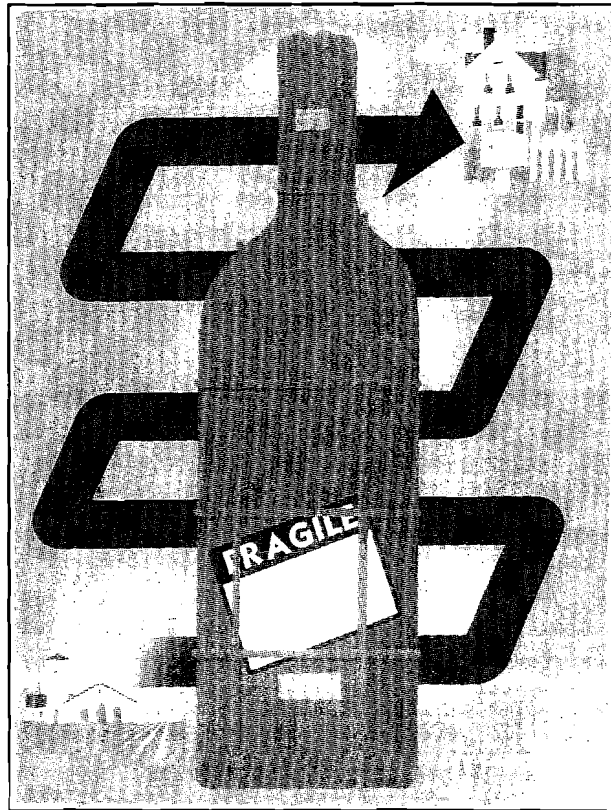


# MICAP RECAP

August 2005

## Direct shipping ruling threatens 3-tier alcohol distribution system



For most who read of the Supreme Court's 5-4 decision to allow direct shipping from wineries to consumers, the issue was whether a wine connoisseur in Bloomfield Hills or Grosse Pointe could order an expensive bottle of wine from a boutique California winery over the internet.

That was part of the story, but the most important implication of the court's ruling involved how alcoholic beverages are distributed across America. After the repeal of national Prohibition, the states established what is called a "three-tier system" that requires brewers, distillers and vintners to use a middle man, or distributor, to receive shipments from the manufacturer and

distribute alcoholic beverages to bars, restaurants, party stores and other retailers. The purpose of the three-tier system is to prevent large manufacturers from exercising inordinate power over retailers. It was the abuse of this power and the resulting problems that helped bring about national Prohibition.

Earlier this year, the *Detroit Free Press* did a feature on the Michigan Beer and Wine Wholesalers and their lobbying efforts at the statehouse. The story covered not only PAC contributions, but also how the wholesalers used their facilities to help lawmakers host fund-raisers. When investigative reporters dig into the records as the

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*Free Press* did, it is usually with the expectation that they will find irregularities of some kind, but this effort found nothing out of line. The Michigan Beer and Wine Wholesalers knew the law and followed it scrupulously. They were not just clean, but "squeaky clean."

Still, the public image resulting from the story made many lawmakers a bit wary of voters accusing them of special favors. In this context, Capitol observers have predicted that Michigan's response to the Supreme Court's direct shipping ruling will be to allow both instate and out-of-state wineries to bypass whole-

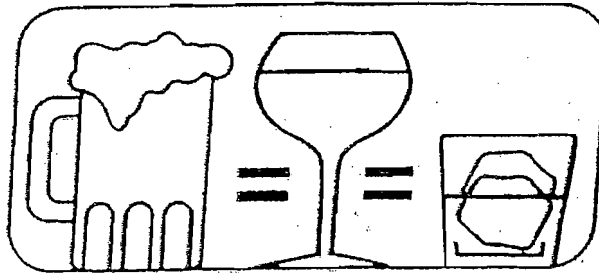
middleman but the retailer as well is going to open the door for illegal underage alcohol sales.

There is no question that if brewers, distillers and vintners are able to bypass wholesalers and retailers, the result will be cheaper booze for the consumer.

With most products that would be doing the consumer a real favor, but alcohol is not like peanut butter or cornflakes. Increasing consumption will result in a negative impact, for the individual and for society as a whole.

The primary opposition in Michigan to direct shipping is from the Committee for a Safe and

## ***EQUIVALENCY***



**"Alcohol is Alcohol is Alcohol"**

salers and sell directly to consumers over the internet.

As we pointed out earlier in this newsletter, the Supreme Court's ruling didn't automatically permit direct shipping. It merely said that each state must make that decision, but with the understanding that it had to be all or nothing. Lawmakers could not allow direct shipping by instate wineries and ban out-of-state vintners.

The real battle here in Michigan and elsewhere across the nation is not merely a struggle between wineries and wholesalers. More important are the implications that impact the three-tier distribution system for beer, wine and liquor.

Alcohol is alcohol is alcohol, whether it is in beer, wine or liquor, and bypassing not only the

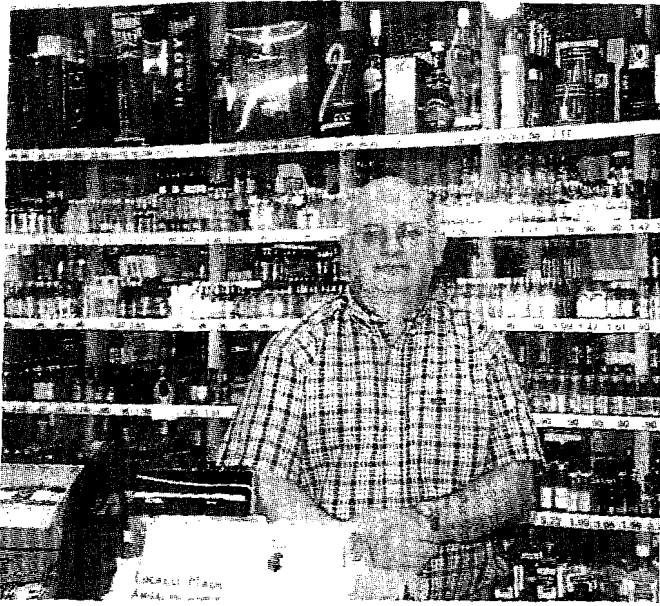
Responsible Michigan, composed of educators, law enforcement and safety officials as well as the wholesalers.

When Michigan lawmakers return from their summer vacation, they will debate two bills, one which would ban all direct shipping and the other that would allow limited shipping, permitting consumers to purchase up to 24 cases of wine a year directly from wineries.

Michigan wineries argue that they need to be able to sell over the internet and that the economic impact of allowing direct shipping is positive for the state.

On the other hand, nobody seems to consider that the state has no guarantee of collecting taxes on alcohol sold over the internet.

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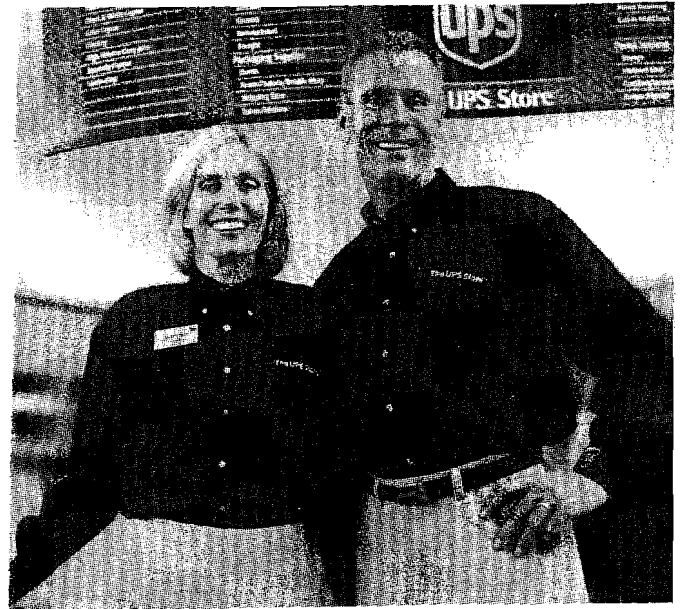


Then there is the matter of underage sales. Craig Wolf, general counsel for the Wine and Spirits Wholesale Association argues that the system is flawed. "All people have to do is click a button that says they are 21 or older. You can't rely on a carrier or online shipper to verify age. It's only a question of time before something bad happens."

The best protection against underage sales is the face-to-face contact with a retailer. The one shown here has never been cited for a violation, although kids have tried to fool him with fake IDs. He has a collection on the wall in his party store, calling it his "wall of shame." There is motivation for licensees to take special care to ensure they don't sell to underage kids, since a violation could result in a suspension or revocation of his liquor license.

Some have argued that those who make delivery for internet sales can also check IDs, but UPS has nothing at stake, nor are they trained to spot fake IDs. Their rewards come from delivering on time, not from preventing underage sales.

If the issue here involved liquor instead of wine, people would be more concerned, but most of the public do not associate wine with alcohol problems. It is important to keep in mind, though,



that alcohol is alcohol is alcohol and wine is not a benign beverage.

The hottest wine market in America today is in Pennsylvania. Although it was not fueled by internet sales, when Jonathan Newman took over as chairman of the Pennsylvania Liquor Control Board, it was his goal to reform the state's distribution system, which had Pennsylvania ranked 47th in the U.S. in wine consumption.

Now that Newman has managed to turn the state's wine marketing system around, they are in competition with states like California, New York and Massachusetts in per capita consumption.

Newman's promotion campaign has increased not only wine sales, but liquor sales as well, and when 2004 figures were recently released, Pennsylvania had experienced a record increase in drunk driving arrests of 13 percent. Rebecca Shaver, MADD's Executive Director, says this increase is a direct result of increased wine and liquor sales.

Not only in Michigan but also in other states across the nation, direct shipping rules are under consideration. For more background on this issue, check out the web site of the Committee for a Safe and Responsible Michigan at [www.safeandresponsible.org](http://www.safeandresponsible.org).

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**A SOBER WAL-MART . . . launches drive into tricky area: Liquor.** Under this headline, the *Wall Street Journal* told how Wal-Mart held a series of meetings two years ago with the world's top liquor makers at its alcohol-free headquarters in the middle of a dry county in Arkansas.

The results of those meetings are now being seen as the world's largest retailer begins to push alcohol sales in an effort to spur lagging growth in its stores across America.

According to AC Nielsen, dry grocery products generate the most revenue for Wal-Mart, with sales of \$29 billion in 2004, followed by general merchandise at \$18.3 billion, health and beauty products at \$16.1 billion and perishable food at \$15.1 billion.

It isn't that alcohol is altogether new to Wal-Mart, since many of its outlets have carried a limited inventory of beer and wine in the past, but the move into hard liquor is something else. Although alcoholic beverages accounted for barely \$1 billion in 2004 sales of \$285 billion, this represented a 154 percent growth since 2000, compared to a growth of only 44 percent for general merchandise.

In its drive to push alcohol sales, the Bentonville, Arkansas company has teamed up with Diageo PLC, the world's largest liquor company and plans to work with Diageo as it does with Proctor and Gamble and Kellogg, developing a new merchandising plan and tripling shelf space devoted to liquor.

Selling more alcohol, however, raises complicated issues for a company that presents itself as a folksy all-American enterprise and an arbiter of social mores. In addition to banning risqué magazines from its stores and selling sanitized versions of CDs with controversial song lyrics, Wal-Mart forbids alcohol consumption on company property and at company events. And when Wal-Mart executives put business meals on their expense accounts, they must personally pay for any alcoholic drinks.

Wal-Mart's push into alcohol is part of its ambition to be a one-stop store catering to almost

all of its customers' needs from coast to coast. The company began selling groceries in a big way just 10 years ago. For years its stores were concentrated in the Midwest and South where many states do not allow supermarkets to sell distilled spirits, but as the Wal-Mart-Diageo partnership gears up, observers anticipate a drive to change how liquor is marketed across America.

Wal-Mart's success has depended on its ability to offer shoppers lower prices and the company has begun to develop a strategy that will allow it to offer liquor at lower prices as well.

Part of that strategy will likely take into account the recent Supreme Court decision to allow direct shipments from wineries to consumers, bypassing wholesalers and retailers. If Wal-Mart were able to purchase liquor directly from distillers, bypassing wholesalers, this would mean customers would be able to buy vodka, rum and gin at a savings of 20 percent or more from current pricing.

Early last year, during a visit to Diageo's U.S. headquarters in Stamford, Conn., some senior Wal-Mart buyers and top Diageo marketing executives toured a local supermarket, Diageo executives say. They spotted a milk drink with dulce de leche, a caramel-like flavor that has spread in recent years to ice cream, candies and other desserts. The Wal-Mart buyers urged Diageo to come up with a dulce de leche spirit, something Diageo hadn't considered, Diageo executives say.

Within months, Diageo designed a dulce de leche liqueur it named Caraluna. Wal-Mart pushed Diageo to work quickly to have it ready to test during the critical Christmas shopping season and agreed to a trial in its Arizona stores. Diageo invented a nonalcoholic whipped topping version of Caraluna that it served on ladyfingers in the liquor aisle so shoppers could sample the flavor of the new liqueur.

Diageo managers are now tweaking Caraluna, which it renamed Dulseda for trademark reasons, in preparation for a national rollout.