



The Honorable Hank Bauer
Chairman
North Carolina Alcoholic Beverage Control Commission
400 E Tryon Rd, Raleigh, NC 27610

Dear Chairman Bauer:

On behalf of thousands of licensed permittees, the North Carolina Retail Merchants Association (NCRMA), the North Carolina Restaurant and Lodging Association (NCRLA), the North Carolina Independent Wine Retailers Association (NCIWRA), the North Carolina Petroleum and Convenience Marketers Association (NCPCM), the North Carolina Craft Brewers Guild (Guild) and the North Carolina Bar Owners Association (NCBOA) respectfully request the North Carolina Alcoholic Beverage Control Commission (NC ABC Commission) halt the implementation, by Empire Distributors, Inc. (Empire) of a case break fee (split case fee) on wine until the implications of this split case fee are fully understood. Should the NC ABC Commission believe split case fees should be the proper public policy for North Carolina, then we encourage the NC ABC Commission to proceed with rule-making pursuant to Chapter 150B of the North Carolina General Statutes.

We understand Empire's basis for the authority for Empire and other wine wholesalers to charge a split case fee on wine is one many disagree with in principle and legally. We believe this decision may have been reached without full understanding and consideration of how this legal opinion would disrupt the marketplace for ABC permittees and customers throughout North Carolina. The authority to charge this split case fee is far from clear and the undersigned parties are confident the split case fee on wine will 1) disrupt how wine is sold in North Carolina by retailers, restaurants, bars, taprooms, breweries and wineries alike 2) increase prices and lower product choice for consumers, and 3) severely tilt the power of the three-tier system squarely towards the wholesale tier. There is no clear statutory authorization by the North Carolina General Assembly for wholesalers to charge a split case fee. Therefore, Empire should not be allowed to proceed with charging a split case fee on wine. Instead, we request a careful review by the NC ABC Commission that includes stakeholders from the three tiers."

In addition to the extreme cost and disruption to North Carolina's wine market described above, the manner in which Empire is implementing this split case fee creates an administrative nightmare for many businesses. In an ill-conceived attempt to sidestep North Carolina's prohibition on quantity discounts, Empire's version of a split case fee has been created in such a manner that many retailers' and restaurants' account payable systems cannot process this new split case fee without timely and expensive information technology infrastructure changes. While Empire has a large market share in the distribution of popular brands of wine including Kendall Jackson, LaCrema, Chateau St Michelle, Sutter Home and 19 Crimes to name a few, this change will force many businesses to operate on two different payment systems depending on the market.

All of this begs the question - if Empire has experienced increased labor costs, (like every other business in North Carolina) why not slightly raise the price of all their products to offset these costs? This would be legal, not pick winners and losers in the wine marketplace, and not create administrative burdens for the customers of Empire. This was exactly what Johnson Brothers eventually decided to do when it also went down the ill-conceived road of split case fees in 2019. More recently, rather than imposing an illegal split case fee, both Grapevine Distributors and Winebow Distributors have announced increases in their price per every bottle in an effort to legally offset their increased shipping and labor costs and manage inflation.

If the NC ABC Commission feels strongly about the wholesaler's ability and authority to charge a split case fee, we strongly encourage the NC ABC Commission to convene a task force, as was done a few years ago with the issue of the delivery of alcohol, or proceed to administrative rule-making to allow for public input on whether a split case fee is good public policy, including the determination of whether a split case fee would have a substantial economic impact under N.C.G.S. 150B-21.4. Such an important policy decision can wait until one of these two actions occurs.

In the event the NC ABC Commission decides not to stop Empire from charging the split case fee on wine beginning January 1, 2023, retailers and restaurants will have to make a business choice to 1) purchase wine by the case to avoid the split case fee – which is a quantity discount specifically prohibited by North Carolina law – and eliminate numerous other brands of wine it offers or 2) purchase wine by amounts less than a case and pay the \$0.36 per bottle split case fee that will then likely get passed along as a higher price to North Carolina consumers. With wine continuing to lose market-share to malt-beverages and spirits, this seems to only make wine even less competitive in the marketplace for ABC permittees selling to consumers.

If retailers decide to purchase wine by the case to avoid the split case fee, the retailer will have to eliminate other brands of wine because their shelves are generally only able to accommodate three bottles per row. By purchasing by the case and avoiding the split case fee, the retailer would be forced to eliminate two brands of wine for every three rows of wine in order to place the entire case of wine on the shelf, meaning less choice of wine for customers. Similarly, many restaurants, bars and wine shops simply do not have the storage space to buy wine by the case. It would also mean a retailer or restaurant would be less willing to stock a brand of wine because they would lose the ability to buy a couple of bottles to determine how it sells due to the higher price point caused by the split case fee. This will be damaging to the smaller brands of wine including many wines produced by North Carolina's wineries.

Because retailers and restaurants would be economically forced to buy wine by the case, which must be paid for at the time of delivery, they will have less available cash to offer additional brands to their customers. Additionally, due to the elimination of brands of wine from the shelf and the inability to return the wine to the wholesaler under North Carolina law, the retailer would have to remove the eliminated brands from the shelves and "fire-sell" these brands at a significant discount to try and recover some small portion of their investment in the product. This will also have a negative impact on customer's perspective of certain wines.

With expensive wines, a restaurant or a small wine shop may only order a half-case of the wine because they must pay for the wine up front and cannot return it to the wholesaler if it does not sell. Buying in these smaller amounts at the same price per bottle allows for better cash flow and much better customer selection. For some retailers, buying wine in less than a case also allows them to better serve their customers with greater variety, but the split case fee will make it that much more difficult to compete against companies like Wine.com and other out-of-state retailers who ship wine into North Carolina every day and will be able to avoid paying Empire's split case fees.

Retailers and restaurants are already at a disadvantage when purchasing from wholesalers because they must pay cash for the product at the time of delivery. Unlike every other product they purchase to operate their business, retailers and restaurants pay for wine and beer upfront at the time of delivery and are offered no payment terms from the wholesalers even though wholesalers themselves often get payment terms from

wineries and breweries. Because consignment sales are prohibited by North Carolina law, wine or beer that goes unsold or is damaged is the sole responsibility of the retailer or restaurant and cannot be returned to the wholesaler. "Additionally, quantity discounts are expressly prohibited by North Carolina law. By Empire proposing this split case fee for wine, which is clearly and unequivocally a quantity discount, it seeks to create a further imbalance where the retailer or restaurant gets no benefit from buying in quantity except when it is beneficial to the wholesale tier."

If this scenario occurred with every other product or service they sell, retailers and restaurants would simply seek out another vendor of the product. However, in this case, retailers and restaurants cannot pass along the split case fee to customers nor can they choose not to do business with Empire for the simple reason that North Carolina law prevents retailers and restaurants from purchasing Empire's popular brands which also include Kendall Jackson, LaCrema, Chateau St Michelle, Sutter Home and 19 Crimes in a large portion of North Carolina. Quite simply, the retailer and restaurant have no choice but to buy from Empire and are being economically coerced to buy more product by the business practices of the wholesaler. The exclusive franchise rights of a wine wholesaler comes with responsibility to service the permittees in their franchise area and in this case it should come without charging permittees a fee for what should be provided in the normal course of business, especially in light of the fact that the wholesaler gets paid at the time of delivery and the permittee cannot return the product.

It should also be noted that located within Article 12 of Chapter 18B entitled "Wine Distribution Agreements," granting wine wholesalers exclusive and monopolistic franchise rights to certain brands of wine are service requirements for wholesalers to comply with as a balance to these franchise rights. N.C.G.S. 18B-1203 entitled "Primary area of responsibility; no discrimination. N.C.G.S. 18B-1203(b) states: "A wholesaler shall service retail permit holders within its designated territory without discrimination." Since the term "service" is not defined within Chapter 18B of the North Carolina General Statutes, nor has the NC ABC Commission defined the term "service" through administrative rule-making, we turn to *Merriman-Webster* for the plain meaning of the term. As a transitive verb the term "service" means "to perform any of the business functions auxiliary to production or distribution of". Utilizing the *Merriman-Webster* plain language of the term "service" it is abundantly clear that removing a bottle of wine from a box at the request of a paying customer is a business function auxiliary to distribution of wine by a wine wholesaler such as Empire.

BACKGROUND

In 2005, the NC ABC Commission, at the request of Windam Wine Distributors, a Gallo wholesaler from Wilmington, approved a policy that required wholesalers to charge a split case fee due to the splitting of a case of wine being a "thing of value". The NC ABC Commission approved this policy change despite the item not appearing on the NC ABC Commission Agenda and without going through Administrative Rule Making as required by Chapter 150B of the North Carolina General Statutes. Soon after the NC ABC Commission approved this policy change requiring a split case fee on wine, the North Carolina General Assembly took quick action to halt the split case fee. The North Carolina General Assembly acted by amending N.C.G.S. 18B-1116 adding a new subsection (c) to clarify that splitting a case of wine was "not a thing of value" thereby negating the split case fee. Specifically, the language read: "As used in this section, the phrase 'giving things of value' shall not include the dividing or removing of individual containers of alcohol from larger packages of alcohol or the delivery of such to the retail permittee." For fourteen years the retail/restaurant tier believed the split case fee to be a non-issue due to the action in 2005 by the North Carolina General Assembly. As previously mentioned, in 2019 Johnson Brothers also announced the imposition of a split case fee due to labor costs but eventually decided to slightly increase the price of all of its products.

LEGAL ANALYSIS

As stated above, it is the belief of the undersigned that the split case fee Empire seeks to impose is clearly in violation of North Carolina law. It is our understanding the opinion of Empire – and maybe other wine

wholesalers – is while wholesalers are not required to charge the split case fee, wholesalers do have the authority to voluntarily charge the split case fee to retail and restaurant permittees. It is also our understanding Empire may have arrived at this legal conclusion erroneously because the amendment to N.C.G.S. 18B-1116, passed by the North Carolina General Assembly in 2005 in reaction to the NC ABC Commission requiring wholesalers to charge a split case fee, prevented the NC ABC Commission from setting that requirement but it did not specifically prevent a wholesaler from voluntarily charging a split fee. However, N.C.G.S. 18B-100 clearly states, “This Chapter shall be liberally construed to the end that the sale, purchase, transportation, manufacturer, consumption, and possession of alcoholic beverages shall be prohibited except as authorized in this Chapter.” Nowhere in Chapter 18B of the North Carolina General Statutes is a split case fee authorized. While it can be argued the North Carolina General Assembly prohibited the NC ABC Commission from requiring wholesalers to charge the split-case fee on wine through its amendment to N.C.G.S. 18B-1116, but left open the ability of a wholesaler to voluntarily charge a split case fee, it is more on point that the North Carolina General Assembly did not expressly provide statutory authority to a wholesaler to charge a retailer or restaurant a split case fee on wine as required in N.C.G.S. 18B-100.

Additionally, the NC ABC Commission, for decades, has gone through the Administrative Procedures Act rule-making process to authorize and adopt various administrative rules regulating the sale of alcohol and industry relations between tiers. For example, the NC ABC Commission Legal Staff is currently reviewing the NC ABC Commission rules around advertising. The NC ABC Commission administrative rules are now contained in Chapter 14B of the North Carolina Administrative Code. Included in administrative rules adopted by the NC ABC Commission is 14B NCAC 15C.0710 “Accepted Trade Practices, Services” that includes services that may be provided by a wholesaler to a permittee including cleaning of coils and shelf schematics. However, there is no mention of split case fees in 14B NCAC 15C.0710 or mention or authorization in the entire Chapter 14B of the North Carolina Administrative Code of, or for, a wholesaler to charge split case fees on wine. There is no specific statutory or administrative authority for a split case fee on wine to be charged by a wholesaler in North Carolina law which runs contrary to N.C.G.S. 18B-100.

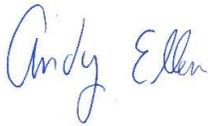
Unlike Alabama, Georgia and South Carolina which allow for split case fees and quantity discounts, North Carolina law clearly and specifically prohibits a wholesaler from providing a quantity discount. 14B NCAC 15C.0704 specifically states: “No wholesaler or his employee shall give any retailer a quantity discount on the price of malt beverages or wine, nor shall a retailer require a wholesaler to provide these quantity discounts.” The prohibition against quantity discounts has been the policy of the State of North Carolina for over 40 years as it was adopted by the North Carolina ABC Commission through administrative rulemaking in 1982 and subsequently amended in 1984. Regardless of what Empire calls the split case fee or case break fee, or if they apply the split case per bottle or per box, one thing is absolutely true and indisputable – if Empire is permitted to charge a split case fee and a retail or restaurant permittee buys an entire case of wine, the retailer or restaurant permittee pays less per bottle of wine than if the retailer or restaurant buys less than a case of wine. This is simply and unequivocally a quantity discount the NC ABC Commission would be allowing Empire to give the retailer and restaurant in order to buy Empire’s products; but conversely if a retailer or restaurant required Empire to provide them a quantity discount it would be assumed this would be in violation of 14A “Quantity Discounts.” North Carolina has always been a “bottle one” pricing state that resulted in equal purchasing power for every size ABC Permittee and Empire’s proposed imposition of the split case fee runs completely contrary to the NC ABC Commission’s long-standing policy against quantity discounts clearly stated in 14B NCAC 15C.0704

Because there is such a divergent view as to the legal authority for Empire to impose the split case fee in North Carolina and the detrimental ramifications the split case fee would have in the marketplace for consumers, retailers and restaurants, we strongly encourage the NC ABC Commission to bring the three tiers together in a task force to discuss these issues. Alternatively, if the NC ABC Commission strongly believes a split case fee to be proper public policy, then the NC ABC Commission should initiate proper rulemaking under Chapter 150B of the North Carolina General Statutes. These would be the appropriate pathways for a discussion of this issue

rather than allowing Empire to proceed with implementation of a split case fee and run roughshod over G.S. 18B-100 and North Carolina's forty-year prohibition against quantity discounts.

It has been a difficult thirty months for retailers and restaurants alike due to COVID, as well as labor and supply chain issues and many are just trying to hang-on while trying to manage cash-flow issues. The retail and restaurant tiers have been forced to increase prices across many items throughout their businesses as inflation and labor issues soar. If wholesalers are feeling the same pressures, they should take the same action Johnson Brothers took three years ago and simply increase their prices across the board in compliance with North Carolina's law. There are three-tiers in North Carolina's alcohol beverage system and there should easily be enough room and opportunity for all three-tiers to grow and prosper. Unfortunately, allowing Empire, or any other wholesaler, to charge a split-case fee without clear statutory authority further slants the playing field away from the manufacturing and retail and restaurant tiers sharply towards the wholesaler tier.

Respectfully,



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Gary Harris
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North Carolina Petroleum and Convenience
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Lynn Minges
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Jason Ruth
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cc: The Honorable Tim Moffitt, Chair, North Carolina House of Representatives Committee on Alcoholic Beverage Control
The Honorable Chuck Edwards, Chair, North Carolina Senate Committee on Commerce and Insurance
The Honorable Todd Johnson, Chair, North Carolina Senate Committee on Commerce and Insurance
The Honorable Tom McInnis, Chair, North Carolina Senate Committee on Commerce and Insurance