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ANHEUSER BUSCH  
companies

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VIA OVERNIGHT MAIL

October 20, 2003

Mr. William H. Foster  
Chief, Regulations and Procedures Division  
Alcohol & Tobacco Tax and Trade Bureau  
P. O. Box 50221  
Washington, DC 20091-0221

Re: TTB Notice No.4

Dear Mr. Foster:

This comment is being submitted in response to the Notice of Proposed Rulemaking published by the Alcohol and Tobacco Tax and Trade Bureau ("TTB") on March 24, 2003. We appreciate the opportunity to comment on this very important issue involving the alcohol beverage industry.

The Proposed 0.50% Standard is Proper

Anheuser-Busch strongly supports the 0.50% standard for flavored malt beverages ("FMBs") and encourages its rapid adoption. Permitting the addition of flavors containing distilled alcohol to malt beverage products if such flavors constitute less than 0.5% by volume of the finished product is soundly based in federal law and public policy. For example, Section 5052(a) of the Internal Revenue Code ("IRC") defines "beer" as ". . . beer, ale, porter, stout, and other similar fermented beverages . . . of any name or description containing one-half of 1 percent or more of alcohol by volume, brewed or produced from malt, wholly or in part, or from any substitute therefor [emphasis added]." 0.5% is the dividing line between products defined and taxed as alcohol beverages in Section 5052 of the IRC and those that are not subject to tax.

The Notice of Proposed Rulemaking raises the critical question whether certain products currently marketed as flavored malt beverages (with added flavorings containing significant amounts of distilled alcohol) should be classified as malt beverages or distilled spirits under the FAA Act and the Internal Revenue Code. As TTB has recognized, the answer to this question affects the rate of tax applicable to those products, the type of premises where they may be produced (brewery or distillery), the way they are labeled, advertised and marketed, and the distribution system by which

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they are sold to retailers and consumers, at the federal and state levels. State regulatory and taxing agencies are deeply concerned about the proper classification of these products as malt beverages or distilled spirits. Considering that as much as 99% of the alcohol in some FMBs comes from added flavorings containing spirit alcohol, TTB must clarify and properly construe the rules classifying malt beverages. Beer and spirits are unique beverages with unique histories and regulations dating back decades and even centuries. The 0.5% proposal is the only viable solution for TTB and the states.

The Reasons for the Q.50/a Standard are Compelling

- The 0.5% standard will not threaten current products. TTB has asked for comments on the viability of products currently in the market. Anheuser-Busch is capable of producing FMBs under the proposed 0.5% standard and is preparing to do so. Our brewmasters have already developed reformulated products under this standard that are virtually indistinguishable in any way from the current products we produce and sell. These reformulated products will have the same clarity, aroma and taste profile of our existing products. Reformulation can be done and no FMB producer should lead TTB to believe otherwise. In fact, the Nebraska Liquor Control Commission ("NLCC") declared on October 7, 2003 that no FMBs could be shipped into the state after January 1, 2004 if they contained more than 0.5% distilled alcohol. Anheuser-Busch immediately informed the NLCC that Anheuser-IBusch could and would comply by that deadline. Further, Anheuser-Busch is prepared to implement the 0.5% standard on a nationwide basis three months following the issuance of TTB's Final Rule. Thereafter, we believe that a timeframe of six months following the suppliers' effective date would be reasonable for wholesalers to sell-through the current product in their warehouses and at retail.

As for the costs to implement the 0.5% standard, it is understood with any new process that there may be associated transition costs. Each and every FMB producer needed certain equipment when they decided to produce their current FMBs, yet TTh (through ATF Ruling 96-1) clearly warned each producer seven years ago that TTB was concerned about this category and that the rules were subject to change at any time. It should be noted that even the 49 percent spirits standard will require process changes and associated transition costs for most producers. At this time, Anheuser-Busch expects the total cost impact across the company's system to be minimal, ranging between a small investment in capital and a net cost savings due to process and material changes. In either event, we do not anticipate the slight change in cost will impact the FMB prices for our wholesalers, retailers or consumers in any way.

- The 0.5% standard will not impede new products. The 0.5% standard will not stifle innovation or expansion of the FMB category. Flavors containing less than 0.50/a alcohol by volume could still be used in the production of a wide variety of malt beverage products that meet consumers ever-changing demand for different taste profiles.

The most straightforward and legitimate examples of how this can be done are seen in the soft drink aisles of every grocery and convenience store. Soda manufacturers use flavors

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containing small amounts of spirit alcohol as a solvent or preservative in many of their products. For obvious reasons, they must keep the level of alcohol below 0.5% alcohol by volume so that their products are not considered distilled spirits nor regulated by the TTB and state alcohol authorities. Flavored sodas are tremendously popular and include cherry, vanilla, citrus, orange and many others. In addition, new soft drink flavors are constantly reaching the market to meet consumer demand for innovative flavored beverages.

Likewise, FMBs can continue to fulfill consumers' ever-changing taste palate and continue to provide great flexibility for FMB producers. Anheuser-Busch currently manufactures citrus, orange, lemon, lime and raspberry FMBs and can continue to manufacture these flavored beverages under a 0.50/o standard with virtually identical characteristics. Thus, it should be made clear that the 0.5% standard will not be an impediment for FMB manufacturers to produce current and new assorted flavored products.

- The 0.5% standard is fair and proper. Some distilled spirit manufacturers assert that since BATF allowed them to make FMBs with virtually unlimited spirits alcohol, it is "unfair" to change anything now. As noted in the Notice of Proposed Rulemaking, BATE has warned producers since 1996 that more restrictive changes were necessary and forthcoming. BATF clearly stated that it did not believe Congress intended distilled spirit alcohol flavorings to provide the dominant source of the alcohol content. In its defense, BATF hardly envisioned that manufacturers would develop products where nearly 990/o of the alcohol content comes from distilled spirit alcohol instead of fermented malt. ATF Ruling 96-1 clearly stated "BATF would be initiating formal rulemaking in the future to consider the prohibition, restriction or limitation on the use of flavor materials containing spirit alcohol." Thus, the industry has been on notice since 1996 that BATF would be looking closer at FMBs. The instant Notice of Proposed Rulemaking is the undertaking that BATF said it would initiate. It is incomprehensible that some industry members would now say they think it is "unfair" to change the standard when those industry members fully understood that the regulatory standards for these products were expressly subject to change.

- The 0.5% standard best supports an orderly regulatory system and an orderly marketplace. The continued sale of current FMBs without change, or reformulated to only meet a 49 percent distilled spirits standard, poses a serious threat to the orderly regulation and marketing of beer and other malt beverages throughout the country. An orderly system is one of the most important duties given to federal and state alcohol regulatory agencies. As made clear by many state regulatory agencies, there will be complete disorder in the nationwide marketplace if FMBs are permitted to contain 49 percent distilled spirits alcohol under federal law, yet most states would only permit 0.5% spirit alcohol. A patchwork of states regulating identical products as distilled spirits in most states, and as beer in others, would cause havoc and tremendous consumer confusion.

Consider the multitude of state border locations where the same FMBs would be characterized as distilled spirits on one side of the border and a malt beverage only yards away. In addition, the television advertising rules governing distilled spirits and malt

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beverage products differ greatly, yet television coverage regularly crosses state lines. Only the 0.5% rule will properly clarify the status of FMBs by providing a national standard that federal and state regulatory and taxing agencies can use effectively to oversee the advertising, taxation and orderly distribution of flavored beverages.

- Public policy supports the 0.5% standard. There is sound public policy and a consumer need for the 0.5% standard. YI7B and most state authorities have expressed serious concerns with the current FMB framework because these products contain such a large amount of distilled spirits alcohol and yet are treated as beer for all purposes. The many concerns are based on the law, as well as on the historical distinctions separating beer from spirits in many important ways. As such, it is TTB's distinct role to conform FMBs to the current and long-standing definitions of "malt beverage," "beer" and "distilled spirits." The IRC's 0.5% threshold, which draws the line between taxable and non-taxable alcohol beverages, provides a proper justification for the 0.5% standard. Many states agree with the 0.5% standard, and without surprise, have similar definitions for beer and distilled spirits in their laws. Federal law also prohibits products that tend to create a misleading impression (27 CFR 7.29) and many states do as well. The 0.5% standard will clarify federal and state public policy as well as the consumers' understanding of FMBs.

#### Any Other Proposed Standard Does Not Comply with the Law

- There is no other lawful standard to adopt that solves regulatory concerns. TTB is also seeking comment on whether there is another justifiable standard that complies with the law and public policy. Simply stated, there is no other legitimate solution to rectify the concerns of TTB, the states and the industry. Some distilled spirit and other manufacturers who produce FMBs, for example, are lobbying for a weaker standard which would require that a beer or malt beverage only derive a majority (that is 51%) of the alcohol from fermentation. Stated another way, up to 49 percent of any beer product could come from distilled spirits alcohol. Although TTB has stated it is interested in comments on this alternative, there is absolutely no basis in the FAA Act or IRC to adopt this standard. Neither the "beer" nor "malt beverage" definitions allow for a product to be made where 49 percent of the alcohol in the finished product can come from distilled spirits. The difference of only a couple of drops between a product that is "mostly" a beer versus "mostly" a distilled spirit would make a mockery of the law, public policy and the many years of distinction between malt beverages and distilled spirits.

- The 49 percent distilled spirits alternative is not consistent with government regulations. Many of the same opponents to the 0.5% standard assert that a 49 percent distilled spirits alternative is consistent with some other government regulations establishing percentage standards for alcohol beverages. Their examples include (1) TTB requires only 25% of the fermentable base in a "malt beverage" to be malt for the product to be considered a malt beverage; (2) TTB requires only 50% of the fermentables in a beer to be grain; (3) for wheat beers, only 250/0 of the fermentable base must be wheat; and (4) for wines, the minimum volume standard for certain varietal grapes is only 51% for the wine to be named as that

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varietal type of wine. None of these examples have anything to do with the proper amount of alcohol content that must be derived from malt fermentation. Instead, they are merely examples of certain physical ingredients that have been permitted for other reasons and purposes. In contrast, a 49 percent distilled spirits standard is nowhere to be found in federal or state laws.

Further, in many states the definitions of malt beverage and distilled spirits contain a 0.5% threshold. In Wisconsin, for example, the definitions of "intoxicating liquor" (their term for "distilled spirits") and "fermented malt beverage" both contain the 0.5% alcohol by volume threshold. Wi. Code §125.02. Similar provisions also exist in Missouri (Mo. Code §311.020), Wyoming (Wy. Code §12-1-101), Texas (Tx. Code Title 1, §1.05), Ohio (Oh. Code §4301.01), Oregon (Or. Code §471.005), and Pennsylvania (Pa. Code Title 47, §102) as well as a number of others. Consequently, a standard where 49 percent of the alcohol content by volume may be derived from distilled spints would not be feasible under state licensing, taxation, advertising, labeling and distribution laws either. Many states have already commented on this issue and agree that the 49 percent distilled spirits alternative simply will not work. In contrast, the states would not need to change anything in their laws to allow

- FMBs using a federal 0.5% standard.

- The 0.5% standard as well as the 49 percent distilled spirits standard will cause current products and producers to make adjustments. Some in favor of the 49 percent distilled spirits standard assert that a smaller change will not threaten current products. On the contrary, reformulation to a 49 percent distilled spirits standard will actually halt sales of these products in a large number of states. Over half of the state alcohol authorities have either formally supported the proposed 0.5% rule or have in the past expressed grave concern for anything other than the 0.5% standard. Even state alcohol regulatory associations (e.g. the National Conference of State Liquor Administrators, the National Alcohol Beverage Control Association and the Joint Committee of the States) endorse the 0.5% standard. Most states have indicated that any standard other than 0.5% -- including a 49 percent distilled spirits concept -- would force the states to declare these products as distilled spirits in all respects, including taxation and distribution. The states which traditionally have followed TTB's guidance would then have to develop and/or enforce their own 0.5% standard, effectively ending federal leadership on the most important alcohol regulation issues. It is clear that FMBs produced under a 49 percent distilled spirits standard will threaten the continued sale of these products through normal beer channels in a large number of states. Such a standard would also cause great inconsistencies across the states. A 49 percent distilled spirits standard would not result in a national standard at all, nor would it ensure the integrity of these products or the regulators who administer them.

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#### Summary

In conclusion, Anheuser-Busch submits that a national 0.5% standard is needed in order to fully alleviate federal and state concerns over the classification of FMBs. It will properly preserve the entire malt beverage category and the long-term viability of FMBs. The 0.5% standard is good for producers, wholesalers, retailers and consumers because:

- It best preserves a uniform, national approach that FMBs can continue to be advertised, distributed, taxed and licensed as beer.
- It will maintain an orderly marketplace and help sustain the FMB category.
- State alcohol beverage and tax commissions will be less likely to attack FMBs for tax, licensing and/or distribution purposes. Most, if not all, of the concerns expressed by state regulators and taxing authorities are effectively addressed in the proposed 0.5% standard.
  - o Any alternative to the 0.5% standard will disrupt thousands of retailers, most of whom are small businesses.
- The standard will preserve the historical and well-founded distinctions between beer and distilled spirits. Consumer confusion will be greatly diminished because all FMBs will be treated the same around the country.
- Current FMBs can survive under the new standard.
  - o The clarity, aroma and taste profile of these products will not change.
  - o Producers have developed reformulated products that will fully comply with TTB's proposed standard. They are virtually indistinguishable in any way from the current products.
  - o Consumer recognition and brand equity in existing FMBs will not be damaged.
- Reformulating FMBs to the 0.5% standard will not impact wholesaler, retailer or consumer prices.
- There will continue to be complete flexibility in creating new and innovative malt beverage products.

Since TTB specifically approved all existing FMB products, we assume the upcoming rule changes will have only prospective application. A final rulemaking should be completed expeditiously so that the states and the industry can properly coordinate the production, distribution and regulation of these products in the future.

#### Other Issues For Which Comments Are Sought

##### 1. Alcohol Content Labeling is Not Necessary.

Anheuser-Busch does not support the amendment to mandate alcohol content labeling only on flavored malt beverage brand labels. We do not believe consumers assume that flavored malt beverages are higher in alcohol content just because there may be a spirit brand name

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on the label. Most major FMB products already state the alcohol content on the brand label. For example, Anheuser-Busch chose to label its Bacardi Silver brands with the alcohol content to make it clear to consumers that they have the same alcohol content as our regular malt beverage products. The decision to label alcohol content, however, should be decided by the individual industry member, not mandated by government regulation, and not mandated for one type of malt beverage.

2. Anheuser-Busch Supports the Proposal for Labeling and Advertising But Cautions That It May Be Too Vague.

Anheuser-Busch supports the proposal to add language to §7.29 and §7.54 that formally incorporates the provisions of ATF Ruling 2002-2 restricting statements or representations that contain distilled spirit terms or imply that malt beverage products are similar to distilled spirits. TTB's stated purpose for making this change is to not allow distilled spirits terms to be used (1) in brand names, (2) in class and type statements (including statements of composition and fanciful names), and (3) on any label or in an advertisement for a malt beverage. However, TTB has committed that current products containing the brand name of a spirits product as the brand name of a malt beverage will still be permitted. It should be noted that the actual language of this specific proposed regulation appears much more broad and vague than the express purpose of prohibiting the use of distilled spirits terms on labels and in advertising. As a result, TTB should consider more limiting and clear language in its final rule so that it directly mirrors the stated purpose.

Thank you for the opportunity to comment on these important matters. If we can provide any further information, please contact us at your convenience. We appreciate TTB's national leadership over alcohol beverage regulation, and want to see it continue its close working relationships with state alcohol beverage commissions and the industry for the years ahead.

Respectfully submitted,

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