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California Sets the Table for Regulation of Third-Party Wine Providers

by James M. Seff

On November 1, 2011 the California Department of Alcoholic Beverage Control (ABC) issued new guidance regarding the regulation of the ever-increasing number of third-party wine providers (now known informally as TPPs) who advertise and facilitate wine sales on the Internet.

TPPs are a relatively new phenomenon in the U.S. but consumers are seeing them more and more often. With the advent of direct wine shipping to consumers in other states (now permitted by 37 states) under the U.S. Supreme Court's decision in *Granholm v. Heald* in 2005, Internet wine sales enjoyed a substantial increase. But it is often impossible, when looking at a wine website, to know exactly who is selling the wine. Websites from wineries, "virtual" wineries (actually wholesalers who have a special license permitting Internet retail sales), traditional retailers (who sometimes operate as wine "clubs" whose members must buy a monthly or quarterly selection) and even newspapers, magazines, public television stations and "flash sale" membership sites that offer wine (and often other merchandise) at time-limited special prices, all appear to be selling wine. (While sites like Groupon and Open Table that offer discount coupons for food and drinks online share some of a TPP's characteristics, the ABC's Industry Advisory does not address their activities.)

Regardless of the details, TPPs are enjoying enormous popularity and the increasing quantity of wines sold through TPP sites, often at very attractive prices, benefits both consumers and the California wine industry (and especially small wineries without significant marketing money).

California is the largest wine producer and market in the U.S., and its ABC found itself increasingly challenged by the need to regulate non-conventional wine sales. But who was actually making the sales? Had the *Wall Street Journal*, whose WSJ Wine Club is one of the most popular Internet wine sites, decided to become a wine retailer? And if they had, why didn't they hold a California retail license issued by the ABC?

The ABC had been receiving frequent requests from TPPs for approval of their marketing plans and in 2009 the Department issued an Industry Circular which sought to establish some general ground rules. However, the Circular generated many more questions than it answered and, at the same time, the number and variety of TPPs continued to increase.

In March of 2011, the new ABC Director, Jacob Appelsmith, asked industry stakeholders to form a working group to offer advice to the ABC about how to regulate this fast growing segment of the industry. The group, comprised mostly of industry lawyers, developed a set of first principles which the ABC refined and adopted in a new Industry Circular.

First and foremost, the Circular provides that all sales must be by a licensed winegrower or retailer. However, TPPs themselves need not be licensed as long as the retailer maintains the ultimate control of the transaction. Thus, TPPs must transmit orders they receive to a licensee, who can accept the order and ship it from a licensed premises. TPPs can debit a consumer's credit card (acting as the licensee's agent) and remit that amount to the licensee, who can then pay the TPP its commission on the sale. The Department recognizes, however, that these financial transactions can occur almost instantaneously. Or the TPP can pay the full amount it collects into an escrow or similar account operating under the licensee's direction. TPPs must also pay strict attention to California's prohibition on free goods in connection with the sale or distribution of alcoholic beverages (no free shipping or corkscrews and similar items).

The Industry Circular provides that a TPP's compensation must not result in the TPP's de facto control of the licensee. And the compensation must be "reasonable," a term left undefined. The ABC always has the ability to inspect books and records so the TPP's actual compensation could be one of those details in which the devil sometimes hides, at least if the ABC examines the transaction. And for the first time, the ABC officially recognizes that trademarks are valuable property and that, in this context, a TPP may pay a license fee to a trademark owner for the use of its mark in wine sales. The guidance also acknowledges the trademark owner's need to maintain appropriate quality control over its mark.

Importantly, the ABC's Circular is not the result of any statutory or regulatory changes. This permitted the ABC promptly and efficiently to adopt and promulgate the guidance. And, as the ABC expands its experience and understanding of how TPPs operate, it can amend the guidance as necessary. (It also means, of course, that a new ABC Department administration could revoke the guidance altogether, although this is unlikely.)

The ABC issued its Industry Circular at a meeting of the National Conference of State Liquor Administrators. While some states have already taken positions on certain TPP activities, many states may use California's guidance as a template, or at least a starting point, in developing their own rules governing TPPs.

Click here for copies of the ABC's Industry Circular and Press Release.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors of this alert.

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