

DTC FOR NEW YORK WINERIES:

A GUIDE TO USING PHONE, FAX, AND INTERNET ORDERS TO MAXIMIZE PROFIT



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At Tracy Jong Law Firm, we help entrepreneurs in the New York food and beverage industry (restaurants, franchises, wineries, bars, nightclubs, bed and breakfasts, country clubs, microbreweries, microdistilleries, liquor stores, catering establishments, and alcohol retail markets). Our clients need an attorney familiar with the regulatory environment and business practices in their industry. We help you review a potential transaction, identify potential pitfalls and mitigate your risks. We help you draft, review and negotiate agreements and obtain permits and licenses necessary to operate your business. We educate you on how to comply with the law and avoid violations, and help you respond if you receive a violation notice. When you are ready to expand or sell, we help you navigate the process to maximize the return on your investment. Our experience in this area is very broad, so we can swiftly address any of our clients' needs.

Whether you are a start-up establishment, entrepreneur with a dream or a successful business dealing with a business issue or planning for growth, you should consider talking with our experienced legal team. We can help you to keep your business running smoothly, and guide you as you plan for growth.

WE WORK TOGETHER FOR YOUR SUCCESS

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Whatever your needs, we work closely with you, focused on your objectives in each situation, keeping you informed of our activities and inviting your participation throughout the process. Our goal is to offer outstanding value through speed and customer service. Our firm turns most projects around in 5 to 10 business days. When expedited processing is necessary, our teams are flexible and can accommodate even same day service in certain cases. While we work quickly to meet your needs, we still take the time to do a thorough and comprehensive job—offering speedy service without compromising quality.

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PHONE/INTERNET/FAX ORDERS (OFF-SITE) SHIPPED DIRECT TO CONSUMER (DTC)

Who is making money in DTC Sales?

ShipCompliant is an online service that assists wineries in complying with shipping from state to state. It found that 74 percent of the \$1.35 billion of wine shipped direct to consumers in the U.S. came from wineries producing 50,000 cases a year or less. Direct to consumer (“DTC”) sales by shipping is a viable distribution means for small wineries that have trouble getting distribution through more conventional channels. Thus, this is an important and profitable avenue for New York wineries that should not be ignored. DTC sales offer much greater profit margins than the three-tiered system of wholesale distributors and retailers.

New York wineries fall way behind when compared to California wineries in DTC shipment sales. California wineries account for 83% while the rest of the U.S. combined accounts for only 17% of national DTC shipment of wine sales.

ShipCompliant and Wines and Vines Magazine have collaborated on data collection and the study of shipped (not carryout) wines in the national DTC sector. The information is valuable to any winery making decisions about a DTC program. Smaller wineries have especially flourished with DTC shipping programs. The 2012 report by ShipCompliant attributes the growth in winery shipping DTC to several factors: increased wine consumption and interest by U.S. consumers, Baby Boomers reaching peak earning years, the emergence of the internet and social media, an increase in the number of U.S. wineries, and advancements in the shipping and software industries.

Sales volume of DTC-shipped wine increased by 7.2% over the period August 2011 – July 2012 and the retail value of sales increased by 2.9%. While you might expect people to be looking for online deals, the data shows that the average per bottle price was \$37.85. Notably, this 7.2% increase trend exceeds the retail sales increase of table wine at only 2.9%. DTC shipments account for 8.6% of the total U.S. retail market. However, interestingly, boutique (less than 5,000 cases) wineries experienced a 1.5% drop in DTC shipment sales.

The greatest shipment sales volume, 50%, occurred in just 4 calendar months March – April and October – November. This information on seasonal trends is useful in designing your marketing campaign to see the most bang for your buck. Half of your sales in a short window is a great opportunity to engage in concentrated promotions with real ROI.

Wineries with bottles in the \$20.00-50.00 price range do very well in DTC shipment sales. It is worth noting that consumers who were purchasing lower cost wines were seemingly moving to larger wineries, probably due to price fatigue. In terms of volume, 16% of sales were bottles priced under \$15.00, 14% of sales were bottles priced \$15.00-19.99, and 25% of sales were bottles priced \$30.00-\$49.99.

Which wine varietals sold the most in DTC shipment sales? Three varietals accounted for 59% of sales: Cabernet Sauvignon (26%), Pinot Noir (19%), and Chardonnay (14%). Next were Zinfandel and Syrah. New York DTC sales are strong in the Rieslings, with others including Syrah, Chardonnay and Pinot Noir.

One of every three bottles of DTC wine shipments are to Californians. Based on volume alone, a New York winery should consider obtaining licenses and permits to ship to California and Texas at the very least (D.C and Florida don't require a license). The top 10 states account for 74% of DTC shipments are: DC, California, Colorado, Washington, New Hampshire, Oregon, Virginia, Wyoming, Nevada and Minnesota. These states have consumers that are most likely to purchase DTC, although volumes to other states may be higher (see below).

Deciding Where to Ship

The first issue you will want to contend with is where you want to ship your wines. It is the law of the state where the customer is *receiving* delivery that governs. Each state falls into one of three categories:

1. Okay to ship DTC, no permit required;
2. DTC shipment prohibited, or
3. DTC permitted with appropriate licenses and permits.

Let's look at which states fall in to each category.

Where can I ship direct to consumer (DTC) without a permit?

- Alaska
- DC
- Florida
- Minnesota

Where is internet/fax/phone order direct to consumer (DTC) shipping prohibited?

- Alabama
- Arkansas
- Delaware
- Massachusetts (effectively prohibited because of unworkable permit law)
- Mississippi
- Montana
- Oklahoma
- Pennsylvania
- Rhode Island
- South Dakota
- Utah

Where is a permit required to ship direct to consumer DTC for orders by phone/fax/internet?

- Arizona
- Connecticut
- Idaho
- Iowa
- Louisiana
- Michigan
- Nevada
- New York
- North Dakota
- South Carolina
- Vermont
- West Virginia
- California
- Georgia
- Illinois
- Kansas
- Maine
- Missouri
- New Hampshire
- New Mexico
- Ohio
- Tennessee
- Virginia
- Wisconsin
- Colorado
- Hawaii
- Indiana
- Kentucky
- Maryland
- Nebraska
- New Jersey
- North Carolina
- Oregon
- Texas
- Washington
- Wyoming

It is probably not practical to ship to all states with only a modest volume of sales. Later we will look at the costs of permits in various states and the relative complexity of the permit process in these states. It is important to recognize that direct to consumer sales offer much greater profit margin since you go from a three tier structure (manufacturer – wholesale distributor – retailer) to one tier (just you, the winery). The winery then receives 100% of the purchase price rather than 50% of when your wine wholesaled. Thus, the cost of permits may be much less than the profit share given to distributors and retailers. However, in some situations, it simply may not be cost-effective. You'll need to run the numbers and projections for your winery to make informed decisions.

Which states consume the most wine?

The nation's capital, Washington, D.C. has the highest consumption overall. Politicians and alcohol hmmm... well, a good fact to know, especially since no license is required to sell DTC in D.C. So which states are likely to offer the best promise of sales?

Here are the top 10 states in terms of volume of wine consumed:

- New Hampshire
- Massachusetts
- Vermont
- Nevada
- Connecticut
- Delaware
- New Jersey
- Rhode Island
- California
- Hawaii

Local shipment to consumers in New York State

Vehicles used for transportation or trucking of wine in New York State must be registered and permitted by the New York State Liquor Authority. Additionally, a retail licensee's principals and employees may deliver bottles of wine in their own vehicles with a copy of the retail license in the vehicle and a sign with uniform letters 3.5" or more "New York State Retail License No. _____".

Next, you should consider where licensed shippers will deliver, especially if you have an established account or special rate with one carrier.

Is there anywhere FedEx or UPS will not make deliveries of my direct to consumer (DTC) orders?

FedEx and UPS will not ship DTC orders from internet/phone/fax sales in Kentucky and Massachusetts. In New Jersey, FedEx will not ship DTC orders but UPS will.

Record Keeping Requirements for DTC Shipping

To ensure compliance with various federal and state reporting requirements and quantity limits, if a New York winery wants to ship DTC, detailed records should be maintained:

- Bill To Name
- Bill To Address
- Product Type
- Product Volume
- Product Brand
- TTB ID Number of the Wine
- Purchase Date
- Price
- Invoice Number
- Carrier Name Required
- Local Address of Common Carrier

Wineries should maintain shipment records for at least three years.

A Software Service that helps wineries comply with laws of all states it delivers to

ShipCompliant (ShipCompliant.com) is a service that helps wineries comply with shipping rules from state to state. It is a reliable service that is worth looking into for most wineries. In January

2013, the New York State Liquor Authority will rule on the legality of ShipCompliant pricing structures. It is expected to receive full approval. (Our office filed a letter of support because of the cost-effective service it provides).

Obtaining State Direct Shipper Licenses

Delivery of a shipment in the state is deemed a sale in the state. Before the state regulatory authority may issue a direct shipper's license or permit to an out-of-state winery (manufacturer), in addition to requiring a fee, the authority will often consider one or more of the following:

- The applicant for a direct shipper's license must present proof of receipt of a state sales and/or excise tax registration for collecting and remitting any applicable state sales and excise taxes to that state.
- The applicant must consent to the state's jurisdiction and laws, and to be regulated by the state in compliance and disciplinary matters.
- The out-of-state winery may sell to residential customers only wine that it produces, and only for personal consumption (not retail).
- The state where the winery is located has reciprocal wine DTC regulations for New York wineries to residents in its state.
- The shipping winery must require the prospective purchaser to represent his or her age as 21 years or more, and to represent that the wine being purchased is for personal use and not for resale.
- Shipping containers used to deliver wine must be conspicuously labeled with the words: "Contains Wine – Signature of Person Age 21 or Older Required for Delivery-Not for Resale."

The holder of a direct shipper's license must require the common carrier delivering the wine (i) to verify the identity and age of the recipient by means of photographic identification, (ii) to obtain the signature of the recipient on an "acknowledgment of receipt" form approved by the state, and (iii) to refuse delivery where the prospective recipient unreasonably refuses to present proof of age. Information regarding wine sales to residents may be periodically reported to the state liquor authority. National couriers such as FedEx and UPS have special programs for wine deliveries to comply with all local rules and requirements where they ship.

The holder of an out-of-state direct shipper's license must file tax returns and pay applicable state and local sales taxes and state excise taxes.

What does Federal On-Site mean?

A federal Act includes a provision allowing wine, purchased ("on-site") while visiting a winery, to be shipped to another state. Purchases must be in accordance with state law in that the consumer could have legally carried the same amount of wine back on their person as the winery is now able to ship to the consumer. This does not allow the consumer to join a wine club or to make a purchase to be shipped at a later date. It allows the convenience of shipping home what you could have purchased and brought home in-person.

What is a special shipping label?

A special shipping label marks a package as “Adult Signature Required”. Labels can be obtained from your common carrier. Shipping containers used to deliver wine must be conspicuously labeled with the words (or a substantial equivalent): “Contains Wine – Signature of Person Age 21 or Older Required for Delivery-Not for Resale.”

Quantity Limits for DTC Deliveries

Some states have quantity limits for direct to consumer wine shipments. This may be an issue for wine club shipments, so be sure to create your winery’s club offerings to be in full compliance. State rules change frequently so you will want to verify these limits periodically for states you are shipping to from your winery:

1 Case/mo. - DC, NE;

2 Cases/year – MN, WY;

3 Cases/mo. – ND;

4 Cases/year – LA;

5 Cases/year – NH;

12 Cases/year – NV, WI;

15 Cases/mo. – TX;

24 Cases/year – ID, IN, OH;

36 Cases/year – NY;

No Limits: AZ, CA, CO, CT, FL, MA, MI, NJ, WA

Your website should contain details of your winery’s shipping policy. An example shipping policy appears below:

Wine Shipping Policy:

Due to state laws and regulations we can only ship wine to the following states (list of legal states are subject to change):

| | | | | | | |
|---------------------------|-------------------------|-----------------|--------------------------|---------------------------------|-----------------------|------------------|
| <i>Arizona</i> | <i>California</i> | <i>Colorado</i> | <i>Connecticut</i> | <i>District of Columbia</i> | <i>Florida</i> | <i>Idaho</i> |
| <i>Illinois</i> | <i>Indiana</i> | <i>Iowa</i> | <i>Louisiana</i> | <i>Massachusetts</i> | <i>Michigan</i> | <i>Minnesota</i> |
| <i>Missouri</i> | <i>Nebraska</i> | <i>Nevada</i> | <i>New Hampshire</i> | <i>New Jersey</i> | <i>New Mexico</i> | <i>New York</i> |
| <i>North Carolina</i> | <i>North Dakota</i> | <i>Ohio</i> | <i>Oregon</i> | <i>South Carolina</i> | <i>Texas</i> | <i>Virginia</i> |

Washington West Virginia Wisconsin Wyoming

You must be 21 years of age or older to order. By placing your order with our winery, you certify under penalty of perjury that you and the recipient are at least 21 years old. The willful misrepresentation of your age or the age of the recipient is a crime in most states, and if you willfully misrepresent your age or the age of the recipient our winery will cooperate with authorities to prosecute you to the fullest extent of the law. All deliveries of alcohol will require a signature and ID verification by an adult 21 years or older. Some states have monthly or yearly quantity limits.

Important Shipping Details About Delivery Times:

Due to state laws and regulations, wine delivery shipments will vary. For most orders, please allow 1-2 weeks for delivery. Tracking information will be emailed to you when your order has been processed for shipment.

Excise Taxes

Excise taxes are levied by federal, state and local governments in connection with the sale of certain goods. Excise taxes are collected by the producer or retailer rather than paid directly by the consumer (such as with sales tax). Therefore, in a real way, excise taxes remain "hidden" in the price of a product or service, rather than being listed separately. Alcohol and gasoline are prime examples of products where the governments collect excise taxes.

The 2012 Federal TTB tax rates for wine are listed below.

| Wine | Wine Gallon | 750ml bottle |
|-------------------------|----------------------|--------------|
| 14% Alcohol or Less | \$1.07 ¹ | \$0.21 |
| Over 14 to 21% | \$1.57 ¹ | \$0.31 |
| Over 21 to 24% | \$3.15 ¹ | \$0.62 |
| Naturally Sparkling | \$3.40 | \$0.67 |
| Artificially Carbonated | \$3.30 ¹ | \$0.65 |
| Hard Cider | \$0.226 ¹ | \$0.04 |

(¹ \$0.90 credit, or for hard cider \$0.056, may be available for the first 100,000 gallons removed by a small winery producing not more than 150,000 w.g. per year. Decreasing credit rates for a winery producing up to 250,000 w.g. per year.)

The most frustrating part about these taxes is that they are not uniform throughout the United States (all alcohol sales are controlled by the state). Some states have no tax, while others have rates that exceed the federal excise tax rate. Alaska has the highest excise tax at \$2.50 per gallon. The excise tax rates for wine in various states are listed below. As these tax rates change often, be sure to check the state tax department for the current excise tax rates and the necessary reporting forms and procedures to pay the taxes.

**State Table Wine Excise Tax Rates
(Dollars Per Gallon)**

| State | Tax Rate | State | Tax Rate |
|-------------------|-----------------|----------------|-----------------|
| Alabama | \$1.70 | Montana | \$1.06 |
| Alaska | \$2.50 | Nebraska | \$0.95 |
| Arizona | \$0.84 | Nevada | \$0.70 |
| Arkansas | \$1.39 | New Hampshire | - |
| California | \$0.22 | New Jersey | \$0.88 |
| Colorado | \$0.32 | New Mexico | \$1.70 |
| Connecticut | \$0.72 | New York | \$0.30 |
| Delaware | \$0.97 | North Carolina | \$0.79 |
| Dist. Of Columbia | \$1.63 | North Dakota | \$1.06 |
| Florida | \$2.25 | Ohio | \$0.32 |
| Georgia | \$1.51 | Oklahoma | \$0.72 |
| Hawaii | \$1.38 | Oregon | \$0.67 |
| Idaho | \$0.45 | Pennsylvania | - |
| Illinois | \$1.39 | Rhode Island | \$0.60 |
| Indiana | \$0.47 | South Carolina | \$1.08 |
| Iowa | \$1.75 | South Dakota | \$1.21 |
| Kansas | \$0.30 | Tennessee | \$1.27 |
| Kentucky | \$0.50 | Texas | \$0.20 |
| Louisiana | \$0.11 | Utah | - |
| Maine | \$0.60 | Vermont | \$0.55 |
| Maryland | \$1.40 | Virginia | \$1.51 |
| Massachusetts | \$0.55 | Washington | \$0.88 |
| Michigan | \$0.51 | West Virginia | \$1.00 |
| Minnesota | \$1.21 | Wisconsin | \$0.25 |
| Mississippi | - | Wyoming | - |
| Missouri | \$0.42 | | |

State Sales Tax

The average sales tax rates for wine in various states are listed below. As these tax rates change often, be sure to check the state tax department for the current sales tax rates and the necessary reporting forms and procedures to pay the taxes.

Average Sales Taxes by State

| State | Sales Tax | State | Sales Tax |
|-------------------|------------------|----------------|------------------|
| Alabama | 8.45% | Missouri | 6.55% |
| Alaska | 1.35% | Montana | Nil |
| Arizona | 8.15% | Nebraska | 6.00% |
| Arkansas | 8.35% | Nevada | 7.85% |
| California | 8.20% | New Hampshire | Nil |
| Colorado | 6.10% | New Jersey | 6.95% |
| Connecticut | 6.35% | New Mexico | 6.60% |
| Delaware | Nil | New York | 8.40% |
| Dist. Of Columbia | 6.0% | North Carolina | 6.85% |
| Florida | 6.65% | North Dakota | 5.85% |
| Georgia | 6.95% | Ohio | 6.85% |

| | | | |
|---------------|-------|----------------|-------|
| Hawaii | 4.40% | Oklahoma | 8.30% |
| Idaho | 6.05% | Oregon | Nil |
| Illinois | 8.15% | Pennsylvania | 6.40% |
| Indiana | 7.00% | Rhode Island | 7.00% |
| Iowa | 6.85% | South Carolina | 7.10% |
| Kansas | 8.00% | South Dakota | 5.35% |
| Kentucky | 6.00% | Tennessee | 9.45% |
| Louisiana | 8.75% | Texas | 7.95% |
| Maine | 5.00% | Utah | 6.70% |
| Maryland | 6.00% | Vermont | 6.05% |
| Massachusetts | 6.25% | Virginia | 5.00% |
| Michigan | 6.00% | Washington | 8.90% |
| Minnesota | 7.20% | West Virginia | 6.05% |
| Mississippi | 7.00% | Wisconsin | 5.45% |
| | | Wyoming | 5.15% |

On site sales

Sales that are made in your tasting room or retail shop at the winery itself and shipped home are covered under the Federal Act.

Off-site sales

These are sales where the customer is not physically present at your winery when the purchase is made. These include internet, phone, and fax wine orders for shipment and delivery to the customer's home for personal consumption. How difficult is it in each state to get the permits or licenses necessary for DTC shipments?

The process for obtaining a permit varies by state. The relative complexity of the state processes are compared below:

Difficult to Obtain a Permit

| | | | | |
|----|----|----|----|----|
| CT | GA | HI | IL | IN |
| KS | ME | MI | NY | OH |
| TX | VA | WC | WI | |

Easy to Obtain a Permit

| | | |
|----|----|----|
| CO | NH | WY |
|----|----|----|

Medium Complexity to Obtain a Permit

| | | | | |
|----|----|----|----|----|
| AZ | CA | ID | IA | KY |
| LA | MD | MO | NE | NV |
| NM | NC | ND | OR | PA |
| SC | TN | VT | WA | |

The cost of each state's licenses for DTC sales to its residences also vary from state to state. The costs vary from nothing to as much as \$1,000 just for the government fees. Added to that the cost of an attorney or a consultant to assist, it will be important to evaluate if each state is cost-justified.

State Permit and License Costs

| State | Permit Cost | State | Permit Cost |
|--------------|--------------------|--------------|--------------------|
| AZ | \$340 | CA | \$10 |
| CO | \$50 | CT | \$515 |
| GA | \$50 | HI | Varies by county |
| ID | \$50 | IL | \$150-\$1000 |
| IN | \$100 | IA | \$25 |
| KS | \$186 | KY | \$100 |
| LA | \$150 | ME | \$300 |
| MD | \$200 | MI | \$190 |
| MO | \$0 | NE | \$500 |
| NV | \$50-\$500 | NH | \$100 |
| NM | \$50 | NY | \$125 |
| NC | \$0 | ND | \$50 |
| OH | \$125 | OK | \$0 |
| OR | \$50 | PA | \$0 |
| SC | \$650 | TN | \$450 |
| TX | \$470 | VT | \$300 |
| VA | \$160 | WA | \$120 |
| WV | \$150-\$250 | WI | \$320 |
| WY | \$50 | | |

Label Requirements and Registration

The federal government regulates wine labels through the Alcohol and Tobacco Tax and Trade Bureau (the "TTB"). The TTB has adopted a number of regulations that govern the information that labels must, and should not, include.

Most states also regulate wine labels. In general, most states adopt the federal standards, or require federal approval as a prerequisite for state approval. California, for example, only requires that the label receive federal approval; there are no additional state requirements. Other states have their own wine label requirements, which are more restrictive than the federal requirements. Oregon is one of these states. Some states have regulations that restate and emphasize the basic federal requirement that wine labels may not create any erroneous impressions about the wine. Each state's requirements are different and should be thoroughly reviewed to ensure compliance.

Many states also require some sort of additional registration of a brand or label, and/or pricing, with the state alcohol agency. This registration generally identifies the brand owner and any national or state agents for distribution.

The good news is that recent changes to alcohol label laws at the TTB have eased some of the burdens on wineries with respect to label approvals. Wineries can now make minor modifications to TTB approved labels without requiring a new COLA. It is now possible for wineries to add, delete or change awards and medals. Wineries may also reposition any label information (including text, illustrations, graphics, etc.). This allows wineries to move things around to refresh or improve a label, as long as the legal mandatory information is still on the correct label, as well as allowing the winery to make minor corrections to spelling and punctuation that do not change the meaning. Another great new rule - it allows wineries to add, delete or change holiday and/or seasonally themed graphics, artwork and or salutations. Wineries can legally offer customized bottles to private or corporate clients for weddings, birthdays or promotional events. Wineries can also add, delete or change trademark or copyright symbols, kosher symbols, company logos, QR codes and/or social media icons. Wineries can now add, change or delete a vintage date or bottling date, production date (day, month and/or year) or freshness information including bottling, production or expiration dates or codes.

Experience by Other Wineries

Many wineries report that it is challenging to move significant quantities of wine one bottle at a time. Significant infrastructure is often required. Artisanal, low-production wines with a unique story will get lost in the giant “book” of the national and (some) regional distributors. There are challenges for wineries seeking a national consumer distribution because some states are non-reciprocating for DTC wine shipments and about 20% of states don’t allow DTC shipping of wine. 62% of wineries reported recently that DTC is the fastest growing sales channel, but it has not been a game changer. It is estimated that DTC sales account for 10% - 20% for small wineries.

The truth is that the “gross margin” to the winery is substantially greater for DTC sales. But, you have to advertise or solicit the DTC buyer; you maintain communication with the DTC customer; you provide “free” benefits to club members; you pay part (or all) of the cost of packaging and shipping; you own or rent a tasting room and you employ servers, retailers and maintenance staff as well as order fulfillment employees; and, you have a new bookkeeping project to license and pay taxes in any state where you sell direct.

DTC sales allow the winery to build its sales base in a linear fashion (albeit from zero!) and to meet all of its customers in person, and of course retain 100% of the sale price. It also allows the winery to spend more on its product (as necessary), than the 50% of retail (FOB) that it would get in the three tiered system, and eliminates the worry about getting paid from an out-of-state distributor. DTC sales are prepaid in most cases. Channel management is simplified and the winery will have a way to be reconnected with its customer base, since you will virtually meet them all! It’s a slower pace for sure, but a steady one. It is definitely an avenue worth investigating to grow your winery sales and your national presence.