it is quite possible that a minor could purchase wine online.*

*The seller/shipper is extremely limited in the methods available of ascertaining the exact age and identity of the purchaser. They must rely largely upon the purchaser's declaration of being of legal age.*

*Bricks-and-mortar stores are able to have a face-to-face view of the person who is purchasing the wine for a comparison to the identification offered to determine the exact age and identity of the person.*

*The responsibility of insuring the delivery of wine to a person of legal age seems to rest with the courier or deliverer and not the retailer/shipper.*

*Personal Suggestion:*

*As taxation and the loss of revenue through internet sales is a sensitive issue with many states, perhaps adopting some of the concepts and principles that are utilized under IFTA, for fuel tax collection, could be explored and applied to internet sales.*

*I would like to see some research into the idea of each seller collecting the excise and sales tax for every item sold regardless of delivery destination.*

*For example, when a product is sold via the internet or for delivery, the seller retains ownership until the product is delivered to the recipient and wherever the item is delivered would constitute a sale in that state. The retailer would collect the taxes that are applicable for that state and remit them to their resident state. The resident state would then distribute all of the taxes collected to the appropriate receiving state.*

visited on 1/18/2012

# Wisconsin Letter

visited on 1/18/2012



# State of Wisconsin

**Department of Revenue**
**Alcohol and Tobacco Enforcement Section**
2135 Rimrock Road, Sixth Floor
Madison, WI 53713

****

**FAX Number: 608 261-6240**

## Fax Cover Page

**DATE:** 12-18-02 **1** of 5 pages (including cover sheet)

| | | |
|---|---|---|
| **TO:** | Name: | Asheesh Agarwal |
| | Company: | |
| | FAX #: | 202 3263548 |
| **FROM:** | Name: | Roger B. Johnson |
| | Phone #: | (608) 266-6757 |

Please reply when received: YES (NO)

**Comments:**

*****IMPORTANT CONFIDENTIALITY NOTICE*****

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visited on 1/18/2012

## Questions for State Officials Regarding Wine Shipments

Have you had problems with out-of-state or in-state shippers shipping wine directly to minors? If so, how often, and what were the circumstances? NO COMPLAINTS TO DATE. UNKNOWN.

Does your state conduct stings, and how would you learn about problems other than through stings? NO. would learn by complaints by public or industry members, etc.

Based on your experience, do you believe that minors in your state are receiving wine through online direct shipments? Do you believe that direct shipment of wine to minors is (a) a serious problem, (b) a problem, or (c) not a serious problem? NO COMPLAINTS; NOT A SERIOUS PROBLEM.

What enforcement mechanisms do you have against out-of-state suppliers who ship illegally? Have you ever used them? CIVIL ACTION - RESTRAINING ORDERS, ETC. NEVER USED THEM

Do you try to collect sales or excise taxes on shipments of wine into your state, and if so how effective have you been? Have you have any problems collecting taxes from out-of-state shippers? Reciprocal agreements have shippers pay STATE TAX TO THEIR RESPECTIVE STATE IE, CALIFORNIA SHIPPERS INTO WI PAY CALIFORNIA TAX, ETC.

Are there any records or data you could provide the FTC regarding these issues? Reporting required STARTING JAN. 2004 for reciprocal STATES.

What is the volume, in terms of amount shipped and dollar value shipped, of wine that is shipped into your state from out-of-state sources? Do you have any data on how large these shipments are as a percentage of all wine sales in your state? Reporting required 2004 for reciprocal state

Is there any evidence that it is either easier or harder for minors to obtain wine through direct shipment than from offline sources such as bricks-and-mortar stores? BRICKS + MORTAR - ANECDOTAL STORY

Is there anything else that you believe the FTC should know regarding the issue of direct shipment of wine, on the topics of sales to minors, tax collection, or anything else?

See info. (attached) re. Federal Jenkins Act / cigarette sales.

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# Wyoming Letter

visited on 1/18/2012

**Department of Revenue**

*The State* *of Wyoming*

***Liquor Division***

1520 East 5th Street, Cheyenne, Wyoming 82002-0110

JIM GERINGER
*Governor*

EARL ATWOOD
*Director*

LISA K. BURGESS
*Administrator*

AREA CODE (307)
PHONE 777-7231
ADMINISTRATION FAX 777-6255
PURCHASING FAX 777-5872
Website http://revenue.state.wy.us

MEMORANDUM

TO: Asheesh Agarwal, FTC

FROM: Lisa K. Burgess, Administrator

SUBJECT: Direct Wine Shipments - Minors

DATE: December 4, 2002

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Wyoming's direct wine shipment law went into effect July 1, 2001. The law requires the out-of-state shipper to ensure a duly licensed carrier makes all shipments and that the carrier obtains an adult signature prior to leaving the shipment at any household.

The Liquor Division is not authorized to engage in string-type operations to ensure the carrier is in fact complying with the direct shipment law regarding the receipt of an adult signature. However, if we were notified or had reason to believe a violation was occurring we would involve the appropriate state agencies to investigate the claim. Retailers and consumers regularly contact our office when they feel a violation of the liquor code has or is occurring. We have not had any complaints brought forward regarding a minor receiving a direct shipment of wine since the July 1, 2001 went into effect.