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## BILL ANALYSIS

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Senate Bill 625 (as enrolled)

House Bill 4959 (as enrolled)

Sponsor: Senator Michelle A. McManus (S.B. 625)

Representative Chris Ward (H.B. 4959)

Senate Committee: Economic Development, Small Business and Regulatory Reform

House Committee: Regulatory Reform (H.B. 4959)

**PUBLIC ACT 268 of 2005**

**PUBLIC ACT 269 of 2005**

Date Completed: 4-7-06

**CONTENT**

**Senate Bill 625** amended the Michigan Liquor Control Code to do the following:

- Authorize the Liquor Control Commission to grant a direct shipper license that allows wine makers to engage in the sale, delivery, or importation of wine to consumers in a transaction by mail, internet, telephone, or other electronic means.
- Limit the retail sale, delivery, or importation of wine by a direct shipper to Michigan consumers to not more than 1,500 nine-liter cases (13,500 liters total) annually.
- Require direct shippers to verify the age of the individual placing an order, and label containers as provided in the bill.
- Require the person taking an order for direct shipment to record information about the person placing the order.
- Prescribe a \$100 fee for a direct shipper license, and require the Commission to use the fee revenue to investigate and audit direct shippers.

**House Bill 4959** amended the Code to do the following:

- Allow a wine maker to sell wine by direct shipment and at retail on the licensed premises.
- Redefine "wine maker" and provide an alternative definition if the

section containing the revised definition is held unconstitutional.

- Provide that a wine maker and a small wine maker may not also be licensed as a specially designated merchant (SDM) or a specially designated distributor (SDD).
- Provide that an SDM and an SDD may not also hold a wine maker or small wine maker license.
- Create the "Direct Shipper Enforcement Revolving Fund" for the deposit of direct shipper license fees and fines imposed by the Commission for violations.

Senate Bill 625 defines "direct shipper" as "a person who engages in the sale, delivery, or importation of wine, to consumers in this state, that he or she produces and bottles or wine that is manufactured by a wine maker for another wine maker and that is transacted or caused to be transacted through the use of any mail order, internet, telephone, computer, device, or other electronic means, or sells directly to consumers on the winery premises".

Each bill states that if an appellate court finds the bill unconstitutional, "then it is the intent of the legislature that a good faith effort be made to amend section 305 of the Michigan liquor control code...to make it less burdensome for a small winery to terminate an agreement with a wholesaler". (Section 305 governs the business relations between wine wholesalers and wine suppliers, i.e., wine makers and outstate sellers of wine.)

The bills were tie-barred to each other and took effect on December 16, 2005.

### **Senate Bill 625**

#### **Sale/Delivery/Importation by Direct Shipper**

Under the Code, a sale, delivery, or importation of alcoholic liquor may not be made in this State except by the Liquor Control Commission (LCC), its authorized agent or distributor, an authorized distribution agent approved by the LCC, or a person licensed by the LCC, or by prior written order of the LCC. For the purpose of this provision, the sale, delivery, or importation of alcoholic liquor includes the sale, delivery, or importation transacted or caused to be transacted by means of any mail order, internet, telephone, computer, device, or other electronic means. Under the bill, this applies except as provided below.

The bill specifies that the sale, delivery, or importation of wine to consumers in this State, by a person who both produces and bottles the wine or wine that is manufactured by a wine maker for another wine maker and that is transacted or caused to be transacted by means of any mail order, internet, telephone, computer, device, or other electronic means, or sold directly to a consumer on the winery premises, may be done only by a direct shipper. If a retail sale, delivery, or importation of wine occurs by any of these means, the direct shipper must hold a direct shipper license and comply with all of the requirements described below. (The bill defines "consumer" as an individual who purchases wine for personal consumption and not for resale.)

A direct shipper must pay applicable taxes to the LCC and pay any applicable taxes to the Department of Treasury as directed by the Department. Upon the Department's request, the direct shipper must furnish an affidavit to verify payment.

A direct shipper must verify the age of the individual placing the order by obtaining from him or her a copy of a photo identification issued by this State, another state, or the Federal government, or by using an identification verification service. The person receiving and accepting the order on behalf of the direct shipper must

record the name, address, birth date, and telephone number of the person placing the order on the order form or other verifiable record of a type and generated in a manner approved by the LCC, and give the Commission a duplicate copy. (The bill defines "identification verification service" as any internet-based service approved by the LCC specializing in age and identity verification.)

Upon request of the LCC, a direct shipper must make available to it any document used to verify the age of the individual ordering or receiving the wine from the shipper.

A direct shipper must stamp, print, or label on the outside of the shipping container that the package "Contains alcohol. Must be delivered to a person 21 years of age or older." At the time of delivery, the recipient must provide photo ID verifying his or her age along with a signature.

A direct shipper also must place on the top panel of the container a label containing the direct shipper license number, the order number, the name and address of the individual placing the order, and the name of the designated recipient, if different from the individual placing the order.

A direct shipper may not ship more than 1,500 nine-liter cases, or 13,500 liters in total, of wine in a calendar year to Michigan consumers. If a direct shipper, whether located in or outside of this State, owns, in whole or in part, or commonly manages one or more direct shippers, it may not in combination ship to consumers in Michigan more than 13,500 liters of wine in the aggregate.

Quarterly, a direct shipper must pay wine taxes and report to the LCC the total amount of wine, by type, brand, and price, shipped to Michigan consumers during the preceding calendar quarter, and the order numbers. A direct shipper also must authorize and allow the LCC and the Department to audit the shipper's records.

A direct shipper must comply with all prohibitions of the laws of this State, including sales to minors. A direct shipper also consent to the jurisdiction of the Commission and the Department, and the courts of this State concerning enforcement

of these provisions and any related laws, rules, and regulations.

#### Direct Shipper License

Under the bill, a direct shipper may not engage in the sale, delivery, or importation of wine to a consumer unless it applies for and is granted a direct shipper license from the LCC. Only the following qualify for a direct shipper license:

- A licensed wine maker.
- A wine producer and bottler located inside this country but outside of Michigan holding both a Federal basic permit issued by the Alcohol and Tobacco Tax and Trade Bureau and a license to manufacture wine in its state of domicile.

The bill states that these provisions do not prohibit wine tasting or the retail sale by a wine maker of wines that he or she produced and bottled or wine manufactured for that wine maker by another wine maker, if done in compliance with the Code.

An applicant for a license must submit an application to the LCC in a written or electronic format provided by the Commission, accompanied by an application and initial license fee of \$100. The application also must be accompanied by a copy or other evidence of the existing Federal basic permit or license, or both, held by the applicant. A direct shipper may renew its license annually by submitting a \$100 license renewal fee and a completed renewal application. The LCC must use the license fees to conduct investigations and audits of direct shippers.

The failure to renew, or the revocation or suspension of an applicant's existing Michigan license, Federal basic permit, or license to manufacture wine in its state of domicile, is grounds for revocation or denial of the direct shipper license.

If a direct shipper is found guilty of violating the Code or a rule promulgated by the LCC, the Commission must notify the alcoholic liquor control agency in the shipper's state of domicile and the Alcohol and Tobacco Tax and Trade Bureau of the U.S. Department of Treasury.

#### People Taking Orders & Delivering

Under the bill, a person taking an order on behalf of a direct shipper must comply with some of the requirements that pertain to direct shippers. The applicable requirements include verifying the age of the individual placing the order; making age verification documents available to the LCC; labeling containers; and complying with all prohibitions of the laws of the State.

Previously, the person who delivered liquor for a retailer had to verify that the individual accepting delivery was of legal age and was the individual who placed the order or the designated recipient residing at the same address, or was otherwise authorized to receive alcoholic liquor through a rule promulgated by the LCC. Under the bill, the delivery person must verify that the individual accepting delivery is of legal age and is the individual who placed the order or the designated recipient, is an individual of legal age currently occupying or present at the address, or is an individual otherwise authorized through a rule promulgated by the Commission.

Under the Code, if a delivery person, after a diligent inquiry, determines that the purchaser or designated recipient is not of legal age, the delivery person must return the liquor to the retailer. A delivery person who returns liquor to the retailer because he or she cannot obtain the purchaser's or designated recipient's legal age is not liable for any damages suffered by the purchaser or retailer. Under the bill, a delivery person also must return liquor to a direct shipper, and is not liable for damages suffered by the shipper.

#### **House Bill 4959**

##### Wine Maker; Retail Sales

Section 113 of the Code defines various terms, including "wine maker". Previously, "wine maker" meant any person licensed by the Commission to manufacture wine and sell, at wholesale or retail, wine manufactured by that person. The bill redefined the term as "any person licensed by the commission to manufacture wine and to sell that wine to a wholesaler, to a consumer by direct shipment, at retail on the licensed winery premises, to sell that

wine to a retailer, and as provided for in section 537" (described below).

The bill repeals Section 113 if any provision of the section is held unconstitutional by a court of competent jurisdiction and the allowable time for filing an appeal has expired or the appellant has exhausted all of his or her avenues of appeal. In that event, Section 113a, added by the bill, will take effect. Section 113a defines "wine maker" as any person licensed by the Commission to manufacture wine, to sell that wine to a wholesaler, to sell that wine by direct shipment to a consumer, at retail on the licensed winery premises, and as provided for in Section 537, but not to sell wine to a retailer.

Section 537 describes classes of vendors that may sell alcoholic liquor at retail. The bill adds the following:

- Direct shippers where wine may be sold and shipped directly to the consumer.
- Wine makers where wine may be sold by direct shipment, at retail on the licensed premises, and as provided for in Sections 537(2) and 537(3).

(Under Section 537(2), a wine maker may sell its wine in a restaurant for consumption on or off the premises if the restaurant is owned by the wine maker or operated by another person under an agreement approved by the LCC and located on the premises where the wine maker is licensed. Section 537(3) permits a wine maker, with the LCC's approval, to conduct wine tastings of its wines and to sell its wine for off-premises consumption at a location other than the premises where the wine maker is licensed to manufacture wine, under certain conditions.)

#### Direct Shipper Enforcement Fund

The bill creates the Direct Shipper Enforcement Revolving Fund in the State Treasury. The license fee imposed on direct shippers and any violation fines imposed by the LCC must be deposited into the Fund. The Commission may spend money from the Fund, upon appropriation, only for enforcing Section 203 and related projects. (Section 203 governs the sale, delivery, and importation of alcoholic liquor and, under Senate Bill 625, contains the provisions regulating direct shippers.)

The State Treasurer must direct the investment of the Fund and credit to it interest and earnings from Fund investments. Money in the Fund at the close of the fiscal year must remain in the Fund.

#### SDM & SDD Licenses

Under the Code, a specially designated merchant is a person to whom the LCC grants a license to sell beer and/or wine at retail for consumption off the licensed premises. A specially designated distributor is a person engaged in an established business licensed by the LCC to distribute spirits and mixed spirit drink in the original package for off-premises consumption.

The Code prohibits a warehouse, mixed spirit drink manufacturer, wholesaler, outstate seller of beer, outstate seller of mixed drink, outstate seller of wine, or vendor of spirits from being licensed as an SDM or an SDD. Under the bill, a wine maker and a small wine maker also may not be licensed as an SDM or an SDD. Any wine maker or small wine maker holding an SDM or SDD license on the bill's effective date may continue to hold the license.

Previously, the Code also stated that a warehouse, mixed spirit drink manufacturer, wholesaler, vendor of spirits, or outstate seller of beer, mixed drink, or wine could not be permitted to sell or deliver to the consumer any quantity of alcoholic liquor at retail. The bill deleted that language.

The Code prohibits an SDM and an SDD from holding a mixed spirit drink manufacturer, wholesaler, warehouse, or outstate seller of beer, wine, or mixed spirit drink license. The bill also prohibits an SDM and an SDD from holding a wine maker or small wine maker license. An SDM or SDD holding such a license on the bill's effective date may continue to do so.

(A small wine maker is a wine maker manufacturing or bottling not more than 50,000 gallons of wine in one calendar year. An outstate seller of wine is a person licensed by the LCC to sell wine that has not been manufactured in this State to a wholesaler in this State in accordance with rules promulgated by the Commission.)

## Brewers

Under Section 537, the classes of vendors that may sell alcoholic liquor at retail include microbrewers where beer produced by the micro brewer may be sold to a consumer for consumption on or off the brewery premises. (A micro brewer is a brewer that produces less than 30,000 barrels of beer per year.)

Under the bill, retail vendors also include brewers selling less than 200,000 barrels of beer per year where beer produced by the brewer may be sold to a consumer for consumption on or off the premises.

MCL 436.1203 (S.B. 625)  
436.1113 et al. (H.B. 4959)

## **BACKGROUND**

The ability of out-of-State wineries to ship wine directly to consumers in Michigan was the subject of litigation in recent years. In December 2005, the United States Supreme Court found that Michigan's alcohol distribution system unconstitutionally discriminated against out-of-State wineries in favor of in-State wineries (*Granholm, et al. v Heald, et al.*, 544 U.S. \_\_\_\_). The Supreme Court's decision is described briefly below.

Most alcoholic beverages in Michigan are distributed through the State's three-tier system, which is governed by the Michigan Liquor Control Code and administrative rules promulgated by the Liquor Control Commission. Producers or distillers, whether located within or outside of the State, generally may sell only to licensed in-State wholesalers. Wholesalers, in turn, may sell only to in-State retailers. Licensed retailers sell alcoholic beverages to consumers at retail locations and, subject to certain restrictions, through home delivery.

Like other producers, wine makers typically must distribute their wine through wholesalers. The law allowed an in-State winery, however, to obtain a "wine maker" license, which permitted it to ship directly to Michigan customers. An out-of-State wine maker, on the other hand, could obtain an "outstate seller of wine" license, which allowed it to sell only to in-State wholesalers.

Several Michigan residents, joined by an out-of-State winery, sued various State officials in the United States District Court for the Eastern District of Michigan. The plaintiffs contended that Michigan's direct shipment laws discriminated against interstate commerce in violation of the Commerce Clause of the United States Constitution, which grants Congress the power to regulate commerce among the states. The District Court upheld the State's distribution system, and the U.S. Court of Appeals for the Sixth Circuit reversed.

The U.S. Supreme Court agreed that Michigan's laws violated the Commerce Clause. According to the Court, the discriminatory character of the Michigan system was obvious: "Michigan allows in-state wineries to ship directly to consumers, subject only to a licensing requirement. Out-of-state wineries, whether licensed or not, face a complete ban on direct shipment. The differential treatment requires all out-of-state wine, but not all in-state wine, to pass through an in-state wholesaler and retailer before reaching consumers. These two extra layers of overhead increase the cost of out-of-state wines to Michigan consumers. The cost differential, and in some cases the inability to secure a wholesaler for small shipments, can effectively bar small wineries from the Michigan market."

Contrary to the defendants' arguments, the Court held that this discrimination was neither authorized nor permitted by Section 2 of the 21<sup>st</sup> Amendment to the U.S. Constitution, which reads: "The transportation or importation into any State...for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." Based on precedent and the amendment's history, the Court found that this provision does not allow states to regulate the direct shipment of wine on terms that discriminate in favor of in-state producers.

The Court then considered whether the State's system "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives". The Court addressed the two principal justifications advanced by the State: keeping alcohol out of the hands of minors, and facilitating tax collection. The Court found no concrete evidence to support

State's contention that the direct shipment of wine was likely to increase alcohol consumption by minors. The Court also found that the tax-collection argument was a "diversion" because Michigan does not rely on wholesalers to collect taxes on wine imported from out-of-State.

In addition, the Court pointed out that Michigan benefits from provisions of Federal law that supply incentives for wineries to comply with state regulations. The Alcohol and Tobacco Tax and Trade Bureau (formerly the Bureau of Alcohol, Tobacco, and Firearms) may revoke a winery's Federal license if it violates state law, and a winery cannot operate in any state without a Federal license. Also, the Twenty-First Amendment Enforcement Act gives state attorneys general the power to sue wineries in Federal court to enjoin violations of state law.

In conclusion, the Court held that states have broad power to regulate liquor under Section 2 of the 21<sup>st</sup> Amendment. "This power, however, does not allow States to ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers. If a State chooses to allow direct shipment of wine, it must do so on evenhanded terms."

Legislative Analyst: Suzanne Lowe

### **FISCAL IMPACT**

Senate Bill 625 allows the Liquor Control Commission to charge a \$100 application fee and a \$100 annual license fee of any direct shipper. Additionally, the bill increases the regulatory responsibilities of the Commission by requiring that audits be performed on these shippers to verify sales figures. The amount of revenue generated from these new license fees will depend on participation levels.

Revenue from these fees will be deposited into the Direct Shipper Enforcement Revolving Fund, which House Bill 4959 establishes, and may be used only for licensing and regulation costs attributable to the direct shipping vendor class.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.