

# Legislative Analysis

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## **ALCOHOL: DISCONTINUE DIRECT SALES TO CONSUMERS BY RETAILERS**

Mitchell Bean, Director  
Phone: (517) 373-8080  
<http://www.house.mi.gov/hfa>

**House Bill 6644 without amendment**  
**Sponsor: Rep. Barbara Farrah**  
**Committee: Regulatory Reform**

### **First Analysis (12-2-08)**

**BRIEF SUMMARY:** The bill would restrict the sale and delivery of alcoholic liquor by licensed retailers to on-premises transactions.

**FISCAL IMPACT:** A fiscal analysis is in process.

### **THE APPARENT PROBLEM:**

Michigan regulates the manufacture, importation, transportation, warehousing, and retail sales of alcohol through a three-tier system in which licensed manufacturers and suppliers sell their products to licensed wholesalers, licensed wholesalers sell the product lines they carry to licensed retailers, and licensed retailers sell directly to consumers. The tiers are kept separate, meaning that a person or company can only operate at one of the tiers; for example, a manufacturer is prohibited from also being licensed as a wholesaler or retailer. However, there are a few narrow exceptions. For example, brewpubs and micro breweries are allowed to sell the beer they brew at their licensed premises to consumers for consumption either on or off the premises.

Another long-time exception in the liquor code allowed licensed wineries located within Michigan to sell their own products at wholesale to restaurants or retailers and also to sell at retail to consumers at the winery and at sites where tastings are conducted. In addition, in-state wineries were also allowed to ship their products directly to consumers residing in Michigan. These practices were threatened in the spring of 2005 when the U.S. Supreme Court struck down the provision allowing Michigan wineries, but not out-of-state wineries, to directly ship their products to Michigan consumers. The reasoning of the court in *Granholm v Heald*, 544 US 460 (2005) was that allowing in-state, but not out-of-state wineries, to ship directly to consumers violated the Commerce Clause of the U.S. Constitution because it discriminated against the out-of-state wineries.

Legislation was enacted later that year to create a direct shipper license available to both in-state and out-of-state wineries. Under the legislation, Michigan wineries were able to continue selling and shipping their products to restaurants and consumers within the state and to consumers in other states if permitted under that state's law, and Michigan residents were able to receive shipments of wine from out-of-state wineries licensed as a direct shipper.

Not long afterward, another lawsuit was filed against the state alleging similar laws allowing in-state wine retailers – but not out-of-state retailers – to ship wine directly to Michigan consumers was unconstitutional for the same reasons expressed in *Heald*, and therefore went against the Supreme Court’s decision in that case. The action was brought by a Florida-based retailer of alcoholic liquor and two Michigan residents who claim the wine of their choice is not readily available from Michigan retailers. According to the plaintiffs, the law is burdensome and constitutes differential and discriminatory treatment of out-of-state businesses because Michigan law prohibits out-of-state retailers from being able to ship wine to Michigan residents unless the retailer maintains a physical presence in the state and fits into the state’s three-tier system of retailers who sell only those products bought from licensed wholesalers who had bought from licensed manufacturers or suppliers.

Recently, a federal district court granted the motion for summary judgment by the plaintiffs in this case, *Siesta Village Market, LLC v Granholm* (Docket # 06-CV-13041), and ordered that the State of Michigan be enjoined (or prohibited) “from prohibiting out-of-state wine retailers from selling, delivering and shipping wine through interstate commerce direct to consumers” and from enforcing certain provisions of the liquor code “which prohibits out-of-state wine retailers from selling, delivering and shipping wine through interstate commerce directly to consumers in Michigan.” Recently, the state was granted a stay of the order pending an appeal.

The effect of the federal court order is that unless it is reversed on appeal, any retail establishment in the U.S. could sell and ship wine directly to Michigan residents via the Internet, mail order, or telephone sales. In addition, though the thrust of the *Siesta Village Market* case was limited to wine, the affected provisions of the liquor code pertain also to direct deliveries to consumers of beer and spirits by state-licensed retailers. It is reasonable to assume that it is only a matter of time before another legal challenge arises to allow every liquor retailer in the nation to ship any alcoholic beverage to Michigan residents. If that were to happen, the entire 3-tier system would be threatened.

Currently, there is no legal framework to license these out-of-state retail liquor establishments and to collect the same excise taxes and sales and use taxes levied on Michigan retailers and suppliers. The state would stand to lose untold amounts of revenue that support the state’s General Fund and School Aid Fund. To address the immediate concern, legislation has been requested by the Michigan Liquor Control Commission to repeal the provision allowing off-premises liquor licensees to directly deliver alcoholic liquor to consumers in the state. Provisions pertaining to the direct shipper license allowing in-state and out-of-state wineries to directly ship their products to state residents would not be affected.

### ***THE CONTENT OF THE BILL:***

Under the Michigan Liquor Control Code, only the Liquor Control Commission and certain persons licensed or authorized by the commission are allowed to sell, deliver, or import alcoholic beverages into the state. The sale, delivery, or importation of alcoholic liquor includes, but is not limited to, "the sale, delivery, or importation of alcoholic liquor transacted or caused to be transacted by means of any mail order, Internet, telephone,

computer, device, or other electronic means." A retail sale, delivery, or importation of alcohol by any of these means is permitted if the retailer complies with listed requirements, such as being licensed under state law, paying applicable taxes to the commission, and not selling alcohol to minors. In addition, the retailer must verify the age of the individual placing the order and certain personal identifying information must be recorded by the person taking the order. Further, the retailer must comply with packaging and labeling requirements.

House Bill 6644 would amend the Michigan Liquor Control Code to delete the provisions described above. Instead, the bill would specify that notwithstanding a commission rule allowing an off-premises licensee to deliver a preordered quantity of alcoholic liquor to a customer, a retailer could not deliver alcoholic liquor to a consumer at his or her home or business or at any location away from the retailer's licensed premises.

The purpose of the provision, as specified in the bill, would be to exercise the state's constitutional authority under the Commerce Clause (Section 2 of Amendment XXI of the U.S. Constitution) and the inherent police powers to regulate the transportation and delivery of alcoholic liquor. The regulation described in the bill is considered necessary for both of the following reasons:

- To promote the public health, safety, and welfare.
- To maintain strong, stable, and effective regulation by having beer and wine sold by retailers to Michigan consumers by passing through the three-tier distribution system established under the code.

The bill would also delete several references to direct retail sales of alcoholic liquor to consumers and revise those provisions to pertain only to direct sales of wine to consumers by those holding a direct shippers license.

MCL 436.1203

### ***BACKGROUND INFORMATION:***

Michigan's Liquor Laws. Beer and wine is distributed in Michigan via a "three-tier system." A business may be licensed as either a supplier (brewers and vintners), wholesaler, or retailer (restaurants, package stores). Generally, a supplier contracts with a wholesaler to deliver a particular brand of product to licensed retailers in a designated geographic region. As part of the criteria for licensing, both wholesalers and retailers must have a building located within the state, but suppliers can be located either within or outside of the state. An "outstate" seller's license permits a supplier to handle products manufactured in other states and countries. Michigan wineries and microbreweries may sell their products directly to consumers on their own premises or directly to wholesalers, who then sell the product to retailers; an out-of-state winery or brewery is typically licensed as an outstate seller of beer or wine and sells its products to wholesalers. Very small breweries or wineries, who may not find it profitable to carry a license as an outstate seller, can sell to a licensed outstate seller of beer or wine, who then can market these products in the state.

Spirits are distributed in a similar manner, except that the state fills the role of the wholesaler. Under legislation that privatized the delivery system of spirits in the state, authorized distribution agents (ADAs) operate as agents of the state to receive shipments from suppliers, and warehouse and deliver spirits to retailers. Under the regulatory framework, manufacturers of spirits contract with an ADA to be the exclusive distributor of that product. A licensed retailer orders the desired product from whichever ADA represents that particular brand. The ADA forwards the order to the Michigan Liquor Control Commission (MLCC), which forwards the order to the supplier. The supplier ships to the ADA, who then delivers the product to the retailer for sale to the consumer.

Only a licensed retailer may sell directly to a consumer (except for wineries and microbreweries who may sell from their licensed premises only). Retailers are licensed for off-premise consumption (grocery stores, package stores) or on-premise consumption (restaurants, bars). There are two classifications of off-premise license: a Specially Designated Merchant (SDM) may sell beer and wine and a Specially Designated Distributor (SDD) may sell spirits. An SDD licensee may also hold an SDM license. With some exceptions, an SDD license is subject to a quota restriction based on population with one license per 3,000 population.

An unlicensed person who engages in any act that requires a license is guilty of a felony punishable by up to one year in jail and/or a \$1,000 fine. The law also allows the commission to levy a \$5,000 fine and to issue an assessment and demand for taxes owed. Michigan law does not prohibit a company from selling beer, wine, or spirits via the Internet or mail order, but requires that a business fit within the structure of the regulatory scheme in place. Basically, an in- or out-of-state business, in order to legally sell alcoholic products through these means, would first have to order from a licensed supplier (or, in the case of spirits, a licensed ADA), who would then sell the product to a licensed wholesaler, who would then deliver the product to an in-state licensed retailer, who then would repackage the product and deliver it to the person making the order. According to the MLCC, a small number of out-of-state companies are legally selling alcohol through sites on the Internet or through mail order.

Sales to Minors. The Liquor Control Code prohibits the sale or furnishing of alcohol to minors. Licensees guilty of a violation face both criminal and administrative sanctions, including license revocation. Also, a local government can, by resolution, request the MLCC to revoke a license for an off-premise licensee (SDD or SDM) who was found to have sold alcohol to minors three times in a calendar year [MCL 436.1501(3)] if the sales did not involve the use of a false ID.

Licensees are required to make a diligent inquiry to determine the age of a purchaser, which includes checking IDs. The Michigan Licensed Beverage Association sponsors an alcohol management training program that, among other things, trains employees of liquor licensees to do ID checks, as well as recognize when a customer is intoxicated.

Any person who sells or furnishes alcohol to a minor is guilty of a misdemeanor punishable by a fine of up to \$1,000 and imprisonment for up to 60 days for a first offense, and by a fine of up to \$2,500 and up to 90 days imprisonment for a second or subsequent offense. Delivery of alcohol to a minor by a nonlicensee that leads to the

death of the minor is a felony, punishable by up to 10 years in prison, a fine of up to \$5,000, or both.

Liquor Taxes. The MLCC levies a 51-65 percent markup on the cost of spirits from the supplier; the markup plus the supplier's cost becomes the base price. In addition, the commission then levies a four percent specific tax on the base price which is earmarked for the General Fund, a four percent excise tax earmarked for the School Aid Fund, a four percent specific tax earmarked for the Convention Facility Development Fund, and a 1.85 percent specific tax on off-premise sales earmarked for the Liquor Purchase Revolving Fund. These taxes are collected and remitted to the commission by the licensed retailers.

Wine with 16 percent or less alcohol is taxed at 13.5 cents per liter, and wine with more than 16 percent alcohol is taxed at 20 cents per liter. Beer is taxed \$6.30 per barrel (smaller breweries and brewpubs are eligible for a \$2 per barrel credit). Mixed spirit drinks are taxed at 48 cents per liter. These taxes are collected and remitted to the commission by the licensed suppliers.

Sales and Use Tax. The issue of uniformity of sales and use tax laws is a hotly debated topic, as it is reported that over 7,500 state and local units of government currently levy sales taxes. Forty-five states have a sales and use tax in effect (Alaska does not have a state-imposed sales tax, but some local jurisdictions have a local sales tax.) A sales tax of six percent is collected on certain goods and services, including alcoholic liquor, purchased within the state of Michigan and a six percent use tax is levied on those same goods and services purchased outside of Michigan (remote sales), but consumed in the state, for which no sales tax (or a lower sales tax) was paid. About 73 percent of the sales tax and thirty-three percent of the use tax collected in Michigan goes to the School Aid Fund. The use tax in Michigan has been in effect since 1937, and is a complement to the sales tax. Businesses located outside of Michigan but having nexus within the state (a legal standard for determining whether physical presence exists) are required to collect and remit Michigan use tax, but the state cannot require a company that does not have nexus to collect the tax. It then becomes the consumer's responsibility to remit the appropriate use tax to the Michigan Department of Treasury on his or her state income tax form. Purchases made over the Internet or through catalog sales that do not charge Michigan sales tax are also subject to the use tax.

## ***ARGUMENTS:***

### ***For:***

Alcohol, unlike other products available for consumers, needs to be strictly regulated because of the potential for abuse, addictions, and intoxicating effects. The current system of alcohol regulation, in place for 75 years, has served the businesses and residents of the state well. The three-tier system, as it is called, protects against abuse in the delivery of alcohol to consumers by prohibiting, with a few exceptions, a business to be involved in more than one aspect. A business can manufacture, sell and deliver to retailers, or sell at retail to consumers.

Without swift passage and enactment of the bill, Michigan's three-tier system would be at risk of being dismantled and current licensees would be disadvantaged economically if they had to compete with large out-of-state Internet or mail order alcohol companies.

Without the bill, and if the plaintiffs in the current court case prevail on appeal, any business selling wine could sell directly to Michigan consumers. There would be no oversight by state regulators regarding quality, compliance with labeling laws, adherence to the prohibition on selling to minors, and no way to collect sales taxes, use taxes, and various excise taxes which generate more than \$200 million a year in revenue. If another law suit were filed, based on the same arguments of unfair trade practices between in-state and out-of-state retail sales involving beer and spirits, the situation would worsen.

Currently, there is no mechanism in place to license out-of-state retailers and to collect the appropriate sales, use, and/or excise tax on sales originating from out-of-state retailers. For instance, some of the taxes are not collected or remitted to the state by retailers, but by wholesalers. Since allowing direct delivery by out-of-state retailers would circumvent wholesalers, the state would lose untold amounts of revenue at a time when the state still suffers ongoing budget shortfalls. In addition, with only 44 enforcement officers, the Liquor Control Commission would be unable to enforce provisions of the liquor code that would apply to out-of-state retailers.

Passage and enactment of the bill, on the other hand, would give time for the case to be litigated and for the commission and lawmakers to examine the issue and see if a regulatory structure could be developed and implemented that would give equal treatment to in-state and out-of-state retailers, yet still protect the public from unscrupulous business owners, and that would create a mechanism by which to collect appropriate taxes. In the meantime, the bill would protect the three-tier system, ensure that laws prohibiting sales to minors are adhered to,

***Against:***

Many Michigan businesses with off-premises licenses rely on phone, Internet, or catalog sales and deliveries of alcohol to consumers. In addition, some restaurants that do catering and have a specially designated merchant (SDM) license rely on supplying beer and wine to off-premises catered events. The bill would end these practices and so could seriously affect a business' ability to stay afloat in a troubled economy. Lawmakers were able to develop a workable system by which both in-state and out-of-state wineries could ship their products directly to consumers, with all applicable taxes being collected. It would seem, therefore, that a system fair to both in-state and out-of-state retailers, that allowed for the collection of taxes by out-of-state retailers and enforcement of various liquor code regulations, would be possible.

***Response:***

A restaurant that catered off-premises events could still supply the alcohol, but someone involved in the event would have to arrange for pick up. As to retailers who currently ship alcohol products to in-state residents, other arrangements would need to be worked out until such time as regulations that would treat in-state and out-of-state retailers the same could be developed and implemented. However, not enacting the bill could also negatively affect in-state retailers by opening up competition with out-of-state companies

that would not be paying license fees, collecting and remitting taxes, or complying with other liquor code regulations.

***Against:***

The bill is unfair to wine and liquor connoisseurs who cannot find local outlets that carry the products they seek. For instance, beer and wine retailers can only offer the products that wholesalers in their geographic area carry. Most wholesalers do not carry products from small manufacturers. Therefore, the only way a Michigan consumer can obtain some products is by ordering direct from an out-of-state retail company.

***POSITIONS:***

The Michigan Liquor Control Commission supports the bill. (11-13-08)

The Michigan Beer and Wine Wholesalers Association supports the bill. (11-13-08)

The Michigan Restaurant Association opposes the bill. (11-13-08)

Legislative Analyst: Susan Stutzky  
Fiscal Analyst: Mark Wolf

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.