

An Economic Success Story

The independence of Virginia's licensed beer distributors and licensed wine distributors is at the heart of the Three Tier System.

- They are responsible for thousands of jobs, generate hundreds of millions of dollars in economic activity and annually pay or generate millions of dollars in state and local taxes.
- Consumer choice is phenomenal. No other consumer products industry distributes as many product choices as wine and beer wholesalers. The ABC Board, for example, has currently registered more than 30,000 wine products for sale in the Commonwealth. The ABC Board has registered more than 5,500 different brands of beer for sale in the state.
- Competition in the beer and wine industries enables these products, despite their high taxes, to sell consistently at prices lower than inflation.



Any way you measure it, the Three Tier System is working for consumers and for the Commonwealth.



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VIRGINIA'S
INDEPENDENT
BEER AND WINE
WHOLESALERS:

Protecting Consumer Choice



Keeping
Virginia
Tax Dollars
in Virginia

Lessons of History

The alcoholic beverage industry has been a major part of the American economy since colonial days.

One of Thomas Jefferson's first acts as President was to repeal a federal whiskey tax, stating that *"an excise tax on distilled spirits is hostile to the genius of a free people."* Congress did not dare tax alcohol again until the Civil War.

It was the revenue from the income tax that made Prohibition possible. But Prohibition was a spectacular failure. The saloon was replaced by the speakeasy, a free market was replaced by an ocean of corruption and organized crime flourished. By the presidential election of 1932, both political parties were committed to repeal.

To America's lasting benefit, however, some of the lessons of history were learned. Prohibition was initially popular because the alcohol industry was out of control. In pre-Prohibition days, brewers, vintners and distillers often sold their products through their own retail outlets, called "tied houses," using any marketing means possible to sell excessive amounts of their product (including the infamous "free lunches" laced with salt).

So federal alcohol *prohibition* was replaced by state-based systems of alcohol *control*. It was a stroke of genius.

What is the Three Tier System?

At the heart of the control system in all fifty states is the Three Tier System, with the industry broken into three separate, state-regulated components:

- Licensed distillers, brewers and vintners
- Licensed wholesalers
- Licensed retailers

Generally, each tier must remain independent of the other two. Every manufacturer must sell through a licensed wholesaler, and every retailer must buy from a licensed wholesaler. With very limited exceptions, including Virginia's Consumer-Direct Wine and Beer Shipment Law, manufacturers cannot sell directly to retailers or the public, nor can they own retail outlets.

Virginia's wine and beer wholesalers are strong supporters of the Three Tier System as a mechanism for maintaining product choice, regulatory control and tax collection.

Benefits of the Three Tier System

The Three Tier System prevents vertical integration of the alcohol industry, thereby protecting competition and consumer choice from the corrosive effects of conglomerate monopolies. Why is this in the public interest? Alcohol products enjoy widespread consumer appeal but at the same time generate widespread demands for regulation.

The Three Tier System effectively requires the alcohol industry to consist of a large number of competitors. Those engaged in distribution and retailing are mostly small businesses and virtually all are located here in Virginia. Thus, they are easier to regulate than huge, remote conglomerates, some of which might be located overseas. This helps ensure that every product sold in Virginia pays its fair share of Virginia taxes, collected by the licensees themselves.

Most importantly, since the distribution tier cannot be controlled by manufacturers, it is relatively easy for new products to enter the industry and gain market access through such independent distributors. Witness, for example, the Virginia craft-brewed products and wines that have arrived in the marketplace in recent years and enjoy considerable consumer appeal.

The Virginia Winery Distribution Company, established in 2007 by the General Assembly, is an example of how the three tier system can accommodate change. The VWDC, a unique public-private partnership, works with wineries and wholesalers to provide market access for products not already enjoying robust distribution.

The Three Tier System also provides "rules of the road" that guarantee consumer choice and competition by restricting unfair competition:

- Retailers can operate free from undue pressure to buy (or not buy) particular products or use particular marketing techniques.
- It is illegal for big retailers to pressure wholesalers for concessions not available to "mom and pop" grocery stores and convenience stores.
- Wholesalers cannot be pressured to "buy" retail shelf space for wine or beer. If allowed, this would restrict consumer choice to only those products sold by the wealthiest wholesalers.

Several Related Laws Are Equally Important To Preserving Competition and Control.

Virginia Franchise Law

The Beer and Wine Franchise Acts protect distributors from intimidation, bullying and abuse by more powerful manufacturers. They serve the public's legitimate interest by restraining overly-aggressive behavior in the marketing of alcoholic beverage products.

Generally, the Beer and Wine Franchise Acts prohibit breweries and wineries from:

- Terminating the distributor except where the distributor has failed to perform properly.
- Threatening to give the distributor's business to another distributor in the same market.
- Trying to dictate the distributor's prices charged to retailers.
- Unreasonably preventing the distributor from selling his or her business.

The Virginia ABC Board is authorized to determine whether violations of the Franchise Acts have occurred. That agency, with its expertise in the Virginia alcohol industry, has more than 20 years of experience in adjudicating franchise cases and has ruled in favor of breweries and wineries about as often as it has ruled in favor of distributors.

The Cash Law

It is illegal for a beer or wine wholesaler to give credit to a retailer and should remain so. All products must be paid for at the time of the transaction, either by currency, check or electronic funds transfer. The benefits of this system are obvious:

- It preserves the Three Tier System by keeping entities truly independent. Otherwise, distributors could dominate retailers by becoming their private bankers.
- It helps make sure that new retailers commence business with sufficient capital. This reduces the chance that excessive reliance on credit arrangements will lead to financial instability and, as a result, ABC regulatory problems.
- Credit is never free, and the cost of credit (especially bad credit) would be added to the product price ultimately paid by consumers.

The Dillon Rule

Like many Virginia businesses, Virginia's wine and beer wholesalers are strong supporters of the Dillon Rule, which limits local government authority to those powers expressly granted by the General Assembly. The last thing Virginians need is a patchwork of local alcohol regulations and taxing schemes.

Consumer-Direct Wine & Beer Shipments

Legislation passed by the 2003 General Assembly allows Virginians of legal age to receive two cases of wine and two cases of beer each month from ABC Board licensees authorized to ship these products directly to consumers.

This legislation matches consumer convenience with controls to protect public safety and collect applicable taxes while providing enhanced market access for small producers of wine and beer.

Forced Deposit Taxes

Virginia does not force her people to pay refundable deposits on beverage containers and should continue to resist the idea. In other states, this system has created more problems than it has solved, with consumers picking up the tab for an inefficient waste disposal system. As a better alternative, Virginia's beer and wine industry pays the majority of revenues collected under dedicated litter control and recycling taxes used to promote a litter free future and recycling.

The more than \$1.5 million in grants provided to localities in fiscal year 2010 produced more than \$11 million in matching funds and services, or a funding match of 730%: all used to collect litter, promote recycling and educate Virginians about keeping our state clean. Voluntary recycling of glass, aluminum and other packaging materials is now well established thanks in large measure to these local efforts.

It's worth noting that 95% of all litter and recycling taxes collected in the Commonwealth are controlled by local program managers, not Richmond bureaucrats.

Initiative and Referendum

Virginia's business community is strongly opposed to the introduction of the Initiative and Referendum process in Virginia. America's founders intentionally created a republic, governed by elected representatives, to prevent the excesses of pure democracy.

In states where direct legislation by referendum is common, the result is often voter confusion and cynicism.

Special interest groups with the deepest pockets and the slickest advertising often win. Once the dust settles, if the voters have been lied to, who is held accountable? No one. In Virginia, the General Assembly is accountable.

Virginia's beer and wine wholesalers join in the opposition to Initiative and Referendum, knowing that their industry would be a target for many of the initiatives.

Virginia's Excise Taxes Are High Enough

- Virginia's excise taxes on wine and beer are already among the nation's and region's highest.
- Virginia's wine excise tax is the nation's sixth highest.
- Virginia's beer excise tax is the nation's sixteenth highest.
- On a regional basis, Virginia's beer and wine excise taxes are higher than virtually all of those in our neighboring states:

the only excise tax in a neighboring state that is higher than a Virginia excise tax is the North Carolina beer excise tax.

- Virginia collected more than \$44.4 million in beer excise taxes and more than \$33 million in wine excise taxes in fiscal year 2010.

Don't Dismantle Virginia's Successful ABC System

- The 21st Amendment to the U.S. Constitution, which ended Prohibition, gave states control over alcoholic beverages. The 21st Amendment conveys to Virginia the right and the responsibility to regulate alcohol in a manner consistent with Virginia needs and Virginia values.
- After Prohibition, the General Assembly carefully and deliberately created an ABC system that has provided an effective balance of control, service and revenue for almost eighty years.
- ABC generates badly-needed revenue for critical public services, including education, law enforcement and mental health programs. In FY 2010 alone, ABC generated almost \$259 million in taxes and profits for the Commonwealth's General Fund.

■ ABC works to ensure that adults of legal age who choose to purchase alcohol can do so in an environment that operates in compliance with the laws and regulations of the Commonwealth.

■ ABC does exactly what most Virginians want it to do. Spirits are available in clean, well run and reasonably located stores statewide. Many of these stores are open seven days a week. ABC's retail operation is transparent and free of the corruption that has plagued some states with privatized liquor stores.

■ Virginia's wine and beer distributors support the alcoholic beverage control system that has served the Commonwealth's citizens well for almost eighty years.

■ In short, the current ABC system helps to support Virginia's quality of life. ABC is not "broken" and does not need to be "fixed."