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## Wine Sales Thrive As Old Barriers Start to Crumble

 By VANESSA O'CONNELL  
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The business of wine is breaking free of one of the world's most archaic and tangled retail systems. That and an explosion of new ways to buy wine.

One of wine's new winners is Gary Vaynerchuk, a 30-year-old Belarus immigrant who recently dipped, inhaled deeply, and stared into a videocamera. "Bell pepper, green pepper, red pepper," he declared. "



Gary Vaynerchuk

That observation helped ring up sales of 194 cases of 2003 Nobeia Chinon Red Wine Library in Springfield, N.J. It used to be a small store in a New York City neighborhood. It is now the highest-grossing independently owned wine and liquor retailers in the nation, having been launched in 1997 and buoyed by Mr. Vaynerchuk's folksy online reviews -- grape

The market is in upheaval because its many barriers are starting to crumble. Reform is forcing retailers to buy through wholesalers at pre-established prices. Several are now buying wine directly from out-of-state producers and retailers.

At the same time, giant players like **Costco Wholesale Corp.** -- today the biggest -- are pushing reforms that would largely eliminate the industry's powerful middlemen.

**VENDING VINTAGES**


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Vanessa O'Connell talks<sup>2</sup> with Gary Vaynerchuk about the business of selling wine today.

The changing landscape is helping wine sales. At Costco Stores Inc., shoppers can buy Chardonnay for \$10 a bottle. Most stores carry wine, compared to 280 liquor stores. Wine is outpacing that of beer and liquor, accounting for \$7 billion on table wine at food, drug and liquor stores they spent the previous year.

For decades, wine and liquor marketers have been restrained by the 21st Amendment, which ended Prohibition to control sales of alcoholic beverages. Fearful that a single player might dominate alcohol sales as a result of a new marketing system.

**Power of the Wholesalers**

By law, producers could sell alcohol only to state-licensed wholesalers. Wholesalers then sold products to consumers. Until recently, the three-tier system -- with its patchwork of state regulations -- made it difficult to sell in Missouri, even had laws in place setting a minimum wholesale price for wine and liquor sold in the state.

mandated minimum markups of 10% or more, or were required to sell each wine to all retailers in a st

Retailers grew dependent on wholesalers -- some larger than the companies whose products they sell. Inc. is the market leader, with roughly \$7 billion in annual revenue, according to the research firm **Imj Constellation Brands Inc.**, by comparison, has roughly \$3.2 billion in annual wine sales.

Wholesalers only carry certain brands in a particular market, so stores must often go to dozens of then wholesaler does business in every state, national chains might have to deal with more than 450 differe



The snarl of rules explains why no retailer has emerged to carv with coffee, Victoria's Secret with lingerie or Home Depot with

Over the past several years, a spate of mergers in the wine busi anxious to maintain their bargaining power. Giant companies li fought state-mandated controls on wholesale prices and some o

### First Big Challenge

The first major challenge to the old system came in the late 199 California and elsewhere. Eager to ship wine to customers in in campaigns against laws barring interstate wine sales in Indiana.

Their efforts culminated in a major victory last year, when the shipments to consumers from wineries both in and out of state sanctioned interstate sales, it left it up to each state to permit th producers, which are fewer in number than wineries and whose across the U.S.

Today, 34 states let consumers order direct from out-of-state w shipments, thanks to lobbying in the 1980s and 1990s in those :

Big retailers such as Costco, Target and **Wal-Mart Stores Inc.** are now pushing for change too, eyein found that at its new, upscale store in Plano, Texas -- where the median household income is nearly tv section generates more sales per square foot than dairy products.

Costco mounted a federal court challenge to the three-tier system in Washington state's U.S. district ct Marsha Pechman issued a sweeping ruling, calling state wine and liquor regulations "plainly anticompe

### Advice to Lawmakers

Judge Pechman not only struck down state pricing controls but also, earlier in the case, she prompted enacted new legislation allowing out-of-state wineries and brewers to ship their products directly to W

If the court's rulings ultimately are upheld on appeal and applied broadly, they could drive wine prices clubs and other wine discounters could benefit the most because they compete ferociously on price. C for deals on fine wines, especially from France.

Washington's alcohol control board and wholesalers have filed separate appeals. Wholesalers say they retailers and helping smaller stores compete.

Costco is "trying to change the system so they can apply direct pressure on suppliers without wholesaler for Wine and Spirits Wholesalers of America. "The regulations challenged by Costco -- such as uniform intended to prevent big retailers from having advantages over the mom and pops, who lack the resour

John Sullivan, associate general counsel for Costco, says its suit is about "bringing competition to the subject to the same competition as every other facet of business." He says Costco is not trying to do a that wholesalers should have a special protection from competition just because of the things that hap

In the months since the ruling, Costco has begun trying to get out-of-state wine and beer suppliers to s our best," Mr. Sullivan says. "The current system has some inertia and there's great resistance" from w

"Everybody wants to see how this plays out," says Mike Martin, a spokesman for Constellation Brand

Last year's Supreme Court decision regarding interstate trade applied to wineries, not retailers. But stc wine stores, wanting to directly ship bottles to consumers nationwide, have begun mounting their own

Earlier this year, for instance, California-based Wine Country Gift Baskets.com, K&L Wine Merchan stores in an alliance to change the rules. The group hired Northern California wineries' legal counsel - W. Starr of Kirkland & Ellis -- to help them challenge bans on out-of-state retail orders in states such suspend enforcement of its ban.

Amid the gradual erosion of rigid rules, other marketers are rushing into the business of selling wine. floor displays to unusual packaging -- to lure consumers. The players include startups such WineStyle which popped up in 17 states in the past two years. It focuses largely in states with less-restrictive win California and Minnesota.

As retailers gain clout, more sellers are similarly threatening the role of wholesalers by selling their ov under, these store brands are at least twice as profitable to retailers as other wine. Most retailers don't shoppers generally can't tell the difference, and don't seem to care.

At Cost Plus Inc.'s World Market, a home-textiles chain that is also one the largest wine sellers in the Chilean merlot, and Timbuktu Big Block Red, a South Australian blend -- just as if they were any oth

### **Cheaper Products**

Wine shoppers are romping through a new world of choices. Ruthann Stambaugh of Deltona, Fla., say from around the world, some of which she purchased from Wal-Mart's Sam's Club, where prices on sc wine merchants.

Mr. Vaynerchuk, the director of operations at the Wine Library, started the store's Web site nearly a d take orders for pick-up. Some states allowed shipping from his store but he didn't bother untangling th

Over the years, he started keeping track of states that allowed direct delivery. He pounces with each n had begun allowing shipments from out-of-state retailers, Mr. Vaynerchuk quickly removed the state sent out email notices to the hundreds of Texans who had previously sent his store email inquiries.

His video tastings appear online almost every day, and they sell wine. Even a \$60 old-growth Tuscan sales rise by 5%.

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## Sour Grapes

Wineries and wine retailers are fighting state restrictions on direct shipments to consumers.

**For wineries, fewer restrictions**

Since a Supreme Court ruling last year, the number of states in which residents can receive direct shipments from out-of-state wineries has risen by eight, to 34.

**For wine retailers, tough limits remain**

Retailers have begun to mount their own case against state restrictions. In May, a court order in Texas suspended a ban on out-of-state shipments.

**Legend:**

- Vt.
- N.H.
- R.I.
- Conn.
- N.J.
- Del.
- Md.

Note: Massachusetts, Indiana and Kentucky have passed but not yet fully implemented laws allowing out-of-state winery shipments.

\* Residents in orange-colored states can only get retail wine shipments from other orange states.

- Allows out-of-state entities to ship directly to residents, with some exceptions.
- Allows shipments from out-of-state entities, so long as those states also allow out-of-state shipments\*
- Prohibits out-of-state shipments, with some exceptions

Sources: Wine Institute; Specialty Wine Retailers Association

URL for th  
<http://online>

Hyperlinks  
(1) [http://orqW7GfptE!  
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