

BRIEFING PAPER

Flavored Alcoholic Beverages and the Youth Market: Are State Laws Being Violated? Does the Violation Constitute a Tax and Consumer Fraud? How Should States Respond to Federal Regulatory Decisions?¹

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¹ This briefing paper is drawn from a more detailed report that is available on request from the author.

Background

Flavored Alcoholic Beverages (FABs) (also called alcopops, Ready-To-Drink beverages, or Flavored Malt Beverages) denote a relatively new category in the alcohol market. Developed and distributed mostly by distillers, they are often produced through licensing arrangements with brewers. Many FABs carry distilled spirits' brand names (*e.g.*, Smirnoff Ice, Bacardi Silver, and Skyy Blue). FABs are produced as follows: a liquid is derived from malt and it is filtered to remove most or all taste, odor, and alcohol. "Flavoring" is then added to the liquid, which includes distilled alcohol. Although the beverages contain distilled alcohol (in some cases with most or all brewed alcohol removed) the alcohol industry distributes these products as malt beverages.² This classification has three main advantages for distillers that make it easier for them to market alcohol products to underage drinkers. Beer is: (1) advertised on electronic media; (2) taxed at substantially lower tax rates; and (3) available in a greater number of retail locations, particularly those likely to be frequented by underage drinkers.

Federal Regulatory Action

The Bureau of Alcohol, Tobacco and Firearms (BATF) held in March 1996 that, under federal law, FABs should be classified as distilled spirits and not beer.³ BATF did not enforce the 1996 ruling, permitting the producers to continue treating the products as beer under federal law pending rulemaking by the agency. In 2002, the BATF revisited the subject, reiterating the 1996 ruling that these products are distilled spirits and not malt beverages. The agency explained that it had received requests for clarification from state alcohol control and revenue agencies about the nature of FABs. In addition, they pointed out the likelihood that FAB advertising and labeling creates consumer confusion as to the source of their alcohol content. The BATF concluded that the use of distilled liquor brands in FABs names was not in itself misleading, but that labeling and advertising statements which used alcohol types or distilled spirits brand names in any context (other than the brand name) would be presumed to be misleading.⁴ Once again they promised formal rule change in the near future and announced that they were undertaking a study of FABs to inform that process.

²The manufacturing process is described in: Federal Register/Vol. 68, No. 56/Monday, March 24, 2003/Proposed Rules <http://www.ttb.gov/alcohol/rules/index.htm>.

³ The BATF ruling states: "Held, a malt beverage under the FAA Act may only contain alcohol which is the result of alcoholic fermentation at the brewery." ATF Rul. 96-1 (March 1996) available at <http://www.ttb.gov/alcohol/info/revrulex.htm>

The federal definitions of distilled spirits and malt beverages in the FAAA are as follows:

Malt beverage: "[A] beverage made by the alcoholic fermentation of an infusion or decoction, or combination of both, in potable brewing water, of malted barley with hops, or their parts, or their products, and with or without other malted cereals, and with or without the addition of unmalted or prepared cereals, other carbohydrate or products prepared therefrom, and with or without the addition of carbon dioxide, and with or without other wholesome products suitable for human food consumption." 27 U.S.C. § 211(a)(7)

Distilled spirits: "[E]thyl alcohol, hydrated oxide of ethyl, spirits of wine, whiskey, rum, brandy, gin, and other distilled spirits, including all dilutions and mixtures thereof, for non-industrial use." 27 U.S.C. § 211(a)(5).

As noted *infra* at n. 7, TTB impliedly overruled this decision in 2004, and promulgated a rule that up to 49 percent of the alcohol found in FABs to be derived from distilled alcohol, despite its apparent conflict with this statutory language.

⁴ Labeling and Advertising of Flavored Malt Beverages. Dept of the Treasury BATF circular 2002-4. 4/18/02 <http://www.ttb.gov/pub/ind_circulars/ic2002_04.htm>.

In March 2003, the Trade and Tax Bureau (TTB), the successor bureau to BATF, issued its long-promised notice of rule change. The release summarizes the TTB's analysis of FABs: Of the 114 FABs tested, 105 contained over 76 percent alcohol derived from distilled alcohol, and 95 percent have less than 25 percent alcohol volume from fermentation. Based on the findings of the analysis and a review of relevant state law, the Bureau proposed classifying FABs which contain more the 0.5 percent added distilled product as distilled spirits.⁵ The Bureau asked for comments from all interested parties both on the proposed rule and a possible alternative rule that would allow up to 49 percent of the alcohol in FABs to be derived from distilled product.

TTB received thousands of comments from alcohol producers, regulatory agencies, retailers, public health organization, and private citizens, among others. As anticipated, the beer industry supported the proposed rule change and distillers and most retailers opposed it.⁶ TTB took no action for nearly two years, until January 2005, when it issued its final rule and adopted the 49 percent limit. The decision was justified based on a finding that the .5 percent proposed rule would cause undue economic hardship to small producers of FABs. Potential public health impacts of the regulatory decision were not addressed. TTB provided no explanation for its implicit rejection of the ATF's previous determination in 1996 that FABs could not contain any distilled alcohol (beyond .5 percent).⁷

Impact of the TTB Ruling on State Regulation

States have concurrent jurisdiction with TTB regarding the classification of alcohol products as beer or distilled spirits. States have their own definitions of these products, and they have the authority to develop their own regulatory and tax structures. As shown in Appendix A, in at least 34 states, current statutory definitions appear to require that FABs that contain any distilled alcohol should be treated as distilled spirits (except those with less than .5 percent alcohol, considered a trace amount found in some nonalcoholic beverages). For example, Maine has a special classification for "low-alcohol spirits products" and its definition of beer states that distilled spirits may not be added.⁸ Ten states have definitions that are unclear and need a regulatory agency and/or court interpretation before a final determination can be made. The remaining six states and the District of Columbia appear to appropriately classify FABs as malt beverages under their current definitions.

Because of the states' independent authority and separate definitions of malt beverages, the TTB decision to allow up to 49 percent of the alcohol in FABs to be derived from distilled alcohol

⁵ Federal Register/Vol. 68, No. 56/Monday, March 24, 2003/Proposed Rules
<http://www.ttb.gov/alcohol/rules/index.htm>, see attached summary.

⁶ For the Beer Institute's analysis of the law and a statement of its position, see Testimony of Arthur J. DeCelle, Executive Vice President and General Counsel, The Beer Institute, Nebraska State Legislature Committee on General Affairs, Interim Hearing on L.R. 370, December 7, 2004.

⁷ The TTB apparent interpretation of the federal statutory definitions appear to be in error, since the definition of distilled spirits states that beverages that contain distilled spirits, including mixtures or dilutions, remain classified as distilled spirits. See *supra*, note 3. The Oregon Liquor Control Commission concluded that FABs should be classified as distilled spirits, interpreting a state law that contained less clear definitions than those found in federal statutes. (Memorandum from Chairman Philip D. Lang of the Oregon Liquor Control Commission, to the Off Premises and Wholesale Malt Beverages, Wine Licensees, and Distillery Representatives [April. 8, 2003]. See Appendix A for Oregon definitions. No other state agency or court has addressed this specific legal question.

⁸ Maine Title 28-A § 2

creates a conflict between federal and state law and regulatory practice. FAB producers are apparently in continuing violation of state laws in at least 34 states.

State Tax Savings Realized by the FAB Industry

The most readily apparent effect of these violations of state law involves state taxes. As shown in Tables 1 and 2, the tax savings of having FABs misclassified as malt beverages results in substantial savings for the FAB producers. Table 2 estimates that the producers have saved \$241.6 million in state taxes in 2002 in the 27 states where FABs are apparently misclassified and the misclassification has resulted in lower taxes that can be estimated. (In seven states where an apparent misclassification has occurred, the tax consequences could not be calculated.) Because no data is publicly available regarding sales of FABs on a state-by-state basis, the sales estimates have been based on each state's share of the U.S. population. Thus, the estimates are preliminary and designed to give only a general guide regarding the magnitude of the tax savings.

Does the violation of state laws constitute a consumer fraud or unfair business practice?

The FAB producers' violation of state laws regarding their products' classification has deeper implications than just the unjust enrichment associated with the failure to pay appropriate state taxes. Their actions may constitute a consumer fraud or unfair business practice if they were taken in order to target the illegal underage market. As noted above, treating FABs as a beer instead of distilled spirits creates enormous benefits for distillers in terms of wider availability, lower prices, and easier access to electronic media advertising, all critical variables in reaching young drinkers. The process used for making the beverages suggests a deliberate effort to circumvent the law in order to gain these marketing advantages. If the legal violations can be linked to a plan for encouraging underage drinking, the potential legal consequences could be severe.

FAB producers argue that the products are designed for and used primarily by consumers 21 years and older. The Federal Trade Commission issued a report in September 2003 which supported these industry assertions.⁹ However, the FTC based its conclusion entirely on documents submitted to it by the producers and made no independent assessment of the attractiveness of FABs to underage drinkers or the marketing practices of the producers that may target underage audiences.

Available evidence is highly suggestive that FABs are popular with young people. Most recently, the Monitoring the Future survey of high school students found that girls in particular are attracted to FABs, reporting higher rates of 30 day prevalence for these products than beer. For boys, the consumption of the two products is similar in the eighth grade, but beer becomes more popular with age (see Table 3). Nearly one-third of high school seniors report regular consumption of FABs. These figures are remarkable, since beer has 33 times the volume sales of FABs, indicating that a large percentage of the FAB market is consumed by underage drinkers.

Data on FAB marketing practices suggest that producers are highly attentive to the youth market. The product design itself caters to immature tastes, and several industry publications state that

⁹ FED. TRADE COMM'N, ALCOHOL MARKETING AND ADVERTISING: A REPORT TO CONGRESS (September 2003), available at <http://www.ftc.gov/os/2003/09/alcohol08report.pdf>.

FABs are designed for “entry level drinkers” or some similar term.¹⁰ Nearly 90 percent of the population begins drinking before the age of 21, and the average age of initiation is now below 16 and dropping steadily.¹¹ The vast majority of entry level drinkers are clearly underage.

Reports from the Center on Alcohol Marketing and Youth document that FAB advertising is placed in media that has disproportionate youth audiences. For example, CAMY’s report on magazine advertisements in 2001 found FAB advertisers exposed youth to 60 percent more print advertising per capita than adults.¹² Similar findings have been reported for FAB advertising on radio and television.¹³

Recommended State Responses to the TTB Final Ruling

States can expect legislative proposals from FAB producers to conform state law to the TTB ruling. Because TTB fails to address the public health and safety concerns associated with FABs, states should not treat FABs as beer and should take action to reduce their youth appeal. The recommended approach is to establish a separate definition for FABs that is in conformity with industry practice (which treats FABs as a separate category of beverage), apply higher excise tax rates, and restrict their availability. Several European countries have raised taxes on FABs because of their appeal to youth.¹⁴ Research demonstrates that higher alcohol excise taxes and restricted availability reduce youth consumption and associated problems.¹⁵

Proposed Statutory Definition of FABs

In most states, regulatory definitions of FABs conflict with industry practice. FABs are defined legally based on the origin of the alcohol they contain (malt-based, wine, or distilled spirits), yet the industry treats the beverages as a unitary category without regard to the derivation of the

¹⁰ See, e.g., David Leonhardt, *A Little Booze for the Kiddies? “Alcopops” Pitched to Younger Drinkers are Stirring Controversy*, BUSINESS WEEK, Sept. 23, 1996, at 158; Michael Sherer, *Mad for Malternatives: Sales of Alternative Malt Beverages are Exploding. Will the Trend Last?*, BEVERAGE DYNAMICS, May-June 2002, at 6-10.

¹¹ MICHAEL PERGAMIT, LYNN HUANG, & JULIE LANE, THE LONG TERM IMPACT OF ADOLESCENT RISKY BEHAVIORS AND FAMILY ENVIRONMENT, (National Opinion Research Center, University of Chicago ed., 2001) (report submitted to the Office of the Assistant Secretary for Planning and Evaluation, U.S. Dept. of Health and Human Services) available at <http://aspe.hhs.gov/hsp/riskybehav01/chapt4.htm>.

¹² CENTER ON ALCOHOL MARKETING AND YOUTH, OVEREXPOSED: YOUTH A TARGET OF ALCOHOL ADVERTISING IN MAGAZINES (Center on Alcohol Marketing and Youth ed., 2002), available at <http://camy.org/research/files/overexposed0902.pdf>.

¹³ CENTER ON ALCOHOL MARKETING AND YOUTH, RADIO DAZE: ALCOHOL ADS TUNE IN UNDERAGE YOUTH (Center on Alcohol Marketing and Youth ed., 2003), available at <http://camy.org/research/files/radio0303.pdf> [hereinafter RADIO DAZE].; CENTER ON ALCOHOL MARKETING AND YOUTH, YOUTH EXPOSURE TO ALCOHOL ADS ON TELEVISION 2002: FROM 2001 TO 2002 ALCOHOL’S ADLAND GREW VASTER (Center on Alcohol Marketing and Youth ed., 2004), available at <http://camy.org/research/tv0404/report.pdf>

¹⁴ Staff, *Europe Takes on Alcopops*, DEUTSCHE WELLE (Aug. 7, 2004), available at http://www.dw-world.de/english/0,3367,1433_A_1291395_1_A,00.html; Deborah Haynes, *Huge Alcopops Tax to Stop Swiss Youngsters Boozing, But Industry Cries Foul*, AGENCE FRANCE-PRESSE (October 10, 2003); and Staff, *Germany Taxes Alcopops to End Youth Appeal*, Worldwatch, DW Berlin (August 3, 2004), available at: <http://203.15.102.140/news/worldwatch/worldwatch.php3?choser=2004-08-03#Germany%20taxes%20alcohops%20to%20end%20youth%20appeal>.

¹⁵ Institute of Medicine, *Reducing Underage Drinking: A Collective Responsibility*. Washington DC: National Academies Press, 2003.

alcohol. As analyzed elsewhere,¹⁶ the regulatory structures have prompted the industry to use various production techniques in order to claim FABs are malt-based (which results in distinct marketing advantages) even though the vast majority of them derive most of the alcohol from distilled spirits contained in additives.

States should update their statutory definitions to reflect industry practice and create a new definition of FABs that treats this as a unitary category without regard to the derivation of the alcohol. Hawaii already has such a definition as to malt-based and wine FABs, and several states have separate definitions for spirit FABs.¹⁷ The model definition below is based on these statutes as well as on a review of industry practice.

Proposed Model Definition of Flavored Alcoholic Beverages

Definition of "Flavored Alcoholic Beverages"

A. "Flavored Alcoholic Beverages" means:

(1) A malt beverage containing a malt base or beer and added natural or artificial blending material such as fruit juices, flavors, flavorings, colorings, or preservatives where such blending material constitute .5 percent or more of the alcohol by volume contained in the finished beverage; or

(2) A beverage containing wine and more than fifteen per cent added natural or artificial blending material, such as fruit juices, flavors, flavorings, or adjuncts, water (plain, carbonated, or sparkling), colorings, or preservatives; or

(3) A beverage containing distilled alcohol and added natural or artificial blending material such as fruit juices, flavors, flavorings, colorings, or preservatives.

B. "Regular Flavored Alcoholic Beverage" means a Flavored Alcoholic Beverage with an alcohol content of less than 6 percent by volume regardless of the derivation of the alcohol.

C. "Fortified Flavored Alcoholic Beverage" means a Flavored Alcoholic Beverage with an alcohol content of at least 6 percent but less than [12] percent by volume regardless of the derivation of the alcohol.

[Note: Upper limit for fortified FABs may vary by state based on current categories of distilled spirits and wine.]

Proposed Excise Tax Rates on Flavored Malt Beverages

As noted above, because of their special appeal to youth, FABs should be taxed at a high rate to reduce their appeal to youth. A state may simply impose the current tax on distilled spirits, which generally is significantly higher than beer excise tax rates. Under current law in most states, distilled spirits taxes should be applied to FABs because they contain distilled alcohol. The only reason why distilled spirits tax rates are not being used currently is because states are not enforcing current definitions. This approach therefore does not technically involve a tax increase but rather a decision to enforce current law. Higher rates for fortified FABs are also recommended.

¹⁶ See note 1, *supra*.

¹⁷ See Appendix B.

Proposed Availability Restrictions

As a relatively new category in the alcohol market that attracts high levels of youth consumption, states should consider restricting FAB availability, particularly in outlets where young people are likely to obtain them, such as gas stations and convenience stores. This can be accomplished in most states by permitting their sale only in retail outlets that sell distilled spirits.

Conclusion

TTB's recent decision to allow FABs to contain 49 percent alcohol derived from distilled alcohol creates a dilemma for state governments. Instead of providing a national standard for classification of these products, it has created apparent conflicts with the laws of most states. TTB's decision ignored public health concerns regarding these products, basing its decision on potential adverse economic impacts on the small FAB producers.

With TTB's abdication of responsibility, states need to enforce their laws, impose appropriate taxes, and investigate the marketing practices of FAB producers. States should anticipate that FAB producers will be seeking changes to the definitions of various alcohol products in an effort to allow them to continue to market FABs as beer even if they contain distilled alcohol. States should resist this lobbying effort and instead consider legislation that creates a separate category of alcoholic beverages for FABs that is not based on the source of the alcohol in the beverage. This new FAB category should be taxed and allowed to be sold in a manner that will reduce the FABs' appeal to underage drinkers.

Available evidence suggests that FABs are highly attractive to underage youth and that FAB marketing practices are targeting a youth audience. Protecting our youth should be the top priority in determining how best to regulate and tax these beverages, not the narrow economic interests of the FAB producers.

Table 1
State Excise Tax Rates for Beer and Distilled Spirits:
States That Misclassified FABs¹⁸

State	Beer Excise Tax Rate \$/gallon	Distilled Spirits Excise Tax Rate \$/gallon ¹⁹	Estimated Underpayment \$/gallon
AZ	\$0.16	\$3.00	\$2.84
AR	\$0.24	\$0.50	\$0.26
CA	\$0.20	\$3.30	\$3.10
CT	\$0.19	\$2.05	\$1.86
CO	\$0.08	\$2.28	\$2.20
DE	\$0.16	\$3.64	\$3.48
FL	\$0.48	\$2.25	\$1.77
KS	\$0.18	\$2.50	\$2.32
KY	\$0.08	\$1.92	\$1.84
ME	\$0.35	\$1.54	\$1.19
MD	\$0.35	\$1.50	\$1.15
MA	\$0.11	\$1.10	\$0.99
MI	\$0.20	\$1.82	\$1.61
MN	\$0.15	\$5.03	\$4.88
MS	\$0.43	\$2.50	\$2.07
MO	\$0.06	\$2.00	\$1.94
NE	\$0.23	\$3.00	\$2.77
NV	\$0.09	\$0.40	\$0.31
NJ	\$0.12	\$4.40	\$4.28
NY	\$0.13	\$2.54	\$2.41
OH	\$0.18	\$1.20 ²⁰	\$1.02
OK	\$0.40	\$5.56	\$5.16
RI	\$0.10	\$1.10	\$1.00
SD	\$0.27	\$0.93	\$0.66
TN	\$0.14	\$1.10	\$0.96
TX	\$0.19	\$2.40	\$2.21
WA	\$0.26	\$9.24	\$8.98
US median	\$0.19	\$3.75	\$3.56

Sources: National Institute on Alcohol Abuse and Alcoholism, *Alcohol Policy Information System (APIS)*, available <http://alcoholpolicy.niaaa.nih.gov/> (state tax rates: data as of Jan.1, 2003); Federation of Tax Administrators, *State Liquor Excise Tax Rates*, available http://www.taxadmin.org/fta/rate/tax_stru.html#Excise (U.S. median rate last updated Jan. 1, 2004); Federation of Tax Administrators, *State Beer Excise Tax Rates*, available http://www.taxadmin.org/fta/rate/tax_stru.html#Excise (U.S. median rate last updated Jan. 1, 2004).

¹⁸ Table lists primary volume tax for each state. Other alcohol taxes may apply. Legal citations and additional detail regarding methodology for selecting states that misclassify FABs are available upon request from the author. Note that seven states (Hawaii, Idaho, Iowa, Louisiana, North Carolina, Oregon, and Virginia) have statutory definitions that appear to conflict with the TTB ruling but are not included in the table (see Appendix A). They are excluded because either there are no excise tax consequences (*e.g.*, if the proper classification were applied, the state taxes on FABs and beer would be the same) or the tax consequences of the misclassification are uncertain (*e.g.*, the state applies an excise tax on beer but a sales tax on distilled spirits).

¹⁹ Some states have multiple distilled spirits tax rates that vary according to alcohol content; we have applied the tax rate appropriate to the alcohol content of FABs by including the rate applicable to beverages of 5 percent or less alcohol content (either by weight or by volume).

²⁰ Tax rate is for “mixed beverages” rather than distilled spirits, the appropriate tax for FABs in Ohio.

TABLE 2: Estimated Tax Savings by FAB Producers, 2002²¹

State	14-18+ Total Population Estimate	percent of US Population	Imputed Sales (Gallons)	Excise Tax Underpayment (\$/gallon)	Imputed Annual Tax Underpayment (2002)
Arizona	4,384,359	1.87%	2,745,272	\$2.84	7,796,572
Arkansas	2,199,484	0.94%	1,377,210	\$0.26	358,075
California	28,122,096	12.00%	17,608,685	\$3.10	54,586,925
Connecticut	2,840,997	1.21%	1,778,894	\$1.86	3,308,742
Colorado	3,653,354	1.56%	2,287,552	\$2.20	5,032,615
Delaware	663,430	0.28%	415,408	\$3.48	1,445,618
Florida	13,995,224	5.97%	8,763,127	\$1.77	15,510,735
Kansas	2,189,573	0.93%	1,371,004	\$2.32	3,180,729
Kentucky	3,347,730	1.43%	2,096,185	\$1.84	3,856,981
Maine	1,093,574	0.47%	684,743	\$1.19	814,844
Maryland	4,447,348	1.90%	2,784,712	\$1.15	3,202,419
Massachusetts	5,285,632	2.26%	3,309,605	\$0.99	3,276,509
Michigan	8,131,571	3.47%	5,091,593	\$1.61	8,197,465
Minnesota	4,109,418	1.75%	2,573,117	\$4.88	12,556,812
Mississippi	2,291,891	0.98%	1,435,070	\$2.07	2,970,596
Missouri	4,626,746	1.97%	2,897,043	\$1.94	5,620,263
Nebraska	1,400,882	0.60%	877,164	\$2.77	2,429,744
Nevada	1,781,147	0.76%	1,115,267	\$0.31	345,733
New Jersey	6,982,892	2.98%	4,372,347	\$4.28	18,713,643
New York	15,686,184	6.70%	9,821,924	\$2.41	23,670,836
Ohio	9,273,745	3.96%	5,806,767	\$1.02	5,922,902
Oklahoma	2,833,797	1.21%	1,774,386	\$5.16	9,155,829
Rhode Island	889,120	0.38%	556,724	\$1.00	556,724
South Dakota	616,515	0.26%	386,032	\$0.66	254,781
Tennessee	4,761,614	2.03%	2,981,491	\$0.96	2,862,231
Texas	17,225,921	7.35%	10,786,032	\$2.21	23,837,131
Washington	4,984,663	2.13%	3,121,153	\$8.98	28,027,953

Total Tax Savings on Taxes for 27 States:

\$247,493,407

U.S. CENSUS BUREAU, U.S. DEP'T OF COMMERCE, POPULATION ESTIMATES FROM JULY 1, 2003 (U.S. Census Bureau, 2003).

²¹ Table lists primary volume tax for each state. Other alcohol taxes may apply. Legal citations and additional detail regarding methodology for selecting states that misclassify FABs are available upon request from the author. Note that seven states (Hawaii, Idaho, Iowa, Louisiana, North Carolina, Oregon, and Virginia) have statutory definitions that appear to conflict with the TTB ruling but are not included in the table (see Appendix A). They are excluded because either there are no excise tax consequences (*e.g.*, if the proper classification were applied, the state taxes on FABs and beer would be the same) or the tax consequences of the misclassification are uncertain (*e.g.*, the state applies an excise tax on beer but a sales tax on distilled spirits).

TABLE 3
Prevalence, High School Students, Beer compared to Flavored Alcohol Beverages (malternatives/alcopops), 2004

<u>8th grade</u>	Beer	FAB
boys	14.0	12.7
girls	14.6	16.3
<u>10th grade</u>		
boys	30.7	24.5
girls	22.3	25.6
<u>12th grade</u>		
boys	44.1	28.9
girls	32.1	33.2

Source: Monitoring the Future Study, University of Michigan, 2004. Data on FAB prevalence reported at <http://www.monitoringthefuture.org/data/04data/pr04t19.pdf> . Data on beer prevalence provided by authors.

APPENDIX A

Classification of States' Alcohol Definitions And Assessment of Potential Conflicts With TTB Final Ruling on FMBs

In classifying states with alcohol definitions that may conflict with the TTB's Final Rule regarding FMBs, we reviewed each state's statutes regarding definitions of the relevant alcoholic beverage terms ("distilled spirits," "beer," "malt beverages," etc.). While the classifications were made by analyzing each state's unique provisions and assessing how a state may interpret its provisions, there was no examination of case law to determine whether a particular state has elaborated further on the meaning of these terms.

Generally, most of the states classified as having definitions that may conflict with the TTB's Final Ruling fall into one (or more) of four categories:

- (1) **The definition of "beer," "malt beverage" or similar term specifically excludes distillation, distilled alcohol or excludes any substances other than specified ingredients listed (e.g., pure hops).** States that fall into this category include: AZ, KY, LA, ME, and MO. Following are example provisions:

In Arizona: "'Malt liquor' means any liquid that contains more than one-half of one per cent alcohol by volume and that is made by the process of fermentation and not distillation of hops or grains, but not including: (a) Liquids made by the process of distillation of such substances. . . ." Ariz. Rev. Stat. s. 42-3001

In Maine: "'Malt liquor' includes beverages made with malt liquor, but to which no spirits are added." Me. Rev. Stat. Ann. tit. 28-A, s. 2

- (2) **The definition of "distilled spirits," "liquor" or similar term specifies that all dilutions, mixtures or solutions of distilled alcohol or any beverage that "contains" distilled spirits shall be classified as distilled spirits.**²² States that fall into this category include: AK, CA, CO, DE, FL, IA, KS, MD, MN, MS, NE, NJ, NY, NC, RI, TX, TN, WA. Following are example provisions:

In California: "'Distilled spirits' means an alcoholic beverage obtained by the distillation of fermented agricultural products...spirits of wine, whiskey, rum, brandy, and gin, including all dilutions and mixtures thereof." Cal. Bus. & Prof. Code s. 23005

In Washington: "'Spirits' means any beverage which contains alcohol obtained by distillation" Wash. Rev. Code s. 66.04.010

²² As noted *supra* at n. 3-6, ATF ruled in 1996 that federal statutory definitions that fall within this category required that FABs cannot contain distilled alcohol. However, the TTB (ATF's successor agency) impliedly overruled this decision in its 2005 rule permitting up to 49% of the alcohol in FABs to contain distilled alcohol. The ruling gives no explanation for this reversal, relying on TTB's broad regulatory powers. States are not bound by the TTB ruling, which appears on its face to violate federal statutory provisions.

- (3) **There is a separate category for low-alcohol spirits products or “other” alcoholic beverages.** States in this category include: AR, CT, HI, ID, LA, ME, MA, MI, OH, OK, RI, SD, VA. Following are example provisions:

In Maine: “‘Low-alcohol spirits product’ means a product containing spirits that has an alcohol content of less than 6% by volume.” Me. Rev. Stat. Ann. tit. 28-A, s. 2

In Connecticut: “‘Liquor cooler’ means any liquid combined with liquor. . .containing not more than seven per cent of alcohol by volume. . .” Conn. Gen. Stat. s. 12-433

- (4) **Combinations of various types of alcohol are considered to be distilled spirits.** States in this category include: NV, CT, CO. Following are example provisions:

In Connecticut: “Any liquid or solid containing more than one of the four varieties [alcohol, spirits, wine and beer] is considered as belonging to that variety which has the higher percentage of alcohol, according to the following order: Alcohol, spirits, wine and beer. . . .” Conn. Gen. Stat. s. 30-1

In Colorado: “Any liquid or solid containing beer or wine in combination with any other liquor. . .shall not be construed to be fermented malt or malt or vinous liquor but shall be construed to be spirituous liquor.” Colo. Rev. Stat. s. 12-47-103.

- (5) **State regulatory agency has determined that FABs with distilled alcohol content should be classified as distilled spirits instead of beer based on an analysis of state law.** Oregon is the only state in this category.²³

Ten states have statutory definitions that are ambiguous regarding the appropriate classification of FABs (AL, AK, GA, NM, ND, PA, SC, VT, WV, WI). A review by the relevant state regulatory agency and/or state court will be necessary to determine how FABs should be classified in these states. Six states (IN, IL, MT, NH, UT, WY) and the District of Columbia appear to have statutory definitions that are in conformity with the TTB final rule.

The following tables provide a state-by-state review of relevant statutory definitions.

[Insert Excel Tables Here]

²³ Memorandum from Chairman Philip D. Lang of the Oregon Liquor Control Commission, to the Off Premises and Wholesale Malt Beverages, Wine Licensees, and Distillery Representatives (April. 8, 2003).

APPENDIX B

State Definitions of the FAB Category of Alcoholic Beverages ²⁴

Hawaii:

"Cooler beverage" means either (1) a wine cooler containing wine and more than fifteen per cent added natural or artificial blending material, such as fruit juices, flavors, flavorings, or adjuncts, water (plain, carbonated, or sparkling), colorings, or preservatives, and which contains less than seven per cent of alcohol by volume; or (2) a malt beverage cooler containing beer and added natural or artificial blending material such as fruit juices, flavors, flavorings, colorings, or preservatives, and which contains less than seven per cent of alcohol by volume.

* * Haw. Rev. Stat. s. 244D-1

Indiana

The term "flavored malt beverage" means an alcoholic beverage that has all of the following attributes:

(1) The alcoholic beverage is made from a malt beverage base that is flavored with aromatic essences or other flavorings in quantities and proportions that result in a product that possesses a character and flavor distinctive from the malt beverage base and is distinguishable from other malt beverages.

Ind. Code s. 7.1-1-3-16.7

Maine:

2. Definitions

* * *

16-A. Low-alcohol spirits product. "Low-alcohol spirits product" means a product containing spirits that has an alcohol content of less than 6% by volume.

* * *

31. Spirits. "Spirits" means any liquor produced by distillation or, if produced by any other process, strengthened or fortified by the addition of distilled spirits of any kind.

"Spirits" does not include low-alcohol spirits products or fortified wine.

* * * Me. Rev. Stat. Ann. tit. 28-A, s. 2

South Dakota:

For the purposes of this section, diluted beverages are alcoholic beverages prepared from the admixture of spirits or wine with water, dairy products, fruit juices, or vegetable juices, to which may be added natural flavors, artificial flavors, sweetening agents, or food additives to produce a beverage distinct and unique from the spirits or wine. In no case

²⁴ Source: Alcohol Policy Information System (APIS), available from <http://alcoholpolicy.niaaa.nih.gov/> (data as of 1/1/2004).

does the term, diluted beverages, include beverages which contain in excess of twelve percent alcohol by weight. S.D. Codified Laws s. 35-5-3

Virginia

Low alcohol beverage cooler'' means a drink containing one-half of one percent or more of alcohol by volume, but not more than seven and one-half percent alcohol by volume, and consisting of spirits mixed with nonalcoholic beverages or flavoring or coloring materials; it may also contain water, fruit juices, fruit adjuncts, sugar, carbon dioxide, preservatives or other similar products manufactured by fermenting fruit or fruit juices. Low alcohol beverage coolers shall be treated as wine for all purposes of this title.

Va. Code Ann. s. 4.1-100