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Chief, Regulations & Procedures Division
Attn: No. 4
Alcohol & Tobacco Tax & Trade Bureau
P.O. Box 50221
Washington, D. C. 20091

Dear Sir or Madam:

The Food Marketing Institute (FMI) respectfully submits the following formal comments in response to regulations that are being proposed by the Department of Treasury and its Alcohol and Tobacco Tax and Trade Bureau (TTB) that would affect the production, taxation, composition, labeling and advertising of alcohol beverages marketed as “flavored malt beverages”.

By way of background, FMI is a non-profit association that conducts programs in research, education, industry relations and public affairs on behalf of its 2,300 members and their subsidiaries. Our membership includes food retailers and wholesalers, as well as their customers, in the United States and around the world. FMI’s domestic member companies operate approximately 26,000 retail food stores with a combined annual sales volume of \$340 billion, which represents three-quarters of all grocery store sales in the United States.

In terms of FMI’s interest in this regulatory proceeding, a typical supermarket in today’s competitive marketplace offers over 30,000 items or SKUs for sale to consumers. In particular, beverage sales which encompass soft drinks, bottled water, and alcoholic beverages are an extremely important and robust product category for the grocery store industry. According to the most recent statistics for the year 2002, alcoholic beverage sales in supermarkets remain strong, representing approximately 3.4 percent of total store sales, and that the beer category which includes ale, malt liquor, malt beverage, stouts and porter, generates some \$12.5 billion in sales. Information Resources Inc. reports that flavored malt beverage sales are now outpacing overall beer sales, and this category’s dollar sales were up 40.9 percent through the first nine months of 2002 compared to the same nine month period in 2001. The target audience for flavored malt beverages are consumers, ages 21 to 27, who may not like beer and want to try new drink products.

One of the more critical issues raised in the TTB’s proposed rulemaking is whether certain products currently marketed as flavored malt beverages should be

classified as malt beverages or distilled spirits under the Federal Alcohol Administration Act. Although flavored malt beverages have roughly the same alcohol content as beer, the TTB contends that these products should be classified as distilled spirits because the majority of the alcohol in many flavored malt beverages is derived from distilled spirits and not from the brewing process. While FMI does not dispute the fact that added flavoring from a neutral alcohol base provides the majority of a flavored malt beverage's alcohol content, we wish to point out that the federal government has allowed the use of flavors containing alcohol without limitation for more than two decades. As a result, consumers now have a wide range of choices and flavors to select from based upon this long-standing federal standard. Therefore, it is our position that it would be unfair to eliminate this standard for those companies that make flavored malt beverages and the growing number of consumers who purchases these products.

Additionally, it is FMI's overriding concern that if flavored malt beverages are required to be labeled as distilled spirits as suggested in the TTB proposed rulemaking, these products would not be permitted to be sold in many supermarkets in those jurisdictions where the law allows only beer and/or wine sales in a grocery store setting. As such, if grocery stores were precluded from selling flavored malt beverages, customers will be inconvenienced and would have to go to either a liquor store or ABC store to make their purchases. Thus, FMI strongly objects to having flavored malt beverages labeled as distilled spirits.

Along these same lines, FMI would further object to subjecting flavored malt beverages to a higher tax rate that is applicable to distilled spirits. As we previously stated in our comments, flavored malt beverages have about the same alcohol content as regular beers, and should be taxed at the same rate as beer regardless of the fact that a certain percentage of the alcohol in flavored malt beverages is derived from distilled spirits and not from the brewing process. Thus, it is our industry's position that products should be taxed according to their alcohol content and not based on artificial distinctions, relating to labeling nomenclature, brewing process or added flavorings. This would clearly be a more equitable tax policy for this beverage category and for adult consumers who purchase these types of products.

The TTB's rulemaking further proposes to require mandatory alcohol content labeling for any malt beverage that contains alcohol from a source other than from fermentation at a brewery. The Department proposal argues for the need for such labeling disclosures on the grounds that consumers have limited experience with flavored malt beverages, and that consumers are likely to be confused as to their actual alcohol content due to their label appearance and the use of brand-names of well-known distilled spirits.

To the extent that flavored malt beverages have been marketed for more than 20 years, FMI would disagree with the TTB's contention that consumers are unfamiliar with this product category. Instead, the supermarket industry believes adult consumers are both knowledgeable about flavored malt beverages and fully understand that they have a much lower alcohol content than distilled spirits. However, because most flavored malt

beverages already disclose the product's alcohol content, FMI believes that the proposed alcohol content labeling requirement, while not necessary, would not pose a significant burden to the companies that brew these products.

The TTB's rulemaking proposes to allow the addition of flavorings and other materials containing alcohol to malt beverage products provided that the alcohol from such materials constitutes less than 0.5% by volume of the finished product. In addition to this proposed standard, the TTB welcomes comments on an alternative standard which would be consistent with the Federal Alcohol Administration Act (FAA Act) definition of malt beverage, such as requiring that the alcohol content of a malt beverage be "predominantly;" i.e.; at least 51 percent derived from fermentation at the brewery.

While the 0.5% proposed standard might seem reasonable, FMI has been advised by the makers of flavored malt beverages that such a standard if adopted would significantly complicate the production process as affected companies would have to reformulate their products to comply with the new standard. Reformulation will raise production costs for the makers of flavored malt beverages substantially, resulting in higher prices to customers at the retail level. Most significantly, reformulation may potentially change the taste of flavored malt beverage products that have enjoyed success in the marketplace, making them less enjoyable for consumers, and supermarkets could see declining sales.

Thus, due to the adverse consequences that would result from the adoption of the 0.5% standard, FMI wishes to go on record in support of the alternative TTB standard that at least 51% of alcohol content of a malt beverage be derived from fermentation at the brewery. In our view, the so-called "predominance" standard is a fair standard and is more consistent with the policy that the federal government has followed for the past two decades. Moreover, adoption of the alternative standard will help to ensure that flavored malt beverage products will continue to taste the same which means that consumers will more likely continue to purchase these products. Additionally, the "predominance" standard would be less costly for flavored malt beverage companies in terms of reformulation and the production costs which will help to preserve competition in the marketplace. Thus, FMI urges TTB to adopt the alternative "predominance" standard.

In closing, FMI appreciates the opportunity to participate in the TTB rulemaking, and it is our hope that our formal comments will be given careful consideration.

Sincerely,



John J. Motley III
Senior Vice President
Government and Public Affairs