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

Office of Policy Planning
Bureau of Competition
Bureau of Consumer Protection
Bureau of Economics
Northeast Regional Office

March 29, 2004

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Chairman, Senate Committee on Transportation
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Dean G. Skelos
Deputy Majority Leader, Senate
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Re: Assembly bill 9560-A, Senate bills 6060-A and 1192

Dear Chairmen Magee and Kuhl, and Deputy Majority Leader Skelos:

The staffs of the Federal Trade Commission's Office of Policy Planning, Bureau of Competition, Bureau of Consumer Protection, Bureau of Economics, and Northeast Regional Office are pleased to respond to your requests for comments on New York Assembly bill 9560-A, and Senate bills 6060-A and 1192. These bills would allow out-of-state vendors to ship wine directly to New York consumers if the vendors comply with certain regulatory requirements, such as labeling delivery packages and reporting sales to state authorities. In letters dated February 10 and 25, 2004, you asked us to examine the bills, and specifically to discuss the information regarding "the opponents' arguments related to sales to minors and harm to the three-tier system, as well as the proponents' arguments regarding the positive impact for consumers and state revenues."[1] You also referenced pending litigation.[2]

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[1] This letter expresses the views of the FTC's Office of Policy Planning, Bureau of Competition, Bureau of Consumer Protection, Bureau of Economics, and Northeast Regional Office. The letter does not necessarily represent the views of the Commission or of any individual Commissioner. The Commission has, however, voted to authorize us to submit these comments.

[2] *See* Swedenburg v. Kelly, 358 F.3d 223 (2d Cir. 2004) (upholding New York's direct shipping regulations).

We believe that, if enacted, all three bills would enhance consumer welfare and allow New York to meet its other public policy goals. By allowing interstate direct shipping, the bills could allow New York residents to purchase a greater variety of wines at lower prices. Senate bill 1192 would provide the greatest benefits by allowing both out-of-state wineries and retailers to obtain out-of-state shipper's licenses. In addition, by requiring vendors and common carriers to comply with various regulatory requirements, similar to those adopted in other states, all three bills would allow New York to limit shipments to minors and to collect taxes on out-of-state shipments. Finally, the bills would remove one of the largest barriers to greater e-commerce in the wine industry. We base our analysis on a recent FTC staff report that extensively analyzed the direct shipping issue, and on the Commission's testimony at a recent congressional hearing (copies of both attached). A summary of our analysis is below:

- Variety. Direct shipping allows consumers to purchase many wines that are not available in nearby bricks-and-mortar stores. An FTC staff study found that 15% of a sample of popular wines available online were not available from retail wine stores within ten miles of McLean, Virginia. Direct shipping also gives consumers easier access to thousands of labels from smaller wineries.

- Prices. Depending on the wine's price, the quantity purchased, and the method of delivery, consumers can save money by having wine shipped directly to them. 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 FTC staff 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.

- Sales to minors. The states that permit interstate direct shipping generally report few or no problems with shipments to minors. These states have generally adopted less restrictive means of regulating interstate direct shipments, such as requiring that package delivery companies obtain an adult signature at the time of delivery. The pending bills contain these same types of safeguards.

- Taxes. Several states collect taxes on interstate direct shipments. States such as New Hampshire have sought to achieve voluntary compliance through less restrictive means, such as by requiring out-of-state suppliers to obtain permits. Most of these states report few or no problems with tax collection.

- E-commerce. State bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine. Approximately 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.

For these reasons, we believe that, if enacted, the bills would enhance consumer welfare and allow New York to meet its other public policy goals.

Interest and Experience of the Federal Trade Commission

The FTC is charged by statute with preventing unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.[3] Under this statutory mandate, the Commission seeks to identify business practices and regulations that impede competition without offering countervailing benefits to consumers. In particular, Commission staff have often assessed the competitive impact of regulations involving alcohol distribution. For example, the staff has analyzed franchise laws that grant wholesalers preferential contract rights. In Illinois, the staff examined 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.[4] 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.[5] 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.[6]

FTC staff have also studied the direct shipping issue. In October 2002, the Commission held a workshop to evaluate possible anticompetitive barriers to e-commerce in wine and many other industries.[7] At the workshop, FTC staff heard testimony from all sides of the wine issue, including wineries, wholesalers, and state regulators. The staff also gathered evidence from package delivery companies, the Alcohol and Tobacco Tax and Trade Bureau ("TTB"), and regulators in states that allow direct shipping. Finally, FTC staff conducted the first empirical study of a wine market in a state that banned interstate direct shipping. The study examined the wine market in McLean, Virginia ("McLean study"), and compared the prices and choices that consumers could find in area stores to those available online. The authors chose McLean 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

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[3] Federal Trade Commission Act, 15 U.S.C. § 45.

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

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

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

[7] Public Workshop: Possible Anticompetitive Efforts to Restrict Competition on the Internet, 67 Fed. Reg. 48,472 (2002). The workshop's homepage is at http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm, its transcript is at http://www.ftc.gov/opp/ecommerce/anticompetitive/021008antitrans.pdf, and all of the panelists' written statements are at http://www.ftc.gov/opp/ecommerce/anticompetitive/agenda.htm.

cater to sophisticated wine drinkers.[8] In July 2003 FTC staff issued a comprehensive report on the direct shipping issue ("Wine Report"),[9] and in October 2003, the Commission testified at a related congressional hearing.[10]

Analysis of Pending Bills

All three bills would allow out-of-state vendors to ship wine directly to New York residents if those vendors satisfy certain regulatory requirements. Under Senate bill 1192, both out-of-state manufacturers and retailers could obtain an out-of-state shipper's license if those vendors hold a license to sell or manufacture wine in another state, and if that other state affords New York's vendors reciprocal treatment. To obtain an out-of-state shipper's license, vendors must pay an annual fee of $125 and present New York's state liquor authority with a copy of a current license from the other state. A license allows vendors to ship wine directly to New York residents who are 21 years or older.

Senate bill 1192 imposes several requirements on out-of-state shippers. In sending the wine, the shipper must ensure that the delivery package has a conspicuous label noting that the package contains alcohol and requires an adult signature for delivery, and the shipper must require common carriers to obtain an adult signature at the time of delivery. In addition, the shipper must provide the state liquor authority with annual reports that include, among other information, the total volume of shipments into New York and the purchaser's name and birth date. The shipper must pay all state and local sales and excise taxes, keep records for three years, and consent to New York's jurisdiction for enforcement purposes. Finally, the bill gives the state liquor authority the power to suspend or revoke an out-of-state shipper's license.

Assembly bill 9560-A and Senate bill 6060-A have similar provisions, with a few important exceptions. These bills would allow only out-of-state wineries, not retailers, to obtain out-of-state shipper's licenses, and in addition to a license, an out-of-state winery would have to obtain a "certificate of authority" and a "registration as a distributor." The bills also cap wine shipments at two cases per month to any New York resident. Finally, the bills directly require common carriers to verify the age of recipients.

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[8] *See* Wine Report at 18 n.81. It is likely that, in larger markets, bricks-and-mortar retailers may offer somewhat more choices, and that in smaller markets, bricks-and-mortar retailers may offer somewhat fewer choices.

[9] FTC Staff Report, *Possible Anticompetitive Barriers to E-Commerce: Wine* (July 2003), at http://www.ftc.gov/os/2003/07/winereport2.pdf.

[10] *See* Prepared Statement of the FTC Concerning "E-Commerce: The Case of Online Wine Sales and Direct Shipment," Before the Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce, United States House of Representatives (October 30, 2003), at http://www.ftc.gov/os/2003/10/031030ecommercewine.htm.

I. The Bills Would Allow Consumers to Purchase a Greater Variety of Wines

The bills would substantially increase the variety of wines available to consumers. Through direct shipping, and particularly through the Internet, consumers can conveniently purchase many wines that are not available in nearby bricks-and-mortar stores. The Internet effectively expands the geographic market by allowing online vendors to compete nationally. An individual online store may feature more products than many bricks-and-mortar retail locations. More importantly, 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. As a result, direct shipping can give consumers convenient access to many more wines, including popular labels. Using the *Wine and Spirits* list of the top 50 most popular wines in America, the McLean study found that 15% of the wines available online were not available from retail wine stores within ten miles of McLean. For the bottles that were unavailable in the McLean vicinity, 8 out of 15 came from among the 20 most popular bottles.[11] In addition to popular wines, direct shipping also gives consumers access to thousands of smaller labels from around the country.

Bricks-and-mortar retailers may not have the demand or shelf-space to justify keeping a large variety of wines in stock. According to a trade association, domestic wineries produce approximately 25,000 wine labels, and even in a large market like Illinois, only slightly more than 500 of these labels are available through the three-tier system.[12] Moreover, smaller wineries may be unable to distribute their wines through the three-tier system. 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."[13] Another court found that the three-tier system "may lock most [out-of-state producers] 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."[14]

Consumers are likely to value having a variety of wines from which to choose. One wine magazine, for example, reviews over 10,000 different wines annually. Similarly, an economist

[11] *See* Wine Report, App. A. The FTC's Bureau of Economics contributed to the Wine Report, and the McLean study, which is attached to the report, has been published as Alan E. Wiseman and Jerry Ellig, *How Many Bottles Make a Case Against Prohbition?* (Bureau of Economics, Federal Trade Commission, Working Paper No. 258, March 2003).

[12] *See* Wine Report at 24.

[13] 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).

[14] Dickerson v. Bailey, 212 F.Supp.2d 673, 694-95 (S.D. Tex. 2002), *aff'd*, 336 F.3d 388 (5th Cir. 2003).

testified that “the value to consumers of direct wine shipments com[es] primarily from access to wines that are not available in their communities.”[15]

II. The Bills Could Allow Consumers to Purchase Wine at Lower Prices

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. In addition, direct shipping lets consumers avoid the “cost” of spending time to travel to a bricks-and-mortar store.[16]

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. In states that allow direct shipping, 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 franchise laws.[17] This competition likely forces down prices. One 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.”[18] Likewise, a Nobel laureate in economics has explained how direct shipping benefits consumers:

> consumers benefit from free markets operated with the minimum government regulation required for consumer protection. . . . The restrictions on direct

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[15] *See See* Daniel L. McFadden, Written Statement 2, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/mcfadden.pdf. On the importance of variety, see Thomas B. Leary, *The Significance of Variety in Antitrust Analysis*, 68 ANTITRUST L.J. 1007 (2001). Some, however, have determined that consumers already have enough choices. *See* Statement of Juanita D. Duggan Concerning “E-Commerce: The Case of Online Wine Sales and Direct Shipment” 18, Before the Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce, United States House of Representatives (October 30, 2003) (“The average retail store in most States carries between 300 and 500 different wine brands at any given moment. Can you imagine selecting from that many toothpastes or contact lenses or cars?”).

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

[17] *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.

[18] 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*, 336 F.3d 388 (5th Cir. 2003).

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.[19]

Because all three bills permit direct shipping, all would increase competition and allow consumers to find lower prices. Of the three bills, Senate bill 1192 would increase competition the most by allowing out-of-state retailers, as well as wineries, to obtain out-of-state shipper's licenses. This additional competition likely would allow consumers to find even lower prices. The McLean study found that "the lowest online prices overwhelmingly come not from wineries, but from out-of-state retail outlets that have web-accessible inventories."[20]

To provide New York consumers with the greatest benefits, the bills should ensure that licensing procedures for out-of-state vendors are not overly burdensome. For example, to ship into New York, Assembly bill 9560-A and Senate bill 6060-A require out-of-state wineries to obtain a "certificate of authority" and a "registration as a distributor" in addition to an out-of-state shipper's license. All three bills require out-of-state vendors to pay an annual fee of $125. Such restrictions may constrain competition. Depending on the volume of purchases in a state, even seemingly small fees can deter smaller wineries from shipping wine.[21] In addition, some states have created complex licensing procedures and regulations that deter suppliers and package delivery companies from shipping wine to those states. Furthermore, all three bills allow out-of-state vendors to obtain New York licenses only if those vendors are located in states that afford New York's vendors reciprocal treatment. This restriction will prevent some out-of-state vendors from shipping to New York residents, thereby somewhat limiting competition and consumer choice. To obtain the greatest benefits from competition, a policy should ensure that permit procedures, fees, and regulations are reasonably calculated to meet the state's legitimate regulatory goals.

III. States that Permit Interstate Direct Shipping of Wine Generally Report Few or No Problems with Direct Shipments to Minors

Although direct shipping can provide consumers with important benefits, policymakers have expressed concern that direct shipping might exacerbate the problem of underage drinking. As FTC staff recognized in the Wine Report and in other documents, underage alcohol use

[19] *See* Daniel L. McFadden, Written Statement 1, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/mcfadden.pdf.

[20] Wine Report at App. A 25 n.22.

[21] *See* Wine Report at 41.

imposes significant costs, in both human and economic terms.[22] In the context of the direct shipping of wine, however, the evidence shows that the states that permit interstate direct shipping generally report few or no problems with shipments to minors.

A. Evidence from States That Allow Direct Shipping

FTC staff contacted officials from many states that allow interstate direct shipping and asked them whether they had experienced problems with shipping to minors. These states generally report few, if any, problems with direct shipping 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. None of them report more than isolated instances of minors buying or even attempting to buy wine online.[23] State regulators uniformly expressed greater concern about underage access to alcohol through traditional avenues.

The state officials offered many possible explanations for their experiences. Several state officials opined that minors are more interested in beer and spirits than wine.[24] New Hampshire concluded that minors are less likely to purchase wine online because of the extra expense of ordering over the Internet.[25] This conclusion corresponds 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.[26] 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. Similarly, several state officials also commented that, based on their experience, minors were much more likely to buy alcohol through offline sources than over the Internet.[27] 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.[28]

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[22] *See id*. at 26-38; 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.

[23] *See* Wine Report at 26-40.

[24] *See id*. at 32 (chart summarizing state responses), App. B (letters from state officials). *See also* Wall Street Journal, Editorial, *The Carafe is Half Full,* WALL ST. J., July 3, 2003, at A10 (arguing that teenagers are not interested in expensive wines, and that "[t]hirty states allow wine shipments within their borders without a surge in teen drinking").

[25] *Id*. at App. B (New Hampshire letter).

[26] *See id*. at App. A.

[27] *See id.* at App. B (California testimony; letters from New Hampshire and Wisconsin).

[28] *See id.* at notes 47-50 and accompanying text.

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.[29] FTC staff cannot rule out the possibility that minors are buying wine online undetected by state officials.

Nevertheless, the staff is aware of no systematic studies assessing whether direct shipping increases alcohol consumption by minors. FTC staff found only one study that might address the impact of direct shipping of wine on underage drinking. This study examines the impact of "home delivery" of keg beer and other alcohol on underage drinking from such traditional retailers such as local liquor stores.[30] Although the study raises important issues of concern, it provides little information upon which to assess interstate direct shipping of wine. The study does not specifically address online sales, interstate direct shipment via package delivery companies, or wine. For example, one of the study's key findings is that "[o]utlets providing delivery services were more likely to sell keg beer." Moreover, the study itself states that "data presented here do not reveal the frequency of delivery use or whether delivery purchases served as a primary source of alcohol," and the study does not assess whether home delivery or direct shipping increases underage alcohol consumption above the level that would occur without those channels.[31]

The data from state compliance checks, or stings, in theory could provide additional evidence on the impact of interstate direct shipping on underage drinking. Several 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. These data, however, are also inconclusive. Stings and anecdotes have shown that minors are able to buy wine online, but there are not enough data from which to conclude that minors can buy wine more or less easily online than offline. For instance, 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.[32] On the other hand, New Hampshire has run compliance checks in the past but

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[29] *See* Testimony of Irene Mead 196, at http://www.ftc.gov/opp/ecommerce/anticompetitive/021008antitrans.pdf.

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

[31] The National Academy of Sciences cites this study, and only this study, for the proposition that "[s]urveys of underage purchase of alcohol over the Internet or through home delivery show that small percentages (10 percent) of young people report obtaining alcohol in this manner." *See* Reducing Underage Drinking: A Collective Responsibility 174-75 (2004). As noted in the text, however, the cited study does not discuss the Internet or sales from out-of-state vendors.

[32] *See* Wine Report at 35.

did not report any problems with interstate direct shipping to minors.[33] Moreover, the bricks-and-mortar sting data show comparable results. These stings typically find that minors are able to buy alcohol between 15-30% of the time. 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.[34] Ultimately, there are little data indicating whether a retail clerk is a more or less reliable gatekeeper than a common carrier's delivery person. Of course, efforts should be made to minimize underage purchases of alcohol, both online and offline, and New York's bills incorporate safeguards against direct shipping to minors.

B. Less Restrictive Regulatory Tools

Many states have decided that they can prevent direct shipping to minors through non-discriminatory, less restrictive means than a complete ban. For example, some states have applied the same types of safeguards to direct shipments that already apply to bricks-and-mortar retailers, such as requirements that package delivery companies obtain an adult signature at the time of delivery. In addition, 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.[35]

New York's bills contain these types of safeguards. In sending the wine, the shipper must ensure that the delivery package has a conspicuous label, and the common carrier must obtain an adult signature at the time of delivery. In addition, the shipper must register with the state and consent to jurisdiction within New York for enforcement purposes. Finally, the bills give the state liquor authority the power to suspend or revoke an out-of-state shipper's license. Notably, New York's bills contain all of the safeguards recommended by both the National Academy of Sciences, which recommended "tightening access" rather than banning interstate direct shipping, and FTC staff.[36]

To the extent that minors do buy wine online, some argue that they lack adequate enforcement tools against out-of-state suppliers. They contend that the states 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 occur." They 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. They note that, in contrast,

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[33] *See id.* at App. B (New Hampshire letter).

[34] *See id.* (noting a success rate of 30% in bricks-and-mortar stings); Letter from Tina Schultz, National Alcohol Beverage Control Association, to FTC 2-4 (Jan. 31, 2002) (citing state statistics).

[35] *See* Wine Report at App. B (letters from Nebraska, New Hampshire, and Wyoming).

[36] *See* Wine Report; NAS, Reducing Underage Drinking: A Collective Responsibility 174-75 (2004).

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.[37]

States, however, have a variety of 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.[38] 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"), an 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."[39] NABCA also said that the Act would help states "overcome the jurisdictional hurdles" in enforcing their laws.[40] Finally, TTB, which has authority to revoke a winery's basic permit, will assist states in combating significant violations of state law.[41]

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.[42] 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."[43]

Overall, the evidence shows a few clear results. States that permit interstate direct shipping have adopted various procedural safeguards and enforcement mechanisms to prevent sales to minors. These states 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. The McLean study suggests that an interstate shipping ban primarily deprives consumers of access to lower-cost sources of high-end, expensive wines, and to a larger variety

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[37] *See* Wine Report at 29-30.

[38] 27 U.S.C. § 122a (2002); 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); Bolick v. Roberts, 199 F.Supp.2d 397, 442 (E.D. Va. 2002) (addendum), *vacated on other grounds*, Bolick v. Danielson, 330 F.3d 274 (4th Cir. 2003).

[39] 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.

[40] *Id*. *See also* Wine Report at App. B (noting that Illinois could use the Act).

[41] 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.

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

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

of all 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. There is, therefore, apparently no empirical evidence that bans on interstate direct shipping promote temperance. Because New York's bills contain the same types of recommended safeguards as those adopted by states that allow interstate direct shipping and report few problems, it is likely that New York will experience few, if any, problems with direct shipments of wine to minors.

IV. States that Permit Interstate Direct Shipping of Wine Generally 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.[44] New York's bills incorporate these types of requirements. Of these states, most 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]."[45] North Dakota reports that "Taxes are collected. No problems to date that we are aware of."[46]

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.[47]

Furthermore, 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. On the other hand, there is no evidence showing that states must ban interstate direct shipping, rather than adopting a less restrictive alternative, to raise revenue.

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

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[44] *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.

[45] *See* Wine Report at App. B (Nebraska letter).

[46] *See id.* (North Dakota letter).

[47] *See id.* (New Hampshire letter).

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. 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. 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. Moreover, if interstate direct shipping increases overall commerce in wine, overall tax revenue could rise.[48]

V. The Bills Would Promote E-Commerce and Interstate Commerce

The Internet lets consumers purchase an unprecedented array of goods and services from the convenience of their homes. Consumers can find thousands of goods, from thousands of suppliers around the country, and have those goods delivered to their doors. State bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine. In states that ban interstate direct shipping, the bans prevent consumers from conveniently purchasing wine from suppliers around the country.[49]

The direct shipping issue has broader implications for interstate e-commerce. In many industries, including many professional and financial services, states require that potential suppliers maintain a physical office within the state, or that they hire state residents.[50] Under current New York law, for example, out-of-state wineries can obtain a license to distribute and sell alcohol in New York only if they "comply with the licensing requirements of [New York] Law, including establishing and maintaining a physical presence in New York."[51] These requirements ostensibly allow states to maintain tighter regulatory control over the supplier, but they also significantly raise the cost to online suppliers to doing business within a particular state. They deprive online suppliers of one of the main efficiency benefits of e-commerce, the ability to provide goods and services over large distances without the need for a substantial, far-flung physical presence. They also demonstrate how seemingly neutral restrictions can deprive online firms of a legitimate competitive advantage. State physical presence laws apply equally

[48] *See id*. at 39-40.

[49] *See, e.g.*, Virginia Postrel, *A Look at Wine Sales over the Internet Shows the Price of Some Regulations in the Name of Consumer Protection*, N.Y. TIMES, July 17, 2003, at C2 (criticizing bans on interstate direct shipping as a barrier to e-commerce).

[50] At the workshop, FTC staff examined potentially anticompetitive barriers to e-commerce in many other industries: auctions; automobiles; caskets; contact lenses; cyber schools; online legal services; real estate, mortgages, and financial services; retailing; and telemedicine and online pharmaceutical sales. *See* Workshop Homepage, at http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm.

[51] Swedenburg v. Kelly, 358 F.3d 223, 228-29 (2d Cir. 2004).

to in-state and out-of-state firms. In reality, though, these requirements impose disproportionate costs on online firms by diminishing or eliminating one of their advantages. Moreover, online firms, unlike bricks-and-mortar firms, may not enjoy the full financial benefits of maintaining an in-state office, because only part of their client base will reside in any particular state.

On the other hand, there is little evidence that in-state office requirements are necessary to advance consumer protection goals. For instance, there is little evidence that in-state office requirements reduce the incidence of consumer fraud by "fly-by-night"operators who deceive consumers and then disappear. FTC staff have ample experience demonstrating that deceptive lending can harm consumers, particularly for low-income and unsophisticated borrowers.[52] There is, however, no necessary correlation between a lender's propensity to deceive consumers and the presence or absence of in-state offices or personnel. In a number of the most significant deceptive lending cases brought by the Commission, the lenders operated in-state offices.[53]

Physical presence is not necessary to ensure accountability.[54] Nor is the issue of enforcement unique to wine. As with catalogue sales or online sales of other products, a variety of general laws and regulations protect consumers and provide legal remedies. Consumers can use general contract and tort law, as well as other specific state consumer protection laws and federal laws, to seek legal redress against out-of-state suppliers. State enforcement agencies can use a variety of legal tools, such as the Twenty-First Amendment Enforcement Act and cooperation with other states' enforcement agencies. Moreover, federal agencies, including the FTC, TTB, and Department of Justice, have authority to bring enforcement actions against sellers who violate the law. At best, physical presence requirements are an expensive, inefficient means of getting an incremental increase in regulatory authority. At worst, if extended to other industries, physical presence requirements could seriously imperil the growth of e-commerce.

Finally, your letter asked us to comment on arguments regarding "harm to the three-tier system." The FTC's statutory mandate, of course, is to promote competition and consumer welfare, not producer welfare. Having said that, the evidence suggests that expanded e-commerce would improve market conditions by giving wineries (including New York wineries), the first tier of the system, extra distribution outlets. Moreover, expanded e-commerce likely would not spell the end of bricks-and-mortar wholesalers or retailers. Because of shipping costs, consumers generally can find lower prices for less expensive wines in bricks-and-mortar stores.

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[52] *See* Prepared Statement of the Federal Trade Commission on Efforts to Combat Unfair and Deceptive Subprime Lending, before the Senate Special Committee on Aging 4-8, February 24, 2004, at http://www.ftc.gov/os/2004/02/02242004subprimelendingtest.pdf.

[53] *See*, *e.g.*, The Associates, No. 1:01-CV-00606 (N.D. Ga. 2001); First Alliance Mortgage Co., et al., No. SACV 00-964 DOC (Eex) (C.D. Cal. 2000); Mercantile Mortgage Co., No. 02-5079 (N.D. Ill. 2002).

[54] *Cf. Swedenburg*, 358 F.3d at 237-38.

In states that permit interstate direct shipping, such as California and Illinois, wholesalers and retailers continue to enjoy the bulk of sales.[55]

Conclusion

Based on an extensive review of the evidence, FTC staff believes that, if enacted, any of the bills would enhance consumer welfare and would allow New York to meet its other public policy goals. FTC staff also believes that Senate bill 1192 would provide greater benefits to consumers than Assembly bill 9560-A or Senate bill 6060-A, because that bill would allow both out-of-state wineries and retailers to obtain out-of-state shipper's licenses.

Respectfully submitted,

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[55] *See* Daniel L. McFadden, Written Statement 2, at http://www.ftc.gov/opp/ecommerce/anticompetitive/panel/mcfadden.pdf ("If direct interstate wine shipments were reopened, I would foresee some competitive pressure on distributors and retailers, primarily from direct wine sales to large retailers, but no substantial restructuring of the industry. I find it particularly sad that the anti-interstate shipping legislation that has been passed is so disproportionate in its negative impact on consumers relative to the very modest protection it provides to traditional distributors and retailers").