

ABC Enforcement Trends and Predictions

What wineries should know about beverage law, rules and investigations

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MANY FORTUNATE CALIFORNIA WINERIES only deal with the **California Department of Alcoholic Beverage Control** (ABC) when they apply for and renew their licenses, but the ABC is actively conducting enforcement actions and investigations all over the state, often as a result of anonymous complaints, but also based on industry trends that challenge the existing laws or just as a result of random attendance at industry events.

According to the ABC at a stakeholders' meeting in early February 2017, there are 90,000 alcohol beverage licensees in the state but less than 100 agents and investigators—a challenge that requires prioritization of their efforts. As regulatory counsel to the wine industry for over three decades, our firm has been well-positioned to monitor and respond to enforcement trends and priorities over the years. We believe it is worthwhile to take stock of where the ABC has been focusing its enforcement efforts over the last couple of years and what the grape leaves are showing for this year and beyond.

Defending ABC Trade Practice Cases

Hinman & Carmichael LLP has never shied away from challenging the ABC's interpretation and application of the ABC Act to industry members when we believe that the agency has departed from the actual intent and purpose of the law or made incorrect assumptions based on faulty facts. The past few years have been no different. We have defended a significant number of interesting cases before the ABC and the ABC Appeals Board that have involved alleged violations of the "tied house" laws, which restrict the interactions between the manufacturing tier and the retail tier. The tied house laws, historical legacies from the original concerns leading to Prohibition, prevent suppliers, such as winegrowers, from providing money or any other thing of value, directly or indirectly, to retail licensees, unless there is a specific exception that permits the activity. There have been times over the past few years that the ABC has taken a zealous approach (too zealous in our view) to this well-intentioned mandate, and we have been at the forefront of challenging the ABC on these actions when the facts and circumstances warrant it.

Social Media and Retail-sponsored Charity Events

In 2015, wineries received a big "like" for their ability to advertise, on social media and otherwise, their involvement in non-profit events that also have retail licensee sponsors. As many wineries may recall, the ABC filed a series of accusations against 11 suppliers and a grocery store retailer for giving, and receiving, a "thing of value" in violation of Business and Professions Code Section 25502(a)(2) after the various wineries and breweries posted on social media that they were sponsors of, and were going to be providing tastings at, the "Save Mart Grape Escape," an event put on by the **Sacramento Convention and Visitors Bureau**. The ABC took issue with the fact that the suppliers used the name of the title sponsor of the event, a retail licensee, in their posts and alleged that the suppliers were giving the retail licensee an unlawful thing of value by using the official title of the event and the event logo. One winery decided to fight the accusation (the other accused event participants settled the accusation with the ABC in lieu of defending the case), and we took and tried the case. The Administrative Law Judge (ALJ) who presided over the hearing agreed with our defense theory and found in favor of the winery, holding that under California law, in order to find a violation of Business and Professions Code Section 25502(a)(2), there must be some proof of a corrupt intent on the part of the supplier beyond posting their participation on social media. The ABC disagreed and rejected the ALJ's finding, but decided to dismiss the accusation "in the interests of justice" because, in the meantime, the California Legislature attempted to address this issue. While the defense that there must be corrupt intent remains a point of contention between us and the ABC the federal government (the **Alcohol and Tobacco Tax and Trade Bureau** or TTB) interprets their regulations to require "inducement and exclusion," which is a form of corrupt intent.

In direct response to the wine industry's outcry over these accusations leveled against the wineries, the California Legislature amended the ABC Act to add Business and Professions Section Code 23355.3, which addresses

the issue of inter-tier sponsorships of non-profit events. This new section permits non-retail and retail licensees to sponsor, advertise (including on social media) and participate in events conducted by or for the benefit of non-profit organizations. This statute does not address other types of events that do not include nonprofit beneficiaries, and it adds restrictions on how non-profit events must be structured, but many wineries appreciate clarification around this common event structure in California. Still, the ABC's non-adoption of the ALJ's decision means that the ABC could bring social media thing of value cases, even when a supplier has no intention of inducing the retailer to purchase their products or to exclude the products of others. Until a new case comes along for clarity on this point, suppliers still need to be very careful with their communications involving retailers and interactions with them at events in consideration of the tied-house laws.

Indirect Ownership and Payments to a Retail Licensee: The BottleRock Sponsorship Trap

Last year saw the thrilling (for wine law buffs, at least) conclusion to the accusations brought against a number of wineries that sponsored the 2013 **BottleRock** festival in Napa. These cases called into question the ability of wineries to sponsor events without fully vetting the organizers for possible retail ties. Following the 2013 festival, ABC investigators reviewed confidential ABC records to discover the producers of the BottleRock festival indirectly held interests in one of the venues used for after parties during the festival. Because this venue had a retail license, the ABC alleged that the sponsorship fees paid by the wineries to the festival indirectly benefited the retailer through the indirect ownership and the rental fees paid to the venue, therefore violating California's tied-house laws. While the majority of the two dozen wineries and suppliers settled the accusations and paid fines to the ABC, Hinman & Carmichael LLP defended a half dozen of the indicted wineries at ABC hearings. The ABC ruled against all the wineries, finding that it didn't matter that the suppliers didn't know about a retail connection or payment made by the event organizers; knowledge or intent was not required for a supplier to indirectly provide an unlawful payment to a retailer.

After appealing the decisions to the ABC Appeals Board, we obtained dismissals of the alleged tied-house violations. The Appeals Board found that the ABC's interpretation of Section 25502(a) was faulty in that the ABC attempted to apply the "direct or indirect" language to the interest in the retail license, whereas it should have been applied to how the thing of value was provided to the retailer for the purpose of inducing a sale. These decisions have clarified how the ABC must evaluate potential tied-house violations involving indirect business interests and transactions, namely that the important factor is the nature and purpose of the thing of value, not the nature of the ownership interest in the retail license. This result should give suppliers some comfort in sponsoring events, which has become an increasingly important way to reach consumers. While normal diligence is always a good idea (as are representations and warranties in agreements about retail connections), wineries should not lose sleep over the potential hidden, undisclosed interests in, or payments to, retailers.

In these cases, the ABC also charged that providing wine in return for promotional services constituted giving away free goods in violation of the law. This charge was squarely rejected by the Appeals Board, reinforcing the all-important principle that product may be traded for promotional and other services.

Winemaker's Dinners: The Details Matter

We have seen a recent spate of investigations, inquiries and accusations relating to one of the wine industry's most treasured exceptions, the so-called "winemaker's dinner" (in quotes because neither the actual winemaker nor dinner is required for this kind of event). Under Business and Professions Code Section 25503.4, a winegrower, his or her agent, or a wine importer may participate in educational events for consumers at on-sale licensed premises (generally, restaurants, bars, clubs and wine bars within retail shops). This privilege permits wineries to provide consumers with limited complimentary tastings of their wines at the retailer's premises, making this exception to the tied-house laws an extremely popular and important way for wineries to engage with their consumers, while providing retailers special educational experiences. But if not structured properly, or if other ABC laws and rules are violated at these events, they can be prime targets for ABC enforcement. Over the past few years, the ABC has been actively investigating winemaker's dinners, including attending the dinners in an undercover capacity, often catching suppliers overstepping their privileges and retailers seeking more than what is permitted. Many of these trouble spots can be easily avoided if identified in advance of the event.

Winemaker's Dinner Lesson 1: Avoid Consignment Sales

Last year, a client winery was investigated and ultimately received a warning from the ABC when it brought wine to a winemaker's dinner hosted by a restaurant. Cognizant of the fact that it was not permitted to sell wine to the consumers at the dinner, the winery instead arranged with the retailer that hosted the dinner to sell closed bottles of wine to the guests following the dinner. But rather than selling the wine to the restaurant in advance, the winery brought the wine with them to the dinner, and the retailer sold some, but not all, of the wine to guests following the dinner. After the dinner, the winery representatives took the excess wine back and charged the restaurant just for the wine that was sold. This practice of either the winery retaining title to the wine the retailer is selling or the retailer being able to return the wine at any time prior to sale is considered an unlawful consignment sale under Business and Professions Code Section 25503 and is not permitted as part of the winemaker dinner exception. The better practice in this case would have been to sell the retailer the wine in advance and not take returns of the wine, or to accept "expressions of interest" from guests at the event that could be processed back at the winery after the event.

Winemaker's Dinner Lesson 2: The Permitted Pouring Amounts Matter

At another event, a different winery client came under investigation and was also fortunate to receive a warning rather than an accusation for giving away more wine to guests than is permitted under Business and Professions Code 25503.4. Rather than pouring the limited three 1-ounce sample sizes at the event, the winery poured full glasses of wine to the guests, and at the end of the evening the winery gave one of the guests a bottle of wine. Unfortunately for the winery, that guest was an ABC agent, who probably enjoyed the wine with a nice home-cooked meal but was investigating the event. The lesson here is straightforward: the devil is in the details, so to take advantage of the winemaker's dinner privilege, know the rules!

What's Next? Initial Trends and Expectations for 2017

This year began with a rapid series of press releases from the ABC about retail license suspensions. These releases are coming at a swifter pace and in higher numbers than normal, indicating either that the ABC is stepping up enforcement actions, or it is making its successful enforcement actions more public in hopes of frightening other licensees into compliance. Either way, all types of licensees should be sure to review their compliance protocols and know that when considering settlement offers for accusations, ABC press releases about the guilty pleading may be part of the deal, as will be mandatory future reporting of the guilty plea on all other required filings (including DTC permits) in California and in other states.

The Credit Law Rears Its Ugly Head: What You Should Know

A client winery recently settled an accusation for violations of California's credit law. For wineries that take advantage of the privilege to self-distribute in California, this warrants special attention.

Business and Professions Code Section 25509 contains two connected yet distinct requirements with regard to how a supplier, such as a winery, collects payments from retailers and charges interest on past-due accounts. First, a supplier is required to charge a retail client 1 percent interest if it has not been paid in full by the 42nd day after delivery and is required to tack on an additional 1 percent interest for each subsequent 30 days of lateness. Second, on top of this interest requirement, the supplier is also required to place any retail client that has unpaid amounts owed beyond 30 days after delivery on a cash upon delivery or advance payment requirement. The retailer must stay on this type of payment program until all past-due amounts have been paid and the account is current.

The calculation is not made on a discrete invoice-by-invoice basis (as most purchase transactions are considered today in order to monitor and track specific product deliveries), but rather on the total amount of debt outstanding between the supplier and the retailer at any time, as determined by the supplier's records. If any debt owed by a retailer goes over 30 days from the date of delivery of any specific purchase (regardless of the reason, including claimed non-receipt of the product), all subsequent transactions between that supplier and that retailer must be cash before delivery or cash on delivery until the account is brought current.

Wineries should make sure that their invoicing reflects these requirements, and that they keep track of the staleness of their invoices, lest the ABC request a look at their books. Our client was cooperative with the ABC's investigation and agreed to put in place safeguards to ensure that the credit laws were followed. As a result, they were able to settle the accusation on reasonable terms, but penalties can be substantial. For example, the ABC can look to the actual benefit received by the retailer and assess fines and/or license suspensions based on that amount, which depending on the circumstances and the number of accounts, could be substantial.

A word to the wise: the credit law should be followed, and the failure to do so can have severe consequences. Both accounting and sales departments should be trained on these requirements, and invoices should clearly lay out these statutory payment terms, required interest charges for late payments and the cash on delivery requirement for accounts in arrears.

Unlicensed Third Parties: What Are Their Limits?

Another major area that the ABC has been looking into are the relationships between unlicensed third-party providers, or TPPs, and the licensees to which they provide services. The ABC issued two separate industry advisories in 2009 and 2011 that describe the different laws and regulations that may apply to licensee relationships with TPPs and provide certain frameworks for how these relationships should be approached. These California advisories have been incredibly important to these primarily technology, marketing and delivery providers, by influencing other state approaches to TPPs and helping these businesses expand to other states that trust the California ABC's approach to the issue. Being based in San Francisco, we've seen many of these new apps, websites and services come through our doors and have helped many of them set up compliant models around the country. Many of these TPPs are trying to find ways to push the boundaries of the alcohol laws and regulations, many of which have not been updated since the advent of computers, let alone smartphones, just-in-time delivery apps and the many new methods for marketing wine and other consumer products online.

We have had TPP clients investigated by the ABC and questioned about their business structure and practices, but so far, larger investigations have taken place in other states like New York, where declaratory rulings may be sought. The ABC has reminded licensees that when they engage TPPs to provide them with services, the licensee is ultimately responsible for all of the activities performed on their behalf. On this point, we agree and suggest that licensees carefully evaluate service agreements with these TPPs to ensure that the payment structure, flow of funds and services provided comply with the industry advisories.

Prescription Lawyering

While we thoroughly enjoy defending accusations in ABC hearings and before the ABC Appeals Board, we also enjoy preventative lawyering, by shedding light on compliance issues that wineries can address in-house before receiving an investigation or an accusation. The top ABC priorities will always be public safety and preventing sales to minors, so wineries need to focus their compliance efforts on those issues first and foremost. From there, wineries should learn and understand the tied-house laws and how they affect sales, marketing and accounting practices so that they can train their employees and third-party representatives to avoid the common traps. Wineries also have a responsibility and incentive to educate the event organizers and third-party providers they choose to work with about the complications and opportunities for marketing and advertising alcoholic beverages. If all that happens, we may see fewer accusations and enforcement actions—but more healthy and profitable wineries, which to us is the best possible result. **WBM**

*Want more? Rebecca Stamey-White will be moderating a regulator panel at the annual **National Conference of State Liquor Authorities** (NCSLA.org) in Denver, Colorado in June 2017 on ABC enforcement priorities around the country.*