

2011 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1340

2011 HOUSE STANDING COMMITTEE MINUTES

House Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1340
January 24, 2011
13310

Conference Committee

Committee Clerk Signature

Ellen Litang

Explanation or reason for introduction of bill/resolution:

Relating to sales by a domestic winery

Committee minutes:

Chairman Keiser: Opens the hearing on HB 1340.

Representative Ruby~District 38, Minot: As we went through the discussion about the winery license that was put in place, it has been a success. We have 8 manufactures, 3 are being considered and 1 of those 3 is waiting to see how this bill goes through before they decide. We heard discussion about the 3 tier, self distribution to direct consumer. If you ask any of the wineries what is the one key element that will help your company, let us do what about 30 other states do and us send our product to retail. I have a handout from Rod Ballinger.

Rob Balenger~Chairman G&WPC: (See attached testimony 1).

Chairman Keiser: Questions for Representative Ruby:

Representative N Johnson: You said that there were 30 some states that already do this direct, how do they get around the 3 tier system?

Representative Ruby: I will let someone else address that question.

Greg Krieger~President of the North Dakota Grape Growers' Association: (see attached testimony 2).

Representative M Nelson: What is the hold up for growers to get in the normal 3 tier system and market their product effectively?

Greg Krieger: What this bill does not do is mandate the state wineries to bypass the 3 tier system. It gives them the option to go direct to a neighborhood. We did have someone who approached a distributor and was told he was not big enough, it is a problem.

Chairman Keiser: If you go direct to the retail, then if I'm a wholesaler, I have no incentive to work with you. You might win direct access, but lose the support of the wholesale community. Do you have any reservations about that?

Greg Krieger: A lot of our wineries don't want to distribute state wide, what they would like to do is just go local community area. What we want to do with this bill for us wineries is get a bigger footprint in their communities, so visitor can come and have that opportunity to some of the local wines.

Representative Nathe: As we heard in the last bill, do you see a scenario would use a wholesaler? As in the last bill, the wholesaler is eating into the profits. This bill seems to be cutting out the wholesaler.

Greg Krieger: It doesn't cut them out is gives them the option. If a winery wanted to disturbed over a large area, it would be more efficient for them to use a wholesaler but if they just want to take it across town, why do they have to be at the mercy of a wholesaler to get their product there. Why should we have that impediment?

Representative Nathe: Isn't it the business mouth for the winery to keep it local anyways? I fail to see where the motivation is for someone like yourself to use a wholesaler.

Greg Krieger: There is a cost of going to wholesalers and that's factored in. There is an economic incentive to bypass for the retailer to purchase this product at a cheaper price but also more competitive because there is some cheap wine products on the market.

Vice Chairman Kasper: Are you familiar with how many wineries have been able to use the wholesalers to market their product throughout North Dakota?

Greg Krieger: As far as I know only 2 wineries that are using the wholesalers to distribute their wine. A lot of the wineries just don't have the volume of product to satisfy the needs of the wholesalers.

Vice Chairman Kasper: It appears that the small wineries in the local area that don't do a lot of business that would like to be able to sell locally. Would it possibly work if the bill were amended to within 25 to 50 mile radius of a winery, they could sell direct, but if they go outside that radius, then they go to a wholesaler?

Greg Krieger: I can't answer for everyone. For efficiency purposes, is nice to have a distribution framework like the wholesalers have. Some of the wineries will continue to use wholesalers to get their product to the far corners of the state. All we ask is give them the option.

Representative Clark: Can you tell me how big the North Dakota grape crop is and does any of it go to juice production?

Greg Krieger: The last tally was 20,000 vines and equal about 40-50 acres, you get 10-15 pounds per plant, that's about 2/3 of gallon of wine. It takes 3 years for the grapes to start producing and about 5 years to reach peak production. The last couple year have been

brutal for winter survival and getting a decent yields. Research and varieties are being done.

Chairman Keiser: North Dakota wineries, isn't it true that the majority of their products are not grape related wines.

Greg Krieger: That's probably true.

Ryan Subart~on behalf of John Steffes-Prairiewood Winery: (see attached testimony for John Steffes 3): Emphasizes paragraph 5.

Chairman Keiser: Anyone else here to testify on HB 1340?

Rodney Hogan~Red Trail Vinyard-Buffalo, ND: I support this bill. The Red Trail Vinyard is a vineyard and we don't make wine, however we do the rest of the process. The people that travel through North Dakota and the one thing they want are North Dakota wines. We sold fruit wine until we could grow grapes. We want to put our wine for sale in different liquor stores. The distributor said, no, we are not going to do that because your wine is just like this other guy's wine. Well my thought was, it's just like milk, there is Cass Clay and Bridgman, and it's all milk. Rhubarb wine is rhubarb wine and the only difference is its different labels. This bill will help me, it's not that I want to cut out the distributor, but I want to help them. I want to be able to promote my own wine because I have the passion and vested interest to do this. The wine that we have now in liquor stores is only there for one reason and not because of our distributor, it's because of me. I went there and told them about our wine. Its North Dakota grape wine and the distributor didn't help us. This bill is critical to the wine industry. Are we going to let the wineries fail because we can't go promote our won product and sell it direct, just for now; we don't want to cut them out.

Vice Chairman Kasper: You say that you don't want to cut them out, what do you mean by that?

Rodney Hogen: I think this bill permits use wholesalers or not use them.

Vice Chairman Kasper: So if you don't use wholesalers then you cut them out and if you use wholesalers you don't them out, is that what you mean?

Rodney Hogan: I'm just saying that we should have the opportunity to promote our wine now. If it gets big enough where we need them, then we will have to use them.

Vice Chairman Kasper: Again, if you don't use the wholesaler, then you're saying that you would not pay their fee?

Rod Hogen: That's right.

Vice Chairman Kasper: How many bottles of wine do you produce per year?

Rod Hogen: About 3000 bottles.

Vice Chairman Kasper: Are you able to sell them quite easily?

Rod Hogen: We sell at our tasting room maybe a 1/3 of that and the rest we have to go through a liquor store.

Chairman Keiser: Anyone else here to testify in support of HB 1340?

Allan Fuller~Vinyards Cellar Winery here in Bismarck: I'm in support of this bill mainly because we self distribute and self distribution is the best. Wineries use self distribution to develop important relationships with local outlets and create brand recognition and market demand for their wine. Wholesalers cannot do this for small wineries with limit quantities; it's not cost effective for them. Wholesalers promote large inventories from large outside manufacturers. It promotes free trade which benefits consumers. With the retail option bill, consumers have access to many other wines not made available by large wholesalers. My take on 3 tier system is the primarily reason was, for being introduced after prohibition was to eliminate the obscene power by producers of alcohol. As the number of wholesalers in America has dwindled, usually as a result of buy outs and mergers, the enormous power has been concentrated in a hand full of distributors and they now control the 1st & 3rd tier of the alcohol distribution. The circumstances that the 3 tier system has meant to clean up, now exists only with the wholesalers in control. Most states have recognized this system does not work when trying to develop a winery. The largest growing viticulture state, it's Iowa, it's getting closer.

Vice Chairman Kasper: If you have land right next to Lake Sakakawea, is that an ideal spot because of the condensation that comes off the lake or does that not matter?

Alan Fuller: I don't grow grapes. It may be better is what's in the ground you have to work with and how it drains.

Representative Ruby: Could you get us a list of those states that allow since 1980? Are you aware of the concerns of the 3 tier system and the Supreme Court concerns I'm sure that we are going to hear about?

Alan Fuller: I'm not aware of it.

Chairman Keiser: Anyone else here to testify in support, in opposition to HB 1340?

Patrick Ward~Lobbist on behalf of North Dakota Wholesale Liquor Dealers Association: (see attached testimony 4).

Representative N Johnson: How do they allow other states to do it?

Pat Ward: I don't believe that's true. I can check into it.

Representative Ruby: After that Supreme Court decision, North Dakota law was changed, mainly because at that time we weren't allowing anybody direct ship to consumer in state but they could do it out of state, so we were protecting the wholesales in state at the time. After that decision, the tax department put changes in that said, at the time we

also had reciprocity, so that states could bring, as long as we had the reciprocity agreement, they didn't have to go through the permitting process state by state if you were in that group. That was changed and because of the Granholm case, we had to allow the direct consistent in state as well as out of state because that's what we had, to keep our license consistent with that case? Is that how you remember that?

Pat Ward: Yes, basically.

Representative Ruby: So where in this law that says that we would be treating the in-state wineries different?

Pat Ward: If you look at your bill, this is a direct to retail provision. The 3 words that you are adding in the bill are letting the domestic winery to ship direct to retail. That's not allowed. An out of state winery can't do that. If you open that can of worms, you open up a big can of worms.

Representative Ruby: I believe that if they are classified as the same type of winery, they could.

Pat Ward: I would disagree because it says a farm or domestic winery located in this state is worked into the language of your bill.

Representative Ruby: That's also the language allows the direct to consumer inside and outside of the state, so it's the same thing.

Pat Ward: It would not be the same in that the out of state wineries are not necessarily farm wineries. Again you would be favoring your local business by providing an exception for a farm winery and not allowing other wineries to have the same rights.

Representative Ruby: That's the same language that's allowing the direct to consumer.

Pat Ward: We have another law that permits shipping to consumers directly from out of state. There are people from the tax department that are more expert than I am. My point is whether or not our law, our law is currently, may not be in compliance with the constitution and subject to attack. I don't know if anyone has asked the Attorney General for an opinion on that. Clearly if you put in this direct to retail, the people that would have an interest in challenging it are much likely to challenge it.

Representative Ruby: Remains to be seen, but currently the wineries pay the wholesale tax when they sell direct to consumer at this time as well. They have to pay the wholesale and retail tax, correct?

Pat Ward: That right but they would have the tax directly as opposed to the collection being at the wholesale level.

Representative Ruby: Correct, so that's in the reporting that they need to do. So they would also do that with this direct to retail.

Pat Ward: If this law were to somehow pass, I imagine that the system that would have to be set up.

Representative Boe: Is the 3 tier system that we are circumventing and that's where the legal challenge would come from?

Pat Ward: The 3 tier system is based on federal law that is designed to eliminate vertical integration in the liquor business to keep say Budweiser from having its own stores in Bismarck. In North Dakota the way the 3 tier system works is the wholesale is where the beer checks into the state and gets to the stores. The tax is collected at that place and there is one check to the tax department, which makes the collection of tax to much easier to keep track of tax and liquor coming in.

Representative Boe: If we circumvent that, that's where the legal challenge is, the Granholm because we went around the 3 tier system?

Pat Ward: The legal challenge was out of state companies that were being treated differently in terms of shipping wine into the state. If was a combination of the out of state companies that wanted to ship on the same terms into the state and some individuals in the states that wanted to buy from those out of state companies that brought the lawsuit.

Chairman Keiser: Just to clarify, it was in effect changes in application of the 3 tier system, to in state versus out of state.

Pat Ward: It was that but actually it was an attempt to give a local advantage in that industry.

Vice Chairman Kasper: On your testimony page 2 about the violation of the constitution, you quote differential treatment between in state and out of state wineries constituted explicated discrimination against interstate commerce.

Pat Ward: That correct.

Vice Chairman Kasper: Now, currently, our out of state wineries allowed to go direct in North Dakota or do they all go through a wholesaler.

Pat Ward: Currently out of state wineries can ship limited numbers of bottles into the state in accordance to our law. That's a result of litigation like the Granholm case. You can order wine, shipped to your home, there is the tax department rules that apply and you follow the terms the amount wine you can get in a month. I believe those out of state wineries have to register and I don't know what that permit cost.

Vice Chairman Kasper: In order to make the in state wineries the same could we not set up that same system?

Pat Ward: As far as shipping wine in state, we already have that. What this bill does is allows the wineries to ship direct directly to the retailer. Another point, there is nothing to

stop these fellows from going to the retailer and saying, "you should market my product". If there is a demand for that product, these wholesalers will provide it.

Vice Chairman Kasper: Something for nothing is an idea that people don't cotton to. You suggested that the wineries do their own marketing, call the wholesaler and say I found a customer for you, here the customer goes to pick up the order and I will give you my override. Isn't that what the fee the wholesalers receive is there to do the marketing for the customer that they have?

Pat Ward: That part of the package they do, they also distribute it and deliver. My point is that there is nothing in the law the way it's written now, that prevents the domestic wineries from encouraging retailers to sell their product. If the demand is there, the wine will get there. It's not the wholesalers keeping the wine out the stores, it's the store don't want it.

Vice Chairman Kasper: Do you see any way that HB 1340 be modified to comply with Granholm?

Pat Ward: I don't, unless you let out of state wineries ship direct to retail and I would certainly fight that.

Vice Chairman Kasper: What would cut out the wholesaler?

Pat Ward: It would cut out the wholesaler and change the world.

Vice Chairman Kasper: The area you underlined "to regulate commerce with foreign nations and among the several states". Do you see a leap what the Supreme Court has taken this commerce clause because we are dealing in state versus among the states?

Pat Ward: No, this is the same situation are the facts in the case that the Supreme Court decided. I will point out that it was a 5 to 4 decision and the opinion was written by Justice Kennedy, one of the most conservative judges. It was to get together on interstate commerce. It was a problem during the articles of confederation and a problem with colonies, this is the same logic taken 200 years down the road. Reads quote from Justice Kennedy. That is the intent of this farm winery from the beginning is to give it an advantage for this local business and so far it's been a de minimis thing. This additional language is very dangerous. We have been encouraging this business, but we have given them enough advantages and I do think they have a little niche market. Now that it's here, this bill goes too far.

Representative Ruby: I'm pleased that you are placing your argument on the fact that this is treating wineries different from in state and out of state and I dispute your views that this does treat out of state wineries any different that our current law right now allowing wineries to sell direct to consumer. The same ones that qualify now to send direct of consumers, as North Dakota wineries can sell direct for consumer for out of state as long as they permit, the out of state one can sell direct to consumer, as they permit, so this bill does not protect just North Dakota wineries from doing the same thing. I know that's where your main opposition is because we have big wineries that are going to come in just flood North

Dakota with wine. My question in this is do you think the rest of the country is bigger market for wine drinkers than the other wineries view North Dakota to be?

Pat Ward: I became lost in your question.

Representative Ruby: Our state is a much bigger market than in state, correct.

Pat Ward: Absolutely but what your bill does is permits the domestic wineries to sell direct to retail. We no longer talking about selling direct consumers either, but now you are talking about actually taking the liquor, by passing the wholesaler and going to the retailer. That a problem because you have to afford the same luxury to Gallo. Gallo would take their trucks and go past the wholesaler, right to the liquor stores and you would create problems and interstate competition. I don't think it was your intent but I do believe that is what the bill allows.

Representative Ruby: Isn't that the same argument you use when we first made these changes to the winery bill?

Pat Ward: The argument is much more refined than when we brought it up earlier. The Granholm case has come along and it's so specific to this issue that I just don't see any other way to get around it.

Vice Chairman Kasper: Is there any way the domestic wineries are saying that the wholesalers not marketing their product. With the system here you are land locked with these domestic wineries and wholesalers and they are frustrated, how do we fix where they are not getting a fair shake on their marketing?

Pat Ward: What I'm hearing is that they are not turning people down. If the market doesn't bear it, the wholesalers can't make the make the retailers take it.

Chairman Keiser: Anyone else here to testify in opposition HB 1340.

Rob Hanson~General Manager of JBLC-North Dakota, North Dakota Wholesalers' Assiciation: (See attached testimony 5).

Representative Boe: If I was a wine manufacturer and I came to your facility and wanted you to be my distributor, who owns the stock once I deliver it to you?

Rob Hanson: I buy the product from you, once I buy it from you; it's my responsibility to sell.

Representative Boe: When I ask you to distribute my product, you take a speculative position on the success of that?

Rob Hanson: To someone on the outside, that makes sense, but we have a responsibility to the industry that goes beyond just making a buck. I don't know of any wholesaler that has been approached by a domestic winery about selling his product and was told no. As the North Dakota Wholesaler Association have a commitment to say no to anyone. One

because we think it's the right thing to do and two because I don't want to be up here doing this again.

Representative Ruby: One of the comments that I wanted to clarify, you mention the tax department with all 8, so that they only can deal with 1, but aren't they pretty much in contact and in relationship with those wineries as well? They are individually collecting taxes on an ongoing base of the wholesale taxes from their selling from the premises and also the retail tax from the consumer when they sell direct to the consumer?

Rob Hanson: That's a good point. The one thing that I would saying that everybody that sells in North Dakota collects the state tax that North Dakota is due and submits it out of the goodness of their heart. I would like to believe that everybody that is shipping into the state of North Dakota right now is doing so legally, collecting taxes and submitting that to North Dakota. Domestic wineries are already paying taxes of production and I don't have a problem with that, I don't think that's an issue.

Representative Ruby: My discussion with the producers, they are in support with the tax department that they has the ability to audit some of the carriers that are shipping it in and they were in support of the proposal that was considered for this session but was dropped by the tax department.

Chairman Keiser: Anyone else here to testify in opposition of HB 1340?

Janet Seaworth~Executive Secretary & Legal Counsel for North Dakota Beer Distributors Association: (See attached testimony 6).

Chairman Keiser: Anyone else here to testify in opposition to HB 1340?

Daniel Rouse~Legal Counsel to North Dakota Office of State Tax Commissioner: (see attached testimony 7).

Representative Ruby: When that decision came down, the tax office made some changes to the winery law, they got rid of the reciprocity, went back to the permitting and the whole thing. That exact language that is this winery law right now, the new language does not restrict anymore that currently exists for direct to consumers. Nobody has explained in a way that I understand, how the same language is protective to North Dakota wineries over the out of state.

Daniel Rouse: The domestic winery law has one of the principle requirements that the winery be in North Dakota. Therefore, this law, if enacted, allows a North Dakota winery to bypass the wholesaler tier and sell its products directly to retail. The critical element is that this applies to North Dakota wineries. The impact of the law is broader than that; it allows a preferential treatment to the North Dakota wineries. That same treatment is not available to any other winery from any other portion in the world. It's simply per say, facially, unconstitutional.

Representative Ruby: I'm still not getting it, the same exact law deals with North Dakota wineries in direct to consumer in state and out of state, so how direct to retail in state and

out of state and I admit it allows out of state to direct ship to in state to consumer. The existing allows us to do it now. This does the same thing to the retailers. It solves this smoke screen of this Supreme Court decision because it does not restrict the out of state wineries from direct to retail or direct to consumer we have now, correct?

Daniel Rouse: We do have a law that allows for limited amounts of wine to be shipped directly from manufacturers, in state and out of state, to private individuals in limited quantities for personal consumption. That is not this law, this law is related to and exclusive to North Dakota based domestic wineries. If this law is enacted those North Dakota based wineries would be able to bypass the wholesale tier and go directly to the retail tier in unlimited quantities anywhere. That same privilege would not be allowed to any other manufacturer of wine anywhere else in the world. It's our position as an agency that the phrase was used "the camel's nose under the tent", that an appropriate characterization because it's our expectation this would not be limited to wine. This would be seen as an opportunity to exploit by manufacturers all alcoholic beverages everywhere. You're correct in both the direct shipping law as well as in the domestic winery, there is a direct to retail carve out. The history of this law was intended to be a value added agricultural enhancement for North Dakota farm wineries. It has stayed relatively true to that core intent and it's a good thing. What is happening is this opens a huge door for anyone to come into North Dakota and to exploit it in North Dakota and take advantage of the fact that you have different treatment for the same entities and that's an unsustainable position.

Representative Boe: Who licenses the distributors?

Daniel Rouse: Our office.

Representative Boe: If tomorrow I wanted to become a distributor, what do I have to do?

Daniel Rouse: You would complete an application; file a fee with our office, background information that has to be reviewed about you and a criminal history check. That has the expectation that you would be going in this for a valid reason.

Representative Boe: Can I do that for one product?

Daniel Rouse: There are no limitations in the law that I'm aware as to 1 or 1,000 products; it's a matter of what's economically viable for you.

Representative Boe: Am I limited to where can I distribute?

Daniel Rouse: The wholesale community of all alcoholic beverages has districts, regions and sectors of the state that they are geographically limited to.

Representative M Nelson: The law we can't discriminate between in state and out of state, but it's actually legal for private corporations to say this is the sole distributor within this region and this guy that is out of state can't come in here, is that correct?

Daniel Rouse: Discrimination from the manufacturer to the wholesale tier is not allowed, but from the wholesale to the retail is not allowed either. As far as the establishment of geographic regions for the wholesale community, that is done by agreement amongst the wholesale community.

Representative Nathe: Hypothetically, if I have a winery and I'm not happy with my distributors, could I go ahead to be a distributor and just distribute my wine.

Daniel Rouse: You can't occupy more than one tier in the community.

Vice Chairman Kasper: Your concern that wineries might sell other type of alcohol; this is just the beginning of the sale of product. Did you mean that?

Daniel Rouse: I don't believe that I said that and if I did I apologize, that was not my intent. I'm saying that if they get this preferential treatment, it's our belief that other manufacturers of other alcoholic beverages including wine, would ask for that same treatment.

Vice Chairman Kasper: You don't imply that the wineries are going to sell anything but wine based upon the North Dakota statue, is that correct?

Daniel Rouse: We have no reason to believe the wineries would want to sell any other product.

Chairman Keiser: Anyone here to testify in opposition to HB 1340?

Alan Laier: I have been in the alcohol business for 38 years. In all my years of business, there has been a 3 tier system for wine, beer and spirit. I see HB 1340 as the beginning of the breakdown of this system. I do believe the system works. Direct sales from manufacturer to retail would crush most retailers in rural North Dakota. Wholesalers have established routes in rural areas that are serviced every 2 weeks at best. I do not believe that manufacturers can improve upon this. The 3 tier system works best for everyone and is not broke. Wineries and breweries from North Dakota should join the crowd and not go against it. I urge a NO vote on HB 1340 so everyone can be on the same playing field.

Representative Kreun: You buy from a distributor wholesaler

Alan Laier: Yes.

Representative Kreun: Can you buy from a different distributor wholesaler?

Alan Laier: Yes.

Representative Kreun: Anyone you want?

Alan Laier: Yes.

Representative Kreun: How do they get their license, do they fill out the application and to that. Would you buy different wholesalers?

Alan Laier: Sure, if they have something I can sell.

Chairman Keiser: Anyone else here to testify in opposition, neutral to HB 1340?

Chairman Keiser: Close the hearing on HB 1340.

2011 HOUSE STANDING COMMITTEE MINUTES

House Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1340
January 24, 2001
13314

Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

Relating to sales by a domestic winery

Committee Work Minutes:

Chairman Keiser: Opens the work session on HB 1340

Representative Ruby: I forwarded email that was sent from **Jeff Peterson~Pointe of View Winery** and he is involved with a group called "Wine America" and he has checked into what other states do. Reads the email sent. **(see attached email testimony)**. What we were told about the breakdown of the 3 tier system, the Granholm Supreme Court case, has all been thrown up in every state and in many bills we have heard in the past. It isn't a problem in those states. My main frustration with the tax office and I was told well, we are neutral on both of them. Three minutes before the hearing I was told they were against it. The common courtesy didn't come back.

Chairman Keiser: Looking at the case summary, in Michigan, was one of the Granholm states, that's wrong or this is wrong.

Representative Ruby: In the initial case, there were a lot of reciprocity agreements and there were a lot of states that were treating wineries different. I don't know what the difference is on that but basically that case cost us the reciprocity that we previously had and everyone had to go to a permit state, as long as you are treating them equally. What the difference in part of the case in contest, I'm not sure.

Vice Chairman Kasper: Representative Ruby, on top of page 2 of Pat Wards testimony, he cites the Supreme Court, how that state laws allowing "differential treatment between in state and out of state wineries constitute explicit discrimination against interstate commerce". Are you telling me that this bill does not discriminate between in state and out of state wineries that are treated the same? Is that what this bill does?

Representative Ruby: The way I interpret it, the way the law applies to the direct consumer part follows the same way as direct to retail. There is no preference of in state or out of state, in state is in this bill. I don't know what law they were talking about in direct consumer, because the ability to go to direct to consumer is written right here in this bill. Starting on line 1, so it basically it allowed to and from. The tax office gets the information

from any company that wants to send wine in this state must get license with the tax department because after reciprocity was removed, we became a permit state again.

Chairman Keiser: Now read line 15 and 16, which is really where the change is. That's the concern, not on line 1.

Representative Ruby: The reason I answered that is because that is what current law allowed was direct to consumers and it was also direct to consumers in and out of state and other companies have that ability to do it under the language right here. If we now allow direct to retail, we are not restricting any of the other out of state companies from doing the same thing.

Vice Chairman Kasper: Doesn't this bill continually say that a domestic winery and by definition, a domestic winery is located inside of North Dakota. I don't think this allows an out of state winery to sell direct to retail. We would have to say a domestic winery or a non-domestic winery would be able to do so and that would disrupt the entire 3 tier system.

Representative Ruby: There are companies right now that are sending wine in to North Dakota because of this bill and the direct to consumer.

Chairman Keiser: There is question; we have wine shipped directly to our house outside the state which is legal.

Vice Chairman Kasper: I see the problem here, we have small domestic wineries that can't product a whole lot of wine, some don't have grape, so the distributors, not enough product, not enough demand, too expensive, we are not interested in distributing. Local wineries are saying, how do I get my wares out there if I can't distribute it? We have a catch 22. What if we put an amendment that would allow domestic to do this within a 25 or 50 mile radius of their location for two years, to help get the demand going, then have it sunset and see what has happened in 2 years.

Representative Ruby: Opening for a challenge.

Representative N Johnson: It allows the domestic wineries that are from our state to do this thing, it doesn't allow someone outside of our state to come in and do the retail part. That's where you don't have it opened up to interstate commerce and that it applies to a domestic winery.

Representative Ruby: Since out of state manufacturers can sell to wholesalers and can sell to consumers without explicitly saying that. We are not specifically stating the wholesalers, that wineries from other state can also send to wholesalers or also send to consumers. We are not specifically saying that here, prohibiting either.

Representative N Johnson: Question is selling direct to a retailer, that what this would allow and that's not covered. That's the difference in my mind is that we are saying that someone in state can sell directly to a retailer but anyone from out of state can go to a wholesaler or direct to consumer but cannot go to retail.

Representative Sukut: You are talking about selling to the end consumer and selling to the retailer that is 2 entirely different things. You are cutting out the wholesaler and trying to figure out how you are going to do the tax part is going to create a problem. I am still wondering was that this from the federal standpoint this was not legal. You have a problem there.

Representative Ruby: That brings up a good point. The federal is heavily regulated. Certainly it wasn't the intent to just have this affect domestic winery, I assumed the language up top "the ability to sell in state and out of state", which allowed the consistency of allowing the other companies the same from outside the state. If we needed to amend this to where it says a domestic winery or outside winery that complies with state licenses and taxes is included in this, I don't have a problem with this. The intent was not to protect.

Chairman Keiser: I cannot support this for 3 reasons. First is it will create a significant work load for the tax department but they didn't put it in their fiscal note. My biggest concern, you cannot be a manufacturer and retailer at once. You can't have both; it's one of those unintended consequences. The second thing, the Joel Gilbertson-ND Beer Distributor's Association, here is kind of an importer of fine wines from small wineries from California, and he would negotiate contracts with them. If the wineries and other liquor sources can come directly into the state and negotiate with the retailer, it's going to be the Wal-Mart effect. There will be big and small losers. Little wineries don't understand the full impact.

Representative Amerman: In the state of North Dakota, how do you become a wholesaler.

Blaine Brunberger~North Dakota Tax Department: Fill out an application and answer some basic questions. They have to have a warehouse in North Dakota, a set of records, also cannot be permitted a felon type of offense and that's pretty much it. They have to pay the applicable fee whether it's a liquor license or wholesale beer license.

Chairman Keiser: What do you want to do?

Representative Boe: Is there some way a tax incentive to pick up the smaller wineries. I don't know what the fiscal note would be?

Vice Chairman Kasper: Won't we still be getting to the antidiscrimination clause of this case, we charge less tax on an in state versus an out of state.

Representative Ruby: I don't know if they are asking for that. Most of them are paying for their costs. A winery was told by a distributor that he would have to give exclusivity and they made it seem that there are other entities that would demand that and they were doing that themselves. There is a lot of turf war and don't want to see an infringement on it. They are held hostage in my opinion, that's the intent of the bill.

Chairman Keiser: Committee, what are your wishes?

Representative Clark: Moves a Do Not Pass.

Representative N Johnson: Second.

Chairman Keiser: Further discussion. We have a motion for a Do Not Pass.

Roll call was taken on HB 1340 for a Do Not Pass with 9 yeas, 5 nays, 0 absent and Representative Sukut is the carrier.

FISCAL NOTE
 Requested by Legislative Council
 04/11/2011

Amendment to: HB 1340

1A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

| | 2009-2011 Biennium | | 2011-2013 Biennium | | 2013-2015 Biennium | |
|----------------|--------------------|-------------|--------------------|-------------|--------------------|-------------|
| | General Fund | Other Funds | General Fund | Other Funds | General Fund | Other Funds |
| Revenues | | | | | | |
| Expenditures | | | | | | |
| Appropriations | | | | | | |

1B. **County, city, and school district fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

| 2009-2011 Biennium | | | 2011-2013 Biennium | | | 2013-2015 Biennium | | |
|--------------------|--------|------------------|--------------------|--------|------------------|--------------------|--------|------------------|
| Counties | Cities | School Districts | Counties | Cities | School Districts | Counties | Cities | School Districts |
| | | | | | | | | |

2A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

HB 1340 with Senate Amendments enables a domestic winery to sell its products directly to a retail licensee, to a wholesaler, or to an end consumer.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

If enacted, HB 1340 with Senate Amendments may result in increased sales by domestic wineries. The amount of the potential increase cannot be determined.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

| | | | |
|----------------------|----------------------|-----------------------|----------------------------|
| Name: | Kathryn L. Strombeck | Agency: | Office of Tax Commissioner |
| Phone Number: | 328-3402 | Date Prepared: | 04/11/2011 |

FISCAL NOTE

Requested by Legislative Council
01/19/2011

Bill/Resolution No.: HB 1340

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

| | 2009-2011 Biennium | | 2011-2013 Biennium | | 2013-2015 Biennium | |
|----------------|--------------------|-------------|--------------------|-------------|--------------------|-------------|
| | General Fund | Other Funds | General Fund | Other Funds | General Fund | Other Funds |
| Revenues | | | | | | |
| Expenditures | | | | | | |
| Appropriations | | | | | | |

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

| 2009-2011 Biennium | | | 2011-2013 Biennium | | | 2013-2015 Biennium | | |
|--------------------|--------|------------------|--------------------|--------|------------------|--------------------|--------|------------------|
| Counties | Cities | School Districts | Counties | Cities | School Districts | Counties | Cities | School Districts |
| | | | | | | | | |

2A. Bill and fiscal impact summary: *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

HB 1340 enables a domestic winery to sell its products directly to a retail licensee, to a wholesaler, or to an end consumer.

B. Fiscal impact sections: *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

If enacted, HB 1340 may result in increased sales by domestic wineries. The amount of the potential increase cannot be determined.

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. Appropriations: *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

| | | | |
|----------------------|----------------------|-----------------------|----------------------------|
| Name: | Kathryn L. Strombeck | Agency: | Office of Tax Commissioner |
| Phone Number: | 328-3402 | Date Prepared: | 01/22/2011 |

Date: Jan 24-2011

Roll Call Vote # 1

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES

BILL/RESOLUTION NO. 1340

House House Industry, Business and Labor Committee

Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: Do Pass Do Not Pass Amended Adopt Amendment

Motion Made By Rep Clark Seconded By Rep Johnson

| Representatives | Yes | No | Representatives | Yes | No |
|--------------------------|-----|----|--------------------------|-----|----|
| Chairman Keiser | ✓ | | Representative Amerman | | ✓ |
| Vice Chairman Kasper | | ✓ | Representative Boe | ✓ | |
| Representative Clark | ✓ | | Representative Gruchalla | ✓ | |
| Representative Frantsvog | | ✓ | Representative M Nelson | | ✓ |
| Representative N Johnson | ✓ | | | | |
| Representative Kreun | ✓ | | | | |
| Representative Nathe | ✓ | | | | |
| Representative Ruby | | ✓ | | | |
| Representative Sukut | ✓ | | | | |
| Representative Vigesaa | ✓ | | | | |

Total Yes 9 No 5

Absent 0

Floor Assignment Rep Sukut

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1340: Industry, Business and Labor Committee (Rep. Keiser, Chairman)
recommends **DO NOT PASS** (9 YEAS, 5 NAYS, 0 ABSENT AND NOT VOTING).
HB 1340 was placed on the Eleventh order on the calendar.

2011 SENATE JUDICIARY

HB 1340

2011 SENATE STANDING COMMITTEE MINUTES

Senate Judiciary Committee
Fort Lincoln Room, State Capitol

HB1340
3/16/11
Job #15536

Conference Committee

Committee Clerk Signature 

Explanation or reason for introduction of bill/resolution:

Relating to sales by a domestic winery

Minutes:

There is attached testimony

Senator Nething – Chairman

Representative Ruby – District 38 - Introduces the bill and explains the intent – He says this bill basically allows wineries to go direct to retail and create their market. He hands out a map of the US showing the difference in how states handle self-distribution. He says the Grape and Wine Program committee asked their attorney to draft an amendment to make sure they are consistent with the Granholm case. He hands out the amendment. He explains face to face transactions that are not happening currently. He says the big companies are not going to come in to distribute their own product. They will still use distributors.

Senator Nething – Asks if the amendment he is proposing abolishes the 3-tier system.

Ruby – Replies that he does not see it as abolishing it.

Senator Nething – Says the way he understands it once you take out the word domestic and leave winery what happens is any winery any place can sell directly to anybody. By treating everybody equally all over the US then we haven't violated that constitutional decision.

Ruby – Agrees, he says the deviation of the 3-tier system basically is in place already with the direct to consumer. Said he would like to defer questions to others who may know.

Senator Nething – Says as he sees it by removing it totally disrupts the system that has not had a problem.

Jeff Peterson – Pointe of View Winery & Vineyard in Burlington, ND – See written testimony. He says they have modeled this after Oregon where it is working very effectively.

Senator Nething - Says he has observed Wal-Mart and they totally bi-pass wholesalers which is their whole theory. He asks how they can say it would not impact wholesalers.

Peterson – Responds that the large manufactures are going to have to get in the distribution business for that to happen. It is not happening in other states with Wal-Mart why would it happen in ND.

Senator Nething – Questions whether the language with domestic removed is the same in other states.

Peterson – Said the amendments make sure the bill is constitutionally solid as in relation to direct to retail.

Senator Nething – Says he doesn't think Peterson understands the amendment because it says wholesaler or directly to a retailer. The way he understands it, it totally removes any requirement that we currently have in ND today from any outside distributor.

Peterson – Responds that it allows wine manufacturers from outside the state to sell direct to retailers with the amendment but that is a requirement to keep the bill constitutionally solid.

Senator Nething – Said he wonders if making this requirement isn't damaging something more to help out another party.

Peterson – He said a free market dictates what gets sold and that is what will happen here. He said you have to go out and build relationships with your product and make sure retailers are happy with it. He goes on to say most wineries that do that and develop a very large distribution set up for their business eventually hand it over to the larger wholesalers. He says the risk is at the level of the winery to develop that product.

Senator Nething – Asks how big a market he has.

Peterson – Responds he has a small winery and produces upwards of 2500 gallons. He said that is a miniscule amount and they primarily market in the Minot area.

Senator Olafson – Asks if some wholesalers refuse to carry his product.

Peterson – Related his experiences dealing with distributions in other markets.

Greg Krieger – Member of the ND Grape Growers Association – See written testimony.

Senator Nething – Asks how many members are in the Association and on average how many grape grower employees.

Krieger – Replies there is about 100 members and employ maybe one per vineyard.

Senator Olafson – Says as he reads the amendments it will allow a winery from anywhere to ship products to ND consumers. He asks how that will help small ND wineries.

Krieger – Replies we are already inundated with inexpensive wines from other countries and states but there is a lot of interest in ND products. He says there are flavors in our wines you can't get anywhere else.

Senator Nething – Asks how they distribute those wines.

Krieger – Says he is a grape grower and sells his grapes to wineries in the state and they sell on premises or with wholesalers.

Rod Ballinger – Chairman of the Grape and Wine Program Committee and owner of the Bear Creek Winery in Fargo – See written testimony.

Senator Nething – Asks how many employees are involved in the industry.

Ballinger – Replies presently there are 8 wineries with 3 more coming, approximately 50 or 60 and hoping to expand.

Senator Sitte – Asks about Iowa's wholesaling of wine.

Ballinger – Explains that 94% of Iowa's wine is distributed through wholesaling.

Senator Sitte – Asks if that would be the same in ND.

Ballinger – Responds not at first, you will probably see a lot of self distribution but as the wineries grow then the wholesaling rate will go up.

Paul Anderson – President of the ND Grape Growers Association – Reads a letter from John Steffes – See written testimony.

Bob Thaden – Tongue River Winery, Montana & member of the ND Grape Growers Association – See written testimony.

Allan Fuller – Bismarck – Wine license holder – in support of the bill.

Opposition

Patrick Ward – Attorney with Zuger Kirmis & Smith, Bismarck – See written testimony.

Senator Olafson – Asks how the amendments affect the constitutionality concern.

Ward – Replies the amendments he has seen would vastly improve the constitutionality issue but his concern is that if you do that you open the 3rd tier and do away with our 3 tier system and allow any winery anywhere to ship directly to retail in ND and it would not be limited like the Montana version, it would be wide open.

Senator Olafson – Asks him what the difference would be with what is proposed in this bill and the way Montana currently operates.

Ward – Said he is not an expert on Montana law but he has looked at it and it is his understanding that an out of state winery in Montana has to have a \$400 license renewed annually and the wine shipments have to be in the wineries own trucks, equipment, employees by contract or with a licensed Montana wholesaler or by common carrier. Shipments by common carrier are limited to 3 cases per day to any single retail outlet.

Senator Olafson – Asks if the Montana law is far more restrictive than what is here.

Ward – Responds, absolutely.

Rob Hanson – President of the Wine and Spirits Wholesalers Association – See written testimony. Also hands out letters of opposition from other retailers.

Senator Sitte – Asks what has been happening in other states.

Hanson – Relates he is not aware of what is happening in other states and tells about a lawsuit brought by the state of Washington against Cosco.

Janet Seaworth – Executive Secretary and Legal Counsel for the ND Beer Distributors Association – See written testimony.

Randy Christensen – Beverage Wholesaler, Fargo – He explains that there was some limited access in the market, 99.9 % of the wine and spirits distribution was dominated by two major wine and liquor houses located in Fargo but since 2001 – 03 they have amended their federal basic permit to allow for the distribution of beer, wine and spirits. They have also acquired the state \$1000 wine distributor license. He says there are 7 communities now that have access to the market for wholesalers that didn't have it before. He goes on to explain what they must do as wholesalers.

Wade Schwan – Wholesaler, Devils Lake, ND – Speaks of his distributing of products around ND. He says he distributes for local wineries and worries that small wineries in other states will ship into ND.

Senator Olafson – Asks if this will have an impact on small town retailers.

Schwan – Replies that the further out he delivers the more it costs him but he averages the cost. He wonders if the wineries in ND are going to deliver small amounts all around ND.

Sophia Preszler – Citizen - Would like all to know she is a total abstainer and always has been and is not causing the tax payer extra money because she is a drinker.

Allan Lier – Owner of Main Bar, Bismarck – Believes this will be a breakdown of the 3-tier system. He believes the Grape Growers have gotten more concessions than any other retailer. He says direct sales from the manufacturer to the retailer will crush most small retailers in ND including him. He explains how the 3-tier system works for everyone and would like the wineries and breweries in ND to join the crowd not go against it.

Tom Miller – Captain Jacks Liquor, Bismarck – Thinks there is nothing but bad in this bill for them. He says the potential for big box stores to run their trucks is there and it will happen.

Neutral

Daniel Rouse – ND Tax Dept. – See written testimony.

Tom Trenbeth – Attorney General's Office – Speaks on the amendment.

Close the hearing on HB1340

2011 SENATE STANDING COMMITTEE MINUTES

Senate Judiciary Committee
Fort Lincoln Room, State Capitol

HB1340
3/21/11
Job #15770

Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

Relating to sales by a domestic winery

Minutes:

Senator Nething – Chairman

Senator Sitte brings in an amendment from Rep. Dan Ruby. Rep. Ruby said in a note to Senator Sitte that he has asked the Attorney General to issue a statement to the committee that the updated amendment will satisfy the Attorney General's concerns. The Intern distributes the amendment.

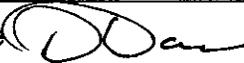
2011 SENATE STANDING COMMITTEE MINUTES

Senate Judiciary Committee
Fort Lincoln Room, State Capitol

HB1340
3/22/11
Job #15844

Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

Minutes:

There is attached testimony

Senator Nething – Chairman

Committee work

The committee discusses a proposed amendment that was brought in. Senator Nething says the amendment solves part of the constitutionality problem because it opens it up to all to ship in. He says it affects only those that are less than 25,000 gallons.

Senator Sittee moves to adopt the amendment

Senator Olafson seconds

Verbal vote – all yes

Senator Olafson moves a do not pass as amended

Senator Nelson seconded

Discussion

Senator Site says she will oppose that motion because we spend so much money on economic development and here is a case where we have put money into this program and this is a way for government to get out of the way for small producers, people less the 25,000 gallons, and let them try out a new business. She says ND should be opened to try new things. Senator Nething says one of the things we have tried to do with economic development is not to interfere with the current in a competitive way, we have tried to bring in new things but this time this bill interferes competitively. He said he tries not to upset something that is working. Senator Lyson says this is not soda pop we are talking about, this is alcohol and he is opposed to having it mailed out. Senator Sorvaag is concerned about the hundreds that could bring it in. He says this doesn't just benefit the 8 that are here. Senator Nething says it is also a regulatory problem as well and the collecting of the taxes. Senator Olafson mentions that by adopting these amendments does not eliminate the possibility of a constitutional challenge. Senator Nelson mentions she was on the committee when this group asked to get started and be licensed in the state. She goes on

to say that every session they ask for a little more and thinks there is a lot more that requires study.

Roll call vote on a do not pass as amended

5 yes, 1 no

Motion passes

Senator Nething will carry

11.0608.01003
Title.

Prepared by the Legislative Council staff for
Representative Ruby
March 4, 2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1340

Page 1, line 2, remove "domestic"

Page 2, line 1, overstrike "domestic"

Page 2, line 13, overstrike "domestic"

Page 2, line 17, overstrike the first "domestic"

Page 2, line 17, overstrike the second "domestic"

Page 2, line 25, overstrike "domestic"

Renumber accordingly

Date: 3/22/11
Roll Call Vote # 1

2011 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1346

Senate Judiciary Committee

Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: Do Pass Do Not Pass Amended Adopt Amendment
 Rerefer to Appropriations Reconsider

Motion Made By Senator Sitte Seconded By Senator Olafson

| Senators | Yes | No | Senators | Yes | No |
|------------------------------|-----|----|----------------|-----|----|
| Dave Nething - Chairman | | | Carolyn Nelson | | |
| Curtis Olafson - V. Chairman | | | | | |
| Stanley Lyson | | | | | |
| Margaret Sitte | | | | | |
| Ronald Sorvaag | | | | | |
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Total (Yes) _____ No _____

Absent _____

Floor Assignment Senator

If the vote is on an amendment, briefly indicate intent:

Verbal - yes

Date: 3/22/11
Roll Call Vote # 2

2011 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1340

Senate Judiciary Committee

Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: Do Pass Do Not Pass Amended Adopt Amendment
 Rerefer to Appropriations Reconsider

Motion Made By Senator Olafson Seconded By Senator Nelson

| Senators | Yes | No | Senators | Yes | No |
|------------------------------|-----|----|----------------|-----|----|
| Dave Nething - Chairman | X | | Carolyn Nelson | X | |
| Curtis Olafson - V. Chairman | X | | | | |
| Stanley Lyson | X | | | | |
| Margaret Sitte | | X | | | |
| Ronald Sorvaag | X | | | | |
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Total (Yes) 5 No 1

Absent 0

Floor Assignment Senator Nething

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1340: Judiciary Committee (Sen. Nething, Chairman) recommends AMENDMENTS AS FOLLOWS and when so amended, recommends **DO NOT PASS** (5 YEAS, 1 NAYS, 0 ABSENT AND NOT VOTING). HB 1340 was placed on the Sixth order on the calendar.

Page 1, line 2, remove "domestic"

Page 2, line 1, overstrike "domestic"

Page 2, line 10, overstrike "domestic"

Page 2, line 13, overstrike "domestic"

Page 2, line 17, overstrike the first "domestic"

Page 2, line 17, overstrike the second "domestic"

Page 2, line 25, overstrike "domestic"

Renumber accordingly

2011 TESTIMONY

HB 1340

Ruby, Dan J.

From: Jeff [jeff@povwinery.com]
Date: Monday, January 24, 2011 1:03 PM
To: Ruby, Dan J.
Subject: HB 1340

Dan,

Feel free to edit. Let me know if I missed something we discussed.

The strategies (litigation threats) used by the wholesaler's today has been used in just about every state in the union. It has not caused the outcomes the wholesale industry preached. Just the opposite, it has strengthened all tiers. As such approximately 30 states allow the self distribution option to their wine industry and approximately 17 of those 30 states allow that privilege only to their in state wineries. As an example, in 2005 Michigan allowed the direct to retail option to their in state wine industry only. The wholesalers screamed litigation will come as a result so the state wrote in a provision that said if the law were to be legally challenged then the law would revert back to the three-tier system. That law has been in effect since 2005 and still has not been challenged. In the midwest, South Dakota, Minnesota, Iowa, Michigan, Missouri, just to name a few all allow the self distribution option, it is the heartbeat of a healthy wine industry. Many state's wine industry would not have the economic impact it has on their state if it were not for this option and many will tell you that they would be out of business if they lost the privilege. North Dakota has eight licensed wineries and modest impact to the economy. We can grow that with this option.

Previously I contacted Ed Phillips wholesaling to distribute my product in the Fargo Market. I was told by Rob Hanson that the only way he would do it is if I gave him exclusive rights to distribute across the entire state. I believe I still have that e-mail correspondence. I previously agreed to such an exclusivity with another wholesaler and it was a catastrophe. Retailers were constantly calling me on how they could get my product in their store. Usually the small retailers in small communities. The wholesalers focus on the big retailers in the state.

Sincerely,

Jeff Peterson
Pointe of View Winery
Burlington, ND

Dear Committee Members,

I am very excited to see this very important bill being introduced and have worked with Rep. Ruby on many winery issues in the past. When I was approached about this bill, I felt the timing to introduce this Retail Option Bill was right. As you may recall, the Grape and Wine Program Committee (G&WPC) was mandated by the 61st Legislative Assembly to promote the grape and wine industry in the state of North Dakota. It is broadly represented by very qualified, passionate, and dedicated members appointed by the Governor's Office, the Agriculture Commissioner, the Commerce Commissioner, NDSU, SBARE, and the North Dakota Grape Growers Association. We were required to submit a progress report to this Legislative Session and I have attached a copy of this report for your review. This is presented for your information to bring you to speed on our accomplishments thus far and planned future endeavors. After I heard of the possible introduction of the Retail Option Bill, I immediately called for a meeting of the G&WPC to gauge the level of support among the representatives of the previously listed agencies. I am extremely pleased to report that I got an unqualified, unanimous "yes" vote of approval for the support of this legislation. I will speak for the committee on this and encourage you to contact me or any one of the members of the G&WPC on this issue or any other grape and wine related matters. Our contact information is listed in the Attachment.

Here are some points to consider:

1. This is not a bill to bypass the three tier system. It merely gives the wineries the option to go direct to retailers or the option to use their own respective wholesalers. In fact, I have talked with some wineries that will continue to use their own wholesalers regardless of the outcome of this bill. If this bill passes, some may choose to use both methods while others may opt to use their own distributing. Essentially, this bill gives wineries the flexibility to pursue the method of distribution they feel that will make them more competitive and, thus, more economical viable.
2. Self distribution has been the most single important factor in the growth of many state's wine industry since 1980
3. Wineries use self distribution to develop important relationships with local outlets and creates brand recognition and market demand for their wines. Wholesalers cannot do this for small wineries with limited quantities because it is not cost effective for them. Wholesalers need to promote large inventories from large outside manufacturers.
4. This distribution option promotes free trade which benefits consumers. With the Retail Option Bill, consumers would have access to many other wines not made available by large wholesalers.
5. The passage of this bill would enhance North Dakota agriculture and agritourism by introducing a wider range of customers to high quality, locally produced products. The

importance of agritourism was one of the main points brought out in the Governor's budget speech earlier this month.

6. This legislation would increase the demand for high quality North Dakota grown grapes.

7. How does the state regulate the flow of alcohol from outside manufacturers to ND retailer? In other words, accountability. In essence, the same way they do with direct to consumer shipments. ND retailers cannot nor would want to conduct business with manufactures not registered with ND. This is the Tax Departments job.

8. The primary reason the three-tier system was introduced after prohibition was to eliminate the obscene power once wielded by the producers of alcohol. As the numbers of wholesalers in America has dwindled, usually as a result of buyouts and mergers, that enormous power has been concentrated in a handful of distributors that now control the first and third tier of alcohol distribution. The circumstances that the three-tier system was meant to clean up now exist again, only with the wholesalers in control. There is no relevancy between the immediate post prohibition era and the current distribution issues of rural North Dakota today. Most states have recognized this system does not work when trying to develop a winery agritourism industry and thus have modified their laws to reflect support for their industry and have did so without detriment to the wholesale industry. Currently about 30 states have direct to retail options.

There will be much information presented on this issue, some valid and some not. I hope it can remain simple, factual, and to the point. I strongly encourage your support for this legislation. Thank you much for your time and will look forward to working with you on this bill.

Sincerely,
Rod Ballinger Chairman G&WPC

Representative Carlson,

In accordance with Section 3 of Senate Bill No. 2373, I am reporting to you and the legislative assembly on the progress on this bill and the involvement of the Grape and Wine Program Committee (G&WPC). A seven-member committee was put together to advise the Agriculture Commissioner and NDSU on priorities for research on the grape and wine industry in this state. The sum of \$250,000 was granted by matching funds to the extent of \$4 for each \$1 provided from other sources. Thus far, we have secured about two thirds of the matching funds required. I must say that as Chairman of the G&WPC, I was provided with the very best and most experienced personnel through the various agency representatives. I lobbied hard for this team and am grateful to all for their considerations and committee appointments.

From the onset, it was the committee's feelings that research for true cold hardy grape varieties would be the priority followed later by more attention to education, marketing and promotion of the industry. The varieties that are planted in this state now are primarily Elmer Swenson and the University of Minnesota varieties that do grow well in only a limited area of the state but are just not cold hardy enough for our weather conditions statewide. They are primarily bred for southern Minnesota and northern Iowa. We felt that flexibility was the key for us and adjusting our priorities would be paramount in ensuring the success of this bill. We selected NDSU as the main research facility and after close consultation with them, we would provide the university with a "roadmap" to carry out the project. We realized that NDSU had the best breeding program in the country but had little experience with grapes. We felt the best way was to bring in some outside grape breeding experience to enhance and expedite NDSU's endeavors. I cannot say enough how cooperative and willing NDSU was with this proposed arrangement. With all the experience on the committee (one member alone has over 30 years of grape breeding experience), we turned to a well-known cold weather grape-breeding consultant, Mark Hart, from Wisconsin for further advice. He toured the state and talked to many people involved with the grape and wine industry. We also consulted with Tyler Kaban of the University of Saskatchewan about the accelerated greenhouse breeding methods that he pioneered. After much thought and discussion, we presented NDSU with the "roadmap" that we envisioned as having the best chance for success. They agreed with the ten recommendations and four objectives developed by the committee and began immediately with Dr. Harlene Hatterman-Valenti leading the project for the university. Thus far, we have hired a part-time cold hardy grape breeder, identified one PhD candidate at NDSU, and have worked with many other enthusiastic students, growers and volunteers. Since April, the project has collected over 50 different parental lines, performed almost a hundred crosses, and grown several thousand seedlings from materials of our own breeding parents, as well as, seeds donated from interested and generous people from the Upper Midwest and Canada. These seedlings have already been planted into a field nursery to test for cold hardiness this upcoming winter. As other funds become available, we will initiate "Phase Two" of our proposal to include an additional research PhD candidate at NDSU with an emphasis in Enology. We have also continued germ-plasm collection with the location of many wild grape cultivars from river valleys across the state of North Dakota. This passion, coupled with our accelerated and traditional breeding techniques and evaluations, will increase our chances for a timely, successful program. As these new varieties become available, we anticipate more of our time and funds will be dedicated to education, marketing, and promotion as mentioned earlier.

Additionally, the committee has directed and helped organize the following:

1. The construction of a Riparia (wild river grapes) preservation vineyard on the NDSU campus for future conservation and use as breeding parents.
2. Summer 2009 - Absaraka vineyard tour and training with NDSU plant diagnostician and USDA entomologist. About 50 attendees.
3. Fall 2009 - Winemaking Project launched to utilize wine grapes produced at NDSU research locations and private vineyards. Novice winemakers had the opportunity to learn about roles that sugar and acid balance, yeast strains, skin contact time, and grape varieties make in producing a quality wine. About 25 participants.
4. Feb 2010 - G&WPC provided the funds to pay for part of the expenses for NDGGA members attending the MGGA Cold Climate Conference in Minneapolis. About 25 members took part. A record number from this region.
5. North Dakota Grape Growers Association (NDGGA) annual meeting in Carrington. About 100 people attended.
6. April 2010 - NDGGA sponsored 2 grape pruning clinics in Minot and Buffalo. Began the distribution of hard-to-get cuttings of selected cold hardy grape varieties. About 100 people attended.
7. September 11, 2010 - NDGGA Summer Vineyard Tour in Bismarck area with 100 people in attendance.

The concept of developing new grape varieties, the evaluation of current and new cultivars, enology, new winery and vineyard upstarts, and marketing will be a concerted effort on the part of the G&WPC, the NDGGA, NDSU, various state agencies, legislators, and the people of this state. It will truly be a team effort! I envision a day

when there will be wineries that dot the landscape along the towns, roads and highway system of this state that visitors can stop in for wine tasting made with grapes varieties developed here. Our Agritourism oriented wineries may also serve as hosting facilities for weddings, tasting events, office parties, holiday gatherings, and many other organized events, as well as promoting a wine culture and gracious way of living across our state. I have included the email addresses of the seven-member G&WPC. Please feel free to contact any one of us with questions, comments, or suggestions concerning SB2373 or any other matters about our grape and wine industry.

Rod Ballinger rodb@cableone.net - Fargo - Chairman G&WPC - owner Bear Creek Winery

Greg Krieger krieger@polarcomm.com - Galesburg - President NDGGA - wine maker - vineyard owner - Agriculture Commissioner designee

Alan Verbitsky averbitsky@SRT.COM - Minot - wine maker - vineyard owner - NDGGA appointee

Jeff Peterson jeff@povwinery.com - Minot - owner Pointe-of-View Winery - Governor appointee

Tom Plocher tplocher@msn.com Hugo Minn. - author "Northern Winework" - grape breeder, grower, and winemaker - NDSU designee

Rodney Howe rodneyhndsupernet.com - Hettinger - President SBARE and SBARE appointee

Jacob Belanger belangerjacob@hotmail.com - Hawley, Minn. - attorney - winemaker - vineyard owner - Commerce Commissioner appointee

Thank-you very much for your time and I am looking forward to the 62nd Legislative session.

Sincerely,
Rod Ballinger Chairman G&WPC

Testimony of Greg Krieger

Chairman Keiser and members of the Committee:

I am Greg Krieger, President of the North Dakota Grape Growers' Association. I am also the North Dakota Ag Department's representative on the Grape and Wine Program Committee that was created by the 61st Legislative Assembly with the passage of SB 2373. I live near Galesburg, in southwest Traill County, and I grow grapes. I am here in support of HB1340, the primary purpose of which is to provide marketing flexibility for North Dakota's domestic wineries.

Ever since the North Dakota Grape Growers' Association was formed in 2006 and I realized how many North Dakotans are interested in growing grapes, I have had one nagging fear in the back of my mind. What if, at some point in the near future, all of those tens of thousands of grape vines that have been planted in North Dakota in recent years produce a bumper crop, and there is no market for those grapes? Like any other agricultural commodity, grapes need a reliable outlet for their product. Unlike most other North Dakota crops, grapes do not produce the year they are planted, but, rather, reach peak production four to five years down the road. As existing vineyards approach maturity, as new vineyards become established, and as new, higher yielding grape varieties are developed and planted out in North Dakota vineyards, our state's grape production will continue to rise.

Sure, grapes can be sold at farmers' markets, eaten fresh or made into juice or jelly. Seedless North Dakota-grown grapes can and have been made into raisins. However, by far, the largest outlet for grapes is for wine made at wineries and, to a lesser extent, by home winemakers. Unlike North Dakota's grain crops, grapes are perishable and cannot wait weeks or months until a suitable market outlet is found.

Therefore, it is imperative that we foster a favorable climate in which our state's wineries can thrive and sustain a steady demand for the grapes that are going to be produced in North Dakota in ever-increasing amounts.

The success of North Dakota's grape growers depends on the economic viability our state's wineries. Most of our state's wineries are small and are not seeking to market their product nationwide or even statewide. What they would really like to do, however, is to be able to market their wines directly to licensed bottle shops, bars and restaurants in their local communities. This bill would enable them to do that. That is why I respectfully urge you to support HB1340.

Thank you for your attention.

Sincerely,

Greg Krieger, Pres. NDGGA
922 150th Ave SE
Galesburg, ND 58035
E-mail: krieger@polarcomm.com
Phone: 701-430-0281
NDGGA website: www.ndgga.org

Testimony 3

HB 1340

Testimony of John Steffes

Hi. My name is John Steffes. My wife and I own and operate Prairiewood Winery by Elliott, ND. We have been licensed as a winery since 2006.

During the summer when people are traveling, we have good traffic through our winery. People want to come out to see the vineyard and sample our wines. We also do a few offsite events a year to sell our products at events such as the Pride of Dakota showcases in Fargo and Bismarck.

We have had inquiries from people who have purchased our products at either our winery or one of the shows we have attended. They wanted to purchase more but were looking for a store that carried our products in towns like Fargo, Bismarck, or Jamestown so they wouldn't have to make a special trip to our rural location, especially in the winter months, to buy our products.

We have also had North Dakota businesses inquire about how they could obtain our product for resale at their establishments. At this point, we cannot sell to businesses that want to carry our products. Being able to sell to other businesses directly would greatly boost our sales.

In the past, I have talked to a couple of wholesalers about carrying our products so our wines would be more accessible to people. At that time they were unwilling to do so. One of the reasons given was that we couldn't provide them with a sufficient volume of product on a consistent basis. Given the size of our winery and volume of wine we produce, how could we? The second reason given was that they thought our price was too high. They didn't think people would buy it since they had access to cheaper imported wines from countries like Australia, most of which retail for \$5 a bottle. The feedback we have been getting from our customers is that they are willing to spend more for a higher quality North Dakota made product.

Given our rural location, we are unable to grow our business because we can't get our product to the consumer. The proposed changes to this bill, which would allow, but not require, us to sell our wines directly to retailers, would greatly benefit all the small wineries in the state. I believe with these changes we would be able to expand our vineyard as well as purchase grapes from other producers and grow our business. This bill, if passed, would promote North Dakota's grape and wine industry in general. That is why I urge you to support House Bill 1340.

**Testimony in Opposition to HB 1340
House Industry Business & Labor Committee
January 24, 2011**

Good morning Chairman Keiser and Committee Members. My name is Pat Ward. I am an attorney here in Bismarck at Zuger Kirmis & Smith. I am here today on behalf of the North Dakota Wholesale Liquor Dealers Association in opposition to House Bill 1340, a bill relating to sales by a domestic winery.

Passing this bill would violate the United States Constitution and deviate from United States Supreme Court precedent. The problem is that the bill is requesting for domestic and foreign (out-of-state) wineries be treated differently.

North Dakota has a long established three-tier system for the manufacture and distribution of alcohol products which is designed to ensure that all liquor sold in the state is accounted for and taxes are collected. This system involves the manufacturer, wholesaler, and retailer. Taxes are collected at the wholesale level of this tiered system.

By passing this bill, domestic wineries will be given a tax advantage. This bill would allow them to skip the tier that imposes state taxes. Out-of-state wineries would still follow the three-tier system and pay these taxes. Giving this sort of financial advantage to domestic wineries is a violation of the United States Constitution.

In Granholm v. Heald, 544 U.S. 460 (2005), these exact types of statutes involving domestic wineries attempting to make direct sales and avoid the three-

tiered structure were held to violate the Dormant Commerce Clause found in Article 1, section 8, clause 3, of the United States Constitution. The Supreme Court held that state laws allowing “differential treatment between in-state and out-of state wineries constitute[d] explicit discrimination against interstate commerce.”

The ability to regulate interstate commerce was a right that was specifically reserved for the federal government. States were not given this right. Writing for the majority, Justice Kennedy explained:

“ Time and again this Court has held, that in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate ‘differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.’ This rule is essential to the foundations of the Union. . . .States may not enact laws that burden out-of-state producers or shippers simply to give a competitive advantage to in-state businesses. This mandate ‘reflects a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.”



I have attached a copy of the Commerce Clause along with my testimony for your convenience.

I urge you to uphold the Constitution and place a "do not pass" on this bill.



JENNIFER M. GRANHOLM, GOVERNOR OF MICHIGAN, et al., Petitioners
v. ELEANOR HEALD, et al. MICHIGAN BEER & WINE WHOLESALERS
ASSOCIATION, Petitioner v. ELEANOR HEALD, et al. JUANITA
SWEDENBURG, et al., Petitioners v. EDWARD D. KELLY, CHAIRMAN,
NEW YORK DIVISION OF ALCOHOLIC BEVERAGE CONTROL, STATE
LIQUOR AUTHORITY, et al.

(03-1116), (03-1120), (03-1274)

SUPREME COURT OF THE UNITED STATES

544 U.S. 460; 125 S. Ct. 1885; 161 L. Ed. 2d 796; 2005 U.S. LEXIS
4174; 73 U.S.L.W. 4321; 18 Fla. L. Weekly Fed. S 263

December 7, 2004, Argued

May 16, 2005, * Decided

CASE SUMMARY

PROCEDURAL POSTURE: In separate actions, petitioner/respondent wineries sued respondent/petitioner state officials, alleging that state laws discriminated against out-of-state wineries in violation of U.S. Const. art. I, § 8, cl. 3. Upon grants of writs of certiorari, appeals were taken from judgments of the U.S. Courts of Appeals for the Second and Sixth Circuits which conflicted in determining whether the laws were permissible under U.S. Const. amend XXI, § 2.

OVERVIEW: The state laws allowed in-state wineries to make direct sales to customers but effectively permitted out-of-state wineries to make sales only through wholesalers and retailers at greater expense. The wineries contended that the regulatory schemes discriminated against interstate commerce, but the officials argued that the schemes were necessary to prevent underage persons from purchasing wine and to promote the collection of taxes. The U.S. Supreme Court held that the state laws discriminated against interstate commerce and that the discrimination was neither authorized nor permitted by U.S. Const. amend XXI, § 2. The constitutional authority of the state to regulate the importation of intoxicating liquors was limited by the requirement under U.S. Const. art. I, § 8, cl. 3, that such regulation could not discriminate against the out-of-state wineries in favor of in-state wineries. Further, reasonable nondiscriminatory alternatives were available to address the purchase of wine by minors and the states' ability to collect taxes, and the officials failed to show any legitimate local purpose that could not have been advanced by evenhanded requirements.

OUTCOME: The judgment holding that the state laws were invalid was affirmed, and the conflicting judgment was reversed and remanded for further proceedings.

Granholm v. Heald, 544 U.S. 460 (U.S. 2005)

respectively. If any bill shall not be returned by the president within ten days (Sundays excepted) after it shall have been presented to him, the same shall be a law, in like manner as if he had signed it, unless the Congress by their adjournment, prevent its return, in which case it shall not be a law.

Every order, resolution, or vote to which the concurrence of the senate and house of representatives may be necessary (except on a question of adjournment) shall be presented to the president of the United States, and before the same shall take effect, shall be approved by him, or being disapproved by him, shall be repassed by two-thirds of the senate and house of representatives, according to the rules and limitations prescribed in the case of a bill.

§ 8. The Congress shall have power:

To lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States.

To borrow money on the credit of the United States.

To regulate commerce with foreign nations, and among the several states, and with the Indian tribes.

To establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States.

To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures.

To provide for the punishment of counterfeiting the securities and current coin of the United States.

To establish post offices and post roads.

To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.

To constitute tribunals inferior to the Supreme Court.

To define and punish piracies and felonies committed on the high seas, and offenses against the law of nations.

To declare war, grant letters of marque and reprisal, and make rules concerning captures on land and water.

To raise and support armies; but no appropriation of money to that use shall be for a longer term than two years.

To provide and maintain a navy.

To make rules for the government and regulation of the land and naval forces.

To provide for calling forth the militia to execute the laws of the union, suppress insurrections, and repel invasions.

To provide for organizing, arming, and disciplining the militia, and for governing such part of them as may be employed in the service of the United States, reserving to the state respectively the appointment of the officers and the authority of training the militia, according to the discipline prescribed by Congress.



Testimony 5

JOHNSON BROTHERS NORTHWEST BEVERAGES, INC.

1358 North 39th Street • Fargo, ND 58102 • (701) 282-4660 • Fax (701) 282-8869

George J. Keiser
Members
Industry, Business & Labor Committee
ND House of Representatives

Re: Opposition to HB1340

When ND opened its doors to allow Domestic Wineries to ship out of state and, by reciprocity, to allow out-of-state wineries, wholesalers and retailers to ship directly to consumers, the prevailing thought was to allow a fledgling ND industry to grow and allow a few wine club members to bring in their latest, "I'm the only one who has it" wines. Little thought was given to what else might be in "Pandora's Box".

Now we are faced with a bill which, for the benefit of a few in-state wineries, threatens a state government model that has proved over time that it works.

The Domestic Winery industry has come to the legislature every session since the original legislation asking for exceptions and special considerations. Changes have been granted that address ingredient requirements. Changes have been made that allow Domestic Wineries to sample and sell wine by the glass or in sealed containers on their premises. Changes have been made to allow off-site sales at various functions (currently 20 per year).

State law currently requires Domestic Wineries to deliver their products to licensed retail outlets only through a licensed ND wholesaler. This is available to every Domestic Winery. To my knowledge, no Domestic Winery has been turned down by a wholesaler who refuses to distribute their wines. On the contrary, we

actively approach new Domestic Wineries and ask if we can represent their brands. Some say yes, some say no, but the option is there for them.

ND has similar laws to all of the other states. It is the three-tiered system. It prevents a supplier from being a wholesaler, a wholesaler from being a retailer, etc. Some control states have their government acting as a wholesaler/retailer but that number is declining. In no states can anyone be all three. ND law requires that licensed retailers may purchase alcoholic beverages only from ND licensed wholesalers.

This provides the state with a cost effective, time tested vehicle for administration, regulation and tax collection. If Domestic Wineries are allowed to ship directly to retail, any winery in the country will be able to do the same, thanks to the reciprocity laws that come with "Pandora's Box".

The administration of such a system would require many more people at the Tax Commissioner and Attorney General's level just to regulate and enforce the laws and collect the taxes: significant government growth. This would also force more business to major markets, threatening the industry in rural areas as the current established distribution system goes away.

As I see it, the Domestic Wineries have two big concerns: making good wine and getting their product to market. \$350,000 was given to this industry by the legislature at the last session. This money was to research and promote the production of better grapes and better wines, not to throw out the current three-tiered system. What are the results of that investment? How was that money spent?

As I mentioned, we represent the products of a successful Domestic Winery, the Maple River Winery. This "small" business has grown exponentially since its inception. Their products do very well on-site, at off-site functions, through the mail and internet and yes, through the wholesale/retail system in the state. They enjoy good distribution and are well received by retailers and by the consumer. Good products will sell.

I think that if Domestic Wineries can go directly to retail, that will likely be their only vehicle to get their products to the ND consumer and their exposure to the consumer would go down significantly. Then what? What will the next session be asked to do? Entrepreneurism is a wonderful thing but at what level does it become an entitlement with a state guarantee.

I ask for your support in opposing HB 1340.

Robert L. Hansen
General Manager
JBLC-ND
ND Wholesalers' Association

Testimony
HB 1340
January 24, 2011
House Industry, Business and Labor Committee

Mr. Chairman, members of the Committee, my name is Janet Seaworth. I am the executive secretary and legal counsel for the North Dakota Beer Distributors Association. We have 17 family owned and operated beer wholesalers in North Dakota. Many are now in their third-generation of family ownership. We are opposed to HB 1340.

Although this bill deals with domestic wineries, this is not a wine issue. This is a three-tier issue and the fact that this bill provides for an unlawful in-state preference raises our concerns, because it has the potential to subject the state to expensive litigation that could invalidate the three-tier system and impede the state's ability to regulate alcohol.

This bill would allow in-state wineries to by-pass the three-tier system by selling direct to retailers. That is exactly the type of arrangement that the three-tier system was designed to prevent. If suppliers are able to sell direct to retailers, they will be able to exert pressure on retailers to sell their products exclusively, and to increase sales without regard to the social implications. This bill sets up the very situation that enabled the prior abuses that lead to prohibition. While some may argue that our domestic wineries would never engage in such practices, we aren't talking about just North Dakota wineries; out-of-state suppliers will want the same deal. Under *Granholm v. Heald*, what you allow for in-state producers, you must allow for out-of-state producers.

This bill calls for an unconstitutional in-state preference. HB 1340, which would allow in-state wineries to sell direct to retailers is clearly unlawful under *Granholm v. Heald*. In *Granholm*, the U.S. Supreme Court invalidated two states' direct shipping laws allowing in-state wineries to ship wine they produced directly to consumers, but barring out-of-state wineries from doing the same. The Court was clear "that States may not give a discriminatory preference to their own producers." 544 U.S. 460, 486. HB 1340 provides a specific exception to North Dakota's three-tier system favoring in-state producers. That is not allowed under *Granholm*.

If this preference is allowed, out-of-state wineries will want the same exception. If they sue to invalidate the law (and the remedy is to "level up" and allow out-of-state producers the same deal), the protections afforded to retailers will go away. That is, the laws prohibiting discrimination and the integration of the tiers will not apply - wineries will not have to give the same deals, offer the same products, etc. They can and will discriminate among retailers. They will cut deals with the largest retailers to gain market share by selling at the lowest possible price. Small retailers will not be served and they will have no bargaining power. Selection and availability will be reduced as the largest producers seek to do business with the largest retailers. That is not good public policy. Moreover, the state will have the disadvantage of trying to regulate many out-of-state wineries, rather than a few in-state wholesalers.

Right now, any domestic winery in North Dakota that wants a distributor can get one, or already has one. It does not seem prudent to allow a few domestic wineries an exception that they don't need, that violates *Granholm*, that impugns the three-tier system and makes the state's ability to regulate alcohol more difficult, and that has the potential to cost this state millions of dollars in legal fees and opposing attorneys fees. If Gallo were to challenge this under *Granholm*, Gallo would win.

And while this bill involves wine, it's not a wine issue. It's a three-tier issue that affects the state's ability to regulate alcohol. Clearly major brewers would want the same deal as that sought by the domestic wineries.

We urge you to vote no on HB 1340.

Janet Demarais Seaworth
Executive Secretary and Legal Counsel
North Dakota Beer Distributors Association

MEMORANDUM

To: Janet D. Seaworth
From: Michael D. Madigan
Re: House Bill No. 1340
Date: January 21, 2011

INTRODUCTION

Pursuant to your request, I have reviewed House Bill No. 1340. In particular, you sought my opinion on whether House Bill 1340 passed muster under the dormant Commerce Clause of the U.S. Constitution. For reasons that follow, I do not believe that this Bill is constitutional under current dormant Commerce Clause standards.

ANALYSIS

As background, I am licensed to practice in the states of Minnesota and Wisconsin. I am also licensed to practice before the United States Supreme Court and the 1st, 4th, 7th, 8th, and 9th Circuit Courts of Appeal.

During my career, I have represented numerous beer wholesalers and beer wholesaler associations across the country. In pertinent part, I serve as Counsel to the National Beer Wholesalers Association, the Minnesota Beer Wholesalers Association, and the Beverage Distributors of New Hampshire. I have been retained by numerous other beer wholesaler associations to analyze liquor laws and recommend statutory changes. I have presented numerous seminars and been a featured speaker at annual meetings and conferences of the NBWA, the Center for Alcohol Policy, as well as many state beer wholesalers associations. I was counsel of record on behalf of the NBWA regarding amicus briefs submitted to the United States Supreme Court and the 1st, 4th, 7th, and 9th Circuit Courts of Appeals in cases challenging state liquor laws (similar to House Bill 1340) under the dormant Commerce Clause.

The most prominent feature of our state liquor regulatory structures is the three-tier system. It was created to avoid the harmful effects of vertical integration in the industry by restricting suppliers, distributors and retailers to one level of activity. Prior to the enactment of three-tier and tied-house laws, suppliers owned retailers "lock, stock and barrel", the origin of that phrase. The resulting "tied-houses" led to excessive retail capacity and cutthroat competition for market share, which, in turn, led to intemperate consumption as a consequence of excessive sales stimulation. It also had all of the vices of absentee ownership. Suppliers were not typically based in the local community where they sold

product and, accordingly, were not particularly sensitive to local concern and social influence. The three-tier system creates a transparent and accountable distribution system which facilitates effective regulation by the state. Also, because of the very nature of their operations, firms in the distribution and retailing tier have a local presence which makes them more amenable to regulation and naturally keeps them accountable. Also, by prohibiting tied-houses, competition, a diversity of products, and availability of products are enhanced as the economic incentives are removed that encourage wholesalers and retailers to favor the products of a particular supplier.

Ordinarily, in our constitutional scheme, if a federal law conflicts with a state law, the federal law trumps and the state law is preempted. State laws regulating intoxicating liquor are treated differently, however, by virtue of the 21st Amendment. Until recently, courts interpreted the 21st Amendment to mean that state liquor laws were exempt from challenge under the Commerce Clause of the Constitution (which is the source of Congress' power to regulate interstate commerce). Accordingly, if a state liquor law conflicted with a federal law, the state liquor law controlled and the federal law was preempted. Furthermore, states were exempt from challenge under what is referred to as the "dormant" Commerce Clause which ordinarily prohibits a state from passing a law which discriminates against out of state businesses in favor of in-state businesses (and thereby "burdens" interstate commerce).

That long line of cases, however, was recently overruled by a 5-4 majority in the United States Supreme Court case of *Granholm vs. Heald*. At issue in that case were laws in Michigan and New York which permitted in-state wineries to ship direct to consumers but prohibited out-of-state wineries from doing so. The Court held that:

"States have broad power to regulate liquor under § 2 of the Twenty-first 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. Without demonstrating the need for discrimination, New York and Michigan have enacted regulations that disadvantage out-of-state wine producers. Under our Commerce Clause jurisprudence, these regulations cannot stand."

Accordingly, *Granholm* changed the rules of the game. Although the three-tier system itself is "unquestionably legitimate", states could no longer pass liquor laws that expressly discriminate against out-of-state businesses. A state law is expressly discriminatory if it treats in-state entities differently than out-of-state entities. If a state law does facially discriminate, it is almost per se unconstitutional.

House Bill 1340

As it currently exists, House Bill 1340 appears to be facially discriminatory and therefore unconstitutional under *Granholm* because differentiates between in-state and out-of-state wineries. A

"domestic" winery may sell directly to a wholesaler or to a retailer but an out-of-state winery may not do so. This is precisely the type of liquor statute that was declared unconstitutional in Granholm. I should also mention that if a state passes a law which is unconstitutional, the state will be held liable for the attorneys fees incurred by a party who brings suits and prevailed. In Granholm, for instance, Michigan was required to pay the Plaintiff's attorneys fees in an amount that exceeded One Million Dollars.

Conclusion

In my opinion, House Bill 1340 is unconstitutional under the Granholm decision. I will furnish you with a copy of that decision by separate email. The State should be advised of this vulnerability and of its exposure to attorneys fees should the Bill pass. Thank you for your consideration. If you have any questions with regard to the above, or if I can be of further assistance, please do not hesitate to contact me.

Mike Madigan

**TESTIMONY OF THE NORTH DAKOTA OFFICE OF STATE TAX COMMISSIONER
BEFORE THE
HOUSE INDUSTRY, BUSINESS AND LABOR COMMITTEE**

HOUSE BILL 1340

JANUARY 24, 2011

Chairman Keiser, members of the House Industry, Business and Labor Committee, my name is Daniel Rouse. I am Legal Counsel to the North Dakota Office of State Tax Commissioner. I am here today on behalf of Tax Commissioner Cory Fong to testify in opposition of House Bill 1340.

The North Dakota Tax Commissioner's Office is responsible for the regulation of domestic wineries that operate in North Dakota. Our administration and regulation of domestic wineries is based on North Dakota law, which is founded upon the three-tier system of alcoholic beverage regulation (i.e., manufacturers, who make the alcoholic beverages and sell it to wholesalers, who in turn sell the manufacturer's product to retailers, who sell it to the ultimate retail customers).

Alcoholic beverages are a highly regulated product. This is because of the significant public concern over how alcoholic beverages are made, sold, taxed, and the need for regulatory authorities to closely monitor the entire life span of these beverages at each tier. The three-tier system is a transparent and long-used method of regulation of these products. The North Dakota Office of State Tax Commissioner firmly believes in the three-tier system of alcoholic beverage regulation as the best means to regulate the flow of alcoholic beverages from the point of manufacturing to purchase at retail.

House Bill 1340, if enacted, would violate the three-tier system in North Dakota. It would allow North Dakota domestic wineries to by-pass the wholesale tier and sell their products directly to a retailer. In so doing, it would give domestic wineries a preferential status that no other wineries, specifically out of state wineries, could have. In fact, no other manufacturer of alcoholic beverages, in-state or out-of-state, would enjoy this privilege. That is discrimination in violation of the United States Constitution.

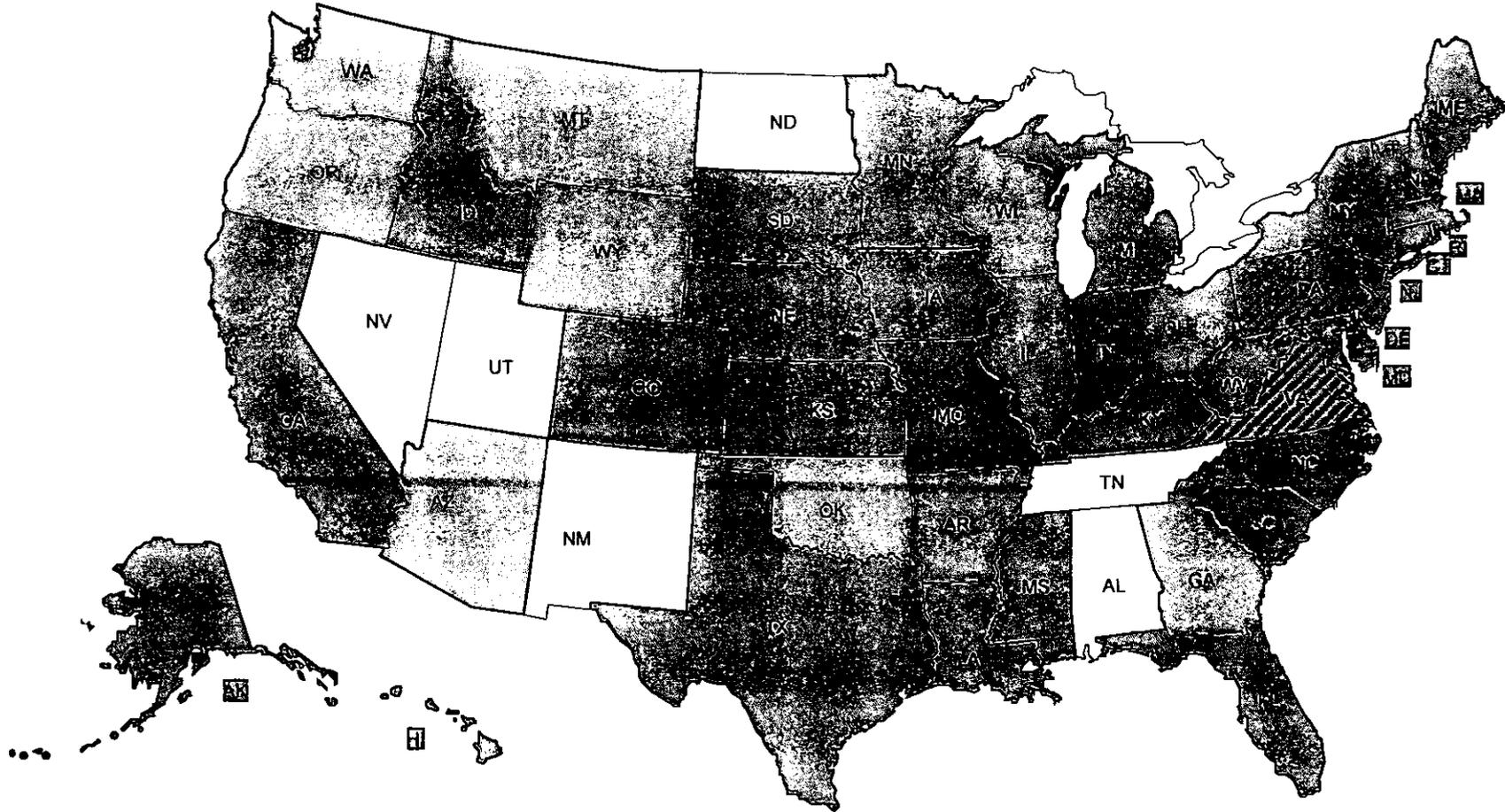
Preferential treatment of in-state wineries to the detriment of out-of-state wineries was the subject of a lawsuit that was ultimately decided by the United States Supreme Court in 2005. In Granholm v. Heald, 544 U.S. 460, the Supreme Court ruled that the three-tier system of alcoholic beverage regulation prohibited such preferential treatment of in-state wineries because out-of-state wineries were not given the same treatment. The Supreme Court, in making this decision, described the three-tier system as “unquestionably legitimate.” The Granholm case remains the law of the land today. In the opinion of the Tax Commissioner, HB 1340, if enacted, would be a clear violation of the holding of the Supreme Court in that case.

Additionally, if this preferential treatment is made into law, out-of-state wineries, and quite possibly all alcoholic beverage manufacturers (i.e., liquor and beer), will likely want the same treatment. Since our laws would not allow North Dakota to offer that same treatment, the probable outcome would be a lawsuit of substantial size and expense to North Dakota, where the state would defend this law. It is unlikely the State would prevail in such a case.

However, the impact of such a loss to the state would reach far beyond just dollars. Retailers in North Dakota would lose the protections they have under the three-tier system. In other words, wineries (and again, quite possibly all alcoholic beverage manufacturers at some point) could freely discriminate among their retailers. And, the State would be in the nearly impossible position of trying to regulate a large number of out-of-state manufacturers instead of the few North Dakota wholesalers we now have.

In summary, this bill, if enacted, will violate United States Supreme Court case law, dismantle the three-tier system in North Dakota, severely impair the State’s ability to regulate this area of commerce, and likely cost the State a significant amount of time and money to defend its position in court. For those reasons, Mr. Chairman, and members of the Committee, the Tax Commissioner respectfully requests that you do not pass HB 1340. I would be happy to respond to any questions. Thank you.

Snapshot of Self-Distribution Legislative Actions as of 6/10/10



Green – Allowed intrastate SD; Status has Remained Unchanged
Red – SD Privilege Removed ***Blue – Limited SD expanded to out-of-state wineries***

Ruby
AMEND

11.0608.01003
Title.

Prepared by the Legislative Council staff for
Representative Ruby
March 4, 2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1340

- Page 1, line 2, remove "domestic"
- Page 2, line 1, overstrike "domestic"
- Page 2, line 13, overstrike "domestic"
- Page 2, line 17, overstrike the first "domestic"
- Page 2, line 17, overstrike the second "domestic"
- Page 2, line 25, overstrike "domestic"
- Renumber accordingly

①

HB 1340

Chairman Nething and members of the committee:

My name is Jeff Peterson and I am owner and operator of Pointe of View Winery & Vineyard in Burlington, North Dakota.

Self distribution has been the single most important factor in the growth of the small winery agritourism industry in the United States. 1340 is a minor deviation from the three-tier system, it merely gives the wineries the option to sell direct to retailers or the option of using their own respective wholesalers. As a small business owner, I personally am a big proponent of open trade. 1340 promotes free trade which benefits everyone. Currently approximately 39 states allow the option of direct to retail sales.

Wineries use self distribution to develop important relationships with local outlets and create brand recognition and market demand for their wines. Wholesalers can not do this for small wineries with limited quantities. It is not cost effective for them. Wholesalers need to promote large inventories from large outside manufacturers.

Currently wineries inside and outside of the state may sell their product directly to a consumer in the state of ND. The revenue generated for the ND tax office as a result is significant. What we're asking for is that same privilege direct to the state's retailers.

With the acceptance of Representative Ruby's amendment the bill would be constitutional. Any suggested amendments by other parties will only be an attempt to jeopardize that status. Please dismiss any such suggestions.

Your going to hear some very aggressive assertions of how 1340 is a complete breakdown of the three-tier system and will result in job loss, Gallo Wines and other large wine manufacturers setting up direct distribution in ND, and accountability issues. These are all nonsense.

A suggestion for licensing for out of state manufacturers would be an annual one hundred dollar license fee.

When dealing with winery self distribution privileges we are dealing with one of the components of agri-tourism and the buy-local movement. Winery privileges aren't merely offered to local wineries to sell wine. They promote local agriculture, a state's agricultural potential and heritage, and the preservation of rural landscapes.

Thank you for your time and please recommend a do pass for HB 1340.

Sincerely, Jeff Peterson, Pointe of View Winery.

Senator Nething and members of the committee,

My name is Greg Krieger. I am a grape grower from Galesburg. I am charter member and past president of the North Dakota Grape Growers' Association, and I'm here to speak in favor of HB1340.

In the past five years, tens of thousands of grapevines have been planted in ND. Many of them will soon be approaching full production, and still more are being planted. Since grapes are a new crop to our state, our association and its members, in close cooperation with NDSU, have been involved with variety screening, grower education efforts, and research projects. In the past year, an accelerated grape breeding program has been initiated at NDSU to develop even better varieties for our state than what we currently have available.

Like anyone involved in production agriculture, we battle the weather and pests. After a couple of challenging years, I am hopeful that we are poised for a bumper crop this year. One of my biggest fears, however, is that once we get that big crop, there won't be an adequate market for all of it. HB1340 provides a no-cost-to-the-taxpayer, free market solution to that potential problem by making wineries more economically viable so they can create a demand for all those future grapes.



The multiple benefits of a healthy grape and wine industry to any state's economy are well-known, so I won't dwell on that. Instead, I want to address the points that were brought up in the House testimony by this bill's opponents, a shadowy group known as the wholesalers or distributors. This is the third bill and the third legislative session where I have worked to try to get something passed for the benefit of North Dakota's fledgling wine and grape industry. Rather than work with us, the wholesalers and their professional lobbyists have vigorously opposed every one of those bills. The first two bills focused on getting support for doing basic research on grapes for our state, and the wholesalers opposed it. The purpose of HB1340 is to give North Dakota's wineries a better shot at success, and the wholesalers are opposing it, too. How can we possibly expect the wholesalers to market our state's wines in good faith when their attitude is so antagonistic?

It would take too long to individually address all of the points made by the wholesalers previously, so I have instead highlighted them below so you can refer to them if they come up during today's testimony. Some of the key words to look for include constitutionality, Granholm-Heald, Freeman-Corzine, dormant commerce clause, violation of the three tier system, discrimination, special interest, tied houses, Gallo, protecting the consumer, protecting the wineries, organized crime, tax collection, mangoes and pineapples. Perhaps they will try to make an issue of topics like cherry picking, festival days, how research dollars have been spent, or breweries. Other things to listen for are bullying and threats of lawsuits.

I am curious why the wholesalers oppose HB1340. Do these secretive businesses need to be continually propped up by archaic distribution laws because they are so inefficient? Or is it perhaps that their businesses are so extremely profitable that they cannot afford to lose even a

fraction of one percent of their volume? Whatever it is, they are not serving the interests of North Dakota.

HB 1340 is not a bill to bypass the three-tier system. This bill just allows small North Dakota wineries the opportunity to ~~grow to the size where it will someday make sense for them to have their product distributed by wholesalers.~~

As much as the wholesalers would like you to believe otherwise, there is nothing sacred about the three-tier system. Even if there were, this bill still leaves it intact.

What do the wholesalers possibly have to lose if a domestic winery takes all the risk to create a marketable product, develops consumer demand for that product, and then comes to one of them, or to one of their competitors, to have that product distributed?

The wholesalers' arguments against this bill ring hollow. I have no idea what their next argument or scare tactic will be. In a rather morbidly curious manner, I am glad to have a front row seat to see what they come up with next.

* * * * *

Speaking for the wholesalers in the House IBL Committee in opposition to HB1340 was attorney Patrick Ward, wholesaler Rob Hansen, attorney Janet Seaworth, and our very own tax department's attorney, Dan Rouse.

In his written testimony, Randy Kieffer, president of Dakota Sales Company, stated this bill is "among the most **special interest**" proposed in the history of legislation in our state regarding the control of the sale and taxation of alcoholic beverages." Who is the **special interest** in this situation? A broad coalition representing the Department of Agriculture, the Governor's Office, the Commerce Department, NDSU, in-state and out-of-state wineries, in-state and out-of-state grape growers, wine drinkers, tourists and researchers? Or a secretive, well-funded oligopoly of multi-million and multi-billion dollar, mostly out-of-state-owned businesses?

Mr. Kieffer further wrote, "Both HB 1339 and HB 1340 are bad bills that should never have been passed by the House as the Representatives were told in testimony and on the floor that they violate the US **Constitution**. I would hope you would vote to not repeat this mistake so as not to put our state at risk of defending **lawsuits** and destroying **lawsuits** and destroying a system that has worked near flawlessly for 75+ years."

North Dakota's current winery law allows domestic wineries to ship directly to consumers both in- and out-of-state. It is this bill's supporters' desire to allow both in- and out-of-state wineries to sell directly to North Dakota retail establishments. Patrick Ward himself said we cannot allow in-state wineries to sell directly to retailers without allowing out-of-state wineries to do the same. That is exactly what we would like to do. The **Supreme Court** decisions rendered in the **Granholm-Heald** and **Freeman-Corzine lawsuits** are of no consequence here since our law doesn't violate the **dormant commerce clause** of the US **Constitution**.

Threats of **lawsuits**? In his House floor testimony, Representative and IBL Committee member Bill Amerman said, "No one is going to be suing North Dakota."

The three tier system is not enshrined in the **Constitution**. It is not even mentioned in the **21st Amendment**. Contrary to Rob Hansen's written testimony stating, "ND has similar laws to all of the other states", there is a lot of variation in how states regulate alcohol. And the majority of them allow wineries to self distribute.

Republic National Distribution Company is reputedly the nation's second largest wholesaler and is based out of Louisiana, or maybe Texas, or maybe Atlanta, Georgia. It is hard to find out for sure. Phillips Distilling Company, the maker of Phillips vodka and peppermint schnapps, is headquartered in Minneapolis. It was founded by a man named Ed Phillips, and he had some sons. There is a distribution company called Ed Phillips and Sons that based in Fargo. Some of the major breweries (Anheuser-Busch, Coors) also have affiliated distributing companies. These companies are too smart to violate the letter of the law prohibiting ownership of both manufacturing and distributing tiers by the same entity, but they are certainly **violating** the spirit of the **three tier system**.

When the three tier system was set up in the 1930s, America was dealing with Al Capone, Model T Fords, speakeasies, "**tied houses**" (retailers handling only the products of one manufacturer), and alcohol manufacturers with too much control over how their product was brought to the marketplace. The picture today is much different. We have the internet, Facebook, globalism, agri-tourism, cold climate grape varieties, and now it is the wholesalers who have too much control. Today we have distributors involved in importing of alcohol; we have distributors owned by or closely aligned with manufacturers, and we have distributors fighting this bill. So just who is it that is **violating** the original intent of the **three tier system**?

The intent of HB1340 is not to challenge the pretense that the three tier system is inviolate. That ship sailed a long time ago.

During the historical leg of Janet Seaworth's extensive testimony in opposition to this bill she curiously stated, "**Organized crime** was also interested in economic development." For those of us who see economic development for North Dakota as a good thing, that comparison is too offensive for words.

Another key point that was stressed during the House testimony was **discrimination**. Apparently, by the wholesalers' definition, if a winery were to self distribute only to select retailers, it would constitute **discrimination**. By that logic, if a winery's product is distributed only within its home state, that winery would still be discriminating against out-of-state retailers.

Rob Hansen testified that the wholesalers "have a commitment to not say no to anybody" so therefore they don't **discriminate**, but we heard testimony saying some North Dakota wholesalers had done exactly that and refused to carry a winery's product. In reality, in order to stay in business wholesalers must constantly **discriminate** between profitable and non-profitable brands and between what sells and what doesn't. An article in The Forum from February 19, 2011 stated, "Asked if wholesalers were concerned that self-distribution would cut into their business, [beer wholesaler Randy] Christianson said wholesalers currently don't make money from domestic wineries because the industry is so small."

Another boogey man the wholesalers mentioned repeatedly during the House testimony was the large California winery, **Gallo**. The wholesalers may claim their opposition is to **protect ND wineries** from outside competition. According to them, if this bill passed, little old North Dakota would be flooded with wine from the likes of **Gallo**. The reality: Oregon is a “blue” state (one that allows both in- and out-of-state wineries to self distribute within the state) with hundreds of wineries. Oregon is next door to California, yet has a thriving wine industry and is not being overrun by the likes of **Gallo**. The wholesalers conveniently neglected to mention the current flood of wines in our retail outlets is not **Gallo** wine, but rather imported wines from countries such as Australia. That is probably because that wine is being imported and distributed by their fellow wholesalers, another **violation** of the spirit of the **Three Tier System**.

Protecting the consumer? I’m curious who is supposed to be protecting us from the occasional skunky beer or that bland, non-descript wine or those cheap wines whose only bouquet is the smell of oak and ethyl alcohol? If protecting consumers from poor quality products is the wholesalers’ responsibility, they’re not doing a very good job of it.

What paper tiger will the wholesalers come up with next? More misinformation relating to **funding, tax collection**? Patrick Ward said this bill would “allow the wineries to skip the tier that imposes the state **tax**.” That is just preposterous because no winery would risk losing its license by not collecting and submitting the required **taxes**.

Perhaps we will hear more mockery from Patrick Ward asking if we will be trying to grow **pineapples and mangoes** next. He apparently doesn’t realize that grapes have been growing in North Dakota longer than wheat and corn have been.

More **bullying** or hints of a **boycott** of the domestic wineries by the wholesalers? Rob Hansen wrote, “I think that if Domestic Wineries can go directly to retail, that will likely be their only vehicle to get their products to the ND consumer.” Is that a **threat** that the wholesalers won’t carry domestic wine if this bill passes?

Just what are these guys afraid of? My Theory: Wholesaling is a volume-based business more so than a quality-dependent business. In a mature market, after nearly every potential customer has been reached, the only way to increase sales is to increase the amount consumed per customer. As evidence I’ll point to Miller’s old “Tastes Great/Less Filling” beer ads and the current “Drinkability” campaign from Bud Lite. On the wine side we have an abundance of imported wines such as Yellow Tail and Barefoot that sell for \$5 or \$6 a bottle. When that price is still not low enough to move inventory, some retailers resort to penny sales in which a customer can buy one bottle at the regular price and a second bottle for just a penny. It is my opinion that the large alcohol manufacturers and large wholesalers view their customers the same way that Big Tobacco does. The more addicts, the better it is for business. I googled “How many alcohol distributors are there in North Dakota” and couldn’t find the answer. I checked the yellow pages and found three pages listing alcoholism treatment centers, but after looking under alcohol, beer, beverage, distilled, distribution, spirits, wholesale and wine, I could find only one listing for a wholesaler. They are a secretive group. Even when I searched for a specific wholesale business, I seldom found a website for it.

The wholesalers have grown too powerful and no longer need to be protected by the state.

Chairman Nething and members of the Committee,

My name is Rod Ballinger and I am Chairman of the Grape and Wine Program (G&WPC). I am also owner of the Bear Creek Winery in Fargo. I hope my testimony here will reflect my responsibilities and duties as a member of this committee rather than an owner of a North Dakota domestic winery. As you may recall, the G&WPC was mandated by the 61st Legislative Assembly to promote the grape and wine industry in North Dakota. It is broadly represented by qualified, passionate, and dedicated members appointed by the Governor's Office, the Agriculture Commissioner, the Commerce Commissioner, NDSU, SBARE, and the North Dakota Grape Growers Association. On initial committee meetings, we looked at ourselves to present a "roadmap", if you will, and set priorities to best utilize the tax payer's money. It was determined early, that the priorities would first lend itself to research for grape breeding and growing and eventually would shift more towards winemaking, education, marketing and promotion. We realized early that the real "engine" of the industry were the wineries and that they would drive the industry. I was required by legislation to submit a progress report to the 62 nd Legislative Assembly. I have included a copy of it.

After hearing of the possible introduction of the Retail Option Bill, I immediately called a meeting of the G&WPC to gauge the level of support among the members. We looked at many aspects and possible effects of this bill to include the issues of research, agriculture, commerce, legal, promotion and education. We took into account the impact of all groups including the research facilities, grape growers, wineries, consumers, the Tax Department, the wholesalers, tax payers and the agencies represented by this committee. I report to you that the result vote for the support of HB1340 was an unanimous "yes".

We looked to the Tax Department to follow the bill, remain neutral, present all information with regard to feasibility, constitutionality, and accountability that are essential for Legislators to render a well-informed decision. I had talked with Rep. Ruby about providing a copy of the bill immediately to the Tax Department to review for their information and interpretation with regards to the bill. He had already offered them this courtesy well prior to the bill being introduced. I confirmed the receipt of the proposed bill with the Tax Department and offered our assistance. To my knowledge, the wineries or the G&WPC were not consulted as the Tax Department formulated a plan for the House hearing. We then had to assume they would do the research and provide all the pertinent information.

After a 9-5 "do not pass" in the House IBL committee, the grape and wine industry in a grass roots movement went to work to get the facts. We talked to liquor control agencies of many states, wineries from around the country, and legislators from our state. An overturned House vote of 2-1 was a clear result of many facts that were incomplete by the Tax Department and inaccurate by the wholesaling industry. We then sought legal counsel from our own appointed attorney from the North Dakota Attorney General's office who worked with us and legal counsel from Wine America to ensure we

had the appropriate language in the bill. We also looked to our own committee expertise, Jacob Belanger, who is the ND Commerce Commissioner appointee to the G&WPC. He is also an attorney and very familiar with Commerce Clause issues. We gathered statistical data from the Wine Institute and many other agencies to support and verify our findings. We reached an agreement and submitted the amendments to the Attorney General and the Tax Department. Rep. Ruby has now presented it to you. This bill is constitutionally solid. Of the 39 states that allow self distribution, we feel we have the "model" bill before you now by allowing intrastate distribution expanded to out of state wineries with no discrimination.

I must comment on testimony given by Robert Hansen, General Manager Johnson Brothers Liquor Company and a member of the Wholesalers' Association. He spoke in opposition to this bill in the House IBL Committee. He said, quote "\$350,000 was given to this industry at the last session to research and promote the production of better grapes and better wines, not to throw out the current three-tiered system. What are the results of that investment? How was that money spent?", post quote. Well, here the facts. The legislators granted \$250,000 after a 4 to 1 match of \$62,500, for the industry. We have met the matching funds and the questions he refers to are included in my Progress Report mentioned earlier and on file with the OMB. It was well distributed by the leaders of both Houses and Jim Smith of the Legislative Counsel months ago. It is available for all to review. His closing comment was particularly intriguing as well. "Entrepreneurism, he says is a wonderful thing but at what level does it become an entitlement with a state guarantee." I believe his key word "Entrepreneurism" should be substituted with the word "Wholesaling" to read. Wholesaling is a wonderful thing but a what level does wholesaling become an entitlement with a state guarantee!

Here are a few concerns that may be presented by the opposition in addition to constitutionality issues that I have already addressed.

1. Accountability. 39 state are allowing self distribution now and I am sure that our fine Tax Department will find a the way to account for the increased revenue.
2. Large out of state winery self distribution. In other words, Gallo self distributing. Other states have just not seen this. Debbie Amsberry, assistant director Financial Services for the Oregon LiquorControl Commission (OLCC), the regulatory agency for their state, has told me this has not happened in Oregon, at all. She cites that it is too inefficient for large wineries to ship directly to retailers and that they themselves would then have to pay the excise tax. That has not happened in Montana either.
3. Job loss. A free market system of distribution will not cause jobs to be lost. It will increase the number of jobs
4. Breakdown of the three-tier system. This is only an option for the wineries to use self distribution just like they have the option to distribute our product.

Winery models do vary from state to state. We have analyzed most and have taken the best parts from all for use in our bill. I will talk briefly about one that has had much success in recent years. Iowa had about 13 wineries in the mid-1990's. Today there are 86 licensed wineries with several more coming on board this year. Their impact to the Iowa's economy exceeded 234 million dollars in 2010. I recently talked with Mike White who is the Extension Specialist for Iowa State University. I asked him to give the 3 most important reasons for the success of the wine industry in Iowa. Here is his reply.

1. University of Minnesota wine-grape breeding program. We now have our own grape breeding program at NDSU are well on the way to breeding true cold climate grapes for North Dakota and areas that surround us.
2. Government agencies/legislators/university, all working together to assist the wine grape industry. We are doing that through the G&WPC and the North Dakota Grape Growers Association. (NDGGA)
3. Most importantly, open up laws that allow wineries to easily market their product. That is why we are here! 94% of their wine that is distributed is by wholesaling

In my travels across this state and country, I have found one attribute that is quite common to everyone involved in the grape and wine industry. It is what binds us all together and is the reason we are here today. Passion! We love this industry! Well, what do we want? Who do we want to be like? What we really want, is to be like us! We want our own variety of grapes developed by our own research university. We want these grapes evaluated across our great state. We want our farmers to plant these grapes in their vineyards on our unique soil and climatic conditions that are part of us. We want the wine makers to create their own style of wine. We want our wineries and vineyard to thrive and be a major part of value added agriculture and the agritourism market. We want new wineries to open up. We want to work with our wholesalers and see our wineries flourish with a distribution model that works effectively for everyone. We want our customers more educated and ensure they get a good quality wine at a fair value. We want our tax payers to see increased revenue benefits as a result of our growing industry. We want to work with all our local and state agencies, including our own Tax Department, to create new laws and modify the existing ones that are unique to this state. We want to bring pride to North Dakota and create an environment that pushes our grape and wine industry to a new level.

This is what we need.

The time is now.

This is rural North Dakota 2011, not Chicago 1932.

This is why we are here.

This is what we would like you to consider.

Thank you for your time.

Sincerely, Rod Ballinger Chairman Grape and Wine Program Committee

Representative Carlson,

In accordance with Section 3 of Senate Bill No. 2373, I am reporting to you and the legislative assembly on the progress on this bill and the involvement of the Grape and Wine Program Committee (G&WPC). A seven-member committee was put together to advise the Agriculture Commissioner and NDSU on priorities for research on the grape and wine industry in this state. The sum of \$250,000 was granted by matching funds to the extent of \$4 for each \$1 provided from other sources. Thus far, we have secured about two thirds of the matching funds required. I must say that as Chairman of the G&WPC, I was provided with the very best and most experienced personnel through the various agency representatives. I lobbied hard for this team and am grateful to all for their considerations and committee appointments.

From the onset, it was the committee's feelings that research for true cold hardy grape varieties would be the priority followed later by more attention to education, marketing and promotion of the industry. The varieties that are planted in this state now are primarily Elmer Swenson and the University of Minnesota varieties that do grow well in only a limited area of the state but are just not cold hardy enough for our weather conditions statewide. They are primarily bred for southern Minnesota and northern Iowa. We felt that flexibility was the key for us and adjusting our priorities would be paramount in ensuring the success of this bill. We selected NDSU as the main research facility and after close consultation with them, we would provide the university with a "roadmap" to carry out the project. We realized that NDSU had the best breeding program in the country but had little experience with grapes. We felt the best way was to bring in some outside grape breeding experience to enhance and expedite NDSU's endeavors. I cannot say enough how cooperative and willing NDSU was with this proposed arrangement. With all the experience on the committee (one member alone has over 30 years of grape breeding experience), we turned to a well-known cold weather grape-breeding consultant, Mark Hart, from Wisconsin for further advice. He toured the state and talked to many people involved with the grape and wine industry. We also consulted with Tyler Kaban of the University of Saskatchewan about the accelerated greenhouse breeding methods that he pioneered. After much thought and discussion, we presented NDSU with the "roadmap" that we envisioned as having the best chance for success. They agreed with the ten recommendations and four objectives developed by the committee and began immediately with Dr. Hariene Hatterman-Valenti leading the project for the university. Thus far, we have hired a part-time cold hardy grape breeder, identified one PhD candidate at NDSU, and have worked with many other enthusiastic students, growers and volunteers. Since April, the project has collected over 50 different parental lines, performed almost a hundred crosses, and grown several thousand seedlings from materials of our own breeding parents, as well as, seeds donated from interested and generous people from the Upper Midwest and Canada. These seedlings have already been planted into a field nursery to test for cold hardiness this upcoming winter. As other funds become available, we will initiate "Phase Two" of our proposal to include an additional research PhD candidate at NDSU with an emphasis in Enology. We have also continued germ-plasm collection with the location of many wild grape cultivars from river valleys across the state of North Dakota. This passion, coupled with our accelerated and traditional breeding techniques and evaluations, will increase our chances for a timely, successful program. As these new varieties become available, we anticipate more of our time and funds will be dedicated to education, marketing, and promotion as mentioned earlier.

Additionally, the committee has directed and helped organize the following:

1. The construction of a Riparia (wild river grapes) preservation vineyard on the NDSU campus for future conservation and use as breeding parents.
2. Summer 2009 - Absaraka vineyard tour and training with NDSU plant diagnostician and USDA entomologist. About 50 attendees.
3. Fall 2009 - Winemaking Project launched to utilize wine grapes produced at NDSU research locations and private vineyards. Novice winemakers had the opportunity to learn about roles that sugar and acid balance, yeast strains, skin contact time, and grape varieties make in producing a quality wine. About 25 participants.
4. Feb 2010 - G&WPC provided the funds to pay for part of the expenses for NDGGA members attending the MGGA Cold Climate Conference in Minneapolis. About 25 members took part. A record number from this region.
5. North Dakota Grape Growers Association (NDGGA) annual meeting in Carrington. About 100 people attended.
6. April 2010 - NDGGA sponsored 2 grape pruning clinics in Minot and Buffalo. Began the distribution of hard-to-get cuttings of selected cold hardy grape varieties. About 100 people attended.
7. September 11, 2010 - NDGGA Summer Vineyard Tour in Bismarck area with 100 people in attendance.

The concept of developing new grape varieties, the evaluation of current and new cultivars, enology, new winery and vineyard upstarts, and marketing will be a concerted effort on the part of the G&WPC, the NDGGA, NDSU, various state agencies, legislators, and the people of this state. It will truly be a team effort! I envision a day

when there will be wineries that dot the landscape along the towns, roads and highway system of this state that visitors can stop in for wine tasting made with grapes varieties developed here. Our Agritourism oriented wineries may also serve as hosting facilities for weddings, tasting events, office parties, holiday gatherings, and many other organized events, as well as promoting a wine culture and gracious way of living across our state. I have included the email addresses of the seven-member G&WPC. Please feel free to contact any one of us with questions, comments, or suggestions concerning SB2373 or any other matters about our grape and wine industry.

Rod Ballinger rodb@cableone.net - Fargo - Chairman G&WPC - owner Bear Creek Winery

Greg Krieger krieger@polarcomm.com - Galesburg - President NDGGA - wine maker - vineyard owner - Agriculture Commissioner designee

Alan Verbitsky averbitsky@SRT.COM - Minot - wine maker - vineyard owner - NDGGA appointee

Jeff Peterson jeff@povwinery.com - Minot - owner Pointe-of-View Winery - Governor appointee

Tom Plocher tplocher@msn.com Hugo Minn. - author "Northern Winework" - grape breeder, grower, and winemaker - NDSU designee

Rodney Howe rodneyhndsupernet.com - Hettinger - President SBARE and SBARE appointee

Jacob Belanger belangerjacob@hotmail.com - Hawley, Minn. - attorney - winemaker - vineyard owner - Commerce Commissioner appointee

Thank-you very much for your time and I am looking forward to the 62nd Legislative session.

Sincerely,
Rod Ballinger Chairman G&WPC

Testimony of John Steffes

Hi. My name is John Steffes. My wife and I own and operate Prairiewood Winery by Elliott, ND. We have been licensed as a winery since 2006.

During the summer when people are traveling, we have good traffic through our winery. People want to come out to see the vineyard and sample our wines. We also do a few offsite events a year to sell our products at events such as the Pride of Dakota showcases in Fargo and Bismarck.

We have had inquiries from people who have purchased our products at either our winery or one of the shows we have attended. They wanted to purchase more but were looking for a store that carried our products in towns like Fargo, Bismarck, or Jamestown so they wouldn't have to make a special trip to our rural location, especially in the winter months, to buy our products.

We have also had North Dakota businesses inquire about how they could obtain our product for resale at their establishments. At this point, we cannot sell to businesses that want to carry our products. ~~Being able to sell to other businesses directly would greatly boost our sales.~~

In the past, I have talked to a couple of wholesalers about carrying our products so our wines would be more accessible to people. At that time they were unwilling to do so. One of the reasons given was that we couldn't provide them with a sufficient volume of product on a consistent basis. Given the size of our winery and volume of wine we produce, how could we? The second reason given was that they thought our price was too high. They didn't think people would buy it since they had access to cheaper imported wines from countries like Australia, most of which retail for under \$5 a bottle. The feedback we have been getting from our customers is that they are willing to spend more for a higher quality North Dakota made product.

Given our rural location, we are unable to grow our business because we can't get our product to the consumer. The proposed changes to this bill, which would allow, but not require, us to sell our wines directly to retailers, would greatly benefit all the small wineries in the state. I believe with these changes we would be able to expand our vineyard as well as purchase grapes from other producers and grow our business. This bill, if passed, would promote North Dakota's grape and wine industry in general. That is why I urge you to support House Bill 1340.

STATEMENT TO THE SENATE JUDICIARY COMMITTEE OF NORTH DAKOTA BY ROBERT THADEN, owner and winemaker of Tongue River Vineyard & Winery LLC in Miles City, Montana, a state that DOES allow wineries to sell directly to any retailers holding a valid wine retail license, including state liquor stores, and many restaurants, grocery stores, and convenience stores.

Let me tell you a little about us. I am an early retired United Church of Christ pastor, married to a North Dakota woman from Hebron, Alexander, Arnegard, Watford City and Williston who is a speech pathologist. We have two children. 6 years ago we began planting a vineyard, and after an investment of nearly a quarter million dollars in plants, trellises, building and equipment, we opened Tongue River Vineyard & Winery last October.

Let me touch briefly on several issues. Other speakers may have or will speak to some of these in more detail.

Legality: The constitutional question seems to hang on whether a state allows direct sales just from wineries within North Dakota, or sales from wineries situated in any state to retailers in North Dakota. Montana, and a dozen other states, allows direct sales from any Licensed winery in the US. That completely avoids the basic constitutional issue regarding fairness in interstate commerce.

Would there be a Tsunami of out-state 'direct to retail' sales?: A major fear of allowing the direct retail option for wineries is that a tsunami of wineries from other states will inundate North Dakota wine retailers and damage the business of distributors. I've printed for you a copy of the most recent Montana monthly wine tax report for Jan 2011 which lists all of the entities doing any wine sales in Montana that month. If you look at the list, you will see that \$171,943 wine tax was collected in January. There were four out of state wineries (*marked with a left facing arrow*), counting Merry Cellars in Billings, actually a resale point for a winery in Washington state. Two of them had no sales. The other two accounted for \$57 worth of wine tax in January, amounting to .03%— not 3%, but 3% divided by 100.

Would Distributors be displaced by winery direct sales?: If you look at Montana wineries with any sales at all, the tax amounts to \$484. Shawna Christianson, our winery rep at MT dept of Revenue, tells me that of the 13 wineries licensed in Montana, our winery is one of only two that does much direct sales. But let's assume that all the wine from Montana wineries is sold to distributors. That amounts to .28%, or only about 1/4 of 1% of the wine business in Montana, despite the fact that Montana has allowed the direct retail option for over ten years. Transportation costs and a lot more work in packing and shipping simply make it unfeasible for out of state wineries.

Wisdom from other States: Illinois, in its laws says, at 235 ILCS 5/3-12, "It is the intent of this subsection to promote and continue orderly markets. The General Assembly finds that in order to preserve Illinois' regulatory distribution system it is necessary to create an exception for smaller makers of wine as their wines are frequently adjusted in varietals, mixes, vintages, and taste to find and create market niches sometimes too small for distributor or importing distributor business strategies. Limited self-distribution rights



will afford and allow smaller makers of wine access to the marketplace in order to develop a customer base without impairing the integrity of the 3-tier system."

Wisdom from your own distributors: Randy Christianson, president of Beverage Wholesalers, Inc in Fargo said, according to the Fargo Forum, Feb 19th, to reporter Marino Eccher.

1) "Wineries that struggle to find distribution may have quality or volume issues that make distribution problematic or unattractive." I agree with Randy regarding volume issues. A small winery has a hard time overcoming volume issues because they often make wine in small enough lots that distributors find it unprofitable to carry their wine. But as far as the quality issue is concerned: A winery with poor quality wine selling directly to a retailer will quickly get weeded out if the retailer gets complaints from consumers.

2) Randy said further that "wholesalers currently don't make money from domestic wineries because their industry is so small." Again, I agree with him. In both North Dakota and Montana, the market share of wine sold in our states is somewhere under 1%. If we went out of business tomorrow, the wholesalers wouldn't even notice our absence. So it would have a miniscule impact on distributors to allow wineries the direct sale option.

How has direct sales affected our winery in Miles City, Montana? Our first month 90% of our income came from sales from our tasting room. We gradually added three retailers who now account for 54% of our gross sales. This fall we expect to expand to stores in 2 or 3 small neighboring towns and perhaps the local supper clubs with beer & wine licenses. From that point on we WILL be using a distributor because we will have grown beyond our ability to self-distribute and we'll be big enough that we will need to work fulltime on our vineyard and winery operations, and we will be very attractive to a distributor, with proven brands, proven sales, proven demand.

With the direct sale option, the winery and not the distributor, takes all the risks. They do the advertising. If they make poor wine, their sales begin to fail. They do all the legwork of establishing a loyal customer base. They gain the interest of local retailers. They discover which wines sell and which ones don't. If they continue to grow, then after a couple of years, they look for larger markets. At some point, the growing winery no longer has time to do direct distribution, and wishes to concentrate time, money and energy on the manufacturing of good wine, leaving it to distributors to pick up the reins of distribution. By allowing the direct retail option, the distributor gets a proven, advertised, polished product.

Are there tax collection difficulties? Absolutely not! I am required by law to report my wine sales each month. Not to do so means I lose my license. Why would any winery risk that?

There's no doubt that the direct to retail option would increase the business of North Dakota wineries, both to retailers and to the public at their tasting rooms and eventually to distributors as wineries grow. How does that affect the state?

It would increase North Dakota's tax base and business base. Wineries with the direct option are likely to increase the purchase of North Dakota produced wine. The most direct impact of that fact is that more money stays in North Dakota. Well over 95% of the wine bought in North Dakota is produced in California, Oregon, Washington, Australia, South Africa, Chile and.....Mars. And probably about half of the value of that bottle of wine goes right out of the state to that manufacturer and the shippers and packers that get it to the North Dakota border. But with North Dakota produced wine, all of it— 100% of the money spent for that bottle of wine stays in North Dakota. North Dakota alcohol tax increases, and North Dakota dollars don't go out of state.

Finally, I'm married to a North Dakotan. You are a state of hard working, good, honest, generous spirited people. My wife and son and I are proud members of the North Dakota Grape Growers' Association. We wish Montana were progressive enough to have such an association itself. My wife frequently remarks about the economic solidity of North Dakota and its record in providing excellent education to students, and taking care of its people and its communities.

In short, the direct retail option for North Dakota wineries is a win/win change for everybody: better quality wine, more revenue to cities, more state tax revenue, better tourist attractions, and finally better business options for your North Dakota distributors because more of your wineries would become established, sought out, well-advertised and larger volume businesses making them more lucrative partners for the distributors.

There are NO down sides. I strongly urge you to pass HB 1340

Robert L Thaden

Tongue River Vineyard & Winery LLC

137 Morning Star Ln

Miles City, MT 59301

cell 406-853-1028 You can reach me right now at this number.

bob@tongueriverwinery.com

www.tongueriverwinery.com

Interesting factoids:

1. 25 years ago there were less than 5 wineries within 10 miles of Walla Walla, WA. Today, there are over 160 wineries in that same area.
2. In 2000, there were 13 wineries in Iowa. Today there are over 400 commercial vineyards and over 80 wineries. In 2008, The Iowa Department of Economic Development commissioned a study of the wine impact in Iowa. That study reported a yearly impact of \$234 million! ND is where Iowa was 10 years ago. *Imagine that same thing happening in North Dakota!*
3. Why am I promoting this? The more that wineries do well with tourists in North Dakota, the better chance those same tourists will stop at Tongue River Winery. It's good for you, good for us.



Montana Department of Revenue



Dan Bucks
Director

Brian Schweitzer
Governor

TONGUE RIVER VINEYARD & WINERY LLC
137 MORNING STAR LN
MILES CITY MT 59301-9126

Letter Date: February 28, 2011

Letter ID: L0181816064
Account ID: 6459749-004-WIT
Account Type: Wine Tax

Subject: Wine Tax

MTN: 6459749

Dear Business Owner,

Please find your report Wine report for the month of January-2011. If you have questions, contact LaNora Stigen at 406-444-5807

Wholesaler/Location

Jan-2011

| | |
|---|-------------|
| ← BLODGETT CANYON CELLARS LLC, CORVALLIS | \$10.33 |
| BLUE ROCK DISTRIBUTING CO, SIDNEY | \$3,163.73 |
| BRIGGS DISTRIBUTING COMPANY INC, BILLINGS | \$13,088.83 |
| BRONKEN'S DISTRIBUTING, BOZEMAN | \$12,575.25 |
| CARDINAL DISTRIBUTING COMPANY, BOZEMAN | \$14,734.48 |
| + CLINT PECK ENTERPRISES INC, BILLINGS | \$174.35 |
| EAGLE BEVERAGE, GREAT FALLS | \$5,471.55 |
| + FLATHEAD LAKE WINERY LLC - SOLE MEMBER, COLUMBIA FALLS | \$12.15 |
| ← FOUNDRY VINEYARDS LLC, WALLA WALLA | \$0.00 |
| FUN BEVERAGE INC, KALISPELL | \$22,761.91 |
| GEORGE'S DIST-FLATHEAD WAREHOUSE, HELENA | \$0.00 |
| GEORGE'S DISTRIBUTING, HELENA | \$10,789.37 |
| HAVRE DISTRIBUTORS INC, HAVRE | \$1,061.60 |
| + HIDDEN LEGENDS WINERY, VICTOR | \$126.36 |
| INTERMOUNTAIN DISTRIBUTING CO, BILLINGS | \$767.09 |
| INTERMOUNTAIN DISTRIBUTING CO, BILLINGS | \$20,660.70 |
| + LOLO PEAK WINERY INC, MISSOULA | \$11.75 |
| ← MERRY CELLARS, BILLINGS | \$46.88 |
| + MISSION MOUNTAIN WINERY INC, DAYTON | \$26.73 |
| + MISSOULA WINERY LLC, MISSOULA | \$59.19 |
| + MONTANA CIDERWORKS, SULA | \$4.86 |

revenue.mt.gov

▲ Toll free 1-856-859-2254 (in Helena, 444-5900)

▲ TDD (406) 444-2830

| | |
|---|---------------------|
| MOUNTAIN COUNTRY DISTRIBUTING, BOZEMAN | \$12,431.09 |
| NEMONT BEVERAGE CORP, GLASGOW | \$1,203.99 |
| ← QUINTA SANTA ROSA LLC, LOS OLIVOS | \$0.00 |
| SHEPHERD COMPANY, BUTTE | \$72.90 |
| SUMMIT BEVERAGE, BUTTE | \$10,740.72 |
| SUMMIT BEVERAGE, MISSOULA | \$37,691.01 |
| THOMPSON DISTRIBUTING INC, BUTTE | \$644.34 |
| + TONGUE RIVER VINEYARD & WINERY LLC, MILES CITY | \$52.34 |
| + TRAPPER PEAK WINERY, LLP - PARTNERS KEITH, DARBY | \$7.29 |
| WINEGARDNERS WINES INC, BOZEMAN | \$3,542.67 |
| Total | \$171,943.46 |

← = NON-MOUNTAIN WINERIES \$ 59.00 0.03%
 + = MOUNTAIN WINERIES \$ 164.30 0.09%
 DISTRIBUTED WINE → \$ 171,943.46 99.69%

**Testimony in Opposition to HB 1340
Senate Judiciary Committee**

Good morning Chairman Nething and Committee Members. My name is Pat Ward. I am an attorney here in Bismarck at Zuger Kirmis & Smith. I am here today on behalf of the North Dakota Wholesale Liquor Dealers Association in opposition to HB 1340, a bill relating to sales by a domestic winery.

Passing this bill as written would violate the United States Constitution and deviate from United States Supreme Court precedent. The problem is that the bill is requesting for domestic and foreign (out-of-state) wineries to be treated differently.

The domestic wineries are a fledgling hobby industry in the state. There are only 8 domestic wineries and the total tax revenue they have generated since 2007 is less than \$20,000 or less than \$5,000/year. The current tax on wine is \$.50 per gallon. In contrast, your liquor wholesalers have paid an average of \$500,000 in taxes on wine imported into this state. (Attachment 1.)

Each and every session the wineries come forward like the birds at my bird feeder looking for more. There have been changes made in the law every session in their favor. There have been large appropriations to help develop this industry. This session we have expanded the number of events permits and days which they can sell off premises in HB 1099.

3 Tier System

North Dakota has a long established 3-tier system for the manufacture and distribution of alcohol products which is designed to ensure that all liquor sold in the state is accounted for and taxes are collected. This system involves the manufacturer, wholesaler, and retailer as separate tiers. Taxes are collected at the wholesale level of this tiered system as wine and liquor come into the state. Retailers like this system and do not want to deal directly with these domestic wineries. Wineries are already permitted to sell at the winery, special events, and ship direct to consumers.

Commerce Clause

By passing this bill as written, domestic wineries will be given an unconstitutional advantage. This bill would allow them to skip the wholesale tier and cherry pick the top retail locations. A domestic winery would occupy all 3 tiers. Out-of-state wineries would still have to follow the 3-tier system. Giving this sort of advantage to domestic wineries is a violation of the United States Constitution. The domestic or farm winery favoritism statutes have led other states into wasteful and losing litigation. In Granholm v. Heald, 544 U.S. 460 (2005), these exact types of statutes involving domestic wineries attempting to make direct sales and avoid the 3-tiered structure were held to violate the Dormant Commerce Clause found in Article 1, section 8, clause 3, of the United States Constitution. The Supreme Court held that state laws allowing "differential treatment between in-

state and out-of-state wineries constitute[d] explicit discrimination against interstate commerce.”

The ability to regulate interstate commerce is a right that was specifically reserved by the constitution to the federal government. States were not given this right. Writing for the majority, Justice Kennedy explained:

“Time and again this Court has held, that in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate ‘differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.’ This rule is essential to the foundations of the Union . . . States may not enact laws that burden out-of-state producers or shippers simply to give a competitive advantage to in-state businesses. This mandate ‘reflects a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations amount the Colonies and later among the States under the Articles of Conference.”

Just last December, the Federal Court of Appeals in Freeman v. Corzine reaffirmed this decision in a New Jersey winery case.

I have attached a copy of the Commerce Clause (Attachment 2), as well as a summary of the Granholm opinion (Attachment 3), along with my testimony for your convenience.

Domestic Winery History

Last session in SB 2373 this body gave the domestic winery and grape growers \$250,000 to create a grape and wine program fund. Since then less than \$10,000 in tax revenue has been collected from this industry. In an earlier session there was another equally large appropriation. Where has this money gone? SB 2373 required a report to the 62nd legislative assembly. Should we not wait and see where this money goes and what it accomplishes?

These wineries have been given more than enough opportunity to get off the ground and get going. They are diverting and benefitting from taxes collected on foreign wines. Allowing them to sell direct to retail will not increase their production or sales. It will quite likely have the opposite effect as others from out of state move in and sell better quality wine even cheaper. Do not risk opening up a longstanding successful system by passing HB 1340, with or without the amendments. Doing so will destabilize a successful industry to assist 8 very small businesses.

Attached is an amendment which would limit the amount a winery can sell direct to retail. It would also limit or level down the bill to 2005 status if it is challenged by a larger out of state winery and declared unconstitutional. If you are inclined to add amendments to this bill, we would ask you to add these as well to protect your 3-tier system from depredation by large wineries in conjunction with large retail stores if this is deemed unconstitutional. (Attachment 4.)

I urge you to follow the United States Constitution, respect our 3-tier system, and place a "Do Not Pass" recommendation on this bill. I introduce Rob Hansen from Johnson Brothers who has a few things to say.

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| Calendar Year | Wine <17% Alcohol Tax Paid by Liquor Wholesalers | Wine < 17% Alcohol Tax Paid by Domestic Wineries |
|----------------------|--|--|
| 2007 | 423,090.00 | 5,939.16 |
| 2008 | 455,017.45 | 4,107.90 |
| 2009 | 478,897.62 | 4,234.32 |
| 2010 | 509,192.65 | 4,506.73 |
| Total | 1,866,197.72 | 18,788.11 |
| | | |

2/22/2011

respectively. If any bill shall not be returned by the president within ten days (Sundays excepted) after it shall have been presented to him, the same shall be a law, in like manner as if he had signed it, unless the Congress by their adjournment, prevent its return, in which case it shall not be a law.

Every order, resolution, or vote to which the concurrence of the senate and house of representatives may be necessary (except on a question of adjournment) shall be presented to the president of the United States, and before the same shall take effect, shall be approved by him, or being disapproved by him, shall be repassed by two-thirds of the senate and house of representatives, according to the rules and limitations prescribed in the case of a bill.

§ 8. The Congress shall have power:

To lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States.

To borrow money on the credit of the United States.

To regulate commerce with foreign nations, and among the several states, and with the Indian tribes.

To establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States.

To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures.

To provide for the punishment of counterfeiting the securities and current coin of the United States.

To establish post offices and post roads.

To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.

To constitute tribunals inferior to the Supreme Court.

To define and punish piracies and felonies committed on the high seas, and offenses against the law of nations.

To declare war, grant letters of marque and reprisal, and make rules concerning captures on land and water.

To raise and support armies; but no appropriation of money to that use shall be for a longer term than two years.

To provide and maintain a navy.

To make rules for the government and regulation of the land and naval forces.

To provide for calling forth the militia to execute the laws of the union, suppress insurrections, and repel invasions.

To provide for organizing, arming, and disciplining the militia, and for governing such part of them as may be employed in the service of the United States, reserving to the state respectively the appointment of the officers and the authority of training the militia, according to the discipline prescribed by Congress.

JENNIFER M. GRANHOLM, GOVERNOR OF MICHIGAN, et al., Petitioners
v. ELEANOR HEALD, et al. MICHIGAN BEER & WINE WHOLESALERS
ASSOCIATION, Petitioner v. ELEANOR HEALD, et al. JUANITA
SWEDENBURG, et al., Petitioners v. EDWARD D. KELLY, CHAIRMAN,
NEW YORK DIVISION OF ALCOHOLIC BEVERAGE CONTROL, STATE
LIQUOR AUTHORITY, et al.

(03-1116), (03-1120), (03-1274)

SUPREME COURT OF THE UNITED STATES

544 U.S. 460; 125 S. Ct. 1885; 161 L. Ed. 2d 796; 2005 U.S. LEXIS
4174; 73 U.S.L.W. 4321; 18 Fla. L. Weekly Fed. S 263

December 7, 2004, Argued

May 16, 2005, * Decided

CASE SUMMARY

PROCEDURAL POSTURE: In separate actions, petitioner/respondent wineries sued respondent/petitioner state officials, alleging that state laws discriminated against out-of-state wineries in violation of U.S. Const. art. I, § 8, cl. 3. Upon grants of writs of certiorari, appeals were taken from judgments of the U.S. Courts of Appeals for the Second and Sixth Circuits which conflicted in determining whether the laws were permissible under U.S. Const. amend XXI, § 2.

OVERVIEW: The state laws allowed in-state wineries to make direct sales to customers but effectively permitted out-of-state wineries to make sales only through wholesalers and retailers at greater expense. The wineries contended that the regulatory schemes discriminated against interstate commerce, but the officials argued that the schemes were necessary to prevent underage persons from purchasing wine and to promote the collection of taxes. The U.S. Supreme Court held that the state laws discriminated against interstate commerce and that the discrimination was neither authorized nor permitted by U.S. Const. amend XXI, § 2. The constitutional authority of the state to regulate the importation of intoxicating liquors was limited by the requirement under U.S. Const. art. I, § 8, cl. 3, that such regulation could not discriminate against the out-of-state wineries in favor of in-state wineries. Further, reasonable nondiscriminatory alternatives were available to address the purchase of wine by minors and the states' ability to collect taxes, and the officials failed to show any legitimate local purpose that could not have been advanced by evenhanded requirements.

OUTCOME: The judgment holding that the state laws were invalid was affirmed, and the conflicting judgment was reversed and remanded for further proceedings.

PROPOSED AMENDMENTS TO HOUSE BILL 1340

Page 2, line 16, after "licensee." Insert "A domestic winery shall not sell more than 5000 gallons of wine direct to retail in a calendar year. Deliveries direct to retailers must be made by the wineries' own trucks, equipment, and employees and not by common or private carrier. Domestic wineries selling direct to retail must obtain a wholesale license and comply with all wholesaling requirements."

Page 3, after line 2, insert:

5. In the event a court of competent jurisdiction holds this section or any part of it unconstitutional or otherwise invalid, it shall revert back to its 2005 form.



JOHNSON BROTHERS NORTHWEST BEVERAGES, INC.

1358 North 39th Street • Fargo, ND 58102 • (701) 282-4660 • Fax (701) 282-8869

March 16, 2011

Senator Nething
Committee Members
Senate Judiciary Committee
ND State Legislature

My name is Rob Hansen. I am the president of the ND Wine & Spirits Wholesale Association. I'm here to testify in opposition to HB 1340, the Winery Direct Ship Bill.

This bill is a threat to the alcoholic beverage industry in ND; at all levels. Some points to consider:

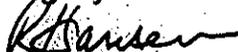
1. There is a huge disadvantage to smaller retailers, particularly in rural communities, who realistically will not be able to access these out-of-state wineries – especially at competitive prices. This will result in more migration to “big box” retailers who already pull a lot of business from the small towns.
2. Retailers who understand this bill do not want direct shipping. They realize that this will result in more expense for no increase in sales.
3. This would result in a significantly increased burden and expense to the state. Instead of a few distributors who currently collect and submit all excise taxes to the Tax Commissioner, there could be hundreds of wineries who ship direct with no control or requirement to report and pay taxes except their conscience. All of these would have to be

administered and monitored. Retailers would no longer be required to purchase from ND licensed wholesalers. This would put a lot of pressure on the Attorney General's office. Where is the accountability? What will the increased costs be?

4. There are more than 18 wine and spirits distributors, 20 beer distributors, 1200 retail outlets and thousands of employees. Why put this industry at risk needlessly?

HB 1340 started out as a domestic winery bill which has now morphed into something much bigger. This is either a back door attempt to get around the constitutional concerns of the original bill or there is a bigger agenda.

I see no advantage in this bill for any part of the industry other than big box retailers. This bill is designed to completely destroy the three tier system in ND. In the best interests of the entire industry in ND, I urge you to vote NO on HB 1340.


Rob Hansen
JBLC-ND



HB 1340:

HB 1340 if passed would disrupt many things in North Dakota's three tier system.

First, "Big Box" retailers would gain a significant advantage if these wineries fight for shelf space in their stores. In turn making it hard for smaller retailers to compete and ultimately not being able to carry their product. As a small retailer this would make it hard for me to carry their wines no less compete on price. Wineries would also get to set their own price at their "RETAIL SHOPS" once again making it hard to compete. I do not know if these wineries understand that this bill might actually hurt their overall sales by having smaller footprints in many stores.

Second, when bills like this become law it opens many different avenues to other similar bills to get passed. Soon out of state wineries, liquor companies or beer companies may be authorized to deliver to large "Big Box" warehouses directly. We small local retailers would once again not be able to compete fairly.

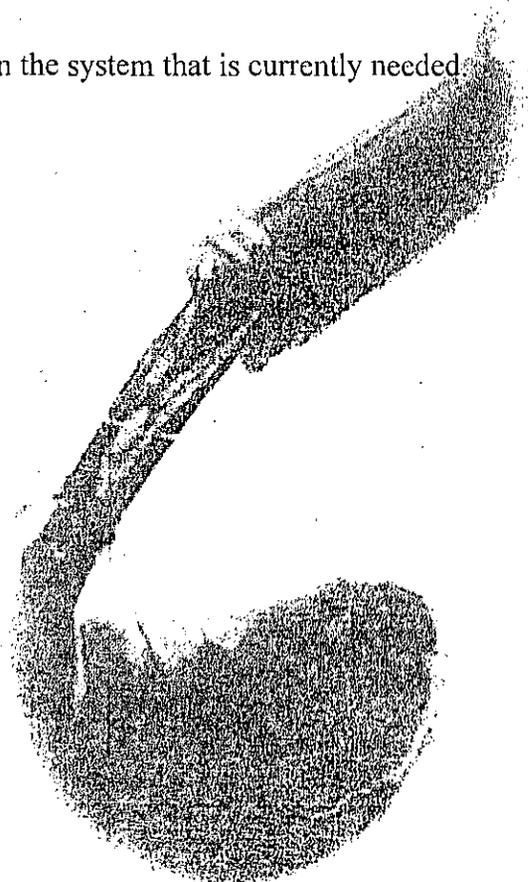
Finally, HB 1340 would ultimately create more confusion in the system that is currently needed. Therefore a do not pass on HB 1340 is needed.

Thanks

A handwritten signature in black ink, appearing to be "Cork & Barrel".

Cork & Barrel

A second handwritten signature in black ink, appearing to be "Cork & Barrel".



To: The Honorable 2011 Legislators

From: Gary A. Peterson, Partner of Dakota Silver

Re: HB 1340

I am writing about the change of language that is being introduced to change section 5-01-17 of the North Dakota Century Code. I am not for the change for a couple of reasons.

1. This will help neither the small winery nor the average on / off sale.
2. The big box retailer will have an edge as they could buy the rights to a complete winery. They do have that much buying power. Right now I can compete with them. Please don't take that away from us. This Bill won't enhance the way of life for the average North Dakota citizen.

I respectfully request that you Do Not Pass this Bill 1340.

Thank you,



Gary A. Peterson

Senator Nething, Chairman
Committee Members
Senate Judiciary Committee
ND State Legislature

Senator Nething,

As the owner of a liquor store in Fargo for 35 years, I am concerned about HB 1340. This would put myself and all other independent stores at a definite disadvantage against the big multiple outlet retailers. This bill is definitely not good for North Dakota.

Thank you.

Havery Nicholson, Pres
K.W.K. Inc.
d/b/a The Spirit Shop
Fargo, ND



O'Kelly's

3800 Main Avenue
Fargo, ND 58103

March 15, 2011

Senator Nething
Judiciary Committee Members
North Dakota Legislature

I own O'Kelly's Tastes and Toddies in Fargo and I am very concerned about the direct ship bill. I feel that it's bad for North Dakota, especially small businesses, and has to be much worse in some of the smaller rural communities. This could force many to close their doors.

I urge you to vote No on HB 1340, the direct ship bill.

Regards,



Mike Clevenger
Owner / O'Kelly's
Fargo

Testimony
HB 1340
March 16, 2011
Senate Judiciary Committee

Mr. Chairman, members of the Committee, my name is Janet Seaworth. I am the executive secretary and legal counsel for the North Dakota Beer Distributors Association. We have 17 family owned and operated beer wholesalers in North Dakota. Many are now in their third-generation of family ownership. We are opposed to HB 1340.

Although this bill deals with domestic wineries, this is not a wine issue. This is a three-tier issue and the fact that this bill provides for an unlawful in-state preference raises our concerns, because it has the potential to subject the state to expensive litigation that could invalidate the three-tier system and impede the state's ability to regulate alcohol.

This bill would allow in-state wineries to by-pass the three-tier system by selling direct to retailers. That is exactly the type of arrangement that the three-tier system was designed to prevent. If suppliers are able to sell direct to retailers, they will be able to exert pressure on retailers to sell their products exclusively, and to increase sales without regard to the social implications. This bill sets up the very situation that enabled the prior abuses that lead to prohibition. While some may argue that our domestic wineries would never engage in such practices, we aren't talking about just North Dakota wineries; out-of-state suppliers will want the same deal. Under *Granholm v. Heald*, what you allow for in-state producers, you must allow for out-of-state producers.

This bill calls for an unconstitutional in-state preference. HB 1340, which would allow in-state wineries to sell direct to retailers is clearly unlawful under *Granholm v. Heald*. In *Granholm*, the U.S. Supreme Court invalidated two states' direct shipping laws allowing in-state wineries to ship wine they produced directly to consumers, but barring out-of-state wineries from doing the same. The Court was clear "that States may not give a discriminatory preference to their own producers." 544 U.S. 460, 486. HB 1340 provides a specific exception to North Dakota's three-tier system favoring in-state producers. That is not allowed under *Granholm*.

If out-of-state wineries ship direct to retail under *Granholm*, the state will lose significant dollars in tax revenue. Liquor wholesalers paid \$4.6 million in taxes last year, \$536,000 in wine taxes alone. If out-of-state wineries are allowed to ship to retail, there will be no way to collect the tax that is due, because the tax is levied at the wholesale level. According to the Tax Department, it has no way to know whether out-of-state wineries are selling direct to retailers, and they have no jurisdiction over retailers. They will be unable to collect the excise tax. In our view, it makes no sense to give up millions of dollars in tax revenue, in exchange for allowing a few in-state wineries to sell direct. North Dakota can't rely on an "honor system" for the payment of wine taxes.

Allowing alcohol to ship direct from the manufacturer to the retailer will increase the state's regulatory burden. Currently, all sales of wine in the state can be tracked by the state as a result of reporting required from the licensed in-state businesses that distribute alcoholic beverages. If HB 1340 is passed, and out-of-state wineries ship direct to retail, there will be an increased flow of wine into the state resulting in an additional burden on the state's regulation of alcoholic beverages. The state will have the disadvantage of trying to regulate many out-of-state wineries, rather than a few in-state wholesalers.

The level playing field retailers have now will go away. Right now, the three-tier system ensures a level playing field - no wholesaler may discriminate among retailers in price, price promotions, etc. If wineries can sell direct to retailers, those protections go away. HB 1340 does not require domestic wineries to treat retailers alike. And if out-of-state wineries are allowed to sell direct to retailers, those wineries will cut deals with favored retailers for shelf space - they can and will discriminate and they won't be selling to or servicing the small accounts. The result will be less selection and less availability at your local retailer. Small retailers will suffer - they will not be served and they will have no bargaining power. And local wineries will be squeezed out as California wineries cut deals with large retailers to increase their market share and shelf space.

North Dakota's distributors are already distributing wine from in-state producers. Many of our beer distributors have liquor licenses and are distributing domestic wines, with success. This bill is not about access to market. It's about wineries wanting to cherry-pick retailers and by-pass the regulatory system.

North Dakota's regulatory system has worked very well for over 75 years. We have an orderly alcohol distribution system. We enjoy unprecedented consumer choice and product freshness in this state. HB 1340 poses significant challenges to the state's ability to regulate alcohol, collect taxes, ensure product integrity and safety, and it exposes our laws to significant legal challenges. We ask that you give the bill a strong do not pass recommendation.

Janet Demarais Seaworth
Executive Secretary and Legal Counsel
North Dakota Beer Distributors Association

**TESTIMONY OF THE NORTH DAKOTA OFFICE OF STATE TAX COMMISSIONER
BEFORE THE
SENATE JUDICIARY COMMITTEE**

**HOUSE BILL NO. 1340
MARCH 16, 2011**

Chairman Nething, and members of the Senate Judiciary Committee, my name is Daniel Rouse. I am Legal Counsel to the North Dakota Office of State Tax Commissioner. I am here today on behalf of Tax Commissioner Cory Fong to express our concerns with House Bill 1340.

The North Dakota Tax Commissioner's Office is responsible for the regulation of domestic wineries that operate in North Dakota. Our administration and regulation of domestic wineries is based on North Dakota law, which is founded upon the three-tier system of alcoholic beverage regulation (i.e., manufacturers, who make the alcoholic beverages and sell it to wholesalers, who in turn sell the manufacturer's product to retailers, who sell it to the ultimate retail customers).

Alcoholic beverages are a highly regulated product. This is because of the significant public concern over how alcoholic beverages are made, sold, taxed, and the need for regulatory authorities to closely monitor the entire life span of these beverages at each tier. The three-tier system is a transparent and long-used method of regulation of these products. The North Dakota Office of State Tax Commissioner firmly believes in the three-tier system of alcoholic beverage regulation as the best means to regulate the flow of alcoholic beverages from the point of manufacturing to purchase at retail.

House Bill 1340, if enacted, would deviate from the three-tier system in North Dakota. It would allow North Dakota domestic wineries to by-pass the wholesale tier and sell their products directly to a retailer. In so doing, it would give domestic wineries a preferential status that no other wineries, specifically out of state wineries, could have. In fact, no other manufacturer of alcoholic beverages, in-state or out-of-state, would enjoy this privilege.

Additionally, if this preferential treatment is made into law, out-of-state wineries, and quite possibly all alcoholic beverage manufacturers (i.e., liquor and beer), will likely want the

same treatment. This would present a significant challenge to the Tax Department in collection of the tax on alcohol when the products are brought into North Dakota.

Currently, that collection, as well as reporting of the product being brought into North Dakota, is the responsibility of wholesalers. Under this bill, the manufacturer would be responsible for the collection and remittance of the wholesale tax, and the Tax Department would be forced to somehow determine which manufacturers were directing products from anywhere in the world to North Dakota retailers and seek payment of the tax and information related to the activity from those manufacturers. The ability of the Tax Department to carry out its statutory obligations to regulate the delivery of alcoholic beverages into North Dakota, the sales of those beverages, and collection of the tax associated with those sales, would be substantially impaired.

For these reasons, Mr. Chairman, and members of the Committee, the Tax Commissioner respectfully requests that you take these concerns into consideration when deliberating HB 1340. I would be happy to respond to any questions. Thank you.

MEMO

TO: Senator Nething, Chairman
Senate Judiciary Committee

FROM: Thomas L. Trenbeath
Chief Deputy Attorney General

RE: HB 1340

Last Wednesday, March 16, I appeared before your committee on HB 1340. I appeared on behalf of the Attorney General, in a neutral position, but expressed the view that certain provisions of the bill could violate the Commerce Clause of the United States Constitution, and that a resulting "1983" action could end up costing the State of North Dakota considerable money. At that time I was aware of the amendment that was about to be distributed which removed the word "domestic" from several places in the bill. Having previously reviewed the proposed amendment I expressed my view, to the sponsors of the amendment as well as to the prime sponsor of the bill. I had also suggested a method whereby the amendment might be improved.

Subsequent to the hearing on the bill there have been several discussions between the supporters of the bill and the Attorney General and senior staff. The attached proposed amendment incorporates the previously referenced changes suggested by this office. As such, although the Attorney General can never guarantee that a statute is free from successful constitutional challenge, the attached endorsement if adopted would satisfy those concerns previously expressed in testimony.

11.0608.01004
Title.

Prepared by the Legislative Council staff for
Representative Ruby
March 18, 2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1340

Page 1, line 2, remove "domestic"

Page 2, line 1, overstrike "domestic"

Page 2, line 10, overstrike "domestic"

Page 2, line 13, overstrike "domestic"

Page 2, line 17, overstrike the first "domestic"

Page 2, line 17, overstrike the second "domestic"

Page 2, line 25, overstrike "domestic"

Renumber accordingly